<u>The Start-Up Quandary….To 3PL or Not to 3PL, That is the Question</u>

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Intro & Definitions

We have all worked for, or worked with, companies that are infatuated with their acronyms. Whether you are looking for the cover-sheet on your *TPS Report* or simply sending a *CYA* email, we quickly assimilate acronyms and abbreviations into our daily-use vocabulary. In this opinion-piece, I am primarily focused on two closely related acronyms: 3PL and ROI.

> **3PL (Third Party Logistics):** A company that manages part or all of another company's product supply chain operations. These services can include warehousing, transportation and various other value-added processes related to the outsourced movement of goods.
> **ROI:** Return on Investment

I would like to explore a question that most start-ups encounter at least a few times during the course of their evolution: *Should I outsource my supply chain operation to a 3PL provider or should I make the investment to own my operation?*

Like fingerprints, there are no two companies that are exactly alike, which makes it difficult to issue a singular assessment tool that will concisely answer this outsourcing question for every possible corporate variation. What I propose here is a series of qualifying assessment points that will help shed some light on your available alternatives.

Scenario

Let's say that you are the owner of, or you are responsible for, a company that sells or distributes physical products to some segment of the population. Your company could be a well-established brand or you could be the newest trend, either way your company makes-buys-or-builds something that needs to get from where it is into the hands of someone who will pay you for it. In strategically managing the challenge of getting your organization to the next-level, you arrive at a decision-point question: *Is my operation, whether in-house OR out-sourced, prepared to scale with my business demands?*

Some of the most recognizable businesses in existence started in a garage. Whether you are Hewlett-Packard, Amazon, Clif Bar or you are running a successful eBay Store, the garage floor was likely your launching pad. Let's use this garage-industry point in your company's evolution as the basis for our decision-tree:

What You Have:

- A storefront: a catalog, an on-line shop, a flea-market stand, a YouTube Channel, an 800#, QVC air time....
- Customers who are already buying your products
- Vendors that supply you with raw materials, components or finished-goods inventory (FGI)
- Strong prospects for future growth
- A strong desire to do more, be more and grow your business

What You Need:

- More of *everything* listed above because your garage is fully maxed out with shelving, inventory, packaging, etc.

What Your Options Are:

- Do Nothing
- Build or Buy Your Own Warehouse
- Co-locate Your Business with Another Similar Business
- Rent a Warehouse and Hire Your Own Staff
- Hire a 3rd Party Logistics Provider

Do Nothing: As stated earlier, you have strong prospects for immediate and future success and an equally strong desire to grow your nascent business into the next HP or Clif Bar. Doing nothing is not really an option for you, now is it?

Upside: Zero cost
Downside: Zero growth

Build or Buy Your Own Warehouse: If the world's two most limited resources (time and money) are somehow in abundant supply for you, then this option may be feasible for your business. Also, depending on how you apply the ROI equation to your P&L, this approach can chart a path to long-term profitability that you might not otherwise encounter.

Upside: Complete control and ownership
Downside: Upfront capital required and excessive patience are necessary

Co-locate with Another Business: Many of the most successful companies have deep "integration" with their vendors and suppliers. In this stage of your growth, it might make sense for you to co-locate with one of your vendors or suppliers to be actually, physically integrated. Think of the speed and savings that comes from being on-site with one of your primary business partners. In this scenario, you would have to negotiate a shared-expenses equation for the various cost aspects involved in funding this shared business services arrangement.

Upside: Supplier/vendor synergy and speed to replenish materials
Downside: Lack of control and clarity in resource allocation

Rent a Warehouse and Hire Staff: Maybe you have plenty of time, but less capital than described in the previous example. At any moment in time, there are millions of square feet of warehouse space available to lease. No matter how specific and exacting your businesses warehousing requirements are (climate controlled, geographic location, air-quality/cleanliness, security, proximity to an air/port, etc.), there is bound to be available square footage already built and waiting for you to take occupancy. Once you have found your spot on the map and negotiated a favorable lease, you simply need to recruit-hire-&-train your staff.

Upside: Your name on the lease equates to total facility control
Downside: Uncertainty that your new lease will parallel your business' growth appetite

Hire a 3PL Provider: In consideration of where you are in your business growth curve, this may be the best approach to sampling all of the options available to you, as listed above. If time and money are not infinitely available, then the outsourced approach to building your operation might be the most logical path. In working with a 3PL partner, you will not need to build or rent your own facility. They will provide the building, staffing, and maintenance for your needs and they also provide the upside that helps you offset risk in the event of dramatic swings in your businesses growth. In the same way that renting a home can insulate you from the risks and costs associated with being a title-holder, "renting" your warehouse and staff can provide similar benefits. The downside here is that you will end up paying more per unit consumed (labor hour, square foot occupied, cardboard box shipped) than if you owned the facility, operation and staffing.

We are defining this growth point as a period where demand and upside potential are definitely in your favor. You do not have the year-over-year history yet to predict what the next several years will look like, much less what your supply chain needs will be in that same timeframe.

Upside:	Partnering with a professional organization means that you don't need to prepare for every eventuality. You define your strategic direction and they execute it.
Downside:	Increased cost per unit consumed and a limited ability to drive out the cost of your professional partner's profit margin.

In a future posting, I will explore the same decision making process in reverse: When is it time to bring your out-sourced operation back under your control and what are the issues and concerns relative to taking on a project like that.

We could easily commit significantly more time and attention to any single aspect of the opinions listed above. Not all of the scenarios I have presented will apply to your situation, nor is this an exhaustive listing of every possible permutation, but based on my experience in working with many different 3PL partners, there are certainly themes that emerge and consistencies that can be drawn.

Reference Questions to Consider in the 3PL Selection Process:

- Is my 3PL partner close to me, my suppliers and my customers?
    - Cost and transit-time considerations need to be determined before selecting a new home for your warehouse and fulfillment operation.
- Does my 3PL partner have enough space and staffing to handle my business in addition to all of their other clients?
    - If my business is exactly like every other client they have, will there be enough space and labor to address an industry wide spike in product popularity. Is the local labor market tapped out or will they be able to replenish their staffing. Are they bursting at their proverbial seams in their current facility with no prospects to expand or are they part of a campus-environment where existing vacant space can be procured on a moments notice.
- Where will my business fall in the rank-order of this 3PL's customer base?
    - How many other clients (read: divergent interests from my own) is my 3PL serving and will I be able to get attention to my businesses unique growth needs. You don't want to be on the bottom of their list of customers because despite what you are told, this is where you reside in the virtual pecking order.
- What is the average tenure of their clients?
    - If your 3PL experiences frequent customer-churn, this should serve as a warning sign. References need to be checked very carefully. A valuable service partner will work to grow with your business, it is in their best interests to do so. If a 3PL has several long-term clients who have exhibited significant YoY growth, this is a very good sign that they value their partners.
- What exactly am I paying for and how will that be presented to me?
    - In a shared space and shared labor arrangement, there needs to be a clear documentation of what are considered chargeable actions. It is vitally important that you are able to cost-model your first year based on the 3PL's invoicing model. Spend a significant amount of time working with their Finance/Accounting function to be certain that you are considering everything before signing a service agreement.
- Will I have access to the Leadership and Executive teams?
    - The flatter and leaner the 3PL organization, the more likely you are to have a voice in influencing their ability to meet your needs. You should know their CEO and be organizationally welcomed to contact him/her directly. If you sense that there is an ivory-tower complex in existence, you should be very concerned.
- What are their disaster recovery plans and how will they ensure that your business is always open?
    - Weather may be considered out of their control, but their ability to react and respond to events of this nature will define the extent to which they value your business. The reason you are ostensibly paying more to be in a 3PL relationship is to ensure that your provider can navigate these challenges on your behalf. This is what they do for a living.
- How do I drive costs out of my 3PL relationship?
    - Knowing that you and your 3PL have similar goals and interests (i.e. similar ways to reduce costs) means that you will have fewer inherent conflicts as your businesses grow. If your 3PL's best-interests do not mirror your best-interests, be forewarned that your will encounter strategic turbulence.

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The Optimum Team

Kelan Raph – Chief Consultant
Kelan has provided global logistics & transportation solutions to the world's leading manufacturers, distributors, and retailers. With over two decades of hands-on international logistics & transportation experience, he is able to create and implement supply chain efficiencies that get bottom line results. He loves the problem solving that goes into his practice and truly enjoys building solutions customized to his client's business strategy.

John Mandel – Senior Consultant
John has nearly 20 years of experience in directing and sustaining organizational performance that drives productivity & bottom-line profit improvement in logistics, transportation, & warehouse operations. He has managed all aspects of an organization's financial and operational processes to drive best-in-class supply chain practices vital to optimizing performance, productivity, and cost containment.

Arun Rao – Technology Consultant
Arun is an entrepreneur with over 20 years of experience in supply chain & enterprise software. He has worked for several successful venture-backed startups as well as large multinational companies where he managed multi-million dollar projects, implemented complex & innovative solutions, & built cross-functional, geographically diverse teams. Arun is an avid hiker, likes reading fiction, the occasional game of chess and traveling.

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Wenting Pan – Senior Supply Chain Analyst
Wenting received her Ph.D in Operations and Decision Technologies from the University of California, Irvine. She is currently an Assistant Professor in Operations and Quantitative Methods at Saint Mary's College and her research interests includes managing supply chain uncertainty, sourcing strategies, game theory, supply chain management, operations research, and decision analysis.

Janel Alimboyoguen – Project Manager
Janel is a graduate of Santa Clara University with an Accounting & Information Systems degree. She is versed in marketing, accounting, and business administration. She has had previous experience with C-level support and financial project management. She is passionate about bringing Lean concepts to all aspects of business operations. She is deeply involved with the community through the Rotaract Club of Silicon Valley, a group of young professionals dedicated to community service.

Kevin Smith – Supply Chain Analyst
Kevin is an Economics graduate from UC Berkeley. He is currently working towards his Masters in Global Supply Chain Management with USC. Between undergraduate & graduate school, he worked with Apple as an Operations Manager. His constant desire to improve the status quo and ask questions works in his favor as Optimum's resident data analyst. Kevin is passionate about educating people about the importance of operations & optimization.

Peter Bui – Operations Analyst

With his excellent interpersonal skills, Peter is Optimum's first point of contact with new & potential clients. He has had previous operations experience with a major retailer and distribution centers. He has also assisted in change management efforts for various companies. He is passionate about creating operations that run smoothly and is deeply involved in optimizing supply chains with Optimum.

Pedro Nguyen – Operations Analyst

Based upon a background in business management, Pedro provides Optimum and its clients with keen insight and skills in operational management. His skills are valuably applicable to the processes of the supply chain industry - purchasing, inventory management, logistics, and integrated business process management. His experience in creating SOPs helps set businesses up for success.