

SUPPLY CHAIN TRENDS AND ISSUES

Is the key to improving supply chain outsourcing relationships to focus on "What's in it for we?" and not "What's in it for me?"

That change in attitude is the foundation of the new concept of Vested Outsourcing, recently introduced by Kate Vitasek and others at the University of Tennessee. Last week, we explored some of the basics of this concept, which has its roots in the related concept of "Performance-Based Logistics." Last week, we explored the basic tenets of the approach, as well as what Vitasek sees as the pillars of success. (See ["Is Vested Outsourcing" the Key to Fixing What Ails Most Outsourcing Relationships?](#); to see a video interview, go here: [Supply Chain Video: Time for "Vested Outsourcing" Partnerships?](#))

This week, we look at how it might play out in practice in more detail.

"The term "vested" really connotes that this is a higher level of outsourcing," Vitasek says. "It is really beyond putting performance metrics as part of the deal, and really investing in the relationship."

Vitasek says at the core of VO is the alignment of metrics – so that all parties become focused on the same quantifiable objectives. That means, for example, that if a 3PL or contract manufacturer finds a way to innovate and reduce costs, they shouldn't be penalized for that – and should in fact have some upside. Both sides need to benefit in the financial results of improvement or innovation.

"The rules of the game need to be clearly spelled out through the contract and contract incentives that balance the risk/reward. This encourages and rewards supplier innovation," Vitasek says.

Is "Vested Outsourcing" the Key to Fixing What Ails Most Outsourcing Relationships? Part 2



SCDigest Editorial Staff

She offers the example of a company that would like to reduce logistics costs by say \$1 million while maintain service levels. If a 3PL can find a way to accomplish that, which potentially could reduce their transaction volume or revenues from a client, they need to have some upside – sharing in the savings for some period of time.

That sounds a lot like "gainsharing," a concept that has been around for some time, but Vitasek says VO uses gainsharing principles in part but adds a more strategic component that has a higher focus on fostering a climate of innovation in the relationship.

"Where profit-sharing is based on profitability or cost measures – or,

managing one's portion of the existing piece of the pie – Vested Outsourcing focuses on value creation, making the pie bigger so all parties can enjoy a bigger share," Vitasek says.

Changing Paradigms

Vitasek says developing a Vested Outsourcing approach generally requires a change in paradigms, especially for the shipper. For example, many companies are leery of long term contracts with outsourcers. They may also not like to think of outsourcers making high profit margins – even if that comes as a result of saving the shippers even more. They may be uncomfortable with allowing outsourcers fairly

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free rein to come up with ideas to meet supply chain goals.

But those paradigms need to be dispelled, Vitasek says.

Toyota, a company well known for the quality of the relationships with its logistics service providers, has been following a different path for years. It often asks its LSPs to come up with cost savings ideas that may hurt the 3PL's top and even bottom line numbers in the short term, but it generally gets high levels of participation in such initiatives in part because the LSPs know they are in it for the long term, and not likely to be thrown out in the next round of contract negotiations. Helping Toyota improve its competitive position is ultimately good for those LSPs too.

"Toyota is a great example of the "What's in it for we" approach," Vitasek says. "The LSPs know they are in it for the long haul, and that's why you see the innovation. With a longer term vested relationship, suppliers want to innovate

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Will Vested Outsourcing catch on? It seems likely most companies will find the approach appealing for some outsourced relationships, but whether they can make the leap to change the way they do business is the real question.

Vitasek says Vested Outsourcing relationships are probably not for all outsource relationships. She says it is probably best suited for more complex situations, and are perfect when you want to mature beyond a preferred supplier relationship – but don't want to jump into a strategic alliance. (See graphic nearby.)

In fact, Vitasek says the best scenario for Vested Outsourcing is when the supply chain scenario is complex and the company does not have a lot of internal expertise.