

Industrial Services Outsourcing Hasn't Delivered the Value

"Productivity and Service Quality are the key value levers for Industrial Services."

Outsourcing is based on the principle that a focused company can do it better at lower overall cost. Back office support such as Finance and IT have moved to India, Asia, Eastern Europe, etc., where customers have experienced great reductions in costs through labor cost arbitrage. However, in both Industrial Services and Facilities Management [henceforth we will use IS for both] outsourcing has failed to deliver additional value beyond removing technicians from costly benefits packages and increasing focus on services.

The Promise of IS Outsourcing: IS outsourcing providers promise better safety, reliability, schedule compliance, expertise and lower cost.

The Results:

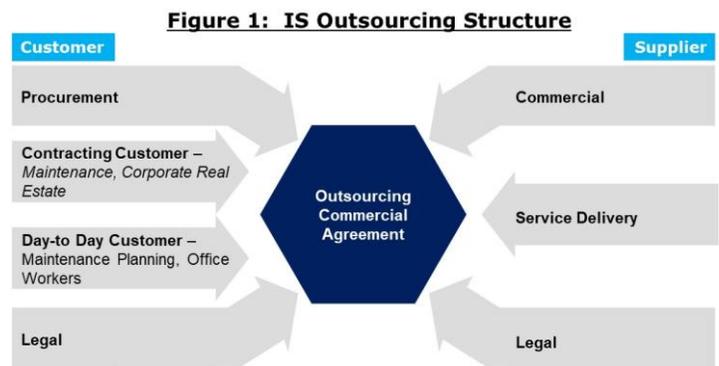
- Safety incidents have trended down but often failed to achieve the annual goals.
- Reliability has generally improved but recent surveys have indicated a turning point as experienced workers retire.
- Schedule Compliance continues to be a challenge with companies struggling to manage the end-to-end supply chain, with labor shortages being a contributing factor.
- Lower Cost were initially achieved by streamlining benefits; however, scale and productivity improvements have been elusive.
- Productivity increases, as measured by wrench time, have stagnated at ~20%. *[Beware of claims of higher productivity.]*

IS Supply / Demand Challenge: Industrial Services are much different than traditional services. One can easily calculate the number of Help Desk clerks, Accountants or Janitors for the given job and much of the work can be performed remotely. Conversely, IS faces many challenges:

- Demand Variability: demand varies in response to outages and reactive maintenance workload.
- Specialty Services: while the bulk of IS activities are of general nature, many specialty services are needed, often for short periods of time.

- Location: IS can rarely be provided remotely from low cost countries. The service locations can be quite remote with substantial travel time.
- Supply: The IS workforce may be located at service bases or may be transient. Either way, travel is an important consideration.
- Cost of Failure / Risk: Safety, fires, loss of containment, equipment failures all have considerable business cost (\$100s of millions) and potentially, LTO.

Structural Challenges Undermining IS Value: The supplier – customer relationship in IS outsourcing is fraught with challenges that undermine value delivery (Figure 1 and 2).



On the Customer side Procurement is looking for qualified suppliers who bid the lowest price. Procurement uses bidding to discover the current market price. Contracting and Daily Customers want better service and innovation. Conversely, Legal wants to shift the risk to the supplier both for equipment failure and to respond to various emergencies.

Figure 2: Impact of Purely Functional Optimization

Desired Outcomes	Customer			Supplier		
	Procurement	Contracting Customer	Daily Customer	Legal	Commercial	Service Delivery
Lower Cost	↓	↓			↓	
Improved Service			↑			
Innovation		↑	↑			
Risk Minimization		↓		↓	↓	
Safety Incidents		↓		↓		↓
Fair Return					↑	↑
Daily KPIs			↑			↑



On the Supplier side, organizational silos exacerbate the challenge. Commercial is rewarded for selling the work often with limited regard for the company's ability to deliver the work. Commercial faces the challenge of coming in with a low offer but has few levers to walk the value of the contract up. Meanwhile, Service Delivery faces the conundrum of responding to every request from the Daily Customer to achieve high customer satisfaction scores – which tends to drive costs up – while managing against a budget and avoiding the moral hazard of under maintaining equipment.

Suffice it to say, that mistrust can fester and customers often put extensive monitoring programs in place to check IS provider's performance. The cost of these teams can negate any positive value created by outsourcing.

Industry Response: The IS industry is wrestling with these challenges and taking steps to improve.

Vested Outsourcing was developed to address the misaligned incentives. This has worked well for more predictable (and steady) outsourcing needs but has had limited traction in the IS space given that outsourcing providers aren't willing to take on millions in liability nor are customers willing to pay for the risk.

Looming Innovations to Disrupt IS Outsourcing: Drones, sensors, big data analytics are all combining to make IS more predictable and reduce the level of reactive maintenance. This will reduce both the level and variability of demand.

Industry Challenges

An Oil & Gas company saw a consistent pattern from its wellsite service providers. The vendors had T&M contracts and consistently turned in invoices for 8 to 10 hours of work. However, when a company representative was observing the work, invoiced time was in the 4 to 6-hour range.

A chemical company assessed its' IS contractor's productivity at about 20% time-on-tools. Lacking trust in the provider, the company employed

several inspectors to insure the work was performed to standard.

The Solution: The commercial dialog needs to expand to focus on productivity and service quality. Gain sharing mechanisms alone cannot promote change. Rather, we see two complimentary solutions:

1. **Unitization of Work:** Industry has mixed views on Unit Rate contracts. However, unit rates do align incentives and encourage more work productivity.
2. **Focus on Productivity:** With wrench times averaging just 20%, a few-point increase in productivity is more valuable than cost reduction. However, suppliers have limited incentive to drive productivity improvement since it reduces monthly revenues. Rather customers should redirect their "surveillance teams" from the non-value-added activity of contract compliance to jointly leading productivity improvement projects with their vendors, with vendors being rewarded for positive results.
- 3.

Positive results when the emphasis is on productivity and service quality

A facilities management company was struggling to breakeven despite a massive order book. By focusing on technician productivity and procurement effectiveness for 3rd party providers, they were able to increase margins and capture new business.

This industrial company had multiple sites that were on average achieving 20% maintenance wrench time despite the support of a mobile maintenance team. By focusing on productivity and removing waste from the process as well as optimizing the mobile team, the industrial service organization raised wrench time consistently to 35-40%. With less on site workers, safety also improved.

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Successful Industrial Service and Facilities Management outsourcing is all about capturing the value in workforce productivity and service quality.



