

Partnering in UK Defence Procurement: Myth or Reality

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Abstract

Since the 1998 Strategic Defence Review the Government has reversed its competition policy and now seeks to improve Defence procurement relationships with industry through partnering. The Smart Procurement Initiative intends to improve Departmental processes but, at a time when the Defence industries are concentrating and globalising, substantive relationship improvements are hard to find. The Supply Chain, Relationship Marketing and Transaction Cost Economics (TCE) literatures offer numerous 'recipes' for optimising business-to-business relationships. However, advice on how to undertake successful partnering arrangements within an increasingly monopolistic, Defence industrial market is lacking. This paper presents a review of the literatures and suggests potential areas for research.

Keywords: Defence procurement, supply chain management, relationship marketing, transaction cost economics, monopoly

Introduction

Context

The relationship between the Ministry of Defence (MoD) and the UK Defence Industries has always been a difficult one. With equipment expenditure of £9,803 million in 1999/00 (DASA, 1999), the MoD has immense power as British industry's largest single customer. It can thus determine the '*size, structure, conduct, ownership and performance of the industry through pricing, profitability, technical progress and exports*' (Hartley 1998). On the other hand, industry is a major exporter and contributor to the UK's balance of payments and by extending production for foreign sales ensures that the MoD's equipment unit costs are reduced. It also has a key role in developing strategically important technologies such as aero engines. Lastly, the major companies such as British Aerospace Systems, Rolls Royce, VSEL and Royal Ordnance who are virtual domestic monopolies have considerable opportunity to team with foreign companies to further reduce competitive forces. Thus the relationship between the MoD and its industrial suppliers is dominated by a monopoly market in which each side wields considerable power and where potentially, lack of trust can reduce efficiency and value outcomes (Parker & Hartley 1997).

Against this background, in the 1999 Defence White Paper (Cm 4446, 1999) the Government made a clear statement of policy that its Smart Procurement initiative depends heavily on the concept of partnership in order to reap the benefits of competition and collaboration.

Agenda

The aims of this paper are to articulate the problem faced by the MoD and the UK Defence Industries in moving away from traditional adversarial relationships, to identify some common change drivers from the Supply Chain, Relationship Marketing and TCE literature, to draw out the key relational components from these areas (including concepts from Psychology, Sociology and Organisation theory) and to conclude by offering suggestions for future research.

UK Defence Procurement

Historical Perspective

Superpower politics, nuclear deterrence and the arms race overshadowed the years of the Cold war until 1989 and the clearly defined threat from the Warsaw Pact provided a period of stability for UK's armed forces (JWP 0-01, 1997). The logistics imperative was high readiness using large stockpiles;

cost optimisation was not important. Relationships with industrial suppliers were shaped very much by the political requirement to support domestic companies, R&D and strategic technologies. As a result the British Defence Industry enjoyed good profits through cost plus development contracts and non-competitive, cost-based contracts for production. However, the MoD was not a demanding customer and value for money was low, quality was poor and contracting relationships lacked trust and were epitomised by costly, cancelled projects (HC 138, 1998). The geo-political transformation that followed the fall of the Berlin Wall allowed the Government to refocus its Defence expenditure on less costly, low intensity operations and to reap 'peace dividends' from reduced support costs. Thus between 1985 and 1997 spending on equipment reduced by 40%, by 45% on R&D and Defence Industry employees fell by 50%. Half of these job losses occurred between 1990 and 1995 (DASA 1999) reflecting the 'shake-out' following the end of the Cold War.

The Defence Industries

The impact of reduced spending and the loss of the 'cosy relationship' through increased competition and opening up the market to foreign companies (Hartley 1998) was cataclysmic. The period was characterised by radical downsizing, concentration, and collaboration with other companies and efforts to reduce over-capacity continue to this day (Hartley 1998). In consequence, 'bad feelings' became fixed in the Defence Industry culture and reduced its capacity to enter into trusting contractual relationships.

MoD Developments

Over the last 10 years the MOD has been driven relentlessly by operational, financial and political pressures to become smaller, flatter and more flexible by using out-sourcing, rationalisation, redundancies and stock reduction programmes (Cm 4446, 1999). Unfavourable Public Accounts Committee and National Audit Office reports have driven the pace of change. Measures to increase the number of competitive contracts, to focus on life-cycle costs, to reduce specification rigidity (Cardinal Points Specification), to promote more cost effective operations (Competing for Quality) and to open up defence activities to external funding (Private Finance Initiative) have been initiated. From 1994 the formation of Multi-Disciplinary Groups brought together formerly disparate teams of engineering, procurement, commercial and finance personnel to improve the in-Service support and procurement functions. More recently the Smart Procurement Initiative (HC 138, 1998), introduced the concept of Integrated Project Teams to bring about further process improvements.

Partnering and the MoD

The concept of Partnering that has been acknowledged by the private sector as 'best practice' in managing customer/supplier relationships to provide mutually beneficial results. The MoD has come to the same conclusion because some means of overcoming adversarial relationships within a market containing few competitors is essential (MoD/CBI 1988). However, despite clear strategic intentions, practical implementation of partnering arrangements by the MOD has been slow, patchy and clouded by uncertainty over ways and means. Furthermore, the fundamental differences of aims by both sides appear to make the selection of common objectives difficult and problematic. Overcoming these difficulties is the business problem faced by MoD and its industrial suppliers.

Drivers for Change in Business-to-business Relationships

In the last 20 years strong competitive pressures such as scarcity of resources, increased competition, globalisation of markets, faster change and higher customer expectations (Scott & Westbrook, 1991) have forced companies to search for reduced transaction costs and more efficient, agile processes (Christopher, 1997). A number of solutions have been adopted. Firstly, quality systems, such as TQM, have encouraged 'reverse marketing' starting with the customer (demand driven/flexible manufacturing) and moving back to procurement process efficiencies (reduced cycle times and inventory) (Cavatino, 1992). Secondly, the need to optimise the supply chain has stimulated the use of IS tools and networks and highlighted the importance of supply chain relationships using fewer, key suppliers (Lewin & Johnston, 1997) and co-ordinated processes (Cooper et al, 1997, Christopher, 1992) to build competitive advantage (Wilson, 1995). This competitive advantage includes access to new technologies, information, skills and markets (Ring & Van de Ven, 1992) and, increased capabilities and agility (Wilding, 1999) to provide a wider range of products and services. Moreover, these changes have demanded improved management that realises the importance of customer satisfaction, customer retention and relationships to the firm's performance (Mohr & Spekman, 1994). These competitive and process changes have resulted in organisations migrating from bureaucratic

hierarchies to more decentralised structures in search of increased flexibility. In summary, when allied to a concentrating and globalising trend of business, these factors have produced a dramatic shift from domestic, transactional sourcing to a New Procurement Paradigm based upon global, relational sourcing (Sheth & Sharma, 1997).

Supply Chain Relationships

Supply Chain Management

The concept of Supply Chain Management (SCM) evolved from logistics, which as both a military and a civil concept was largely concerned with efficient internal planning and operational processes (Langley et al, 1992). Relationships did not feature highly because interfaces with external agencies were largely seen as outside the scope. SCM on the other hand, can be seen as an integrative, proactive philosophy (Matthyssens & Van den Bulte, 1994) to manage the total flow of a distribution channel to the ultimate customer – like ‘a well-balanced and well-practiced relay team’ (Cooper & Ellram, 1993). This integrated approach is represented in Figure 1 and the need for closer relationships, including trust, commitment and collaboration between supply chain members to ensure

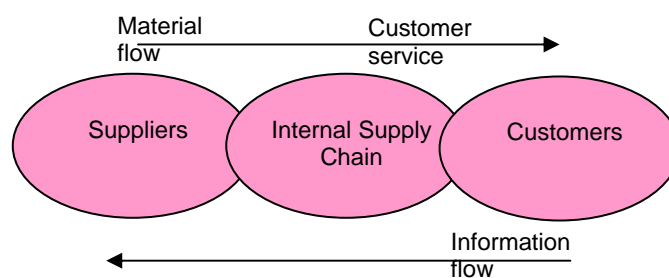


Figure 1. External Logistics Integration – SCM (adapted from Stevens, 1989)

success in these arrangements is clearly inferred (Spekman et al, 1998). Bechtel & Jayaram (1997) extend this concept further and suggest that SCM provides a business environment in which firms closely co-operate rather than compete to achieve mutual goals.

Relational Rather Than Transactional

Because of the management costs involved (Cavinato, 1992), firms select their most critical channels and reduce the number of suppliers in the chain (Ellram, 1991) in order to work more closely and effectively with them over the longer term (Scott & Westbrook, 1991). However, integration of this nature is more than a change of scope. It represents a change in attitude away from the adversarial attitude to one of mutual support and co-operation (Stevens, 1989, Hulme, 1997) and provides a real opportunity to focus on customer value rather than transaction costs (Cavinato, 1992).

Relational supply chain business dealings are given a number of labels. Partnering/partnership sourcing generically are demand-led, integrated, inter-company relationships based on collaboration (Bechtel & Jayaram, 1997, Macbeth & Fergusson, 1994). They are long-termed and focussed on complex, joint problem solving (Hulme, 1997, Olsen & Ellram, 1997). They are tailored business arrangement based on mutual trust, commitment, openness, shared risks and rewards that leverage the skills of each partner to achieve competitive performance not achieved by individual partners (Cooper & Gardner, 1993, Ellram & Edis, 1996, Lambert et al, 1996). Co-makership describes a seamless end-to-end pipeline between the supplier and the customer and emphasises high quality processes and open information flows (Christopher, 1992, 1997, Harrison, 1990). More simply, an arrangement where suppliers and customers are inextricably linked (Spekman et al, 1998, Weinstein, 1992).

Trust is seen as an essential component of successful relationships. Although a complex term, it can be defined as a cyclical process of making commitments, following them through and communicating the results (Cooper et al 1997). It is also fragile needing rapid, clear communication mechanisms to prevent local problems from endangering the relationship. But, it is just as important to build up a culture of ‘do as you say,’ sensitivity, dedication and goodwill (Macbeth and Ferguson, 1994). More specifically at the individual level, ‘Emotional Intelligence’ is important to maintaining standards of honesty and integrity (Wilding, 1999). The literature generally agrees that a significant change in

attitude at the organisational and personal levels is essential to the success of closer supply chain relationships.

SCM in Practice

In concluding this section it is important not to underestimate the practical difficulties in making supply chain partnering work. Most managers and academics are fully aware of the principles of SCM but so often the espoused values do not meet the theory in use (Braithwaite, 1998). Despite the availability of modern information systems, successfully implemented examples are few (Macbeth & Fergusson, 1994, Cooper et al 1997, Spekman et al, 1998). The main obstacle is motivating chain members and company staff by communicating a clear vision of the benefits to be achieved in an environment of great complexity and uncertainty. The key advice is to maintain simple objectives and exercise leadership in carrying them out (Braithwaite, 1998).

Relationship Marketing

Managerial Marketing & Networks

As organisations have migrated from bureaucratic hierarchies to more flexible and decentralised structures and buyer-seller relationships have become less adversarial, the role of marketing within the firm has changed. Initially Managerial Marketing emphasised discrete transactions, planning, control and profit maximisation (Webster, 1992) and the aim was to *preclude killing and stealing* (Dwyer et al, 1987). It thrived in large organisations in the 1970s and 80s and usually operated in an adversarial mode (McDonald et al, 1997). Next came the theory of Industrial Networks which saw pairs of firms in dyadic relationships forming focal, value-added partnerships and, together with a secondary network of other firms, managing the flow of goods and services around a specific market opportunity (Anderson et al, 1994). This offered a first insight into the complexity of business relationships and a realisation that they could be other than adversarial (McDonald et al, 1997).

Interactions & Marriage

The need to find richer meaning in these relationships was explored through the work of the European Industrial Marketing Group (IMP) led by Hakan Hakansson in 1982 (Wilson, 1995, Metcalf et al, 1992, Ford, 1980). They saw complex interactions between firms within networks and measured the degree of closeness of their relationships terming the result 'embeddedness' (Anderson et al, 1994). Beyond the IMP's Interactionist perspective was the Marriage Analogy, which saw building and sustaining customer and infrastructure relationships (McDonald et al, 1997) requiring similar relationship qualities to those in marriage. Here, a firm achieved reduced uncertainty, managed dependence, exchange efficiency and social satisfaction without recourse to law to settle disputes (Dwyer et al, 1987, Moss Kanter, 199, Gundlach & Murphy, 1993). This phase of Relationship Marketing development brought a clearer view of the variety and closeness of many business-to-business relationships and became the precursor of the current New Marketing Paradigm.

New Marketing & Key Account Management

Current thinking reflects the view that all marketing activities are directed towards establishing, developing and maintaining successful relational exchanges. It involves designing and negotiating strategic partnerships with vendors and technology partners through which the firm deploys its distinctive competencies to serve market opportunities (Webster, 1992). The quintessential manifestation of New or Relational Marketing is Key Account Management (KAM) and here, the strategic importance of relationship building and maintenance is recognised by the appointment of senior managers to provide high level expertise and management to this key task (MacDonald et al, 1997).

Relationship Building

The Relationship Marketing Literature clearly underlines the importance of behavioral variables such as trust and commitment (Morgan & Hunt, 1994), co-operation (Axelrod, 1984), co-ordination (Sheth & Sharma, 1997), collaboration (Anderson et al, 1994), long-term orientation (Oliver, 1990), interdependence (Mohr & Spekman, 1994), power (Hatch, 1997), conflict (Eisenhardt et al, 1997), adaptation (Metcalf et al, 1992) and finally communication (Lewin & Johnston, 1997) to building and maintaining successful business-to-business relationships. The table in Figure 2 summarises a number of practical management measures that can be taken in this respect however, important culture changes are also required. There is a need to develop a corporate culture where companies can operate in a climate of trust and openness (Mohr & Spekman, 1994). This might be accomplished

by changing the reward systems which reinforce the behaviours that generate trust, mutual goals and adaption (Wilson, 1995) but, the difficulty of changing the mindsets of staff should not be underestimated (Sheth & Sharma, 1997, Watson, 1999). Finally, although a number of writers note the importance of rich interpersonal relationships (Moorman, 1992, Moss Kanter, 1994, Gulati, 1995) to the growth of trust, it is more pragmatic to

<ul style="list-style-type: none"> • First Generation Partnering: • Agreeing mutual objectives. • Making decisions and resolving problems openly as agree at the start of the project. • Aiming at targets that provide continuous measurable improvements.
<ul style="list-style-type: none"> • Second Generation Partnering: • Develop strategy jointly. • Embrace participating firms fully. • Ensure equity by allowing all to be rewarded on the basis of fair prices and profits. • Integrate firms through co-operation and trust. • Benchmark performance accurately. • Establish best practice processes and procedures. • React to feedback positively and quickly.
<ul style="list-style-type: none"> • Third Generation Partnering: • Understand the client's business and its success factors. • Take joint responsibility for key outputs. • Turn the main processes into a seamless chain of value-adding activities. • Mobilise full partnership development expertise. • Create expert teams and Key Account Managers. • Innovate jointly.

Figure 2. The Three Generations of Partnering (adapted from Watson, 1999)

view these relationships as business partnerships where close personal relationships are not essential and where enlightened self-interest operates such that both press hard for advantage but stay within their trust compact (Wilson, 1995, Kumar, 1996, Goleman 1998). In the final analysis, business relationships depend on a clear understanding of each party's needs and the maintenance of an agreed framework within which to prosecute shared objectives.

Transaction Cost Economics & Relationships

'Make or Buy'

The doctrine of the price mechanism as the key determinant of business survival was overtaken by Coase's (1937) search for realism in economic thinking. He believed that the human and monetary costs of transactions governed whether it was cheaper to do the work in-house or to buy the good or service in the open market. However, as business deals become more extended and the costs of resolving disputes in the courts rise (Macaulay, 1963), a range of contracting options (classical, neo-classical, relational) are used to cope with both the length and depth of business transactions (Macneil, 1980). Economics thus displays a richer view of business exchanges than the simple make or buy approach.

TCE - New Institutional Economics

Williamson's (1975, 1979, 1996) extended these ideas in his seminal TCE theory where the main purpose and effect of a firm is to economise on the cost of transactions including negotiating and enforcing contracts and internal control and management overheads. The incorporation of a series of human variables is used in the Organisation Failure Framework – see Figure 3 - to demonstrate their limitations in complex markets. Williamson (1975) proposed that the reaction to market failure was a shift towards Small Numbers where there are few sellers/buyers (monopoly/monopsony). Although TCE explained the monopoly phenomenon, it was considered as a short-term, highly undesirable aberration to be overcome by market forces (Williamson, 1996). Like Macneil (1980), Williamson (1979) also identified a range of contracting options to be matched to the depth and frequency of

business transactions (Market Governance, Trilateral Governance, Transaction-specific Governance). But, he is clear that efficiency, credibility and reputation based upon calculativeness are the secrets of successful business relations (Hill, 1990) rather than altruistic concepts such as trust.

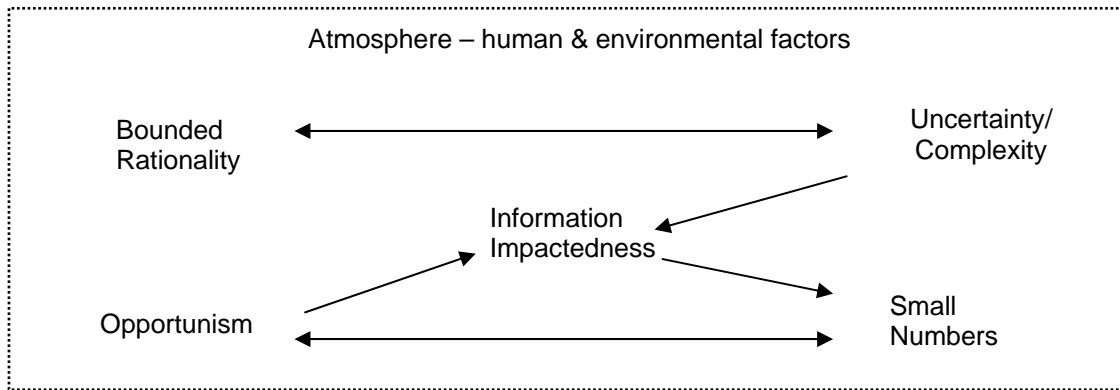


Figure 3. The Organisation Failure Framework (Williamson, 1975)

TCE Theory Developments

TCE’s monochrome view of the economic organisation as an efficiency-driven, market or hierarchy containing calculative, self-interested employees who must be watched and controlled (Ghoshal & Moran, 1996, Granovetter, 1985, Kramer, 1999, Ring & Van de Ven, 1992) does not fit with current, more socially constructed approaches. TCE theory developers believe that employees are more likely to associate with the goals of the firm if they are inspired by higher moral values (Argyres, 1999, Beamish & Banks, 1987, Ouchi, 1980) and if there is trust, then co-operation will be reciprocated (Kramer, 1999). This does not mean that Williamson’s ideas are wrong, it is the difference of putting a symbolic interpretivist/socially constructed rather than a modernist view on TCE (Hatch, 1997).

TCE - Defence Procurement Application

Contract and economic writers conclude that there is a spectrum of economic relationships that range between in-house production and the spot market (Hartley & Parker, 1997, Macneil, 1980, Williamson, 1975). Where either party has disproportionate power (monopoly or monopsony), equivalent to Williamson’s Organisation Failure condition (Williamson, 1975), then the welfare benefits will be unbalanced. This will induce a strong incentive to break out of an unsatisfactory condition and move towards the open market end of the spectrum. However, because in Defence procurement a stable monopoly has been established for the main contracts (Hartley, 1998), the result has been a mutual reduction in power, a lack of incentive to co-operate and the creation of an adversarial relationship without the freedom to look to the market for alternatives (Parker & Hartley, 1997) as shown in Figure 4.

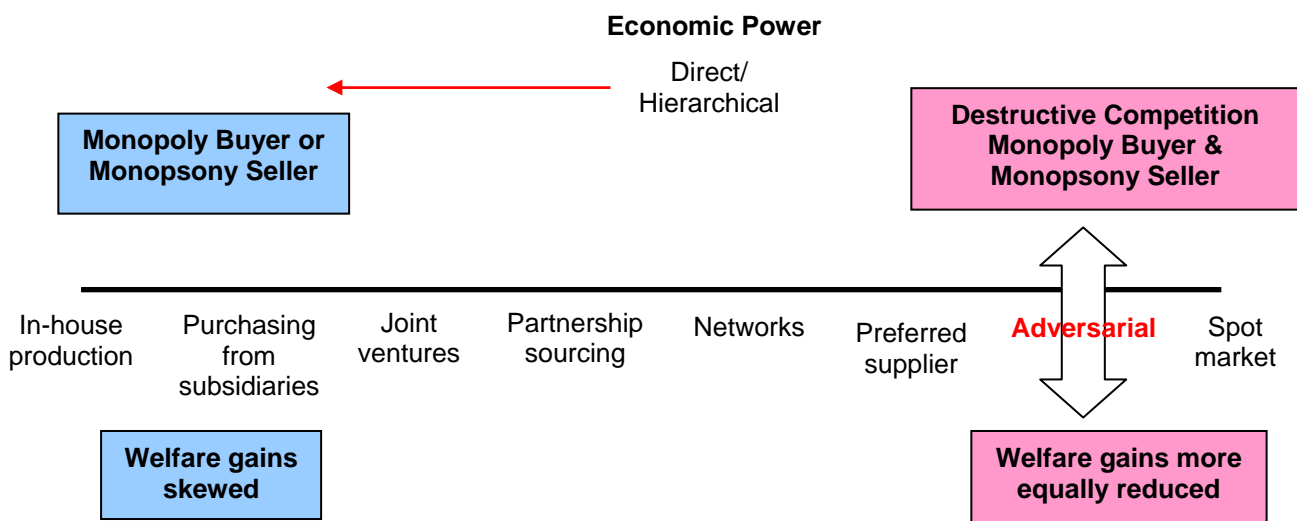


Figure 4. The Procurement Continuum – Monopoly Buyer & Monopsony Seller (adapted from Parker & Hartley, 1997)

Parker & Hartley (1997) propose that in these circumstances adversarial competition should be abandoned and collaboration based on long-term, trusting relationships should be established but, they offer little hope of success because of MoD's poor project management record.

Conclusion & Potential Questions

The literatures reviewed indicate a general drift from transactional to relational business-to-business dealings due to organisational reactions to competitive pressures. There is also considerable practical advice on business relationship improvement but little evidence of successful implementation. Other than within Transaction Cost Economics there is limited theory and overall, the amount of supporting empirical research is thin. Finally, virtually all the literature concentrates on normal market conditions within the commercial environment and excludes the monopolistic aspects of UK Defence Procurement. The following potential questions for further research are therefore:

- Is it possible to translate the supply chain partnering principles from the commercial environment to that of Defence procurement in order to achieve the same efficiency improvement aims?
- Can ideas from Relationship Marketing theory be used to facilitate improved relationships between the MoD and its industrial partners?
- How is it possible to improve sustained economic relationships between the MoD and its suppliers within a monopoly market?
- How can behavioral factors such as trust be used to improve the quality of MoD's supply chain relationships with industry?

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