



White Paper

Strategic Sourcing Overview: Manufacturing Services

Manufacturing Services can include any type of services category that is a critical application in the daily function of manufacturing. When prioritizing sourcing projects, services have traditionally been secondary due to their complex nature, and have often been untouched by procurement. Although the process of sourcing these categories may not be as intuitive as tangible commodities, their more complex nature often translates into high savings percentages and, therefore, huge wins, when properly addressed.

Objectives of Sourcing Manufacturing Services are often similar to those of other categories:

- Examine vendor relationships across all business units and geographies; leverage spend and use strategic sourcing techniques to negotiate competitive pricing from qualified vendors
- Achieve cost reduction targets while maintaining or improving quality and service
- Improve spend forecast accuracy, cost awareness
- Develop and implement multi-year contracts with standardized terms and conditions across the corporation
- Reduce redundancy of activities within each business unit -- supplier qualification, bidding and performance management
- Streamline and improve existing processes while sharing best practices and knowledge across divisions and geographies

Trends in Manufacturing Sourcing

In recent years, there has been a surge in the sourcing of non-core MRO and manufacturing services categories, as these spend-areas have often been untouched, or only loosely managed. A major force in driving this change is not only corporate mandates to bring unmanaged spend under control, but also a corporate alignment of sustainability goals and objectives. Technology, increasingly used for quality control, is a key contributor to outlining quality requirements, gathering and sanitizing specifications and approving suppliers. Typically, manufacturing services projects are charged on a "per-project" basis, with little visibility into cost composition. Procurement's role is to use sourcing expertise to unbundle costs into cost drivers, such as labor, time, material, and equipment rentals. The coordination between technology and procurement has led to a massive consolidation of vendors geographically and a standardization of services and supplies across locations.

Types of Manufacturing Services Categories

- Motor Repair
- Janitorial (and other facilities services)
- Engineering and Construction Services
- Maintenance and New Construction (Roofing, Insulation, Painting)
- Equipment Leasing

Each organization may classify manufacturing services in a different way, and the specific categories within it depend on the industry. The important thing to note is that common characteristics allow similar sourcing strategies to be followed, resulting in realized savings. The beauty of these categories is that a similar

sourcing strategy can be used to address categories that may seem to span the gamut of services. This is because the underlying cost drivers, restrictions, and desired outcomes are often structured similarly. Considerably different categories can be addressed with the same sourcing strategy.

Characteristics of Services categories

Complexity of Spend: Manufacturing services categories are often decentralized, with relatively low spend on a site specific basis, but sizable spend across the enterprise. This spend is often unmanaged, or loosely managed at the local level.

Regional: Vendors tend to be local or regional, with few to no formal contracts in place.

Emotional: Due to the local nature of the categories and relationships formed, manufacturing services categories tend to be fairly emotional.

Information Management: There is rarely a common taxonomy across sites, and internal data is often extremely high level. In technical services categories, each site may have unique specific systems or products that are part of larger capital projects. Quality data is hard to manage and must often be obtained from vendors.

Components of Cost

Manufacturing services categories are often billed on a per-project basis, without visibility into the cost drivers. It is critical to understand the cost drivers that contribute to the overall project cost and to negotiate on as many aspects of the total cost as possible.

Labor Costs: Hourly wage rate and the number of work hours

Material Costs: Cost of raw materials and any consumables, including a mark-up percentage

Equipment: Tools and equipment used/bought/rented by the service provider

Transportation: Any cost associated with the transport of material, equipment, labor to site

Supplier Margins: Overhead, benefits, insurance, profit

Opportunity Costs: Cost to client for supplier response time, and the time it takes to fix the problem

Best Practices

In technical services categories, project success is augmented by the involvement of technology or a domain expert with deep category expertise. When reviewing the qualitative aspects of the potential vendors, the technology experts play a critical role in determining the qualitative characteristics required of a “qualified” vendor. These qualities may be government-regulated, industry-regulated, or determined on a company or business unit basis. Where few viable alternative suppliers exist, it may fall on the technology expert to work with a new vendor to come up with a technological equivalent. The qualification process can be lengthy, depending on the complexity of the category, and should be built into the timeline.

Unlike commodity categories, the scope of services being sourced may not always be standard. It could be location- specific, business unit-specific, or time-specific. In order to address this challenge, the key is to identify and work with common factors between vendors and projects, such as labor rates, job descriptions, or equipment rates. This could necessitate innovative structuring of pricing sheets, questionnaires, etc. As mentioned earlier, any outliers or specific requirements can be treated as exceptions.

Repairs and certain other service categories tend to be sourced regionally or locally, and sometimes no national players exist. In order to address this, put preferred pricing in place with regional or national vendors, as justified by the facilities requirements.

Unbundling the costs of a job is only part of the equation; it's important to understand the effective efficiency of each of the suppliers, and there are a few ways that this can be done. Putting together a market basket of sample jobs or projects allows the vendors to bid on actual work and to provide estimates of their timing to complete such tasks. If possible, provide historic references, where baseline spend and timing data exists, so total job cost can be compared across vendors and also compared to historic costs.

Spend per job is often very varied in manufacturing services categories, from a few large or capital projects

to many smaller one-off projects. When gathering data and focusing sourcing efforts, a best practice is to focus your efforts on the portion of the spend that will make the biggest impact, typically 80 per cent of the spend. This 80 per cent rule should also be considered when awarding business and setting stakeholder expectations regarding outcomes. In services especially, it's important to set everyone's expectations that there will always be exceptions to the award, whether it be for emergency reasons or advanced technical requirements. The important message to share is that the sourcing initiative will address the majority of the day to day business, but there will be a contingency plan in place for any exceptions that will come up. Additionally, for practicality of data collection, it's helpful to set a spend threshold (for example: jobs over \$10,000)

In services categories, where project scope or spend may not be well defined year on year, it is often helpful to focus on TCO (Total Cost of Ownership) savings. These can include volume rebates or any type of value added service that a vendor brings to the table. Some vendors can guarantee a level of year on year savings through methods like SKU rationalization, training, warranties and sharing best practices. Without a volume guarantee, these TCO savings can reflect hard dollar savings to the client that is reflective of the volume of business with each vendor.

Managing Your Category in the Future

Once you have chosen your preferred vendor(s), you can ensure that you are able to realize savings by establishing a rate card based on mutually agreed upon parameters. If a group of preferred vendors has been selected, jobs or projects can be bid out to this group of vendors to ensure continuous competition. Processes for TCO reporting should be implemented with local and corporate sign-offs on savings opportunities. Suppliers should be prepared to provide detailed monthly billing reports with all cost drivers broken out. Monthly reporting is a critical habit that will allow easy auditing, as well as provide a central repository for relevant data for the next time that the project comes up for negotiation.



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