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Outsourcing:a Magic Solution?

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BACKGROUND

Recent years have seen a big move towards the outsourcing of various elements of supply chain functionality. Traditionally, companies have outsourced transport activities to third party logistics (3PL) service providers. This was based on strategic as well as more operational factors. At a strategic level the desire to focus on "core competencies" meant that activities, such as transportation which were regarded as "non-core", had the potential to be outsourced. This left management with more time to focus on improving competitive advantage through the core business of the firm. At an operational level, sometimes companies have become aware of third party organisations that could carry out transportation functions more cost effectively and more speedily and with higher levels of customer service. Over a period of time the outsourcing focus has embraced other supply chain activities. In particular, logistics and distribution activities beyond those which are purely transportation-based (e.g. warehousing and inventory management) have increasingly been outsourced. In recent years "offshoring" of manufacturing functionality has become more common as companies seek the potential cost benefits associated with manufacturing in lower labour cost economies. The huge investment by Western companies in manufacturing capability in parts of Eastern Europe and Asia, most notably in China, is evidence of this trend.

OUTSOURCING AND SCM

Outsourcing and offshoring have been facilitated by the significant changes which have occurred in the international economic and business environment (during the last two decades in particular). It has resulted in supply chains becoming both more global and more virtual. These factors have resulted in supply chain design becoming more complex and have sharpened the focus on the need for more robust approaches to supply chain design and re-engineering. NITL's definition of supply chain management, based on the buy-make-store-move-sell model, can be used to illustrate some of these trends.

| Global Sourcing | Access to Low Cost Manufacturing Worldwide | Need for Distribution Strategies to Exploit Global Market | Global Markets |

Figure 1 – Impact of globalisation on supply chain configuration.

Figure 1 indicates that global sourcing of raw materials and other inputs has now become a reality for many organisations as the structure of the international economic and business environment evolves. This evolution, largely based on the reduction of barriers to the movement of capital, goods, services, people and information internationally, has also made access to lower cost manufacturing worldwide possible.

Furthermore, as markets have opened up internationally for a range of products and services, international (and in some cases global) selling has become the reality. All of this has implications for the logistics and distribution strategies of companies. In short, as economic globalisation has happened so supply chain architectures have become more global.

| BUY | MAKE | STORE | MOVE | SELL |
| Purchasing Consortia (EPC) | Non-core Labour Costs | Outsource to 3PL and 4PL Companies | | JVs in Sales and Marketing |

Figure 2 – Impact of outsourcing on supply chain configuration.

towards models which are based on management and control through effective supply chain relationship management. In short, as this process of vertical disintegration has taken place so supply chain architectures have become more virtual. The traditional fully vertically integrated approaches are being replaced by contemporary fully virtually integrated approaches – a new FVI is evolving.

NITL defines SCM in terms of its Four Fundamentals. The fourth fundamental recognises relationship management as a key element of good practice. This has become increasingly the case as outsourcing has become the norm for many supply chain activities in many industries. In short, SCM is concerned with value creation and increasing amounts of value are now being delivered through effective collaboration with external organisations. Indeed, thinking about the concept of value purely from the perspective of the value creation potential which exists within the four walls of one's own company is extremely limiting and can impose artificial and unnecessary barriers to the improvement of competitive advantage. This is a theme which will be returned to in a subsequent edition of Logistics Solutions.

STAGE	STEP
INITIATION	- Set project scope, objectives and time plan - Create project team or task force
DATA COLLECTION	- Determine structure of supply chain and objectives of each element - Supply chain audit: detailed data collection concerning the companies and their competitors, markets, currently available resources and future resource requirements
ANALYSIS	- Preliminary analysis of supply chain - Identification of key supply chain business processes
PLANNING / DESIGN	- Realignment of organisation and operations in line with key business processes - Detailed design of organisational structures - Detailed design of operational procedures - Develop business plans
IMPLEMENTATION	- Development implementation plans - Implementation of change - Performance measurement - Continuous improvement

Figure 3 – The Systems Approach Methodology

In tandem with globalisation the trend towards outsourcing of supply chain functionality has changed configurations as indicated in Figure 2. Key supply chain activities such as transportation, warehousing and manufacturing are increasingly being outsourced to third-party organisations. The "store" and "move" activities are being carried out by 3PL and 4PL (Fourth Party Logistics) organisations. Outsourcing of manufacturing capability is being driven by the strategic (i.e. outsourcing of "non-core" activities) and operational (i.e. offshore to lower labour cost locations particularly for labour intensive production) considerations. Furthermore, responsibility for sourcing and procurement is increasingly being pooled in some industries as a result of the establishment of purchasing consortia. Developments in technology have facilitated this with the creation of electronic purchasing consortia (EPC)[1]. Finally, much of the selling and marketing of products to end users is carried out using third parties (e.g. using joint ventures with appropriate organisations). This has resulted in a shift away from the traditional model of supply chain "control through ownership"

1. EPC is the subject of a number of major research projects in NITL. Please contact the author for further information.

A Methodological Approach to Outsourcing

The systems approach to supply chain design/re-engineering has been the subject of a number of previous articles in Logistics Solutions. It is based around a methodology which is robust in a variety of situations. Indeed, the new challenges outlined earlier can be dealt with effectively using this type of methodology. The key stages of any supply chain design process using this approach, and their constituent steps, are shown in Figure 3.

Furthermore, a number of specific outsourcing methodologies have been developed. One of the best known is Greaver's seven-step approach which is outlined in Figure 4[2].

- Planning initiatives

- Exploring strategic implications

- Analysing costs/ performance

- Selecting providers

- Negotiating terms

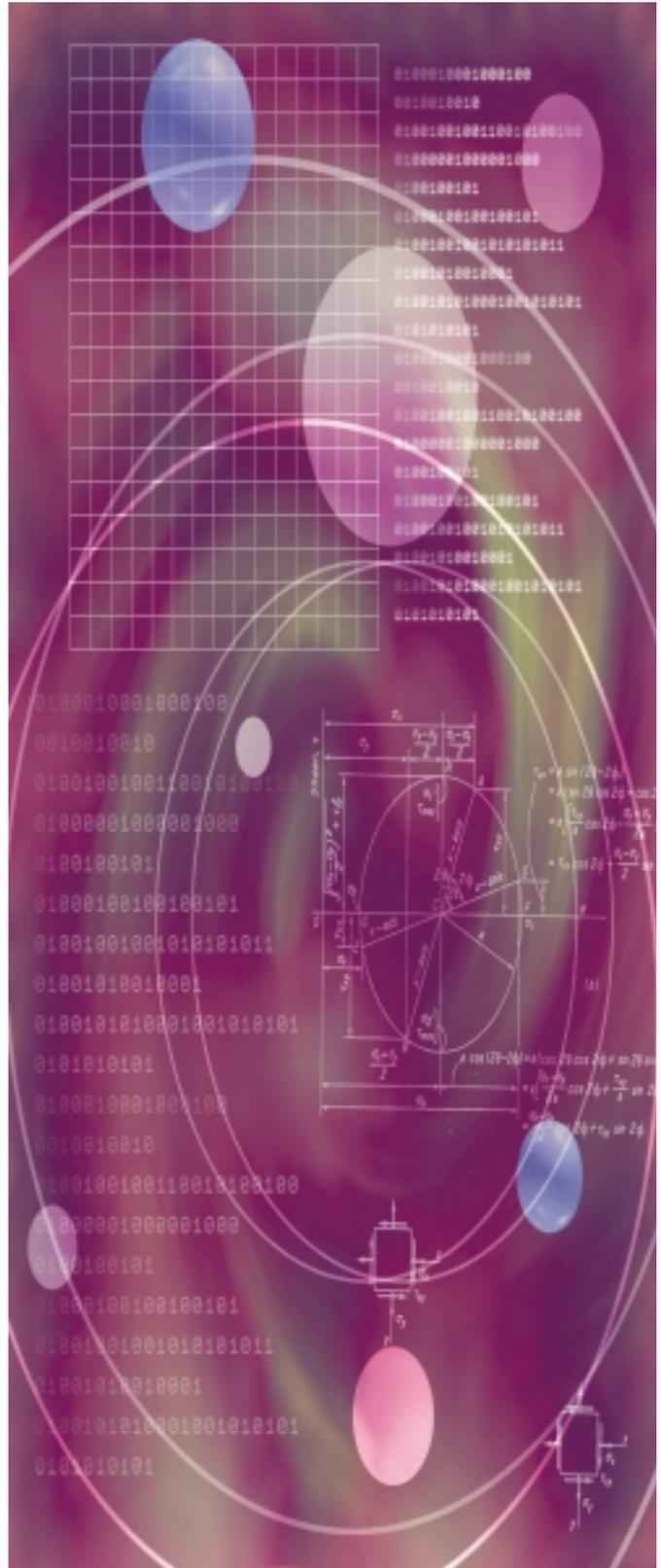- Transitioning resources

- Managing relationships

Figure 4 – Greaver's Outsourcing Methodology

Such methodologies are useful in ensuring that a logical and systematic approach is followed through the various stages of any outsourcing project. However, it is important that the outsourcing of any element of supply chain functionality is regarded first and foremost as an integral part of supply chain management and the overall supply chain design / re-engineering process. For this reason, the author has developed a methodology for the outsourcing of any supply chain activity. It is informed by approaches such a Greaver's, as well as by the author's experience of the specific issues involved. This approach can be used in conjunction with the overall systems approach methodology, thus ensuring that a holistic and integrated approach is adopted. The Technical Focus in this edition provides some more detail about this approach, which addresses three main questions:

- To outsource or not to outsource (that is the question!)?

- Outsource to whom?

- How are relationships managed and performance improved?

Answering each of these questions invariably involves consideration of a range of quite often interdependent variables and is, therefore, quite a complex process. However, there are a number of issues which typically need to be addressed. These are discussed briefly in the following sections.

2. Strategic Outsourcing, Maurice F. Greaver II, Amacom, 1999.

To outsource or not to outsource? For strategic outsourcing this needs to be driven primarily by an analysis of core competencies. A key element of strategy formulation in any organisation involves determining which business activities to focus or concentrate on (i.e. identification of the core competencies). Any supply chain activities regarded as being non-core then become potential candidates for outsourcing. Assessing how realistic this potential is and then prioritising candidate activities based on estimated expected benefits are the other key steps.

Outsource to whom? This begins with a detailed definition of requirements, which can in turn be developed into a request for quotations (RFQ) or a request for expressions of interest. Possible candidate providers of the required products and/or services can be identified. This is followed by the selection of the preferred supplier. Selection of a preferred supplier usually involves some form of short-listing process against a set of agreed criteria. These criteria are specified based on the requirement that any chosen supplier can meet requirements in terms of quality, price and service, not only now but into the future. The latter often involves a strategic and financial assessment of the potential supplier. The short-listed suppliers will then usually be the subject of a more detailed assessment, based on a more comprehensive list of selection criteria. Finally, the supplier (or suppliers) is/are chosen and an appropriate contract and service level agreement (SLA) drawn up.

How are relationships managed and performance improved? This is a complex and multi-dimensional activity. It typically involves the continuous review of supplier performance, as well as the more formal periodic review of the overall relationship. In line with the "what gets measured gets done" philosophy, reviews need to be based on pre-determined performance standards. This provides a rational basis for continuous improvement. Collaborative customer/supplier problem identification also has a potentially important role to play.

Some Concluding Comments

What's the bad news? It is unfortunate that outsourcing has come to be regarded as a kind of panacea or "magic solution" in some organisations. Several examples of failure with which the author is familiar have resulted directly from this approach. The move towards the outsourcing of labour-intensive manufacturing activities, with a view to gaining access to relatively low labour cost production, is a particular case in point. Such moves have frequently failed to achieve anything close to the expected (or, indeed, potential) benefits. In some extreme cases it has directly contributed to corporate collapse. As the aforementioned Greaver very aptly put it:

> "Like marriage, outsourcing is much easier to consummate (improperly) than it is to terminate, and recover from, if done poorly."

So what's the good news? The good news is that many companies have derived significant benefits from the outsourcing of various supply chain activities. This is true in traditional industries such as clothing and textiles, as well as in hi tech sectors such as electronics. In some cases companies can attribute their very survival to successful outsourcing. As pointed out earlier, outsourcing and the development of effective collaborative arrangements has the potential to contribute significantly to value-adding potential. In the oft-quoted words of Dr. Joachim Milberg, former Chairman of BMW,

> "Those who work alone can only accumulate, but those who collaborate intelligently can multiply."

What are the lessons? The key lessons are that the potential benefits of outsourcing can only be achieved if:

1. it is not regarded as a "magic solution";

2. it is implemented as an integral part of supply chain design; and

3. all analysis, planning and implementation is carried out logically and systematically, with proper attention to detail.

In short, outsourcing can not be carried out in a vacuum. It needs to be part of an overall integrated approach to SCM. The methodological approach outlined in this article has a role to play in ensuring that this happens in practice.