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for capital*

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***Benchmarking Your  
Way to Success***

PAGE 16

---

***Leading Edge Logistics  
Technologies Advancing  
Research at the  
University of Toronto***

PAGE 18

---

***Benefits of Applying  
Activity Based Costing  
in a Distribution  
Network***

PAGE 20

---

***Value Chain Strategy:  
Securing A Competitive  
Advantage***

PAGE 24

---



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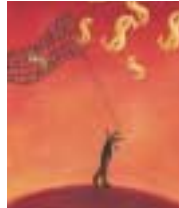
*Transportation Fueled by Thinking*

*Another example of ingenuity by Canadian Pacific Railway*

## features SUMMER 2002

---

# 14



### *The Competition for Capital*

Too often an organization's financial decision makers lack the data to make informed decisions about logistics initiatives that are traditionally complex and costly. Acklands Grainger's President Douglas Harrison shows us how to achieve a positive outcome and find the capital to grow your business.

---

# 16



### *Benchmarking Your Way to Success*

Here's a well honed way to apply benchmarking to enhance your company's profits and shareholder value, based on Deloitte & Touche's annual benchmark study of North American food processors.

---

# 18



### *Logistics Technologies Advance Research at the University of Toronto*

Stephen Whittaker, director of University of Toronto's Procurement Services, describes how eProcurement is poised to revolutionize business processes that today impose barriers to what's core to any university - research and teaching resources.

---

# 20



### *The Benefits of Applying Activity Based Costing in a Distribution Network*

Dale Ross, Vice President, Logistics/Commercial, Effem Inc., provides a comprehensive look at Activity Based Costing (ABC) usage in distribution networks and shows how ABC affords a more accurate picture of a product's actual cost compared to conventional accounting methods.

---

# 24



### *A Value Chain Strategy: Securing A Competitive Advantage*

Sean Watson, Business Development Manager, Tronicus Inc. takes an insightful and strategic look at how the vertical integration of your value chain can transform businesses and bolster your shareholders' wealth.

---

# Contents

## departments SUMMER 2002

### News

- 8** INDEX  
*Company and Organization Listings*
- 9** NEWS  
*Who is Shaping Your Logistics Future?*
- 10** ANNOUNCEMENTS  
*On The Move*
- 11** CALENDAR  
*Upcoming Events*
- 29** NEW PROFESSIONAL LOGISTICIANS  
*Who Reads Logistics Quarterly?*

### Columns

- 12** PRESIDENT'S VIEWPOINT  
*Wanted: Breakthrough to Greatness,*  
*by Victor Deyglio*
- 26** CAIE REPORT  
*What are your Customs Strategies?,*  
*by Bob Armstrong*
- 27** LOGISTICS TOOL KIT  
*Outsourcing – It's a Learned Skill,*  
*by Paul Ragan*
- 31** LEADERSHIP IN LOGISTICS,  
A QUÉBEC PERSPECTIVE  
*Logistics in Quebec, What's Up*  
*by Pierre Massicotte*
- 34** BEST PRACTICES  
*Who Cares if you Scored a Hat Trick in a 5-3 Loss?*  
*by Dan Carruthers*
- 38** EDITOR'S VIEWPOINT  
*What's Questionable,*  
*by Fred Moody*

Ideas for Leadership in Logistics



VOLUME 8 ISSUE 2, SUMMER 2002



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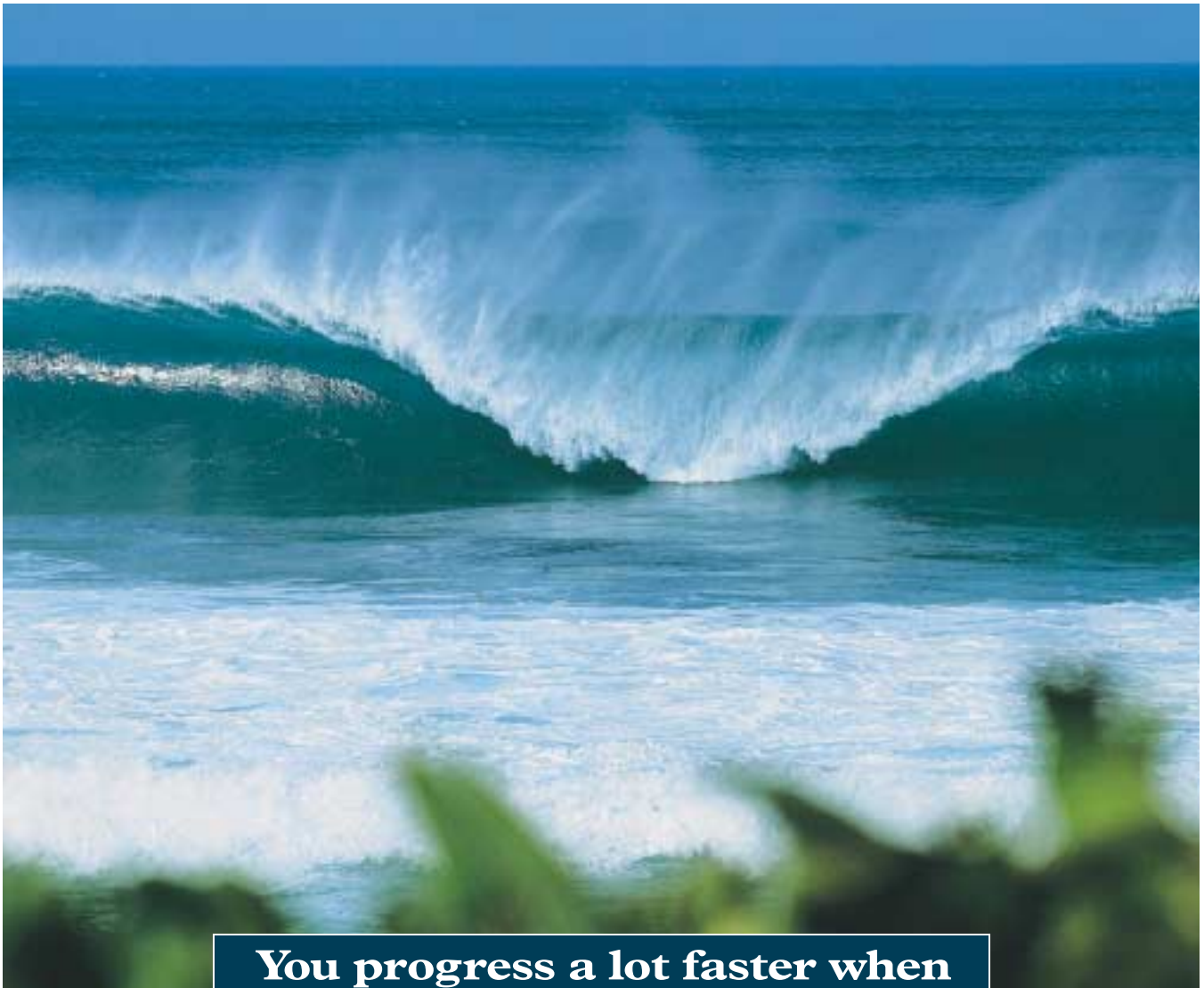
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Fred Moody,  
LQ™  
2 Bloor St. W.,  
Suite 100, Box 473,  
Toronto, ON, M4W 3E2,  
Tel: (416) 461-8355  
Toll Free: 1-800-843-1687  
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### Company and Organization Listing

Page numbers listed indicate the first page of the article in which the company and organization appears — or where there is simply a notation or credit to a company.

Abbott	32	Lyreco Office Products	19
Acklands-Grainger Inc.	23	Michigan State University	10
AST&L	10	Nadiscorp	9, 27, 28
Bestfoods	9	NHL	34
C.I.T.T.	23	Penn State University	10
Canada Customs and Revenue Agency	26	Professional Logistics Institute	32
Canadian Association of Importers and Exporters	26	Québec	9
Canadian Association of Supply Chain & Logistics	22	Reimer Express	9
CITA	11	Saint-Laurent	9
Council of Logistics Management	10, 11, 31	SAP	19
CTI	10	Saskatoon	9
Delfour	10	Schenker AG	9
Dell Computers	19	Schenker of Canada	9, 10
Deloitte & Touche	16, 17	Team Canada	34, 35
Drackett Company	10	Team U.S.A.	34, 35
FedEx Freight	9	The German Canadian Business and Professional Association	9
Gillette	32	TNT North America	10
Heriot-Watt University	23	Tronicus Inc.	25
Institut de formation en gestion du transport et la logistique du Québec (IFGTL)	31	U.S. Customs Trade Partnership Against Terrorism	26
International Intermodal Association of North America	11	Unilver	9
iWheels International	34, 35	Université du Québec a Montréal	31
Karcher Canada	9	University of Laval	31
Kimberly-Clark	32	University of Pittsburgh	19
Kroger	32	University of Toronto	18, 23
L'Ecole des hautes études commerciaux (HEC)	31	VWR Canlab	19
L'Oréal Canada	9, 32	WERC	10
L'Oréal S.A.	9	Winnipeg	9
Lipton	9	Yellow Freight Corporation	10
		York University	11

### Companies and Organizations with New PLogs

Companies referred to in LQ™'s New Professional Logisticians Section (pages 29 & 30)

3M Canada	Greyhound Canada	Richter Consulting
Acklands-Grainger	Transportation Company	Roxul Inc.
Bell Distribution Inc.	Highliner Foods Inc.	Shared Healthcare Supply Services
Caboodles Cosmetics Inc.	Hudson Bay Company	Sobeys Inc.
Canada Post Corporation / Northern Services	IBM	Sobeys Inc.
Canadian Tire Corp.	Irving Oil Limited	Telus Mobility
CHEP Canada Inc.	J.H. Bachmann Canada Inc.	Toyota Canada Inc.
City Cartage Systems	Jade Management Group	Trimac Transportation System
Coca-Cola Bottling Co.	KN Lead Logistics	Tronicus
Compaq Canada Inc.	KN Logistics, a division of Kuehne and Nagel Int'l	University of Toronto
DND	Livingston International	UPS (Canada) Ltd.
DND (FMF Cape Scott)	Loblaw Companies East Ltd.	Venmar Ventilation Inc.
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Galileo Canada	Nestle Canada Inc.	
Distribution Systems Inc.	Norfalco Sales Inc.	

### Advertisers

Companies listed in alphabetical order

BCG Logistics	33	TNT Logistics North America	2
Connetix	4	Tower Group	3
iWheels Logistics	35	Yellow	37
Nadiscorp Logistics Group Inc.	39		
Norman G. Jensen Inc.	32		
PBB	38		
SAP	40		
The Canadian Professional Logistics Institute	6		



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IBM-Canada Ltd.

### MAGAZINE

FRED MOODY  
Publisher & Editor  
fmoodym@LogisticsQuarterly.com

JON REID  
Senior Editor  
jreid@LogisticsQuarterly.com

VICTOR DEYGLIO  
CPLI President & Editorial Director  
vdeyglio@loginsstitute.ca

CHRISTINE HALLAS  
Copy Editor  
challas@LogisticsQuarterly.com

GREG SHANKS  
Creative Director  
gshanks@LogisticsQuarterly.com

BILL MCCARVELL  
Circulation Manager  
bmccarvell@LogisticsQuarterly.com

## industry news SUMMER 2002

### L'ORÉAL CANADA EXPANDING: MORE THAN 100 NEW JOBS AND A \$100M INVESTMENT Montréal, PQ

The Deputy Premier of Québec and Minister of State for the Economy and Finance, Pauline Marois, along with Jochen Zaumseil, president and CEO of L'Oréal Canada, and André Rémillard, senior vice-president, Finance and Administration of L'Oréal Canada, have announced major investments in the borough of Saint-Laurent. L'Oréal Canada is investing \$100 million in a plan to expand its production plant, its Canadian distribution centre and its consumer service and technical training centre. In doing so, the subsidiary will create more than 100 jobs over three years. Investissement Québec is injecting \$5.5 million in the project in the form of a reimbursable financial contribution through the Private Investment and Job Creation Promotion Fund (FAIRE).

According to the Deputy Premier, "As a business, L'Oréal has leveraged the exceptional conditions that Québec offers to the manufacturing and distribution industries. With our operating costs—which are among the lowest in North America—the active support of the government, and an abundant, qualified work force, we were able to convince the multinational to expand its operations here in Québec and to create 100 direct high-quality jobs. This is a concrete example of the positive effects of our economic policy."

#### Saint-Laurent manufacturing centre

L'Oréal Canada, a subsidiary of the French multinational L'Oréal S.A., is the largest cosmetics company in Canada and the only manufacturer of haircare products based in Québec. Chosen for the manufacture of professional haircolour products, the company's Saint-Laurent plant will double its production capacity in order to export to 15 countries. The plant will produce close to 150 million units a year notably for the Redken, L'Oréal Professional and Matrix brands. The plant size will increase from 135,000 square feet to 256,000 square feet, with construction of the building to be completed in May 2003.



### UNILEVER AND SCHENKER EXPAND PARTNERSHIP IN CANADA Essen/Toronto

#### 300,000 sq. ft. dedicated facility with leading technology tools

Unilever has awarded Schenker of Canada a long-term logistics services contract. This elevates Schenker's position as Unilever Canada's largest strategic logistics service partner. Under this agreement, Schenker will consolidate Unilever Canada's Lipton and recently acquired Bestfoods brands into a central strategic logistics center.

Don Cockburn, Director of Warehousing and Transportation for Unilever Canada notes: "Our two companies are entering into a long-term business relationship that we are confident will be successful." Schenker is managing the business at a newly constructed, state-of-the-art distribution center, located in Brampton, Ontario. The 300,000 sq. ft. dedicated facility combines strategic automation with leading technology tools to deliver optimal efficiency and quality. This is expected to deliver higher downstream value to Unilever's customers.

"This new business is another important step on our way of expanding our logistics services in North America, efficiently combining our experience in warehousing and distribution with our world-wide network," comments Schenker AG CEO Håkan Larsson. Schenker is a significant contract logistics provider in Canada. Heiner Murmann, CEO of Schenker Canada says: "The expansion of our relationship with Unilever is an important milestone for Schenker and strengthens our position as a leading integrated logistics solutions provider. Unilever shares our vision that a top performing logistics facility can be a strategic advantage. We are excited that they have selected our innovative solution."

Schenker of Canada is a leading integrated global logistics services company. Schenker's Canadian network spans coast to coast and has over 600 employees with more than 30 offices and locations.

With annual sales of Euro 6.1 billion, nearly 32,000 employees and approximately 1,000 offices around the world, the Stinnes subsidiary Schenker is one of the world's leading providers of integrated logistics services, offering land transport, air and sea freight

as well as comprehensive logistics solutions and global supply chain management from a single source.

### FEDEx FREIGHT'S RATES RISE Memphis, Tenn.

FedEx is implementing a 5.9 percent general rate increase effective July 22 this year. The rate increase will enable the company to make investments for better customer service, noted the company's press release.

The increase applies to FedEx Freight East and FedEx Freight West and covers intra- and interstate traffic, including Canadian transborder and other international lanes as well as minimum and accessoril charges.

"This increase is necessary to support and improve our technology offerings, service centres, equipment and safety and security programs," notes Dennie Carey, FedEx's senior vice president of marketing.

### THE GERMAN-CANADIAN BUSINESS AND PROFESSIONAL ASSOCIATION

The German-Canadian Business and Professional Association recently held an open house held in cooperation with the German Chamber of Industry and Commerce, with the evening hosted by Randy Klein, president of Karcher Canada Inc. Mr. Klein provided delegates with an insightful overview of how Karcher is growing in Canada through local Canadian marketing acumen coupled with European marketing savvy and outstanding cleaning products.



(Left to right): Jan Heck, president of Miele Canada, president of the Canadian-German Business and Professional Association, Randy Klein, President of Karcher Canada, Larry Rodo, senior vice-president, Nadiscorp Logistics Group Inc.

### REIMER EXPRESS DRIVERS AWARDED FOR EXCELLENCE Winnipeg, MB

Four Reimer Express drivers from Winnipeg, MB, finished first in their classes at Manitoba's Provincial Truck Driving Championships. As the provincial champions Gary Good, Denis Tqllaire, Trevor Mulder and John Novak will form part of the six-man team that represents Manitoba at the National Truck Driving Championships in Saskatoon, Sask on September 6-7.

# Announcements

## on the move SUMMER 2002

### NADISCORP LOGISTICS GROUP INC. EXPANDS ITS EXECUTIVE TEAM

Mr. Paul Ragan, president of Nadiscorp Logistics Group Inc. (NLGI), a Mississauga-based leading 3PL provider, is pleased to announce the following appointments:

**Darryl Bosmans,**  
*Controller*

Nadiscorp's new controller is a Chartered Accountant, a designation earned with Arthur Andersen LLP, and a graduate of the University of Windsor. Darryl comes from a national charity with experience in decentralized management. Some of his major accomplishments include the implementation of business unit reporting, as well as special program reporting. Darryl's responsibilities encompassed all facets of general ledger management, external reporting and maintaining banking relationships.

In his new role, Darryl will be responsible for day-to-day activity of the Finance Department, including payroll, accounts receivable, accounts payable and other general accounting operations. Darryl's new responsibilities also cover budget planning and reviewing, along with monitoring and analyzing company's financial information on a daily basis.

**Steve Sorge,**  
*Director Client Services*

Steve comes to NLGI after spending four years in the Inventory, Purchasing and Planning Department at Rogers Cable. Steve's chief achievements include reducing Rogers' investment in inventory and improving inventory availability by establishing strategic relationships. Steve earned his Chartered Accountant designation with Arthur Andersen LLP.

As the new director of Client Services, Steve leads the Front Office Group, managing the Logistics and Administrative Services departments, while overseeing the continuous improvement of existing operating practices and development of new value-added services. Steve will be responsible for identifying and performance measures as key indicators to determine overall operational effectiveness. He is also involved in project management concerning new client initiatives.

### LQ ADVISORY BOARD ANNOUNCEMENT

We are pleased to announce four colleagues have accepted LQ's invitation to participate on its Advisory Board. Please join me in welcoming:



**David J. Closs**  
*Department of Marketing and Supply Chain Management  
Michigan State University*

Dr. Closs, B.S., 1972; M.B.A., 1976; Ph.D., 1978, Michigan State University, is Broad Professor, Department of Marketing and Supply Chain Management, Michigan State University, has held several positions at Michigan

State University, from Assistant Professor (1978-1985) and Associate Professor (1988-1992), to Professor (1992-Present). He is the former Editor Journal of Business Logistics; Editorial Board, Journal of Business Logistics, International Journal of Physical Distribution and Logistics Management; International Journal of Supply Chain Management; Reviewer, Journal of International Marketing, Logistics Educator's Conference. He has consulted with a wide variety of Fortune 500 companies and presented Executive Seminars on Logistics Strategy, Forecasting and Inventory Management, Information Systems, and Logistics Modeling. His memberships include the Council of Logistics Management and Academy of Marketing Science. He has received several awards of excellence, including: Special Kearney Award, National Council of Physical Distribution Management (1977); Plowman Award (Best Paper) Logistics Educator's Conference (1982, 1983, 1998).



**Mark Morrison,**  
*Senior Vice President of Business Development,  
TNT North America*

Mr. Morrison has expanded TNT's customer base in the automotive, electronic, and tire industries as well as adding new business in the areas of retail, utilities, fast-moving consumer goods, and e-commerce.

Prior to joining CTI (now TNT Logistics North America) in 1993, Mr. Morrison served as the Senior Vice President of Inchcape Shipping Services, and as the Vice President of the Atlantic Division at Crowley Maritime. He is a member of the Council of Logistics Management and a mentor in logistics for the University of North Florida. He frequently contributes commentary for several leading trade publications and is a member of the TNT Logistics Development Board which focuses on connecting global customers and identifying and executing logistics best practices around the TNT world. Mr. Morrison received his Bachelor of Arts degree in Accounting from San Francisco State University.



**Robert Novack**  
*Associate Professor of Business Logistics  
Department of Business Logistics  
Penn State University*

Dr. Novack is currently an Associate Professor of Business Logistics in the Department of Business Logistics at Penn State. He received his B.S. in Business Logistics in 1977 from Penn State, an M.B.A. with an emphasis in Business Logistics in 1979 from Penn State, and a Ph.D. in Business Logistics in 1987 from the University of Tennessee. From 1979 to 1981, Dr. Novack worked in Operations and planning for the Yellow

Freight Corporation in Overland park, KS. From 1981 to 1984, Dr. Novack worked for the Drackett Company in Cincinnati, OH. His current research interests focus on the quantification of logistics value and supply chain performance measurement. He is the co-author of two textbooks: Transportation (with John Coyle and Ed Bardi), and Creating Logistics Value: Themes for the Future (with Lloyd Rinehart and John Langley). He has published numerous articles in the Journal of Business Logistics and the Transportation Journal, among others. Dr. Novack is a member of AST&L, CLM, and WERC.

**Michaela Radman**  
*Manager, Marketing & Tender Mgmt.  
Schenker International*

Ms. Radman's eight years experience in supply chain management includes transportation, logistics service procurement globally. She had spent the last four years of her career with a global leader in telecommunications, focusing on outsourcing/divestiture of various aspects of logistics operations, managing RFI, RFP, and RFQ process, and 3PL Global Management. She has recently changed careers with a current focus on Global Tender Management & Logistics Marketing for Schenker Stinnes Logistics.

### DELFOUR

John Harris recently joined Markham-based Delfour Corporation as the Executive Vice President of Sales and Marketing. In his new role with overall responsibility for business development, Mr. Harris reports directly to Delfour's president and CEO, Joe Couto. Mr. Harris joins Delfour with 18 years of experience in the application and service solutions industry, and most recently as a member of an executive turn-around team at World Gaming plc.

Incorporate in 1988, Delfour develops, markets and supports supply chain executive solutions and consulting services designed primarily to service 3PLs.

### Coming this Fall: LQ's Special Healthcare Report

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## upcoming events SUMMER 2002

### *July 2002*

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July 29 - August 2

**Supply Chain Network Optimization**

The Donald B. McCaskill Centre, York University, Toronto, Tel 416-360-8850.

### *August 2002*

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August 1-2

**Collaborative Business Planning and Operations**

The Miles S. Nadal Management Centre, York University, Toronto, Contact info at: 416-360-8850

### *September 2002*

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September 9 & 10

**CITA-ACTI North American Transportation Conference: Solving Today's Transportation Puzzle**

Toronto, Ontario, Westin Harbour Castle. For further details contact Sophie Tourangeau at (613) 235-2482.

September 12-13

**Information Technology Conference. Do you have IT? Practical Solutions for Today's Competitive Market.**

International Warehouse Logistics Association, Toronto, ON (Wyndham Bristol Hotel). To register or learn more about the conference contact: Donna Henderson at (847) 292-1891 or dhenderson@iwla.com

September 29 - October 2

**The Council of Logistics Management's 2002 Annual Conference, The Rules are Changing**

San Francisco, California, Contact: Tel: 630-574-0985, E-mail: clmadmin@clmi.org

### *November 2002*

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November 16 - 19

**International Intermodal Expo, Intermodal Association of North America**

Anaheim Convention Centre, Anaheim, CA. Contact: Connie Sheffield, 301-982-3499 Ext. 12

### *January 2003*

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January 27 - 29, July 2 - 4

**Healthcare Supply Chain Management**

Schulich School of Business, York University, Toronto. Contact Elaine Gutmacher, 416-736-2100 Ext. 22386.



# WANTED *Breakthrough to Greatness*

(THE FOLLOWING IS A CONTINUATION OF VICTOR DEYGLIO'S COMMENTS FROM THE BOOK *GOOD TO GREAT* BY JIM COLLINS ET AL.)

We plan strategies in terms of where, how and who: we first decide where we want to go (vision), design how to get there (process), and identify who's driving the bus (people). To go from good to great, Level 5 leaders reverse the thinking: they first got the right people on the bus (and the wrong people off the bus), and then figured out where to drive it. In effect, L-5 leaders are strategic thinkers, not just strategic planners.

## Order of Magnitude

There is a distinction between strategic thinking and strategic planning. All planning entails the "vision-process-people" template. Often, what distinguishes strategic planning from any other planning is the order of magnitude: the more far reaching the plan, the more strategic we call it.

All plans fall within horizons and all horizons are limits. Planning, *de facto*, limits our actions to the options determined by the vision looming on the horizon.

## Difference in Kind

Strategic thinking, on the other hand, is opportunistic, and is based on three truths:

- *Flexibility*: if you begin with "who," rather than "what," you more easily adapt to a changing world. If people get on the bus because of where it is going, and you need to change directions along the way, you also need to change the people. If they get on the bus

because of who is there, then direction doesn't matter, and change becomes part of the dynamic.

- *Self-motivation*: with the right people on the bus, the problem of "motivating and managing" dissipates.

- *Great people*: the wrong people suck the life out of vision. They are not motivated in themselves, and they demotivate other and sustain mediocrity.

L-5 leaders didn't assemble the right team to realize the strategic plan; they didn't do the strategic plan until they had the right people. Before vision, before strategy, before tactics, before organizational structure, before technology – assemble the right people.

## The Right People

L-5 leaders rejected the leadership model characterized as "genius with a thousand helpers." Instead, they created environments where hardworking people thrive and whose moral code required building excellence for its own sake.

In seeking the right people, good-to-great companies placed greater weight on character attributes than on specific educational background, practical skills, specialized knowledge or work experience.

## Rigorous vs Ruthless.

Transformation from good-to-great is not easy, and great companies are tough places to work in. But they are not ruth-

less cultures; rather, they are rigorous cultures:

- To be ruthless means hacking and cutting, especially in difficult times.

- To be rigorous means consistently applying exacting standards at all times and all levels.

The ultimate throttle on growth for any company is not markets, technology, competition, or products. It is the ability to get and keep the right people.

## Disciplines of Rigor

1. When in doubt, keep looking:

- No company can grow revenues consistently faster than its ability to get enough of the right people to implement that growth.

- If your growth rate in revenues consistently outpaces your growth rate in people, you simply will not – indeed cannot – build a great company.

2. When you know you need to make a people change, act:

- The moment you need to manage someone, you've made a hiring mistake. The best people don't need to be managed. Guided, taught, led – yes. But not managed.

- Strong performers are intrinsically motivated by performance

- Waiting too long before acting is unfair to the people who need to get off the bus. For every minute you allow people to continue holding seats when you know they will not make it in the end, you're stealing a portion of their life.

3. Put your best people on your biggest opportunities, not your biggest problems:

- Managing problems makes you good; building opportunities is the way to become great.
- When you decide to sell off your problems, don't sell off your best people too.
- If you create a place where the best people always have a seat on the bus, they're more likely to support changes in direction.

## A Great Life

If we don't spend the vast majority of our time with people we love and respect, we cannot possibly have a great life. But if we spend the vast majority of our time with people we love and respect – people we really enjoy being on the bus with and who will never disappoint us – then we will almost certainly have a great life, no matter where the bus goes.

## Breakthrough

"Greatness" demands disciplined people, disciplined thought, and disciplined action.

Disciplined thought begins by confronting the brutal facts. We fail to succeed when we divert our energy looking for the silver bullet that leads to instant turn-around... "the big breakthrough."

Yes, Virginia, there is such a thing as the "big breakthrough." Breakthrough results come about by a series of good decisions, diligently executed and accumulated one on top of another.

## Disciplined Thinking

The origins of disciplined thinking are brutal, and the process is difficult, but disciplined thinking should never brutalize. We begin by questioning everything, especially our assumptions.

We must leave our comfort zones to begin a journey along an unknown path with no clear destination. Frightening, but it's the only path to a real breakthrough.

As leaders we need to create a climate where truth is heard. Some suggestions:

- Lead with questions, not answers. Search for the truth; don't deposit it.
- Engage in dialogue and debate, not coercion. People shouldn't just have their say; who cares what most people have to say. People need the opportunity to be heard in the search for the right

answers to the right questions, no matter how raw the process.

- Conduct autopsies, without blame. Search for understanding, not a victim.
- Build "red flag" mechanisms. Turn information into "information that cannot be ignored."

Finally, apply the Stockdale Paradox (named after Admiral Jim Stockdale, Vietnam POW):

- Retain faith that you will prevail in the end, regardless of the difficulties, and
- Confront the most brutal facts of your current reality, whatever they might be.

## Insight

L-5 leaders cultivate insight that allows them to see through complexity and discern underlying patterns. They see what is essential, and ignore the rest.

In a direct reference to Chapter Five of *Good to Great*, I was once described as a hedgehog. When I first read the description of the hedgehog, I was a bit taken-aback:

The hedgehog is a dowdy creature, looking like a genetic mix-up between a porcupine and a small armadillo. He waddles along, going about his simple way, searching for lunch and taking care of his home.

It did not comfort my ego to contrast this description to that of the fox: a cunning creature, fast, sleek, beautiful, fleet of foot, and crafty. And the gales of laughter from Institute staff about waddling and searching for lunch provided no balm. A quick look in the mirror, however, gave rise to a chuckle of recognition.

Physical attributes aside, the ancient Greek fable of the Fox and Hedgehog is about the power of insight that derives from disciplined thought. The fable is about winning and losing, and losing is about becoming lunch:

The fox is a cunning creature, able to devise a myriad of complex strategies for sneak attacks upon the hedgehog. Day in and day out, the fox circles around the hedgehog's den, waiting for the perfect moment to pounce.

The hedgehog, minding his own business, wanders right into the path of the fox. The fox leaps out, bounding across the ground, lightning fast. Rolling into a perfect little ball, the hedgehog becomes a sphere of sharp spikes, pointing outward in all directions.

The fox sees the hedgehog defense and calls off the attack. Retreating back to the forest, the fox begins to calculate a new line of attack. Each day, some version of this battle between the hedgehog and the fox takes place, and despite the greater cunning of the fox, the hedgehog always wins.

The essayist Isaiah Berlin divided the world into foxes and hedgehogs: Foxes pursue many ends at the same time and see the world in all its complexity. They are scattered or diffused, moving on many levels, never integrating their thinking into one overall concept or unifying vision.

Hedgehogs simplify a complex world into a single organizing idea, a basic principle or concept that unifies and guides everything. It doesn't matter how complex the world, the hedgehog reduces all challenges and dilemmas to simple "hedgehog ideas." For the hedgehog, anything that does not somehow relate to the "hedgehog idea" holds no relevance.

Great hedgehogs from history: Freud and the unconscious, Darwin and natural selection, Marx and class struggle, Einstein and relativity... the essence of profound thinking is simplicity.

## Hedgehog Concept

All good-to-great companies attained a very simple concept that they used as a frame of reference for all their decisions, and this understanding coincided with breakthrough results. It isn't simply about strategy; it's about discovering the foundation of strategic thinking that flows from deep understanding about the following 3 things:

1. What can you be best in the world at?
2. What drives your economic engine?
3. What are you deeply passionate about?

Best in the world is not simply about core competence: Just because you possess a core competence doesn't mean you can be the best in the world at it. Even worse, if you cannot be best in the world at your core business, then your core business cannot form the basis of going from good to great. If you can't be best in the world at it, then why are you doing it?

Defining "best in the world" requires piercing insight and egoless

(PRESIDENT'S VIEWPOINT, *continued on page 32*)



# The competition for Capital

NEED MONEY FOR A NEW PROJECT? UNDERSTANDING HOW YOUR ORGANIZATION MAKES FINANCIAL DECISIONS CAN FACILITATE A POSITIVE OUTCOME.



Determining where to invest its capital is one of the biggest decisions an organization has to make. Ultimately, what's at stake is shareholder value. A positive return on capital can enhance shareholder value and, clearly, the converse is true.

Since there is typically a limit to how much capital is available in any one year, projects must compete to get the capital they need to go forward.

That is why it is so critical for every manager to understand how capital decisions are made in his or her company – and to have a clear picture of why some projects are approved while others are declined?

For logistics management, this is a particularly valuable knowledge base. Logistics projects are often complex, lengthy and costly. Providing financial decision-makers in your organization with an appropriate business case on your project – in a way that meets their needs – is critical to the success of your proposal.

## SOME REALITIES ABOUT CAPITAL

Capital is scarce – or is it? Capital is often referred to as a scarce resource. But let's look at this a little more closely. While capital is not unlimited, it's

not really scarce either. Pension funds and other investors are always on the look out for investments that provide a solid return.

A more accurate statement is the fact that short-term capital in any organization is finite.

Capital markets are efficient and allow for the pricing of a company's capital fairly easily. The cost of capital starts with a "risk-free cost" which applies to all companies. But this risk-free cost assumes that there is no risk in the investment. Since this is not the case with most investments, the market then provides an assessment of the risk in question and adds a cost associated with that risk to the risk-free rate.

Capital markets are global. Billions of dollars flow into and out of Canada annually. Investors make decisions to move capital around to accommodate a specific business need or to invest in a project that offers a solid return.

The number one goal is shareholder value. A company's key stakeholders include customers, suppliers, the community, employees and shareholders; but there is little doubt that most companies' number one stakeholder is the shareholder. When a company works to increase shareholder value and

obtain capital from shareholders, it can then effectively address the needs of other stakeholders.

In an effort to provide value, an organization needs to determine the primary goal of its shareholders. This can vary from an income goal where shareholders want regular ongoing income in the form of dividends to a growth objective where shareholders want to see to the share price increase.

Other shareholder goals can include safety where a lower return is acceptable in exchange for low risk investing; liquidity where stock can be sold quickly and investments converted to cash; or tax minimization where investment decisions are made in an effort to minimize tax implications.

Since it is virtually impossible to meet all of these shareholder goals within one organization, most companies will focus on selling their stock to a specific shareholder profile.

## WHERE A COMPANY GETS ITS CAPITAL

Simply stated, capital comes in two forms – debt and equity.

Debt capital includes such vehicles as bonds, loans and lines of credit. These are relatively low risk “secured” sources where debt holders receive their money before equity holders in the event the company declares bankruptcy. With this lower risk comes a lower return.

On the other hand, equity capital like common stocks, preferred stocks and a relatively new form of equity called income trusts comes with a high level of risk. If the company declares bankruptcy, the shareholder may receive nothing. In the case of common shares and income trusts, shareholders receive money only when the company makes a profit.

Most companies access both debt and equity sources for their capital requirements. Since debt capital is always cheaper than equity, a company needs to decide what the correct split

between debt and equity is for its particular situation. Once that split is determined, a company can calculate its cost of capital. Clearly, if the debt-to-equity-capital ratio changes, so will the cost of capital.

## THE LINE IN THE SAND

Cost of capital (see schematic) is one of the most important calculations a company makes. The cost of capital calculation or Weighted Average Cost of Capital (WACC) determines what the minimum required return on any investment has to be in order to pay for the capital.

If you are looking for capital allocation for a new venture, a new project or departmental expansion, it is critical that you understand your organization’s cost of capital. The hard reality is – if your project doesn’t deliver a return that at least covers the company’s cost of capital, it should never get off the ground.

Common arguments departments make when looking for funds are that the investment is “strategic” or that it is “critical to future growth” or it is “too difficult to measure the return.” In the final analysis, however, if you don’t work with the financial people in your

organization to measure what the true cost of capital is, including the return on capital for your project, you are doing your company and its shareholders a

## Financial Statements

### What they are and what they do

Within any organization, there are four key financial statements.

**THE BALANCE SHEET.** This document shows assets, liabilities and owners’ equity. Capital shows up in assets since it is used to pay for investments; it also shows up in owners’ equity since this is where the owners’ share investment is shown.

**INCOME STATEMENT.** Sometimes referred to as the P&L (Profit and Loss Statement), this is where revenues and expenses, and the resulting net income are expressed.

**RETAINED EARNINGS STATEMENT.** This document shows the profit or loss that is not paid out to shareholders.

**STATEMENT OF CHANGES IN FINANCIAL POSITION.** Here the company reports cash flow. Many organizations operate under the theory that “cash is king.” That being the case, this is one of the most critical reports. If you don’t have cash to pay suppliers, shareholders and employees, you don’t have a company.

## What is the Company’s Cost of Capital?

### Weighted Average Cost of Capital (WACC) calculation

$$\text{WACC} = \frac{\text{Debt Market Value}}{\text{Total Market Value}} \times \text{Debt Required Rate} + \frac{\text{Equity Market Value}}{\text{Total Market Value}} \times \text{Equity Required Rate}$$

**EXAMPLE: DEBT IS 40%, COST IS 9%.**

**EQUITY IS 60%, COST IS 15%.**

**WACC CALCULATION FOR THIS EXAMPLE:**

$$12.6\% = 40\% \times 9\% + 60\% \times 15\%$$

(COMPETITION, continued on page 23)



# Benchmarking your way to success

By *Nathalie Duchesnay*



*Benchmarking can provide your organization with a valuable measure of performance that is both qualitative and quantitative.*

Benchmarking is one of the most powerful tools a business can use to manage and measure profitability across the supply chain. Properly applied within the appropriate parameters, benchmarking can enhance your competitiveness, increase shareholder value and provide your business with a long-term strategic focus. It can also identify opportunities for improving key components in the supply chain and optimize the allocation of resources.

Deloitte & Touche has been conducting an annual benchmark study of North American food processors since 1993, analyzing financial results, tracking industry trends and comparing Canada's performance with that of the United States. Each year, the firm publishes the results of the study in a report, *Benchmarking for Success* that has become the industry's best-known scorecard.

Benchmarking can provide your organization with a valuable measure of performance that is both qualitative and quantitative. Benchmarking checks and refines tactical and strategic objectives and management's understanding of the business, and at the same time provides insights into the competition's strengths and weaknesses.

Benchmarking can also shed light on an organization's internal operations. It can identify breakthrough practices and innovations in areas such as technology, structure and measurement systems. It builds enthusiasm and commitment for change among

employees by creating a corporate culture that carries a sense of urgency, builds confidence and encourages challenging the status quo. Finally, it helps a business to focus scarce resources more effectively by showing the magnitude of opportunities available, supplying a framework for prioritization and providing input into the action planning process.

The process of benchmarking comprises seven steps:

1. defining the objectives;
2. determining the peers;
3. identifying measurements;
4. defining sources;
5. gathering data;
6. analyzing results;
7. and drawing conclusions.

The first four steps — defining the objectives; determining the peers; identifying measurements; and defining sources — are fundamental to the successful completion of the exercise and must be carried out during the planning and scoping phase. Let us look at each one of these four steps in detail.

## **Step 1 - Defining the Objectives**

You must first define the objectives you want the benchmarking to achieve. Do you want to measure profitability, efficiency or solvency, or do you feel the need to meet the benchmark or beat the benchmark? It is worth spending time on this part of the process because the ultimate

success of benchmarking will depend on how relevant your objectives are to your overall corporate strategy.

At the same time, the scope of the benchmarking process needs to be defined — it should be tied to the benchmark objectives you have chosen. To narrow the scope, you need to consider a number of questions. What are the geographical parameters: city, country or continent? In order to understand your industry's best practices, it may be necessary to move beyond your national borders. Are you interested in current information or historical, and if historical, how far back do you want to go? Do you want to discover best practices in your industry? Do you want to find the answers to tomorrow's challenges by learning about leading-edge industries or companies and applying those insights to your own business?

## Step 2 - Determining Your Peers

It is essential to choose the right peers or comparators for your benchmarking exercise. It may be that within your industry there is no suitable peer, and you may have to look to other industries to find an appropriate match. For example, a mid-size regional brewer might find that trying to benchmark against large international competitors and microbreweries leads to unsatisfactory results, whereas a more logical benchmark might be companies of a similar size in a somewhat comparable sector, such as the beverage industry.

How many peers do you need? While Deloitte & Touche compiled data from almost 150 North American companies for its 2001 *Benchmarking for Success* study, you can effectively benchmark with far fewer — even one peer may provide the results you require. Far more important than the number of peers you choose is the fact that they are wholly relevant to your objectives.

## Step 3 - Identifying Measurements

You may choose from a variety of measurements when you plan your benchmarking process. The seven most frequently used ratios fall into the areas of profitability, efficiency and solvency.

Profitability ratios indicate how successful the business is in providing a return to the owners.

**EBT On Sales** Earnings before taxes and extraordinary items, expressed as a percentage of net sales. This ratio is a key measure of profitability, which indicates how efficiently a company has been able to transform annual sales into earnings.

**Return On Assets (ROA)** Earnings before extraordinary items as a percentage of average total assets. This is a key profitability measure that can be expressed on a before- or after-tax basis. It reflects the percentage profitability being generated on the assets employed.

**Return On Equity (ROE)** Earnings before extraordinary items as a percentage of equity. This figure can be expressed on a before- or after-tax basis and is the ultimate indicator of the company's profitability.

**Return On Equity (EBITDA)** Earnings before interest, taxes, depreciation and amortization as a percentage of equity. This figure is used to assess a company's financial performance before debt burden and taxation. EBITDA is often referred to as operating cash flow, due to its exclusion of depreciation and amortization, which are non-cash expenses.

Efficiency ratios will indicate how well a company is using its assets and can help you evaluate how effectively it is managed.

**Gross Margins (GM)** Net sales less cost of goods sold, divided by net sales. This reflects how well production costs are managed and whether pricing policies provide adequate coverage of fixed costs to earn a profit.

Solvency ratios demonstrate a company's ability to meet short-term and long-term obligations, thus providing an indication of solvency or liquidity.

**LTD To Equity** Long-term debt as a percentage of total equity. This is an indication of the total amount of financial leverage employed by a company and is a key indicator of its capital structure.

**Total Debt To Equity** Total liabilities (long-term and current) as a percentage of total equity. This indicates how much

of a company's total liabilities are financed by creditors.

## Step 4 - Defining Sources

The final step in planning the benchmark process is to define the sources of information to be employed. These can include industry and analyst reports, online databases, professional associations, personal interviews, structured surveys, on-site observations and interviews with customers and suppliers.

Once you have successfully completed the planning and scoping phase, you must then proceed to gathering and analyzing data, and drawing your conclusions. It is critical that you take the information to the next level, asking yourself the questions: What does the information mean? What do you do? When do you do it? How do you do it? From that, you can develop your action plan.

Be warned, there are pitfalls to benchmarking. The benchmark may be unfocused because the scope is too broad. The data required may be unreliable or unavailable — for example, selected peers may have different business models. Lack of qualitative data or best practices may result in a focus on numbers rather than concept during the analysis stage. In addition, there may be a lack of commitment to benchmarking by management and a failure to draw up an action plan after the process is complete.

If, however, you follow the steps outlined in this article, you will find benchmarking enhances your profits and shareholder value, provides guidance with your strategic planning and resource allocation, and improves your corporate confidence and culture.

*NATHALIE DUCHESNAY is a manager, specializing in strategic planning, at Deloitte & Touche. In addition to serving clients in the manufacturing industry, she has conducted many industry studies on productivity, such as Benchmarking for Success, a review of North American agri-food companies that compares Canadian and American performance.*

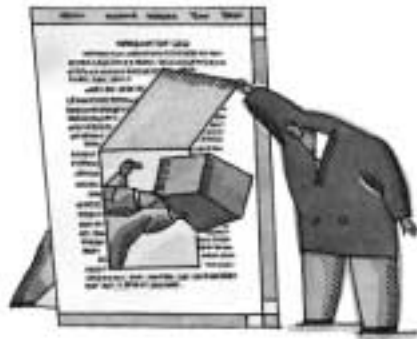


By Stephen Whittaker

## Leading Edge

# Logistics Technologies Advancing Research

at the University of Toronto



**A** research university is probably among the last areas one might think of as a hotbed of opportunity for new logistics technologies. In the case of University of Toronto, eProcurement is poised to revolutionize the business processes that today impose tremendous barriers to effective use of research and teaching resources.

It is a widely held truth that for research to occur those engaged in research need the freedom to acquire products from any source they can find to meet their objectives. This is commonly referred to as 'academic freedom of choice.' This principle poses enormous challenges for universities faced with the need to balance empowering researchers while containing the administrative demands such an open framework creates. For the researcher (or Principal Investigator) on a day-to-day basis, empowerment can be a two-edged sword. Once the realm of central administration, researchers in decentralized institutions

have had to become skilled in sourcing, negotiating and expediting while developing expertise in accounting, import, customs and supplier relationship management. In a large, complex institution like UofT the result often is myriad homegrown business processes or 'shadow systems' designed to

meet parochial needs. The impact of this state of affairs is daunting.

An internal feasibility study uncovered some sobering facts. Highly skilled laboratory technicians, trained and employed to support principal investigators in their research, were spending as much as 40% of their time on procurement activities. Similarly, business officers, whose core responsibility is to provide budgeting and financial management support to principal investigators and their funding bodies, were occupied 30% of the time with procurement activities. Add to this the knowledge that off-contract spending was costing millions in lost discounts and the course of action was clear. A solution had to be found to drive down process costs and increase productivity by enabling our researchers to invest more time and dollars in their research and teaching. While containing product costs had always been a concern, finding a solution that enabled researchers to do more research and their support staff to more effectively support that research became our primary driver.

Solution alternatives were plentiful as were the business models. UofT has had a successful purchasing card program for a number of years. Unleashing the masses armed with pCards and access to Internet shopping appeared to be a quick solution but was not enough to meet the needs of such a diverse and complex organization. The ultimate solution had to have the potential to become the purchasing channel of choice. This meant optimizing the end-user experience and by 'end-user'

*To achieve this goal,  
the ultimate system had  
to be easy to use with a  
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financial systems.*

our definition had to include every function that touched the process from shop to pay.

To achieve this goal, the ultimate system had to be easy to use with a broad, deep product offering, fully integrated with the university's financial systems and with the flexibility to tailor business rules to locally defined standards. The sole absolute that would render a solution unacceptable was in the area of costs passed along to the end-user. In this era of continuing budget cuts, universities need to leverage every opportunity to stretch financial resources. Therefore any business model based on transaction fees or subscriptions would not gain the broad acceptance that would be necessary for the viability of the system.

A number of options were explored including 3rd party catalogue aggregators, eMarketplaces and in-house solutions. Most solution providers heavily promoted the product cost savings that their systems would make possible by way of curtailing maverick spending. We felt that while this was attractive in its own right – the ROI forecasts suggested that ANY solution would be better than nothing – the proposals did not adequately address the end-to-end process improvements we believed represented the real benefit. Virtually all proponents claimed their products capable of being integrated with our ERP system and therefore take us the rest of the way through the purchase cycle, but few if any had actually done it or could reasonably estimate the cost of doing so.

Ultimately the University decided in favour of developing a supplier portal based on Enterprise Buyer Professional, an eProcurement module of SAP the university's ERP system. This option had a number of appealing characteristics. For the university there would be no new intermediaries added to the supply chain that would have the potential to add cost to the process or cloud the business relationship. This strategy had great appeal for suppliers also, which we felt was critical. We recognized early on that

significant cooperation and commitment of our suppliers would be necessary to ensure a successful project. Using a portal strategy we would leverage the investment suppliers had already made in eCommerce infrastructure limiting the need for any additional investment to developing electronic document exchange functionality for the purchase order and invoice.

We saw a number of other important benefits to the portal strategy. Financially and strategically this approach represented the lowest risk. We were able to limit financial risk by implementing a pilot with limited users and suppliers. This enabled us to proceed cautiously with frequent consultation with stakeholders. Up front investment was limited to software licenses and consulting services where we were careful to ensure that supplier enablement skills were transferred to our internal development staff. In this way we were able to work closely with a pilot group of end-users and with a few

*At the time of this writing, UofT has engaged several suppliers including VWR Canlab, Lyreco Office Products and Dell Computers.*

suppliers to identify specific functionality preferences and requirements with a manageable working group. The objective of the pilot was twofold; to ensure that the final product released to the general population would meet key functional needs, and to develop a supplier enablement template that would allow us to engage a critical mass of suppliers at a brisk but controllable rate.

At the time of this writing, UofT has engaged several suppliers including VWR Canlab, Lyreco Office Products and Dell Computers. Users are able to shop at one or all suppliers in a single 'shopping excursion.' Principal Investigators are able to designate Lab Technicians or other support staff to purchase on behalf of the lab with spending limits or

commodity restrictions, as he/she deems appropriate.

## The eProcurement Process

At the start of a shopping excursion the user is presented with a familiar web interface. With a single authentication the user has access to all of the suppliers in the portal, each of which presents the user with UofT contracted pricing and the suppliers' lead times. Based on the commodity or end-use of the product as indicated by the user the system tags each line item with the correct tax applicability code. The 'backend' system routes electronic shopping 'carts' to predefined approval authorities and verifies that the research accounts have the funds available to commit the purchase. Once these checkpoints are passed, the SAP system transmits purchase orders to the suppliers' ERP systems where orders are queued for fulfillment. When the goods are shipped, the supplier transmits an electronic

invoice where it is parked in the university financial system. Finally when the goods arrive the end-user acknowledges receipt in the system, a process analogous to checking a packing slip. At this point the system has the information required to attempt a 3-way match of PO, Goods Receipt and Vendor Invoice. Upon successful 3-way match the system queues the invoice for payment via electronic funds transfer, completing the purchase cycle.

## What have we accomplished?

The process for the Principal Investigator is dramatically simplified. Shopping is reduced to 'point-and-click.' They no

(LOGISTICS TECHNOLOGIES, *continued on page 23*)

BENEFITS OF APPLYING

# Activity Based Costing

IN A DISTRIBUTION  
NETWORK



By Dale Ross



*In many warehouse operations labor costs represent the largest single cost component and can be as high as 60% or more of the total budget.*

There has been considerable literature on Activity Based Costing (ABC) in the last 10 years. For those who are unfamiliar with this methodology a good place to start is to review the publications of Narcyz Roztocki of the University of Pittsburgh.

Activity Based costing in its simplest form is an accounting technique that allocates costs to products and services based on the activities of these products and services. It is one of several accounting methods that have been used over the years. Traditionally costs have been allocated based on an organizations structure, budget accounts or by some method of applying direct and indirect costs.

Many believe, including the author, that ABC when used correctly can provide a "truer" cost of the product or service provided to the end user. This is important as it will help to identify which products and services make/lose money and by how much. It also improves the strategic decision making process especially by identifying opportunities for both cost and price improvements.

Traditional costing systems tend to be based on historical information allocating overhead (logistics) usually on a volume-based measurement. ABC applies resource use directly

to the output based on the actual work related activities that are required to produce the output with limited arbitrary allocations of indirect or overhead costs. The objective is to make indirect costs direct by tracing all expenses by an activity.

The objective here is not to debate the different accounting methods that are used to allocating costs but to show how ABC could be used in a distribution network. There are far more qualified individuals who have debated these issues in the trade journals. Each method has their advantages and limitations. It is sufficient for the purpose of this article that we agree that ABC when "properly applied" will provide a different picture of the actual cost of a product or service that may be more accurate than traditional accounting methods.

Current literature typically uses a manufacturing example to illustrate the possible results of using the different cost allocations. Traditional accounting allocates overhead normally by volume. ABC by measuring activities can focus on cross-functional processes that can help to identify non-value-adding activities and pin point the true drivers of cost at each stage in the process. The result is a more refined system of allocating overheads to products according to the demand by each activity. This focuses management's attention on the underlying causes of cost.

This is especially important for logistics practitioners who want to show the direct impact of logistics costs to the bottom line. It emphasizes the importance of measuring the key performance indicators because "What gets measured gets done." ABC improves the transparency of costs arising from many distribution channels and helps to identify the real profitability of market segments.

There are several misconceptions about ABC. First it is not a software package but a costing methodology that can be supported with a software package. This can improve the results by enforcing a proven discipline to the over all process. Second, many believe that ABC calculates "true" product costs and will result in better business performance. In reality ABC can provide a more accurate estimate of cost information but how it is used is still up to the manager.

For example, it is possible to impact sales and profits of an organization by identifying a more accurate price value relationship for products and services. Firms that use gross margin pricing many not be competitive in the market place because they are over charging for certain items. Conversely they may not be charging enough for other items which are utilizing scarce resources that could be reallocated to provide more profitable services that were not previously identified.

One of the issues with applying ABC is the level of effort required to implement a meaningful system. You must identify the key activities to be measured, the cost for these activities and than determine the cost drivers for each one. This can be time consuming and the data collection substantial. Too many activities and the results may not be worth the effort. Not enough and the accuracy may be suspect. Finding the proper balance is key to success.

Due to the complexity involved many organizations engage costly consultants and/or expensive software packages. These will certainly improve the result but in many cases are unnecessary. Some times it is better to be approximately right than precisely wrong. There are several ABC models available for measuring the costs of operating distribution networks. Those designed by accountants tend to be overly complex and have too many variables that do not add value to the process. Many logistics practitioners on the other hand are not sufficiently comfortable with the financial systems to be able to determine what are the key measurable cost drivers. A situation tailor made for hungry consultants.

Typical efficiency measurements of a distribution operation are cost per case, cost as a percentage of sales, cost per ton, cost per mile, etc. These are all valid and effective in managing the day to day operations and are necessary to maintain good cost control. What we also need for the strategic managing purchases are the costs to service specific customer, handle each product and service and ideally the cost by customer and product.

A simplified model that is currently in place tracks only three basic activities, order processing, selection of orders by customer and shipments of orders. This model was designed for a specific company but has been used elsewhere with some success. While it does not measure sufficient variables to ensure that all costs are allocated correctly it is directly accurate and will provide data that can improve the decision making process.

Let's start with order processing. We all recognize that handling a customer order requires resources, time and equipment even if automated. The more orders the more resources needed to handle the volume. A simple method

of identifying this cost is to divide the total cost of the order processing process department by the number of orders handled. The order-processing department can include customer service including the warehouse order coordinators and some informational technology. This has been estimated from anywhere from \$50 to \$125 per order. We will assume \$50 for this exercise, which is probably low.

In many warehouse operations labor costs represent the largest single cost component and can be as high as 60% or more of the total budget. Typically, selection of orders is the largest component of the total labor cost. By measuring this activity it is possible to allocate costs to specific orders. The key insight is to identify the single most important activity in the operation and than meas-

*The objective of this article is not to provide a definitive model for applying ABC but to show how some companies have tackled the issue...*

ure it. This activity will vary by operation and as will be elaborated can be refined.

The model was first developed using a manual process by capturing a random sample of orders and measuring the actual time to select each one. The next step was to perform a regression analysis on the data testing the hypothesis that there is a direct relationship between order size and productivity rates. The cost allocation for each selection hour was estimated by dividing the total warehouse costs by the total selection hours, which we will assume, is \$100 per hour. The result was the following productivity table:

Scale	Cases/Hour	Cost Per Case
<10	30	\$3.33
11-30	60	\$1.67
31-200	80	\$1.25
201-300	100	\$1.00
301-450	120	\$0.83
451-550	130	\$0.77
551-700	140	\$0.71
701-1000	150	\$0.67
>1000	170	\$0.59

Costs can now be allocated to each individual customer order by adding \$50 for order processing and than an appropriate cost for order size using the table above. This can all be accomplished using spreadsheet software. In reality this process was further refined by sub dividing the warehouse operation into clearly distinct departments. In this case it was dry grocery, dairy, produce, frozen and repack. Productivity tables were developed for each department using the same technique. Eventually the process was automated using engineered labor standards.

Allocating transportation costs can be relatively simple if you are using common carriers or it may be necessary to become more creative if you are using your own fleet. Common carriers typically charge by weight using a tariff by

shipping lane. Accessory charges are also isolated by invoice and can be allocated by customer.

In this model it was necessary to allocate the costs for an in house fleet. This was accomplished by allocating costs based on drive time and unloads times to each customer. Similar to the warehouse, a cost for operating hour was calculated by dividing the total operating costs for the fleet by total drive and unloads times based on engineered standards. Where less than trucks load orders shared a vehicle costs was allocated by cube utilization as we normally cubed out before weighting out.

A similar model can easily be developed for allocating the logistics costs for an individual product. The key activities to measure are receiving, storage, selection, loading, transportation and an over head allocation. Productivity standards can be developed for receiving product based on cases per hour and the method of receiving such as "hand bombing," pallets, etc. The hourly costs for the receiving crew, which normally includes the put-away function, can be estimated including the equipment. A cost per case is than calculated for each individual product. The process for loading trailers and allocating these costs is the same as the receiving exercise.

A simple method of allocating selection costs, at least initially, is to divide the total direct selection labor costs by the total cases selected resulting in a cost per case. A further refinement of dividing the warehouse into functional department similar to the first model described earlier is highly recommended.

An issue that needs further discussion is the location of the product in the warehouse and the potential affect that this could have on the cost allocation. Efficiency operators attempt to minimize travel time by locating fast moving items close to the receiving/shipping doors. This can reduce the handling time and ultimately the cost allocation for these items. As a general rule management decisions that can favour the cost allocation for an item over another should be avoided in the calculation. The costs should be socialized such as in the selection process described above. This avoids arguments above the placement and handling of products that could favor one item over another that does not support maximizing the overall cost effectiveness of the total operation.

The allocation of storage costs normally creates some healthy debate. It involves two components, a cost based on the value of the product as well as physical storage. It also has the added complexity of wanting to allocate the costs by sales units. Costs such as insurance, over, shorts and damages and the cost on money are determined based on the value of the product. We are assuming that the cost of money is the actual costs of borrowing from a financial institutional or prime plus 1%. It could be argued that we should be using the opportunity cost of money or the companies hurdle rate as inventories are an investment against risk and should complete with other capital projects.

The following table will help to calculate the allocation of these costs.

Inventory Turns	Case Value		
	\$5.00	\$20.00	\$40.00
10	\$0.049	\$0.197	\$0.394
20	\$0.025	\$0.099	\$0.197
30	\$0.016	\$0.066	\$0.131
40	\$0.010	\$0.039	\$0.079
Variable	9.86%		

Assuming that the cost of carrying this inventory is 9.86% of the inventory value it is allocated over the sales units by the cost of the value of the individual unit divided by its inventory turns. (E.g. (9.86% \* \$5.00)/10= \$0.049)

Similarly the physical storage costs need to be allocated over the total sales units. This includes rent, hydro, labor, physical labor, repairs, equipment etc. To simplify this exercise the value of physical storage can be calculated as what every is remaining after the previous allocations, excluding the cost of money which is not normally included in the warehouse budget. This would include over heads and provides a method of allocating this variable by a key activity. The cost per cubic foot is the result of the remaining physical storage value divided by the total actual cube of the inventory not the cubic capacity.

The following table shows some possible calculations.

Inventory Turns	Case Cube		
	0.10	0.50	1.00
10	\$0.048	\$0.241	\$0.481
20	\$0.024	\$0.120	\$0.241
30	\$0.016	\$0.080	\$0.160
40	\$0.012	\$0.060	\$0.120
50	\$0.010	\$0.048	\$0.096
Variable	\$4.81 Cost Per Cubic Foot		

Assuming that the annualized cost per cubic foot of storage space is \$4.81 than a case that is 0.10 cubic foot and turns 10 times will cost \$0.048 per sales unit. Transportation is the only remaining activity and is allocated the same as in the first model. The final allocation by each unit is the sum of each of these activities. The third model cost by customer by product has yet to be developed but is believed to be feasible and may have already been completed by some enterprising logistics practitioner.

The objective of this article is not to provide a definitive model for applying ABC but to show how some companies have tackled the issue and to encourage debate on the subject. Supply chains in almost all industries are under increasing pressure to become more efficient and cost effective. Knowledge of the 'true costs' of a product or service (which includes all handling and distribution costs) is an essential tool to effectively embark upon supply chain management initiatives.

ABC is a useful tool that provides a means to measure and control key strategic priorities to reduce costs and develop economic incentives to encourage the end user to pull products through the distribution network improving the over all efficiency of the supply chain.

*This article is a summary of a recent presentation made at the Canadian Association of Supply Chain & Logistics Management 35th Annual Conference in May of this year.*

DALE ROSS is Vice President, Logistics/Commercial, Effem Inc.

disservice. Simply, your project should not go forward.

## TOOLS TO SUPPORT THE CAPITAL INVESTMENT DECISION

Assuming the cost of capital is the starting point for any investment decision, there are a number of different tools that can be used to assess the profitability of a project, or a company for that matter.

**Leasing.** The lease versus buy decision is one of the more common tools. It looks at a particular asset and assesses whether it is better to tie up your own capital (buy) or use that of the supplier's (lease).

**Present value.** This tool looks at a stream of cash inflows and outflows over a period of time and brings that stream to present time using a discount rate to see the value of the project. Present value can also be used for capital budgeting. The discount rate then becomes the "hurdle rate" which determines the cost of capital on the project and whether it creates shareholder value.

**Internal rate of return.** In evaluating a project's capital return, this tool uses a present value dollar amount to determine a percentage

return. This percentage can then be compared to other projects and a priority list, based on the highest return, can be established. In this way, a company can maximize returns by focusing only on the most profitable projects.

**EVA (Economic Value Added).** Looking at individual projects (or a company as a whole), this tool determines whether the project is profitable and adding value. It measures the cost of capital employed less the operating profits. If the remaining number is positive, the project is adding value.

## GETTING TO YES

Given that the amount of capital available at any point in time is finite, getting the go-ahead can still be difficult even when a good return on capital exists. Remember, the overall goal is to maximize shareholder value. Different companies may allocate capital in different ways – by department, by region, by project level – or simply, across the organization as a whole. Whatever the allocation method, only those projects that are profitable should make the short list. From there, selection becomes a relatively simple process of

approving projects starting with the most profitable down to the least profitable – until the money runs out.

This can mean a profitable project doesn't get approved. But the final arbiter should always be maximum return on investment.

Projects that are argued on "soft" costs or emotion don't even make the short list.

If you want your project to succeed in the "competition for capital," make it a point to understand your company's goals and objectives, its approach to finance, what its goals are for delivering shareholder value and what profit means to your organization.

Partnering with the financial group in your company and recognizing the hard reality of return on investment are essential steps if you want to get your next project on the approved list.

**DOUGLAS HARRISON** is President of Acklands-Grainger Inc., the leading distributor in Canada of industrial, fleet and safety supplies, with 200 branches from coast to coast. Mr. Harrison is a graduate and member of C.I.T.T., and a member of the Canadian Professional Logistic Institute. He holds an MBA from Heriot-Watt University in Edinburgh, Scotland.

longer need to be concerned with budget over-runs, applying the correct sales tax or getting the contracted price.

For financial managers detailed, real-time information, elimination of budget risk and clear audit trail puts an end to the days of the paper chase and shuffling funds between accounts to cover over-drafts.

Central Procurement departments have consumption reporting at a granular level of detail that was once the stuff of dreams. eProcurement is seen as the dawning of an era of supply base de-fragmentation.

For the university's supply partners the opportunities come in the form of increased market share and reduced cost of doing business; two essential factors in

driving down product costs for end-users. The eProcurement environment also enables suppliers to get closer to the consumer facilitating communication and collaboration.

## Where do we go from here?

The most important next step for the university is to attain a critical mass of suppliers that will maximize the utility of the system for the community. But there are opportunities well beyond the supplier Pareto point. As an internal tool it won't be long before our building maintenance crews are equipped with wireless devices enabling them to access the system from any work site on campus to order repair parts.

Leveraging eProcurement through integrating it with our student registration systems hold tremendous promise to make life easier for students. Soon it will be possible to enable students to order the text books prescribed by the courses selected and have them delivered to their home or campus residence. Ditto for personal computers that need to adhere to university technical specifications.

In essence, we are only bound by the limits of our imagination. One thing is certain. eProcurement at the University of Toronto is just the beginning of a process that will revolutionize the way academia and the business world engage.

**STEPHEN WHITTAKER, P.Log.** is Director of Procurement Services, University of Toronto

# VALUE CHAIN STRATEGY:

## SECURING A COMPETITIVE ADVANTAGE

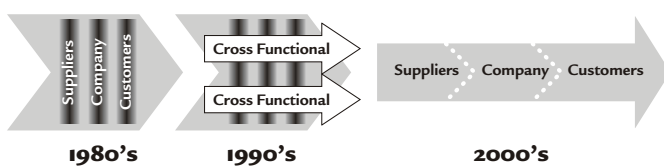


by Sean Watson



Businesses are increasingly establishing competitive advantage by re-engineering their value chain. Value Chain re-engineering requires a new approach to capturing value, modelling and designing business process and rules, implementing technology-powered processes, and executing the new vision on an inter-enterprise basis. As companies assess their value chain requirements, they should ask themselves if they have the necessary control to influence change over the value chain, and the right people, processes and technologies to undertake the initiative?

### VALUE CHAIN EVOLUTION



*New and re-emerging pressures are evolving the value chain into an integrated and responsive performance system*

### CURRENT VALUE CHAIN PRESSURES

- **Market Pressures** – Globalization, Cost Pressures, & Local Responsiveness
- **Business Pressures** – Core Competency, Market Strategy (Domestic or Global), New Competitors/ New Business Models, and Outsourcing
- **Operations** – Scope, Flexibility, Customization, Supplier Responsibility,
  - Across all organizational areas there is the pressure to reduce costs and increase performance.

### VALUE CHAIN MODEL

Given today's technology enabled environment, the value chain has the capability to match supply with demand at every level. Instant information access, visibility and control have transformed traditional intra-enterprise business focus to one of inter-enterprise. As organizations drive shareholder wealth by concentrating resources on core activities, the vertical integration of many participants in the value chain becomes critical.

Once again, opportunities derived from vertical integration are before us. As business processes weave together across organizations, functional work units are removed through streamlining and inter-enterprise economies of scale are achieved. That said, the traditional notion of vertical integration is vanishing. Vertical integration is no longer an asset-based advantage - it is an information advantage. Companies will not purchase every process in their value chain; they will form a seamless process through strategic alignment. The new Henry Fords will be those companies that recognize their symbiosis with trading partners and collaborate for both functional and financial advantage. Strategic collaboration provides the basis to control the value chain and sustain competitive advantage. It is foreseen that the new form of business competition will not be on the basis of product or service, but on the basis of value chain superiority. Companies that have products and services available when required, at prices that reflect the value they create, will define their marketplace.

### ASSESSING

With this emerging business climate, traditional intra-enterprise modelling techniques have become inadequate.

To achieve the benefits that inter-enterprise collaboration promises; new methods to test scenarios along the value chain are required. Simulation technology allows businesses to weigh the impacts of re-engineering on all value chain stakeholders before allocating capital and resources. These technologies identify the benefits (and costs) applicable to all parties involved in the proposed value chain reengineering. Performance metrics for all parties across the value chain are established and accounted for, with a new inter-enterprise balanced scorecard. Once the new network is designed, optimization technology allows for constant recalibration of key variables such as capacity changes or exchange rates.

### THIRD PARTY PERSPECTIVE

To counter the change management challenge, 3rd party involvement can be a strategic benefit. Armed with a balance of people, process, and technology, a 3rd party delivers best-practice expertise. A 3rd party serves as an objective integrator, acting as a liaison and a confidential unbiased decision advisor among the businesses involved. Through business process outsourcing, an 'objective integrator' approach reduces the financial and organizational risk that can accompany cross-enterprise business process re-engineering, ultimately delivering the modeled value to all parties.

### NEW 'BALANCED' SCORECARD

ORGANIZATION/STAKEHOLDER(S)	ACTIVITY/PROCESS	KEY PERFORMANCE METRICS	GOALS
<b>MAKE</b> • Production • Suppliers	• Raw Material Utilization • Production Labour Costs • Supply & Demand Matching	• Raw Material Waste • Overtime • Order Fill Rates	• 1% Waste • 5% of Wages O/T • 95% Fill Rate
<b>MARKETING/SALES &amp; CUSTOMER SERVICE</b>	• Customer Service • Revenue Enhancement • Cycle Time	• Customer Satisfaction Survey • Repeat Orders • On Time or at Time	• Increase in CSI • % Increase in Repeat Orders • % OT AT
<b>MOVE INBOUND &amp; OUTBOUND</b> • Service Providers	• Raw Material Costs • Logistics Costs (Inbound & Outbound) • Labour Costs	• LTL Costs • Expedite Costs • Accessorial	• Less Than 2% For LTL • Less Than 1% For expedite • 1% of COGS For Accessorial
<b>BUY</b> • Customer	• Receiving • Stocking to Demand	• Dock Labour • Inventory Carrying Costs	• 5% Reduction in Dock Labour • 10% Reduction in Carrying Costs

### IMPLEMENT & OPERATE

Creating a model and developing a new measurement scorecard is only part of the puzzle. Modelling calculates metrics and showcases optimal network opportunities, but it does not deliver value. The output of the modeling exercise, or the new network design, must be implemented, operated and sustained. Properly executed, the predicted value can be achieved across the value chain, matching the balanced scorecard. Designs based on the modeling effort are not easily implemented cross enterprise. In the past many supply chain activities were conducted in-house with functional success. As the supply chain focus extends to the greater value chain, change management issues arise and there is a need to consider alternatives for taking control and influencing change. The value chain typically encompasses several business and service partners, posing the challenge of integration and collaboration across cultures. Collaboration provides a new set of implementation challenges, as the full participation of other value chain stakeholders is essential - to realize the potential benefits modeled and deliver to the value chain balanced scorecard.

### ON THAT NOTE

Results speak for themselves. Companies are beginning to realize value chain benefits through the use of an integrated approach. Businesses are also discovering the capital and organizational freedom that a holistic 3rd party service provides as they do not have to invest in expensive technology and processes. Inter-enterprise economies of scale are delivered through the alignment of common supply chain functions such as demand forecasting, procurement, and logistics with other partners throughout the value chain. The ultimate output is competitive advantage; the longer and more complex the string of business processes, the harder it is to transform them into a competitive advantage. Once integrated, value chain re-engineering can provide differentiation and cost efficiencies that are difficult for competitors to imitate.

*SEAN WATSON is a Business Development Manager at Tronicus Inc., a 3rd party supply chain management provider. Sean has a track record of creating valuable supply chain strategies and solutions for major corporations.*



# What are *your* Customs Strategies?

Over the last couple of decades modes of transportation and logistics strategies for getting goods from origin to destination have vastly improved. New markets around the world have opened up and goods are literally now being sourced from around the globe. Companies have subsequently profited and ultimately the end customer has benefited as well. Through the use of advanced technologies greater efficiencies have been gained in the movement and tracking of goods. One area, however, that has historically received little attention in the overall scheme of supply chain strategy has been customs. The integration of customs in the overall supply chain has never been more important than it is today.

The terrorist attacks of last September have not simply faded to the back pages of history books. There still remains

a grave concern by governments that a company's supply chain could be used for a terrorist's purposes. Therefore, Customs authorities in Canada, the United States and elsewhere around the world are tightening the controls over what crosses its borders. As Canadian

companies continue to source their goods from more and more countries abroad the need for a company to have a well planned in-house customs strategy is critical to its success in this new world of international trade.

In a previous article I had highlighted the direction that the Canada Customs and Revenue Agency (CCRA) was taking. This direction was towards an environment where Customs data would have to be provided to the CCRA electronically on a pre-arrival basis. Depending upon the mode of transportation, the goods would have to be reported for admissibility to Canada from a couple hours prior to arrival to a couple of days prior to arrival of the goods. Whether this new requirement will or will not be an issue to a Canadian importer will depend upon a number of factors and some of the key factors will be who your supplier is, where they are located and whether their processes meet the new CCRA requirements.

In Canada, the CCRA has had a Partners in Protection program for a number of years now. This program had

been created to curb illicit trade and had received the buy-in and support of a number of commercial carriers. Whether this program now gets modified to more closely resemble the U.S. Customs Trade Partnership Against Terrorism (C-TPAT) program remains to be seen. Why the concern? Well, under the U.S. C-TPAT program an importer in effect agrees to having their supplier comply with the security requirements laid out in this program. It may be a challenge for large multinational corporations to place these new security demands on their offshore suppliers but it may be an almost insurmountable challenge for some smaller and mid-sized Canadian companies to exact those kinds of requirements of their offshore suppliers.

Whether your offshore suppliers can provide customs data to you electronically will be one question but whether your international suppliers are willing and able to meet CCRA's new requirements in order for you to be able to demonstrate to the CCRA that you are a good corporate citizen and that your goods are secure will be a totally different question. Effective integration of a company's supply chain partners has historically always been problematic and a challenge but this new world of increased security will start putting demands upon your international suppliers which they will not likely be able to meet.

*The terrorist attacks  
of last September  
have not simply faded  
to the back pages  
of history books.*

(CAIE, continued on page 28)



# Outsourcing, It's a Learned Skill

The truth is outsourcing is a skill frequently learned after much disappointment and many hard knocks. This may sound strange coming from someone who is responsible for several businesses that have at their core outsourcing of logistics services. However, I have learned through the years that the key to a positive outsourcing relationship is very much like the key to other successful partnerships in life, communication, commitment and information.

At Nadiscorp we talk the talk on outsourcing and we also walk the walk. We believe that there are services that we cannot provide for ourselves as capably as others can, hence, we attempt to find the best at a certain discipline and work at establishing a relationship using our own business principles.

One of the most successful outsourcing partnerships we have is with CGI. They host all of our systems and provide disaster recovery services for all Nadiscorp's daily transactions. This allows us to have scalable capacity and access to the talent of that organization to advance our technology requirements.

The results speak for themselves; a system up time that is above 99.8%, and through structured and continuous information exchange with CGI, we have reduced our costs and added many enhancements throughout our relationship. We understand each other because we are speaking the same language – outsourceese.

The greatest opportunities for our company do not come from taking business from our competitors (something we are not reluctant to do), but from working with potential clients to develop a solution that works for everyone. There are several market place analyses that indicate the non-transportation logistics outsourcing opportunities in North America represent greater than 75% of the total spend. That is business that is today not outsourced.

Our focus, as we go to market, is convincing organizations that we can improve their logistics results across the board and demonstrating that they will remain in control of their business. I believe this is the key to an outsourcing sell in almost any industry. Demonstrate competence and provide the client with tools that will keep them in control.

The first of the three cornerstones is communication. That means both organizations are speaking with each other and more importantly, they are both listening to what is being said. This communication needs to occur at several levels within both companies. I call it the zipper effect. If people at the different levels are communicating openly and factually many problems will come to the surface and be resolved at the early stages.

Assessing the culture of the other partner is a critical part of the communication activity. This needs to be done carefully and absent of personal bias. Both companies need to ask and answer

blunt questions about the fit. You will be working together daily, potentially for many years and will depend on each other in many unforeseen ways. A question to ask is "Are they smart and do I like them?"

The second fundamental is commitment. This would seem to be easy from the outsourcing company's perspective – it's more business. Like most things it is not that simple. The outsourcing service provider must be prepared to commit to many things as the relationship unfolds.

Many prospective clients have asked me through the years; 'can you do the job' and what they should be asking is 'will you do the job?' A subtle but very important distinction. What the later question implies is; does everyone in your organization understand our requirements and will they sacrifice to make it happen for us?

From the clients perspective it is essential to know that your outsourced service provider is committed to your business and that you have observed tangible evidence of that during the 'engagement' process.

- What capital investment are they making for your business?
- Quality and timeliness of responses to requests?

(TOOL KIT, continued on page 28)

- The readiness of senior management people to be available and do they understand the proposition in front of them?
- Are the right people involved in the implementation project and do they dedicate the time required to get the job done?

It is important to read the signs and probe at depth on the questions that most certainly will arise.

Commitment is like most things – it goes both ways in outsourcing. The people throughout the client's organization need to understand the strategic benefit to their company and aggressively support the decision that has been made – to outsource. My observation has been that many companies have a form of guerilla warfare going on around the decision to outsource.

A client that has one lone champion of the project supported benignly by the CEO is one to be concerned about. The chance of success diminishes greatly if there are a number of people in the company with hostility towards the partnership. This is not an experiment or a trial balloon; it is a very serious investment of finite resources and a reputation maker, or breaker.

The outsourced service provider must read the prospect clearly and ask questions of the people at every level. Do not listen for the answers you want to hear. If commitment is weak there are many ways to strengthen their resolve.

The key is a factual discussion with the leader of the organization about the complexity and long-term nature of what you are both doing. Then objectively assess that person's determination and capability to make it happen. If the answer is on the negative side of "maybe," a time – out is warranted prior to getting in deeper.

The third fundamental of outsourcing is information. There are many clichés about information and the times we live in 'the information age' and they are all representative of the needs of the partners contemplating an outsourcing alliance. You will never know enough and you have an absolute need to be sure that what you know is correct.

This is where the participants in this business relationship need to be accountable to each other. We have

found that many companies do not have good information on the logistics activities they presently manage. Hence one of the reasons they are moving to the outsourced model. However, this is where you begin to walk through the minefield.

Everyone involved needs to demand rigor on getting the necessary information and challenging the assumptions no matter how insignificant they may seem at the time. Something as straightforward as the number of cartons that can be stacked on a pallet can have a huge impact on storage space and the monthly cost of services.

Be wary of using averages, most of the time they lead to flawed conclusions and surprises when the operation begins. This is a long-term business relationship and is worth the extra effort. There are instances when the information is just not available and a certain level of assessment will have to occur.

After the estimations have been made and challenged they need to be entered in the cost model. Then proceed with the completion of Standard Operating Procedures. Both items will become part of the contract. This does not need to mean a 56-page legal document but it needs to be enforceable and will guide the business relationship absent of factual information.

The relevant information about the key supply chain metrics that were used to develop the costs must be in that contract. Information such as; product weights and densities, number of SKU's, number of orders and lines per week and per month, order size and one of the most important – turnover. Certain information will be more critical to the performance of each supply chain, but remember what got you here.

This is a long-term alliance that must work for all the partners. There has to be benefits for everyone involved. The supply chain needs to work more effectively and deliver cost savings to the client. The outsourcing company needs to make a profit and be incented to deliver savings on a consistent basis.

PAUL RAGAN is President of Nadiscorp Logistics Group Inc.

The larger the number of international suppliers a company has, the greater responsibility it will have as it imports goods from these companies. The factors for consideration will now not only be whether the supplier can produce quality, low-cost goods that can be delivered when and where you need them, provide the customs data in the format required. They will also need to, in effect, "guarantee" that everything that is involved in their sourcing, manufacturing and shipping operation is secure. If you are sourcing materials from lesser-developed countries some of these new Customs requirements will be next to impossible to meet.

The challenges moving forward will be greater for companies involved in international trade. These new Customs security initiatives will take some time to be fully implemented. They will start off as being programs those companies can voluntarily participate in. However, moving forward, the expectation is that voluntary Customs programs will to a certain extent become mandatory programs. What can the Canadian company that is sourcing abroad expect? Well, the most obvious is higher cost, from each partner in the supply chain, which will be added to the end cost of the imported products. Furthermore, if a Canadian company is exporting any of their products to the United States, they will be required to meet the new security requirements as laid out in the U. S. Customs C-TPAT program if their U. S. customers are C-TPAT participants.

Although international trade has created tremendous opportunities for Canadian companies, these opportunities will only be able to remain as opportunities and not hindrances if a company has been able to incorporate an adequate customs strategy into their supply chain process. If you move goods across borders, having a customs strategy will no longer be optional but will be a critical component of whether your business will succeed or fail.

BOB ARMSTRONG, CITP is President, Canadian Association of Importers and Exporters Inc.

# Who Reads Logistics Quarterly? New Professional Logisticians



**Don Anderson, P.Log.,**  
Operations Specialist,  
IBM,  
Markham, ON



**Paul Antonellis, P.Log.,**  
Supply Chain Execution,  
Tronicus,  
Mississauga, ON



**Denis J.N.D. Bouchard,**  
P.Log., J4 Logistics,  
National Defence  
Headquarters, DND,  
Ottawa, ON



**Fernando Cabral, P.Log.,**  
Branch Manager,  
UPS (Canada) Ltd.,  
Mississauga, ON



**Brian Clark, P.Log.,**  
National Manager,  
Parts Operations,  
Toyota Canada Inc.,  
Scarborough, ON



**Robert A. Cullen, P.Log.,**  
Director of Materials  
Management,  
Shared Healthcare  
Supply Services,  
Toronto, ON



**Nancy De Grandpre, P.Log.,**  
Traffic Manager, Venmar  
Ventilation Inc.,  
Drummondville, PQ



**Alan Derbyshire, P.Log.,**  
Director of Global  
Supply Operations,  
Compaq Canada Inc.,  
Hull, PQ



**Anne Marie Doty, P.Log.,**  
Supply Chain Systems  
Administrator,  
Molson Canada,  
Toronto, ON



**Osama Elmadhoon,**  
P.Log., Logistics  
Engineering Analyst,  
Acklands-Grainger,  
Richmond Hill, ON



**Natalie Fanelli, P.Log.,**  
Purchasing Manager,  
Bell Distribution Inc.,  
Mississauga, ON



**Jody Fitzpatrick, P.Log.,**  
Team Lead - Capacity  
Planning Dept.,  
Canadian Tire Corp.,  
Brampton, ON



**Peter Flannery, P.Log.,**  
Logistics Specialist,  
Molson Canada,  
Etobicoke, ON



**Vince Galati, P.Log.,**  
Materials Management  
Analyst,  
3M Canada,  
London, ON



**Michael Gomes, P.Log.,**  
President,  
City Cartage Systems,  
Mississauga, ON



**Errol Gonsalves, P.Log.,**  
Team Lead,  
Canadian Tire Corp.,  
Brampton, ON



**Murratte Graves, P.Log.,**  
Director, Strategic  
Purchasing, Irving Oil  
Limited,  
Saint John, NB



**Karen Hagler, P.Log.,**  
Marketing Manager -  
Transportation Services,  
Livingston International,  
Etobicoke, ON



**Stephen Holder, P.Log.,**  
Team Leader, Canadian  
Tire Corp.,  
Brampton, ON



**Chris Jarvis, P.Log.,**  
Project Manager,  
Hudson Bay Company,  
Toronto, ON



**Edouard Larocque, P.Log.,**  
Manager, Logistics &  
Transportation,  
Canada Post Corporation /  
Northern Services,  
Ottawa, ON



**Brenda Lemieux, P.Log.,**  
Director of Operations,  
KN Logistics, a division  
of Kuehne and Nagel Int'l,  
Mississauga, ON



**Richard Livingstone,**  
P.Log., DMSCR 3-2,  
DND,  
Ottawa, ON



**John MacLeod, P.Log.,**  
Distribution Manager,  
Highliner Foods Inc.,  
Lunenburg, NS



**Robert MacNeill, P.Log.,**  
Senior Supply Tech,  
DND (MOG 5),  
Halifax, NS



**Joe Malon P.Log.**  
Distribution Manager  
- Western Canada,  
Nestle Canada  
- Ice Cream Division,  
Edmonton, AB



**Lauren McKinlay, P.Log.,**  
Senior Inventory Analyst,  
Galileo Canada  
Distribution Systems Inc.,  
Toronto, ON



**Craig McLaughlin, P.Log.,**  
Senior Director, Supply  
Chain Integration, Nestle  
Canada Inc.,  
North York, ON



**Stéphane Michaud, P.Log.,**  
Region Accounts Manager,  
Quebec,  
Trimac Transportation  
System,  
Pointe-Claire, PQ



**Anthony Milonas, P.Log.,**  
Vice-President - Courier  
Express and Customer  
Relations, Greyhound  
Canada Transportation  
Company, Calgary, AB

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**Rick Moores, P.Log.,**  
Operations Planner,  
Canadian Tire Corp.,  
Brampton, ON



**Bob Morgan, P.Log.,**  
Project Manager,  
Sobeys Inc.,  
Toronto, ON



**Paul Nugent, P.Log.,**  
Leader Global Logistics,  
Montreal/Toronto,  
KN Lead Logistics,  
Dorval, PQ



**Ron Patterson, P.Log.,**  
Team Lead,  
Canadian Tire Corp.,  
Brampton, ON



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Manager, Strategic  
Purchasing,  
Irving Oil Limited,  
Saint John, NB



**Frank Peronace, P.Log.,**  
Montreal, PQ



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Manager,  
Ocean Freight, J.H.  
Bachmann Canada Inc.,  
Mississauga, ON



**Nicole Rigaud, P.Log.,**  
Director,  
National Accounts,  
CHEP Canada Inc.,  
Mississauga, ON



**Mark Robbins, P.Log.,**  
Division Distribution  
Manager,  
Coca-Cola Bottling Co.,  
Toronto, ON



**Stephen Rowe, P.Log.,**  
Fleet Coordinator,  
Norfalco Sales Inc.,  
Mississauga, O



**Carol Rusinko, P.Log.,**  
Team Lead,  
Canadian Tire Corp.,  
Brampton, ON



**Kristina Schultze, P.Log.,**  
Supply Chain Manager,  
Caboodles Cosmetics Inc.,  
New Westminster, BC



**Michael Scott, P.Log.,**  
Customer Service/Finance  
Administrator,  
University of Toronto,  
Toronto, ON



**Phil Shires, P.Log.,**  
Material Administration  
and Support Manager,  
DND (FMF Cape Scott),  
Halifax, NS



**Philippa Smith, P.Log.,**  
Business Analyst,  
Westech Information  
Systems (BC Hydro),  
Burnaby, BC



**Michael L. Vineberg,**  
P.Log., Consultant,  
Richter Consulting,  
Montreal, PQ



**Grant Wattman, P.Log.,**  
Managing Director,  
Jade Management Group,  
Houston, TX



**Kathy Williams, P.Log.,**  
Team Leader -  
Reverse Flow,  
Canadian Tire Corp.,  
Brampton, ON



**Wes Woof, P.Log.,**  
Logistics Manager,  
Roxul Inc.,  
Milton, ON

### *New Professional Logisticians whose photo was unavailable at press time*

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P.Log., Administrator, Transportation & Logistics, Telus Mobility, Toronto, ON

**George Asimakis,**  
P.Log., Sr. Director, Industrial Engineering, Loblaw Companies East Ltd., Etobicoke, ON

**Peter Reed,**  
P.Log., Vice President, Logistics Services, Sobeys Inc., Toronto, ON

**Bruce MacLean,**  
P.Log., DMMD 3-4, DND, Orleans, ON

(EDITOR'S VIEWPOINT, *continued from page 38*)

they want to hold at this time. It has also been suggested that what we're witnessing isn't, in fact, a spike in demand. Instead, it's a return to normal volumes not enjoyed during the past year. Transportation companies heading south may also be ensuring fewer trailers are on the road and that they're full. After all, they're being impacted by increased operating costs due to the southbound border delays.

I look forward to your input about this issue, and comments concerning our new look. I thank you and our board for helping to create the LQ of the future, and I wish you a safe and happy summer.

**FRED MOODY** is publisher and editor of LQ™.  
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## Logistics in Quebec, *What's Up*

*Globally, the last decade has been marked by the emergence of Logistics. Many companies, often industry leaders, have identified the potential of logistics as a key to increase competitiveness and profitability. Companies in Québec are not different. Locally, large multinationals, but also small companies, PME (Petite Moyenne Entreprise) as we call them, forced to compete in a global market have been quick to respond and adopt logistic projects. As a result, the logistics community has grown rapidly. Via this editorial and with the help of my logistician peers I will present you with some of these companies, their challenges and their initiatives. I will also report on the activities of the associations, universities and government to support and enhance the development of logistics in Quebec. In fact, since Quebec has a strong "savoir faire" and a lot of potential in logistics, I shall share with you "What's Up" in logistics in Quebec.*

*As an introduction to this editorial and in order to set the tone of "What's Up," let us have a look at the feel and position of logistics in Quebec.*

### **The state of Logistics in Quebec**

At the last Council of Logistics Management (CLM) conference in Montreal in April 2002, Mr. Jacques Roy, professor at l'École des hautes études commerciales (HEC), was invited to present the result of a study conducted for the "Institut de formation en gestion du transport et de la logistique du Québec (IFGTL)" and sponsored by the Quebec Ministry of Finance. The study was realized with the participation of professors from Quebec universities:

Université du Québec à Montréal (UQAM), University Laval and HEC.

The objective of the study was to identify the major trends and best practices in logistics, to outline the current training program offered and to define the needs and requirements, as well as to propose means to improve logistics management and training. The methodology adopted included a literature review, many personal interviews with logistics executives and a comprehensive logistical survey.

### **Major trends and Best Practices**

Globalization, E-business and reverse logistics are the major trends with increased customer requirements as the leading trend.

Among the best practices, the use of information and communication technologies are at the top of the list, followed by partnership, performance measurement, customer relationship management and knowledge management. Large companies are implementing practices such as: VMI, Partnership, Just In Time and Continuous Replenishment. They also make an extensive use of systems such as ERP, WMS, MRP, DRP. Information system implementation projects have been key priorities for the last few years, however, "On Time Delivery" seems to be the major challenge for most companies. With only 61% of manufacturers reaching the 95% mark for "On Time Delivery," wholesalers and retailers

are struggling to serve the increased customer requirements.

The survey respondents are quite satisfied with the way their company manages logistics activities. They have seen growing commitment of top management for logistics projects and they believe it will continue, as more emphasis is put on the logistics deliverables.

The logistics function is emerging in the organization. In the majority of companies we find a vice president or director of Logistics, and this holds true for 82% of large companies.

### **Training needs for current and new logisticians**

In the 90's, formal logistics training was rather rare, if it existed at all in Quebec. For that reason many logisticians with different backgrounds (technician, engineer, BAA, MBA) have learned on the job. It is not the case anymore. Even though it is not yet well known by the industry, training programs are developing rapidly with strong focus on these programs by colleges and universities in order to meet the newly growing requirements. As a result, qualified graduates in logistics are entering the market.

Moreover, some companies are developing cooperative initiative with academic establishments to enhance programs in the field of logistics. Such initiatives are very beneficial to all: students, universities and industries.

## Summary of findings

- Companies in Quebec have identified the potential of logistics as a key to increase competitiveness and profitability. The trends and best practices identified are similar to those found throughout industries in North America.

- Logistics is emerging rapidly in Quebec, but is still somehow misunderstood, especially in the smaller company (PME).

- The integration of logistics activities is more advanced in the larger company

- Existing academic programs are adequate... but still not well known.

- In order to satisfy their current and future needs in logistics, companies will hire hundreds of college and university graduates.

## Recommendation and Call to Action

Quebec is very well positioned to play a significant role in logistics in North America. To start, the industry has demon-

strated leadership, undertaking many key initiatives to enhance operational efficiency. Subsequently, the academic community has developed training programs to prepare future qualified logisticians and finally the logistics associations and governments are supporting the effort.

The study concluded with the following recommendations:

- To increase Logistics awareness in Quebec
- To publicize existing educational programs
- To develop financial assistance for Logistics training for smaller companies (PME)
- To support research in Logistics
- To promote alliance between industry and academic establishments in the field of Logistics.

Many thanks to Jacques Roy, professor at HEC, for his collaboration with this article.

PIERRE MASSICOTTE, P.Log, V.P. Supply Chain, L'Oréal Canada Inc., Director, CLM Quebec Roundtable

(PRESIDENT'S VIEWPOINT, continued from page 13)

clarity. The hedgehog's "best in the world" is not about a goal or strategy or intention or plan to become the best. It's an understanding of what you can be the best at.

We suffer from the curse of competence, but we never attain complete mastery and fulfillment. Consider the Gretzky Phenomenon: if I can't play my best, then I cannot play at all, because the game is no longer fun.

Doing what you are good at will only make you good. Focusing solely on what you can potentially do better than any other organization is the only path to greatness.

## Economic Engine

It's not about the micro-economics of your sector or even your company. It's about the economic indicator that will drive your company from good to great. Remember: the hedgehog objective is about insight and understanding, not about plans and strategies.

If you could pick one and only one ratio – profit per x (or, in the social sector, cash flow per x) – to systematically increase over time, what x would have the greatest and most sustainable impact on your economic engine?

The denominator question serves as a mechanism to force deeper understanding of the key drivers in your economic engine. The discipline of one denominator forces us to clarify our thinking. Some examples are:

- *Abbott*: shift from profit per product line to profit per employee fit with the idea of contributing to cost-effective health care

- *Gillette*: shift from profit per division to profit per customer reflected the economic power of repeatable purchases (razor cartridges) times high profit per purchase (non disposable razors)

- *Kimberly-Clark*: shift from profit per fixed asset (the mills) to profit per consumer brand would be less cyclical and more profitable in both good and bad times.

- *Kroger*: shift from profit per store to profit per local population reflected the insight that local market share drove grocery economics (if you cannot attain number one or number two in local share, you should not play).

Passion. We should only do those things we are passionate about. You can't manufacture passion or motivate people to feel passionate.

Ultimately, it's about value. Kimberly-Clark executives made the shift to paper-based consumer products in large part because they could get more passionate about them. As one executive put it, the traditional paper products are okay, but "they just don't have the charisma of a diaper."

So, what are you: a Fox or a Hedgehog?

VICTOR DEYGLIO is President of The Professional Logistics Institute, based in Toronto, Ontario. vdeyglgio@loginstitute.ca

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## Who Cares if you Scored **A HAT TRICK** in a 5-3 Loss?

Back in February, hockey fans across the country enjoyed a thrill of a lifetime when Team Canada won Olympic Gold with a decisive win over Team USA. Every four years since 1952, we sent a team with the hope of regaining bragging rights for a game we believe in our hearts is 'our game.' It sure wasn't a lack of talent that prevented the Canadian teams from winning over the years. Arguably some of the most talented players in the history of the sport had a shot at winning Olympic Gold for Canada. In recent years particularly, Team Canada really was an "all-star" team in every sense of the word, sporting the best of the NHL. Yet every four years, Canada's hopes fell short of the illusive dream, proving that stacking the team with great players is not the same thing as putting a winning team on the ice.

Any player who makes it to the NHL is classed among the best in their sport. It takes a blend of skill, speed, strength, conditioning, a lifetime of practice, passion for the game, plus something called 'puck sense'... an intuitive perception for the flow of the game. Yet all the skill development and training in the world doesn't make a journeyman into a legend of the game like a Gretsky. Only a handful of players have had the 'gift.' While most players know where they should be at any given time on the ice... Gretsky seemed to know where everyone else was as well. While players all know where the puck is... he seemed to know where it was going to be.

Throughout his career, he controlled the play because he seemed to process more information about the dynamics on the ice and did it faster than anyone else in the game. And yet as great as Mr. Gretsky may have been, he never won a championship alone... but he sure added a lot of horsepower to a team's potential.

### ***Let's look at how the same idea applies in Supply Chain Management.***

Perhaps your company has built a great management team. It is a group of men and women who are considered the best in their field. There is a manufacturing guru who can crank out the volume of blue and red widgets, keep the quality and costs absolutely consistent, plus keep it all on schedule. There is a sales wizard who has a nose for finding customers and opportunities no one else knew existed. The CFO has cash flow down to a science, inventories are under control, and life is good. However, the issue of supply chain management somehow falls outside the box when it comes to the impact across the entire company.

The very word "supply chain" implies that the concept is a continuum or a process... finding a source of input materials that is cost-positive and dependable – manufacturing a consistent finished product at the lowest cost – and moving it to the end user on time and at the lowest price. The effective supply chain optimizes all of these

ensuring the best use of capital from beginning to end of the process – the collecting of the dollars from the customer, covering all of the costs, intentionally or unintentionally built into process.

However, all too often supply chain decisions are localized. Sales managers often react to the immediate demands of customers, even if it means risking the disruption of manufacturing schedules. At the same time, your plant manager knows that longer lead times can mean big league savings in just batch processing and inventory management alone. In the scramble to solve a short-term dilemma, traffic staff finds a motor carrier that can rush goods direct to a remote market. While that may maintain a customer and keep the sales department happy, who knows how it may impact profit in the process. Your all-star team is handpicked because they are good at what they do. They have just scored another goal in a tight game, but how are they doing on the season. Supply Chain Management isn't like golf... it's a team sport. Like hockey, stacking the team with great players, is not the same thing as putting a winning team on the ice.

If you have strong management in the key areas of your company, how do you make the supply chain decisions that work for the company, not just each department? The answer, as my colleague Martin Kelly from iWheels Logistics discussed in the winter issue

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of Logistics Quarterly, is knowing exactly what your costs are today, and then setting benchmarks and Key Performance Indicators (KPI's) to measure changes that occur, either by design or because we live in a dynamic world. They are the 'league statistics' and they can tell you more than if you're just winning or losing. They can tell you whether you've got a shot at going to the Stanley Cup finals. Let's take a look at a real case study.

Our example is a company that manufactures plastic bags for the retail trade. This company makes them all... from drug stores to shopping malls, from big bags with handles to fancy ones with draw strings. These bags are definitely a commodity item. The company's sales focus is clearly volume and the market is all across North America. Customers view the product as straight expense because they are not being resold for a profit. The market is extremely competitive and is driven by customer demand. With wide distribution and diverse customer base some customers are more costly to service than others. The company operates five manufacturing facilities and four warehouses. Some of the warehouses are located directly next to manufacturing facility because there is just no space in the plant left for storage.

The management structure is relatively common to medium size entrepreneurial companies. The CEO is both the biggest sales producer and the ultimate decision-maker. The company employs over 400 employees. They are mostly laborers, but there are few key technical people as well... all in all, a good team. Some of the plants specialize in different types of packaging products. That means the technology in one facility may be different from another and the raw material may come from different sources. Logistics and transportation are considered plant issues. And as such, everyone grumbles about the cost but know that "cheaper" may mean sacrificing customer service and ultimately their perception of the company's performance.

The company sells both direct to end-users as well as through distributors. It is clearly driven by volume. The customer base is a mix of large retail chains with multiple stores. Some make a central buy, but have the product dropped shipped to the local outlet. In other cases, the bags might be shipped to a distribution center. Plus there are a

large number of mom & pop customers across the USA and Canada. Most of the sales come in over the phone and immediately pushed through to manufacturing. They are often custom orders with unique printing or packaging requirements.

A critical factor in the company's operation is buying the resin, which represents 60% of the cost of the product. It is a volatile market and costs literally fluctuate daily. Larger customers tend to understand the impact of resin prices on the cost of the poly-bags they need. As a result, when they see the cost of resin going up, they place large orders and stockpile. When costs go down, they immediately want to see a cheaper bag. It is the primary area of focus for management attention and intervention.

In this roller coaster market, "being competitive" is literally an issue of a few pennies here and there. Stripping cost out of the supply chain has more impact than just profitability. It's about survival. So where does the company start? Well, they start with what they know. First, they have freight bills and they have a record of customer shipments. This gives them the total cost of shipping product to customers and if they are lucky, they may be able to isolate costs to specific customers. Simple math pegs the transportation cost for all of the bags shipped to all customers across North America at 6.1¢/lb. Their goal is to reduce the cost to a nickel.

However, there is a lot of information we don't know, such as the cost of dealing with any individual customers. We don't know whether the bottom line for the large volume buyer warrants the high discounts after all of the service demands are factored into the equation. The company moves inventory from one warehouse to another as many as three times before shipping to customers, but that cost is not reflected in the cost of shipping goods to market. The company might know its total freight bill, but it does not distinguish service vs. costs between regions, direct sales to major customers or bulk shipments to distributors. We don't know the actual or opportunity cost of taking a big order, juggling the production schedules paying an inflated spot price on resin... because the priority is on sales volume. Are the same service (and cost) standards being applied to "expensive" customers as to strategic partners? Are

order patterns changing, costing more per unit for the same revenue returns?

One thing we do know is that any and all supply chain related decisions are going to impact customer service, manufacturing and certainly profitability. What we do not know is how they will impact on other customers, product quality or even the bottom line if we don't have benchmarks and KPI's. With the right measurement tools, good service options can be investigated and improvements tracked. With no benchmarks, benefits tend to get lost in individual issues without the benefit of seeing the big picture. While everyone on the team is trying to do the right thing – having good measurement around the whole process ensures each team member can see the impact of good business decisions.

To return to the hockey analogy for a minute, corporate success is about more than just great individual effort. It's about controlling the flow of the game. We have all heard the phrase, "the whole is greater than the sum of its parts." Supply chain management is a classic example. What good does it do if manufacturing is meeting deliveries, but quality is suffering... if sales volumes are sky-rocketing, but delivery promises are just unreasonable and jeopardize manufacturing cycles... if purchasing has finally found a carrier that saves a nickel a mile, but customer appointments are being missed? If Paul Henderson's big goal came in the sixth game and Canada lost the seventh game to the Soviets, do you think anyone outside of Toronto would remember Paul's hockey achievements? Do you think anyone remembers who scored the goals for Team USA after Canada won the Gold?

So back to the original question. Where is the value to the company, when one of your all-stars scores a "hat trick" but you still end up losing the game... or even worse finishing the season out of the play-offs? With the right team goals and the KPI's to measure effort, your team may have championship potential. As a bonus, you might also see an improvement in individual performance stats. But if your management team is making decisions without them... then sorry, you're still just playing road hockey.

DAN CARRUTHERS, *New Business Development, iWheels International*

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## What's Questionable

At LQ we need your opinion. For eight years LQ has upheld its primary goal, namely, to be the only publication with the consistent mission to be a logistics publication written by professionals for professionals in the field of logistics in Canada – affording authoritative

thinking on the complex and fast-changing work of the logistics. While we would never depart from our legacy of providing the finest of editorial content, we're changing, as evidenced by this issue. We're updating our design. We've introduced several new mem-

bers to our board as announced in our news section. We're becoming more international in scope. And we have launched several pilot surveys.

Engaging our board and soon our readership with survey questions posted online and within LQ keeps us better informed about trends and provides editorial direction. It also puts ideas through some rigorous testing and dialogue before they might be applied toward strategic thinking.

Our first LQ survey focused on carrier capacity in Canada and was prompted by signals that there is a significant reduction in terms of carrier capacity in the transborder marketplace this spring and summer. Not surprisingly, the driver shortage, a dramatic hike in insurance rates, rising truck costs with new emission standards coming to the fore, and even greater competition the United States with Mexico penetrating that market this fall, are taking their toll, or will likely do so soon. The situation in Canada has left some businesses unable to meet demand and a rising number of U.S. carriers are refusing business in Canada in order to avoid the costly ride back home.

Furthermore, the driver shortage is not impacting carriers equally. Dedicated carriers with dedicated drivers and stable volumes remain unimpacted. Less Than Truckload (LTL) carriers with a solid base of drivers, often unionized, are not likely to be impacted in the adverse way that truckload (TL) carriers have been.

This already daunting situation is now aggravated by what is perceived to be an increase in demand. The recently perceived spike in demand for carriers in this transborder market has been linked to many companies speculating on the amount of inventories

(EDITOR'S VIEWPOINT, continued on page 30)

**Okay, time for plan B!**

**PLAN A**

- Research HS code and marking regulations. Forward info to vendor.
- Fax P.O. to vendor.
- Find a forwarder and make arrangements for air freight.
- Fill out Customs invoice and these other forms (if I remember how!)
- Find carrier to haul from airport to warehouse.
- Fax all this paperwork to everybody.
- Call Customs broker again – are we set up for pre-release?
- Call forwarder again – is shipment on schedule? Wish I could just check on-line...
- Let warehouse know it's coming. Make sure they call as soon as truck gets in!
- Fax all these orders to warehouse.
- Call warehouse – did the orders go out yet? Are we going to meet the deadline?
- Try to get some sleep tonight.
- Figure out what to do with returns...um, maybe there won't be any.

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The image features three globes stacked vertically, each with horizontal light rays extending from its right side. The top globe is set against a yellow and orange background, the middle one against a red and orange background, and the bottom one against a blue background. The globes are semi-transparent, showing the continents and grid lines.

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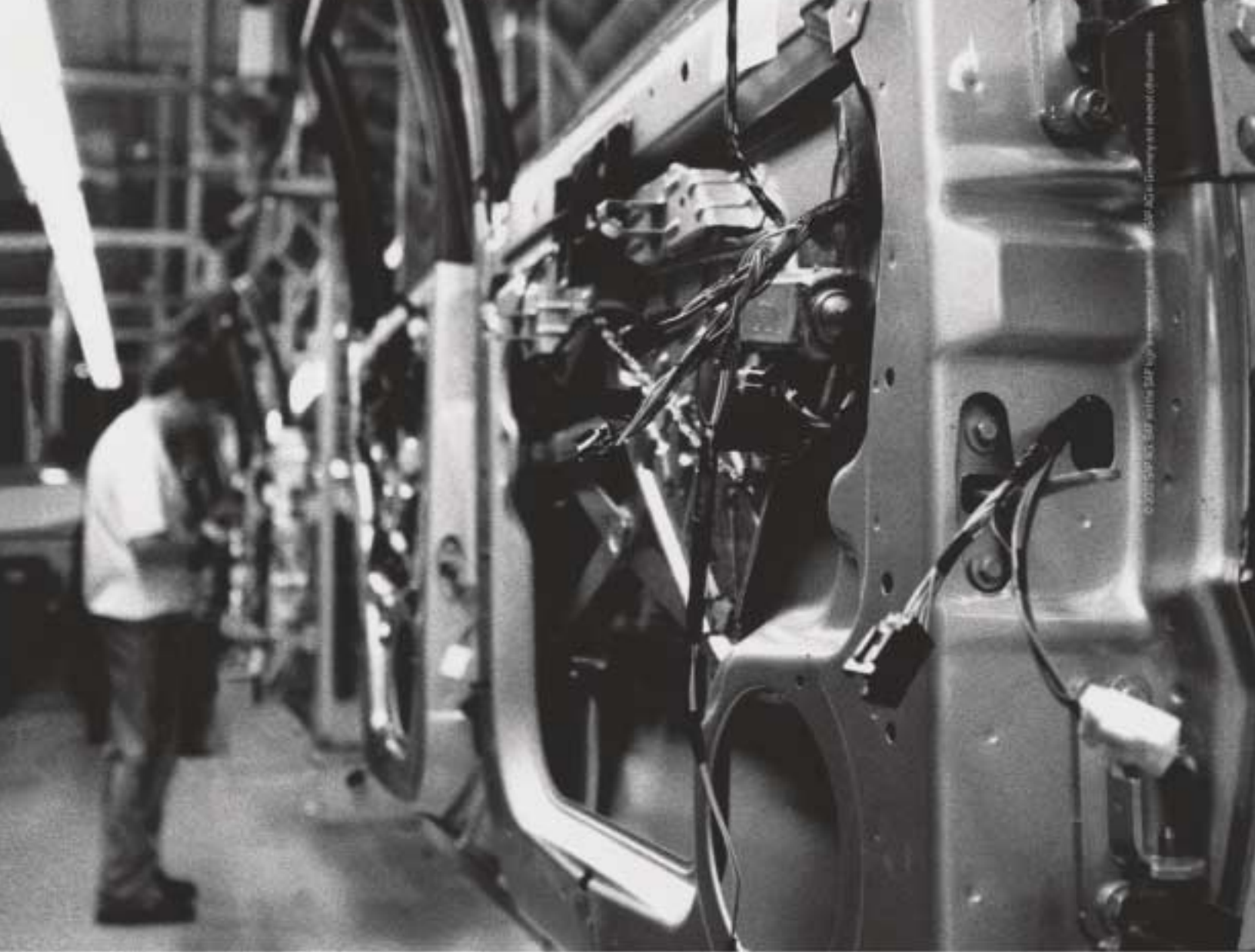
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