

## OUTSOURCING IN TRANSPORTATION

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**Abstract:** *The contribution deals with the outsourcing of logistics activities in transportation to third parties. Outsourcing is the use of an outside distribution company to perform all or part of company's material management of product distribution functions. The paper deals with a range of benefits and barriers to implementation outsourcing into transportation.*

**Key words:** *outsourcing, logistics, third-party logistics, supply chain management*

### TECHNOLOGY, ORGANIZATION AND MANAGEMENT OF TRANSPORT

#### INTRODUCTION

Logistics activities are expensive and capital-intensive. To move and store materials and distribute products requires a lot of space, a lot of equipment, a lot of people, and, increasingly, a lot of computer hardware and software. The outsourcing of logistics activities to third parties represents a great opportunity in some circumstances but a significant risk in others. The uncertainty inherent in outsourcing is, in fact, one of the main reasons why so few outsourcing projects have actually been attempted in the Slovak Republic. Only through the analysis of the costs and benefits will a company be able to know whether logistics outsourcing is an attractive alternative to business as usual.

#### 2 INFRASTRUCTURE ELEMENTS

Outsourcing is the use of an outside distribution company – a transportation carrier, warehouse – to perform all or part of a company's material management or product distribution functions. The scope can be narrow, limited to the simple purchasing of traditional

transportation or warehousing services, or broad, encompassing complex contracts for total supply chain management.

It can be traditional, involving the outsourcing of services that exactly duplicate the work previously performed internally, or innovative, incorporating cutting-edge logistics management tools to improve the effectiveness of the logistics function.

Outsourcing providers usually supply physical and managerial infrastructure elements:

- trucks
- warehouses
- labor and management services
- material handling assets

#### 3 BENEFITS OF OUTSOURCING

The benefits of outsourcing are not limited to reducing logistics costs. Companies can also reap a number of other improvements in both service and efficiency:

- ***Unified point of contact.***

Dealing with a single provider with more services on a long-term basis is easier and more effective than working with a battery of third parties, as it enables shipper and supplier to get closer through

the use of electronic data interchange (EDI), stationing supplier personnel in shipper organizations, and so forth.

- ***Simpler, more reliable supply chain.***

A single provider managing a supply chain can result in a more reliable, predictable flow of materials, reducing the need for in-channel safety stocks of inventory. Frequently, the speed with which material flows through the channel is also increased, further reducing inventory.

- ***Increased customer responsiveness.***

A predictable, reliable supply chain improves the quality of service provided to customers.

- ***Access to innovative logistics management techniques and information systems.***

Frequently, suppliers whose sole business focus is logistics management have developed techniques and systems that are more advanced than those individual companies are able to develop for themselves.

- ***Expertise in unfamiliar geographic areas.***

A third-party supplier may have distribution expertise in geographic territories that are new to a company.

- ***Reduced investment requirements.***

Utilizing assets supplied by others, such as trucks and warehouses, saves capitals for critical needs like manufacturing and new product development.

#### **4 BARRIERS TO IMPLEMENTATION**

Implementation of outsourcing in transportation in Slovakia is so slow. The reasons are complex, but they can be boiled down to three key barriers that exist in many companies.

**Many functions are affected.** Outsourcing is much more complicated than buying simple transportation or contract-carriage services. The functions affected by and thus involved in the decision include not only logistics is a relatively new concept, internal procedures have not been formalized in most companies to accommodate decisions on logistics outsourcing.

**Functional buying behavior and reward structures may inhibit innovation.** Implementation of contract logistics opportunity may enable a company to reduce its

transportation costs by realizing scale economies, simplified and improved routing, and other efficiencies. In many cases, however, the principal benefit is a reduction in overall logistics costs – not necessarily transportation costs. If the manager responsible for promoting a contract logistics opportunity is evaluated and rewarded solely by his ability to reduce transportation costs, the manager may be unwilling to undertake the difficult task of selling a contract logistics opportunity to the many different functions inside a corporation that need to buy in.

**Inventory is “nobody’s responsibility”.** For many companies, the principal benefit of a simpler, more reliable supply chain is reduced in-channel inventory. Although this benefit is real, in many organizations it is difficult to identify who is responsible for inventory levels and is thus the most interested in achieving inventory reduction. If the principal benefit is “nobody’s responsibility”, it may be difficult to find someone inside a corporation willing to sponsor the pursuit of a contract logistics opportunity.

#### **5 WHAT DO YOU OUTSOURCE**

Increasing numbers of shippers are realizing the potential economic advantages of outsourcing their logistics activities. In fact, 60% of Fortune 500 companies report having at least one contract with a third party logistics provider.

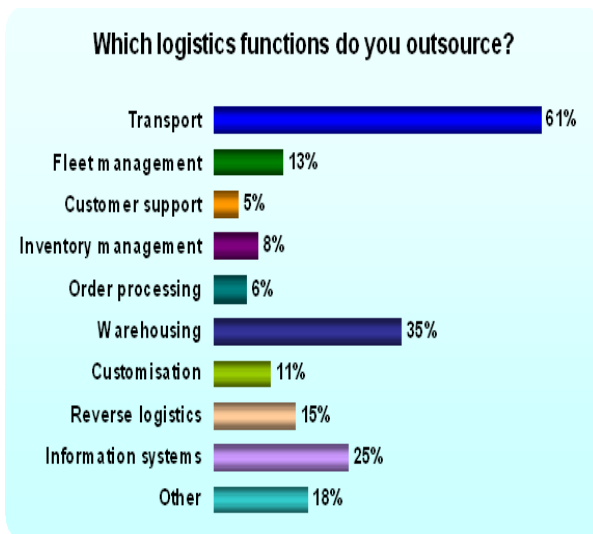
However, if 3PLs want to retain those prestigious contracts, they need to do much more than just deliver the goods. Logistics outsourcing is a dynamic, shifting and growing business environment, and shipper-3PL relationships are evolving into proactive and cohesive partnerships.

A quarter of the respondents outsource their information systems, indicating increasing confidence in 3PLs’ data security levels and their ability to manage the data. However, fleet management is only outsourced by 13% of the respondents.

Three quarters of the respondents said that co-ordination of warehousing, manufacturing and inventory management answers their logistics issues, around the same percentage of those who face frequent and dramatic shifts in customer demand.

The main reason is that outsourcing provides the client with instant access to resources like world-class services, products, processes and technology, without the need for investment in infrastructure.

Just over three quarters of the respondents believe that outsourcing logistics activities is the answer when it comes to expanding distribution systems without major capital expenses in labour, assets and technology.



**Fig 1 Outsourced logistics functions**

## 6 MANAGING LOGISTICS OUTSOURCING RISKS

Clients who outsource their logistics activities expect their 3PLs to operate as an extension of their management team, proactively seeking new ways to reduce logistics costs without compromising efficiency, and developing new and innovative logistics solutions.

While the potential for increased efficiencies and cost savings through outsourcing logistics is considerable, the survey responses highlight several areas of weakness in shipper-3PL relationships.

The parties often have different perspectives and expectations of a logistics contract. Half of the survey respondents pointed to “inefficient management” and one-third to “a clash of company cultures” as leading factors in the collapse of logistics contracts.



**Fig 2 Factors to make outsourcing strategy fail**

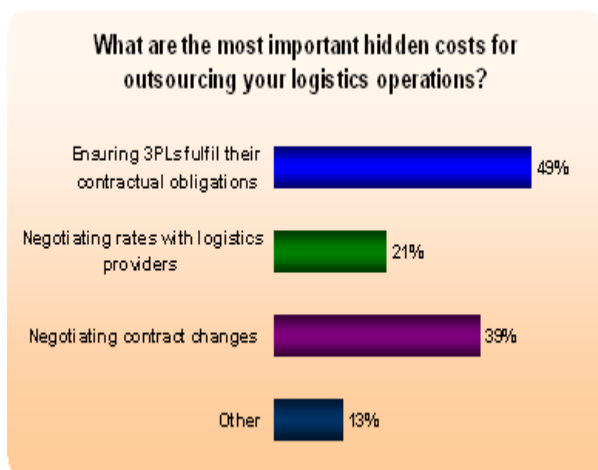
A quarter of the respondents regarded “loss of logistics innovative capacity” as one of the factors that could adversely impact their outsourcing strategies.

While a logistics company may focus on optimising revenue through tried-and-tested procedures, the client may be looking for some fresh thinking on the optimum way to get his products to market. “Here is where a meeting of the minds at top management level becomes crucial,” says Unilever’s Rod Turner.

3PLs need to immerse themselves in the client company’s culture and adapt to its management style. In return, shippers need to see their 3PLs as an extension of the management team, rather than merely vendors.

“In cases where a long-term relationship with mutual trust has been established, Volvo Logistics is close to being an integral part of management,” says Volvo Logistics’ Benny Guttman. “This has proven successful when it comes to continuous improvements.”

Other areas of concern revealed by the survey are evaluating and monitoring 3PL performance (27% of the respondents), and fear of becoming overly dependent on or losing control over the 3PL (29% and 20% respectively). However, shippers also believe that effective communication and process transparency diminishes the perception of ‘handing over control’ to a third party.

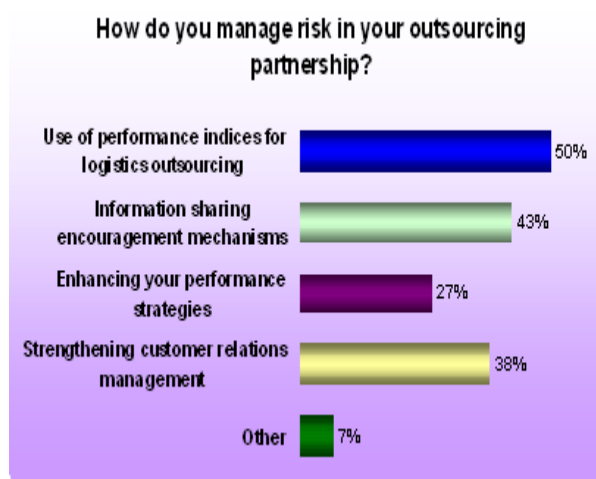


**Fig 3 Hidden costs for outsourcing**

With “hidden costs” high on the list of concerns, almost half of the respondents agreed that the major hidden cost is “ensuring that 3PLs fulfilled their obligations”. Other hidden costs included negotiating rates and contract changes to keep pace with changing requirements.

Based on the survey responses and follow-up interviews, the report suggests several ways to reduce the risk of 3PLs adding to the cost of business.

The most important safeguard is effective communication. It is imperative to establish well-defined requirements and procedures so that your logistics partner knows what is expected and how these expectations will be met and monitored. This will ensure that there will be dedicated resources available to meet anticipated needs. A good communication flow at all levels will reduce uncertainty and minimise risk.



**Fig 4 Managing risk in outsourcing**

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## ПРЕХВЪРЛЯНЕ НА ДЕЙНОСТИ В ТРАНСПОРТА

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**Резюме:** Докладът разглежда прехвърлянето на логистични дейности в транспорта на трети лица. Прехвърлянето е използвано на външна дистрибуторска компания за изпълнение на цялото или част от материалното управление на функциите на компанията за разпределяне на продукцията. Докладът представя ползите и бариерите при осъществяване на прехвърлянето в транспорта.

**Ключови думи:** прехвърляне, логистика, логистика на трети лица, управление на веригата за снабдяване.