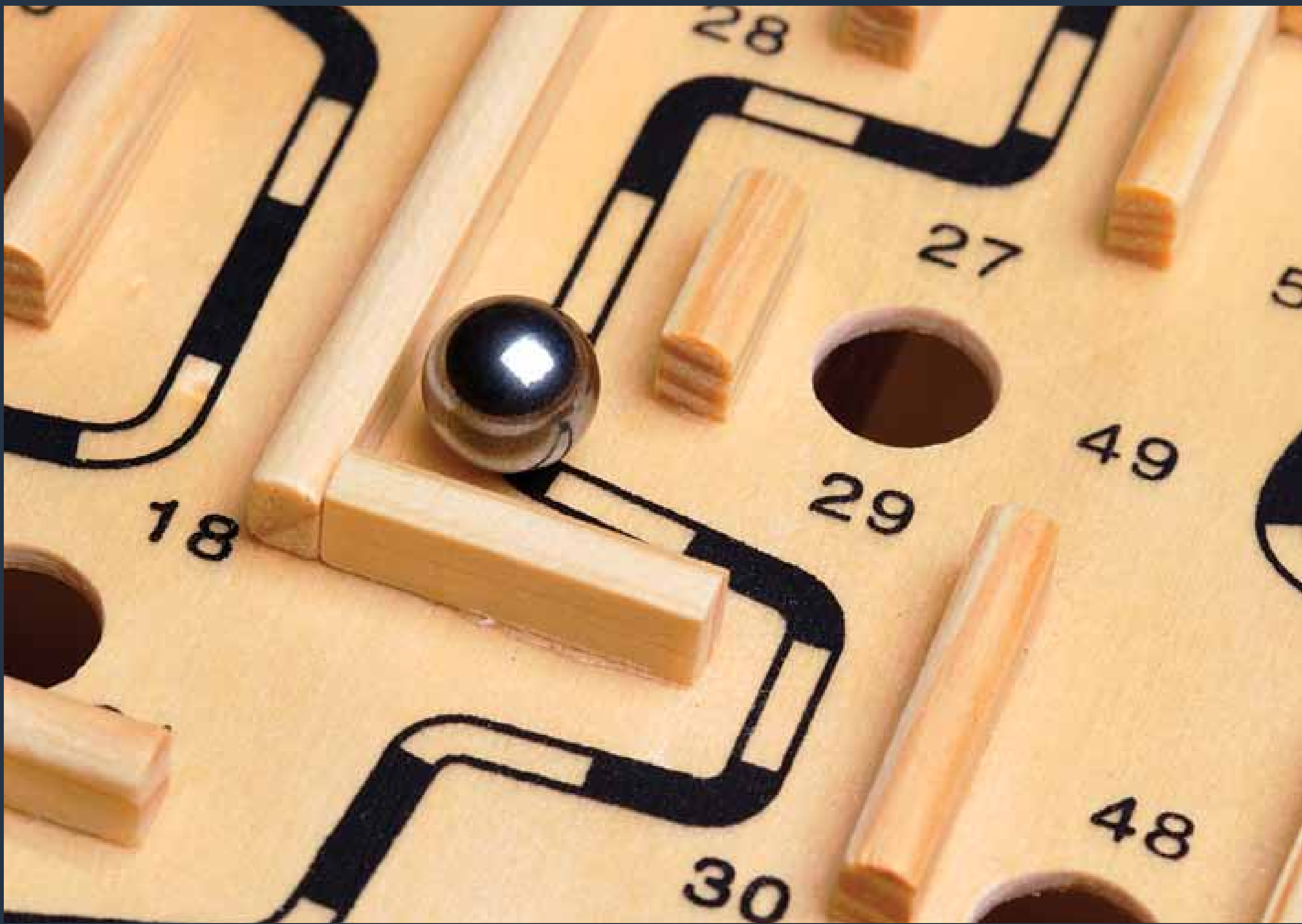
2010 Third-Party Logistics Study ✦ Findings of the 15th Annual Study

FAST-MOVING CONSUMER GOODS INDUSTRY



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This report presents an excerpt of the *2010 15th Annual Third-Party Logistics Study* addressing supply chain and logistics issues affecting the fast-moving consumer goods market. The *Annual Third-Party Logistics Study* documents the growth and evolution of the third-party logistics (3PL) industry and each year, takes an in-depth look at special topics and vertical markets. The study team sought a deeper understanding of the challenges facing the high-volume, low-margin fast-moving consumer goods industry, as well as the strategies that fast-moving consumer goods shippers and 3PLs are using to manage issues such as reducing costs, perfect order fulfillment and rapidly sensing and responding to changes in consumer demand. The study results are based on four streams of research: a web-based survey, desk research, focus interviews with industry experts and a facilitated shipper workshop, and include perspectives from both shippers and third-party logistics providers.

FAST-MOVING CONSUMER GOODS

Demanding Consumers Increase Supply Chain Pressures

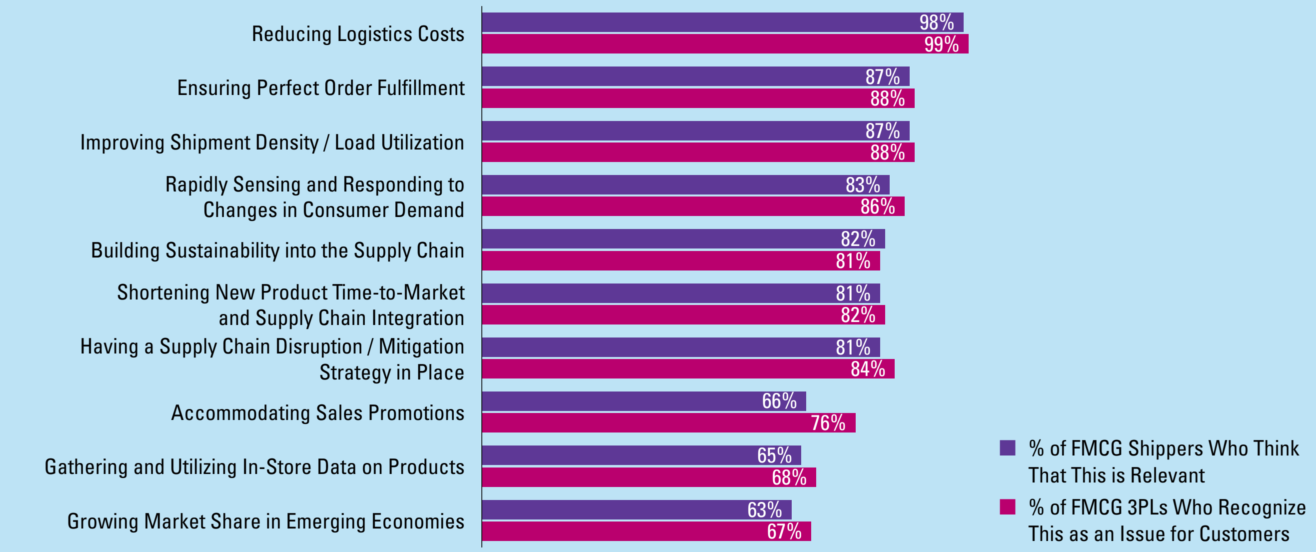
A more cautious, less loyal shopper has emerged in the global recession, challenging consumer goods manufacturers and their supplier and retailer partners to become more demand-driven and responsive. A value-conscious customer is particularly challenging for producers of fast-moving consumer goods, defined as products replaced or used up in a short period of time – such as trendy apparel, toiletries, and groceries – that are non-durable and sold directly to the end consumer. With large volumes and low margins, fast-moving consumer goods companies (FMCG) must respond quickly to deliver in-demand, on-trend products to shoppers when and where they want them, to avoid getting stuck with undesirable merchandise.

TOP LOGISTICS CONCERNS

It's not surprising that manufacturers of fast-moving consumer goods cite a long list of high-priority concerns for their supply chains. Reducing logistics costs is the perennial number one goal across all industries in the *Annual 3PL Study* (**Figure 18**), but other priorities speak to the particular challenges of the fast-moving consumer goods category, including perfect order fulfillment (87%) rapidly sensing and responding to changes in consumer demand (83%) and shortening new product time-to-market and supply chain integration (81%).

FIGURE 18

Reducing Logistics Costs is a Top Concern for FMCG Companies



Source: *2010 15th Annual Third-Party Logistics Study*

Swedish manufacturer Oriflame Cosmetics, for example, delivers direct-to-consumer within 24 to 48 hours of when the order is placed; in some markets that means home delivery or delivery to one home on behalf of several customers, while other markets favor pickup at a kiosk or service center. That's challenging the manufacturer to increase order accuracy and work to avoid out-of-stocks while coping with the costs incurred by operating so many delivery models.

Fast-moving consumer goods manufacturers are acting on growing global awareness of the need to mitigate the environmental impact of manufacturing and logistics processes, with 82% placing priority on building sustainability into the supply chain. Green is no longer leading edge or pioneering; it is now a normal part of a company's operations, driving the need for manufacturers and others to develop cohesive and comprehensive earth-friendly sourcing strategies.

Improving shipment density and load utilization is one of these strategies (87%), enabling manufacturers to maximize use of shipment capacity to reduce emissions, wasted capacity and potentially costs as well. Limited Brands Logistics Services, for example, continues to work on new configurations of its carton proportions to fit as much merchandise into containers as possible.

"Sustainability is a mandate to do a better job in the logistics area," says one FMCG executive, whose company has been testing hybrid electric delivery trucks and working to comply with emerging sustainability regulations in jurisdictions such as California. "Because only 160 to 170 miles is the usual length that our products travel to get to their final destination, it's difficult for us to take advantage of multimodal alternatives, like truck/rail or truck/ship," he says.

Bringing 3PLs into the planning of promotions "allowed an extra set of hands and eyes beneficial to getting products to the shelves faster."

3PLS AND SHIPPERS SHARE PERSPECTIVE

Fortunately, fast-moving consumer goods manufacturers and the 3PLs that serve them are remarkably aligned in their assessment of these top concerns. These results seem to imply a much closer agreement between the two groups than there might have been ten to fifteen years ago.

The only slight deviation occurs in accommodating sales promotions, where 3PL respondents are more likely to consider this a top priority than shipper respondents (76% vs. 66%). Perhaps this is due to fast-moving consumer goods companies' often heavy reliance on promotions; for many in this category, much of the business is promotional, so the inventory spikes promotions create are simply business as usual. Additionally, accommodating the spikes in volume generated by a promotion requires speed, visibility and IT connections. One shipper says bringing their 3PLs into the planning of promotions "allowed an extra set of hands and eyes beneficial to getting products to the shelves faster. Our 3PLs assist in expediting shipments through changing ocean moves to airfreight or cross-docking at the destination to reduce handling time."

While fast-moving consumer goods shippers and 3PLs may agree on the issues, they view differently the role 3PLs can play in addressing them. **Figure 19** reveals what issues fast-moving consumer goods shipper respondents see 3PLs helping them to manage, versus the types of issues 3PLs think shippers will implement along with them.

Fast-moving consumer goods shipper respondents are closely aligned on their view of 3PLs' role in helping to improve shipment density/load utilization, reduce logistics costs, and put a supply chain disruption/mitigation strategy in place, as well as on perfect order fulfillment and sustainability projects.

"Sustainability is very important to our company," says Frits Voortman, Director, Corporate Supply Chain at FrieslandCampina. "We will be coming out with new, improved sustainability program post-merger and we will expect 3PLs to help."

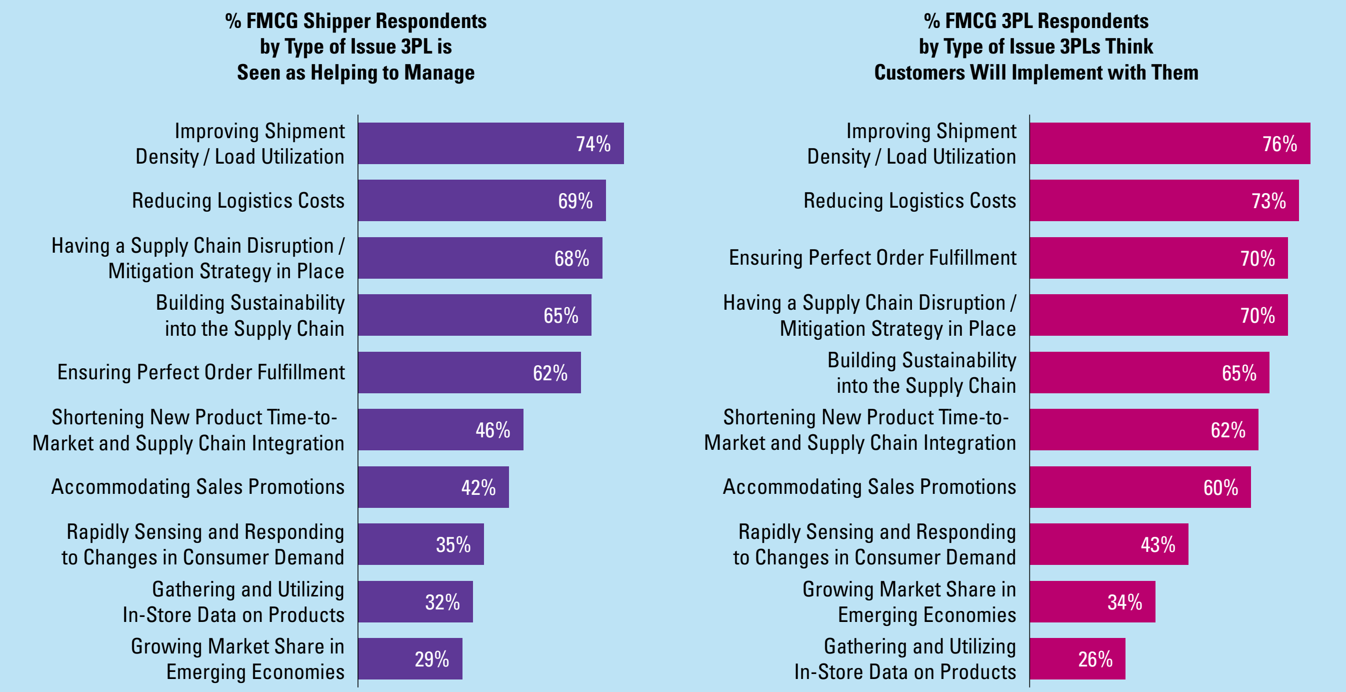
But shippers are less likely than 3PLs (46% vs. 62%) to see 3PLs playing a role in shortening new product time-to-market and supply chain integration. This is another area that, like sales promotions, requires speed, visibility and a strong shipper-3PL IT connection; issues of trust and collaboration may also be at play. "Shippers likely see a goal of shortening new product time-to-market as a broadly cross-functional effort that requires the shipper to manage activity among internal functions (from design to production to logistics to sales to marketing) and external partners," including the 3PL, says a leading retailer.

The disparity seen earlier in sales promotion occurs again here, with just 42% of shipper respondents seeing a role for 3PLs, while 60% of 3PLs see one. At one FMCG shipper, for example, creation of a 3PL joint venture with a sister company means high-velocity and high-volume – and presumably more heavily promoted – goods are handled internally, while 3PLs are used for not-core business, such as products that are low volume or not fast moving, or where the company has not migrated to new IT systems.

But others rely on 3PLs precisely for the excess capacity demanded by things like promotions. For example, Oriflame Cosmetics, which conducts as many as 40 promotional campaigns each year for each of the eight European countries being served from its Warsaw DC, shares its forecast with its 3PL a year in advance to jointly plan labor and other needs. "This joint planning certainly brings us benefits in the warehouse operation," says Gokhan Cakmak, Logistics Manager, Global. "In transport this is more difficult where we need to sometimes find up to three times more capacity. The 3PL assists to then bring in more capacity, working with other companies."

FIGURE 19

FMCG Shippers and 3PLs See 3PLs' Capabilities Differently



Source: *2010 15th Annual Third-Party Logistics Study*

COLLABORATING ON COSTS

Despite the priority placed on reducing logistics costs and the fairly close alignment in how fast-moving consumer goods shipper respondents and 3PLs see the 3PL's role in helping to reduce logistics costs, shippers are involving 3PLs in cost-reduction strategies less often that one might expect (**Figure 20**).

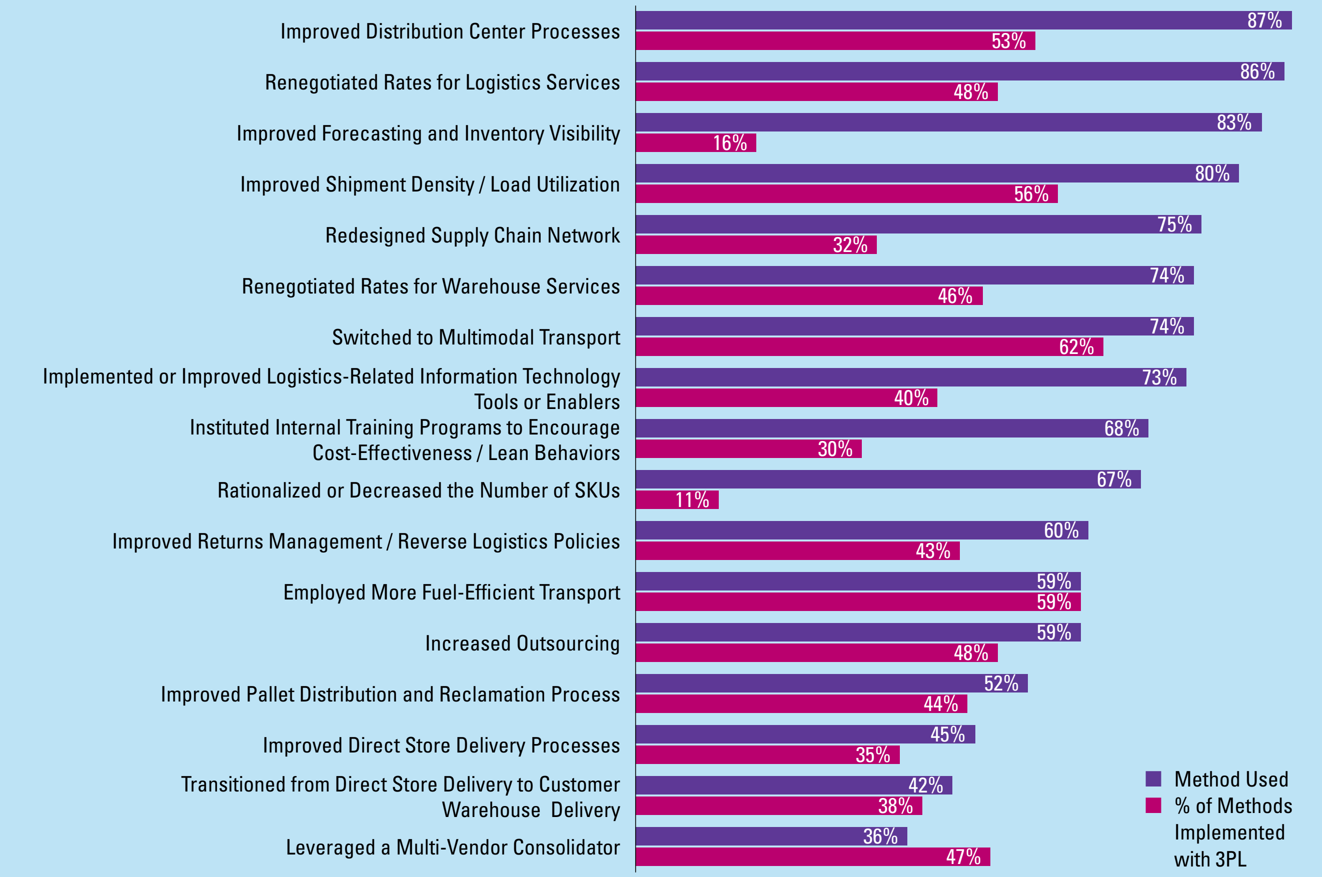
Improved Distribution Center Processes: Seeking strategies to improve warehouse processes and attain better KPIs is the most-used cost-reduction strategy (87%) by fast-moving consumer goods shipper respondents. Beverage distributor Ben E. Keith Company, for example, is using its warehouse management system to better track manpower and hours and is bringing in temporary workers to address spikes in volume. However, just 53% of shipper respondents are implementing DC process improvements in partnership with a 3PL, despite the fact that 73% of this group outsources warehousing to a 3PL. One possible interpretation is that these process reform efforts are focused more often on those warehouse operations retained internally rather than those outsourced.

Renegotiated Rates for Logistics Services: A high number of shipper respondents use renegotiation of rates as a method to reduce logistics costs (86% for logistics services and 74% for warehouse services). Shippers also have the opportunity to use 3PLs to help them renegotiate rates with other supply chain vendors, but more than half of the respondents do not report doing this. This could mean that these negotiations are one-sided, or shippers question 3PLs' capabilities or availability for this service. It is possible that joint negotiations could drive increased savings and improve collaboration and relationships between the parties.

Improved Forecasting and Inventory Visibility: A great number (83%) of fast-moving consumer goods shipper respondents are seeking to improve forecasting and inventory visibility to reduce costs, but a limited number of respondents have implemented solutions with 3PLs (16%). During interviews several shippers and 3PLs noted the increased importance and reliance on reliable forecasting and visibility; this requires increased collaboration and trust among 3PLs and shippers to drive improvements. One shipper comments, "We

FIGURE 20

FMCG Shippers' Most-Used Cost-Reduction Strategies Don't Always Involve 3PLs



Source: *2010 15th Annual Third-Party Logistics Study*

understand the importance of improved forecasting and visibility and continue to invest in initiatives that drive productivity and operating improvements. A current project will improve forecasting and inventory visibility across our trading partners and enable us to improve visibility and availability of product to our 3PLs for scheduling and movement of goods."

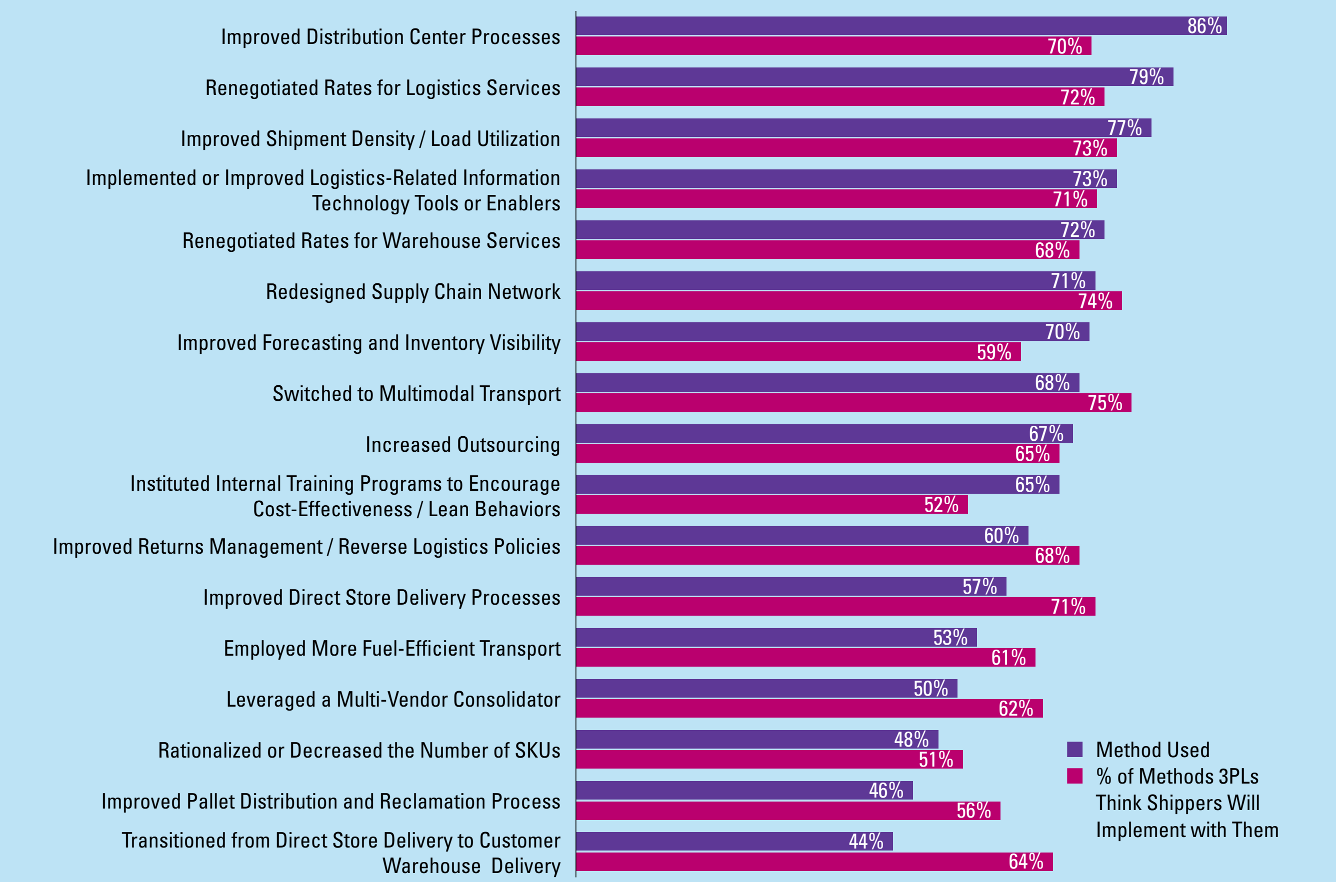
Some 3PLs and carriers are looking to push shippers for more sharing of forecasts to even out the peaks and troughs that put extra costs into the supply chain. The recent economic crisis and subsequent shipment recoveries put increased pressure on 3PLs and carriers who either sat on empty space or sat with too much cargo to move. Uncertainty leads to increased costs in the supply chain for both shippers and 3PLs. 3PLs are anxious to work with shippers to increase their forecasting visibility and accuracy and have started looking at implementing reward/penalty systems to achieve a more reliable supply chain. The challenges we are seeing now used to be evident over shorter and more anticipated peaks (for example, summer peak season, Christmas or Chinese New Year). This year there has been a more tidal capacity challenge, says one 3PL provider, which is causing carriers and 3PLs to cap commitments and consider penalizing significant short shipment/no-shows.

Redesigned the Supply Chain Network: Three-quarters of fast-moving consumer goods shipper respondents are employing supply chain network redesign to reduce logistics costs, but just 32% are doing so with a 3PL. For example, to support its retail operations, Limited Brands offers 3PL services to other retailers aggregating volume to more than 40 nodes around the US and is maximizing its use of a delivery agent network. Limited is also increasing shipments into Canada to support the company's growth in the Canadian market. It may be the case that shippers don't view their 3PLs as having the strategic or IT expertise necessary to carry out this type of initiative.

Interestingly, 3PLs perceive themselves playing a much larger role in fast-moving consumer goods shipper respondents' logistics cost reduction efforts. **Figure 21** reveals what methods 3PLs believe their shipper customers are using to reduce costs and the percentage of those efforts implemented with a 3PL.

FIGURE 21

3PLs Perceive Themselves Playing a Much Larger Cost-Reduction Role



Source: *2010 15th Annual Third-Party Logistics Study*

This study has consistently found that trust issues impede the progress of 3PLs and shippers toward more strategic and collaborative relationships, and that phenomenon could be at work here. 3PLs have the responsibility to demonstrate their capability to take on a more strategic role and convince users to accept them as strategic partners. In the *2009 Third-Party Logistics Study*'s chapter on Supply Chain Orchestration, 38% of shipper respondents said 3PLs lack the business expertise that would coax them to increase outsourcing to 3PLs. Both sides have to be ready.

As a retailer involved with both fast-moving consumer goods companies and 3PLs put it, "Shippers outsource what they cannot do well – i.e., their problems. They want the 3PL to make the problems go away. To the extent the problem requires skills, assets and technology that the shipper does not have, the relationship can work. But to the extent the problem is an underlying economic or market condition, the problem is still there, but less immediate to the shipper via the outsourcing."

FMCG AND TOTAL LANDED COST

Fast-moving consumer goods shipper respondents are slightly more likely than the overall 3PL survey respondent base to use total landed cost calculation extensively in their businesses. As with the overall population, these users most often use spreadsheets for total landed cost calculation, followed by internally developed tools.

However, among those who use TLC minimally or do not use TLC calculation at all, their reasons for not doing so differ. While just 31% of minimal/non-users from the overall respondent base do not do so due to a lack of sufficient time for analysis, 61% of fast-moving consumer goods shipper respondents cite this, the biggest reason for non-use, perhaps reflecting the high-velocity nature of this vertical, where decisions must be made within a shorter period of time than spreadsheet-based analysis would permit. Lack of available data is the largest obstacle for overall users, a problem experienced equally by fast-moving consumer goods shipper respondents.

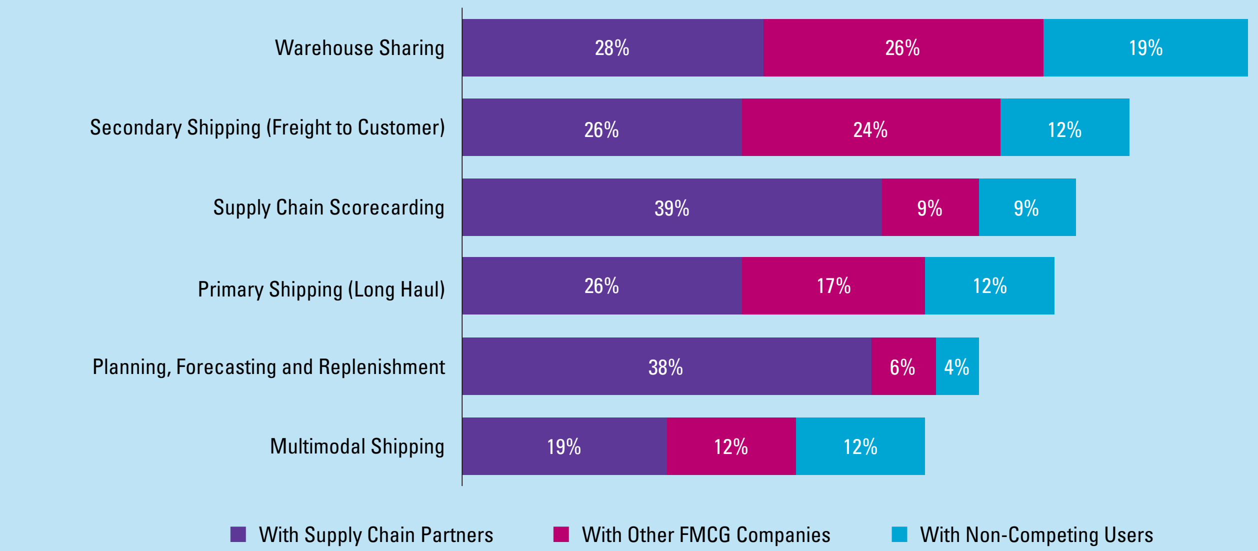
TRANSPORTATION AND WAREHOUSE SHARING

Some shippers are sharing transportation and warehouse capacity to reduce logistics costs and improve sustainability. **Figure 22** illustrates the various types of sharing initiatives and frequency of use.

Warehouse sharing is the most commonly used strategy, with 28% of fast-moving consumer goods shipper respondents engaging in this practice with supply chain partners, 26% doing so with other FMCG companies,

FIGURE 22

Many FMCG Shipper Respondents are Undertaking Transportation or Warehouse Sharing



Source: *2010 15th Annual Third-Party Logistics Study*

and 19% with non-competing shippers. Some of this sharing, however, may be attributable to the use of 3PLs who maximize their assets by maintaining multiple customers' inventory in one facility, rather than an arrangement made at the shippers' direction.

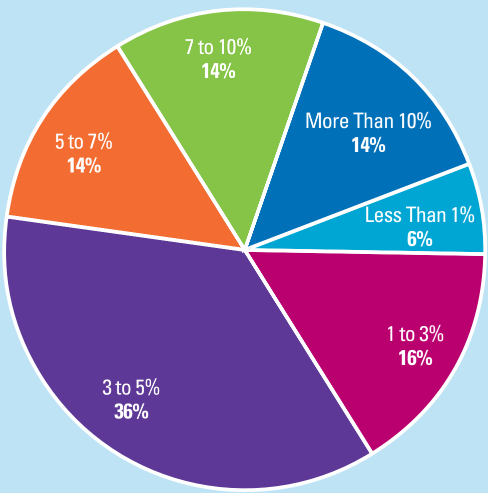
One retailer notes that the organization's 3PL selection for outsourced distribution operations did consider the 3PLs' other customers as a potential benefit. However, "To the extent that cost savings were the result of sharing resources managed through a 3PL, we would expect that the 3PL would prefer not to fully share that information, as the leverage of shared resources is part of their profit model."

Shipping is also a popular place for resource-sharing. Secondary shipping (freight to customer) is the most widely used, and the most likely to be undertaken with another fast-moving consumer goods company. Primary shipping (long haul) is slightly less used, followed by multi-modal shipping.

"We collaborate on transportation with other, but non-competitive, food and beverage manufacturers -- not commingling, but sharing lanes," says one FMCG manufacturer. "It seems to work for us and for those participating." However, the company has resisted others' overtures to share warehouse space. "We feel it adds more touches (and cost) to the supply chain," he adds.

FIGURE 23

More Than Half the Savings Levels Experienced through Sharing Are Under 5%



Source: *2010 15th Annual Third-Party Logistics Study*

About half those shippers and 3PLs who have a transportation or warehouse sharing arrangement work with a 4PL to carry out the arrangement.

While two-thirds of those involved with warehouse transportation sharing initiatives have recognized cost savings, the level of savings has been limited (58% are less than 5%), 13% saw no savings, and 21% do not know the savings. This would suggest that KPIs need to be improved or supplemented to capture results from this type of initiative. KPIs used in the past to measure the supply chain are not necessarily the ones that will bring success in the future. **Figure 23** reveals a breakdown in the level of savings experienced by those fast-moving consumer goods shipper respondents that saw a savings.

FAST-MOVING CONSUMER GOODS: KEY TAKEAWAYS

- The high-volume, low-margin fast-moving consumer goods manufacturer must become more demand-driven to serve a less loyal, more cautious post-recession shopper whenever and wherever they are motivated to buy. Those pressures are putting perfect order fulfillment (87%), rapidly sensing and responding to changes in consumer demand (83%), and shortening new product time-to-market and supply chain integration (81%) at the top of their list of supply chain priorities alongside reducing logistics costs. Fast-moving consumer goods manufacturers and the 3PLs that serve them are closely aligned in ranking top concerns, reflecting 3PLs' solid understanding of their customers' businesses.

- But they have some diverging views on the role 3PLs can play in helping shippers address these concerns. Shippers want 3PLs to help improve shipment density/load utilization, reduce logistics costs and establish a supply chain disruption/mitigation strategy, but they consider them less often for goals such as shortening new product time-to-market and supply chain integration. Shippers are also involving 3PLs in cost-reduction strategies less often than one might expect, with the biggest gaps in improved forecasting and inventory capabilities, rationalizing SKUs and redesigning the supply chain network. 3PLs see their role as much larger in these and other services. The trust issues that have consistently slowed the evolution of shipper-3PL relationships may be a factor in these gaps. Some shippers have tested sharing warehousing and transportation as a green and cost reduction strategy, with most reporting savings of less than 5%.

ABOUT*the*STUDY

This *2010 15th Annual Third-Party Logistics Study*, based on research conducted in mid-2010, examines the current state of the global market for 3PL services, and explores in depth issues surrounding total landed cost calculation. The report also investigates supply chain issues and 3PL usage in two vertical markets, Life Sciences and Fast-Moving Consumer Goods.

The *2010 3PL Study* includes four streams of research: a web-based survey, desk research, focus interviews with industry experts and a facilitated shipper workshop. Survey results are based on responses from a significant number of 3PL providers as well as 1,133 3PL users and non-users from a broad range of industries and geographies. In additional to the fast-moving consumer goods results present in this report, here are some findings from the complete study:

- The *2010 3PL Study* affirms that shippers regard logistics and supply chain management as key to their success, and many credit 3PLs with helping them to achieve critical service, cost, and customer satisfaction goals. The overall percentage of revenues shippers direct to outsourcing of logistics services was lower than in recent years, but others increased use of outsourced logistics services. While shippers report a narrowing of the IT Capability Gap – the difference between shippers' view of the extent to which IT is a necessary element of 3PL expertise, and their satisfaction with 3PLs' IT capabilities – a new one is emerging between the ratings that shippers and 3PL s assign to various aspects of the 3PL-shipper relationship, particularly regarding 3PLs' ability to deliver innovation.

- In the *2009 Third-Party Logistics Study*, 64% of shipper respondents cited total landed cost (TLC) reporting and analysis – the sum of all costs associated with making and delivering products to the point where they produce revenue – as a critical 3PL capability. Yet in *The 2010 Study* just 23% of 3PL respondents reported extensively providing TLC analysis/reports to their customers. Moving to sophisticated TLC capability requires C-level leadership, process change and systems transformation for both shippers and 3PLs.

- Product integrity and compliance requirements, an inherently complex trading partner ecosystem, and demanding customer service and cost requirements are just a few of the challenges shippers and 3PLs are facing in the US $1.2 trillion life sciences industry. Fully 62% of life sciences shippers cite ensuring product quality as a significant challenge and rank quality procedures highly (70%) as a service they want 3PL s to provide, although just 45% of 3PL s currently provide them. The sometimes critical nature of life sciences products accentuates the need for flexible and responsive supply chains.

As economic conditions improve it's time to consider the role 3PLs played in helping shippers weather the recent economic storm. Increased use of outsourcing and high satisfaction levels suggest that 3PLs can certainly take some credit for their customers' results; now it's time to document the lessons learned. One is that when shippers or 3PLs hesitate to share ideas of a strategic or operational nature, they put up hurdles that are very difficult to clear. The future growth and development of the 3PL sector depends on both parties to approach their relationships with an open and collaborative spirit.

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