

The Reason Logistics is Seldom Optimized An Argument for Outsourcing Responsibility

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Most companies are held back by their logistics¹. Organizations do exactly what they are built to do. This article explores why logistics needs help and suggests a solution.

Let me describe an example company. XYZ Corp. is a U.S. manufacturer of apparel. XYZ's supply chain begins with buying cotton and yarn. Their highly automated plants produce fabric and dye it to the appropriate color. Like most companies in that industry, years ago, they were forced to sew their garments in Central America, China and India where low labor rates allow them to compete. They ship the cloth they manufacture to cutting facilities which cut it into parts. Cutting facilities are proximate to the sew plants around the world. Finished goods are containerized and shipped to their distribution centers on both East and West coasts of the United States. XYZ ships from its DCs to those of its customers, major retailers across North America.

Now let's look at XYZ's well defined functional organization chart. Each employee has one boss. Communication lines are straightforward and well defined. Each functional area is organized to perform its function efficiently.

XYZ Functional Organization

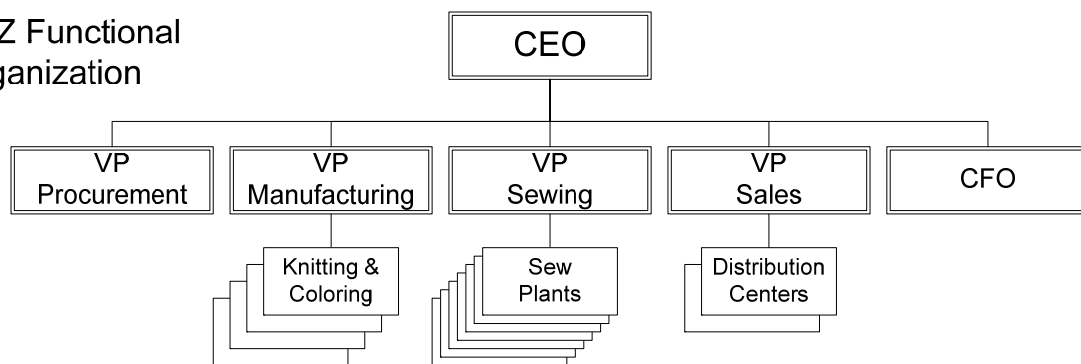


Figure 1.

Under the CEO there is a VP of procurement who is responsible for purchasing and raw materials; a manufacturing VP who manages seven knitting and coloring plants in the U.S. and Mexico; a VP of Sewing who oversees company owned sew plants and sewing contractors; a VP of Sales and Marketing who runs the sales force, customer service and the DCs that serve the customers; a CFO who controls accounting, information systems and human resources.

Then, there is logistics. It crosses all the functional areas. Logistics is a function with multiple bosses. How will logistics fare? Who will be its champion? The CEO? If he is

¹ To be clear, by logistics, I refer not just to moving goods but also, more broadly, to the timing of the flows of goods, where they are held and in what quantities.

the visionary leader he should be, he expects logistics to work flawlessly but in the background. He won't likely be the champion. XYZ Corp. addresses the problem by having the manager of its Transportation Department report to the VP of Procurement. The logic of this appointment was the CEO thought he was the VP with the most extra time. (Ask any VP of a major company how much "extra time" they have. You already know the answer.) If you asked the VP of Procurement, is procurement more important or is logistics more important? Again, you know his answer.

As a result, there are multiple priorities in logistics, making it the worst run, least effective area of the corporation with little or no clout and buy-in from other areas. When it is even mentioned, the comment is a complaint. Who is at fault for logistics difficulties? It is hard to blame anyone. In fact, the question is wrong. XYZ Corp. was designed to perform 5 major functions well in order to produce money. Logistics is not one of the 5 functions. XYZ thought enough of each employee to protect them from being pulled in multiple directions to give them clear, unequivocal directions. Poor logistics.

Measurements are a significant part of the problem at XYZ. The CEO worked with each of his direct reports to define very few focusing measurements, through which he holds them accountable. Like most companies, XYZ Corp. measures each functional area in isolation from the others. The CFO, for example, is measured on the timeliness and accuracy of financial statements, maintaining lines of credit and reducing employee turnover. The Sewing VP is measured on dozens of garments produced each day through his factories. The procurement VP is responsible for lowering the cost of raw materials. Unfortunately, these measurements don't necessarily help the whole company make more profit.

As an example, four years ago, the previous VP of Procurement received a \$20,000 bonus for saving \$1 million per year in raw material costs. XYZ accepted larger minimum order quantities, as a concession to their supplier. Disposals of obsolete raw materials increased slowly from one half million dollars per year, over the next few years, finally stabilizing at \$2 million dollars per year. Over the same time frame, the supplier worked their prices back up.

Silo optima cause negative effects on the whole system. Due to local departmental measurements, logistics suffered at XYZ. Remember there is no Logistics Department. Making the effort to fix logistics does not increase any top manager's measurements. Measurements drive actions, just as they are supposed to. Therefore, Problems in logistics are not easily rectified at XYZ.

Is this applicable in your company? Your functional organization is probably fine, logically built around core competencies. For most companies, logistics is not a core competence. A natural tendency would be to outsource logistics. Many companies have outsourced portions of their logistics. There are trucking firms with "Logistics" in their name who will function as your traffic department. The management of warehouses can be outsourced to a rapidly growing number of third party logistics (3PL) companies.

Unfortunately, until now, no company would take responsibility for the important part: **having the right inventory at the right place at the right time.** They may claim to but

they don't. The trucking company may usually deliver the cargo where it should be within their lead time. BUT, if you don't ship it on time; it's not their fault. A 3PL may hold their margin for managing your warehouse to 15% of their cost. BUT, if the cost goes up, due to their lack of incentive to reduce it; you'll pay 15% of a bigger number.

The perfect company to outsource to is one that

- eliminates cross functional responsibility;
- keeps your logistics focused on earning more profit over the long term;
- handles complex supply chains crossing the world;
- doesn't require you to outsource your warehouse to them;
- if you do outsource your warehouse to them, has 99.997% (6σ) inventory accuracy;
- offers complete visibility of your inventory and its movements anywhere in the world via any web browser;
- improves on hand availability, usually by an order of magnitude;
- reduces inventory levels by 20% to 50%;
- defers most fees until after your return on inventory increases;
- helps you get buy-in for these solutions throughout your own company.

IDEA is the only company that delivers all ten. I wish that there were more outsourcing companies with all these capabilities. It would be easier to decide to outsource, if there were. Of course, it is not necessary to outsource to get such results. There is no reason that your company cannot achieve the benefits that come from the ten items above, as long as you are willing to change your paradigm and stop copying your competitors. After all, no company ever created and maintained a decisive competitive edge using a copycat strategy.

IDEA'S WAY OF THINKING

- *Neither an accurate forecast nor changing vendors is required for success*
- *There is a way to both increase sales and reduce inventory*
- *Supply chains sell less when clogged with inventory*
- *In the long term, unless the supply chain sells more no link can sell more*
- *We must help clients gain buy-in internally and with supply chain partners*
- *The majority of our fees are based on improved return on inventory*

IDEA'S METHOD

- *Verify the existence of inventory imbalances and the benefits of moving from a "Push" to a "Pull" system*
- *Gain top management buy-in to the assessment and support of the approach*
- *Build knowledge and understanding across the supply chain, at all levels*
- *Utilize systems that deliver actionable information, integrated with existing software*
- *Work with you until expected results are achieved*
- *Share the tools and know-how to continually improve results*

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