

# Chapter 3

## Contracting for Logistics Services: A Critical Appraisal of the Outsourcing Process

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### ABSTRACT

*This chapter seeks to critically revisit existing third party logistics (3PL) purchasing literature with the aim of bridging the gap between academic research and industry practice regarding logistics outsourcing. This is achieved by focusing on hitherto under-emphasized issues (in the academic literature) relating to the role of the service provider, as opposed to that of the buyer, in 3PL exchange design and management, and the dynamics of the outsourcing process. Drawing on recent developments and practices in the 3PL industry and two in-depth case studies of logistics outsourcing, the study suggests that, under increasing complexity and uncertainty levels, the service provider in interaction with the buying firm significantly influences service definition, design, and evaluation throughout the outsourcing process. The exchanged service is not determined from the outset of the outsourcing process but it is (re)shaped in an iterative and ongoing fashion. Based on such findings, the chapter calls for increased emphasis on a dynamic and inter-organizational (buyer-service provider) perspective into the study of logistics outsourcing processes.*

### INTRODUCTION

A wide range of organisations both in the private and public sector focus on core skills and competences and contract-out non-core activities, thus increasing the share of bought-in goods and business services (Axelsson and Wynstra, 2002;

Gadde and Håkansson, 2001). The latest forms of this trend include off-shoring and near-shoring, where products and services are sourced from low-cost regions and countries such as China and India. Generally speaking, it is estimated that purchasing-to-sales ratios are in the range of 50-70% for manufacturing sectors and 80-95% for retailers (Axelsson et al., 2005), with the majority of purchases concerning business services. The

DOI: 10.4018/978-1-4666-2008-7.ch003

continuing trend of outsourcing in supply chains in tandem with a shifting emphasis towards integrated product-service offerings have resulted in an increasing importance of business-to-business (B2B) service markets.

Outsourcing logistics services is a typical example of such developments. According to a recent study (Lieb and Butner, 2007), the global third party logistics (3PL) industry generates annual revenues in excess of \$225 (£110) billion by serving the needs of raw material producers, manufactures, retailers and public sector agencies. A notable example in Europe is the ongoing deal between the UK National Health Service (NHS) and DHL, a leading express parcels and contract logistics operator, for the procurement, storage and distribution of hospital supplies across the country. The ten-year contract is expected to affect the provision of £22 billions of medical goods and services and result in £1.1 billion of cost savings (NHS Supply Chain, 2011). Despite the widespread adoption of third party logistics globally, there are still reported problems associated with the design and control of outsourcing relationships such as inadequate definition of services and performance measurement difficulties (Wilding & Juriado, 2004; Ackerman, 1996).

This chapter deals with such problems by focusing on the process of outsourcing logistics services, i.e. the process of designing a logistics service contract and managing the logistics outsourcing relationships in the post-contracting period. Drawing on recent developments in the contract logistics market and two in-depth case studies of logistics outsourcing from the UK market context, the study seeks to critically revisit existing literature with the aim of bridging the gap between academic research and industry practice regarding logistics outsourcing. This is achieved by focusing on hitherto under-emphasised issues (in the academic literature) relating to the role of the service provider, as opposed to that of the buyer, in 3PL exchange design and management, and the dynamics of the outsourcing process.

## **BACKGROUND**

This section reviews the extant third party logistics literature and motivates the research objective by discussing the weaknesses of existing logistics outsourcing process frameworks.

### **Third Party Logistics**

Outsourcing of logistics activities in a wide variety of industrial sectors such as automotive, hi-tech and consumer electronics, healthcare, chemicals, and retail is continuing at a steady pace. The continuing wave of consolidation within the 3PL industry has also resulted in the emergence of large companies that have the capabilities to offer sophisticated logistics solutions on a continental or even global scale (Selviaridis, 2008). A well-known example is the recent merger of DHL and Exel, a leading UK logistics company, with the aim of creating a global service network including air and ocean freight and contract logistics solutions. Such logistics service providers (LSPs) increasingly strive to assume a more strategic role within the supply chain of clients, expanding their scale and scope of operations.

These industry developments have triggered academic interest in this field with research and publications being on the rise (Selviaridis & Spring, 2007). Terms such as logistics outsourcing, third party logistics and contract logistics have been widely used to describe the organizational practice of contracting-out part of or all logistics activities that were previously performed in-house (Aertsen, 1993; Bowersox, 1990; Lieb, 1992; Sink et al., 1996). 3PL is usually associated with the offering of multiple, bundled services, rather than just isolated transport or warehousing functions (Leahy et al., 1995). In recent years several other related terms have emerged with the aim of describing more advanced and complicated contracting arrangements in the industry. The term 4PL™, for instance, is a trademark owned by Accenture and it was originally developed to

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