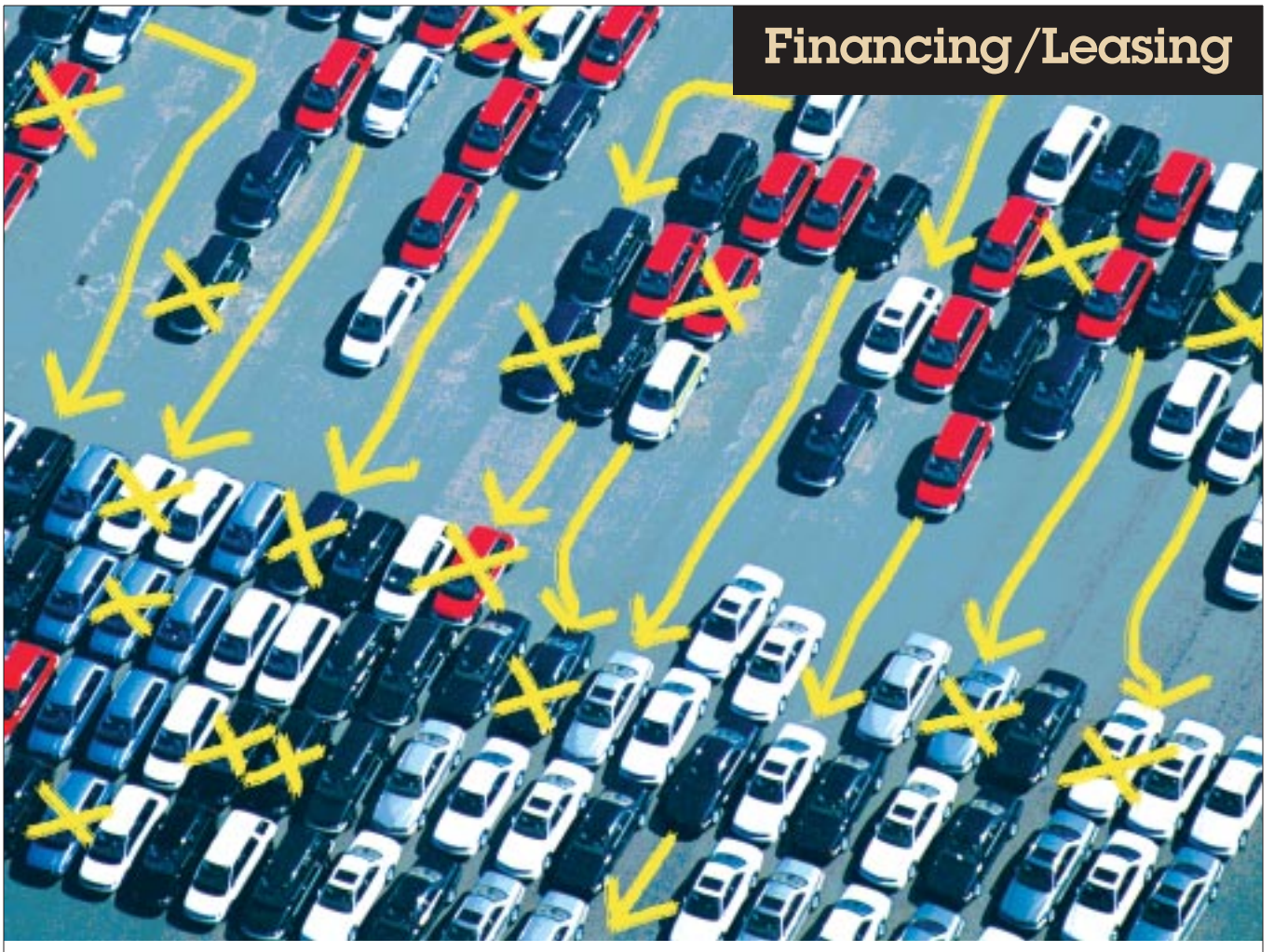


SAVE $1 Million WITH BETTER Fleet Management

HERE ARE SOME TIPS ON HOW TO DO IT.

BY SCOTT PATTULLO

Many companies have large groups of employees, such as sales reps and field service technicians, who regularly need vehicle transportation to do their work. These employees make critical contributions to revenue generation and customer satisfaction. Company executives understand the importance of keeping these employees productive, but they are often less aware of the significant productivity and cost-

savings benefits that come from effectively supporting employees' transportation needs.

THE CHALLENGES OF MANAGING FLEET COSTS

Vehicle-centric businesses, such as distribution companies, are knowledgeable about fleet management and generally have the in-house expertise to do it well. For the rest of us, however, management time is focused on the core business of developing pharmaceuticals, manufacturing chemicals, running restaurants, or marketing soft drinks. We don't have the expertise or the inclination to invest much time or energy in managing the fleet. In addition, vehicle expenses by their very nature are

decentralized—typically occurring in small transactions across broad geography and many employees—and, on the surface, appear difficult to control.

In fact, a fleet is simply a business tool, in many ways no different from a desktop computer or a piece of manufacturing equipment. Focusing on the vehicle fleet via basic policies and a little centralized control can enhance worker productivity and yield major cost savings. Good fleet management can ensure that workers get the transportation they need and sometimes deliver $1 million in cost savings for a typical mid- to large-size enterprise.

COMPANY-PROVIDED VEHICLE VS. DRIVER REIMBURSEMENT

The first question finance managers often ask is, "Why should we provide vehicles? Why not require that employees use their personal vehicles for business transportation and then reimburse them per mile for the use?"

Drivers acquire, finance, insure, and repair their vehicles at retail, while their employers can source all of those expenses at wholesale. If you reimburse your employees for the full cost of using their vehicles for business, then an employee-provided vehicle will be more expensive than the alternative. If you reimburse your drivers at a rate that's less than their full cost, your employees are actually paying to work for you—a risky situation, especially when another potential employer comes calling.

Other practical considerations enter into reimbursement vs. providing a company vehicle. The ability to carry cargo, such as tools, spare parts, or sales samples, may be required, and using the right vehicles for the job will have a major impact on worker productivity. Controlling image is also a likely priority. That recent college graduate's rusty 1982 Subaru may not project the best image when taking a prospective client to lunch, and that flashy BMW may imply company margins are a little too fat when you're trying to win that hospital supply contract. Finally, safety and liability exposures are the same whether your employees are driving the company's vehicle or their own. But only on the company vehicle do you know that the brakes and tires have been properly maintained.

WHAT'S THE COST?

Fleet costs are usually segmented into direct and indirect expenses. Sourcing and finance staffs typically focus on direct expenses, which show up as bills from vendors and on employee T&E forms, are more easily measured, and often are the focus of cost-reduction efforts. Indirect expenses are less visible and typically more difficult to track, but they can have a greater impact on the business.

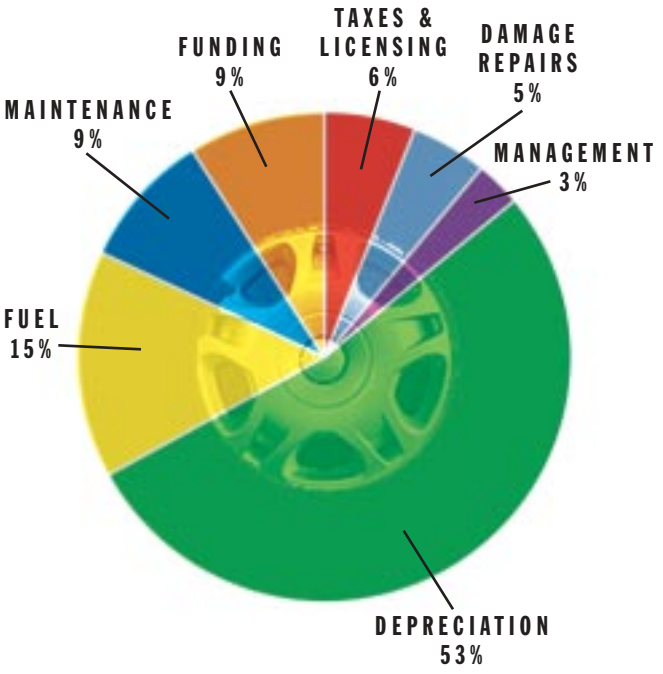
Direct Costs	Indirect Costs
Depreciation	Driver downtime
Maintenance	Lost revenue
Fuel	Customer satisfaction
Funding	Administration
Taxes	Marketing value
Accident repairs	
Insurance	
Fees	

In the explanation of cost-management strategies that follows, let's first get control of direct fleet costs, then move to indirect costs. The example in Figure 1 illustrates a typical large vehicle fleet with hypothetical costs. Your company's fleet may be larger or smaller, but the same concepts will apply.

COST-REDUCTION STRATEGIES

For every fleet, depreciation is by far the largest expense, so many of these cost-reduction strategies are directed at managing depreciation. Acquiring the right vehicles for the lowest cost, operating vehicles for the optimal life cycle by application, and obtaining maximum resale value for used vehicles are all part of the equation. As a first

Figure 1: Direct Costs—Typical Large Commercial Fleets



PROFILE OF OUR EXAMPLE FLEET

750 Vehicles

- **300 Sales Vehicles**
- **300 Service Vans**
- **150 Manager and Work Vehicles**

$7.5 Million Annual Direct Cost

step, however, let's focus on vehicles we don't need.

Eliminate excess vehicles. Every company has changes in its workforce. Workers leave the company or move into positions that don't require a vehicle. A 20% annual change among driver populations is common, and many of the vehicles those workers were driving sit idle for extended periods. In field-service applications, vehicles are often shared by many workers at a branch location. The number of vehicles needed is tied to the level of business activity for that branch location, and branch managers will often hold extras to avoid being caught short.

In both cases, those excess vehicles have a cost, even the ones that are fully depreciated. They must be insured. They get damaged and must be repaired. Occasionally, someone will replace the tires or change the oil. And they have a cash-value carrying cost. That means the cost of holding an excess vehicle can easily be estimated at $1,000 per year. You can identify underutilized or excess vehicles by obtaining odometer data through a fleet fuel card, by tracking changes in the driver database automatically through the HR department, and by benchmarking revenue dollars per vehicle across branches. In our example fleet (Figure 1), we will dispose of 50 excess vehicles now sitting in the driveways of district managers and at branch locations, saving $50,000 per year.

Use the right vehicle with the right equipment for the job. Feature and model creep are common causes of excess vehicle depreciation. Drivers love SUVs, four-wheel drive, extended cabs, leather seats, larger engines, and all sorts of other features. Providing vehicles with those options may be good for morale and can be a good business decision, but it will add to the depreciation cost. Also, choosing vehicles without regard to expected resale value can result in higher depreciation. In our example fleet, we will convert 200 sales vehicles from SUVs to sedans and remove some unnecessary features in our work vehicles, saving $365,000 in annual depreciation expense.

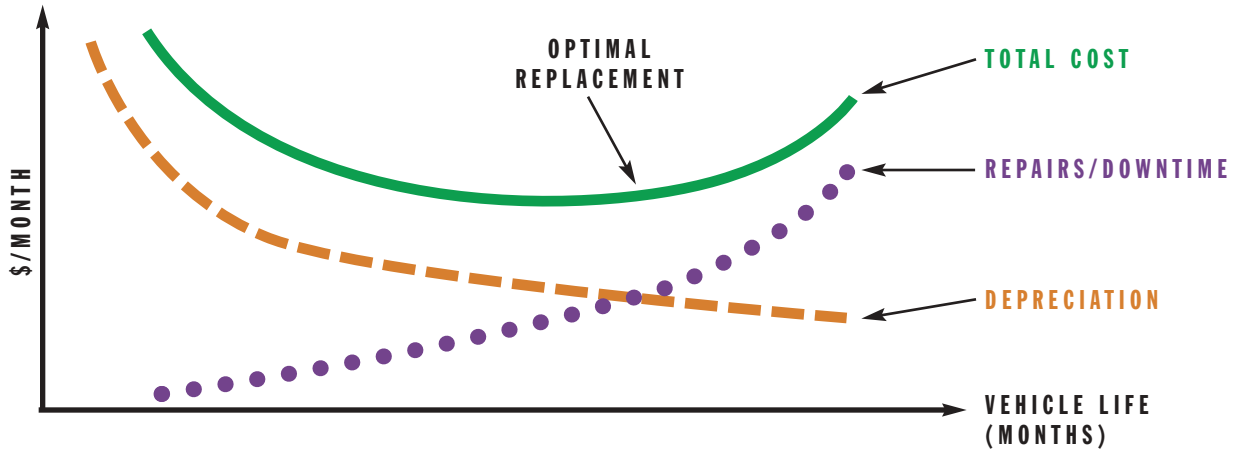
Negotiate well with vehicle manufacturers. After specifying the right vehicle, acquire it for the best possible price. Vehicle manufacturers compete aggressively for market share and have significantly increased purchase incentives for retail and fleet customers who buy new vehicles. By sourcing with one manufacturer, our example fleet will improve net discounts by 5%, reducing depreciation by $225,000 per year.

Avoid purchasing from dealer stock. Dealer-stock vehicles are equipped for the retail market and will typically have $1,000 to $2,000 additional content than you need for an appropriately equipped fleet vehicle. In our example fleet, only 15% of our annual purchases have been from dealer stock, but, with better planning, we can lower that to 5% and reduce annual depreciation by $40,000.

Define optimal life cycle by vehicle application. Keeping vehicles in service for the optimal time is a major cost savings. Depreciation per month declines as a vehicle ages, so replacing vehicles too soon can result in high average depreciation per month.

Conversely, maintenance repair costs and the probability for unscheduled downtime increase as a vehicle ages, so keeping vehicles too long can result in high repair costs and lost productivity to the driver. The optimal replacement cycle is at the low point on the total operating cost curve. Calculating that point precisely for each vehicle application is difficult, but it can be approximated

Figure 2: Identifying Optimal Replacement Timing



through experience and by benchmarking other similar fleet applications at other companies. For the 225 annual replacements in our example fleet, optimizing vehicle life cycle will save $500 per vehicle, or $110,000 per year.

Replace vehicles in the early fall. Once optimal life cycles are defined, additional savings are possible by deviating somewhat from optimal replacement mileage for late spring and early winter replacements. With the introduction of new-model-year vehicles each fall, values decline sharply for newer used vehicles as they become another model year older. Market prices for typical fleet replacements—three-year-old sedans, SUVs, and light-duty trucks—decline $1,000 to $1,500 from September to December, but new-vehicle prices are generally constant throughout the year, so replacing vehicles ahead of this decline in value reduces depreciation. It also makes good economic sense to push late spring replacements into the early fall to avoid placing a new vehicle into service that becomes a year "old" shortly afterwards. For our example fleet, moving a portion of our annual replacements into the early fall reduces depreciation expense by $100,000.

Sell used vehicles in competitive resale markets. Most fleets value their used vehicles based on market values published from various industry sources and are satisfied with the sale of an individual vehicle if they realize close to the market average or, worse, something higher than book value. This approach ignores that those published market values are the mean of a distribution of high and low prices. Too often in a negotiated sale, the purchasing dealer or driver knows the condition of the vehicle better than the seller, and pricing it at market average gives the upside to the buyer. Only by pricing negotiated sales above the market average or by selling in a competitive bidding market with a larger population of buyers can sellers capture above-the-mean value for themselves. For our example fleet, this approach provides an additional 5% in average resale prices, or $65,000 per year.

Reduce accidents. Moving beyond depreciation to other operating costs, direct and indirect accident costs are very significant for most companies. Fleet vehicle accidents require an average of $1,500 to $1,800 in vehicle repairs, but total accident costs are perhaps closer to $9,000 per incident when indirect costs such as injuries, liability, property damage, and workers' compensation are included. Typical fleet annual accident rates range from 15% to 40% of all vehicles, so the savings opportunities by reducing accidents are substantial. By mandating pre-employment and annual motor vehicle records checks, requiring safe-driver training, and enforcing a safety scoring system, our example fleet can reduce its accident rate by 15% and save $315,000 per year.

Manage maintenance. Along with reducing accidents, managing vehicle maintenance offers significant cost savings. Few fleet operators have the technical expertise, systems, and vendor network to manage the maintenance for their vehicles spread across the country, but by using a professional maintenance management service, they can ensure proper repairs at the right price, compliance with preventative maintenance schedules, and driver time savings. Our example fleet will easily save $100,000 per year in maintenance repairs and warranty credits on a managed maintenance program.

Reduce fuel cost with focus on miles per gallon. Finally, fuel is a large direct operating expense, especially for fleets with high mileage per month. Many fleet operators approach fuel cost savings by looking for purchase

discounts, which aren't really feasible unless the fleet can fuel in volume at a single site. Fleet fuel cards can be used to direct driver purchases away from premium fuel, which offers some benefits, but the most significant fuel savings come from selecting more fuel-efficient vehicles. Moving away from heavy vehicles and larger engines can provide 30% to 50% fuel economy increases. Our example fleet will increase average fuel economy by only three miles per gallon, but the savings are worth $200,000 per year. Also, a fleet fuel card will help move 8% of fuel purchases away from premium fuel, saving up to $18,000 per year.

Fund the fleet efficiently. Proper vehicle financing obviously shouldn't be overlooked, but this is a topic that you, as financial professionals, are probably most familiar with, so I won't venture into a complex treasury discussion on funding sources and interest rates. Leasing vs. ownership is a common funding decision for fleet vehicles, and the economic analysis often ends in a tie. The decision to lease or own frequently hinges simply on balance-sheet considerations. As a nod to you, let's assume our example fleet is already funded efficiently and take no savings credit.

DIRECT COST SAVINGS SUMMARY

Like many fleets, our example fleet wasn't badly run, but it needed some focused attention to improve cost efficiency. Through a handful of good fleet-management practices, our cost savings scorecard reflects a 22% reduction in the cost of our fleet and looks like this:

OPPORTUNITIES	POTENTIAL SAVINGS($000)
Eliminate excess vehicles	$ 50
Choose right vehicle/right equipment	$ 365
Negotiate well	$ 225
Avoid dealer purchases	$ 40
Optimal life cycles	$ 110
Early fall replacements	$ 100
Competitive resale markets	$ 65
Reduce accidents	$ 315
Manage maintenance	$ 100
Fuel policy compliance	$ 18
Higher MPG vehicles	$ 200
Total	**$1,588**

INDIRECT COST SAVINGS

Indirect fleet costs are more difficult to track than direct costs, but they are certainly no less important. A fleet is a business tool that produces benefits for the business. If it isn't managed properly, those benefits are lost. In fleet applications where the driver is connected directly to revenue generation and customer service, unscheduled vehicle downtime or high driver administration time can be far more costly in lost revenue than the cost of the fleet. In fleet applications where the vehicle is a part of the driver's overall compensation, the perk value of the vehicle can contribute to reducing employee turnover. Finally, the fleet vehicle is part of the image projected by the company to the customer, and it can detract from or contribute to the company's overall marketing efforts.

Avoiding downtime and lost revenue. The cost of downtime varies by business and vehicle application. In some cases, a missed appointment or a work order not completed can simply be rescheduled for another day, and only the driver's time is lost. In other situations, that missed appointment can result in major revenue loss or customer disruption, and the cost of downtime is far higher than lost productivity. Reducing accidents, choosing more reliable vehicles and replacing them earlier, monitoring preventative maintenance, and keeping replacement vehicles all contribute to reducing downtime. The economic benefit to your business of each fleet management strategy can be weighed against the incremental program costs and the right approach put in place for each vehicle application.

Reducing turnover. In many vehicle applications, fleet has a perk value and should be viewed like any other employee benefit. It is by no means a precise science, but benefits managers benchmark against competitive employers and survey their own employees to judge the competitiveness of their benefits package. The fleet vehicle program can be evaluated similarly and the appropriate program put in place.

Fleet management is a rather obscure topic that, for most businesses, is far from top of mind and is often overlooked. Companies may outsource management of their fleet or handle it internally, but, either way, good fleet management is worth the effort. It can produce significant cost savings and increase worker productivity. ■

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