

# Supply Chain

EUROPE

May/June 2010

www.scemagazine.com

ISSN 1742-447X

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### OUTSOURCING

Ten fatal errors, and five ways to combat them

### PROCUREMENT

Closing the source to pay loop



# MOTOR INDUSTRY

Jaguar's outsourcing success  
Accelerating out of a spin

... source ... make ... store ... ship ... deliver ... recycle ...

# THE FIVE GOLDEN RULES TO TRANSFORMING OUTSOURCING PARTNERSHIPS

As co-author of a new book entitled 'Vested Outsourcing,' Kate Vitasek — a leading academic from the University of Tennessee — outlines the ten key ailments that commonly afflict outsourced partnerships, and presents five golden rules for success.

Outsourcing has been an established commercial practice for a quarter of a century — since the days when Peter Drucker coined the mantra: "Do what you do best, and outsource the rest." Although precise definitions are contentious, it has been estimated that outsourcing programmes account for 12% of US GDP. Three out of five companies, polled in a recent PricewaterhouseCoopers survey, have outsourced at least some business processes, and a 2008 Deloitte Consulting Outsourcing Report suggested that "83% of respondents reported that their projects had met their ROI goals of slightly above 25%."

And yet, business is littered with stories of outsourcing projects that fail — or perhaps, more importantly, fail to stay the distance. There are initial gains, certainly, but followed by a relationship that descends into acrimony. Some partnerships, such as the 20-year alliance between Jaguar and Unipart Logistics, just keep on delivering for both parties; others run

into the sand. This perplexed the United States Air Force (USAF), which spends more than \$60 billion a year with outsourcing partners. Why are some deals, such as that of GE with the US Navy for maintenance of the J404 aircraft engine, so successful, whilst other apparently similar deals disappoint or fail? USAF asked the University of Tennessee to investigate, and the results are contained in 'Vested Outsourcing — five rules that will transform outsourcing.'<sup>1</sup>

Lead author Kate Vitasek explains that after studying many outsourcing relationships in logistics and in other business processes, they have identified ten 'ailments' that impede successful outsourcing, and the five rules that will help both sides to find 'the pony.' 'The pony,' Vitasek explains, is the difference between today's solution and what the optimized solution could look like — if the parties only knew to look for it. (The derivation comes from the dialogue: "Why are you excavating that pile of horse manure, little boy?" "Why Sir, for this amount of manure there must

be a pony in their somewhere"). The point is that, except for the outsourcing of the most commoditized services and processes, real and enduring success for both parties comes from thinking and acting, not about 'What's in it for me?' (WIFM), but 'What's in it for WE?' (WIFWE). In other words, says Vitasek, outsourcing partnerships are not to be seen as a zero-sum game; by working together and following the five rules, the game gets bigger for both sides. That's the pony.

There is little that is surprising there. Most firms go into outsourcing arrangements with at least the vague idea that they will bring inputs and resources together — capital assets, skills, knowledge or whatever — to benefit both sides. So what are these ailments that frustrate such good intentions? It's worth noting, although not explicit in 'Vested Outsourcing,' that several of these behaviours are not exclusive to outsourcing. They can be found, for example, in the relationships between different departments of the same



organization if those are working to differing objectives and incentives.

The ten key ailments highlighted by Vitasek are

- 1. Penny wise, pound foolish.** A company outsources purely on cost. This can lead to trade-offs in quality and service, 'beating up' the supplier, and a vicious cycle of re-bidding, and transitioning to a new 'cheaper' supplier. Either outsource providers will refuse to work with that firm, or they may bid so low that they go out of business.
- 2. The 'outsourcing paradox'** is Vitasek's term for the situation where the service buyer's 'experts' attempt to define a 'perfect' Statement of Work on how the process is to be performed, down to the last touch. Obviously, there is then no scope for the service provider to bring their own skills, knowledge and abilities to the table.
- 3. The activity trap.** Related to the last point, this is where providers are rewarded on a transaction basis — the more operations they perform, the greater their revenue and profit. Clearly, there is no incentive to reduce the number of non-value-added transactions, because that would result in loss of revenue.
- 4. 'The junkyard dog factor,'** as Vitasek terms it, is where employees in the outsourcing firm, to protect their own jobs or status, insist that certain processes simply must stay in house. Often, notes Vitasek, this also means that the 'best' employees, perhaps those who wrote the Statement of Work in ailment 2, are retained in house as largely unnecessary 'supplier managers.'
- 5. The honeymoon effect.** Initially all is positive, as the provider ramps up to meet the customer's expectations. But after a time, the low hanging fruit has been plucked, there is little incentive for the supplier to try harder for the more difficult goals, or to renew investment, and the relationship deteriorates.
- 6. Sandbagging.** To get over the honeymoon effect, a buyer might offer bonuses that are payable on set performance improvements — perhaps a certain percentage reduction in inventory holding each year. It may, in fact, be possible to outperform this, especially in the early years, but the provider will be sorely tempted to 'bank' this potential gain against harder times.
- 7. The zero-sum game.** This is self-explanatory — the belief that if something is good for the outsource provider, it is automatically bad for the buying side. Almost everyone in business school has studied game theory, but it seems much harder to think 'win-win' in practice. Vitasek extols 'the power of ANDS:' 'can I have improved service AND lower cost?' The answer is probably, but not if you don't believe in the possibility of 'win-win' to start with.
- 8. Driving blind** is quite simply the failure of the parties to start off with an agreed

definition of what success will look like.

Often, costs are tracked, but there is little formal governance devoted to the other aspects of the relationship, such as service levels.

- 9. Measurement minutiae** shows up in a plethora of metrics, designed to capture every single aspect of the outsource provider's performance — perhaps 50 or 100 metrics — requiring years of person-time, and many of which may be of little practical assistance, if indeed they are ever reviewed at all.
- 10. 'The power of not doing.'** The contract may, for example, specify quarterly review meetings around a scorecard of metrics, but if the metrics are not monitored and the meetings not held, sub-optimal performance should hardly come as a surprise.

Those are the common problems that Vitasek and her team have identified in failed or failing outsourcing arrangements. But is there an alternative approach? How have relationships such as that of Jaguar and Unipart Logistics managed to avoid at least the majority of these traps?, Vitasek says: "First, you really have to believe that there is value (the pony) to be had by going down the vested outsourcing route. If not, don't go down that path. The conventional approach treats outsourcing almost as a commodity: I have low skills so I'm going to outsource to an expert, but the process is of low value to me, so I'll use Adam Smith market forces to drive down costs. But even in a moderately complex outsourcing model there will be a few suppliers that are really good, that could provide a huge opportunity to unlock value. I'm going to outsource to you because you are smarter than me, you're going to unlock that value and together we are going to share it."

For success in these sorts of outsourcing partnerships, 'Vested outsourcing' implies the adoption, by both sides, of five rules.

**Rule 1:** Focus on outcome, not transactions. Flip the thinking from what detailed operations the service provider is performing to desired outcomes. How is the provider improving turnaround or whatever the problem was? Desired outcomes are still quantifiable, but take a different form — they may be targets for availability, reliability, revenue generation, employee or customer satisfaction and the like. For example, Unipart Logistics and Jaguar have a joint vision 'To support Jaguar Dealers in delivering a Unique Personal Ownership to



Jaguar drivers worldwide, ensuring industry leading owner loyalty through partnership and world-class logistics.' This joint vision empowers Unipart Logistics to deliver the logistics solution that enables Jaguar to maintain its leading position and its quality image.

**Rule 2:** Focus on the 'what' and not the 'how.' If the partnership is going to be outcome-based, it can no longer have a hundred different Service Level Agreements (SLAs) that the buyer is going to micromanage. The outsource provider has won the contract because he is supposed to have the expertise that the buyer lacks. So the latter has to trust the former to solve problems. The service provider is, or should be, constantly in the marketplace, keeping tabs on new developments and processes. Performance partnerships let each firm do what it does best — unless you have the skills and resources to keep up with the latest innovations — so leave the details to the experts. Don't

paint the supplier into a box, but give him the flexibility to bring his skills to the job. In the Jaguar-Unipart relationship, Unipart Logistics invests in the creation and implementation of unique processes and products to maintain a continuous improvement to its service. For instance, the Direct to Dealer programme has increased availability and shortened lead-time on customer-critical orders.

**Rule 3:** Be very clear about well-defined and measurable outcomes. Ideally, there shouldn't be more than about five high-level metrics. All parties, which may of course include users and other stakeholders that aren't directly signing the contract, need to spend time collaboratively, during the outsourcing process, and especially during the contract negotiations, to establish explicit definitions for how relationship success will be measured. Given those outcomes, the service provider can propose a solution that will deliver at an acceptable pre-determined price.

## Driving Jaguar's Global Aftermarket Support

A Jaguar is an instantly recognizable symbol of success, reflected in its reputation for quality and unsurpassed customer service. Maintaining its leading position and its quality brand image demands excellence in aftermarket and service support — something that the Jaguar team delivers through a long-standing partnership with Unipart Logistics.

The two companies have worked together for more than 20 years. Unipart Logistics have provided Jaguar with a full automotive parts service — which includes sourcing, storing, processing and despatching parts from 14 warehouses, located in the UK, USA, Canada, Germany, Spain, Russia, China, Japan and South Africa — to more than 700 Jaguar dealers in at least 60 countries. Unipart Logistics teams provide dedicated customer service, procurement, pricing, parts marketing and finance support. Its aim is to ensure that the right part is in the right place at the right time, 24 hours a day, seven days a week.

In addition to delivering a global logistics service, Unipart Logistics invests in the creation and implementation of unique processes and products to maintain continuous improvement to its service for Jaguar. The company supports the car maker's expansion into emerging markets, such as China and Russia, by project managing the delivery of new warehouse facilities. And, once the facility has 'gone live,' it then delivers ongoing aftermarket parts logistics and business services support, including

- Unipart Logistics System (ULS) — a global, end-to-end supply chain system, with an accompanying set of business processes.
- Unidial Parts Communication — a browser-based, multi-lingual management system, which links into the Unipart Logistics System and enables dealers to track orders in real-time.

- Unipart Parts Replenishment System (UPR) — an online business system to manage a dealer's inventory, improving their availability and automatically replenishing stock.
- Direct to Dealer (D2D) programme — this has increased the availability and shortened the lead-time on critical orders, servicing key European dealers directly from the UK warehouse, with emergency orders coming from one of Unipart Logistics' European facilities.

During recent years, Unipart Logistics has developed the Jaguar Global Control Centre as the focal point to manage, monitor and provide finger-tip control of the complex Jaguar aftermarket parts supply chain, using a SAP enterprise resource planning system that provides a single version of the truth. This state-of-the-art centre brings together people, processes and systems to continuously improve each step of the supply chain and create harmony. Regular reviews of service level targets between Jaguar and Unipart Logistics ensure that supply chain performance is quantified. These service level targets range from availability through to problem resolution and customer satisfaction. An ongoing joint commitment to focus on the customer ensures that world-class levels of service are consistently achieved.

Unipart Logistics is fully involved in Jaguar's business, from a new model's development through to its launch, and the support continues throughout the whole of the car's lifespan. With the provision of a Jaguar Classic service, Unipart Logistics manages the "whole life" of the vehicle, providing parts and specialist customer support on Classic vehicles, such as the E-Type.

### More information

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This actually constitutes a fundamental shift in the business model, it moves risk from the outsourcing company to the service provider, and the latter is paid for the value the desirable outcomes produce, not for the activities performed. The Jaguar Global Control Centre is the focal point to manage, measure and control the complex Jaguar aftermarket parts supply chain, from scheduling orders on suppliers through to dealer deliveries. It brings together people, processes and systems to continuously improve each step of the supply chain.

**Rule 4:** Optimize pricing model incentives for the best cost/service trade-offs. Vitasek says: "I need to pay on incentives that encourage you to optimize my trade-offs, to find the 'power of AND.' When you achieve 'AND,' how am I going to pay you?" This may imply open book accounting, although Vitasek acknowledges that isn't always possible. Vested Outsourcing does not guarantee higher profits for service

providers — they are taking a calculated risk. But it does provide them with the autonomy and authority to make strategic investments in their processes that can generate a greater ROI for them over time, perhaps more than a conventional cost-plus or fixed price contract might produce, during the same period.

Unipart Logistics invested significant resource in reviewing compliance and reducing duty payments — the benefits of which were shared between both companies.

**Rule 5:** A governance structure should provide insight, not merely oversight. In the early days of outsourcing, the authors say, some companies simply threw the work over the fence, with poorly defined requirements and few, or no, performance metrics or SLAs. Unfortunately, some have gone to the other extreme, with small armies micromanaging the outsource providers. The structure that governs an outsource agreement should be providing both

parties with real knowledge of how operations are developing and improving. And, of course, of where the next threats and challenges may be coming from. As Vitasek says: "Contracts may be static, but outsourcing is dynamic."

The Unipart Logistics team work with Jaguar engineers, during the development of a new vehicle, to ensure a high level of parts availability to underpin a car's debut. The collaborative relationship works too to support Jaguar's expansion into new markets, such as China, where Unipart Logistics has delivered a fully operational warehouse in Suzhou, near Shanghai.

Jaguar and Unipart Logistics are cited by Vitasek as having an outsourcing relationship that has, in large part, avoided the 'ailments' and followed the 'rules,' as shown by the fact that the arrangement has continued to succeed for two decades — even surviving changes of ownership at Jaguar. She claims that "Jaguar say 'we never look at the contract, we behave this way.' I advocate writing a contract that's right for business, but then shove it under the table and don't look at it. What Jaguar and Unipart Logistics have is a shared vision, as well as one of the best 'lean' philosophies in the world, outside Toyota. End-to-end, total-cost, lean thinking applied across the supply chain is pretty powerful. Unipart Logistics convey their lean thinking to the supply chain, which then unlocks value for Jaguar.

"It is no coincidence that Jaguar is Number One in the JD Powers survey for aftermarket support. Unipart Logistics has enabled Jaguar to achieve this, and it is something that has happened over many years. Like GE and the Navy, Unipart Logistics makes sure the parts are there. Unipart and Jaguar have followed the rules — with a shared vision and a long-term contract on a lean path," says Vitasek. And that makes for an effective and workable partnership. •

### Reference

1. K. Vitasek, M. Ledyard, K. Manrodt; published by Palgrave Macmillan.

### For more information

Kate Vitasek is a faculty member at the University of Tennessee's Center for Executive Education, and the founder of Supply Chain Visions. Her co-authors, Mike Ledyard, an experienced supply chain executive in international sourcing, manufacture and importing, and Karl Manrodt, an Associate Professor at Georgia Southern University, with a special interest in performance management.