Using outcome-oriented contracts to foster performance improvements in logistics outsourcing relationships

Torsten Steinbach*

Carl Marcus Wallenburg*

Florian Urmetzer

UNIVERSITY OF CAMBRIDGE
Cambridge Service Alliance

*WHU – Otto Beisheim School of Management

Agenda

- Background to the study
- Research question
- Outcome
- Summary / implications & limitations

Objective and background

- logistics outsourcing is the established practice of contracting a specialized logistics service provider (LSP)
- continuous improvement is particularly important in the highly competitive logistics industry

- results include reduced costs and increased service performance

We asked 2,203 LSP Managers
231 survey responses, for this study 114 complete survey results were used

Definitions

- outcome oriented contracts, are aiming to payment at least in part to performance achievement and are suggested to foster innovation activities.

- innovation enablers:
  - the service provider's autonomy that allows sufficient freedom to innovate the daily operational activities
  - the rewards system that can result in increased profits

- can facilitate innovation efforts as performance improvements are remunerated via contractually defined incentives

Definitions (Negative views)

- since the service provider has autonomy with regards to how it delivers the agreed outcomes,
    - once processes are in place to satisfy customer expectations, the provider might stop experimenting with alternative approaches
- outcome-oriented contracts may stifle overachievement once the provider reaches the maximum potential customer remuneration
- depending on the specific contractual terms, outcome-oriented contracts might focus provider activities on cutting costs rather than improving services

Result overview

Hypothesis		Independent variables	Dependent variable: proactive improvement	
			Standardized path coefficients	p-values
H1	(+)	Bonus payments	**0.173***	0.068
H2	(n.s.)	Malus payments	-0.102	0.297
H3	(+)	Link to manager compensation	**0.197***	0.099
H4	(+ and < H3)	Link to operations staff compensation	-0.039	0.720
H5	(-)	Number of KPIs	-0.095	0.300
H6	(+)	KPI adjustments	**0.196***	0.052
		Controls		
		LSP size	-0.011	0.918
		Customer size (relative to LSP)	0.081	0.462
		Familiarity with the customer	0.031	0.742
		Customer outsourcing experience	-0.027	0.801
		Innovation alignment	0.240**	0.011
		R^2	0.19	
		R^2 with controls only	0.06	

* $p < 0.1$ ** $p < 0.05$

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1. Bonus Payments (supported)

A firm should be incentivised positively on good performance

2. Malus payment (not supported)
Penalty payments

Penalty payments seemed not to help increase performance of a firm

3. Link to manager compensation (supported)

Compensation of the managers responsible for the business relationship was seen as positive.

4. Link to operations staff (not supported)

Incentivising operations staff directly for innovations and performance was not supported

5. Number of KPIs (not supported)

To have a large number of KPIs to support the contract was not supported, but simple to understand and effective KPIs were preferred.

6. KPI adjustments (supported)

It was supported to be able to change and enhance the KPIs during the contract period on the basis of experience gathered

Summary and conclusion

- performance based contracts can be used to incentivise innovation and improvement! As well as performance.
- negative (malus payments) are considered not to be working
- performance metric systems should ensure that their goals are well reflected in the KPIs.
- at the same time, customers and service providers are advised to allow frequent adjustments
- outcome-oriented contracts can increase proactive improvement behaviour by the service providers when they are designed and implemented effectively

Torsten Steinbach
Carl Marcus Wallenburg
Dr. Florian Urmetzer

www.cambridgeservicealliance.org

ftu20@cam.ac.uk

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