

As businesses grow, it can be difficult to continue to meet the demands of warehousing and distribution, without making significant investments in systems and facilities. Being closer to the customer to reduce time and transit and freight costs are aspects that increase the complexity needed from a fulfillment perspective. This is where third-party logistics (3PL) can help augment your distribution network.

In the fulfillment industry, using 3PLs is the outsourcing of a company's warehousing, value add services, fulfillment, and distribution to a third-party company. These services vary depending on a company's objectives and requirements. Services may include:

- Receiving and processing of domestic and imported goods
- Inbound inspection and quality assurance for goods
- Bulk warehousing and storage of goods
- Distributed order management and fulfillment of customer orders
- Managing shipments to distributors and big-box retailers including compliance, labeling, and ASN or EDI requirements
- Support of Amazon 1P, FBA, FBM orders, and other marketplace transactions
- Dropship management and fulfillment from retailers or manufacturers
- Inventory management for all goods including cycle counting, serialization, lot tracking, and expiration date management
- Value-added services including kitting and light assembly
- Freight and transportation management including small parcel, less than truckload, and full truckload services
- Returns processing for customer orders (also called reverse logistics)
- Refurbishment of returned goods

The strength of 3PL capabilities is in their network of fulfillment centers, transportation, and carrier capabilities and the technology and automation implemented within the facilities to support client needs.

This page explains many details important to understanding 3PL benefits, selecting, contracting, and implementing a 3PL company:

- How multi channel businesses profitably use 3PL services
- Selecting the right 3PL service for your business
- How to compare internal fulfillment costs to 3PL proposed costs
- How to build and maintain a strong 3PL relationship
- How to transition to a 3PL service
- Contracting with 3PL companies
- Additional 3PL resources

In working with companies to evaluate and select the right 3PL company, we are often helping management to understand the benefits and advantages of using the right 3PL to continue to grow their business and meet the customers' expectations. To continue to support internal fulfillment, a company must continually invest in:

- Distribution centers, whether upgrades, expansions or additional facilities.
- Warehouse Management Systems (WMS).
- Automation and technology such as conveyance, sortation, or robotics for instance.
- These investments can come at a high cost and divert resources and capital away from potentially other critical investments to grow top-line sales or in merchandise development.

In addition, with increased customer demand and order volumes, the challenge of recruiting, training, and employee retention becomes harder for companies to manage in addition to the increased employee HR costs.

The benefits of utilizing a 3PL include:

## **Reduce capital required.**

Using a 3PL can greatly reduce the capital required to continually meet your customer's demand. Third-Party Logistics gives you the infrastructure, management, and workforce to grow sales without adding employees, facilities, and systems.

## **Reduce fulfillment costs and stabilize expenses.**

3PLs can reduce fulfillment costs and stabilize expenses as a business grows. Since 3PLs charge for their services on the basis of usage, you should expect your invoiced costs to rise and fall based on use and transaction volume, the space required, and services used. Another way to think about this is, by using 3PL, you turn the fixed costs of facilities, systems, and automation assets into a variable cost.

## **Reduce fulfillment time.**

Strategically located fulfillment facilities, you can reduce order fulfillment time to customers and shipping expenses.

## **Reduce transit time and shipping costs.**

3PLs often have multiple facilities strategically located throughout the US. This allows companies to fulfill orders from multiple DCs which reduces the time in transit and shipping cost.

## **Optimizes time to focus on priorities.**

Outsourcing Supply Chain Management to Third-Party Logistics companies gives management the time to focus on core competencies, such as:

- Brand and Internet marketing.
- Developing other sales channels.
- Expansion of merchandise assortment In working with companies to evaluate and select the right

With so many 3PLs in the marketplace, it can be difficult to determine which 3PL is the right partner for you. One way to compare the capabilities is to develop a comprehensive list of business requirements in a formal RFP that all vendors can evaluate. By documenting your business requirements, all vendors are seeing the same data and information which creates a consistent set of discussions with vendors.

Your 3PL requirements should incorporate the following:

- An order file which simply shows the:
  - The date the order was placed.
  - The order number.
  - The SKUs ordered, as well as the quantity.
  - The method of shipping.
- An understanding of inbound shipments should portray, as accurately as possible, what SKUs and quantities are received throughout the year. This helps 3PL vendors to understand the frequency and volume of their inbound inventory.
- Your anticipated growth rates for at least the next 2 to 3 years, should include orders, inventory, and SKU growth rates.
- Your individual business requirements that are unique to your business, products, and customers, include:

- Kitting or light assembly needs.
  - Inbound inspection/QA needs.
  - Storage requirements for inventory, such as temperature control or high-security areas.
  - Inventory management needs include cycle counting and whether you have inventory that requires serialization, expiration date, or lot tracking.
  - Packaging and shipping requirements, including packaging materials and whether anything is to be branded supplies.
- An overview of the systems that you utilize today so the vendor can provide an overview and price for integrating data.
- Your overall timeline for evaluating and selecting a 3PL partner, as well as your anticipated shipment date with the 3PL.
- What do you expect back from vendors including their detailed pricing?

There are hundreds of Third-Party Logistics providers. How do you [select the provider](#) that's right for your business? At a high level, here are the steps we recommend following to select and contract with a 3PL:

- Determine management's multi-year fulfillment objectives.
- Document the transactional volumes such as orders, lines and units by sales channel and develop a detailed RFP as discussed above, to ensure that each vendor understands your company, and your expectations for receiving a bid.
- Identify a qualified shortlist of 3PL vendors.
- Receive and analyze bids, narrowing them down to two finalists.
- Complete due diligence through reference checks and site visits.
- Negotiate the pricing, SLAs, and contracts with the 3PL finalist.

As you think about management's objectives, turn those into the business statistics, process, and [systems requirements](#) for the prospective 3PL.

One of the major factors in 3PL selection is the proposed fulfillment costs for the current year's business and projecting the fulfillment details forward three years. These costs and details are used by the 3PL to estimate the cost of services.

Total fulfillment costs are based on four major categories of costs:

- Product storage includes the space required for all bulk stock and forward pick locations within the 3PLs facility.
- Fulfillment fees cover the 3PLs services from the time inventory is received through picking, packing, and shipping of customer orders.
- Value-Added Services (VAS), these services cover various special projects such as relabeling or bagging of inventory, kitting, and light assembly for instance.
- Packing and shipping supplies which include boxes, void fill, and pallets if necessary.
- Account management and IT services include the monthly service fees associated with the 3PL managing your account. For some vendors, this includes any IT or software fees associated with their WMS or even EDI requirements for your company. This may also include your cycle counting needs depending on your requirements.

Typically, outbound shipping costs are quoted separately and should be analyzed separately to determine if you should remain on your own contracts, or take advantage of the 3PLs carrier rates.

At the heart of accurate pricing is collecting, analyzing, and projecting the details of your fulfillment operation for the expected contract duration to get accurate costs by year. **Read: How to Improve Your New Systems Selection and Implementation Process**

During the selection process, it is important to [compare 3PL costs to your internal expenses](#). These costs are typically calculated using a few metrics such as:

- Cost per transaction – Depending on your business, this could be on a cost per order fulfilled basis, cost per outbound shipment, or even cost per unit fulfilled.
- Fulfillment costs are a percent of net sales.

Use the RFP process discussed above to receive the detailed bids from 3PL vendors. Be sure to take your assumptions regarding orders, lines, units, receipts, etc., and extend them to build out the annual costs for the initial year as well as subsequent years.

You will find that not all 3PLs invoice for the same line items, which makes the comparison challenge. This is why you will want to distill the bids to a cost per order, shipment, or unit fulfilled based on your business characteristics.

Your internal costs will also be in a different format than the 3PL vendors. Most likely your internal costs will be in more of a P&L view which means you will need to distill the data to the same level as the 3PL vendors – i.e., cost per order, shipment, unit fulfilled, etc.

For example, fulfillment managers using internal fulfillment approve expenses for leases monthly, but generally don't incorporate them into their cost per order thinking. This may represent 15% to 20% of the fully-loaded costs. They rightfully focus on costs they can control that impact order processing, such as direct labor and packing supplies.

To be comparable, over and above direct and indirect labor costs, a fully loaded cost must include the following:

- Lease costs, taxes, common area maintenance, and utilities.
- Depreciation or amortization of facilities, systems, and assets.
- IT costs or allocation of management expenses.

Will a 3PL partnership allow you to avoid facility expansion or a move to a new facility, or eliminate projects requiring capital expenditures for technology and automation? If so, a 3PL strategy may positively affect your company's future growth, the capital needed, and business requirements. Include this in your analysis and comparison between internal and 3PL costs.

Some businesses may be apprehensive about turning overall, or part of the fulfillment functions to a 3PL. However, with the right due diligence, companies can build the confidence needed when making the decision.

Once you have narrowed down your preferred 3PL vendors to one or maybe two vendors, your due diligence should include understanding the following components:

➤ Does your preferred vendor have a culture that fits well with your business?

- Do you get the sense that you are not too small of a client for the 3PL vendor, or perhaps too large?
- Do you get the sense that they see you as just an additional revenue stream?
- Do you believe that they will be a partner which will help bring ideas to your company to help scale and streamline costs?

➤ When you visit the vendor's facility, does it appear well organized and maintained?

- Is there care taken to keep the facility clean and free of excess trash and empty cartons?
- Do the workers take care of the facility they work in?
- Does the 3PL take care of its employees? Simply seeing some areas like break rooms will give you a sense of how well the employees are looked after.

- Is there room for growth within the facility, or is it overly full?
- Speak with clients of similar size currently being fulfilled by the 3PL, ask how well they support their business.
- How quick are they to respond to different challenges?
  - How well have they kept to pricing?
  - Were there unexpected prices or challenges that weren't known ahead of time?
  - Ask them, if they had to do it all over again, would they select the same vendor?

Pricing is an important component to selecting the right 3PL vendor, but it isn't the only aspect that should factor into the decision. Make sure that you understand the other facets that could impact your growth.

Many new users are concerned about turning over a critical part of their customer service (order fulfillment and distribution) to an outside third party. They're afraid that a 3PL won't provide the same level of care or attention to detail.

Building a strong relationship with the right 3PL begins with the proper level of due diligence, an often-overlooked aspect. This due diligence should include:

- Reference checks to ensure that the level of care and attention to detail is being met with other clients.
- Site visits to the 3PLs facility – is the facility well organized and clean, are other customers' inventory well maintained, etc.
- Discussions with the vendor will tell you whether there is a cultural fit, or whether you are just another client.
- Before contracting with the vendor, set your expectations for quality and services – these should then make their way into the contract.

Assuming you have selected the right vendor for your business, it is critical to dedicate the right level of resources to keep things running smoothly. This first starts with having a dedicated resource within your company that is the liaison between your company and the 3PL vendor. This resource is responsible for:

- Notifying the 3PL of any product, packaging, or shipping changes.
- Training the 3PL on your products, receiving through packing processes, and dealing with returns.
- Reviewing the 3PL invoices and reconciling any problems.
- Providing regular updates to your internal management team.
- Performance monitoring of the 3PL. Many of our clients outsource fulfillment cost-effectively by managing **11 key indicators** important to keeping 3PL service at high levels.
- Working with the 3PL on any problems that arise in the operations.

A second important aspect to making this work effectively is developing a strong partnership with the 3PL's management and ownership. Give them every opportunity to help you understand and help grow your business. Be open with your strategic objectives, what the merchandise direction will be in the future, and the sales plans you wish to achieve.

One recommendation for keeping service high and costs in line is to write measurable standards into the contract. Every month have a brief standing call where your senior management and the 3PL review the successes and areas of needed improvement. While liaisons between companies will be meeting via phone and email daily, it's crucial for the management of your company and the 3PL to step back and briefly take the checkpoint monthly.

nce you select a 3PL vendor, you will want to negotiate certain aspects of the pricing to be in line with the Service Level Agreements (SLAs) and review the vendor's contract, working towards executing a **mutually beneficial contract** that encapsulates all the promises and expectations discussed throughout the sales process.

For standard legal language, the 3PL will likely use a contract that is standard among its clients (known as a "master agreement") which vendors will be open to some changes but will resist language that is only one-sided towards the client or overreaches.

Addendums to the master agreement are typically your opportunity to customize the contract to your business. Typical addendums include the statement of work, pricing, standards for performance, processing procedures, and schedules. Spend the time analyzing and planning the three years' business proforma so that you don't incur higher-than-expected costs.

One of the most critical aspects of any 3PL contract is the language **surrounding pricing and rate increases**. It is vital to ensure that the language is fair for both the customer, as well as the 3PL. Negotiating the agreement takes time and a combination of business sense and legal guidance.

You'll want to discuss the contract with all stakeholders, upper management, and your attorney. Speaking with an experienced 3PL consultant can help you think through the consequences of various actions and potential problems.

Project management and planning are critical to [implementing the 3PL](#) transition. Some 3PL implementations could be done in as little as 60 to 90 days, while others take four or six months depending on the complexity. During that time, you'll need a full-time project manager to plan out and track the status of the tasks daily and report to all stakeholders weekly. This is not the responsibility of the vendor, although they will keep you updated on the status of their tasks.

Another major task in making this transition is planning and executing the move of inventory to the 3PL. This involves counting, preparing, palletizing, transporting, and efficiently putting the inventory away in the new facility with high accuracy. It also includes minimizing shipping downtime.

One of the most important aspects of transitioning to a 3PL is the data integrations, these will include:

- Inbound purchase orders and ASNs from your system
- Item and vendor updates from your system
- Inventory movements from the 3PL
- Shipping notifications and details back from the 3PL
- Integrations to various marketplaces
- EDI transactions

It is important to have resources available to assist with the integration specifications and testing process. These could be your own resources that understand your ERP system, or resources from the ERP vendor that can assist with preparing the files, etc.

The 3PL vendor will also need to understand various aspects of your business so that the facility can be set up, and their people can be trained. You will need to educate and train the vendor on the following:

- Inbound inspection of the product during the receiving process. How products are to be picked –are there kits on the fly, or VAS that are required.
- Your packing standards and processes for customer orders.
- Returns processing and inventory disposition processes.
- Refurbishing of the returned product if necessary.

In order to get the processes you want, you need to work closely with the 3PL, sharing your documentation and standards.

Many multichannel and e-commerce businesses use profitably 3PL for fulfillment and distribution. Third-Party Fulfillment can reduce the capital required to grow your business and reduce/stabilize costs. To do so, you must clearly identify your business requirements and key data about your business and project these forward three years.

Establishing a positive relationship with a 3PL requires good planning and control. Service levels and management processes should become part of contractual agreements to keep customer service high and at the budget you expected. Using an experienced 3PL fulfillment consultant can help you select and implement the right service provider to gain the benefits discussed.

## **ADDITIONAL 3PL RESOURCES FROM F. CURTIS BARRY & COMPANY**

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As part of 3PL Selection Projects, F. Curtis Barry & Company helps businesses identify their requirements and a short list of qualified vendors for your business. [\*\*Click here for some 3PL providers you should consider researching their capabilities.\*\*](#)

Of course, if your business is considering the transition to a 3PL and you'd like expert assistance considering, planning and navigating that transition, we're available to help. You can [\*\*request information here\*\*](#) or contact one of our experts today to explore 3PL opportunities for your company at 804-740-8743.