



## The influence of contractual and relational factors on the effectiveness of third party logistics relationships

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### ABSTRACT

Outsourcing has become popular in both management literature and practice, but few studies have examined the effects of two important and potentially complementary elements – contractual and relational elements – on the effectiveness of logistics outsourcing relationships. It is theorized that contract formality, the thoroughness of contract negotiations, trust and commitment increase the effectiveness of 3PL provider–client relationships. For empirical validation a survey was carried out in the 3PL industry among both 3PL providers and clients. Using PLS path modelling, we observed that for both LSPs and clients, contract formality, trust and commitment are all positively related to relationship effectiveness. The results for negotiation thoroughness are mixed. The model explains 59% (LSPs) and 60% (clients) of the variance in relationship effectiveness. It is concluded that both ‘hard’ contractual aspects and ‘soft’ relationship aspects are important for effective supply chain collaboration. Theoretical and managerial implications are provided.

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### 1. Introduction

Global supply chains are a source of competitive advantage (Manuj and Mentzer, 2008), and supply chain collaboration is a valuable approach for reaching world class operational performance (Verecke and Muylle, 2006). Logistics outsourcing has attracted growing interest in recent years as managers consider whether it is in their best interest to perform activities in-house or let them perform by a logistics service provider (LSP) (Bolumole et al., 2007). LSPs are companies, which perform logistics services on behalf of others, either completely or only in part (Delfmann et al., 2002; Krauth et al., 2005). Examples of such logistics services are inventory management, warehousing, procurement, transportation, systems administration, information systems, materials sub-assembly, contract manufacturing and import, and export assistance.

According to Bagchi and Virum (1996, p. 93), a logistics alliance is “a long-term partnership arrangement between a shipper and a logistics vendor for providing a wide array of logistics services including transportation, warehousing, inventory control, distribution, and other value-added activities”. It is widely believed that collaboration among supply chain members will lead to competitive advantage for all (Mentzer et al., 2000).

The idea behind collaboration is that one firm has insufficient capabilities and resources to successfully compete by itself. Because of increasingly demanding customers, firms need to perform better. Through collaboration, firms can combine their strengths, share risks and rewards, and achieve higher performance. However, in practice, few firms actually collaborate on a level that goes deep enough to achieve an effective and efficient supply chain (Min et al., 2005). “Supply chain collaboration seems to have great potential, but further investigation is needed to understand its practical value” (Min et al., 2005, p. 238).

There have been many studies investigating success factors for third party logistics (3PL) partnerships (e.g., Van Laarhoven et al., 2000). In our study, we focus on two categories of success factors that have the potential to complement each other: ‘hard’ contractual factors and ‘soft’ relational factors (Poppo and Zenger, 2002). In regard to contractual factors, it is important to design an optimal contract, which is acceptable to both the client and the LSP and, at the same time, induces the LSP to truthfully reveal his capability (Lim, 2000). According to Selviaridis and Spring (2007, p. 140), empirical research should be directed towards contractual practices: “There is a need to examine (empirically) whether contracts are important in terms of relationship management or represent only part of the business deal and the client-3PL provider relationship”. Contracting agreements are perceived to be central to the creation of effective logistics outsourcing relationships (Boyson et al., 1999). In regard to relational factors, a growing number of LSPs try to become of strategic importance in their clients’ supply chains. Because of mergers and acquisitions

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and horizontal alliances with other LSPs, LSPs have been able to extend their scale and scope of operations, which has resulted in the offering of sophisticated logistics solutions, sometimes even on a global scale (Selviaridis and Spring, 2007). Those LSPs aim for long-term relationships built on trust and commitment (Morgan and Hunt, 1994). Successful collaboration between LSPs and clients is thought to yield significant benefits, such as inventory reduction, better quality, improved delivery, reduced costs, shorter lead-times, and higher flexibility (Min et al., 2005; Vereecke and Muylle, 2006).

Both contractual and relational factors have independently proven to be important for successful inter-organisational relationships. However, there are few studies that combine contractual and relational elements and investigate their effects on relationship success (see Poppo and Zenger (2002) for an exception). Following the call for further research on contractual practices in the 3PL industry by Selviaridis and Spring (2007), the purpose of this paper is to empirically test the effects of both contractual and relational factors on the effectiveness of 3PL user-provider relationships. The existing 3PL literature has mainly been descriptive and demographic in nature (see e.g., Lieb and Bentz, 2005), often lacking a strong theoretical basis (Selviaridis and Spring, 2007). By developing and testing specific hypotheses based on the extensive literature on contracts and especially on relationships, we contribute to a stronger theoretical basis of 3PL literature and to the broader field of buyer-supplier relationships as well. Furthermore, by considering both sides of the 3PL user-provider relationship, we are able to test for any differences in the way both groups perceive their relationships with the other party. The findings of this study provide supply chain practitioners with a clearer understanding of the connection between their contractual and relational efforts in 3PL user-provider relationships and the effectiveness of these relationships. Thereby, we show them how they can increase relationship effectiveness.

The paper is structured as follows. We first provide a theoretical framework leading to the development of hypotheses and a conceptual model. Then, the methods used to empirically test the model are explained. Next, the results of the empirical research are presented. Finally, conclusions, implications for management and theory, limitations and suggestions for further research are provided.

## 2. Literature review

### 2.1. Logistics outsourcing and 3PL

At the end of the 1980s, outsourcing logistics activities was quite a new phenomenon and by the end of the 1990s, logistics still did not seem to be on the agenda of top management. However, outsourcing all or part of the logistics activities in a supply chain to logistics service providers has now become the norm across most industries (Van Laarhoven et al., 2000), with more and more companies recognising the benefits of outsourcing to firms that can meet their requirements (Webb and Laborde, 2005). As logistics becomes more sophisticated and the gap between what companies want to accomplish and what they can do in-house continues to grow, the rationale for outsourcing to third parties increases. Logistics outsourcing represents a specifically defined, often contractual relationship based on third-parties meeting specified performance criteria set by client organisations (Bolumole, 2003). The most commonly outsourced functions are those that are non-core, routine-based, or asset based (Boyson et al., 1999).

The decision whether to outsource logistics activities depends on both internal and external considerations (Selviaridis and Spring, 2007). Internal considerations can be product-related (e.g., special handling needs), process-related (e.g., cycle times, resources and

capabilities), or network-related (e.g., countries served), but also difficulties with managing logistics in-house and the special expertise of the provider support the decision to outsource (Sankaran et al., 2002). External considerations are changes in the business environment, increased competition, pressure for cost reduction, the need for strategic flexibility, the focus on core competencies, the improvement of service quality and the resulting need to restructure supply chains (Qureshi et al., 2007; Selviaridis and Spring, 2007).

In our research, we use the definition offered by Bask (2001, p. 474), who describes 3PL as “relationships between interfaces in the supply chains and 3PL providers, where logistics services are offered, from basic to customized ones, in a shorter or longer-term relationship, with the aim of effectiveness and efficiency”. The roles of LSPs vary according to the level of outsourcing, from only transportation services to complete integrated-logistics, value-added services and global management of the customers’ logistical setups (Stefansson, 2005). 3PL providers can offer logistics expertise as well as cost advantages to individual organisations, because they provide an opportunity for organisations not to tie up unnecessary capital in costly logistics-related equipment such as warehouses, trucks and sorting equipment (Bolumole, 2003). Further potential benefits from outsourcing to 3PL providers are increased customer satisfaction and access to new markets (Bask, 2001).

### 2.2. Relationships and relationship effectiveness

Similar to 3PL, relationship marketing has only quite recently become an important concept in the literature, from the 1980s and 1990s onwards (Knemeyer and Murphy, 2005). Since then, collaboration between supply chain members has oftentimes been studied from a relationship marketing perspective (see e.g., Knemeyer and Murphy, 2004). According to this perspective, long-term relationships characterised by trust and commitment lead to better performance than single, short-term exchange between parties (Min et al., 2005). Relationship marketing can be defined as “all marketing activities directed toward establishing, developing, and maintaining successful relational exchanges” (Morgan and Hunt, 1994, p. 22).

According to Qureshi et al. (2007) and Frankel et al. (1996), commitment and trust, communication, top management support, a long term contract, willingness to be flexible, clear and consistent goals, and coordination are the enablers of a successful 3PL relationship. In the broader marketing literature on buyer-supplier relationships, trust and commitment have been stated numerous times as essential factors for successful relationships (e.g., Morgan and Hunt, 1994). Therefore, we take these two constructs to represent the relational factors affecting the effectiveness of client-LSP relationships.

In our study, we take the construct of relationship effectiveness to measure the success of 3PL provider-client relationships. This construct is drawn from van de Ven (1976) and Ruekert and Walker (1987), and it can be defined in terms of a psychosocial outcome, namely how worthwhile, equitable, productive and satisfying the client perceives his/her working relationship with the LSP to be, and vice versa. The reasons for choosing a psychosocial outcome to measure relationship effectiveness are two-fold: (1) past studies on effective working relationships have also focused on subjective outcomes (Chimhanzi and Morgan, 2005; Kahn et al., 2004; Massey and Dawes, 2007; Stoel, 2002), and (2) objective measures of effectiveness (e.g., sales volume) may not accurately reflect the quality of a relationship due to confounding factors, such as long sales cycles (Smith and Barclay, 1997).

### 2.3. Contracts

The greatest risk in outsourcing is non-performance (Domberger, 1998). Usually there are contractual instruments in

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