Challenges & Opportunities

Insights to Take Advantage of the Changing Business Landscape

By Chaille Brindley

From new competitors to regulatory changes and shifting customer demands, the pallet industry faces an unprecedented level of both opportunities and challenges. Smart companies will take advantage of them. Others will be rolled over by them or even pushed out of business.

While this is not a doomsday scenario, it certainly could be for those who refuse to innovate or simply do the same old thing.

The Second Coming of the Block Pallet

One of the biggest pieces of news to come along in a while was the unofficial announcement that Costco Wholesale wants to move to block pallets starting in 2009. Citing safety reasons, Costco wants to limit the use of stringer pallets. The big box retailer only wants to do a limited number of sorts at its distribution centers. And it appears that the winners so far are iGPS, CHEP, PECO, CPC and possibly a white wood pallet that would be designed to a tight specification under development by the National Wooden Pallet & Container Association (NWPCA).

Products arriving on pallets that do not meet the standards will be refused or in some cases repalletized, which would result in a charge back to the supplier. Currently, Costco allows stringer pallets.

While Costco is only one retailer, it is a big one. And everyone wants to know if other retailers will follow suit. Block pallets have already been a big deal for many products in the fast moving consumers goods supply chain. Rental companies, such as CHEP and PECO, have used block pallets for years. There has been a looming possibility that major grocery retailers would demand a shift to block pallets. That has never happened even though block pallets provided by rental companies have gobbled up a large amount of the consumer goods market. There is a sense that this could be the beginning of a block pallet revolution. That doesn't bode well for many white wood pallet companies that primarily deal with stringer designs.

Nobody knows if the market will tip in the block pallet direction. But this is at least something that companies should prepare for and be able to supply. The real problem for wood pallet companies is that block pallets cost more to produce. Suppliers won't likely want to pay for the added cost. That is what has kept stringer pallets going in the consumer goods chain for a number of years.

New Competitors See an Opening

The last few years have seen the rise of new players and increased competition from alternative materials. The *Pallet Enterprise* has already covered the developing of iGPS, the first all-plastic pallet pool serving the general U.S. market. iGPS is looking to develop a relationship with recyclers and already has more orders than it can currently service. It hopes to add millions of pallets to its pool over the next couple of years.

Steel is getting in on the pooling act too. One of the largest steel pallet and racking companies in the country, Worthington Steelpac (www.steelpacpallets.com), has built a new highly automated facility in York, Penn. Worthington Steelpac hopes its new plant will allow it to move beyond just custom fabrication. This new plant is coming online as the company launches a 48x40 pallet designed to meet the needs of retailers and industrial applications.

Called the Steelpac Distribution Pallet, it's the first light weight, flame-resistant steel pallet designed to meet Grocery Manufacturers Association (GMA) capacity and compatibility standards, according to Worthington. The new design has been tested with big box retailers and consumer packaged goods companies.

Jon Holthaus, sales manager for Worthington Steelpac, said "Our steel distribution pallet had less than a 5% damage rate, which is five times less than the average damage rate of a traditional wood block style pallet."

While the pallet is more cost effective than many other metal designs thanks to automation, it is still too expensive to be used in anything other than a closed loop, controlled situation. Holthaus said that the key markets are printing and industrial applications as well as some pharmaceutical or food manufacturing operations.

Holthaus said that the Steelpac Distribution Pallet will be priced somewhere between a heavy-duty wood block pallet (like PECO or CHEP) and a comparable, high-quality plastic pallet.

Worthington Industries has worked closely with retailers and product manufacturers to identify desired characteristics and develop a pallet that will work in the consumer goods supply chain. While the pallet may be too expensive for most retail applications, Worthington Industries has demonstrated what a metal pallet can do as far as damage resistance and racking strength. Retailers are not likely to switch to metal any time soon, but at least, they have had a taste of the benefits offered by metal pallets.

Made of galvanized steel, the Steelpac Distribution Pallet offers more than 3,500 pounds of unsupported racking capacity. Features include: four-way access, lightweight, flame retardant, superior racking strength compared to traditional pallets, and recyclable. Also it does not attract or harbor insects and prevents rust.

The industry is starting to see more collaboration or new ventures between wood and alternative material vendors. A number of years ago Rehrig Pacific and Penn Pallet worked to develop Rehrig Penn Logistics, which provides wood pallet management and dock sweeps for Wal-Mart and other retailers.

Last year, Worthington ventured into wood pallets by purchasing a partial ownership stake in LEFCO Industries, LLC. The resulting joint venture became LEFCO Worthington, LLC. In addition to continuing LEFCO's existing products, the joint venture manufactures steel rack systems for a variety of industries, including automotive and trucking. The new company is a minority business enterprise (MBE), which gives it a bidding advantage for some government and private sector contracts. LEFCO operates a manufacturing facility in Cleveland, Ohio, where the company produces engineered wooden crates and specialty pallets.

Toro Pallets LCC has partnered with Ongweoweh Corp. to provide pallet management and logistics services for its metal pallet customers. The need to cut costs and improve sustainability may be a driver for more pooled packaging in the future. It will be important for the wood pallet industry to present itself as a systematic solution and not just a one-way shipping platform. Winning that battle is as much public relations and paperwork as anything else.

Changes in technology may impact the market as well. Plastics companies have worked to reduce the amount of virgin material required in pallets. Biocomposite technology could take this even further by drastically reducing the amount of plastic needed to produce a pallet. This in turn would lower the cost. Sound far fetched? Greystone Logistics Inc. has introduced a new biocomposite pallet that is made from waste coming from ethanol plants.

Growth is one reason to explain the increasing level of competition. But there is also a growing concern over the size of CHEP and the need for viable alternatives to develop. Neither retailers nor consumer goods manufacturers want only one or two suppliers when it comes to transport packaging.

Pallet users continue to demand options. **Bob Moore, president of iGPS, said, "Retailers, like Costco, don't want any one pallet supplier to be able to strong arm them that is why they are looking to diversify their supplier base." Moore pointed to what Wal-Mart has done with its pallet sweep business as an example. Big companies have seen what CHEP did in the United Kingdom when it had little competition, prices skyrocketed and quality suffered.**

Anyone who regularly watches the U.S. CHEP pool is aware that quality has been allowed to suffer. Part of this may be due to the aging pool. Another significant factor is lax repair standards that allow the company to hit profit targets. Our research has confirmed reports of pallet quality concerns from both CHEP customers and recyclers.

CHEP has essentially dominated the 48x40 market for years, and it currently faces extreme customer dissatisfaction. This has opened up a door for competitors that see opportunities to grow and snatch business away from CHEP.

Reverse Logistics Could Drive Future Industry Growth

Beyond just selling pallets, companies need to see themselves and develop capabilities to provide logistics services for a wide variety of transport packaging. This includes wood, plastic and metal.

Moore said, "The real win is that recyclers have an invaluable infrastructure for reverse logistics."

iGPS is looking to partner with recyclers to help it get back its expensive asset in timely manner. The name of the game in pallet rental is asset turns. The longer a pallet remains lost, the more expensive it gets. One of the biggest advantages that a recycler provides to rental companies is speed not just getting the asset back. Giving the high cost of wood, plastic and metal pallets, the need to manage them effectively makes pallet recyclers the key to any large-scale pool.

Sam McAdow, president of Buckeye Diamond Logistics and a leading recycler, said, "All of these rental pools need an infrastructure in place to help them manage their assets. I feel that we can setup a business model that will work for everyone. But recyclers have to be firm on what they charge."

No pallet company is going to get rich off what CHEP currently offers through its Asset Recovery Program (ARP). Many struggle to recover their costs. But this attitude may change as more rental pallets enter the market. The real key is for recyclers to understand the value of their service and to demand just compensation. The current antitrust case brought by recyclers against CHEP could also change the legal landscape and mindset of what reverse pallet logistics is really worth.

Beyond just pallet logistics, there are a wide variety of needs that customers have. You might not even be aware of it because you haven't asked.

According to the Council of Supply Chain Management Professionals, logistics costs continue to grow at a faster pace than the overall economy. Total logistics costs have gone up 63% during the last decade. Trying to handle the logistics burdens caused by globalization has drastically increased the need for third party logistics firms. Reverse logistics is gaining momentum too as cutting down on waste in all areas of the supply chain is becoming a bigger priority.

Five to ten years ago there was a trend to build very large mega-distribution centers and consolidate inventory in just a few spots around the country. Today these warehouses are being abandoned in favor of smaller facilities servicing fewer regionally collocated customers. This enables immediate response to supply requests and shortens delivery times.

Many small local and regional truck carriers are entering the marketplace to provide additional services including warehousing and inventory management. Pallet companies could get in on this action if they wanted to diversify. Beyond simply making money, the more you do for a client the less likely you are to get thrown out the door because some other vendor undercuts your price by a nickel.

In some cases, product is being stored regularly in trailers and containers in open facilities throughout the system, rather than in traditional warehouses. This allows for quick response to deliver product right when customers want it. This too could be an area for expansion by enterprising pallet companies.

Brambles Ltd., the parent company of CHEP, recently acquired LeanLogistics (www.leanlogistics.com), a technology-based transport and supply chain solutions firm. The acquisition will enable CHEP to provide new and value-enhanced services to U.S. customers.

Kevin Shuba, Group President, CHEP Americas said, "We will now be able to offer customers the ability to optimize transport routes and reduce empty transport miles by using the most efficient transport provider available. This will be possible through the leveraging of CHEP's extensive database of supply chain movements and the innovative technology of LeanLogistics."

LeanLogistics, which was bought for $45 million, will operate as a division of CHEP. LeanLogistics provides on-demand network optimization solutions to more than 40 major corporations. Its focus is reducing transportation costs and optimizes supply chain efficiency.

Opportunities Abound for Enterprising Company

The next few years promise to be very challenging for the industry. But it also provides just as many opportunities for those who will dare to be on the cutting edge.

