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Fleet & Distribution Outsourcing

The Ins and Outs of Your Outsourcing Project

There are many details to learn when outsourcing your vehicles. Discover how outsourcing can be the answer for you.

Previous discussion focused around the general nature of fleet and distribution outsourcing where some of the factors that have made it a growing presence in the water quality industry and business in general were reviewed (*WQP*, April 2000). Listed were some basic questions that an owner or manager of operations might ask himself when contemplating whether outsourcing might make sense for his company. For the second installment of the discussion, some steps will be suggested to use in performing such a process. They will include

- setting the scope of your outsourcing initiative,
- prescribing project management guidelines,
- gathering in-house information,
- conducting a competitive bidding process,
- performing an analysis of ownership vs. outside alternatives and
- making the decision and designing an implementation plan.

If you follow these steps, you should be able to manage the process through to win-win results for your company and your fleet and distribution partner.

Define the Scope of the Project

Decide which areas and depth of fleet and distribution outsourcing initially make sense for your current operation. Consider your perceived operational strengths and weaknesses, both in operational service level and cost performance. Establish the improvement goals and objectives you would like to achieve as a result of the process. The choices range from simple purchasing of fuel at a retail site up to a complete supply chain logistics management package. You have a wide range of choices to make, and you must define the boundaries of the project at the beginning of the process or you will not be able to perform a proper analysis at the conclusion of your effort. The range of choices might be as follows.

✔ **Level 1 Options**

- *Licensing and Permitting* (legalization)
- *Preventive Maintenance and Minor Repairs*, as needed
- *Major Vehicle Repairs*, as needed (i.e., engine rebuild, frame work, body work, painting, etc.)
- *Road Service*, as needed (emergency response, tire repair)
- *Environment Cleanup Response*
- *Replacement or Additional Vehicles (rentals)*, as needed
- *Fuel Sales* with volume discount

✔ **Level 2 Options**

- *Installment Purchase:* Available for truck, tractor, trailer or dolly, all or some.
- *Tire Leasing:* Paid for by the mile, usually in tenths of a cent/mile (mils).
- *Driver Leasing:* Can be paid for by the mile, the hour or a custom formula. Be careful to check liability and property damage insurance coverage by lessor.
- *Dock-Worker/Stevedore Leasing:* Fully-burdened part-time or casual labor, usually paid for by the hour.

✔ **Level 3 Options**

- *Vehicle Finance Lease (Closed End or Walk-Away):* Fixed rate with no obligation at termination (but with strict operating mileage limits and penalties for excessive mileage and vehicle mechanical/appearance conditions), and conservative (understated) residual values.
- *TRAC (Terminal Rental Adjustment Clause) Lease (Open End):* Vehicle lease with an estimated residual value as close to fair market value as possible. At end of lease, vehicle is sold. Any amount above residual returned to lessee. Any amount below residual to be paid by lessee to lessor.
- *Contract Maintenance:* Includes a variety of different methods, which include guaranteed programs with fixed rates, modified guaranteed programs with some components not covered in the guarantee or pegged rates (both parties set an estimated "peg" rate, then agree on a periodic basis to pay more or receive credit to adjust actual costs vs. the peg estimate) or simple sales and service (burdened labor rate and marked-up parts and materials).

✔ **Level 4 Option**

Full Service Leasing: Includes vehicle acquisition/disposal, financing, all maintenance and repair, emergency services, spare vehicle replacement, safety programs, all legalization, fuel availability and mileage reporting by a lessor for a particular vehicle.

✔ **Level 5 Option**

Contract Trucking: Provides specified number of loads/miles or freight volume and drivers at fixed rates to be directed by the shipper at will during specified days and time periods. (Trucks would not necessarily be dedicated to one shipper at all times.) Also called Volume Tender.

✔ **Level 6 Option**

Dedicated Contract Trucking: Includes all of Level 5 directed by carrier's dispatch control, and equipment is dedicated to the one shipper's account: specified and purchased/leased for that account, not useable by other shippers.

✔ **Level 7 Option**

Contract Logistics: Includes all of Level 6 controlled by the contractor on behalf of the shipper, but might include shipping, warehousing, inventory control, information processing, financial management and delivery, on-site installations, etc.

Project Management Guidelines

Consider the sensitivity of an outsourcing decision process and insist on as much confidentiality as you feel is justified. In some cases, off-site meeting locations might be appropriate. You don't want to indirectly threaten the job security of those employees who might be affected by an outsourcing move untilyou've made the decision and you've developed a plan for their employment transition.

Select a project team. In small companies, such a team might be made up of the owner and his accountant. In larger firms, it could include the vice president of operations, controller and human resources manager, but it should be as inter-disciplinary as possible without compromising confidentiality.

Set a finite time frame and specific goals for the process. Establish your expectations for the team to understand at the outset of the process. Establish quantitative and qualitative goals simultaneously, because they always are linked in the real world.

Be sure to structure your analysis to anticipate the future of your business needs. A perfect analysis of today woudn't be very helpful. Ideally, your project should include a computer spreadsheet or proforma that will be able to show you the effects of various potential levels of future activity.

Gathering In-House Information

Depending on the level of outsourcing you have selected for analysis, you now must acquire information from your proprietary fleet operation. The accuracy of the information is critical for the analysis process. You will be choosing between continuing with your current in-house operation or committing to an outsourced provider.

First, acquire the vehicle operating data to include number of units, hours/miles of annual operation, hours the vehicle must be operational and periods of non-use. Find your vehicle specifications/designs and some recent capital costs for acquisition as well as trade in or disposal recovery for sale of old vehicles.

Next, get your current cost/expense data. The analysis of performance and cost is always difficult to perform and, often, certain cost components are ignored or under-counted. The manner in which individual businesses account for their assets and expenses is highly variable, and the chart of accounts of one firm may not be easily translateable to another. Regardless, the process must be approached in a comprehensive and rigorous manner so that true relative value can be established. The following is a list of cost components of the fleet, transportation and distribution environment. Use it as a checklist to verify that the various cost components of your operation are accounted for.

✔ **Management, supervisory and clerical/technical staff costs.** Salaries and wages, employment taxes, employee benefits, business expenses/travel, automobiles and utility vehicles supporting the offices.

✔ **Distribution/transportation/fleet management facility costs.** Rent/depreciation, taxes on buildings and properties, utilities on building and property, maintenance of building and properties, facility services, service vehicles, insurance/liability/risk.

✔ **Driver labor costs.** Wages and benefits; indirect labor costs; employee

benefits/ labor burden; maintenance of DOT-required files and documentation; administrative costs; hiring, training, education and employee turnover; direct cost of hiring new employees; training of new employees; re-training and continuing education of existing employees, direct costs, downtime, termination of existing employees; cost to document; potential liability and replacement requirement; liability exposure; motor vehicle accidents;
and supplies and equipment.

✔ **Vehicle Costs.** Acquisition costs, vehicle financing costs, legalization, vehicle in-service costs, vehicle disposal, residual obligation, if any, and vehicle lease costs.

✔ **Vehicle Fueling Costs.** Fuel cost including all taxes, fueling labor, fuel inventory cost (cost of money), fuel consumption rates, tank and pump costs, and liability for any spill or leakage.

✔ **Vehicle Maintenance Costs.** Preventive maintenance services, labor hours for each service (fully burdened), parts and supplies, space in your facilities, vehicle downtime for service, tires (include cost of replacement rims and wheel weights, recap recovery rates), road service expenses (include time, labor and mileage for service vehicle), add-oil, other fluids and supplies, powertrain adjustments/ repairs, major components (cost and expected life), federal and state inspections, towing/road service, and vehicle washing.

✔ **Internal Shop Costs.**

✔ **Tools and equipment.**

✔ **Cost and maintenance of office equipment.**

✔ **Direct Shop Facility Costs.** Depreciation or rent, taxes, utilities, building maintenance, service vehicle(s), uniforms, shop towels, rugs, shop supplies, disposal costs (non-hazardous and hazardous), recovery of funds from sale of scrap.

In addition, you should consider the following costs and opportunity costs.

✔ **The cost of downtime.** When your vehicle cannot perform its intended delivery and service function, the cost of downtime often is far greater than the pure out-of-pocket costs of the repairs involved. Consider that each breakdown has a service cost to you and you customers. Poor service eventually can lead to lost accounts and revenue. Your potential new customer's perception of the condition of your fleet, if poor, may prevent you from gaining new business as well.

✔ **Shuttle/hiking costs.** Which costs must be incurred for getting the fleet equipment from where it is normally domiciled to where it must be serviced or repaired? Determine the distance and time, frequency and burdened labor cost. Identify who will incur this cost—the operator or maintenance provider. If service is provided on site by a mobile unit, what is the upcharge for this service?

✔ **Value of alternative use of facility and contiguous property.** Many individuals ignore or under-value the alternative uses for which their fleet facilities might otherwise be used if not occupied and used as a vehicle service operation. Interests within or without the firm may see the property in an entirely different higher and best use if the availability of the property were considered.

✔ **Substitute vehicle costs.** One doesn't always require a replacement vehicle when maintenance or repairs deadline a vehicle, but when a replacement is required, the cost is significant, not only for the vehicle itself but for the logistics/hiking to get it to where it is needed. Additional spare vehicles, even though completely depreciated, are not free but require maintenance, insurance and legalization. Such typically older vehicles also perform with poorer fuel economy and longer trip times.

✔ **The cost of invested money.** A company may have a more attractive opportunity to use the capital funds that may be tied up in the value of fleet equipment and facilities currently associated with proprietary fleet ownership, operation and repair. The return on such invested assets may be superior, and more in keeping with the firm's core competency and essential value-added. A given bank line of credit amount will be available for use in greater profit-producing applications. Also, be sure to use a Net Present Value process to evaluate the real and constant cost of capital and expense over the true projection of the life of the asset(s), (i.e., a Discounted Cash Flow (DCF) analysis.)

✔ **Effective tax rate.** Be sure to consider the tax implications of inside vs. outside alternatives. Individual cost and investment components of either alternative have different tax consequences that will affect the economics of the decision. Alternative Minimum Tax (AMT) and Modified Accelerated Cost Recovery System (MACRS) must be considered.

✔ **Consumer Price Index (CPI) Applicability.** Verify the contractual obligations for CPI applicability to any negotiated rates. Conversely, be realistic about the effects of anticipated inflation upon any proprietary operation being compared.

✔ **Return on assets (ROI) measurement.** In ownership, vehicles are reflected as assets on the balance sheet. The more owned vehicles, the lower the ROI. Many investors consider ROI to be a major factor in assessing the relative value of a company.

Conducting a Competitive Bid for Your Fleet/Distribution Business

From the in-house analysis of your operation, you can put together a description of what you might need from an outsourced supplier. Whether you put together a simple one-page description of the operation along with some operating statistics or you create a full-blown and detailed request for proposal (RFP) package, you will be asking potential suppliers to bid on your business as defined by this document. Ideally, you will receive responses that allow you to compare apples to apples. In each case, share the detailed truth of your operation, but you can insist on confidentiality.

There are many firms that would like to do business with you. If you look in the Yellow Pages, you'll find thousands of companies involved with vehicle maintenance and repair services and hundreds who want to sell or lease vehicles to you. Clearly, you cannot speak to all of them. Use judgement in selecting those firms you might like to ask to participate in your bid based on local word-of-mouth reputation, trade press materials, references in your personal business community or the Better Business Bureau. If you currently have a favorable business relationship with a fleet service or truck rental firm, you might invite them to bid for a higher echelon service. In any case, select no more than three or four competitors for your bid.

You can present your bid individually or in a group, but be sure to provide the same access of information to all bidders. You either may accept a verbal commitment for confidentiality of the process or demand a written document. Allow a reasonable period for questions and answers and be accessible for additional questions from the bidders as they might come up. Set a specific date and time for the deadline for bid submittal. You may wish to visit the company's facilities, and you should request a list of current customer references for whom similar services are being performed.

Performing Your Analysis

Use an interdisciplinary team to review the submitted bids. Assemble the materials you have developed and create a matrix for comparison. Establish your current and future in-house performance levels and costs as your baseline, making allowances for expected changes in the future.

Compare the services and rates submitted by each competitor for best value. Be sure not to confuse true long-term value for lowest commodity price. Consider the proximity of facilities and the remote service/emergency response and support capabilities each vendor presents. Assess each bidder's experience and core competencies in light of what you require from him. Call or visit with the bidder to clarify any ambiguity, omission or other question regarding the bid that you may have.

Finally, compare the best of the outside bids with your in-house assessment. Be sure to place a value on various intangible components of each case and make your decision. If you decide to select an outsourced proposal, inform the winner and the unsuccessful bidders in writing as a courtesy. If you should decide to remain with your proprietary operation, you also should inform the bidders in writing of your decision.

Implementing an Outsourced Fleet or Distribution Partnership

If you have decided to make a commitment to an outsourced partner, sit down with the sales and operating representatives of the firm and review the contract(s) and various obligations of the parties. Establish a reasonable implementation timeline and establish responsibilities. Don't set a schedule that is beyond either party's ability to meet. Include a reasonable cushion for unanticipated events. Further, recommendations including the following.

- **Describe the disposition** of all vehicles, facilities, personnel, equipment and supplies. Identify all new or used equipment that will be brought in, and verify specifications and availability. Be very sensitive to any unresolved hazardous materials liabilities in your existing facilities.
- **Define the logistics of the relationship** (i.e., where will thevehicle(s) be parked, serviced, fueled, etc.). Who is responsible for their movement in these processes?
- **Identify the key personnel** from each

party who will make the process function, and who will be responsible for essential communications and adapting the process during start-up and thereafter.

- **Discuss the quality management processes** that will be employed for continuous improvement of the relationship and service performance.
- **Establish key performance indicators** that will be used to measure the partnership status and expected improvements throughout the relationship. Agree on the frequency and distribution of them.
- **Define the procedures to be followed** in the event that there is a problem that cannot be resolved by the key personnel from each party. Who is the individual from each party that can be approached for the appeal process.
- **Agree on a schedule and method** to inform all interested parties in each company as to the outsourced decision and any transitions that will be accomplished.

Conclusion

You've got a business to run. And it's a business that serves customers with water quality products and services. That's your reason for being in business, and you've sustained your business by doing it better and smarter each year. You're not too interested in trucks or transportation—it's a necessary evil. But consider that virtually everything you do requires a truck. A truck that can carry the product or deliver the service, efficiently and dependably. Take stock of how well your trucks perform for you and at what cost. Consider outsourced fleet and distribution alternatives as an opportunity to improve service to your customers, enhance your fleet image to prospective customers and control fleet costs. You owe it to your business future to take a serious look.

About the Author

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