

# An introduction to 3pl management essay



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According to Coyle et al, while the emergence and growth of the third party logistics industry was a major phenomenon of the 1990s, thoughts differ as to how best to define this type of logistics provider and what services might be included.

Basically, 3PL firms are typically external suppliers that provide all or part of an organization's logistics function. Some of the multiple services which are also integrated in nature, provided by the 3PL firms are transportation-based, warehouse/distribution-based, forwarder-based, financial-based and information-based.

Directly related to 3PL is the growing need for fourth-party logistics (4PL), which is the relationship that provides a wide range of integrative supply chain services to organizations. (Coyle et al., 2003).

Thus, it is the potential development of the next phase of outsourcing and should be taken seriously by logisticians/supply chain practitioners.

## **2. 1 Categorization of 3PL services provided**

Rushton et al., (2010) note that 3PL firms provide either dedicated/exclusive operation or multi-user/shared operation to their clients.

Dedicated service provision refers to a situation where the 3PL firm provides a complete logistics or distribution function. In this case, the 3PL firm provides the client with all dedicated outsourced services and meet decision criteria/distribution requirements exclusively, on international, national or regional levels. This type of service is more common in the UK but it is also used in Europe and North America.

Multi-user function on the other hand, relates to the operations of the 3PL firm which cater for a group of client companies, mostly within the service provider's operation, instead of just a single client. For instance, the clients may all be producers or dealers of similar goods and their products may all be delivered to the same or similar customers – pharmaceuticals products to retailers, food to hotels or restaurant, etc.

From the case study, the existing 3PL provider operates as a dedicated service provider at ATC.

It is important for ATC to recognize that the selection of a 3PL contractor is part of the procurement of service and therefore the right processes should be followed to ensure that ATC gets value for its money.

This paper therefore examines among other things the steps/processes, service level agreement, benefits, factors and areas that ATC should consider to realize the full benefits of outsourcing its distribution function to a 3PL contractor.

## **2. 2 Drivers/Benefits of Outsourcing**

The major drivers have been categorized into four (4) namely organizational, financial, service and physical factors, (Rushton et al., 2010).

With regard to organizational factors, one of the key reasons for ATC to outsource its distribution function is the opportunity for ATC to concentrate on their core business or core competence. Simply put, outsourcing allows everyone to focus on what they do best. Funds which ATC would otherwise have used to procure vehicles and other equipment for distribution purposes

could be invested in other operational areas to bring growth and profitability to the organization.

Moreover, the use of a 3PL firm can enable ATC to have access to wider knowledge. This could be done through the chance to use cutting edge technology like RFID (Radio Frequency Identification Device), track and trace, GIS (Geographic Information Systems), or by having access to a wider management know-how and awareness away from that of ATC, in order to be in tune with the technological pace.

For financial factors, it may be realized that the engagement of 3PL firms would allow for a better appreciation of actual operational costs. It is likely that ATC would make payments to its 3PL firm on a regular basis, typically every month, and this will make the definite distribution costs very visible. It will therefore be useful for financial planning.

As regards service, service level enhancement is usually achievable through outsourcing to 3PL provider because if for instance ATC decides to embark on an in-house distribution operation, it may struggle with the initial capital outlay, and ATC may have difficulty in identifying and putting into practice any possible service enhancement. It would therefore be strategic for ATC to outsource to a 3PL firm.

In relation to physical factors, as ATC grows, especially in the framework of both global sources and global markets, management needs to recognize that logistics and supply chain structures have become multifaceted. Long distance travel, intermodal transport, customs processes, different depot

types, cultural differences, among other things may be involved in the 3PL operation.

More so, special vehicle features such as vehicle size, body quality, equipment and unit load specifications may all be affected depending on weight/volume ratios and any 'special' product to be transported. Thus, the use of a specialist 3PL firm by ATC would be more advisable.

Other benefits include ensuring cost reduction, attainment of competitive advantage over competitors and economies of scale with the creation of division of labour and involvement of specialists to perform the appropriate or suitable tasks. Also improving quality, technology and responsiveness and also enabling continuous improvement in the value stream are other benefits that could be derived from engaging the services of a 3PL firm to perform ATC's distribution function.

The use of their well-developed information system, coupled with adequate knowledge of the jurisdiction including its terrain as well as their ability to obtain more favourable shipping rates due to the fact that they clear goods in bulk which could attract discounts are also some of the benefits that could be derived from engaging local 3PL firm by ATC.

Similarly, outsourcing the distribution function of ATC to 3PL firm that has the experience and the resources not only to do it better, but also cheaper makes business sense. Surely, it will be better to outsource to the distribution function to a 3PL provider if the company is not in the business to manage inventory, pick and pack, fulfill and process orders and manage returns.

## **2. 3 Reasons why some organizations are reluctant to outsource some functions to 3PL contractors**

Some companies are reluctant to outsource certain aspects of their operations to 3PL providers for several reasons. Some of them have been indicated below:

Basic delivery systems may be incompatible: This is applicable to the use of preselected orders that require special equipment to unload the goods. In some cases, the 3PL firm contracted may not have the capacity to perform certain tasks and therefore other means may have to be found to deliver the items and this can be both expensive and unproductive.

Changeover costs: sometimes the cost of moving from in-house operation to 3PL distribution provider does not make financial sense. The sunk costs associated with disposing of existing infrastructure and equipment such as vehicles as a result of the 3PL arrangement can be a disincentive for most companies to outsource their distribution function to 3PL provider.

Third party distribution providers may lack the requisite experience of client business' products and markets, even though the growth in specialist distribution firm has helped to alter this perception.

Cultural incompatibility between contractor and client may be a challenge. It is now an accepted fact that cultures vary fairly radically from one company to another. Technically, there should be no clash of culture in a contractor/client relationship since this may lead to conflicts once the operations kick-start.

It is also alleged that the use of 3PL distribution can lead to a loss of control over the delivery operation. This may be imperative if logistics function is considered to be a major element of competitive edge. They are also scared that it might be difficult for the user company to revert to their logistics operation should it decide to do so.

Some companies feel that brand integrity may be compromised. The use of a 3PL provider implies that the company may be denied the opportunity to use its branded vehicle for distribution and so the value of advertising on vehicles is denied them.

The confidentiality of information when using a 3PL distribution service may be one of the reasons some companies are reluctant in entering into such arrangement. There are fears that very important classified information might be divulged as a result of the using 3PL provider and this could have consequences for the company's competitive advantage.

Before outsourcing any function, particularly, the logistics function to a 3PL firm, ATC should conduct a SWOT, PESTLE and other critical analyses determine whether or not it is still necessary to continue with the existing outsourcing decision. This decision should also be informed by the benefits and challenges of outsourcing explained in items 2. 2 and 2. 3 above, respectively.

## **2. 4 Service Level Agreement (SLA)**

One of the areas of contract that can determine its success or otherwise is Service Level Agreement (SLA). SLAs should sum up the contract obligations and are generally part of the initial contract agreement. They normally

include all aspects of outsourcing provision and usually define the services that are to be provided. They should particularly spell out in detail the level of service to be performed. Both the contractor and user should take centre stage in drawing up the SLA.

Rushton et al., (2010), observes that typically, SLA will include:

A description of the service to be provided;

Service standards that are to be met;

Client and provider responsibilities;

Provisions for compliance (legal, regulatory, etc.);

Monitoring mechanisms and reporting requirements;

Dispute resolution;

Compensation for service level failure;

Performance review procedure and timetable;

Revised procedure for activity or technical change.

Certainly, the SLA is a very important document in contract administration.

Aside from describing and determining the expected standards of the service to be provided, the roles of both parties should be clearly spelt out. Similarly, the SLA should contain aspects of compliance such as legal or regulatory issues. The SLA should also entail dispute resolution provisions to guide the 2 parties in the event that disagreements arise during the period of the



contract is in being. The SLA should also cater for compensation in case there is service level disappointment. It is also imperative to include provisions to cater for performance review processes and their timelines as well as contract review processes for operational or technical amendment.

Directly related to SLA is the expectations of 3PL providers of their customers.

Rushton, A. and Walker, S., (2007), note that the 3PLs expectations of customers include:

Mutually beneficial, long-term relationships;

Trust, openness and information sharing;

Dedicating the right customer resources at the right levels;

Clear service-level agreements (SLAs);

Fiduciary responsibility and overall fairness in pricing.

One of the surest ways of addressing ATC's transport and distribution problems is to do a critical analysis, properly identify current challenges confronting ATC, and prescribe appropriate areas to consider in the contract.

It is related in the case study that the current distribution of goods to customers had been outsourced to a local third party (3PL) contractor and that ATC is apparently not receiving the best of services from this existing 3PL contractor. Increasing complaints about late deliveries to clients and

challenges posed by their driver's poor attitude are some of the problems emanating from the operations of the 3PL firm.

The contractor's performance is not closely monitored probably due to the fact that there is no formal service level agreement in place. Also, the existing contract which was let five years ago expires in two month's time.

Dede, the recently appointed manager with responsibility for ATC's Logistics operations has done some diagnosis/identification of the problems and that is a positive step to look at the areas when renewing existing 3PL distribution contract which is almost due for renewal .

In view of the fact that the current 3PL provider had not performed satisfactorily, especially in the midst of increased competition from large retailers, ATC may have to revisit the requirements and decide whether to renew the contract of the existing 3PL provider or to engage the services of an entirely new organization altogether. The steps indicated below (outsourcing steps/process) should be given serious consideration and followed to ensure value for money.

This means that the next contract to be signed between ATC and any 3PL firm should among other things, seek to address the loopholes and for that matter the challenges of the existing contract to achieve competitive advantage. A lucid service level agreement (SLA), which content shall clearly establish the requisite performance level should be drawn and rigorously implemented. Similarly, provision for the monitoring and management of the contract should be incorporated into the SLA.

## **2. 5 Outsourcing Steps / Process**

A number of options are available to ATC and the option chosen will determine the process that will be adopted and followed. Thus, if in the estimation of ATC, the 3PL contractor's non-performance is as a result of ATC's failure to monitor and manage the 5-year contract that was let, then ATC could conveniently go ahead and renew the contract of the existing 3PL firm on the premise that ATC will put measures in place to step up supervision/management of the contract. Alternatively, if the 3PL provider's under-performance is as a result of its own inefficiencies, then it would make a lot of business sense to take corrective steps to engage the services of an entirely different company to perform the distribution role. The diagram which appears below typically outlines steps that will guide the selection of a third party distribution contract, especially where a tender process is to be adopted to select the most preferred contractor:

Figure 2. 0 Key steps of the contractor selection process, source: Rushton A. et al (2010), page 542

In selecting the most preferred 3PL provider, ATC should be guided by indicators such as quality of service provided (speed and accuracy of service), quality of people (human resource calibre), cost of service (how economical the company is), countrywide capability (in terms of available equipment including vehicles, technology and other resources), sector experience (expertise and know-how), flexibility in problem solving and adjusting systems of 3PL to work with that of ATC.

## **2. 6 Factors to consider in renewing the 3PL distribution contract**

Globally, but especially in Europe, the number of 3PL users not renewing more than half of their contracts have increased considerably since the last time Eye for Transport conducted its “ 3PL Selection & Contracts Renewal” study in 2009. Only 10% of 3PL users renew their 3PL contracts for longer than 3 years (Material Handling & Logistics, 2012).

To be able to effectively renew 3PL contract, there is the need to have a service level agreement in place which clearly indicate key performance indicators (KPI's). This is because it provides common ground for working through issues, improving delivery service, monitoring costs, and identifying new opportunities.

Constantly evaluating the effectiveness of 3PL provider is critical to determine if the company's logistics requirements are being met. A service level scorecard may be developed and used to serve as a performance checklist for 3PL provider. This should however be updated to reflect current trends or changes within the supply chain of the company.

In as much as the key performance indicators will vary by industry and priorities, the key ones that are to be considered in the event that ATC decides to renew the contract of its 3PL provider have been discussed here under:

Freight Cost - This is perhaps the most critical factor that ATC has to consider in deciding whether or not to renew the contract of the 3PL firm. This is because one of the key reasons if not the key reason why

organizations engage the services of a 3PL provider is to save costs and therefore if it turns out that it is not cost effective to continue to do business with the 3PL provider, then the whole purpose has been defeated. Therefore, in renewing the contract the cost component of the 3PL provider's services, thus the cost of freighting goods per shipment, per case, per ton-mile as well as by location, status of customers, and mode of transport used should be monitored. A decision should therefore be reached as to whether ATC is getting value-for-money services and whether it is not relatively expensive doing business with the existing 3PL provider. Management of ATC should take keen interest in this matter.

On-time delivery - Levels of delivery service across ATC's network, particularly for key customers, as well as for inbound loads if applicable, is another factor to be considered. Even though targets set for these areas will and should vary based on in-house and customer requirements, they should be keenly monitored and accurate records kept to enable ATC make an informed decision on the existing 3PL firm. Management of ATC could delegate this function to the dispatch department since they had been cited in the case study as being in charge of the day-to-day interaction with the 3PL firm. Supervision from Top Management will be relevant to ensure that the right things are being done.

Loads Accepted by Primary and Secondary Carriers - It is very important to closely monitor the nature and amount of goods to be delivered to customers. ATC should not be disadvantaged in any way and therefore irrespective of the nature and amount of goods to be freighted, the expectation is that the 3PL firm is resourced and has the capacity to deliver

the orders of ATC's customers to them without restrictions. The 3PL firm should be able to freight goods ranging from a small parcel containing say expensive jewelry to a large amount of goods that would require an articulated vehicle to freight to a customer. Anything short of this means that the 3PL firm is not fit for purpose. Indeed this has implications for cost trends and capacity issues. In this regard, it should be carefully considered when renewing the contract of the 3PL provider.

**Sustainability Measures** - The statistics on important parameters such as the quantity of goods shipped through intermodal transport across the coverage zone of ATC as well as estimated total miles covered via Smartway carriers should be monitored. These statistics should be critically analyzed viz-a-viz the resources of the current 3PL firm to determine its capacity to sustain the provision of logistics requirements of the business, particularly, if the needs of the business are growing.

**Accurate treatment of customer orders** - In deciding to renew the existing contract of 3PL firm of ATC, it is very imperative to evaluate how it treats customers' orders. This includes complaints made by customer with regard to deliveries made to them by the 3PL firm such as the timeliness and accuracy of deliveries. For instance, if ATC continues to log complaints from customers to the effect that they have been receiving wrong deliveries and or their orders have been mistakenly delivered to a different addresses or deliveries have consistently arrived late with or without prior information to them (customer), then ATC may have difficulty renewing the existing contract of the 3PL firm.

Reporting system - In renewing the contract of 3PL provider, the robustness of its reporting system should be critically assessed. The reporting system used by the 3PL firm should have the capacity to collect, process, store, generate and transmit reliable and valid information on their operations to ATC. The reporting system should also be user friendly and should also make information widely available to its users, particularly the management of ATC to enable the making of informed decisions. The reporting system should allow different staff of ATC to access different levels of information at any point in time; thus the higher the position of an officer at ATC, the greater his access to information from the system. The availability of these features on the reporting system of 3PL provider will be a key factor when renewing its contract.

Continuous monitoring of costs and budget - The ability of the 3PL provider to consistently monitor the estimated cost and budget within which it is expected to operate will be considered when renewing its contract. The total amount of unnecessary excess costs or bills/claims made in respect of hidden charges should also be considered during the renewal of its contract.

Feedback of statistical information - This will include information such as number of deliveries done within the period under review, the nature/status of the goods delivered (for example number of small drops, high value items, heavy products which may require special equipment to unload, fragile items, number of complaints received from customers, incidents/accidents that recorded as well as the quantity of customers' goods that were damaged during the period. This feedback should be communicated to the management of ATC in a timely manner for informed decision making. The <https://assignbuster.com/an-introduction-to-3pl-management-essay/>

frequency at which feedback of statistical information was provided would be considered during the renewal of the contract.

There are a number of other aspects of the contract that should be considered by ATC to make an informed decision to renew the 3PL distribution contract and even determine the appropriateness of the contract agreement document.

It is important to note that both parties can create a contract that is designed around long term strategic partnership that focuses on mutual profitability.

Similarly, there is the need to consider sharing of common customer service vision and mutual trust, economic risk and how to manage them along and whether the parties to the contract can maintain or uphold ATC's intended standards service.

ATC is advised to contract a kind of partnership they can trust and that is also tailored towards cost effective solutions to identified current problems.

## **2. 7 Other Areas to consider in the Distribution contract document**

Beyond the factors discussed above, there are a number of other very important areas to consider when preparing the contract document between ATC and the 3 PL provider. Some of them have been discussed hereunder:

### **2. 7. 1 Terms and Conditions and Common Issues**

Distribution agreements usually incorporate the terms and conditions of supply and sale, sometimes as a schedule or annex to the agreement. These



should include all the nitty-gritty regarding supplies and sales, including the delivery of goods, the shift of risk and title in the goods, inspection needs, returns, and so on. Distribution agreements can be deficient of competitive law and therefore some care should be taken with their drafting.

Common areas that ATC needs to consider when drafting a good distribution agreement are:

The scope of the agreement;

Exclusivity or non-exclusivity (taking into consideration competition law);

Non-compete requirements (taking into consideration competition law);

Minimum performance responsibilities;

Reporting duties;

Marketing rights;

Trade name licensing;

The relevant terms and conditions of sales;

The circumstances under which the agreement may be ended; and

The implementations of termination.

Informal understanding often results in misunderstanding. The process of jointly drafting a contract helps to ensure that the parties really agree upon the terms of the deal. It is equally important to note that where

misunderstanding occurs, a written agreement will usually be helpful in their resolution.

### **2. 7. 2 Minimum Target Obligations**

The minimum target obligation ATC has imposed on the 3PL firm to ensure that the relevant market is fully exploited will be assessed. The minimum target requirement can either be for a minimum level of sales by the 3PL provider its customers, or for a minimum level of procurement done by the distributor from the supplier. There should also be a provision in the agreement as to how to handle distributor's failure to comply with the minimum targets.

### **2. 7. 3 Binding Effect of Distribution Agreement**

Once both parties have signed the agreement it becomes a legally binding contract. Amendments, unless otherwise agreed upon by both parties, cannot be made and will usually call for a new distribution agreement to be created and signed. The agreement is typically based on the laws of the jurisdiction of operation where distribution occurs. In case of abroad, needed alteration have to be made in accordance with legal requirements of the jurisdiction where the distribution will take place. ATC needs to take this into consideration when renewing the 3PL provider's contract.

### **2. 7. 4 Termination**

The termination of the agreement and its consequences may be dealt with in a several ways. One issue that will require particular attention is disposal of stock on termination. The agreement should clearly define the roles of both the Principal and the 3PL distributor to ensure that both parties adhere to the

terms of the agreement. The extent to which this is being enforced will be considered during the renewal of ATC 3PL provider's contract.

## **2. 8 Management of 3PL contract**

The causes of failures of 3PL contracts could basically be attributable to poor management of the relationship between the 2 parties. It is therefore imperative to note that both parties have a joint responsibility to make the relationship work. In view of this, management of the 3PL contract should be clearly spelt out in the Service Level Agreement.

To develop a true partnership requires a high degree of trust and collaboration. It is believed that the degree of trust in a relationship determines the level of flexibility a client will allow the 3PL in operating to the best of its capability.

A good collaborative approach will also support business change and challenges, allowing both parties to review continually the current state against the vision and to agree actions to be taken to stay on course.

Another key ingredient for ensuring a good relationship between provider and client is good communication. Of course, communication is the responsibility of both parties in the relationship and to ensure good levels of communication they both need to provide channels for this to happen.

Monitoring is another important ingredient that should be incorporated into the SLA and should be used as one of the tools to effectively manage the 3PL contract. Regardless of running a logistics operation as an in-house manager or as a third party contract manager the basic reasons for monitoring the

operation are very similar; to measure whether the operation is meeting set service levels at an acceptable cost.

Rushton, A. and Walker, S., (2007) observed that the final part of the outsourcing process is, therefore, to ensure that the contractor is adequately managed. This is a key consideration that is sadly neglected by some users. The signing of the contract should not be seen as the end of the outsourcing process. It is vital to continue to control and monitor the 3PL to ensure that the overall business and operational objectives are achieved.

Other key factors to consider in renewing 3PL contract or perhaps outsourcing a function to 3PL firm have been discussed here under:

Set goals/establish KPIs: this deals with the determination of goals, in line with the company's vision and also in line with the contract, the Service Level Agreement, the budget and motivation. These are then translated into suitable metrics in the Management Information System (MIS).

Track performance: this relates to the supervision and where necessary controlling of the MIS and suitable key metrics at all activity levels. It encompasses regular review meetings to be held at various hierarchical echelon and its regularity as well as open book audits where necessary.

Identify opportunities: this includes both functional re-adjustments (workers, facilities, etc) and potential strategic and tactical enhancement that ATC could take advantage of.

Review and refine: this involves executing planned, strategic and functional improvements, fine-tuning and re-determining KPIs as necessary to reflect current trends.

Competitive benchmarking: this includes the comparison of performance with competitors that are doing well within the same industry. This is aimed at achieving continuous improvement. Areas that could be looked at when benchmarking include cost of operations, timeliness in performing tasks, among others. Assuming that the 3PL gets paid by results achieved, it will be encouraged to invest in efficient modern technologies. In cases where both in-house and 3PL function operate within the same business network then one may be benchmarked against each other. This should certainly create an uninterrupted healthy internal competitive pressure.

From the case study, no monitoring mechanism had been put in place to check the operations of the 3PL since SLA was non-existent. In fact, it was the Dispatch Department that does the day-to-day interaction with the contractor. This should certainly be a worrying trend for Dede and ATC for that matter.

Similarly, consistent monitoring of costs as well as investigations conducted into any customer grievance or delays should be communicated to the management of ATC for necessary action. Producing and submitting periodic, preferably, monthly operating reports would be helpful for monitoring and controlling the operations of the 3PL provider. From the case study, none of this was being done.

It is to be emphasized that once the contract is awarded to a third party, ATC should not just sit back and relax with the hope that it needs not worry about the operations of the 3PL provider anymore. It is very important to make sure that the selected third party distributor is meeting the terms of the contract. In this regard, unambiguous roles should be assigned from either sides for managing the contract to guarantee that the contract provisions and for that matter, service levels are met.

The management of the SLA and its contents for ATC has been summarized in the diagram below:

Figure 3. 0 An overall approach to outsourcing management, source:  
Rushton et al., (2010) page 568

## **Conclusion**

In as much as some companies are reluctant to engage the services of 3PL firms to undertake some functions of their operations, more and more businesses are outsourcing some functions, particularly, logistics/supply chain to specialists who have the expertise to deliver excellence and efficiency at reduced cost.

This arrangement certainly allows companies to concentrate on their core business, capabilities and competencies. However, trust and confidence in the 3PL firm coupled with the signing of a working contract which also contains a comprehen