

A Pygmy's Journey

How to reduce equipment costs without cutting maintenance

PART 1 OF 2

By Preston Ingalls

Let's start this off on the right foot. This article is all about how to affect fleet cost containment in the real world for your equipment division. Before I explain what Pygmies have to do with fleet costs, let's set the stage for our little adventure with a primer on cost containment.

COST CONTAINMENT

Cost containment begins with cost management, which is the process of planning and controlling the budget of a business. Many construction businesses employ cost management plans for specific construction projects, as well as for overall business management.

When applying it to a construction project, projected expenditures are calculated while the project is still in the planning stage so that they can be sanctioned beforehand. During the actual construction project, all expenses are recorded and examined to ensure alignment with the cost management plan. After the project is finished, the predicted costs and actual costs can be compared and analyzed, which helps to true-up future cost management budgets.

It would be unfathomable to imagine conducting business any other way. After all, we bid jobs with a sharp pencil and frugal calculations to secure the winning bid. We hate leaving money on the table (too much difference between your company's winning bid and the next runner-up) or losing a bid by a percent or two. Consequently, cost management is the key to our company's vitality and health.

THE JOURNEY BEGINS

We have been applying these concepts for years in managing construction projects, yet when it comes to managing the costs of running our fleets, it's not quite a rigorous protocol. The latitude or variances in costs can be troublesome on a project when we have allocated so much for equipment costs and then watch the job margins shrink as additional equipment costs are applied to the project. Even in cases where it isn't applied directly to a given project, the company has to absorb the costs.

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In other scenarios, the bid rates are moderately deflated because the true rates of renting the equipment from the Equipment Division would place us in a noncompetitive position, which is too prohibitive. In this case, the company has to eat the delta (or difference), but at least we have competitive pricing and can get work.

It is a dilemma. If we price the bids with true costs of fleet usage and upkeep, we may be over-priced in bidding. If we don't bid true costs, it will eventually affect the margins as the excess costs have to be covered by the company one way or another, leading to lower profits. The good news is that you are in the same quagmire as many of your competitors. The bad news is that it's not reassuring.

MEASURING UP WITHOUT CUTTING DOWN

The question remains: How can I reduce my equipment costs without instructing them to simply cut their current level of maintenance? We know that's a double-edged sword as neglected equipment often results in higher costs. This is true because small problems that could have been caught and resolved in the early stages of degradation must now wait until they advance to more serious downtime and costs. So, what is the answer?

The shop appears to be a big black hole to pour in your money. It's a necessary evil—right? It has to be as challenging as balancing the Federal Budget—right? Wrong.

If you want to reduce your fleet costs, you first need to understand them. Where are your costs relative to others? I mean; are you in line or way out of whack comparatively to other company's like yours? After all, you may think you are the tallest guy in the jungle until you started visiting surrounding tribes and then you find out you were merely the tallest Pygmy in your tribe. That may be enlightening but it's also certainly demoralizing.

METHOD OF COMPARISON

Like our tribe of Pygmies where height is relative, so too are fleet costs, which means that some method of comparison is in order. In the case of our diminutive friend, they need to think it through before backing up to the doorjamb of the hooch and marking off the top of their head to compare to others. They have to realize that the doorjamb has to remain

in the village and can't be comfortably carried to other villages in the vicinity.

Let's try something more portable ... like a string, but let's mark it off in some form of units or even increments so we will know how much above or below we really are. This will assist us on our pilgrimage so we can now measure the difference to determine how our

height stacks up with all the other jungle occupants.

In part two of this article, we'll look at two simple ratios to make the case for fleet costs and find the true measure of a Pygmy. Until then, enjoy the journey! ■

Look for part two of this article in the next issue of MCS.



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PART 2 OF 2

By Preston Ingalls

In part one of this article, we shared a primer on cost containment and looked at reducing the cost of maintenance without losing the level of maintenance. Methods of comparison were addressed. As we continue the journey to find the true measure of a Pygmy, we'll look at two simple ratios to make the case for fleet costs.

IT'S ALL RELATIVE FOR PYGMIES AND FLEET COSTS

For our fleet costs case, let's use two simple ratios. The first, Cost Ratio One (CR1) is called Maintenance Cost as a Percent of Estimated Asset Value, or Fleet Replacement Value (FRV). The denominator will be the costs to replace our entire fleet at today's prices with comparable rates.

In other words, if something happened to your entire fleet, what would it cost you to replace it with like-kind replacements rather than brand new equipment? After all, if something happened to your entire fleet, the insurance company probably won't be so generous as to say "Go buy all new replacements." They would want you to replace with similarly aged and holed equipment to be fair, which makes sense.

So the FRV is the combined residual values of all the equipment. Maybe you already had it as the "insured value" or capital value (collateral) for securing money from the bank.

Now that we know the FRV, calculate the total costs for maintenance activities. This would include:

- All maintenance labor
- Contractor costs
- Parts and materials
- Any overhead burden (shop costs, utilities, management and support staff)

It would not include:

- Fuel (as a production consumable it's not a cost to maintain)
- Depreciation (a tax burden on a fleet but not a maintenance cost)

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THE TRUE MEASURE OF A PYGMY

We are looking for the "cost to maintain" versus the entire cost to have the fleet. It's like asking the jungle inhabitant to remove his shoes to get a true height.

He may argue that the shoes are a part of him and his height should account for that, but he needs to be reminded we want to compare apples to apples or "tootsies to tootsies." After all, a pair of sandals has a different elevation than a pair of boots. That analogy correlates to the fact that while a vehicle's depreciation burden is indeed an obligation, it is only remotely connected to the "cost to maintain."

After we divide the Maintenance Cost (MC) by the Fleet Replacement Value (FRV), we get a ratio that lets us compare our organization's fleet maintenance costs to others. Let's say our Annual Maintenance Costs are \$7.5 million and our FRV is \$45 million, then:

$CR1 = MC/FRV$ then CR1 is $\$7.5 \text{ mill}/\$45 \text{ mill} = 16.6 \text{ percent}$

Now compare that to the Industry Average of 15 percent, which means you are close to construction industry averages. However, the Best in Class (in the industry) is 4 to 5 percent, so you are spending about three times as much as Best-in-Class operations. If you think 4 to 5 percent is low, bear in mind that World Class (across all industries) is 2.5 to 3 percent.

The second ratio, which we will call Cost Ratio 2 (CR2), will be comparing our Maintenance Costs (MC) to our Annual Revenue (AR), or total sales. We now know what our

Maintenance Costs are and total sales or Annual Revenue is \$125 million, then:

$CR2 = MC/AR$ then CR2 is $\$7.5 \text{ mill}/\$125 \text{ mill} = 6 \text{ percent}$

If we compare CR2 to the Industry Average of 11 percent, we see we are almost half, but Best-in-Class in the industry is 1.5 to 2 percent. Once again, it looks like we are three times of Best-in-Class. Both CR1 and CR2 show we are spending way too much on maintaining our fleet compared to others and especially operations that have really refined their maintenance practices.

STANDING TALL BY CUTTING COSTS

Our Pygmy now has a broader appreciation of his height compared to others, but are there any ways to change it? He now knows that there are communities that he and his tribe might not do as well against in a basketball game.

Unlike the Pygmy example where height is predestined, we can reduce costs with a robust maintenance improvement program. Two successful processes that have been around for many years are called Total Productive Maintenance (TPM) and Total Process Reliability (TPR). Both are extremely similar to each other and focus on practices to improve uptime while reducing costs.

Our little buddy may choose to ignore any efforts to improve his height by blaming it on genetics. Then again, he may choose to learn what is different about these other tribes that allow them to grow taller folks. Yeah, right! ■

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