GSCLG

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GLOBAL SUPPLY CHAIN REVIEW

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GERRY SMITH

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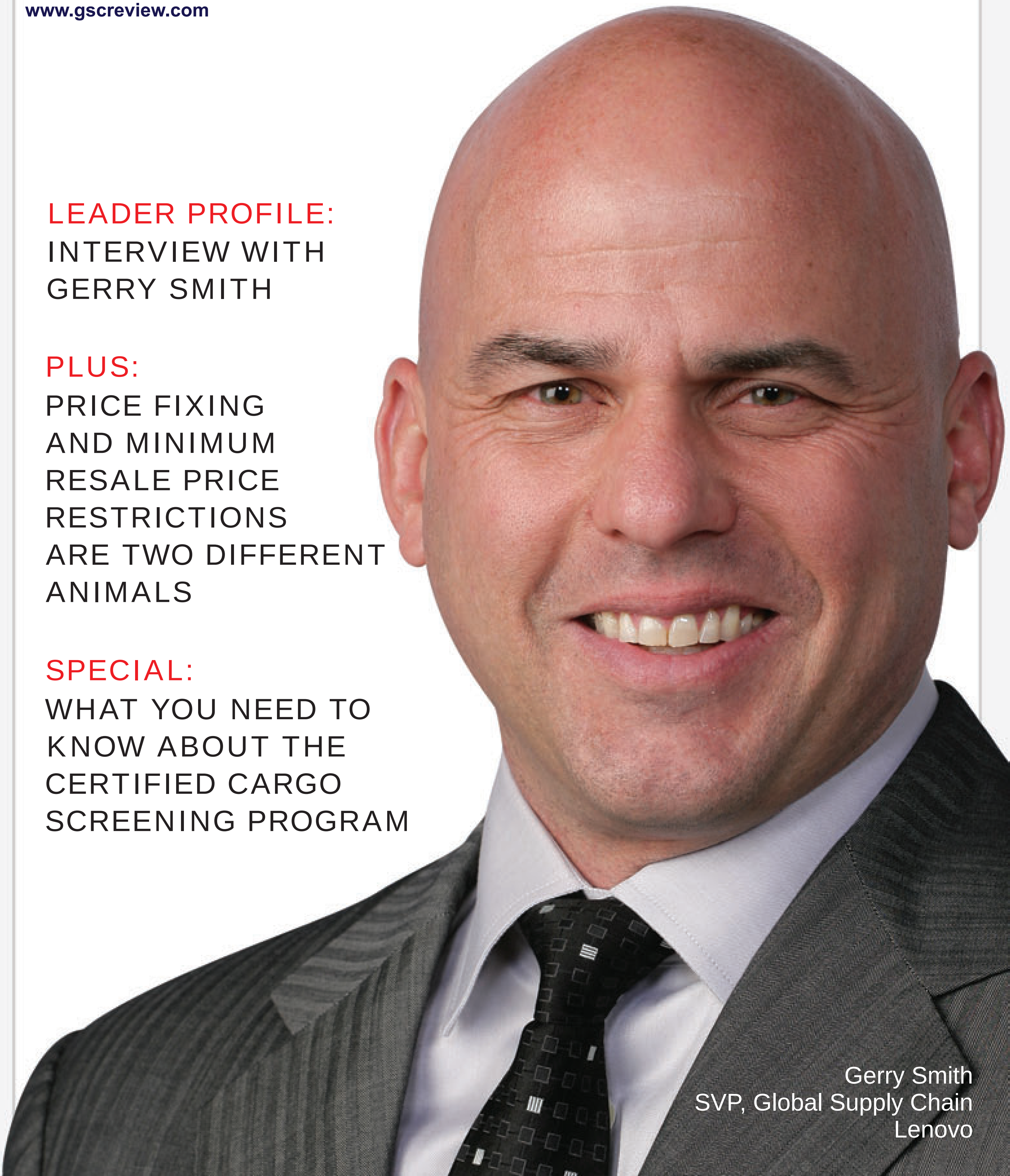

Gerry Smith
SVP, Global Supply Chain
Lenovo

Message from the President of GSCLG

The GSC Review Magazine continues its series of profiling outstanding individuals in Supply Chain. This month, we present an interview with Gerry Smith, Senior Vice President of Global Supply Chain, at Lenovo.

Smith is responsible for end-to-end supply chain at Lenovo, including order management, supply planning, procurement, manufacturing, logistics and fulfillment operations. Gerry was recently named Supply Chain Executive of the Year at the SCM Logistics World 2009 conference, and Lenovo won the 2009 Supply Chain Excellence award, recognizing innovation and superior execution in supply chain management.

Smith is a leader with a superb ability to manage across varying geographies and organizations. He holds a Bachelor's degree in Finance and Marketing from Pacific Lutheran University.

We will do our best to continue to provide you with interviews of leaders that deserve your recognition. I ask our readers to send in the names of those you would like to see interviewed so we can learn from their views and accomplishments. We started this series in 2009 and we have an excellent lineup of individuals to fill out 2010.

You can find past interviews at http://gscreview.com/home_com.php.

We celebrate supply chain leaders with vision, passion, and care for their customers and employees. These leaders provide the value shareholders deserve; they ensure that their customers keep moving forward while dealing with global challenges affecting the day-to-day operations. If we recognize great performance and leadership potential, we will promote our capacity to lead both operationally as well as at the C-level. As senior-level supply chain leaders, the senior executives featured in our magazine should be recognized by their peers and by the industry. We hope to see them grow and become the future CEOs that we all deserve and admire.

We are honored to present Gerry Smith, Senior Vice President of Global Supply Chain at Lenovo and look forward to honoring many more like him in the Global Supply Chain Review.

Sergio Retamal

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CERTIFIED CARGO SCREENING PROGRAM (CCSP)

You've spent time thinking outside the box.
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☑ Think outside the box ☐ Look at what's inside the box

Does supply chain security keep you up at night? First, US-bound ocean containers were subjected to the reporting requirements of the 24-Hour Advance Manifest rule, and then to the Importer Security Filing. Now, air shipments transported on board passenger aircraft will need to be screened.

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- Avoid the bottlenecks at the freight forwarder and at the airlines
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- Avoid damage to your cargo by screenings outside your control

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GLOBAL4PL SUPPLY CHAIN SERVICES

Gerry Smith is Senior Vice President, Global Supply Chain at Lenovo, currently the fastest growing major PC company in the world. Gerry joined Lenovo in 2006 and is responsible for end-to-end supply chain management encompassing order management, supply planning, procurement, manufacturing, logistics and fulfillment operations. Gerry was recently named Supply Chain Executive of the Year at the SCM Logistics World 2009 conference, and Lenovo won the 2009 Supply Chain Excellence award recognizing innovation and superior execution in supply chain management.

Before joining Lenovo, Gerry held a number of leadership roles at Dell, including Vice President and General Manager of Notebook Development, of Peripherals Development and of the Display Line of Business. He holds a Bachelor's degree in Finance and Marketing from Pacific Lutheran University.

Lenovo is dedicated to building exceptionally engineered personal computers and mobile Internet devices. Formed by Lenovo Group's acquisition of the former IBM Personal Computing Division, the company develops, manufactures and markets reliable, high-quality, secure and easy-to-use technology products and services worldwide. These include the award-winning ThinkPad line of notebook PCs and the company's Idea-branded consumer PC products. Lenovo has major research centers in Yamato, Japan; Beijing, Shanghai and Shenzhen, China; and Raleigh, North Carolina.

It's been five years since the Lenovo acquisition announcement of IBM's PC business. What has changed in the supply chain?

With the acquisition in 2005, Lenovo jumped overnight from being the world's ninth largest PC company to the third largest. Along with that came the challenge of integrating two sizable supply chains, which had different target markets and were operating separately.

When I joined Lenovo in 2006 I pushed to have one consolidated supply chain. There was a lot of confusion - from Procurement to Manufacturing to Logistics - because we lacked a singular, common purpose. Operations needed to be stabilized first, and then the work began to bring the supply chains together, efficiently and consistently.

What parts of the organization did you focus on first?

We had to immediately improve execution, and needed the right set of key performance indicators (KPIs). When I first started, the supply chain had over 125 KPIs. We knew what we had to do, but we couldn't get there quickly with so many targets. It was almost impossible for anyone on an individual basis to see the end-to-end picture.

So we narrowed down this long list of priorities to four main KPIs: cost, on-time delivery, cash conversion and quality. These KPIs are focused, they are counterbalancing, and we think they are the right ones. We energized the teams around these KPIs by standardizing everything, defining roles and responsibilities, developing consistent processes, and driving efficiencies using Lean Six Sigma methodologies.

We instituted a very disciplined business management system to monitor and measure these KPIs. Keeping a pulse on performance requires a daily commitment to execute, as well as frequent reviews by executive management. A strong management system also provides the team with support when challenges arise and decisions need to be made quickly.

Finally, we put the right talent in place to focus on key initiatives. These changes have enabled us to make tremendous progress.

Did the company support this plan?

We aligned our Global Supply Chain (GSC) strategy with our corporate strategy. Lenovo has a very straightforward strategy - we call it Protect and Attack. Protect our key markets - this is China and our mature "Think" business with our corporate accounts. Attack our emerging, transactional markets and build a presence in the home/small business (SMB) segments across that space.

It's been a very successful strategy for Lenovo - and as the business expands we are seeing a lot of growth from the transactional market segment.

This two-pronged business strategy, established in early 2009 by our CEO, Yuanqing Yang, also required alignment of the supply chain to the customers in each market. To do this, we focused on tailoring our supply chain operations to customer needs, closely managing supplier risk caused by volatile market conditions last year.

We organized our supply chain team to maintain centralization of critical global functions, such as procurement, manufacturing and logistics - to drive best practices while aligning the customer support functions to the emerging and mature markets. This organizational change better positioned us to aggressively drive cost reductions and improve delivery to our customers.

How were you able to modify your approach, especially during the economic downturn?

In a recession, business realignment must be done quickly, as the speed of change becomes more important than ever. We redeployed the organization to drive a dual supply chain model based on the different needs of each customer segment - a "Responsive" model for relationship customers, and an "Efficient" model for our transactional customers. Our supply chains are now customer driven rather than a one-size-fits-all model.

For the Responsive supply chain, if a global customer needs a specialized solution, there's a variety of things we will offer above and beyond the norm to customize the product. Our Efficient model offers a different level of deliverables tailored for the transactional SMB market. These systems are built to plan and shipped via ocean to deliver a very low cost and predictable solution.

We resourced each model differently, and put different cost structures in place. We aligned our front-end fulfillment organization and back-end procurement teams top to bottom in this structure, and aligned with our Think and Idea business units as well. The supply chains run separately but are connected across common areas of procurement, manufacturing and logistics where we can leverage economies of scale and run them together efficiently.

Introducing the dual supply chains tailored to the market has helped us tremendously to weather the downturn as we now have a very customer-centric model.

How did customer demand change during the recession?

Even in a global recession, customer spending doesn't stop. But habits do change. Companies need to cut costs and focus on their core businesses during these times, and often will compromise on PC features to save money, for example.

The customer value proposition is at the heart of Lenovo's approach to supply chain design. We reevaluated all of our product offerings, processes and end-to-end costs. Product development and procurement teams took a closer look at product design and parts sourcing to determine what tradeoffs could be made to meet the new benchmark for customer value.

Repositioning our supply chain really helped us meet these demand changes. Lenovo's new structure better enables us to anticipate and serve the needs of customers around the world.

How were you able to manage risk on the supply side?

Like most companies, weathering the recession required that we have a deeper focus on our supply base in all parts of the world. Volatility forced us to develop new practices to manage supplier risk.

We enhanced our supplier development reviews focusing on first, second and third tier suppliers. The focus was not only on suppliers of highly specialized or high volume components, but also on vendors that make basic, yet essential, parts. Losing either could have resulted in supply chain disruption.

We've solidified a number of long term agreements. Those have paid great dividends - in the tough times we took care of each other, and as the markets recovered they helped Lenovo ensure we had continuity of supply.

Moving forward, strong collaboration with our suppliers will provide greater visibility within the end-to-end supply chain and increase our responsiveness to changing market conditions. These relationships are our lifeblood for success.

How important is contract manufacturing for your business?

We continue to maintain a mix of company-owned and outsourced manufacturing. We regularly assess our global manufacturing network to ensure it's fully optimized for our size and scale in the industry, and designed to best meet Lenovo's tactical and strategic needs for our customers.

We look at three areas in our manufacturing sourcing decisions: cycle time, cost per box, and the delivery commitment to the customer. This model offers us a lot of scale and flexibility. We will typically manufacture more complex products in house. Less complex products - such as netbooks, consumer PCs and others - are often manufactured externally. Our partnerships with ODMs are driven by cost and capacity, especially as we've moved to more direct-ship methods.

Our partners do a great job on certain types of products, but our internal manufacturing is optimized for responsive, higher-service type requirements. This balance of manufacturing sourcing has worked very well for us.

How do you grade Lenovo's supply chain overall performance in client satisfaction?

We're currently ranked first in notebook PC delivery and customer satisfaction according to market research firm TBR. This is a huge accomplishment and one of my proudest moments in this job. We are on par and surpassing Dell and HP in some areas. Four years ago we were not even close.

Going forward, the question is how do we separate ourselves from the competition? The good news is we're seeing companies copying our supply chain strategy, which we take as a form of flattery. We have the leadership in place, the end-to-end vision and the ability to scale above and beyond the other market players. It's just a matter of executing to our strategy now, working with our supply base and listening to our customers.

You mentioned on-time delivery as a key performance indicator.

It's incredibly important. We expanded the idea of delivery performance to represent overall "serviceability." This is defined in two key areas: reliability and speed. Reliability is shipping product to the first date committed to customers. Speed is related to order-to-delivery cycle time. Lenovo conducted customer surveys, and found these are the two most important requirements.

We've had dramatic improvement in materials management, putting inventory (DOI) buffers in place across all commodities, upgrading and training our procurement talent, improving our supply demand forecast, and implementing value stream mapping. In order to further improve on-time delivery, we were able to cut out 30 hours of manufacturing cycle time internally and we required the same from our external partners. In addition, a lot of improvements were made in our logistics network, ensuring consistency and efficiency across the end-to-end supply chain.

What are your biggest external challenges?

Component supply is incredibly constrained right now. The rise of multimedia products - mobile phones and other consumer electronics - is siphoning off demand for memory, displays and other components. With tight availability, prices increase, lead times extend and delivery dates get pushed. In addition, logistics capacity is tight. Fuel costs have gone up considerably in the last year.

Our global supply chain has really effective business management systems to ensure supply continuity and logistics control. As I said before, we have great relationships with our suppliers, and we're managing component constraints through long term agreements, buy-aheads, and inventory management. On the logistics side, we have the flexibility to vary our mode of transportation, and we're doing more and more ocean shipping. Ocean freight is obviously more cost efficient and environmentally friendly, and we're conditioning our sales teams and customers to increase its use. We've got a very dynamic logistics network, and we're able to leverage ocean shipments while maintaining on-time delivery commitments to customers.

Sounds like visibility is critical.

The fastest way to fail is not having clarity and visibility to data or a problem. If I know something is going to break and I know it immediately, I can marshal my team to respond, react, and drive change. If we get it 30 days later or 60 days later, we fall behind the competition.

The key, for me, is having the architecture and backbone: if I can see the data immediately, I can respond. And if I can respond quicker than my competitor to lock up supply, I can potentially turn a problem into an advantage. We have spent a great deal of time on business transformation to ensure our systems deliver transparency and instant access to our supplier and customer data.

We use Lean Six Sigma (LSS) and instill a culture of continuous improvement. We've seen dramatic improvements in manufacturing and logistics cycle time, cost per box and scalability using LSS.

Lean Six Sigma helped us improve our supply chain core processes by 30 percent last year. We closed over 400 projects not just in GSC, but across the company. We hold quarterly reviews to track our progress. We want to make sure LSS doesn't become a bureaucratic "check-the-box" type training, so we are careful to have finance do the auditing. It's driving a culture of continuous improvement.

What kinds of traits do a CPO or Supply Chain executive need to drive change in an organization?

Leaders in this industry must develop a global mindset - and by this I don't mean learning how to run an international organization, or understanding multiple languages or working with suppliers in different countries. A global mindset means developing an entire approach toward problem solving, information processing, managing people, seeking compromise, bringing teams together, building relationships with suppliers, and running an organization in a borderless economic environment.

The global mindset also helps with demand planning and market sensing capabilities - these are key competencies.

People need to be flexible and adaptable, to recognize the need for change both personally as well as organizationally. If you don't change you fail, and Lenovo's gone through a lot of change in the past few years. We laid the foundation in the last two to three years, and we're seeing the results of that now.

You're an American working in Singapore. How tough was that transition?

I've worked here now for about six years. I was the last person you would have thought would make an overseas move. My wife and I have four children, and back in the U.S., we were deeply embedded in the community where we lived. I was active in our church, and I was always running around to soccer practices and other family activities. No one would have predicted that I would be an expat someday.

But moving to Singapore was without a doubt the best thing I've done for my career. Living in a different country changes who you are. It has helped me to be so much more aware of different points of view and different ways to approach a problem. It helps you avoid "groupthink" and it broadens your experiences. I encourage all my high-potentials to take an international assignment, and I've built my team with people from all around the world.

What do you suggest to international assignees on how to best adjust to these types of moves?

From my perspective, you have to immediately integrate yourself and your family into that region's local community. I coached my kids' sports teams at their international school and we met a lot of other families that way. Being involved in community organizations or other groups can help develop a social base quickly. If you're traveling a lot and the family is on their own, it's valuable to have that network of friends locally.

There's nothing better for your career as well. You can't place a value on being located in Asia when it comes to relationships with Asian suppliers. You can talk with suppliers without either of you having to make special arrangements. You can make supplier visits without being jet-lagged or more spontaneously if needed to address issues. And being here in Asia, many more regions are accessible - you can be in several countries in a three hour flight.

Supply chain is all about relationships, and relationships are built on face time. So being able to visit suppliers frequently helps drive success in the inter-company relationships.

How do you keep a global team motivated and effective?

Keeping your strategy clear goes a long way. Our goal is to become the number one supply chain in the PC business in the next three years. We also aspire to be in the top 10 globally across all industries. This is something that everyone can understand and get behind.

To rally our people around common principles, we have developed a culture of meeting commitments and taking ownership. This simply means "we do what we say and we own what we do." We call this the "Lenovo Way," and we emphasize it not only as a principle that shapes our culture, but as a critical element in our business strategy. It is important that our leaders embrace this way of thinking to grow as individuals, as well as to help others develop and succeed.

What kinds of talent development programs do you support?

The number one reason for success of any company is its people. Once you believe this, human capital management becomes vitally important. Our employees have development opportunities at both the corporate and the supply chain organization levels. Key talent is identified through a company-wide HR assessment program, as well as through leadership and personality profiling such as DISC. Our high potential employees are then provided with various tools to develop a global mindset through extensive mentoring, 360 feedback, executive one-on-ones, international assignments, and Lean Six Sigma training.

We have developed several supply chain-specific programs to invest in our people. For example, our GSC Organization & Leadership Development program - known as GOLD - provides our top talent with opportunities to develop their global and strategic thinking, gain customer insight, and also hone their leadership style.

It is important to employees that we invest in their future with the company, hold them accountable for results and reward them for their efforts. Also, we actively promote diversity in our staff to foster innovation and continuous improvement. This makes us much stronger as a global team.

Developing talent internally is key as Lenovo grows and scales. So we're making a big investment in people in the GSC organization.

Where are you taking the supply chain going forward?

We just finished our fiscal year with the lowest cost per box in Lenovo's history, our delivery performance is meeting industry benchmarks and we've made huge improvements in cash management. And we continue to have best-in-class quality across our notebook and desktop PCs.

The game changer for us will be transforming the supply chain to become more demand driven and customer focused. This means moving from an internal to external view, using data and customer feedback to drive everything from product design to new delivery methods. It means transforming and simplifying our processes and metrics to be more customer centric.

Lenovo is in a great position now to win. We are the fastest growing major PC company, and have the number one market share in the largest PC market in the world - China. We are positioned to be the top one or two PC companies in the next five years. Chasing that top spot is a lot of fun.

Every day, I am amazed at what our team accomplishes. And it's only going to get better.

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We are a group of the most influential, accomplished, and renowned executives from some of the better known corporations worldwide. We continue to seek those individuals who have made the most significant contributions to the advancement of the supply chain industry at the same time helping their companies' bottom lines. In other words, the Top 25 Global Supply Chain Leaders LinkedIn group seeks individuals that will inspire both veterans and new hires in supply chain. These are the individuals people would like to be when they reach their professional goals.

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Price Fixing and Minimum Resale Price Restrictions Are Two Different Animals

Businesspersons making real-life pricing decisions need to know the difference.

By Paul Gift, PhD

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http://gbr.pepperdine.edu/092/rpm.html

The term "price fixing" has a strong negative connotation, and deservedly so. However, it is frequently misused by politicians, the media, and lawyers in reference to manufacturer-imposed, minimum resale price restrictions, which can actually be beneficial for business and consumers.

The world of minimum resale price maintenance (RPM) has been in flux in recent years. In 2007, the U.S. Supreme Court relaxed antitrust restrictions on the practice, and in response, legislation was introduced in the U.S. Senate to change the antitrust laws and re-strengthen regulation in this area. This article informs managers about the differences between price fixing and minimum RPM; the potential risks and rewards of employing a minimum RPM strategy; and the state of the economic, legal, and political environment with respect to minimum RPM. Consequently, managers should be able to make better decisions regarding "one of the hottest issues in retailing: whether manufacturers can force retailers to charge customers a minimum . . . price."

Horizontal Conspiracy among Competitors

Classic price fixing is typically referred to as horizontal price fixing-in supply chain terminology, horizontal arrangements are those between competitors operating at the same level of distribution, and vertical arrangements are those between businesses operating at distinct levels of distribution. Horizontal price fixing is an agreement among competitors to restrain price competition in some way. Two examples of such agreements were in the mid-1990s, when Archer Daniels Midland executives were caught on FBI surveillance tapes fixing the price of lysine, a feed additive, with competitors across the globe, and in 2007, when multiple airlines were fined more than $1 billion for colluding to fix fuel surcharges from 2004 to 2006.

Price-fixing arrangements are *agreements among competitors* to compete less vigorously; they can affect prices, price formulas, margins, discounts, or wages. They also can allocate customers or sales volume across competitors without explicit discussion of prices. One company's unilateral conduct, which involves no explicit or implicit agreement among competitors, does not constitute price fixing.

Social Harm

An economic analysis of price fixing is relatively simple. In a quest for enhanced profits, conspirators agree to set prices above levels obtained in a competitive environment, thereby minimizing competition and reducing output. This harms both consumers and overall economic wellbeing-there are no consumer or social benefits from price fixing.

Legal Status of Price Fixing

Typical of antitrust legislation, economic analysis of conduct is the impetus for law. The U.S. Supreme Court has long held that price fixing agreements are "per se" unlawful; that is, they are illegal "without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." According to the Court, per se rules should be confined to business conduct "that would always or almost always tend to restrict competition and decrease output." Price-fixing agreements do exactly this and pose an "actual or potential threat to the central nervous system of the economy." The free-market competitive process in the United States is the foundation of the enormous growth in standard of living over the past 200-plus years. As price fixing threatens that process, it is taken very seriously and punished strictly.

Businesspeople should expect legal repercussions, even incarceration, if they engage in price fixing. Businesspeople with advanced degrees, such as MBAs, should expect more severe penalties, such as longer prison sentences, as they "should know better." The rule of thumb is to never discuss prices with competitors-do not even *appear* to discuss prices. Price fixing should be painstakingly avoided in business.

Minimum RPM is Vertical and is Not an Agreement among Competitors

Minimum RPM is a vertical price restriction imposed by an upstream manufacturer on downstream distributors, dealers, or retailers (henceforth, all will be referred to as "retailers"). Typically, a manufacturer specifies a minimum price above which its retailers must sell its product(s). The manufacturer monitors the retailers or employs a monitoring agent to ensure their performance. If retailers are discovered pricing below the specified minimum price, they are terminated or threatened with termination.

Sony, LeapFrog, Black & Decker, Cisco Systems, JVC, Samsung, and Panasonic have all employed minimum RPM strategies. Other examples include:

- In 1997, Leegin Creative Leather Products instituted a "Brighton Retail Pricing and Promotion Policy" for retailers selling their women's fashion accessories. Leegin terminated retailers who priced below the suggested level.
- From 1988 to 1999, Nine West Group used minimum RPM to restrict the retail prices of their women's shoes and their dealers' promotional periods.

Minimum RPM is frequently referred to by politicians, members of the media, and sometimes lawyers as *vertical price fixing*; but that terminology is inaccurate and misleading as it imparts the negative connotation of horizontal price fixing conspiracies on a non-conspiratorial practice that often has legitimate business purposes and consumer benefits. While use of minimum RPM is sometimes alleged in the operation of price-fixing conspiracies, in and of itself no other competitors are involved in the decision. Minimum RPM is a *vertical price restriction*, not a price-fixing arrangement.

Uses and Abuses of Minimum RPM

Possible Benefits

Minimum RPM arrangements can prevent consumers from "free-riding" on retailers' provision of special services. For example, take the case of a high-tech camera manufacturer. Full-service retailers providing well-trained sales personnel, well-staffed sales floors, product demonstrations, and other promotional services are unlikely to be able to compete on price with discount retailers who provide few or no services. If the price difference is large enough, consumers have an incentive to obtain services at a full-service retailer before buying the camera from a discount retailer. Over the long run, this discourages full-service retailers from providing special services, and consequently, harms the manufacturer via lost incremental sales and competitive disadvantage. Minimum RPM can prevent this type of consumer free-riding by restricting the ability of discount retailers to undercut full-service retailers.

Minimum RPM can mitigate problems between manufacturers and retailers even when consumers are unlikely to free-ride. For example, when retailers decide on the level and types of services and sales effort to provide for a product, they consider their own markup, not the manufacturer's. Suppose that Levi Strauss & Co, a popular denim wear manufacturer, has a $50 wholesale markup on a brand of women's jeans while its retailer has a $10 retail markup. The retailer would not spend $15 on promotional displays or extra sales efforts that would induce one additional consumer to buy; however, Levi's profits would increase, so it is in Levi's interest to motivate the retailer to invest and compete for incremental sales. This example illustrates just how easily the private interests of retailers and manufacturers can be misaligned, especially when there is a large difference in markups. In stark contrast to price-fixing arrangements, promotional, brand image, or sales-effort investments are competitive and geared towards incremental sales.

To address the incentive problem, minimum RPM arrangements would offer larger discount-restricted markups to retailers; convey the types of services, effort, and brand image desired; monitor retail prices, tion. If a manufacturer were interested in using its market power to raise consumer prices, it could simply increase its wholesale prices to retailers. In the end, minimum RPM yields a larger markup for retailers as opposed to manufacturers. This is a common phenomenon in economics: a business practice that appears to harm competition actually has a legitimate, competitive justification when analyzed more exhaustively.

In price-fixing conspiracies, the initiators are competitors who realize that they will be better off if they minimize group competition. With minimum RPM, a single manufacturer influences downstream retailers' behavior through an increased markup, so they will compete more aggressively on non-price dimensions; meanwhile, competition amongst manufacturers is not affected. This enhances intra-brand non-price competition and overall inter-brand competition via a non-conspiratorial restriction of intra-brand price competition. The net effect on consumers and social wellbeing requires a deeper analysis and more careful consideration than is currently provided by those who label minimum RPM "vertical price fixing."

Possible Harm

The common scenarios in which minimum RPM purportedly harms the market involve price fixing and exclusion of rivals. Minimum RPM is sometimes alleged to support a price-fixing conspiracy between competing manufacturers or a price-fixing conspiracy between retailers who collectively pressure the manufacturer to implement minimum RPM. A 1991 study in the *Journal of Law & Economics* estimated that only 13 percent of minimum RPM cases filed over a seven-year period included allegations of horizontal price fixing. Even so, price fixing should never be undertaken, whether or not the conspiracy involves minimum RPM. If a businessperson's retailers apply pressure to implement minimum RPM or increase minimum prices, the businessperson may be accused of facilitating a retail price fixing conspiracy. Do not take part in this. Immediately seek legal counsel.

Another scenario in which minimum RPM may harm the competitive process is when attractive retail markups, provided by minimum RPM, induce retailers not to stock the products of a manufacturer's competitors. Such exclusion is similar to a manufacturer using exclusive contracts at the retail level to exclude rivals from "retail space" critical to competition. This scenario requires that a manufacturer have a substantial market share.

Legal Status of Minimum RPM

In 1911, the U.S. Supreme Court held that minimum RPM arrangements are per se illegal when a manufacturer agrees with retailers on a minimum retail price. A loophole was created in 1919 when the Court allowed manufacturers to unilaterally impose minimum RPM, provided there was no agreement with retailers. In what is known as the "Colgate Doctrine," the Court noted that antitrust law, in particular the Sherman Act, "does not prevent a manufacturer engaged in a private business from announcing in advance the prices at which his goods may be resold and refusing to deal with wholesalers and retailers who do not conform to such prices." Passed in 1890, the Sherman Act was the first U.S. federal antitrust statute. It was designed to promote competition by limiting the monopolistic restraint of trade and certain types of monopolization of markets.

Over time, antitrust laws evolve as economic knowledge and research progress and new insights are gleaned into procompetitive reasons for hard-to-understand business practices. Since "the economics literature is replete with procompetitive justifications" for minimum RPM, the practice can offer business and consumer benefits, and does not "always or almost always" restrict competition. The Supreme Court determined that minimum RPM agreements should be judged according to the "rule of reason" in a landmark June 2007 decision (*Leegin Creative Leather Products, Inc. v. PSKS*, Inc., i.e. the Leegin decision).

"Rule of reason" determines illegality on a case-by-case basis, whereby "the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition." This rule not only examines circumstances, but also weighs likely harm as well as legitimate business justifications and consumer benefits (i.e., procompetitive justifications). Thus, minimum RPM is not always legal or illegal, but each case will be analyzed on an individual basis, taking all relevant factors into consideration. It is worth noting that a significant amount of U.S. state law and legislation conforms to the new federal standard, but not all do.

Recent Developments in Minimum RPM

In 2007, U.S. senators sponsored the Discount Pricing Consumer Protection Act as a bill "to correct the Supreme Court's mistaken interpretation of the Sherman Act in the Leegin decision." The bill did not pass by the end of the 110th Congress, but has already been re-sponsored in the current 111th Congress. It would amend the antitrust laws to restore the rule that minimum RPM agreements violate the Sherman Act. The attorneys general of 35 states support the bill, while the Department of Justice and the Federal Trade Commission (FTC) support the Leegin decision.

The Leegin decision is already affecting business practices in the United States. In March 2000, Nine West settled its use of minimum RPM agreements with the FTC. In May 2008, after the Leegin decision, the FTC modified its order and allowed Nine West to use minimum RPM agreements, subject to periodic reports. Relying on the rule of reason rationale, the FTC evaluated the merits of this particular case, and determined that Nine West's use of minimum RPM agreements did not "pose any potential competitive concerns" because of "among other things, 'its modest market share.'" Because of the Leegin decision, the courts and the FTC are not forced to prohibit business decisions that are competitive in nature and they can study those that fall into a shade of gray.

Summary and Conclusions

To associate minimum RPM with the term "price fixing" is improper and flat-out wrong. Minimum RPM is a business practice that can benefit companies and consumers-in stark contrast to price-fixing conspiracies. With the Leegin decision, federal law conformed to economic analysis, recognizing minimum RPM's potential benefits and the reality that it does not "always or almost always" restrict competition. Thus, managers should treat minimum RPM as any other strategic business practice that has potential benefits but can be abused, such as exclusive contracts, tie-in sales, exclusive territories, and maximum RPM.

Minimum RPM arrangements should be carefully analyzed to predict and weigh all of the risks and rewards. If a manager has a competitive interest in a minimum RPM strategy, expert antitrust legal advice should be obtained, especially considering the pending bill (which will affect agreements, as opposed to unilateral conduct, if passed) and the different state laws that may be inconsistent with federal law.

Remember, minimum RPM is not price fixing in the economic sense, no matter what politicians say or the media writes. If fully informed and strategically employed, minimum RPM can solve a company's incentive problems with retailers, enabling it to more effectively compete against rival brands by better managing its brand image and providing desired promotional services and sales effort.

About the Author:

__Dr. Paul Gift__ is an assistant professor of economics at the Graziadio School of Business and Management. He earned his master's and PhD in economics from UCLA. Prior to joining the Graziadio School, Dr. Gift worked as an economist in the litigation consulting industry, providing expert witness support for antitrust and financial fraud cases as well as estimation of economic damages. He joined Pepperdine as a practitioner faculty member in 2004 and a tenure-track faculty member in 2006. While at Pepperdine, he has engaged in both litigation and managerial consulting work as an independent contractor. Dr. Gift specializes in antitrust economics, industrial organization, and econometrics. In the antitrust realm, he has worked on cases involving issues such as monopolization, foreclosure, exclusive dealing, tying, bundling, horizontal price fixing, and general estimation of economic damages.

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What You Should Know About the Updated Certified Cargo Screening Program

By Douglas Brittin,
General Manager, Air Cargo Programs
Transportation Security Administration

The US Department of Homeland Security has provided an overview of the CCSP. Click on the link below to view the file.

Link to PDF

Why should shippers join the Certified Cargo Screening Program (CCSP) if forwarders and airlines can screen the cargo?

Any company who ships on passenger aircraft will be affected by the 100 percent cargo screening mandate contained in the 9/11 Act. The decision on how to screen cargo, whether through a freight forwarder, cargo screening facility, or through the airline, is ultimately up to the shipper. It is important for all industries to understand how this mandate affects their companies.

Shippers of difficult to screen goods (large skids of any product, pharmaceuticals, perishables, chemicals, powders, and others) or those who want to ensure the integrity of packages throughout the supply chain, should strongly consider joining the CCSP. CCSP distributes screening throughout the supply chain to avoid potential bottlenecks of cargo at the airport while allowing participants to screen cargo offsite and transport it to the airport securely. Shippers should understand that in most cases, shipments they tender on skids or pallets will be taken apart and screened at the piece level by others, as the law requires.

Participation in CCSP means cargo screened by shippers will avoid delays, and the airlines conducting screening will not have to open containers jeopardizing sensitive cargo. By joining CCSP, shippers can avoid voided warranties on electronics, the spoiling of fresh products, and the contamination of pharmaceuticals.

The 100 screening mandate will go into effect on August 1, 2010. If a facility has not become certified through CCSP or planned for another entity to screen their freight, it will not be uplifted on a passenger aircraft.

We are already validated by C-TPAT. Do we still need to screen the cargo?

Yes, CCSP requires actual cargo screening, and because of that the background checks for personnel must be done through TSA's Security Threat Assessment process. TSA built the basic structure of CCSP around the C-TPAT model- physical, IT security, background checks- but there are key differences including cargo screening. In addition, C-TPAT is "company-wide", whereas CCSP is site-specific due to the need for specific security requirements around the screening area, which are typically more stringent than C-TPAT. CCSP also requires specific levels of training, especially in regards to screening processes.

We have multiple shipping facilities. Does each location need to be CCSP certified, or just the last facility where cargo was located before being delivered to the airline?

Cargo screening may take place at any point in the supply as long as the screening facility is a CCSF and the chain of custody requirements are met. Some shippers may choose to certify one, while others may decide to certify each facility. The decision is unique and must be based on a number of variables including size, volume of cargo shipped on passenger aircraft and the type of products shipped. Most companies select the last facility where the cargo is located before shipping.

Does the TSA or US government have funds available to help pay for the screening equipment or will screening operations be an added expense to companies?

The 9/11 Act, which included the 100 percent cargo screening mandate, did not appropriate funds to offset the cost of security screening.

Do parcel shipments shipped via international courier (FedEx, UPS, etc.) need to be screened?

All cargo tendered on passenger aircraft must be screened. Cargo shipped on all cargo aircraft is not subject to the Congressionally mandated 100 percent screening requirement. Some "all-cargo" carriers regularly tender their shipments to passenger airlines at US export gateways, and that cargo must then be screened before being placed on a passenger aircraft.

What if cargo is booked for transit on a cargo aircraft but is bumped and then loaded onto a passenger aircraft? Is screening then required? Which party (airline, freight forwarder, or shipper) is then responsible for screening?

Starting August 1, 2010, all cargo transported on passenger aircraft must undergo security screening. The passenger airlines are responsible for ensuring all cargo carried on their aircraft undergoes screening.

What about cargo that is inbound to the US? Are there plans to expand such screening requirements, similar to CBP's implementation of the ISF in ocean shipments?

The scope of the 9/11 Act requirement for inbound passenger air cargo presents significant challenges in the international air cargo environment and requires an approach that increases the security of the global supply chain without unduly impeding the flow of global commerce. TSA has recently increased the percentage of cargo to be screened before entry to the USA, and will continue to work closely with industry and its international partners to achieve this requirement as soon as possible.

Are there different levels of training for the airline, the freight forwarder, and the shipper, in order to become CCSP certified?

Specialized training is required for all persons who will conduct screening, handle cargo, or have access to designated screening areas. Shippers should visit www.tsa.gov/CCSP to get information on CCSP requirements.

Does the TSA conduct random, unannounced, audits of screening procedures and records of airlines, freight forwarders, and shippers?

In addition to meeting initial certification requirements, CCSFs are subject to routine and unannounced audits, inspections and spot checks.

About the Author:

Douglas Brittin,
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Doug Brittin joined the Transportation Security Administration (TSA) Air Cargo Office in June 2007. He has held executive level sales, marketing and operations positions within the transportation and logistics industry at companies such as BAX Global, Panalpina, Emery and Menlo Worldwide. Doug has over 30 years of experience in the industry, including the rail and trucking sectors. In his capacity as General Manager of Air Cargo Programs at TSA headquarters in Arlington, VA, Doug manages a staff of over 90 security experts, program managers and contractors. In addition to leadership and management responsibilities for the air cargo Technology, Indirect Air Carrier (IAC) Program and Policy branches, he is responsible for developing, staffing, training and equipping the Certified Cargo Screening Program.

Doug is a graduate of the University of Denver.

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Module 5: License Application and Supporting Documentation

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