

## **THIRD PARTY LOGISTICS - CREATING STRATEGIC ALLIANCES WITH THIRD PARTY PROVIDERS**

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### **THE EVOLUTION OF LOGISTICS FACILITIES**

Warehousing and transportation has been a feature of every business activity that has produced a product since man began to harvest and hoard food, make clothes and tools and much later grow crops and animals and then produce goods. The need to provide a buffer between supply and demand has been with us for thousands of years. The storage and movement of the essentials of life date back to the very early "warehouse" - a cave or even a hole in the ground - and transportation to man himself.

Business today still struggles with the issue of matching supply and demand, and it has been a challenge for businesses throughout centuries. Through misunderstanding, the lack of awareness and skill in this area, many sound enterprises have been brought to their knees.

Logistics functional operations have historically been a lower order activity, an area with little skill and training, poor facilities and infrastructure, receiving little support from the organisation and often operating under very difficult conditions. Only the military appeared to have a healthy regard for the impact of

the supply line - perhaps because many a warrior learned the hard way that inadequate logistics support frequently leads to defeat!

Many organisations have neglected their needs for many years, with inadequate and inappropriate buildings, poor equipment, little or no systems and poorly trained personnel. Added to this was often poor leadership and a senior executive group that did not understand the inter-relationships between the dependence of each operating unit on others. The need to communicate within the business was not recognised and often resulted in vigorously working against the best interests of the customer.

Much of this was driven by the "Silo" mentality, where the departments or "Silos" of a business operated with a degree of independence and attitudes towards many of their colleagues, that must have caused many to wonder if they did indeed all work for the same organisation.

The common understanding of the Supply Chain - how it operates, what are the key issues, what impacts on it and

how, is it capable of meeting the needs of the customers - has been a mystery for many businesses for many years. There are still a considerable number that have yet to understand the mystery of the

Supply Chain, but there is an increasing awareness of the potent forces available in delivering the service differential that today is often the only distinguishing feature between competitors.

## **WHY ORGANISATIONS CONSIDER THIRD PARTY LOGISTICS?**

Stories abound of businesses reaching a crisis stage with an inability to deliver the goods to the customer on due date, as the volumes simply outgrew the facilities to a point where the operations virtually ground to a halt. With little or no planning, many organisations used their existing facilities in a sub - optimal manner.

It has often been a major crisis in the movement of goods through the Supply Chain, that has led to the loss of a major customer and a realisation by senior management that the logistics operations of the business is not only important but it is also in dire need of the correct resources, training, systems and support.

Sales volumes continue to be sought with increasing vigour often manifesting problems in the Supply Chain with bottlenecks in the warehouse and prevent customer commitments from being met. Customers are, in general terms, less tolerant of service failures than they were in the past.

Customer service problems are often compounded by operating a warehouse at a location that is now too distant from ones customers and/or suppliers. Market demographics continue to change and the longer the Supply Chain the greater are the customer service problems, even though we are in a global economy and the world is getting smaller.

We cannot operate in 1997 as we did in 1987, we will not be able to operate in 2007 as we do in 1977.

### **What Is Third Party Logistics?**

Essentially it is outsourcing the functional, operational logistics activities, predominantly warehousing and transportation. There are many examples around the world, in many industries where these activities are being performed on a "Service Provider" basis as they lack the "intelligence" that is synonymous with a strategic focus.

Many of these claim to be a Strategic Alliance, however, very few are truly strategic in their execution.

One of the most difficult questions is "How much of the complete distribution package does the Third Party provider do and how much does the business retain?"

## Traditional vs Strategic Contract Logistics

Traditional logistics typically cover smaller, shorter term contracts that cover only a single mode or service with the decision making at a lower level in the buying organisation. In effect a short term arrangement based on the asset base of the Third Party provider whereas the Contract Logistics provider has a focus on systems, processes, management and

organisational capabilities and they in turn often outsource components such as transport to ensure that the customer is provided with a contract service that meets their needs. The following table, adapted from A.T Kearney, Logistics Consultants of Chicago, USA, indicates the differences between these two contrasting approaches.

### Differences Between Traditional Logistics Services and Contract Logistics

Dimensions	Traditional Services	Contract Logistics
<i>Services Offered</i>	<i>Standardised</i>	<i>Tailored</i>
Focus	Single Mode or Service	The Supply Chain - emphasis on inventory
Transport Buyer Focus	Optimise a single mode-cost/service trade-off	Optimise the Supply Chain - inventory/transport trade-off
Contract Size and Length	Typically small	Large, multi-year
Negotiating Period	One to four months	Six to eighteen months
Buyers Switching Costs	Low - operational issues	High - systems, organisation issues
Potential for Service Expansion	Low - perhaps more of the same	High - expansion into supply chain
Operations Requirements	Existing operations	New, with significant developments/improvements
Decision Maker	Traffic/Transport Manager	Senior Corporate Management

Adapted from: A.T. Kearney, Chicago

A series of questions need to be addressed, many of them well beyond those directly concerned with the provision of the "hardware" and the functional activities of receipt of goods, put away into storage, pick and pack, order assembly, despatch and delivery.

There are many questions to consider - a small sample includes the following:

- What are the operational and service goals required?
- How accountable are the respective parties to each other?
- Who will manage the inventory levels?
- Who will deal with our customers and on what basis?
- Will we use the Providers systems and processes? If so, will they link into our systems and how?
- Who will undertake the functions of purchasing and inbound freight services?

These are some of the key questions that differentiate Service Providers from Strategic Partners in Logistics. They will provide the basis for very sophisticated

contracts to be developed from a basic contract and grow as the level of trust and understanding develops between the parties.

## **DEFINING NEEDS AND SELECTING EXTERNAL PROVIDERS**

Merely deciding to go to a Third Party Provider will not necessarily solve the existing distribution problems. The relationship between the parties will quickly become strained if the buyer enters into a Third Party logistics contract knowing that there are problems and then refusing to acknowledge their existence. There are a number of cases where this has occurred and the relationship is generally unable to withstand the impact of those attitudes.

Unless the parties are totally open and honest, they are unlikely to identify where and how the Third Party Provider is able to assist in improving the operations. There must be an economic justification for moving to an outsourcing arrangement at the same time maintaining or, preferably, enhancing customer service. The outsourcing option must fit with the overall strategy of the business which addresses the question for both parties - "What business are we in?" and specifically "What is Core Business?"

In many industries, operating the logistics facilities is not a core business activity and it is not a positive contributor to the business. Companies need to focus on their strengths and apply their resources to areas that generate growth and wealth for the stakeholders.

The parties must be comfortable with each other in terms of style, culture and philosophies upon which is the basis to develop a trust between them particularly in the areas of sensitive information. Both parties need to be objective and work jointly towards improving both businesses - unless there is a Win - Win outcome, the relationship is unlikely to realise the full potential.

Contract Logistics, in a well developed environment, often includes all aspects in the Supply Chain but both parties need to determine, agree and clearly understand who is responsible for what activities. The tasks need to be very clearly specified and the accountabilities agreed. The relationships at both operational and policy levels in both organisations are critical to the success of Contract Logistics relationships.

### **Selecting Contract Logistics Providers**

Select the preferred Third Party Provider carefully. In order for this to work both parties must commit to an open and trust based partnership. The success will not depend on the assets or hardware offered by the provider, it will be based on their people, their processes and their attitudes

towards you and your customers. Establish whether or not there is a cultural alignment, do they have a partnership and entrepreneurial style that is backed by a vision that is compatible with yours.

The provider selected should be one that will be around for a long time which can be identified through experience and a solid history of performance. If your company has plans to expand globally, then select a partner that has the necessary capabilities in other markets and can grow with you. Information technology should be an area of high priority for all Contract Logistics providers because it is the key to the future of leading edge logistics.

Through alliances and in-house capabilities, the selected provider should be able to put together an integrated,

customised logistics solution that will meet the needs you have both agreed. Leading Logistics providers should be able to develop full business solutions and identify where they can add value to your business. In addition to the ability to develop new, customised processes, the selected provider have the tools and processes to implement the operation and be the guide through the change process. Perhaps the final question is in regard to risk. Is the selected provider willing to share both the financial rewards and risks associated with the partnership? If not, then reconsider the selection of the preferred provider.

## **MAKING STRATEGIC ALLIANCES WORK SUCCESSFULLY**

Successful strategic alliances have generally been achieved over an extended period of time as both parties found the increasing sharing of information, ideas, technologies and future directions of their respective businesses, a natural way of doing business. These relationships do not evolve because two parties merely decide to operate more closely with each other.

Successful alliances have a number of underlying principles including:

- Alliances must have executive support from both parties
- There is no set recipe for alliance formation
- Trust and results supplant contracts
- Measurements demonstrate alliance successes
- Trust in the sharing of sensitive and confidential information
- Support for the core competencies
- Enhancement of the competitive advantage
- Risk sharing
- Concentrating on customer service
- Extensive and shared planning
- Joint operating controls
- Mutuality - the ability to develop, establish and obtain joint goals
- Corporate compatibility in both culture and business objectives
- A managerial philosophy and technique that embodies teamwork
- Symmetry - no junior partner
- Open communications
- Financial benefits for both parties

## **BENEFITS AND RISKS WITH THIRD PARTY LOGISTICS**

The benefits should be apparent in a number of the following areas and be capable of being costed to determine the value to the business

- Reduced cycle times and improved performance
- Reduction in capital invested and a restructured Balance Sheet
- Reduced direct operating costs and cost of inventory
- Improved customer service
- Increased business volumes
- Improved and often specialised management information
- Increased productivity and efficiency through better management skills
- Improved human relations

Typically there are a number of areas of risk that cause concern. Some of these I have touched on earlier but a short check list is worthy of consideration.

- Loss of control - is this real or perceived?

- Lack of confidentiality of information
- Security and rotation of inventory
- Poor performance by Third Party provider and a risk of falling customer service levels
- Inability to establish accountabilities
- Unclear protocols in dealing with end customers
- Lack of priority considerations

However, well researched, clear rules and well documented contracts between organisations that share common goals and philosophies will do much to eliminate these issues. It is most important that both organisations identify the Critical Success Factors, link them to their respective corporate goals with a clear understanding of the key drivers in the business. These measures should then be related to the performance criteria in the contract between the parties and become the foundation of the relationship.

## **WORLD TRENDS IN THIRD PARTY LOGISTICS**

In general terms there are a number of issues worthy of note before considering what is happening in specific markets around the world. Outsourcing is growing around the world at an increasing rate - not only in logistics but also in many other areas.

This growth is expected to continue at an accelerating rate in Australia, US, Europe and Japan with the relationships becoming more open and more enduring as strategic based partnerships evolve.

The Contract Logistics providers are rapidly developing their management and operational skill base to develop and provide innovative and effective total business solutions. Information technology is being used at an increasing rate by Contract Logistics providers and

their access to leading information systems and processes has improved dramatically over the past five or so years. A brief overview of Contact Logistics in Australia, USA, and Europe/UK provide a view of the future.

### **Australia**

- Confidence in the ability of Third Party Contract Logistics providers is now growing rapidly after some concerns and hesitation in the 1980's
- Slow start in developing contracts but now growing rapidly
- The need to manage Third Party providers is now recognised

- Transport companies are now recruiting professional logisticians
- There has been a significant reduction in the number of service providers to large manufacturers

### **United States of America**

- Ryder Integrated Logistics, one of the leading Third Party providers in the USA was the first in this field to earn more than \$US1 billion in 1996
- Growth in Contract Logistics in US is expected to exceed 20% pa until 1999
- Contract Logistics providers are moving from asset based to skill and management based approach

- The application of "gain-sharing" is a key contract principle
- Future customers will be in industries that are driven by time-cycle reductions, be at a critical point of change and have large, complex global supply chains

### **Europe/UK**

- Focus has moved to manage the region as a single market
- Inventories are being centralised to service the total region
- Third Party providers are being required to cover the whole region
- Fourth Party Logistics organisations are emerging as the Joint Venture operating company to manage the

- with increasing multi-country sourcing of materials
- Third Party services are now entering a phase of maturity with many contracts in their fourth and fifth terms - relationships that are in the range of 15 to 25 years old logistics processes, outsourcing the functional activities to the Third Party Providers

## KEY ISSUES FOR THE 21<sup>ST</sup> CENTURY

The information technology explosion is with us now and the rapid growth in this area is making communications virtually instantaneous around the world. There is now a substantial and rapidly growing Third Party Logistics industry in many parts of the world. Expansion of these companies into new markets, particularly South East Asia, is likely to accelerate over the next five to ten years.

The processes, systems and methodologies are now well developed and there are some outstanding Third Party Logistics operations in the UK, Europe and USA. Many of the leading operations in these countries have already established operations elsewhere in the world, often working with an existing customer to reach further back into or further forward into their Supply Chain. International procurement is a key driver behind the growth of global logistics with materials being sourced from many locations and being assembled, processed and converted in other countries.

Key indicators for the years ahead as seen at the 1996 Council of Logistics Management Conference in Orlando, Florida included:

- A reduction in cycle times
- The integration of technology and information systems
- A significant growth in outsourcing
- Improvements in skill levels

- Third Party providers will need to demonstrate an ability to secure and hold contracts, developing them into long term relationships
- There will be increased trust based on the "Open Book" style of relationship

However, in a number of cases Third Party Providers have failed to meet the expectations of their clients and the market place. This has provided an opportunity for Fourth Party Logistics operations to secure the unsecured and available benefits. The Fourth Party Organisation is a joint venture between a primary client and one or more equity partners, established as a separate legal entity charged with the responsibility of managing all aspects of the Supply Chain. The key focus of these organisations is the delivery of optimum benefits through the use of information technology and extensive strategic management.

The extent to which these new Fourth Party Logistics providers can penetrate the existing Third Party market will depend on the value of the benefits delivered by the Third Party Logistics Providers. Those who can and do embrace the concept of strategic alliances and actually deliver services in a cooperative strategic manner are most likely to succeed in retaining their business. Those who fail to grasp the significance of the strategic alliance are likely to remain "hardware and functional providers" and may well be overtaken by the Fourth Party Logistics organisations.