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Outsourcing Logistic and Supply Chain

Effects on small & medium size enterprises

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<p>Outsourcing is an act of transferring company's activities or business processes to third party provider. Almost all business processes can be outsourced, from simple payroll to manufacturing and everything between. Logistics outsourcing provides companies of all sizes to transfer resources from non-core functions to the core business.</p> <p>The target of this thesis is to present the general ideas, partner selection and the benefits and negative sides of outsourcing and logistics outsourcing. Further attention to small and medium sized companies is given in the research. The reader will gain understanding on the basics of business process outsourcing and how it can be implemented in the market-place.</p> <p>The research consists secondary research of literature type. Sources both published and online are used on this research to construct the base for the theory which is completed and compared to a case study on small Finnish company which outsourced its logistics processes.</p> <p>The main findings are the possibilities of outsourcing and how widely it is used to gain competitive advantage. The research also brings out ways to select the outsourcing partner and review different kind of logistics outsourcing possibilities. Lastly the case study gives insights on the real world applications of these outsourcing actions. The reader will gain valuable knowledge about outsourcing and how it effects small and medium size companies.</p>	
Keywords	outsourcing, logistics, supply chain, supplier selection

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1 Introduction

Outsourcing has been hot topic in the news for the last years. Unfortunately the tone of these news relating to outsourcing has not been very “good” in a sense that many see outsourcing as a bad thing. However, hopefully the following research on outsourcing can provide more objective image on the subject.

1.1 Objectives and limitations of the study

The objective and main research question of this thesis is to provide an overview of general business operations outsourcing and how logistics outsourcing affects small and medium sized companies and their customers. Addition to this logistics and supply chain outsourcing are studied to understand some of the specific points related to the topic.

Being able to understand why companies of all sizes have pressure to outsource at least some of their functions and how the actions they take effect the companies themselves and also different stakeholders is important, since outsourcing has become such a huge driving force in today’s business world.

A closer look on some of the effects of outsourcing are taken in this theses, primarily relating to logistics and supply chain side, with related case examples and surveys done to study the issue. This also includes outsourcing partner selection and ideas why companies should or should not outsource their operations. Some of the challenges of outsourcing are presented in both general and logistics point of view as well as the main drawbacks.

Outsourcing is a vast topic which spreads to different fields of business, because of that the study will not take account every business process that can be outsourced but is limited to general ideas of outsourcing and more in-depth study of logistics outsourcing. Relationships or important effects on small and medium size enterprises is pointed out in parts where it is sawn necessary. Different ideas of outsourcing presented may not be possible to be implemented in all cases of outsourcing and their effect may vary depending on the individual operation, company, culture and time. The case study presented is done on small company and the persons interviewed on the study represent opinions of

their own and not the general opinion of the company or the opinion of others working in the company at the time.

The first part of the study explains basic ideas of outsourcing, how outsourcing can be defined and what are the main drivers or reasons of outsourcing. To aid the reader, some basic examples and cases of outsourcing are represented as well as an example method of outsourcing partner selection process.

The second part is meant to give closer look on some logistic and supply chain related outsourcing possibilities. These include such as physical transportation & storage, manufacturing, information services and reverse logistics. The concept of make-or-buy is also explained and some theories of the selection are presented.

The last part will bring out discussion on the negative aspects of outsourcing and a case example on small company which had some of its logistics functions outsourced due international buyout of the company. By the end of this thesis, the reader will have better understanding on outsourcing and how it affects companies and businesses in general, be able to identify outsourcing possibilities and how it may introduce competitive advantage to a company.

1.2 Research method

In order to conduct a research, a correct research method, which fits the issue in hand, must be chosen. The research method chosen effects the tools used to study the issue and also the way the data is processed and presented. In business studies research the method is usually chosen between two alternatives, qualitative and quantitative methods. (Bell & Bryman 2007: 28)

In the following part a brief explanation of the two research methods, qualitative and quantitative, is given as well as reasons why qualitative method was chosen and how the research was approached.

1.2.1 Qualitative research method

Qualitative research emphasizes on the behaviour and reason, to understand the issue, rather than quantities of data analysis, it is to understand and gain insight on the problem at hand and is more exploratory and flexible than quantitative method. The data collection and analysis is conducted via questions and interviews and as more data is collected the problem clarifies. (Ghauri & Grønhaug 2005: 202-204)

Qualitative research can also be described as inductive. It generates theory rather than tests a theory as in quantitative research (Bell & Bryman 2007: 28). An observer looks into the issue and generates the conclusion by forming an impression of it.

The main steps in qualitative research are to: Generate research question, select relevant subjects, collection of relevant data, interpretation of data, theoretical work and lastly forming conclusion. First steps are to identify the problem and related subjects. After this comes the collection of data, as already mentioned, this can be done by interviews and questions to the subjects. Analysing the results of the interviews is done and rising results are reflected to the research questions, underlying reasons and solutions are identified which are then pointed out in the conclusion or findings. (Bell & Bryman 2007: 405-407)

1.2.2 Quantitative research method

Quantitative research is method where, in general, numerical data plays the main role. The relationship is studied as objectively as possible, relying on hard cold facts rather than feelings and opinions. Quantitative research works well on subjects that can be measured in some way, such as relationships between two variables, on the other hand it lacks the “human” element of qualitative research method. (Bell & Bryman 2007: 154)

In quantitative research, the progress is very linear. After studying the theory, a hypothesis is formed. Hypothesis is proposal or an educated guess of why certain thing is happening, it works as a base for the research. Depending on the type of problem, a certain type of qualitative research is conducted. The data can be collected in different ways, such as studying figures or mass fill out forms, but so that it fits the needs of the research. Group of subjects or respondents are chosen and the chosen method of data collection is done. In the processing of quantitative data, a different programs can be used to help

the researcher to confirm or disconfirm the original hypothesis. The findings and conclusions are reflected on the theory to see if a solution can be found. (Bell & Bryman 2007: 155-157)

1.2.3 Chosen research method and steps taken

Qualitative research method was chosen since it can be seen best fit this research, additionally literature and theoretical study acts as support for it. This type of research concentrated more on “words” and interviews in collection and analysis rather than the “hard cold numbers” or quantitative researches involving questionnaires. (Bell & Bryman 2007: 402)

Preliminary or secondary research or was conducted on the theory of the subject which then assisted on the generation of the research questions and serves as the first chapters of this research. Both published work and online resources were used in the study of theory of outsourcing. These included textbooks from authors such as Alan Rushton and fair amount of others, as well as number of survey and research documents which were conducted by companies of different fields. Online resources are used to support the theory found on the printed material and to bring different views on the subject.

To reflect the theory of outsourcing into real business life, a case study was conducted. Case study company was a small Finnish company Navsystems Oy which act as electronics distributor. Through acquisition, the company changed owner from Finnish entrepreneur to multinational electronics manufacturer. Because of this there were major changes in the company's structure including its logistics structure.

Private interview were conducted to an employee of the company at the time to find out how these changes effected the company, its functions, the daily activities, customer relations and how the employee felt about the changes in company structure. Because of the size of the company and since some time has passed since the change in the organisation, the opportunities number of interviews was very limited and it is fair to say that the results could vary slightly if more interviews would have been conducted. . This of course affects the way how interview results could be used to justify the theory. Nevertheless the interviews give a good image on what actually happens when SME's have some of their functions outsourced. Addition to the employee interview, an interview to one of the former customer of the company was done to find out some of the effects on

customers point of view. This offered unique chance to compare the results of the two views.

Based on the theoretical data collected and the insights gain from the case study interviews, a conclusion is presented which presented the possible outcomes of outsourcing activities as well as how these may affect the personnel and customers of a company which has or is thinking of outsourcing as way to increase their competitiveness.

2 Basis for business process outsourcing

Global outsourcing is growing, recent survey by Information Service Group Inc. or ISG (2014: 3) shows that the global value of outsourcing contracts rise 13% compared to same time in 2013, reaching over 17 billion US. Dollars a year. To understand the fundamentals of outsourcing, this part of the research is dedicated to explaining the main principals of business process outsourcing (BPO) and why it plays such a major part in modern business life.

2.1 Definition of Outsourcing

Business outsourcing can easily be defined as moving parts of business processes from the company to an outside provider (Duening & Click 2005: 2). These processes can be tasks which have previously been carried out by the company itself or new ones which rise from different business needs. Des Dearlove (2003: 163) states that outsourcing is responses to the question: "Which areas of activity are central to our businesses, and which can best be performed by external suppliers?"

As businesses productivity rises, the individual tasks of the workers get more and more specialized. (Deal & Kennedy 1999: 89-90) Companies cannot excel in all possible business processes and processes which require knowledge that the company does not have in-house, but which is available from specialist, can be contracted from outside provider (Dearlove 2003: 163-164).

An example of outsourced process could be telemarketing, where a company purchases sales service from specialized operator with professional staff and resources. By doing

this the company may see savings in costs and increased efficiency compared to an option where they would have built their telesales department from ground up.

Drive to be efficient through BPO can also be mean of eliminating business activities which are not part the core competences of the company or otherwise require in-house specialist. Activities, such as many back-office functions, can now days easily be out-sourced to third party providers. Removing such internal processes may have positive effect on company's cost efficiency and other expenses. (Duening & Click 2005: 2-3) O utsourcing internal activities also frees resources to other projects such as R&D.

2.2 Reasons for business outsourcing

Outsourcing business processes is not always the right move for every company and not all processes should be given to third parties. Regardless of the size of the company some processes are suitable for outsourcing. BPO was initially way for large companies to mainly reduce their costs, today a lot of small and medium size companies (SMEs) can also benefit from outsourcing and, even because of it, compete with larger enterprises. (Duening & Click 2005: 34-35)

In "Essentials of Business Process Outsourcing" Duening and Click (2005: 35) highlight five possible reasons why enterprises would choose to outsource their processes. The following figure presents these reasons:

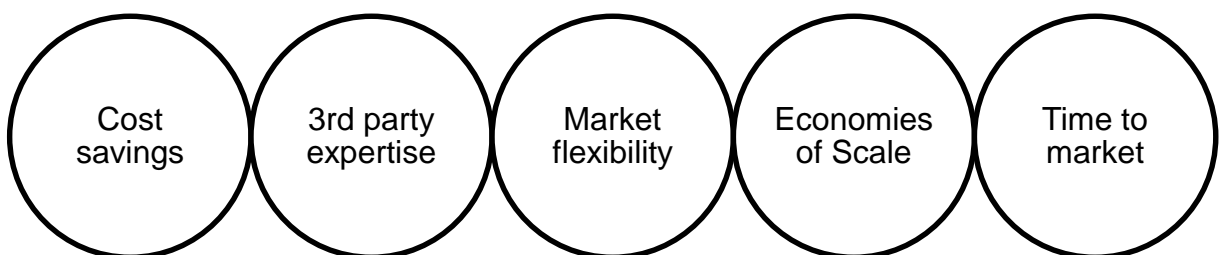


Figure 1 Reasons for adopting BPO (Duening & Click 2005: 35)

Even SME's can have great cost saving benefits by outsourcing, already mentioned, back office activities. These services are widely available and easy to obtain. (Rampton, 2012) The same goes for larger enterprises; production, warehousing, sales and many other activities are widely outsourced. Cost savings can also be achieved by offshoring, meaning that the company moves, for example, production to another country. When

talking about cost saving through outsourcing it is important to make the difference between the two. (Matthews 2012)

By outsourcing, the company can obtain certain expertise that can be hard to find or too expensive in-house. Such expertise can include activities ranging from IT solutions to transportation. This kind of information expertise can be vital to SME's, especially when it is important to implement them quickly (Wilson 2014). Outsourcing can also increase company's ability to react on certain changes in the market place and therefore increasing the market flexibility.

Benefit from economies of scale can easily be archived by third party, being able to gather activities from larger pool of firms. In many cases it is also cheaper to outsource specialised processes where the company does not have ability to great demand high enough to make use of economies of scale by themselves. It is also possible for companies to take in activities, becoming the outsourcer. (The Economist 2008) Economies of scale have also huge impact on labour costs, including HR and administration costs (Robinson 2013).

Multinational and offshore outsourcing has the benefit of being available round the clock which reduces time to market. As previously mentioned, specialised expertise from outsourcer may result to time benefits on setting up business processes as well as being able to quickly scale the operations to necessary level. (Deloitte Consulting 2013)

Together these main reasons, addition to others such as transfer of risks, form the basics of why companies, small to large, would consider outsourcing to enchant their business. Naturally not all of these main reasons are equally appreciated; reasons such as "cost savings" and "third party expertise" are more common than others (Deloitte Consulting 2013).

In joint study of KPMG's, one of the world biggest auditors, and Hfs Research Ltd (2013) 43% of the 399 enterprises see that cost reduction is most critical aspect of outsourcing decision and another 44% see that it is important. The second most important factor for outsourcing was greater flexibility (37% critical / 45% important) and third important factor being "Standardized processes" at 35% critical and 39% important. In the study, expertise gains were not seen as critical but very important, the same goes for operations in global market (market flexibility)

In 20th century the model of large companies was to own and manage all its assets but at the same time expand to take advantage of economies of scale and broaden their business activities to secure more profits. This model of controlling all business processes lead to complex and overlapping management structures. To stay flexible and adaptive to the changing business environment, a new model of core business focus started to emerge. In the 90s companies started to focus more on costs saving by giving up non-essential activities. (Handfield 2006)

Well known case from 1989 was Eastman Kodak's decision to outsource its IT systems to IBM. This was seen as revolutionary and lead to a wave of large companies outsourcing their IT services. (Handfield 2006) In the 1990s Kodak's IT services were directed on different internal systems and services. The CEO of the time, Katharine Hudson, began changing the IT functions so that so that different IT processes were valued on how they related to the core business. Highly valued functions, such as R&D were kept in house when lower valued were give away.

At the time Kodak's decision was criticized by many. Giving up responsibilities to third party was seen as reducing the company's power. Eastman Kodak defended their decision by claiming that they could divert their resources to the core business and reduce their costs. (Dickson 2011)

2.3 Choosing the right service provider

Choosing the right partner to work with is crucial in successful outsourcing process. The selection should be done carefully, in different steps, to ensure that the company requirements are met. It is most important to have clear plan and known objectives to the selection can be successfully completed. Rushton and Walker suggest following way of selection, described in the figure 2, to successful and practical selection of third party service provider. This multiple step way ensures that the company takes account all the critical factors as well as gives an excellent base form to follow: (Rushton & Walker 2007: 268)

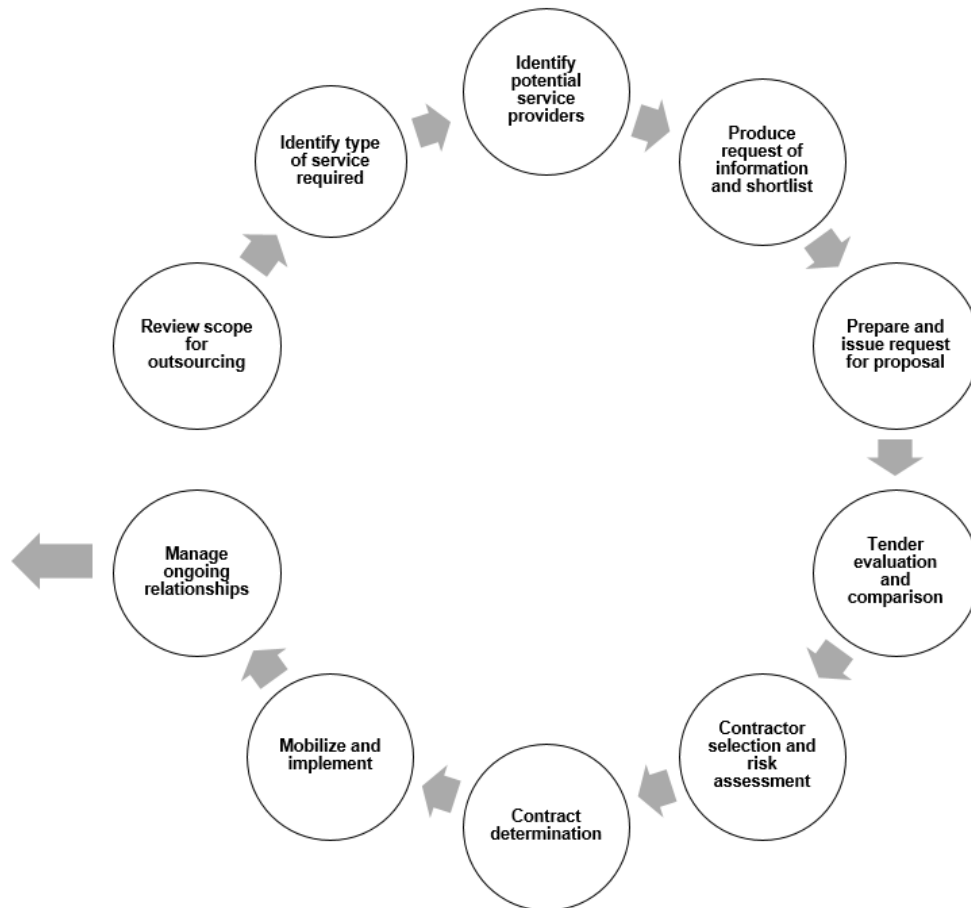


Figure 2: Key steps of contractor selection process (Rushton & Walker 2007: 269)

As described in figure 2, the first stages of the process should be identifying the internal needs of the company and based on those review which services should be outsourced. The next step is to scout for potential contractors, for example in logistics third party logistics providers (3PL's), form a list of possible partners and then issue quotations, followed by the final selection of the contractor. The final part is to implement and manage the chosen outsourced process. (Rushton & Walker 2007: 269)

Some of the key issues of the first steps of outsourcing process is to consider if it is the suitable solution for the issue at hand. The "scoping" part of the process should answer few simple questions such as: "Why to outsource?" and "What are the requirements for the company?" The solution for the problem or issue could also be found internally and see if it would it possible to solve without consulting outsiders. The main key is to understand the underlying reasons for the decision and being aware of which kind of relation

the company wants with the contractor. Some clear objectives should help on the decision to outsource and also for finding the possible other solutions. (Rushton & Walker 2007: 271-272)

It should be considered how far the company is willing to go regarding to the processes outsourced. Broadly there are three choices to make: Not outsourcing, some outsourcing and full outsourcing. Not outsourcing, or keeping in-house, may require large financial and workforce related investment but gives the company full control; whereas full outsourcing requires little investments but gives away the control. There is also the middle ground to give away some processes and keeping some in-house, this serve as compromise. (Rushton & Walker 2007: 271-274) If it is concluded that outsourcing is the right step, the company can move into finding the right contractor for the job.

The next step is to make a list of potential partners which may have qualities that are needed for the particular outsourcing need. This step may start just as internet search or other quick method to find contractors. This step may vary depending on the outsourcing need and on the fact that how experienced the company is. Larger companies which already have some of their processes outsourced may have very good idea on who they want to work with or how to find the suitable partner, where a start-up may have no clue how to do this. (Duening & Click 2005: 98)

Listing the possible partners' helps on creating so called long list which has all the possible contractors that meet the requirements. Tendering and asking for quotations can be very time and resource consuming so it is helpful for the next steps to write off service providers which do not meet the need in the first place before contacting the partners. (Duening & Click 2005: 104) Based on this long list, request for information process or RFI should be started. This step is to find out if the contractors in long list have interest in offering possible solutions for the company. It may be that the planned outsourced process might be too small or large for some of the contractors or that they see they do not have required capabilities to handle the project. RFI should contain necessary information for the contractors, such as requirements & needs, scale of the project and possible time constraint. Based on the answers on RFI, shortlist should be made which only contains the suitable partners for final selection round. (Rushton & Walker 2007: 275-277)

RFI responses should reveal if the possible contractor is suitable or not. It should contain information such as (Duening & Click 2005: 106-107):

- What are the capabilities of the contractor?
- How many clients do the contractor have?
- Are there clashes of interest?
- Does the contractor have the necessary capabilities?
- How does the contractor fit in with the client company's culture?

If necessary the RFI answer should contain supporting evidence, product for review for example, and some financial information since outsourcing contract are usually planned to last for a longer time periods. (Rushton & Walker 2007: 277)

The final selection round involves requests for proposals and quotations for the asked outsourcing project. The goal is to further reduce the shortlist until only two or three preferred contractors which meet the requirements are left. These revolve around the contractors in shortlist, finding the best solution based on the information given and solutions offered. To be able to compare different contractors, it is important that it is indicated which kind of response is wanted, this is also called preferred response. The preferred response outlines the terms in which companies are evaluated, these can be in goals, metrics, costs or other necessary criteria. Without this "set of rules" it may become difficult to found the necessary information needed to perform fair and detailed evaluation between the candidates. This step act as a final tool before preparing the actual contract. (Rushton & Walker 2007: 282-289)

Proposals and quotations usually contain already confidential information such as final projected costs and other final details. Final qualitative and quantitative assessments should be made. Qualitative assessment considers the non-countable properties of the proposals, how they meet the requirements of the company, possible future strategy and how the overall features of the outsourcer fit in. It also values the "human" side of the contract, experience of the outsourcers' management, HR and training. Quantitative evaluates the countable properties. These include such as costs and for example in logistics possible delivery times and so. (Rushton & Walker 2007: 283-5)

The final step, which in many cases is overlooked is risk assessment, this is made to identify the potential "wrong goes" when the actual switch of responsibility and operations

happen. (Rushton & Walker 2007: 290-293) Once this step is completed and final suitable partner is found, can outsourcing contract be made.

By now it should be clear which of the shortlist candidates has the best solution. The outsourcer meets the short and long term demands, has the right properties and costs are in acceptable level. It is time to make the contract. Outsourcing contract differs from traditional vendor – supplier contract since the mind-set is different. In the vendor-supplier transaction both parties are trying to as much value out of each other where as in outsourcing contract the deal should benefit both parties the client and the service provider. More compromises can be made since the contract is usually longer term and more flexible in terms of its terms. Once details such as the governing law, excuse clauses, final responsibilities and costs are agreed upon, should the contract be signed. (Duening & Click 2005: 116-121)

Now the outsourcing process moves to the final stage, implementation and monitoring. The plans on the contract should now be made reality, the first steps to the implementation should be a management plan which outlines the actual process changes and the timetable for them Outsourcing can also have an effect on the employees of the client company,, unfortunately these are usually job cuts if there is question outsourcing already existing processes. This can be one of the hardest challenges, especially for smaller companies, to cope with; despite this the business needs to move forwards. . (Duening & Click 2005: 136-138, 150-151)

Difficulties, especially in the beginning of the actual implementation phase, are not too uncommon. These problems can be identified benchmarking and evaluating how the new processes work. In case where the client company is a larger and well known one, public relations and handling outside pressure may require increase attention. Also the customers of the client company should be made aware of the changes happening, especially if they have direct effect on them, a good example of this could be change in the warehouse operator and location. (Duening & Click 2005: 152-155)

3 Logistics and Supply Chain process outsourcing

Logistics and supply chain management are important part of efficient business practice. Increasing demands from customers, more frequent new product launches and rise of just-in-time deliveries has forced companies to focus on efficiency. Supply chains stretch on multiple continents, combining all forms of transport from rail to road and to air. New demands for ancillary processes, such as labelling, packing and reverse logistics, are needed to answer the needs of new, possible, multinational customer base. For all companies, no matter how big or small, this means a huge challenge. (Rushton & Walker 2007: 1-2)

Globalization has meant that the market places have become global as well. If a company wants to grow or even survive in both local and global markets, they have to take this into account. Logistic networks have become more and more difficult to manage without specialized knowledge on planning, execution and management of the whole process. Best solution for many companies is often an outsourced logistics operator. (Rushton & Walker 2007: 8-9)

Today, there is immense selection of different logistics operations and services which can be outsourced. It might be that not every company wants to outsource everything, maybe only parts of their operations, but it is very probable that, if wanted, every aspect of logistics can be handled by third party. (Rushton, et al. 2006: 69)

In the following we take more detail look on logistics outsourcing to third party operators, different processes, operations and activities of it and how especially SME's can use logistics outsourcing as method to gain competitive advantage.

3.1 Selecting outsourced logistic and supply chain operations

As already mentioned, there are number of operations which can be given to outside providers. To better understand which of these operations could be outsourced, the company has to understand its logistics structure. This includes the physical flow of goods, from supplier to the end customer, as well as the information flow or data flow from the field all way back to purchasing and manufacturing. Also worth to mention is that all so

important reverse logistics, the flow backwards, should not be forgotten. (Rushton & Walker 2007: 105)

Rushton and Walker (2007: 105) broadly categorize these operations in three main alternatives:

1. Physical logistics and delivery (Outbound)
 - a. Transportation
 - b. Manufacturing
 - c. Packing
 - d. Physical flow of goods
2. Non-physical logistics (Information)
 - a. IT services
 - b. Operations management services
3. Reverse-logistics (Inbound)
 - a. Returns
 - b. Disposal of goods
 - c. Flow of physical goods from downstream to upstream

The following figure gives better image on these three and where they stand in the supply chain:

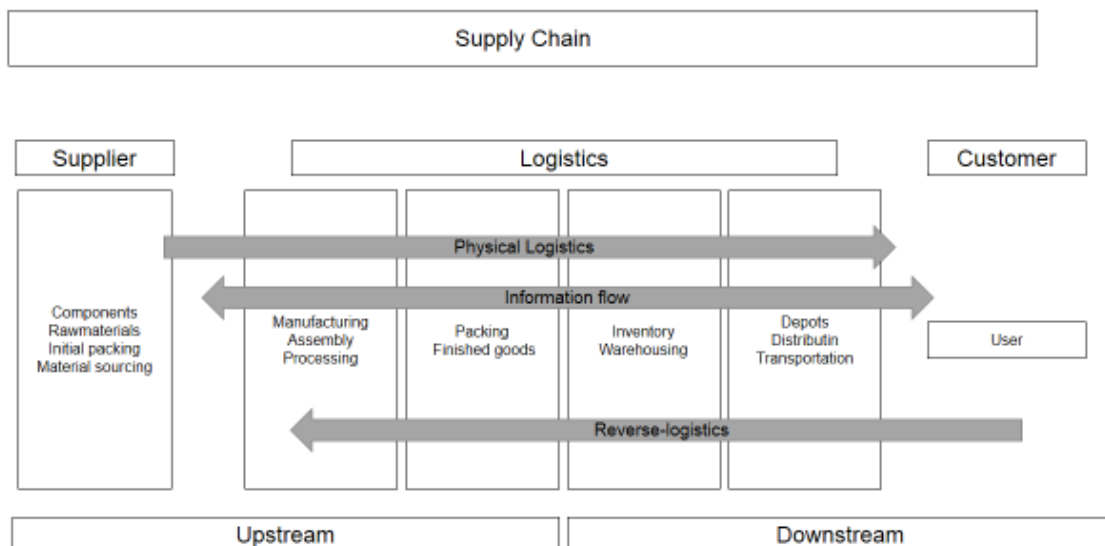


Figure 3. Simplified supply chain, logistics structure and flow of goods & information (Rushton & Walker 2007: 107)

Logistics outsourcing is commonly seen as just transportation or warehousing (in physical logistics) given to third parties but as seen in figure 2 there are a lot more possibilities addition to these traditional ones. To choose which of these operations should or should not be kept in-house is again a harder question. There are the driving factors of outsourcing, already mentioned, but as outsourced logistics functions may affect the core business of a company more than, for example back office functions, businesses need to consider different logistic functions, the benefits and negatives of possible outsourcing and how they are tied to their core business, individually before making decision to outsource (Rushton & Walker 2007: 201).

Never the less a recent study conducted by Capgemini, together with Penn State University and other sponsors, (2014) shows that demand for 3PL or third party logistics is rising, as it has for recent years. 3PL is a term used for a logistics provider which offers outsourcing solutions for parts of logistics process or even for the whole supply chain. The following figure shows which operations the 581 3PL logistics user of the study have outsourced.

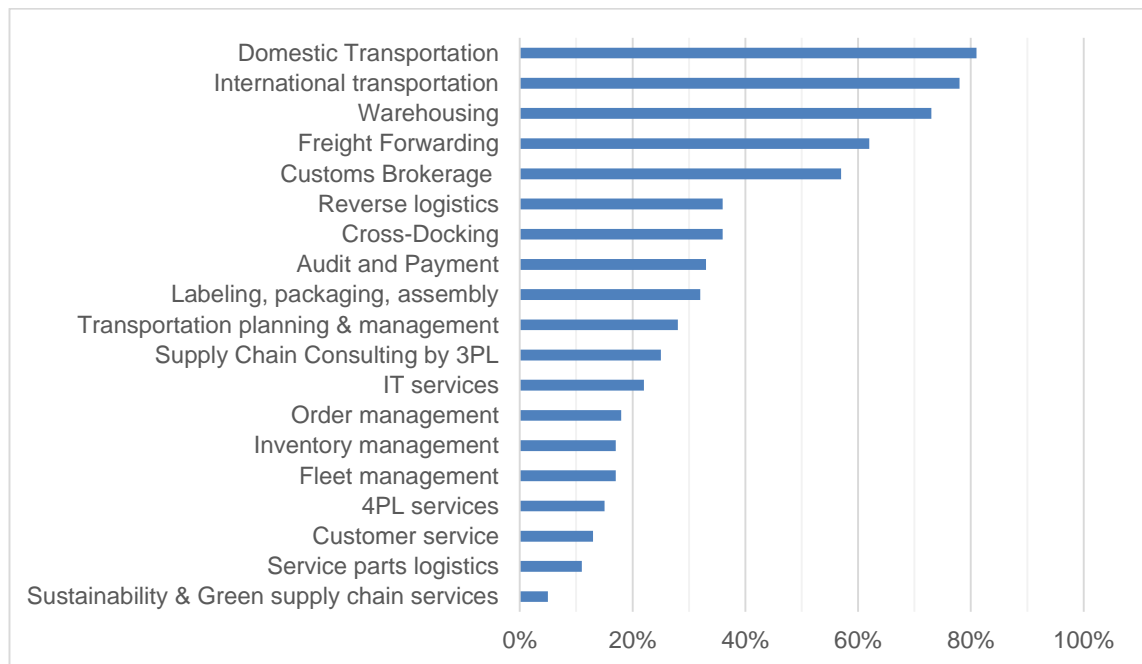


Figure 4. Shippers Continue to Outsource a Wide Variety of Logistics Services. Study by Capgemini (2014: 12)

This study gives us a good reference point of which services are most popular to be outsourced. It also gives any company, big or small, a good starting point on considering which operations could be outsourced.

3.2 Physical logistics outsourcing possibilities

Physical logistics can be considered to be the flow of goods from receiving an order to delivery to the customer. Some of the main activities are inventory control, warehousing, handling packaging and transportation. (Lysons & Farrington 2012: 83-84) These physical logistic activities are also something that SME's can outsource.

As seen in the figure 3 transportation, both domestic and international, are the most outsourced logistic activities. Transportation is not usually seen as activity that adds value or is one of the core competences of a company, unless the company is of course a logistics or transportation company. The primary function of transportation is to move goods as effect as possible. This usually means that the vehicles operated should work 24 hours a day. (Rushton & Walker 2007: 113) For SME's with limed capabilities and also limited need for transport, it might be a good idea to outsource this to an outside provider. Transportation providers are usually easy to find and as the service is simple enough, the implementation can be done quickly and without high costs.

Another big operation which is highly outsourced is warehousing. Especially bigger companies which are driving higher productivity levels, have increasingly outsourced their warehouses to specialised logistics companies (Klein, 2009). One of the concerns of outsourcing warehousing is the ownership of assets, such as buildings and equipment. Especially small companies might feel that they lose too much control over their business. Outsourced warehousing does not mean that all warehousing activities have to be given to 3PL operator, there is also the possibility to outsource, for example, only the workforce or the equipment. (Rushton & Walker 2007: 110)

Closely involved to warehousing, packaging can be outsourced. This gives possibilities to quickly enchant the product for new market or if there other changes for example in labelling. Packaging has more than just one function in logistics, it offers protection, storage, transportation, handling and information properties. (DHL logistics, 2008)

Good packaging should give the product enough protection that it arrives safely all the way to the customer, meet warehousing demands regards to being stackable and certain

size. It should be made into a form and size that allows optimal use of space with the lowest weight. Finally, the package should offer necessary information about the product, what it is, is it perishable, and other data that the possible user might need or want to know. (DHL logistics, 2008) In the survey, over 30% of the companies had outsourced packaging and labelling, which can be considered quite a high number (Capgemini & Langley 2014: 12). For small and medium size enterprises, outsourced packaging and labelling services may offer savings in designing and manufacturing.

3.3 Manufacturing: make or buy decision and information systems

Choosing if a product should be kept in-house or be purchased can be a hard one. The most important factors to consider are the costs and availability of production capabilities. A company may choose to buy a product rather than manufacture it themselves if it is cheaper to make and if there are no means of production easily obtainable. These make or buy decisions can be commonplace to a start-up with little resources.

Lysons and Farrington (2012: 381) present the following figure to use as a base when deciding to make or buy.

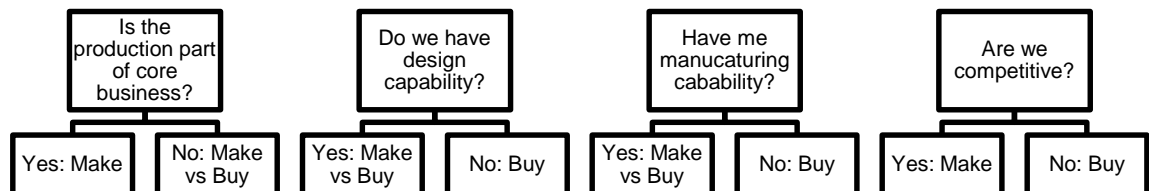


Figure 5: Decision process for make or buy (Lysons & Farrington 2012: 381)

If the company's core business is to manufacture certain goods, they should. Unless the good to manufacture is for some reason unimportant and easily & cheaply attainable elsewhere. Does the company have the design expertise? Design can also be bought from third party. Then the decision comes down to means of manufacture. Especially

heavy production capabilities can be very expensive and put the company on lot of financial stress. Lastly, can the company be competitive if it chooses to manufacture their product. (Lysons & Farrington 2012: 381-382)

Quantitative analysis can be made to compare the costs of own manufacturing and outsourcing production. The cost structure of outsourced product can be simplified as: cost of purchasing the goods from the supplier and costs of transportation. The costs of own production includes variable costs and fixed costs. These are the costs of setting up the production and then cost of producing each product. Usually the economies of scale have huge impact on which option is more attractive. (Li, 2014)

The quality of potential outsourced production should be considered. This includes not only the production capabilities & quality but also non-physical qualities such as trustworthiness and management level. It should not be any company's interest to see their product being copied because of information leaks from the third party supplier. (Li, 2014)

Addition to the physical production and movement of goods, an enterprise can move its logistics management and information related services to an outside provider. These information management related services include such as IT, Logistics software, quality inspections and more are closely related to warehousing and its management. (Inbound Logistics, 2008)

3.4 Reverse Logistics

Company's logistics processes are normally designed to transfer goods and materials from upstream to downstream, from production to the end-customer. Usually only the information and other non-physical logistic "actions" are moving the opposite direction. Nevertheless there are situations where it is necessary to move goods back from the downstream to the upstream. Some of these cases are: Product recalls, returns and disposal of unwanted or un-needed goods. (Rushton, et al. 2006: 587)

Lysons and Farrington define reverse logistics as following:

The process of planning, implementing and controlling the efficient, cost-effective flow of raw materials, in process inventory, finished goods and related information from the point of consumption to the point of origin for the purpose of recapturing value or proper disposal. (Lysons & Farrington 2012: 88)

This “unusual” movement of goods presents a number of challenges to companies of all size, but there are also businesses where these reverse logistic operations play a major part in daily activities. These companies are such as, mail order or internet based companies, especially fashion and clothing related. In these kind of businesses the return rate of sold goods is very high. For these companies it is important to handle the reverse logistics part of the business effectively. (Rushton, et al. 2006: 588) To better illustrate this movement please see the following figure 5:

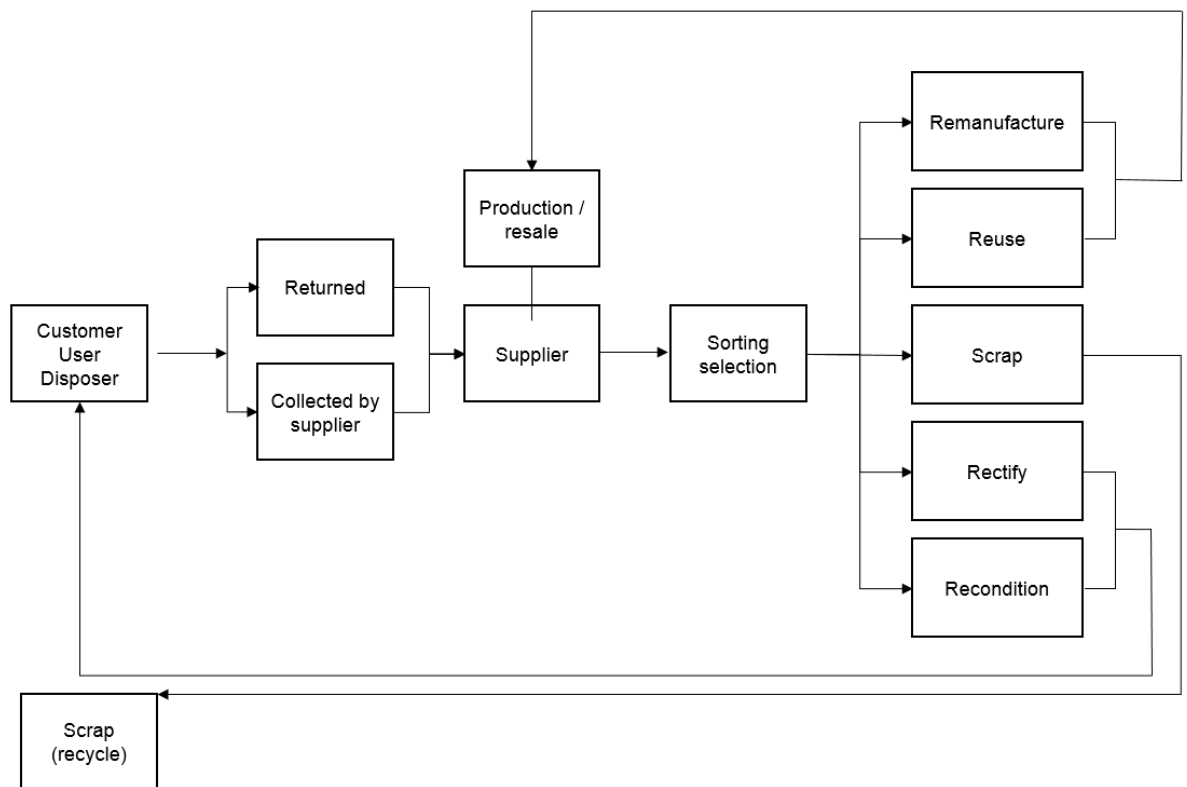


Figure 6: Reverse logistics network (Lysons & Farrington 2012: 88)

Recent survey by Deloitte Consulting (Deloitte Consulting 2014: 3) shows that reverse logistics represent 0.1 to 1%, 0,5% in average, of the sales value of product and up to 10% of cost of goods sold is directly or indirectly is resultant to reverse logistics.

The same survey also remarks that, if managed well, reverse logistics have the potential to retain almost third of the product value. The study by Capgemini (2014) presented in figure 3 shows that almost 40% of the companies in the study have their reverse logistics handled by 3PL provider.

The returned goods normally contain value in form of resale value, as “Reman” or remanufactured product or as parts and raw materials. Addition to the actual movement of physical goods, reverse logistics and its activities offer also a lot of information about the sold goods and market & customer preferences. For example if certain goods have higher than average percentage of return it is a good indication that there is something wrong in the goods or there are better goods available in the marketplace. (Deloitte Consulting 2014: 5)

4 Critic on Outsourcing

As already mentioned, there are number of reasons why enterprises should outsource some of their processes to third party providers but as always there are also drawbacks to this. In following we go through some of the disadvantages of outsourcing regarding to how it affects the organization, financials, service and the actual physical goods and deliveries outsourced.

4.1 Organizational challenges and effects on employment

Outsourcing is not the answer for all problems. 3PL’s can improve company’s logistics functions but they are not miracle workers. There are times when the expectations of the outsourcer and the 3PL provider do not meet because of unrealistic demands. (Hansen, 2003) Also worth to remember is that the 3PL:s are also businesses, responsible to their owners and shareholders so it is safe to assume that their actions are, in the end, to benefit first their selves and then their clients.

Possible 3PL distribution partner may not have the necessary information or experience of the company’s market or product, which may lead to number of problems regarding to the way the market is seen and products handled. The company is also no longer in charge of where, how many or which kind of distribution channels are used or which type of transport vehicles are used. As company does not handle their own logistics anymore, the logistics expertise that the company may have had before is also lost in the process. Reverting back to “own logistics” gets harder, if for some reason, there comes a time where some or all of the logistic processes have to be taken back in-house. (Rushton &

Walker 2007: 223-224) There may well be advantages to maintain certain functions in house.

When activities are outsourced to another country, there is also a chance to so called culture clash. The organization types are not same between companies, there can be differences in such as commitment, responsiveness and ability to make initiative. (Overby, 2011) It is important that there are no clashes that can be overcome easily in the 3PL relationship since it may have major impact on how operations are run. (Rushton & Walker 2007: 223) When tasks or operations are given to third party, the client company also gives away managerial control. This means that even though the third party is working to them, they might not be driven by the same standards and to keep in mind is that the third party is most likely offering the same service to other companies as well. (Bucki, 2014)

As many of the jobs, especially manufacturing related, are outsourced to countries with lower labour costs; developed countries such as USA and many European Union countries have seen major loss of lower paid jobs. A study suggests that between 2001 and 2011 2.7 million jobs, mainly in manufacturing, were lost to China from USA (Scott, 2012).

4.2 Financial factors

There are several different cost and financial reason for outsourcing. Having control over the capital costs is one of the major ones. Fixed costs are converted into variables which makes it possible for investments into the core business of the company. For small companies, outsourcing some activities allows to avoid large expenses in the early life of the business, it also allows investments into the more revenue producing activities which may make the company more attractive to investors. (AllBusiness.com, 2008) Of course there is the chance that necessary investments are not made because outsourcing seems too good in the short term.

Improvements in cash flow can occur if the new logistics service provider is willing to purchase some of the outsourcer's assets. Again, this money can be diverted to more productive activities Getting rid of the fixed assets also means that these are taken out of company's balance sheet. (Rushton & Walker 2007: 225)

When operations are handled by another company, especially if these operations are vital ones, the company is tied to the financial well-being of the outsourcing company. There is a change that the outsourcing company may go bankrupt leaving the clients into a ditch. (Bucki, 2014)

4.3 Service quality

Logistics customer service goes through the whole supply chain. From the manufacturing to the end customer, it should provide goods, information and services in such way that the customer is satisfied and it is cost-efficient to the supplier of the goods. (Sadler 2007: 70-71)

Logistics service is mainly about delivering goods and services to the customer (Sadler 2007: 71). Although outsourcing is mainly done to save costs, it should not be in the cost of quality. Losing quality is often seen as one of the negative sides of outsourcing. A number of companies which have changed to 3PL are complaining about the poor service level, slower than expected delivery times, and lower quality control. In the worst case scenario these issues force the company to in-house already outsourced services. (Barrett, 2010)

In Deloitte survey regarding outsourcing and how satisfied companies were to their outsourcer, (Deloitte Development LLC 2012: 16) the overall quality of outsourcer service was the main reason in more than two thirds of the cases where the outsourcing contract was terminated. These results indicate that quality is above the quick savings.

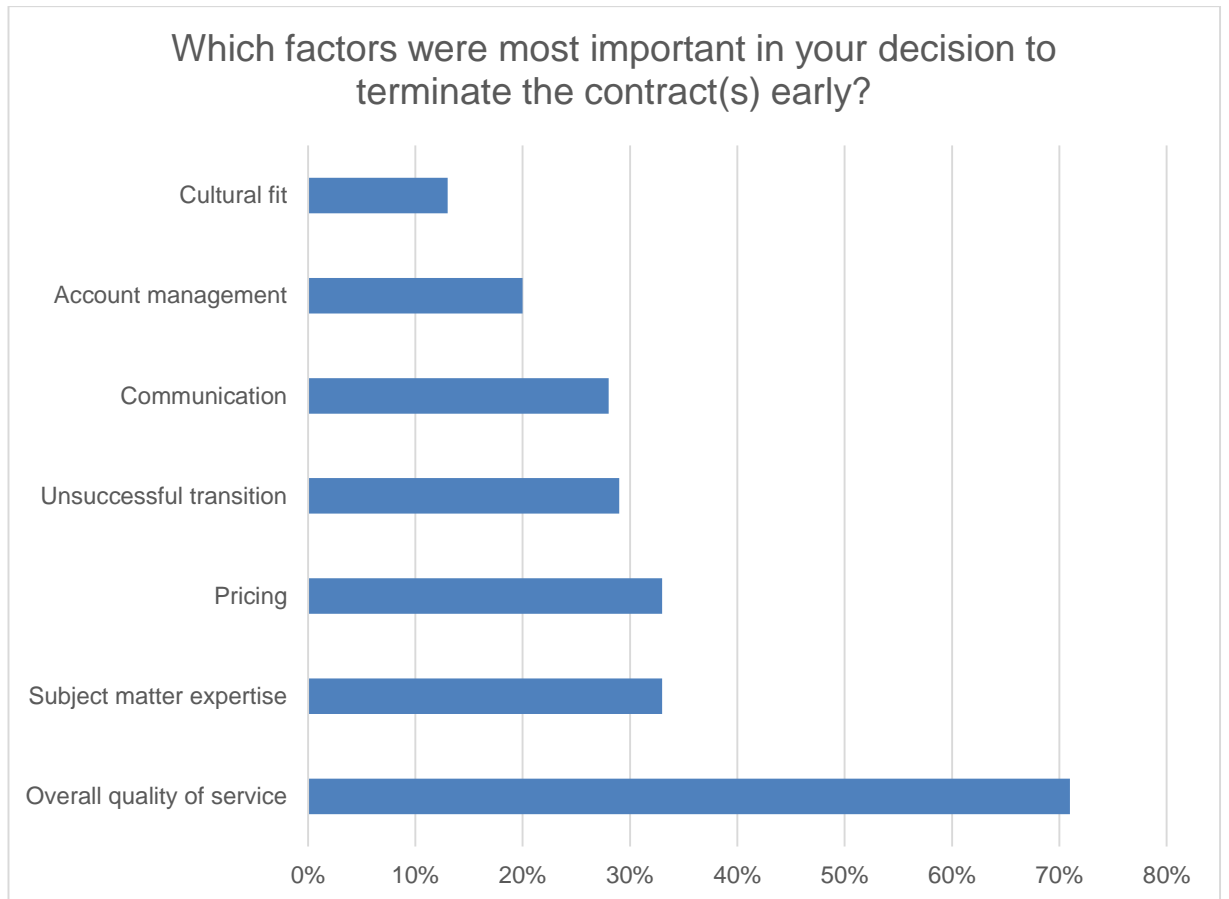


Figure 7: The factors why outsourcing contracts were terminated early (Deloitte Development LLC 2012: 16)

Providing good customer service is the key to maintain good relations and successful business. Satisfied customer is more likely to use the services of the company again and on the other hand failure in customer service may lose them for life. (Campbell, 2013) Great customer service is way for a company to differentiate from competition, offer better solutions for their customers and even save money when problems can be sorted in less time. (Stengel, 2012) When company outsources operations and loses some of the control over them, they also outsource service related to that.

When service operations are outsourced it becomes harder to identify problems in service as well as implement improvements to fix these problems. This goes against the idea that outsourcing should make the business more flexible. (Rushton & Walker 2007: 226)

4.4 Losing control over the product

The requirements of the product may differ from the services offered by the third party. This may relate to the number of deliveries required or to the form of the product, for example if the product is such type that there is specialized equipment needed to unload it. In some cases the product itself might not be suitable for another party to handle. (Rushton & Walker 2007: 228)

Closely related to logistics quality is the product quality. Product quality control gets harder and harder the further away the manufacturing is transferred. The third party may be very good at a complex specific task but cannot handle any variation. (Barrett, 2010) This is a major issue which has direct impact also on customers and customer relations, especially in cases where small changes to the end product, for example a logo change or software update on electronics, could be the make or break on the marketplace.

5 Case: Navsystems Oy, Buyout leading to logistics outsourcing

5.1 Company Introduction and background

Navsystems Oy (the company) was founded in 1995 and the main business considered electronics importation and distribution mainly to Finnish retailers. The company started with three employees and in 2008 it employed seven and had turnover of just short of 4 million euros. The success of the company was due to the excellent timing of the business, in 1995 Finland was quickly recovering from recession which meant that “ordinary” people had more money to spend on non-essential luxury items. At the same time the costs electronics saw major reduction.

In 2008, after one of the most successful year in the company’s history, it was bought out and became a subsidiary of marine electronics manufacturer Raymarine Ltd, today owned by US. based FLIR systems Inc. In the result of the buyout, the business and old employees together with current order book, customer accounts and warehouse were transferred to the new owner. The new subsidiary stayed relatively independent for the next two years having its own warehousing, accounting and other “normal” business activities handled in-house.

In 2010 at the time United Kingdom based owner made decision to outsource some logistics functions of all their subsidiaries to a 3PL Rhenus Logistics, a multinational German based service provider, this included warehousing and transportation. Addition to this order processing, reverse logistics and accounting were offshored to Belgium for cost saving reasons. The subsidiaries were left with responsibilities of local marketing, business to business sales and customer support.

These decisions lead to changes in the organisation of the Finnish subsidiary as well. Within a year the warehouse and all order & invoicing related functions were transferred to outside provider. Changes this big affected the employees of the company and customers alike.

5.2 Reliability of research

The number of interview persons is small which affects the results. Reliability of the study suffers because of this smaller group. Therefore it must be said that the opinions of the interviewees represent their own views concerning the case and outsourcing in general. If a larger group of interviewees would have been interview and the case company would have been larger, different results may have been present.

5.3 Interviews and interviewee background

The research for the case study was conducted via interview of employee of the time when the major outsourcing decisions happened. How the change affected the responsibilities and daily activities of the company. Also an interview to a former customer of time to find out some of the effects on the customer of a company which has its logistic actions outsourced.

The personal interviews are important so that a more precise understanding of the effects of outsourcing can be made and to see if the findings of the research relate to the theory already mentioned in previous chapters. These two interviews give a view of the effects on logistics outsourcing in small company and how it affects both the company itself and also a customer of the company.

The person's interviews for this study were two ladies working in accounting of the company and as buyer in a customer of the company at the time. Their age varies between 30 to 40 and both have more than five years of experience in their field of expertise.

The first interviewee is Liisa Leinonen. Former accountant and sales assistant of the company. She started in the company all the way from 1995 to 2010 when after the outsourcing process was completed was let go since there was no accounting related functions in the Finnish company.

The second interviewee is Anne Similä, working as Buyer and Store Manager in a customer company at the time. She was responsible for ordering goods from the company during the time when the transfer from in-house to outsourced operations was done. Currently she is still working in the same position.

5.4 Interview questions

The in-depth interviews were conducted in unstructured way. This allowed more freedom and flexibility to ask also unplanned questions along the interviews. It also gave the interviewees a chance to freely express their ideas and opinions about the process. The six main questions were presented to both interviewees, these questions can be found in appendix 1, and based on the answers to these questions additional questions were asked during the interview. Since outsourcing is such a vast topic, the main "weight" on the questions was in the logistics part of outsourcing.

The main questions made it possible to conduct the interviews in reasonable timetable. The pre made questions were given to the interviewees before the interviews so that they could prepare and think them through. This also made it so that the interviewees know the topic of the conversation ahead of time. The total time of the interviews varied from 20 to 30 minutes depending on the interviewee.

After the interviews were conducted the answers were analysed and compared against the theoretical part of this thesis. This allows to see if the theory and practice follow each other, at least in the case studied.

5.5 Outsourcing effects on the company: Major changes is the daily operations

As basically all physical logistics functions were outsourced, a lot of daily activities changed in the company. As it was a quite small company, the employees had also responsibly outside their primary job description. The warehouse related functions such as packing and sending the goods was handled by a warehouse worker but a lot of order processing and things such as ordering a collection of goods was done by the interviewee:

Everything related to logistics ended, except for sales of course, for example inputting orders, packing the outgoing order in the warehouse and other thing related to the sending of the products. We no longer needed to contact couriers or follow up the deliveries. Also invoicing the deliveries and accounting was outsourced.

L.Leinonen

Among the outsourced functions, deliveries were affected a lot. Formerly the warehouse of the company was located in Finland but was now transferred in to the Netherlands. Naturally this also changed the way customers received the goods they ordered and changed the responsibilities in the organisation. These changes also made it possible to concentrate the company's resources to other things:

The delivery time to the customers got longer mostly in very urgent cases where the customer could no longer come to pick up, for example warranty replacement products but they had to make an order which was the delivered to them. Our service dealers could not for example take items for testing. On the other hand our supply capabilities got better, the new warehouse had items in stock that we previously had to specially order for the customer.

We were no longer responsible to handle the warehouse in Finland and the related things such as predict the demand during peak season, which was difficult at the times. This free up a lot of time to concentrate on other areas such as sales.

L.Leinonen

The changes to the customers was tried to keep at minimum, although it was no very successful. When asked about the service provided by the company and if there were positive or negatives changes, one very important factor came up. The new staff in the 3PL operator did not have the needed product knowledge or understanding of the business:

The personnel in the new warehouse did not have enough training or knowledge of our business and products. When customer asked something related to the products from the warehouse, they did not know about these things. Previously the customer could ask these product related questions from the same people the ordered the goods from but not anymore. There should have been more training for the order processing people in Netherlands or some of the Finnish staff should have been send to tutor the new employees... Also they did not know the differences between our different customers.

The positives, other than the improved supply, was that after everything was working, the sales could concentrate on actual sales rather than being on the phone and writing down orders. They could be out of the office much more than previously.

L.Leinonen

The shift of responsibilities was also done in very quickly which resulted as miss communications between the company and the 3PL, New ERP system was also implemented since the former systems was not compatible with the 3PL's IT systems. Because of this there were also delays in the process which meant that some of the changes were made during the peak season where the company's resources should have been in sales and customer support rather than "fighting" with new IT systems and procedures. The customers were also not informed about the changes soon enough in advance which lead to confusion about who to contact in certain issues at times.

The reason for logistics operations outsourcing was cost related. There was a decision made to concentrate on the core business of the company and reduce the amount of resources used to support functions. The reason why 3PL was chosen is that the parent company had already some of their functions, such as enterprise level accounting and treasury, moved to Netherlands.

...decided to move all subsidiary warehousing and logistics to one place. The main reason being fierce competition at the time. Cost savings are made, even in the cost of service level.

L.Leinonen

5.6 Outsourcing effects on customer: Less change than expected

When the logistic services were transferred to the 3PL the customers of the company had to make changes as well. The interactions, for example order of goods, had to be done either online or by contacting the order processing staff in Netherlands. These

changes were seen positive, especially once the outsourcing process was completed, since the customer was no longer so much tied to the company but could independently perform some purchasing functions.

Some of the changes were positive. Good thing was the possibility to order goods online and to see the stock situation right away, rather than dial up someone to check it. We were no longer tied to working hours either, I could make the order basically anytime of the day. In the end, some of the changes made my work easier as well.

A.Similä

The overall service level that the company provided was seen to stay quite the same, although the amount of personal communication was reduced. For example the company's personnel was contacted only if there was a problem or a question which needed quick answer. The actual performance of the company's new warehousing and transportation services was seen to be quite good; it was also one of the main reasons for the positive tone.

...it does not matter where the warehouse is located as long as the deliveries are not affected. The delivery times were not affected, we still got the goods which were in stock within the next day... The product knowledge of the staff in Netherlands was not great but we did not expect it to be. Sometimes this was became an issue.

A.Similä

The interviewee saw that the main reasons for the overall "boom" of outsourcing in the business field are due to the competition and also cost reduction. The prices of the products are going down but the demand stays about the same. This would mean that the supplier need to find new margins from different sources. The company was not the only one to outsource their logistics operations at the time, the interviewee mentioned. Other competing companies at time were practicing outsourcing as well.

5.7 Comparing the interview results and ideas of improvement

The interviews conducted brought out quite expected results when comparing to the theory of outsourcing reviewed in previous chapters. The company experienced both positive and negative changes with also reflected to their customers. Interestingly the inter-

viewed company's former employee brought out more negative sides than the interviewed on the customer side. Although there can be easy explanation to this, companies in general do not want to show their weaknesses especially to their customers, but want to have as positive image on public as possible.

In both interviews the lack of certain knowledge about the company's products and business by the 3PL was mentioned. This goes hand with the critic on logistics outsourcing. The company interviewee also pointed out that there should have been more training for the new staff at 3PL about the products and companies. This could be something to that should have done differently. The same can be said about informing the customers on company's internal changes which in some occasions lead to confusions.

It came evident that as long as the deliveries and other business functions worked well, the customers of the company had no preferences if the logistics were kept in-house or outsourced logistics provider. The interviewee saw a number of benefits about the services that the 3PL could provide. If these services, such as online stock situation checks, would have been implemented into the company's former in-house system, a considerable amount of both capital and time investments should have been committed.

Also important thing to point out was the timing of the whole outsourcing operation. In this case, the changes were implemented during peak season which was not seen as the optimal way. The implementations should have been done in the slow season, which in this case would have been in the winter, so that the impacts on sales would have been minimal.

In a perfect situation, the outsourcing process would have been done without any negative effects on the business. Unfortunately in practice this can be very difficult since it is almost impossible to predict all the possible effects and issues which may or may not rise during the transaction from in-house operations to third party provided solution. In the end, the process was seen to be success within the case company, despite the difficulties and issues they had during the process.

6 Conclusions

The purpose of this thesis is to study outsourcing, logistics outsourcing, and its effects on smaller companies. The work has brought out the main ideas of outsourcing and, especially in the case studied, some of its effects as well as presented tools on identifying outsourcing possibilities and service provider selection. The service selection process has a step by step guide which can be used to find the perfect solution depending on the outsourced business activity.

In the secondary research, the foundations or basics of outsourcing are gone through to develop the basic understanding on the subject as well as explanations on why companies would consider outsourcing. Further information about logistics outsourcing is given along with relevant data about how common outsourcing is and which business processes could be outsourced.

The literature used has been selected so that it is relevant to the subject, is valid and not outdated and academically suitable. The online material used is to add in to the written literature and also further bring the data up to date.

In the primary research, a case company was presented. Despite the small group of interviewees, the data collected gives interesting insights outside of the theoretical framework and about what actually happens when business processes are outsourced. The interviews also give validity to the theoretical part of the study and show the relationship between the two.

Outsourcing has become such a common business practice that it is implemented practically by all companies regardless of their size. This can be anything from payroll service to whole production including product design outsourcing. The solution it offers a set of tools for a company to improve their competitiveness. The third party studies presented support this and also give an idea of how big of a phenomenon outsourcing has become in a very short time.

The objectives of outsourcing which are presented in the previous parts of this study can be seen as the main reason for today's global outsourcing. When considering small and medium size companies, the main benefits are the reduced costs, reduced need of

capital investment and gains in business flexibility. As scarce resources of a better invested in the core business of the company, business growth can be expected and if outsourcing is one of the ways to archive this, it should be well considered. Although as mentioned, outsourcing is not for every company and not all business processes should be outsourced.

Recommended further studies would include more in-depth research on outsourcing activities depending on the company size and nationality. Large companies have much more resources to keep activities in-house or have quantities big enough to have great effect on their outsourcing partners. For the case company it would be recommended to do further research on the management of the change and try to calculate the exact benefits or negatives that the outsourcing has brought.

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Interview questions

Interviewee information

Name:

Position at the time:

1. How did the outsourcing affect your duties in the company?
2. How did outsourcing affect the daily logistics operations?
3. Did you see any positive or negative changes?
4. .Did you feel that the service provided by the company changed afterwards?
5. What do you think that were the main reasons for the outsourcing?
6. What should have done differently?

Content of the appendix is placed here.

Abbreviations

BPO: Business Process Outsourcing.

RFI: Request for information

Reman: Remanufactured

Shippers: Owner of goods being transported in any mode of transport.

SME: Small & Medium size Enterprises

3PL: Third party logistic service provider