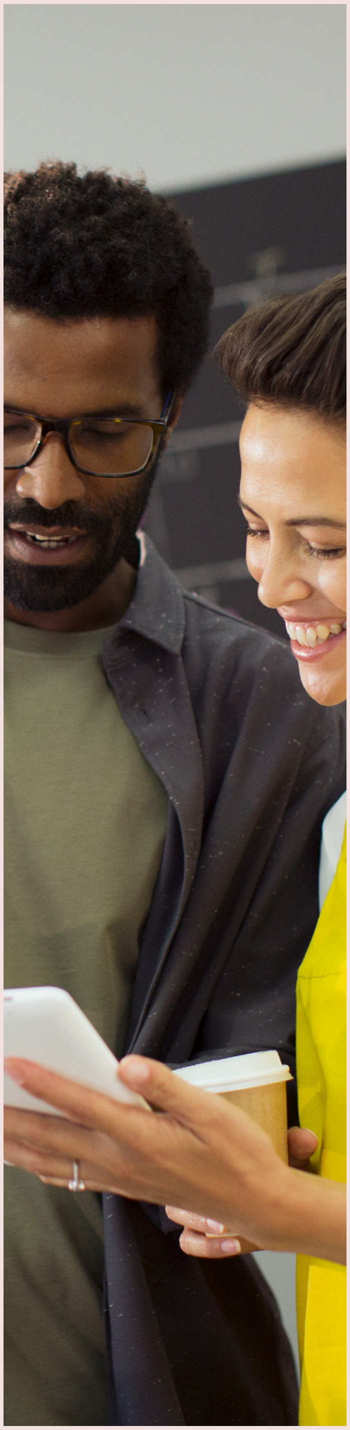
CASE STUDY



REDUCED COSTS OF THIRD-PARTY CONTAINMENT SERVICES USING SPEND ANALYSIS

Abstract

Although third-party containment services are a necessary evil in the metal-mechanic industry, there exists great scope to keep their costs at a minimum. That is what Infosys BPM accomplished for one of its clients in the automotive sector, with spend-analysis based supplier negotiations and consolidation.

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Third-party containment services - a necessary evil

Containment services are common in the metal-mechanic industry, and are related to the sorting, inspection, and certification of parts received from suppliers. Sometimes due to unexpected quality issues in the upstream supply-chain, some components delivered by suppliers to a manufacturer's assembly-line are found to be faulty during quality inspections.

When such lots are detected, containment services providers work towards preventing a shut-down of the assembly-line, by performing activities relating to the segregation of the good pieces from the non-conforming pieces. In some cases, when there are not enough acceptable pieces to keep the assembly line running, the containment services provider performs activities relating to the reworking of faulty components.

There are huge financial and reputational costs to be paid in case production lines get disrupted. So, although using containment services impacts the manufacturer's profitability and/or the final price of the product, yet they are a necessary evil. Such services are typically delivered by third-parties in order to maintain the neutrality of judgements on faulty parts, which also impacts the scorecards of suppliers.

An opportunity to bring down containment costs

For one of its automotive clients, Infosys BPM suggested a spend-mitigation initiative to renegotiate third-party containment services, as there were opportunities to optimize the supply base and reduce rates.

The Infosys BPM team aimed at providing value-add throughout the process of service provider selections, negotiations, and contracting.

Analyzing the containment spends to identify the scope for mitigation

For the scope of the project, the total spend was identified through the purchase order report. ~$7M was split among six suppliers; three suppliers with large spends, one with medium spend, and the remaining two with low spend. Another part of the process was to understand the different services, the manufacturing plants involved, the key users, as well as the previous year's historical information for a better idea on the potential opportunity on the segment.

Input:
- Spend data
- Existing segment strategies
- Existing contracts/pricelists
- Existing catalogues
- Best practices
- Benchmarks to compare
- Workshops

Actions:
- Conduct spend analyses to identify consolidation/rationalization opportunities
- Execute buying channel analyses to identify areas of improvements
- Identify catalogue opportunities and review current performance
- Compare existing strategies against best practices and benchmarks
- Identify first list of opportunities
- Review list of opportunities

Output:
- Validated list of opportunities
- Action plan including timings

Figure 1: Towards an action plan

With the support of the client's category manager, the Infosys BPM team complemented the analysis with the data from supplier sales reports. These reports contained detailed information on the volumes, services, prices, and rates per hour of the suppliers. Once the team collated all the supplier-related information, they compared the values to identify similarities between the types of services received.

In general, it was found that all the suppliers were providing either the same or similar services — basically inspection and supervising— but at different rates. One case even had two suppliers providing the same services for the same manufacturing plant, but with different rates. To deal with this scenario, rate references were obtained from three other external suppliers to complete the market comparison and move forward to define a cost optimization strategy.

Supplier Name	MFG plant	Country	Service Provided	Service Name (Function, Role, Category)	Hourly rate	Surcharges and additional costs charged	Month	Monthly hours worked	Total Sales (unit price by volume)	Currency

Figure 2: Sample template

SUPPLIER "C"					
Quantity of Hours 2015	**POSITION**				
Division	**Inspector Overtime**	**Inspector Straight Time**	**Supervisor Overtime**	**Supervisor Straight Time**	**Grand Total**
MFG PLANT A	2	14		14	29
MFG PLANT B	128	701	10	169	1,007
MFG PLANT C	23	97	6	30	156
MFG PLANT D	535	2,058	4	413	3,010
MFG PLANT E	68	737	57	679	1,541
MFG PLANT F	2,468	18,630	327	2,559	23,989
MFG PLANT G	6,497	33,989	2,379	8,985	51,850
MFG PLANT H	1,711	12,839	1,177	6,249	21,980
MFG PLANT I	13	152	2	52	218
MFG PLANT J		48		21	68
MFG PLANT K		9		3	12
MFG PLANT L	90	1,901	49	771	2,810
Grand Total	**11,533**	**71,173**	**4,011**	**19,942**	**1,06,669**

Figure 3: Hours charged by supplier "C"

Service Offering	Country	Plant/Site Name	UOM (Hour, Day, etc)	Currency	Rate 2015
Inspector	USA	Mfg Plant A, Mfg Plant B, Mfg Plant C, Mfg Plant D, Mfg Plant E, Mfg Plant F, Mfg Plant G, Mfg Plant H, Mfg Plant I, Mfg Plant J, Mfg Plant K, Mfg Plant L	Hour	USD	$20.00
Supervisor	USA	Mfg Plant A, Mfg Plant B, Mfg Plant C, Mfg Plant D, Mfg Plant E, Mfg Plant F, Mfg Plant G, Mfg Plant H, Mfg Plant I, Mfg Plant J, Mfg Plant K, Mfg Plant L	Hour	USD	$25.00
Site Manager	USA	Mfg Plant A, Mfg Plant B, Mfg Plant C, Mfg Plant D, Mfg Plant E, Mfg Plant F, Mfg Plant G, Mfg Plant H, Mfg Plant I, Mfg Plant J, Mfg Plant K, Mfg Plant L	Hour	USD	No Charge
CMM Operator	USA	Mfg Plant A, Mfg Plant B, Mfg Plant C, Mfg Plant D, Mfg Plant E, Mfg Plant F, Mfg Plant G, Mfg Plant H, Mfg Plant I, Mfg Plant J, Mfg Plant K, Mfg Plant L	Hour	USD	$32.00

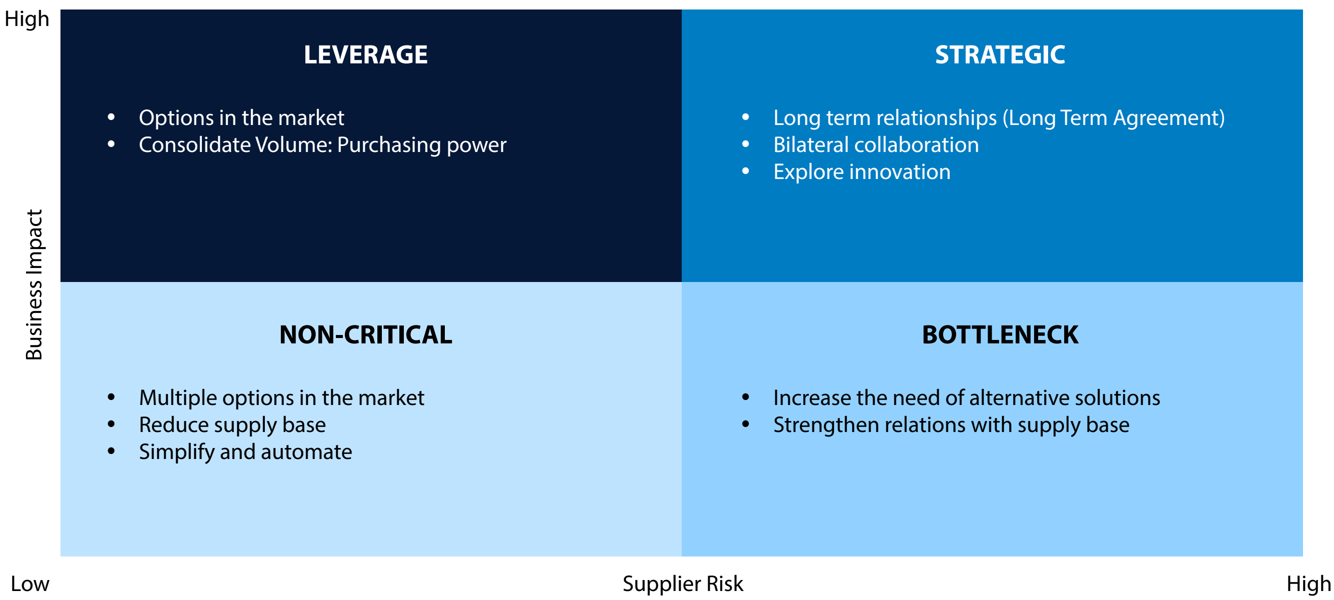
Figure 4: Rates charged by supplier "C"

Defining the strategy with a supplier matrix

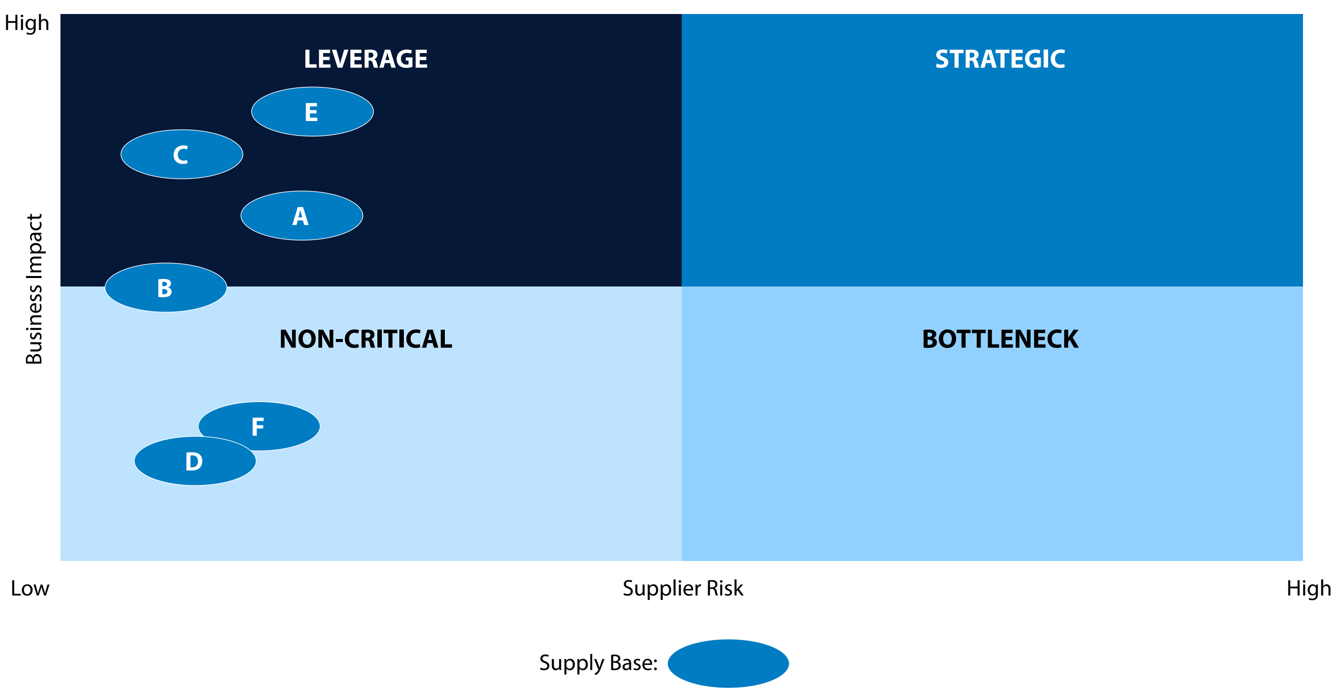
Based on the findings of the spend analysis the team created a supplier matrix with the support of the client's category manager and other stakeholders, in order to identify the suppliers' strengths and weaknesses. Two suppliers were local, and the other four had a more national scope, but one of them was plagued by quality issues.

At the end of the collaborative effort which threw up several other findings, the decision was made to consolidate the business amongst the three main suppliers and renegotiate their rates, while keeping a local supplier as a backup in case of extreme urgency. The main reason for this being the complexity of the containment service is low but the impact on the business is high.

Sourcing Strategy



Sourcing Strategy



Consolidating the supplier base with negotiations

The team then released an RFP clearly indicating that they would select only four suppliers, by including this clause in the commercial terms and conditions. All the suppliers submitted their proposals and based on the information they provided the team selected three main suppliers for further negotiations.

During the process of negotiations, the team and the shortlisted suppliers discussed the best acceptable terms, the acceptable terms, and the minimum acceptable terms. In addition to challenging the prices, their agreements included clauses on increasing pay terms, annual rebates, fixed rates, and penalties in case of rejections from the assembly line.

In exchange for these terms, the team offered long-term agreements for 3 years, increased scope and spend, and the opportunity to be considered as the preferred supplier for new manufacturing plants.

Negotiation challenges and benefits

In the earlier stages, the suppliers were very cooperative in terms of sharing information but during the negotiation process some of them were reluctant to reduce their rates. The Infosys BPM team pushed them to improve their rates, showing them how their business had been growing without any benefit to the client, how their rates were higher in comparison with the market, and highlighting the risk of their business being reduced. They also discussed the opportunities to increase their revenues if they accepted the conditions. At the end of the negotiations, there were better proposals from each supplier and the process of closing the agreements were more fluent.

Another challenge was to involve the key stakeholders in order to get information about the suppliers, if they were doing well or if they were having issues. In order to gain the stakeholders' trust, the client's Category Manager extended a lot of needed support through scheduling conference calls, share findings, the plan, and the potential benefits, and acquiring other missing information.

The payoff and the lessons learned

There were several outcomes of the containment spend mitigation initiative, including:

- 8% in rate reduction,
- Supply base reduction from 6 to 3 main players,
- Long term agreements with fixed rates (three years) and an annual rebate of 2.5%, and
- Homologated rates and penalties for rejections on assembly line.

Also, looking back at the journey, the Infosys BPM team distilled several key learnings and takeaways for similar initiatives in the future.

First, it is important to have alignment with the client's category manager but even more so with the business stakeholders (final users). Second, the understanding of service scope is very important in order to create an assertive template for RFP requirement and yet to be flexible in the process of negotiation. Lastly, the negotiations need to be always aligned with the client's expectation, and yet also be designed to build trust with the supplier base.

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