SADDLE CREEK CORPORATION®

Whitepaper Series

2010 Distribution Network Trends Report

This industry-wide report explores emerging trends in the design and management of supply chain distribution networks as the logistics industry weathers today's turbulent economic times.

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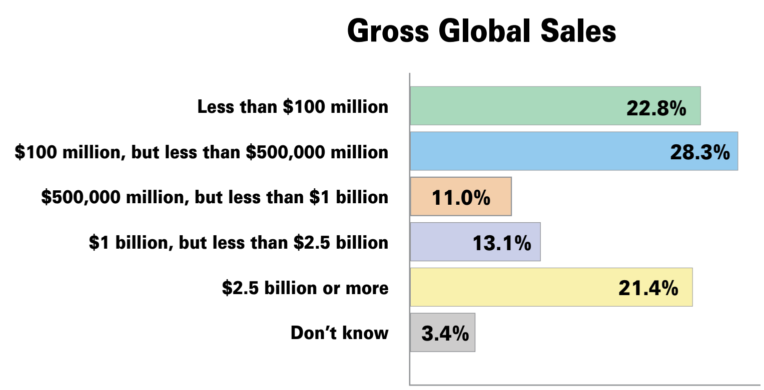
Overview

Over the past 24 months, the logistics industry has suffered through a bleak economic period, marked by reduced consumer demand, excess inventory, price pressures, plant shutdowns, and financial constraints. Companies have had to reevaluate their supply chains carefully in an effort to identify opportunities to create efficiencies and cut costs.

Distribution networks play a critical role in the supply chain, and the design and management of these networks has been closely scrutinized. Companies have explored a variety of related strategies in order to adapt to the changing economy.

To gain a better understanding of how distribution networks have been impacted by economic conditions, Saddle Creek Corporation conducted a survey of logistics industry professionals. A total of 235 surveys were completed in May 2010, making this research statistically valid. Of those who were logistics decision-makers responsible for managing their company's supply chain activities, there was a diverse cross-response among market segments, including: manufacturers (34.5%), retailers (18.6%) and distributors (46.9%) involved in executive management (8.3%); supply chain, logistics, or distribution management (50.3%); or operations management (41.4%).

Respondents' companies range in size from less than $100 million in gross global sales (22.8%) to $2.5 billion or more (21.4%). Respondents came from a wide variety of industries. While no single industry accounted for more than 20% of the total responses, food and beverage (18.6%) and retail (17.9%) were most highly represented.

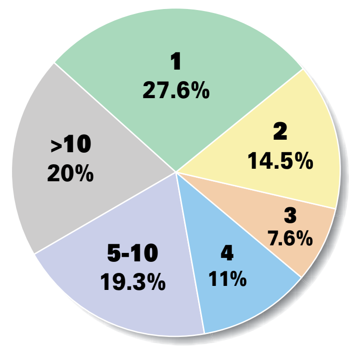


Supply Chain Distribution Network Design

Looking at current distribution networks, approximately one third of respondents distribute their products (or have retail stores) internationally while 40.7% have national distribution and 26.9% have regional distribution.

Overall, their number of distribution nodes varied widely from a single DC or node (27.6%) to more than 10 nodes (20%). Interestingly, the number of nodes did not vary substantially by geographic coverage. While companies distributing regionally might be expected to have fewer distribution nodes, in fact, 46.2% of these respondents had more than five nodes.

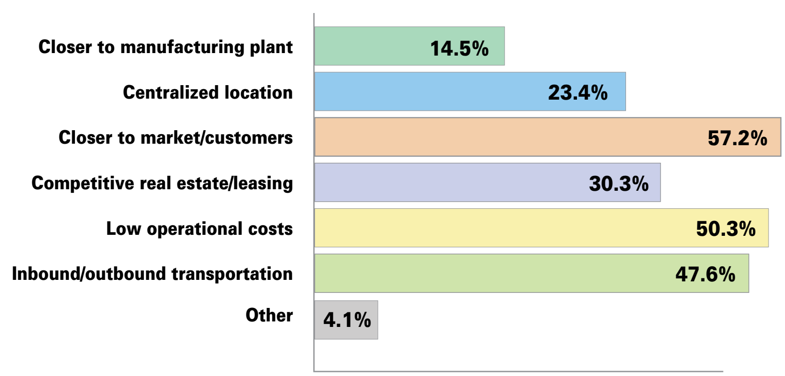
Number of DCs/Nodes in Network



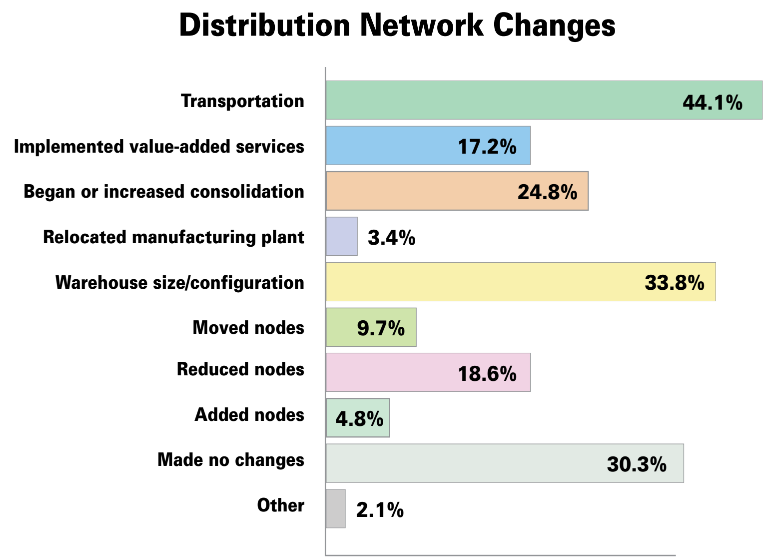
The relative size of a company is a more reliable predictor of network size. For companies with more than $2.5 billion in sales, 61.3% have more than 10 nodes. Companies with $1 billion to $2.5 billion in sales are more likely to have 5 to 10 nodes (47.4%). On the other end of the spectrum, 57.6% of respondents from companies with less than $100 million in sales have a single node. Companies with $100 to $500 million are most likely to have one (26.8%) or two (24.4%). Companies with $500 million to $1 billion in sales are fairly evenly divided with roughly half operating four or more DCs.

Strong preferences emerged when respondents were asked about optimal characteristics for a DC location. Significantly more respondents most highly valued a location closer to their market/customers (57.2%) than a location closer to the manufacturing plant (14.5%), suggesting the priority placed on last-mile distribution. Low operational costs and readily available inbound/outbound transportation also rated highly when selecting a geographic location (50.3% and 47.6% respectively).

Optimal Characteristics for DC Location



Emerging Trends in Distribution Network Design



Two thirds of respondents confirmed that they had made changes to their supply chain distribution network design as a result of recent economic challenges, illustrating the severity of the recession.

The top three areas of change for respondents overall included transportation-related changes (44.1%); warehouse size and/or configuration (33.8%); and consolidation of shipments from suppliers (24.8%).

Nearly one-third of respondents (30.3%) have made no significant changes to their supply chain distribution network in this struggling economy, primarily because the current network satisfactorily meets their requirements. Others have not changed for a variety of reasons, including the fact that they lack other viable options, financial resources, or staff resources to implement changes.

In looking at respondents' changes by group, manufacturers were less likely to make changes to transportation (38%, compared to 44.1% overall) and more likely to reduce the number of nodes in their supply chain (24%, compared to 18.6% overall) while distributors were more likely to make changes in transportation (50%) than respondents overall. This is most likely due to the fact that transportation is more closely tied to a distributor's core competency than it is for manufacturers and retailers.

Reflective of the overall respondents, retailers said that transportation, warehouse size/configuration and consolidation were top areas of change. However, this group made the fewest alterations to their supply chain, with 51.9% reporting having made no changes due to economic challenges.

Naturally, company size had a considerable impact on the likelihood of incorporating change. Companies with $2.5 billion or more in gross global sales chose to move nodes most often (22.6%, compared to overall average of 9.7%) or reduce nodes (38.7%, compared to overall average of 18.6%) – not surprising since this group has the greatest number of nodes. Companies with $500 million to $1 billion were most likely to have changed warehouse size/ configuration (50%). While a sizable percentage of all groups made changes in transportation, this group looked at this area most closely (62.5%). Companies with $100 to $500 million turned to consolidation most often although all groups said they had begun or increased consolidation. Those with less than $100 million in sales were much more likely to have implemented value added services (30.3% compared to 17.2% overall).

Changes by Company Size

	Less than $100 million	$100 to $500 million	$500 million to less than $1 billion	$1 billion to less than $2.5 billion	$2.5 billion or more
Changes to transportation	48.5%	43.9%	62.5%	42.1%	38.7%
Implemented value-added services	30.3%	19.5%	0.0%	10.5%	12.9%
Began or increased consolidation	27.3%	31.7%	18.8%	15.8%	25.8%
Relocated manufacturing plant	0.0%	2.4%	0.0%	0.0%	12.9%
Changed warehouse size/ configuration	27.3%	31.7%	50.0%	10.5%	45.2%
Moved nodes to new locations	6.1%	12.2%	0.0%	0.0%	22.6%
Reduced nodes	6.1%	14.6%	18.8%	21.1%	38.7%
Added nodes	3.0%	9.8%	0.0%	0.0%	6.5%
Made no changes	33.3%	34.1%	25.0%	31.6%	22.6%

This breakdown suggests that larger companies tended to make deeper organizational changes, while smaller companies looked to everyday adjustments that would be easier to implement. Changes in transportation, for example, can have a direct, immediate impact on the bottom line while the ROI for brick-and-mortar changes can take longer to become apparent.

Transportation

When asked which of the network design changes that they have implemented have been most effective, respondents frequently mentioned changes in transportation (i.e. modal shifts, re-negotiating fuel surcharges, transportation network restructuring) – perhaps recognizing the immediate results.

They specifically cited a number of initiatives, including:

- Transportation routing
- Negotiating rate changes and fuel surcharges
- Shipment consolidation
- Reducing frequency of deliveries
- Direct plant shipping initiatives
- Increased use of intermodal opportunities

Changes are being made with an eye on balancing customer needs with the bottom line. One respondent in the retail sector notes, "We are managing our ship methods better to ensure customer satisfaction, but doing so in the most cost-effective manner. We've reduced our percent of revenue on shipping by 1.5%."

Research sponsor Saddle Creek Corporation is also seeing a shift in customers' approach to their supply chains. "Instead of simply doing things the way they always have, companies are looking for creative solutions to help control costs," says Mike DelBovo, senior vice president, Saddle Creek Transportation. "For example, one manufacturer was regularly shipping between its warehouses coast to coast. By using intermodal instead of truck, they cut costs by 42 percent. For another customer, changing packaging and product design helped to increase freight density and, thereby, lower freight costs."

Warehousing

A number of respondents considered changes at the warehouse level to be most valuable to their overall operations improvements. Examples included:

- Improving inventory control
- Reconfiguring warehouse layout/racking and slotting
- Adding small parcel shipping lines and stations
- Adding a slow-moving section to DC
- Simplifying warehouse processes
- Renegotiating real estate leases
- Right-sizing regional nodes

A few respondents mentioned re-investing in their business through warehouse improvements (i.e. implementing WMS, changing demand planning software, improving technology, modernizing material handling equipment) as a way to improve productivity. Others reported taking advantage of the depressed real estate and construction markets to expand facilities.

Changes at the warehouse level can lead to a significant improvement in the bottom line. One respondent in the manufacturing sector said, "We have worked to better manage our inventory levels, and have been able to reduce the amount of inventory we carry and still meet customer needs. As a result we have been able to reduce DC (warehouse) space which has been a cost savings to the company."

"We're seeing logistics customers becoming more strategic in how they utilize space and assets," says Tom Patterson, senior vice president of warehouse operations at Saddle Creek. "As companies reduce and consolidate inventory, they begin to seek out more cost-effective warehousing options."

One option that many companies are exploring, Patterson says, is a shared-space warehousing environment in which a third-party provider manages multiple-client operations in a single facility with room for expansion.

"Shared space gives companies a creative way to consolidate operations while increasing flexibility and controlling costs," Patterson says. "It allows them to accommodate the ebb and flow of their business and adapt more quickly to changes in the marketplace while creating a number of efficiencies. Not only do customers avoid the fixed cost of leasing more space than they need on an on-going basis – they also save on operating, personnel and other management costs by sharing those costs with others."

Operations

Respondents also mentioned a variety of operational improvements such as:

- Shifting to flexible manufacturing
- Making internal procurement changes
- Optimizing processes
- Redesigning the flow of imported goods
- Changing manufacturing sources
- Reducing the workforce

Clearly, the economic environment has driven companies to look at a wide variety of strategies to control and drive down operating costs to alleviate margin and pricing pressures.

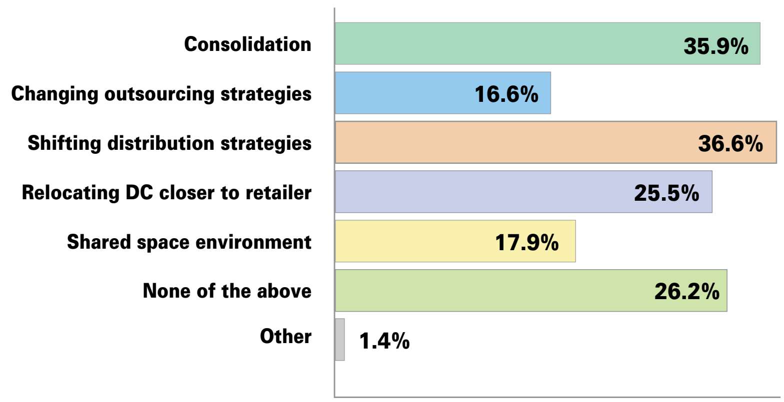
Regional Challenges

The majority of respondents say that there is not a specific geographic region that they have difficulty servicing. For those who are facing regional challenges, however, the West is most difficult to serve from a distribution standpoint for 14.5% of respondents. The Northwest also proves to be a challenge for 9.7% of respondents.

Reasons for challenges varied, but increased cost and delivery time were frequently mentioned. Space costs are also an issue, as one West Coast-based distributor bemoaned the prohibitive "cost of owning/running bricks and mortar in this part of the country."

To service different markets or geographies, respondents report exploring a number of strategies, the most common of which is shifting distribution strategies to improve inventory cycle time (36.6%). Increasing the velocity of inventory often helps companies to service challenging markets more efficiently and cost effectively.

Options Explored to Service Different Markets



One way in which companies are achieving improved inventory cycle time is through cross-docking, the practice of receiving product and shipping it out the same day or overnight without putting it into storage.

"Companies across the country are finding that cross-docking allows them to take costs out of their supply chains and accelerate the velocity of inventory, so they can get their products to market more quickly and economically," says Saddle Creek's DelBovo.

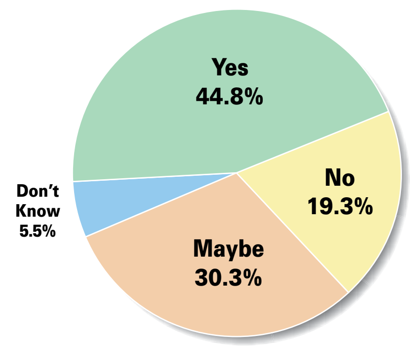
"Product customization can also be an effective way to improve cycle time," says Saddle Creek's Patterson. "It allows manufacturers to delay product configuration until the last possible minute to meet current demand while controlling the cost of carrying and managing a heavy volume of safety stock." From creating rainbow packs to making minor mechanical alterations, customizing products as close to the customer as possible can speed the time to market considerably.

Near-Term Outlook for Distribution Network Design

More changes in distribution practices are expected as companies enter the current economic recovery period. When asked about plans for the next 12 to 18 months, nearly half of respondents (44.8%) expected to make additional changes, while 30.3% were unsure.

Respondents overwhelmingly attributed the need for change to controlling costs. In an open-ended question about factors driving the decision to reevaluate the distribution network, half of respondents mentioned cost. A number of respondents also noted a need to maintain or improve service levels and address customer demands. Competitive pressures were also cited often. A handful of respondents said that business growth was driving the decision.

Plans for Change During Recovery



Plans for change are, for the most part, very reflective of changes made already – transportation (35.2%), warehouse size/configuration (40.7%), and consolidation (20.7%). Companies with more than $2.5 billion in sales expect to make the most sweeping changes, with significant response percentages in every category. Companies with less than $100 million in sales also appear to be looking closely at every aspect of their operations. It appears that companies are recognizing the value of closely analyzing their supply chain and see changes in this area to be just as worthwhile in less volatile economic times.

It is worth noting that 13.8% of respondents plan to add nodes, compared to 4.8% who have added them already. Respondents from companies with $500 million to $1 billion in sales (25%) and more than $2.5 billion in sales (19.4%) were most likely to add nodes in the next 12 to 18 months. Manufacturers and retailers appear to be leading this charge.

Conversely, fewer respondents overall are planning on reducing the number of nodes (9.7%, compared to 18.6% who reduced them already). Distributors are less likely to reduce nodes than manufacturers and retailers. These trends appear to be signs of economic optimism.

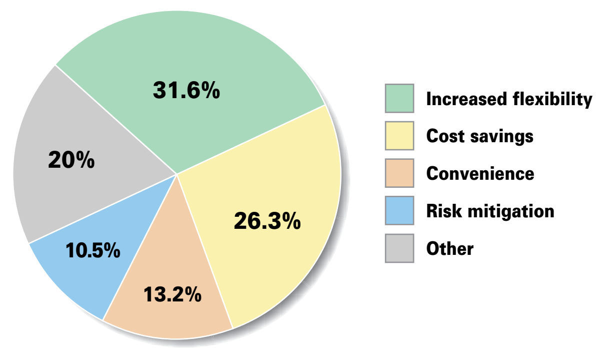
Supply Chain Distribution Network Management

Just over one fourth of respondents (26.2%) currently outsource logistics services. Large companies with $1 billion to $2.5 billion (31.6%) and more than $2.5 billion in sales (41.9%) use outsourcing practices most, although many small to mid-sized companies with less than $100 million (15.2%), $100 to $500 million (26.8%), and $500 million to $1 billion in sales (12.5%) also outsource.

The scope of the distribution network also appears to be a factor. Companies with more extensive distribution networks are more likely to outsource. Of respondents who outsource, 34.3% have more than 10 nodes, and 28.6% have 5 to 10 nodes.

Respondents who outsource see the biggest benefits of the practice to be increased flexibility (31.6%), cost savings (26.3%), and convenience (13.2%). Priorities vary by company size. For large companies with more than $2.5 billion in sales, flexibility and cost savings are most critical. Those with $500 million to $2.5 billion consider convenience to be key. For those with $500 million or less in sales, the greatest benefit is flexibility. Regardless of the order of priority, outsourcing offers distinct advantages that are particularly valuable in tough economic times. Those companies not currently outsourcing may find that these benefits warrant a closer look at the practice.

Biggest Advantage of Outsourcing Distribution



Emerging Trends in Distribution Network Management

Just as supply chain distribution network design has changed as a result of the economic environment, so, too, has the management of distribution networks. Many companies have added or changed vendors (24.8%), changed the size of facilities (17.9%), increased or began outsourcing (12.4%) or, conversely, reduced outsourcing (10.3%). For approximately half of respondents (52.4%), recent economic challenges have had no impact on the management of their supply chain distribution network management.

Mid-sized companies with sales of $100 to $500 million (17%) and $500 million to $1 billion (18.8%), and very large companies of $2.5 billion or more (16.2%) are most likely to increase or begin outsourcing. For manufacturers, specifically, increasing outsourcing seemed to be more common with 20% increasing or beginning outsourcing. Distributors and retailers were less likely to do so (8.9% and 7.4% respectively).

"We are seeing an increasing number of companies coming to Saddle Creek looking for ways to lower cost and improve service to customers," says Patterson. "There's no question, tough economic times have caused more people to realize the benefits of focusing on their core competency."

In order to focus on core strengths during this troubled economic period, more than half of all companies who outsource say they have asked for new things from their warehousing service provider or 3PL from a distribution standpoint. Aside from cost reduction, the most common request is for information in the form of real-time tracking, statistical data, more reporting, ASN's, etc. Other mentions include making the facility more economical to operate, adapting to internal information technology applications, mode optimization, consolidation and improved costing models.

Near-Term Outlook for Distribution Network Management

In the next 12 to 18 months, the majority will uphold the status quo, with 62.1% of respondents expecting distribution network management to remain the same. For those planning to make changes, more respondents are likely to change the size of facilities (20.7%) than add or change vendors (17.2%), while outsourcing plans increase slightly (13.1%).

Respondents who outsource (57.9%) expect their level of outsourcing to remain the same and 18.4% plan to increase outsourcing somewhat or substantially, indicating that they recognize the value of the practice in difficult economic times. For 18.5% of respondents, a decrease in outsourcing is expected.

The biggest change can be expected for companies with less than $100 million in sales who currently outsource. Of these, 40% plan to increase their outsourcing. Companies with $1 billion to $2.5 billion in sales also plan to increase outsourcing (33.4%).

Of those respondents who do not currently outsource, 12% expect to begin outsourcing over the next 12 to 18 months, signaling that they recognize the value proposition for the practice.

Moving Forward

The majority of companies have looked to their supply chains to help them through recent economic challenges. They recognized the distinct impact that distribution network changes in areas such as warehousing and transportation can have on their bottom line.

As they enter a period marked by less economic turbulence, companies are continuing to look closely at their distribution networks, realizing that the strategies which helped them to cut costs and increase efficiencies in troubled times have the potential to serve as a point of differentiation for their businesses as the economy improves.

A substantial number of companies look to outsourcing as a way to effectively and efficiently manage their distribution network. They see value in the convenience, flexibility and cost savings that experienced third-party providers can offer.

As companies are called on increasingly to streamline operations, they will continue to refine their distribution network design and management for optimal performance.

About Saddle Creek Corporation

This research was sponsored by Saddle Creek Corporation, a third-party logistics company that provides integrated services nationwide – warehousing, transportation and contract packaging.

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