

Building Bridges: Relationship Management is the New Core Competency

Why efficiently managing partnerships is at the root of all successful logistics outsourcing.

White Paper

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The growth of logistics outsourcing continues, with some estimates putting the total outsourcing logistics market at nearly 10 percent of the total \$1.3 trillion spent on logistics-related activities in the United States. The largest logistics service providers currently enjoy annual revenue growth rates of 10 percent, as shippers continue to focus their core businesses while engaging outside experts to achieve competitive advantage.

Consider this surprising statistic, however. Despite the apparent win-win opportunity for service providers and shippers, more than half of all outsourced logistics contracts end within five years. (Source: WERC)

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Why? We're not exactly sure because, like many industries, we tend not to talk about failures. Perhaps we fear such notoriety might slow the outsourcing growth trend. Perhaps it's that failures often are perceived to typically be the fault of the third party. Outsourcers, too, are reluctant to discuss the potential lessons learned from these failed marriages and how those lessons might be brought to bear in today's logistics environment.

Make no mistake; the rewards of a successful logistics outsourcing partnership are enormous. In the telecommunications industry, for instance, the total logistics costs for companies regarded as having "best-in-class" logistics practices equal 7.3 percent of revenues; the median is 14.3 percent (source: PRTM). For a \$1 billion company using a third party to drive best practice performance, that difference equates to nearly \$70 million annually. A poorly managed partnership can result in downside that is just as enormous, based on poor performance, lost sales and shattered customer confidence.

It seems apparent that identifying what makes some logistics outsourcing relationships flourish while others do not would pay handsomely. It's our experience, as this article will outline, that effective relationship management is at the root of all successful outsourcing partnerships.

There is a proven model for successful relationship management. It involves the creation of a structured dialogue where both shipper and service provider invest in the relationship and take a more collaborative approach throughout the process. This article looks at how companies and their logistics partners can better manage this process from its strategic inception through tactical implementation, as the two firms integrate their operations.

THE COURTING STAGE

Let's make clear that what happens before the search for a third-party logistics partner is the most important period in the entire outsourcing chronology. As illustrated in the stages of the

"Outsourcing Process" diagram (figure A), most activity occurs in the planning stages – well before outsourcing. It's imperative that the outsourcing company does two things: (1) clearly define its strategic reasons for outsourcing logistics and (2) gain executive sponsorship for the decision. Executive support is critical since the company actually may need to initially invest additional resources to maximize the outsourcing benefits. Next, the company must clearly define specific objectives and expected benefits.

It shouldn't be surprising that most companies cite "unclear expectations" as the main reason logistics outsourcing deals fail. The two partners must mutually agree on the outcomes at the start of the relationship. These outcomes should not be defined solely in cost-reduction terms. Too often, outsourcing companies fail to assess the total value and revenue growth opportunities linked to an agile logistics infrastructure that drives consistent, superior customer service. In the larger picture, that may be where the most value can be found.

Outsourcing Process



Figure A

Why don't outsourcing companies invest the necessary time planning for success? Some equate "outsourcing" with "out of my company and out of my hair." In fact, the number one reason outsourcing relationships of any kind fail is a lack of resources deployed to manage the relationship (source: Outsourcing World Summit).

Companies may be outsourcing logistics to focus on their core businesses but they must develop a new core competency - relationship management.

It's no coincidence that leaders in the area of managing logistics service providers, such as Sun Microsystems and Nortel Networks, have dedicated staff to manage their relationships with third-party providers. This staff actively monitors the relationship to assure the company is maximizing outsourcing benefits.

Once the outsourcing company finishes the tough up-front work, the next step is choosing the right partner. Unfortunately, both parties frequently enter the dialogue in "buyer vs. seller" modes. The potential pitfalls are obvious. On the one hand, companies often fail to share all the data available with their prospective partner. Third parties, on the other hand, faced with circumstances they know may lead to less-than-optimum results (e.g., poor or no data), fail to push back and actively manage the data-sharing process.

Third parties' expertise demands that they bear the burden for making sure the relationship gets off to the best start. Many buyers of logistics services do not deal with outsourcing and start-up issues as part of their daily routine. It's up to the logistics services provider to know when things are headed in the wrong direction and to say, "Stop!"

Some outsourcing relationships are doomed from the start because of what does or doesn't happen during the planning and selling stages. The answer – for both shipper and service partner – is to shed the inclination to "make a deal" and instead decide to collaborate to solve a logistics problem.

GETTING HITCHED

That sense of mutual ownership must extend beyond the third-party selection point. The partnership period begins in earnest during the critical 60-days-before through 90-days-after the transition point. This is a period when clear and frequent communication is essential.

Some service providers make the mistake of using a "SWAT" team approach to transition management. In these instances, a special team comes in to get the operation rolling before moving on to another project after a brief transition phase. While a short-term transition team may keep all the balls in the air during this critical period, a new team cannot be expected to sustain this juggling act.

A better model is a third-party dedicated team that works with the customer during – and beyond – the initial transition to assure successful long-term integration and sustained operational excellence. The model should be an integration team rather than a transition team.

This integration team must use documented process steps in establishing clear timelines and metrics. It must invest time to communicate clearly and often about progress, particularly in areas where objectives may slip. Good partners over-communicate rather than under-communicate.

Sharing good as well as bad news, successful integration teams keep

surprises to a minimum while earning their new customer's respect.

Realistic outsourcing companies don't expect perfection from the start. In fact, they anticipate minor hiccups as new staff is trained to understand their business' nuances. They also invest appropriate resources to aid in the transition. This assistance should stop short of micromanaging the implementation. Remember, third parties add the greatest value leveraging their expertise to bring best-practice performance to bear on an outsourcing company's operation. Little value is added when the third party simply provides the labor to implement a pre-ordained strategy or process.

AFTER HONEYMOON IS OVER

Let's say the shipper has taken a careful, planned approach to outsourcing part or all of its logistics functions. There is a strategic imperative to outsource, objectives are clear and the company has developed a good collaborative working relationship with its service partner. The challenge becomes how to manage the relationship to continue to drive superior value and results.

Most logistics service providers, asked how they manage quality assurance, can provide stacks of procedure manuals and flow charts to assuage the most skeptical quality-assurance manager. After all, logistics is an operational function that requires the operating disciplines exemplified by detailed procedure manuals.

Ask the same service providers, however, how they assure quality in relationship management and you will hear words like "trust," "communication," "partnership," and "honesty." Encouraging words – but absent strict disciplines, they may not

translate into action and benefits. We need to get beyond talk to institutionalize relationship management. Third parties must have the processes in place to manage dynamic relationships that require constant monitoring to adapt to clients' changing needs.

Here are several specific ways both the shipper and service provider can formalize the critical process of relationship management.

- **Appoint a business manager.** This is the "relationship manager" with overall responsibility for directing client-related activities, from strategic planning to day-to-day operations to customer service. He or she is the single access point to the third party. This manager must not be saddled with excess operational responsibility. Too often this person is relationship manager in name only, spending too much time fighting operational brushfires while the relationship goes unattended. He or she must be allowed to invest the necessary time to understand the customer's business and make proactive suggestions based on the provider's experience. Customers want and expect this level of support from third parties.

The outsourcing company must treat its third party and the third party's business manager as partners, providing access to strategic plans and other key information. Shippers should also consider appointing their own specific resource to monitor, support and get the most value from the third party's expertise.

- **Drive ownership** of the customer's objectives to the operations level. Associates who handle the product must have visibility to and understanding of the customer objectives that drive logistics success. Too often the

service provider does not effectively communicate objectives to the people who do the work and have the most influence on whether or not operational metrics are met.

- **Assess customer confidence** at different levels of the organization. It's important for the service provider to periodically review perceived customer value by asking, "How are we doing?" This review, occurring outside the day-to-day operational context, should pose these questions to both strategic-level upper management contacts and daily contacts. The service provider will often be surprised to discover that, at different levels, the customer's perceptions of delivered value vary widely.

Such surveys demand an investment in time by both the shipper and its service provider. They must both be willing to reassess not just "Where do we go from here?" but "Where do we need to go to drive the business forward?" The key to success, of course, is not only asking but also doing. Service providers must listen – and act – on the input for this survey process to have credibility and value.

- **Structure the relationship's economics** to drive continuous improvement. While a "cost plus" pricing model is common, it does not incent the provider to continue to drive out process inefficiencies. Outsourcers and their service providers should consider a unit rate structure that rewards the provider who constantly asks, "How can I improve the process to do more with less?" It may be difficult to establish unit rates at the onset of a relationship but mutually agreeable rates can be determined after the business dynamics are well understood.

Contractual gain-sharing agreements are another way to drive accountability to a bottom-line level. They provide a clear incentive for the service provider to continue to generate service improvements and cost control. Typically, the third party receives a percentage of the documented value. For example, if a service provider suggests a new packing method that eliminates waste and annually saves \$100,000 in packaging costs, the provider may receive 25 percent of first-year savings, after which all savings accrue to the customer. Incentives should also be linked to quality improvements that may not have a measurable savings benefit but nonetheless drive significant value.

A word of caution: Gain-sharing agreements are difficult to monitor and manage and should only be developed where there is a strong, trusting relationship between the two organizations.

The biggest misperception about the longevity of third-party outsourcing arrangements is that the relationship will continue if the provider continues to meet and exceed customer service requirements. In fact, service consistency is merely the price of entry in today's logistics environment. Customers expect their provider to consistently deliver high service quality while being agile and innovative.

Long-term customer loyalty, however, can only be built after the tactical foundation has been laid, as illustrated in Figure B. It's clear that the interactions required to maintain relationships differ significantly from those that sustain and grow the relationship. Loyalty is not won at the bottom of this relationship hierarchy triangle.

ANTICIPATING NEEDS

At the apex of the model, third parties not only respond to customer requirements, but also – based on an in-depth understanding of their customer’s business – anticipate needs and offer proactive solutions. This level of strategic interaction requires a service provider equipped with the necessary orientation and commitment to this level of value. It also demands a shipper willing to embrace its service provider as a true strategic partner who is given access to strategic plans and other data.

Logistics outsourcing relationships may exist at one of three levels:

1. The third party implements one or more logistics functions, such as warehousing or transportation. Cost drives this tactical solution; the provider is viewed as a commodity.
2. The third party executes logistics functions but also adds value by designing solutions. Shippers pay more for this value-added service.
3. In its ultimate state, the company and its third-party service provider are fully integrated: at the strategic level with joint planning teams; at the operational

The Customer Relationship Hierarchy

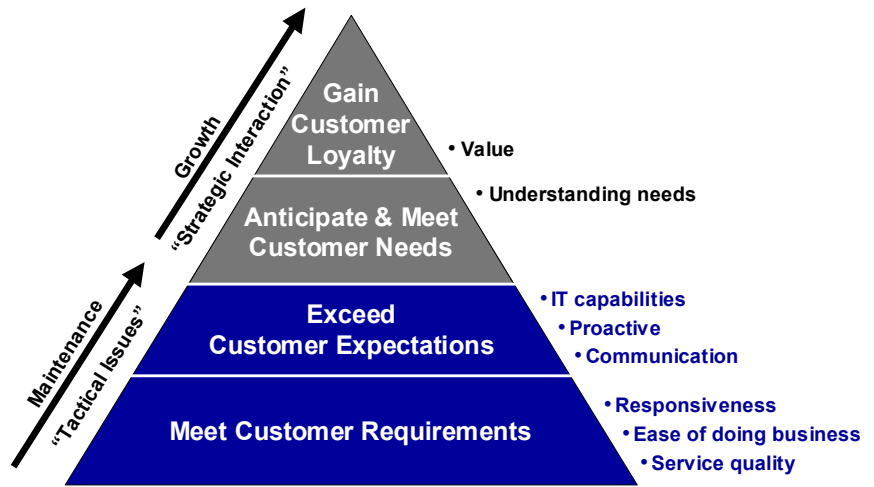


Figure B

level with cross-functional improvement teams; and at the systems level with integrated information systems that interact in real time. Here the third party designs, as well as executes, logistics strategy, becoming part of the shipper’s extended enterprise - part of its business family.

It’s at Level Three where maximum value can be derived. Of course, not all companies desire this level of integration with their logistics provider. But even purely tactical relationships can be enhanced when

there is a strategic rationale for outsourcing; where expectations between shipper and provider are clear; and there are adequate resources invested and a structure in place to proactively manage the relationship.

Regardless of specifics, in the end, effective relationship management is at the root of all successful outsourcing.

