Understanding the Supply Chain Component Linkages

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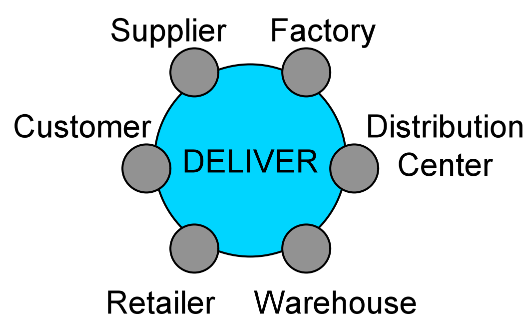
In last month's column, I referred briefly to 'partnering' between Logistics Service Providers (LSP) and their clients, the shippers. I presented an overview of some key business processes that companies need to collaborate on, such as the development of a holistic sourcing strategy, sales and operations planning (S&OP), inventory planning and management, sales forecasting and distribution planning. These processes all contribute to and have an impact on the traditional process that the both sides have always had a transactional relationship: transportation planning and management. Underlying this relationship must also be a core information sharing relationship providing visibility and real-time updates.

I was at the recent Latin American annual logistics conference event, *XIII Forum Internacional & Expo Logistica*, in Rio. I was struck by a couple of different thoughts: one, the fact that there were so many logistics providers (as opposed to consulting firms and software companies, which usually haunt such events in large numbers), and two, the fact that these logistics companies were not quite fully aware of how the critical components of supply chain tie together, and how to leverage each component / service fully as an LSP or as a client. Looking back at earlier conversations with their counterparts here in the US or in Europe at other similar events, this seems to be a global phenomenon. My goal in this column is to provide more insight into this linkage between these supply chain components.

Figure 1: Center of the Universe Perspective
Source: Equus Consulting



In many instances logistics service providers (LSP) view the world from their perspective, and don't see the bigger picture (see Figure 1). 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 & Transportation (DELIVER), as a whole, 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 that "supply chains are becoming one area where distinction is possible, powerful, and increasingly difficult to replicate." Further, they believe that the "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 wake-up call."

We believe that this is one of the key elements in the burning platform for the industry today, making the case for change in perspective a fundamental shift in perspective that needs to occur in the industry in order to survive and be a player for the next twenty years. In this article we hope to shed some more light on what the Logistics & Transportation industry needs to do to change their outlook.

Go Ahead, Differentiate Yourself

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, as we described, 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 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 because of 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 at which the 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 huge hits to their profitability, since price is their only apparent differentiator.

Instead of competing only on price, LSPs need to expand the scope of their services significantly, and enter the business playground of other supply chain specialties besides transportation and distribution. Most 3PLs who have ventured into this space have stayed close to their ‘border’ and not tried to expand into spaces such as demand planning, production planning, and materials planning.

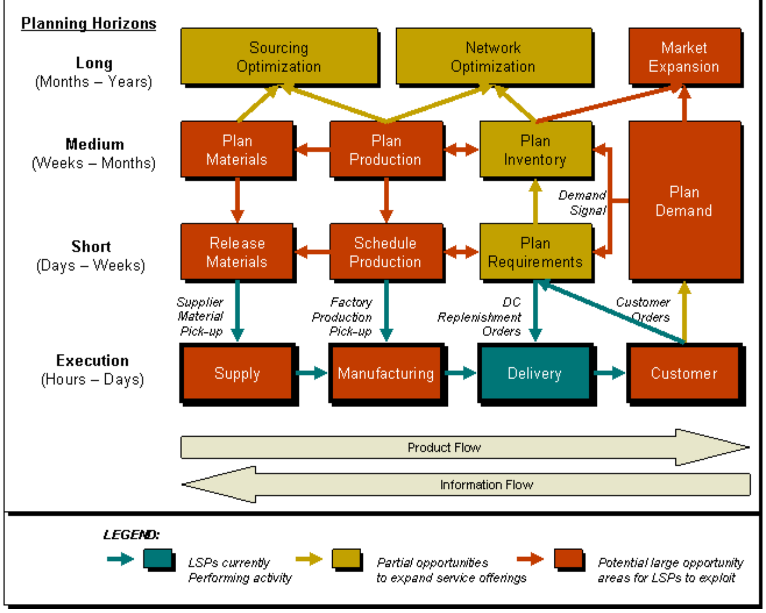
To the net benefit of the LSPs, they are using sophisticated IT systems to optimize the flow of product and information throughout the supply chains under their control. The impact of the advancement of IT systems has proven to be a double-edged sword for LSPs. On one hand, they can add this as part of their service offerings, raising their contract billing to the clients, and setting themselves apart from competitors with their systems (which also are as of late becoming more commoditized). On the other hand, they are making more visible and quantifiable what are considered ‘information-related logistics costs’, such as margin on lost sales, markdowns, and inventory financing costs. Wielding the latter information-related costs, clients find themselves with one more weapon in their arsenal with which to attack their LSPs to drive down margins even further. In some industries, such as apparel, these information-related costs can make up almost 70% of total logistics costs.

Manufacturers & Shippers Need the Extra Help

As globalization takes more of a hold on manufacturing companies, they begin to venture into ’10,000 mile supply chains’. As this happens, it becomes more difficult and unwieldy for companies to keep their ‘empires’ under control, let alone fully optimize their supply chains. This is where the LSP can play a major role.

In Figure 2, we have shown the different supply chain components and activity flows that LSPs are traditionally (not) involved in. Whereas they are heavily involved with the different functions within the principal component shown as 'DELIVERY', they are only beginning to exploit the other areas such as Requirements Planning, Inventory Planning, Network Optimization, and Sourcing Optimization. We say only partially exploiting these areas because they are optimizing based on the variables that they control and have knowledge of (transportation, warehousing, distribution costs and constraints) as opposed to holistically (market expansion, trade barriers, competitive pressures, supplier and production constraints, etc.). We believe that there is enormous opportunity in these areas and beyond.

Figure 2: **Supply Chain Management Components and Flows**
Source: Equus Consulting



'Greenfield' opportunities for these LSPs would be the other areas indicated in red, such as demand planning, supply planning, and other areas, where LSPs have not attempted to penetrate yet with any critical mass whatsoever. This is where LSPs, if they feel it is not their core competency, should partner with consulting firms to gain leverage and insight into these spaces, so as to increase the total value equation for their clients.

Manufacturers and shippers need to stop looking at their LSP as just a transportation or warehousing provider, and more of an *Integrated Business Partner.* They should involve the LSPs and their partners into more in-depth relationships as opposed to throwing orders over the wall. There is great value to be generated in these opportunity areas by all parties.

A recent *Customer Advisory Board* workshop we performed with a LSP client indicated that customers are ready for this type of service expansion, and welcome it. In the words of one of the customers, "it's all well and good that you can show me with 99.9% accuracy that I have no inventory of a particular product in my warehouse, but what can you help me do about it to avoid this problem in the future?"

This is where LSPs must look to expand their services to add value to their relationships and to their clients.

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