Last month, US food giant Kellogg’s announced it would stop its direct-store delivery (DSD) operations and instead start to supply its customers using a network of distribution centres. The move has a major impact on the company’s logistics—but if Kellogg’s succeeds, other food manufacturers are expected to follow.

Kellogg’s is not in a unique situation. In fact, many other US and European food companies have been ramping up the discussion on distribution strategies in the past few years. The main reason for this is a rise in logistics costs due to an increasing variety of distribution channels and stricter fulfilment requirements set by customers. So although food companies cannot permit any mistakes when it comes to the distribution of their products, an increasing number are open to the idea of changing their logistical operations.

**Distribution isn’t getting any cheaper**

New distribution channels such as e-commerce, convenience stores, and home delivery are the biggest game-changers. These new channels, combined with increasing fulfilment requirements, mean shippers are asked to make more trips, in less time, delivering smaller batches, at more uncertain intervals.

On top of that, some countries are experiencing rapidly growing wages in the logistics sector. The fact that American truck drivers’ wages are growing faster than any other profession could have made it more attractive for Kellogg’s to move away from DSD operations.

These new shipping demands are problematic. Not only does this complicate the efficient use of trucks and drivers; it also increases costs at warehouses and distribution centres (DC). One solution would be to adjust to the new requirements and invest in logistics assets, such as smaller, multi-temperature trucks and automated warehouses. But this is quite a capital-intensive strategy. Another solution could be to look for economies of scale by using third-party logistics (3PL) that combines the storage and shipment needs of multiple manufacturers.

**Insourcing... outsourcing... haven’t we had this discussion?**

The discussion surrounding the pros and cons of outsourcing food logistics is far from new, but the increasing levels of service expected by customers in retail, among other factors, may lead to a stronger case for outsourcing. In fact, after a stable period, outsourcing of food logistics is once again growing steadily in Europe, as can be seen in the rise of third-party transports (see Figure 1).
Figure 1: Outsourcing of food & beverage transport is growing steadily in Europe, 2009-2015

In the US, growth in food warehouse capacity also shows a stronger need for public, or 3PL, warehouse space than for private warehouses. This development again signals an increase in outsourcing (see Figure 2).

Figure 2: Growth of public (3PL-run) food logistics warehouses outpaces private warehouse growth, 1995-2014

What to expect from other manufacturers

The costs of logistics are also rising for other manufacturers, so they too will be interested in seeing how successful the move by Kellogg’s turns out to be. There are, however, several circumstances withholding other manufacturers from making the same move. Exiting DSD or outsourcing logistics is less interesting for companies with simpler distribution, due to, for instance, a limited number of SKUs and a limited number of customers. The most important reason to keep operating a DSD model seems to be that marketing, customer service, and market intelligence can only be secured by having direct store-delivery operations. But last year’s move away from DSD by Twinkies producer Hostess showed that these needs can also be met through partnerships with logistics companies and retailers. And if Kellogg’s also succeeds, this may trigger numerous others.
The food sector as an attractive market for logistics providers

Kellogg’s will likely use the distribution network of retailers, but may also outsource some of its logistics needs to 3PLs. In general, the increasing complexity of food distribution is an opportunity for 3PLs. The temperature and food safety requirements of food logistics raise some barriers for entry and allow for some slightly higher margins. The growing importance of having logistics partners that can deal with omni-channel food distribution is also expected to lead to more long-term and more attractive relationships between food producers and logistics suppliers.