

# Corporate strategies and logistics

*Logistics executives need to help corporate boardrooms understand logistics implications.*

BY DEEP R. PAREKH

Corporate strategies once were like the old Soviet “five-year plans.” They were monumental pieces of work, for which a lot of effort went in. They conceived blue-sky ideas and put them into somewhat actionable elements and attempted to execute them, without ever considering whether the plans succeeded or failed; whether they were feasible or not.

The corporate strategy was somewhat similar; a thick binder put together by the most expensive and famous consultants that money could buy, with no regard how well the company could execute on it to deliver the potential results implied therein.

By contrast today, corporate strategies are dynamic documents that reflect more of a “business plan” than a “business monument.” These “live” documents are the navigation chart of the chief executive officer and the board, to guide them through the perilous waters of competitive marketplaces, internationalization, mergers and acquisitions, diversification, divestiture, new market exploration, and many more exciting places. Corporate strategies also provide the company’s leaders with a systematic approach to the mundane necessities of cost reductions, efficiency and productivity increases, and operational effectiveness.

Accelerated relocation of manufacturing and knowledge-based businesses to lower cost labor markets is impacting logistics decisions. We find sales and operations planning, organizational agility, and global sourcing are becoming more and more critical in today’s shifting corporate environment. Mergers and acquisitions activity is on the rise once again. Lanes are becoming more and more congested globally, forcing companies to think of their overall distribution and manufacturing strategies. Further, with the focus on growth these days, in many industries, working capital is becoming of great interest to corporate strategy agendas, along with third-party logistics outsourcing.

Considering these factors, we find, with increasing frequency, that corporate strategies are having impact on logistics decisions.

## Logistics: Strategic business partner

Due to various changes in competitive strategy and globalization, more logistics-related issues are entering boardroom discussions. Logistics directors are having to think of themselves more and more as global business partners and strategic advisors than simply line managers of a corporate functional silo. Besides having their particular subject matter knowledge in logistics, they are and will also be expected to be aware of growing trends in business competitiveness and in corporate strategy matters. Strategic matters include concepts such as outsourcing, vertical integration, contingency planning, growth agendas, global sourcing, information technology, working capital related issues, speed to market, winning with customers, and fiscal incentives. They are likely going to be asked about their opinions on all these areas, in company board discussions, as the road map of the company is laid out or modified on a frequent basis.

## Corporate outsourcing decisions

Companies are considering outsourcing options more frequently due to domestic and international pricing pressures, combined with the competitive pressures of efficiently and effectively running a corporation. Today, we find companies are chasing lower cost as the primary factor. Strategic outsourcing considerations need to be based on a holistic view of the business, not just cost.

Functions generally considered for outsourcing include sales, finance and accounting, manufacturing, distribution, and logistics. These help drive higher growth, lower cost, higher service, and speed to market, all of which together deliver a winning strategy. Whereas the impact for finance and accounting outsourcing does not impact logistics, the other functions significantly impact logistics.

Consider sales outsourcing as a way to grow in new markets — this has a considerable impact when shipping to places that lack sufficient infrastructure for distribution, such as warehouses and roads. In this case, the marginal cost increase for distributing to new remote locations might negate any profitability brought into the bottom line. Further, because it may be a highly competitive location for the company, it may not get the best freight rates and priority from a distribution standpoint. When sales is outsourced, we find in some cases that the agreements aren’t clearly drawn up between the original company and the company to which sales are outsourced. When this is the case, disruptive behaviors can begin to emerge, such as pushing product towards the end of an accounting period to gain a certain financial incentive. When this type of thing happens, the company’s logistics get thrown out of whack, with increased expedites, increased redeployment, and order returns and cancellations, all of which erode the product margin. In addition, service standards may also drop due to miscommunication between outsourcers and companies.

Consider manufacturing outsourcing, where the function is moved to another facility in another location. In many cases, companies justify this on the basis of reduced manufacturing cost, but do not take into account the increase in lead time, inventory, and risk to the business that unfolds from that decision. A consumer electronics company several years ago decided to move manufacturing operations from the United States to Mexico (during the early days of the North American Free Trade Agreement), and subsequently to China (before the boom). Whereas they indeed enjoyed lower manufacturing cost, their predictability on the supply of product went down dramatically, thereby dramatically eroding customer service. They had to reconfigure their entire logistics systems and agreements to align with the manufacturing outsourcing decision, at a huge cost. The company also lost a significant portion of their control over their logistics, since everything had to be shipped on some predetermined maritime shipping schedule from China. Further, since English was not a common language in China, attempting to find out what happened to a particular shipment and the root cause of any issue was far from simple. Combine that with the fact that, according to a 2003 Accenture survey, 91 percent of respondents

reported that they planned to increase their sourcing from lower cost countries and regions, get ready for some big implications in the logistics industry!

Logistics can also be outsourced as a strategic decision, but that too, has significant implications and is not an easy process, and needs to be carefully thought through. The \$100-billion logistics outsourcing industry plays an increasingly important role in the world economy. McKinsey & Co. projects an annual growth rate of the outsourced logistics industry at about 9 percent for North America, 8 percent for Western Europe, and about 14 percent for the rest of the world, most of which we consider “emerging markets.” Striking agreements that lack discipline and fail to have repercussions is one of the key risks in this area. We also find an example of a houseware and apparel company that outsourced its logistics function to a third-party logistics provider (3PL). Due to a poorly conceptualized agreement structure, the logistics provider found itself constantly expediting large items such as sofas and curtains at no additional charge to the consumer, but at very high cost to the houseware company, making the company, among other factors, go out of business. On the other hand, we find many relationships of outsourced logistics truly blossoming and creating enormous value for both parties.

**Vertical integration can change 3PLs’ trade terms, pricing**

Vertical integration refers to the single ownership of more than one part of the organization’s supply chain. Some companies own their suppliers, some own their logistics providers or distributors, and some own the retail end of the chain. Corporate decisions such as acquiring or divesting of a supplier are made when companies want to gain more control and margin, or cash and focus, respectively. Acquiring the supplier can often mean expanding the supplier so as to provide to other players in the market as well. Some consumer products companies, for instance, own the oil manufacturer who supplies them, so as to hold their margins on products, but also make a profit by selling oil to other companies. Meanwhile, for example, an auto parts manufacturer’s divestiture of an auto parts manufacturer was more for focus on core business, since the parts manufacturer was large enough with a sufficiently captive customer to survive on its own, and perhaps also be innovative enough to create other subassemblies for the car manufacturer.

Both these options have their implications on the logistics end of things. Sometimes, trade terms and pricing are subject to change based on the relationship between the provider and the other party in the chain (such as the retailer, supplier, manufacturer, distributor). This can cause a significant change in margin for the provider, and may drive them to lose a customer to protect their margins. At the same time, it can also create opportunities as the divested business grows and secures more customers, perhaps increasing business with the logistics provider.

**IT: Quantum value or nemesis?**

A strategic decision to implement a particular Enterprise Resource Planning (ERP) software is one that has an impact in all parts of the organization, from accounting to logistics. These implementations change the way business is conducted, and provides a structured format of different functions and organizations working together. These implementations can cost millions of dollars, and are one that companies takes very seriously, since there’s so much at stake.

Generally, smaller suppliers, vendors, or providers who decide not to change their systems or spend money on integrating their systems with the company’s are likely to find themselves sidestepped and dropped as a supplier or vendor, in this fiercely competitive environment.

ERP software gives the enterprise a unique ability to connect all parts of the organization in one working “instance,” where the business information is supposed to flow seamlessly from one function to another. There is usually a central data repository called a “business warehouse” that houses of all the master data, such as vendor names, addresses, billing information, trade terms, lead times, source locations, destination locations, bills of material, product formulas and recipes, and so on. The order management system is embedded within the ERP system as well, where lot sizes, lead times, trade terms, and discounting information is dynamically maintained. Further, advanced shipment notices (ASN), bills of lading, delivery statistics, conformance performance indicators, and other such information are stored and maintained as well.

Integrating logistics systems with the corporate ERP system is not easy, and can be time consuming and resource intensive, not to mention cost heavy. It requires careful forward thinking in terms of data standards, communication protocols, data architecture, and the right software to process the information in an intelligent and efficient manner, providing required information in a timely manner.

Whereas in-house logistics might be included in the scope of the ERP implementation, 3PLs may not, and a decision to implement the “connectors” with the client’s ERP system might mean the difference between continuing business and no more business. When the logistics provider is external, it requires significant planning as to which system to acquire and how to implement, because different clients will have different ERP systems, and logistics provider partners will have yet other systems. Linking together all these systems, which may be dynamic, going forward can be a challenge, but also an immense opportunity to differentiate themselves as providers.

As companies decide to leverage new technology such as radio frequency identification (RFID), the information and data collection, assimilation, management, processing, and actioning requirements will only grow in terms of complexity for the logistics providers and in-house logistics functional teams.

**S&OP drive intelligent business decisions**

Sales and Operations Planning (S&OP) is about the alignment of targets and objectives, across functions by taking businesses sales and marketing ambitions, supply possibilities and financial goals and balancing them to create a single, achievable plan.

When considering demand forecasts for products, the different business functions are developing their own estimates of what the forecast should be, and there is a breakdown in communication between the various functions. This creates significant disconnects and service issues when things go astray, as they do so often. There is a need for different functions to align themselves using S&OP.

Whereas inventory reduction has always been one of the most sought-after prizes for supply chain managers, it is coming under much more scrutiny these days, where the focus is becoming working capital as a whole, and not just the stock component. Companies are putting strategies in place to leverage the concepts of S&OP

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worldwide, to gain visibility into the business and hence make better, more informed, fact-based decisions. The opportunities in having an effective S&OP process are: significantly reduced trade working capital, higher service levels, lower production failures, and better business target achievement (indicated in higher revenues).

Martin Jarvis, the leader of the Global S&OP Program at Unilever, one of the largest home care, personal care and packaged foods companies in the world, provided his thoughts on S&OP:

“Businesses are faced with a multitude of complex options to evaluate when creating plans: cross-border sourcing; within country long distance haulage; make or buy; self financing vs. bank financing; increased customer service vs. wider distribution; customer service vs. stock holding; sell to modern trade or traditional trade; and so on. There are so many options that unless there is a strong process for making those trade-off decisions transparent then, at best, opportunities are missed and, at worst, chaos results. Properly run, the S&OP process presents those trade-off decisions compiled from detailed work throughout the company to the board in a clear, actionable and timely way,” Jarvis said.

### Working capital, free cash flow to fuel growth

In today’s global competitive environment, companies are looking for cash to fund their growth. In a 2004 McKinsey & Co. survey of global business executives, 84 percent of respondents felt that competition during the last five years has increased, and cite pricing pressure as the single most pressing business concern during the next 12 months. Combine this with the fact that these same executives plan on achieving their growth with new customers, and providing new products and services in the existing markets, where competition is so stiff and fierce, and where they come under pricing pressure, as opposed to entering into new markets.

The only way that can be made feasible is by pouring significant cash into the business to fund these aggressive growth agendas. This fuel for growth must come from freeing up cash within the business wherever they can find it. Focus therefore falls on inventory, creditors, and debtors, order to cash velocity, and time to market velocity. Companies are putting together strategic cash-generation programs, where all these factors are being taken into account under one umbrella, to accelerate this investment within the business.

Whereas they are sometimes included within the scope of S&OP programs mentioned earlier, for some companies, they are worth discussing on their own, since they are so important for cash generation. For some of the larger companies we have worked with, the working capital employed on a per-day basis for accounts receivable (debtors) is in the millions of dollars, and sometimes the same case for stock. If by improving the workflow within an organization you reduce the time to process the payment for an order by just one day, it can have an impact of millions of dollars flowing into the business earlier, which can be used to fund customer based activities; similarly with the order to cash time frame. Since, in most cases, it is customary to pay for goods only when they are received, delivering one day earlier, or cutting back the time of a carrier waiting in line to be loaded or unloaded can mean that the company can reinvest millions more into the business.

We are all familiar with the benefits of reduced inventory while maintaining service levels. With working capital programs, the entire concept of having inventory is being examined with renewed interest. Focus is expanding from finished goods inventory to materials

inventory, which is often forgotten or not given adequate attention. Delving deeper, there are analyses being done for each type of inventory, to explore whether the inventory is there for a specific reason or not, such as lead times, minimum lot sizes, transit times, minimum run quantities, production or supply cycles, demand volatility, and supply volatility. Logistics groups must re-evaluate their lead times, putting product on trucks while it is in a “quality hold” mode, or even finishing assembly at the point of delivery, to deliver more cash to the business.

### Reorganizing around customers can yield rewards for all

Corporate strategy often yields organizational restructuring. Some companies are tending towards reorganizing around the customers. This means creating organizational working teams with a customer orientation. As customers become more demanding over time, and their needs become more specific, it makes more sense for companies to organize around them, as opposed to approaching their portfolio of customers with a one-size-fits-all strategy. Organizing around the customer therefore makes sense from maintaining service, but also maintaining or growing margin, as they become more efficient at it.

When companies reorganize in this manner, they rarely come down to the logistics teams, which are viewed as common resource, just as manufacturing. When companies go that extra mile and also reconfigure the logistics organization, it can yield good results, since the cost-to-serve can be calculated carefully, something not done often, if at all. By being able to measure the cost-to-serve and control it, companies can provide customers with customized logistics services, and almost run the logistics teams like a third-party organization, in pay-for-service mode, which customers and consumers are used to.

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### 3PL corporate strategy must plan for future

What started off as simply outsourcing the additional transportation required beyond what companies could handle themselves with their in-house logistics services capacity, the 3PL business has grown by leaps and bounds in the last two decades. Some studies indicate that in Western Europe, 3PLs account for 25 percent of all volume shipments, with the United States not far behind. The compounded growth rate of the 3PL industry has been about 8 percent to 10 percent per year, since the mid-1990s, and is anticipated to continue.

Customers are demanding more from their 3PLs, and the pressure is increasing between players in the industry to provide more services while cutting their prices, making the return on invested capital become more unsavory over time. This in some ways contradicts the widely published growth and sustainability statistics mentioned earlier.

One of the ways in which this growth can be obtained is through acquisition, which then is no surprise when we see the industry consolidating through each recent year. This is compounded by the fact that freight forwarders, express integrators, contract manufacturers and wholesale distributors all want to and are getting into the 3PL business, thereby increasing competition and pressuring down prices even more.

Corporate strategy at 3PLs has focused on scale and cost. This has resulted, as mentioned earlier, in an increased incidence of consolidation in the industry. 3PLs have also been wise in opening

up shop and expanding operations in countries and regions ahead of their customers, a well-anticipated move in places like China and India, where trade with North America and Europe is on a foreseeable upward trend. In order for the industry to continue in a sustainable manner (without relying on consolidation) the players must come up with some other game plan. Though some 3PLs have scaled up and attempted to consolidate operations between various client companies, there have been significant operational lapses for some clients, which has deterred the 3PLs from progressing further along these lines. However, we also see contrary examples, where 3PLs, because of formal business processes and significant investment and training in technology, are very successful.

One of the issues is how 3PLs have evolved. From being experts in warehousing and transportation costs, they are still trying to create a faster steam engine, when the world is now looking for electric trains, so to speak. They have been unable to grow sufficient expertise and knowledge in advanced supply chain management techniques and technologies beyond their traditional scope. UPS Consulting is one of the only companies that actually has a supply chain consulting division among the other 3PL and transportation companies. If 3PLs truly want to get into integrated supply chain management services, they need to position themselves as such, and not have the traditional divisions of "freight forwarding" and "supply chain services." The fact that they don't integrate the two as one common platform service indicates a mind set of "traditional transportation efficiency" and "all other logistics related services." The consulting services can provide the 3PL with a closed book approach to pricing with clients, who traditionally have known enough about the cost side of things on the typical logistics services to push down the prices. The consulting division can properly assess the areas where the 3PL can add significant value (and not just in the transportation segment). They can provide consulting services to get the client to leading practice standards, in addition to providing the services necessary in various other upstream supply chain activities in addition to transportation efficiencies.

### Expanding to emerging markets

As companies begin to adjust their strategies to expand their scope of growth beyond their traditional borders to take advantage of globalization, their primary criteria for expansion is market size and growth potential. Most strategy analyses call for them to understand local laws and governmental regulations, but not at the logistics infrastructure that will move their products from supplier to factory to distribution center or port. Whereas superficial analyses will account for basic infrastructure such as airports, highways and shipping ports, but rarely look at local transportation efficiencies, fragmentation of the local logistics marketplace, freight pricing, productivity, efficient customs clearance, and quality trucking services.

Whereas direct costs such as transportation, warehousing, and handling, are somewhat transparent and easier to estimate, indirect costs such as unnecessarily high inventory, stock outs, product obsolescence, and erosion of customer loyalty are more difficult to perceive. Older trucking fleets that are not fuel-efficient, break down more often, and are slower than newer fleets, increase the average in-transit time, thereby increasing stock requirements. Similarly, there might be political factors in play, which result in long customs clearance times or excessive bureaucracy, all of which, once again, increase overall time to market and supply variability, resulting in higher stock and compromised customer service levels. Cultural differences regarding "on-time" deliveries or damage can harm customer loyalty and hidden costs to companies expanding to emerging markets.

### Driving towards demand driven supply networks

The newest approach to supply chain management, by redefining the framework and boundaries, is taking U.S. companies by storm. Many companies' strategies are trying to launch demand driven supply networks (DDSN) programs as part of their "revamping the company for the 21st century" strategies. DDSN is in response to startling indicators in the face of all the improvements and technologies that exist in the field of supply chain management today. A recent report by AMR Research indicated median time to market for new product introduction in the consumer goods industry of 27.5 months, and median days of supply on hand for the semiconductor manufacturers of 190 days.

As the traditional framework of supply chain management evolves into DDSN, the way traditional logistics managers will need to look at the supply chain will have to change. Instead of viewing the chain as a linear concept, with supplier, manufacturer, distributor, wholesaler, retailer as a sequential concept, the new framework requires a different view. Imagine the chain instead, as focus on three points of view: demand, supply, and product. These three elements have activities happening within each that have no interaction with the other, but also have important overlaps, which must be integrated at the right time.

This is an evolving view of supply chain management, but nonetheless, one that logistics managers must be aware of, as these strategies include these programs as we progress forward to higher productivity, efficiency, and complexity of our organizations and our competition.

### Chemical industry: Strategic requirement for growth

According to a recent AMR Research report, the chemical industry can harbor profitable growth by segmenting services through product and service innovation. The industry seems to be oriented more towards cost reduction and not growth. Operational excellence has been the mantra for the chemical industry through several years. We find that this in and of itself will not stimulate the company into growth. The industry needs to focus on the longer term, where innovation is key.

Low growth, product commoditization, and industry consolidation characterize the industry today, being the source of several of the growth issues. In addition, increasing globalization, big variances in return on invested capital, and the increasing burden of regulatory compliance makes the landscape even more challenging for the conceptualization and execution of a strategic and sustainable growth agenda.

During the last decade, basic chemicals experienced little or no growth, specialty chemicals and consumer products lag the economy, and only the life sciences sector propelled forward at a higher growth rate. Although chemicals has very high research and development costs compared to other manufacturing sectors, the rate of innovation is disproportional to the investment. Patent expiration and access to specifications and formulations across the public domain (via the Internet) lowers barriers to entry, accelerating commoditization. Intense merger and acquisition activity has led to consolidation in the market, leveraging product applications, chemical platforms, and process technologies.

The chemical industry has done much to excel in operations within their four walls, but big opportunities in operational excellence lie outside, in areas such as outsourcing of logistics. The industry has the highest transportation and distribution cost of the manufacturing industries benchmarked by AMR Benchmark Analytix, some 20 percent to 30 percent higher than leading practice figures, a strategic decision to be made by the boards of chemical companies.

Further, as we refer to segmented services above, the chemical

industry needs some strategic decision to segment customers, products, and offerings to customers. One of the ways this can be done is through efficient use of logistics services and IT platforms for the movement of product and information. Leaders in the industry employ customer demand-driven strategies for manufacturing, reducing volatility in return on assets, through various programs such as common production run strategy programs, milk-run materials deployment, and others. Milk runs can be facilitated by an efficient use of a 3PL, who can gather all the materials from various supply sources required for a particular manufacturing batch, and deliver minutes before the production run begins.

**View from the boardroom**

There seems to be a general lack of understanding of longer-term strategic visions for their enterprises. There is a greater than necessary focus on the short-term issues, and a less-than-needed focus on longer term issues, which can eventually determine whether the company will be sustainable or not. In a recent McKinsey & Co. survey of business leaders, only 11 percent of the board had a “complete understanding” of the strategy of the company, surprisingly low for being the ultimate leaders and carrying the burden of fiduciary responsibility. The survey goes on to identify that more than half of respondents say they have a limited or no clear sense of their companies’ prospects five to 10 years down the road.

Further, only 4 percent seem to believe that they fully understand

their companies’ long-term position, and more than 50 percent show that they have very little understanding of the five or 10 critical initiatives that their companies need in order to be sustainable in the future. More surprisingly, 37 percent of executives believe the board has little or no understanding of the long-term risks of their companies.

Given these alarming statistics, logistics managers, directors, and vice presidents better play their active role in helping the board recognize the issues that can hurt the company’s long-term future if they don’t understand the logistics implications of their corporate strategies.

Whether it be regarding manufacturing consolidation, 3PL outsourcing, expansion in new markets, globalization, working capital optimization, global sourcing, information technology leverage, organizational restructuring, or sales and operations planning, all of these have an impact on the logistics decisions that a company makes. Logistics professionals will be called upon with greater frequency, to evaluate implications as corporate strategies involve more decisions that impact it.

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# China shippers fight back

*Asian shippers’ councils look for ways to end carriers’ opaque surcharges, malpractices.*

BY WILLY LIN

The fourth Shanghai, Taiwan, Hong Kong and Macau shippers organizations’ working group meeting June 12-14 in Shenzhen included shipper representative groups from Beijing, Jiangsu, Guangdong and Xiamen as well.

The groups gathered to discuss issues of mutual interest, including freight rates and the state of the freight market, tariffs and strengthening the organizations to promote and protect the interest of shippers in the China areas.

Freight rates have dropped since the start of the year, and the industry is bracing itself for the influx of new capacity later this year and in 2006, which will likely result in further lowering of rates.

But what we uncovered at the meeting that was so astonishing was the number of surcharges shippers are being charged in the different regions of the China area (see table).

As shippers from the different areas of China started to discuss and compare surcharges, the list kept growing. While some surcharges are called the same thing

in the different regions, some vary in name, although are the same in nature.

Shippers are alarmed over the revelations of the long lists of surcharges, and it is time the industry took a hard look into the matter. The surcharges may or may not be justified, but their legality could be called

into question in certain areas. It has even been revealed that there are instances when shipping lines refuse carriage of freight if the shipper or forwarder refuses to pay a surcharge. Shippers believe it would be smart of the shipping lines to engage in dialogue and consultation before they plan to impose a new charge.

An example of how serious the matter has become was raised by shippers groups in the Xiamen port (A complete report of the case is available in English at the Web site [www.port315.com/wqsj\\_detail.asp?id=20](http://www.port315.com/wqsj_detail.asp?id=20)). Following the protest of several shippers and transport associations of Xiamen, Maersk Sealand issued a “customer advisory” April 1 that four mandatory fees, including “Sealing the Seal Fee,” would be removed May 1. The

## Eastbound transpacific surcharges

(From Shanghai, Hong Kong, Taiwan and Macau)

**Shipping line surcharges**

- Terminal Handling Charge
- Documentation Fee
- Bunker Adjustment Factor
- Currency Adjustment Factor
- Port Congestion Surcharge
- Peak Season Surcharge
- Security Surcharge
- Handling Charge
- Canal Transit Fee

**Terminal operator surcharges**

- Gate Charge
- Security Surcharge

**Government fees/taxes**

- Port Construction Fee (mainland China)
- Port Charge (mainland China)
- Trade Services Charge (Taiwan)
- Trade Promotion Fee (Taiwan)
- Import/Export Declaration Fee (Hong Kong)

**Macau/Hong Kong Freight Charges**

- Feeder Charge
- Macau Operation Charge
- Local Transport Fuel Surcharge
- Macau Handling Charge

Sources: Hong Kong, Shanghai, Taiwan and Macau shippers councils.