



## SPARE PARTS

# LOGISTICS FOR THE LONG RUN

For many manufacturing companies, the spare parts business is a major source of profit, and manufacturers have done much to expand and enhance it. There's still room for improvement, however: Significant value could be unlocked through an iterative program to professionalize spare parts pricing and optimize spare parts logistics.

For many years, the spare parts business has generated significant profit for manufacturing companies, leading them to expand and improve this business over the past 10-15 years. Key levers they have used to do so have included systemizing pricing, active marketing of spare parts, and improving underlying organizational conditions and management systems. Today, some machinery and plant engineering companies can boast of high contribution margins from spare parts. In many instances, however, there is still considerable room for improvement in spare parts logistics. Not every manufacturing company has perfected the delicate balancing act of delivering customer satisfaction, efficiency, and optimal working capital. But this will be essential in the future, given increasingly global markets, a diversifying competitive landscape, and the growing complexity of spare parts logistics.

### THE SPECIAL NEEDS OF SPARE PARTS

The spare parts business is fundamentally different from the new machinery business. As a rule, it involves several thousand product codes, ranging from commodities to proprietary parts; relatively small order volumes, which can be difficult to forecast; and exacting requirements in terms of order turnaround times and delivery dates. Those customers who are increasingly professionalizing their activities are aware of the special characteristics

of this business and are thus often willing to pay a price premium, provided that they are satisfied with the performance of their spare parts provider.

In some cases, premium machinery and plant engineering companies try to meet these requirements by maintaining (too) high of spare parts stocks (tying up working capital) and using comparatively complex and expensive logistics processes. It is true that distinct tools, processes, and structures are needed for spare parts logistics, but often individual processes suffer from being too closely interlinked with the new machinery business; that is, similar mechanisms are used to manage two very different businesses.

### ELMINATING OPERATIONAL INEFFICIENCIES AND MARGIN SLIPPAGE

An examination of the performance of selected machinery and plant engineering companies reveals a striking disconnect between the high gross margins and the earnings before interest and taxes (EBIT) of the spare parts business – a sure indicator of process inefficiencies. Too often, parts are sent from one place to another without rhyme or reason, creating more costs if a part is at the wrong place at the wrong time (“spare parts tourism”). Equally, redundant and overly fragmented structures are often still the order of the day.

In these cases, companies need to take the next step in optimizing their spare parts logistics, with the goal of keeping down costs and freeing up working capital, while meeting stringent customer demands. Such a program requires a more strategic and holistic approach to sustainably aligning spare parts logistics, rather than relying on historically grown structures and processes. For example, better segmentation of spare parts can generate better parts-specific strategies. Big data techniques can be used to process and translate relevant information into key performance indicators (KPIs), increase forecasting precision, and better support decision-making through appropriate algorithms and innovative tools.

The end goal of such an optimization process is the elimination of unnecessary redundancies and overstock and the creation of efficient structures and processes at the global level. This should be backed up with training for management to ensure that key learnings and changes are embedded into the DNA of the organization.

DELIVERING CUSTOMER SATISFACTION, IMPROVING EFFICIENCY, AND OPTIMIZING WORKING CAPITAL WILL BE EVEN MORE CHALLENGING IN THE FUTURE FOR THE SPARE PARTS BUSINESS.



Wolfgang Weger

Wolfgang.Weger@oliverwyman.com

+49 89 939 49 430

Romed Kelp

Romed.Kelp@oliverwyman.com

+49 89 939 49 485