Research on Analysis and Control of Enterprise Logistics Outsourcing Risks

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Abstract

Logistics outsourcing is an effective way for enterprise to improve logistics speed, strengthen core competitiveness and decrease logistics cost. On the basis of the analysis on the various risks enterprise faces in logistics outsourcing, the control model of enterprise logistics outsourcing risks shall be constructed and the corresponding control strategies shall be systematically put forward so as to lay a foundation for the enterprises-decision of logistics outsourcing in theory.

Keywords: outsourcing; outsourcing risks; risks control

1. Introduction

In the 21st century, the competition among enterprises has given way to the cooperation on the supply chain. With the development of specialized operation theory, enterprise logistics outsourcing has been discussed as one of the hot topics in theory circle and enterprise practice. As the theory about the management of supply chain has been formed and improved, logistics outsourcing has tended to become the target of enterprise’s development. However, in reality, due to the high rate of chronic self-supporting situation of logistics enterprise in China, it is not appropriate for all enterprises to adopt logistics outsourcing. Outsourcing is only a way to fulfill enterprise strategy. Otherwise, there still exit a lot of problems in the near future. Therefore, whether the outsourcing of enterprise logistics is adopted counts on its situation and the service capacity of the third party logistics.

2. Connotation of outsourcing

Outsourcing is also named as external commission, or resources outsourcing. So far, There is no a unified and clear definition for outsourcing. Its nature is to entrust the matters which can’t be done or can’t be done well but others do better to them. To be exact, outsourcing is a management strategy and operation form. That is to say, a certain company, in line with the agreement reached with external other enterprise, outsources its business and function for which internal employees are responsible to the
professional and efficient provider. Outsourcing is regarded as an effective means to help enterprise to administer the environment of end users.

Logistics outsourcing is defined as manufacturing enterprise entrusts its logistics business to professional logistics company (3pl) in order to centralize its resources, save its management cost and enhance its core competitiveness through the contract signed by two parties. Logistics outsourcing is a long-term, strategic, mutual penetrating and beneficial business commission and contract execution way.

3. **Theory basis of enterprise logistics outsourcing risk control**

The theory in relation to enterprise logistics outsourcing risk control mainly refer to resource-based View, core competence theory and principal-agent theory. They shall be explained briefly as follows:

3.1. **Resource-based view**

In 1984, the publication of Wernerfelt’s *Resource-based View of the Firm* marked the birth of resource-based view. In accordance with resource-based view, the enterprise is the collection of various resources. Given various reasons, every enterprise has its own different resource, i.e. heterogeneity. The heterogeneity determines the difference of enterprise competitiveness. To sum up, resource-based view mainly includes three aspects: the special heterogeneity of the resources, the non-imitation of the resources and the acquisition and management of special resources.

3.2. **Core competence theory**

Core competence theory was first put forward by American scholar C. K. Prahalad and English scholar G. Hamel in 1990. “The Core Competence of the Corporation” published in *Harvard Business Review* has become one of the most classic articles. Since then, core competence theory, as one of the forefront problems in management theory, has been a major concern.

According to core competence theory, all resources, knowledge and ability of the enterprise can not develop sustainable competitive advantage. So, core competence and non-core competence can be distinguished mainly from the following five aspects: 1) Value. Core competence should play an important role in the value customers pay attention to. 2) Heterogeneity. An ability to become the core competence must be unique, scarce, which the current and potential competitors don’t have. 3) Non-imitation. Other enterprises can’t acquire it, which is not easily imitated by competitors. 4) Difficult to find alternative. There is no strategic equivalent. 5) Extension. For the enterprise in general, core competence, as the foundation of the whole enterprise, can produce a series of other products and services and develop economies of scope through innovation and diversification strategy. Only when the enterprise resources, knowledge and skills at the same time meet the above-mentioned five standards will they become the core competence of the enterprise, thus developing the enterprise sustainable competitive advantage.

3.3. **Principal-agent theory**

In the 1930s, American economist Berle and Means put forward “principle –agent theory” because that the owner of the enterprise acts as its operator concurrently has huge drawbacks. In it, they advocate the separation of ownership and management right and its owner shall reserve its residual claim and its management right shall be transferred.

According to principal-agent theory, with the great development of productivity and large-scale production, the principal-agent relationship comes into being. On the one hand, the development of productivity makes further refinement of division of labor and the owner of the rights cannot exercise all rights because of knowledge, ability and energy. On the other hand, specialization produces a large number of agents with professional knowledge, who have energy and ability to exercise the commissioned rights.
But in principal-agent relationship, because of the difference of utility functions between the principal and the agent, the principal is in pursuit of his biggest wealth, while the agent pursues the maximum of his own salary and allowance and income, luxury consumption and leisure time, which inevitably leads to the conflict of their interest. Without the effective institutional arrangements, the behavior of the agent probably eventually damages principal benefit.

4. Control model of enterprises logistics outsourcing risks

The basic objectives of risk control are to dispose and control risks reasonably and to get as big security assurance as possible with the smallest logistics expenses. Based on outsourcing risk control theory and the goals and requirements of risk control, the paper shall provide a model framework of logistics outsourcing risk control. The details are shown in Figure 1:

![Figure 1 Control Model of Logistics Outsourcing Risks](image)

In the model of the framework, at first, the possible risks shall be analyzed in logistics outsourcing. Then, the strategic decision of risk control shall be analyzed, namely, the recognition of enterprise core competence and the definition of cooperation idea. The specific strategies, centered on strategic decision, to implement the strategic target shall be pointed out, mainly include choosing appropriate outsourcing partner, strengthening the contract management, adjusting enterprise organization structure, strictly controlling enterprise outsourcing activities, establishing the performance evaluation system and utilizing the laws and regulations reasonably. To a certain extent, these strategies mutually coordinate and promote each other.

5. Analysis on logistics outsourcing risks

According to the framework of risk control model, logistics outsourcing risks mainly include contract risk, management risk, information risk, market risk and financial risk.

5.1. Contract risks

Contract risk is the primary one. The design of outsourcing contract according to logistics outsourcing shall cause contract risks because the provider of the third party logistics cannot fulfill the tasks or logistics principal cannot pay expenses on time stipulated in the contract, etc. Generally speaking, the provider of the third party logistics can fulfill the tasks stipulated in the contract. However, given the limited resource of logistics provider, it may not complete all the outsourced tasks in busy season. In this case, partial outsourcing can not be accomplished with the result that the consigner’s interests are damaged.
5.2. Management risk

In the cooperation between the industrial or circulation enterprise and logistics provider, the difference of their management methods and enterprise culture possibly causes the management risk of logistics outsourcing. If the outsourcing enterprise cannot correctly deal with their cultural conflicts, fully assess logistics provider, effectively manage logistics provider with the result that logistics outsourcing fails to be completed. In the operation process of logistics outsourcing, there exist all sorts of difficulties. For example, if the third party logistics provider changes the pattern of logistics service, which shall influence all the staff and even be boycotted by them, the normal production and operation shall be influenced. In addition, the logistics outsourcing shall affect the interests of some employees, which also causes their boycotts.

5.3. Information risk

In logistics outsourcing process, the outsourcing enterprise shall share a lot of customer information, commodity information and management information with the logistics provider. Consequently, the above-mentioned information is likely to be given away. What’s more, after the end of their cooperation, though both parties sign confidential agreement, it is more likely that much information of the outsourcing enterprise shall be given away, which causes great losses.

5.4. Market risk

Market risk refers to the one arising from such external environment as market fluctuation, for example labor price, raw materials price, the changes of consume demand and the one arising from the fluctuation of logistics service market. When logistics market booms, raw materials price, labor price and market service price increase. Because market service price is higher than that stipulated in the outsourcing contract, logistics principal benefits; when logistics market is slump and gloomy, market service price is lower than that stipulated in the outsourcing contract, logistics principal suffers losses. In the long run, after logistics outsourcing, the principal is more dependent on the provider, and pays more attention to the cost, thus reducing its own logistics innovation falling into a passive situation in the cooperation. However, when the outsourcing enterprise tries running the logistics business by itself, it shall face a series of problems, such as the shortage of talents and experience and the deficiency of management.

5.5. Financial risk

Financial risk indicates the enterprise’s return on investment is lower than that of the expectation after logistics outsourcing due to many factors. After logistics outsourcing, great changes of the enterprise’s surroundings may take place or it cannot make thorough considerations when signing a contract, resulting in the return on investment lower than that of the expectation. In addition, the enterprise has paid great human, material and financial resources for looking for the right logistics provider, negotiating and supervising its service level. The above-mentioned implied transaction cost shall result in the enterprise’s financial risk.

6. Control strategies of logistics outsourcing risks

6.1. Identifying the core competence of enterprise

Outsourcing is only a way to realize enterprise strategy without the scope of enterprise’s development strategy. The first thing for the enterprise to decide logistics outsourcing is to make certain that the logistics
provider can meet the enterprise’s demand in the field and the provider’s operation cost is lower than the enterprise’s and the provider’s operation quality is better than the enterprise’s. Otherwise, logistics outsourcing fails to be implemented and causes a series of problems. Therefore, the enterprise should analyze whether logistics is its core competence and whether logistics can bring extra economic interests according to its own logistics. Only the enterprise has suitable providers and the strata of the enterprise management also recognize the importance of outsourcing before deciding whether to implement outsourcing.

6.2. “Win-win” principle

Logistics outsourcing means that both parties interest is tied together and good cooperation shall make both parties benefit so the poor performance of any party will make both parties damaged. For the choice of logistics provider, we should not only focus on the improvement of enterprise internal core competence but also treat logistics outsourcing with a long-term strategic thought. Outsourcing is helpful for the enterprise to maximize its own interest and for the logistics provider to sustain the stable development so as to reach a win-win status.

6.3. Choosing the right outsourcing partner

The enterprise shall choose the outsourcing partner according to its own development stage, its resources and the strategic need of its future development. At first, the enterprise should investigate, analyze and evaluate the potential logistics providers, to be specific, investigate the management situation, the strategic orientation, information technology support, its own plasticity, compatibility and the operation experience of logistics provider in the field, etc; evaluate the cost of engaging in logistics, its long-term development and its credibility, etc. thus, picking up the most appropriate provider. Otherwise, logistics outsourcing fails to be implemented and causes a series of problems.

6.4. Strengthening the contract management

The goal of enterprise logistics outsourcing is to establish the sharing mechanism of the bilateral benefits and risks. Generally, the enterprise shall sign two agreements with logistics provider. One agreement includes general terms for some issues related to laws and regulations, such as insurance, confidentiality, compensation, force majeure and the rescission of the contract; the other one is related to business and the stipulation should be specific and operable so as to avoid the ambiguity terms. The termination clause should be defined in the agreement. In the execution of the agreement, the enterprise should ask that logistics provider to complete logistics business and constrain logistics provider to meet their agreement without breaching it so as to ensure the outsourcing activities smoothly.

6.5. Adjusting enterprise’s organization structure

Enterprise logistics outsourcing shall be conditioned by the enterprise culture, internal original work process and boycotted by employees. Therefore, the adjustment of enterprise organization structure is mainly to solve the following problems: how to adjust business process according to the existing strategy; whether enterprise culture encourages innovation and transformation, how to treat the transformation for enterprise leaders and employees; how to conduct continuous and effective supervision of outsourcing business, etc. The adjustment of organization structure should be conducted from the angle of strategy so as to find the optimal partner. Besides, a sound management system shall be established around the partnership so as to achieve the success of the outsourcing strategy.
6.6. Strictly control enterprise outsourcing activities

The strict control of outsourcing activities is the primary guarantee of the successful implementation of outsourcing. The enterprise and the third party logistics provider shall build clear communication channel and co-compile operation norm. The enterprise should not think once logistics outsourcing, the third party service provider is responsible for everything. In fact, it should set up logistics business process, define the information channel and compile the operational standards for both sides’ reference. The operational standards enable both parties to keep the same step in the working process and can be regarded as the standard and basis for inspecting whether the logistics business can meet the requirements.

6.7. Establishing performance evaluation system

For the establishment of the performance evaluation system of logistics outsourcing, the following three points should be paid attention to:

- The measurement standard should be defined as quantitative, clear and definite. The explanation for the standard should be unique and unambiguous in order to prepare for the avoidance of disputes and responsibilities. So, in case of any dispute, the standards can give the basis for settling the disputes.
- For the implementation of logistics outsourcing, the enterprise shall has a group of full-time personnel. For their performance evaluation, the operational standards should be formulated.
- The evaluation and measurement mechanism of outsourcing performance should be flexible and be adjusted according to the changes of outside environment.
- Reasonable utilization of laws and regulations.

Reasonable utilization of law can safeguard vital interests. According to relevant laws, in the effective contract of logistics outsourcing signed, risk responsibility should be defined and its own legal rights and interests should be safeguarded. The enterprise shall make full use of legal means to prevent it from risks.

7. Conclusion

Logistics outsourcing is a double edged sword. The appropriate application to it shall effectively reduce logistics cost, strengthen enterprise’s flexibility and promote enterprise’s competitiveness. On the contrary, the inappropriate application to it is likely to lose its control of logistics and its competitive advantage. The above-mentioned analyses on enterprise logistics outsourcing risks shall prove the theoretical reference for logistics outsourcing and have certain reference value for the both sides of logistics business.

References