

FOUR BARRIERS TO OUTSOURCING:

A Challenge for third party Logistics Providers

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The success of third party logistics providers (3PLs) rises and falls with the ever-shifting strategies of the manufacturers, suppliers and retailers that make up their customer base. Today, outsourcing is on the ascent. But can 3PLs keep supporting the demand?

3PLs are no strangers to change. The types of functions they provide, and the customers they serve, have transformed considerably in the decades since logistics outsourcing first became a supply chain management option. "The degree of value-added services that [logistics] companies provide now is much more wide-ranging, broader and deeper," says David Buckby, economist with Transport Intelligence.

These days, the chief driver of change in the logistics landscape is the emergence of the omnichannel. What once consisted primarily of fulfilling large orders to brick-and-mortar stores has morphed into a broad array of services in support of e-commerce shoppers. And those buyers are growing more demanding by the moment.

"There's a reason why the topic of the omnichannel continues to be brought up in terms of challenges in today's supply chain," says Tom Kretschmer, vice president and general manager of retail and consumer brands at Ryder. "Your supply chain must be flexible, agile, precise and productive to handle the volume and channel swings from day to day to support it."

"Retailers are struggling to figure out what sort of omnichannel network you have to have to satisfy customer needs," says Robert Lieb, professor of supply chain management at Northeastern University. In addition, they're faced with the dilemma of handling returns, which can account for up to 30 percent of total online sales.

Additional challenges for 3PLs and suppliers alike include a marked shift in global sourcing, triggered by rising wages in China and the uncertainties that come with maintaining long supply lines; a new emphasis among suppliers on maintaining visibility across multiple tiers of the chain; a heightened awareness of the need for better risk-management strategies, and the growing complexity of supply chains generally, wherein a single product might be sourced and manufactured in multiple countries.

You might think these myriad complications would drive suppliers into the arms of 3PLs – who are, after all, the acknowledged experts in managing and moving product worldwide. And to a great extent that's true; in fact, it helps to explain why outsourcing today is on the rise.

At the same time, 3PLs must contend with a number of reservations that suppliers might harbor, justified



or not. They break down into four potential barriers to outsourcing: cost, control, commitment and risk.

CONCERNS OVER COST

The issue of cost is especially critical, because of the very nature of the modern-day omnichannel. Given the razor-like margins of retail, sliced even thinner by the economics of e-commerce delivery, suppliers might wonder if there's room for an intermediary to thrive.

With a giant like Amazon dominating the e-commerce sector, marked by a willingness to operate a good portion of its business at a loss for extended periods of time, rival e-tailers find themselves under intense margin pressure. "Right now it's an extremely competitive marketplace, with more and more people getting into it every day," says Lieb. "That means margins are going to be very thin."

3PLs have struggled with maintaining profitable operations since the industry's inception. So, is there room within the demanding omnichannel for their services, which must be priced to ensure a fair return?

Kretschmer states that 3PLs can actually reduce the cost of omnichannel fulfillment, "by bringing multiple clients to bear to create density and shared networks. The pressure to reduce cost yet improve speed and reliability is creating momentum to try new strategies." says Kretschmer.

An area of focus for Ryder is the sharing of warehousing and transportation assets. On the facilities side, a multi-client approach allows the 3PL to balance seasonal demand with countercyclical products. For transportation, it can lead to the "Uberization" of delivery networks, making better use of available resources.

Margins remain tight, Kretschmer acknowledges, but 3PLs can still play a key role in ensuring the cost-competitiveness of their supplier and retailer base.

The services of 3PLs today, while under severe pricing pressure, are anything but a commodity. Kretschmer says suppliers are depending on outsourcing partners to present them with opportunities for continuous improvement and innovation. Initiatives might include kaizens on critical processes, the implementation of employee suggestions, technology enhancements, value-stream mapping and enhanced problem-solving capabilities.

3PLs can also aid suppliers that are selling through Amazon, notes Chris Elliott, senior strategy consultant with Blue Horseshoe Solutions. "Not many manufacturers are going to want to set up





operations to support all of those Amazon distribution centers," he says. "Many are looking to outsourcing providers to hold their inventory and ship it to Amazon when it's requested." In the process, a supplier can replicate the scale of Amazon's network by relying on that of a 3PL, without paying a premium for the assets.

For suppliers struggling to compete in this challenging marketplace, control is every bit as important a factor as cost. 3PLs allow clients to focus on their core competencies, rather than be saddled with the physical movement of goods. But that mustn't lead to a loss of control over the larger supply chain. If a delivery fails in any way, it's the brand that suffers, not the logistics provider.

MORE CONTROL

The solution lies in actionable data that drives improved service and cost for the client. The client might not be asserting direct control over the logistics function, but, they need to understand the health of their supply chain all day, every day.

A successful 3PL will keep the client informed of any potential problems, allowing the parties to take action to head off glitches in the supply line. The client must also possess detailed intelligence on the 3PL's performance, often in the form of regular report cards. Says Kretschmer: "Transparency of performance through the right metrics are essential to the success of vested partnerships."

Concerns over control shouldn't blind companies to the benefits of an outsourcing relationship, according to Lieb. "It's realistic to understand that they're in no position to take care of it themselves," he says. "The scope [of the marketplace] is growing so fast that a lot of companies don't have the internal bandwidth. They're in new territory, to a great extent."

A NEED FOR COMMITMENT

No outsourcing relationship can succeed today without a firm commitment from both sides. The supplier needs to know that the 3PL is dedicated to its business. And the 3PL must be certain that the deal justifies the substantial resources that it must bring to bear on the customer's behalf.

Early outsourcing contracts didn't last much longer than a year – far too short for a complex, modern-day relationship. Even three years, which has become the industry standard in many cases, isn't long enough to convince the 3PL to make the necessary capital improvements to its network, says John Langley, professor of supply chain management at Penn State. But 10 years is probably too long, at least in the current business environment. "There's some point in between where both parties get confidence

in longevity," he says.

Kretschmer is seeing an increase in the number of five-year outsourcing agreements. "We're getting smarter about how to create contracts where there's mutual commitment around cost, service, continuous improvement, and proper incentives to motivate both parties." he said. Hence the growing popularity of the vested relationship, whereby the parties' fortunes are tightly linked.

One key to the success of a long-term relationship is the 3PL's responsiveness to change, says Langley. Suppliers need to know that their logistics partners can adjust to inevitable shifts in their sourcing patterns and customer base. That trait becomes especially crucial in the age of the omnichannel, with market leaders seeking constant innovation in their service offerings, including faster fulfillment and a greater range of delivery options.

TACKLING RISK

Finally, there's the all-important consideration of risk. A string of recent natural disasters around the world, coupled with spates of congestion at major gateways, has forced companies to take a fresh look at their overarching risk-management strategies. (And, in some cases, adopt one for the first time.) Outsourcing partners are a critical part of that equation. Customers must be confident that a 3PL can provide alternatives to a disrupted supply network at a moment's notice.

3PLs help to alleviate risk by acting as a source of supply chain talent, says Kretschmer. "As companies go through the outsourcing process, they want to understand who's going to operate their business," he says. Having the right people in place is paramount to getting off to a good start and establishing a culture of great service, continuous improvement and an urgency to respond to a crisis quickly and effectively.

The increasing complexity of global supply chains bodes well for the continued growth of 3PLs, as long as they can address customers' questions about their level of expertise, skillset and degree of commitment to the relationship. And many today seem satisfied with the answers they're getting. Among Fortune 500 companies, Lieb has seen the percentage of logistics budgets devoted to outsourcing rise over the years from 35 percent to as high as 80 percent. "There are a lot of companies that have been very pleased with these relationships," he says.

It seems likely that 3PLs will be called upon to perform an even broader range of tasks in the years ahead, especially those that relate to the ever-evolving omnichannel. "There's a huge opportunity for outsourcing in this space," says Elliott.

