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A third-party logistics provider: To be or not to be a highly reliable organization

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ABSTRACT

This case presents information on the emergence of third-party logistics (3PL) operators in El Salvador. Salvadoran Logistics Provider (SLP) is one of such 3PL. The case uses qualitative and quantitative information to discuss gaps as compared with world-class operators. It describes in detail all in-warehouse operations: receiving, put away, storage, order picking, and shipping; distribution (layout) according to product family zones; and different storage systems and put-away systems used by SLP. Students will have to choose one of several warehouse options presented in this case to carry out the logistics operations of the largest retailer in El Salvador during the Christmas season. However, decision must go beyond a mere numerical estimation to include analysis of more quantitative and strategic factors. It is not a coincidence that since its inception, SLP has deployed the framework of Highly Reliable Organizations, to manage the risk and complexity of its customers' supply chains.

1. Introduction

In the morning of Monday, May 14, José Carlos Zablah, general manager at Salvadoran Logistics Provider (SLP), had just gotten off the phone with a high-ranking executive at Calleja Group, El Salvador's largest supermarket chain. This retailer was asking for a service bid to outsource the logistics of its Christmas season imports. This operation would require receiving 80 containers over a 3-month period, storing 4000 SKUs, and supplying 87 stores on a fixed time and date schedule.

While excited about this business opportunity for SLP, Mr. Zablah knew that, before submitting a bid, he had to look into SLP's storage operations to find improvement opportunities and to rise to this challenge. To this end, he asked Ronald Escobar, an engineer who managed the process and quality area, to do some research on several performance metrics and world-class storing practices in order to compare them with SLP's current operations. He also asked Engineer César Aguiñada, operations manager, to look for available warehouses with the capacity required for this new business. Anticipating that the actual demand could differ from Calleja Group's estimate, Zablah told Aguiñada that warehouse options should feature some flexibility, both in terms of storage area as well as lease period. When Mr. Zablah realized that actual demand might differ from the estimates provided by the executive of Grupo Calleja he pointed out to Engineer Aguiñada the need for flexibility in the options to be considered, both in terms of storage area and in terms of contract period.

They had 2 weeks to answer whether or not they would accept the request. However, to do so, Mr. Zablah had to ensure not only the availability of space required to meet the strict conditions set by the potential new customer once the options were assessed, but also that the gap between SLP storage practices and those of the world-class benchmark was minimal. In case the proposal was accepted, they had to rely on their experience to handle the various stages of the complex logistical process, do an impeccable job in terms of attention to detail, anticipate, and react to the slightest hint of failure and always strive for excellence in handling operational details, not only to position themselves as a reliable logistics provider in the domestic market but also in view of the opportunity this would offer them to venture into the regional market.

2. Major retailers and their distribution centers

Calleja Group was El Salvador's largest retail chain, with 87 stores divided into two formats: 62 Súper Selectos and 15 Selectos Markets. Format choice depended on the size of the cities served by stores: while Súper Selectos were located in large cities, Selectos Markets catered to smaller towns in El Salvador's hinterlands. Calleja's leading competitor was Walmart, a multinational company that owned 79 stores in El Salvador: 25 supermarkets called La Despensa de Don Juan, two Walmart hypermarkets, 51 smaller supermarkets called Despensas Familiares (with a format resembling Calleja's Selectos Markets), and a Maxi Despensa (a discount hypermarket).

Owned by a large Peruvian business group, Ransa was a third-party logistics service supplier that Calleja Group had hired to outsource its operations. Ransa operated distribution centers in a number of Latin American countries, including Peru, Ecuador, and Bolivia. In 2006,

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Ransa established an 183,000-square-foot distribution center (DC) in Apopa. With its 36-ft-high walls and its capacity for 22,000 pallet positions, this warehouse had called for a hefty investment ranging from US$8.5 million to US$ 10 million, as reported by the press. When this distribution center started operating, Calleja secured savings in administrative and logistic expenses as well as transportation costs, while enhancing product handling and reducing merchandise damage. Before Ransa established this distribution center, Calleja's suppliers delivered orders to stores. Ricardo Velásquez, the group's deputy executive director, commented on Ransa's DC opening, “It not only brings savings for us but for our vendors as well. It makes more business sense to make one large delivery than making 70.” In September 2011, Ransa invested US$3 million to expand the DC's refrigerated storage room another 21,313 square feet for a total of 1300 positions in the perishable product category.

Building a centralized DC would enable Calleja Group to become more competitive to face Walmart's arrival in Central America. In 2005, Walmart acquired 33% of CARHCO's stock. This holding owned La Despensa de Don Juan supermarkets and other chains in Guatemala and Costa Rica. The next year, Walmart increased its share to 51%. By 2009, it owned 519 stores in Central America, and, in 2010, it consolidated its regional operations into Walmart Mexico and Central America. Walmart was the largest retailer in the region, operating in Guatemala, El Salvador, Honduras, Nicaragua, and Costa Rica.

Following its low-price strategy supported by operating efficiency, Walmart brought to Central America some of the practices it used in the United States, including its Retail-Link (the system in-use by Walmart to share inventory turnover data and to issue purchase orders online) data management system and the use of DCs to make centralized deliveries. Walmart relied on eleven distribution centers in Central America. In 2008, it had built a 326,146-square-foot DC in El Salvador's Apopa district, very near Ransa's DC. This area had become very attractive for logistics companies when a highway was built to provide easy access to several locations, bypassing San Salvador's jammed suburbs.

3. Salvadoran logistics provider

SLP was an outsourcing logistic service provider (3PL) founded in 2004, when Distribuidora Centroamericana (DIA), a Zablah Group company, decided to outsource its storage and distribution operations. In 2005, SLP started providing logistics services to Distribuidora Nacional (Disna), another company owned by Zablah Group. That same year, SLP incorporated a new client, Agroquímica Internacional (Agrinter), another Zablah Group affiliate, and was forced to open a new 25,295-square-foot DC to accommodate this company's products.

In early 2006, as part of its growth plan, SLP moved from DIA's warehouses to an 80,729-square-foot distribution center located in Santa Lucía, a town in Delgado City's district. Later that year, in October, it added another Zablah Group company, Unión Distribuidora Salvadoreña (Udisa), to its customer portfolio. This growth and the results achieved led SLP to consider providing services to third parties to compete in the open market. If SLP is really competitive, then it will be able to grow in the face of its new local competitors and eventually offer services in the region. The key to the business of outsourcing logistics services is precisely framed by the concept of highly reliable organizations, which are characterized by preoccupation with failure, reluctance to simplify interpretations, sensitivity to operations, commitment to resilience, and deference to expertise. SLP deployed this framework from the start to manage the risk and complexity of customers' supply chains.

This meticulous attention to detail allowed SLP to capture from the time it launched its value proposition clients like Shell (lubricants), SC Johnson (household cleaning products, room sprays, and insecticides), and JohnsonDiversey (industrial cleaning products). SLP ended its first year with 103 employees. In 2008, SLP inaugurated its third storage center at Distribuidora Zablah S.A.'s (Diszasa's) premises in Santa Tecla. This facility featured two 3767-square-foot warehouses: one for refrigerated products and another one for frozen products. By 2012, SLP boasted 16,000 rack and floor positions in three DCs, totaling an area of 212,587 square feet, with 179,757 square feet for dry storage in its Santa Lucía distribution center, which included a 116,250-square-foot warehouse and another, 63,507-square-foot facility that would soon be fit to serve as a bonded warehouse. A bonded warehouse is a building or other secured area in which dutiable goods may be stored. Custom duties are paid when goods leave the premises. With 34,000 SKU in its portfolio, SLP oversaw 150 container deliveries, 17,882 order fulfillment requests, 232,920 lines, and 1400 shipments every month. An SKU (stock keeping unit) is a code used to identify each distinct product or item for retail sales. The term “line” refers to the number of SKUs contained in an order. The term “line” refers to the number of SKUs contained in an order. Using SKUs, companies can keep systematic track of their inventories. The domestic market widely recognized SLP management of the complexity underlying the various supply chains it served in parallel and almost flawlessly.

SLP's service offerings included imports, storage, inventory management, complementary services, and distribution. The company featured six functional areas: operations, engineering and quality, purchasing, marketing, back office, and fleet. Overall, its headcount included 154 full-time employees and 270 outsourced associates (see Fig. 1). Out of the 154 employees in its payroll, 97 served at the DC, performing operating tasks on a single, 8-h shift from Monday through Friday and

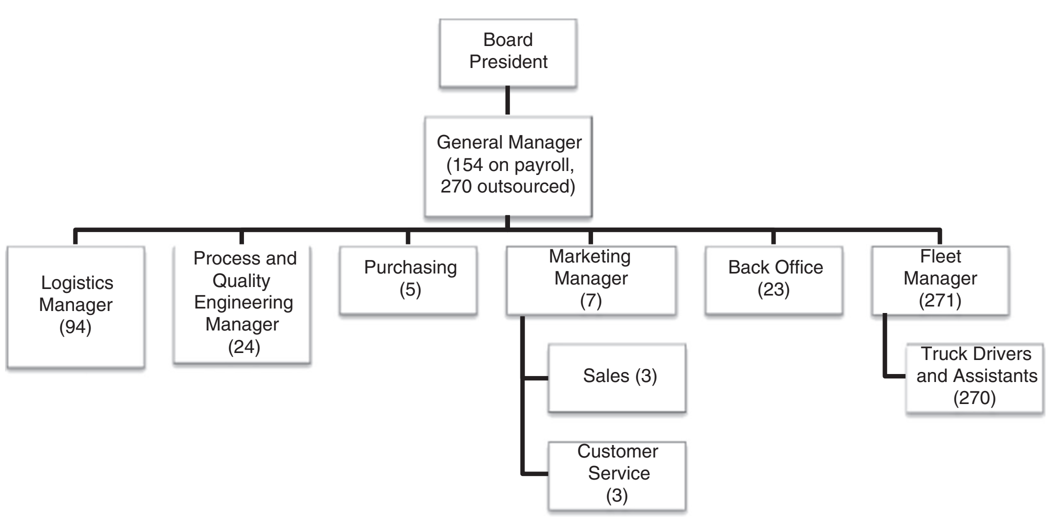

Fig. 1. Salvadoran logistics provider's organization chart. *Source*: SLP service presentation for marketing purposes, updated as of May current year.

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