Gazing into the mirror

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IBM Institute for Business Value

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By Karen Butner

Our 2006 3PL CEO Study reveals leading third-party logistics providers (3PLs) are looking to find their way in a world in which their roles are growing and becoming increasingly complex. Faced with external influences — such as a demanding customer base seeking geographic expansion — and mounting internal issues, it’s time for 3PLs to focus on simplicity, innovation and better supply chain management.

Introduction
The 2006 3PL CEO Study, conducted by IBM Global Business Services, in conjunction with Dr. Robert Lieb, Professor of Supply Chain Management, College of Business Administration, Northeastern University, was designed to identify current and projected trends in the logistics industry. Forty-four CEOs from major third-party logistics companies were surveyed. Respondents were from: North America (22); Europe (11); and Asia Pacific (11).

Evolving needs drive innovation agendas
The role of logistics providers is changing in response to globally expanding requirements for integrated transportation and distribution capabilities. At the heart of this change is a continuing drive to transform 3PLs from price-driven contract service providers to strategic partners that add value for their enterprise customers.

From a customer standpoint, 3PLs will continue to grow in significance as integral parts of sourcing, capacity and operational strategies. However, as 3PLs suffer the inevitable growing pains, their customers will need to both enable and endure industry changes in order to effectively integrate and use 3PL services.

This relationship between service provider and customer (or, preferably, partner and enterprise) forms a critical balance point for the industry’s success. Both entities must be able to openly embrace tighter and tighter relationships in terms of information sharing, resource coordination, system integration, management
oversight and even financial transparency. At the same time, they should be careful to manage the factors this type of relationship brings, including accountability, price/cost controls and competitiveness.

The continued shift to meet customer needs drives 3PL growth both internally and externally. From the outside, scale and geographic reach become more important in the delivery of solutions, perhaps turning management’s focus from lifting pallets and fueling trucks to mergers and acquisitions (M&A) activity and geopolitical prowess. Growth also comes from inside 3PLs, creating challenges in human resources, process effectiveness, and technology.

This brief will examine four focal points of interest to 3PL leadership and their customers, as revealed by the 2006 3PL CEO Study, and will recommend actions designed to better position the industry for growth.

- **Growth and globalization:** addressing the needs and challenges of growth, M&As and international expansion within the 3PL market and customer base

- **Value propositions and service offerings:** understanding how the 3PL value proposition and portfolio of services are evolving, including the roles of outsourcing and the lead logistic provider, as well as overall value creation for customers

- **Customer relationship and partnership:** addressing the challenges and benefits of building more comprehensive and integral relationships between customers and 3PL service providers

- **Operational effectiveness and innovation:** focusing on the continuing imperative to perform more optimally, with higher quality and better margins. This includes improving human resources, processes and technology.
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Engines of 3PL growth: Customer demands and innovation

It is rare that any industry escapes change, and the 3PL industry is no exception. The good news, however, is that because of recent changes, global 3PL revenues have been growing steadily over the past five years. Additionally, growth goals are generally being met, and most companies are maintaining moderate-to-ample profit margins. Our 2006 3PL CEO Study reveals the current wave of change sweeping the industry is driving providers to become bigger, stronger and more focused on providing value to their customers. This type of upward, improvement-oriented change can be characterized as growth, and it's a top agenda item for the CEOs of leading 3PLs.

But growth is often tough and carries with it certain risks. It requires investments and can foster competitive uncertainty. Companies able to meet this growth challenge, while mitigating the trials and pains of its effects, should be best suited to take and maintain leadership positions within the industry.

Our study shows the source of this growth is broadly coming from two interconnected areas: the evolving needs of the 3PL customer; and a drive toward innovation and improvement within the industry.

The evolving needs and demands of the 3PL customer

To a large extent, the push for growth is coming directly from the needs of the 3PL customer. Corporate mandates from industries that rely on logistics have focused on globalization, improving sourcing strategies and price negotiations, expanding the role of partners and providers, and using technology as a key enabler.

According to our study participants, the top industry dynamics are pricing pressure and the need for additional services. The next two most important dynamics are large-scale mergers and geographic expansion (see Figure 1). All of these dynamics seem to be in

![Figure 1. CEO perception of most important industry dynamics.](chart)

Source: 2006 3PL CEO survey.

“Points” reflect a weighted score based on CEOs prioritizing multiple responses. European and Asia Pacific scores were weighted to illustrate relative values to U.S. scores.
response to a growing need to globalize, while streamlining logistics across more borders and reducing the number of provider relationships the customer must maintain. In the European market, for example, globalization pressures mainly came from following customers into new regions. In Asia, the push to enter China, which survey respondents identified as the fastest growing revenue source over the past three years, was the key driver. In North America, increasing geographic coverage was rated the top opportunity.

Increased geographic coverage and M&As are also tightly related, as M&As are often key strategies in globalization. Interestingly, while M&A activity was a major dynamic in Europe, its use as a growth strategy was cited as eight times more important two years ago. This suggests that even if mergers aren’t being initiated currently, the post-merger effects may be driving market tension; two years isn’t much time in terms of integrating company operations and realizing the competitive synergies of past mergers.

The top customer demands driving the 3PL industry toward growth include:

- **Going global with suppliers, customers and resources:** Customers are seeking lower cost sources of product supply, manufacturing and logistics services.
- **Improved international operations:** Customers want increased speed and effectiveness in conducting business across global boundaries while reducing the effort.

including better collaboration and coordination across countries and regions and within the confines of their own businesses.

- **Outsourcing appetite:** Customers are exhibiting a willingness and appetite to move more logistics-related services outside their companies, most likely to improve capacity dynamics, reduce risk in owning/managing logistics operations and take advantage of logistics expertise from external sources.

- **Overall improved logistics internally:** Customers now require greater efficiency and effectiveness across the supply chain and shipping/storage cycle, including better utilization of their own internal logistics resources, more visibility of the entire logistics cycle/process and greater data integration.

**Growing capacity globally: China, India and Eastern Europe**

China will remain the most important 3PL growth revenue source into 2008, as projected by the study. However, if current trends continue, India’s total 3PL revenues will have tripled since 2004. Many providers have established operations in China, but have had mixed success in meeting various goals, due primarily to logistics-related capacity and infrastructure constraints. During the past several years, European 3PLs have responded to the 2004 expansion of the European Union (EU) in a number of ways, the most prevalent of which is following existing customers that are expanding into new EU member countries (see Figure 2).
Mergers and acquisitions

M&A activity was consistently mentioned as a key industry dynamic by respondents in the 2006 3PL study. Twenty-three of the 44 CEOs reported their companies had been involved in significant M&A activity in their regions during the past year. To a degree, we can infer this push is driven largely from customer demands for 3PLs to quickly extend geographic reach, offer new services and deliver better prices. This trend is worldwide. CEOs in all regions expect a significant percentage of their
revenue growth in the next three years to come from M&A activity (percent of growth related to acquisitions, versus other factors such as internal growth):

- North America: 15 percent
- Europe: 17 percent
- Asia Pacific: 23 percent.

Consolidation is the market effect of widespread M&A activity. While individual companies grow larger, the competitor base (or provider base, for customers) grows smaller. Two-thirds of the CEOs ranked continued consolidation among the most important regional changes they expect during the next three years. Consolidation itself changes how companies are differentiated in the marketplace. In many cases, consolidation builds sameness among a shorter list of bigger players. Niche and smaller contenders often have to deepen their specialties to compete or be swallowed up altogether. In Asia Pacific, respondents felt they had yet to achieve the proper scale in the marketplace. In Europe and North America, where scale is achieved, some wondered if bigger was necessarily better.

M&A and consolidation brings growing pains to both 3PLs and their customers. According to the 2006 3PL study, CEOs across all regions cited human issues – both at the leadership level and at the staff level – as among the primary challenges. Geopolitical concerns, such as regulation, culture differences and infrastructure, were also cited. Customer focus and meeting expectations were cited both as major challenges and as key strategic focal points going forward.

Consolidation efforts, if managed correctly, should help 3PLs meet some of the requirements of enterprise customers. Eventually, the larger 3PL entities will be able to provide more services, a broader geographic presence and better cost structures through M&A activity. The challenges will come with the growing pains associated with many consolidation efforts: integration problems; customer service and delivery breakdowns; reworking of finance and billing processes; and a potential clash of cultures as the 3PL brings together source companies. With this in mind, 3PLs will have to extend significant internal energies to help their M&As create the expected value.

3PLs are becoming selective about customers

The survey data shows that 3PLs are becoming more selective about the relationships they enter into, ultimately looking for fewer customers with greater collaboration and larger financial/time commitments. In most industries, M&A activity is pursued to acquire more customers. With 3PLs, it would appear that M&A activity is driven by trying to serve fewer customers with broader and improved service.

Innovation from within

As customers demand more from their logistics partners, 3PLs are constantly developing new service offerings, new capabilities and expanded reach. For each improvement one company brings to market, there is a potential to change the entire playing field for the other players. Ultimately, new developments often become widely adopted and lose their competitive advantage.

Technology leads the list of business innovations and advancements. Overwhelmingly, most CEOs across the globe are using technology in attempts to build collaborative working relationships with key customers. These technologies include customer relationship management (CRM) software, supply
chain visibility tools, decision-support analytical platforms and electronic data interchange (EDI) linkages (see Figure 3).

At the same time, technology is not the cure-all. In North America, for example, the high cost and low return of information technology was cited by CEOs as the second largest problem they face.

Interestingly, while Radio Frequency Identification (RFID) technology is often discussed and highly visible in the media, its deployment within 3PLs is quite sparse. On average, less than 10 percent of companies globally are committed to the technology – and only about 10 percent are piloting RFID programs. Again, participation may be linked to customer readiness and the existing logistics infrastructure (for example, ports, OEM warehouses) for this technology. At the same time, the low adoption of RFID may present an opportunity for differentiation for a provider ready to act sooner than later.

**Pricing pressure as indicator and impetus**

In all regions, pricing pressure was far and away the biggest issue. This can indicate a highly competitive and parallel industry in which many providers may bid to provide identical services, often differentiating themselves primarily on a cost basis. This is often evidenced in the transportation industry. There are typically two responses to downward price pressure:

1) **Further commoditize service offerings and beat competitors on raw price points** – This strategy has been historically difficult to sustain, unless supported by longer-term service level agreements (SLAs) for standardized offerings.

2) **Change the pricing conversation to one of value creation and differentiation** – As customers seek more services and 3PLs seek more exclusive relationships, this seems to be the prominent direction preferred by 3PL CEOs.

![FIGURE 3. Use of technology to collaborate with key customers.](image-url)

**Technology used**

- CRM software
- Supply chain visibility tools
- Supply chain integration software
- Software that supports analytical projects for customers
- Customer performance portals
- EDI linkages to customers

*Source: IBM Institute for Business Value analysis.*
In practice, companies must pursue both strategies to compete. The response from the CEOs, though, resoundingly points to shifting toward a more differentiated value proposition that involves deeper partnerships, more exclusive customer relationships, tighter IT integration with customers, and greater responsiveness to customers’ needs for more services and geographic coverage.

The modern 3PL continues to change the value proposition from service provider to solution partner
The shift to solution partner is certainly not a new trend; it has been underway for years. The importance of this finding, though, is that this shift continues to be a key competitive driver in the marketplace and that there is still plenty of work to do in order to achieve it. If anything, this ongoing trend should remind 3PL leaders and their customers where to focus their strategic and tactical energies.

In executing this strategy, leaders should look at both how they project their value propositions to the marketplace, as well as how they deliver against the promises they make. Partners act differently. They work to understand needs. They provide advice. They respond differently to problems. They customize their services. A solution partnership, when executed correctly, can reward the 3PL with greater account penetration, easier sales cycles, fewer price-led bidding wars, better margins, and, potentially, long-term profitable relationships.

Focal points for the 3PL industry
While the 2006 3PL CEO study covered many topics, from profitability to technology, four areas emerged as key points of focus for the industry and its participants. This section will discuss these areas in greater detail, exploring key challenges cited by the surveyed CEOs, along with implications and actions that may be considered. While the lists of challenges and implications discussed here are not comprehensive, they do illustrate many of the top problems and solutions 3PL executives have on their strategic agenda.

Growth and globalization
Growth for 3PLs comes in many different flavors and guises: M&A; international expansion; organic growth (that is, new customer acquisition); account penetration; and increasing scale. All of these present two quandaries: “Which strategies do I use to grow?” and “Now that I’m growing, how do I manage the change?”

The CEOs of companies serving the Asia Pacific region project substantially higher company and industry growth rates when compared to Europe, for example (see Figure 4).

![Figure 4. Projections of company and industry growth rates in Asia Pacific and Europe.](image-url)
According to the 2006 3PL study, growth and globalization challenges were recurring themes. In most cases, the challenges of growth were more focused on the after-effects of growth, rather than determining how to get bigger. This was particularly prevalent in North American and European markets, where many growth goals have been achieved. The focus is now turning to specialization and fine-tuning the new, larger organizations. Listed below are some of the key recurring challenges cited by 3PL CEOs:

- Addressing a wide range of people issues, including blending different “cultures,” handling redundancy and dealing with compensation issues
- Difficulty integrating operations, reporting and IT systems
- Finding managers with “theater-wide” knowledge – more than just single- or dual-country expertise
- Finding adequate supplies of skilled resources to support entry into new markets
- Comply with different national and local regulations and laws within different regions.

**Value proposition and service offering**

As 3PLs move to become more partner-like with their customers, the mix of services they offer must change as well. In addition to adding services to the menu, 3PLs must also find the parts of their services that differentiate their entire offering and be able to communicate that value to the marketplace.

A value proposition usually has three parts:

- An explicit confirmation of the customers’ requirements
- A listing of services, products and offerings
- Areas of differentiation.

Obviously for 3PLs, distribution activities and transporting goods will always be the most important aspect of the value proposition, and no roster of add-ons will ever disguise poor logistics services. The opportunity will be in finding new ways to meet the customer’s entire scope of needs, making the logistics process easier for customers, bringing expertise to the relationship and developing innovative new services that generate business value for the customer.

Figure 5 shows the most commonly cited customer-facing, value proposition factors by region. We discovered similarities and differences in what these companies emphasize in order to differentiate themselves from competitors in the regional markets. The recurring themes are those of reach, breadth, experience, excellence, talent and customer focus. Despite claims that “pricing pressure” is the largest industry dynamic, customers apparently do not come to the table with low costs as their primary value driver.

Some of the challenges that 3PLs encounter in expanding their service offering portfolios include:

- Client perception that 3PLs provide a service, not a strategic partnership
- Lack of commitment by customers’ top management

Opportunities exist for finding new ways to meet a customer’s entire scope of needs.
Operational effectiveness and innovation
Operational effectiveness, in general terms, is how companies do things better, cheaper, faster, with higher quality and better yields. The effect on customer relationships and market performance is two-fold: 3PLs' margins improve, making pricing more flexible; and their service delivery can become a competitive differentiator.

Technology, it seems, is always at the forefront of this conversation, and for good reasons. Technology is constantly evolving, it's scalable and it has the potential for "quantum-shift" type improvements. For example, in North America, offering advanced IT solutions is the second most important value driver, while high IT cost and low return on IT investments rank as the second largest issue. Even so, the most resounding operational concern among 3PL CEOs wasn't technology or infrastructure, but people.

People, in the end, are the lifeblood of the logistics industry. In terms of international and M&A growth, finding and integrating quality, skilled staff – from leadership to line personnel – continue to be difficult challenges. European
and Asia Pacific respondents were the most vocal about human resource issues; however, it is likely these challenges resonate with all 3PL leaders.

Listed below are top operational effectiveness and innovation challenges cited by our surveyed CEOs:

- Hiring and retaining high-quality human resources (Europe and Asia Pacific)
- Intense competition for skilled human resources (Asia Pacific)
- Increasing operating costs as wages rise
- Offering advantaged IT solutions, such as end-to-end visibility.

While the four focus areas affected all 3PLs to some degree, the growing emphasis on customer relationships, partnerships and integration seemed to connect and crossover in nearly every case.

Making the grade: Recommendations
The 3PL industry is highly challenged by many issues that have been shared as either strategic direction or evolving complexities by the CEOs surveyed. For each of these, we offer a glimpse into possible remedies:

Mergers and acquisitions
- Pre-merger operational planning (e.g., technology integration, staffing concerns) is often shortchanged because top-line planning (e.g., new markets, new services) takes the priority. Consider involving more operational planning and expertise in up-front merger planning activities.

- Merged companies often adopt many “inherited” projects and initiatives. In many cases, these projects become irrelevant to the new vision. Companies should create a new or refined operational vision for the merged company and reconcile projects to that vision.

Globalization
- Finding local expertise, whether in staff, partnered companies or acquisition candidates, is the well-known and, arguably, easiest way to grow expertise in a particular region.

- Geopolitical and regulatory concerns were most prominent in Asia. While managing different laws and regulations is difficult, it may be a key benefit to customers that do not want to manage these items themselves. Mastering these issues may become a point of differentiation, particularly in niche segments and geographies.

Expanded services and solutions
- Outsourcing has many benefits for customers. One of those is leveraging a firm’s expertise. Consider the role of knowledge programs to strengthen this attribute.

- Information technology investments may provide two-fold benefits: while they improve internal operations, they can also be shared with customers to provide extra value and new service offerings.

Working with large, complex enterprise customers
- Develop a restructured customer service organization to assure that key accounts receive uniform quality of service around the globe.

- Support collaborative transportation planning, new supply chain management capabilities and analytic projects with key customers.

A new operational vision should be created for a “merged” company.
**Contractual structures and incentives**

- Increase emphasis on risk-sharing and gain-sharing in longer-term contracts with key customers.

- Focus on value creation for customers – even in areas in which the 3PL does not directly provide the service.

Looking forward, customers’ expanded requirements and innovation will continue to be two of the primary drivers of change within the 3PL industry. How these changes manifest themselves and are converted to competitive advantage will ultimately ride on the decisions of the 3PL CEOs and leaders, and how well their organizations can act upon them.

**About the author**

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