The Internet’s next phase

Next week the Council of Logistics Management holds its annual conference in New Orleans. The topic this year is “redefining logistics.com.” It dramatically demonstrates the distance the logistics industry has traveled in a generation.

In the late 1970s, two events forever changed the transportation and logistics industries. First, transportation deregulation allowed customers and providers to negotiate — and innovate — purchased services. Second, high interest rates forced companies to focus on total logistics costs instead of to simply the cost of purchased transportation.

Over the next 10 years, logistics evolved into supply chain management. The focus switched from pure expense reduction to increased profitability and shareholder value. Companies realized that an enhanced supply chain could generate profitable growth, working capital reduction, improved efficiency of fixed assets, minimized global tax exposure and, of course, cost minimization.

Now factor into this the explosion of the Internet. Andy Grove, chairman of Intel, said, “In five years time, all companies will be Internet companies, or they won’t be companies at all.” The capabilities provided by the Internet have clear applications in the logistics world. Transaction information can be shared in real-time, costs can be reduced, business relationships can be transformed and customer service improved.

The Internet and B2B exchanges are changing the supply chain into a demand chain. Market power is shifting from those who manufacture to those who buy, while development of vertical exchanges has altered business protocol in its own way. Internet applications are varied, ranging from buy-side auctions and exchanges to seller-oriented exchanges and catalogs. Yet: all of the exchanges emphasize efficiency and increased market scope, while providing price transparency across all suppliers.

In this environment, opportunities for transportation exchanges seemed obvious. Fragmented industries with many buyers and sellers are best suited to exchanges. According to a 1997 report by the U.S. Census Bureau, the transportation and logistics industry is one of the three most highly fragmented business sectors (defined by the ratio of total companies to the size of the market.) Credit Suisse First Boston estimated that the top ten companies in this industry control only 12% of the market.

Despite the positive climate for transportation exchanges, there has been no clear market leader. Some exchanges with high-minded expectations have progressed minimally from their bulletin board origins. Reasons for this lack of innovation are surprisingly complicated.

First, some carriers have been hesitant to embrace a practice which could lower their rates. This has certainly been the case with ocean shipping exchanges, where, as a result, there is often little supply (or "liquidity") response to market demand. Shippers often find rates higher than those in their existing contracts, with no guarantees of proper execution.

Ironically, such a market could help freight intermediaries, who originally feared that exchanges would displace them. Furthermore, the market may not have been as opportune for auction as some exchanges had hoped.

Unlike pure commodities, which experienced great success with raw materials, paper and airline seats, transportation might not be as fungible. Many customers rely on a core carrier concept and only seek auctions on a small portion of their business.

Managing the core carriers is probably a better business prospect for Internet transportation companies. In fact, some of the early transportation exchanges (e.g., CelereX) are abandoning their initial business missions of auctioning space and are attempting to become transportation management systems that seek to provide total transaction visibility for their customer.

These new companies might be called 3.5PLs, operating somewhere between 3PLs, who manage a specific supply chain and 4PLs, who manage the 3PLs.

Meanwhile, two logistics issues await resolution. The first is the "ship-it" button on B2B exchanges. As the B2C (business-to-consumer) companies demonstrated last year, a business that cannot execute customer fulfillment is no business at all. Since more than 1,000 B2B marketplaces now compete with each other, cost-effectiveness of delivery could determine success. While some 3PLs are forging strategic links with these marketplaces, other solutions, such as a logistics exchange, may also emerge.

All of this activity points to the critical importance of integrated data and information flow between exchanges and transaction participants. The Internet has greatly reduced transmission costs of passing data, but integration is another issue. Many B2B exchanges have found that their ability to grow has been severely constrained by lack of integration capability.

If past meetings provide any roadmap, the CLM conference promises to address a wide range of issues in a rapidly changing industry. Since the pace of change shows no signs of slowing, only true innovators will succeed.

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