Companies in China should select a logistics provider with a global network of offices, standard procedures, and up-to-date information technology systems.

Nine Rules for Logistics in China

A carefully selected logistics partner can help companies overcome their China supply chain challenges.

Rosemary Coates

Logistics is an essential component of a successful deal anywhere in the world, but especially in China where services offered may not be what they seem. Global supply chains are easily disrupted when companies do not consider critical logistics services or blindly trust their supplier to arrange transportation and the export of products from China.

To avoid these supply chain traps, consider these nine rules:

1. Carefully select a logistics and transportation supplier

There are thousands of small logistics companies in China that advertise as freight forwarders and export trade brokers. Almost anyone will say they can do this job because they have connections to trade services. But so many things can go wrong and result in supply chain disasters. If a company cannot get goods to market in time for the season or the sale, or to meet peak demand, the company's logistics network has failed.

Small freight forwarders can provide personalized service when a company needs special care, but they may also add time and frustration to your supply chain. Because they are independent businesses, small, independent Chinese forwarders rely on a network of agency relationships and one-off favors to move freight. Essentially, these small forwarders and brokers are just cargo coordinators. They typically do not own any of their own equipment, make no investments in capital equipment or systems, and rely on subcontractors to provide trucking, air, and ocean freight. Their networks are only as strong as the weakest link. It is common to see small forwarders like this in tier-two or tier-three cities, moving cargo in tricycle carts from manufacturing sites to airports. Some of these companies also subcontract the preparation of export documentation, including US Customs' 10+2 reporting—the information now required to be processed before an ocean shipment, bound for the United States, can leave a foreign country—which can cause delays in China if documents are not properly prepared. Companies should select a freight forwarder or broker with a global network of company-owned offices, standard procedures, and information technology (IT) systems capabilities that comply with the complicated export and import regulations.

Global logistics providers that have established offices across China, such as Expeditors International of Washington, Inc., CEVA Logistics, DB Schenker, Kuehne & Nagel International AG, among others, offer advantages, including:

- Standardization and consistency of procedures worldwide;
- Up-to-date information about export/import regulations;
- Communications standards and protocols;
- Global IT systems to track the many documents required for global trade shipment progression and compliance with trade regulations;
- Negotiated rates and schedules with air and ocean carriers;
- Standard documents and assistance with completing them;
- Landed cost and total cost estimations; and
- Familiarity with International Commerce Terms of Sale (Incoterms).

Keep in mind that just because these forwarders are larger does not mean they are more expensive. Very often, the size of the forwarder allows them to negotiate for better volume rates from ocean and air carriers.

2. Make sure logistics providers have systems capabilities

In the past, logistics was all about moving boxes and getting space on aircraft and ocean vessels. In the early 1990s, with the wide implementation of enterprise resource planning (ERP) systems at most companies, visibility and synchronization became king. Companies could then truly see the impact of disruptions in scheduling caused by delays in transit. As a result, logistics progressed from moving boxes to moving information.

Now, it is extremely important to know where freight is in the supply chain, inventory levels by location, and what is expected to move from your suppliers. This is because manufacturers and retailers need to plan for arrivals or delays using their own ERP or other systems. Without accurate logistics information about shipments from China, entire supply chains can be disrupted—or worse, shut down.

Logistics providers should be partners in gathering and reporting information to help manage a company's supply chain. To accomplish this, logistics providers have to make large investments in their own systems. The ability to provide information is no longer an option, but a basic service offering. Companies should be able to search and schedule online, transmit information electronically (such as Advance Shipment Notices and trade compliance information), and receive automated notices when there are delays or disruptions. Logistics providers should have sufficient IT staff to integrate or interface their systems with any company's systems.

Closely tying IT systems creates a deeper level of partnership that must be monitored and managed. Importers should plan to go to China on a regular basis to review the logistics operations and the associated IT systems. Start with a written audit plan and review sample transactions every time you visit.

Background on Incoterms

International Commerce Terms of Sale (Incoterms) apply to delivery of goods sold, and exclude intangibles like computer software. Use of Incoterms reduces or eliminates uncertainties from differing interpretations in contracts. The Incoterms are updated to reflect new usage about every 10 years. Among the most commonly used Incoterms are EXW (Ex works), FOB (Free on Board), CIF (Cost, Insurance, and Freight), DDP (Delivered Duty Paid), and FCA (Free Carrier). The International Chamber of Commerce (ICC) introduced Incoterms in 1936.

Since then, the ICC has updated them seven times to keep pace with the development of international trade. The latest edition of Incoterms is Incoterms 2010, which took effect in January 2011. The ICC publishes a brief introduction to Incoterms as well as a fact sheet on its website. The section does not provide every answer, but will help companies understand how Incoterms are organized. For more information, visit www.iccwbo.org/incoterms.

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3. Compare rates and services

Business conditions in China change rapidly. Companies need to be aware of pricing in the market and service offerings. One of my clients was very surprised to find out that while their logistics provider seemed to have competitive pricing, they were five years behind in systems capabilities and had not made other process or productivity improvements for several years.

I recommend that companies forge a long-term relationship with their logistics providers and encourage and monitor productivity improvements through IT systems, shared forecasts, and strong quarterly evaluations. But it is also very important that companies stay current with the marketplace. On trips to China, visit other facilities and talk to other providers to make sure service offerings are competitive and up-to-date.

It is also prudent to go through a bidding or request-for-proposals (RFP) process every two to three years. Even if a company does not want to change providers, this process will at least provide an opportunity to review the business in depth and determine where improvements can be made.

A company's purchasing department can help write an RFP that stays within company guidelines and includes all of the questions required to attain comparative information. Companies can also engage a consultant if assistance is needed in the RFP process for logistics providers. Consultants will bring marketplace information and objective rigor to the process.

Quick Glance

- A logistics supplier should gather and report information to help manage a company's supply chain.
- Companies should develop indicators and review logistics providers' performance every quarter.
- Companies should visit their China operations quarterly to audit and observe their operations on the ground.

4. Consider central China

I spoke at a logistics conference in Chengdu, Sichuan last year and was surprised by the rivalry for logistics business between Chengdu and Chongqing. Both cities have experienced better-than-average economic growth and attracted high-tech and automotive manufacturing. The two cities are rapidly building logistics capabilities to support the manufacturers that are moving there, and vying for new business. The PRC government is also moving quickly to construct additional high-speed rail links and new superhighways from this area to the eastern coastal export cities. Local governments are offering attractive financial benefits, such as tax breaks and other financial incentives.

Consider locating manufacturing in one of these cities where wages are one-quarter of those in the eastern cities. In western and central cities, many experienced migrant workers are closer to home, the workforce is plentiful, and vertical integration of vendors in the supply chain is spawning many alternative local suppliers.

Recently built super highways and rail lines to the interior of China allow for fast movement of cargo. Adding a day or two to the transit time from the interior to the coast will not make much difference in costs or time to market. The logistics infrastructure of warehousing and distribution centers is newly built and readily available.

5. Rigorously review logistics providers

Too often my clients will tell me that they hold quarterly business reviews (QBRs) with their logistics providers, but when I dig deeper, I find that the QBRs are nothing more than activity reviews. These meetings focus on how many shipments, containers, or millions of pounds were moved, hours worked, and other countable topics. However, a QBR should be multi-dimensional and include quality and productivity measures in addition to activity measures. Further, the quarterly evaluation process should be completed by both the company and the logistics provider, to give two-way feedback.

QBRs should include a review of topics such as:

- On-time service;
- Errors by category;
- Response time;
- Specific problems or challenges during the past period;
- Potential ways to automate the communications between companies;
- Improvement in automation and processes to increase productivity;
- Revenue generated per quarter and quarter-over-quarter revenue comparison; and
- Training and education. (For example, a company should educate a logistics provider on its products and business, and the logistics provider should educate the company on services and new trade compliance regulations and procedures.)

Regardless of what a company chooses to measure, all categories and key performance indicators (KPIs) should align with corporate goals. Managers should ask themselves the following questions: Have I read my own company's annual report? Do I clearly understand this year's goals and objectives? Do all of the company's logistics performance indicators support these goals? If the answer is no, the company is measuring the wrong things.

A logistics provider should also measure the company it serves. The logistics provider should give feedback on things like their customers' response times, productivity improvements, issue resolution, and training. Two-way communications between the logistics provider and their customers will provide valuable input regarding areas where improvements need to be made.

6. Know your Incoterms

Incoterms, or International Commerce Terms of Sale, were developed by the International Chamber of Commerce (ICC), and they are recognized by most countries. The latest versions, Incoterms 2010, are commonly used, standardized

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terms that stipulate who pays for what in international shipping and who assumes risk (see p.14).

Correct use of Incoterms helps to provide legal certainty between buyers and sellers. To be sure of using Incoterms correctly, companies should consult the full ICC texts or use a consultant. A company needs to understand the financial and risk responsibilities for the Incoterms in its contracts with Chinese suppliers.

7. Export/import compliance is required

Before 9/11, the United States maintained a list of "denied parties" with whom US companies could not legally do business. After 9/11, the restricted parties list (RPL) ballooned to more than one million names. To comply with the law, every order from every customer must be checked against the RPL. With so many names on the list, it is nearly impossible to do this manually. As a result, many companies rely on logistics providers to check the list for them. The Chinese office of a logistics provider should have technology that performs this task in seconds online. In addition, a company and its logistics provider should have written procedures for handling matches to names on the list.

On the import side, a Chinese logistics provider should be able to prepare standard and non-standard documents that will allow a company to clear US Customs easily and legally. This means that for imports into the United States, the documents need to be in English, and completed quickly with all information required so as not to delay any shipments. In addition, for ocean shipments, the freight forwarder must submit 10+2 information electronically to US Customs before the container is loaded onto the vessel in China. This is yet another reason to use a global logistics company with IT capability.

Add a review of compliance systems and procedures to your checklist for every visit to China. A company's internal audit and trade compliance staff can assist with developing this checklist. I recommend that companies visit their China logistics provider two to four times per year and on each visit, review the procedures, validate that these procedures are being followed, and provide training if necessary.

8. Determine the best approach for serving the burgeoning Chinese domestic market

Most of my clients have started to develop robust approaches to selling inside of China. With the rise of the Chinese middle class and the enormous PRC government market, foreign companies see a huge new market opportunity to sell goods. Factories producing goods for export may also be licensed to produce goods for the growing Chinese market. But beware, logistics and distribution within China to support domestic sales are very different from exporting from China.

Chinese distribution channels may be somewhat longer and more complex than the United States. For example, luxury goods retailers have found a robust market in China's big cities, but these retailers are also opening stores in the tier-two cities. Logistics for tier-two and tier-three cities may not be as sophisticated and may require unique delivery solutions. In large cities, multi-stop deliveries to several retail stores are coordinated by a retail logistics company. In a tier-three city, the retailer may have to wait a week or more for a single store delivery from the airport that is passed from trucker to delivery cart.

Setting up an effective and efficient domestic Chinese distribution system will take time. Companies need to consider and vet logistics providers, resellers, and wholesalers. China is a new and diverse market for delivery of goods so the process may be uneven for a few years. As a result, companies should consider where to locate inventories and distribution centers. Further, if a company produces and plans to market industrial products, it will need to consider delivery sites and capabilities before shipping goods. Older buildings and factories may not have adequate facilities such as truck docks and fork lift equipment.

Overall, logistics and transportation capabilities are maturing across China, and in some areas logistics capabilities are considered world class. Be sure to select logistics providers and partners with global networks and standards, and measure them regularly and rigorously. For distribution within China, verify the capabilities of partners and understand the delivery points. Companies should not assume that every delivery place can accept trucks, has fork lifts, or other equipment. Verify where you plan to deliver—dock, warehouse, or other location—and the equipment available.

9. Visit China often

There is no substitute for regular, structured visits to vendors and logistics providers in China. Companies should never assume that just because policies and procedures are stated in a contract that any of them will be followed. In the Western world, we view a contract and written procedures as the end product to be executed. In China, the contract is just the beginning of doing business together. Contracts and written procedures are often viewed as guidelines and are subject to interpretation. If companies want procedures to be followed precisely, they must monitor and audit the Chinese operations regularly.

I typically recommend that companies visit their China operations quarterly. During these visits, companies should audit the processes through observation and by using a validation checklist. Ask to see the operations while people are working, then return for a surprise visit later that day or evening.

When companies cannot employ a full-time person in China to watch over and manage operations, it is important to hire a trusted agent who resides in China to work on behalf of the company. (Some consulting companies provide these services for a fee.) Even with the addition of local services to oversee operations, companies still need to make an effort to visit China quarterly. 完

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Rosemary Coates *(rcoates@bluesilkconsulting.com) is the president of Blue Silk Consulting, a global supply chain consulting firm and the author of* 42 Rules for Sourcing and Manufacturing in China*, a top seller on Amazon. She is currently working on her second book,* 42 Rules for Superior Field Service*, which will be published in the summer of 2012.*