

is established with shippers and warehouses to provide real-time inventory and shipment information. Shipment information is entered into Midship.com at different points along the supply chain by various parts of the Mid-Ship Group when needed.

“Tracking bulk and breakbulk shipments online brings challenges, which are both similar to and different from containerized cargo,” said Anton C. Posner, senior vice president of Mid-Ship Logistics. “Containerized cargo tracking is focused on the container ID (identification) number, whereas bulk and breakbulk is focused on tons or pieces, ship names, and barge numbers.



**Posner**

“Like containerized cargo, we are dealing with many different service partners, such as stevedores, terminals, barge lines, truckers and railroads. But often we are working with less technologically sophisticated partners and mom-and-pop outfits, so electronic data transfer is not always possible,” he said.

Posner added that Midship.com is password protected and encrypted. “Our clients can access their respective shipment information, but cannot see other client information,” he said.

**Steel Markets.** Today, Mid-Ship Group’s logistics business is split between steel and dry bulk shippers. The company’s

**George S. Kachmar**  
president,  
Mid-Ship Logistics



***“In the units of Mid-Ship we preach supply chain management. Logistics may be a service offering, but it doesn’t mean chartering, for example, is not speaking logistics.”***

strength in steel has encouraged it to increase its presence in the domestic market as well as abroad during the past five years.

“Our steel clients are changing. Through industry consolidation, there are more direct relationships between steel producers and consumers,” Diamond said. “We’ve tried to anticipate these trends and their impact on logistics.”

In 2002, the company opened offices in New Orleans and Miami. Through the formation of Mid-Ship Transport in June

2004, the company now has an office in Pittsburgh. Much of the steel that arrives in New Orleans is barged up the U.S. inland waterway system to manufacturers in Pittsburgh, Chicago and St. Louis areas.

For international coverage, Mid-Ship Group prefers alliances and partnerships with overseas logistics providers. In 2003, the company partnered with Imperial Logistics International of Germany; Ocean Shipping Services in Tampico, Mexico; and Power Base in Beijing.

Last year, however, Mid-Ship Group opened its own office in Istanbul. “Turkey is a huge steel producer, receiving inbound scrap from the United States and shipping much of it out as finished product,” Posner said.

Mid-Ship Logistics is involved with both import and export steel shipments in China. The logistics company manages delivery of high-grade steel to specialized industries in China by coordinating with Power Base, Mid-Ship Beijing and MIL to arrange transport of steel by small coastal bulk carriers to ports not accessible by larger ship operators. “Doing this minimizes the overland transport which can be difficult and more expensive,” Posner said.

Mid-Ship Group believes China will provide more opportunities to expand its logistics service offerings in the transpacific, as well as in intra-Asia.

“We have to set realistic goals in China,” Diamond said. “The Chinese steel market is still in transition.” ■

## Paradox of specialization

*Logistics service providers need to redefine their corporate and business strategies.*

BY DEEP R. PAREKH

A recent conversation with some doctors revealed how traditional general practitioners are seeing their practices dwindle over time, increasingly yielding patients to specialists.

Thinking about this further made me realize how, in the age of Wal-Mart and megastores, customers seek out niche players to serve whatever specialty needs they might have, whether it be cheeses, coffee shops, books or vitamins. These specialty retailers and service providers — Starbucks being a case in point — make tremendous margins in the process.

As generalization has yielded to specialization in order to provide services that are differentiated from competitors, the supply chain management industry is providing a starkly contrasting point of view. One would think that since freight forwarding and logistics are subsets and specialized services of supply chain management, they would command higher prices and margins. However, quite the opposite is true. The more generalized the service, the higher the margins and market potential seem to be.

This peculiar industry dynamic is caused in part by rampant proliferation in the number of competitors. Barriers to entry fall dramatically the more specialized you get, so that ostensibly, any guy with a truck is potentially a competitor for companies in the courier, freight forwarding or logistics industry. This is not true for the supply chain management industry, where significant knowledge, experience, and client base are required to enter and gain scale and vertical market share. The proliferation of players in freight forwarding and logistics is also in part responsible for the increased consolidation we see in the market today, as a natural economic response when there are too many fragmented players in the industry.

The most vulnerable sectors within the logistics and transportation vertical are the Forwarder-3PL and U.S. trucking sectors, where the barriers to entry for competition are lowest. On the same note, we find the Maritime and Railroad sectors relatively more difficult to enter because of the obvious entry investment required. Curiously, the Integrator sector enjoys good returns on investment,

due to their somewhat opaque cost structure, which we will discuss further in this article.

This apparent paradox of specialization requires scrutiny. What is the corporate and business strategy of the logistics and freight forwarders in the marketplace today, and is there a way to reverse this phenomenon of lower returns for higher specialization, and make more clear how a logistics company would achieve the benefits of special- ization? This article looks at how companies may consider other corporate and business strategies to explore how to exploit the value of their businesses, and set their strategies on the right track.

### Low Returns on Specialization

The return on invested capital for Logistics and 3PL companies is troubling. In recent years, top companies have averaged about 7 percent, which is just about the same or lower than their weighted average cost of capital (WACC). Profitability (operating profit margin) is relatively low and although increasing, their industry risk is increasing as well, creating a higher WACC.

According to the *McKinsey Quarterly*, “these disappointing returns can be explained only in part by overpayment for acquisitions and delays in capturing integration benefits.” Other significant factors in these low returns have been customers themselves, in their customary tendency to shop around aggressively, parceling out pieces of the supply chain activities to different providers. During this process, providers reduce their own ability to differentiate themselves, since it is difficult to optimize their operations with piecemeal work from different companies. We find customers purchasing logistics services as commodities, in the face of providers trying to set themselves apart.

Since many buyers of logistics services come from the industry itself, they are quite aware of the cost structures. And in this transparency of cost bases lies the true pitfall of the industry. The *McKinsey Quarterly* said: “about half of the industry’s contracts are ‘open book’ — so customers know what costs the provider bear — and include contract-margin and cost-reduction commitments.” We also see that in the United States, while the Standard and Poor’s 500-stock index rose 17 percent annually between 1990 and 2000, the transportation index rose just 8 percent per year, during the same decade.

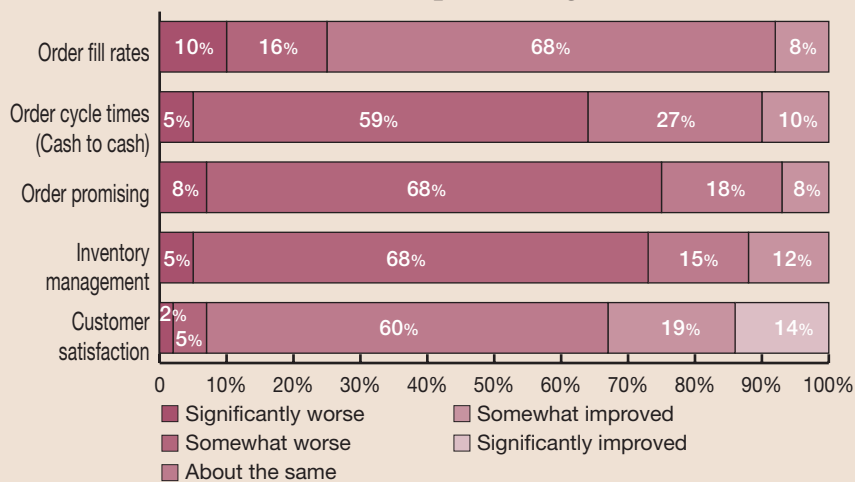
### Shortcomings in Business Benefits

#### Endanger Core Business Models of LSPs

When AMR Research did an analysis on business benefits of using Logistics Service Providers (LSPs), the results were disturbingly bleak. As Table 1 shows, for most criteria of benefits realization, LSPs performed “about the same” at best, to “significantly worse” at worst — not a spectacular scorecard for businesses whose core competencies are measured on the basis of these

Table 1

### Business benefit impact using an LSP



Note: Some categories don’t add up to 100 percent due to rounding.

Source: AMR Research 2003.

criteria. It’s surprising to see the scores so low, to be honest. Based on conversations with our own customer research team, at least items such as order fill rates and order promising should have fared better. It was not expected that inventory management and cash-to-cash times would improve dramatically, as most of the control still lies within the hands of the LSP clients. Some long-term benefits for the clients of these LSPs were expected.

Further, it is surprising then that the industry is still growing in spite of these types of benefits not having been realized.

Research from AMR did indicate that, of the clients who outsource their logistics services, 57 percent outsource less than half of the activities, and only 4 percent outsource their entire logistics function. This also helps explain the fragmented recruitment and cherry-picking of logistics services that other reports indicate is occurring in the industry, which helps drive down prices and global sub-optimization of assets and trade networks.

### Customers’ Expectations of LSPs Increase

Companies are increasingly asking LSPs to create alternative supply chain network designs to minimize overall cost (although in reality these types of analyses primarily take into account only transportation costs and variable warehousing costs). The larger-sized customers (who are cross-region and perhaps global) also want to reap the benefits of not only global sourcing and network designs, but also want the provider to make or create services for them on a global basis. Providers are basically specialists in various slivers of the industry, and are very hard pressed to do this, since their resources are also constrained, and their priorities may not be completely aligned with those of the customer, however much they might want to serve that customer.

Inconsistent with this demand for a greater list and wider scope of services, customers want to consistently pay less each successive year for logistics services. They have been able to make this dream come true by stimulating competition in the local fragmented marketplace for logistics services, thus driving down prices, but to their own detriment. They then need to add another layer of Lead Logistics Management to manage all these fragmented pieces, to orchestrate the various components of their supply chains. The result is a business model that is under pricing pressure and scope creep, to the point that lines between differentiating qualities of providers and specialists is blurring so that all players end up looking the same. When specialists are no longer viewed as specialists, they cannot afford to price themselves as such, and therefore take a huge hit to profits, since price is their only apparent differentiator.

### Game’s Changing, LSPs Aren’t Keeping Up

The above research clearly shows that customers’ expectations have outpaced LSPs’ ability to respond. Those who want to survive

and thrive need to change their business models so that they are structurally and technologically more appropriate, and they more effectively use assets. They improve economies of scale, increase geographic scope, and address needs of a wider range of customers.

Or do they? Perhaps they need to have a more unorthodox, outside-the-box strategy and approach, which fundamentally changes the rules of the game that is being played.

Since price differentiation is the only real game LSPs are playing, they are able to offer customers substantial savings on warehousing and transportation costs, even though the service areas and delivery metrics are the same or somewhat worse in many cases. Service and time losses are tolerated by LSP clients as the cost of substantial savings.

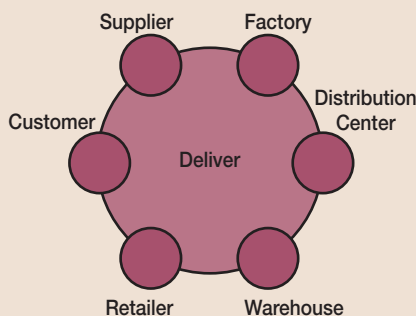
In addition, for some industries such as high-tech and electronics, cross-border trade has dramatically increased — as much as “35 percent of total industry value”, according to a recent McKinsey report. The results are clients “moving away from contracts for single localized services — a solitary warehouse in one country,” for instance.

LSPs have benefited from using sophisticated information technology systems to optimize the flow of product and information throughout supply chains under their control. It adds to their service offerings, raises their contract billing to the clients, and sets themselves apart from competitors. However, these same systems are making more visible and quantifiable what are considered “information-related logistics costs,” such as margin on lost sales, markdowns, and inventory financing costs. This information puts one more weapon in the LSP client’s arsenal with which to attack the LSP to even further drive down its margin. In some industries, such as apparel, these information-related costs can make up almost 70 percent of total logistics costs.

Another issue that troubles these logistics specialists is they can rarely cash in on good performance, as customers demand even higher standards. Whatever value is generated in improved performance is harbored by the client, as the provider is unable to see a gain while a contract is still valid. Research finds that customers’ low renewal rates with service providers can lead to excess warehouse or freight capacity, which service providers may then be unable to leverage to scale.

This contract-based approach also is to the detriment of the LSPs. In an attempt to accelerate client sales of their services, they often do not benchmark or establish internal leading practice standards, thereby constantly reinventing the wheel in several of their operations regionally and globally, much to the frustration of the global customer. A McKinsey report claims “productivity differences of 50 percent to 75 percent among similar operations in the same industrial sector and even the same country.” Providers’ operations are mired in fixing problems rather than studying their clients

**Table 2**  
**Center of the commerce perspective**



Source: AMR Research 2003.

to build a true partnering relationship, and the potential for selling clients higher-value upstream services, such as supply chain planning and strategic thinking.

**Call to Action for LSPs**

When the Council of Logistics Management changed its name to the Council of Supply Chain Management Professionals (CSCMP), there were some very irritable reactions in the logistics and transportation industry, indicating the organization had “sold-out.” This overall view is common in industry circles. Considering that the supply chain industry comprises four key segments — PLAN, BUY, MAKE, DELIVER, the DELIVER segment often seems to be splintered off from the rest.

Digging deeper, we find an interesting point of view from the DELIVER (traditionally the logistics and transportation) segment. In many instances they view the world from their perspective, and don’t see the bigger picture (see Table 2). For them, DELIVER is the center of the universe, and all the other functions are merely areas that are unable to function without the DELIVER segment. Whereas supply chains would be crippled without the DELIVER function, it stands far from being the center of the enterprise universe.

Supply chains, and not just logistics and transportation, are gaining importance worldwide as the centers of the universe of the enterprise. Quoting the supply chain as the next “Killer App,” the *Harvard Business Review* believes “supply chains are becoming one area where distinction is possible, powerful, and increasingly difficult to replicate.” Further, the review believes “supply chains are becoming the basis for competition; let IBM’s sale of its PC business and the impending merger between Gillette and Proctor & Gamble be your wakeup call.”

Hopefully, this article sheds light on what the logistics and transportation industry needs to do to answer that call.

**Corporate, Business Strategies.** Two key components of a business’ plan need to be determined:

- The business-level strategy, which is the issue of how to build a sustainable competitive advantage in a discrete and identifiable market.
- The corporate-level strategy, which is an overall plan for a diversified company.

The two are but two sides of the same coin. Phrased more inclusively by Collis & Montgomery in their book *Corporate Strategy*: “Corporate strategy is the way a company creates value through the configuration of its multimarket activities.” This definition has three facets: the first is emphasis on “value creation” as the ultimate goal of corporate strategy. The second is the focus on the enterprise’s multimarket scope (“configuration”), including the product, geographic, and vertical boundaries. The third is the emphasis on how the firm manages the activities and business that stand within the enterprise hierarchy (“coordination”), recognizing the importance and framework of this corporate

**Table 3**  
**Corporate strategy framework**



\* Adapted from *Corporate Strategy*, by Collis and Montgomery.

Source: AMR Research 2003.

strategy.

A model frequently used for analyzing strategy is also part of Collis & Montgomery's book, which balances Resource, Vertical, and Organization, based on the central columns of Vision, and Goals and Objectives, to gain a corporate advantage (Table 3). Let's examine each of these essential building blocks for how LSPs need to rethink their strategy:

- **Vision.** Without vision, any road could possibly seem like the right one, whereas in reality it may be to the detriment of the company. Today, the LSP marketplace is full of confusion, with very few players being clear about

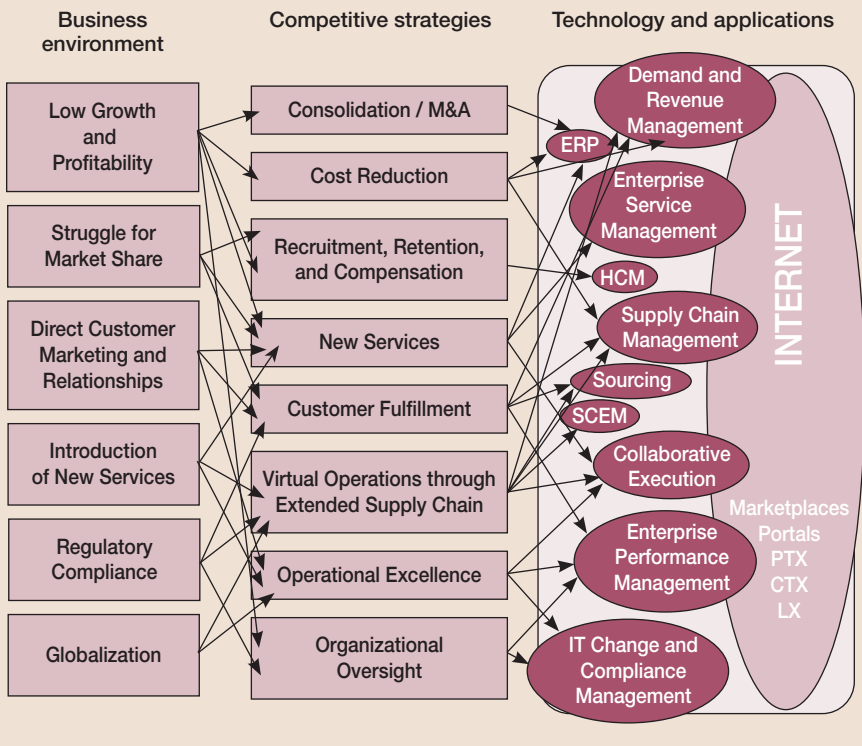
where they are headed. Most categorize themselves in the buckets of "freight forwarder," "3PL," "LSP," or "Integrator," whereas they are doing a little of everything. Further, they have Web sites proudly displaying this lack of coherent vision.

The other common misrepresentation is spelling out their vision as "wanting to excel in freight forwarding and supply chain management." Wait a minute, since when did freight forwarding (within the traditional Logistics field) divorce itself from the overarching field of supply chain management? A powerful vision should continuously stretch the company's capabilities, and capture its aspirations and ambitions in an overarching statement. Ford had such a vision: to put "a car in every home." Microsoft's vision has been to put "a computer on every desk, and in every home, running on Microsoft software."

The vision also establishes the domain in which the provider will operate, thereby clearly establishing what is within scope and what is not. This takes diligence both during the creation of the vision following it, not to get distracted by what

Table 4

### Business benefit impact using an LSP



Source: AMR Research 2003.

other players in the market are doing, unless it truly offers a tremendous opportunity or wards off a significant threat.

- **Goals and Objectives.** Whereas the vision might be too overarching to be actionable in specific activities, the goals and objectives serve as the milestones for achieving the vision.

The staff of a company views them more affably, because they are more tangible and achievable. Whereas goals are more qualitative, objectives are more quantitative in nature. An example of a goal might be "become a global organization," whereas an example of an objective might

be "achieve benchmarking excellence in service of 99 percent by end of 2006." Whereas the Vision might evolve slowly over time, the goals and objectives are constantly being created and achieved, and constitute the more important strategic hurdles for the company. The corollary to this is that not achieving the goals and objectives threatens the credibility of the very vision itself.

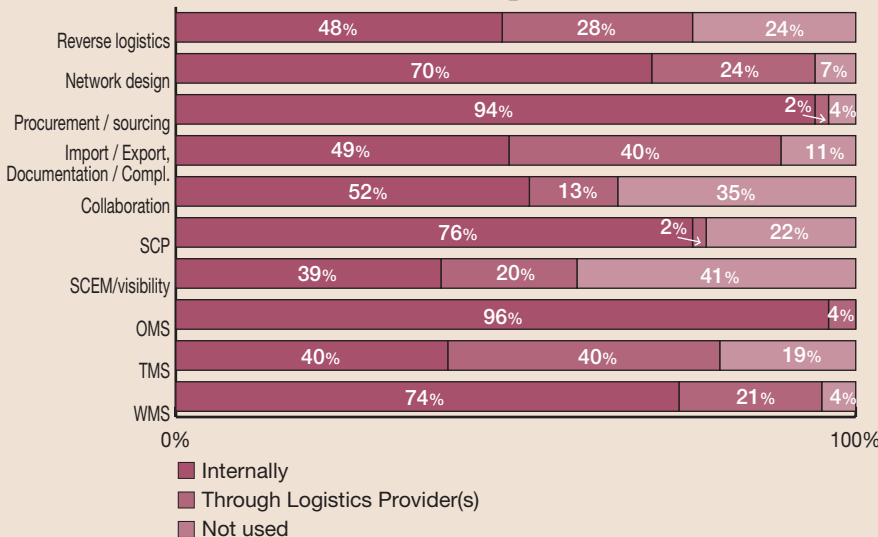
- **Resources.** These comprise the LSP's assets, capabilities and skills. Resources determine not what the provider *wants to do*, but the constraints of what it *can do*. These are the elements on which competition between firms is based on, and where differentiation can be sought. The Resources of the LSP may determine what types of market opportunities would be appropriate for the provider to pursue viably. Resources are the root of value creation for the business.

- **Verticals.** This refers to the industry verticals in which the LSP operates, and to the competitive strategy it adopts in each vertical.

Clearly it cannot have the same value add for all verticals, hence how it serves each vertical must be different, and within

Table 5

### Users' source of capabilities



Note: Some categories don't add up to 100 percent due to rounding.

Source: AMR Research 2003.

that difference, other areas of value may be delivered. Choosing one or more industry verticals to operate within is of core importance to the LSP, since it obviously cannot play in all areas with equal efficacy. Each vertical has economic and geopolitical differences, and the LSP must be sure to analyze them in detail before entering them. Decisions to play or not play in a vertical can impact margin, tie-up resources, and lead the company in a different direction.

- **Organization.** The LSP's structure, systems, and processes are included in this area. Clearly these are the foundation stones of how the LSP operates, and their importance is well known and well published. Within the structure, an LSP may debate whether to operate on a local, regional, or global basis, whether to have centralized or decentralized client management, and what type of scaling to pursue, whether it be acquisition-based or greenfield. Within systems, the LSP must define the formal set of policies and routines that govern the organization, the rules that define how objectives will be accomplished. In the *process* area, the LSP must describe the network of interactions that must exist in order to make the organization operate efficiently.

- **Competitive Advantage.** LSPs must see the business environment around them and within their organization, and figure out how to operate and what type of strategy to follow.

There are many environments that dictate different approaches, as shown in the figure alongside (Table 4). Low growth and profitability can dictate that the LSP follow a strategy to consolidate to increase scale and asset utilization. They may alternately, or in addition, follow an aggressive cost reduction strategy. They may be struggling for market share, and therefore follow a strategy to create new innovative services.

Having introduced new services, they may want to conduct virtual operations through trading exchanges. Globalization may make them focus on operating excellence and conducting virtual operations as well. In all of these pursuits, technology may play a vital role in enabling any or all of these strategies and create a competitive advantage for the LSP.

**New Sources Of Value.** Table 5 shows the areas of logistics functions being performed by companies themselves, those being performed by providers, and those not being performed at all. This is a truly insightful picture of where LSPs can expand their services, and what potential value they might gain. Even if we look at just areas that are not being addressed by LSP client companies, we can see that there is significant potential in several areas.

In reverse logistics, for instance, 24 percent of companies are not leveraging this capability either internally or through an LSP. The same is the case for supply chain event management/visibility, where 41 percent of companies are not using any capability for this process. In transportation management systems, 19 percent are not leveraging capabilities. If LSPs consider expanding outside their core competency, there are many more pursuits, the fruits could be even greater in value in more upstream activities such as supply chain planning, procurement and sourcing, and order management, where companies are mostly leveraging their internal capabilities.

When we examine the Web sites of several LSPs, we see them playing in a very small scope of work, not leveraging the full potential of information they have access to. Where they provide visibility of the shipment status, they fall short of acting on it. When they provide network studies, they fall short of making the introductions between their clients and providers of warehousing facilities to create a network of value for all parties involved. Even in the global logistics arena, a core competency, in many cases we hear customers wishing for additional services, such as brokering relationships between suppliers and manufacturers, creating and managing supply relationships, and other areas, for which companies are likely to and ready to pay top dollar. In other areas such as supply chain management, LSPs have virtually no experience or credibility, nor in the collaboration space. Here again, LSPs have the potential to create some brand extensions and play in this space along with other top players, since the market is big enough to endure several other players.

**Horizontalization.** There is potential for LSPs to expand within one particular "sliver" of an operation that they perform. If they perform it at a global benchmark level, they actually sell that particular sliver of service to other LSPs, so that other LSPs need not perform that function for themselves.

A good example is Sabre, the American Airlines created system for passenger reservations, which created the standard, and several online travel agencies leverage this capability and don't reinvent the wheel. Other such players are LSG Skychefs for airline catering, and yet others for equipment maintenance. Horizontalization allows LSPs to extend their excellence throughout the industry and make perhaps a traditional cost-centric area into a profit-centric area.

## Think Different, Get With It, Move Forward

Shareholders are going to tire of the fact that LSPs are not proving their value. Before this gets too far, LSPs need to change their market strategy, and start changing their business models and strategies. It has been shown why specialization doesn't pay off when it has become commoditized, as it's no longer considered "specialization." It's just a commodity.

Price is no longer a differentiator. Margins can't afford that anymore, and the bigger players can afford to stay in the game longer than smaller players. There will continue to be some consolidation in the industry, but selling out in this manner would be giving up market value.

There is tremendous scope to grow the LSP business further, and expand it into new areas which have been off the radar so far, or under-exploited.

Moving up the value chain could be of great advantage to the LSPs and create great value for the customer.

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