

WHAT IS SLOWLY RUSTING YOUR GLOBAL SUPPLY CHAIN?

Government Incentives and Cargo Crime

David Serafine, Clareo, Inc.

Within the past decade or so, companies have had a laser-like focus on trying to reduce cost in their supply chains. Companies have utilized technology in assisting “Just In Time” models, procurement to drive lower costs with vendors, have outsourced all manufacturing to third parties (ODM-original design manufacturer), etc. While *traditional* cost drivers remain a primary consideration in measuring supply chain effectiveness, other critical factors are not receiving the same focus. These neglected areas have the capacity to grind a company’s global operation to a halt. Furthermore, the financial impact of these two factors would equal the yearly revenue of a Fortune 500 company. I am referring to government supply chain incentives and the impact of cargo crime.

We all know the tragic story about September 11th, 2001. We also know that life as we knew it changed and terrorism was no longer something we only read about in a foreign land. The sense of vulnerability, panic and a “call to action” swept across the country and this complex wave of emotion translated into responsibility by the government to protect the country. An initial response to securing borders post 9/11 was C-TPAT, Customs Trade Partnership Against Terrorism. Boiled down to simplest terms, C-TPAT is a government initiative which “incentivizes” domestic importers to help improve global supply chain visibility and security. If companies engage in the voluntary program, they have to demonstrate a better understanding of their supplier’s sites, risk mitigation programs, processes and develop an ongoing communication with regard to these activities with CBP (customs and border protection). Those that receive acceptance by CBP into the program are demonstrating their willingness to assist the U.S. government in protecting the borders. In exchange for their good faith actions, these companies are seen as a “lower risk” importer and therefore subjected to fewer inspections, faster processing times at ports and borders and are closer to obtaining other MRAs (mutual recognition agreements) from foreign governments. These are mirror programs in foreign countries that would provide the U.S. companies quicker shipments into these areas, further saving time and money. Ultimately, this program will enhance a company’s “Just in Time” capabilities.

As of 2009, approximately 8,000 domestic companies have entered Phase 1 of the C-TPAT program. This means they have submitted their paperwork to CBP and the initial paperwork has been approved. Approximately 400 have a Tier 3 status which equates to a “best in class” standard for their supply chain programs. This suggests that 7,600

companies have yet to be reviewed by CBP, which among other things, includes a visit to their suppliers' locations and the importer of record sites. The huge disparity in those who have entered the program and those who are at the Tier 3 level (the ones receiving the most benefits from the government) are due to many reasons but there are a couple that are worth mentioning. First, the CBP does not have the bandwidth to keep up with those trying to enter the program. Companies are starting to realize the financial impact of delays at the port, future inspections, etc and are now "joining the race". This is stressing the existing program and resources. This issue will force some flexibility with the program and for the first time in 2008, a pilot program tested the feasibility of outsourcing part of this review function to third parties. As of this writing, it is unknown what the next steps will be but that action by CBP underscores the issue of program overload.

Second, the requirements of having a true understanding of one's suppliers and their security within supply chains is relatively new and requires more work. Prior to 9/11/2001, it was not common for companies to understand their partner's physical security, Personnel security and IT security programs, examples of areas that impact C-TPAT membership. The requirements to move from Tier 1-3 are progressive; some companies are still developing their global security infrastructure to meet minimum acceptable standards.

One key point worth noting, is that at times, companies' procurement objectives (primarily cost reduction) are diametrically opposed to the physical act of securing global supply chains (improving security infrastructure and processes to mitigate risk) and that has an impact on obtaining and maintaining a C-TPAT status. This is one of the biggest challenges to the security industry as a whole and not just with regard to supply chain security: ***if security practitioners cannot accurately define security RFP requirements, forecast the necessary cost to achieve results and quantify true Return on Investment, then the procurement process cannot be all inclusive, and will therefore continue falling short of the C-TPAT requirements.***

What does this mean for global supply chains? It means a few things, but most importantly, it will be next to ***impossible*** for companies to profitably compete if they are not part of the C-TPAT program. Based on the program as it stands, companies are roughly 5-7 times more likely to undergo random inspections by CBP if they are not C-TPAT certified. In addition to the cost of more frequent auditing, the failure to exploit the peripheral benefits generated by C-TPAT compounds the supply chain cost. A study conducted by Barchi Peleg-Gillai in 2006 compels companies to consider taking advantage of all government sponsored programs, like C-TPAT. Here are a few benefits that were reported by interviewees (15 companies took part in the study).

- 1) 38% reduction in theft

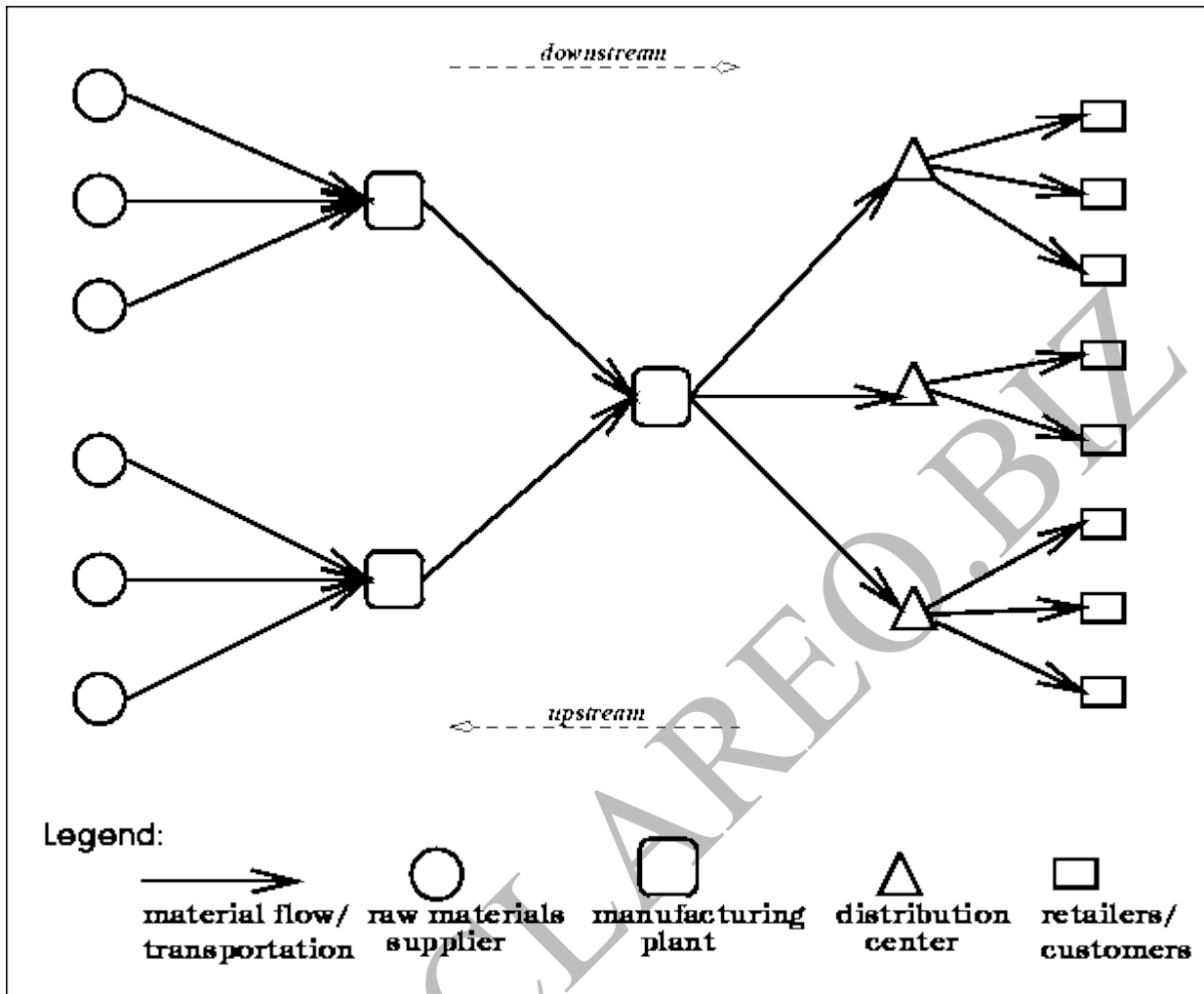
- 2) 14% reduction in excess inventory
- 3) 26% reduction in customer attrition
- 4) 29% reduction in transit time

3pls also benefitted from the government incentive programs with results such as a **75% reduction in inventory and a 50% reduction in damages**. The main point from the study is that each company saved what translated into “millions” of dollars based on benefits of the program. Another issue to consider is that of “reciprocity”. companies in the future will not partner with those unless they are C-TPAT approved as well...The C-TPAT program will be a “cost of doing business” that will repay itself many times over in new deals, efficiencies and a process improvements.

One final note about government incentive programs: These should NOT define your security program but should be part and parcel of a much more robust risk mitigation operation. Obtaining the government incentives is a positive step but in and of themselves will not fully cover risks to your supply chain. Cargo crime is evolving to a much more effective level than what basic standard security programs can manage.

When purchasing an item, whether the item is a pair of shoes, sunglasses, computer or piece of furniture, we rarely stop and consider what drives the actual **cost** of the product. Sure, we know that salaries and benefits comprise a portion, sales and administrative costs, transport costs, warehousing costs, etc. However, there is one other factor I would suggest that is included in the price of a commodity: cost of Theft. This epidemic has a direct impact on global supply chains, will impact future sales and reduce profitability of companies. As stated in the opening paragraph, The Total financial impact of cargo crime would equal the yearly revenues of some well-known fortune 500 companies.

This is a basic supply chain model that companies would employ to get product from raw material suppliers (on the left) and eventually to the end customer on the far right. Every symbol represents an area where a portion of theft occurs. For this example, we are including all types of theft together from small scale employee pilferage to full-scale hi-jackings. The point is that every company within this supply chain has a theft factor that cumulatively adds to the end commodity cost.



When trying to ascertain what impact cargo crime has on supply chains and therefore commodity cost, you would first have to understand the all-inclusive costs of each theft and how frequently those are taking place. This is part of the problem and one key reason why cargo crime is called “the Silent Crime”. If \$1 billion was reported stolen last year alone, industry experts argue the real value is anywhere from 3-5 times that amount. Companies do not report losses for a number of reasons, which range from not knowing they had a loss up to the realization that coming forward about their loss will significantly damage their product integrity. The \$1 billion figure does not include the other areas of profit loss such as increased insurance premiums, the delta between the deductible and actual recovery and most importantly, lost sales.

Cargo crime has an enormous impact on supply chain effectiveness and cost. Let's assume a 53ft truck bound for the local distributor has been stolen in transit. Consider the number of actions that must be undertaken to correct the issue: manufacturer needs

to notify end customer of the product loss (it will not be available for purchase/use), suppliers of additional part needs, issuing changes or concessions to unhappy customers, damage control by sales teams which pulls them away from generating new sales, the battle between who is at fault for the loss (legal teams involved), etc. Cargo crime is a nightmare to a “Just In Time” supply chain process and the timing of which cannot be forecasted. It has the ability to overburden suppliers and 3pls, further increasing damages to product and deviations in shipments. Simple logic states that the more shipments, the more opportunities for failure.

An all too common response to cargo crime is for companies to re-bid lanes for 3pls and suppliers, trying to find someone “to do it better”. This is not a root cause analysis of what created the problem in the first place. Process issues on the manufacturer side often contribute to the problem and switching vendors will not treat the disease. An additional problem with this “re-bid” approach to cargo crime, coupled with the cost of doing so, is the very nature of how some companies seem to continuously operate in “silos”. Interdepartmental communication that considers shared objectives is a rarity as it pertains to supply chain security. The end to end process of building an effective RFP, following through on the agreed to contractual terms and effectively communicating the total **company Value** of the investments, should be the primary objective.

An even more harmful, naïve, approach to handling cargo crime (commonly negotiated when analyzing suppliers) is that of insurance as a security risk mitigation program. It is frightening at the number of companies that defend stolen goods with the response of “we have insurance”. Without proactive risk mitigation security programs, Insurance alone actually **encourages** future targeting of product and increase in losses. Stated simply, insurance has never stopped an organized gang from taking product. It has however allowed manufacturers and 3pls to defray the impact of the loss back to the end consumer, while ignoring the root cause issue that is damaging product integrity, profitability and even your C-TPAT status. If this is the current approach in your global supply chain security program, Clareo Inc can help define a more effective strategy and improve your results.

Since 9/11, many companies have entered the supply chain market. Seal manufacturers, technology companies, point to point escort companies, business process improvement companies, etc. are all looking to tap into the Multi-billion dollar supply chain support market. Each company may offer a product but what is the value of the product and how does this item fit your specific risks and needs? For instance, a technology company has a vested interest in selling their products and buyers need to understand the difference between a device that supplements a well designed asset protection program and a perceived panacea for their cargo crime problem. Technology

in one country may be enough to meet the risk for the moment, but may have marginal success elsewhere.

When looking for a security firm to meet your supply chain security program objectives (obtaining all government incentives and cargo crime reduction), make certain you ask a few questions. Have their personnel worked extensively ***on the ground*** around the globe on supply chain security issues? It is one thing to be well-versed in government incentive program language and it is another to have conducted on the ground assessments in the very countries manufacturers are importing from. Does the company have experience in designing secure supply chains (vetting carriers, designing facilities, understanding the different components of supply chains and their inherent risks, developing effective RFPs, etc). This is very different than completing pre-designed forms. Every country has different risks, customs, geographies, etc that dictate thought about the proposed solutions and ultimately, program integration. Simply buying “off the shelf” software solutions or technology alone will not effectively meet the evolving cargo crime pandemic. Customizing a solution to meet the customer’s needs is much more effective and will generate a longer lasting ROI than a cookie cutter approach. Finally, does your client provide tangible ROI (Return on Investment) from the previous programs they have implemented? What should your expected ROI be for your security dollar? Effectiveness from their programs should be defined in real savings and reduction in loss. Find a company with a holistic approach to your global supply chain security program and this will not only ensure you are operating as smoothly as possible but also as cost effectively.

For more information, contact **David Serafine, CPP**

President and CEO

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