GSCLG

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GLOBAL SUPPLY CHAIN REVIEW

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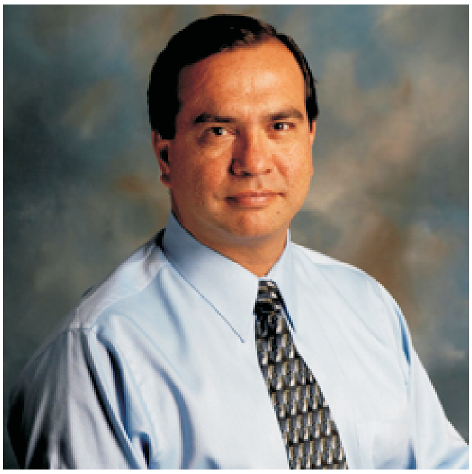
OFFSHORE OUTSOURCING: ITS EFFECT ON CUSTOMER SATISFACTION

AT THE LOGISTICS INTERSECTION

DELL UPDATE: DELL PLANS TO SELL FACTORIES

Larry Woelk
of George Henderson International
London, UK

The Positive Effect Of High Oil Prices
Message from the President of GSCLG



It was Albert Einstein who once said "Imagination is more important than knowledge." How far would Einstein need to stretch his imagination to see the good in our current fuel situation? Even though the high cost of oil is having a significantly negative effect on the economy and is putting additional pressure on supply chain professionals trying to make their budgets, it does create some positive effects.

It forces supply chain professionals, as well as companies, to review inefficiencies. Whether we like to admit it or not, not a single supply chain in the market is absolutely efficient. It is not always possible to pass on the cost to the final customer even with the high cost of fuel and the pressure from our companies and service providers to achieve revenue goals.

It forces companies to review their overall sourcing strategies which are not always guided by efficiency but rather by a reduction in the cost of labor. If the weak dollar continues to lose value against other currencies, as it has in the last year, then there is no realistic way to maintain the current labor cost since it takes more dollars to buy the same amount of labor.

Insourcing may be worth examining closer since labor cost savings may be more significant than they have historically been. Bringing back (to the United States) some of the higher skill jobs is economically advantageous after having calculated some of the negative effects of outsourcing on customer service levels, supply chain risks, and longer supply chains.

Higher fuel costs poses the problem of calculating the right level of inventory when the carrying cost is not as high or volatile as fuel cost in increasingly less flexible supply chains. The loss of capacity by airlines in some areas adds to the rigidity of supply chains, resulting in seemingly out-of-control budgets.

When was the last time your company compared the current carrying cost versus the cost of an additional week of inventory? What "ideal" level of inventory will allow your company to downgrade the mode of transportation, utilize forward warehouse(s), optimize transportation modality, and reduce the overall cost of the supply chain? The number of changes your company implements to reduce cost, to reduce carbon dioxide, and to achieve a more efficient supply chain will force the rest of the players to plan better.

An efficient supply chain is not only cost efficient but green as well.

Higher fuel costs are compounded by inefficient packaging. Not every package will be on the shelves of a retail store. If your product will not be on display there is no need to inundate our landfills with garbage. Reduce the size of your packaging by a few units and you may save millions of dollars. If your total cost of actual freight is higher than the dimensional weight by 14% your packaging is not optimal from a cost point of view. Most companies run above 30% dimensional weight on their shipments meaning that there is a significant opportunity to save on cost and a few trees as well.

It requires us to revisit the concept of efficiency. The fact that FedEx and other carriers are efficient does not imply that your company is efficient by association. If all the cost reductions are centered on personnel then your strategy to achieve an optimal supply chain is reduced to giving the whole logistics business to a single carrier, at which point your company may not be cost-efficient.

It forces companies to rethink express service. If you knew that you can deliver to 90% of your customers via ground in three days anywhere in the USA, why would you ship on express service level on Thursdays and Fridays? You will be paying express when most of the cargo will move on the ground. Knowing what can be executed by a different mode of transportation may save you millions of dollars.

As supply chain professionals we are expected to deliver results which are difficult to attain under the current market conditions. However, these are the same conditions that will open the doors for you and your organizations to implement new levels of efficiencies and creativities which can only be achieved during times of instability. During turbulent times companies must be willing to try different strategies to maintain a competitive advantage. After all, strategy is about doing things differently than your competition.

I would like to leave you with a couple of quotes to ponder:

> *"Leadership is action, not position."* -- Donald H. McGannon
>
> *"Leadership is much more an art, a belief, a condition of the heart, than a set of things to do. The visible signs of artful leadership are expressed, ultimately, in its practice."*-- Max DePree

Sergio Retamal
President of GSCLG

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At The Logistics Intersection

By Larry Woelk, George Henderson International

The dynamics of moving goods through the supply chain has changed dramatically over the past couple of decades. It used to be that freight forwarders moved freight airport to airport or port to port by using shipping and air lines; customs brokers only did customs clearance; hauliers picked things up and delivered them to ports and airports; 3PLs took care of warehousing and distribution and integrators didn't even exist. Logistics providers are no longer sector specific. In the 21st Century, everyone is doing, or at least trying to do, everything. Supply chain service providers are 'meeting in the middle'.

Freight forwarders are providing distribution and warehousing; third party logistics providers, or 3PLs, are moving freight from one side of the world to the other; and shipping lines are providing multimodal end to end services. In fact, freight forwarders aren't even called freight forwarders anymore - they're called 'logistics' companies. Participants in all service sectors provide services they didn't understand, or weren't interested in, before the meeting-in-the-middle movement started.

With industry consolidation and expansion of services, it's interesting to take a look at who might get to the middle first - although some might argue they are already there. Logistics providers roughly fall into two categories - asset based or non-asset based. Third party logistics companies, or 3PLs, are asset based. They take over their customers' logistics functions, such as warehouses, distribution centres, vehicles, IT systems and the like. It's not this black and white and indeed 3PLs do a lot outsourcing themselves. But basically, they sign long term contracts which commit themselves to fixed assets. Shipping lines, airlines, express integrators and trucking companies are also asset based. These service providers move things around by owning whatever is doing the moving.

Freight forwarders, on the other hand, are non-asset based. Of course they have warehouses and vehicles but generally they avoid at all costs fixed assets. Freight forwarders don't own planes and ships. The newest service sector is 4PL, or 4th Party Logistics Provider. 4PLs are virtually asset free. They 'manage' supply chains using the asset based and non-asset based providers to do the work.

It is fair to say that asset based companies and non-asset based companies did not, at least in the early days, understand each other. 3PLs and carriers make money by 'sweating' their assets. Using them around the clock if necessary and being better at sweating them than their customers. Otherwise the customer would do it for himself. Freight forwarders make money by avoiding assets at all costs. But they know which carriers to use for what to get the best service - and rates. Because they have so much freight to move around they get huge discounts from the carriers and are very good at negotiating low rates.

Learning how to manage services on the other side is indeed challenging. It requires managers and executives with entirely different skill sets. It also requires understanding a different kind of balance sheet. If you are a freight forwarder and you have a light asset based balance sheet, it takes a different mindset to understand and manage one that is full of fixed assets, and vice versa.

Margins are another challenge in getting to the middle. Express integrators and freight forwarders are a good example. Integrators have high margins when compared to freight forwarders. Express shipments are light and the revenue and margin per kilo is high. Freight forwarder shipments are heavy and the revenue and margin are small. If you're an express integrator, or a 3PL for that matter, and you acquire a freight forwarder, your margins are going to tumble - something that shareholders and the City don't like. 'Meeting in the middle' might look good strategically but may negatively impact the balance sheet.

Another challenge to getting to the middle, even if you do understand the other side, is managing services you're not familiar with. The acquiring company tends to keep their managers and not the acquired ones. If a manager is used to managing assets he's not going to do a very good job managing services that don't use assets. In fact, all too often, even acquisitions in the same sector fail, or at least struggle, because the acquirer's managers prevail and the acquired ones leave. A lot of talent that is needed to manage the combined company walks out the door.

Combining companies from different service sectors, such as freight forwarders, express and 3PLs offers additional challenges. Finding a CEO who understands and can manage different sectors is the first. Such individuals are hard to find and often they have a 'bias' for the sector they know best. Freight forwarders who acquire 3PLs have a better record of making it work. This could be because the nature of freight forwarding is to push the service boundaries so they are better at going into new territory. 3PLs who acquire freight forwarders on the other hand, don't seem to fare so well.

Business development is the next challenge. You would think it fairly easy to sell end to end, we can do everything, services. Wrong. First of all, it's hard to find sales people who know the whole supply chain. A bigger problem is having a transparent, one contact, connected approach to the customer. All too often customers have to deal with several, sometimes as many as 4 or 5, representatives - one from each service sector. Another problem is getting the different divisions to 'cross over' sell. This means selling the services of the other divisions. As an example, the 3PL account manger may push back and say, 'what if I bring in our freight forwarding side and they mess it up? Then I'm going to lose my account.' If that happens he's going to lose revenue. CEOs don't seem to know how to manage this. Rather than say, 'sorry, we've acquired these companies to offer end to end services so you will work together', they tend to retreat into focusing on each division's bottom line.

Does 'meeting in the middle' actually work? There's a lot of evidence out there that it doesn't. That's not to say it won't eventually but for the time being the best performers are those who have kept focused on their core service. An expert, actually my wife, makes an analogy with

About the Author:

Larry Woelk has spent almost all his career in Europe and held senior executive and board level positions with Airborne Express, BAX Global, John Menzies, LEP International and Pinkerton Security. He has run companies and divisions in supply chain security; logistics operations and communication; 4PL management; and freight audit and pay processes. His career gives him extensive experience of the wide-ranging logistics industry, including air, ocean, road transport and courier express, in domestic and international markets.

Larry holds university degrees in mathematics and French as well as an MBA. He is a Fellow of the Chartered Institute of Logistics & Transport and a member of the Logistics Directors Forum and ELUPEG.

Larry is one of best known industry experts in all modes of international shipping. His advice has been sought by some of the largest forwarders and integrators in the world. His network of contacts spans the globe. Larry joined George Henderson International in 2007 to head up the international division.

the restaurant business. These days, many restaurants have 'global' menus. Individual items come from all corners of the world. However, if you want good French food, you go to a French restaurant; Italian to an Italian, Indian to an Indian, etc. I've never heard any one say, 'I feel like French tonight, let's go to a Harvester'. Does the same apply to logistics? E.g. if you want your freight moved you go to a freight forwarder; warehousing and distribution to a 3PL; etc. interesting analogy.

Provider capability has become so complex that 4PLs have emerged on the scene. 4PLs manage the end-to-end supply chain for the shipper. They have considerable expertise in knowing who the best providers are for which services and areas. Providers included 3PLs, freight forwarders, shipping lines, hauliers, customs brokers, express integrators and everything in between. 4PLs maintain that the 21st century supply chain is so complex that it needs to be managed by an expert. With the provider sectors 'meeting in the middle' and many exclaiming that they can do anything anywhere, or more accurately, everything everywhere, shippers are offered a one-stop shop solution. This is good for the 4PLs because they can manage a global supply chain using a variety of providers.

Some have stated that it is very difficult for a 4PL to gain the comprehensive intelligence needed to make critical decisions for the shipper. This is easily remedied by the placement of 4PL personnel in-house with the shipper.

Many shippers have reduced their logistics staff and many no longer have the internal expertise to manage their supply chains. Additionally, service providers are looking for people with expanded skill sets. As an example, freight forwarders want people who understand third party logistics; 3PLs want people who know freight forwarding; and shipping lines want people experienced in logistics. At the end of the day, 'meeting in the middle' depends on finding the right people.

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How Offshore Outsourcing Affects Customer Satisfaction

By Dr. Jonathan Whitaker, University of Richmond, Dr. M.S. Krishnan, University of Michigan and Dr. Claes Fornell, Ross School of Business. Wall Street Journal, September 13, 2008.

The outsourcing of customer service to offshore providers has gotten a lot of bad press in the U.S., with reports citing language problems and the exporting of jobs. But, despite the potential for such reports to alienate consumers, this offshoring continues to grow, driven mainly by the lower labor costs overseas.

Are companies that send customer service abroad making a mistake? It's hard to answer that question without knowing offshoring's actual impact on customer satisfaction.

Our research indicates the effect in most cases is significantly negative --but similar to the effect of outsourcing customer service domestically. That suggests companies shouldn't necessarily forgo the savings they can reap from offshoring. But if they're going to do it, they'd better do it right.

Negative Numbers

We analyzed the offshoring and outsourcing activities of 150 North American companies and business units from 1998 to 2006. As a group, those that outsourced customer service saw a drop in their score on the American Consumer Satisfaction Index, or ACSI, a measure created by the National Quality Research Center at the University of Michigan. The declines were roughly the same whether companies outsourced customer service domestically or overseas.

ACSI scores tend to move in the same direction as companies' share prices. Based on the historical data showing that connection, the average ACSI decline we found at companies outsourcing customer service is associated with a drop of roughly 1% to 5% in a company's market capitalization, depending on what industry the company is in. That's a steep price to pay. But there are ways to make outsourced customer service more palatable to customers or to mitigate its negative effects, and in some respects that may be easier to do with offshoring. And there are offshoring alternatives that can save a company money without damaging its relationship with its customers.

An important step companies can take to improve the quality of outsourced customer service is to ensure that the provider has all the information necessary to help the customer and full authority to do so. Sometimes, because a company wants to protect information about its customers, the customer-service provider isn't given complete customer histories and profiles. Or the provider's authority to resolve complaints is limited; for instance, the provider may not be permitted to grant credits to customers. Companies need to weigh their concerns about information security and financial control against the damage that such arrangements can do to customer satisfaction.

Tapping Technology

Companies can also make customer service more effective by taking advantage of the technological innovations that some providers offer, and here there may sometimes be an advantage in offshoring. That's because some foreign outsourcing providers have offerings their domestic counterparts can't match in terms of technologies that help guide customer service by recognizing patterns in consumer behavior.

One way to mitigate the damage from outsourcing customer service is to invest the money the company saves to improve the quality of the company's products or services, or to cut prices, rather than simply pocket the savings as extra profit. Our findings suggest that this isn't happening in most cases. Among the companies we studied that had outsourced customer service, there was no increase in the perceived value component of their overall customer-satisfaction score: Their customers didn't feel that they were getting any more for their money than they did before the company started outsourcing.

Here again there may be an advantage in offshoring. If a company can save more by sending customer service overseas, it will have more opportunity to devote at least some of that money to upgrading its business.

In addition to considering whether or not to offshore customer service, companies should consider whether back-office functions such as information technology may be suitable for offshoring. Our study found that back-office offshoring had no effect on overall customer satisfaction. So the savings a company garners this way aren't offset by dissatisfaction among customers.

About the Authors:

Dr. Whitaker is an assistant professor of management at the University of Richmond's Robins School of Business in Richmond, Va.

Dr. Krishnan is a Hallman fellow and professor of business information technology at the University of Michigan's Ross School of Business.

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Dell Plans To Sell Factories In Effort To Cut Costs

By Justin Scheck, Wall Street Journal, September 5, 2008

Dell Inc. is trying to sell its computer factories around the world, a move to sharply overhaul a production model that was long a hallmark of the PC giant's strategy but is no longer competitive.

In recent months, according to people familiar with the matter, Dell has approached contract computer manufacturers with offers to sell the plants. One person briefed on the plan said he expects the company to sell most -- and possibly all -- of its factories "within the next 18 months." Other factories could close, this person said. Dell would enter into agreements with the contract manufacturers to produce its Pcs.

The plan is the latest sign of changes in the global PC business, and the increasing pressure on Dell to improve its profitability. The Round Rock, Texas, company last week reported disappointing quarterly profit that helped send shares down more than 18%, and has been trying to reduce expenses since early last year. Dell, which led the industry in lean manufacturing approaches and build-to-order PC manufacturing, now finds itself lagging rivals in wringing the most savings by outsourcing operations to production partners.

Any factory sales are contingent on Dell finding buyers. The most likely candidates are big contract manufacturers -- most of which are based in Asia -- that may hope to get a bigger piece of Dell's business. A company that purchases a Dell factory would likely be contracted to continue making computers there for Dell, said one person with knowledge of the talks.

Dell's factories were originally tailored for a PC market that was driven by corporate customers ordering large volumes of desktop PCs. But over the past three years, growth has shifted to laptops sold to consumers at retail stores. Dell has lagged behind competitors in coming up with a streamlined system to build portable Pcs.

A Dell spokesman asked to comment referred to a company filing with the Securities and Exchange Commission earlier this year that said Dell is "continuing to expand our use of original design manufacturing partnerships and manufacturing outsourcing relationships."

Dell could face several obstacles to selling its plants. Contract manufacturers may be hesitant to buy factories in places with high labor costs, like the U.S., said one person with knowledge of the talks. And some facilities could be encumbered by agreements with local governments. Dell's North Carolina plant, for example, received several million dollars of state and local tax incentives that are contingent on the factory meeting certain employment and local-investment goals by 2015.

Michael Dell, the company's founder, drove an innovative strategy of selling computers directly to customers, only building them after they were ordered. After a customer places an order through the Web or over the phone, the company's factories assemble the needed components, load PCs with software and ship them in a matter of hours.

The system eliminated idle inventory and maximized Dell's cash flow. The company owns factories in Texas, Tennessee, North Carolina, Florida, Ireland, India, China, Brazil, Malaysia and Lodz, Poland, where it opened a plant early last year.

Dell's plants are still regarded as efficient at churning out desktop PCs. But within the industry, company-owned factories aren't considered the least expensive way to produce laptops, which have been the main driver of growth lately and are complex and labor-intensive to assemble. Rivals such as Hewlett-Packard Co. years ago shifted to contract manufacturers -- companies that provide production services to others -- to build their portable computers. H-P builds "less than half" of its PCs in facilities it owns, wrote Tony Prophet, H-P's senior vice president for PC supply chain, in an e-mail.

Contract manufacturers can generally produce computers more cheaply because their entire operations are narrowly focused on finding efficiencies in manufacturing, as opposed to large firms like Dell, which must also balance marketing and other considerations.

For many Dell notebooks, a contract manufacturer already partially builds each system in a plant in Asia. The half-built computers are then shipped to one of Dell's own plants where assembly is completed. Because each computer goes to two factories, Dell refers to the system as "two touch."

Dell began efforts to cut manufacturing costs last year. It has farmed out an increasing number of products to contract manufacturers such as Taiwan's Foxconn Group to eliminate two-touch production of some notebooks, and earlier this year closed down one of its own plants in Texas.

Selling factories could be a culmination of a plan Dell started last year to increase its reliance on contract manufacturers, something competitors did first. "A lot of companies are already on that model," said Mike Cannon, Dell's production chief, in an interview earlier this year. "We're playing catch-up there."

H-P, for example, transferred a leased PC plant in Australia to Foxconn in 2005. Apple Inc. has many of its PCs shipped directly from Asian manufacturers' plants to customers.

Series of Steps

Reducing costs for manufacturing and other operations is one of a series of steps Dell hopes will restore momentum after a slide that saw the company lose its position as the world's biggest PC maker by sales to H-P. Mr. Dell returned as chief executive in January 2007, and said he would revive the company through a combination of investments and strategy changes -- including the introduction of sales through retail stores -- and move to cost cuts.

Since then, Dell has unveiled a series of more stylish products and laid off about 8,500 workers. The company sold 53% more consumer PCs in its fiscal quarter ended Aug. 1 than it did a year earlier, sending its world-wide consumer market share to 9.1%, up from 7.5% at the same time last year, the company said.

But Dell reported a 17% drop in quarterly income compared with last year. Profit margins fell, the consumer business lost money, and the company said costs remained too high to compensate for the growing investment in new markets, which included aggressive cuts to PC prices to help drive sales, especially in Europe.

Part of Dell's problem is the long-term shift by consumers to buy laptops, which many consumers prefer to buy in retail stores. The company has addressed that issue, offering machines through channels such as Best Buy.

But its factories are geared toward building PCs for direct-order customers. The two-touch system was one result; Dell couldn't figure out how to efficiently link its custom-order system to the contractors' factories, said people familiar with the matter. In the past, the extra shipping and assembly costs associated with the two-touch system weren't significant problems for Dell, since the company maintained relatively high profit margins by avoiding marketing and other costs associated with selling through retail channels.

Manufacturing Costs

As Dell moved into retail stores last year -- and as PC prices continued to drop and transport prices went up -- manufacturing costs have become a bigger issue. In its last quarter, Dell saw a 2% annual decline in desktop sales and a 26% jump in notebook revenue.

Due in part to the production system, Dell's operating margin last quarter was 5%, said Lou Miscioscia, an analyst at Cowen & Co., while H-P's margin in PCs was nearly 5.7%.

Dell, whose latest balance sheet values all its property, plant and equipment at $2.6 billion, isn't likely to reap a financial windfall from selling factories, said Mr. Miscioscia. Instead, the benefits of shedding factories would come over the long term, through reduced spending.

Improving Dell's manufacturing processes is the responsibility of Mr. Cannon, the production chief who was hired by Mr. Dell after his return early last year. Mr. Cannon was formerly CEO of contract manufacturer Solectron, which is now owned by Flextronics Inc.

Mr. Cannon initially delayed a plan early last year that would have streamlined the manufacturing system, said several current and former executives. In the interview this year, Mr. Cannon declined to comment on that plan, but said he has been working since his arrival at Dell to outsource more of its manufacturing. Asked if the company might sell or close some plants, Mr. Cannon said, "Everything's on the table." The Dell spokesman said Thursday Mr. Cannon was unavailable for comment.

The Global Supply Chain Leaders Group

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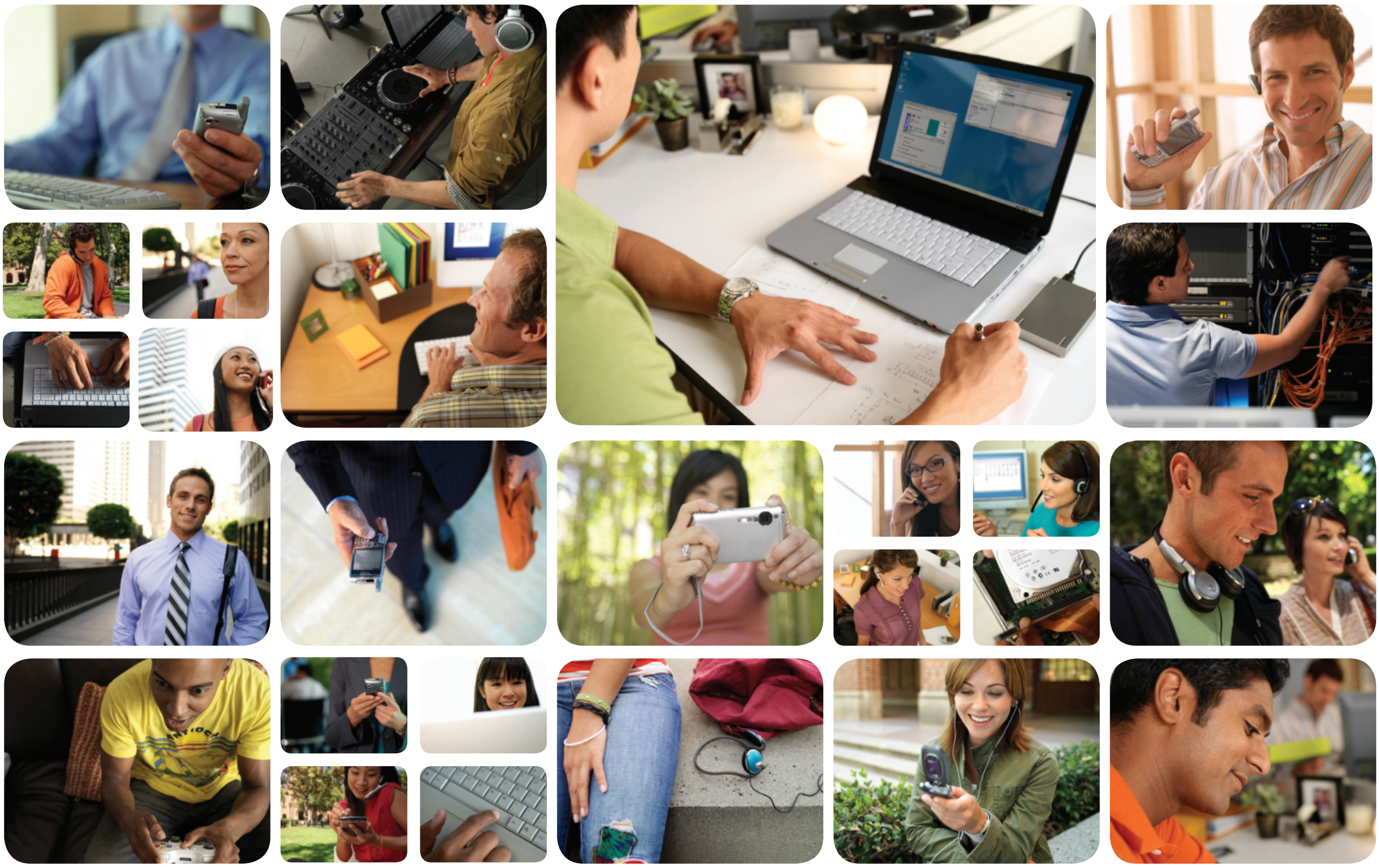

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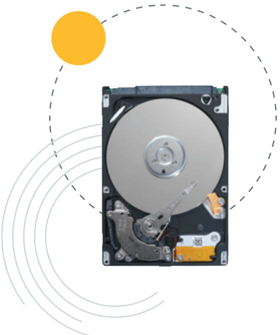

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