PRIVATE VS. PUBLIC WAREHOUSING: AN ECONOMIC ANALYSIS

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Presents an industry viewpoint of the advantages and disadvantages of using private versus public warehousing in the food processing industry.

I think a convincing case could be made for either a public or a private facility; although frankly, I lean toward the public concept for reasons I will outline later.

I do hope, however, we can have a two-way discussion of the merits of each.

It goes without saying that there are many differences of opinion as to the desirability and economic feasibility of company-owned warehouses. In many respects it is not unlike the situation of private vs. public carriage.

Some firms may find justification for heavy investments because of operating costs, control of service, marketing advantages, or some combination of these; and others may find it desirable to use common carrier transportation services.

In my company, we have thirteen distribution centers. Four of these are privately owned and operated plant/distribution center complexes, and nine are located in public warehouses. These centers are fairly well spread geographically, and range in size from 45,000 square feet to 250,000 square feet. The average size is slightly less than 100,000 square feet.

I would like to discuss with you some of the reasons why we have taken this particular approach. Most of these reasons will not be unfamiliar to any of you. In fact, many of them can be found in any good distribution textbook. I do hope, however, that I can share with you some practical application of these points.

As I see it there are eight basic considerations in deciding between a private and a public distribution center or warehouse.

The first, and probably the most important, is the capital investment consideration. There are substantial costs of starting up a new warehouse. You can spend a million and a half or two million dollars without too much difficulty and still be faced with the high costs of hiring and training warehouse personnel. Creed Jenkins in his book *Modern Warehouse Management* states that the company warehouse should operate at costs ranging from 10 to 25% lower than the rates public warehouses would have to charge, and many advocates of private facilities maintain that even with a heavy investment there still is sufficient return to be gained. Obviously, the warehouseman is making a profit, so why not take it for yourself.

Each time we establish a distribution center we make what we feel is a fairly sophisticated project evaluation.

This particular project had a negative present value of \$112,000 in favor of the public facility or a rate of return, if a private investment, of only about 6%. We are convinced that we can get more than this for our money by putting it into manufacturing facilities or new products. There is no question in our minds that we can do the job at less cost, but it is a question of capital priorities. Basically, we are food processors, not warehousemen. These evaluations, of course, sometimes indicate the opposite course of action, and each situation has to be considered on its own merits.

Closely related to this is the question of the type of building and/or equipment to provide. When a company plans a distribution facility, it plans for a life ranging from 20 to 40 years.

I think that we will all agree, or at least hope, that there are many technological break throughs around the corner in both buildings and warehousing systems. I personally have looked at no less than eight different proposals for automated warehousing. In the face of this uncertainty, in building a private warehouse, we run the very high risk of having an obsolete facility on our hands. Even in the best of times, it is difficult to predict future utilization or capability, but in environments such as today's, it borders on the impossible.

A third consideration is flexibility of location, or a lack of it, as the case may be. Most of our public distribution center contracts are relatively short term and locations can be changed without the difficulty, and often substantial cost, or ridding yourself of privately owned buildings. When marketing conditions or business characteristics change, or even when you simply make a bad decision, the public contract affords you the convenience and economy of relatively easy exit from a market.

A few years ago, we made a very comprehensive distribution center location study, including all the appropriate cost and service data. The market was a very compact one with all our major accounts located within 200 miles. There was an excellent warehouse operator in the city and the railroad was quite willing to establish attractive rate and transit considerations for us. Common carrier services and transit times appeared to be more than adequate. In fact, the package appeared to be one of the best we had ever put together. To make a long story short, however, the operation was a dismal failure. In spite of the efforts of our company, and those of the warehouse operator, the rail service was completely unsatisfactory and our customer relationships deteriorated rapidly almost from the first day of operation.

Because we were in a public warehouse, we were able to close this operation and move to a more favorable location. There was no substantial cost penalty to us. If we had built this warehouse ourselves, however, the capital cost would have been somewhere in the neighborhood of one and one half million dollars for building and equipment. I don't need to tell you how popular we in distribution would have been around our company if this had happened.

Another popular selling point for the public warehouse, and a point which should be considered, is the need for additional space for seasonable or other kinds of fluctuations. Although we do not take as much advantage of this as some other users do, it is extremely convenient, as well as economical, to have extra space available right at your distribution location.

In the grocery business, new products and promotions are extremely important; and we can achieve the most impact by hitting all major markets on the same day. Public warehouses are invaluable for this kind of operation.

Although I am sure this business is not always attractive to the public warehouseman, by setting up spot stocks around the country, we can secure retail distribution in all markets on virtually the same day. Obviously, this would not be possible with private operations.

Another major public warehouse advantage, in my opinion, is the labor flexibility you are able to achieve. We have experienced work stoppages in our company, but because we depend so heavily upon public warehouses for our distribution, we have been able to operate with a minimum of inconvenience and additional expense. This consideration is particularly important since recently the courts have said that a labor union does not have the right to picket a public warehouse when that union is in a labor dispute with a customer of the warehouse (Auburndale Freezer Corp. Et al Vs. NLRB).

As you know, the consolidation of the products of various manufacturers is a popular concept, particularly in grocery products.

Many warehouses offer consolidation programs of various descriptions, and I think these will become even more important than they are today. In the food area, as the food distributors develop more sophisticated inventory control techniques and improve stock turnover, the manufacturers will be faced with smaller, more frequent shipments. For some chains and manufacturers, a small order may be a carload; but for many others, it will not be. These programs - both rail and truck - will help hold down distribution costs, while still providing a service which the trade will find more and more attractive as their sophistication increases. These programs, naturally, are not generally available at a privately owned distribution center.

I might mention in passing a concept with which we are intrigued, and that is a joint manufacturers' facility in certain major markets.

Briefly, we would be interested in getting a public warehouse to operate a facility for eight to ten grocery product manufacturers and make store door deliveries, by-passing the customers' warehouses.

This would shift the inventories back to us, but we believe, and have confirmed with some chains, that the trade would be willing to pay for such a service.

With taxes as they are today, we certainly cannot overlook the tax implications of the warehousing decision. You may be familiar with the various freeport laws, providing tax shelter for products stored in public warehouses. Of course, some of these provide that private warehouses have the same advantages that public warehouses do. Other state laws do not; and in these cases, the public operator has a definite advantage. In almost all states there is a definite advantage to owning no property within that state. A corporation which owns property in a state is considered "doing business" in that state and they are subject to various state taxes. This can be quite significant, especially in states such as Pennsylvania.

The last thing I will mention is an argument which is advanced for both the privately owned and public warehouse. That is the control feature. It has been said that a private warehouse is an integral part of an overall management plan dedicated to company objectives and therefore is somehow superior to the public operation. We have found that our public operators do as good a job as private warehouses. This is because the public warehouseman, with an account of this size on a relatively short term contract, has a very definite incentive to do a good job. We have found that they respond as fast and as efficiently as our own people. At the same time, we try to share with our public operators the same management skills that direct the rest of the company's activities.

I have somewhat deliberately slanted my remarks toward the public operations, not only because it is closer to my personal philosophy, but hopefully to generate some discussion from the private warehouse advocates in the room.

As I said earlier, each question must be considered on its own merits, but the eight points we have discussed all should be evaluated even if some are discounted for one reason or another.

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AN ECONOMIC ANALYSIS

A Typical Project Evaluation

Private Vs. Public Warehouse
Requirement: 50,000 Square Feet

Public Warehouse Annual Cost

Storage	$ 50,000
Handling	172,000
Total	$222,000

Company Warehouse Annual Operating Cost

Labor	$110,000
Taxes & Insurance	18,000
Maintenance & Utilities	10,000
Total	$138,000

Annual Depreciation on Buildings and Equipment

$ 28,000

Initial Investment

Building	$440,000
Land	10,000
Equipment	50,000
Furniture, etc.	10,000
Start-up Costs	8,000
Total	$518,000

CASH FLOW ANALYSIS (000's of $)

Year	Depre-ciation	Operating Savings	Depre-ciation Tax Shield	Income Tax	Net	Present Value Discount @ 10%	Total Present Value
0	$ 0	$ 0	$ 0	$ 0	$(518)	--	$(518)
1	28	76	15	42	49	.909	45
2	28	84	15	46	53	.826	44
3	28	84	15	46	53	.751	40
4	28	84	15	46	53	.683	36
5	28	84	15	46	53	.621	33
6	28	84	15	46	53	.564	30
7	28	84	15	46	53	.513	27
8	28	84	15	46	53	.467	25
9	28	84	15	46	53	.424	23
10	28	84	15	46	53	.386	21
11	0	0	0	0	235	.350	82
Total Present Value							$(112)

Return on Investment is Approximately 6%