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Extending Your Enterprise

Supply Chain Flexibility

Are You Ready to Dance?

Jaison Augustine, Vice President
Shipping and Logistics, WNS Global Services

As the world watched the captivating fireworks and synchronized movements of hundreds of performers at the Beijing Olympics, the logistics industry was grappling with its own synchronization efforts behind the scenes to keep critical supply chains in motion around Beijing.

The Chinese government had ordered the closure of several factories around the city in an attempt to improve the air quality ahead of the Olympic Games. They also imposed severe restrictions on the movement of cargo trucks around the city a month in advance. While these restrictions where challenging for companies operating and distributing in the local area, they also had ramifications for companies sourcing from Beijing, proving that global supply chains must be flexible to deal with surprises and disruptions.

Adverse market conditions and volatility in oil prices have instigated a crisis for businesses in general and the logistics industry in particular. Simple economics dictates that when there is a tightening of the credit market it lowers disposable incomes as well as the demand for products and services. Manufacturers have to lower production or reduce production costs to keep up with the rising costs of international transportation. This has a direct impact on the business of logistics.

The dramatic rise in oil prices generated extreme views from some analysts. The cost of shipping a standard 40-foot container nearly tripled since 2000, and most carriers are passing on the cost through fuel surcharges.

Some have predicted the end of globalization as the cost of transporting goods from distant sourcing countries like China has begun to offset low production costs. While such predictions lack a credible base, companies are rethinking their sourcing strategies to include near-shore production.

Dean Scott Dawson of the Portland State University School of Business recognizes the combination of rising wages in low-cost countries, corporate commitments to reduce carbon emissions and the high oil costs are combining to increase manufacturing and shipping costs. Dawson believes that the high cost of operating overseas will lead to a 'Made in America' renaissance.

According to a recent McKinsey & Company report, executives managing global supply networks are sharply scaling back offshore production plans and bringing manufacturing back to or close to the United States.

Nike, which works with manufacturers in China, Vietnam, Indonesia and Thailand to produce all of its footwear, manufactures its Air-Sole cushioning components in the U.S. and ships them to overseas manufacturing plants for the final assembly. Nike is streamlining this process and evaluating bringing manufacturing back to the United Sates.

The American Trucking Associations (ATA) forecast 'a mild recession' in the United States when truck tonnage took a sharp turn downward in August. According to ATA Economist Bob Costello, with freight volumes weakening, the industry is expected to be well into a mild recession later this year and early next year.

Similarly, ocean carriers have far too much capacity. Expect charter rates to fall and ship owners to delay deployment of ships that come off their leases rather than to try and re-charter them. Carriers may try to push back on the shipyards by canceling some orders, even if they have to pay a penalty to do so.

Matthew K. Rose, chairman, president and CEO of BNSF Railway, North America's largest intermodal railroad, told analysts in July, “We're not getting any indications at this point that there's going to be any significant peak season this year.”

All this is beginning to show in the declining operating results of companies. FedEx, for instance, posted a fiscal first quarter operating income of USD 630 million, down 23 percent from USD 814 million last year. According to an earnings release, “strong cost management actions were more than offset by global economic weakness, higher fuel prices and the related negative effects of higher fuel surcharges.”

FedEx has responded to the potential for near-sourcing to become a trend by launching next-day express service in Mexico. FedEx is expecting companies to consolidate their domestic shipping along with their cross-border (Mexican) shipping.

How should manufacturers or sellers of manufactured goods address this complex issue of flexible supply chains to adjust to the economic and competitive environment? A recent AT Kearney report focuses on network design, flexible supplier relationships, simplification of the transaction processing and IT connectivity. These are all elements that can enhance flexibility and allow companies to ‘substitute’ one channel for the other during difficult times.

Increasingly, companies need a partner to manage logistics and other non-core processes allowing them to focus more on their business strategy, expanding markets and acquiring new customers. McKinsey & Company makes its case for ‘unbundling the corporation.’ According to McKinsey, most companies are three businesses combined: one that focuses on customer relationships, another developing products and the third that supplies the infrastructure.

The culture and dynamics in each of these three components vary widely and, due to a forced integration into one entity, they cannot function optimally, often causing conflict. The case for moving ‘non-core’ pieces to specialists is very strong and two major trends will begin to emerge as a result:

Outsourcing of the logistics function to 3PLs. According to Armstrong and Associates the size of the 3PL market in 2007 was roughly USD 122 billion. This has been growing every year. Following a non-asset based model, 3PL providers have more flexibility in a softer demand environment than asset-based carriers as these providers do not need to own planes, ships, a fleet of trucks or a substantial fixed cost network. Of the thousands of 3PL providers globally, the ones that have innovative service offerings, better reach and the ability to offer technology solutions stand a better chance in this competitive industry.

Outsourcing of business processes is another important piece of unbundling the corporation. Moving back-office processes to business process outsource companies has advantages. Processes such as finance and accounting, human resources, contact center, procurement and several other transactional and rules based processes can be performed with greater efficiency.

For 3PLs, this could be a time of growth as companies seek to disband their fixed infrastructure to manage the complex logistics function and move to a more variable cost base.

All three segments need to think outside the box and challenge traditional operating paradigms to emerge successful from this overall downturn.

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While the credit crisis in the U.S. persists, economic woes spread to European and Japanese markets, and even China has seen a softening of growth (which for the first time is below 10 percent). The logistics industry must gear itself for a period of uncertainty and weak economic activity. Considering the intertwined nature of the global supply chain, where the fates of involved players are inextricably linked to one another, there is a need to stay flexible and move in step with your partner in the chain - like those performers at Beijing, are you ready to dance?

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