Linen Rental Programs in Industrial Laundry; Are They Delivering the Desired Results to the Customer?

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Overview

One of the primary concepts in any business processing outsourcing solution is the ability to provide a service to the customer that is ***faster, better and cheaper*** than performing the function in-house. Many industrial laundry outsourcing firms that rent linens to their customers are certainly able to lower the relative processing cost of performing the laundry function in-house, however they often increase the overall laundry cost for their customers while quickly eroding initial customer savings. In this paper we explore the background of the linen rental industry, why linen rental exists in industrial laundry, how such programs in certain situations can add cost to the service supply chain, and highlight key questions one should ask when evaluating laundry outsourcing as a means to lower operational cost ***regardless of who owns the linen***.

The Evolution of Linen Rental Programs

Although linen rental programs date back to the industrial revolution and horse and buggy deliveries, the core service offering and corresponding value proposition remains the same. A service provider stocks a customer with an ample supply of linen and periodically the soiled product is exchanged with new product so that a customer can avoid the cost of purchasing and washing linens needed for their business. Shop towels, aprons, napery and uniforms are all common products that were rented and in most cases the local mechanic, restaurateur or small business owner saw great benefit from this type of service because of the economies of scale it provided. There was little comparison of the cost of purchasing laundry equipment, linen, and processing cost for a small local business to that of a linen supplier who could consolidate large volumes of linen, command volume discounts on linen purchases and invest in the necessary equipment to process the laundry efficiently. Renting linens made good business sense for all involved.

Current Industry Characteristics

Today, the linen and uniform supply industry includes approximately 2,500 companies with combined annual revenues of $9 billion. 75 percent of this revenue is generated from approximately 50 organizations including large public companies such as Cintas, Aramark and G&K Services. This concentrated industry has seen significant consolidation over the years and despite current economic challenges, the industry is fairly stable by offering a reliable, value added service to a broad array of customers.

Similar to linen supply companies, industrial laundry companies who provide large scale laundry services to hotels and hospitals also offer linen rental options as a means to entice customers to outsource laundry operations. The main selling point being cost avoidance; by outsourcing a customer can avoid the expense of purchasing and replenishing linen. Angelica Corporation is one of the largest players in this highly fragmented space; in total they represent roughly 5 percent of the combined hospitality and healthcare market share. The remainder is served by a multitude of regional and local players who have typically served their specific market for a number of decades.

Why Companies Choose to Participate in Industrial Linen Rental Programs

If someone were to say you could lower your processing costs, avoid buying inventory and make your life easier by outsourcing linen processing you would be intrigued to listen. In certain cases the laundry company might even buy your existing equipment if you operate an in-house laundry. If the perceived value was great enough you might even decide to proceed, especially if you are faced with labor issues, aging equipment, higher utility costs and pressure to do more with less. Such scenarios are precisely why people sign up for linen rental / outsourcing relationships. Quite simply, the perceived benefits far outweigh the drawbacks. The advent of saving money, simplifying operations and avoiding expensive investments in non-core operations ultimately win over any apprehension about lack of visibility, control or contractual commitments.

The Challenge with Linen Rental Programs

All industrial linen rental contracts are priced by the outsourcing facility on either a cost per pound or cost per item laundered. Given this pricing structure, when companies decide to outsource this function laundry becomes an infinitely variable expense to a customer which certainly can be a benefit, but more often is a drawback because it translates into added cost, but why?

In order to answer this, one must remember what the laundry function was like when done in-house. One of the biggest issues laundry staff faced was how do I get the laundry done in time? Keep in mind a fixed budget is in place for the total amount of linen allocated to the operation and in turn, little if no extra inventory existed. Seeing as the laundry staff is dependent on receiving clean linens daily, they find themselves involuntarily compensating for the fact that they have limited amounts of supply to work with – they learn to make do with what they have. Ultimately this leads to lower consumption, inventory levels, and in turn a leaner operation. Certainly stock outages and cases of extreme shortages can severely impact overall operations, but in general a leaner inventory model typically was in place when laundry operations are in-sourced because of internal constraints placed on this ancillary, back-of-the-house function.

A Case of Inventory Obesity

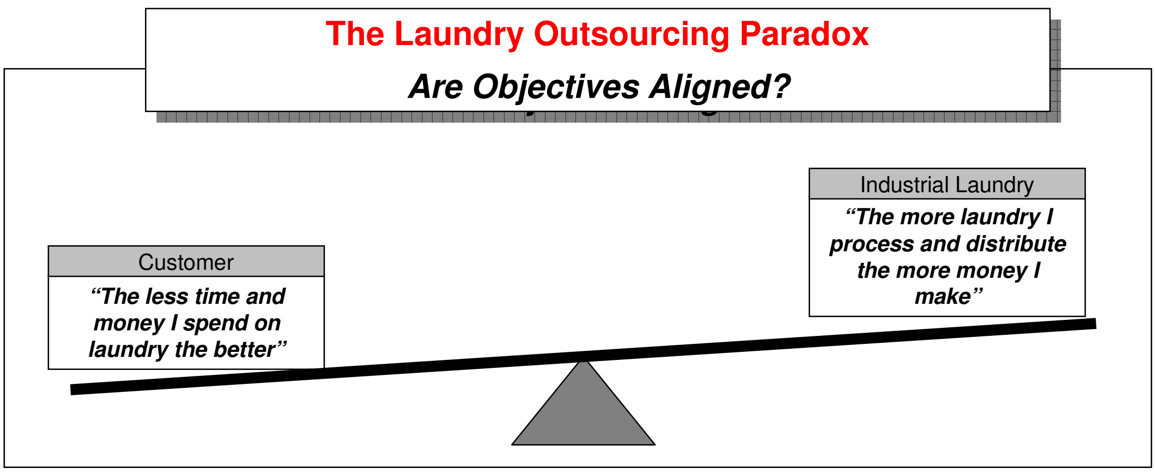
As we all know, obesity is plaguing our country and many have linked this troubling trend to the fact that portions offered up by restaurants and food manufacturers in this country have expanded as fast as our waistlines. Increased portions or in our case, excess inventory, ultimately increases linen consumption. For outsourced programs where linen is made available to the customer, providers are quick to make ample amounts of inventory available so that stock shortages can be avoided. Such additions increase sales for the linen outsourcer which quickly closes the gap on perceived savings since overall laundry costs are higher when compared to in-house operations. Consumption expands and negatively impacts laundry costs despite the lower cost per pound stated in the contract (see figure below).

LINEN OUTSOURCING SENSITIVITY ANALYSIS

	Insource		Outsource	
	Aggregate $	Cost / Lb.	Aggregate $	Cost / Lb.
Total Pounds:		**2,000,000**		**2,000,000**
Personnel	610,000	0.31	380,000	0.19
Utilities	160,000	0.08	80,000	0.04
Supplies	80,000	0.04	40,000	0.02
Equipment	140,000	0.07	40,000	0.02
Linen	60,000	0.03	200,000	0.10
Administration	100,000	0.05	260,000	0.13
TOTAL	**$ 1,150,000**	**$ 0.58**	**$ 1,000,000**	**$ 0.50**

Increase	Total Poundgae
15%	**2,300,000**
Total Spend	**1,150,000**
Savings %	**0%**

In the figure above, a 15 percent increase in laundry consumption quickly voids out the cost per pound savings when evaluating outsourcing options. To add insult to injury, even though internal controls are eventually put in place to monitor consumption, rarely is an outsourced laundry provider the one who will push such an agenda because it means less revenue for their company in the long run. This dynamic is what we commonly refer to as “The Laundry Outsourcing Paradox”.



This misalignment of objectives between the parties manifests itself in the form of a contentious relationship where both parties place blame on the other for routine issues that arise during the course of the relationship. In the end, the contract is used to settle most disputes and given the iron clad nature of the contract the industrial laundry company usually wins. Parties search for common ground and tepid customer satisfaction usually settles in as the program reaches steady state. Collaboration only happens when problems exist and most decisions, including contract renewals, are driven by price.

Overall, customer turnover in the industry remains high and is one of the primary reasons for industry fragmentation. As contracts come up for renewal, aggressive competitors attempt to capitalize on the challenges of the current relationship and in many cases are able to spring customers from the incumbent provider but the underlying issues remain. Often the decision to outsource is irreversible since space once allocated to the on-premise laundry is reallocated for other uses. In the end customers make the best of the situation and get concessions from incumbents wherever possible.

Fine Print: A Primary Reason Why Industrial Linen Rental Programs Exist

Anyone who has been in an industrial laundry understands it is a highly mechanized, expensive capability to create. Today, to build a plant that will process 10 million pounds of laundry annually can cost in excess of $6 million to build from scratch and take over six months to complete. Such an undertaking can be a daunting task considering in most cases customers often sign up only when the plant is ready to process laundry and even then, are leery to commit until the plant has worked out the start-up kinks. Therefore, in order for industrial laundry companies and their stakeholders to get more comfortable with the investment needs of industrial laundry, they need to improve the quality of the revenue stream and create barriers for customers to change providers. By offering to ‘buy’ the linen on behalf of the customer, industrial laundry companies contractually solidify the revenue stream over a set period of time. By doing so, they are able to balance the contractual commitments of revenue with the capital investment needs of the business.

Contracts often stipulate that in exchange of this commitment, the launderer expects a long-term commitment (3-5 years) and if they choose to leave, stiff penalties and buy back provisions are levied. It is customary in traditional linen rental programs for up to 50 percent of the weekly invoiced amount times the remaining periods left on the contract to be assessed as a termination fee. For example, if an organization consuming 2 million pounds of laundry a year is being charged $0.50 per pound and wants to break a contract halfway through a 5-year commitment, the customer would be required to pay $1,250,000. This does not include the linen they would need to buy if they chose to stray from the rental model. Other nefarious terms and conditions such as automatic renewals, lengthy notice periods, and generous cure provisions are additional ways for the industrial laundry customer to forcefully retain the customer. In the end, customers look to alternatives which include in-sourcing or moving providers. When providers are changed, customers find themselves in all too familiar territory once the start-up phase has ended.

The Cornerstone of Successful Business Process Outsourcing

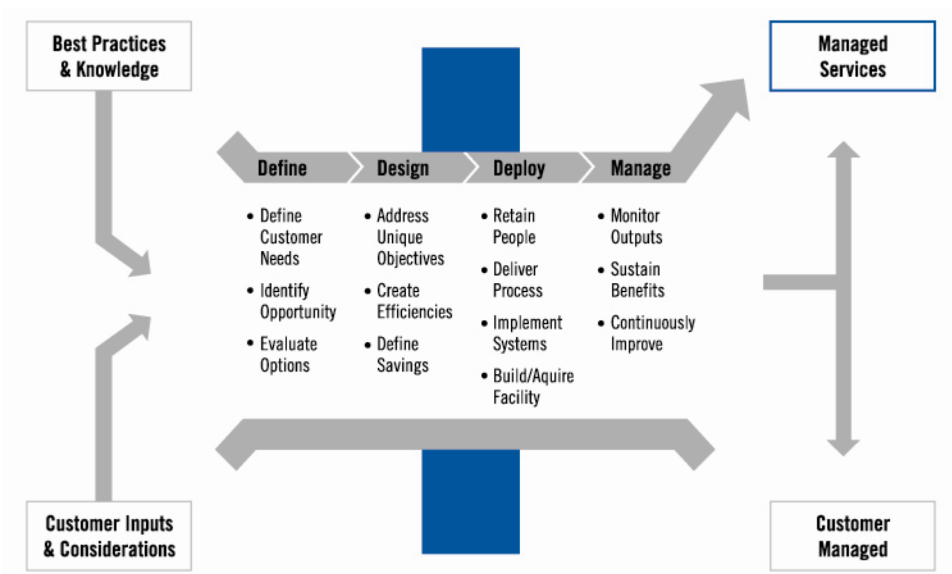
For anyone who is looking to outsource the laundry function, the fundamental question that must be asked is what does utopia look like? By asking this question executives begin to think about what it should cost, how it could be improved, what can I leverage better, and what hurdles are preventing us from getting there. As in the case with any business processing outsourcing solution it must ultimately ***be faster, better and cheaper*** than performing the function in-house. After asking these questions, if what an outsourcing company is offering aligns with the desired model, then its worth exploring. In most cases of industrial laundry outsourcing, customers rely on the idea that whatever people are most commonly doing must be the only option and the path they should follow. Because of this, they quickly jump to address current obstacles versus strive for efficiency based on an open-minded perspective on what their laundry function should look like. In the end, they solve symptoms and rarely get the desired results.

Turning Bridge's Managed Service Solution

Turning Bridge delivers comprehensive solutions that address laundry related problems plaguing the healthcare and hospitality industry. For Turning Bridge's customers the decision regarding how to effectively process the laundry becomes less about in-sourcing and outsourcing, rather, about designing an optimal laundry solution ***without bias towards facility location, linen ownership or equipment.***

When talking with customers or potential customers, it is imperative to discuss what utopia looks like for them and their business. Then, we're able to collaborate to design the best solution given the unique circumstances and preferences of our customers. By combining our best practices and knowledge regarding what an optimal laundry solution should look like both inside the laundry facility and inside our customers' facilities, we ultimately build a solution that *is* ***faster, better and cheaper*** than the current solution or what the customer could have come up with on their own. In the end, Turning Bridge's managed service solution is aligned with our customers' objectives since our underlying value is driven by what value we can deliver to our customers.

TURNING BRIDGE MANAGED SERVICE SOLUTION



About Turning Bridge
Turning Bridge was formed in 2009 and is a managed service and outsourcing company that combines diverse experience, comprehensive capabilities and operational excellence in all that it provides to customers. Focusing on the hospitality and healthcare industries, Turning Bridge collaborates with clients to help them become more efficient and effective organizations. Learn more about Turning Bridge services at www.turningbridge.com.