

Pitfalls of a 4PL haul

With the road ahead looking increasingly rocky for the 3PL/4PL Logistics Business looks at how to best navigate the difficult legal terrain often facing these hardy and adaptable service providers. Putting forward the case for the defence is Jeremy Clarke, the head of LLC Law Solicitors, a UK based law firm dedicated to logistics and specialists in 3PL/4PL contract logistics.

Some five years ago supply chain consultants focussed their research on developing an all encapsulating supply chain solution which swiftly became known as 4PL. The objective behind that short acronym was a solution which would allow logistics operations to overcome very real physical limitations and be more effectively managed for the future.

To understand the catalyst for this development you need to consider the changing market for production and product flows at the time. The 80's and 90's saw outsourcing of conventional supply chain services mature into a new multi-billion Euro market comprised of larger asset intensive providers like Hays, Wincanton, Exel and Christian Salvesen.

A demanding market

The consequence was double digit growth as companies increasingly outsourced their conventional transport and warehousing operations to the third-party providers of logistics services (3PL). Simultaneously, the horizons for the sales and marketing arms of all producers were fast expanding in the fight for market share and increased volume, lower unit costs and increased profitability. The intense competition for the sale of consumer and industrial products meant that more than ever all potential cost savings and efficiencies had to be realised.

Unquestionably the strategic importance of both 3PL and in-house logistics had risen in the 80's. The early 90's saw a wide gap evolving between the end-customers' realisation of the operational demands inherent in their global and trans-national operations, and the ability of 3PLs to provide management of worldwide operations seamlessly.

So, having matured only recently, by the mid to late 90's conventional 3PL services appeared unable to meet the challenge of their customer's cross-continent and increasingly just-in-time production (JIT) flows. As such the industry came under intense scrutiny with commentators focussing on the industry's palpable

failure to meet its customers' needs.

By the late 90's an integrated vision of logistics suggested that global production, distribution and sale would necessitate a new breed of truly global 'single source' 3PL operators.



Observing the legal requirements, Jeremy Clarke.

www.LLCLaw.co.uk

jclarke@LLCLaw.co.uk

t: 020 7471 0371

f: 020 7386 0176

Such a vision anticipated massive investments in country-wide offices, assets and IT systems spread across continents under the umbrella of a single company. This vision was never realised, in part because of the fragmented nature of local and national distribution, the associated costs and because, fortunately, an alternative evolved to save the day.

That alternative was the concept of the 4PL, the term originally coined by Andersen Consulting (formerly Accenture, now IBM Consulting). At its simplest, the model provided for an additional and higher layer of logistics management.

Crucially, 4PLs would operate at a holistic level, using IT to gain access to and to disseminate all the product sourcing, distribution and end-customer data required to properly manage a fully integrated network of conventional service providers. Such conventional services would for the most part be physically performed on the ground by the traditional 3PLs.

Proper management

Companies like Lex Auto Logistics include as part of their 4PL service offering the acquisition of its customers' inventories which sit on Lex's balance sheet enabling it to properly manage and reduce its customers' inventories. In the extreme, a 4PL working alongside a network of 3PLs can perform or at least manage all of manufacturing company's non-core activities outside of sales and marketing.

The potential growth still has a long way to go but sits comfortably with the other value adding activities (postponed manufacture etc) which the 3PLs are keen to develop.

The positive effects of this transformation have been at least twofold. 4PLs have been able to provide the essential ingredient for an end-to-end solution and the cement required to network globally disparate operators in a way that was unthinkable in the 90s.

Secondly, 3PLs entering the 4PL market have been able to move away from the low margin commodity pricing increasingly associated with transport and non value-adding warehousing, focusing instead on more profitable 4PL services.

Let's collaborate

This development and the degree of collaboration required to make 4PL as a concept work was and will continue to be in large part made possible by the simultaneously advances taking place in mobile technology, web-enabled and browser-based IT solutions and the synchronisation and integration of such applications into manufacturers' ERP systems. This has provided, in theory, almost limitless visibility across global supply chains.

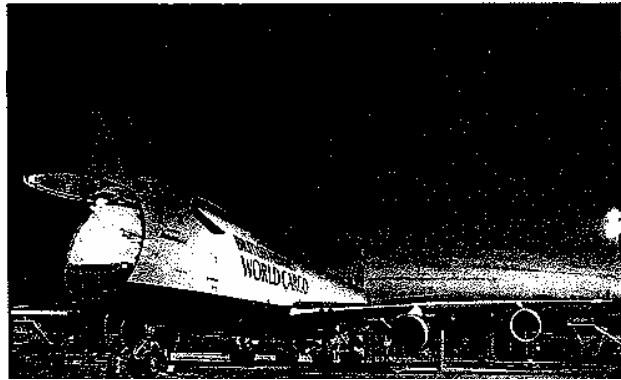
Being IT driven, operators have been able to set-up dedicated 4PL operations up as separate and independent companies, like 3T Logistics in the UK. However, in the case of TDG, this included forming a separate 'Scio' business in partnership with Cap Gemini Ernest and Young with whom TDG has sought to develop a consultancy style offering with the ultimate aim of providing a more intelligent solution. However, the state of current technology, its costs and the inherent risk of obsolescence are still a limiting factor for some 4 PL's future development.

Take control

However, 4PLs are continuing to be set-up despite the lull which followed their modelling in the 90s. Tesco has forged ahead with its factory gate pricing arrangements by which it has taken over control of inbound supplies to its RDC's.

Last year GIST set up a 4PL with the High Street retailer New Look involving over 280 suppliers in over 30 countries. UPS has for several years made a conscious effort to build-up its 4PL applications business in the form of UPS Worldwide Logistics and which, for a number of years, was the fastest growing part of its business. UPS has for several years made a conscious effort to build-up its 4PL applications business in the form of UPS Worldwide Logistics and which, for a number of years, was the fastest growing part of its business.

The introduction of the 4PL function results in day-to-day responsibility for interfacing with and managing product flows being transferred from the manufacturer



Global transport networks – an essential part of the contracted delivery scheduling.

to its chosen 4PL service provider. As a result, the multiple interfaces that must necessarily exist between suppliers, supplier's transport companies, manufacturer, manufacturer's transport companies, manufacturer's RDC and ultimately to end customer are now primarily routed through the 4PL.

This simplified scenario should, in the global context, be extended in the reader's eye to cover containerised and conventional shipments, air freight movements, factory gate pricing initiatives etc which result in a vastly more complex matrix of contact points and resulting management problems.

Perhaps unsurprisingly, the new breed of 4PL service providers have to make use of conventional 3PL contact structures in order to meet the requirements of 4PL arrangements. At best this has resulted in confusion and at worst a failed solution.

When properly constructed, 4PL arrangements are likely to include any or all of the following over and above the sister 3PL arrangements which will continue both up and down stream:

- Gain-sharing financial incentives: With the focus on 4PL's delivering measurable cost savings and service level improvements, the financial structures must incorporate workable mechanisms for establishing the original or base-line costs and the means by which these will be assessed against future costs so that any actual cost savings can be shared in an agreed ratio between the 4PL and its customer.

The broader picture

- Agency Functions: As noted above, in relation to the selection, negotiation and contracting of 3PL services, the 4PL does not replace conventional 3PL services, but rather over-lays such services. Those arrangements will continue to exist. However, with its broader experience of 3PLs generally (including comparative cost and service level data) and a holistic overview of the specific operations in question, the 4PL should leverage efficiency and reduce costs acting for and on behalf of the manufacturing principle.

The parameters of the 4PLs agency appointment need to be clearly set out and all too often this important structural point is omitted completely. In particular pro-

3/4PL LOGISTICS

forma 3PL contracts should be prepared for use by the 4PL which in turn need then only revert to its customer to agreed material changes to the same.

Where a 4PL is held-out as part of the manufacturers own operation (undisclosed agency) the specific safeguards should be put in place regarding intellectual property, use of company letterheads e-mail formats and similar with an exclusion of any rights in respect of the same, especially post termination.

- **Independence and Arms Length Conduct:** Given that 4PLs may well purchase 3 PL services from within their own organisation the assessment and charging mechanisms by which the 4PL makes its decisions have got to be open book, arms length and designed so as to realise an improvement over related market prices

- **Service Levels, Liquidated Damages & Key Performance Measures:** These require much more careful consideration and drafting for 4PL arrangements, especially since many operational issues which must be addressed will inevitably be being considered for the first time. The KPIs for the 4PL will focus in part on achieving the cost savings referred to above, but also on enforcing, back-to-back, the 3PL's service levels for which it is responsible for managing.

- **Format and regularity of Reporting:** With the strategic importance of the operations managed by the 4PL greater care and attention should be focussed on the data received by the 4PL's customer to ensure that the end-to-end supply chain is clearly being properly managed. The reporting will not only address the 4PL's compliance with its specific service levels, but also include exception reports in relation to the 3PLs' performance.

- **Inplants and related Security Issues:** Given the matrix of interfaces between both the data held on the Relevant ERP system and physical flow of products and operators responsible for transporting or storing the same, the 4PL will frequently wish to have a presence on its customer's site(s). As such, care needs to be taken to ensure compliance with security, health and safety and the customer's general codes of conduct and procedural requirements when on site.

Make it clear

- **Use of and Access to Customer's ERP system:** The level of required access for employees of the 4PL in the new operating environment far exceeds that which would have been provided under earlier 3PL arrangements. Clear procedures must be set out in relation to authority to access, security, and the avoidance of alterations to the system and/or the introduction of viruses. Additional development and/or enhancement may be required to all or a part of the IT system, and responsibility for and rights to such work should be clarified and expressly provided for.

The market for the required integrating software is now mature, with companies like CAPS Logistics and Descartes (used by GIST - formerly BOC) actively building market share. The issue of IT is critical to the success of any 4PL solution and the process of transitioning to and integrating the 4PL solution with the rest of the ERP will need careful management.

- **Contract Monitoring:** This particular area of the contract takes on a whole new dimension where the 4PL's responsibilities extend either up or downstream of conventional manufacturing logistics. If something goes wrong in such an environment, the escalation procedures need to be in place to ensure that the customer of the 4PL can immediately have a say in any decision which may impact adversely on its business.

- **Employees:** Frequently the outsourcing of 4PL functions will result in a transfer of the customer's staff to the 4PL (albeit that some strategically important ones may remain).

- **Termination & Disputes:** Additional issues may need to be addressed in relation to change of control (should the 4PL sell out) and exiting the sites and returning key data post the termination of the contract. Mechanisms for resolving otherwise contentious financial disputes should be built-in to resolve so as to avoid unnecessary litigation.

The Future

In a sense, there is nothing new behind the concept of 4PL arrangements. Management, supervision and planning have always taken place albeit internally and perhaps inefficiently. However, with the growing sophistication of supply chains such functions are increasingly outsourced to expert 4PL service companies or at the very least separate, identifiable units within the customer's organisation.

The nature of such integration services are clearly here for the long term. However, there are additional costs involved and, as such, 4PLs may not be appropriate for all products across all supply chains - it certainly is not the case that one size fits all. For the time being at least 4PL arrangements appear to be working well for high value, short life products with high price depreciation. But as the scope of 4PL services becomes better known and more common place costs will fall and 4PL will expand its reach.

At that time the activities and services associated with 4PL functions will increasingly be considered as standard components (at their more basic level) in the package of basic outsourced logistics services across all product lines and equivalent to the basic 3PL services of today. As such, we can say that the 4PL concept is not a redundant dinosaur and will be with us for the long term.