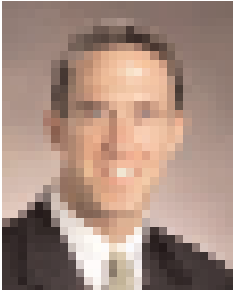


LOGISTICS INNOVATIONS FOR INDUSTRIAL USERS OF OFFSHORE MANUFACTURING



by
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As your vehicle parallels the length of a newly constructed mega one-million-square foot distribution center on the interstate one night, you might think to yourself, “What a beautiful sight!—New concrete, new rack, all loaded with product on the shelf.” Well, it may be a beautiful sight to an industrial real estate professional, but not so much to Russ Boyd, manager of supply quality for telecom giant Ericsson.

Pressure to Reduce Costs

Russ Boyd is responsible for one thing when it comes to inventory—keeping it off the shelves and moving through the supply chain. Keeping product moving is what is on the minds of most corporate logistic managers these days and several trends in the logistics industry are affecting the use of industrial space. Our sluggish economy is putting cost-reduction pressure on manufacturing, pushing more and more of it offshore, instigating the composition of new warehousing networks, and spawning transportation management innovations through the use of technology. All this is changing the industry and the industrial real estate landscape.

The Movement Offshore

By now everyone knows that labor has been the driving force behind manufacturing’s gravitation to the Orient. At only three

percent of European or Japanese labor cost, China offers some of the lowest labor costs in the world. But we should also be aware that China is also the largest future market for logistics’ expansion. Our Asian counterparts are being challenged to match the performance of their developed U.S. counterparts in expectation of inventory accuracy, real-time tracking, and contingency planning in handling product.

America’s CFOs are relying on overseas labor markets to educate themselves to meet our standards of customer service. As these countries obtain the confidence of corporate America, more and more jobs go overseas. We are seeing an example of this in the call center industry, as it continues to explode in India. And in Beijing, the American Society of Transportation and Logistics has expanded its certification to Asia participants to train thousands in warehouse management systems. In today’s world, logistics experts in America expect a distribution center (DC) in Shanghai to operate like a DC in Columbus, Ohio.

Trend to Manufacture Smaller Products Overseas

Some U.S. companies want to see as much of the manufacturing process as possible go to China. This is especially true for products that are getting smaller and smaller like computers and electronics. They now take up less

cubic space on cargo ships while crossing the Pacific. In addition, these commodities weigh less than they used to and have made overseas shipping cost even less of a deterrent. Large TVs and mega servers that are subject to as much as five percent U.S. import tariff, can still primarily be assembled here while smaller components arrive just in time (JIT) from Korea and Thailand.

This trend is placing more emphasis on port locations for quick deployment of inventory on entry to the United States. Port cities have erupted with new activity in cross-docking and bulk break sites in the last two years, especially on the West Coast. According to the Japan Maritime Research Institute, U.S. bound cargo from Asia hit record levels in 2002, up 20 percent from 2001. With Honda planning to build a plant in China dedicated exclusively to exporting up to 300,000 cars per year, and Ford announcing plans to source one billion car parts from China in 2003, this bustle is not likely to stop.

Less Need for Land-Locked U.S. Mega Warehouses

As other countries continue to raise their standards of quality of labor, manufacturing, and logistics, we will continue to need fewer mega warehouses in sparsely populated, land-locked American. It is still up for debate as to whether or not this overseas trend will mean "less" net absorption of industrial space in the United States. A survey of Third Party Logistics Providers (3PLs) by the IWLA indicates the opposite. It shows that 66 percent of the logistics companies surveyed expect to see an increase in supply chain contracts. What this means is that the configuration of the space and where it's located is changing, not necessarily the total amount of space in the network.

Distribution Networks—Transportation

The goal to reduce cost in the supply chain and keep product moving has also affected distribution networks in the United States. Why would a large U.S. corporation want to own millions of dollars in fixed assets in fixed locations when they can take advantage of a logistics network called a "Merge in Transit Network" (MITN) offered by many national and global 3PLs? A MITN allows a company to control not just warehousing and inventory cost, by only paying for space they use, but also have greater control on transportation cost as well.

Corporations today are trying to avoid setting minimum guarantees on occupancy. They only want to pay for space they use and be allowed to flex in and out of space as needed. In theory, MITNs utilize multiple, smaller, sort and merge facilities and reduce long distance LTL hauls. From a real estate standpoint, this marks

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a shift away from the 400,000 to 700,000-square-foot DC. The shape of the network looks more like a linkage of 100,000-200,000 square foot spaces. The 3PLs keep the product moving instead of sitting in a central warehouse or being dropped off, for example, to a display building specialist. Today, 3PLs are the specialists and they build the displays or add the labels. In a MITN, 3PLs don't just move

product around, they can assemble it, test it, redirect it and package it or customize whatever service a client may need. 3PLs are being asked to perform more and more of these value-added services throughout the supply chain while product is "in route to the customer."

Transportation and Technology

There is hope that the use of these MITNs and the use of real-time technology to track inventory is also enabling the industrial user to reduce transportation cost. With motor freight transportation costs accounting for more than 50 percent of all U.S. business logistics costs (*Cass Information Systems Annual State of Logistics Report, 2002*), MITNs can be an attractive consideration to corporate supply chain executives.

The real cost inefficiency in motor freight transportation is in small shipments and LTL shipments over long distances. Companies can't control cost by shipping less frequently at the sacrifice of customer service. But with a MITN they can utilize dozens of smaller warehouses to merge and consolidate freight to reduce cost. In addition, transportation managers are using technology to bring more diversity in the solutions they offer versus traditional common carriers. These companies are emerging as the most profitable segment of our industry.

The *Journal of Commerce* reported in April 2003 that companies like CH Robinson, Expeditors International, and Landstar Logistics all reported double digit, after tax net margins. LTL haulers like ABF and Conway are upgrading their systems and adjusting their networks so they can offer on-time delivery and tracking to compete with small package specialists like UPS and FedEx in business-to-business shipping. A great deal of consolidation continues in the industry. This trend makes it more difficult for smaller transportation companies to compete. Smaller companies are looking for niche markets or are closing their doors.

The Evolution of the "Industrial User"

We can see why trends are encouraging industrial users, particularly 3PLs, to depart from referring to themselves as warehouse providers. Instead, they are supply chain managers (SCM) that handle all physical operations for companies that design and market products produced offshore. ❖

