BEATING THE ODDS IN LATIN AMERICA

Multinational corporations are gambling on the Latin American market's growth potential. But when it comes to meeting the region's supply chain challenges, all bets are off.

By Lisa Harrington

"Latin America has transformed itself into a set of fast-growing, emerging economies," says Jose Fernando Nava, president, Latin America, for DHL Supply Chain. "Many countries have developed sound economic policies, with good reserves. The level of public debt is lower compared to other economies. Commodity exports have risen for the past several years, and internal consumption is flourishing."

Consumer credit, which was largely absent 15 years ago, is becoming more available in the larger countries—fueling economic activity. "Home loans, which we have always taken for granted in the United States, were non-existent in Latin America 20 years ago," says Nava. "Today, credit is present in many forms—for car, construction, and home loans, as well as credit cards."

These developments have created internal demand, which has attracted new investment by many global players in industries such as consumer goods, high-tech, and electronics. The region also is benefiting from a recent shift in global manufacturing strategy for large multinational corporations.

"Companies that had located all their manufacturing plants in China are looking to reduce supply chain risk by moving some production to Mexico and Brazil to serve the Americas market," notes Claudia Roa, vice president of Latin America for DHL Customer Solutions & Innovation.

"Doing business in Latin America, however, is rife with complexities," Roa cautions. "Logistics costs are high compared to other regions of the world—about 15 percent of the cost of goods sold. Countries are trying to find ways to reduce these costs, but it will take time."

In the meantime, supply chain management in these countries requires creativity, perseverance, investment, good partnerships, and strong local relationships.

UNIQUE CHALLENGES

Emerging growth economies pose unique challenges for all supply chains, and Latin America is no exception.

Underlying supply chain development is the fact that Latin American consumers are becoming more sophisticated. "A few years ago, if consumers in Mexico bought chocolate from a convenience store, it would be white because it was so old," Nava explains. "They wouldn't even think about returning it, because that was the norm."

Today, that's not acceptable. Supply chains must be able to deliver quality in both product and services, while becoming more efficient and effective.

Third-party logistics (3PL) companies are investing aggressively in Latin America, particularly in Brazil, Mexico, Chile, Argentina, Colombia, and Peru. Brazil ranks third behind China and India in market compatibility, market size, and growth prospects for 3PLs, according to Agility's latest *Index of Logistics Services Development in Emerging Markets*.

"Though Brazil's infrastructure score remains weak, investment is set to intensify in the run-up to both the 2014 World Cup and 2016 Olympic Games," the study says. "When respondents were asked to rank countries with the biggest potential to become a major logistics market in the future, Brazil placed third in the survey."

Mexico clings to top-10 status in the Agility index. "Mexico has seen a continuous decline in its score due to high levels of crime and violence caused by drug-related trafficking," the report indicates. "On the plus side, the country has seen reasonable economic growth in recent years, and benefits from a strong service sector.

"In addition, foreign direct investment into Mexico remains high, and does not seem to be deterred by crime levels—reflecting the relatively easy access to its market and economy Mexico offers international companies," the report says.

Going forward, the following five issues will play a major role in how successfully Latin America develops as a manufacturing, distribution, and logistics market:

1. LAGGING PRODUCTIVITY. Weak productivity is the main reason for Latin America's relatively slow growth. Since 1991, average productivity in the region has increased by only 1.4 percent each year—much less than in Asian economies. Restrictive labor rules and sector-specific regulations persist across the region, limiting the capacity of more productive companies to expand. High social taxes and stringent job security laws make firing redundant employees difficult, and employers reluctant to hire.

"Boosting productivity and competitiveness remains a key policy challenge over the medium and long term," agrees Nicolás Eyzaguirre, director of the International Monetary Fund's Western Hemisphere Department.

2. LACK OF SUPPLY CHAIN EXPERTISE. "Compared to developed countries, Latin America has to invest more in training, especially at the managerial level," Nava comments. "The challenge is that universities in Latin America are not yet offering logistics degrees. It's only a topic within other curricula, such as industrial engineering. People entering the logistics field have to learn everything from how to manage a distribution center to how to interact with customers. This takes time.

"The managerial level is where Latin America's talent issue is most acute," he continues. "High unemployment levels may suggest plenty of workers are available. But that aggregate number doesn't capture the scarcity of trained logistics talent."

3. SYSTEMS. The third big issue for logistics operations in Latin America is information systems and infrastructure.

"The region is comprised of emerging economies, so systems infrastructure generally lacks sophistication or, in some cases, availability," Nava reports. DHL's strategy is to invest in systems and build the same common platform in Latin America that it operates in North America.

Technology is particularly important when managing transportation in Latin America. "Transportation is highly fragmented," Nava explains. "We have to deal with many owner-operators. And in Brazil,

each state levies myriad regulations and taxes. That creates a lot of transactions for our transportation management system (TMS) to handle. A TMS is still too expensive for a single company to justify, particularly in a region where capital is tight. Latin American companies without a TMS end up doing a lot of manual work."

4. SECURITY. Crime is pervasive throughout Latin America, and takes a heavy toll. The homicide rate in some Latin American cities is extremely high. Rio de Janeiro has 33 homicides per 100,000 people each year, compared with four in New York City in 2009 and three in Toronto in 2007, according to a McKinsey & Company report. Monterrey's homicide rate grew at an "astonishing" rate in 2011-2012, says the report, due to increasing drug-related violence.

Economists estimate that Mexico's security issues could reduce the country's GDP by one percent to two percent in 2012.

Organized crime is becoming more sophisticated, requiring 3PL providers to

invest heavily in increasing the standards and sophistication of their security systems and procedures.

"Security is a never-ending battle because the moment you think you're up to speed, something new arises," says Nava. "It drives costs up."

Surface transportation is the most difficult security risk area of the supply chain in Latin America. "There usually aren't multiple routes to destinations within a country. In many cases, criminals simply block the highway and start checking trucks to see what products they like," Nava reports. "The police are understaffed so they cannot patrol every road. On certain routes, DHL uses a private security force to escort its trucks."

To combat highjacking, more trucks—especially in Brazil and Mexico—are being equipped with state-of-the-art GPS tracking systems so they can be monitored in real time wherever they are. Subscription-based tracking solutions will more than double by 2014 in Latin America, according to C.J. Driscoll & Associates. Brazil, in particular, will see significant growth thanks to a new regulation, Contran 245, which will require GPS tracking devices in all vehicles sold there.

"Some Latin American carriers are more advanced in tracking than we are in the United States," notes Wendy Herrick, vice president of customer service and logistics for North America, Unilever, and former director-logistics for the Americas for Unilever. "Go to a transportation office, and you'll find a huge control room with screens monitoring every truck and every delivery. The security problem has actually helped develop transportation in Latin America."

5. TRANSPORTATION INFRASTRUCTURE. Latin America is a long way from perfect in terms of infrastructure. Ports are congested, roads are inadequate, and the pace of investment is slow.

"Many countries are concerned that the pace of growth will outstrip the rate of infrastructure improvement, which, in turn, will keep logistics costs high," observes Roa. "Increasingly, countries realize that if they don't improve, the region will not be able to grow and compete."

More progressive Latin American countries such as Panama, Colombia, and Uruguay have established free-trade zones, which attract heavy distribution-related investment. In Panama, logistics hub development is booming, a by-product of the country's progressive stance on trade and the expansion of the Panama Canal.

Unilever is among the fast-growing consumer goods companies in Latin America and is supporting that growth with investments in manufacturing and distribution facilities.

UNILEVER'S LATIN AMERICA STRATEGY

Clearly, global corporations see Latin America as a high-growth market for the next decade or more. Unilever is no exception. "Latin America is a big opportunity for us," notes Herrick. "Our first-quarter 2012 results show tremendous growth there."

Unilever is investing heavily in manufacturing capacity throughout the region. In April 2012, the company announced plans to invest $500 million in production and distribution facilities in Mexico. Earlier in the year, Unilever CEO Paul Polman unveiled plans to build production and distribution facilities in Colombia to support growth there. The company will invest about €75 million over the next three years to build a state-of-the-art laundry detergents factory and distribution complex at Palmira, Valle del Cauca, to increase

Unilever's capacity for growth, and meet increasing demand for laundry products in Colombia and other parts of Latin America. The goal is to enable Unilever to produce locally and/or regionally, thereby delivering products more quickly to consumers.

"Unilever has set an ambitious goal—to double the size of its business while reducing environmental impact," says Pier Luigi Sigismondi, Unilever's chief supply chain officer. "These new facilities will help us continue to grow in Colombia.

"Our business in Latin America makes up a significant portion of the 54 percent of business that Unilever currently generates from emerging markets," Sigismondi says. "We expect that figure to rise significantly in the future."

Unilever ties supply chain network design directly to supporting its growth vision in Latin America. "We have a clear strategy by customer channel," Herrick notes. "The drug store and value channels are big in Brazil, for example. We look at the market as a matrix, considering the end-to-end supply chain, not just distribution or manufacturing. We then identify what it will take to support growth in these channels."

In many cases, Unilever partners with 3PLs to handle warehousing and transportation. "3PLs with experience in Latin American countries know how to manage the complexities," says Herrick. "In Brazil, for instance, transportation is complicated. Carriers use five or six different truck sizes, depending on the channel requirements. They tailor the equipment to the type of customer.

"The transportation industry is fragmented in Latin America, with a lot of small players," Herrick continues. "That

Ocean Rates and Capacity Outlook

With ocean trade a critical lynchpin of Latin America's future prosperity, what does the near-term capacity and rate picture look like? To find out, *Inbound Logistics* spoke with Mike Wilson, senior vice president, business operations, for Hamburg Süd North America, one of the major liner companies servicing the Latin America trades.

"The container trades in Latin America will likely experience what the liner industry calls the 'cascading effect' – big ships displacing small ships," Wilson notes. While this effect may mean lower rates in the short term, it raises real concerns for the long-term health of containership companies and, thus, the future of capacity.

"Between 2005 and 2009, global liner capacity grew ahead of cargo growth," Wilson explains. "In 2011-2012, cargo capacity and growth nearly equalized, but excess capacity continued to build as new ships entered the ordering, construction, and delivery pipeline. As these new ships come online in the next few years, ship supply will outstrip demand, based on anticipated cargo levels worldwide.

"Supply/demand equalization could take place by 2018, if no new ships are added," he continues. "Unfortunately, this is not likely to be the case, as economics (fuel, capital) will drive the trend toward newer and bigger ships with a lower capital and operational cost per slot."

Given this reality, what do carriers do with their older, smaller, less-efficient ships? "The initial step to improve utilization was to 'slow steam'—run slower, which means carriers needed more ships deployed," says Wilson. "Once slow steaming is maximized, excess capacity is moved to other trades. This is called 'cascading.'

"Cascading, however, only works to the point of saturation in the receiving trade," he continues. "Cascading is happening in the Latin American trades today, as well as in other areas of the world. This has a negative effect on rates, and subsequently on carrier balance sheets. This may be good for shippers in the short term, but eventually, unless volumes increase, carriers will decide to tie up vessels —take them out of service and wait."

Rates will improve at that point, as capacity and volume find more equilibrium. This could create service issues in high-growth trades such as Brazil and other Latin American economies.

Container shipping lines such as Hamburg Süd are "cascading" vessels, which will impact rates and capacity.

"As volume in these trade lanes continues to grow, and capacity in other trades is in excess, the 'cascading' of vessels into these trades is a likely outcome," asserts Wilson.

makes it more difficult to manage, especially when handling volume spikes. And having no rail service in Latin America puts pressure on pricing."

Unilever uses a mix of local and big-name global 3PLs to service its business in Latin America. "It hasn't been easy for some global 3PLs to break into the market," Herrick notes. "We want to see more 3PL presence in Latin America. It serves our mutual best interests and injects healthy competition."

NIKE'S BRAZIL BOOM

With Brazil hosting the World Cup in 2014 and the Summer Olympics in 2016, it's no surprise that Nike views the country as a huge opportunity. In fact, Nike's operations there are poised to become one of the company's largest in the world.

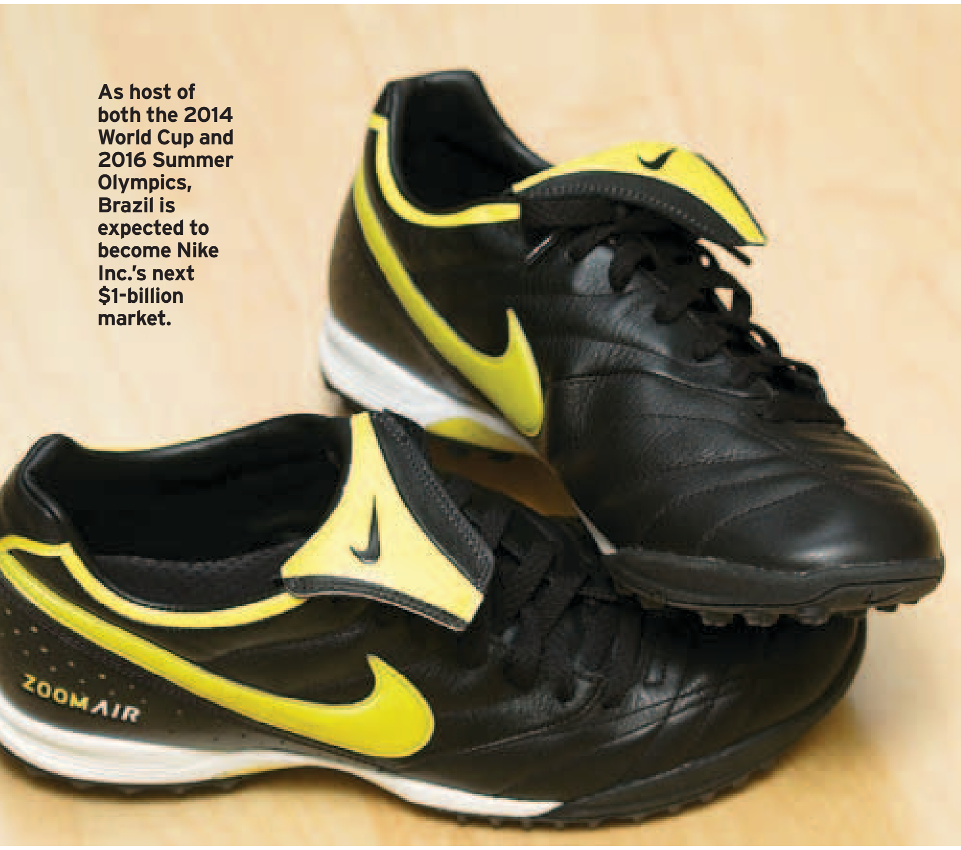
As part of its Brazil market strategy, the footwear giant introduces a new line of products every three months, creating peak volumes on specific launch dates. This seasonality demands supply chain flexibility and visibility to ensure product launches are managed efficiently and cost effectively.

"We receive products from hundreds of factories worldwide and deliver them to thousands of stores across Brazil," explains Leonardo Silvério, national logistics manager for Nike. "The only way to succeed in managing this complex supply chain is to work closely with reliable partners — whether they are suppliers or retail clients."

Nike partnered with DHL Supply Chain to implement an integrated logistics program in Brazil. DHL responds dynamically to order requests from Nike using sophisticated order management and fulfillment systems and processes, integrated route and shipment planning, and delivery service management. Specific components of the program include:

- Monitoring products at every stage in the warehousing and distribution process through RFID systems.
- Real-time monitoring of work flow and productivity in the DHL-Nike distribution center, visible to associates via television monitor.
- Assembling products in accordance with the retail customer's request (size, color, model, quantity).
- Labeling or placing alarms on products so they are delivered to the retailer ready for sale, including the price or bar codes to be used for store inventory control.
- Transmitting information in real time when the delivery is accepted or rejected.

Its 3PL partnership with DHL Supply Chain has enabled Nike to improve customer service levels throughout Brazil while keeping up with rapidly growing order volume. The solution has reduced overall supply chain costs, and outperformed expectations in 42 categories including inbound, outbound, picking, and shipping, within the first 45 days of operation.



As host of both the 2014 World Cup and 2016 Summer Olympics, Brazil is expected to become Nike Inc.'s next $1-billion market.

ALL ABOUT GROWTH

From a supply chain perspective, Latin America "is all about growth," according to Herrick of Unilever. "From the shipper perspective, you have to have the wisdom to take a step back, and understand the culture and how you do business there. It's exciting to be part of a growing area. It's like going back to the 1950s and 1960s in the United States, when businesses were keen to grow and develop."

Understanding the true dynamics of the market, such as infrastructure and distribution challenges, is crucial. "When companies consider entering the Latin American market, they need to realize that each country has different complexities and challenges," Roa advises.

"Many regulations can impact logistics and supply chains," Roa adds. "If companies want to invest, they must understand these regulations, and work with stable logistics partners that can guide them in the process."