

THIRD PARTY LOGISTICS AND LOGISTICS ALLIANCES
- OUTSOURCING OF ACTIVITIES
OR “INSOURCING” OF RESOURCES?

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ABSTRACT

For the last couple of decades the interest in logistics alliances and third party logistics (TPL) has been growing in academia and industry. The common perspective is to consider TPL as outsourcing of logistics activities. The aim of this paper is to take a complementary perspective by looking at TPL rather as insourcing of resources; i.e. the shipper gets access to the providers' resources.

We start by presenting some basic characteristics of the established view of TPL and some of the problems with TPL identified in prior studies. We further discuss how these problems could be tackled if viewed as resource insourcing rather than activity outsourcing. The analysis indicates that such a perspective provides a useful complement for the understanding of TPL in the four phases of pre-alliance considerations, implementation, alliance operations, and performance assessment. For example, as resources are shared among a number of actors, adaptations in the resource collection of each party are required. This can reduce costs for all participants, but demands a long-term perspective with regards to investments. Further, the fear of losing control when using TPL can be helped through developing close relationships thus gaining indirect control of the provider's resources. Another example concerns the implementation phase where a resource insourcing perspective would recommend the shipper to avoid detailed direction of suppliers who have been chosen for their competence to provide good services.

1 INTRODUCTION

For the last couple of decades the interest in logistics alliances and TPL (third party logistics) has been growing in both industry and academia. Typical research issues investigated are the motives underlying these strategic efforts, division of labour in logistics alliances, intensity in the co-operation between the provider and the user, development and control of the logistics process and the strategic choices for the service providers. The common perspective applied in these studies is to consider the ongoing efforts as outsourcing of logistics activities. This is quite understandable bearing in mind that logistics in general has increasingly become focused on efficiency in the performance of logistics activities (Stock 1990).

In this paper we suggest a complementary perspective on TPL and logistics alliances. A review of studies and practices of TPL clearly indicates that outsourcing of activities is only one of the possible interpretations of TPL. Closer examination shows that it might as well be seen as a means to access resources owned by other firms. For example, Razzaque and Sheng (1998) argue that one of the most important reasons for employing third-party logistics providers is their ability to support clients with “expertise and experience that otherwise would be difficult to acquire, or costly to have in-house” (p. 93). In this way companies can increase the resource base considerably because ‘firms can access more than they can control’ (Loasby 1998). Therefore, relying on the resources of others through close relationships can be regarded as an indirect control of resources (Gadde and Håkansson 2001). Thus, the interpretation of “insourcing” of resources should be that a shipper makes use of the logistics resources owned by the service provider.

The aim of the paper is to explore TPL and logistics alliances from a resource insourcing perspective. We begin the paper by providing some arguments for a resource view on logistics in general. Then we continue by presenting some basic characteristics of the established view of TPL. After that we identify some of the problems reported in previous studies of TPL-alliances. In the analysis we discuss whether some of these problems would have been tackled in other ways if viewed as resource insourcing rather than activity outsourcing. We conclude the paper by arguing that a resource sharing perspective provides a useful complement for the analysis and understanding of TPL.

2 TOWARD A RESOURCE VIEW OF LOGISTICS

As argued above the focus of logistics has been on the efficient undertaking of the activities in the flow of material from source to user (Stock 1990). A review of logistics literature (Gadde et al 2002) concludes that the activity-based perspective has been reinforced over time. Logistics resources are regarded more as ‘facilitators’ than ‘facilities’, whereas in earlier times, the resource perspective was more in focus. While Heskett et al (1964) identified two basic *resource* elements in logistics, for example, Coyle et al (1992) take ‘two interrelated basic *activities*’ as their starting point: movement and storage. In this case the activities required for movement and storage determine both the need for resources and their utilisation. The main issue for logisticians has been to decide on the optimal mix of customer service and logistics costs (Ballou 1992). Of course, the changes in the mix of activities impact on resource utilisation and the need for resource acquisition. However, the resource dimension is treated more indirectly than directly - the attention to resources is

directed through the activities. Further logistics operations have been heavily influenced by concepts including Time Based management, Lean Production and Efficient Consumer Response - techniques that have moved logistics in the direction of a process orientation.

The increasing attention to Supply Chain Management (SCM) has of course also affected the view of logistics. According to Christopher (1998) implementation of SCM aims at achieving “a more profitable outcome for all parties in the chain” (p. 18). To be able to do this we argue that there is a need for a resource focus. The highlighting of activities in mainstream logistics literature have been questioned by other authors too. Stock (1990) analysed the development of thinking about logistics and found it somewhat problematic that the discipline had retained its focus ‘on the logistics activity as a means to an end’ (p.3). According to the author ‘there is nothing wrong with this approach’, but it tends to obscure other important aspects. One such aspect, not mentioned by Stock, is the resource perspective. Harrison and van Hoek (2002) also suggest a reorientation of the view of logistics. They argue that the definition should take its point of departure in ‘the alignment of capabilities of supply chain partners’. Accordingly, we suggest a complementary perspective on TPL and logistics alliances – viewing it from a resource sharing point of view. First, however, we present and discuss some aspects of the mainstream view of TPL.

3 THE MAINSTREAM VIEW OF TPL

For shippers the main drivers for utilising TPL typically involves focusing on the own core business, cost reduction, risk sharing, simplification of administrative processes and access to more efficient and effective physical processes (Andersson 1997). The TPL-concept is

used in different contexts and with different degrees of precision. A definition representative of the established view of TPL is the following:

Third party logistics involves the use of external companies to perform logistics functions that have traditionally been performed within an organisation. The functions performed by the third party can encompass the entire logistics process or selected activities within that process. (Skjoett-Larsen 2000:113)

According to this definition (and most others) there is a focus on the functions performed and the party that is responsible for carrying out the functions. Most definitions are quite loose when it comes to which activities that are included. For example van Laarhoven et al (2000:426) argue that TPL involves “at least management and execution of transportation and warehousing”. Further they state that other activities might be included, such as inventory management, information related activities like tracking and tracing goods, assembly and installation of products or even supply chain management. Furthermore, in mainstream definitions the question of resources is seldom addressed. The attention from users and providers towards the resource aspect of TPL is not very much in focus. For example, Murphy and Poist (2000) analysed the perceptions of service providers and users concerning key factors in logistics alliances. Both parties considered ‘customer orientation’ and ‘dependability’ to be the most important factors. Among 25 factors both service providers and users perceived the least important factor to be ‘sharing of facilities and human resources’.

The strong TPL focus on activities reflects the prevailing view of logistics as presented above. Over the last three decades an increasing process orientation has emphasised the activity dimension in logistics networks (Gadde et al 2002). During this period resources have been on the top of the agenda as well. However, issues related to just-in-time deliveries and lean production have mainly stressed the need to strip the assets of the company. For example, in an analysis of the advantages of outsourcing to TPL-providers it is argued that “it reduces capital investment in facilities..., equipment..., information technology...and manpower” (Razzaque and Sheng 1998:95). The conclusion of this section is that up till now resources has not been considered a crucial issue in analyses of TPL and logistics alliances. Resources have been regarded as means for improving the performance of logistics activities rather than representing value in them. On the contrary, firms have deliberately made efforts to dispose of them.

4 SOME PROBLEMS IN TPL AND LOGISTICS ALLIANCES

There are numerous studies of successful TPL-operations, which will not be repeated here. Instead, our interest is focused on the efforts that have not been that successful. Closer examination reveals that these cases are not too uncommon. However, while the benefits of TPL have been well documented the pitfalls and problems have received less attention (Lambert et al 1999). A literature review indicates that problems are encountered in three phases: (i) when a shipper analyses the possibilities to start using a TPL-provider, (ii) in the implementation phase, (iii) in alliance operations, and (iv) in the auditing of the alliance.

In the first phase (pre-alliance) a number of internal concerns of the shipper can be identified. Bagchi and Virum (1996) studied twelve logistics alliances and found that shippers' carefully considered which logistics activities that should remain internal and which should be outsourced. Furthermore, they paid a lot of attention looking for solutions to the problems related to reduction of human resources accompanying logistics outsourcing. Other issues had to do with the number of suppliers to use and opportunities to co-operate with other users in order to increase the scale in the operations of the service providers. Some of the outsourcing firms were even uncertain about the true costs of their own operations.

In this paper we are mostly occupied with issues related to the potential partners. Lieb and Randall (1996) found that the respondents in a survey identified three main concerns in the first phase:

- The perceived loss of direct control of logistics activities
- Uncertainties about the service levels of the TPL-provider
- Questions concerning the true costs of using a third party provider

It seems most likely that these concerns will impact on both the propensities to make use of TPL and the forms of interaction and co-operation that are entered. Razzaque and Sheng (1998) who found that loss of control to TPL-providers appears to be the most common reservation against the use of contract logistics drew similar conclusions. They also report

that shippers' feared that "the third party may be inadequate in its capabilities to meet user's requirements" (ibid. p. 96).

When it comes to the implementation phase the survey by Lieb and Randall (1996) showed that two thirds of the users experienced significant impediments in bringing third-party services on line. Frequently occurring implementation problems included:

- difficulties encountered in teaching third-party personnel
- cultural differences between the two companies
- the need to integrate computer and information systems

Both Razzaque and Sheng (1998) and Bagchi and Virum (1996) come up with mainly the same conclusions, namely, the failure to manage providers properly, providers that underestimate the required level of logistics competence, lacking understanding of the other party, and the absence of advanced information technology linking manufacturer, carrier, warehouse and customer operations.

In ongoing alliances two principal problems seem to occur. The first is related to the actual operations that take place, while the second has to do with performance assessment and evaluation. Dreyer (1997) studied the development of three logistics alliances and identified a number of obstacles in the alliance operation phase. One main problem was that the provider was perceived to have inadequate capacity to maintain the service level agreed upon. On the other hand the provider felt the compensation for the actual workload to be

insufficient. In turn these effects seemed related to two significant relationship issues in general. First, the sharing of business information among the parties was insufficient to provide appropriate conditions for co-operation. Second, the division of responsibilities among the two partners was unclear. These problems are rooted in the first phase and often occur because the parties put in too little efforts in relationship building on the personal level (Bagchi and Virum 1996). Even though great efforts are undertaken in the operation phase, it seems difficult to rectify the problems once operation has started. Dreyer (1997) found that the management was occupied coping with the day to day operations, and too little attention was directed towards future development. Progress in productivity and service improvements was consequently slow.

Improving progress in productivity and services requires relevant auditing systems and processes. Lieb and Randall (1996) noted the lack of clear performance criteria as a severe drawback in this respect. In the same vein Razzaque and Sheng (1998) found that “difficulty of assessing the savings to be gained through outsourcing creates additional problems” (ibid. p. 96). Dreyer (1997) observed difficulties in establishing well functioning measuring systems for evaluation of performance in the alliances. In turn these shortcomings made it difficult to agree on common goals for efficiency improvements.

These findings from a ‘phase-oriented literature review’ may be complemented with the results from a process study of three logistics alliances over three to four years (Dreyer 1997). During that time period so serious problems occurred that two of the alliances were dissolved. In the third, the service provider wanted to terminate the relationship, but the

shipper disagreed and the alliance has survived up to this date in spite of a major conflict in the third year. In the two alliances that collapsed both parties agreed that the quality of the services and the operational costs/prices were far from the goals that were established at the outset. Important reasons for this included the following:

- Neither of the parties did prepare well enough for the changes that had to be done in their own organisations before starting the operation.
- The need to plan and co-operate was grossly underestimated both before starting and during the operations.
- In one of the cases the shipper was lacking a basic level of logistics competence.
- The malignant operations were allowed to continue during the operations phase, and in the audition phase the base for saving the alliance was disintegrated.

This very limited literature review indicates that there are several pitfalls in the relationship between a shipper and a TPL-provider. Our basic assumption is that some of the situations causing these problems would be handled in other ways if TPL were considered insourcing of resources rather than outsourcing of activities.

5 TPL AND INSOURCING OF RESOURCES

This analysis follows the line in the foregoing section. We start by discussing the situation before the alliance is initiated and continue with the implementation, operations, and auditing phases.

5.1 Pre-alliance considerations

Outsourcing is a common theme not only in logistics – it has been a general recommendation for improving performance in most types of industrial activities. There are massive indications that increasing outsourcing sometimes is a very proficient means to enhance efficiency and effectiveness. However, in many cases the outcome of these recommendations has been far from successful. According to Greco (1997) a large survey showed that 51% of the responding firms had brought back the outsourced activity in-house. One of the main reasons for these problems and pitfalls seems to be that these important decisions are not given the strategic attention they deserve. For example, Ellram and Billington (2001) argue that US-companies still continue to outsource primarily on short-term costs. Greco (1997) found that decisions to outsource were often made “in the face of looming deadlines to drastically reduce budgets” (p. 52). The information available about inducements concerning third-party logistics makes it reasonable to assume that they follow the same pattern. In particular ‘general alliances’ are mainly focusing on short-term cost savings. Firms involved in ‘special’ and ‘dedicated’ alliances have a longer time horizon, such as IBM and Nedlloyd.

It is obvious, however, that the main benefits from TPL reside in other dimensions. For example, Sheffi (1990) and Virum (1993) analysed the primary drivers for a shipper to rely on service providers and came up with the following arguments (complementing the concern to focus on core competence):

- better transportation solutions

- cost savings and improved services
- need for more professional and better equipped logistics services
- development of necessary technological expertise and computerised systems which is beyond the scope of many companies.
- more flexible processes
- simplification of administrative processes
- access to ready made logistics services when entering new markets

The list of potential improvements of shippers' performance clearly indicates the relevance of a resource insourcing perspective, as most effects require the utilisation of the resources of other firms. Identifying appropriate means for resource sharing is a time-consuming process requiring various mutual adaptations (Håkansson and Snehota 1995). If decisions to rely on TPL are taken with the objective of saving on short-term costs it comes as no surprise that problems arise. The adaptations required among shipper and provider must be considered investments, and like all investments they pay-off only over time.

The TPL-problems related to this first phase have to do with lack of control, uncertainties about costs, and doubts concerning the competence of the service provider (the third of these aspects will be treated in the discussion of the implementation phase). When it comes to control it is true that relying on TPL-providers reduces direct control. This outcome can not be avoided as it follows from ambitions to make use of resources owned by other firms. However, this does not mean that the user of the resource will lose control completely. As

argued above a company may obtain indirect control over these resources through the relationships that are developed with the resource provider.

The second problem in the pre-TPL phase is the concern about costs. It will always be impossible to predict the costs of entering TPL. Added to that, few shippers know their own logistics costs before entering an alliance. This makes it even more problematic to anticipate the benefits – both in terms of size and in which dimensions they occur. The outcome in this respect depends on the type of relationship that is established and how close the parties work together. To illustrate this we turn to a pragmatic classification of TPL-alliances in terms of the characteristics of the providers and what they offer (Virum 1993).

- ***General providers - sharing standard resources.***

In these alliances a logistics company is utilising the same resources when serving different kinds of shippers. The work force, warehouses, means of transport, freight terminals, data system and handling equipment are used for services provided to various shippers.

Normally there is a requirement that the goods must be in the form of standardised pallets or other unit loads.

- ***Specialised providers - sharing resources for a given type of goods.***

In these alliances the provider's resources are designed for a specific type of goods, for instance frozen food, chemicals or valuable items. The resources are selected to give the

highest efficiency and the right quality in the flow of the particular type of goods in question.

- ***Dedicated providers – resources utilised by one user only.***

These are alliances where there is only one user of the services and the resources are specially selected to fulfil his needs. Examples are the alliances between Frans Maas and Xerox and Nedlloyd and IBM. In these cases the service may be presented with an exclusive character in the market.

The services rendered in these three types of operations are very different when it comes to the costs and benefits they represent for the user. In particular they put different requirements on the resource input from the shipper in terms of investments and relationship involvement. This is illustrated in figure 1 where the types of operations are grouped according to focus on activities or resources versus the extent of specialisation of the services.

INSERT FIGURE 1 HERE

For general services the main focus is on reaping economies of scale by serving many shippers relying on standardised services. Therefore, activities need to be executed with minimum efforts at a prescribed quality. Specialised services are technically designed for a given type of goods and the need of specific resources is a main concern. At the same time there is a need for marketing these services. Several shippers must use the same services in order to get a base for economies of scale. Dedicated services, finally, are tailor made to fit

the needs of individual shippers and here the economic use of resources is an important issue in all phases of the alliance. We believe that a resource insourcing perspective would improve the opportunities to tackle the issues related to the phase before an alliance is entered. For example, such a view could eliminate fears of reduced control and impose a more long-term orientation when it comes to economic effects.

5.2 Implementation

Three problems related to this phase were identified in the review. First, if TPL is regarded as activity outsourcing it is not likely that problems concerning cultural differences will get sufficient attention. On the other hand, if it is seen as making use of others' resources it might be perceived a crucial issue. Second, according to Monczka and Morgan (2000) many companies have failed to understand that when in-house manufacturing is replaced by outsourced activities, there is still a need for the buyer to be involved in the operations. In particular, appropriate and synchronised information systems is of crucial relevance for efficient co-ordination of activities. Over time specialisation and interdependence has increased in industrial systems. In turn, this development enhances the need for co-ordination among activities and resources, because activities that are outsourced to other firms are withdrawn from the prevailing mechanisms for co-ordination in the firm. These mechanisms must be replaced by inter-firm co-ordination and too often problems occur in implementation. If TPL-decisions were seen as resource insourcing we believe that issues related to well-functioning information and communication systems should be regarded prerequisites for an alliance, rather than unanticipated problems occurring after start-up.

The third aspect - 'difficulties in teaching third parties' - relates to the fear that third parties may be inadequate in its capabilities, which came out as one of the reasons for resisting TPL. Formulations of this type clearly reflect an activity outsourcing perspective. The underlying notion seems to be that, for some reasons, a service provider may be able to improve the performance of these activities – 'but we, as shippers know better how to do it and we need to teach the provider'. A resource insourcing perspective would most likely come up with other conclusions. For example, Quinn (1999) argues that buying firms should avoid too detailed direction of suppliers because the provider has been chosen for its competence and, typically, has more knowledge depth than the buying firm should. Therefore, he recommends buyers to shift the outlook to managing *what* result is desired rather than *how* this result is to be achieved. If the buyer specifies how to do the job in too much detail "it will kill innovation and vitiate the suppliers' great advantage" (ibid. p. 19). Araujo et al (1999) bring up the same issue and argue that too much direction will impose unnecessary restrictions on the supplier in finding the most efficient solutions.

5.3 Alliance operations

In this phase two general problems in relationships were identified in the literature review. The first concerns the sharing of business information which appeared to be insufficient to provide appropriate conditions for co-operation. This issue has always been a main problem for the joint operations of firms in marketing channels and is based on lack of trust among producer and distributor, in turn leading to a channel atmosphere characterised by power and conflict (see for example Hunt and Ray 1981). However, over time channel relationships have changed in the direction of more co-operative arrangements. For

example Hardy and Magrath (1988) illustrate how more partnership-oriented producer-distributor relations brought success to many manufacturers. Attaining the benefits from these partnerships required a more collaborative atmosphere and also more openness in information exchange (see for example Reddy and Marvin 1988). In the purchasing field McIvor (2001) analysed the joint costs rationalisation efforts of buyers and suppliers. Gaining potential benefits in this respect requires sharing information about the cost structures on both sides of the customer-supplier dyad. He found severe problems in implementing open book costing and cost transparency because some suppliers were suspicious of the motives of the customer. However, even in this area there are significant examples of improvements that can be achieved when the business partners realise the potential residing in close co-operation. For illustrations of benefits from information sharing in buyer-seller alliances see for example Gadde and Håkansson (2001). This is in line with results from studies of logistics alliances – information sharing is necessary. For example, one study concluded that the main strength of the success of one particular alliance was close and open communication between the actors that took part (Persson and Virum 2000). If TPL is considered as outsourcing of activities, fear of sharing information with the supplier may result because the buyer feels a loss of control as discussed in the section 5.1. Considering TPL rather as insourcing of resources gives the buyer less fear of this because closer relationships are developed. It also gives an incentive for the buyer to share the information in order to improve utilisation of its “own” resources. Information about campaigns, new products, etc. makes it easier for the supplier to tune the logistics operations in accordance with changing needs (Persson and Virum 2000:35).

As long as TPL is considered mainly as outsourcing of activities the business exchange is focused on single transactions. If this perspective is applied in the alliance operations phase the potential benefits of TPL and logistics alliances will not be realised. However, if the view is shifted toward insourcing of resources examples from other company functions indicate that it is the relationship to the counterparts that is focused rather than the single transactions. Widening the perspective in this respect is the breeding ground for mutual adaptations and performance improvements. Once firms start to collaborate and identify opportunities for joint efforts they will also be able – and required – to solve the second general problem in this phase. A clear division of responsibilities among the alliance partners is a prerequisite for successful collaboration. This also links back to the implementation phase where an insourcing perspective suggests that more responsibility for how results are achieved, is handed over to the supplier. Division of responsibilities may be easier if the supplier has a more active role also in such decisions.

5.4 Performance assessment

The review identified problems related to the difficulties in establishing performance criteria, assessing progress and finding ways of distributing the economic gains among the actors involved. All these issues are crucial from a resource point-of-view as well.

However, also in this respect there is a fundamental difference between the two perspectives. If TPL is perceived as outsourcing of activities the performance criteria most certainly will be focused on the efficiency of the specific activity concerned and the shipper will probably be satisfied if performance increases. If TPL is perceived as resource sharing the buying company might consider also other ways to utilise the resources of the service

provider. By combining these resources with others, that are directly and indirectly controlled, the shipper might be able to improve its operations even further and increase the value provided to its own customers. In turn, this approach will call for diversified performance criteria.

Establishing adequate performance criteria is important because it is absolutely necessary for both parties to continuously monitor the costs and benefits of an alliance. Adaptations are always costly and can be justified only when the benefits of the alliance outweigh these costs. The benefits from alliances are not reaped automatically. For example, Kapour and Gupta (1997) found alliances where the customer “had been overpaying for services in the name of partnerships, the terms and benefits of which could not be identified, let alone quantified”.

6 CONCLUDING DISCUSSION

We started this paper with the ambition of exploring a potential complementary interpretation of TPL and logistics alliances. Contrary to mainstream literature our suggestion was to view this phenomenon as insourcing of resources. In particular we raised the issue whether some of the problems with TPL (which were identified in various studies) would be possible to overcome by using this complementary perspective.

Our analysis shows that a resource sharing view clearly would impact on the focus and attention of the buying firm. It is evident that in all four problem areas identified a shipper with a resource sharing view most likely would have tackled some of the situations quite

differently – presumably in a better way. On the other hand, some situations might have been dealt with in less proficient ways than when an outsourcing perspective is applied. Therefore our basic argument is that a resource sharing view on TPL and logistics alliances is a useful complementary perspective. With a resource sharing view the usage of a specific resource is no longer a given. By combining it in new ways with existing and new resources its value can always be enhanced.

Applying the resource insourcing perspective extends the strategic space available for shippers. Regarded in this way logistics improvements may be obtained not only through co-operation with suppliers, customers, and third and fourth party logistics providers. In some cases a shipper may benefit even more from resource sharing with competitors. In the alliances between the large food retailers and logistics companies in England, the retailers often own the distribution centres while logistics companies run the operations. In some cases two or more competing retailers co-operate in financing facilities they are going to share and form alliances with the same logistics company. By banding together the volumes of goods, they obtain scale gains in warehousing, ICT and transport, but at the same time they generally specify service standards that are in some aspects different.

Another example is Forlagsentralen in Oslo, a third party firm specialising in distribution of books, from the printers to the bookshops in Norway. They carry out complete order fulfilment services, including warehousing, transport, order receiving, sales statistics and collection of payments for 380 different publishing houses. The two owners of this company are Aschehoug and Gyldendal Norsk Forlag, two large publishers that are competing fiercely with each other and with the other publishers using the services of the

provider. The main purpose for competitors to take part in alliances of this type is the fact that they have no possibility to obtain the same low costs on their own. By sharing resources, particularly in warehousing, transport, data processing and communication, they provide the necessary base for the logistics company to obtain economies of scale, scope and governance, which in turn favours the competing publishers.

Within research and in business much effort has been invested in order to understand how TPL and logistics alliances are and could be used in order to improve the competitiveness of buyers as well as suppliers. This paper has suggested a complementary view on outsourcing that has the potential of contributing the understanding of TPL, for studies and research as well as for practitioners. We believe that it would be interesting to apply this perspective on prior studies of alliances as well as collecting new data on other logistics alliances and use of third party logistics.

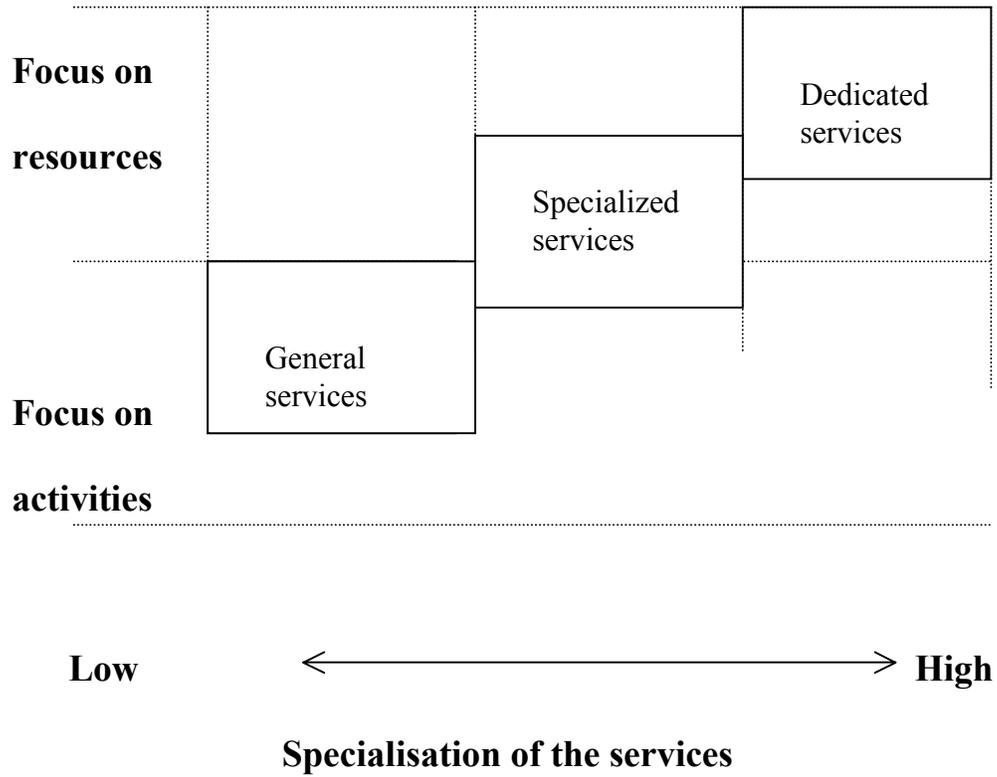


Figure 1: Focus and dependence for three types of services

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