

Effective Supply Chain Management - Outsourcing

There has been a move by many companies in recent years to outsource certain functions. Companies are outsourcing call centres, IT, manufacturing, warehousing, co-packing, transportation, returns, and more. I think many companies are making snap decisions to outsource without proper analysis and worse, many are discarding outsourcing as an option in favour of the status quo for no other reason than the perception that outsourcing may show a weakness in one's ability to run an efficient organization.

I recently spent some time at a fairly large US producer/distributor of bed and bath products. The main warehouse was about 350K sq. ft. There was a high sku count with this type of product and since they dealt with large retailers, return rates were high. As well, shelf life is relatively short since it is considered fashion and is heavily influenced by trends in colour, pattern, and style. Overall, the company was pretty well run by some talented people.

The company would accept any returns from its customers. Returns would include quality problems and items that the retailer no longer required or wanted to balance its current inventory. The company would accept the returns in whatever condition they were received, use a small army to determine if the stock could be sent back to normal bin locations or if it had to be sent to an alternate area that dealt with non-current (discontinued or surplus) or defective inventory.

The company developed a plan to manage and liquidate the non-current returns. A mezzanine area of about 45,000 square feet was used to store the inventory in bins, to repack orders as received, and to label shipments. An elaborate website was developed to allow customers to select and order items from the clearance operation. About 125 orders were processed daily. They had some success clearing the non-current inventory but the inventory levels continued to grow.

There were several problems with the plan:

- The General Manager of the entire facility was spending over 20% of his time baby-sitting the clearance operation
- The website had to be continually updated with additional returned product and revised availability
- They had been forced to use outside warehouse space because the mezzanine restricted overall warehouse capacity and growth
- Returns would sit up to 3 weeks prior to being processed taking up valuable space
- Unusually high amounts of labour were required to repack non-current stock for potential resale.

The biggest problem was that the company had been losing considerable money for several years on the clearance operation and didn't know it. A P&L statement for the

clearance operation was created that quantified the loss and allowed direct comparison to the primary operations of the company. The initial reaction of the executive was that this type of clearance operation was simply a cost of doing business. Proper analysis was done including how a liquidation company could help and a comparison of current internal costs of the clearance operation versus using liquidation companies that could support this type of operation. Subsequently, the clearance operation was closed in favour of outsourcing to a liquidator.

I'm not suggesting that all functions that are losing money within a company should be outsourced but I am suggesting that they should be considered in the context of how they fit within the core strengths and strategic direction of the company.

In this case, the company's core strength is product development, sales, and distribution. The clearance operation is not core and did not provide any sort of competitive advantage leaving it in-house.

Here are some basic points to consider when determining if outsourcing might be right for you:

- How is your current strategic direction different from 5 years ago?
- Have the changes to the strategic direction been planned or did they simply evolve?
- Can you measure the performance of all functions within your company?
- Do you know the costs of each function?
- Are there common struggles in your operation that you just don't seem to be able to solve?
- What are your core strengths?
- What functions provide a competitive advantage?
- What functions have customer service level implications?

For most outsourced services, there are a number of qualified companies. Use a detailed RFI to get to a shortlist and then use a concise RFP so that an apples-to-apples comparison can be made to determine the best provider for you. If the RFP is not clear, you will end up receiving a number of submissions where interpretation will be required and you may not be able to determine a clear solution.

Sandra Donald is a Senior Consultant with Supply Chain Systems Ltd., a niche consulting firm working with companies interested in improving their supply chain and operational efficiencies. Visit www.supplychainsystems.com or call 905-454-8529. Copyright of Sandra Donald, 2006.