



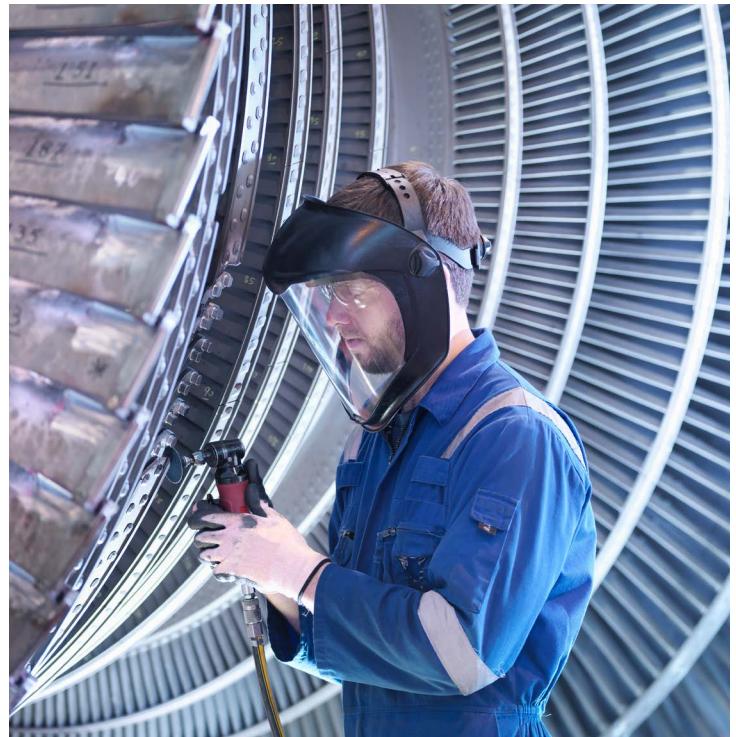
A&M INSIGHTS

SOURCING EXCELLENCE IN MAINTENANCE, REPAIR AND OVERHAUL (MRO SERVICES)

DECEMBER 2018

Overview

There is no question that these are challenging times for Chief Procurement Officers (CPOs). To name a few issues currently being faced: the hype around digitisation of procurement, new tariffs around the world shattering supply chains and continued increase of material costs. While concentrating on these new challenges, there is a risk that a more basic requirement – namely to focus on continuously optimizing the spend volume, is lost. This is especially true for more complex spend categories. In many companies there is no comprehensive procurement strategy for MRO services and spare parts which often leads to fewer service providers competing for the work, poor decision-making and ultimately untapped savings.



Companies often ignore significant cost reduction potential regarding MRO services and spare parts. There are no easy wins in this area, but if a business is prepared to apply cross-functional skills and efforts, this can yield qualitative and economic benefits.

We have identified five calls to action for CPOs:

1 Use of Best-in-Class procurement levers

After pursuing traditional cost reduction strategies like volume concentration, best-cost-country sourcing, and process improvement, CPOs should take the next step and introduce purchasers to more advanced procurement levers.

These include:

Leverage Smart Contracting: This can be an effective source of cost savings especially for MRO services. Moving from contracts based on time and material to those based on outcome or up-time have been shown to generate cost savings anywhere from 15 to 25 percent. The use of incentives can be powerful tools to drive service providers to act in ways that benefit both parties more explicitly. Examples includes clauses on Productivity Gain Share, (uptime) targets and Key Performance Indicator (KPI) related bonus/penalties. Also, full service and extended guarantee contracts offer strong potential for cost savings.

Foster competition of OEM vs non-OEM: The supplier market for maintenance services consists of many different OEM, specialty, and general third-party providers with different levels of competitiveness. Also, for spare parts OEMs price mark-ups vary depending on the uniqueness and the value proposition of the parts in question. Companies can reduce costs substantially by optimizing the portfolio for proprietary intellectual property whilst outsourcing commodity parts and services. Since complexity is usually a major cost driver, another option is to standardise services and tools and to introduce catalogues that keep the number and variety needed to a minimum.

Unbundle the purchase of services and spare parts from the assets purchase: Where several items are bundled, there is an inevitable lack of transparency on the overall value for money. It is much better to unbundle all the various elements namely the asset itself, spare parts, consumables, maintenance services and tools and receive a price for each element separately. In doing this, it is much easier to understand the true costs and pricing strategy of the supplier. Only when you are bound to the Original Equipment Manufacturer (OEM) for the respective service or spare part (e.g. due to warranty or liability reasons) or if you want to find out the most competitive total OEM price, is bundled pricing favourable, since you benefit from your bargaining power at the time of the asset purchase.

Base the sourcing decision on the Total Cost of Ownership (TCO): Looking at the TCO along the full lifecycle is key for MRO services and spare parts procurement, since for many assets the true costs are hidden in the services, spare parts, and consumables, rather than in the initial asset price. Make-or-Buy considerations (see Table 2) may also play a vital role in performing TCO calculations to help companies ultimately make the right decision.

Bring transparency to your MRO services and spare parts portfolio: Use the A&M equipment/service matrix (see Table 1) to help structure your portfolio. This matrix can be used to allocate spend volume to the respective equipment/service combination and to structure the supply base (OEMs, specialists, 3rd party providers) as preparation for the request for information/quotation (RfI/RfQ) process.

Table 1: A&M Equipment/Service Matrix

		Equipment							
		Production Machinery	Measuring Equipment	Laboratory Equipment	Heating / Climate	Pipeline Systems	Ovens	Ware & Transportation Systems	Tools
Service	Clean (Simple)	34.500	28.000	28.700	8.500	89.700	0	24.800	152.000
	Maintain / Calibrate (Medium)	243.700	35.800	164.000	13.500	59.300	0	83.800	362.700
	Repair (Complex)	147.000	12.700	53.700	5.700	34.700	0	24.800	99.500
	Retrofit (Complex)	87.000	0	0	32.800	86.400	0	12.600	243.800

Client Example (Data in €)



2 Development of a fact-based Make-or-Buy strategy for MRO services

A good start to define a Make-or-Buy strategy is to allocate the current spend volumes according to the different services and the various equipment types with the help of A&M's Equipment/Service matrix mentioned previously and shown in Table 1.

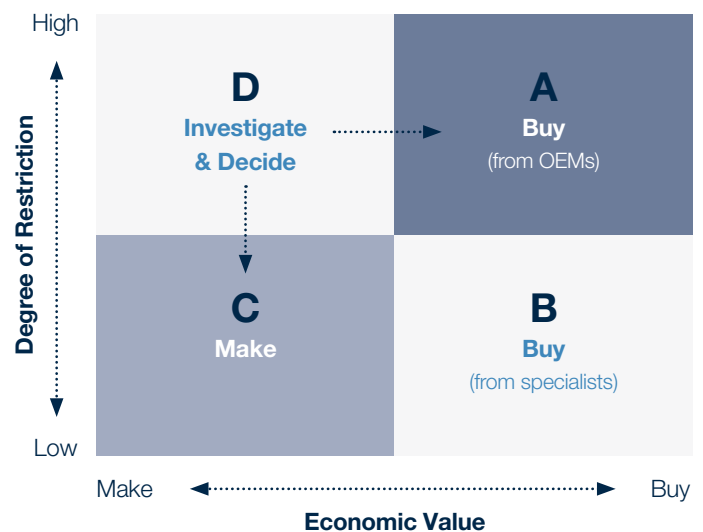
Having understood the spend volumes more deeply, for each Equipment/Service combination with significant spend, the next step is to determine the "degree of restriction" and the "economic value". The "degree of restriction" assessment involves consideration of the criticality of the respective service regarding warranty, liability, and safety issues (consult Operations team, review contracts, etc.).

This is then followed by determining the "economic value". For this, create the "Make" business case (if required skills are not available, include the costs for acquiring these skills) and the "Buy" business case. Both need to be based on the Total Cost of Ownership (TCO) concept. Compare them to determine what strategy is superior economically.

The matrix in Table 2 provides guidance on applying the appropriate strategy.

Table 2: Make-or-Buy Matrix to support MRO services strategic options

"Make or Buy" Matrix



- A. Economic Value suggests Buy and High Degree of Restriction: Recommendation is to buy the service from the OEM
- B. Economic Value suggests Buy and Low Degree of Restriction: Recommendation is to buy the service from a specialist or general 3rd party provider
- C. Economic Value suggests Make and Low Degree of Restriction: Recommendation is to perform the services inhouse

- D. Economic Value suggests Make and High Degree of Restriction: Recommendation is to thoroughly investigate the criticality regarding warranty, liability, and safety. If any of these cannot be compromised, buy the service from the OEM. If there is flexibility and the required skills are available inhouse, perform the services inhouse.



3 Clearly define the responsibilities between Operations and Procurement Functions

In a surprisingly high number of companies, MRO services and spare parts are still sourced with limited procurement involvement. Operations drives the sourcing of machines and for various reasons, services and spare parts are often included in the package at the cost of transparency and competitive pricing.

Best practice is to collaborate as a team such that the category strategy is defined jointly, with Operations defining technical specifications, and procurement driving the sourcing process.

4 Right capabilities and experience

Competence in the sourcing of MRO services and spare parts is clearly a challenge. Strong technical and economical skills are required to maximise the results and avoid pitfalls such as:

- Merely renegotiating hourly rates for MRO services. Hourly rates are meaningless unless they are bound to the outcome. For example, what milestone is achieved within the defined number of hours? What uptime is guaranteed? What is the penalty if uptime is not met? What is the productivity improvement of the service provider over time?
- Accepting the OEM's mantra: "Maintenance and spare parts have direct impact on safety, warranty, and liability." Of course, OEMs try to establish this mantra to sell the whole package. But this must be questioned case-by-case to allow competition. Also, at the latest when the warranty runs out there is freedom to move to a competitor. The value is unlocked by unbundling the purchase of services and spare parts, aside from the assets purchase.

5 Adequate service provider management

Ensuring that the service provider is closely managed and well-integrated into internal processes is a key prerequisite for successful collaboration. Also a machine-related maintenance strategy that aligns service intervals and content across sites needs to be defined, together with the respective provider. Unambiguous service level agreements (SLAs) defined for optimum lifecycle management must be in place, containing clear objectives and conditions. These should include for example Gain-Share-Models for improved productivity e.g. through the introduction of best practices such as predictive maintenance.



Next Steps

To understand where your business lies with regard to excellence in MRO services sourcing, ask yourself these five questions:

- 1 Do you continuously inject competitiveness into your supply base by periodically executing sourcing events followed by supplier swaps (where beneficial) and by rigid supplier (performance) management?
- 2 Do you leverage the variety of service providers and spare parts manufacturers in the market: OEMs vs competitive specialists vs general 3rd party providers?
- 3 Do you have smart contracts in place that incentivise your service providers to act in your interest (outcome/uptime basis, clause on Productivity Gain Share, bonus/penalty clause, SLA, etc.)?
- 4 Do you have transparency regarding your suppliers' true costs and pricing strategy on assets vs spare parts vs consumables vs maintenance services vs tools?
- 5 Do you have a clearly defined Make-or-Buy strategy for MRO services in place which has been implemented?

If you are hesitating to answer any of these questions above with an unreserved "Yes", please contact us to discuss together how to best explore this potential.

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