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## Research Report

# Logistics Outsourcing – An Innovative Strategy or a Logistical Nightmare?

Supervisor: **Professor David Walters**

Student Name: Sangam VK

Student ID: 06199518

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## ABSTRACT

In the past, a typical company would manage all logistics processes by itself, end-to-end. Larger organisations are able to manage these activities better because they gain economies of scale from processing all logistics functions. However, business rivalry and globalisation have forced many organisations to rationalise all activities from marketing to production, human resources and now also logistics. In the process, the organisational focus has now shifted from an organisation carrying out all its activities to concentrating on its core activities; non-core activities such as logistics and other back office functions are being outsourced.

Outsourcing of logistics and supply chain services is not a new concept. While outsourcing has seen renewed emphasis in recent years, the practice can be traced back to almost as far as one would care to research it. In *Warehousing Profitably*, Ackerman (2000) suggests that one of the first business logistics arrangements is described in *The Bible*, Genesis 41<sup>1</sup>:

This is an account of the seven years of plenty during which the people in the land of Egypt accumulated crops for the predicted seven years of famine. The grains and other fruits of their labours were taken to storehouses for safekeeping.

One could argue that this could be the beginning of logistics outsourcing in the form of warehousing by a third party.

What we see today is the advanced and most modern form of outsourcing which includes value added services beyond anyone's imagination. This has contributed to the phenomenal growth of the logistics outsourcing industry worldwide. According to a recent study by Armstrong & Associates Inc., the logistics and supply chain outsourcing business exceeded US\$100 billion in 2005 in the United States of America alone. This is a 16% increase over the previous year's turnover<sup>2</sup>. This figure includes 22% revenue generated by value added services. The global revenue of Third Party Logistics (3PL) companies in 2005 was US\$ 333 billion<sup>3</sup>.

However, the success of outsourcing is in question due to an increasing number of outsourcing initiatives failing within the first year and continued discontent among the outsourcing business community. "About one quarter of all logistics outsourcing agreements fail within the first year, and 60 percent within three years," says Jim Tompkins, CEO and founder of supply chain consulting firm Tompkins Associates, Raleigh, N.C. A recent Warehousing Education and Research Council (WERC) pamphlet reported that 55% of logistics outsourcing alliances are terminated after 3-5 years. In some cases it was noticed that the relationship ended even before completion of the first year of operation. According to a survey reported by the *Journal of Commerce*, 43% of identified users of 3PLs in North America cancelled at least one 3PL contract in 1998<sup>4</sup>.

Outsourcing of logistics and supply chain activities is considered an innovative solution in view of expanding and increasingly growing globalisation. However, the outsourcing of non-core activities to a third party is not always successful. This particular issue encouraged me to investigate the reasons for outsourcing failures. This research focuses on the reasons for outsourcing failure and discontent among the outsourcing community.

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