

Meeting the Outsource Challenge: Competing for Equipment Maintenance Services

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Outsourcing and privatization are national business trends that are becoming increasingly relevant to public-sector equipment managers. The premise that many of the publicly provided services are better performed by the private sector has been embraced by many members of state legislatures, county commissions, and city councils. The City of Charlotte has adopted a comprehensive managed competition program as a strategy to test this premise and to drive improvements in cost and services to the public.

The City's Equipment Management Division (EMD) recently won a competition with private-sector firms for the right to continue providing vehicle maintenance services to the City of Charlotte. EMD incorporated a number of private-sector business strategies and practices in its winning bid, including performance-based pay, self-directed work teams, and profit sharing. A number of lessons were learned from the competition process, including the importance of organizing for competition, designing business like cost structures, knowing your competition, and being proactive.

Public-sector employees are not accustomed to competing for their jobs. Our competitors are skilled at competition and are continuously seeking opportunities to expand business. In order to survive in this environment, we must "think private" and also seek to maximize the inherent advantages we have as nonprofit governmental agencies.

WHY ARE OUTSOURCING AND PRIVATIZATION ISSUES?

Privatization of public-provided services continues to be a hotly debated issue. Many members of state legislatures, county commissions, and city councils have embraced the premise that the private sector can deliver most public services better, faster, and more cheaply than can public employees. Moreover, many businesses and public agencies have concluded that most support services are not "core" and, therefore, are candidates for outsourcing.

A recent study in the journal *Public Works* (1) reported that 32 percent of public-sector managers feel that the trend toward privatization of equipment maintenance services will increase in the future. Only 2 percent believe that the trend will decrease. There were similar results for other public works functions, so the consensus is that our customers will also face the privatization issue with increasing frequency.

Outsourcing is another trend that bears watching. Groups that provide services to internal customers, such as information technology or equipment management organizations, are especially vulnerable to this trend. This is the case not only because these services are seen by many as not being core services, but also because many internal services providers have fallen well short of meeting their customers'

expectations. Richard Hays observes that internal services providers share the following characteristics (2):

- They are large, collectively representing more than 40 percent of employment in most firms.
- They are important. They are key early contributors to a chain of service that ends with the final customer.
- They are linked in issues and concerns, sharing common critical success factors and constraints.
- They are sources of frustration. Many are the targets of criticism for service that is seen as ineffective and expensive.

Large and expensive, important but ineffective—these linkages are what drive some customers to seek alternatives to internal service organizations.

Clearly, privatization and outsourcing are national trends that are becoming increasingly relevant to public equipment managers—due to the frequency of their application and because both trends lead decision makers to the conclusion that our organizations would be better off hiring someone else to do our jobs.

Within this environment it is essential that public equipment management organizations prove their worth to their customers and to their agencies. This proof can be provided in a number of ways, including benchmarking, customer satisfaction surveys, and consultant studies. However, there is no better way to prove that you are best in class than by beating formidable opponents in open competition on a level playing field.

Done properly, competing and winning provides irrefutable evidence that the in-house service provider is the provider of choice for its customers. Successfully risking it all in competition provides a powerful argument to counter the privatization political agenda and the latest management theory du jour (e.g., “steer, don’t row”). Can the same be said for a benchmarking study?

CHARLOTTE’S MANAGED COMPETITION PROGRAM

The City of Charlotte has adopted a comprehensive managed competition program as a method of ensuring that taxpayers receive the best services at the lowest cost. Whether the service provider is public or private is not an issue for most service areas (public safety and regulatory services are an exception). The bottom line is who can demonstrate that they can perform a service better, faster, and more cheaply. As a result, nearly every service provided by the City that is also available from private-sector firms is a candidate for competition.

The competition process in Charlotte is elaborate and time consuming. It has to be, in order for the program to have credibility with City Council and private-sector firms. Great effort is expended to ensure that the playing field is level—that City services are fully costed and that there are no unfair advantages for the in-house competitor. Inherent advantages such as nonprofit status are fine. However, advantages such as having exclusive access to historical cost records or not having to pay rent on facilities or depreciation expenses are not allowed.

A great deal of effort is also expended to ensure impartiality and unbiased evaluation of proposals. Therefore, City Council has appointed a citizen-based Privatization and Competition Advisory Committee (PCAC). All major competitions are guided by an independent evaluation team comprised of members of the PCAC as well as City staff who are not involved with the service group that is competing. The largest competitions are also likely to have technical consultants assisting the evaluation team in writing the Request for Proposals (RFP) and in evaluating proposals.

The competition process in Charlotte begins with each Key Business Unit preparing a competition plan. This plan identifies services that are most appropriate for competition and the anticipated timing of upcoming competitions. A Request For Qualifications is issued on the larger and more complex projects in order to pre-qualify bidders. This strategy avoids the potentially difficult situation of having to explain to City Council that the small company that submitted a very attractive low bid is not qualified to do the work. After pre-qualifying vendors, an RFP is developed by the organization that manages the service to be bid. The evaluation team and the PCAC review the draft RFP. The pre-qualified bidders are also invited to review and comment on the RFP. Finally, a mandatory pre-proposal conference is held.

The organization that will be competing for the service must establish a bid team that will be separated from any proposal evaluation duties. The bid team is treated the same way as the other proposers. As previously noted, the in-house proposal must be fully costed and include all applicable overhead costs. In order to accomplish this, the City has established a comprehensive cost allocation plan that distributes all citywide overheads to each department. The avoidable amount of these costs as well as other layers of overheads are then included in the in-house bid.

After proposals have been submitted, the evaluation team reviews the proposals and recommends awards based on previously established evaluation criteria. The PCAC reviews the recommendation and forwards the issue to City Council for final approval.

This is just an overview of the major steps involved in a service competition in Charlotte. The process is designed to be fair and to produce credible results that can be supported by the community. To date, 38 competitions have been held, with City organizations winning 28 and the private sector ten. A total of \$4.4 million in savings has been identified from competition and privatization, and 108 positions have been eliminated.

EMD VEHICLE MAINTENANCE COMPETITION

With a total of 3,600 units, the City's fleet is one of the largest in the Southeast. The replacement value of the fleet is approximately \$100 million. With the exception of Transit Buses and Aviation Department vehicles, the entire fleet was covered by the competition.

The competition process for vehicle maintenance services began in winter of 1996 with issuance of the Request for Qualifications. Three firms were found to meet the qualifications (the City, Ryder, and Tecom), and two were found not to meet required qualifications (experience with large, diverse fleets and financial strength). The RFP was drafted in early 1997 and, after much review, was issued in July. Proposals were due in September. The evaluation process was completed in October, and contract services began on January 5, 1998.

As with any complicated legal document, the RFP was a lengthy and detailed document. Some of its more-important provisions are noted below:

- The contract term is for 3 years with two 1-year renewals at the City's option.
- Fleet asset management services such as replacement planning, specifications, and other administrative activities were not included in the competition and remain with the City.
- The contractor does not have a guaranteed monopoly but will have to continue to exceed customers' expectations in order to retain their business.
- The contractor must use the City's Fleet Management Information System.
- The City's employees were at risk since the contractor was under no obligation to hire existing staff.
- Use of the City's four shop facilities was provided to all bidders for \$1 per year.
- Services were separated into two types: *target services*, which are routine and predictable activities for which proposers had to provide a fixed annual bid, and *non-target services*, unpredictable activities over which the contractor has no control. These services include accident damage repair, equipment modifications, and damage caused by acts of nature. Proposers had to provide time and materials rates for these services.
- Detailed standards of maintenance were established to provide bidders with baseline expectations for the continued condition of the City's fleet.
- Financial incentives were established for exceeding performance standards in the areas of fleet availability, repair service turnaround time, and preventive maintenance program compliance. Liquidated damages were also established for failure to meet standards.
- Any savings from the target services bid will be shared with the contractor on a 50/50 basis (gainsharing).

Preparing the City's Bid

EMD formed a bid team to prepare the City's proposal. This team consisted of the division director, the vehicle maintenance manager, a mechanic, the division's business manager, and a member of the City's human resources staff. EMD also hired a consultant (Spectrum Consultants) to identify uncompetitive practices and to assist the bid team in proposal preparation. The bid team focused on adopting a number of private-sector business practices that would improve EMD's competitive position. Some of the key bid provisions are listed below:

- *Fewer/higher paid staff.* Over the past 8 years the size of the maintenance staff has been reduced from a high of 90 in 1993 to 67 positions that were included in the bid. During the same period the size of the fleet increased by 12 percent.
- *Fewer supervisory and support staff.* Two parts and two service writer positions were eliminated. In addition, first line supervisors are expected to work on the shop floor 50 percent of the time.

- *ASE (Automotive Service Excellence) certifications required.* Achievement of ASE Master is required for highest-level technician position. A minimum of three certifications is required for journey level.
- *Self-directed work teams.* High-involvement team training has facilitated the reduction in supervisory and support staff as technicians have taken responsibility for making more business decisions.
- *Increased overtime and training budgets.*
- *Incentive pay and performance bonuses.* EMD included \$50,000 in the bid, to pay bonuses for such items as exceeding flat rate job standards, employee of the quarter and year, earning Automotive Service Excellence certifications, and safety awards. In addition, bonuses are also available for exceeding contract performance standards. These bonuses are paid on a team basis.

A summary of EMD's first-year bid is included in Table 1.

TABLE 1 Equipment Maintenance Division First-Year Bid

COST FACTOR	FIRST-YEAR BID (\$ million)	PERCENTAGE OF TOTAL
Salaries and benefits	2.7	41.5
Parts	2.2	33.8
Sublet services	1.0	15.4
Operating expenses	0.4	6.2
Overhead	0.2	3.1
Total	6.5	100.0

Evaluating the Bids

To provide technical expertise in evaluating proposals, the evaluation team retained the consulting firm of David M. Griffith. Proposals were evaluated in terms of the 3-year net present value of the fixed bid for target services, transition costs, and an estimate of non-target services costs based on the rate structure contained in the bids and the City's historical experience. A summary of the bids for a three-year term is detailed Table 2.

TABLE 2 Summary of Bids for Three-Year Term

SERVICES	EMD (\$ million)	RYDER (\$ million)	TECOM (\$ million)
Target	20.6	23.4	24.2
Non-target estimate	3.5	2.8	3.2
Total	24.1	26.2	27.4
Difference (%)	0%	+ 9%	+ 12%

LESSONS LEARNED

Participating in a managed competition is a very informative process. Every aspect of the operation must be examined in detail for relevance, efficiency, effectiveness, and cost. You must sharpen your understanding of your customers' business requirements and also take steps to understand your competitors' strengths and weaknesses. Finally, you must develop new sets of skills in areas such as marketing, advanced customer service techniques, business planning, profit and loss analysis, team building, finance and accounting, contract monitoring, and incentive pay plans. Public-sector managers and employees have not traditionally required proficiency with these skill sets. Yet proficiency with these skill sets is a prerequisite to success in a competitive environment. EMD learned a number of specific lessons in the process of winning the competition. Most lessons learned are related to the themes detailed above and include the following:

- *We are not the shop, the garage, or maintenance.* Many view our organizations as a bunch of grease monkeys out in our dingy shops changing oil and fixing flat tires. We must change this view and effectively market our services so that leadership of our agencies understands the importance, impact, and value of our operations. We must foster an image that we are asset managers in charge of delivering essential mobility services to our customers.

In Charlotte, our services impact the cost of nearly every service provided by the City, impact the productivity of nearly every City employee, support emergency services making the difference between life and death, and support maintenance of the City's infrastructure—all of which make possible a thriving economy and high quality of life. Our success is vital to the success of our customers. I know this, and you know this, but does the head of your agency know this? Being in a position to answer emphatically "yes" is important to success in competition and is a key to long-term survival for any internal service provider.

- *Know your costs; design business like cost centers.* A thorough and intimate understanding of all of your cost factors is essential. You cannot manage cost if you cannot accurately measure cost. We found that many agencies that we contacted for benchmarking information either did not know their costs (all they had was high-level budget information) or did not understand their costs (when we asked for fully burdened labor rates, we often received answers such as "\$15 to \$20 per hour").

One way to better understand your costs is to construct separate cost centers around your various lines of business. Therefore, separate cost centers (and budgets) should be established for asset management activities, maintenance, parts, sublet services, fuel, and motor pool activities. A separate charge back methodology should also be established for each cost center (e.g., a monthly rate for asset management, a percentage markup for parts, and direct billing for maintenance services rendered). Not only does this provide improved clarity and allow more intelligent management decisions, but it also improves your competitive position by correctly assigning costs away from services

that will be subject to competition (such as maintenance), instead assigning them to services that will be excluded from competition (such as asset management).

- *Competition can come from many sources.* Privatization companies (such as Ryder Managed Logistics Services, Tecom, Baker Support Services, and Butler Fleet Services) are not the only potential competition for public-sector equipment managers. National leasing companies such as GE Capital are interested in expanding from their traditional customer base of commercial fleets. As greater numbers of public agencies consider leasing as an option to finance their equipment acquisitions, leasing companies view the public sector as potential customers for the full range of comprehensive fleet services that they currently provide to many businesses.

Another potential competitor for the public-sector fleet business is the electric utility industry. Facing fierce competition due to deregulation, power companies are downsizing operations, including fleets. As a result, their fleet organizations have excess capacity in personnel and shop facilities, and are seeking additional customers. Even small, local vehicle repair businesses can be powerful competitors for the public-sector fleet business. The current primary contractor for Los Angeles County grew from a small local repair company to a subcontractor of the original prime contractor (Holmes and Narver) to assuming the role of prime contractor and winning a subsequent renewal contract.

A final source of competition deserves special attention. Our customers can be the most likely reason that competition becomes an active issue for public-sector equipment managers. This is so because our customers themselves are under increasing pressure to hold competitions for services. More and more public agencies are holding competitions for a wide range of public works services, including refuse collection, street sweeping, water and sewer plant operation, paratransit services, and road maintenance. We all realize that equipment represents a major cost factor for many of our customers. Therefore, when they are under the gun of competition, so are we. Do not be surprised if, one day soon, a major customer knocks on your door requesting a 3-year bid for equipment maintenance services to be incorporated in his competitive proposal. By the way, what would the impact be on your operation if one of your larger customers lost a competition and went out of business?

- *Know your competition.* You should always be in tune with your competitive position in the equipment maintenance marketplace. How do you compare with other public-sector fleets in your area? How do you stack up against the best in class in your region? Most importantly, how do you compare to potential competitors such as the local electric utility, privatization companies such as Ryder, or local equipment repair companies? You should visit your competitors. Understand what they do differently from what you do, and understand their weaknesses as well. Then, incorporate those business practices that make you more competitive.

- *Organize for competition.* Developing a lean and mean organization chart is an important step towards being competitive. Public-sector fleet organizations are often overstaffed, with high supervisor-to-technician ratios and excess administrative positions. This is a serious problem for these fleets, not only because it hurts their competitive position, but also because it is generally difficult to quickly reduce staff or change position classifications in the public sector. In Charlotte we were fortunate in that we had

a number of years of lead-time to prepare for competition, to reduce staff through attrition, and to make incremental changes. Additional changes were included in our bid, but the changes would have had to be drastic if we had not started the re-engineering process years earlier.

- *Be customer centered.* Do not forget your customers during the debate over competition. Being competitive means more than having low cost, productive shop operations. The real goal is to make your customers' operations more productive. This cannot be accomplished only by providing the best services at the lowest cost; it also requires a focus on understanding and meeting customers' needs. This means providing extended service hours, offering field services, using vendors that are convenient to remote customers' locations, and so forth. In Charlotte, it also means fostering a close partnership with our customers and involving them in all significant business decisions through having our largest customers sit on a Board of Directors for our business.

- *Be proactive.* Privatization and competition are real trends within our industry. Therefore, it must be a priority for all equipment managers to get out in front of the trend and become experts in this field. I have received a number of panic-stricken calls from equipment managers who just left the City Manager's office with instructions to get their numbers together by the end of the week for comparison to numbers provided by a privatization company at a meeting with the Mayor the day before. This kind of situation happens. If it happens to you and you are not already prepared, you may have a serious problem.

- *Involve your employees.* Competition, privatization, re-engineering, and right sizing all mean one thing to employees—their jobs are at risk. If your organization is getting involved in one of these programs, employees' stress levels will go up, the number of wild rumors will increase, and morale will suffer. In order to minimize this process, it is important to keep employees involved early. There may be someone in your organization who can help you develop a communications plan. We took advantage of advice from the City's Corporate Communications group. Our efforts to build a team-based organization also helped foster better communications.

CONCLUSIONS

I have spoken with many equipment managers who view privatization and leasing companies as the enemy. These companies are cast in the role of villains who will not hesitate to lie, cheat, and steal in order to wrest our customers away from us. I do not agree with this view at all. The privatization and leasing companies are good at what they do and most often add value to their clients' operations. There is a competitive industry and they are continuously seeking good business opportunities. If you represent a good business opportunity for them, then you only have yourself to blame.

Successfully winning the managed competition in Charlotte was very gratifying and is certainly the highlight of my professional career—not only because winning feels better than losing, but also because we are very proud of the positive changes that we were able to incorporate into our bid. Only through risking it all in competition were we able to gain performance-based pay, incentive bonuses, and profit sharing. Competition affords an opportunity for public agencies to accomplish things that would never be

possible in the normal course of business in our bureaucratic, civil service–based environment.

Ours is a competitive society. Competition is all around us. The reality of the new world order is that more and more public agencies will be forced to compete. Competition is neither good nor bad; it is simply the way our business will be conducted in the future. Public-sector employees are not accustomed to competing for their jobs. However, our competitors are skilled at competition. Thus, in order to keep our jobs we must become competitive and we must be prepared. That is the way it is. Predator or prey, eat or be eaten. Faced with this reality, you really have no choice. If you are going to play this game, play to win.

REFERENCES

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2. Hays, R. D. *Internal Service Excellence: A Manager's Guide to Building World-Class Internal Service Unit Performance*. Summit Executive Press, Sarasota, 1996.