

**OUTSOURCING TO TPL FIRMS:
PRESENT CUSTOMERS AS A DECISION CRITERIA**

ABSTRACT

Third-party logistics providers (TPLs) and their connections with customers have been described in different ways in the literature. In this article we consider three important aspects TPLs interactions with their customers.

First, TPLs can be usefully analyzed in terms of the different economies that they achieve, and how they can coordinate differing demands from their customers to achieve efficiency. The second aspect of TPL interaction with customers is the relation between one TPL and a specific customer, with the TPL providing services of superior quality or low cost. The third aspect of TPL interaction with customers is the relation between the customers themselves. We know from previous studies that TPL firms have few customers and deep relationships in most cases (Andersson, 1997). The consequences for the buyer of the TPL losing or gaining a big customer can then influence the economies of scale and scope extensively.

The IMP literature has a great deal to say about interaction between industrial actors and we propose to connect this study to IMP writings on interaction and network effects rather than just the effects between a TPL and single customer. The position of a service provider such as a TPL can usefully be studied by considering IMP dimensions of actors, activities and resources (Håkansson & Snehota, 1995).

We report on the initial interviews of a study to explore the relations between TPLs and their buyers, with particular focus on how coordination of services is handled. Initial results show that the points from the interviews really touch upon two levels. There is one level to do with the physical network and logistics operations, and another which deals with the actors and the way they interact. We suggest that the Johansson & Matsson (1992) model of the network and production system can explain how these two levels interact and propose to employ it more extensively.

KEY WORDS

Third-party logistics, purchasing logistics services, buyer coordination

PURPOSE OF THE PAPER

Third-party logistics providers (TPLs) and their connections with customers have been described in different ways in the literature. These firms can be usefully analyzed in terms of the different economies that they achieve, and how they can coordinate differing demands from their customers to achieve competitive advantage. In practice, we often see that TPLs take on any potential customer and try to work with their present customer base to achieve some advantages of scale or a level of operational efficiency. This is an important topic since it speaks to the role of the TPL, be it to achieve lower costs at the margin, achieving a different level of scale effects to its customers or a different level of performance through reorganizing parts of its activities. Typically these issues have been analyzed from the TPL's point of view, i.e. how can it achieve efficiency (Bolumole, 2001).

It is in the interest of the TPLs customers that the TPL is successful in reducing costs or providing high quality. However this is a very passive view of the buyer. Considering that the buyer of TPL services can have an extensive purchasing process and evaluation process of alternative TPL providers, the question becomes what the buyer can do to influence the economies of scale and scope. We know from previous studies that TPL firms have a few customers and deep relationships in most cases (Andersson, 1997). To achieve economies some coordination of the activities carried out by the TPL must be carried out across different customers. This coordination must happen in a network setting with the TPL and its customers as part of a larger network of firms which can all influence the opportunities for coordination. To investigate this issue we propose two research questions:

How does coordination take place for the services provided by TPL firms?

What role do customers play in the coordination of TPL services?

LITERATURE REVIEW

In this article we consider three important aspects of TPLs interactions with their customers. We consider how TPLs achieve economic efficiency, how they interact with a specific customer and then expand this to the network.

HOW TPLS ACHIEVE ECONOMIC EFFICIENCY

First, TPLs can be usefully analyzed in terms of the different economies that they achieve, and how they can coordinate differing demands from their customers to achieve efficiency. In practice, we often see that TPLs take on any potential customer and try to work with their present customer base to achieve some advantages of scale or a level of operational efficiency. There is considerable focus on growth (Hertz and Alfredsson, 2003). This is an important topic since it speaks to the role of the TPL, be it to achieve lower costs at the margin, achieving a different level of scale effects to its customers or a different level of performance through reorganizing parts of its activities. Typically these issues have been analyzed from the TPL's point of view, i.e. how can it achieve efficiency (Bolumole, 2001).

The literature on TPLs and efficiency can be more accurately described as a relatively eclectic collection of theory to explain how TPLs achieve greater effectiveness or efficiency. Hertz and Macquet (2006) suggest that this argument can be made in accordance with 3 elements in one dimension – the network, the product or market and finally the strategy, and 2 elements in the other dimension – whether activities are similar or complementary.

The activities dimension is based on Richardson's (1972) framework which defines the domain of an industry in terms of activities:

It is convenient to think of industry as carrying out an indefinitely large number of activities... And we have to recognize that these activities have to be carried out by organisations with appropriate capabilities, or, in other words, with appropriate knowledge, experience and skills. (Richardson, 1972, p.888).

Activities can relate to each other in two ways. They can be similar: "Activities which require the same capability for their undertaking I shall call similar activities" (Richardson, 1972, p.888). Carrying out many similar activities is a way for a firm to focus on its core and to achieve economies of scale in operations. A second dimension is that activities can be complementary: "...activities are complementary when they represent different phases of a process of production and require in some way or another to be co-ordinated (Richardson, 1972, p.889)." Activities which are complementary have to be coordinated both qualitatively meaning the interfaces between the activities have to be agreed and adapted, and they have to be coordinated quantitatively so the output from one process matches the required inputs for the next process. This conceptualization is certainly relevant within logistics where the task is often to enable the smooth progress from one activity to another in terms of space and time. A final sharpening of the requirements occurs when activities are closely complementary meaning they have to be matched on a one-to-one basis. For example activities related to a custom-ordered car have to be carried out so that the particular car ordered by the customer is subject to the correct activities such as installation of optional extras.

The second dimension consists of the network, product and strategy. The network aspect can be related to the structure of the relationships between firms. For example, in the industrial network approach the exchange within a relationship involves not only an economic, physical, technical, legal and knowledge exchange between firms but also a social exchange where trust and communication is vital. These exchange dimensions are interacting. (Hertz, 1993; Håkansson & Snehota, 1995). However, trust between firms seems to be especially important when there is much at stake for the firms. This is often true when a firm is outsourcing parts of its supply, operations and/or distribution to TPL (Maltz & Ellram, 1997). Even though trust is of basic importance to each single relationship, trust does not have to exist directly between the relationships in a network such as between different customers (Hertz and Macquet, 2006).

The second argument is knowledge of specific markets and products. A TPL can specialize in providing services for a specific group of firms and accumulate particularly relevant market knowledge for these, basing its competitive advantage on this (Persson and Virum, 2001). This is analogous to arguments made by Potter that firms can be needs-based or variety-based. Variety based firms focus on their internal quality in terms of particular products, whereas needs-based firms are adaptive to particular sets of customers (Porter, 1996).

Finally the TPL may base itself on the strategy or structure of the distribution channel. This aspect can have many dimensions but here we focus on a few that are central to supply chain management. Notably firms can focus on cost efficiency or customer responsiveness (quality) as the basis for competing (Fisher, 1997, Persson and Virum, 2001). A second central supply chain issue is to what degree the supply chain is postponement and speculation based and how to adapt services and its own systems accordingly (Alderson, 1965, Bucklin, 1965, van Hoek, 2001). What this literature does well is explain various basis for the TPL to

compete with other firms, but it is less clear on why one particular approach is more appropriate than another, and how the transitions and overlaps between the different approaches might work.

THE TPL AND A SPECIFIC CUSTOMER

The second aspect of TPL interaction with customers is the relation between one TPL and a specific customer, with the TPL providing services of superior quality or low cost. Considering that the buyer of TPL services can have an extensive purchasing process and evaluation process of alternative TPL providers, the question is also what the buyer can do to influence the economies of scale and scope. This one-to-one view of the TPL and its customer has been handled both from an outsourcing point of view and in purchasing literature.

Several streams of literature deal with TPLs directly or indirectly (Marasco, 2008). One stream is concerned with generalized questions of how to handle outsourcing to TPLs and how to manage the relation with the TPL. A relatively close relationship with the TPL is often suggested (Andersson, 1997) in order to communicate needs and ensure that the activities of the TPL are sufficiently and tightly integrated with those of the firm. Arm's length transactions are seen as inappropriate for managing many of the specialized services that the TPL can provide (Bolumole, 2003). Considerable attention is paid to the issue of what activities can be outsourced and the fit with remaining activities. One important argument is that the TPL is a specialist able to carry out activities better. Furthermore, the focus is often on the quality and nature of the relation between a specific buying firm and a specific TPL (Berglund et al., 1999). There is limited attention to the other bonds of the TPL and how these can affect its ability to carry out processes for the buying firm. Indeed it is quite possible to handle this outsourcing incorrectly and success is not a given (Gadde and Hulthen, 2009).

This can involve defining the criteria for buying TPL services, decision on which services to buy in a more formal sense than in the first section above, and evaluation and maintenance of the contracts with TPLs (McGinnis et al., 1995). In short, this is a part of the purchasing literature dealing with buying TPL services (Menon et al., 1998, van Damme and van Amstel, 1996). Criteria are typically those used in purchasing in general – costs, quality criteria, track record, capacity and financial solidity of the TPL, as well as a plethora of others as appropriate (Gibson et al., 2008). These criteria may have some relevance to the issue of cooperation and outsourcing as defined in the first stream of literature here, creating a connection between the two. However, there is generally no attempt to tie this to the issues in the second type of literature to the extent that these involve the relations of the TPL to other firms. That is, if the services of the TPL are based on purchasing specialized equipment this may be included in the buying criteria, but the way the TPL works with other customers and the way this impacts on what it is able to provide in terms of service is not raised as an issue. This creates a clear disconnection between both the outsourcing approach to looking at TPLs, the purchasing approach to determining and selecting TPLs, and a significant part of how TPLs actually become good at their business and create efficiencies. Indeed, it may be more important what other customers the TPL is already working with rather than the exact investments it has made in specific equipment.

RELATIONS BETWEEN THE CUSTOMERS – THE NETWORK

The third aspect of TPL interaction with customers is the relation between the customers themselves, as well as with other actors. We know from previous studies that TPL firms have

few customers and deep relationships in most cases (Andersson, 1997). The consequences for the buyer of the TPL losing or gaining a big customer can then influence the economies of scale and scope extensively. These efficiencies then must necessarily happen through achieving some kind of fit between the customer and TPL which is not captured in the literature on purchasing criteria and to a much greater extent relates to what other customers the TPL has and how it works with these. This is fundamentally a question about the network the firms operate in, and how the interdependencies between the activities and resources of the customer firms are exploited.

	Similarities	Complementarities
Network related dimensions	Same customers´ customer Same suppliers Advanced comp IT systems- similar demands	Direct connection in the supply chain
Product related characteristics	Same products Similar value Similar handling Similar complexity	Demand fluctuation over seasons, weeks,etc
Strategy related	Same philosophy/ culture and basic strategy Same strategy-postponement or speculation to same customers customer Degree and ways of outsourcing	Different basic strategies

Figure 1: Framework (Hertz and Macquet, 2006)

Combining the two dimensions discussed above we arrive at Figure 1 which we employ to structure our data collection and discussion. This is the framework we employ in the analysis. However, there are additional network conceptions to consider. Johansson & Mattson (1992) represent the network as two levels – one activity level corresponding to the logistics activities here, and one actor level representing social ties and where decisions regarding how to act to change or modify the activities is made. This adds a more long-term and strategic level which can be used to explain some of the changes and adaptations made in the activity layer – i.e. the way the firms interact also influences how they choose to divide and carry out activities.

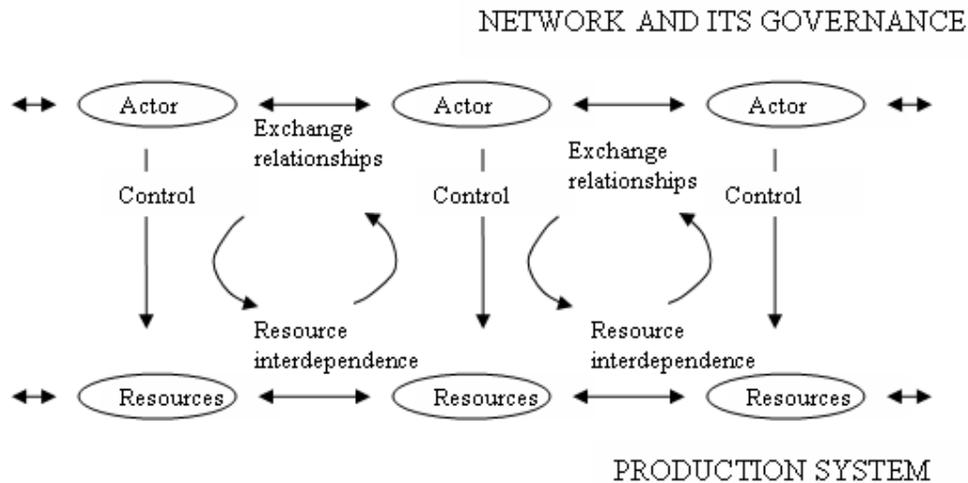


Figure 2: Network and Production System (From Johansson & Mattson, 1992).

METHOD

The topic of customer coordination for third-party logistics is relatively unexplored and puts us in a context of discovery, attempting to understand concepts and approaches to describe such coordination. A case-study approach using largely interpretative data eliciting the opinions of various informants is appropriate to this type of study (Yin, 2003). In this article we report findings from a pre-study carried out to start investigating these issues. We carried out interviews with experienced employees in several third-party logistics firms and their customers in order to obtain first impressions on the relevance of our thinking and the problems as seen by industry insiders. Interviews were carried out by telephone, and referring to a short list of main issues we wanted to cover but allowing the interview subject to go beyond this if they so wished in order to obtain active data (Dubois and Gadde, 2002). Interviews notes were typed up immediately after the interview and cross-checked with a second researcher to verify and improve the interpretations. The observations and discussion in the interview were then entered as findings relevant to the framework above.

The study will be continued with more interviews, expanding the selection of both providers and buyers of TPL services.

FINDINGS

At this stage we cannot show a meaningful case but relate some of the initial findings from the interviews under the three main headings in the model above.

NETWORK-RELATED ISSUES

Our interviews show that buyers do ask for reference customers, but this seems more related to trust rather than coordination of activities. Asking for reference customers is seen as

normal and important in evaluating a logistics service provider. For example, if the TPL already supplies a large and well-known firm this increases the chance that it can perform as needed. Large customers are seen as important. From the customer side this is important both from the point of view that performance in terms of cost and service increases. If the TPL has relations to other important markets this is seen as interesting and can be the basis for considering the TPL as a supplier. On the other hand there is a risk in that losing the customer can lead to a considerable change for the customer as well. From the TPL side, there will not necessarily be a specific adaptation on losing a big customer, but it is important to be open about this vis-à-vis remaining customers. Storage services can benefit from joint facilities for many customers, but in practice these are often divided by customer to avoid the consequences of errors in picking. In general, large customers use a fairly standardized selection process which matches the purchasing literature, whereas small customers are concerned with finding a provider they trust. Both small and large firms seem to consider the size of the TPL compared to themselves – they do not want to be either too large or too small compared to the TPL. If they are too large then they don't get the benefits of scale, and if too small they lose the close relation to the TPL which is important for the arrangement in the first place.

There is some matching of customers taking place, but primarily within transport matching customers with light and heavy types of cargo to improve the overall use of transport resources. Customers on their side can use the relations that providers have to major customers or markets as a guide to whether they can provide services.

One interviewee commented that it is important to discuss customer service with customers. This TPL had a large meeting with its main customers to discuss future solutions and future demands on logistics. The idea is both to obtain such ideas at an early stage and to allow the customers to discuss with each other. The effect was seen in part when some customers restructured an international supply chain based on a change made by one customer and discussed in the meetings.

Several interviewees both from the TPL and purchasing side pointed out that it is important to find good incoming and outgoing solutions to Sweden. Often this pertains to geographical coverage. In certain cases TPLs are organized according to markets for certain types of products where they can provide services to several levels of the supply chain, e.g. marine goods.

In general customers seem to split into several categories. Some are not concerned about customer coordination at all where others are aware that this can bring benefits. The latter category are not however focused on the costs or limitations of customer coordination.

PRODUCT-RELATED ISSUES

Both the buyer and provider side seem to agree that knowledge of the product and relevant logistics requirements is an essential component for the TPL. The degree to which the firm "can deliver" is vital for the customer. Competence of the product but also the customer's business is essential as a competitive factor. One interviewee expressed this as knowledge of the "solutions" that the customers provide, a wider concept than just the product. Another pointed out that in their industry they delivered a working concept at the customer site rather than a product. Increasingly, just knowing the product is not the whole story. Furthermore, even the basic product knowledge and competence must be combined with knowledge about the changing points of delivery, or nodes relevant for logistics.

Reference customers are also seen as important in terms of demonstrating product knowledge, a slightly different argument to the trust argument made in the previous section. TPL has some “selection” of customers through limiting the type of goods handled. This means that customers with certain types of products are not relevant. On the customer side the argument is the same – it is made very clear in tender documents or when asking for quotes what the requirements are in terms of performance and capacity, and this will make some logistics service providers exclude themselves from competition. One customer did however emphasize that where providers are used over time the customer builds up an extensive historical database of performance which is very important when making future decisions.

Customers are continually updated on particular events relevant to their supply chains, e.g. whether the situation in Egypt affected supply chains. Some activity is also carried out in the other end of the supply chain - some main customers have many suppliers in China – these are invited to meetings. The TPL will also try to sell to them directly as this “builds in” the TPL in the network. One issue is however that for customers with many suppliers “somebody is always dealing with someone” i.e. there are so many ties that there are bound to be some between suppliers of goods and services, and many of these are not significant enough for the firm to consider specifically.

STRATEGY-RELATED ISSUES

One interviewee commented that typically it is possible to combine customers with different strategies, but this is much more difficult if the customer and TPL strategy deviates. Much easier to combine if strategy can be translated to specific requirements on service and lead-time. Customers with different requirements in terms of service/cost can be handled partially through outsourcing to different sub-suppliers. For example, a customer focused on high performance would be assigned one sub-supplier, whilst one focusing primarily on cost would use another. One of the buyers of TPL services pointed out that capacity and geographical coverage was very important but that this could be provided through alliances or sub-suppliers. A highly important aspect for the buyers but not mentioned by the TPLs so far is that of environmental standards. One of the buyers interviewed mentioned environmental standards as one of the top requirements, to the extent that TPLs were expected to have an environmental strategy and work with this “in the right way.” This is an example of a “deal-breaker” for the buyer where the TPL must perform. However, the buyer did not define a particular standard such as ISO as essential and thus leaves some scope for the supplier to choose how to deal with the issue.

ANALYSIS

There are some important implications of even this initial limited data collection. Here we focus on those seen as most pertinent to the research questions. This should be seen as an initial analysis and will be expanded when more of the data has been gathered.

The importance of product knowledge seems clear for the respondents and this in itself is not surprising. What we do find is that rather than just focusing on product knowledge, it is important for the service providers both to consider what services the customer provides, and to understand at least part of the customer’s thinking. The services provides may be more or less tied to an actual product, i.e. it can be a product with additional services, or it can be largely about putting together a “solution” for the customer. This enables an understanding of both how activities can be made more similar, e.g. doing the same thing for many firms,

and more complementary – how can the TPL assist the customer in making their supply chains work better.

To a large extent this is related to knowledge development and how activities are organized. It is possible to standardize and modularize many activities for specific industries thus creating economies, indeed this is a basic challenge in logistics (Fabbe-Costes et al., 2006). Once activities are standardized and modularized it is much easier to combine them and offer them to new customers. For products these approaches are well known (van Hoek, 2000) but for the services or “solutions” seen here new opportunities are likely. Since they are new it is even more important what the firms do, and the actor or social layer becomes essential for development.

The exchange of information and ideas is a second extension to our model. Simply putting the customers together or letting them walk around the warehouse can be sufficient to create change as they adapt to each other’s ways of working. Part of this exchange relates to opportunities, but it is of course possible that information exchange between customers can lead to new ways of working together and initiatives from the customers that are important for the TPL in turn. One of the interviewees pointed out that they had just arranged a meeting with their major customers. The list included a number of different firms at different stages of the supply chain and did not necessarily seem consistent. However, all the firms were large international firms dependent on multinational distribution. In a sense they had similar or potentially similar networks meaning there was a physical similarity, but the meetings also worked at a different level reflecting the actors in the Johansson & Mattsson model. These findings can be tied to previous research showing the importance of buyer-supplier interaction (Gadde and Hulthen, 2009).

What we see from the empirical findings above is that there is both awareness that coordination between customers can lead to benefits for the customer and TPL providers overall, and some very limited initiatives by the TPL providers and other logistics firms to facilitate some initial steps in this direction. To a certain extent it is still seen as the TPLs business to coordinate the needs of their different customers, and for some tasks this is possible without significant customer participation. However for others customer participation is necessary and indeed can be sufficient to create changes when the customers interact.

CONCLUSIONS AND FURTHER RESEARCH

The study is still at an early stage, but we would like to highlight three main conclusions and avenues for further research

One is that some of the points from the interviews really touch upon two levels. There is one level to do with the physical network and logistics operations, and another which deals with the actors and the way they interact. We suggest that the Johansson & Mattsson model can explain how these two levels interact and propose to employ it more extensively.

Second, this level makes it possible to change the activities carried out, creating new similarities and reorganizing the system based in large part on interactions between the different actors involved. The initiatives for this seem to be largely on the part of the logistics providers. Indeed, we find that the customers do not have customer coordination in

mind when selecting which TPL provider to use, but may consider this later on when the selection has already been made.

Third, the framework as employed here covers the network, products and strategy. We suggest that it can be expanded with processes, especially as several of the firms interviewed do not see themselves as selling only products, but rather solutions which involve a number of services beyond just the products themselves.

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