

Securing large contracts with original equipment manufacturers (OEMs) has long been the ultimate goal of fabricators and machine shops. Traditionally these contracts have provided not only revenue, but stability and economies of scale. Today's OEM contract is ever changing and evolving. While still a necessary element of any subcontractor's business plan, a new set of requirements and risks have been introduced. Making OEM contracts a profitable component of your business mix requires an understanding of the new realities and challenges facing today's OEM subcontractor.

DEFLATION

The old adage "What got you to the game won't keep you there," has never been truer in the OEM contract world than today. Although most subcontractors approach the bid process with a sharpened pencil to deliver a price capable of winning the business, the harsh reality is that OEMs now expect that sharpened pencil to remain out – delivering continued price improvements throughout the contract-better known as *deflation*. It is not at all uncommon in today's market to see expectations for year-over-year piece part deflation of 5% or more.

TRANSPARANCY

In the past, a subcontractor's diligence in purchasing raw materials, booking transportation and managing scrap presented an opportunity to improve profitability. Nowadays, OEMs recognize that the raw material component cost is easily 30-60% of total product cost. As a result, OEMs are taking a more aggressive role in dictating sources of supply and in some cases even negotiating raw material prices. Today's trend is toward more open partnerships between the OEM and the subcontractor with greater transparency surrounding all costs associated with the delivery of the finished part.

SHARED INVENTORY MANAGEMENT

Holding and managing excess inventory is a significant business expense. In the interest of controlling costs and delay inventory ownership, OEMs are seeking to only maintain the components needed to produce their finished goods. The implementation of strategies like kitting and Kanban have become more prevalent in the OEM – subcontractor relationship. As a result, successful subcontractors are required to not only convert metal, but also be more astute managers of inputs and raw materials. If the subcontractor does not have strong backwards integration into their raw material supplier along with forward visibility into finished part build schedules, they can easily be left holding the bag--with an increased inventory position and ultimately increased costs.

EXTENDED CONTRACT PERIODS

The typical length of OEM contracts is growing. Entering a three to five year-*or more*-contract is becoming the norm. This trend increases the level of risk even for the successful subcontractor. Today's subcontractors must be ready to put their best foot forward during initial negotiations, while maintaining a plan to remain profitable for the length of the contract. Winning a contract without a strong outlook for profitability can sting for several years. Conversely, due to the length of these new contracts, losing a bid can negatively impact revenue for years to come.

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Budgeting, planning and forecasting are essential for determining an organizations' inventory and financial goals. However, there's been a paradigm shift in in production planning. Moving a production model from Just-in-Case to Just-in-Time is the ultimate goal for today's OEM. In a perfect world, it wouldn't be necessary to hold any inventory. Raw materials would arrive according to orders and move immediately into production. Today's OEMs are moving to that demand driven manufacturing model, basing production on actual orders rather than forecasts.

Securing and successfully managing today's OEM contract is becoming an increasingly difficult task for sub-contractors. Finding a partner that is experienced negotiating, maintaining and most importantly initiating a creative approach towards these contracts, increases the chance of its success and profitability. United Performance Metals has been effectively partnering with OEM subcontractors to profitably supporting OEM programs for more than 30 years. For more information, contact us at 888.282.3292 today.