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The Purchase Logic for Contract Logistics: The Benefits of Outsourcing Distribution

Contract logistics is one of the fastest growing and most exciting industries today. One of the major reasons for this growth is corporate America's renewed interest in outsourcing and its return to focusing on its core competencies. To succeed in this market, logistics providers must thoroughly understand the purchase logic for their services and for outsourcing in general.

Purchase Logic is the description of how and why someone buys a particular product or service. It has three components: desired benefits, barriers to purchase, and the process by which a purchase decision is made. In this piece we present the benefits of contract logistics. In order to fully understand the purchase logic for this industry, you must also explore the barriers to purchase and the purchase decision-making process associated with contract logistics.

Huge Market

As American businesses seek to reduce costs, to increase productivity and to provide the services demanded by their customers, their use of contract logistics has increased dramatically. In 2000 the market for contract logistics exceeded \$50 billion. It is now more than \$100 billion.

Origin of Idea

The growth of logistics has also been driven by retailers' and manufacturers' increased insistence on rapid response inventory replenishment. The idea of rapid inventory replenishment was first articulated in 1919 by Richard "Red" Dupree, General Sales Manager and later Chief Executive Officer of Procter & Gamble. His concept was: "Sell so that we will be filling retail shelves as they become empty." Seventy years later, this idea is reshaping how companies do business and creating a new one: contract logistics.

Definition

What is contract logistics? Contract logistics is the outsourcing of the distribution function. Contract logistics providers invest in assets, dedicate capacity and personnel, and customize information systems and communications in order to improve the productivity and customer satisfaction of their manufacturing and retailing clients. Successful companies have found that delivering the right

products in the right quantity to the right place at the right time and at the right cost is a key differentiator today.

Based on numerous pieces of marketing research and 20 years of work with contract logistics providers and users, we have identified the benefits that underlie the buying decision for contract logistics. This Urban Wallace analysis was presented in the Fifth Annual State of Logistics conference in Washington, D.C. and appeared in Ryder's 1994 annual report. Follow-up analysis was included in the 13th and 14th Annual State of Logistics Report by Robert V. Delaney (available on this site).

Why Would a Company Buy Contract Logistics?

There are two tiers of benefits that create an interest in contract logistics. First there are the benefits of optimizing distribution. This first set of benefits can be achieved internally or through contract logistics services. Second, there are distinct benefits to outsourcing distribution to a third party. Companies seeking contract logistics seek both kinds of benefits.

I. Benefits of Optimizing Distribution:

DISTRIBUTION SAVINGS

Process simplification lowers overall distribution costs. Faster delivery reduces finished goods inventory and thus lowers the costs of handling and owning this inventory.

GREATER CONTROL OF BUSINESS

Your products remain accessible throughout all stages of distribution, making it easier for you to respond to problems or new opportunities quickly. Separately, you gain increased financial flexibility because faster delivery means faster collection of receivables.

MANUFACTURING SAVINGS

More efficient distribution allows for reduced work-in-process inventory. Increased operational flexibility enables you to manage production better and to allocate resources more efficiently.

CUSTOMER SERVICE AND SATISFACTION IMPROVEMENTS

Faster, more flexible and more responsive product delivery helps you better meet your customers' needs. It permits you to offer more customized products as well as just-in-time delivery. As a result, customers are more satisfied and loyal.

MARKETING BENEFITS

You'll never miss a sale again because of "out-of-stocks." Faster distribution means more selling days for retailers. Increased flexibility makes it easier to enter and to supply new markets, and to do so quickly. Great (as opposed to just good) distribution gives you information you can use about your customers and their needs.

The benefits of optimizing distribution can be achieved either with an in-house distribution system or through outsourcing. In general, however, the best way to optimize distribution is to outsource it. Logistics providers can and do deliver greater savings and increased efficiencies because distribution is their business. They have greater resources and specialized expertise that is hard to find in-house. Logistics providers also build integration economies that in-house transportation departments, no matter how large, can rarely match. Furthermore, the contract ensures that distribution process improvements and the resulting savings will be pursued continuously and single-mindedly automatically.

In addition to the benefits of optimizing distribution, outsourcing delivers three other benefits which companies cannot realize in-house.

II. Benefits of Outsourcing Distribution:

FINANCIAL LEVERAGE

Outsourcing distribution permits you to get out of the transportation and warehousing businesses altogether, reducing equipment, facilities and personnel, as well as freeing up cash and improving ROI.

FREE UP MANAGEMENT

Management is free to concentrate on core business activities like Manufacturing, Marketing or Research and Development. Whatever your product, wherever your factory, you don't have to concern yourself with distribution. No longer must you worry about unions, complex government regulations and inventory levels.

RISK REDUCTION

Outsourcing provides distribution insurance that a manufacturing company cannot secure by itself. Logistics providers have the resources to keep your distribution network running in spite of unexpected disaster, wherever it strikes. Earthquakes, fires, floods, snow and strikes all wreak havoc on smaller, less flexible distribution departments.

This list of the benefits offered by contract logistics does not address why a company would select one logistics provider versus another. To do so, you must identify the benefits which you offer that differentiate you from other logistics providers. Then you must identify those customers who desire these specific, differentiating benefits. Such a process entails an in-depth examination of the purchase logic for your specific offering followed by market segmentation that matches your offering with customers who want it.

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- Identify Market Segments That Want a Product or Service
- Purchase Logic: The Foundation of Marketing Strategy