

Outsourcing Distribution Centers Offers More Flexibility, Less Risk

White Paper

Global sourcing and manufacturing
compels companies to rethink U.S.
distribution networks



Fashion companies are almost entirely dependent on bringing goods in from multiple global sources. Fashion retail chain Anchor Blue is no exception. The problem was, it had little control over its supply chain operations. The company had no visibility into where goods were and it was taking on average three-and-a-half days for product to move through the distribution center. The lack of visibility led stores to order more product, which increased inventory costs. And if goods were lost, it took dozens of phone calls to resolve the problem while the store went without merchandise.¹

Companies like this are facing the new manufacturing conundrum:

- They built a centralized distribution center (DC) network 10-15 years ago based on sourcing in the U.S. or NAFTA countries;
- They've moved production offshore to multiple regions that are continually changing, and now are shipping product across the country to old DCs, often to ship it back again to customers;
- Suppliers can't provide the value-added services needed to meet customer requirements;
- Ports and the areas around them are congested;
- Transportation costs are out of control due to limited capacity and escalating fuel costs.

These conditions are not going to change—in fact, the complexity of the global supply chain will most likely increase. What companies need to remain competitive is flexibility in their DC networks.

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“In reviewing all of these issues, we decided it made the most sense to outsource the DC to a third-party logistics provider,” said Richard Space, senior vice president for logistics and sourcing for Anchor Blue. “It was clearly not this company’s core competency and it was costing us a lot.”

Flexibility is strategic

In this era of global outsourcing, spiraling costs, and customized configurations, flexible logistics management is strategically critical to companies’ bottom lines, but often management doesn’t grasp the effect poor logistics has on profit margins.

“Executive management in the vast majority of companies has not yet truly embraced supply chain distribution and warehousing as a strategic and competitive advantage,” said Rick Duris, president of Business Technology Group.

“Logistics does not show up as an asset. The perception is that it is an expense—something to be minimized or squeezed. Management doesn’t understand it and the impact it can have on profits.”¹

Under the old model where goods were sourced primarily in NAFTA countries (with heavy emphasis on the U.S.), shipping all the goods to one or two DCs to be bundled and labeled, then shipped to customers wasn’t all that inefficient. But now with the sources of goods shifting continuously and entering ports all over the country, using a traditional DC network doesn’t make sense.

Company-owned versus outsourced DC networks

If your company needs to modernize its DC network, there are two options: build your own or outsource.

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¹ Katrina C. Arabe, “Top 10 Distribution Concerns, Doing More With Less,” ThomasNet, March 14, 2003.

The 'build your own' option is ideal if logistics is a core competency of your company and you have the time to build and capital to fund the projects.

For most companies, outsourcing logistics and warehouse/DC operations makes the most sense. With an outsourced solution you get:

- Best-in-class logistics/DC operations
- DCs that are closer to ports and customers
- Operations that are up and running in a few months
- Industry-specific services that require little to no customization
- Flexibility in managing business and supplier changes
- The ability to easily and quickly add short- or long-term capabilities
- Seamless integration of data from WMS system to internal systems for real-time visibility of your supply chain
- Value-add services (e.g. labeling, bundling, kitting) to meet specific customer requirements
- Lower costs while improving customer service

According to the study, *The State of Logistics Outsourcing 2007*², 69 percent of companies surveyed were using 3PLs for warehouse/distribution center management. Almost two-thirds of companies surveyed felt the use of 3PLs had a positive impact on customer service. Nearly 75 percent agreed with the statement "Our use of 3PLs has had a positive impact on business process efficiencies." And almost half were able to measure a return on investment from using a 3PL.

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² C. John Langley Jr., Ph.D., "The State of Logistics Outsourcing 2007," the 12th annual survey sponsored by Capgemini U.S. LLC, Georgia Institute of Technology, SAP and DHL.

“Companies continue to look at rationalizing their networks and continually look at ‘how do I get assets off my balance sheet or increase my return on assets?’” said John Porter, senior vice president with CB Richard Ellis. “This could mean devising more structured financial solutions or outsourcing to a third-party logistics provider. At the same time the pressure to globalize logistics networks demands that distribution networks be optimized.”³

Flexibility is key

The costs of operating old DC networks is not the overhead, it’s the lack of flexibility to respond nimbly to changes in the market or customer requirements, or unforeseen shifts in the supply chain. Having DCs close to customers allows companies to be much more responsive and deliver goods faster, cheaper and exactly the way the customer requests.

“Companies are turning to 3PLs to act as warehouses for them,” said Walter Byrd, senior director at Cushman & Wakefield. “They’re saying, ‘I want 15,000 to 20,000 square feet dedicated to me.’ Many of the 3PLs occupy three or four buildings each at about 500,000 to 600,000 square feet.”⁴

3PLs have the advantage of operating several shared, multi-client DCs, enabling companies to extend their operations to within short-haul ranges. As the company’s business grows and changes, 3PLs can easily adapt, adding locations and services, and giving companies a significant advantage over those competitors’ old, centralized DC networks.

And while the benefits of outsourcing include cutting costs out of the supply chain, the benefit often overlooked is an

³ David J. Closs, Michigan State University, “The Implications of \$4/gallon Fuel,” *Logistics Quarterly*, Vol. 14, Issue 2, 2008

⁴ Marcia Jedd, “Trends in Selecting Distribution Centers Are All Over the Map,” *Global Logistics and Supply Chain Strategies*, March 2001

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increase in sales due to agility of the supply chain.

For example, Anchor Blue saw its cost of processing drop from 33 cents to 19 cents per unit when they switched to an outsourced DC operation, while increasing its ability to move product from 19 million pieces to 26 million pieces annually. Their delivery to stores improved and with its more streamlined product flow, the company's buyers are better able to gauge consumer reaction and adjust orders accordingly, which is critical in a business as trendy as teen fashion.

Added-value services

Because 3PLs are focused entirely on logistics management, they can deliver other capabilities as part of their service package.

When Philips Consumer Electronics wanted to improve its logistics and DC operations, Ryder used its in-house engineering staff and proprietary software to analyze Philips' customer locations and freight volumes. The result was a new DC in Dallas/Ft. Worth that put product within two days of 80 percent of Philips' customers, reducing transportation cost and improving customer service.⁵

Ryder also manages Philips' cross-border operation—previously run in-house—and using its in-house tools, it provides load optimization of Philips' complex product line, which includes electronic equipment as small as handheld devices and as large as flat-screen TVs.

Because 3PLs work with a variety of companies, they've developed best-in-breed logistics/DC operational practices, which directly benefits customers.

⁵ Jean V. Murphy, "Philips Consumer Electronics Revamps Distribution With Outsourced Solution," *Global Logistics & Supply Chain Strategies*, August 2003.

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The nimble supply chain

Outsourcing opens options for finding new suppliers and providing new products to your customers. A typical scenario might look like:

A company sells shower curtain/curtain ring sets to retailers across the country. It has been sourcing its goods for years from a supplier in Mexico and processing shipments in its Dallas/Ft. Worth DC. Now its largest customer, based in California, wants a special curtain set it can private label.

The company finds the ideal item from a supplier in South Korea. Not only is it exactly what the customer wants, this premium item is less expensive than the company's usual sets. The South Korean supplier doesn't manufacture curtain rings, but a supplier is found in China that sells them for a fraction of the cost.

The shipment from South Korea will enter the country through the Port of Tacoma; the Chinese goods through the Port of Long Beach.

In the old, centralized DC network, the company would:

- Hire carriers to transport the goods from Tacoma and Long Beach to its DC in Dallas/Ft. Worth;
- Bundle and label the goods;
- Ship the finished goods back to the customer's warehouse in Los Angeles.

By the time it reaches the customer, the cost of transportation has made the premium product less profitable than its standard sets.

Under the outsourced DC scenario:

- Short-haul carriers would transport the goods

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from Tacoma and Long Beach to a DC in Sacramento;

- There, the sets would be assembled and compliance labeled;
- The finished goods are shipped to the customer's LA warehouse.

The new product now retains its healthy profit margin and the goods reach the customer in a fraction of the time, improving customer service.

Outsourcing best practices

If outsourcing is a compelling option, there are best practices that can make the transition more successful. According to a recent survey of 100 top retail and related companies by the Supply Chain Consortium,⁶ “the key to success in outsourcing distribution centers is communication between the company and its 3PL provider.”

Also cited in the report include:

- Most companies allow 3PLs to provide the technology that drives their DC, because of the experience 3PLs have in implementing and operating these complex systems.
- Sixty percent of respondents have a negotiated rate structure for their contracts with 3PL providers; 40 percent are in a cost plus contract.
- 80 percent of respondents indicated their company has a formal process for outsourcing.

Like any strategic initiative, outsourcing DCs takes comprehensive preparation, clear definition of the scope of the project and metrics to measure its success or failure.

⁶ Steven Simonson, Principal, Tompkins Associates Principal, “Outsourced DC Operations,” Supply Chain Consortium, 2007

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Keeping your options open

The old scenario of one or two centralized distribution centers is giving way to a new paradigm of moving operations closer to the customer. Outsourced DCs provide more options and quicker execution than maintaining older networks or trying to build new DC operations internally.

Outsourcing is the easiest way for companies to:

- Add state-of-the-art DC capabilities closer to ports and customers
- Cut transportation costs
- Speed products to customers
- Meet customer requirements, including labeling, kitting and bundling
- Manage seasonal business fluctuations more efficiently
- Provide better customer service and grow their businesses

Outsourcing DCs provides companies the flexibility to add new products, markets, sources of goods and capabilities while keeping their focus on their core business. It's the competitive edge needed to be successful in an economy where the global supply chain grows more complex every day.

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