

# PRACTIX

*Good Practices in Purchasing & Supply Chain Management*

## Supply Base Reduction Within Supply Base Reduction

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 **CAPS**  
RESEARCH

VOLUME

6

JANUARY  
2003

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### Executive Summary

As a strategic function, some of the most important and fundamental decisions that purchasing and supply management can make concern the creation and management of its supply base. One important decision relating to the design and administration of an organization's supply base is the number of suppliers who will be utilized for a given product or service. Reducing the number of suppliers can lead to many benefits for the organization. This best practices report describes the successful implementation of supply base reduction efforts of a company in the transportation industry.

### Background

Fleet Corporation (not its real name) operates nearly 30,000 trucks, one of the largest fleets in North America. The company provides transportation services to more than 25 million residential, municipal, and industrial customers across North America. With more than 1,200 operating and maintenance locations, Fleet faces some daunting challenges when it

comes to replacement parts for its vehicles. In the past, these 1,200 locations have dealt with thousands of different parts suppliers across the country. Fleet is in the process of moving toward centralized strategy development and price negotiation, but will still have decentralized order execution. On the corporate level, Fleet now has 10 strategic sourcing teams working closely with people throughout the company to define needs, find the best suppliers, and develop systems for streamlined purchasing.

One of the key points of Fleet's overall business strategy focusing on operational excellence involves implementing a procurement and sourcing process that will leverage the company's size and total purchasing ability to realize savings and discounts through consolidation and reduction of the number of suppliers used. By reducing the number of suppliers it uses, Fleet can partner with select suppliers to ensure low prices, high quality, timely delivery, and strong customer support.

**Chassis and Body Parts Project**

One specific supply base reduction project that Fleet has recently undertaken involves chassis and body part purchases for its fleet of trucks. Chassis and body parts were selected for supply base reduction efforts because the supply base was highly fragmented, the purchase volumes were not leveraged, there was no centralized purchasing process, these areas of spend involved a lot of money which provided a good opportunity for savings, and because opportunities for standardization existed. The supply base reduction efforts in the chassis and body parts categories resulted in a reduction from over 15,000 suppliers to a preferred supplier list of six chassis parts suppliers and six body parts suppliers.

**Nature of Supply Market**

The supply market for vehicle parts is comprised of many suppliers in a highly competitive struggle to earn customers. The products are readily available from many sources, and supplier location has traditionally been an important selection criterion. Figure 1 lists the key players in the chassis and body parts market. These key players are discussed in more detail in the following paragraphs.

*Parts Manufacturers* – Parts manufacturers make parts for both chassis manufacturers and for the parts after-market. These manufacturers typically specialize in a particular parts category (i.e., brake parts, lighting, electrical, filters). Volume can be leveraged to a significant degree with parts manufacturers and is key to reduced pricing.

*Parts OEMs* – Parts OEMs buy manufacturer-designed or proprietary parts from parts manufacturers as well as through vertically integrated operations or subsidiaries. Parts OEMs sell proprietary parts to fleet owners and end users through authorized dealerships. They market to fleet owners and end users based on quality, warranty (part and vehicle), and fit for use (original specification), rather than on price.

*Parts Distributors* – Parts distributors buy general application (all-make) parts from parts manufacturers. These parts are essentially from the same manufacturer and are the same parts as those sold by the OEMs. Distributors do not compete with OEMs on quality or fit for use but may compete on warranty (both parts and labor) as well as price. Parts distributors compete primarily on price through private label parts, a price strategy driven to a significant degree by volume since it facilitates distributor negotiations with manufacturers. Distributors sell parts to fleet owners and end users directly or through dealers. Distributors provide parts warranties and other value-added services to fleet owners and end users. The cost of switching from one distributor to another is relatively low. Distributors focus on raising the cost of switching through contractual and/or value-added offerings such as parts purchasing/inventory management systems tied to the distributor and provided to fleet owners and end users at no cost. Distributors have the capability to manage pricing through their distribution networks by adjusting pricing and/or margins to provide specific price points to fleet owners and end users.

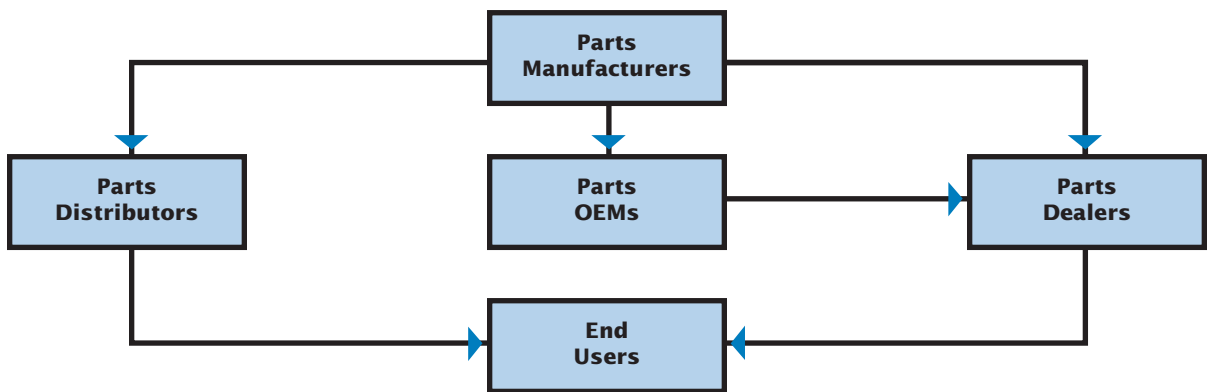


Figure 1:  
Key Players in  
Chassis and Body  
Parts Market

*Parts Dealers* – Parts dealers are the retail level outlet for parts for both chassis manufacturers and parts distributors as well as in most cases being vehicle manufacturer(s) dealers. Parts dealers compete on price, customer service/relationships, and value-added services (i.e., point of sale inventory, delivery, parts consignment, core management). Parts dealers typically provide in-shop and/or on-site vehicle service capabilities to fleet owners/end users. Parts dealers provide a supply chain buffer by having inventory available and/or offering consigned inventories to customers.

**Strategic Sourcing Process**

As part of its centralization efforts, Fleet utilizes a seven-step process to purposely choose suppliers (see Table 1). Fleet has utilized this process in many purchase categories to date. The specifics of the chassis and body parts project are discussed in the following sections.

**Steps one and two** involved establishing a cross-functional team and developing the strategy for selecting suppliers for this family of parts as well as establishing the goals and objectives of the project. This cross-functional team was comprised of fleet managers, maintenance managers, parts managers, and purchasing personnel.

**Step three** involved collecting information about the spend and gathering information about the suppliers being utilized. Since Fleet had no centralized purchasing system, these data were collected mainly through accounts payable records and by contacting some suppliers for information on what Fleet had purchased from them over the previous couple of years.

**Step four** involved developing the RFP that would be used to gather information from suppliers. The RFP mentioned that supplier selection would be based on five criteria: product and technology leadership, service and support leadership, quality, delivery and lead time performance, and total cost performance. Weights were assigned to each of these categories in order to assist in ranking potential suppliers.

Table 1:  
Seven-Step Strategic  
Sourcing Process

Step	Action
1	Form the Sourcing Team
2	Develop Sourcing Strategy
3	Generate Supplier Portfolio
4	RFP Process Development
5	Negotiate/Select Competitive Supplier(s)
6	Operational Integration
7	Benchmarking and Improvement

Based on the information that had been collected about the supply base, Fleet sent an RFI to 12 suppliers that had the ability to provide a national parts program. The national presence of these suppliers and their ability to provide a national parts program was judged by their size in terms of revenues and their number of operating locations. These suppliers were then invited to talk to the cross-functional team about how they could help improve efficiency and reduce costs.

Three suppliers were eliminated from further consideration at this point in the process. RFPs were sent to the remaining nine suppliers. After receiving the RFPs back from these suppliers, the cross-functional team developed target pricing based on the lowest price for each item. The cross-functional team then sent another RFP to these companies specifying these target prices and asking if the suppliers could meet these prices. Most of the suppliers were close to, but still above, the target prices.

*As part of the implementation process, suppliers were classified into three tiers.*

After receiving the RFPs back from suppliers, six suppliers were chosen (**step five**) to supply all of the chassis parts requirements. A similar process was used to select six suppliers to supply the body parts requirements. The main reason that six suppliers were chosen was to leverage Fleet's purchasing volume. Six suppliers were chosen because they would be able to fill the requirements and still provide each location with options. Having six suppliers allows the suppliers to compete on service and in some cases on special pricing. The locations are allowed to decide which of the preferred suppliers they will utilize, based on service levels. Fleet believes that six suppliers are the right number nationally, but that within each region there should be two suppliers utilized for a vast majority of the parts purchases.

**Step six** involved making the change to the selected suppliers. As part of this step, Fleet sent out the new supplier list and parts pricing from each supplier to locations via mass e-mail communication and the company intranet site.

Fleet also began monitoring compliance by carefully tracking what was being purchased from these suppliers. An e-procurement system is being developed to help drive compliance by showing only approved suppliers and by making it much more difficult to buy from non-approved suppliers. The system will allow overall visibility into what is being purchased.

As part of the implementation process, suppliers were classified into three tiers. Tier 1 was comprised of a direct ship supplier and two other suppliers that the locations were encouraged to use as their preferred suppliers. The ship direct channel is price-effective while the dealer channel is time-effective. For ship direct, parts are supplied from a supplier-partner's regional warehouse, eliminating the middleman (the dealer) and the associated costs. There is typically a 48- to 72-hour turnaround time after placing the order, and a minimum purchase to waive freight charges. On the other hand, a dealership can typically deliver within hours with no freight charge while charging a higher price. Ship direct channels are best suited for those parts that are used frequently and have no core charges, where the dominant cost is the part itself. The dealer channel is best suited for parts that are urgently needed, have core charges, or where the dominant cost is the loss of use of a high-dollar asset like a transportation vehicle. Tier 2 consisted of two other suppliers whose prices were not as good as the first-tier suppliers and who could not furnish support with consignment and core management from all dealers, but who might be better located for certain areas or might better fulfill the needs of certain regions based on the type of vehicles operated and other criteria. The third tier consisted of an auto parts dealer with many locations that could be used in emergency situations or for parts for support vehicles operated by each facility rather than the larger, more specialized vehicles. Initially, Fleet encouraged its locations to utilize Tier 1 suppliers before Tier 2 suppliers and Tier 2 suppliers before Tier 3 suppliers whenever possible. But upon implementation, it was discovered that in some cases, moving away from a Tier 2 supplier was counterproductive to the sourcing process.

In those cases, the Tier 2 suppliers, even though they charged higher prices, were able to provide the lowest total cost solution to Fleet’s locations. Because of this, Fleet leveled the playing field among suppliers by doing away with the tiering approach. It is currently up to each location to choose the supplier that best meets all of its requirements for its parts supplies.

Once the supply base reduction project had been implemented, **step seven** involved developing a separate team to analyze the project, validate savings, and recommend additional exercises to increase savings. Table 2 lists the critical success factors of supply base reduction efforts identified by Fleet.

**Supply Base Reduction Within Supply Base Reduction**

In addition to reducing the number of parts suppliers at the OEM level, Fleet has also reduced the number of suppliers at other levels in the distribution channel. As part of the chassis and body parts supply base reduction efforts, Fleet negotiated specific discounts with parts OEMs. In order to offer such discounts to a buying organization, these OEMs must get consensus from most of the dealers in their distribution network, which allows them to go only so far on price cuts. Realizing this, Fleet has negotiated with specific dealers in certain geographic regions in order to get additional discounts by driving volume through a limited

number of dealers within the OEMs dealer network. Since dealers are independent of the parent companies (OEMs), Fleet has been able to get lower rates by negotiating with specific dealers.

To further increase leverage and reduce prices, Fleet has also negotiated directly with manufacturers. Dealerships often offer a number of parts that will work in a given application, often from one of several manufacturers. By standardizing to a specific part for each application, Fleet has been able to increase its leverage with the manufacturer and has been able to negotiate better pricing that flows through to the dealers and on to Fleet locations. Negotiating at three levels of the distribution channel is an important part of Fleet’s strategy. There are opportunities to reduce the number of suppliers, reduce the number of parts used, and negotiate better pricing at every level of the market structure.

**Benefits of Supply Base Reduction**

The two benefits that Fleet has seen corporate-wide from the supply base reduction efforts have been reduced costs and increased service from suppliers. By reducing the supply base and negotiating prices with the selected suppliers, Fleet was able to reduce costs by about 9 percent on its chassis and body parts purchases.

Table 2:  
Critical  
Success  
Factors

Get top management support
Hire the right people for the project
Utilize cross-functional teams – get input from everyone involved so that they buy into the outcome.
Understand the organization’s needs, goals, and objectives prior to making changes
Get good/accurate information on the spend prior to making changes
Pick the right suppliers

Another benefit of supply base reduction activities is that they uncover process flaws in bad practices that were hidden or covered by the ease of getting parts from local suppliers. For example, suppose that the previously used supplier was located across the street from the maintenance shop. That supplier would be able to get shop workers out of many binds by having the necessary parts so close by, but these

rescue efforts would come at a higher price because of the expedited delivery. Poor planning and poor processes would be hidden. By moving to fewer national suppliers, processes must be improved because of the often longer lead times in getting parts. Table 3 provides information on several other additional benefits that have been realized from this project.

Table 3:  
Additional Benefits

<p><b>Technology</b></p>	<p>Access to technology has increased through supply base reduction efforts. Specifically, those suppliers who have received much more volume and longer-term commitments have been much more willing to invest in R&amp;D that will improve their products or processes.</p>
<p><b>Availability/ Capacity</b></p>	<p>Working closely with fewer dealers allows them to stock what is needed because of the steady nature of a majority of replacement parts.</p>
<p><b>Supplier Management Costs</b></p>	<p>Initially, supplier management costs increase because of the hours of work required during the supply base reduction process and because strategic partnership relationships require much more effort than traditional competitive bidding types of buyer/supplier relationships. However, over the long run, once these relationships have been established and are running smoothly, Fleet anticipates a reduction in the supplier management costs or total system costs.</p>
<p><b>Quality</b></p>	<p>Fleet is able to work more closely with its preferred suppliers and provide them information about quality defects as part of supplier development activities that would not be possible with a very large supply base.</p>
<p><b>Inventory Levels</b></p>	<p>Working closely with a few suppliers and providing them visibility into the total purchases for a given part has led to higher inventory turns of the suppliers' inventory and a reduction in Fleet's inventory levels.</p>
<p><b>Vendor Managed Inventory</b></p>	<p>Another way that Fleet is reducing its inventory is by having its suppliers manage its parts inventories in certain locations. This has led to a reduction in the number of obsolete parts. Vendor managed inventory (VMI) would not have been possible when thousands of suppliers were utilized for chassis and body parts.</p>



### Win/Win Situation

In addition to the benefits that Fleet has received, reducing the supply base has also resulted in many benefits for its suppliers. The first, and most obvious, benefit is a larger revenue base because of the increased number of parts being sold. As Fleet's suppliers purchase or produce more of a specific part, economies of scale and volume discounts mean that they can not only pass along price savings to Fleet, but that they can also either reduce the prices charged to other customers and thereby earn more business, or they can earn higher margins while keeping the prices paid by these other customers the same.

*This type of detailed feedback would not be possible with a very large supply base.*

The second benefit for suppliers is the opportunity to perform major repairs/service as part of preventive maintenance agreements. This can be a definite benefit to the dealers that also helps them earn even more revenues. Parts are low margin commodities whereas there are higher margins in services. Most of the dealerships want both the parts and service part of Fleet's businesses. Many are willing to negotiate better prices on parts in order to secure the service portion of the business.

The third benefit is information about parts usage and forecasts about future needs. Information about inventory levels, usage rates, fill rates, and forecasts has been shared with suppliers. This information helps the suppliers better plan and manage their inventory levels.

The fourth benefit is that suppliers get detailed feedback from Fleet locations about how to improve their operations. This type of detailed feedback would not be possible with a very large supply base.

### Conclusion

This case study illustrates the supply base process utilized by Fleet Corporation and the benefits that have been achieved through this process. One important aspect of this supply base reduction project was reducing the supply base at multiple levels within the distribution channel in order to increase leverage and drive performance improvements in product costs, quality levels, technology, inventory levels, and supplier management costs. In the end, reducing the supply base has been a win/win situation for both Fleet and its chosen suppliers.