

Outsourcing Allows Distribution Companies to Gain Competitive Advantage

Distribution companies are no longer simple transporters of goods. As their clients grow more customer-centric, supply chains - the playing field for distribution companies - are being transformed into demand chains. Clients are holding the companies responsible for the availability of goods all the way from the manufacturer to the end customer. This transformation is pushing distribution companies to find new ways to think and work. They have expanded their portfolio of services, offering not only standard services such as transportation of goods but going so far as to design complex supply chains for their clients.

Distribution companies are expected to develop a supply chain capability that dovetails with the overall business strategy, while continuing to improve profitability. No easy task, especially since they must also address the complexities arising from this dynamic environment. Capgemini analyzed the challenges that companies in the distribution industries face in this constantly changing environment and came up with some ideas on how outsourcing might help address the majority of these challenges and help these companies gain a competitive advantage as well.



CHALLENGES FACED BY DISTRIBUTION SECTOR

The challenges that distribution companies face can be grouped into four broad themes:

▪ Ever-Increasing Operational Complexity

As their clients' production and sales components have grown more global, distribution companies have followed them across the globe, either for the promise of more business or for the fear of losing existing business. At the same time, distribution companies have continued to offer their clients customized solutions. The random expansion of capabilities while continuing to customize has resulted in an overabundance of IT systems within distribution companies, forcing them to spend more time addressing internal technical complexities instead of focusing on enhanced customer service. An unfortunate consequence of increased operational complexities has been pricing and service inefficiencies, which almost invariably leads to increased margin pressures.

▪ Varying Levels of Industry Consolidation

The level of industry consolidation within distribution fluctuates for several reasons. One is the need to tap emerging markets. As a short term solution, many companies have looked to mergers and acquisitions (M&A) as a way to expand their capabilities. The privatization and deregulation of some sub-industries such as the parcel and cargo transport segments has greatly increased the competitive pressures for incumbents, highlighting the need for cost optimization.

▪ Changing Business Model

How customers and the public view the role and scope of a logistics service provider has certainly changed and evolved over the last few years, forcing distribution companies to transform their business model in order to keep up with industry standards. Companies now offer differentiated services, from plain vanilla offerings to complex planning and optimization services. But as companies attempt to add more value to their offerings, they run the risk of having their existing offerings become more and more commoditized. A common result, especially when dealing with a huge portfolio of offerings, is that margins earned by distribution companies on value-added offerings are negated by low-margin offerings.

▪ Increasing Technology Adoption

Development and commercialization of new technologies such as Transportation Management Systems (TMS) and Customer Relationship Management (CRM) have raised the bar for customer service for distribution companies. While some new technologies, like real-time track and trace, route optimization, RFID and asset tracking are being offered, many others are being ignored because the development of these technologies outstrips the ability of both the distribution companies and their customers to use them.

OUTSOURCING AS A SOLUTION

For the purposes of this article, the term outsourcing is used to identify three elements of IT outsourcing - Infrastructure Management (IM), Application Management (AM) and Business Process Outsourcing (BPO). Using this definition, an outsourced environment has been shown to often bring gains in efficiency to companies, specifically through scale, technology and expertise. Outsourcing can also help companies reduce costs associated with labor and real estate. Taking advantage of an outsourcing vendor's global, center-based distributed delivery brings further economies of scale and process efficiency.

Outsourcing can be particularly successful in dealing with the challenges faced by distribution companies. Let's take a closer look at the four areas mentioned earlier.

▪ Ever-increasing Operational Complexity

Commonly, companies will increase IT investments in order to deal with operational complexity but the result is usually an assortment of IT systems greatly in need of integration. Using an outsourcing approach allows distribution companies to consolidate and rationalize their global IT network. As an example, a large carrier was able to reduce its



servers by half, resulting in a savings of up to 5% of its IT development costs within three years by outsourcing its IT operations.

▪ **Varying Levels of Industry Consolidation**

The last decade has seen high levels of consolidation within the industry. There are many critical factors involved in successful M&As but one that seems to be fairly consistent is systems integration. If the outsourcing vendor is already engaged with the merging parties, it offers the hope and benefit of seamless systems integration. This enables companies to focus their energies on other more critical aspects of the merger. On the other hand, if the vendor is brought in after the merger, it can help address the inevitable redundancies, possibly by turning fixed costs of human resources, technology and facilities into an adjustable fee where the client pays just for what it uses.

▪ **Changing Business Model**

The business model of distribution companies has changed both in terms of value addition and level of involvement in their client's supply chain. By managing non-core functions, outsourcing allows companies to focus on emerging business opportunities and to quickly scale up and down support functions with little impact on capital expenditure. An example is a leading logistics company that recently restructured its entire organization, using a Shared Services framework. They bundled all common and non-business specific services globally, kept all core operating responsibilities within four business units and created one customer interface for their top 100 customers.

▪ **Increasing Technology Adoption**

Distribution companies are grappling with integration issues for the plethora of systems that already exist across their business units globally (and/or regionally). Outsourcing vendors, through their experience,



can help distribution companies streamline their IT systems and reduce cost. Through outsourcing, distribution companies can reduce their IT maintenance by passing off their legacy systems to vendors that have the necessary scale and also have easy access to necessary skills required to implement and manage new technologies.

COMPETITIVE ADVANTAGE

By addressing specific, increasingly more complex key challenges, outsourcing allows distribution companies to achieve increasing levels of competitive advantage.

▪ **LEVEL 1 - Cost leadership**

Outsourcing helps achieve cost savings by converting fixed costs to variable costs

▪ **LEVEL 2 - Quality of Service**

Outsourcing ensures consistent service quality through well-defined service level agreements (SLA)

▪ **LEVEL 3 - Agility**

Outsourcing allows quick scale-ups and scale-downs, and also offers the facility of on-demand services (for example, SaaS)

▪ **LEVEL 4 - Innovation**

Outsourcing enables companies to follow innovative business models or deliver innovative services by allowing them to focus on their core competencies, while avoiding huge IT investments

These levels are sequential in nature, so distribution companies can expect incremental gains as they increase their level of IT and business process outsourcing.

CONCLUSION

Some distribution companies are already using outsourcing to their advantage but primarily for short to medium term IT outsourcing. They generally lag behind other industries in the use of BPO. A good starting point for these companies might be to standardize and commoditize their business processes and maybe introduce a Shared Services model that would progressively transform their support services so that they could eventually be outsourced.

Done well, outsourcing can reward companies by reducing their costs, giving them access to expertise they may not be able to afford or find in-house and freeing them up to devote more of their time to their core business activities. It is these promises that will have executives looking more and more to outsourcing in the years ahead.

CAPGEMINI, THE RIGHT WAY TO OUTSOURCE

Capgemini has long demonstrated leadership and commitment to the transportation and logistics industry with its tools, research and programs, including the LSP Industry Diagnostic and the annual Third-Party Logistics Study. By taking a strategic approach to outsourcing, LSPs can create a new business model that enables rapid business transformation with greater flexibility and less risk. As a leader in Transformational Outsourcing, Capgemini works with companies to build collaborative solutions, helping suppliers define their objectives and align best-fit solutions to meet their needs.

Capgemini's Transportation Industry Diagnostic, can help identify opportunities for improvement, the business case for change and the

necessary action plans, including change management. The power of this tool is in its repository that contains our transportation industry business process models. Those models, in turn, are tied to best practices, key metrics, potential business benefits, and representative application architectures. Our Diagnostic will help ensure that technology and business processes are aligned to support the company as it competes in an ever-changing business environment.

For more information please contact:

Dennis Wereldsma
Global Leader – Distribution
+31 30 689 2478
dennis.wereldsma@capgemini.com



About Capgemini and the Collaborative Business Experience

Capgemini, one of the world's foremost providers of consulting, technology and outsourcing services, enables its clients to transform and perform through technologies. Capgemini provides its clients with insights and capabilities that boost their freedom to achieve superior results through a unique way of working—the Collaborative Business Experience®—and

through a global delivery model called Rightshore®, which aims to offer the right resources in the right location at competitive cost. Present in 36 countries, Capgemini reported 2007 global revenues of EUR 8.7 billion and employs over 86,000 people worldwide.

More information is available at www.capgemini.com.

About Capgemini's Distribution Practice

Capgemini's Distribution practice serves 14 of the top 20 global Logistics Service Providers (LSPs) and has spent more than 30 years helping LSPs successfully navigate a rapidly evolving business environment. By drawing on global technology skills and a proven ability to design and implement business strategies, Capgemini's Distribution practice is able to offer customers ERP, transportation and warehouse management solutions that allow them to achieve better, faster, more sustainable results.

For more information: www.capgemini.com/industries/distribution.