



# How Freight Term Optimization (FTO) Minimizes Transportation Costs and Maximizes Margins

Logistics and transportation organizations are under pressure to ensure their freight is being managed at the right place and at the right time, but they often overlook the importance of ensuring the right freight is being managed. Shippers and logistics service providers (LSPs) can address this oversight by strategically assessing and establishing optimal freight terms to minimize costs and maximize margins. In many cases, transportation leaders are unable to confidently provide an answer to the following questions:

- Does my company have visibility to costs and performance metrics for supplier/vendor-managed freight?
- Are the processes and systems we have in place today capable of continually analyzing and optimizing prepaid versus collect lanes for existing or new suppliers/vendors?
- As we add more freight to the collect program, can the operation scale with the increased volume?
- In addition to reduced total-landed-costs, what are the additional supply chain benefits to term conversion?

This is where freight term optimization (FTO) can help. On the surface, FTO is a program which enables the proper conversion of vendors to the most advantageous freight terms across all lanes, both inbound and outbound. Due to the sheer scope of FTO, companies need to be prepared to invest time into the program year over year to reap the benefits in an accelerating manner. Unlike some other initiatives, FTO is better defined as a program rather than a project due to the perpetual nature of the task. While employing third-party assistance to quantify, define, and implement the initial process can be necessary, it does not stop there. It is important to understand the definition of FTO.



## UNDERSTANDING FREIGHT TERM OPTIMIZATION (FTO)

**“Optimization is the action of making the best or most effective use of a situation or resource.”**

In the transportation world, the “situation” is always changing. To see true savings, business leaders must look at FTO from a long-term perspective. Consequently, there will be some organizational implications to this, as roles and responsibilities will be cross functional. While it may sound like an intimidating task, the upside is significant if proper program design and planning are accounted for.

### Use Case Scenarios

For example, the simplest conversion opportunity is the inbound truckload move; it is easy to compare costs and manage the move once converted. However, there are many other ways to move the right freight, such as taking advantage of consolidation and mode optimization. Oftentimes, the term “conversion analysis process” provides visibility to make these additional changes. In other cases,



a lane might have both prepaid and collect freight on it, posing a perfect order consolidation opportunity, which is also easy to execute. Furthermore, shipment modal decisions could even be analyzed to consolidate orders and shipments from a single vendor, potentially allowing shipments that were once LTL to move as a single truckload shipment. The act of converting prepaid freight to collect on inbound should be influenced by the ability to leverage resources (the people and processes) and tools (the systems and internal/external data) to make sophisticated decisions across all lanes, modes and types of freight.

When taking the time to strategically plan and analyze data, supplier/vendor negotiations will evolve to become more deliberate. In some scenarios, it would even be beneficial to only convert one of the supplier's/vendor's lanes to collect, leaving the others prepaid. Each negotiation will look different than the last, but with the right process and tools in place, the decisions can be made easily.

Many leaders may think it is impossible to implement due to limited visibility to their company's purchase orders or struggle related to limited knowledge of vendor-managed moves, in which case they are not alone. Transportation managers have been facing this issue for quite some time, which is what usually prevents businesses from unlocking the potential FTO opportunity. Add resistance from merchants on top of this and the business case for FTO weakens drastically. With proper establishment of goals and the necessary roles and responsibilities of an FTO team, companies tend to find this seemingly complex process be more feasible.

### **Determining Readiness**

Before launching a program, a project, or supplier/vendor negotiation, companies must take the time to assess their readiness. A thorough evaluation of process, systems and organizational readiness is

necessary to understand capabilities and ultimately gauge the realistic amount of savings that can be captured.

Understanding current processes will provide the insight needed to set FTO goals and expectations. Current processes pertaining to managed transportation need to be evaluated to get an idea of the feasibility of adding more suppliers/vendors to the program. In cases when tasks like sourcing, planning, execution and other administrative responsibilities require high amounts of manual intervention, it is likely for the process and team members to become overwhelmed. This may cause businesses to recognize the need for additional hires to handle the increased workload. With this in mind, it is important that the entire scope of the program is taken into consideration when evaluating current state processes. This includes breaking down processes based on specific criteria and documenting exceptions to processes. For example, if private fleet will be in-scope, companies will also need to ensure current processes across inbound and outbound transportation departments can even support leveraging backhaul capacity. Knowing the ins and outs of current state processes will provide the means to developing a methodical and effective approach to FTO.

Systems readiness will make a big difference in both the efficiency and effectiveness of an FTO program. Similar to process readiness, systems should be evaluated, keeping in mind the specific goals of the project and accounting for all potential scenarios. A major concern is that systems may not be mature enough to handle increased volume as more suppliers/vendors are onboarded to collect, or that system capabilities are not being leveraged to their full extent. Given the abundance of data needed to analyze and assess term conversion opportunities, companies with highly integrated systems tend to have a significant advantage. In most cases, data is gathered from several different systems and sources making systems readiness applicable across nearly the entire systems landscape. TMS-enabled businesses,

for example, will likely see higher returns than those that are not due to the ability to automate processes involved with planning and executing collect shipments.

Depending on the company, warehouse and yard management systems also come in to play, along with several other supporting systems if they store information that will enable supplier/vendor analysis. Proper planning and a dedicated FTO team can minimize and prevent potential issues that could arise from systems with limited capabilities or poor integrations. Determining system constraints cannot be overlooked, however, as it will allow program leaders to establish timelines and set reasonable goals.

### **Roles and Responsibilities Needed for a Successful FTO Execution**

Successful execution of FTO will be highly dependent on the structure and relationships within the organization. Leaders need to ask questions regarding whether the right people are in the right positions to support a robust in-house FTO program. Depending on the number of suppliers/vendors available to convert and company size, it may be recommended that specific roles and responsibilities are established to form a dedicated FTO team. Generally, this team would consist of a project manager-type role, a supplier/vendor analyst role, and a negotiation lead. The project manager would be expected to oversee the entire FTO process and handle the associated administrative tasks, whereas the supplier/vendor analyst role would oversee pulling together the necessary data/reports to make conversion decisions. The negotiation lead would take on the responsibility of initiating conversation and following up on potential conversions with favorable suppliers/vendors. These responsibilities are not rigid, though, and companies will likely see differences in the makeup of the team depending on the level of cross-functional involvement.

As mentioned previously, this is not going to happen at the snap of a consultant's finger. The long-term success of the program is dependent upon the work ethic, collaboration, and enthusiasm from the transportation, merchandising, and, likely, IT teams. Merchants, specifically, are very critical to the process due to their strong relationships with suppliers/vendors and intricacies of supplier/vendor contracts and incentive structures; incentives may need to be put in place to ensure positive outputs. At a broader level, the program's success is directly related to the involvement of executives. In many cases, executive support fades away once the program is signed off on. For FTO, though, active engagement with the steering committee is critical to success since the program impacts spans across several business functions.



## The FTO Process: From Data Collection to Post-Negotiation Analysis

At the onset of an FTO program, the foundations will be laid down in the data collection phase. A representative sample of transactional data (typically a year's worth) is crucial to form a basis for understanding current lanes and applying that knowledge to future lanes. Although digging up a year's worth of shipment data might sound like an unreasonable or futile task, there are several ways this could be achieved. The first places to look are the transportation management system (TMS) and audit applications. Additional data sources are logistics service providers, the enterprise resource planning (ERP) system, master data management applications, the warehouse management system (WMS) (ASNs and warehouse receipts), and sometimes file cabinets. The analysis of this shipment data will be greatly enhanced by the incorporation of master data into the data request as well. Master data will provide insight to key details like supplier/vendor names and ship from/to locations. Reference data, such as carrier rates, is also of incredible importance for assessing the viability of conversions, as one might guess. Since it is unlikely to have carrier rates that cover all lanes, including those currently vendor-managed, companies will have to leverage benchmarking data to provide additional estimates as needed.

Once data is collected, it needs to be applied appropriately to unveil potential opportunity. The data must be cleansed, validated, and structured so that it can be transformed into the decision-tool for FTO cost savings. The tool, or FTO database (FTODB), should be created and used to easily review data and help with decision making from supplier/vendor identification through conversion success. The FTODB will vary based on the company and the data provided but will consistently serve the same purpose. When built correctly the FTODB will be leveraged on an ongoing basis by a trained resource, eliminating the headache of restructuring data every time

a new supplier/vendor conversion is initiated. If not, the length of a conversion will be exacerbated by the tedious tasks of data collection, cleanse, and validation. The FTODB should be very flexible and, although most outputs will vary, a summary export of key supplier/vendor information will be necessary regardless.

A key benefit of an FTODB is the ability to leverage reports for supplier/vendor prioritization. The supplier/vendor-level report from the tool must be comprehensive enough so that the top suppliers/vendors to convert immediately stand out to members of the FTO team. Parties involved with the FTO program should meet on a recurring basis to review summaries and agree upon the most favorable suppliers/vendors to engage with. Members of the transportation team will likely provide context for the quantitative details, like lanes, rates, modes, etc., whereas merchants or buyers will be more involved in providing qualitative details like supplier/vendor history, past performances and relationships.

Like most criteria, the prioritization of suppliers/vendors will be heavily influenced by company-specific nuances. Many companies will prioritize suppliers/vendors on lanes that overlap with collect lanes as a starting point. Other businesses may want to go after suppliers/vendors with high truckload volumes or maybe those within a short distance from a crossdocking facility, if applicable. Once suppliers/vendors are prioritized, deeper dives should be conducted to validate the decision before initiating conversation with those selected. The timeline of a negotiation is dependent on who the supplier/vendor is, previous engagements with them, and the aggressiveness of the ask, among other things.

To have an outcome that is both transferrable and scalable, processes need to be well-documented and easy to follow. Standard operating





procedures (SOPs) should be written and followed so that the process is easy to re-create time after time. In addition, a repository should be kept which tracks suppliers/vendors and conversion details. This will keep the FTO team organized and allow for better tracking of conversions.

Then once a negotiation is finalized and freight conversion is executed, transportation costs must be monitored periodically to ensure the conversion was beneficial. Transportation costs should be measured against the estimated savings to judge the success of the program, make necessary changes where needed, and provide guidance for future conversions.

## CONCLUSION

While FTO may look like a daunting task, the benefits outweigh the effort tremendously. A successful FTO program is easily attainable with the right tools, consistent processes, and clear communication techniques in place.

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