

Partnership Lessons From Defence Procurement

by Richard Wilding and Andrew Humphries

Working within a monopoly is very different from working within a competitive environment. Partners are locked into a relationship with no escape. This can be a marriage made in heaven or, as often is the case, a marriage made in hell.

This paper describes research undertaken by Cranfield School of Management within the Defence Procurement environment, which reviewed 54 monopolistic relationships responsible for £575.8 million of expenditure. It describes the ‘Spirals of Success and Failure’ that occur and the lessons that can be applied to both monopolistic and competitive business-to-business relationships.

Background

The insistence by the Government that partnering arrangements within Defence Procurement should become the norm – rather than the traditional, adversarial, competitive approach – has driven the Ministry

of Defence and its suppliers to review their business relationships.

Pressure to reduce the spending on defence has resulted in the Ministry of Defence pursuing “greater value for money” from the equipment budget. This is approximately £10 billion and is used to fund new projects – such as Eurofighter – and the support of existing equipment, for example, Challenger main-battle tanks and submarines. Initiatives such as ‘Smart Acquisition’, with an emphasis on procurement process improvement and the formation of the Defence Logistics Organisation have become the cornerstones of this policy.



Typical Aircraft IPT Organisation

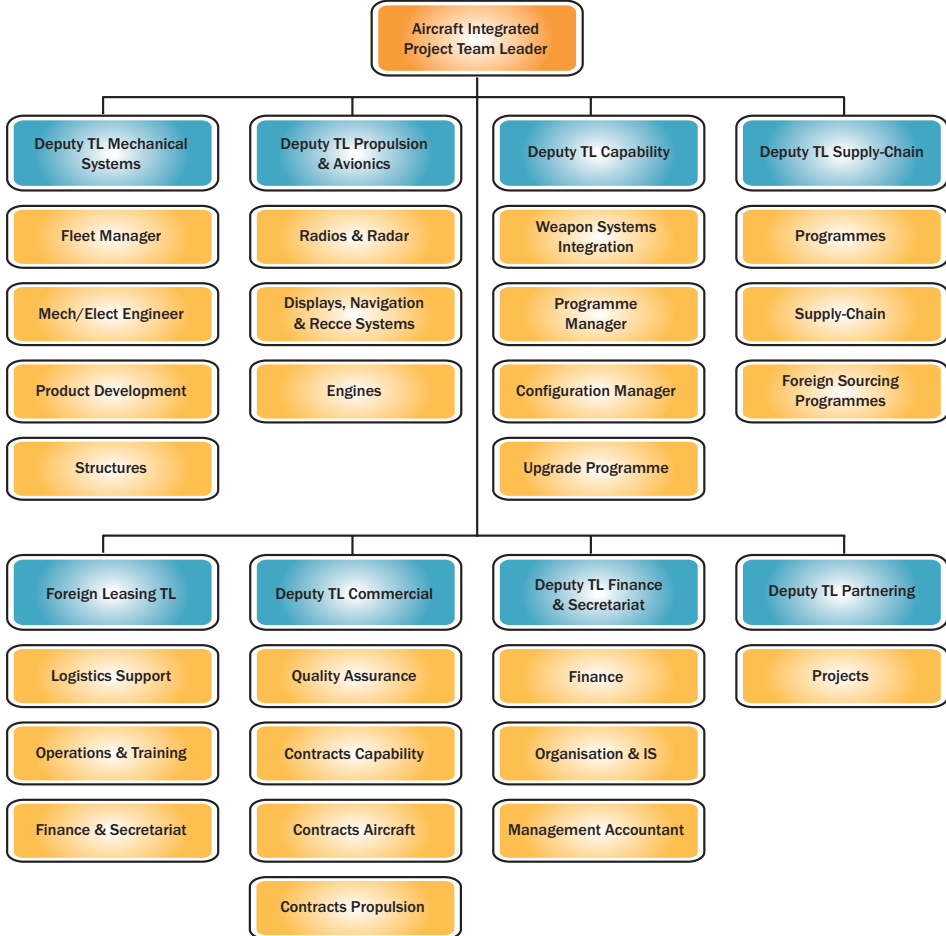


Figure 1

Within the last three years the introduction of 'Integrated Project Teams' (IPTs), which consist of Ministry of Defence and industrial expertise, have been brought together to manage the individual contractual relationships. For example, the Harrier combat aircraft has within its IPT: technical – design engineers, software engineers, safety and configuration managers; finance – management accountants and budget staff; logistics – category and supply-chain specialists; commercial – contract managers. Figure 1, on the previous page, shows a typical, large IPT organisation for a military aircraft. The IPT is responsible for the total, through-life management of the weapons systems, that is, from cradle to grave. Within the Defence environment this cycle could run over 50 years or more; for example, the Canberra aircraft came into existence in the late 1940s and is still in use today. Because of the strategic nature of these relationships there is often no competitive alternative – there is a single buyer and a single supplier, and the arrangement is monopolistic.

The IPTs have the task of delivering business benefits using streamlined processes under the maxim Faster, Cheaper, Better – and using the assumption that partnering will allow them to overcome the adversarial relationships within a defence market containing few competitors. However, despite clear strategic intentions, practical implementation of partnering arrangements has been slow, patchy and clouded by uncertainty over ways and means and it is argued that improvement has been difficult to realise. Furthermore, the fundamental differences of aims by both sides of the buyer-seller relationship appear to make

the selection of common objectives a focus for distrust and treat partnership as just a new way of getting close to the other party in order to take undue advantage.

The National Audit Office's *Major Projects Report 2001* demonstrates the magnitude of the problem. It was found that across all new military equipment projects a 6.6% cost overrun worth £2.6 billion had occurred during 2001, on new product introduction the average project is 29 months behind schedule which equates to additional costs across all projects of £1.38 billion. The report also found that there was a capability shortfall, that is, in 75% of cases the projects were not delivering what was originally specified! In summary, overcoming the problem of balancing monopoly and partnering appears to be a key issue in making 'Smart Acquisition' work.

Monopoly and the Relationship 'Spiral of Failure'

One possible explanation for the implementation problems outlined can be found in economics theory. Economists believe that monopolies are short-term, highly undesirable market aberrations that would normally be dealt with by government anti-trust regulation. However, with Defence Procurement, where monopoly exists, it is in the public interest! Research shows that within monopolies the customers and suppliers generally put up with a mutually suboptimal position. Moreover, without the pressure from a competitive market, they tend to be prone to inefficiency, decay and flabbiness and costs

Relationship 'Spiral of Failure'

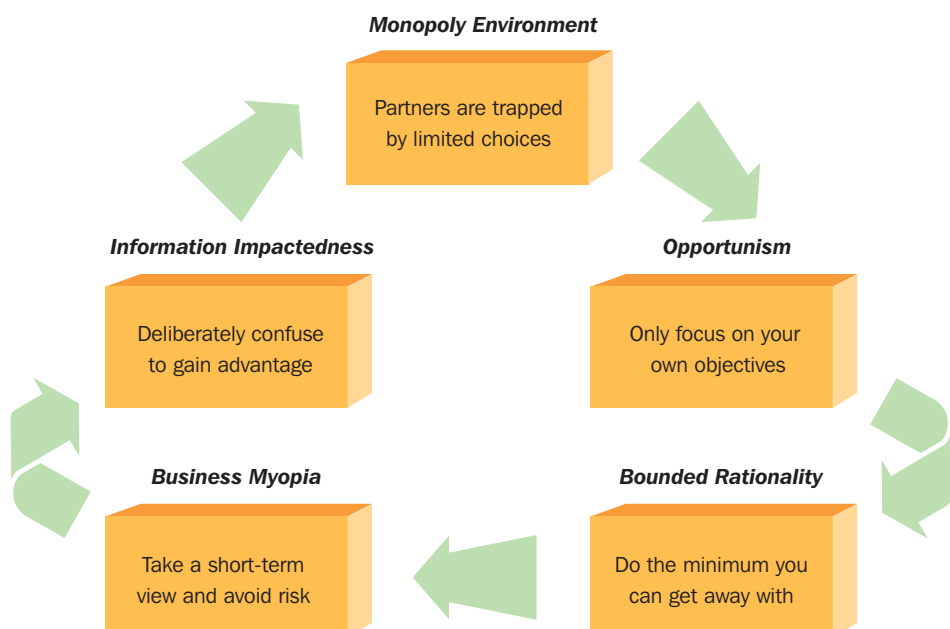


Figure 2

Relationship ‘Spiral of Success’

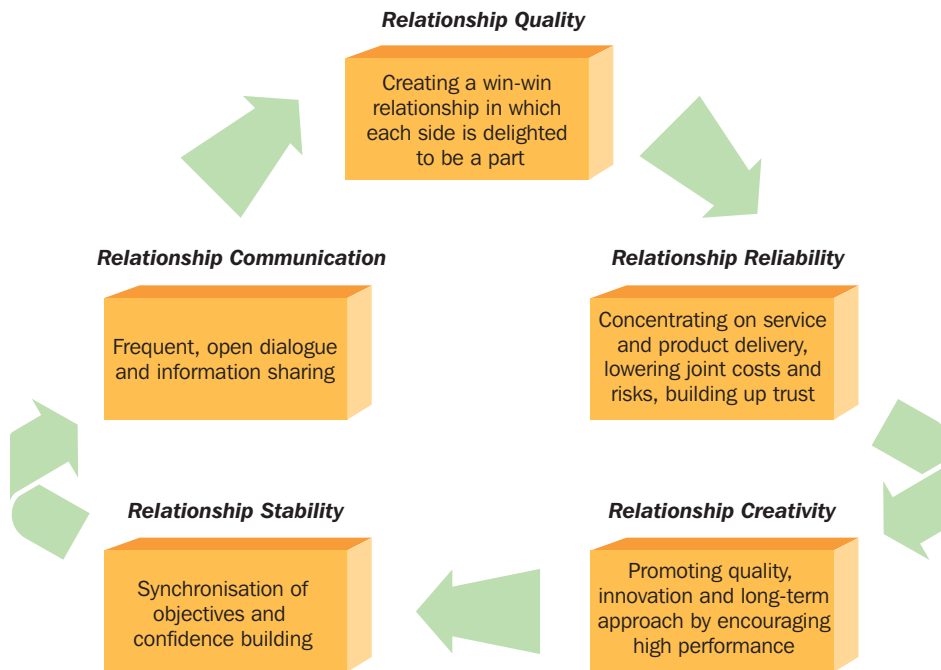


Figure 3

are poorly controlled and service quality is low. However, in a stable monopoly situation the opportunity to escape is not available and the result can be an impasse where both customer and supplier have neither the power nor the motivation to improve the relationship.

Figure 2, on the previous page, shows the monopoly relationship ‘Spiral of Failure’. This stylised view, based upon economic theory, paints a bleak picture, but elements are recognisable within the Defence Procurement Environment.

We start with the ‘Monopoly Environment’. In this situation buyer and seller have limited choices, they are trapped by limited options, neither side is able to leave the relationship and the lack of freedom has a negative effect on managers’ attitudes to trusting the other party and co-operating with them. This leads to ‘Opportunism’ where each party becomes self-seeking, focusing on their own selfish objectives disregarding the other party’s needs. This then causes ‘Bounded Rationality’, when necessary joint activities occur the bare minimum of contribution is made with parties only doing what they can control. ‘Business Myopia’ then occurs, both parties become short-sighted, deliberately taking a short-term, fire-fighting view of the business environment avoiding risks and minimising investment in relationship building activities, for example, product and process development, information systems and people.

Within this environment the only way to gain competitive advantage is to use information as a weapon, often called ‘Information

Impactedness’. Information is used for your own selfish purposes and, if necessary, parties provide ‘disinformation’ to confound the partner. Being ‘economical with the truth’ may also occur in an organisation’s attempt to gain the upper hand. This then leads into a further limitation of options for both parties, further reducing managers’ options and choices creating an even more monopolistic monopoly, thus driving the relationship into a downward spiral.

Monopoly and the Relationship ‘Spiral of Success’

In contrast to the monopoly ‘Spiral of Failure’, relationship marketing and supply-chain management theory provide an alternative and more optimistic, view on business relationships. By addressing key issues within the relationship, a ‘Spiral of Success’ can be created benefiting both parties and subsequently generating a win-win environment. Figure 3 depicts the relationship ‘Spiral of Success’.

The starting point is ‘Relationship Quality’, this is achieved by incentivising a quality relationship with highly rewarding shared gains, where both sides feel the need to strive for the mutual good and equity. This creates a win-win relationship where each side is delighted to be a part. This leads to ‘Relationship Reliability’ where measures are implemented to strengthen the relationship by creating a reliable business infrastructure and focusing on service and product delivery, lowering joint costs and risks and building up trust between both parties.



Having achieved these foundations 'Relationship Creativity' occurs, this is typified by developing a creative approach to conflict and problem solving, promoting quality, innovation, encouraging high levels of customer service and a long term view of the business relationship. When this occurs a natural response is 'Relationship Stability' which includes working more closely with fewer partners, establishing and pursuing mutual objectives, value creation through joint investment and harmonising processes between both parties.

'Relationship Communication' then becomes critical to further success by creating an environment with multiple communication links at all levels between the organisation including key account management, information systems, sharing business and design data, joint agreed key performance indicators and a recognition that a rapid response to the other parties needs is required. This then results in further improvements in the 'Relationship Quality' and the cycle continues driving the relationship in an upward spiral.

From 'Spiral of Failure' to 'Spiral of Success'

The key question for academics and practitioners working in the monopoly environment is how to break out of the 'Spiral of Failure' and move towards the relationship 'Spiral of Success', thus creating a win-win business environment where both parties innovate and create value. To this end the authors, based at Cranfield School of Management, have undertaken a comprehensive investigation into UK defence procurement relationships. This reviewed 54 monopoly relationships between the Ministry of Defence, Defence Logistics Organisation and industry. These relationships spent a total of £575.8 million during the 2001 financial year. The research involved over 100 one-to-one interviews and the completion of over 600 questionnaires by people on both sides of the monopolistic customer-supplier relationship. The focus of the research was to quantify where each relationship was located between the 'Spiral of Failure' and the 'Spiral of Success' extremes.

The research findings revealed a full spectrum of relationship types – that is, failure to success – and, surprisingly, 77% of these monopolies indicated a satisfaction rate of 50% or higher. The underlying struggle to implement supply-chain management principles such as seamless service delivery systems backed by joint planning, clear performance objectives and measurement and freely available data was

detected. Also, similar to open market situations, evidence of sincere intentions outweighed successfully implemented examples. The inset panels in this article – 'The Good', 'The Average' and 'The Bad – and Ugly!' – giving quotations from both sides of three typical business-to-business relationships investigated during the research show the spectrum from success to failure.

The Good

What the customer says...

We have a win-win, five-year, indexed, firm-price contract. This takes the drama out of renegotiations and incentivises quality because rejects come out of profits. The contract contains simple, obvious, open performance measures that were agreed by all including the end-customer. We thus do not have a contract-monitoring team because it creates distrust and adds cost and we can all concentrate on customer service. The same team that did the negotiations now runs the business, so there is an added incentive to get them right. Every month we have a free exchange of data, which includes forecasts of future activity. Interpersonal relationships are excellent; we all know and trust each other. This is a key success factor.

What the supplier says...

We provide a full service at the customer's operating base where we integrate with the military personnel. Transparency between all parties and a simple, framework contract which simplifies our joint operation frees us to encourage one another to achieve higher levels of success. Our partnering arrangement works really well because of the excellent mix of individuals who really work well together. Another important feature is our frequent information exchange but this would be more efficient if it was by electronic means. We all believe we can make improvements in our performance and are working together to achieve them.

Adversarial behaviour, as one might expect to find in monopolistic relationships, such as deliberately withholding information, unrealistic performance expectations, short-termist commercial policies and unco-operative product strategies, were identified. Environmental problems such as old products, obsolescence, staff and organisational upheavals, poor end-customer visibility and lack of investment in modern procedures and systems, seemed to



accentuate managers' frustrations due to lack of freedom of action and promoted the relationship negativity implied by the 'Spiral of Failure'.

The Average

What the customer says...

Their attitude is: "We are world leaders, if you want our products you pay our prices." Although they know full well we cannot source their products elsewhere, the relationship is still amicable. They recently attempted to modernise their business but they are very traditional and there was much in-built resistance to change. Because our organisations are quite small it is important to be realistic with our relationship improvement expectations. They are a bit like us: evolutionary, quality-oriented, resource-capped and not full of management-speak. They are almost fun to deal with!

What the supplier says...

We are a 'static organisation' that hopes the world will change around us. We pride ourselves on the quality of our people who maintain the good relationship with the IPT, but because of our small size we can only do so much. We constantly have to build new relationships with the IPT because of their high staff turnover; this is very wasteful in resources. Although we have done much to jointly set up objective performance measures they are poor at setting priorities and often cancel tasks without notice.

Some quotations, which illustrate the key concerns of managers over money, commercial, staff and performance, are:

Money

"Our fear is the feast and famine situation of defence spending. There are times when we must stop work, lay off experienced staff and then race to get going again. I worry that we cannot respond fast enough and this adversely affects our service to the end-customer."

"Budget constraints in the MOD reduce the relationship to fire-fighting. It's impossible to plan ahead."

"We are about to sign an incentivised contract and if they do well they will get paid more but, I have not got the money. 'Smart Acquisition' is not geared-up for this kind of flexibility."

Commercial

"The biggest obstacle to improving business performance is the Commercial Department. There is a severe shortage of

resources, risk aversion and lack of flexibility, which leads to significant effort and delay in agreeing contracts."

"A major success factor was the unusual combination of commercial staff on both sides who were lateral thinking and open to new ways of doing business."

"They have an air of arrogance – take it or leave it, we are sole suppliers."

"We have built a 'head' of goodwill despite the problems."

Staff

"The regular cycling of staff is not conducive to building long-term relationships that develop sound working practices and innovation."

"By having a member of staff in their team we are able to communicate much better, reduce misunderstandings, and gain a much clearer idea of the plans for the business."

Performance

"There is a gulf in perception between the sides over performance, which also extends to the front line. Without a common understanding of how we are doing and what we must achieve we cannot move forward."

Generic relationship success factors

Our research found a number of generic factors that enhanced the success of the monopoly relationships.

These are described as:

- Innovative commercial practices such as framework contracting, tough but achievable incentives, and meaningful gainshare
- End-to-end, clearly visible performance objectives agreed by all supply-chain players including the end-customers
- Frequent, interactive, open communications across all levels of the customer/supplier interface especially on performance reviews and continuous improvement of products/services and business processes
- Open, no-blame culture aimed at customer and relationship satisfaction which depend upon personal, trusting relationships
- Joint planning and business systems supported by free-flow of information

These issues are not confined to monopolistic relationships alone but are found in successful commercial supply-chain environments.

Generic relationship failure factors

The research also highlighted a number of important factors that promote failure within the monopoly environment. These are:

“These issues are not confined to monopolistic relationships alone but are found in successful commercial supply-chain environments.”



- Lack of stable customer funding arrangements, which prevent supplier investment planning
- Insufficient project investment, which generates long-term costs and prevents performance incentivisation
- Lack of investment in good staff, which causes unnaturally high turnover and prevents personal relationship development and efficient business processes
- Adversarial, bureaucratic commercial practices and attitudes, which increase project costs, cause delays and reduce trust
- Lack of culture-matching results in ‘them and us’ attitudes, which result in a downward spiral of poor behaviour, reduced benefits and low performance

These factors which cause the relationships to fail also have implications for commercial/competitive environments. With a drive towards single sourcing and long-term relationships, it is important to ensure that a self-induced monopoly style relationship is not created where both parties become trapped in an adversarial situation.

Managing Within a Monopolistic Relationship


Recognising that a monopolistic situation is very unusual is key when developing policies and practices. Things that work within a commercial/competitive relationship may have less relevance or a counterintuitive effect within the monopoly environment.

When managing within a monopolistic relationship it is essential to be aware that:

- There is a need to reduce the impact of environmental influences that, due to the limited availability of options for action, cause frustration and generate negative behaviours; this means building an inventory of environmental problems that are normally considered to be ‘unavoidable features of the business’ and seeking joint, innovative ways of dealing with them
- There is a need to take a strategic approach to measuring the quality of their business-to-business relationships so that the best and worst can be identified and targeted action taken
- Within UK Defence Procurement the pattern of results indicates that managers should pay particular attention to synchronising objectives and confidence-building as well as service and product delivery, lowering joint costs and risks and measures to support the growth of trust

- There is a need to accept that the monopoly environment will, inevitably, reduce relationship quality and that examining relationships from both sides, using this information in an open, constructive manner, will facilitate understanding and, therefore, improvement
- Relationship reviews should be repeated, perhaps annually, so that progress may be tracked and corrective action taken as necessary

Summing Up

In this article we have, by illustrating the extremes of monopoly and good business relationships in ‘Spirals of Failure and Success’, shown how we gauged the relative positions of 54 DLO relationships that we examined in a substantial research project. 

The Bad – and Ugly!

What the customer says...

We are under great pressure to reduce our costs but the firm takes advantage of its sole supplier position by overcharging for proprietary items. “Take it or leave it,” is their attitude. We both realise that the only way forward is to partner but the firm has had its own way for so long that it is very reluctant to change. Its ethos is rooted in the past. They drag their feet over product improvements because they know greater reliability will reduce their earnings on repairs. We have regular order progress meetings but they never fulfil their promises or reply to our requests for information. We feel we are making all the moves to improve the relationship but they are not reciprocated.

What the supplier says...

The IPT does not know what it wants so how can we react properly to their requirements. It does not have a focus in its organisation to deal with us either. We offered it a terminal from our system so that it could check progress but its security people turned it down. It provides no information to enable us to plan ahead. The uncertainty makes it hard to concentrate on customer service. I have not even met the end-customer. At the lower levels its staff are not well trained. It is galling to know my people know more about their jobs than they do. When we first got our teams together we put all the issues on the wall and agreed to change the relationship. They seem to have forgotten all their good intentions!

In addition to the findings described, the research process itself was considered to be of great benefit to the team leaders in each relationship pair. At the end of each questionnaire survey a comparative report was presented which, more often than not, revealed factors about the relationship which came as a surprise. In many cases this introduced new items to the agendas of their joint meetings and feedback suggests that reinvigorated relationships have resulted. This is a clear example of where academic research has brought real and immediate benefit to managers.

In Conclusion

The lessons and issues described in this paper are of relevance to all in business-to-business relationships.

With the increasing need to partner in order to gain competitive advantage, lessons can be learned from the defence procurement situation. It needs to be recognised that in any long-term business relationship maintaining the 'Spiral of Success' needs careful and continuous effort from both sides.

If this is not achieved one could rapidly start to slide down the 'Spiral of Failure' resulting in a lose-lose situation for all parties involved.



Epilogue

The authors are hoping to pilot the relationship analysis methodology developed within this research within commercial/competitive environments. If you would like your organisation and some key partners to take part in these trials, please contact the authors.

About the Authors



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