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**THE EFFECTIVENESS OF LOGISTICS ALLIANCES
EUROPEAN RESEARCH ON THE PERFORMANCE
MEASUREMENT AND CONTRACTUAL SUCCESS
FACTORS IN LOGISTICS PARTNERSHIPS**

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THE EFFECTIVENESS OF LOGISTICS ALLIANCES EUROPEAN RESEARCH ON THE PERFORMANCE MEASUREMENT AND CONTRACTUAL SUCCESS FACTORS IN LOGISTICS PARTNERSHIPS

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Abstract

- The success of a logistics alliance is measured not only by the fulfillment of the strategic goals of each partner but also by the relationship process between the parties involved.
- The perception of the alliance performance of each partner is often different. Partners may have different strategic goals, and they rate the success of the partnership quite differently.
- Furthermore, each party has a poor perception of the degree of satisfaction of its counterpart.
- Throughout the alliance contract it is imperative to pay attention to tasks that involve communication, joint planning and alignment efforts, in order to reduce information asymmetry.

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Introduction and Key Findings

How do managers view the success of a logistics alliance? Are these views shared by both parties to the partnership? As in any long-term relationship between two companies, the success of a logistics alliance is highly dependent upon overcoming asymmetries in information and process. Asymmetries arise in the form of differences and misconceptions about the *a priori* objectives of each party, uncoordinated decision-making or unfair sharing of risks. These gaps occur throughout the partnership; for example, the initial company's expectations, or the private company's objectives and its associated processes and procedures. Similarly, external and internal pressures can aggravate these gaps, and lead to the termination of a partnership. This study analyzes the performance of strategic partnerships using actual responses from the two matched partners in each relationship, to specifically capture the mismatched sentiments between the partners.

The specific objectives are:

- To understand what the managers from each side consider to be successful factors in the logistics partnership. Particularly,
 - ✧ What are the specific dimensions considered by each party to measure performance?
 - ✧ How is the performance of the alliance perceived by each party?
 - ✧ Are the criteria and the performance evaluation different for each party (or conversely, can we refer to a common perception of success/failure)? And,
 - ✧ Is each party accurately aware of the other party's views about the performance of the partnership?
- To understand which factors contribute to the success or failure of logistics alliances (whether they are strategic alignment between organizations, compatibility between organizations, mutual involvement or business and environment change).

Our analysis combined qualitative face-to-face interviews with an extensive quantitative survey in which, for the first time, information on the evaluation of performance was obtained from both parties - the customer and the 3PL (third party logistics) provider - in the same partnership, for 73 matched pairs (i.e. 73 alliances).

¹ This document summarizes the main findings of the above empirical research study developed with the support of CIIL, IESE Business School, and Universitat Politècnica de Catalunya (UPC).

The main findings were:

- *The evaluation of performance is multi-faceted by nature.* We developed *five relevant dimensions of performance* to judge the success in a partnership. Two aggregated dimensions: (1) the overall performance (regardless of previous expectations), and (2) the fulfillment of previous expectations. Three other detailed dimensions were designed to monitor (3) strategic achievement of specific private goals, (4) satisfaction with the operational process, and (5) the achievement of side benefits or spillovers.
- *The private evaluation of the partnership performance is consistent across each dimension.* Managers are in agreement when evaluating the success or failure of a partnership. The partner valuation on each of the five dimensions of performance is consistent with the others for each partner.
- There are, however, *significant differences in the performance evaluation across both parties* in three areas:
 - The strategic objectives of the two partners are different.
 - The valuation of the performance in the *same* partnership is often different.
 - Partners seldom correctly perceive their counterpart's satisfaction with the partnership, and are biased by their own level of satisfaction
- The success or failure of the partnership (as considered by both parties) is tied to the *correct perception of the pursued goals between each party, the mutual involvement in the alliance of both parties and, also, to the environmental changes, experienced predominantly by the customer company.* Contrary to prior belief, it is not related to the level of complexity of the contract or the level of organizational compatibility between the two companies (what we mean by “compatibility” is defined later).

The remaining parts of this report provide a more detailed description of the results of the study. We first discuss why performance should be evaluated by different dimensions and then go on to describe the framework that was developed. The data analyses and results are discussed in relation to: (1) the dimensions of performance, (2) comparisons between the assessments of each party on the performance of the strategic alliance, and (3) the characteristics that affect the success of a partnership contract.²

What do we Mean by Success? The Multi-faceted Nature of Performance in Logistics Alliances

Managers can give an overall judgment on how successful a partnership has been for their company, but often it can be difficult to express which specific aspects have contributed to that success. So, how then can we accurately state that a logistics partnership has been a success or a failure? And why? Being long-term in nature, logistics alliances are too complex to be judged, successful or otherwise, by the use of simplistic measurements such as financial

² This summary does not discuss the complexity of logistics contracts. See “The Handbook of Logistics Contracts” by J. Jané and A. de Ochoa, published by Palgrave-McMillan, 2005.

performance. To be more comprehensive, three additional dimensions of performance are considered: strategic, operational, and achievement of side benefits.

The *strategic performance* (also known as organizational effectiveness) refers to how well the strategic alliance has fulfilled the strategic goals of the companies. Partners pursue a wide variety of goals during a long-term logistics relationship; some common to both parties, some private and others not necessarily shared. These objectives may be related to specific financial outcomes, but they are usually and essentially strategic in nature where results are not quantifiable.

Operational (or process) performance recognizes the dynamic nature of these partnerships, which requires continuous interaction between the two organizations. It measures the quality of the process itself through mechanisms, such as planning, accounting, information exchange and re-negotiation, which are linked to the stability of the strategic alliance.

Finally, companies may also enjoy *beneficial side effects* to the company's operations that were not explicitly sought prior to the strategic alliance. These benefits may be perceived as another dimension of a successful performance.

Considering this, we develop a framework that includes the five dimensions of performance (see box 1).³

- The first two dimensions, 1 (*satisfaction with global performance*) and 2 (*fulfillment of expectations*) are comprehensive measures. Managers are asked for an overall value for each measure. Although both may appear to represent a similar notion, the global performance dimension is more comprehensive as it includes all aspects of the partnership, whereas the fulfillment of expectations is focused on the level of satisfaction with the goals agreed at the beginning of the logistics alliance.
- Dimension 3 (*strategic goals fulfillment*) is a composite measure that captures the specific goals of each party. As envisioned, these goals differ on two counts; 1) different goals for each partner, and 2) different relative importance of each goal for each partner. The lower half of Box 1 shows the different objectives considered and the average importance given to them.
- Dimensions 4 (*satisfaction with performance*) and 5 (*achievement of side benefits*) measure their respective dimensions. The *satisfaction with performance* dimension is of greater relevance since it is often overlooked during performance measurement.

Each Partner's Monolithic Viewpoint of Success or Failure: Private Partnership Evaluation

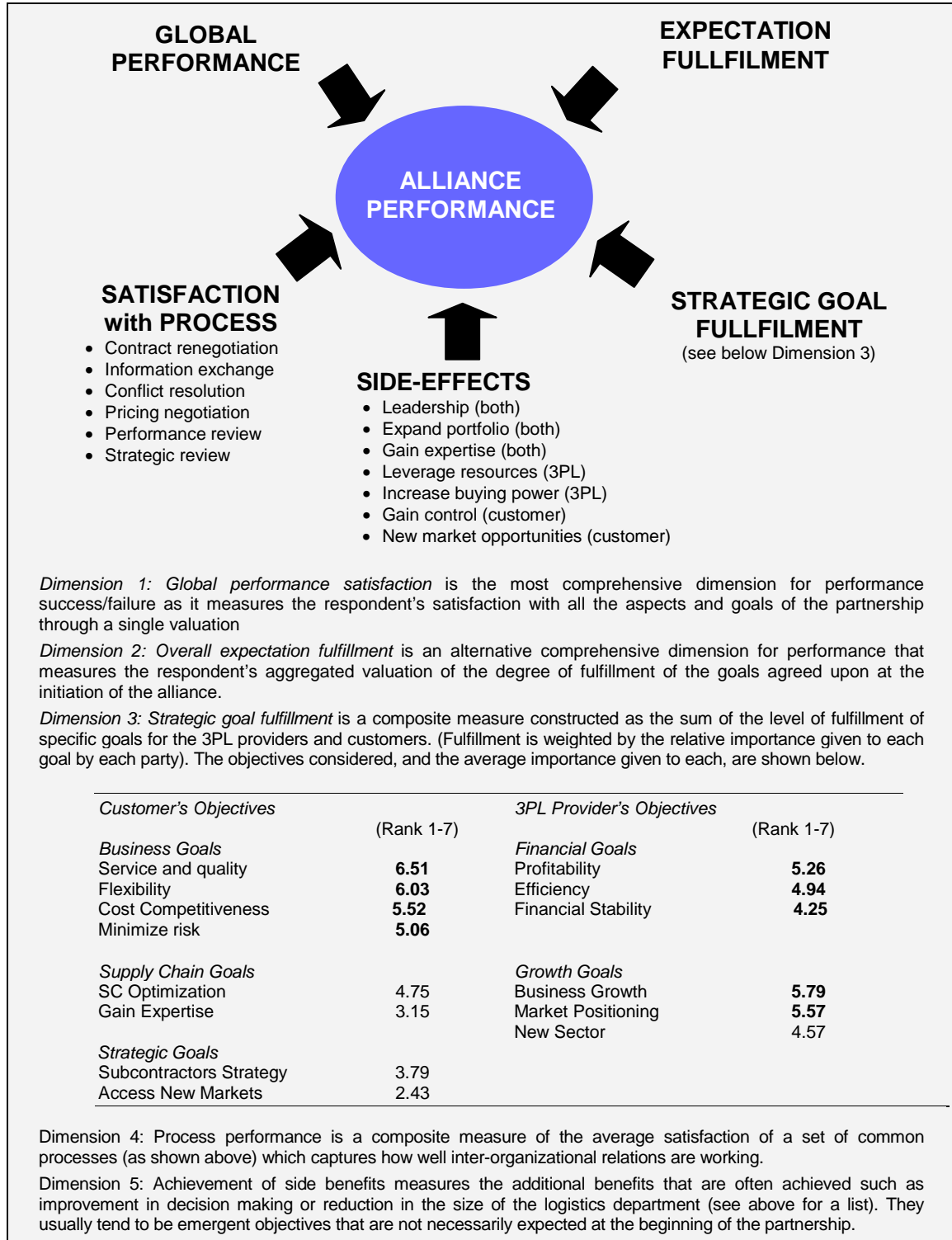
The information obtained from the questionnaires was analyzed separately for the customers and the 3PLs (See Box 2 for a summary of the average satisfaction, for each group, with each dimension of performance, and the degree of correlation among dimensions).

The results show that each manager (whether on the customer side or the 3PL side) evaluates success or failure in a very *monolithic* way, without distinguishing much across the different dimensions, with the exception of the side benefits. In other words, when satisfaction is high in

³For a more detailed description, please see Appendix 1.

one dimension, it tends to be high in the rest of the dimensions. (Note that for each group all measures have significantly high correlations, apart from side benefits). This holds true more for the customers than for 3PLs, which consider the successful achievement of strategic goals less important to judge the overall performance of the alliance.⁴

Box 1. Framework to Measure Performance

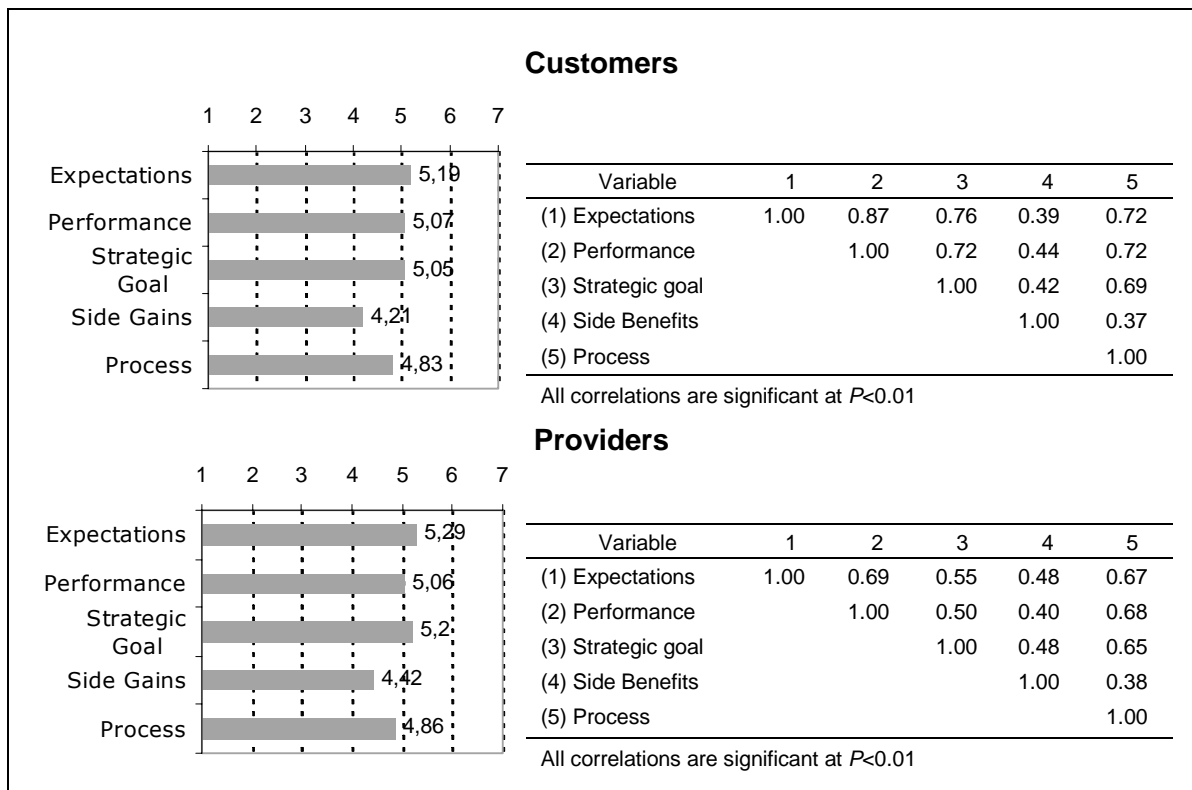


⁴ Statistical reliability tests for the measures suggest that these measures do indeed measure a single underlying concept, i.e., the success or failure of the partnership performance.

More importantly, the results suggest that (1) the achievement of all of the important strategic goals is closely linked to the success of performance, (2) process satisfaction may be as important as achieving these goals, and finally (3) the presence of one dimension without the other dimensions is highly unlikely to occur. This may not come as surprise to logistics managers who are involved in the day-to-day preoccupation of managing customer relationships, or customers who deal with the control of the outsourced logistics.

Also notable is the high degree of correlation of *achieving side benefits* and performance. As remarked earlier, these side benefits were not envisioned prior to the alliance; therefore, it is logical to say that they may not be directly tied to performance. However, the correlations suggest that these benefits may well be present when a partnership is successful.

Box 2. Monolithic View of Performance by Customers and 3PL



Are Customers and Providers Measuring the Same Notion? Comparisons of Each Party's View on Performance

The evaluations of alliance performance by each matched partner (customer and logistics provider) in the 73 alliances were compared, as shown in Box 3. Surprisingly, the degree of correspondence between the customers and the 3PL providers' performance views is much lower than expected (only 39% correlation).

In essence, this result shows that, although each party may be highly consistent in judging his/her level of satisfaction with the partnership, the underlying evaluation of performance is, in many cases, not common to both parties. Consequently, in these cases, it is not surprising that satisfaction may be low.

How Each Party Perceives the Other Party's Satisfaction with the Alliance?

Since the levels of satisfaction may differ across the customer and the 3PL in the same partnership, it is only fair to ask then if the parties are aware of such differences, that is, if at least one party's perception about the other party's level of satisfaction is accurate. Intuition would lead us to believe that these assessments of one another should be accurate, even if their individual performance evaluations differ... but reality shows otherwise.

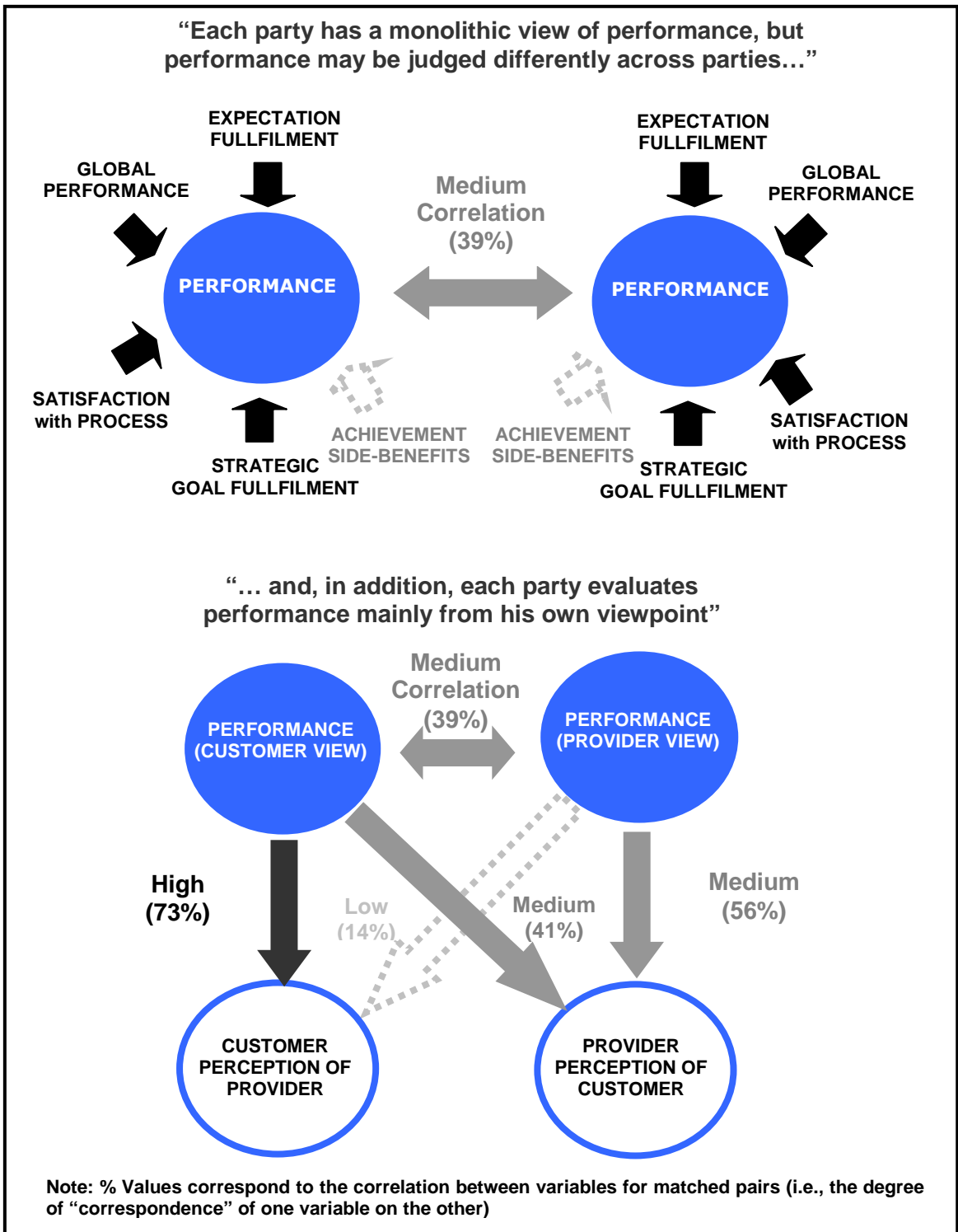
We asked each focal partner for every matched pair – both customers and providers of logistics services – about their perception of the other partner's assessment on the four dimensions of partnership performance.⁵ Measures, which we call *inter-party perceptions*, were developed based on these two paired responses. These responses were then compared with the actual satisfaction with performance for each partner (See lower part of Box 2).

The results show that each party tends to evaluate performance mainly from their own point of view. This centric viewpoint is very true in the case of customers: the perception of the 3PL's satisfaction is highly correlated with their own satisfaction, but not with the actual satisfaction level of the 3PL. Consequently, the perception of the 3PL's satisfaction tends to be more accurate when both parties have positive performance, but it is not accurate when the customer experiences high performance and the service provider experiences low performance. Interestingly, the 3PL providers are more likely to be aware of their customer's satisfaction with the partnership than the other way round, i.e., the 3PL's perception of customer satisfaction is somewhat correlated both with the 3PL's own satisfaction and also with the customer's actual satisfaction. In actual fact, it is not surprising that the customers are less concerned about their providers and that 3PLs have a better understanding of their client satisfaction levels. After all, they are the providers of the service!

Nevertheless, the poor level of understanding among parties is quite disturbing, especially considering the long-term nature of these relationships. It will be in everyone's interests to deeply examine the reasoning behind this mismatch, to look for mechanisms that foster inter-party collaboration.

⁵ The four dimensions were: (1) overall expectation fulfillment, (2) global performance satisfaction, (3) fulfillment of specific strategic goals, and (4) process performance. Customers were not asked about their perceptions of the 3PL's process performance.

Box 3: Relationship Between the Performance of Each Partner in the Alliance



So, How Can I Make my Partnership Successful?

At this point, the whole concept of alliance performance may seem quite elusive, especially taking in account the fact that each partner's performance model is different and, moreover, that the perceptions of their partners do not match. Keeping this in mind, we move on to take on a more practical analysis; to study which types of alliance structures and contractual factors contribute to the success of logistics alliances.

Based on previous studies and our preliminary surveys with managers, we developed a comprehensive range of characteristics that could be related to alliance performance, grouped around four main concepts: (1) the strategic alignment between organizations, (2) compatibility between organizations, (3) mutual involvement, and (4) change, both in business and environment. (See Box 4 – Partnership characteristics leading to success or failure.)

- *Strategic alignment between organizations* consists of characteristics that measure the match between the importance of the relationship for the two companies at different levels, i.e., importance of the strategic goals, the matching of the perceptions of this importance by the other party, the perceived level of alignment of each party's management, etc.
- *Compatibility between organizations* measures characteristics related to the similarity of culture, ownership and decision-making level among the two companies, as well as the prior relationships between the two companies (via previous contractual relationships)...
- *Mutual involvement* characteristics measure the fair participation or commitment of both parties in a contractual relationship, explicitly considering joint planning, existence of risk and reward sharing, and the sharing and contribution of assets.
- *Change* characteristics take into account changes in the business and in the environment. These include the economic situation of the company/partner, market competition in the company's/partner's industry, strategic change of the company/partner, change of ownership of the company/partner, management change of the company/partner, and presence of cross-economic interests⁶.

The data showed only limited evidence of the effect of these characteristics on both the performance evaluation of the customer and the provider. In Box 4, the significant characteristics that positively and negatively affect the customer and the 3PL performance are outlined. (The effects on performance evaluation were obtained by estimating two separate regression models, one linking the partnership characteristics to the customer performance evaluation, and another linking them to the 3PL performance evaluation. The explanatory power of the regression models was low and only a small number of characteristics were significant.)

As envisioned, when the customer evaluates the alliance performance negatively, it is strongly related to the wrong perception of his goals by the logistics provider. Conversely, customer evaluation of performance tends to be positive when there exists a joint planning mechanism between the parties.

On the other hand, the logistics provider's own evaluation of performance is also negative when his perceptions of the customer's strategic goals are wrong. Then, for the satisfaction of both parties, it seems crucial that the 3PL clearly understands the objective of the customers. The

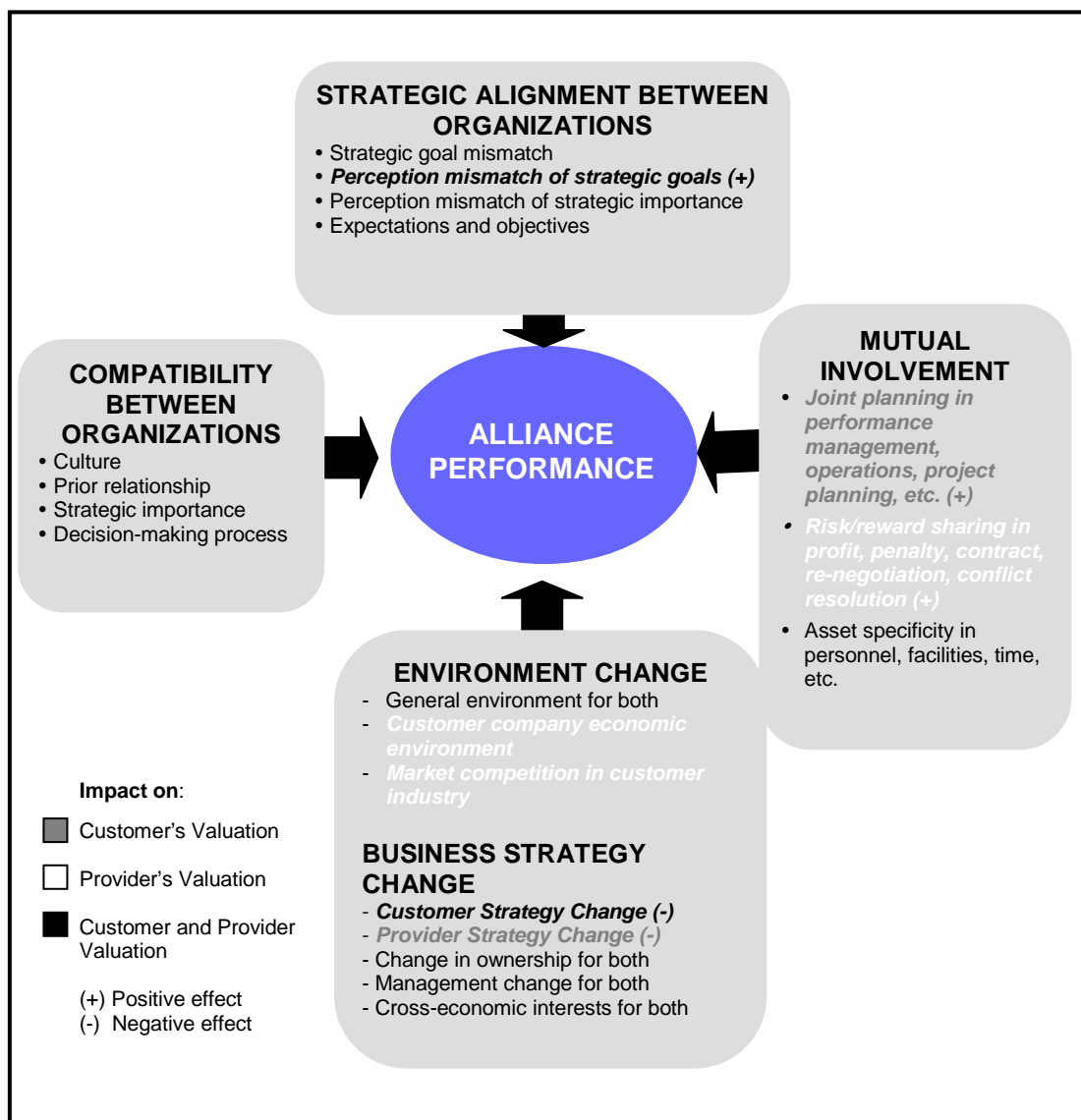
⁶ The following control variables were used: longevity (contract age), contract length, company size, type of industry, type of logistics services, and economic change of contract over revenue.

provider tends to evaluate performance positively when the alliance contract contains financial agreements in the form of sharing risks and rewards.

We were surprised to note that characteristics of compatibility between organizations, which are normally claimed as important mechanisms to foster trust (such as the existence of prior ties or a similar culture and symmetry in decision-making), do not appear to have any effect on the success of the alliance.

On the other hand, potential changes in the business strategy for both the customer and the logistics provider are shown to have a substantial impact on the performance.

Box 4 – Partnership Characteristics Leading to Success or Failure



Although the evidence is not totally conclusive, it does enable us to make some reasonable hypotheses. Without a clear understanding of the customer's objectives and expectations, operational decisions on the part of the service provider would probably mislead and, hence, result in the failure of the partnership. Obviously, this mismatch can be exacerbated if the business objectives of either partner changes over the course of the relationship. In the case where strategic goals are properly set, customers, focused as they normally are on achieving adequate service levels, tend to blame unsatisfactory levels of service on the lack of coordination. 3PLs, on the other hand, are naturally inclined to focus on cost controls and investment outcomes. Consequently, they tend to focus on the customer's lack of commitment in sharing financial risks.

Conclusion: Overcoming the Information and Perception Mismatch is Key

This novel study raises warning signals to the idealistic notion of looking at a long-term logistics partnership as a "one-headed" harmonious relationship. We have made a first attempt to capture and analyze the different views of both parties in a logistics alliance and have assessed the potential impact of contractual factors on the performance of strategic alliances.

Clear initial doubts. Without a clear understanding of the other party's objectives and expectations, operational decisions on behalf of the service provider could be perceived as misleading and lead to partnership failure. It is often explicitly stated in logistics forums that one should not underestimate the time required upfront to understand, align and clarify their expectations, objectives and deliverables. The analyses performed in this study reinforce this idea. By taking advantage of the initial negotiation phase, one should coerce the potential partner to clarify their strategic objectives (mismatched perception of strategic goals and importance) as well as give more importance to the mutual efforts (joint planning and risk/reward sharing).

Develop relationships to overcome mismatched objectives. Strategic alliances may start out as a short-term relationship which, when developed correctly, has the potential to become a long-term trusting relationship. Treating it as a relationship and not as a business deal fosters incentives for the members of the alliance to find ways, both formally and informally, to minimize asymmetric information, hence mismatched objectives and perceptions.

Confronting changes. Customers, as shown earlier, tend to be more focused on achieving adequate service levels. They tend to attribute low levels of service to the lack of coordination. 3PL providers, on the other hand, are naturally inclined to control costs and investment. They attribute alliance failure to the customer's lack of commitment in sharing financial risks. During the contractual relationship, the strategic objectives should be well communicated to both parties. In the extreme case, one should always be prepared to confront changes in any aspect of the business objectives over the course of the relationship.

Manage the process. A strategic alliance is a dynamic relationship where the processes that occur throughout the relationship are of great importance. During the strategic partnership, it is important to keep in mind that each party can have different and changing perceptions of performance and, as such, to take advantage of this opportunity to influence the other party's perception to his/her favor. A successful partnership lies in improving the process performance

in key areas often disregarded in the contract, such as conflict resolution, pricing negotiations, risk/reward sharing, etc.

Process for decision making. Part of managing the process includes having a process for decision making. Knowing that the partners have different goals and perceptions of the alliance, the process must be clear and, above all, transparent to both parties.

Focus on joint communication activities and monitoring. Another important area in managing the process includes making greater efforts, before and during the contractual relationship, to include and focus on tasks that involve communication, joint planning for business plans, resources, revision of operations, etc. Again, this is as a means to reduce communication breakdown, and to align business goals and expectations between the partners.

Periodic monitoring of strategic partners' contributions. Engaging the partners in periodic, planned, personal meetings, people exchange, information sharing, and “blameless reviews” of alliance brings out the explicit and implicit contributions of the partners to the alliance.