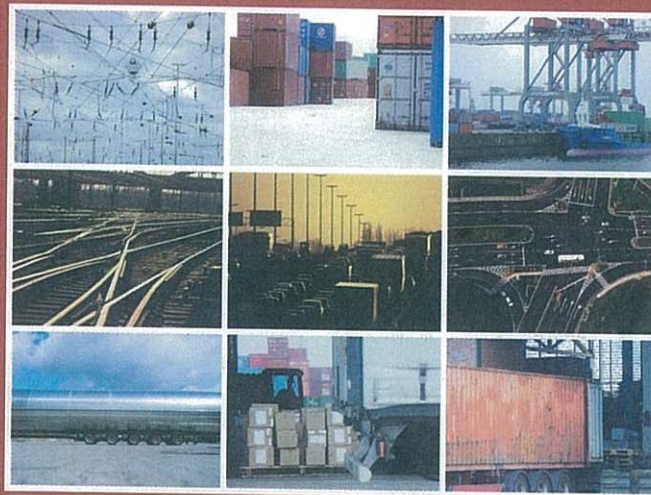


# Mastering the challenges of the supply chain

Trends and vision for European logistics

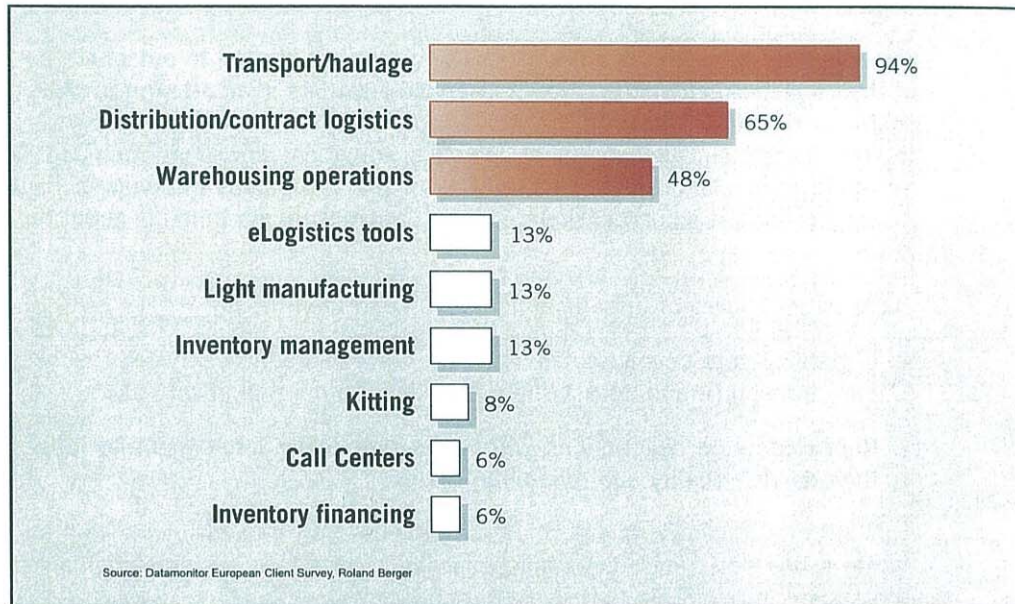


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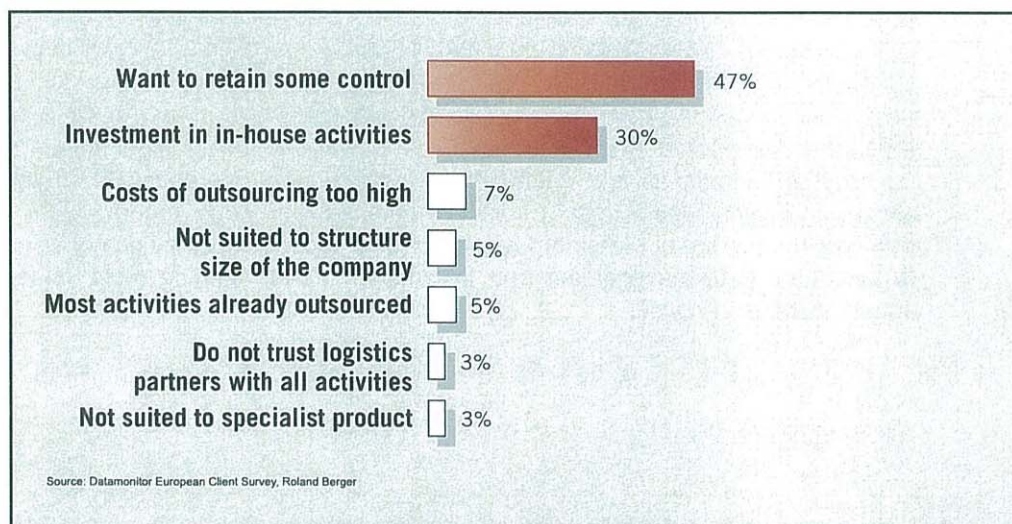


Figure 37 – Share of outsourcing by logistics activity in EU-15, 2001 [%]



When companies are asked why they do not outsource more or all logistics activities, various reasons are usually put forward. As illustrated in Figure 38, the strongest point is that ownership is the best way to control logistics operations. Another popular reason is the level of existing investments in logistics operations.

Figure 38 – Reasons for not outsourcing all logistics activities [%]



Selective outsourcing is preferred by quite a margin over the complete transfer of supply chain control to a full service provider. Some logistics services do show room for further outsourcing, however, since it would allow users to:

- > Save costs and improve quality (logistics service providers are assumed to be able to benefit from economies of scale and more know-how);
- > Free up management capacity and assign it to (core) activities.

This certainly applies to warehousing operations. However, our interviews revealed that some companies prefer to keep warehousing operations in-house, arguing that:

- > LSPs often use an unstable workforce, characterized by high turnover and share of part-timers;
- > Their own employees are more flexible in terms of night and weekend shifts than third party subcontractors. This could be of great importance, for example in the textile manufacturing industry, if shipments from Asia are delayed, etc..

Whatever the scope of outsourcing, logistics users often fail to share relevant information with their logistics service providers. The main reasons are the fear of losing control of the supply chain and disclosing confidential data. Key to the success of logistics outsourcing is, therefore, the development of trust between the LSP and its customers. A major obstacle lies with current purchasing practices: purchasing managers are often rewarded for wringing the best possible price out of suppliers, a practice that's not conducive to nurturing long-standing partnerships.

### **How far can the LSP be squeezed?**

Faced with increased margin pressure, manufacturers and retailers require from their LSPs both flexible contracts (e.g. shorter term) and advantageous financial conditions, putting LSPs under increasing pressure. Many companies view outsourcing merely as a way of cutting costs by getting tenders from multiple logistics service providers on a frequent basis.

Recent experience shows that logistics services providers are then forced to reduce service quality levels.

According to the professionals interviewed, a distinction should be made between mere transportation service companies and logistics service providers. While the trend towards increased squeezing is certainly valid for 1PLs and 2PLs (simple transportation services, no added value), most professionals do not see this trend for 3PLs. Supply chain integration and reliability is starting to be considered more important by logistics users than just cost-cutting and flexibility.



This has to be the case if a company wants to optimize its supply chain efficiency. As supply chain reliability becomes ever more important, logistics users must work with 3PLs with a long-term view, building trust and confidence to allow for relevant data sharing and outsourcing of value-added services.

Some LSPs introduced recently, especially in the UK, cost-plus or open-book pricing policies, to avoid that any price negotiation would endanger service levels.

### Which LSP to select and how to manage it?

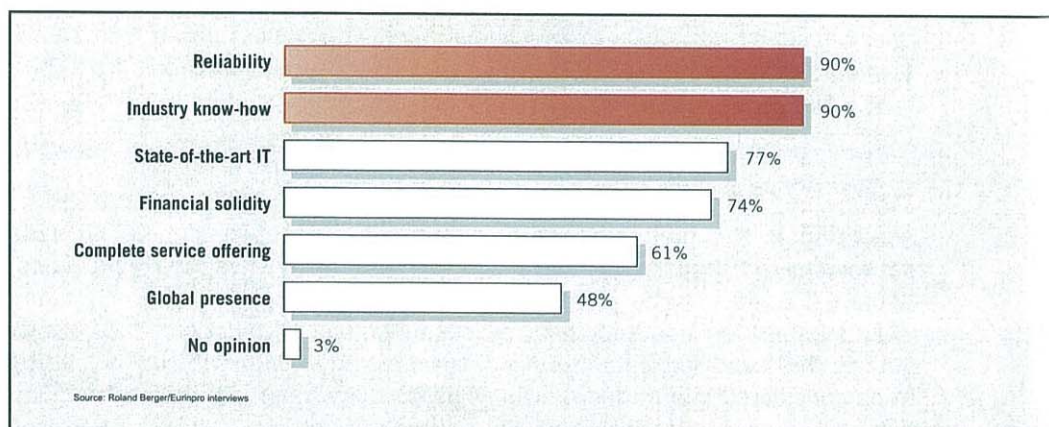
The current tendency of LSPs to become global partners and market full-service offerings providing international one-stop shopping has already been mentioned. For many years, logistics companies have marketed their value-add, innovative and IT driven solutions on a European and global basis.

LSPs often fail to deliver on their promises and, in practice, can't provide their customers with consistent levels of quality across countries. Many LSPs do indeed have difficulties integrating the networks they have acquired or properly managing local subcontractors.

More fundamentally though, this study raises the question whether these strategies are driven by true customer expectations.

The study reveals that internationalization and complete service offerings are not the most important criteria when selecting a logistics service provider (see Figure 39). Most respondents look primarily for industry and local market know-how, financial solidity, reliability, and state-of-the-art IT systems (e.g. GPS tracking and tracing system).

Figure 39 – Answers to: "What are the main ranking criteria when outsourcing to a 3PL?"  
[% of answers]



Also, some large LSPs, that aim at reducing costs, increasingly differentiate their service levels according to customer needs. They distinguish between different customer groups (for example by ABC life-time value analysis), providing very different levels of customer service. For example, while A customers have an access to broad customer support, requests from B and C customers are normally routed to a call center.

This leads to two key observations for the selection process of a LSP:

- > Avoiding complexity by outsourcing to a global, full-service offering LSP may not provide logistics users with the anticipated industry and local know-how they seek;
- > Outsourcing to the largest LSPs may not result in the expected level of customer service. Depending on its size, each company should try to find a service provider that will treat it as a key account.

In particular, small and medium-sized logistics users that often lack strong contract management capabilities experience with SLAs (Service Level Agreements), KPIs (Key Performance Indicators), etc. – should rather rely on an LSP that provides closer collaboration and flexibility to accommodate the needs of the user.



volume brought into and transported across Europe. Second, ports in the "Le Havre-Hamburg" range are expected to remain dominant, since the current lack of appropriate port and trans-alpine infrastructure makes the mid-term future development of Mediterranean ports doubtful. While those overseas "injection" points are being somewhat more peripheral than nowadays, the distance of a given average transportation leg will increase. Third, in order to increase retailers' stock turnover and optimize on-shelf availability, the frequency of deliveries to the point-of-sale or the retailers' distribution center will be further increased, and will in turn trigger "just-in-time" procedures along the entire supply chain, increasing transportation even further. Fourth, global sourcing, manufacturing and distribution are likely to remain the preferred strategy of manufacturers, with the consequences on transport volumes to match;

- > **Supply chain control development: "consumer-facing players in command"** – Consumers are increasingly in command! In Western European's mature and highly competitive markets, the management of customer satisfaction and retention is increasingly important. In addition, since consumer demand patterns are changing (e.g. smart shopping or hybrid consumer groups), the entire supply chain will migrate towards a demand-based approach. Consequently, the role of the supply chain actors in direct contact with the consumers is increasingly important. Retailers (or other consumer-facing players) indeed provide suppliers with the main sales channel, own the point of sale information, provide customers with various services that are key in the consumer's buying process, and master their product categories based on negotiations with suppliers (except for a few "pull" products with highly visible global brands). All this makes the case for an even stronger position of consumer-facing players in the supply chain overall. It is very likely that they will dictate the shape and structure of European logistics streams in the future;
- > **Supply chain integration development: "strive to more integration"** – Over the course of the last decade, manufacturers and retailers have made big steps forward by increasing logistical efficiencies, including significant improvements in order-cycle times and customer service levels. Goals such as order accuracy and better forecasting capability, however, remain somewhat elusive. In addition to tackling these issues, both manufacturers and retailers are increasingly concerned with the difficult task of generating further gains in already efficient supply chain processes. Supply chain integration will be key for the optimization of the logistics flows, migrating from a "sum of parts" to an overall coherent approach.

With this scenario in mind, the supply chain is expected to become increasingly **complex**: the scope of operations will become more and more global (e.g. global sourcing, manufacturing and distribution), the number of supply chain decision makers will grow (e.g. increased outsourcing of manufacturing steps)



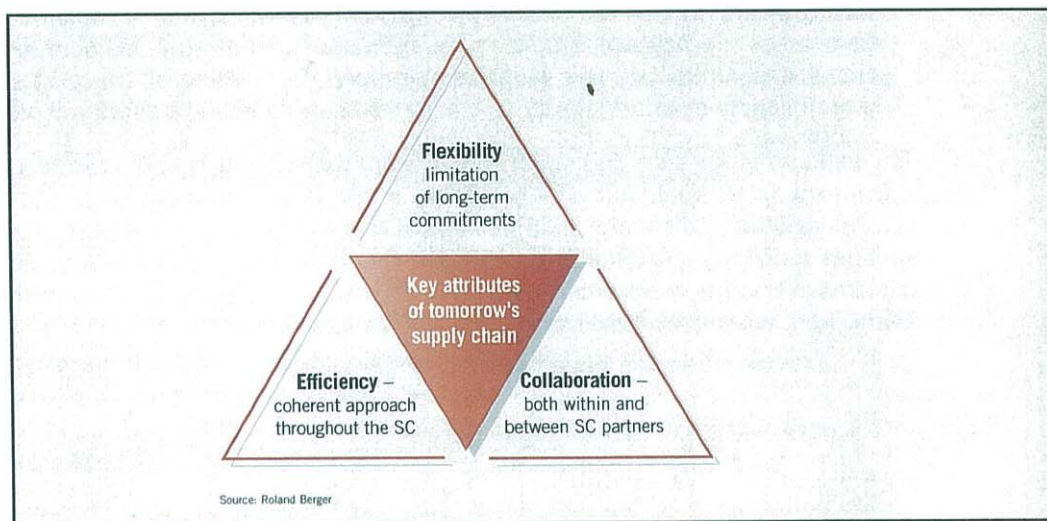
and various different supply chain structures are likely to emerge (e.g. growing distinction between fast and slow networks).

However, the scenario depicted above will also imply a **suffocation** of the Western European supply chain. The Western European infrastructure network is unlikely to accommodate the anticipated increase in transportation volumes. Heavy goods vehicle traffic alone is bound to increase by nearly 50% over its 1998 level over the next decade. Neither the measures taken by the European Union nor private initiatives are expected to lead to a more rational use of the advantages of each mode of transport in the short- to medium-term. This means that regions and main through-routes which are already heavily congested, will have to handle even more traffic.

A third major danger lies ahead for logistics and supply chain management: **inefficiency**. Current supply chain weaknesses (such as poor service levels to consumers, weak sales forecasting ability, etc.) will be felt even more and will have to be addressed.

As a result, three concepts (as illustrated in Figure 42) will become dominant in the supply chain of tomorrow:

*Figure 42 – Key attributes of the supply chain of tomorrow*



- > **Flexibility** – As the logistics landscape becomes ever more blurred, and the future development is still uncertain (e.g. where will the future logistics hotspots to Central & Eastern Europe be located), the ability of companies to adapt to those changing market conditions will be an essential part of their successful business strategy. As a result, all logistics players will tend to search for flexibility in their supply chain by minimizing long-term commitments;





- > **Collaboration** – "Supply chain management is all about software and systems, right? Get the best technology in place, then sit back and watch your processes run smoothly and the savings roll in." If that's true, then why did Jeff Bezos raid Wal\*Mart's boardroom, paying top dollar to bring best-in-class expertise to Amazon? Supply chains it seems, are about talent not just technology, especially as the marketplace grows ever more complex. But getting people to work together is not easy. Creating effective alliances between companies, for instance, is complicated. Purchasing managers are rewarded for wringing the best possible price out of suppliers – a practice that's not conducive to nurturing long-standing partnerships. Internal relationships can even be more difficult to manage. It's been known for long that functional silos hinder communication and efficiency, but many companies still struggle to tear down the walls. Successful supply chain integration can only be realized if a truly "collaborative" atmosphere is achieved between the various departments of a company and between all supply chain players;
- > **Efficiency** – Supply chain efficiency will increasingly be a key lever for both higher revenues and lower costs in the Western European low-margin environment. Return on Capital Employed (ROCE) and Economic-Value-Add (EVA) or similar key performance indicators, as well as optimal cash management, will be the main objectives of stakeholders in companies. Companies will however need to understand that optimization inside individual companies (or even single departments) is a thing of the past – overall supply chain efficiency (i.e. across the entire chain) will be key.

To conclude: in logistics and supply chain management, many paths can lead a company to its goal. But only one route is the best. The measure of successful logistics and supply chain management must be the extent to which it satisfies individual customers. The supply chain has to be aligned with the customers' specific requirements, which means that the flow along the entire chain, from supplier to final customer, must be guaranteed.

**A word to the wise is enough...**

