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"Global Shippers of the New Millennium: What in the World do they Want?"

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Thank you, Jane; Distinguished Colleagues, Ladies and Gentlemen --

I am so pleased to be participating because Containerisation International's conferences tend to get to the heart of the issues that are on the minds not only of the carriers, but of our customers. This 30th Anniversary event is no exception, with its focus on such topics as alliances and mergers, future of EDI, regulatory prospects, intermodal trends, and -- the topic of this panel -- changing customer requirements.

Almost 40 years ago, a lecturer at Harvard Business School named Theodore Levitt wrote a brief article entitled "Marketing Myopia," in which he focused on the railroad, petroleum, automotive and other sectors that had traditionally been considered strong "growth industries," but had subsequently flattened or even ceased to exist -- as did the buggy-whip industry. Levitt observed -- correctly, I think -- that these industries were not victims of external challenges or even market saturation, but of a simple failure of management: they had failed to define their business sectors broadly enough to meet changes in customer preferences and needs.

For example, the railroads thought of themselves as providing only rail services, rather than being key players in the "transportation" industry, constantly vigilant as to the larger transportation concerns of their customers. The price they paid for this "marketing myopia" was to watch in stunned silence as other industries -- automotive, trucking, air transport, even telecommunications -- began to fill the changing needs of the railroads' own customers better than the railroads could!

In which Camp Lies the Threat to our Survival?

When I got Jane's invitation to speak about the changing expectations of customers in <u>our</u> industry, I thought about this now-classic article, which I had read many years ago. Although Jane's title for today's panel is extremely creative:

"Global Shippers of the New Millennium: What in the World Do they Want?"

-- she could just as well have named it:

"Marketing Myopia:
Are Ocean Carriers Going to Deliver the Services Shippers Really Need,
and If they Do Not Do it Quickly,
I Wonder Who Will Come in and Fill the Void?"

Will it be our colleagues in related transportation sectors: the trucking companies? The railroads? The airlines? The freight brokerage companies?

Or will it be our friends in entirely distinct industries: the transportation consulting industry? The information-technology industry? All of these industries -- in part reflecting the admonitions of our mentor at Harvard -- are now defining their corporate missions and mandates more broadly. The truckers and railroads are indeed "transportation companies." The consultants and information people are "problem solvers."

In our own case, we are defining ourselves as a transportation company that supports efficient distribution for our customers, within national borders and globally.

Moving in the Right Direction

Fortunately, I think many in our industry are asking the right questions and refocusing their marketing effort away from just "selling the product that they happen to offer." Some carriers had begun years ago to consider what problems and worries the customer really faces so we can develop products to sell that actually help solve those problems. The impact has been great.

Case in point: following the introduction of through bills-of-lading in the late 1970s in North America, and rising customer interest in reducing transit times by putting international containers on rail cars, a series of terrible winter blizzards occurred that virtually derailed the intermodal concept. Customers, who suddenly experienced severe delays and even losses of their intermodal shipments, were so fearful of this new "intermodal option" that many of them vowed to return forever to the reliability of all-water service. (A few have still not returned!)

But in reality, this railroad-related problem represented an opportunity, and Levitt would argue that the railroads should have been the ones to seize upon it. While of course it was in full collaboration with the railroads, remember that it was not a railroad, but APL -- an ocean carrier -- that addressed the problem by devising the first containerized "unit" trains in 1979-80.

Some of you will recall that, under this program, we literally acquired our own rail cars and controlled their origin-to-destination movement for the customer, and we also monitored the shipment electronically to give customers constant visibility to its whereabouts. The key point I want to make is that this "radical, unconventional response" by an ocean-shipping company was in direct response to customer concerns, rather than a scheme to sell an existing service. And I guarantee you that it shook up our people and our corporate structure, and forced us to think in new ways.

The unit train concept evolved in 1984 to a higher level through the development of fuel-efficient double-stack rail technology and the extensive stacktrain networks of North America. This was a response to another threat to intermodalism -- the lower cost-structure of all-water services. The only answer for the railroads, if we were to preserve the benefits of intermodalism, was to change the overall economics of rail. Enter stacktrain, which not only revolutionized the international-intermodal cost structure, but that of domestic distribution, as well. It is significant that the container, and not the trailer, dominates U.S. intermodalism today.

I think you will agree with me that these radical departures -- led by an ocean carrier -- have been good for customers, who have derived untold benefits in terms of cost improvements and distribution reliability. And these developments have also been good for the long-term survival prospects of both the ocean and railroad industries. I think even Levitt would have approved of these marketing achievements.

Forces Grow in Intensity

I'd like to look with you briefly at the forces that are influencing the direction and the shifts in customer requirements today. I submit that the fundamental need is not so different from what it was in the early 80s, when the customer's biggest concern was how to ensure the reliable, timely delivery of a shipment at a competitive cost -- even in severe winter blizzards. What has changed is the "intensity" of this requirement. I see several underlying forces or trends at work:

GLOBALIZATION -- First, globalization. The business of our customers has become increasingly global and it increasingly requires global support and multimodal capabilities. Also, customers tell us that, in their never-ending quest for lower production costs, they plan to move production to the interior reaches of countries in which they are already operating, and away from the higher-cost coastal regions. So future investment may indeed lie in China or India or Myanmar, but it will be in harder-to-reach places! Obviously, these trends present new demands upon the carrier in terms of extension of intermodal capabilities and information reach.

At the same time, customers are interested today in using fewer service providers, because they want to streamline their vendor relationships. In one recent study, 60 percent of shippers said they are already doing this, and 75 percent said they will do so within two years. How will carriers meet these seemingly divergent customer expectations?

I would like to note that APL's recognition of these requirements by manufacturers and retailers for global support and fewer carriers is a key reason why our company became a member of the NOL group last November. Although APL had distinguished itself as an innovative carrier in three trades -- the trans-Pacific, intra-Asia and North America domestic container markets -- we knew our long-term competitiveness hinged on the ability to participate more actively in the Asia-Europe, trans-Atlantic and North-South Americas trades, and this required access to the resources of a larger organization. Now that we are part of the NOL group, we have just announced our entry into the trans-Atlantic market. We are also pioneering new intermodal connections into the inland regions of Asia.

But there will be few if any service providers that can muster all the capital -- or are willing to take the risks -- to provide multimodal assets on a global basis. This reality has driven the development of today's shipping alliances and even some large-scale mergers.

We are also witnessing cross-border and cross-modal collaborations in the context of this global theme. Regarding the former, we can point to the European ventures involving Norfolk Southern and CSX, as well as the "NAFTA-driven" acquisition of the Illinois Central by the Canadian National. The purchase of the NVOCC/consolidator DSL by BAX Global, an air freight carrier, falls into the latter category. Undoubtedly, this is only the beginning.

INFORMATION - A second customer requirement we are seeing is the need for seamlessness in the delivery of services, and this has become more critical because of the greater number of participants that are collaborating to offer any single service -- much less to offer a complex package of services. The key to meeting this challenge is information technology.

I maintain that the battleground has shifted from the oceans to the land, as I explained a moment ago, and to data! As you will no doubt hear from Diane Silver, my colleague from APL who will address the next panel, information makes "seamlessness" possible by providing the necessary discipline and control across corporate and geographical borders. It is also the key to improved supply-chain management, which I will discuss in a few moments.

I am happy to say that, even under our new ownership, an emphasis on information-technology leadership remains one of our long-range business strategies. This is in keeping with the plans of our customers -- many of whom have moved with us into the new arena of Internet-based information technology.

Related to this point is the fact that shippers themselves have made substantial investments in information technology as a means of integrating their business processes and synchronizing their global supply chains. For example, Owens-Corning has spent US $100 million on enterprise-resource planning (ERP) software from SAP of Germany, and

GM might spend as much as a billion dollars on such a package. In response to software investments of these magnitudes, Sabre Technology Solutions recently observed that "shippers who are investing millions of dollars on software from Manugistics and i2 are not going to want to be told they can't leverage the investment because the carrier doesn't have the data." I absolutely agree, and I believe these investments will play a greater role in driving carrier selection than ever before.

ONE-STOP TRANSPORTATION SHOPPING - A third requirement today is for one-stop transportation shopping. Customers tell us they want a range of capabilities available to them from their principal providers, ranging from basic international ocean service, to door-to-door intermodal deliveries, to domestic distribution within any given marketplace. The catch is that they want all of these capabilities to be under the control of a single provider (or at least obtained through a single contact or organization).

In line with this, they would like single-source accountability for the outcome, even if various collaborators have to later sort out the mess among themselves. In other words, a quick, clean response and no finger-pointing if things go wrong.

So while the provider will be required to offer access to most or all modes, we have observed another interesting shift in customer preferences: the customer today (and probably well into the next Millennium) will be less interested in specifying the mode of transport than in the past. Rather, the customer is going to ask the service provider to help analyze the service-cost tradeoffs of the modes, and to provide the combination that is most cost-effective as part of an overall distribution pattern.

SUPPLY-CHAIN EXPERTISE - The next customer requirement I want to mention is very much related to the comments I just made about the customer's growing need for help in analyzing service-cost tradeoffs. The customer is looking for expertise both in evaluating his supply-chain processes and in more cost-effectively implementing them.

There is a growing sense that forthcoming commercial battles may not simply pit one retailer or manufacturer against another retailer or manufacturer, but will be waged on the basis of the efficiency, cycle-times and customer-responsiveness of their supply chains!

The range of capabilities being sought to prepare for these battles includes consulting and supply-chain-management services, information-intensive consolidation services, improved documentation and tracking capabilities, automated reordering capabilities, quality inspection and control, and domestic and global transportation brokerage capabilities.

In one study, some 80 percent of respondents said they are aiming for improved integration of their supply-chain activities as a key to their success in the next decade. Many of the needed capabilities will be outsourced. For example, one of the American magazines asked its readers last December how many are currently outsourcing these support functions. Twenty-seven percent said they are doing so now, and 33 percent said they intend to do so. The principal reason why these services would be outsourced is that companies want to focus on their core business of manufacturing or retailing, and to benefit from the support of logistics experts. We see this trend reflected in the new business and inquiries at APL's own logistics unit, BLS, and our consolidation unit, ACS.

And the payoff for the companies that effectively use supply-chain management services can be substantial: according to the Center for Transportation Studies at MIT, one group of companies engaged in supply-chain management integration programs achieved a 50 percent reduction in inventories, a 40 percent increase in on-time deliveries, a 27 percent decrease in cumulative cycle time, a doubling of inventory turns, a nine-fold reduction in out-of-stock rates, and a 17 percent increase in revenues!

As a result of rising customer interest in achieving these kinds of benefits, carriers interested in participating in global distribution are all focused, not surprisingly, on the same things: acquiring broader transportation and logistics capabilities on a global scale, while minimizing the risk of acquiring the assets by purchasing or sharing capacity rather than directly investing. They also are rapidly expanding their systems capabilities so they can be the "lead logistics service provider," stitching together all the pieces in order to provide the customer with an integrated, seamless service.

There are two other customer requirements for the next Millennium that I would like to note, although they are different from the ones I have just discussed because they are far from new. They have been around for a long time, and I think they always will be:

EFFICIENT, EFFECTIVE ASSETS - The first one, often taken for granted by the customer but never by the carrier, is the uncompromising need for containers, ships, trains and other transportation assets that are clean, cost-efficient, reliable, secure and available
-- even at peak periods. When you think about how everybody today wants to orchestrate the overall global move for the customer by "using somebody else's assets," and nobody wants to invest in these assets, don't you sometimes wonder: "where will all the assets come from?"

If you do, it's a legitimate question!

Note that carriers today have begun to distinguish between "asset based" and "non-asset based" businesses. The asset-based businesses depend on the control of ships, trains, trucks and containers, as well as container terminals, or certain combinations of these assets. The "non-asset-based businesses engage in third-party logistics management, consulting, consolidation services, etc.

But I must say that I think "non-asset-based" is very much a misnomer; the information and logistics-intensive businesses we operate, including ACS and BLS, derive their success from the unique value of their “assets,” in this case human and information resources.

I also think the non-asset based businesses we operate as part of an asset-based company offer greater value for a number of reasons:

First, they can provide the customer with ready access (through an affiliated company) to superb owned or controlled physical transportation assets that are immediately available if they are deemed to best meet the customer’s requirements.

Second, in many cases, this “in-house access” to transportation assets can also result in improved reliability. For example, tighter schedule adherence can often be achieved by routing shipments within systems and through terminals we directly manage -- such as the state-of-the-art on-dock facility in Los Angeles.

And third, a close relationship with the logistics unit of a global carrier can lead to the establishment of new, customized services to remote locations, investment in terminals or ICDs and/or the deployment of container assets or even feeder vessels to resolve logistical problems. In other words, no non-asset based provider can help manage the flow of product on assets that have yet to be put into place by a carrier.

APL’s own experience in recent years has been to invest in the equipment that it needs in order to ensure availability, including those that are likely to be scarce because of basic supply/demand considerations or because of unique benefits they offer customers. For this reason, the company has invested heavily in equipment such as the more capacious 45-foot, 48-foot and 53-foot containers, double-stack rail cars, state-of-the-art refrigerated containers. The company has also invested in a fleet of fast, highly fuel efficient containerships, including our post-Panamax ships that today help form the basis for competitive transport across the Pacific by all our partners in the New World Alliance.

By the same token, the company has played a creative role in ensuring a high level of utilization of these assets. As an example, six vessels now being deployed in the Asia-Mexico service that we offer with our alliance partners are actually used by one group of carriers between Asia and Mexico, by a second group between Asia and the United States, and by still a third provider who sells space on them between the U.S. mainland and Guam!

Thus, while we are believers in achieving the highest possible utilization of assets, we also believe in developing -- and investing in -- the transportation equipment that will effectively and efficiently support the most demanding global distribution requirements of our customers. So in response to the question, “who will provide the assets, if everybody just wants to be the orchestra leader?”: I expect you will continue to see this carrier and some others striking a balance between asset-based and non-asset based operations, in mixes that reflect market requirements. Some of this investment may be channeled in the future through the alliance members that share the capacity.

SERVICE EXCELLENCE - The final customer requirement that I'll mention -- and one that is only going to intensify in the future -- is the demand for service reliability and overall performance excellence. Many customers make the requirement of 99 percent (or better) on-time reliability, both of pick-up and delivery, an absolute prerequisite to doing business, and they measure every aspect of our service.

Like the demand for state-of-the-art equipment, however, the need for delivery reliability is far from being a new mantra! Because this year is APL's 150th Anniversary, I have been delving a bit into the history of one of our predecessor companies, Pacific Mail Steam Ship Co., which as you may know, launched the first-ever regularly scheduled trans-Pacific steamship route in 1867.

Up until that point, of course, customers indeed desired reliability on the Pacific, but the speed of a sailing ship and its course were heavily influenced by the speed and direction of the wind. Now, with our "state-of-the-art" wooden side-wheelers that were powered by the latest coal-fired engines, precise reliability could be finally be demanded by the customer! How did we do? The scheduled transit time between San Francisco and Yokohama was 22 days, and we actually came in with an average time of 23 days, 19 hours westbound and 22 days, 20 hours eastbound. Not bad for that era!

There's a lesson here that has carried us through the last 131 years and will be good for at least 131 more. In a little-known treatise called Side-Wheelers Across the Pacific, maritime historian John Kemble relates that -- although the practice was frowned upon by the Pacific Mail's management -- the captains of these paddle-wheelers liked to race their vessels between Asia and North America to set new speed records. The company responded to this practice by absolutely forbidding them to do more than 9.5 knots (although they were capable of more) and even demanded that, if they arrived at port early, they cruise up and down the coast so they could tie up precisely on schedule. Why not arrive early?

There were two good reasons: one was to conserve coal bunkers! But the other related to customer expectations. Even in 1867, punctuality meant more than "don't be late;" it also meant "don't be early." While many customers today want shipments not to be late so they can make intermodal connections or be able to roll a rack of garments directly out of the container onto the showroom floor on the day of the big sale, it might surprise you to know that some customers tell us they don't want the shipment to be early, either! This is because their rigid supply-chain "pipeline" cannot accommodate even a day's warehousing or demurrage. And one customer -- an importer of highly seasonal lawn chairs and patio furniture from Asia to North America who buys during the winter in order to get out-of-season prices, absolutely requires us to be late with the delivery -- by a month or two! What lengths we will go to in this business to accommodate the requirements of the customer!

And how much more complex it has become to do so. It now requires the carrier or carrier alliance manager to integrate into its own operations an intimate knowledge of rail, truck and barge operations, to design and operate purpose-built intermodal terminals, to negotiate special berthing arrangements, and to design systems that can provide timely and accurate electronic status reports to the customer.

COST COMPETITIVENESS - The final requirement I would like to mention is the need every customer has for transportation services to be cost-competitive. We clearly understand this requirement, and it has driven a virtual upheaval of corporate restructurings, consolidations, and technological advances within our industry as in other industries.

For example, APL's consolidation with NOL is expected to save $130 million per year in operating costs. Similarly, the wide-body vessels we are contributing to the New World Alliance's trans-Pacific rotations are among the most cost-efficient on a per-slot basis in the industry. Every dollar we can cut out of operating costs helps us hold the lid on the transportation price. Everyone knows those prices, which have steadily declined in both nominal and real terms, are already the best bargain around! I think you will see the carriers continue to focus rigidly on cost-containment wherever it can be implemented without deterioration to the service.

We noted a few minutes ago the trend toward outsourced supply-chain management services, and I gave a few examples of the benefits. I want to reiterate here that effective logistical support can go further in helping global manufacturers and retailers achieve major cost reductions than can a little more downward pressure on shipping rates that are already dangerously depressed.

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Before closing, I want to return to the still-open question I asked at the outset: "who will come in and fill the needs for the global customer in the next millennium, if our industry does not?"

Some carriers have come a lot further than others in meeting the needs we have outlined today. But the customer's compulsion to continuously shift sourcing and assembly patterns in the interest of improved cost-competitiveness is not expected to cease. That means the customer will continue to require that we seamlessly and reliably move product anywhere on the globe, in an information-rich environment and at a very competitive cost. And that need is still unmet!

We can do it from Bangkok to Los Angeles, but we can't do it from Outer Mongolia to Mexico's Yucatan Peninsula, as part of a multi-country sourcing or assembly scheme. Who will come in and supply the missing transportation pieces, or the reach into the interior of Myanmar for the information piece, or the logistics-management piece? Who is best prepared to do the total job?

There are some very interesting players from outside the industry who are leveraging information technology in their 3PL role. Noteworthy for its sheer breadth and blue-chip image is the Ryder-Andersen Consulting-IBM partnership. Similarly, the acquisition of Calibre by Federal Express brings a household name into the game.

If it is to be our own industry, we must evolve diverse new capabilities to meet customer needs through internal development, joint ventures, acquisitions, etc. I envision cross-disciplinary acquisitions as companies seek to acquire proprietary capabilities. Although this will most likely involve carriers making acquisitions in the IT arena, I suppose we might wake up one morning and see banner headlines on the cover of Computer World (and, of course, Containerisation International):

“Microsoft Offers $5 Billion Stock Swap for APL!”

This is a resilient industry and it will adapt to meet the evolving needs of its customers. There is no one better poised to do this. That is because the carriers, in the process of customizing transportation packages for their customers in recent years, have alone been in a position to develop the global infrastructure. And we have learned to manage not only the flow of goods, but the supporting information our customers need.

Our customers are counting on us.

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