Insight from industry

Insights from a logistics partnership

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Abstract

Highlights insights gained from five years of operating experience in a logistics partnership between a large US retailer and a provider of international logistical service. The insights gained from this partnership show that a third-party logistics provider can help a firm achieve substantial results. The path to achieving these results is not without its difficulties, but many of these problems can be anticipated and appropriate actions taken to minimize their disruption. Establishing a measurement system that allows easy and integrated reporting of the status of the enterprise is essential if real progress is to be made in a logistics partnership. An extensive formal and informal communication strategy is essential to address the issues arising from the difficulty of combining two different organizational cultures. Finally, this partnership has shown that if the rewards for both partners are real, tangible, and substantial the partnership can endure.

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Introduction

Much of the material written about logistics partnerships presents the perspectives of partners shortly after the partnership has commenced. This paper focuses on the evaluation of a logistics partnership between a large retailer and a provider of international logistical service based on five years of operating experience. The authors believe that the insights gained from this partnership have wide applicability and merit discussion. Following a brief discussion of the nature of the partnership, the problem areas are identified. Next, the key lessons learned are summarized and recommendations for other logistics partnerships are made.

An international logistics partnership

This paper focuses on the insights gained from a partnership formed between Melville Corporation, a leading specialty retailer in the USA, and Mercantile Logistics, a third-party provider of international logistical services. Melville was a US$12 billion specialty retailer operating stores in the continental USA. At the time of the formation of the partnership it participated in the footwear, apparel, chain drug, toy, and home furnishing retail markets. Melville owned and operated CVS, KayBee, Marshall's, Wilson's, Linen's N Things, Footaction, Bob's, Accessory Lady, Thom McAn, Prints Plus, This End Up, and Meldisco (the footwear segment of Kmart). Mercantile was the logistics division of Maersk, a worldwide transportation firm with headquarters in Copenhagen.

Several factors led Melville to seek the services of a consolidated international logistics service provider. First, Melville recognized the need for international logistics expertise in individual divisions that had not developed those capabilities, as well as to supplement the capabilities of other divisions. Second, consolidation of services with one provider would enable Melville to leverage the combined power of multiple divisions to secure superior services at competitive prices. Third, Melville desired the ability to rapidly expand international sourcing without having to develop logistics infrastructure to support such sources. Finally, consolidating services with one provider would facilitate a world class control system to ensure full visibility of

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the international supply chain from point of order to the point of delivery to the domestic DC. Mercantile was selected because its strategy, management, and capabilities closely aligned with these goals. The vision of the potential of the relationship between the two firms was shared at both the executive and operational level.

Under the terms of the relationship Mercantile Logistics managed all aspects of Melville's import process from vendors located in the Far East. Mercantile Logistics was responsible for coordinating vendor shipments, consolidating freight, booking ocean and air transportation, coordinating US Customs brokerage activities, and scheduling delivery of shipments to a variety of distribution centers located throughout the USA. Melville's divisions provided electronic copies of purchase orders and purchase order changes to Mercantile Logistics daily. Mercantile Logistics managed the activities necessary to ensure that shipments were delivered in accordance with the instruction on the purchase orders and reported status information via daily electronic updates to the information systems of Melville's various divisions.

The partnership was structured to achieve four major operational objectives:

(1) reduce total logistics cost;
(2) reduce transit time;
(3) improve information; and
(4) improve pipeline reliability.

Each of these major objectives was achieved, and in some instances year by year accomplishments widely exceeded expectations. Overall cost was reduced by 12 percent, despite absorbing 2-4 percent per annum increases in ocean freight rates, and reliability was improved to better than 96 percent (measured in terms of purchase orders delivered ‹ two days of planned due date). Transit times were reduced by more than ten days through the use of an information system that tied purchase order due dates to realistic pipeline planning schedules. The information system also provided event tracking on 20 separate stages of the order cycle as purchase orders moved from buyer to vendor to distribution center.

During its existence the Melville/Mercantile Logistics partnership was responsible for the movement of approximately $5 billion of goods at retail. Product flowed from nearly 40 origin points to as many US-based destinations. The partnership accounted for the movement of nearly 70,000 40ft equivalent (FFE) containers during this time period. The volume of activity made this third-party logistics contract one of the largest of its kind to date. However, the partnership was dissolved after five years when Melville announced a strategic realignment that created three new operating companies, including a drug chain holding company, a footwear company and a toy company. Some business units were sold to other corporations. Two of the remaining companies were primarily domestic in their operations, thus reducing the volume of international logistics to the point where many of the shared economies of scale were no longer available. Thus, the relationship between Mercantile and the resulting businesses was restructured to reflect the more individualized needs and requirements of those operations.

Problem areas

Although the outcomes of the partnership have been positive, significant problems were encountered along the way. Notable problem areas included the planning and start-up process, documentation, measurement of progress, and cultural and organizational barriers that proved difficult to overcome. Each of these impediments is discussed below.

Planning and start-up

Melville implemented the new relationship in its largest importing division first to maximize cost reduction potential. Unfortunately, the division was at the beginning of its import processing peak season. Hindsight makes clear that this was not the most prudent strategy. Although Mercantile Logistics had engaged in two months of planning prior to the initiation of import management services, it still could not effectively handle the volume of cargo and data associated with the peak season.

Another problem stemmed from changes to vendor locations. The buying organization was engaged in shifting vendors and factories from Korean and Taiwan-based firms to firms located in mainland China during the start-up phase. This shift rendered all historical data

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on cargo movement (volume by origin port) useless in terms of planning future movements.

The new sourcing locations also changed the import process. Well over 100 e-mail messages a day were sent from Mercantile Logistics operations in the Far East to the divisional headquarters as managers attempted to understand the new process. As a result, attention focused on responding to e-mail and diverted attention from cargo management, documentation, and reporting, causing delayed and/or poor quality management reporting. Often the cargo moved but the information did not. Mercantile Logistics made significant increases in its manpower assigned to information management, and within six to eight weeks managed to correct the problem. The difficult start-up, however, strained the partner relationship for almost two years.

Documentation and measurement

Both organizations struggled with issues of how best to measure and document the achieved results during the early years of the partnership. One issue that proved especially difficult was establishing clear baseline data at a level of granularity that permitted accurate comparison of results. Melville's historical record contained high-level data that indicated the number of containers shipped by origin and destination, total expenditures, and estimates of unit volumes. Although exact details of individual shipments were available in ocean bills of lading, the cost of collecting this historical data was prohibitive.

Shifting sourcing locations also hindered documentation and measurement. Comparing one year's numbers with another became suspect when sourcing locations shifted. The movement into China for lower product prices, for example, resulted in higher transportation costs and longer transit times. It was difficult to explain these results without a measurement system that provided the capability to reflect sourcing changes and compare new functional cost structures against a detailed base case. Three years of experimentation with analysis and reporting processes were required to develop a comprehensive approach to management reporting that clearly revealed the program's progress to the senior management of both partner firms.

Poor data quality presented another challenge to measurement system development. Both the source data and the data captured during the tracking process had to be carefully reviewed. Significant efforts were made to establish editing processes that cleansed the data as it was entered into the system. Vendor codes, port codes, vessel names, dates, and numerous other fields were carefully checked and controlled. Even the most minor problems such as the difference in international and US date formats created problems. Vessels were often reported as departing, for example, on 3/2 (3 February) and arriving on 3/3 (3 March). These inconsistencies were common in the first year operating database. The impact of data quality cannot be underestimated. A report that is 90 percent correct is worthless. Data quality had to be managed to better than 99 percent before operating decisions could be based on reports. This level of accuracy took over six months to achieve.

Another problem focused on turning operating data into information that senior management found useful. The wealth of operating data generated by the information system was summarized and displayed in a wide variety of ways including complex graphics accessible through a sophisticated user interface. Almost any operating question could be answered but the key management question, "Are we better off than we were?" proved difficult to answer. Eventually, a conceptual model of productivity management based on standard costing concepts was developed to relate the operating database to the financial database in a simple format. The final result was a one-page, four-line report that indicated overall performance on a year-over-year basis. The first line displayed overall productivity; the next two lines showed Melville's contributions to productivity changes (volume shipped and lanes utilized); the final line showed Mercantile Logistics' lane cost per cubic meter. It was possible to drill down from these measures to daily operating data to explain a particular element of the productivity equation if necessary.

Culture and organization

Organizational culture and structure had a significant impact on the Melville/Mercantile Logistics partnership. Melville, based in the USA, adopted a relatively short-term focus

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characteristic of publicly held retail organizations and believed strongly in divisional autonomy and accountability. Mercantile Logistics was part of the large Danish firm, A.P. Moller. The culture was private, centralized, and focused on the long term, as is characteristic of organizations in capital-intensive businesses. These two cultures and structures did not mesh easily.

Cultural differences are often not easy to characterize. Differing attitudes toward e-mail by the partner firms in the Melville/ Mercantile Logistics relationship exemplified the gap that initially inhibited effective working relations. When e-mail was first introduced it was deployed as an office-to-office communication system. It was not possible to address individuals within offices. Mercantile adopted the European "model" that e-mail responses represented the entire office while Melville's culture represented the contrasting belief that e-mails were addressed to individuals and individuals assumed responsibility for action. This fundamental difference in approach to responsibility proved to be both educational and frustrating for each party. While these and other differences were eventually overcome and never presented serious problems, it is instructive to note that when two organizations come together in a partnership each brings a distinct cultural tradition and set of operating assumptions. Failure to recognize the differences and to be receptive to reviewing existing culturally driven assumptions generates conflict that is at best counterproductive.

Organizational structure of each of the partners also impacted relationship success. The relative autonomy and individual accountability of the Melville divisions worked against some aspects of the partnership. It was difficult to secure support for efforts that produced significant savings for one division and neutral results for another. It was impossible to implement programs that traded off benefits between divisions. The same was true at Mercantile Logistics as decentralization was rolled out as an A.P. Moller initiative. The interesting dilemma in this partnership was that the overall size of Melville in international logistics permitted development of some programs but the individual accountability of the divisions retarded the development of other programs.

Lessons learned

Although problems were encountered, the Melville/Mercantile Logistics partnership achieved its objectives. In retrospect several lessons were learned that would have allowed those objectives to be achieved earlier and perhaps with less effort. These lessons are discussed below.

Focused measurement

The success of a relationship such as the Melville/Mercantile Logistics partnership requires a sharp focus on mutually agreed upon objectives. In any multi-divisional and multi-party effort there are a myriad of opportunities to explore and ideas to evaluate. Clearly defined objectives provide a way to screen those opportunities and ideas to ensure that the partnership's efforts remain focused on what is important, and unproductive behavior directed toward agendas that fall outside agreed-upon objectives is minimized.

A well-designed measurement system that clearly and unequivocally tracks and simplifies reports is necessary to ensure that both parties stay focused on the objectives. The focus created by appropriate measurement was evident in the quarterly management board meetings of the Melville/ Mercantile Logistics partnership. Before the measurement system was fully refined, the agenda of board meetings was dominated by operating data reviews and problem discussions. Later, almost all of the board's time was focused on strategic decisions required to determine new avenues of co-operation. The experience clearly demonstrates that focus and measurement are intertwined and self-reinforcing. Other organizations entering into logistics partnerships should remember that focus cannot be achieved without emphasizing a well designed measurement system that eliminates ambiguity regarding objective achievement.

Gain sharing

Partnerships are predicated upon the mutual need to share operating assets and resources. Unfortunately, sharing the financial risks and gains that accompany shared operations is difficult to achieve. Logistics service providers are not motivated to put forth maximum effort if they are not provided with an opportunity to share financial rewards.

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Merely "keeping the business" is not a sufficient incentive to make a provider apply the necessary effort to outperform expectations. The Melville/Mercantile Logistics partnership included shared financial savings in the contract. Melville created financial incentives by establishing attainable yearly productivity targets and then sharing all savings beyond those targets with Mercantile Logistics. This method of compensation mirrored Melville's internal system, which provided bonus payments to employees after yearly targets are exceeded.

Communication

Frequent, even repetitive, communication of objectives, measurements, and upcoming changes is essential to keep all parties to a relationship informed and focused. Periodic lapses in communication encourage participants to dissociate themselves from responsibility for partnership objectives and follow their own agendas. In the Melville/Mercantile Logistics partnership this was particularly true when anticipated results were negative. One way that this was avoided was to begin all official communications with a list of events scheduled in the next six months to ensure that that all parties were informed and that there were no surprises.

Frequent formal and informal face-to-face communication also transformed the relationship from a transactional-orientation to a partnership. When participants learn through frequent contact that both sides are making efforts to achieve partnership objectives, the focus of discussions concerning problems shifts from "why did you . . . ?" to "how can we . . . ?" Communication builds a bridge between organizations. Once this bridge is built, partnerships based on trust can be developed.

Limit and define the scope of operations

Many start-up problems in the Melville/Mercantile Logistics partnership could have been avoided by initiating the program with a division that transported smaller volumes of imported product. The lower volume would have provided more time for personnel to learn the issues that were involved in a program of this magnitude. The pressure to achieve dramatic cost reduction, however, dictated the more risky path. Other firms wishing to initiate long-term logistics partnerships are cautioned to establish a pilot program to iron out operational difficulties or at least plan for changing operational processes during slow points in the annual business cycle rather than peaks. Experience has shown that going after the brass ring on the first trip around is an extremely risky strategy.

Conclusions

The Melville/Mercantile Logistics partnership in international logistics has shown that a third-party logistics provider can help a firm achieve substantial results. The path to achieving these results is not without its difficulties, but many of these problems can be anticipated and appropriate actions taken to minimize their disruption. Establishing a measurement system that allows easy and integrated reporting of the status of the enterprise is essential if real progress is to be made in a logistics partnership. An extensive formal and informal communication strategy is essential to address the issues arising from the difficulty of combining two different organizational cultures. Finally, this partnership has shown that if the rewards for both partners are real, tangible, and substantial the partnership can endure.