

PIP

EXECUTIVE EXTRACTS

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Maintenance - Outsourced, but not out of mind

Key points

- Most outsourced contracts have misaligned incentives (supplier not sufficiently incentivised to maximize customer's profit)
- Outsourced contracts involve a lot more work and a higher level of skill than is typically anticipated (but it's much easier to do it right first time than fix it up afterwards).
- There are 5 keys to successful outsourcing:
 - Know why you are outsourcing
 - Don't outsource the understanding and control of the process
 - Select a supplier that can deliver
 - Set up clear, tight controls and alignment through a detailed contract and
 - Proactively manage the contract to ensure excellence in execution.

Although there are many reasons that companies outsource, the trigger is often the realisation that a constant internal headache – such as managing maintenance – could potentially be dispensed with by seeking external expertise. In other words, getting rid of a problem process by paying someone else to manage it.

In theory, handing responsibility to someone else allows additional time and attention to be diverted to more "core" or critical processes/sections of the business. After all, the external service providers would surely have developed expertise in your maintenance issues from having handled exactly the same services and situations in other companies.

Unfortunately, too often it turns out to be quite a different story in practice.

In our experience, completely outsourcing a headache with an attitude of "they'll look after it – it will be fine" is likely to result in it becoming a migraine over time. And by the time you are made aware of the magnitude

of what you are now dealing with, you'll need to spend even more money and time sorting it out.

The principal reasons that maintenance outsourcing can go astray include:

- 1) misjudged decision on whether to outsource or not
- 2) customer does not understand maintenance or how to manage it
- 3) the contract incentives are not aligned to maximising customer profit
- 4) outsourced supplier can't deliver – e.g. don't have the skills to manage the bodies
- 5) performance management doesn't exist from the customer so suppliers get slack

Of these, the most prevalent (if not the most damaging) issue is that outsourced maintenance contracts rarely align incentives. The customer typically feels a lot more pain from poor maintenance than the supplier does and (by the same token) is far more incentivised to push for improvements. →

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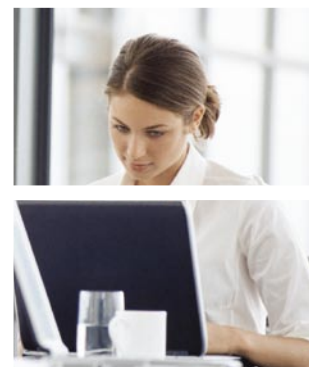
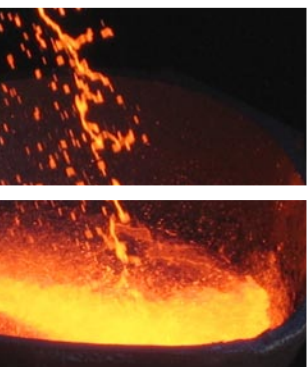
Partners in Performance is a firm that builds better businesses. We deliver rapid performance improvements in industrial, resource, manufacturing and service companies, using specialist teams and a hands-on approach to lower costs and increase revenues.

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“downtime was reduced by 25% and costs reduced by 10% through proactive management of the outsourced contract”

Take an example outsourced maintenance contract (the case study is at end of article) – reducing shut duration by 25% benefits the customer through increased production by \$17 million whereas the supplier stands to gain only \$90,000 in bonus but will potentially lose some \$7m in revenue.

But outsourcing does not have to end in tears. Some careful pre-planning, research, and proactive management of the contract before engaging any external service provider will ensure you maximize the benefits of the relationship, and reduce the chances of any nasty surprises.

PIP has 5 golden rules for maintenance outsourcing that help to ensure the desired outcomes are achieved. We've always found it a lot easier helping clients to set it up correctly than to fix poorly performing contracts afterwards.

1. Know why you are outsourcing

Identifying the core reasons you wish to involve an external agency in running your maintenance will be crucial to ensuring you are able to establish the processes and KPIs which will determine the success of the relationship. Before starting, we suggest that you confirm the following:

- There are strong economic reasons for outsourcing and no strong counterarguments exist
- A competitive market exists or can be developed in your location for the service to be outsourced
- You can develop clear, measurable indicators of contract performance
- You understand this part of the business and therefore know how to manage and measure it (a good indicator would be that you repeatedly score in the top quartile on benchmarking)

2. Don't outsource the understanding and control of the process

The last thing you want is for your supplier to assume control in ways that makes you vulnerable to their leaving.

- Do not abdicate responsibility for strategic decisions relating to maintenance to the supplier, or assume that they are the experts
- Do not outsource what you cannot control. Otherwise you will likely see costs increasing, and important KPIs nose-diving.
- Get your house in order before handing over. This includes all areas such as the processes, the KPIs, accountabilities and skill levels.
- Ensure you own all rights to all the data, instrument histories, databases, metrics and intellectual property, or else risk becoming captive to your supplier.

3. Select a supplier who can deliver

Just because the supplier is a maintenance 'specialist', don't assume they have the skills to deliver material improvement to your business. Many outsourcing firms are little more than body suppliers – and even these people are liable to change.

- Be clear on the specific skills/characteristics that the supplier is renowned for and ensure that they closely match your needs. (Management quality? Low cost? Improved KPIs?).
- Get confirmation on which individuals will be taking key pivotal roles and try and lock in right of refusal on your part for any replacements in the future. If you are not demanding on this front, suppliers will quickly siphon their top performers to customers who are more demanding
- Rigorously check references – wherever possible using your informal networks to get comprehensive feedback

4. Set up a tight contract based on what they have to manage

Don't be tempted to accept a vague contract, either in the interests of flexibility, or with the intention of sorting it out later once underway

- Get the right team in place to work out the total value of the contract to the business (e.g. how much is an hour of downtime really worth to a business?). Recognise that these skills may not lie within your supply department
- Ensure contracts contain the correct incentives for suppliers to deliver against your expectations (safety, skill level of people, profit maximisation not just reduction of the direct contract cost) and that the contractual KPIs and milestones are tracked and managed by the business.
- Check for hidden mark-ups such as corporate fees, annual leave payments, sick leave and sub supplier margins, and eliminate them wherever possible
- Define up front the regular reviews of the contract that will take place and their format.

5. Proactively manage the contract to ensure excellence in execution.

These contracts rarely work unless the customer can and does proactively manage it.

- Ensure you have the resources (quality and quantity) in house to deliver on your side of the contract. If, for example, you have chosen to retain control of the strategy element (e.g. maintenance strategy), and your strategy left something to be desired prior to this, then bite the bullet and upgrade your internal resources
- Match the value of the contract to the company with the resources you put in place to manage it. Too often contracts worth tens or hundreds of millions to the company have a part time, low level manager

in charge of managing them. These people need to have the skills to understand the economic tradeoffs associated with their contract, track KPIs and hold the vendor to account for execution

- Ensure you have enough resources to set the right KPIs, reviews, targets, and baselines in the contract going forward. Don't underestimate how much time this involves on an ongoing basis.
- Put in place the tracking, reporting and review schedules as early as possible to create a high performance culture around the contract
- Establish regular, periodic performance reviews so that any divergence from expectations is addressed quickly

Case Study: Outsourced Maintenance at a major industrial site

Situation

A large metals processing facility had outsourced its maintenance in a \$45m annual contract. A key element of the service to be provided was the performance of regular planned shuts, which had a planned duration of 28 days but frequently overran. The client outsourced maintenance in order to tap into expertise that it had envisaged would increase up-time and generate ongoing cost improvement.

The experience of outsourced maintenance did not match these expectations. A reactive approach, combined with high levels of staff turnover/rework and patchy maintenance histories meant that uptime declined, whilst costs continued to spiral. Furthermore, as the client had disbanded its internal capability and relinquished control over critical data (such as maintenance history), it was poorly positioned either to hold the incumbent supplier to account for failing to deliver promised improvements, or to switch suppliers altogether.

PIP was asked to assist in improving the situation.

Results

- **Reduced duration of planned shuts by 25%**, with associated extra production valued at \$17m per annum.
- **Reduced maintenance cost by 10 per cent (\$5 million)**, partially via introduction of a second supplier on selected elements of the contract (to create competitive tension)
- In-sourced planning and supervision to establish control and rebuild internal competence
- Established supplier management processes and introduced extensive training of in-house personnel on proactive management of such contracts for high performance

PIP's approach to improvement:

1. Established the Total Value of Ownership (and key levers that impact it)

The first objective was to determine the full economics of the contract. As with many outsourced contracts, it had been set up to control direct costs and had not considered the full impact that the maintenance process could have on the business. Neither the site nor the contract was sufficiently focused on the \$750,000 impact in lost contribution of each day's downtime (roughly 6 times the direct cost of the maintenance contract).

The implication was that downtime was the single most important lever to link to supplier incentives from the client perspective. In this case, after reverse engineering the supplier's economics, it was clear that only 10% of the supplier's profit depended on measured KPIs (spread across safety, costs, training, vacancies, rework and availability) and the degree of incentivisation was therefore insufficient to align behaviour. Poor availability, costing the client \$750,000 per day, would only reduce supplier profit by ~1% and would provide them with very limited incentive to invest in improvement.

The excessive focus on direct costs may be because the teams charged with establishing the contracts do not have the breadth of skills needed to identify the financial levers (i.e. understanding of maintenance, marginal production economics, strategy, procurement and incentives).

In addition, the client had not anticipated other financial burdens relating to the contract, such as the rate of turnover among supplier staff. As this was a fly-in, fly-out site with unusual combinations of equipment, it took considerable →

time and expense to induct first-timers for a planned shut (direct costs plus associated accommodation for the 2+ days that were required), and their lack of familiarity with the site also made them less than productive. As the contract did not include as a KPI, the 'portion of the supplier's workforce who were new on each shut, the client was hampered in its efforts to improve this situation. In practice, far from getting the specialist supplier they had outsourced for, the client was effectively the training ground for fresh hires for their supplier. These employees were then transferred to other sites with more demanding contracts and better contract management approaches once they had proved themselves.

The contract also did not specify other critical input KPIs that underpin effective control of performance (e.g. % rework required, % maintenance history recorded, planned versus breakdown maintenance), which meant that the financial consequences for each party were not aligned around preferred client outcomes.

2. Defined a coherent maintenance strategy for the site with the client

Based on the fresh understanding of total value of maintenance spend, this involved laying out an overall maintenance strategy covering:

- Which elements of maintenance it was important for the site to own/retain in house (e.g. strategy and planning function) and which elements the site must control in order to maintain the ability to insource or switch suppliers
- Baselines and target output KPIs they wanted to achieve over the next 5 years (availability, costs, safety) based on a realistic assessment of client's ability to manage the contract and/or insource elements as necessary
- Baselines and target input KPIs for the same period (percent planned maintenance, percent of supplier's people on shuts who were already trained and inducted to this site, percent rework)
- A plan for closing KPI gaps over time. This included a sourcing strategy which (in this case) involved slicing off elements of the contract for another supplier to (i) sharpen the incumbent's focus on performance, (ii) reduce the barriers to switching suppliers if needed, and (iii) build the client-specific capability of

an alternative supplier. This was complemented by a workplan for developing the required internal skills for strategy and planning (which it was decided to bring in house) and contract management.

3. Reverse engineered the supplier's economics

A clear understanding of supplier economics was the key to establishing how best to incentivise them and what degrees of freedom there were when it came to financial negotiation.

4. Developed the framework for a new contract with the incumbent supplier

The final piece in the puzzle was the revitalisation of the working relationship with the incumbent supplier based on a firm understanding of the real drivers of value from the contract.

- The first step was to negotiate a significantly different contract, which aligned both players around maximizing total value for the site. The consequences from the client perspective were that it brought key elements back in house (to increase their ability to manage the contract), it reduced dependence on a single supplier and it increased their level of control/proactive management
- Developed a CPR (critical path reduction) process with client and supplier to identify opportunities to reduce the duration and overruns of the planned shuts significantly. This work rigorously critiqued the critical path to devise alternative approaches, and also reviewed/developed shut management capabilities. Activities on the 'wiring' of shuts typically include clarifying roles, accountabilities and KPIs, streamlining key processes (such as permit to work), semi-automating tracking and reporting mechanisms, instilling more rigour around the review and escalation processes and even reaching back into the supply chain to improve ordering and management of parts for the shut. CPR achieved a 25% reduction in the duration of shuts worth around \$17m per annum in contribution from lost production time.
- Trained both parties in proactive contract management and set up some of the basic wiring to do this, including tracking of key KPIs, standard formats/agendas for reviews and training in holding to account

