OUTSOURCING LIFT TRUCK AND ROLLING STOCK PROCUREMENT AND MANAGEMENT

Dave deGruy
Universal Fleet Services, Inc.
251-304-2100

The purpose of this seminar is to help you make informed decisions about outsourcing Fleet Management (FM) by presenting various considerations for your deliberation. While the following is not intended to be an exhaustive study, hopefully, it will stimulate your thinking as to the program structure that best fits your company. When considering outsourcing, careful attention should be given to the types of programs available and the distinctions between each.

1.0 TYPES OF PROGRAMS

Three basic types of FM outsourcing programs are available; those provided by the manufacturer, leasing companies, or independents. Each program has its distinct differences as outlined below:

Manufacturer programs are provided by the equipment manufacturer or its dealer organization. These focus on the customer’s facilities where the manufacturer has placed its equipment. These programs typically provide the customer with a fleet inventory and certain operating cost projections from the manufacturer’s database. Truck replacement recommendations are made based upon extrapolated cost trends from the manufacturer’s database and the age of customer’s fleet. Shortcomings of this program are that only those facilities where this manufacturer/dealer has a presence can be continually monitored and there is typically reluctance on the customer’s part to share cost data with a manufacturer he is negotiating with for equipment, parts and service.

Some leasing companies offer FM outsourcing programs. These programs allow for managing customer’s facilities without regard to the manufacturer of equipment. Typically they provide an inventory of equipment by facility and some cost analysis based upon customer historical data. These programs are generally offered by the leasing company as a means to secure additional leasing business. While they may offer negotiated discounts on equipment, typically all leasing is done with the company offering the program.

The third type of outsourcing is through an independent FM firm. These programs may be structured in a variety of forms to suit the customer’s particular needs. Master purchase contracts and discounts are negotiated with original equipment manufacturer (OEM) suppliers suitable to the customer and procurement may be competed at customer’s facilities. Additionally, master lease contracts may be set up with multiple leasing companies and these too are competed. Confidentiality agreements may be executed and there are no conflicts of interest inherent in managing customer’s fleet. An independent becomes an extension of the customer by whom he is employed with the added benefits of shared overhead and supplier leverage based upon the total volume of the independent's customer base.

2.0 SUPPLIER SELECTION

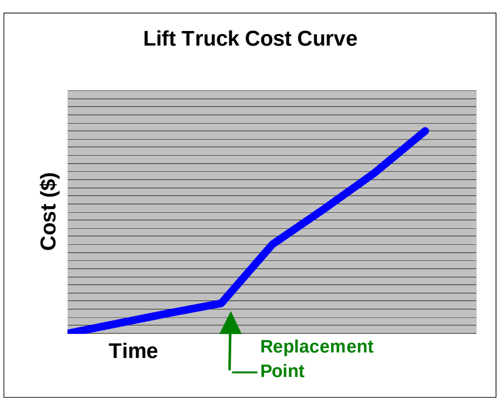
When selecting the equipment manufacturer, care should be taken to qualify suppliers. An investigation and/or survey of current facility satisfaction with certain suppliers can be very helpful in the selection process. Some things to look for when evaluating suppliers are as follows:

1. Quality of equipment
2. Parts availability
3. Service
4. Warranty
5. Full product line
6. Dealer support
7. Research & development programs

After selection of potential suppliers, requests for pricing discounts, extended warranties, etc. should be solicited and evaluated.

3.0 MAINTENANCE COST VERSUS REPLACEMENT CYCLE

When a company is considering a fleet management program one of the most important aspects to realize is the proper replacement cycle of the equipment. Just as it is generally accepted that when an automobile reaches sixty-thousand (60,000) miles it will start incurring much higher maintenance cost, so it is with lift trucks. A liquid propane (LP) lift truck should generally be replaced between 10,000 to 12,000 hours of operation. An electric lift truck should economically last between 12,000 to 15,000 hours of operation. Both of these statistics must also be adjusted for the application and environment within which these trucks are operating. After this point, the probability of a costly major component failure, such as an engine or transmission, is much higher.



Lift trucks and rolling stock are essential to facility operation yet they yield a very low ROI (return on investment). Many projects compete for the scarce capital dollars available to a company and typically lift trucks lose this competition because of their low ROI. When replacement is deferred in this manner, facilities have no choice but to repair aged equipment and maintenance cost continues to escalate year after year.

4.0 LEASING CONSIDERATIONS

For many companies leasing is a viable means of perpetuating a replacement cycle. Initially, there is a large savings as the lease payment is offset by the reduction in maintenance expense. Ultimately, the lease payments become part of the budget process and timed replacements can be effected. If a truck is leased, there is an obligation for a fixed period of time (term) and the leasing company has an expected equipment value and condition (surrender conditions) at the expiration of that term. Many leases have additional charges associated with operating equipment beyond a certain hour meter reading. Rotating equipment during the lease term to equalize hours can dramatically reduce cost.

Companies interested in leasing should also be aware that competition between two or three companies typically produces variation in rates and therefore savings. When executing a master lease contract, a company should consider constructing its own master document. This allows for comparisons to be made under the same parameters. Things to consider when developing or executing master leases are as follows:

1. Indexed rates – This allows for risk sharing between the client and the leasing company. Rates are typically indexed to U.S. Treasury bills (T-bill) and the quoted rate will move and lock-in, relative to the T-bill rate at the time of truck delivery.

2. Interim rents – The client pays additional monthly payments prior to the lease schedule being locked-in. This allows a leasing company to go to the money markets and borrow larger sums based on bundling or aggregating all the transactions for that quarter. Theoretically the leasing company can get better rates and pass these on to their customers. This bundling is usually done quarterly and can add as much as three additional months to the effective term of the lease.

3. Holding or selling of paper – It is a common practice for many leasing companies to sell a lease to free up capital, diversify risk or balance a portfolio. This practice can cause a customer a lot of excessive expense if not handled properly. Purchase order changes, even to automated systems, are costly and time consuming. Many times the company that bought the lease doesn’t make proper notification to the Accounts Payable function responsible for setting up changes. This can result in late fees, confusion and inefficiency.

4. Surrender conditions – Well-defined surrender conditions are a **<u>must</u>** in any leasing contract. As addressed above, many companies sell their paper. The terms of the original contract follow that paper and should contain as little ambiguity as possible. Without definitive surrender conditions, companies can incur additional expenses in repairing equipment to the satisfaction of the current leaseholder. Other issues, which should be addressed, are as follows:

1. Responsible party for the shipping and loading cost
2. Distance limitations
3. Time allowance that equipment may be stored on site before removal
4. What are each party's liabilities during the storage period

5.0 POLICIES AND ADMINISTRATION

After a company has chosen its management firm, picked its suppliers, and decided whether to lease and with whom, there are still many tasks that need to be addressed. A company representative should be appointed with the authority level to facilitate issues both internally and externally. This person must, at least initially, interface with several different departments within the company. He/She must work with the management firm to set the operating parameters by which the program will be executed, translating those parameters into company policy.

An approval process is one of the first such policies to be addressed. This should contain a clear definition of the steps to be followed to procure/replace equipment. A procurement form/package is generally facilitative to this process. It can state the business case, show the financials, and express risk and options. Dollar limits requiring different levels of authorization are also explicitly stated. Procedures, which should be followed in developing this package, are also delineated. Examples include whether facilities are able to choose from any of the qualified suppliers or whether these suppliers must tender a proposal for each procurement. What criteria will be required for procurement/replacement of trucks? Will purchase orders be issued from a central office or will each facility handle it? A competent fleet management firm should be able to facilitate policy development, offer templates, and customize processes to fit the needs of the company.

Concurrent to policy development, separate initiatives should be undertaken at the facility level. A coordinator should be identified at each facility that is responsible for working with the management firm to coordinate the components of the procurement package. Each facility should have an "Optimization" performed. This is a process whereby every equipment piece is identified along with data components such as make, model, year manufactured, serial number, life-to-date hour meter reading, estimated annual hours run, etc. From this data the management firm will recommend a "Rightsizing" of the fleet. This results in outcomes as follow; retain, replace, rotate or retire. These outcomes also take into account equipment configuration and current and projected utilization. With this information, prioritized replacements are established at each facility.

6.0 EQUIPMENT SPECIFICATIONS

Equipment specifications should be examined. Is there an opportunity for standardizing specifications such as back-up alarms, certain color strobe lights, fire extinguishers, etc? Truck capacities should be examined, perhaps standardizing on certain capacities rather than mixing capacities could lead to better pricing, and the flexibility of rotating trucks to equalize annual hours incurred. Standard specifications, where practical, facilitate transfer amongst facilities if there are plant closures or production changes. Specifications also effect the residual value of equipment a leasing company assumes, thereby affecting their quoted rate.

7.0 MAINTENANCE PARADIGM

Maintenance is another opportunity to achieve substantial savings. As earlier mentioned, if a company currently has an aged fleet (average age 10 years or older) there can be an enormous savings initially by replacements. Companies with older fleets have a paradigm shift associated with maintenance. They move from breakdown and repair maintenance to periodic maintenance. Scheduled maintenance is more economical to perform than repairs associated with major component failures. Additionally, this decreases the downtime and potential production delays associated with unscheduled failures. This paradigm shift may also allow for redeployment of maintenance personnel as periodic maintenance does not require as many personnel or the same degree of expertise as is required to effect major repairs.

A company may also want to examine the feasibility of out-sourced maintenance. A management firm should work with the facilities to determine current internal cost and solicit and negotiate with local equipment dealers or suppliers to perform maintenance. A management firm can bring knowledge of competitive rates in local areas as well as across geographic regions. A management firm is also able to leverage its additional customer base to garner competitive rates. Once these rates are determined, a management firm can construct a cost analysis to facilitate the feasibility decision of maintenance outsourcing. If it is desirable to out-source maintenance, there are many ways to construct the contract and the services rendered. Once again, a management firm should assist with advice and templates relative to the particular needs of a facility. Aside from pure economics, a company should also consider labor relations and environment when evaluating outsourced maintenance. If the company is leasing with outsourced maintenance, it is helpful to link the “surrender conditions” of the lease to the maintenance contract. In this way a company will have recourse if the equipment does not meet these conditions.

8.0 MONITORING AND REPORTING

Even when the equipment is being properly replaced and maintained, a competent management firm should monitor maintenance activities to continue effective cost management. This information should separately identify cost associated with abuse and equipment modifications. It should also contain periodic hour meter readings with the date performed. The management company will use this information to effectively cost manage the fleet. Early trends can be identified and addressed. Equipment can be rotated to equalize usage hours. Abusive trends can be brought to management's attention where additional training or disciplinary action can be taken.

9.0 CLOSING CONSIDERATIONS

It is my sincere hope that the information presented above has been helpful and informative. While it is true, that there are many considerations regarding the implementation of a sound outsourced procurement and cost management program, the dividends and savings are well worth it. A company considering FM outsourcing should recognize that fleet management is a perpetual program and carefully choose the management firm with whom to partner. This firm is the initial point of contact to facilitate, arbitrate, and negotiate all aspects of the company's fleet.