

## Strategic Sourcing Case Study: Building A Cooperative Sourcing Alliance In Texas

### Key Findings

- America's Electric Cooperatives face continually changing landscapes impacting the cooperative business model. As such, many cooperatives are implementing efficient resource purchasing and other strategies.
- Utility and manufacturer consolidation has changed the world of equipment and materials purchasing, focusing attention on the need for a cooperative response that is innovative and agile.
- Adopting vendor-managed inventory (VMI) practices to cooperative purchasing and supply networks reduces costs to co-ops and ensures availability of product when needed.
- As a 'green field' start-up in 2001, the Texas Electric Cooperatives' supply organization utilized ground-breaking VMI practices and developed unique strategic sourcing alliances that allowed it to capture significant market share and achieve cost-savings for its members.

### The Sourcing Need

Consolidation has made it harder for electric cooperatives to “go it alone” when it comes to purchasing utility equipment. Over the past 20 years, the number of manufacturers of electrical equipment has dropped dramatically as a result of a wave of mergers and acquisitions. In roughly that same time frame, consolidation has also changed the world of investor-owned utilities. As a result, the dominant equipment supply companies are finding it easier to shift their attention away from distribution networks servicing many smaller utilities in favor of direct sales to the large investor-owned companies. With the network of independent distributors shrinking, the impact on smaller utilities (and, in particular, electric cooperatives) could be higher prices and delays in timely access to the hardware critical to keeping the lights on.

### The Sourcing Solution

Cooperation among cooperatives has been utilized as a way to procure equipment at reasonable prices since 1936, when the first purchasing and supply organization was founded by electric cooperatives in Wisconsin. But, the stakes are higher today and that is opening new opportunities to utilize the cooperative business model to save money and increase efficiency. This case study focuses on the unique efforts underway at the newest cooperative purchasing and supply organization, which is owned and operated by the Texas statewide

cooperative association (the Texas Electric Cooperatives (TEC)<sup>1</sup>), as a part of its manufacturing and distribution services division. TEC is a national leader in employing strategic sourcing alliances to gain market share for its members, and to create joint venture alliances with national providers of products and services in the utility equipment manufacture, supply, and repair sectors. It has adapted vendor-managed inventory (VMI) practices – introduced into supply chain management at corporations like Walmart and Proctor & Gamble in the 1990s – to the cooperative model to dramatically reduce non-hardware costs for its member utilities.

## Project Background

Until 2001, most of the nation’s electric cooperatives were served by eight cooperative-owned and managed purchasing and supply organizations that had been in business for decades. Their development followed the pattern set by the cooperative group purchasing effort launched in Wisconsin. In 1972, the business started by the Wisconsin statewide had become an independent cooperative business, rebranded as the Rural Electric Supply Cooperative (RESCO). Today, RESCO serves a nine-state territory from Michigan to Montana, and serves not just cooperatives, but municipal and investor-owned utilities as well. In 1995, the eight cooperative purchasing organizations (headquartered in Wisconsin, Kentucky, South Carolina, North Carolina, Georgia, Arkansas, Colorado, and Oregon), formed the Electric Utility Distributors Association (EUDA) to facilitate access to a national inventory of materials and services.

The state of Texas represented a hole in the map of this national network of cooperative purchasing. The Texas Electric Cooperatives had long been in the business of manufacturing utility poles and repairing transformers for their member cooperatives. However, when it came to the purchase of other equipment and materials, TEC had gone it alone, relying on independent and national chain distributors.

In 2001, deregulation (even though cooperatives are not deregulated) had pushed some electric cooperatives to compete for business in a wide range of energy services. TEC saw in equipment supply a long-term diversification opportunity that would retain profits within the cooperative family and reduce the total cost of owning equipment.

Johnny Andrews was hired at the end of the first year of the new venture at TEC. In his previous job with WESCO Distribution (a multinational electronics distribution and services company), he had contracted with several Texas cooperatives for materials supply. As a result, he was well-aware of the challenge facing TEC from a then-strong independent and national distributor network. He also recognized the stark difference between that business environment and the drivers behind the launch of the first eight cooperative purchasing organizations. “In 2001 our distribution co-ops didn’t have the same need that the other EUDA organizations faced when they were formed,” says Andrews. TEC faced a very competitive market. Texas co-ops by and large enjoyed attractive options and many had established strong business relationships with manufacturers and distributors. Success would depend upon an innovative use of the cooperative business model and a willingness to employ business techniques and strategies previously untested by other purchasing cooperatives.

The first years at TEC were slow going. “It was really hard early on,” says Andrews, who is now the chief operating officer of TEC’s manufacturing and distribution services division. “We depended on those early

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<sup>1</sup> Texas Electric Cooperatives represents the interests of 75 electric cooperatives with more than 3 million members throughout the state. TEC serves its members by providing products and services that help sustain cooperative businesses in the 21st century.

adopters, the managers that truly embraced the co-op model who said, ‘we believe in you because we’re co-ops. We’ll help you be successful’.”

South Plains Electric Cooperative, headquartered in Lubbock, Texas, was the first to join. “We believed that if we are a part of TEC, it made sense to do business with our cooperative organization,” says Dale Ancell, general manager at South Plains EC. “But in the beginning, we were not sure that this was going to work out to be a viable option. Existing distributors were not very happy that TEC was getting into the business, and they fought them tooth and nail.”

## Changes That Made TEC’s Sourcing Alliance a Success

TEC faced two major barriers to achieving success in launching a cooperative purchasing and supply venture. One was to win sufficient business to achieve the volume necessary to offer competitive pricing. The second was to quickly develop sufficient expertise in the processes that could allow TEC to deliver on its greatest long-term value – being a cooperative partner rather than just a vendor.

Achieving these two goals was especially difficult in a mature and competitive marketplace for the supply of materials and equipment. TEC focused on two critical approaches to establishing a competitive business:

- **Sole source strategic alliance agreements.** While TEC supplies equipment and materials to any Texas municipal or cooperative utility, it emphasizes signing member co-ops to a sole source alliance agreement, which makes TEC the sole supplier of materials to that co-op and ensures the lowest prices and best service. After a slow start, it has signed 26 of the statewide’s 67 members to an alliance agreement.
- **Adopting vendor-managed inventory practices.** By utilizing VMI processes, TEC brings significant cost savings to its alliance members who sign on for one of two levels of VMI service. In the first option TEC manages a co-op’s procurement process, which includes the use of forecasting technology to manage the flow of inventory. In the second option, called the total warehouse alliance, TEC not only handles all procurement and inventory, it staffs and runs the co-op’s warehouse.

Andrews explains that sole sourcing is critical to TEC’s success and is unique among the EUDA members. “We needed to build sales volume if we were going to compete, and to do that, we needed to be the sole source supplier to as many of our co-ops as possible,” he says.

Employing VMI techniques represents another significant area for cost savings. Co-ops that choose the total warehouse option save an average of 25 percent on operations costs, according to Andrews. By turning over the management of supply to TEC, co-ops eliminate the high costs of handling inventory control on an individual basis. This includes removing the hidden costs of “dead stock” – material purchased and kept on the shelf long before it is needed – as well as the risk of “stock outs” – running out of materials and facing the expense and disruption of resupplying on an emergency basis. TEC plugs the work plans of all its alliance members into its planning software, streamlining purchasing, warehousing, and delivery. As consolidation whittled away the options in electrical distribution and supply, the TEC venture began to prosper. It grew from a sales volume of \$1 million in 2001 to \$100 million in 2008. Significant business with large municipals, such as Austin Energy and CPS Energy of San Antonio, has helped TEC grow to sales of \$224 million in 2018. Today, TEC is the largest distributor of General Electric materials and equipment in the country.

TEC's supply program now protects the interests of cooperatives more than ever. Through mergers and acquisitions, market power has shifted to a handful of very large suppliers including General Electric, Hubbell, ABB, Eaton, and Maclean Power. "It's a huge risk for the cooperatives," says Andrews. "If you are a manufacturer, do you want to send sales people all around the country to call on every little utility, or would it make more sense to focus on the three or four largest investor-owned utilities that represent a huge part of your market?" Andrews points out that the \$1.5 billion EUDA cooperative network can compete with the large IOUs for market share.

Dale Ancell observes that "there has been a pretty drastic evolution from the start to now. We went through some growing pains with TEC, but TEC has become a player in this market. Through sheer size and volume, TEC gets better products now. By buying in bulk, it brings us better pricing. Overall, it's very positive; where they are at now is very effective."

TEC has used the sourcing alliance approach to strengthen the capabilities and output of two legacy equipment businesses owned by the statewide organization. Last year, it entered into an alliance agreement with Pittsburgh-based Koppers, the largest manufacturer of utility poles in the U.S. Koppers is managing and modernizing TEC's pole plant in Jasper, Texas, with a goal of doubling production in a few years. Previously in 2006, TEC entered into a joint venture alliance with the Solomon Corporation of Kansas to assume the operations of TEC's electrical transformer repair division. This cooperative-private corporation venture has led to a tripling of annual revenues in the transformer business.

### Value of the TEC Strategic Sourcing Alliance By The Numbers

Since its inception, Alliance-only customers of TEC have enjoyed:

- **\$763 million** in revenue
- **\$84 million** in total savings, which includes:
  - **\$58 million** in operational savings which includes avoided costs in procurement, warehousing and owning inventory
  - **\$25 million** in capital credits returned to Alliance cooperatives
  - **\$1.4 million** in overtime savings when TEC employees are engaged in emergency response and storm restoration
- Savings of up to **25%** on operations costs

## Why Guadalupe Valley Electric Co-op Became The Newest Member of TEC's Sourcing Alliance

One year ago, Guadalupe Valley Electric Cooperative (GVEC) of Gonzales, Texas, turned over its individual ownership and management of its materials and supplies to TEC, becoming the 26<sup>th</sup> Texas cooperative to join the strategic sourcing alliance.

“When we first considered joining a buying alliance and did the math, we wondered ‘Is this too good to be true?’” says Gary Korn, chief financial officer at GVEC. “We just had our one-year anniversary review of the alliance. It’s working out as good, if not better, than we expected.” GVEC received proposals from six suppliers, including TEC. “TEC stood out,” says Korn, and not just on the anticipated economic return. “As a cooperative, its mindset and culture were aligned with our own.”

At first, Korn says, there was some internal reluctance about the co-op turning over all of its warehouse and supply functions to TEC. A key breakthrough came when the GVEC line superintendents and line crews bought in early during the transition. “That’s been a big piece of the success,” says Korn. “TEC had to get the job done, but our superintendents understood the benefits we were gaining.”

If the TEC sourcing alliance works so well, why haven’t more Texas co-ops joined? “I can’t see why you wouldn’t do this,” says Korn. “Once in, you don’t have to look at adding employees – that’s on TEC. TEC has expanded working hours and added employees at no cost to us. I don’t think that there is anything we talked about wanting from the agreement that they didn’t do. Unlike other companies, they are not trying to squeeze a penny out of you, there is no cut throat attitude. TEC said, ‘anything you did before, we’ll do for you. If you want these widgets turned to the left, we’ll turn them to the left.’ It’s a part of their cooperative attitude.”

Dale Ancell of South Plains thinks that some co-ops don’t want to give up local control, and that they have a notion that turning over purchasing to a third party will cost them money. “We have the opposite opinion. I think that we save money,” he says. “We know how to build a distribution system but I’m not sure that we’re plugged in to the world of buying equipment like TEC is.” Korn believes that a reluctance to change is a factor. “In the co-op world, there can be a tendency to keep doing things the way you’ve done them for the past 70 or 80 years.” But, he thinks attitudes are changing. He says that when GVEC general manager and chief executive officer Darren Schauer, who is respected by his peers, made the move, other co-ops took notice. “They’ve been calling us,” says Korn. “When they find out that our co-op has no regrets, that we have not experienced any ‘gotchas,’ I believe that more of our co-ops are in the process of moving to TEC.”

## What Is EUDA and How it Helps Co-ops Respond to Emergencies

The Electric Utility Distributors Association (EUDA) was formed in 1995 to represent the common interests of the (now nine) purchasing and supply organizations that are either independent cooperatives, subsidiaries of statewide associations or G&Ts, or corporations created by cooperatives to meet the needs of member-co-ops, municipal utilities, smaller investor-owned utilities and contractors.

EUDA members collectively have annual revenues of nearly \$1.5 billion. EUDA provides a national inventory of materials and equipment that any member can access in a time of need. Without EUDA, smaller utilities might face supply shortages during major weather events.

EUDA includes:

- **Rural Electric Supply Cooperative** (headquartered in Wisconsin and serving members in Montana, North Dakota, South Dakota, Nebraska, Minnesota, Iowa, Wisconsin, Indiana, Illinois, and Michigan)
- **United Utility Supply** (headquartered in Kentucky and serving all New England and Mid-Atlantic states, plus Kentucky, Alabama, Ohio, Illinois, and Tennessee)
- **Tarheel Electric Membership Association** (headquartered in North Carolina and serving members in North Carolina and Virginia)
- **Cooperative Electric Energy Utility Supply** (serving South Carolina)
- **Gresco Utility Supply** (headquartered in Georgia and serving members in Florida, Mississippi, Louisiana, Georgia, and Tennessee)
- **Arkansas Electric Cooperatives** (headquartered in Arkansas and serving members in Missouri, Arkansas, Oklahoma, Louisiana, and Mississippi)
- **Texas Electric Cooperatives** (headquartered in Texas and serving members in Texas, New Mexico, and Oklahoma)
- **Western United Electric Supply Cooperative** (headquartered in Colorado and serving members in Utah, Wyoming, Nebraska, Colorado, Kansas, Arizona, Nevada, and New Mexico)
- **General Pacific** (headquartered in Oregon and serving members in Idaho, Washington, Oregon, California, Nevada, Montana, Wyoming, and Alaska).

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