# 3pl or third party logistics essay sample

The need for effectively managing the supply chain can be underscored by the amount of costs that are accredited to the process. From facilities maintenance, storage of inventory, utilities, to labor costs, this aspect of the business can account for over 60% of the variable costs of the business (Alexander, 2004, pp. 87). This paper will seek to highlight the importance of entering into a strategic alliance with a Third Party Logistics Provider to manage a company's entire, or even part of the, logistics operations. The various types, the benefits and disadvantages, and the best practices of entering into this relationship will also be discussed. Towards the end, this paper will also highlight the importance of this phenomenon to companies that engage in mass customization, such as the automotive industry.

LOGISTICS

Cahill (2007, pp. 20) defined logistics management in his book, ' Customer Loyalty in Third Party Logistics Relationships: Findings from Studies in Germany and the USA,' as the part of Supply Chain Management that plans, implements, and controls the efficient, effective forward and reverse flow and storage of goods, services and related information between the point of origin and the point of consumption in order to meet customers' requirements. He also provides an alternative definition of logistics, as a flow-oriented design of all value-creation processes. These definitions help us to deduce the importance of logistics management to any company, for the success of a company hinges on providing its customers with the goods that they seek to buy from that company. Not only does the company also have to ensure the arrival of the goods, but it also has to ensure that the goods will arrive in as minimum a period as possible and in the quality that is promised to the customer on sale of the good; this is the point where the efficiency and the effectiveness of the process comes in, and this is also the point where a company can develop its competitive advantage.

In structuring its logistics, the company has to decide whether it will provide logistics capability in-house, outsource it to a third-party, and/or own a subsidiary that provides logistic capabilities (Cahill, 2007). However, once the structure has been established it can still be altered, as was done in the case of Matrah Cold Stores LLC – a leading FMCG distributor in Oman – who recently signed a contract with Agility for the provision of third-party logistic services in Oman.

## COLLABORATION AND STRATEGIC ALLIANCES

Collaboration can be considered as a practice that enables firms to, operationally-speaking, leverage each other, and design an information flow system that allows them to work better as a sum of their parts. This collaboration is facilitated by the advent of effective information technology systems that integrates the information process of the relevant parties.

While the benefits of this approach are widely recognized, it is still seen that companies prefer to not be involved with the same distributor as their products (Coyle, 2008). Companies that look beyond this constricted bias will discover that the benefits to be gleaned from this process can create significant efficiencies in their logistics management.

With third party logistics providers, companies can engage in full collaboration: a combination of horizontal and vertical collaboration that allows greater efficiency gains than either of the two alone. The benefits from this type of collaboration is intended to benefit all the parties involved as the success of this relationship will rest on the extent to which the outcome is shared.

Kaminsky (2004, pp. 113) presents in his book, ‘ Managing the Supply Chain,’ a framework analyzing the need for entering into a collaborative strategic alliance with another company.  The benefits that are supposed to accrue from this process include value addition to products, such as through partnerships that improve distribution times and consistency of delivery; improved market access, by the simple expedient of being able to tap the larger delivery base of a specialized logistics firm; improved operations through lower system costs and cycle times; improved technology by partnering with companies that specialize in logistics IT system; enhanced strategic growth and organizational skills through reduction of market entry barriers and an opportunity for learning from one another’s experience and skill; and improved financials through the sharing of risks, and reduction of costs through specialization. Of the types of alliances that a firm can enter in with regards to management of its supply chain, one in particular is third party logistics.

THIRD-PARTY LOGISTICS

Third-party logistics (3PL) is a phenomenon that gained popularity in the 1990’s as the outsourcing of some, or all of the aspects of a company’s logistics operations to a third-party company (Kaminsky, 2004). The reasons why a company would choose to use a 3PL provider will be discussed later on, but the major reason usually stems from the fact that a 3PL provider has greater experience in logistics management, that can translate into lower costs for the hiring firm. Some of the services that a 3PL firm provides include transportation, financial services, warehousing, customs clearance, distribution, as well as solutions to problems, and/or improvements to a firm's supply chain.

Drivers behind the need to outsource

Although the importance of outsourcing of logistics is not in doubt, there is still a need to identify the major reasons why a firm would consider outsourcing its logistics function. This is the result of a desire to match the requirements and the issues that a potential hiring company might be facing with the benefits and services that a third party logistics firm might be providing, in order to achieve a synergistic relationship that is mutually beneficial.

The reason behind the current trend towards outsourcing could be attributed to the increasing globalization that has caused a surge in international demand, and subsequently, an improvement in the logistics process (Cahill, 2007). Another popular reason for outsourcing is the desire to regain competitive advantage that most of the large companies had foregone in their path towards global expansion. Companies now feel a need to tap only that part of the business in which their core competence lies and thus provide more efficient and effective customer service than before.

Some other, related reasons include the rise in the complexity of the supply chain, which will be greatly simplified from the perspective of the hiring firm once the 3PLP takes over. These 3PLPs also enjoy economies of scale because of their ability to combine delivery of products of different clients together so as to achieve cost benefit through higher volumes. This feature also allows the 3PLPs to smooth out any fluctuations in demand, and supply these services at lower rate than what the hiring firms might have received by managing their own logistics.

The trend towards mass customization is another reason behind the switch to 3PLPs, as the distribution of customized goods is carried out on a per product basis, which makes it difficult for a firm to attain an economic quantity. With 3PLPs guaranteeing delivery at specific times, and with better service, hiring companies will not have to worry about attaining that break-even quantity (Chandra, 2004).

Types

It is common for most 3PL providers to espouse their services as being a one-stop window for all logistics related operations, but it is useful to categorize them. The categories as described by Coyle (2008) in his book, ‘ Aise Pkg’ are transportation based, forwarder based, warehouse/distribution based, financial based, and information based.

Most of the transportation based companies are subsidiaries or major divisions of large transportation firms. They use either leveraged services, in which they use the assets of other companies, or unleveraged services, in which they use assets of the parent company. These companies are not necessarily restricted to merely transporting goods, but can also provide a more diverse and all-encompassing collection of logistic activities, such as DHL, and UPS Supply Chain Solutions.

The major focus of warehouse/distribution based firms is on inventory management through warehousing and distribution. They usually situate their warehouses in Free Trade Zones so as to capture the lower cost of storing a large capacity of goods in a central warehouse, such as in the Jebel Ali Free Zone in UAE.

Forwarder based firms are companies that have broadened their responsibilities as brokers into the third-party logistics service. They usually do not own assets, are very autonomous, and have proven quite competent in their new roles, such as Fritz.

Financial based firms are a category of third-party logistics providers that provide services dealing with the financial aspects of managing inventory, including auditing, freight charges, as well as tracking and monitoring the inventory. Examples of such firms are Cass Information Systems, and GE Information Systems.

Information based firms are in the form of electronic web markets that provide alternative sources for business to business logistics services. These services help improve operations through collaborations with the customers that provides real-time management of the inventor, for example, Nistevo.

Advantages

In choosing how to structure a company’s logistics operations the firm must consider the advantages and disadvantages of the options available to it. In the case of outsourcing to 3PL providers the advantages boil down to two features that a firm looks for: lowered cost, and improved performance (Cahill, 2007).

The cost for the firm is reduced as it no longer has to worry about the overhead costs associated with the transportation and distribution of the goods including, personnel maintenance, the creation and maintenance of information technology to provide real-time tracking and monitoring capability, and the acquisition and maintenance of equipment and facilities. The biggest cost of inventory overhang has also been shifted to the 3PL provider, since it would handle the warehousing aspect as well. These costs are reduced and not merely shifted to payment to the 3PL provider (3PLP) for its services because of the economies of scale that the 3PLP enjoys, because logistics is the core competency of the 3PLP, and because the 3PLP can smoothen out demand fluctuations for its services by diversifying its customer portfolio. These attributes allow the 3PLP to make it beneficial for a company to seek out its services, as opposed to managing the logistics by itself, or through a subsidiary that it owns (Cahill, 2007). .

A company that outsources its supply chain also enhances its own, and the performance of the company to which it outsources by allowing both a chance to engage in activities in which they respectively specialize. This is especially true in the current scenario of scant corporate resources, which has made it increasingly difficult to specialize in every facet of business as was previously the norm (Kaminsky, 2004).

In addition to being able to focus on their core competencies, firms are also provided with greater flexibility, with regards to the decreasing need for them to constantly change their information technology and expertise, and with regards to the conversion of previous overhead fixed costs into variable costs with the advent of using the services of 3PLPs, which allows a company to adapt faster to changes in the business environment (Kaminsky, 2004).

## Disadvantages

The biggest disadvantage to any firm thinking of handing over its logistics to a 3PLP is the loss of control over quality, service and prices (Cahill, 2007). A firm that loses control over its product runs the risk of becoming dependent on the 3PLP for survival, which necessitates either a greater sharing of knowledge than was originally thought beneficial, or a loss in business through possibly lower customer satisfaction. For some businesses this is too much of a risk, which is why it is a general trend for larger companies to employ 3PLPs, as opposed to smaller businesses, as the larger businesses have more power due to their past experience and established goodwill.

With the fall in need for personnel in the logistics department the hiring company would have to lay off its human resource once it switches to a 3PLP. This switch might cause a decrease in employee morale as the employees might perceive that with one aspect of logistics gone, a time might come in which there services would not be needed either. Thus, the fall in morale might adversely affect productivity to the extent that it might offset any potential cost savings from outsourcing the logistics function.

## 3PL Agreement Issues

Apart from the advantages and disadvantages listed above there are several considerations that a firm must take before it decides to enter into an agreement with a third-party logistics provider. These factors will help gauge the need for an outside logistics provider and also determine the type of provider with whom to form a strategic alliance with (Kaminsky, 2004).

The first and foremost is to establish one’s own cost in order to determine whether or not it would be financially beneficial for a firm to handle its own logistics operations. For a firm that has not already been handling its supply chain there are several programs that exist that will help in predicting costs, whereas firms that have already been handling their own logistics can use activity based costing methods to trace costs back to their specific goods. This will also provide the firm with a bargaining chip with which to negotiate the price of the 3PLP.

Apart from the financial aspects, the firm must also consider the intangibles, such as the goodwill it has established over the years and the perception that the 3PLP will send to its customers. A good 3PLP will be flexible enough to adapt its services by performing activities such as keeping the logo of the hiring company on the goods as well as incorporating the hiring company’s uniform while delivering the goods. In addition to this, the 3PLP must also be reliable in its timings and in its quality assurance so as to avoid customer dissatisfaction and complaints.

Another factor that must be considered is the type of 3PLP to invest in, and the extent to which the hiring company will hand over its supply chain management to an outside logistics service provider. Firms that only hire some of the services of a 3PLP usually enter into agreements with providers whose initial foray was in the field they are hiring out for. For example, Federal Express started off by delivering small packages on time, and so that is where its specialization is perceived to lie. Therefore a firm that only seeks to deliver its goods on time will more likely hire FedEx than GATX, whose beginning was as warehouse managers.

Finally, the hiring company must ascertain whether it wants to deal with an asset based, or non-asset based 3PLP. Each has its own pros and cons: usually, asset based 3PLPs have a large customer base and economies of scale and scope, in addition to having the personnel and established procedural systems, and higher bargaining power due to their large size; advantages that appeal greatly to a firm looking to cut down on its costs. On the other hand, non-asset based 3PLPs are less bureaucratic, more flexible in their dealing with the hiring company, and excel in their relevant areas of expertise, while maintaining a low decisions cycle (Kaminsky, 2004).

Choosing a 3PL

There are a number of steps that should be carried out in order to choose the correct 3PLP. The first step is to identify the need for an outsource logistics provider by conducting an analysis of what it is that would be outsourced. The second step is to identify the feasible alternatives, through an assessment of risk of outsourcing. Then these alternatives should be evaluated and one selected. The evaluation process should consider the 3PLP along the following guidelines: the availability of management, the rate at which mistakes are made, the extent to which promises are kept, and most importantly, that delivery is consistently on time. Even then, a benchmark should be established based on other functions that use the service of the shortlisted 3PLP. The next step is to implement the service, by entering into a contract that is based on partnership and full collaboration. And finally, the last step is to conduct a continuous service assessment, possibly by using track cards that monitor the guidelines already established in evaluating the alternatives (Reynolds, 2003).

3PL Implementation

Having selected a third party logistics provider for your company you must now establish an agreement with your potential partner. This stage is critical for the success of the whole process, and it must be devoted a significant amount of time and effort. The startup of the alliance will be the period of the first half of the year in which the hiring company must succinctly identify to the third party logistics provider exactly what the company is looking for in the relationship. The company should be able to provide relevant and measurable performance assessments to the 3PLP so that both firms can judge whether the relationship is mutually beneficial or not. On the other hand, the 3PLP must honestly consider the requirements of the hiring firm and determine whether they can be met realistically.

The important thing to remember at this point is that the relationship between the two firms is that of a partnership and at no point should either party seek to exploit it. To ensure that both parties are on the same proverbial page, a medium of effective communication should exist between the two. Even within the organization, the employees must be informed about the decision to outsource logistics so that they are not caught by surprise, and so that they not feel as if they are not an integral part of the organization. Instead, the employees should get involved appropriately towards making this alliance succeed.

Out of the potential issues that might occur one might be the necessity of a technological system from the 3PLP that is too complex to integrate with that of the firms. But since communication between the two is essential it might be better if either the third party help significantly in integrating and assimilating the systems, or the hiring firm should consider an alternative 3PLP.

Other issues that should be addressed are that the 3PLPs must honor the confidentiality of any information provided them by the hiring company, arbitration proceedings must be decided beforehand, and methods must be discussed that ensure that performance goals are met.

UAE

The importance of the function of logistics in the United Arab Emirates is clearly emphasized by the growing tendency of local companies to use third party logistics providers for their transportation needs. The market for logistics in UAE is expected to grow to US$40 billion by 2010, and this has led to the creation of the Dubai Logistics City; a project which is expected to become the first completely assimilated logistics platform in the world.

To highlight this growing market one can take the example of Pharma World Holdings, the first ever third party logistics pharmaceutical provider in the region. It provides a one stop solution to local as well as international manufacturers, thanks to its advanced IT infrastructure, in addition to its certification for its DRP system.

Another company, one that has engaged the use of a 3PL in the form of GAC Logistics, has renewed its contract so that it can continue to supply its customers with leading retail brands such as Marks & Spencer's. Al Futtaim Retails has been in partnership with GAC since 1996 and was so satisfied with the relationship that it further renewed its contract with the logistics provider. GAC, in a move to cement its position in the GCC market, with regards to its Marks & Spencer's distribution, also decided to invest in a new system for garment hanging.

More recently, in Dubai, Al Yasra received some help from SNS to implement a new IT system that allowed it to sign on its first 3PL customer in the pharmaceutical industry, Yiaco. This move illustrates how the distributor of frozen and chilled foods, and high-end fashion goods entered another industry through the help of a global 3PLP with a company that distributes leading brands such as Bayer, Sanofi-Aventis, and Phizer.

BEST PRACTICES

When a company supplying automotive parts started work with a 3PLP, the management decided to offload the entire logistics operations to the third party, close down its existing distribution networks, and then forget about it (Trebilcock, 2008). On paper the strategy seemed sound – both companies would focus on their respective core competencies – but in actuality the result was poor customer service, missed deadlines and project overruns, which eventually caused the whole relationship to collapse. Such a relationship requires that management acknowledge that its responsibilities do not disappear, even if another company is managing the operations. In order to not make the same mistakes that this firm made, a company should generally follow a certain list of best practices when outsourcing its operations to a 3PLP.

Communication

As mentioned earlier, this relationship is supposed to be a partnership. Each company should be coordinated in its efforts so as to reap a mutual benefit. The best practice is for hiring customers to assign a liaison to the outsourcing company that would be in constant touch with the providers to address any queries that they might have. On the flip side, the 3PLP should assign an account manager to its clients who would work with management and report back to the provider’s directors, thus creating an enabling environment for effective communication.

There are usually three sorts of companies that hire a third party logistics provider: one that cannot handle the distribution function, one that has entered a vertical industry recently, and one that has created a new business unit but hires out its logistics as a temporary measure (Trebilcock, 2008). Regardless of the reason for outsourcing, once the decision to do so has been made the companies must then assure that the practice has been adopted by all facets of the company, from the manufacturing team to the management executives.

Metrics

Having made the decision to outsource the firm should then establish a benchmark of metrics that would be presented to the 3PLP as a measure of the expectations that the customer has from its new partner. The concept behind this practice is to provide the third party with a performance based history, including those metrics which the company is interested in monitoring and enhancing, so that the third party understands the business. For companies that are unaware of how to calculate the internal costs of distribution a 3PLP should place an engineer who would conduct an analysis to establish the baseline and to educate their clients on the current performance of the 3PLP.

These metrics should then be incorporated into a ‘ prenuptial’ document that highlights the expectations of a customer with its 3PLP. This document might contain metrics ranging from the type of machinery to be used to handle the materials, to the level of inventory that must be kept, to the systems that would be used in monitoring the process. It ensures that both parties go into the relationship with a realistic assumption of the level of collaboration they are engaging in.

Establishing worth

The price a 3PLP would charge depends on the type of model they use to determine costs (Trebilcock, 2008). The transactional or traditional unit pricing model espouses the use of a flat fee to the provider for each service that it supplies to the client. For labor intensive activities a variation is used in which the fee is based on a per unit charge that still integrates the range of services that are hired by the client.

In activity based costing the client pays a flat fee as well as a variable fee to the 3PLP. The flat fee covers the fixed costs of running a devoted facility to the client. The variable fee covers costs such as labor, fuel and raw materials.

The cost plus pricing model is a basic model that charges the cost to the 3PLP for providing the services and a certain margin above it for the 3PLPs profit. This model is usually reserved for companies that cannot forecast their demand accurately enough, or that are unaware of their internal costs of distribution.

The last model is usually for long term contracts and is called gain sharing. In this model the third party logistics provider only asks for a fee based on the level of improvement that it makes to the logistics process, in the metrics that the client has already describes as important to it. This model works best for companies that seek to establish a long term relationship on the basis of considerably improved cost and services by the provider.

Coordinator

As discussed earlier, a company should have a representative that is in constant contact with the logistics provider and who coordinates the information flow between the various departments of the company and the provider. The function of the coordinator also involves the sharing of crucial information such as upgraded metrics, goals, and strategies. This sharing ensures that both companies are on the same page, through various meetings that analyze the performance of the 3PLP with respect to the ' prenuptial' that was signed earlier with the client.

By engaging in these practices the 3PLP and the hiring customer ensures that the provider is able to deliver real value to the customer. The result of an effective partnership where there is full collaboration is usually an improvement in costs that lends credence to the decision to outsource in the first place.

MASS CUSTOMIZATION

Companies and industries that seek to provide a greater range of their products customized to the wishes of the customer face a growing array of problems associated with mass customization, with the greatest problem being that of handling the massive amounts of inventory that such a business necessitates in handling customer demand. The emphasis is thus focused on improvement of the operations process that can only be brought about by the use of the more leaner, and cost effective third party logistics providers (Chandra, 2004).

The convolution of the logistics operations is largely the effect of the value of the product and the variety offered by the company. A company that offers a large variety of products that are of high value requires that inventory levels be the first metric that is addressed. On the other hand, a company that offers a large variety of low value products requires that transportation be optimized. With greater variety being linked to mass customization, a third party logistics firm enables the firm to provide greater flexibility and propinquity to the customer without the need to increase the fixed costs, a key consideration for firms that engage in this type of activity.

Job shops are another means of operating a customized product offering company. The problem in accurately forecasting the demand is obviated by this method. Thus, there are lower raw materials and finished goods inventories, but greater work-in-process inventories, which necessitates the use of advanced information technology; technology that is better provided by a 3PLP.

## CONCLUSION

A company that hires a third party logistics provider is ensuring that its logistics operations are being efficiently managed by a specialist, with whom the company has partnered. Although there are pros and cons to engaging in this activity, the reasons for eventually entering into an agreement differ from company to company. In the end, however, the whole argument boils down to whether the costs of hiring a third party would be less than the costs of managing one's own distribution network. Even then, a company who deems that this process is too costly in the short term should consider the long term improvements that the 3PLP could inculcate into the process, potentially offsetting the costs of doing business with them. The only way to make sure that the parties involved have entered into a mutually beneficial relationship is to follow the best practices mentioned earlier, for if the actions of Hewlett-Packard, General Motors, General Electric, Unilever, and P&G are any indication, this practice is growing in importance, and a strategic alliance with a 3PLP may be the best way to focus on strengthening one's competitive advantage with respect to one's rivals.

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