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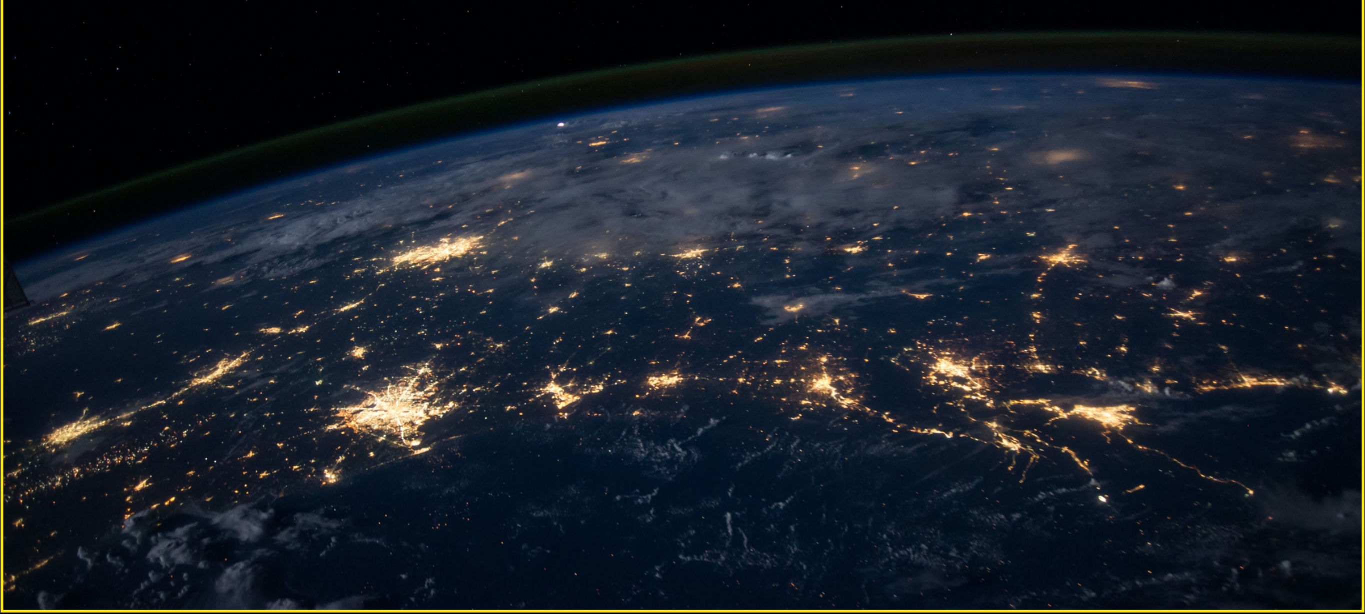
Transparency is an essential tool for successful management

Having an effective Finance function enables freight forwarders to make the right moves – in good and in bad times

Gerard van Kesteren, Financial Navigator

September 2020



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Having an effective Finance function enables freight forwarders to make the right moves – in good and in bad times

These are very challenging times for logistics. An uncertain market environment demands fast-paced yet solid decision making. Although these are uncommon circumstances, the most successful freight forwarders operate on the same basis in crisis and calm times: Decision making is based on rigorous financial transparency.

In this article, I will outline how an effective finance function enables freight forwarders to make the right moves in good and in bad times.

Gerard van Kesteren, Financial Navigator
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We all know that these times are very challenging for logistics. Previously unseen simultaneous disruptions in demand, supply and operations translate into the need for fast-paced decisions in an uncertain environment. Very difficult to navigate, if you do not have the right instruments in place to monitor and manage your financial situation and overall company risks.

However, the most successful companies in freight forwarding do not need to change their operating mode in times of crisis. What makes them successful in calm waters is also a key asset in times of crisis: Decision making is based on rigorous financial transparency – in good and in bad times.

In this article, I want to discuss, what an effective Finance function looks like and what it needs to make it successful.

The role of Finance in high-performance freight forwarders

The ultimate job of Finance is to create transparency. Transparency about company performance, financials and risks. An essential tool for successful management.

Finance is a support function, enabling the business. To make this work, you need to have the right Finance people on board, starting from the top. The role of the CFO is a cooperative challenger, gate keeper and team player – not a "I know it all better" type. This applies to the whole Finance team.

Everyone in Finance needs to think about how they can contribute to make the business successful. That includes keeping finance processes and requirements as lean as possible.

Metric of success: The three key KPIs in freight forwarding

Freight forwarding is a trading business. In essence, a forwarder buys transport capacity from carriers and sells it bundled with additional services, such as customs brokerage, to shippers. The overall price of a shipment is dominated by the transport rate, which in turn is volatile and reacts to a very complex interchange of demand and supply. Usually there is also exchange rate exposure, adding further volatility.

The management team of a freight forwarder needs to be supported by KPIs that truly reflect the success of the company and clearly highlight the risks.

The three key KPIs that meet this requirement are

1. Gross profit (GP) per file
2. Conversion rate (EBIT as percentage of GP)
3. Free cash-flow, i.e. liquidity

Gross profit (GP) per file

Gross profit based KPIs are good measures of success and key metrics to manage performance and benchmark within the company and with peers. The GP reflects the value added by a freight forwarder between buying transport capacity and selling freight forwarding services while eliminating the volatility effect of transport prices. The value added can result from leveraging economies of scale in purchasing, excelling at managing yield, providing value adding services such as customs brokerage and mitigating risks on behalf of all parties involved.

The most successful freight forwarders such as K+N, Expeditors and DSV have a clear focus on maximizing GP via optimizing file profitability. Optimizing at file level enables the front line operation to take charge of controlling shipment costs and optimizing pricing. This practice assigns clear accountability for the profitability of any shipment to operations. However this only works well, if it is embedded in an overall corporate framework with efficient and lean processes and transparency. And here, the Finance function has a key role to play. Leading forwarders have different cultures and organizational models, however their clear focus on optimizing file profitability emerges as a common key factor for their success.

What makes a good “GP per file” KPI? In a target scenario, all costs between gross revenue and gross profit are directly booked against the shipment file. Only by controlling this process is the GP per file meaningful, which in turn is a prerequisite to manage customer profitability in line with forwarding industry best practices.

The road to a trustworthy and accepted GP per file is rocky and full of challenges, such as

- How do we identify and allocate costs that need to be reflected at file level?
- How do we allocate costs and revenue between export and import locations?
- Are our Transport Management and Finance systems capable of properly handling cost and revenue at file level?
- What GP margin target do we need to set in order to cover the overhead costs below GP?

Even if the road can be long and winding, it is of key importance that you never loose sight of your objective to drive business based on GP per file.

Conversion rate

The conversion rate gives a clear view on how well a forwarder is able to convert GP earned into bottom line EBIT. It represents how efficiently and effectively the company manages its processes and costs that can not be directly linked to a shipping file, such as corporate functions and IT systems. The conversion rate is straight forward and unmistaken.

Free cash-flow

As in any trading business, managing cash-flow and liquidity proactively is a great lever for success in forwarding. And a big risk for failure if done poorly.

Driven by high turnover, high cost of sales and high direct costs, cash-flow management is a key job for a Finance function in freight forwarding and a KPI that the whole management team needs to be up to date with at all times. Leveraging purchasing power to negotiate favourable payment terms with your carriers while making sure that the organisation closely follows up on customer payments improves your working capital and ensures financial stability and robustness for the whole company. This enables you to take advantage of market opportunities and endure market disruptions.

Decision making based on transparency

The support and gate-keeper role of Finance includes the responsibility to ensure that decision making is based on transparency. Finance needs to set the right framework for regular management discussions by providing meaningful, complete and correct financial reports, including all cash-flow elements.

Financial transparency should flow from board level down through the company and cascade to all levels of the organisation. It is the job of the whole Finance team to promote and ensure that decisions are taken based on solid financial information.

KEY TAKE AWAY

How an effective Finance function enables the business to make the right moves

- **The job of Finance is to create transparency**, manage risks on behalf of and in cooperation with the business and be a financial gate keeper.
- Set the right frame for your regular management discussions by **providing meaningful, precise and trusted financial reports**. Ensure that these are the foundation of the board room discussion and decision making
- The **key financial KPIs for success in forwarding are the gross profit per file, conversion rate and free cash-flow.** Be rigorous in aligning all parts of the organisation on these KPIs and enforce their importance by linking incentives, customer profitability discussions and overall company decisions to them
- Promote and enforce that **decisions are made on solid business cases** based on future cash flow projections
- **Finance is a support function to enable the business**. Not the other way around!
- **You need to have the right kind of Finance people on board, starting from the top**. The role of the CFO is a cooperative challenger, gate keeper and team player – not an “I know it all better” type. The same applies to the whole Finance team. They need to truly want to make the business successful. That includes keeping finance processes and requirements as lean as possible

Conclusion

An effective Finance function can propel a logistics company from good to great. The most successful forwarders have a world class Finance function.

In this article, I have shared my experiences on how an effective finance function enables freight forwarders to make the right moves in good and in bad times. I am very much looking forward to your perspectives, experiences and thoughts.

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Gerard van Kesteren

Financial Navigator

gerard.vankesteren@corp-navigators.com

Gerard is a financial specialist in the global logistics sector and is a non-executive director in a number of companies, as well as a senior advisor with McKinsey & Company and has extensive international experience and financial management capabilities. Gerard worked with Kuehne + Nagel for a total of 25 years; from 1999 until 2014 as Group CFO and member of the Management Board. In addition, Gerard was awarded the CFO of the Year 2010 and was appointed Chairman of the CFO Circle (Switzerland) 2014-2019.

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