RETAIL CONFERENCE SPEECH

Good morning ladies and gentlemen.

In my presentation today I will draw together strands from the two excellent speeches we have just heard, and try to look forward – to see how supply chain management is likely to develop over the next few years. As you might expect, I will also explain the importance of the logistics contractor in the management of the supply chain.

But I do not believe you can address the future without a proper understanding of where you are – and how you got there – so I will begin with an account of the development of logistics contracting to date. I hope you will forgive me if I indulge myself by peppering it with examples from my own company's operations. On the way, I plan to provide some insight into the professionalism and complexity of modern-day logistics management.

Contract logistics in the United Kingdom is a stable and sophisticated business sector which grew to a position of worldwide pre-eminence in the space of little more than 20 years. This business developed out of a fragmented, unsophisticated transport industry with a highly cyclical performance. How has this happened? And what has made contract logistics so advanced in this country?

I believe these questions are important, because in answering them we can detect some of the processes still active in shaping the industry... and can possibly snatch a few fleeting glimpses into the future.

In the beginning there was deregulation

The first critical factor in the development of contract logistics in the United Kingdom was the licensing and subsequent de-regulation of transport in this country. Road transport, haulage and public warehousing have low thresholds to entry and typically fragmented industrial market structures.

To give you an example… at one time it was said that the fleet size of an average Road Haulage Association member was one-and-a-half vehicles!

Since then, in an attempt to raise margins and protect profits, governments around the world have restricted and regulated transport by licence and tariff.

But the effect of restrictive transport licensing in the UK and overseas, and the regulation of road transport tariffs in the rest of the world, has been stultifying. It retarded capital investment and systems innovation. And it stunted management development in transport.

The UK pioneered de-regulation of road transport in 1968 by introducing a system of licensing on qualitative rather than quantitative grounds.

Today de-regulation is widespread. But it is still a comparatively recent phenomenon in places like North America, South Africa, and many European economies.

In 1968 – the year of de-regulation – Benchmark Logistics was 35 years old, and had 22 staff. Today we employ more than 100,000.

Later that same year, Unisales – which already owned PSD, the former food distribution contractor – purchased Benchmark Logistics in order to diversify into industrial distribution.

Today we are an independent business quoted on the London Stock Exchange, with a market capitalisation of over £1 billion. Nearly 30% of the company is owned by the people who work in it.

Benchmark Logistics is Britain's largest specialist logistics group, handling merchandise ranging from computers to clothing, food to furniture, industrial equipment to DIY goods, and cosmetics to cars.

The importance of structural change

But this is a diversion.   If the de-regulation of road transport proved to be the first critical factor in the evolution of contract logistics in this country, then the second major influence was the increase in scale and concentration of those organisations represented here today – the retailers.

This led to a shift in the balance of power between manufacturers and retailers in most sectors. But this 'power shift' would not have been so interesting had it had not been for the fact that a wider structural change was already starting to spread across industry.

Originally, companies tended to be organised into different departments – buying, manufacturing, packaging, transport, warehousing, marketing – each a separate cost centre.

This compartmentalisation was reinforced by traditional accounting systems. But departmentalised operations are invariably sub-optimal on cost. What one department saves in packaging reduction, for example, is reflected in another's losses through increased damages.

Such divisive internal organisations were compounded by the traditional adversarial external relationships between vendors and buyers. There was little sharing of costs and benefits across departmental or company lines. Someone had to bang heads together! And eventually they did.

What happened was that one of the parties involved began to take control of supply channels, forcing the system to begin to operate as an efficient whole. Which party effectively became 'channel commander' depended on the nature of the industry. In the motor sector, for example, it was the manufacturer who got the supply chain into gear, implementing JIT regimes, reducing inventories and scheduling deliveries.

The high number of mergers in most retail sectors in the UK over recent decades has led to a dramatic increase in scale and concentration within retailing.

Combined with a generally fragmented supply side, this scale meant that it was the retailer which took control of FMCG supply chains.

But whichever side control came from – manufacturing or retail – the channel commanders were wise enough to recognise that there are always trade-offs. For example, while distributing garments on hangers might initially appear to be more expensive than distributing them in boxes, the extra cost is outweighed by the benefits of receiving ready-to-display stock at the retail store.

Channel commanders have been able to enforce integration across legal and financial frontiers, among IT systems, and in the specification of materials handling equipment. They were thus able to counter the claim that distribution management added nothing but cost to a product.

The development of centralised warehousing

I have described how structural change enabled retailers to take control of FMCG supply chains and exercise new logistical strategies. This included the creation of their own distribution fleets, which struck the death knell for manufacturers' own distribution systems. Most sold off in-house systems and contracted back a service to meet their needs.

Tate & Lyle did it in 1986; Philips did it in 1989. Hanson disposed of Lowfield; Geest of ADL. There have been many others. These operations were bought by established companies, like NFC and Danzas, or through management buy-outs, like Tibbett & Britten and Lowfield.[1]

But more importantly, the retailers' new logistical strategies included the development of centralised warehousing, and management through information not ownership.

British retailers were quick to catch on to the advantages of central warehousing. Outside Scandinavia, the UK now has the highest concentration in the world.

Many British retailers were also quick to discover that they could manage distribution systems through information, without having to actually own or operate physical assets. In other words IT provided total visibility of stock and enabled control to be effectively divorced from ownership... opening the door to the professional logistics contractor.

Reasons for contracting out

Today, many major UK retailers have centralised warehousing, and operate a mixture of in-house and contracted-out systems. Significantly, they nearly all contract out to a greater or lesser extent. But what makes them do so?

There is seldom a single reason for contracting out.

[1] Lowfield, ADL, Tibbett & Britten, NFC and Danzas are all now part of DHL.

The original spur, in the pre-Thatcherite Britain of the 1960s and 1970s, was probably the retailers' vulnerability to industrial action, and the wash-over of militant wage demands into their retail operations. Fortunately, this is no longer a critical issue in the UK, although I understand it is still very much alive in Canada, the USA and even some parts of the continental mainland of Europe.

Subsequently, retailers realised that contracting out offered another great advantage. Distribution is a capital intensive and sophisticated business. A typical major retail distribution centre will cost between £15 and £20 million. So a second incentive was opportunity cost and off-balance sheet financing.

A third reason was the emergence in the 1980s of 'core management' philosophies. These prioritised the commitment of human and financial resources and led to the disposal of perceived peripheral activities.

Since 1986 we have ourselves acquired former in-house operations over three continents from companies as diverse as A&C, Dremier, Unisales and Perlworth. There are immediate benefits in realising material and financial resources, benchmarking performance, and being able to apply the contractor's wider knowledge and multi-sector know-how.

Fourthly, there is the socio-economic climate and the problem of recruiting the right calibre of management and employee. Distribution requires dedicated people prepared to work often anti-social hours. A large distribution centre may have as many as 10 or 12 shifts in a 24-hour cycle and can be committed to 364-days-a-year working.

A fifth, and perfectly respectable reason, may simply be managerial and/or financial expediency. Faced with the need to develop national distribution centre networks within extraordinarily tight timeframes of, say, 12 to 18 months, several UK retailers have turned to contractors to provide the necessary managerial and planning resources.

But while all these advantages exist, they are not sufficient in themselves to lead a single retailer (or manufacturer) to contract out.

Advantages of contracting out

To win business, contractors have to demonstrate that they can do the job, and do it well – to the highest quality standards. Like other leading firms, we are committed to achieving recognised quality standards.

Nearly all our 1,400 sites worldwide have IS0 9001 quality certification. But we do not believe that quality simply comes from a manual. Quality is an attitude of mind that we try to ensure is present in everyone – right through the organisation.

Contractors have also to be cost-effective and flexible in a number of ways. First, they must be flexible in the services they offer. In our case these range from 'transport only' to total planning, building, financing and operation of complete multi-million pound distribution centres.

Secondly, they need to be flexible in adapting to the range and variety of clients' systems. The best contractors integrate seamlessly, and apparently effortlessly, into their clients' operations. We have created a specialist facilities management company which supports our IT operations and also trades in its own right.

Thirdly, contractors have to be flexible in their financial arrangements. As I have just mentioned, distribution can be very capital intensive. A Sparkel & Manx RDC, like this one at Bainbridge Falls, represents an investment of £15 to £20 million. We built and operate six of these, and manage a seventh.

And last, but most important of all, contractors have to be flexible in their contractual arrangements. These can range from the simple 'management fee' (where we effectively manage the assets of the client) to acquiring a company's entire distribution operation and developing the business.

A high proportion of our contracts are 'dedicated' – that is the facilities, employees and management are devoted entirely to one client and even the vehicles appear in its colours. This is why many of our 36,000 commercial vehicles may not always be apparent to you.

Alongside flexibility, the contractors' most vital contribution is management. We have consistently added to and developed our stock. We draw on experienced management from across the industry, but take 100 to 150 graduates – together with several dozen MBAs – every year for management training. I am delighted to say the vast majority stay with us.

The partnership principle

Our aim is to establish long-term partnerships with our clients, and to this end most contracts are developed from invitations to tender on variations of what is known as the 'open book' principle. I should, perhaps, emphasise that this is nothing to do with the discredited 'cost plus' system.

Under 'open book', contractor and client recognise the essentially fixed costs of capital commitment to facilities, equipment, establishment and overheads. This is set within a mutually agreed timespan, appropriate periods for notice or extension and, naturally, escape clauses for non-performance.

There is an agreed basis for capital depreciation and the cost of servicing committed capital. On top of this is a management fee related to the total cost, or resources under management. Such agreements provide a degree of commercial transparency which I believe many of you in this room would find surprising!

Clients do not even have the worry that they may be left without facilities should the relationship change. 'Put and call' options written into our contracts allow us or our client, on due notice, to 'call' in and possess, or 'put' to the other party, the purchase of the operational assets, lease, etc, at residual net book value. So if a client wants to rid itself of a contractor and bring in its own management, then it can easily do so.

Our relationships with clients are true partnerships. We place tremendous emphasis on the development of long-term contracts, where we get to know the client well, and the client gets to know us well. But reward and penalty clauses built into the contract ensure that neither side becomes complacent.

How contractors add value

But supply chain management is not only about transport, warehousing, picking and delivery. Contractors like Benchmark Logistics also create and sell value-added services.

Our fashion division, for example, supplies bonded storage, ticketing, re-pressing, and other pre-retailing services. We offer a complete national warehousing and distribution network, with multi-user scheduling, so that clients can defer their payment of duty and VAT by up to 45 days after individual items of merchandise leave the store. We have started calling this ‘superbonding’, and it can substantially improve clients' cash-flow. We are the only contractor to offer it.

In the grocery sector, we are working closely with Republic Foods on the design and planning of a quarter of a million sq ft composite RDC currently being built at Swanleigh in West Sussex.

In the non-food sector, we provide total supply chain management for leading DIY retailer C&R, involving – from overseas alone – some 15,000 containers a year. We take responsibility from the moment the retailer places a purchase order on its suppliers – wherever they are... worldwide.

We also manage the largest DIY goods central warehouse in the world for C&R at Barleycorn, Lancashire, from where we provide the retailer with a nationwide distribution service. It is a 1,260,000 sq ft facility and was acquired and made fully operational in the space of just seven months. A typical pick can be as high as 950,000 cases a day... and yes, I do mean nearly a million cases each day!

In the car distribution sector, we handle 2.3 million cars a year, and offer value-added services such as pre-delivery inspection, customisation, the fitting of air conditioning units and radios, etc... activities which extend to the sewing of leather seats!

In the technology sector, we do things like assembling clients' systems for BlueTech and setting up workstations. We have proved that this work need not require the employment of high cost technicians.

The environment

At Benchmark Logistics we have developed standards for good environmental management. We recognise that road transport is likely to remain a significant contributor to carbon dioxide emissions for some time to come. It would be misleading of us to pretend that our business was always environmentally friendly.

But our objective is clearly expressed in our environmental policy: 'We are committed to minimising environmental damage in all our operations.'

This includes involving employees and management in environmental awareness programmes, reducing vehicle emissions, increasing energy efficiency, working to reduce consumption of non-renewable resources, eliminating pollutants, and recycling and reusing materials. An environmental action plan is being implemented under the management of one of my main board colleagues who has specific responsibility for the environment. We are not alone among the leading logistics contractors in this.

Future development

Historically, most continental European retailers have simply sought to buy transport – at a particular rate per kilo or rate per tonne. But they will never get the most out of the supply chain until they start to think in terms of partnerships with specialists who are able to manage distribution effectively on their behalf and offer added value.

Specialists like Benchmark Logistics who are able to free-up selling space for retailers by providing outside stockholding facilities, yet offer deliveries within 15-minute timeframes. Specialists who can ease the burden on staff at the outlet – and reduce waste – by eliminating a great deal of secondary packaging.

Specialists who can deliver goods in roll cages or reusable tote bins – with no transit packaging and no litter. And with all goods properly labelled and in shelf order.

And specialists who can take away many administrative and stock control burdens.

I believe we will see continued domination of supply channels by the retailers in future. I have two main reasons for thinking this.

First, retailers are still developing in scale, power, internationalisation and cross-border co-operation. Almost every significant domestic enterprise now has at least a European if not an international dimension. The era of trans-European purchasing is approaching, and will bring with it further pressures from retailers to exercise supply chain disciplines.

Elsewhere in the world, fundamental economic restructuring is taking place, with economic realignments – such as the North American Free Trade Area – accelerating the change.

Then there is technological change. Developments in IT and EPoS/scanning mean that retailers have immediate market intelligence. The historical vendors' monopoly of initiative and retail audit data has already been destroyed.

IT will continue to increase speed, resolve complexity and provide total visibility of stock. This will further shorten response times and reduce stocks along the supply chain.

But there is a third, even more recent, force for change... social pressure.

In recent years there have been dramatic developments in consumer attitudes to the environment, packaging, recycling, etc. In the same way that we currently pool pallets, we are seeing the growth in the application of re-usable bins and tote boxes. We provide a crate rental service to C&R's suppliers to save packaging. We offer crate washing services for supermarket produce suppliers.

At just one of our divisions we reclaim 5,000 tonnes of waste paper and plastic a year for recycling.

Looking further ahead, I believe increasing attention on environmental pollution and resource consumption will trigger additional intervention in the supply chain. And all this will increase opportunities for the good logistics contractors.

The benefits of contracting out, the flexibility of the leading contractors and their customer-driven approach, will – I believe – cause retailers, as well as suppliers, to move increasingly towards the outsourcing of their distribution. More and more they will discover that they can exercise effective control through information not ownership.

Thank you for listening to me.

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