



# USAID | DELIVER PROJECT

## Technical Brief

# Logistics Outsourcing and Contract Management in Public Health Settings



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Contracted and public sector staff members prepare last mile deliveries to health facilities from the Oshodi Medical Stores in Nigeria.

**Contracting private logistics service providers can be a unique opportunity to improve supply chain performance, but that performance depends on investing and executing long-term logistics contract management.**

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Has your organization established a goal of logistics performance improvement? Has your organization recently decided to contract with an external private party for warehousing, transport, or other logistics services to support this goal? Is your organization considering this, but is unsure about the resources, skills, and approaches required for ongoing logistics contract management?

This brief offers basic advice for getting the best possible performance from a logistics contract in a public health setting; it also describes the basic duties and required capabilities of a logistics contract manager; plus, it summarizes several tools for contract management. It also both summarizes and complements a USAID | DELIVER PROJECT guide to logistics outsourcing: *Emerging Trends in Supply Chain Management*. This publication discusses, in detail, the concept of strategic outsourcing; the decisionmaking process, which should inform outsourcing; and case examples from the developing country public health context.

## **Best Practices for Successful Logistics Outsourcing and Contract Management in the Public Health Setting**

### **Lay a strong strategic foundation for outsourced logistics services:**

A recent assessment for your organization may have indicated a need to improve its logistics and supply chain operations. In addition to strengthening the internal capacity to perform these tasks, performance improvements can also be made by contracting an outside organization that specializes in logistics services—a third party logistics service provider (3PL). However, the potential for your organization to succeed using an outsourced contract will depend on whether you have a strong strategic foundation for success (Else 2007). Even if you have already outsourced logistics operations, strategic deliberations may be valuable.

After you determine that you need performance improvement for your internal logistics operations, make sure your organization follows these steps to ensure that outsourcing is the right solution:

### **1. Form an internal group of stakeholders to investigate the potential for outsourcing.**

Include staff members who understand your organization's processes, goals, strengths, and weaknesses; who understand the organization's regulatory environment, as well as those with experience in logistics operations. As needed, for an unbiased perspective, you can work with external consultants that specialize in logistics service procurement.

### **2. Identify your organization's core competencies.**

Any activities that are not core competencies, and are underperforming, are possible areas that an outside company could run. At this stage, the stakeholder group should consider—

- the political and regulatory feasibility of outsourcing
- potential funding mechanisms for outsourced activities
- whether viable 3PL candidate companies are available in their setting
- potential effects of outsourcing on internal staff; and the available options for retraining, repurposing, or releasing those staff
- potential sources of disruption or dysfunction if an outside organization performs logistics operations, as well as the impact and likelihood of negative events.

### **3. Conduct a realistic cost-benefit analysis.**

For activities that can be outsourced, (1) estimate the current operating costs of doing the process internally, (2) the costs of improving internal operations to meet performance goals, and (3) the costs of contracting an external company to perform at this level. Cost figures should include direct costs—all supply chain activity costs, including labor and depreciation of owned assets—as well as all applicable indirect overhead costs. Together, with current internal performance data and local 3PL performance benchmarks, this will give the stakeholder group initial information about the comparative costs and benefits of outsourcing.

These steps, presented in greater detail in the USAID | DELIVER PROJECT document listed below, will enable your organization to justify investments needed to manage a contract; and will reassure the stakeholders that the outsourcing is strategically well founded and will contribute to the organization's supply chain performance goals. If your organization already contracts with 3PLs, it is still worthwhile to periodically consider the strategic fit between your organization's goals and the 3PL's competencies, as well as the estimated cost benefit of outsourced logistics operations.

#### **Recommended resources:**

MIT-Zaragoza International Logistics Program. 2011. *Framework on Distribution Outsourcing in Government-Run Distribution Systems*. Zaragoza, Spain: MIT-Zaragoza, Transaid, and VillageReach. Accessible at <http://villagereach.org/vrsite/wp-content/uploads/2011/05/Framework-on-Outsourcing-Reference-Material-for-Nigeria.pdf>

USAID | DELIVER PROJECT, Task Order 1. 2010. *Emerging Trends in Supply Chain Management: Outsourcing Public Health Logistics in Developing Countries*. Arlington, Va.: USAID | DELIVER PROJECT, Task Order 1. Accessible at: [http://deliver.jsi.com/dlvr\\_content/resources/allpubs/guidelines/EmerTrenSCM\\_Outs.pdf](http://deliver.jsi.com/dlvr_content/resources/allpubs/guidelines/EmerTrenSCM_Outs.pdf)

## **Establish and implement a contract that aligns interests across partners while managing the organization's transition to contract management**

If and when a decision is made to contract with an external third party, your organization should establish a contract that will meet performance expectations and manage the organizational restructuring required to ensure a smooth transition to the new contract manager/contractor relationship. The following steps will help to put a manageable contract in place:

### **1. Establish a project implementation team to manage the service procurement process.**

Draw from the original group of stakeholders to identify a cross-sectional group that includes representatives from senior management, financial management, contract experts, and current operations managers. The team will—

- review organizational performance objectives
- review relevant procurement guidelines
- assess internal contract management capacity (see below)
- define the required services and draft the Request for Proposal (RFP)
- execute the 3PL recruitment.

To identify approaches to monitoring and managing potential risks, as identified during the strategic deliberation, the team should also develop a risk management strategy related to the contract. For example, are there ways to mitigate or avoid potential non-performance of the contractor? If your organization already contracts with 3PLs, introducing a risk management strategy can still help identify methods to avoid and reduce exposure to risk.

### **2. Build or hire contract management capacity.**

The ability to successfully manage goods or service suppliers requires specific skills, which draw on knowledge in logistics operations, performance management, contracting, and procurement regulations (APICS 2011). This person (or persons) should have the resources and ability to provide ongoing management attention to the contracted service (see the next section on managing the life of the contract), and should be responsible for recommending contract termination or extension; and, ultimately, for obtaining the highest possible performance for the organization. The contract manager is generally responsible for supporting the organization's logistics service objectives by aligning contractor performance to meet them. Depending on the scale and scope of the contract, the contract manager may be a full time, dedicated staff member.

This job is critical to the success of any contracting effort and, therefore, in a ministry of health (MOH) setting, the contract manager should be a senior government official with project management experience, administrative and analytical support, and authority; who, ideally, reports directly to the minister or permanent secretary (USAID | DELIVER PROJECT 2010).

When logistics operations are newly outsourced, building contract management capacity may require hiring of new staff or additional training for staff who, previously, directly managed operations. For the internal staff transitioning to a contract management role, they should understand the shift in mindset from one of direct management to contractor oversight and relationship management.

### 3. Recruit the 3PL.

Follow all relevant local guidelines and best practices for overseeing and executing the invitation to tender, bid review, vendor negotiations, and signing of the contract. This can be a potentially lengthy process depending on the scope of the contract and the level of regulatory oversight required, but it is crucial for identifying the best possible contractor for your organization’s needs. Awarding work to a contractor who is unable to perform their responsibilities will result in wasted funds, time, and effort, as well as missed performance targets. In designing the invitation to tender, carefully consider the criteria you will use to evaluate responses—price is important, but it should not be a tradeoff for service quality or ability to comply with your regulatory requirements. Consider offering preference to contractors with a proven history of performance. One option for transparently evaluating bids is to use a decision matrix to weight supplier offerings, based on multiple criteria (See table 1). In this example, contract cost is the most important factor, but it is balanced by other important criteria.

**Table 1. Example of a Tender Evaluation Matrix**

Bidder	Technical Quality of Offer	Cost	Payment Terms and Conditions	Additional Services	Experience with Public Health Programs	Weighted Total Score
<b>Weighting of total score</b>						
	<b>35%</b>	<b>40%</b>	<b>10%</b>	<b>5%</b>	<b>10%</b>	
A	5	3	3	3	2	3.6
B	2	4	5	4	5	3.5
C	5	4	4	5	3	4.3
D	3	3	3	5	1	2.9

#### Recommended Resources:

The *CIPS Contract Management Guide* is accessible at:

[http://www.cips.org/documents/CIPS\\_KI\\_Contract%20Management%20Guidev2.pdf](http://www.cips.org/documents/CIPS_KI_Contract%20Management%20Guidev2.pdf)

John Snow, Inc. 2004. *Contracting for Health Care Service Delivery: A Manual for Policy Makers*. Boston, Mass.: John Snow, Inc.

*PATH Procurement Capacity Toolkit*. Accessible at <http://www.path.org/publications/detail.php?i=1652>

### 4. Negotiate a service-level agreement (SLA)

To use as the basic performance standard behind the contract. A properly designed SLA, by outlining specific recourse if performance targets are not achieved, can be an incentive for the contractor; it helps align the contractor with the objectives of your organization and the overall supply chain. For example, a contract for storing health commodities might require the contractor to keep the value of commodities lost to damage or shrinkage within a certain acceptable range. A contract

A service-level agreement (also known as a logistics-service agreement) is the part of the contract that records a common understanding of basic expected performance levels of the contractor, in quantitative terms. It typically should include mutually agreed-upon target performance goals, target floors, and service levels that justify contract cancellation (Dennerl 2012).

for routine delivery of commodities may require the contractor to return a specific percentage of proofs of delivery, or to maintain a certain range of on-time delivery. Choose basic indicators that relate as closely as possible to your organization's logistics objectives—for example, providing commodities of high quality in a timely manner—with realistic service targets. Also, be sure to clearly identify the source of the data, formula for calculation, reporting frequency, and required format for communicating the data.

One MOH parastatal organization in sub-Saharan Africa requires its medicine delivery contractors to provide proofs of delivery (PODs), signed by facility recipients, after every delivery run. This allows the parastatal to maintain accountability over its shipments and ensures that there is no product leakage.

Depending on applicable procurement regulations, to better align contractor performance with your organization's objectives, you can also negotiate the inclusion of contractor performance rewards and incentives into the SLA. Cash bonuses or rewards of increased business volume for sustained high levels of performance and cost reduction are all good approaches for tapping into the financial incentives of private-sector partners (Grubic and Thompson 2002; Eichler et al. 2012).

The SLA should also specify the relevant responsibilities of your organization during ongoing operations. This might include adhering to a specified payment schedule or any operational activities that are important

**When designing a scorecard for a logistics service provider, keep the following in mind:**

- Include metrics that relate to your organization's operational goals, and provide insight into total supply chain performance rather than operational oversight of your supplier.
- Keep the scorecard simple to update and analyze.
- Know that the scorecard's usefulness will be driven by the quality and timeliness of data being reported.

*Adapted from Frentzel 2011*

inputs to the contractor's activities—such as developing order schedules for third-party delivery (Grubic and Thompson 2002). In the public sector, adhering to committed payment schedules is crucial for building trust with private-sector partners and for attracting reputable service providers to bid on future contracts.

Finally, the SLA can be strengthened by contract management tools, such as a routine *scorecard*, sometimes known as a *supplier scorecard*. The scorecard can be the active analysis table for keeping track of and dissecting supplier performance. However, the scorecard also complements the SLA by including additional indicators—ones that don't tie directly to the agreement but that are helpful in understanding performance

outcomes (Dennerl 2012). Potentially, the scorecard can include input and process indicators that can help explain, and even predict, performance outcomes; and can effectively be the monitoring and evaluation framework behind the outsourced operations. Ideally, this should help identify potential causes of poor performance that fall outside the contractor's scope of responsibility. For example, during a contract for routine delivery of commodities, the contractor's rate of on-time deliveries during a particular period might be lower because of an unanticipated increase in volume to be delivered, or because recipient clinicians were not available to sign for deliveries (See table 2). Tracking delivery volumes, in addition to the on-time delivery, could help to show a potential relationship and provide insight for your organization and the contractor to find ways to achieve better performance.

**One MOH contracted a 3PL to manage its central medical stores, and applied the following metrics to its performance management:**

- product availability
- inventory discrepancies
- on-time deliveries
- cost of transport operations
- training of CMS staff.

Negotiations with the contractor for both the SLA and any associated scorecard are an important step in establishing the contract in a way that supports the ability of your organization to successfully manage the contract in the future. To identify potential relevant metrics, refer to the following resources; or ask the supplier if they would be willing to share any scorecards they currently have with other organizations.

**Table 2. Example of a Supplier Scorecard**

Performance Area	Indicator	Goal	Period Average	Jan	Feb	Mar	Apr
Quality	% shipments resulting in product loss or damage	0	1.75	5	2	0	0
Delivery	% shipments within acceptable delivery time window	98	92.25	92	85	96	96
	% proofs of delivery returned	100	99.75	99	100	100	100
Responsiveness	% of emergency deliveries supported within 48 hr period	75	37.5	50	50	50	0
Activity	number of deliveries planned			100	75	76	75
	number of emergency deliveries requested			2	2	2	4
	total volume of deliveries planned (m3)			4.0	3.5	2.7	2.7
Notes				--	--	--	--

**Recommended resources:**

Aronovich, Dana, Marie Tien, Ethan Collins, Adriano Sommerlatte, and Linda Allain. 2010. *Measuring Supply Chain Performance: Guide to Key Performance Indicators for Public Health Managers*. Arlington, Va.: USAID | DELIVER PROJECT, Task Order 1. Accessible at: [http://deliver.jsi.com/dlvr\\_content/resources/allpubs/guidelines/MeasSCPerf.pdf](http://deliver.jsi.com/dlvr_content/resources/allpubs/guidelines/MeasSCPerf.pdf)

**Manage the life of the contract and supplier relationships for the best long-term performance**

Unlike one-off activity services or one-time purchases, contracting for routine operations requires a regular review of performance; the goal is to continue to improve your own organization’s performance during the life of the contract, as outlined during strategic deliberations. After the contract management capacity and tools are in place, a number of recurring tasks should take place to maintain an effective partnership with the service provider within the life of the contract and to maximize value for the end customer—the patients and users of the health system—in the long term. These activities form the core set of long-term responsibilities for the contract management staff.

**I. If outsourcing activities that previously took place in-house, continue change management efforts.**

Follow through on plans for internal capacity building, as well as repurposing and retrenchment of operations staff whose roles have been supplanted by the outsourced contract. Consider using a gradual approach to transition the role of the public sector by freezing new hiring and allowing current staff to gradually retire and be replaced by contractor capacity. The Directorate General for Family Planning in Bangladesh began their transport outsourcing transition by outsourcing 20 percent of delivery operations; based on successful outcomes, they increased to 80 percent, maintaining a portion of operations within direct government control to cover possible non-performance by the 3PL (DELIVER 2007).



## **2. Routinely review contractor performance and work toward continuous improvement.**

You should see the contractor as a supply chain partner that has significant responsibility for overall supply chain performance—the level of service (the *Six Rights*) that patients receive in your public health supply chain will partly depend on the contractor’s performance. However, the performance of the contractor also depends partly on the approach and effort made by the contract management. Contract management staff should fulfill routine, required tasks, including using reported indicators to review and analyze contractor performance; facilitate regular meetings with contractors to review performance; and develop plans for performance improvement, processing of invoices, and general management of the contractor relationship. Other routine, supportive tasks may include producing timely and accurate required documents for contractor operations, such as distribution plans for routine delivery.

Best-in-class commercial companies have established routine approaches to supplier relationship management, or alliance management (Engel 2011). This concept focuses on close, two-way communication between your organization and the contractor, through regular—potentially, monthly or bimonthly—meetings to jointly discuss recent performance, identify causes of and solutions to any performance challenges, and revising goals, if necessary. This approach helps identify and understand performance trends, creating opportunities for service improvement and cost reduction (Dennerl 2012). It is important to prioritize SLAs, including defining and tracking key performance indicators (KPIs) and reviewing results regularly with your 3PL and other key supply chain partners. Regular reviews of KPIs lay the foundation for improving service and lowering costs. Reviewing these metrics together to monitor trends, month after month, provides insight for both parties and establishes the framework for developing action plans to address KPIs that are below the targets, as well as to identify new opportunities (Dennerl 2012). Informal interactions between your organization and the contractor can strengthen the relationship development, but make sure that you establish a single point of contact between the two organizations for formal communications; in this way, the contractor will not receive conflicting instructions or feedback. If adjustments to the contract or supplier scorecard are required, only one person—the contract manager—should have the authority to make these changes.

## **3. Internally, look beyond the life of the current contract to anticipate future service provision.**

While your organization may implement contracts annually, keep in mind that you will still have ongoing, long-term responsibility for commodity availability. Use the contracting approach and the performance data it generates to continuously improve performance within and between contracting cycles, and to advocate for required supply chain strengthening investments.

In the long term, it is also important to complete the outsourcing and contract management cycle by regularly reviewing and updating your organization’s supply chain goals. Over time, the factors that influenced the original decision to outsource logistics activities may change. Your organization’s approach for achieving its performance goals may also change if the goals themselves change. Regularly review and update your organization’s supply chain goals and objectives in line with achieving continuous improvement.

Ultimately, contracting private logistics service providers can be an opportunity to improve supply chain performance, but that performance will also depend on the investment and execution of long-term logistics contract management.

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### **USAID | DELIVER PROJECT**

John Snow, Inc.

1616 Fort Myer Drive, 16th Floor

Arlington, VA 22209 USA

Phone: 703-528-7474

Fax: 703-528-7480

Email: [askdeliver@jsi.com](mailto:askdeliver@jsi.com)

Internet: [deliver.jsi.com](http://deliver.jsi.com)