UNIT 12 OUTSOURCING LOGISTICS MANAGEMENT: ISSUES*

Structure

12.0 OBJECTIVES

After reading this Unit, you should be able to:

- Bring out the various aspects of outsourcing in logistics management;
- Explain the stages of contract life cycle management;
- Describe the types of logistics outsourcing;
- Discuss the factors for success of logistics outsourcing; and
- Analyse the trends of outsourcing

12.1 INTRODUCTION

Logistics outsourcing has assumed importance as companies are deriving benefits through high-quality logistics services provided by a third-party or fourth party logistics company (3/4PL). Service quality becomes one of the most important criteria to outsource logistics services to a service provider. Organisations adopt several business improvement methodologies to enhance the business performance and logistics management has been regarded to be crucial to obtain competitive edge. It is supply chain made up of competing multiple organisations, and not a single company, which is a central tenet in the field of logistics management.

Outsourcing is an arrangement whereby a logistics service provider (LSP) performs services for a company / firm that could be provided in-house facilities. Logistics outsourcing is about subcontracting logistics activities to companies / firms that are equipped to provide the services. Lack of understanding on the part of both user and provider is the major cause of difficulty and failure in the logistics outsourcing relationships. Understanding this aspect shall be useful for facilitating improved logistics outsourcing relationship. Successful companies generally focus on core activities and outsource other required activities.

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12.2 OUTSOURCING LOGISTICS MANAGEMENT

Outsourcing is a make or buy decision which is crucial in determining how a business obtains goods and services. Outsourcing decisions can have corporate strategy implications since employment levels, asset levels and core competencies are involved in this activity. Logistics outsourcing is a business practice in which services or job functions are given to a third party, which traditionally were performed in-house by the company's own employees and staff. Logistics outsourcing is the strategic use of outside parties to perform activities relating to certain aspects. The main issues with outsourcing are:

a) Preoccupation with core businesses and reduction of cost of capital.

b) Access to external expertise and quality improvements.

c) Balancing operational cost savings with the cost of monitoring suppliers.

d) Increased flexibility in business operations.

The benefits of outsourcing are:

a) Lower costs due to economies of scale, downsizing or lower labour rates.

b) Increased efficiency.

c) Focus on strategy/core competencies.

d) Gaining capabilities that are not internally available.

e) Access to skills or resources.

f) Flexibility to meet changing business and commercial conditions.

g) Less investment in internal infrastructure.

h) Access to innovation, intellectual property, and leadership.

i) Possible cash influx resulting from transfer of assets to the new provider.

Risks of outsourcing are:

a) Slower turnaround time.

b) Lack of business or domain knowledge.

c) Lack of control and accountability.

A logistics contract may be used as a basis for outsourcing, and there are a multitude of activities carried out in outsourcing and the problems arising from logistics contracts are like those arising from outsourcing any other contracts.

12.3 CONTRACT LIFECYCLE MANAGEMENT

Contract lifecycle management for a buyer is the process of defining and designing the actual activities needed in each stage for any specific contract, allocating ownership of the activities to individuals or groups, and monitoring the performance of those activities as the contract progresses through its lifecycle. The contract, due to business needs, ensures that the contracted goods or services are delivered by the supplier in accordance with the contract, and realise the expected business benefits and value for money. The stages of contract lifecycle are outlined below.

1) **Contract Initiation.** A procurement starts by clearly describing and documenting the business need before looking for a supplier of the goods or services. It provides the framework to evaluate suppliers. The process by which the buyer finds a supplier for the required goods or service entails use of RFI, RFP, RFQ or RFB (Request for Information, Proposal, Quote or Bid); resulting in several different suppliers submitting their responses for the contract.

2) **Contract Negotiation**. The negotiation of contracts is a specialised activity. A detailed review of the contract with the identified supplier is needed. The buyer sends the responses to the relevant suppliers and negotiations are conducted covering several aspects to reach a consensus. Contract negotiation ensures that the contract is fair and balanced with responsibilities for laid down outcomes. After agreement on the terms and conditions, the successful supplier is awarded the contract.

3) **Contract Execution.** A new contract is approved and signed by different people to reduce the chance of anything unfavourable or risk of any fraud.

4) **Contract Start-up.** This involves a detailed understanding of key information of the contract. It includes the obligations and rights of the buyer and the supplier, method of tracking its compliance, resolution of outstanding matters to be resolved during and immediately after execution, etc.

5) **Contract Operation**. To get the best out of the contract, there is need to continuously monitor the activities. This stage lasts through out the contract term involving several activities as:

   a) **Control Contract Changes**. Changes in requirements, business conditions, regulatory environment, economic trends, and technology can all necessitate a change in a contract. Such changes should be achieved on a timely basis by mutual consent, and through a formal change control process documented in the contract.

   b) **Track Obligations Compliance.** A contract specifies each party's separate and joint obligations. Adhering to such commitments are critical to the contract. A range of activities which should be tracked in a formal way with deadlines being met on time are:

      i) Contractual terms and conditions

      ii) Events and dates

      iii) Laws and regulations

      iv) Internal directives and policies

      v) Jointly agreed processes

   c) **Checking Supplier Performance**. A regular monitoring of supplier performance is necessary to ensure that delivery of goods and services is as per agreement. This checking and reporting by staff can be combined with customer satisfaction survey results for any remedial action like changes in processes, contract terms, service levels, fees etc.

d) **Performing Periodic Reviews.** A contract needs periodical checking for any changes in circumstances affecting the delivery of expected benefits which may necessitate updates to the contract, or the processes laid down in the contract.

6) **Contract Renewal**. This gives an opportunity to improve the terms of a contract and gain better value from supplier. The contracts should be renewed in time if not going in for auto-renew or auto-cancel. A contract should be renewed if:

a) There is an ongoing requirement of the activities.

b) Supplier's service delivery performance has been acceptable.

c) There have been no insurmountable difficulties in achieving high levels of compliance with all obligations.

7) **Contract Close-Out.** The end of a contract on its expiry or its active termination calls for proper planning and a smooth transition-out from the contract. In contract closing out, following activities should be carried out:

a) Issuance of a termination notice before the contract expiry date.

b) Monitor and participate in any disengagement activities needed to move-out from the contract.

c) Return or destroy any confidential information as required by the owner of such information.

d) Transfer any assets, and return any loaned items, as required.

e) Finalise the details of any payments to be made to or by the supplier.

f) Prepare and finalise contract finalisation paperwork and submit and clear any final payments.

g) Perform any other specific post termination obligations.

h) Update the lessons learned for the benefit of all future contracts.

Check Your Progress Exercise 1

Note: 1) Use the space given below for your answers.

2) Check your answers with those given at the end of the Unit.

1) What are the benefits and risks of logistics outsourcing?

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2) Describe the stages of contract lifecycle.

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12.4 TYPES OF LOGISTICS OUTSOURCING

Contract Logistics

Many companies find it more efficient to hire specialised contract logistics companies to manage their logistics for them. In addition to cost, the other advantages are flexibility, improvement of business practices and better efficiency. Contract logistics companies have a deep understanding of how different industries work to best manage the logistics of different companies. They can handle activities such as designing and planning supply chains, facilities, warehousing, transporting, and distributing goods, processing orders, and collecting payments, managing inventory, and even providing many aspects of customer service. They are familiar with the process having expert staff offering comprehensive solutions through various divisions and specialised services, thus creating a value chain that spans from the production line to distribution and to the final point of sale.

Contract logistic companies are invariably started by former logistics managers, who already have a good understanding not only of the industry they work in but also where they may best place their contracts. They are in oil and gas industry, power and energy, petrochemical, renewable energy, infrastructure projects, mining, military, and defence and so on. They can undertake transportation and installation of large loads that require feasibility studies and completing the necessary compliances like customs clearances. Many new services have come to market that transformed the delivery concept allowing pickups and custom delivery beyond the normal scope of delivery hours. Other companies that are working for business to business, focus on large-scale logistical automation that tracks items like shipping containers and freight deliveries for companies using modern software learning tools thus saving money.

Open-book Contract

A current trend in the contracting of outsourced logistics services is towards more transparency in supplier pricing. The buyers want to know that they are getting value for money, that the logistics supply provider (LSP) is not making excess profits at their expense. This is achieved through scrutiny of costs such as labour, materials, overheads and profits. In an open-book contract, the buyer and seller of work/services agree on which costs are remunerable and the margin that the supplier can add to these costs. The customer is then billed on the actual costs incurred plus the agreed margin. Once a company reaches a size where its operational management becomes complex, it looks towards a strategy to outsource their operations, management, transfer their staff and assets. They have a deal with a service contract for several years, based on an open book accounting base plus a margin. This deal allows them to focus on their manufacturing and marketing services of trading and distribution, with the support of an inter-link manager and a few supervisors to manage the logistics operator performance and track costs. The added value provided by the LSP are the efficiencies and productivity gains from their professional management, operational performance, and financial strength to invest in needed assets, systems, and human resources.

The logistics operator business is to manage their client operations, deciding and arranging delivery trucks and other warehousing storage equipment and materials handling vehicles, as well as in IT hardware and software systems. All are charged at cost plus a profit margin under the open book concept. An incentive may be included for the supplier to give a realistic price and to minimise the costs whereby the supplier gets incentives (and penalties) calculated as a percentage of the difference between the real cost of the project and the estimate that was provided.

Business Process Outsourcing (BPO)

Businesses look for suitable logistics process outsourcing partners that will help them increase their work accuracy and reduce operational overheads. Some key reasons why logistic companies look to outsourcing are:

a) **Cost Reduction:** Outsourcing logistics processes to a reliable BPO Partner, can help reduce operational costs by more than half.

b) **Round-the-clock support**: The 24x7 team support help retain valuable customers.

c) **Reduce Track and Trace (TAT)):** Using Workforce Management tool increases efficiency by reducing of TAT of shipments and documentation management.

d) **Re-engineered Business Processes**: Perfect mix of the latest business technologies with re-engineered logistics processes provide competitive edge.

e) **Easy Monitoring and Reporting**: Insights into operations with real-time reports and analysis using easy-to-use dashboards.

Original Equipment Manufacturer (OEM)

Original Equipment Manufacturer (OEM) is a company whose goods are used as components in the products of another company, which then sells the finished items to users. Such products are usually not only of good quality but are also durable. The second firm is referred to as a value-added reseller (VAR) because by augmenting or incorporating features or services, it adds value to the original item. The VAR works closely with the OEM, which often customises designs based on the VAR company's needs and specifications. OEM focuses on business-to-business sales, while VAR sells to the public or other end users.

VARs and OEMs work together. OEMs make sub-assembly parts to sell to VARs. Although some OEMs do make total items for a VAR to market, they usually do not have much of a direct role in determining the finished product. OEMs focus on business-to-business sales, while VARs market to the public or other end users. An increasing number of OEMs are selling their parts or services directly to consumers, in a way making them a VAR.

For example, OEM describes a manufacturer who puts together computers made of other company s parts and then sells the product under its brand name. Examples of OEM are Dell, Hewlett Packard, etc. Apple's iPhone has the Apple logo that is clearly visible to users. It describes its products, but Apple outsources the majority of iPhone manufacturing products to other electronics solutions providers on contract.

12.5 EFFECTIVE LOGISTICS OUTSOURCING: ISSUES

Outsourcing succeeds when it is well thought out and done properly. We shall now discuss some key issues to be kept in view for all parties involved in outsourcing.

1) Know and Define Reasons for Outsourcing

What do you want to accomplish and why? What is it that you want to do better? What would it take to do it and do it well inside the company? Why is that option not viable? For example, in case of freight transportation, the purpose of any company is to reduce freight costs. The problem being encountered could be either high rates, carriers used, or the methods selected; or it can be a symptom of a problem from use of high cost shipping methods, or supplier problems. If the real cause of freight is not identified, then the outsourcing will not be successful, because the reasons for the outsourcing have not been properly identified. Freight also has a service factor, whether it be moving inventory from suppliers, between company operations or to customers, which are to be understood to evaluate the freight cost problem and needs.

2) Evaluate Outsourcing Business Process versus Function

This is the key issue because without this the outsourcing selection may be defective. It defines the needs by identifying partners and designing the ways of outsourcing. Knowing what is being outsourced and why, helps in identifying the type of logistics supply providers (LSPs). The reason for outsourcing may also indicate whether to outsource a function or a process. Outsourcing management of inbound transportation is a function for transfer to an outside party; but the inbound supply chain, including supplier purchase orders, supplier performance and transportation is a process for transfers to an outside provider.

A third-party logistics provider/ company (3PL) is mainly concerned with handling just the logistical process, while a fourth party logistics provider/ company (4 PL) manages almost all aspects of the client's supply chain. At times these may own assets like trucks and warehouses while third party logistic provider may not own the facilities/ assets.

Outsourcing a function versus a process can change the type of service provider that should be evaluated. A third-party logistics company is often used with functions, such as inbound transportation and related activities. Managing a function requires depth of skills sets from the service provider. A fourth party logistics company (4PL) may be the better choice with managing a process, which requires breadth of logistics skill sets.

3) Recognise Seller and Buyer Roles

The involved parties in outsourcing have different expectations. The selling company outsources its services for building own leveraging position with the transport carriers or other providers and reduce costs of warehouses or other operations. The seller may be focused on his/her needs and not focused on the buyer's needs, thus mainly interested in only getting the business.

Outsource providers who see the potential buyer as a client will recognise the unique needs and accordingly develop and manage the relationship. Those providers who view a prospective buyer as a "customer" may not pay the attention to the business after they have gained it. A customer is one of many customers; he is not unique. Such a provider is proactive, not reactive. Client management differentiates successful outsource service providers, for both gaining and retaining business.

4) Detail Your Operations

Stipulate in writing what is done, by whom, how it is done, when and why, highlight its strengths and weaknesses. Clearly understand interfaces between departments and how functions and responsibilities are divided between them. Understand "hidden", and "assumed" work that is done which is beyond the job descriptions, purpose, and responsibilities that outsiders may not notice. The detailed costs of operation such as labour, space, freight etc., are to be worked out.

Define critical points in the function or process which should be mapped as organisational boundaries overlap, defining cross-functional roles and interfaces. It will also show gaps or redundancies which may highlight key areas for the 3 Party Logistics providers or 4 party logistics providers that are critical for success.

5) Set Metrics/Key Performance Indicators and Accountability

The expectations from outsourcing is with specific reason and anticipated results. The planned results should be defined clearly and be tangible. Goals which are vague goals such as "reducing costs", "improving supplier performance" etc., does not ensure accountability and can lead to disputes during the contract. The results should be measurable and be clearly set in early discussions as part of the expectations to know the realities of accomplishing them.

The focus should be on the key metrics and performance indicators that relate to outsourcing success. Accountability and responsibility from and for both parties should be understood. Logistics management is complex having multiple areas of responsibility and accountability with multifunction process over large geographies. It runs from suppliers right through to customers. Hence it is better to identify and define responsibilities and metrics early in the process well before signing of contract.

6) Be Aware of Risks

Outsourcing involves change management, even business process reengineering, is not a guarantee of success with anticipated benefits but has potential downsides. So, one needs to anticipate the various scenarios, internal and external factors that can impact the activities and results.

Hence it is better to do risk assessment, identify real and perceived risks, that shall help to mitigate risks. Think through the probable scenarios – goals not attained, service problems that seriously impact the company as to customer deliveries or with purchase orders from suppliers, inventory difficulties of stock outs or surges in levels, unanticipated cost increases and relate them to available options .

Outsourcing results in transfer of company's knowledge, practices, and resources. In case outsourcing does not work, the company should be prepared to remedy it in an appropriate manner. If it cannot be remedied, agreement can be terminated, and another service provider needs to be identified. The company must carry out proper transfer from one provider to another, regroup and bring the outsourced service under control.

7) Plan the Change

Outsourcing does not work on its own, but parties should plan for the change. There are major and minor tasks to be outsourced and outsourcing results in people and departments giving up ownership of the function or process. All affected parties build teams to detail things to be done, develop the plans and timelines, understand any customisation and reengineering required, coordination of activities and distribution of work or information, and provide training to the people.

8) Manage the Outsource Operations

Successful outsourcing takes effort to manage the LSPs and operations. Use the key performance indicators continuously. Meet regularly, especially during the implementation, to review progress, problems, and successes. Also assess what must be done and who must do it.

Check Your Progress Exercise 2

Note: 1) Use the space given below for your answers.

2) Check your answers with those given at the end of the Unit.

1) Describe some of the types of logistics outsourcing.

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2) Discuss issues involved in success in outsourcing.

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12.6 CONCLUSION

Outsourcing can bring big benefits to businesses, but there are significant risks and challenges when negotiating and managing outsourcing relationships. Fast changing customer demands have an increasing effect on company policies. Advances in technology makes production more more focused. Successful companies will have to concentrate on core activities. Those other than core activities, will have to be outsourced.

Globally and locally, outsourcing has already become the practice in all sectors of business and value chains. Outsourcing has been one of the most used management practices during recent times, and the outsourcing business continues to grow and expand significantly across all value chains.

12.7 GLOSSARY

Business Process Reengineering: It is a business management strategy pioneered in 1990s focusing on the analysis and design of workflows and business processes within an organisation. It is aimed to help organisations fundamentally to rethink about their functioning to improve customer service, cut operational costs and become a successful company to compete in global market.

Contract logistics. Outsourcing of resource management tasks to a third-party logistics company/ provider (3PL).

Logistics contract: A commercial contract under which one party, known as 3PL, provides services of a logistical nature to a customer in exchange for payment of an economic amount.

Request for Bid (RFB): It is a document where a company solicits commodities and services from outsiders. It has all specifications and conditions and terms of contracting. This is used in situations where potential service providers or vendors differ principally on price.

Request for Information (RFI): It is a business process whose purpose is to collect written information on the capabilities of various suppliers in outsourcing. It is generally used to compare and arrive at a decision.

Request for Proposal: It is a document that a company or agency interested in procuring a commodity or service offers to the potential suppliers to submit business proposals.

Request for Quotation: A request for quotation is a business process in which a company or public entity requests a quote from a supplier for the purchase of specific products or services. It involves along with the price, payment terms, quality level etc.

Value Chain: It is a set of activities that an organisation carries out to create value for its customers.

12.8 REFERENCES

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12.9 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress Exercise 1

1) Your answer should include the following points:

   The benefits of logistics outsourcing include:

   - Lower costs
   - Increased efficiency
   - Focus on strategic/core capabilities
   - Access to skills and resources
   - Flexibility
   - Access to innovation
   - Possible cash influx

   Risks of outsourcing are:

   - Slower turnaround time
   - Lack of business or domain knowledge
   - Lack of control and accountability

2) Your answer should include the following points:

   Elaborate on the following stages of contract lifecycle:

   1) Contract Initiation.
   2) Contract Negotiation.
   3) Contract Execution.
   4) Contract Start-up.
   5) Contract Operation.
   6) Contract Renewal.
   7) Contract Close-Out.

Check Your Progress Exercise 2

1) Your answer should include the following points:

   Description of

- Contract Logistics
- Open-Book Contract
- Business Process Outsourcing; and
- Original Equipment Manufacturer.

2) Your answer should include the following points:
   - Issues in achieving success in outsourcing include:
   - Know and Define Reason for Outsourcing.
   - Evaluate Outsourcing Business Process versus Function.
   - Recognise Seller and Buyer Roles.
   - Detail Your Operations.
   - Set Metrics/Key Performance Indicators and Accountability.
   - Be Aware of Risks.
   - Plan the Change.
   - Manage the Outsource Operations.