3PL PERSPECTIVES 2010

A PARADOX BOUND BY DEMAND

by Joseph O'Reilly

Perspective is a weighty word, burdened by limitations. Alone it is siloed, rigid, biased, and exclusive. But give it plurality and perspectives become rich with relevance. Contrasts emerge, tensions arise, commonalities come together, and facts are enforced.

Inbound Logistics' annual *3PL Perspectives* research report follows similar logic, coupling shipper and 3PL insights to illustrate the rapidly changing dynamics of the outsourcing industry. Our "feel" for the third-party logistics space offers give-and-take perspectives of what shippers demand, and how logistics service providers respond. We take these parts, integrate them, and provide a complete view of the market.

Sourcing multiple perspectives offers deep supporting evidence, enhances clarity, and creates stronger analysis supported by fact. It's why businesses embrace 3PL partnerships to begin with.

Outsourcing's value is built upon a fundamental presumption that strength comes in numbers – that best-of-breed logistics providers or an end-to-end integrator, sometimes both, give shippers greater visibility to supply chain challenges than going it alone. Its success is driven by a collective synergy that tears down walls between functional silos, pulls together disparate parts, and creates an integrated network bound by demand.

3PL PERSPECTIVES 2010

Reflecting how unique market circumstances have twisted and torqued supply chains, how innovations in technology, the Internet, and business process strategies have facilitated the movement of information and inventory around the world, and how outsourcing has gained widespread traction, the third-party logistics industry has become somewhat of a paradox. Businesses rely on logistics providers as fixed assets, fundamental partners that strengthen and support the enterprise. At the same time, 3PLs are fluid, flexible, even fleeting. It's a matter of perspective.

There are constants that draw shippers to outsourcing: eliminating costs and creating efficiencies, divesting non-core business functions, and allaying risk. There are also variables: exploring emerging markets, piloting innovative technologies, experimenting with new supply chain strategies. Often that which remains the same, and everything that changes, feed the business case for outsourcing. In good times and bad, however demand dictates, 3PLs learn, evolve, and respond.

Inbound Logistics' annual *3PL Perspectives* market research report and Top 100 3PL directory offer similar yin and yang viewpoints that together coalesce into a comprehensive study of the third-party logistics industry.

First, *Inbound Logistics* solicited nearly 600 third-party logistics service providers to provide detailed information about their services and areas of expertise–geographically, operationally, and vertically. We also asked 3PLs to color this data with contextual insight about business during the past year, relationships with customers, and emerging outsourcing trends. We combined this pool of information with more than 4,000 targeted shipper responses, creating a foil for our analysis–another perspective.

From this sweeping overview of the 3PL industry, we concentrate our focus on the Top 100 3PLs, as selected by *IL* editors–a composite of logistics service providers, from the venerable old guard to a new crop of industry leaders, all of whom are pioneering outsourcing excellence.

Collectively, *3PL Perspectives* and the Top 100 3PL directory marry industry analysis with nuts-and-bolts information about leading logistics service providers. Outsourcing trends are often fleeting but 3PL trendsetters are hard and fast. Welcome to this year's paradox.

DIVERSIFICATION BEARS POSITIVE GAINS

Even as global market conditions swing the supply/demand pendulum in arbitrary directions, forcing businesses to quickly adapt and respond, 3PLs have remained relatively stable–a quality that plays into outsourcing's favor. There have been some notable acquisitions and contractions, and asset-heavy providers have faced their fair share of difficulties in a soft market, but the industry's counter-cyclical resilience remains consistent with last year's report. The outsourced logistics segment is still on solid footing, with gross sales revenue topping out at $107 billion in 2009, compared to $112 billion last year, according to *3PL Perspectives* research.

For many industries, 2009 was a bear market with bare returns. Widespread pressures to reduce costs and manage uncertain demand pushed businesses to lean less on inventory–at the risk of replenishing overstock–and more on third-party logistics partnerships.

Remarkably, despite sluggish consumerism and shrinking freight volumes, 3PLs report a slight increase in new customers this year, with 73 percent building their client rosters by at least five percent, compared to 70 percent in 2009 (**SEE FIGURE 1**). On average, service providers indicate a seven-percent increase in new customers, compared to 6.7 percent last year. By contrast, only seven percent cite business attrition (11 percent in 2009).

3PLs are leaving few links untouched in their search for new customers. Manufacturing remains the Holy Grail for outsourcing demand–but only by mere percentage points–with 96 percent of surveyed 3PLs targeting this market. Distribution/wholesale (also 96 percent), retail/e-business (88 percent), and service industries/government (75 percent) follow accordingly.

That distribution/wholesale has for the first time reached the same level of saturation as manufacturing indicates logistics intermediaries have found solid traction between supply and demand. It suggests 3PLs are cherry-picking business opportunities through existing retail and manufacturing customers, wending their way upstream and downstream in the supply chain, and targeting other third parties as potential prospects.

Service industries and government have consistently been laggards in terms of outsourcing progressiveness. But that tide appears to be turning, with an eight-percent jump in the number of 3PLs selling their services to these sectors.

Finding new customers enabled third-party logistics providers to spring from a prolonged recession relatively unscathed. Respondents to *IL's 3PL Perspectives* study indicate a slight gain in sales and profitability during the past year, each registering 5.9-percent growth on average, up 0.6 percent over 2009 numbers. Still, compared to 2008, when mean sales growth topped 11 percent and profitability almost eight percent, the industry is far from pre-recession normalcy.

Under-performing 3PLs broadly cite diminished customer volumes and price pressures for static growth. Clients pulled back inventories to lower carrying costs; as a result, there was less business in the pipeline.

"Profit margins were compressed, and not as high as expected due to volatile pricing from carriers and brokers alike. We had to keep profits lean to keep competition out," reports one 3PL survey respondent.

Recognizing that sales growth was limited by economic constraints, many third-party logistics companies explored opportunities to grow business beyond their cores, either by diversifying their customer demographic and/or expanding logistics services in these verticals.

For some 3PLs, it was a coordinated strategy to expand business through widespread sales outreach. Others made a concerted effort to amplify existing customer partnerships, for example, targeting vertical markets with differentiated services.

"We centered our sales and prospecting efforts on three market verticals combined with a focused outreach to existing and past customers/prospects," reports another logistics company. "After six months of employing this marketing and sales strategy, our customer base grew by 14 percent."

Similar to last year, 3PL respondents acknowledge that "rising costs" (50 percent) is the greatest challenge they face today. Notably, "technology investment" (46 percent) and "capacity" (44 percent) follow in terms of priority, displacing "finding customers" and "making a profit"–which rank fourth and fifth this year (**SEE FIGURE 5**). What does this mean?

Even as 3PLs cast their nets far and wide for new prospects, they are baiting customers by adding and expanding value. Service providers are profitable because they are helping shippers save money, then sharing in those gains. This trend corresponds with aggregated data from *3PL Perspectives*. Nearly 80 percent of respondents cite organic sales as contributing to growth, with 20 percent indicating organic sales and mergers and acquisitions, and only one percent reporting M&A alone as a factor.

By investing in technology and securing capacity, 3PLs are looking at how they can position and match their value proposition to future demand. It's an impetus that naturally drives organic growth.

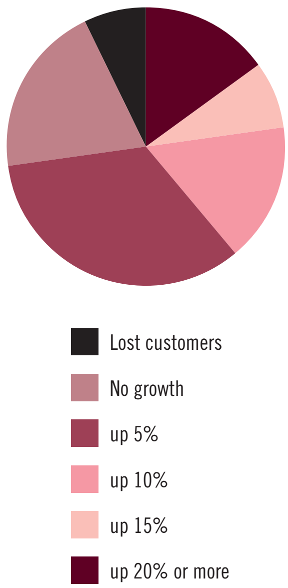
TOOLING UP WITH LOGISTICS IT

From a macro perspective, many logistics companies anticipate a capacity shortage if shipment volumes recover without a corollary rebound in new equipment. Transportation costs will accordingly rise.

On a more granular scale, 3PLs recognize that investments in technology provide greater operational and sales leverage as they expand their value proposition beyond traditional commodity-type services–helping shippers address rising costs and capacity constraints, then probing strategic solutions. "It's about taking a supply chain approach rather than simply a transportation one," a 3PL reports.

Technology is one area where logistics service providers have been concentrating investment. Apart from identifying it as a priority within their industry, 42 percent of 3PLs report that technology strategy and implementation is a concern for their customers as

FIGURE 1 During the last year, how much did your customer base grow?



SOURCE: Inbound Logistics 2010 3PL Perspectives

3PLs Up Close & Personal

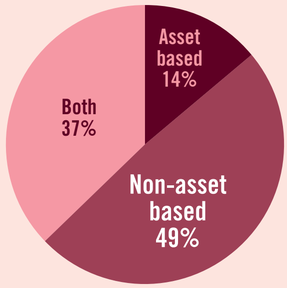
The 3PL industry is well balanced between asset- and non-asset-based service providers. Of surveyed companies, 49 percent operate as non-asset-based service providers, with 51 percent identifying their business as either asset-based or both (**SEE FIGURE 2**). Over the past few years, slight fluctuations in the number of purely asset-based companies – 14 percent in 2010, 16 percent in 2009, 12 percent in 2008 – reflect changing 3PL pedigrees.

For example, some service providers have divested equipment or spun off separate non-asset logistics operations; and technology companies are bundling value-added services around software applications. At the other extreme, carriers and warehouses are expanding their operational taxonomy with logistics capabilities. There are few bounds from where 3PLs emerge, or where they are evolving.

The U.S. 3PL industry remains American to the core with 88 percent serving North America and 15 percent exclusively the United States (**SEE FIGURE 3**). Asia is the top offshore target (48 percent), followed by Europe (46 percent), Southeast Asia and Latin America (42 percent), and the Middle East (37 percent). In spite of a global recession, and perhaps as a consequence, companies are leveraging third-party penetration in offshore markets to capitalize on emerging sales and manufacturing opportunities.

In terms of vertical specialization, consumer product goods and food and beverage are the likeliest outsourcing targets – with 81 percent and 72 percent of 3PLs tailoring services to these industries (**SEE FIGURE 4**) – followed by electronics (66 percent), automotive (62 percent), construction and building materials and footwear/apparel/textile (both 60 percent). Generally, 3PLs find greatest traction in customer-facing verticals that are sensitive to demand, as well as complex manufacturing industries where global sourcing is fractured and widespread.

FIGURE 2 Asset or Non-asset based?



SOURCE: Inbound Logistics 2010 3PL Perspectives

FIGURE 3 Regions 3PLs Serve

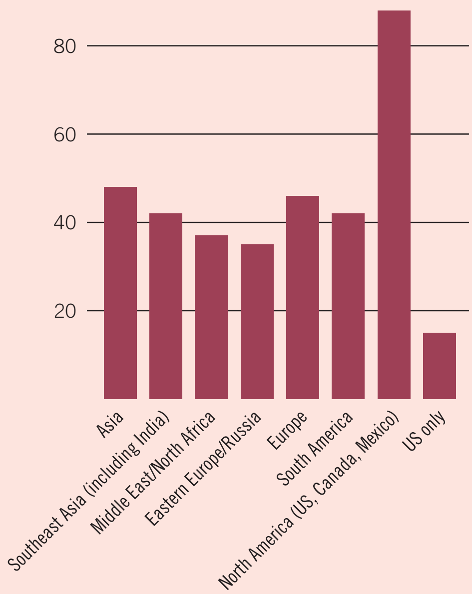
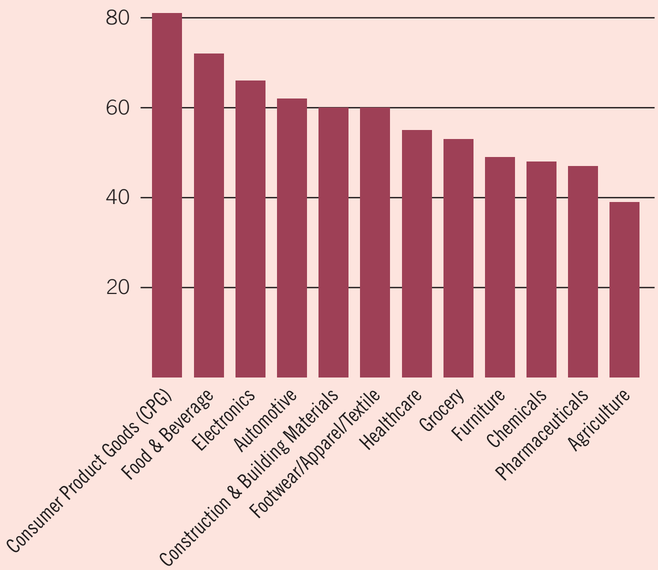


FIGURE 4 Vertical Specializations



SOURCE: Inbound Logistics 2010 3PL Perspectives

well (**SEE FIGURE 6, pg. 90**). Interestingly, shippers don't feel the same way– only 18 percent cite technology as a concern.

In a down economy, outsourcers rely on service providers to offer these types of solutions. Moreover, the technology play gives 3PLs yet another channel to grow partnerships with customers and build even greater value around existing transportation and logistics services. The lines separating 3PLs and logistics IT vendors are quickly dissipating; but intermediaries are gaining advantage by blurring these distinctions, largely because they can execute beyond the technology piece.

Many non-asset-based service providers specifically buttress their value proposition with logistics IT capabilities, either partnering with solution software vendors, or developing their own proprietary systems. That said, the evolution of Software-as-a-Service (SaaS) and on-demand solutions has lowered the barrier of investment for 3PLs across the board–asset- and non-asset-based, large and small.

Network-based access to plug-and-play logistics solutions allows 3PLs to sidestep costly implementations and continually provide updates. Alternatively, these deployments provide customers with greater flexibility to modulate between à la carte IT functionalities rather than acquiring soup-to-nuts solutions.

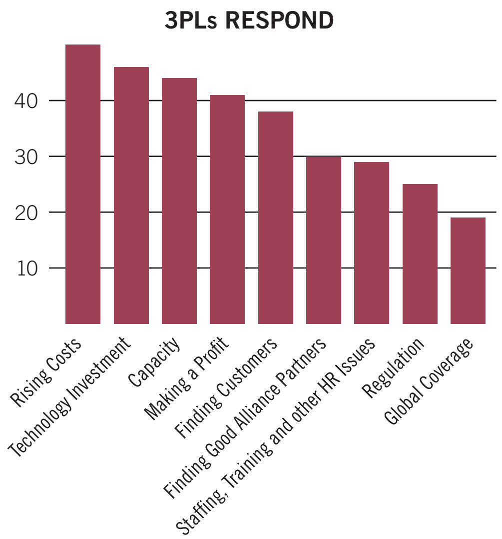
As if shippers needed any more incentive to follow 3PLs into the technology market, some logistics providers are luring prospects with "free" solutions – a managed TMS service, for example, that offers software pro bono in exchange for revenue gain share.

Broadly, electronic data interchange (EDI), visibility solutions, and Web enablement are compulsory for 3PLs today, with 97 percent, 90 percent, and 88 percent offering these respective capabilities. Customer relationship management/supplier relationship technologies (68 percent) and wireless/RFID solutions (64 percent) are gradually gaining traction.

In terms of specific logistics IT investments, 3PLs are fixed on three core areas: TMS (76 percent), optimization solutions (60 percent), and WMS (58 percent). Each represents a critical need for shippers looking to optimize essential transportation and warehousing functions, then everything in between.

Also worth noting, 40 percent of 3PL respondents indicate interest in freight payment/claims/auditing solutions, once primarily a mainstay in the logistics technology space. Beyond the technology, 54 percent of 3PLs offer payment auditing/processing services. Demand for molecular-level detail, clues to where inefficiencies are bleeding costs, gives 3PLs greater control as solution providers, addressing tactical pain points and prescribing strategic fixes.

FIGURE 5 **What are the most important challenges 3PLs face today?**



SOURCE: Inbound Logistics 2010 3PL Perspectives

TAKING STOCK OF INVENTORY

If one area required this level of functional doctoring in 2009, it was the warehouse. With transportation capacity expectedly soft, many companies were able to negotiate more competitive pricing from their carriers and reduce costs accordingly. Inside distribution facilities, however, shippers faced challenges managing less inventory as efficiently and economically as possible.

Unpredictable demand had many

in the wholesale and retail sectors holding off on replenishment, sending inventory-to-sales ratios through the warehouse roof. Some relied on carrying overstock to meet possible demand. Others, at the risk of out-of-stocks, kept inventories lean. Many concentrated their SKU profiles to better manage inventory costs and consumption shifts.

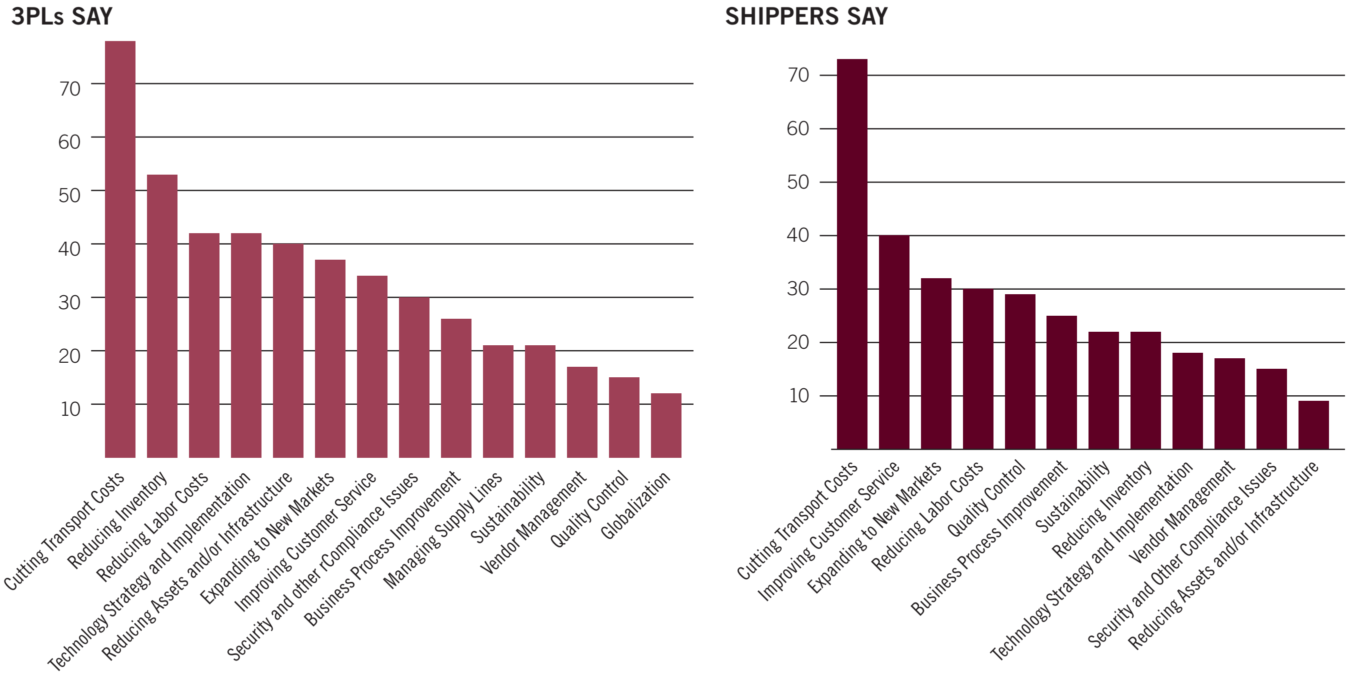
Matching lean freight volumes to an abundance of capacity became a competitive differentiator for shippers. Many looked to pool and consolidate shipments as much as possible to rationalize transportation equipment utilization and costs. The number of 3PLs providing crossdocking services jumped to 83 percent in 2010, versus 77 percent the year before (**SEE FIGURE 7**).

Moreover, 72 percent of responding 3PLs offer inventory management services, up seven percent from 2009. (**SEE FIGURE 8**).

From sophisticated crossdock set-ups to dedicated corner-to-corner warehouse space, 3PLs are increasingly creative helping shippers pull inbound product at volume, break down shipments, and build fuller loads for last-mile delivery–thereby maximizing truckload and intermodal moves and minimizing LTL shipments.

DC management is another area where 3PLs have enabled companies to divest or eliminate costly overhead. Reducing labor costs, assets and infrastructure is top of mind for shippers, with 42 percent and 40 percent of 3PLs citing theses areas as customer priorities, according to *IL's 3PL Perspectives* outreach. For smaller companies without sufficient volumes moving through

FIGURE 6 What are shippers' top challenges?



SOURCE: Inbound Logistics 2010 3PL Perspectives

the system, outsourcing facility management can plug hemorrhaging operational costs.

Couple DC management with pick/pack and subassembly services–74 percent of 3PL respondents offer these capabilities, up seven percent from 2009–and service providers become the de facto distribution cog within an enterprise. Shippers can rely on their warehouse partners to rework DC systems infrastructure, handle technology implementation, and manage seasonal labor needs, all the while uncovering inefficiencies and improving processes.

For many retail businesses, plummeting demand had a draconian impact on in-store sales – it pushed inventory back to the wholesale level. This created incentive for businesses to capitalize on e-fulfillment opportunities where they could liquidate stock farther back in the pipeline and eliminate the cost and time of delivering to retail outlets.

Not surprisingly, 3PLs offering fulfillment services spiked considerably this past year, with 74 percent providing such capabilities, compared to 60 percent in 2009. Also worth noting, direct-to-home fulfillment services among responding 3PLs saw an uptick of five percent versus last year, while intermediaries offering direct-to-store services remained static at 79 percent.

One interesting anomaly this year: the percentage of 3PLs offering vendor-managed inventory services dropped five percent from 2009. This might suggest that volume contraction and SKU shrinkage encouraged companies to bring more inventory back into their facilities to better utilize fixed assets rather than depend on 3PLs and vendors to own and replenish stock, as one 3PL posits. On the other hand, with sales down, companies didn't need stock on hand. Many didn't have cash to invest in inventory for uncertain demand.

MOVING THE NEEDLE WITH THE FREIGHT

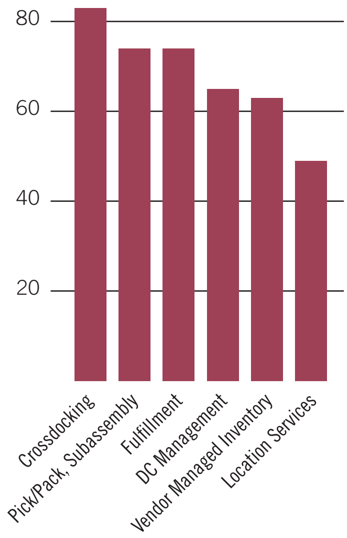
Soft capacity during the past two years afforded shippers greater pricing leverage with carriers and 3PLs. And while volumes remained low, companies found incentive to optimize transportation processes and drive greater efficiency upstream and downstream in the supply chain. Simply, as inventory levels dipped, impediments surfaced.

Seventy-three percent of shippers responding to this year's study identify "reducing transport costs" as their top challenge, mirroring last year's figures. 3PLs share that view, with nearly 80 percent citing it as their customers' greatest priority. Apart from technology, intermediaries are expanding their transportation services to help shippers streamline supply chains from source to shelf.

Pressures to improve transport efficiency materialize in any number of ways as shippers tackle fuel economy, sustainability mandates, time-to-market constraints, total landed costs, and fears of a capacity shortage.

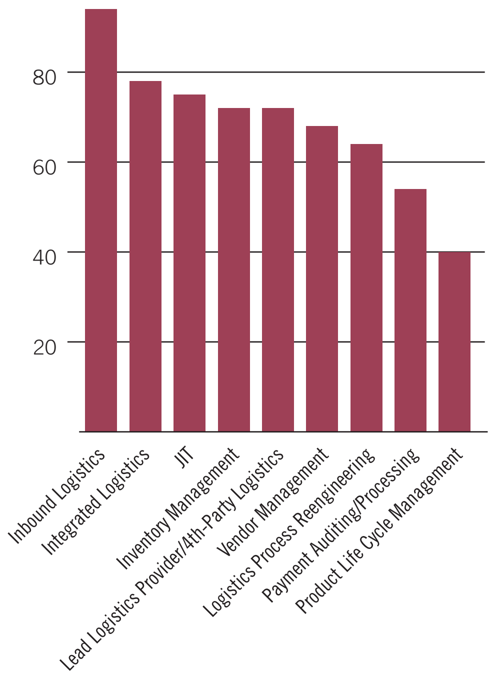
Truckload and less-than-truckload services command the greatest investment in resources from 3PLs, with 93 percent and 91 percent offering these respective capabilities (SEE FIGURE 9). With memories of soaring diesel costs still fresh from two summers ago, and shipment volumes largely desiccated by the recession, shippers found themselves diverting loads to TL as much as possible, using more costly LTL options for shorter hauls.

FIGURE 7 Warehouse Services 3PLs Offer



SOURCE: Inbound Logistics 2010 3PL Perspectives

FIGURE 8 Logistics Services 3PLs Offer



SOURCE: Inbound Logistics 2010 3PL Perspectives

3PL PERSPECTIVES 2010

Shippers are growing increasingly concerned about equipment capacity and driver availability if and when the economy strengthens. While this has yet to materialize, transportation companies have been quick to embrace the certainty of this reality as they look to raise rates. Many shippers are specifically sizing up third-party partnerships with carriers and logistics intermediaries/brokers to help access space if the market tightens. Where freight volumes warrant, some businesses are proactively committing to equipment. This year, 68 percent of 3PLs report that they offer dedicated contract carriage services, comparable to 2009. This number will likely grow into 2011.

Elsewhere, the trend toward distribution network decentralization has helped shorten last-mile transportation legs and given companies the flexibility to utilize other modes for long-distance moves where time and product sensitivity allows. The number of 3PLs offering intermodal capabilities (85 percent) and rail services (72 percent) remains high. As capacity and cost remain latent concerns, and as the railroads reach out to captive shippers and new prospects alike, service providers that can link rail, ocean, barge, and truck modes will grow in importance.

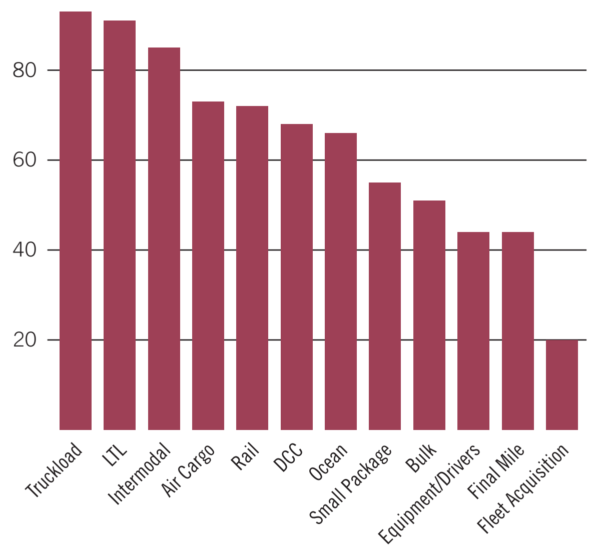
The number of 3PLs offering air cargo services saw a noticeable increase this year, jumping from 66 percent in 2009 to 73 percent, while those offering ocean capabilities remain steady at 66 percent. Freight forwarders are increasingly positioning themselves squarely in the third-party logistics space (some might argue they are non-asset-based 3PLs) to differentiate from the market and because it's a relatively easy progression from operating as a freight agent.

Regulatory pressure is also pushing shippers to outsource supply chain functions that overlap with ocean and airfreight carriage. U.S. Customs and Border Protection's Importer Security Filing went live at the beginning of 2010 after protracted discussions between the private sector and authorities as to how enforcement would unfold. While some consignees have acquired technology applications to aggregate and communicate new data inputs to Customs, others have outsourced the responsibility altogether.

There is value in using "10+2" compliance as incentive to better manage vendors, especially as offshore manufacturing and supplier networks link deeper and grow more convoluted. Apart from meeting regulatory requirements, shippers are leveraging 3PL partnerships to improve quality control and drive supply chain visibility to myriad source points.

From booking ocean and air freight to tracking shipments to aggregating data from vendors and preparing necessary paperwork for regulatory agencies, 3PLs offer shippers and consignees the bandwidth to do it all offshore. Accordingly, 72 percent of respondents offer import/export/customs capabilities, with 68 percent and 38 percent providing vendor management and global trade services, respectively.

FIGURE 9 **Transportation Services 3PLs Offer**



SOURCE: Inbound Logistics 2010 3PL Perspectives

LEADING DEMAND

These types of supply chain management progressions are typical of how 3PLs help customers embrace strategic initiatives that solve functional logistics problems rather than crafting band-aid solutions. That said, only 25 percent of surveyed outsourcers, and 3PLs, view business process improvement as a priority for the shipper community.

Last year, companies were tasked with reducing logistics costs and overhead, which, given budget constraints, naturally pointed to tactical optimization rather than sweeping supply chain change. For example, one area that has received widespread attention from shippers and service providers alike is supply chain sustainability. In 2009, nearly 40 percent of 3PLs cited this as a challenge for customers. This year, only 21 percent responded in kind–and shippers shared that opinion.

Such a precipitous dip in sustainability focus is not surprising, given all the challenges shippers encountered. In small ways, though, optimizing transportation and logistics processes manifested a measure of greenness that may not have been visibly explicit. The business case for sustainability is at the core of supply chain management. Many companies managed products more closely through their entire lifecycle–from raw material sourcing to asset recovery and aftermarket support–to reduce cost and even create new revenue streams. 3PLs remain committed to these green leanings with 81 percent offering reverse logistics solutions and 40 percent providing product lifecycle management services.

While business process improvements the likes of sustainability initiatives may be of less concern for shippers struggling to stay in the black, many 3PLs seize these types of opportunities to help drive strategic change beyond simply transportation or inventory management. Service providers may be coy tipping their hat, but business process improvement is the dangling carrot that builds long-term outsourcing partnerships. To point, 65 percent of surveyed 3PLs offer logistics process re-engineering capabilities, allowing them to assess existing systems and processes to reduce costs and improve business responsiveness and customer service.

Corresponding with last year's data, 94 percent of 3PL respondents offer inbound logistics services and 78 percent integrated logistics services. Helping shippers take control of transportation and distribution processes deeper in the supply chain triggers a cascade of efficiencies downstream. Integrating functional parts, from procurement to inbound transportation to inventory management to outbound delivery, enables companies to more efficiently and economically respond to demand.

This type of visibility to, and control over, inventory and data empowers sophisticated demand-driven logistics processes such as just-in-time fulfillment. Seventy-five percent of 3PLs offer JIT services, which will likely regain favor if consumerism picks up and businesses begin fulfilling inventory to demand in lieu of reactively holding buffer stock.

FOLLOWING DEMAND

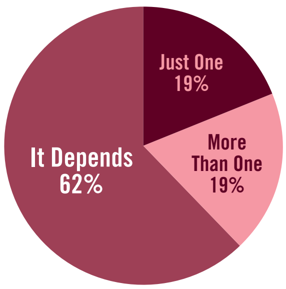
As much as 3PLs take shippers in new directions, both tactically and strategically, customers are equally complicit testing the bounds of outsourcing. For example, the role of fourth-party logistics service providers is gaining broader traction after years of tentative movement in complex sourcing industries such as

FIGURE 10 What is the number one reason 3PL partnerships fail?

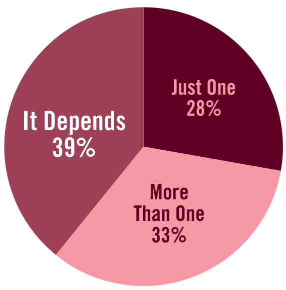
SOURCE: Inbound Logistics 2010 3PL Perspectives

FIGURE 11 Should Customers Generally Partner With One 3PL or More Than One?

3PLs SAY:



SHIPPERS SAY



SOURCE: Inbound Logistics 2010 3PL Perspectives

automotive–72 percent of reporting 3PLs offer this service.

More importantly, when asked what is the one hot button outsourcing trend moving forward, 3PLs overwhelming cite 4PL partnerships and supply chain decentralization.

The challenge of centrally managing global supply chains, shortening supply lines, and reducing total logistics costs has pressed some industries to regionalize production and distribution. Best-of-breed intermediaries with specific geographic, functional, and vertical expertise offer manufacturers and retailers incentive to work with multiple supply chain partners. In turn, this diversification has created a niche for 3PL providers that can manage multi-tiered networks as lead logistics providers.

Another way 3PLs are carving a path for 4PL partnerships is through technology development. Smaller 3PLs are partnering with tech-savvy counterparts to make their solutions available to customers. So a logistics service provider with a homegrown TMS can provide functionality to other 3PLs as well as to their end users – often at a fraction of the spot market cost.

While competitive hubris has always been an obstacle to such arrangements–especially with the threat of 4PLs bypassing 3PLs and working directly with end users–collaboration among service providers, on behest of customers, is becoming much more prevalent. This year, 81 percent of 3PLs think customers should consider more than one service provider, while only 19 percent feel customers should work with one partner (SEE FIGURE 11).

By contrast, in 2009, 63 percent leaned toward multiple partners, suggesting self-interest among 3PLs in a rebounding economy continues to soften. Shippers responding to the same question reveal more conflicted opinions, with 28 percent favoring only one 3PL partner and 72 percent willing to consider multiple 3PLs.

The concern for shippers is having one point of control over outsourcing arrangements rather than a fragmented network of disparate transportation and logistics partners. That said, the business case for working with multiple best-of-breed service providers suggests even further potential growth in the 4PL space.

Introducing the 2010 Top 100 3PL Providers

Inbound Logistics' Top 100 3PL Providers list anchors this otherwise fleeting assessment of the outsourced logistics industry. Our directory of leading logistics service providers offers a detailed snapshot of companies *IL* editors deem best suited to meet your transportation and logistics needs.

Culling this roster of Top 100 3PLs from nearly 300 candidates requires a great deal of due diligence and attention to detail. *IL* editors carefully evaluated questionnaires from third-party logistics providers, in addition to communicating with their customers. The 3PLs we selected are capable of meeting the diverse outsourcing demands of the shipper community.

After you process *3PL Perspectives* and pick apart the Top 100 list, we would like to know what you think. Email us: editor@inboundlogistics.com