As 3PL Demand Grows, Partner Selection is Critical

by Douglas P. Clement, Multichannel Merchant

Consumers may focus on curbside pickup, speed of delivery, trouble-free returns and seamless experiences, but retailers and brands face heightened fulfillment challenges, leading many to embrace outsourcing to third-party logistics (3PLs).

This outsourcing trend lights up a constellation of questions, challenges, advantages and solutions — from the struggle to find warehouse space, labor costs and the pricing implications, to the “honey trap” of VC-fueled 3PL startups that look slick online but don’t have the proficiency to deliver.

Getting it right is essential. For merchants, selecting the right 3PL “can lead to lower cost per order, better focus of management time, smoother scaling during peak holiday season, lowered capital investment in facilities and systems, reduction of time-to-customer, reduced shipping costs and easier distribution of international orders,” Multichannel Merchant said in announcing its 2021 Top 3PLs listing.

Trends in Outsourced Ecommerce Fulfillment

Shipping and supply chain management giant UPS, which offers a range of fulfillment solutions, said the massive spike in ecommerce since the 2020 lockdowns has accelerated its outsourcing growth.

Changing consumer preferences led to smaller order profiles, for example, intensifying delivery requirements.

“This impacted their procurement strategy, inventory levels and space required to serve B2C demand and their ability to serve the multichannel customer,” said Jason Vaughn, UPS Vice President of Distribution and Logistics Operations.

Quantifying the issue, a recent survey of mostly SMBs commissioned by UPS Global Logistics identified the top 5 challenges prompting the desire to outsource:

- Limited space and capacity to fulfill orders
- Increased customer expectations
- Fulfilling orders faster and at lower cost
- Reducing labor costs
- Multiple fulfillment channels

The survey also found 29% of respondents have decided to outsource or are considering it as a result of the pandemic.

John Morris, Executive Managing Director, Americas Industrial and Logistics and Retail Leader for CBRE, contiued on page 2
said the U.S. is “still in the early innings” of what brands and retailers need and want when it comes to outsourced logistics.

Big boxes growing faster than the largest ecommerce retailers is a key driver, Morris said. Major categories in home improvement and discount retail will provide the second wave of demand, followed by a third wave of smaller retailers in multiple markets needing to aggregate freight into centralized hubs for distribution and delivery.

“The fourth wave is single-market retailers who don’t have scale but will offer ship from store, BOPIS and DTC,” Morris said. “How will they do that when they’re smaller in volume? Will malls contract with a 3PL for everyone and put them all in one staging area? The further you move down the four tiers, the more the retailers need outsourcing help.”

Morris said UPS has already seen the first wave: Large retailers and brands needing help executing an omnichannel strategy and an evolving channel mix. “They didn’t have the expertise, efficiency, labor pool and cost structure to scale rapidly and take advantage of what they thought was a temporary shift in channel mix,” Vaughn said.

3PL providers have also heard from smaller but fast-growing sellers who want to expand their reach. “They needed a solution allowing them to easily manage multiple marketplaces, or a fulfillment center closer to customers to reach more of them in 1-3 days,” Vaughn said. “They didn’t have the resources and capital to grow, nor could they cost effectively reach consumers without relying heavily on premium transportation.”

**Fulfillment Land Grab: Space at a Premium, Lots of New Players**

Not only is commercial space scarce and pricey, pushing costs higher for retailers, but many newly-minted 3PLs are rushing into an already crowded space.

“Demand for outsourced fulfillment has been growing double-digits for 10 years,” Morris said. “The names we know are busier than ever and taking down more space than we’ve ever known.” He added 3PLs now effectively control one-third of industrial big-box real estate, eclipsing the major ecommerce providers.

3PLs need to be where the client is, or near a population center, or both. Thus, the market is growing more quickly in gateway markets like Chicago, New York, Los Angeles, Dallas and Atlanta as outsourced ecommerce rises. Vacancy rates are in the low single digits, and the construction pipeline is 50% pre-leased, Morris said.

That pushes business to hot secondary markets like Columbus and Louisville. Nashville, another hot market, is home to curated gift boxes and corporate gifting venture Batch, which essentially serves as a 3PL for its brands. “If you’re looking for warehouse space, you’re competing against the 3PL big boys and even Amazon,” said Batch co-founder Sam Davidson. “It’s just driving up the cost for everybody, and 3PLs have to factor that in.”

The other space crunch involves the sheer volume of 3PL players, said Matthew Hertz, a veteran of Rent the Runway and Birchbox who co-founded Second Marathon to help brands smaller brands source a 3PL. “Every Tom, Dick, and Harry is starting a 3PL,” he said. “It’s like starting a dotcom business in ‘98 or ‘99.”

These subpar 3PLs gain traction, Hertz explained, because retailers Google terms like “how to fulfill my ecommerce orders” or “how to fulfill my Shopify orders” and see results dominated by VC-fueled entities with cash to spend heavily on Google AdWords but not a lot of experience with logistics. “There are 8,000 to 10,000 3PLs out there, but they can’t compete because they don’t have the money for fancy Google AdWords,” Hertz said.

Matt Troy of personal and beauty care seller House of Cheatham recently experienced this phenomenon firsthand. Seeking a new provider, he had to push past 3PLs “with lots of money, lots of tech, lots of volume, lots of capacity,” looking for scale and volume and offering take-it-or-leave-it terms.

“Because ecommerce continues to explode, there’s a body of service providers that are sort of small, maybe regional, that don’t have the scale, the economies or national reach, but they can handle smaller businesses, startups and regional businesses,” Troy said. “Think of it as boutique 3PL.”
What’s the Difference Between a 3PL and a 4PL Provider?

According to Vaughn of UPS, a 3PL owns the warehouses, technology, labor and transportation. A 4PL, by contrast, doesn’t actually provide the services but orchestrates multiple providers, acting like a general contractor.

“The reality today is that most 3PLs serve both roles, providing services like fulfillment and then outsourcing transportation,” he said. “There are potential pros and cons for 3PLs vs. 4PLs.”

Michael Shaughnessy, SVP of Operations, Supply Chain and Emerging Markets at DTC home décor seller Balsam Brands, said the 3PL vs. 4PL decision depends on staffing levels. “If you have a team that can manage 3PLs for you, which is what we do, then you don’t necessarily need a 4PL,” he said. “If you go 4PL and don’t have great performance, what do you do? You don’t have the ability to ensure control. It takes away flexibility as well.”

“My view is a smaller company, especially if it’s got some complexity in the logistical network, like import or export, that’s a good candidate for finding a provider that can act like a prime contractor that can bundle all those services together,” said Paul Huppertz, a partner with global management consultancy Argon & Co.

What Makes a Great Fulfilment Partner?

It all starts with communication, Troy said. “You’ve got to be clear on what you want and need, and stay on it until you get to that point,” he said. “I can’t demand high touch from an organization that does high commodity. It has to be an alignment of destination and strategy. So, the price that falls out of that is the cost.”

Hertz agreed, saying he is seeing brands select a partner that’s not the low-cost leader, in some cases by an order of magnitude.

“Several years ago, it was all about limiting cost, but especially now, with COVID, brands are starting to index to brand management,” he said. “Fulfillment is the business of exception management. When something goes awry, what is the fix? That’s more important than saving a penny or a nickel. You get what you pay for.”

In terms of how much brands will be paying, Davidson has a warning that begins with the cost of labor: Warehouse jobs that had been $12 an hour not too long ago in Nashville are now paying $18, plus a signing bonus.

“If I’m using a 3PL, my pick-and-pack fees are only going to go up because they have to pay more for labor, the cost of corrugated is going up and shipping companies are charging more,” he said. “So, if you lock in a deal today with a 3PL, read it carefully because they’re going to have to charge more.”

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<tr>
<th>Considerations</th>
<th>3PL</th>
<th>4PL</th>
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<tr>
<td>Control and accountability of service</td>
<td>Pro: 3PLs own the asset and generally have better control of the quality of service, accountably and corrective actions</td>
<td>Con: While they are the customer, they generally have little say over process control and delivery of the final service</td>
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<tr>
<td>Pricing</td>
<td>Pro: Better control of price structure</td>
<td>Pro: Can search across multiple suppliers to find the infrastructure you need</td>
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<td>Technology</td>
<td>Con: May not have assets in the right place to meet your specific needs</td>
<td>Con: Less control over price increases due to market conditions.</td>
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<td>Pro: Tend to think logistics processes first and technology second</td>
<td>Con: Providing a layer of cost that does not exist with a 3PL</td>
<td>Pro: Tend to think technology first as the provider, with logistics process second</td>
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<td>Pro: Better processes and accountability lead to more cost-effective execution and quality of service</td>
<td>Pro: Better tech and management services lead to more efficient execution and provider selection</td>
<td>Source: UPS eFulfillment</td>
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Volume Constraints, Temporary Capacity: Q4 Watch

Opinions differ on what retailers can expect in Q4 after the experience with capacity constraints and surge pricing last year.

“Q4 2020 was a unique period,” Vaughn said. “While we had some customers exploding with demands, we had others that were significantly down. From a channel perspective, B2B was generally down due to reduced foot traffic in stores. Those items, coupled with supply constraints, did not create a significant strain on space capacity.”

“There will be lots of challenges involving over-promising on capacity throughout fulfillment system,” Troy said. “Some folks are going to be surprised. Shame on the 3PLs and 4PLs if they’re surprised. I won’t be surprised if the retailers are surprised.”

“Everyone needs space at the same time and nobody has space at the same time,” Hertz said. “Large clients are eating up capacity for Q4, and carriers are not taking on additional capacity for fear of not being able to provide service.”

Shaughnessy pointed out that one way to secure temporary space is to find partners that have offsetting type goods, countercyclical to what you carry.

UPS, meanwhile, has large customers with long-term agreements that have peak planning and management as a major component to ensure FC and transportation capacity, while also being able to flex on a short-term basis. Vaughn said UPS ecommerce fulfillment options are also available for SMB-sized shippers.

The Status of Automation

There are two sides to the automation coin. “It’s slow to arrive,” Shaughnessy said. “I think the large retailers will be able to take advantage of automation but not SMBs. They really get whipsawed by the ups and downs in the labor markets. They can’t invest tens of millions of dollars in automation with 3PL partners they may not be with long term.”

“We’re seeing more requests for the 3PL industry to bring technology to the table,” Huppertz said, regarding larger companies. “These operations are looking for a 3PL to make the investment in a turnkey operation and bill it back with the financing as part of the transaction.”

UPS, meanwhile, is leveraging many hyper-automation technologies like robotic processes, AI and ML, advanced analytics and distribution management systems to drive operational efficiency. The benefit, Vaugh said, is improved capacity and the ability to handle demand spikes, a lower cost of service and improved quality.

The Bottom Line

As ecommerce continues to accelerate at a record pace, the exponential post-pandemic growth for brands, retailers and even Shopify startups bring logistical challenges that demand the right 3PL solution. This is especially true given scarce space, rising costs of labor, transportation and packaging. For many startups, entrepreneurs, SMBs and major players launching new channels, finding a 3PL partner is a now a necessity – and finding the right one is paramount.