Is in-sourcing a viable option?

During these unprecedented economic times, a question frequently aired at present is whether - for those companies who have previously outsourced their logistics operations - in-sourcing is a viable option which could lead to an overall reduction in cost, at least by saving on the margin charged by the 3rd party logistics companies (3PLs).

However there is more to it than that. We also need to look at the reasons why companies outsource in the first place.

During a recent study by the Chartered Institute of Logistics and Transport, it was found that the reason most cited by companies for outsourcing their logistics was the access to greater expertise followed by cost reduction – a reversal of last year's positions. (See table 1 below)

Table 1 – What do you see are the advantages of outsourcing your logistics operation?

Advantage	Position 2009	(2008)	% 2008	% 2009
Cost reduction	2	(1)	21.5%	15.3%
Access to greater expertise	1	(2)	16.9%	16.8%
Concentration on core competencies	4	(3)	15.4%	8.4%
Flexibility	3	(4)	12.3%	11.6%
Less risk	7	(5)	4.6%	3.7%
Less capital expenditure	5	(-)	>3%	7.9%
Variable costs	6	(-)	>3%	5.3%
Consolidation	-	(8)	3.1%	<3%
More professional	-	(9)	3.1%	<3%
Effective resource management	8	(10)	3.1%	3.2%
Improved service	8	(-)	<3%	3.2%
Access to new technology etc	8	(-)	<3%	3.2%
Others e.g. 'One stop shop'; purchasing power			20%	<20.0%

CILT Outsourcing & Procurement Survey 2009

The answer can therefore be yes, no or maybe. A little vague but decisions such as these are complicated. It will depend on a number of factors as follows:

- the cost and level of service currently provided
- the type of operation
- the capital investment required
- the expertise within the company
- how important is logistics to the company

If we take each factor in turn we can determine the viability of in-sourcing in each situation.

a) *The cost and level of service currently provided*
   If the current operation is working well and the supplier is proactive and continuously working towards cost reduction and service improvement the decision to in-source is likely to depend on the type of operation, the overall strategy of the company and the strength of its management team. Recent experience suggests that a number of own account operators are not satisfied with their current arrangements and if the option to in-source was available would seriously consider it, however companies are sometimes restricted by

parent company strategy, capital investment and the will to go through another transformation.

b) *The type of operation*

A dedicated logistics operation is far easier to duplicate whilst there is also the opportunity to transfer both management and employees to the client through TUPE (transfer of undertakings, protection of employment). Whereas if the operation relies on some method of shared resource it makes it very difficult for companies to not only replicate but improve the operation.

However there is a trend emerging for companies, currently operating their own warehouses to rent space to other companies in order to minimise the cost impact. There is also the appearance of collaboration between own account operators. Examples include Kimberley Clark and Heinz and Nestle and United Biscuits. Many retailers are also collaborating with their suppliers in terms of back haul thus minimising the amount of empty running and thus reducing costs.

In terms of collaboration one of the main issues is who drives and facilitates it. At a recent CILT debate Peter Surtees, European Supply Chain Director for Kimberley Clark stated that he was disappointed that 3PLs were not driving collaboration amongst their customers. Alan Devine from Gist felt that 3PLs were proactive when it came to optimising shared use however there is a risk involved if one of the partners decides it's not part of their future strategy for one reason or another.

Therefore the expectation that 3PLs are able to broker shared use amongst manufacturers isn't as straightforward as imagined. 3PLs also tend to be more risk averse in the current climate.

c) *Capital expenditure*

The need to invest capital in logistics operations has also been a major factor in determining whether companies outsource their logistics operations. However in today's market place own account operators are just as likely to get the same deals as their 3PL counterparts both in terms of the contract length and the overall lease and contract hire costs for warehouses and equipment. Investment tends to be in staff as opposed to infrastructure. There is however the cost of I.T. systems which needs to be taken into account. These include Warehouse Management systems, Route Planning Systems and Workforce Management Systems which may all belong to the 3PL.

d) *Staff expertise*

Another reason why companies outsource is a lack of expertise within the company itself. Again this can be rectified by employing experienced supply chain and logistics managers from either the 3PL or own account sector. In fact recent surveys have suggested that manufacturers and retailers are currently strengthening their supply chain teams not only to enhance their own internal operations but also, where outsourced, put pressure on their suppliers to improve performance and reduce costs. Taking on staff does increase the headcount significantly and this may not be an acceptable strategy as far as the Board is concerned.

Another issue here is that when companies outsourced in the past they reduced their supply chain and logistics teams believing that the 3PLs would manage the whole process and there would be little need to oversee the logistics operation.
Therefore the decision to in-source is likely to be a strategy decision for the Board in terms of employing staff as there are sufficient numbers of capable staff available in the current market to work.

e) *Core competencies*
A number of companies will cite outsourcing as part of their ongoing strategy. This not only relates to logistics but also includes Information Technology, Call Centres and other back office operations. This is a viable reason and enables the company to concentrate on its core operations, however it cannot abrogate responsibility for these other functions and needs to manage them closely.

This topic is discussed in more detail in a sister paper titled 'Is logistics a core competence' Richards G (2009). The argument is not really whether logistics in the sense of getting the right product to the right place, at the right time in the right condition at an acceptable price is important to the company but whether the company feels it has the competencies within its own organisation to ensure that the above criteria are met.
If the company decides that it does not want to invest internally in the expertise and is happy with the calibre of the supplier appointed then in-sourcing is unlikely to be an option.

There is no clear cut situation where companies would automatically in-source. UK retailers are a typical example of this. Operating Distribution Centres on behalf of retailers and the delivery to store can be a very straightforward operation and a number of companies, most notably Tesco and Asda Walmart have in-sourced some of these operations, yet Iceland, on the other hand have recently outsourced all their store logistics to DHL in a £500 million contract.
In the former it may be seen that having initially outsourced there is now very little room for improvement in these operations with both parties having taken as much cost out as possible.

In these circumstances all that remains is the 3PL management fee which can range from say 5% to 15% of the total operational cost – a not insignificant number. In these circumstances if the will is there and companies are comfortable with running their own operations there is no reason why in-sourcing could not be an option.

If we examine retailer operations in detail we note that a trend is appearing for certain retailers to reduce their reliance on third parties for store delivery.

Table 2 below compiled from data provided by IGD and other sources, shows how a number of retailers have reduced their reliance on 3PLs. Only Iceland and Somerfield have increased their outsourcing of warehousing operations. Tesco have increased their outsourced transport operations but halved their % of outsourced warehousing.

An example of Tesco in-sourcing is their closure of the Fastway Distribution centre in favour of one of their own Centres. This prompted Transport Intelligence (TI) to comment that "Outsourcing has been the dominant trend in logistics over the past two decades and examples of contracts being taken in-house are rare. The fact that the UK's largest retailer believes it can manage logistics operations more profitably and efficiently itself is particularly noteworthy".

	1998 / 2003		**2007**	
RETAILER	**Warehousing** % outsourced	**Transport** % outsourced	**Warehousing** % outsourced	**Transport** % outsourced
Asda	64	64	4.1	-
Boots	50 (2003)	100 (2003)	10	100
Iceland	45	45	100	100
Sainsbury	64	74	51	51
Somerfield	50	100	100	100
Tesco	38	0	19	41
The Co-operative	11 (2004)	12 (2004)	6.5	6.5
Waitrose	48	48	46.5	42
Wilkinson	0	100	0	100

Table 2 IGD – retail DC operation and store delivery – in-house v outsourced

Where customers are unhappy with the level of service and cost incurred companies are more likely to change supplier than in-source.

The situation becomes more complicated when the management of the logistics operation relies on a significant amount of shared use, either within the warehouse or in terms of the transport operation. In these circumstances it is highly likely that companies will outsource to gain the advantages of working with 3PLs.

Shared warehousing, shared distribution and backhauling are all examples of where outsourcing can add value.

Results from the CILTUK survey show that when asked what the main reasons for outsourcing were, approximately 25% of the responses said flexibility, less capital investment and variable costs which are all allied to shared user operations. Benefits can be gained from shared resources if managed correctly.

In conclusion we can say that in-sourcing can be a viable option where operations are easily transferable and service levels are likely to increase whilst costs reduce as a result of the change. There are, however significant costs associated with these changes as are incurred when changing suppliers. These need to be managed closely and companies need to be confident that senior management and staff are committed to such changes and that the benefits far outweigh the transitional costs and upheaval.

On a final note, working closely with the current supplier, managing the relationship well and ensuring that cost reduction and service targets are written into the Service Level Agreements and monitored and reviewed regularly can make the initial question superfluous.

About the Author

Gwynne Richards FCILT is a Director of Apprise Consulting Ltd a supply chain consultancy. He is also Chairman of the Chartered Institute of Logistics and Transport Outsourcing and Procurement committee.

References

CILT Outsourcing and Procurement Survey 2009,
http://www.ciltuk.org.uk/download/Opquestion.pdf

Manners-Bell, J Transport Intelligence 18/Mar/2009
http://www.transportintelligence.com/briefs/retailing-giant-takes-part-of-its-logistics-in-house/1693/

Retail Logistics 2008 IGD 03/03/2008

Richards G (2009) Is Logistics a Core Competence? Awaiting publication Logistics and Transport Focus CILT

Further information

www.ciltuk.org.uk/pages/oandpforum

www.appriseconsulting.co.uk