Using Key Performance Indices to Motivate a 3PL

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- Looking at the main reasons why users appoint outsourced providers, about half of them relate to cost saving, and half to improvements in service

- Unsurprisingly, users therefore tend to choose a provider who is neither the cheapest bidder nor the most expensive, but rather where there is a balance between reduction in cost and improvement in service

- The potential benefits of appointing a balanced provider are often lost in negotiation because of users trying to get the provider to provide the service at the lowest possible price

- In particular, where outsourcing contracts provide for the achievement of KPIs, they frequently do so by imposing penalties on providers for failing to achieve them

- KPIs can instead be used to motivate a provider to provide a service which is completely tailored to the needs of the individual user

Case Study

- In this scenario, the user is a manufacturer of fragile, expensive crockery
- The suggested KPIs are for illustrative purposes only and are not intended as a serious suggestion as to the KPIs that a user would choose in practice

Case Study

- The use of KPIs as an incentive can be used in association with any pricing mechanism
- For the purposes of this case study though, the outsourcing arrangement is an open book one where the provider’s costs are reimbursed, and where the provider receives a variable management fee of up to £100,000, depending on its performance

KPIs for Crockery Manufacturer

- Damage to goods
- Theft and stock loss
- Orders met same day
- Goods returned
- Picking success
- Cost reduction from previous year

KPIs weighted to reflect their importance to the user

KPI	Weighting
Damage to goods	**15**
Theft and stock loss	**10**
Orders met same day	**20**
Goods returned	**10**
Picking success	**15**
Cost reduction from previous year	**30**
Total	**100**

KPI Matrix

KPI	Weighting	100%	75%	50%	25%	0%
Damage to goods	**15**	**<0.5%**	**0.5- 0.6%**	**0.6%-0.8%**	**0.8-0.9%**	**>0.9%**
Theft and stock loss	**10**	**<0.25%**	**0.25- 0.4%**	**0.4%-0.55**	**0.55-0.7%**	**>0.7%**
Orders met same day	**20**	**>99%**	**99 -98%**	**98-97%**	**97-96%**	**<95%**
Goods returned	**10**	**<1%**	**1-1.2%**	**1.2-1.6%**	**1.6-1.8%**	**>1.8%**
Picking success	**15**	**>99.5%**	**99.5-99%**	**99-98.5%**	**98.5-98%**	**<98%**
Cost reduction from previous year	**30**	**>10%**	**10-8%**	**8-6%**	**6–4%**	**<4%**
Total	**100**					

KPI Matrix

Actuals Achieved

• Damage to goods:	0.56%
• Theft and stock loss:	0.17%
• Orders met same day:	97.2%
• Goods returned:	2%
• Picking success:	98.2%
• Cost reduction :	8.3%

KPI Matrix

KPI	Weighting	100%	75%	50%	25%	0%
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Total	100	10	11.25	10 + 15= 25	3.75	0

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Total	**100**	**10**	**11.25**	**10 + 15= 25**	**3.75**	**0**	**50**

10 + 11.25 + 25 + 3.75 = 50 (out of a possible 100) => 50%

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50% x possible management fee of £100,000 =>

Actual Management Fee of £50,000

- Using KPIs as a motivator, as well as enabling the user to motivate the provider to provide a service which exactly matches the needs of the user, also gives the user the power to incentivise the provider to provide continual improvements throughout the course of a contract, rather than just at the beginning

- Remember that goals determine, and can therefore distort, behaviour

- Consider starting with a restrictive contract, then gradually over time converting it to a motivational one

Three tips for users

1. It works best as a symbiotic relationship – don’t try to get one over on your provider

2. When you extend a contract, don’t just sign the old one again – introduce or review the KPI incentives

3. If you hire specialists, make sure you get the benefit of their specialist knowledge

Three tips for providers

1. Make sure that the people who will perform the contract are heavily involved in its negotiation

2. Find out what the user’s objectives are, and remember that they may not yet know that themselves

3. Take a long-term view of building trust with your users and of educating them

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