LOGISTICS INSIGHTS:

Agility, automation and free trade.

What does the future hold for Asian economies?

Mike Hill, Indigo Asia's Managing Director invited Mark Millar, one of Asia's most respected independent logistics and supply chain experts, to an exclusive interview at The Excelsior Hotel in Causeway Bay, Hong Kong. On the agenda was a discussion about the impact of the TPP (Trans Pacific Partnership) agreement on future growth beyond China; the challenges of running an omnichannel warehouse and wider attitudes towards technology adoption and warehouse automation. Bringing together two logistics experts with a combined 60 years experience working with companies across Asia was bound to result in a lively debate and this article provides a detailed account of their discussion.

LOGISTICS INSIGHTS PART 1: IMPACT OF TPP AND INFRASTRUCTURE ISSUES TO RESOLVE

Mike Hill: How do you think the introduction of TPP will affect the distribution of manufacturing in Asia and in particular the growth of Distribution Centres (DCs) outside of China?

Mark Millar: TPP is probably the most wide-ranging multilateral free trade agreement in terms of the breadth of products it covers and the way 90% of products will be imported into the US tax free from day 1. It has been agreed but remains to be ratified and if Obama can achieve this before his term ends it will have a huge impact on trade and will undoubtedly mean large-scale development of new DCs across the region.

Two countries to watch, which are also members of

the ASEAN economic community, are Vietnam and Malaysia. Of the two, Vietnam is the 'sweetspot' if the TPP is ratified, as imported goods into the US from Vietnam on a weighted average will be 17% cheaper than the same imported products from China. This is because, based on a weighted average, that is the approximate level of tax applied to imported goods from China and will drop to zero rates of tax on about 90% of products.

But the big 'if' in the mix is the Clinton/Obama/Trump trio. If Obama does not get it ratified before he finishes then its future is uncertain, because neither Trump nor Clinton have demonstrated much enthusiasm for more international trade deals. So, assuming it does happen, and we think it will, then yes, it will change the Asian manufacturing landscape and therefore will change the DC landscape.

Mike: If countries like Vietnam will benefit, do they have the infrastructure yet to derive maximum benefit from it?

Mark: Generally levels of infrastructure are poor within the 12 countries involved, although there are some exceptions. Malaysia is further along the development curve than Vietnam. I would say that Vietnam is rather like China was 10 years ago and that's to be expected. It joined the World Trade Organisation 10 years after China and opened its domestic market to international companies offering 100% wholly foreign owned transport warehousing in its domestic market 10 years after China. There are lots of new opportunities for new DC builds and all the major international logistics players, the Damcos, DHLs for example and regional players like Kerry Logistics, have been expanding in Vietnam.

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Mike: Indonesia and the Philippines are also hot spots for new infrastructure development in Asia, but they face different challenges as island archipelagoes. The Philippines has similar potential to Vietnam and in Luzon alone there is a market of 60 million people, but a poor infrastructure on the other islands.

Mark: Yes the problems they face are due to problems with inter island shipping, poor infrastructure on outer islands and congestion. The Philippines is interesting because it is less dependant on exports than China or Vietnam, it's a more self-sufficient domestic economy, which is better insulated against the global trade economy compared with China's for example.

Indonesia has the same island problem but if you strip away the big numbers – 12,000 islands in the archipelago and a population of 260 million people, there are islands that are large enough as individual economies to sustain significant infrastructure growth. Java accounts for 60% of Indonesian GDP and is home to 80 million people – that's enough to keep a business busy for 5 years on a single island.

The challenge for manufacturers is to find logistics service providers that can offer wider coverage beyond Java and Luzon, because they probably have those larger regions covered already and want to have wider reach to other less established areas.

Another interesting place in Asia beyond China, Vietnam, Indonesia and the Philippines is Myanmar. This is the 'new kid on the block' with a lot of exciting developments. They might not be ready just yet to provide DC operations that comply with expected international standards, but it is definitely up and coming. Myanmar has a 55 million population and a large pool of low cost labour available in the short term. In the medium term, as we have experienced in other Asian countries, once employment opportunities increase, the resulting economic prosperity creates a consumer market and an emerging middle class, thereby securing longer term consumer demand.

LOGISTICS INSIGHTS PART 2: OMNICHANNEL AND THE UNIQUE CHALLENGES IT BRINGS

Mike: What do you think are the challenges for a DC in the new omnichannel commerce era?

Mark: The whole omnichannel world is the biggest challenge Asian DCs are facing and I see the next decade of advising companies on how to deal with omnichannel and the ecommerce frenzy as simultaneously the most exciting and most challenging period in my career. It's really stretching the capabilities of traditional logistics service providers who are caught in a model of traditional B2B services and having to adjust to B2C e-commerce orders being shipped directly to the end consumer.

This creates issues on three levels because neither traditional logistics service providers nor manufacturers can operate in a way that: a) meets the expectations of an ever more demanding end consumer who has become accustomed to getting free delivery; b) is satisfactory for their clients, the brand owner or retailer, from either a service level or economic perspective; or 3) that will enable them as the producer or service provider to make money and run a sustainable business.

Manufacturers can either find a solution or outsource their logistics to a service provider. The 3PLs have fewer options and if they cannot find a solution, they risk losing the business. If they want to keep their traditional B2B distribution activities, they will need to find a way to accommodate the growing B2C ecommerce activity and this is a serious challenge because of the competition emerging. There are new entrants appearing everywhere, from new e-commerce logistics providers driving an "uberisation" of the sector, with new types of business models backed by VC money; to the ecommerce providers themselves who are becoming logistics service operators. For instance, is Amazon a logistics company or an ecommerce company? The logistics capabilities of the likes of Amazon, Alibaba, Luzada and JD.com are really what gives them their edge.

Mike: I've noticed that vertical integration is an emerging trend. We have customers in Asia who are moving away from outsourcing their logistics operations to establishing in house expertise and building their own DCs. They are using our WMS technology and intend to offer any surplus logistics capacity to other manufacturers looking for a solution, effectively competing with other 3PLs.

Mark: Pure e-commerce companies are also more nimble. They loose a lot of money on logistics by having to offer free delivery for example, and but can subsidise this because they don't have the same footprint as a retailer with outlets and staff. They have larger margins because they are often selling the same products at the same price as a retailer with stores and without those overheads they can afford to discount too, so it's the traditional retailers who are struggling to keep up with all this.

LOGISTICS INSIGHTS PART 3: HOW DOES CLICK AND COLLECT WORK IN ASIA?

MIKE: HOW IS CLICK AND COLLECT EVOLVING IN ASIA?

Mark: The last mile is the most expensive cost and there are lots of stats on what the cost of the last mile is and in particular, the number of times a delivery fails because people are not at home to collect. In Asia, there is the added complication that a lot of e-commerce orders are offered cash on delivery, especially in China, so that's even more complicated. Click and Collect alleviates some of the burden and there are locker box type systems at publically accessible locations. There is also Click and Collect from stores which brings people to the retailers, but at the same time, it creates a cluster within the store and this can be disruptive to other shoppers without having a dedicated Click and Collect zone in store. It's important that retailers are set up properly to make this a good overall experience and that packages are ready on time and can be found quickly.

Walmart says that of the people in China who use their Click and Collect service, 30% go into the store and buy something else, which is clearly good for business. But that won't suit everyone and you need a retail footprint to manage the opportunity. If you are offering Click and Collect from a depot, there isn't the same opportunity to cross sell and if you are using an intermediary like a convenience store, this can become inconvenient for the convenience shopper, because they are overwhelmed with people collecting orders. The exacerbating factor is what I describe as "the madness of free delivery, compounded by the insanity of free returns." In the garment sector, where you have people buying multiple size and colour options, it's economically unsustainable.

Mike: Organising a DC for omnichannel is the big issue we are seeing customers struggle with. There are so many options and it depends on the business. Do you have a separate warehouse for e-commerce? Different areas in a single DC? Or do you pick orders from the same locations? All the options have pros and cons and provided the WMS technology can support picking single items from cartons, it's all possible. The WMS has to be able to recognise a split carton and older WMS systems cannot cope with that level of detail, it's either a carton of 10 or 1 carton.

LOGISTICS INSIGHTS PART 4: AUTOMATION AND ATTITUDES TOWARDS NEW TECHNOLOGY

Mike: Will the rising cost of doing business in China push manufacturers towards introducing automation into their warehouses?

Mark: No, I don't think costs will have a direct impact, it will be due to other factors. What will push Chinese manufacturers towards introducing more automation in the warehouse is increased pressure to do so from their customers, the brand owners like Nike for instance. Traditionally in China, because of the large pool of available resources, there has been little interest in automation. We are probably a generation away from having Chinese management in local DCs and seeing the level of technology investment that is made in European or US DCs for example. But soon, a new generation of senior management, who are likely to have had an international education and exposure to warehouse automation in other companies, will better

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appreciate that the economics over the medium term make a lot of sense.

Mike: I agree and this thinking is reflected in a discussion we had with a pneumatics company recently about goods received from component suppliers. They experience consistently high levels of shipment accuracy coming from Japan, medium to high from Europe, but much lower accuracy levels from China. Big brands won't accept quality variations like this so the move to automation will be driven by them and their desire for greater accuracy and consistency from all suppliers to meet service level standards

Mike: During your travels around Asia are you seeing any growth in demand for newer warehousing technologies such as 'voice picking', 'pick to light' or integration of WMS systems to intelligent cameras?

Mark: Yes, bearing in mind the caveat around traditional attitudes towards investment in automation. What will drive investment in WMS technology is the availability of Saas applications and the cloud. Culturally, companies in Asia prefer the pay per use model for a number of reasons. Firstly, they don't need an IT department or investment in hardware and they prefer a business model where the cost to them for software is based on the actual number of transactions completed they have completed. In other words, the investment they make in the software directly reflects the revenues they are in turn generating by using the software. This will more likely drive adoption levels because it's easier for a logistics provider to justify the investment cost of a solution that is priced based on the use of that solution.

Voice picking will be popular because the start up phase is minimal, making it straightforward to increase operator headcount and cope with short term peak periods but still achieve high levels of accuracy.

PART 5: CULTURE, INNOVATION AND BREXIT

Mike: There is a lot said about the higher agility of Asian companies, how do they compare to their European or North American counterparts?

Mark: Asian companies are known for being very agile and they are generally better at innovating and adapting to change. They are coming from a less sophisticated starting point which is a double edged sword because although they have less automation, they have less legacy to undo in order to take a new direction and this means more flexibility. In Europe, companies are often encumbered by an entrenched existing model of working such that it makes them resistant to change. Conversely in Asia it is much easier to introduce a change of direction and companies are better at adapting to suit a changing market need and opportunity. Generally Asian companies are more open to new ideas and new ways of working, an entrepreneurial approach to business is prevalent and re-inventing is the norm. For example in the 70s Hong Kong was a manufacturing powerhouse and so many consumer goods had a 'made in Hong Kong' label. Now the country doesn't physically make anything, except a lot of money! They have evolved to become a 99% service based economy and a re-exporter. European companies can learn a lot from their outlook to innovation and business.

Mike: Do you see the Brexit vote having any impact on supply chains providing goods to the UK?

Mark: Who knows what the outcome will be, the immediate impact is obviously the fall in the pound. Long term it could enable the UK to pursue its own path with other major trading nations and increase trade levels without the agreement of other EU members.

Whatever happens, business will find a way through all the politics because consumers want products and businesses want to trade and make money. Look back to 20 years ago when there were restrictions in place between Taiwan and mainland China, they found a way to navigate the political minefield and make money. The same will happen within and outside of the EU. China and the UK have good political connections and it should enable more trade with the Asia region. It's a real opportunity. ■

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