viewpoints

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Capacity

WHAT'S NEXT?

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This is an exciting and challenging time to be in the transportation industry. Perhaps only deregulation in the late 1970s could rival today for the sheer breadth of change that is occurring in so short a period of time. From the third quarter of 2003, continuing through to this day, our nation has struggled to move its freight with the speed and economy that it did just three years ago and during the previous two decades. The capacity of truck and rail carriers has been stretched, with rates rising and uncertainty everywhere.

The economy, politics, regulation, turf wars, shipper "core carrier programs" and ever worsening imbalances of trade have created this massive disruption to our nation's once fluid transportation infrastructure. We are experiencing permanent economic changes and we will not return to the way things were a few years ago.

While we can't stop these forces, as today's participants we do have the potential to positively change the nation's transportation infrastructure to meet tomorrow's challenges. Or we could choose to ignore these conditions and let our elected leaders continue to avoid making the tough decisions. If we do this, we will forever carry the burden that our proud nation's economy slipped to a weaker number two in the world on our watch. Transportation is where it's at—like it or not.

The core carrier methodology used by the largest shippers in the 1990s is dead. That is a controversial statement, but nevertheless it is true. The core carrier jobs, manufacturing and the economy. But then they invariably ask, "so what do the railroads think?" When you acknowledge that the railroads fight against any measure of truck productivity, they customarily disengage from the conversation.

The "Highway Bill" SAFET-LU that was passed after three unacceptable extensions included no fewer than 6,000 ear marks in it, diluting the effectiveness of the already woefully short spending amount. The government's own study calls the Highway Bill incapable of sustaining the nation's existing highway infrastructure, let alone allowing for new building.

Conservative estimates place America's tonnage transportation increases between now and 2020 at 73 percent to over 100 percent.

Let's not blame our leaders for everything. Perhaps the nation's biggest transportation productivity opponent is the railroad industry. They are deathly afraid of truck productivity from the standpoint of "market share" loss. Due to the relatively small number of railroads in the nation, they have the unique ability to raise lots of cash and focus their resources on a few key legislative or regulatory goals. They use their influence in Washington, besting the amount raised by shipper groups like NITL, carrier groups like TCA or ATA, and 3PL groups like TIA on their varied issues.

There is no ambiguity in the railroad industry's position that they refuse to support any increase to trucking productivity. At an industry meeting in Washington on April 3, 2006, a spokesperson was asked, if there was any conceivable way that the railroad industry could reach a compromise in order to change its position relating to truck size and weight issues? The answer was essentially no. His negative answer was in spite of the bombshell he had just laid on the audience that the rail industry would be seeking a 25 percent tax credit from Congress for new track investments. Poet Daniel Defoe once wrote, "Remember, all men would be tyrants if they could."

During that same week *Traffic World* Magazine's cover story stated that UPS is pulling time sensitive freight off the railroads and diverting it to truck. The shipping market is clearly stating that it needs productivity help from truck and rail. The market seems to be telling the railroads that they too need help.

Despite it all, railroads are choosing to fight productivity, and hide behind a thinly guised veil of concern for the nation's highways (which they don't use) and congestion issues. The reality is congestion has worsened and will continue to worsen if size and weight issues aren't addressed. Truck safety has improved steadily too, with deaths involving trucks at or near their lowest historical level, while vehicle ton miles are at their highest. Though these are 21st-century issues, the railroad industry seems intent to plan for tomorrow's national and global challenges with 1970s business thinking, and the very best of 19th-century protectionist ideals.

Conservative estimates place America's tonnage transportation increases between now and 2020 at 73 percent to over 100 percent. Those are staggering amounts especially when you consider that our infrastructure can't seem to effectively handle what we have now.

The successes of the trucking and railroad industries, and indeed our nation's economy, are increasingly bound together. The good of one industry impacts favorably on the good of the other and on the nation as a whole. The railroads and the truckers must (not should, but must) reach a compromise and bring it to Washington. If either side is too afraid to lose a fraction of market share, then they shouldn't be in business in the first place. Business is about competition, imagination, ingenuity and productivity. Stifling productivity is the business of fools.

Clearly American business is adapting to this new environment but it will not be enough. As transportation industry users and as citizens, we must insist to our politicians, our trade associations and our freight providers that enough is enough and we must demand change. We must improve transportation productivity—all modes of transportation. We must invest in easing national bottlenecks, intermodal exchanges and highways and invest less in local politicians' pet projects. Our highways are already overly congested. What will 100 percent more trucks on the road feel like? 100 percent worse than it feels today. ***DTJ***

Just in Time at DOD

A CHANGING MARKETPLACE FOR 3PL SERVICE PROVIDERS

by Kevin N. Speers, Stephen Eisele and Joshua Pavluk
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In the *Art of War*, Sun Tzu observed that "every battle is won or lost before it is ever fought." Embedded in this adage is the timeless value of logistics in sustaining—and preparing for—the onslaught of battle. For millennia, military forces have sought to modernize and enhance their supply chains. The Assyrians recognized the superior mobility of the horse to replace the sturdy but slow moving ox. Like the empires of old, the US military is seeking a horse to replace its proverbial ox—but where to look?

United States military operations in Afghanistan and Iraq heralded a new era of warfighter efficiency enabled by successful interoperability across Services. Compared to the precision and responsiveness of modern-day US military forces, logistics support operations often appeared slow and inadequate. Simply put, the efficiency and effectiveness of the more integrated, joint military surpassed the ability of the support services to keep up.

Military logistics has traditionally been organized, performed, and managed by the Armed Services in cooperation with certain DOD-wide agencies responsible for parts of the distribution chain. More recently, logistics services covering the methodology is a popular practice whereby shippers trimmed back the number of carriers they used from hundreds to as low as a dozen or two. This practice was adopted from purchasing theory, which sought to leverage buying power with fewer sources.

Everywhere in Corporate America, this methodology was implemented. Well meaning, but misguided academia accelerated the adoption of these programs. Freight pricing, particularly truckload freight pricing has much more to do with basic supply and demand forces than leveraged purchasing power. In many cases there is no difference in price between the market and so called "leveraged" truckload pricing in these core programs because the pool of carriers is too thin.

And while it is true that every shipper navigated through 2003 to today due to the close relationships they had with their carriers, something was missing from most core carrier programs—scalability and flexibility. Most shippers, especially the largest corporations, specifically excluded brokers, forwarders and third party logistics (3PL) firms from their core carrier programs. That was a big mistake that virtually every big shipper in the nation is struggling to correct.

Core carrier programs are directly attributable to the growth of the largest TL and LTL carriers. Were it not for the huge overnight demand for core carriers created when academia and large consulting firms pushed this misguided "flavor of the month" to the CEOs of shippers across the country, the enormous capital investment into these largest of trucking firms would not have existed to the extent it did.

Think about this for a moment, if a CEO or CFO gave their logistics department a directive to reduce the number of carriers they use from 150 to 40, who are they going to reach out to? The largest national carriers, naturally! Every shipper in the country reached out to the same large carriers driving an insatiable demand for more equipment and service.

It came as no surprise that when President Bush's tax credit in late 2003 supercharged the American economy after two soft trucking and economic years, many shippers were stung badly by a portion of their former core carriers. Remember, all big shippers have essentially the same core carriers. When the economic table was finally turned, carriers quickly began the process of selecting "core customers" and deciding which of them would get their increasingly valuable equipment. Many carriers today are continuing this rationalizing of their customers. What could shippers do? They desperately needed reserve capacity.

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The greatest assets of a trucker are his trucks, yet they are also the greatest liability. Understanding this, the nation's savviest shippers are busy establishing a new gold standard for transportation management practice. Shippers are finally using that medium that fueled much of deregulation's successes and are finally infusing their core programs with a professional broker and/or 3PL to participate as an equal partner with their carriers. These shippers are collectively working with the broker/3PL community to find that flexibility. Brokers/3PLs have been tapped into the small and medium, the regional and niche carriers for decades. These carriers were largely shut out of core carrier programs and they have capacity, even today.

The major trade associations for shippers and brokers, the National Industrial Transportation League and the Transportation Intermediaries Association, respectively, worked together to establish a model shipper/broker contract—the first of its kind—to accelerate shippers' movement toward and embracement of brokers/3PLs. This new methodology is being referred to as a core "provider" program.

New regulation, politics and anti-productivity lobbying have worsened the nation's driver shortage. In an American Trucking Association/Global Insights study "The US Truck Driver Shortage: Analysis and Forecasts, May 2005," it is stated that for the first time, long distance truck driver pay fell below construction worker pay around year 2000, and as of 2004 had not yet recovered. Prior to 2000, trucker pay had always outperformed construction pay.

Unfortunately, the demographics of our truck driver population show major challenges ahead. The largest segment of driver is upper middle-aged white males. No younger age group is close to the size of this outgoing population. Today's shortage of 20,000 or so drivers is expected to swell much higher during the next decade.

Eisenhower, Carter and Reagan are the nation's only transportation heroes. It is sad that we must look back 20, 30 and 50 years to find leaders who understood the role a sound transportation system plays in our economy and ultimately our power as a nation. Eisenhower established the interstate system—the largest public program ever undertaken in the world. Carter and Reagan deregulated the freight industry. After abundant energy sources, our transportation infrastructure could be the nation's next greatest resource. We're letting that advantage slip away quickly.

Today's leaders are capable of leading, but seem to be perfectly unwilling to lead. Lobbyists seem to pollute their minds and possibly their actions/inactions. Congress had the opportunity to do the right thing and help the economy with respect to driver and other skilled and unskilled worker shortages in April 2006 by addressing immigration, but they conveniently let the legislation die. Republicans blamed the 36 Democrats and then went home. When asked to increase truck productivity, many elected leaders or their staff seemed to grasp the positive effect it would have on transportation, warehousing, and management of assets have been entrusted to commercial players. These outsourcing trends, combined with recent reorganization efforts, have paved the way for an extensive use of commercial solutions to complex supply and logistics challenges, creating a promising environment for commercial third-party logistics (3PL) providers eager to engage the defense logistics market.

APPLYING 3PL TO THE DEFENSE MARKET

If the benefits of 3PL providers in the commercial world are widely recognized, then their entry into the defense market, one would assume, should be welcome. Indeed, the DOD has indicated it would like to see improvements and solutions that draw on industry's experience.

The reality, however, looks different. 3PL companies have yet to gain substantial market share in the defense arena due in part to such unique challenges as constructing an interoperable logistics information system, ensuring access to remote and dangerous areas, and overcoming organizational barriers within DOD. Companies accustomed to doing business in the commercial market may find it intimidating operating in an environment in which their customer at times can be their greatest competitor.

The main agencies responsible for DOD logistics and supply chain management are the Defense Logistics Agency (DLA) and the US Transportation Command (TRANSCOM). DLA is in charge of the packaging, storage, and distribution of consumables needed for combat and troop support at home and abroad. TRANSCOM is responsible for distribution and delivery, with emphasis on transporting materiel to the theater. They are at the center of the military's current logistics transformation efforts and have most to gain theoretically from commercial solutions.

As the logistics arm of the US military outsources an increasingly larger proportion of the logistics effort to commercial providers, significant challenges remain before the full benefits of 3PL can be realized to the level seen in the commercial sector. Not only does managing and integrating the vast defense supply chain require a Herculean effort, but commercial best practices are not always best suited to military needs. As the DOD makes progress in upgrading legacy systems and integrating new commercial technologies, it will become equally incumbent upon commercial providers to adapt to DOD's supply chain, something many providers are presently ill-prepared to do.

CHANGING DISTRIBUTION AUTHORITY WITHIN DOD

TRANSCOM's recent designation as the "owner" of DOD distribution will have significant influence over the expansion of 3PL services in the defense space. Introduced by the Office of the Secretary of Defense (OSD) in 2003, the DPO initiative is intended to better coordinate the Department's logistics operations within the context of the Secretary's broader military transformation objectives. It is supposed to streamline distribution management structures and allow for more efficient flow of information and more effective decision-making. The initial guidelines instructed TRANSCOM to serve as a clearinghouse for distribution coordination throughout the DOD, establishing a contracting agency to handle commercial transportation.

The DPO initiative faces some near-term challenges that have delayed its immediate and full implementation. The DPO moniker affords broad distribution coordination powers to TRANSCOM, but the title currently only grants specific, day-to-day authorities to the command. This has led to some delays in implementing distribution process improvements, including the potential outsourcing of 3PL services.

Prior to DPO, the various TRANSCOM components—the Navy's Military Sealift Command, the Air Force's Air Mobility Command, and the Army's Surface Deployment and Distribution Command—managed military transportation and shipping. Contracting commercial 3PL providers to handle integrated distribution and execution would likely translate into reduced workload for the component commands. DPO challenges TRANSCOM to address the possibility of competing contracted 3PL services against its own internal service providers. 3PL providers are thus faced with the paradox that their largest competitor is also their customer.

DOD has recently taken steps to overcome some of these concerns and develop

workable solutions to effectively implement the goals outlined in the DPO initiative. In particular, DPO's evolution has benefited from key initiatives that could serve as test cases for future 3PL opportunities.

Beginning in the late 1990s, elements of TRANSCOM and DLA worked together to develop a prototype that employed a commercial transportation vendor to provide 3PL services in the southeast US. In 2001 the Military Traffic Management Command (since renamed the Surface Deployment and Distribution Command) awarded a contract to Eagle Global Logistics to provide 3PL services to military customers in the region. Eagle's obligations included the management of outbound freight shipments from both military bases and DLA distribution depots. The goal was to use the lessons learned from this pilot project as a case for coordinated, regional DOD transportation and distribution.

This initiative provided lessons that laid the groundwork for another key 3PL program. This program, known as the Defense

key nodes within DOD distribution networks. It also streamlined domestic distribution operations through further instituting a "hub-and-spoke" distribution system. The number of spokes in DLA's distribution system was reduced, with the surviving spokes now providing only regional distribution support. By reducing the number of distribution centers, as well as cutting the inventories of the current ones, DLA has paved the way for broader utilization of 3PL services. The latter will be required to ensure that internal customers have timely access to needed supplies. Commercial 3PL providers will likely be commercial providers. Yet, DOD, through DLA and TRANSCOM, has come a long way in restructuring its logistics chain of command. This has been part of a necessary evolution to provide greater management oversight, improve responsiveness, and maintain operational tempo in the new era of asymmetric warfighting.

Along with these changes come new opportunities for commercial 3PL providers who might have taken a bleaker view of the defense market to date. The recent DPO initiative and the Department of Defense's evolving geographic footprint hold promise for 3PL activity and pro-

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Transportation Coordination Initiative (DTCI), will likely be awarded in fiscal year 2006 and will give TRANSCOM a significant role in helping manage the military's continental US distribution.

The process of developing DTCI and associated requirements has helped to give practical meaning to the DPO designation. DTCI should help better define TRANSCOM's distribution authority moving forward by further implementing two of the DPO pillars—integrated distribution and execution. The process of implementing these two efforts should address some of the DPO initiative's early challenges, including the question of bureaucratic responsibility. DTCI could also provide a new model for future cooperation between DOD and commercial 3PL providers.

DOD'S CHANGING FOOTPRINT

The 2005 Defense Base Closure and Realignment (BRAC) Commission's report, recently passed into law, is the most important driver behind DOD's changing domestic geographic footprint. During the BRAC deliberations, DOD appeared reluctant to commit precious contracting dollars to soon-to-be outdated distribution systems. Now that DOD has largely defined its near-term domestic distribution structure, 3PL providers are likely to face a more favorable environment in which to operate.

BRAC 2005 reorganized base assets and shifted the relative volume handled at called upon to fill this void, with DTCI serving as a key facilitator along the way.

Domestic structural realignments are not alone in explaining 3PL companies' challenges in penetrating the DOD market. Outside the US, commercial 3PL providers have gained limited traction due to lingering DOD concerns over their ability to perform close to theater. Officials who readily accept the benefits of 3PL services in domestic situations may become far more hesitant when faced with using the same services overseas, especially if distribution moves in and out of a theater of war.

DOD's evolving domestic and international footprint has created an opening for commercial 3PL providers to market their capabilities. Even as large-scale initiatives, such as DTCI, appear ill-suited for operations outside the continental US, companies may find near-term niche arrangements in which they provide overseas logistics services to deployed units. 3PL providers who recognize these changing market dynamics will be well positioned to capture emerging DOD opportunities and to leverage their own strengths against the military's changing domestic and international footprint.

CONCLUSION

Military logistics remains as unpredictable a business as ever, and, combined with a heavily regulated market, this can make the DOD space unattractive to many vide windows for industry to engage with and learn from the customer. By taking on niche roles in critical segments of the DOD supply chain, 3PL companies can gain a better understanding of this market, and gradually the confidence of end-users. Basing market strategy on complete, end-to-end services may not be as prudent, if only because these opportunities are not as common within the defense space.

As the US military continues its transformation into a more flexible force, the need for greater asset visibility and efficiency will drive the call for better supply chain solutions. Like the armies of bygone eras, the US military is moving faster than its oxen can keep up. In the short term, the DOD will not be able to replace all its oxen. But by engaging the customer now and familiarizing themselves with the DOD's changing logistics base, commercial 3PL providers can better position themselves for the opportunities that are likely to emerge in the near future. ***DTJ***

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