



## Executive Summary

### Urgent Findings for 2005 Management of Distribution Outsourcing Vendors

During the teleconference, members confirmed that recent shifts in the market for distribution services have shifted bargaining power from the customer to the provider of services. These shifts reflect rising fuel prices, regulatory change, cross-border security compliance, transportation capacity shortage, growing demand and lengthening supply chains. Furthermore, some providers are leveraging customer and profitability data to hold their clients “captive” to their infrastructure and operations.

The shift in bargaining power is forcing companies to re-evaluate how they do business with outsourcing partners. By integrating too deeply with a few vendors (in pursuit of supplier rationalization, for example), companies risk the “captive trap.” Alternatively, by failing to recognize the shift in bargaining power, companies confront unwillingness on the part of the vendor to invest in the resources required to support their own business.

The fundamental challenge for companies requires avoiding vendor captivity, while still remaining a “customer of choice” to the vendor. Board research indicates a new competitive context will open for companies that can work with partners to find the lowest *total* switching cost, defined as the sum of the switching costs borne by both the vendor and the customer.

### Balancing Global Efficiency with Regional Responsiveness

#### 1. Searching for a single global outsourcing provider?

Think again: Participants unanimously agreed that no warehousing provider has excellence in all regions or activities. Participants, however, argue that the large transportation providers are capable of global engagements and worthy of turn-key contracts.

Key takeaway: Invest in global transportation partnerships, but maintain regional warehousing engagements

#### 2. Thinking that having fewer providers is necessarily better?

Think again: While participants agree that fewer providers is the theoretical ideal, rationalizing the outsourcing supply base typically leads to reduced performance levels without the expected cost savings. As one member stated: “Our approach is to theoretically start with one global provider and justify every addition to our provider base. We do not set a target number, we simply let the performance, IT, and cost figures determine the optimal number. We’re willing to have global, regional, or zone providers – we go by what makes sense.”

Key takeaway: Work with the fewest number of providers that meet performance expectations

#### 3. Relying on size and revenue as an indicator of warehousing provider capabilities?

Think again: In contrast to the conventional wisdom that “bigger is better,” participants noted that provider size and market share have little correlation with performance levels (except noting that larger companies typically have higher quality IT departments). Regional expertise provides a much stronger indicator of provider ability. Moreover, members reported that the ability and qualifications of the facility’s general manager has the greatest performance impact.

Key takeaway: Ensure that working with a provider’s “A” team is negotiated in the outsourcing contract

#### 4. Eliminating providers because they lack expertise in a region?

Think again: For providers that excel in one region but not another, several participants have achieved positive returns from nurturing or strengthening provider capabilities in their weaker regions. While this process does require a resource investment, the cost savings from process and systems synergies across regions often leads to net positive returns.

Key takeaway: Consider a cost-benefit analysis around supporting the expansion of excellent providers into new regions

## Lessons from Technology Integration with Outsourcing Providers

### 5. Planning to use the provider's WMS?

Think again: While outsourcing providers typically have advanced WMS capabilities, members report significant systems integration challenges with order management and enterprise planning systems. Indeed, most participants recommended utilizing in-house owned WMS technologies. As one member stated: "We have found the technology integration works much smoother when we utilize our version of the WMS that's on the same platform as our order fulfillment and ERP systems."

Key takeaway: Consider purchasing or upgrading in-house WMS

### 6. Using the provider's WMS without monitoring WMS data?

Think again: Members report that the information in the WMS is critical to understanding how well the warehouse operation is managed. As one member stated: "The provider's WMS can easily become a black box and then it's very difficult to understand how good of a job they're actually doing for you." When using the provider's WMS, members recommend developing excellent operational KPIs to get visibility into the WMS data.

Key takeaway: Develop tactical KPIs to understand operational performance and WMS details

### 7. Avoiding full systems integration due to security concerns?

Think again: While security concerns should be a deciding factor when considering depth of systems integration, members are getting past this concern by creating plug-and-play interoperability gateways to link the technology systems. For example, one company is creating standard communication standards to enable full systems communication without security concerns.

Key takeaway: Consider alternative technology solutions to overcome security concerns

## Developing Effective Service Level Agreements

### 8. Waiting until the contractual stage to discuss Service Level Agreements?

Think again: Waiting to discuss detailed service and performance level expectations at the contract stage leaves companies vulnerable to creating partnerships with providers that cannot achieve desired performance targets. Participants recommended that service level expectations and definitions should be included in the RFQ, or, at minimum, discussed at the very beginning of the relationship.

Key takeaway: Include service level metrics, definitions, and expectations in the RFQ

### 9. Planning to reduce management and resource attention after signing the contract?

Think again: Participants shared that they typically experience performance improvements during the short window immediately after signing the outsourcing contract. Continual gains, however, often do not materialize. As one member stated: "We find significant improvements at the onset of the relationship, but then both parties get into their transactional grooves and we stop making incremental improvements." Participants suggested maintaining internal resources (particularly operational or front-line staff) responsible for eliminating inefficiency and generating innovative solutions.

Key takeaway: Allocate operational or front-line resources to continually uncover improvement opportunities in the outsourcing relationship

## Working with Fourth-Party Logistics Providers

### 10. Considering fourth-party logistics providers?

Think again: While not unanimous in this belief (some participants have had positive experiences), most members argue against using fourth-party logistics providers (4PLs). Working with 4PLs pushes companies one



additional layer from the day-to-day distribution operations and as one member stated: “There is no reason for me to engage another provider, I should have the capability and the knowledge to take my 3PLs, leverage them together, and gain economies of scale.”

Key takeaway: Maintain the internal competency to manage and leverage logistics providers

**11. Thinking that 4PLs reduce the switching cost problem?**

Think again: Members report that working with 4PLs heightens the cost and service disruption from switching logistics providers. In a 4PL relationship, the 4PL owns the distribution process definitions, management of 3PLs, and customer service solutions, which heightens the risk and complications of switching fourth-party logistics providers. As one member stated: “Everything we have done in the last five years to improve distribution has been done by our current provider and now we are not aware of the details or how to transfer those improvements to our next provider.”

Key takeaway: Ensure clear documentation of process standard operating procedures and how customers are serviced; focusing solely on performance outcomes is not sufficient.