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FROM 3LSP (THIRD PARTY LOGISTICS SERVICE PROVIDER) TO 4LSP (FOURTH PARTY LOGISTICS SERVICE PROVIDER). A CASE STUDY FROM IRELAND

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Abstract

Increased competition, geographically expanded marketplaces, technology replication and an ever discerning consumer base, are reasons why companies need to regularly reappraise their competencies in terms of activities and functions they perform themselves. Where viable alternatives exist, companies should consider outsourcing of non-core activities and functions.

Within SCM (Supply Chain Management) it could be preferable if a “one stop shop” existed for companies seeking to outsource functions identified as non-core. “Traditionally” structured LSP’s who have concentrated their service offer around providing warehousing and transport activities are potentially at a crossroads – clients and potential clients requiring “new” services which could increase LSP’s revenues if provided, whilst failure to provide could perhaps result in clients seeking outsourced services elsewhere.

Keywords outsourcing, fourth party logistics, value chain logistics.

Introduction

Historically, the SCM activities to be outsourced first have typically been warehousing and transport activities, managed on behalf of a client company by a 3LSP. The ease with which competition has entered this market sector has tended to deflate individual 3LSP revenues through sheer supply proliferation. For 3LSPs to make further step changes to their revenue base they will have to enlarge their client base, in a marketplace where alternatives exist for potential clients, or offer an expanded range of SCM activities and functions beyond the “traditional”, so taking on more of an holistic share of a company’s activities.

Within Ireland, opportunities exist to create a “one stop shop” environment for SCM activities. The natural geography that creates an island nation, together with Ireland’s global location in terms of East-West trade positively impact the country’s ability to capture extended sections of resident companies’ pan regional / global supply chains.

Ireland’s indigenous 3LSPs have to safeguard against becoming only “bit players” in the increasingly outsourced global supply chains, by evaluating how best to expand and enhance their service provision. From an evolutionary perspective, the term 4LSP or “Fourth party logistics service provider” (1) has been used since the mid 1990’s to describe this revised provider of outsource capabilities. A 4LSP is “... an integrator that assembles the resources, capabilities and technology of its own organisation and other organisations to design, build and run comprehensive supply chain solutions” (Evans, 1996).

The issues facing Irish 3LSP’s provided the following broad based research objectives:

1. What is the level of knowledge and interest existing within the 3LSP client base with regard to the extended and enhanced supply chain services that could be offered?
2. What obstacles if any, exist for 3LSP’s to expand their range of services offered?
3. Is it possible to construct a roadmap to develop a traditional 3LSP into a 4LSP capable of expanded SCM capabilities?
4. If a roadmap could be constructed, how can we understand any potential that exists for expanding the service provision, in order for a 3LSP to re-position its offering?

The Evolution of 3LSPs to 4LSPs

The logistics functions, tasked with handling warehousing, transport and material management, was first recognised during the era of mass production when a continued supply of materials into sequentially aligned activities of production and distribution was critical to achieving expected economies from volume manufacturing. Through the 1980's, pressures in many international markets forced companies to reduce (amongst others) their warehousing and transport costs to improve profits. Growing from origins in haulage and freight forwarding operations, Third Party Logistics Service Providers (3LSPs) became at this point in time credible alternatives to for company's to outsource their warehousing and transport functions to. A definition of a 3LSP being, "An organisation that carries out activities on behalf of a shipper, which at least include the activities of warehousing and transport" (Van Laarhoven, Berglund and Peters, 2000).

3LSP's attempts to improve revenues, forge stronger client relationships, and importantly, differentiate themselves from their competitors, have revolved around providing "Value Adding Services" (VAS). These have typically comprised activities such as labelling, light assembly, proof of delivery retrieval etc. Generalising, the investment in capital and human intellect in order to provide these services has been "minimal", and operational reconfiguration swift, allowing the 3LSPs a quick ramp up time to provide. Benefits for the client have been in removing activities that were excessively tedious, time-consuming etc.

In entering the 90s it became clear to both sides of the service provision that potentially the process had gone as far as it could. Whilst the service provision has been beneficial to both provider and client, competitive differentiation for the 3LSP has been marginal – a result of the assets and skill sets needed to provision such offers being readily available to all outsourcing providers. The "Results and Finding of the 2001 Sixth Annual Study in Third Party Logistics" (Langley, Allen and Tyndall, 2001) concluded that the markets for 3LSP services are changing rapidly, with both users and providers moving up the curve towards greater levels of sophistication in their management practices and expectations of each other. Additionally, improvements to the revenue base of the 3LSPs and to the cost base of the clients have not experienced the quantum leap improvements first experienced in outsourcing warehousing and transport. It appears that VAS has provided incremental revenue changes, being of less magnitude than warehousing and transport functions and therefore carrying less attractive pricing scales.

In order to capture a greater range of functions / activities from a clients supply chain, many 3LSP's have realised that they need to take a more holistic view of the supply chain, as opposed to improving portions of individual functions and activities on a piecemeal basis. Obstacles to this desire could be those clients who do not use 3LSPs for managing any, or the "significant" parts of their business. Perhaps this reluctance to yield control being founded on the belief that these are core competencies that could not be passed over to another party.

If 3LSPs need to gain control of a wider share of a clients supply chain activities and convince sceptical clients of the validity of their offering, they need to establish and prove themselves as the right partner beyond doubt. For traditionally structured 3LSP's, the need to provision expanded and significant revenue enhancing services will create a "transformational gap" that will need to be bridged in respect of required capabilities and resources. Through strategic alliances with other best of breed logistic service providers, SCM IT (Information Technology) providers and management consultants, certain 3LSPs are attempting to provide more than the asset transference and the one off operating cost reductions that has existed in a traditional outsourced arrangement. Gattorna notes the evolutionary trail from 3 to 4 as illustrated and comments, "While outsourcing third party logistics is now accepted business practice, fourth party logistics is emerging as a breakthrough solution to modern supply chain challenges.....to provide maximum overall benefit."

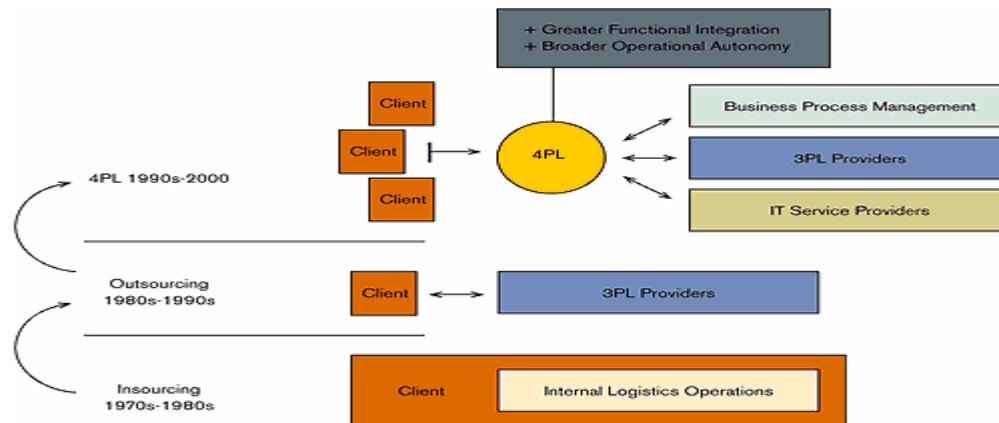


Fig 1: "The Progression of Outsourced Activities", Gattorna 1998.

From the definition supplied by Van Laarhoven et al, a logical first step in determining the necessary requirements to "assemble and run comprehensive supply chain solution" would be to analyse client requirements. There are instances in Ireland however where 3LSP's have assembled what they believe to be "the right" resources and capabilities first, and then attempted to fit these to a prospective clients problems. The illogical sequence of events has impaired any uptake levels by potential clients due to the misalignment of resources and requirements.

To date, very little research work has been undertaken that formally attempts to provision an implementation route or "roadmap" that would be of assistance to traditional 3LSP's if they aspire to expand their service provision and create a step change to their revenue base. This paper attempts to add and to contribute to this field.

The Profile of the Irish 3LSP Company Central to the Research

The company central to the case study is an indigenous Irish 3LSP that has operated in Ireland for over 30 years. Their services primarily centre on warehousing, distribution and freight forwarding operations to Irish, U.K and European markets. Their customer base ranges from indigenous Irish to multinationals, and would cover most industry sectors.

An Overall Description of the Project

The company recently committed sizeable investment into a new purpose built 150,000 square foot distribution centre and are in a position now where they have to attract business volume to the unit. As significant competition exists for the services they offer, the company were keen to move up the outsourced "value chain" and understand the level of awareness and interest that may exist amongst both current clients and potential clients for any additional services, as well as to gauge how they could best pursue any indications of interest. In short, the company were keen to move to an entity offering a much more comprehensive solution to the supply chain issues faced by their (potential) clients – they wanted to be labelled a 4LSP.

The overall mission of the project undertaken therefore was to:

- Identify the additional services and functions that could be undertaken for clients.
- Assess the capability of the company in meeting additional services and functions.
- Gauge the approach that should be adopted to offer these services.

Data Collection Method and Analysis

Initial methodology involved designing a questionnaire for telephone interviews that identified a range of potential services. This was circulated to 20 identified companies to interview, with targeted individuals being Supply Chain Directors, Managing Directors.

Analysis of the responses identified services and functions that were being performed “In House”, by the company, “Contracted Out”, performed by a 3rd party, or “Not Performed”. Respondents had to apply a subjective score for the perceived level of importance that each service / function held to their business. This in turn enabled a ranking system to be built for each individual service / function against who performed it / if it was performed. The company’s supply chain capabilities were then audited as to whether they possessed appropriate physical assets, intellectual / human resources, and supply chain information technology necessary to execute the identified services and functions.

When the overall ranking applied to the importance of the services and functions was combined with the audits assessment on whether the company had the appropriate resources to provide, a matrix was constructed based upon both “Level of Importance” versus “Level of Resources”. The four quadrants of the matrix were:

- Insignificant (Service / Function) with Limited / No Resources.
- Significant (Service / Function) with Limited / No Resources
- Insignificant (Service / Function) with Available Resources.
- Significant (Service / Function) with Available Resources.

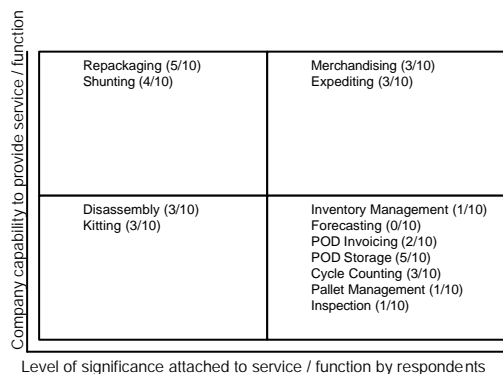


Fig 2: Matrix showing company resource and significance attached to service / function

Within each quadrant was placed the number of respondents who currently outsourced the function.

Final Recommendations to the Company

Each quadrant of the matrix was analysed in conjunction with the company to provide a starting point for how best to progress.

Insignificant (Service / Function) with Limited Resources.

Services positioned in this quadrant should be regarded as “Order qualifying” attributes of an overall service provision, and as such, if offered on their own would not yield any step change to the revenue base from clients. As not all resources are available to provide the service, they would not be actively promoted.

The initial approach for existing clients was determined as:

- Only discuss the possibilities if directly approached.
- Indicate that resources would be client specific and all costs to resource would be reflected in the pricing policy.
- Assess the volume and frequency of the service / function by individual client, and determine and cost the actual resources required.
- Price the business separately from any existing business offering.

The initial approach for potential new clients was determined as:

- Indicate that the possibility exists to offer the service / function if required.
- Assess the volume and frequency of the service / function by individual client, and determine and cost the actual resources required.
- Determine if the price is to be bundled or separated, based on an ability to win other elements of the client's logistics business or not.

Significant Service / Function with Limited Resources

These are regarded as critical functions / services by both existing and potential clients, with few outsourcing. As the company does not possess all required resources, of central priority is the determination that the investment necessary can be covered by the potential profits. Where resources were only available in a limited format, the overall aim for the company was evaluation, followed by education, awareness and convincing.

The initial approach for existing clients was determined as:

- Indicate that the service / function could now be provided.
- Indicate that the resources would be client specific and therefore would be reflected in the pricing policy.
- Understand how the client currently performs these activities.
- Assess the volume and frequency of the service / function by individual client, and assess volume / frequency impact on required resource base.
- Propose the company's operating methodology.
- Promote on the basis that securing reinforces the partnering arrangement.
- Given their significance cost separately to any existing offer, with price initially set to win the business, but towards the "premium" end of the scale.

The initial approach for potential new clients was determined as:

- Build a bank of references as clients are gained that take these expanded services and pro-actively market these expanded offerings to identified potential clients, alongside the core offerings of warehousing, distribution and freight forwarding
- Arrange presentations to interested parties detailing the company ability to perform the service / function.
- Understand how the potential client performs the service / function.
- Assess the volume and frequency of the service / function by individual client, and assess volume / frequency impact on resource base.
- Propose the company's operating methodology.
- Cost this service provision separately to any existing offer, and set a premium price to reflect the significance attached by the client.

Insignificant (Service / Function) with Available Resources

Services positioned in this quadrant to be regarded as "Order qualifying" attributes of an overall service provision and as such, if offered on their own would not yield any step change to the revenue base of the 3LSP.

The initial approach for existing clients was determined as:

- Contact clients indicating the service / function is available.
- Assess the volume and frequency of the service / function by individual client and assess volume / frequency impact on resource base.

- Price the service / function separately to existing service offering, but price to win the business and strengthen provider / client relationships.

The initial approach for potential new clients was determined as:

- Upon client contact indicate the service / function is available as part of the core offering of warehouse / freight forwarding / distribution services.
- Assess the volume and frequency of the service / function by individual client and assess volume / frequency impact on resource base.

As they are order qualifying attributes, bundle the service / function into the core service offering and price the business on a bundled price basis.

Significant Service / Function with Resources

These were regarded as critical functions / services by both existing and potential clients given that a significantly low number of the target group surveyed actually contract them out, and hold true step change ability to the company's revenue. Where resources existed the overall aim for the company was education, awareness, and particularly, convincing, given the level of fear / sceptics that would exist.

The initial approach for existing clients was determined as:

- Arrange presentations detailing the company ability to perform the service / function.
- Understand how the client performs the service / function.
- Assess the volume and frequency of the service / function by individual client, and assess the volume / frequency impact on resource base.
- Propose the company's operating methodology.
- Cost this service provision separately to any existing offer, and charge a premium price to reflect the significance attached by the client.

The initial approach for potential new clients was determined as:

- Pro-actively market these expanded offerings to identified potential clients alongside the core offerings of warehousing, distribution and freight forwarding
- Arrange presentations to interested parties detailing the company ability to perform the service / function.
- Understand how the potential client performs the service / function.
- Assess the volume and frequency of the service / function by individual client and assess the volume / frequency impact on resource base.
- Propose the company's operating methodology.
- Cost this service provision separately to any existing offer, and charge a premium price to reflect the significance attached by the client.

Discussion

- Clients would appear to have little knowledge that an enhanced array of services and functions other than the "traditional" could be outsourced. As a result of this ignorance, the outsourcing areas that holding most prospect for a step change to the revenue base of the 3LSP are the ones deemed most significant to clients and therefore the least likely to be outsourced.
- 3LSP's could still become the partner of choice for a 4LSP who requires the most competent supply of warehousing, distribution and freight forwarding activities – which raises the issue of there being any obligation for a 3LSP to aspire to become a 4LSP
- If a 4LSP is truly an entity that seeks to "design, build and run comprehensive supply chain solutions" then a 3LSP with its experience of warehousing activities et al could form an ideal springboard to progress. Contrasting this however could be the belief that the most efficient way to become a 4LSP could be to originate the business from afresh with no prior pre-conceived experiences, i.e not from the base of a 3LSP.
- The knowledge levels of 3LSP's as to what constitutes "SCM", and therefore their ability to "design, build and run...." is questionable.

Conclusions

Logically, it would appear that there are tremendous efficiencies to be gained by both provider and client alike in a correctly configured 4LSP arrangement. With a 4LSP having both an extended view and control over upstream and downstream operations, it has the ability to arrive at a holistic decision and it is this decision making ability that will ensure that costs and service levels are optimised. Over the last 10 years the discussion has moved from having to correctly describe "What is a 4LSP?" (4), to now having to determine the client opportunities that exist, the resources required to fulfil the opportunities, and the implementation and ongoing management of these new structures.

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