Logistics Outsourcing: It's Not About Reducing Cost

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If you hired a cook to prepare for you, you might expect more variety of cuisines than you would prepare on your own. You might expect the cook to be able to develop a custom menu for you. You would probably expect the meals to be on schedule and to be able to modify the schedule during certain periods such as holidays. You might even expect the cook to get some good deals buying food based on volume discounts by combining purchases with the needs of their other customers. But you probably would not expect to spend less money on meals than you would have spent if you had cooked for yourself because you would have to pay the cook's salary.

Similarly, when companies hire third party logistics companies (3PLs), they often gain capabilities, flexibility, and responsiveness, and they should not base the outsourcing decision on cost savings.

Sure, 3PLs can save money on operating costs, but the savings is a decreasing part of the equation. Third party logistics companies can often purchase packaging, supplies, fuel, and equipment at lower unit prices due to their economies of scale. They sometimes, but not always, pass these lower costs on to their customers in the form of lower costs, which can reduce operating costs. Historically, they have hired union employees into non-union environments, resulting in an immediate cost savings, although sometimes with some encumbrances as employment obligations lapsed or as the union employees quit or retire. But unionization rates have declined dramatically in the past two decades (from 16% to 12% in the US since 1990), reducing this incentive to use 3PLs, and unionization is even less of an issue in developing economies such as Asia.

While operating cost savings is often not the driving force, outsourcing logistics can be financially advantageous insofar as it transfers assets to the 3PL. Offloading tangible assets such as warehouse facilities and vehicles, and intangible assets such as information systems, increases Return on Assets (ROA). Higher ROAs make companies more attractive to lenders and shareholders, making it easier to obtain loans and float shares. Furthermore, a one-time improvement through outsourcing can result in an uptick in the stock price.

However, the main benefit of hiring a 3PL is the capability to better serve customers. Third party logistic companies can provide the following strategic advantages over doing the job in-house:

- 3PLs often have a more global collection and distribution network than many shippers. Their global scale can allow shippers to extend their sourcing and distribution beyond the scope of their existing networks. The sourcing advantage can provide greater cost benefits than shippers may have initially hoped to capture by outsourcing logistics. The distribution benefits may allow them to position for sales in emerging geographies that would have been impossible to reach.
- 3PLs invest heavily in IT platforms that provide measurably higher service levels and service reliability compared to in-house logistics operations. Best-of-breed tran-sportation management systems (TMS) and warehouse management systems (WMS) provide an ability to handle complex pick/pack operations more readily than in-house solutions.
- 3PLs invest in emerging technologies like RFID sooner than their customers do because they can amortize the investment across multiple customers. This results in earlier adoption of important IT capabilities than would have occurred in-house.
- Third party logistics companies often offer value-added services such as custom packaging operations. Examples include clamshell packaging, security packaging, kitting, customized packaging by customer, or personalized packaging by consumer (for example, through individualized insertions).

The logistics outsourcing and selection process should be made in alignment with the overall business strategy. Used correctly, logistics outsourcing can be a key element of effective supply chain management. Therefore, the decision should be made at the senior executive level, and decision-makers should integrate the decision with the company's supply chain management strategy.

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