OUTSOURCING
&
PARTNERSHIPS

The potentials and the pitfalls

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The Partnership Approach

The strategic move away from vertical integration, as well as the cost constraints of the late 80s/early 90s, led to the outsourcing of some of the activities of companies. Included in this outsourcing were activities considered non-core, such as transportation, accounting and administrative functions, as well as the production of key and non-key components.

The Just-In-Time philosophy of having work-in-progress delivered at the right place at the right time revolutionized planning of resource allocation and became a widespread phenomenon. However, dependent upon JITs success was the requirement of close co-operation between client and supplier. The two needed to work as partners if the client was to achieve its operational goals and, along with it, gain possible competitive advantage.

Additionally, the heavy price companies paid in the early 1990s for lack of focus on core competencies in the late 1980s created an inevitable backlash against such excesses as acquiring taxi companies and print facilities, when these were clearly not adding value to the company's drive for competitive edge.

A business' activities can be divided into four main categories, as the table below shows:

TABLE 1. FOUR BUSINESS ACTIVITIES

Category	Reason for outsourcing
Peripheral Providing no source of competitive advantage	Relatively easily sourced from suppliers; minimal risk
Supportive An essential but non-core activity, but failure in this area would cause serious damage to the business	Managers' time and resources better spent on fundamental activities; expertise in maintaining the necessary level of excellence more readily available externally
Strategic An actual or potential source of competitive advantage	Enhanced or better value resources for strategic thinking and capability
Core The primary activity(ies) of the business	None, at least not without considerable contemplation of the costs and benefits

Whilst at first it was such in-house services as catering, cleaning, security, and publishing that were outsourced, eventually it spread to other service sectors such as property and facilities management, information technology and accounting.

It is now estimated that the average number of functions outsourced by organizations has risen 225% (from 1.2 to 3.9) over the past five years and will keep on growing. Leading-edge players are even now asking the question, "Shall we outsource our core activities?" Central to this argument is the possible confusion over core activities (things which are central to what one does) and core competencies (the central things which one does well).

Some are going so far as to outsource their core activities because they believe that by concentrating on what they do best and allowing someone else to bring what they do best (which may be such core activities as treasury management or customer service management), they are able to concentrate on increasing their in-house value-creation.

But such outsourcing programmes can only work through close co-operation between client and supplier. Co-operation that often turns into a more formal style of relationship called 'Partnership.'

Additional benefits

The early close working relationships that were put together through the need to meet the requirements of increased efficiency programmes such as JIT also produced benefits that neither parties might have originally seen. Included in these were:

- Increased flexibility as market forces changed the client's priorities
- Increased commitment to meet the client's goals
- Increased flow of communication and innovation between the two companies
- Less adversarial relationships — resulting in fewer legal disputes
- The development of mutual trust between the two companies
- Increased investment in each other's operations and less business risk, allowing greater capital investment and growth

None of these benefits were originally planned for, however many companies have reported their appearance.

Alliances

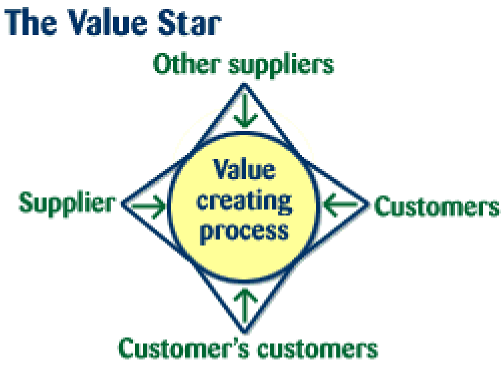
In today's business climate the management of knowledge occupies a prominent place, yet it is seldom possible for companies to acquire full competence in several areas. So many have entered into alliances, both formally and informally. In this way they can concentrate on their core competencies. By collaborating with external partners, companies can achieve greater efficiency, quality and new thinking in a value-creating process.

Value creation and value-added

Traditionally, the concept of value-added has been an accountancy-led one. One definition could be: *a company's turnover minus the cost of bought-in raw materials and services*. However, sometimes a lot of the value accrues from good relationships with suppliers which falls outside of the technical definition. Additionally, the concept of value is now being informally extended to include such intangibles as customer satisfaction, commitment and loyalty, positive emotional responses and brand identity, amongst other things.

So perhaps we can look at value-added as being the outcome of a series of differentiated inputs which provide a benefit, either tangible or intangible, over and above that which would normally occur. These differentiated benefits are often what CEOs are looking for — a way of positively differentiating from competitors and acquiring competitive edge.

The Value Star



Rather than look at the value of a company through the more traditional approach of a value chain analysis, recently the concept of the value star has been mooted in management circles.

The emphasis is on the value that the Customer creates to the product. Do they value it? Do they add to its value in any way?

Findings

What has been found in research is that additional value can be created as relationships are developed and their combined and individual resources mobilized. Additionally, the customers (which in this case can include your company, as you are the customer of your suppliers) are regarded as participants in the co-production of value, rather than remaining passive users. Thus your company is able to directly influence how your suppliers meet your needs. These needs can be both simple — for example the supply of beverage vending machines and supplies — or complex, such as cost efficiencies and reduced complaints from *your* customers (i.e. your employees, internal and external customers).

Two Types of Relationship

This influence can be made to work through two mechanisms:

- Contractual arrangements
- Relationship development

Contractual arrangements can be defined as those relationships where a specification for service has been drawn up, perhaps also including key performance indicators. Additionally, there is normally a set timeframe for the length of the contract, such as one, three or five years.

Relationship development takes the contractual arrangement one stage further, in that both parties set out to work together to improve the provision of services.

Contractual arrangements

Contractual arrangements benefit from a relatively simple management process. The specifications for the provision of products and services are drawn up, sent out to interested parties, scrutinised, further elaborated and a decision made on the eventual supplier. Then monitoring and evaluation of the in-place supplier occurs.

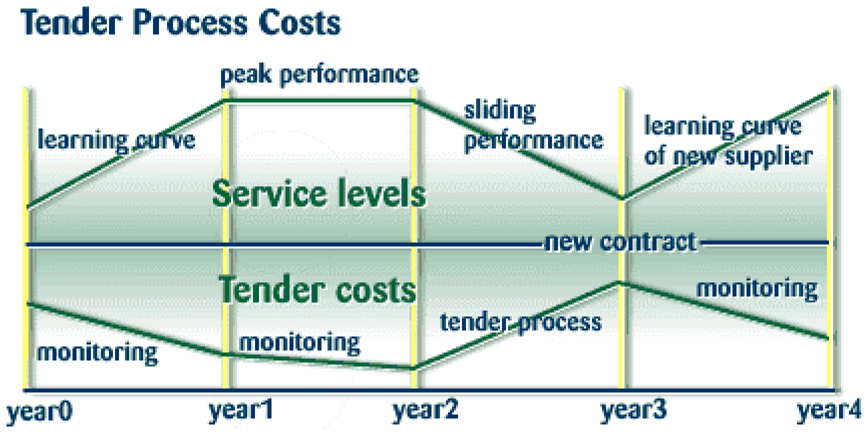
These processes have in-built costs. For example, the average cost of a tender process can be minimum $3,000 per contract, based on a $60,000 per annum manager overseeing the process. Table 2, below, details this cost more clearly.

TABLE 2. TENDER PROCESS COSTS

No. of days	Process
4	Drafting tender, selecting potential suppliers and sending out tender
4	Reviewing returned tenders and arranging presentations
3	Attending presentations
1	Reviewing presentations and making final decision
12	**Cost of $60,000 manager = $3,000**

Similarly, there are monitoring costs. These are less well-defined as, depending upon the supplier, they can be either minimal or rather large. Figure 1 on the next page highlights some of the monitoring and service cost implications in a typical three-year contract.

FIGURE 1. TENDER MONITORING COSTS



Opportunity costs

What often gets overlooked are the opportunity costs that get lost in these types of arrangements. For example, how much money in terms of savings or increased product profitability could have been generated had either of these happened:

- The supplier developed a new product that would either save significant sums or generate significant revenue for both client and supplier
- The supplier and client, in collaboration, thought up new ways to better run and manage old processes, saving costs and generating profits in the process

Not every contract, in its pure old-fashioned sense, takes into account technological developments. Not every contract taps into the creativity of the key players. Not every supplier on a contract wants to freely give away its ideas, its competitive advantage, to a client so that the client can screw a better deal out of another company when it comes to contract renewal/re-tender time. A company can devote so much time to consideration of the financial implications of contracts that it fails to develop its collaborative advantage and thereby neglects a key resource.

Relationship development

Whilst there are many types of relationships, the strongest and closest collaborations are value-chain partnerships, such as supplier-customer relationships. Commitment in these relationships tends to be high, the partners tend to develop joint activities in many functions, operations often overlap, and the relationship thus creates substantial change within each partner's organization.

Additionally, whilst the time-frame of the commitment is usually open-ended, two-way break clauses allow both partners the freedom to dissolve the relationship should either of their priorities change. What is noticed in these types of relationships, however, is the willingness to explore all possible avenues of problem-solving with the partner before the decision is reached to separate. At all stages open and honest discussion takes place at executive levels.

Indeed, successful company relationships very often depend on the creation and maintenance of a comfortable personal relationship between the senior executives. Yet the infrastructure must be in place at the commencement of the partnership that will take into account changes in the line-up of key personnel.

What areas can partnerships be taken into?

One of the main attractions of partnership sourcing is that collaboration can occur in a wide range of different activities — manufacturing, distribution, marketing, R&D, administration, and so on. It seems to predominantly encompass these five areas:

1. **Finance:** Partnership sourcing can markedly reduce the factors that determine total cost. By working with suppliers, organizations can reduce stockholding and lead times. Additionally, partnership sourcing should also ensure that suppliers are paid on time every time.

2. **Research and Development:** Partnerships can provide both parties (or more if a wider-ranging style of partnership, such as multiple partnering, is entered into) with better knowledge of their mutual R&D capabilities. Expert knowledge from both organizations can be shared, for the benefit of both parties. From the supplier's point of view, the longer-term nature of the partnership contract provides the confidence to go ahead with projects that would otherwise be regarded as commercially risky, especially for smaller firms.

3. **Design:** The Japanese automotive and fmcg manufacturers have clearly shown that the input of their suppliers' designers into early design decisions have clear-cut strategic advantages, including greatly reduced product to-market times.

4. **Production:** Improvements in supply chain management and efficiency have been shown by incorporating partnership sourcing practices. Medium- or long-term agreements give suppliers the needed confidence to invest in capital projects, whilst tempering them with the knowledge that they need to keep up their end of the bargain.

5. **Quality:** The depth of relationships generated by the partnering approach makes for a quality approach not always guaranteed by the traditional adversarial contract. Whilst the traditional contractor may wish to keep to specified quality levels, few would pass up the opportunity to 'pull a swift one' over the client and save a few pounds in the process, if they strongly believed that they could get away with it.

Partnership sourcing, when managed properly, creates personal relationships between supplier and contractor — suppliers are less likely to want to short-change a client when they know that they have to keep on seeing them month after month after year. If they lost the agreement through underhand practices, they know that they are saying goodbye to significant revenue. So they are more motivated to ascribe to quality practices and values — after all, it's in their best interests.

The Benefits of Partnership

In every case, a business relationship is more than just the deal. It is a connection between otherwise independent organizations that can take many forms and contains the potential for additional collaboration. It is a mutual agreement to continue to get together, thus its value includes the potential for a stream of opportunities.

Example: Chrysler Corporation

By entering into partnerships with suppliers, the Chrysler Corporation in America (a country with a heavy cultural investment in short-term, purely financial contracts) have reduced their new product development time by 40% — from 234 weeks to 160 weeks. Additionally, by entering into the Japanese-style supplier partnerships (long-term, open-ended, built on trust and honesty) it saved approximately $US75M, or 15% of its total development costs, and $US60M on hard tool costs. Its profit per vehicle has risen from $US250 to $US2,110 in 1994. It's return on assets, once the lowest, has been the highest amongst US car makers since 1992.

SCORE

Additionally, an idea-generating programme called SCORE — Supplier COst Reduction Effort — run with its suppliers generated 3,786 ideas in 1994, producing $US504M in annual savings. As of December 1995, Chrysler had implemented 5,300 ideas that have generated more than $US1.7 billion in annual savings for the company alone. Previously a company known for its adversarial relationships with suppliers, the CEO's message is now, "I want your brainpower, not your profit margins."

Example: ICL

In 1990 British company ICL looked at its relationship with its suppliers. Of the 6,500 suppliers it had on its books, it did 70 per cent of its business with a mere 200 of them. So it set about cementing long-term relationships with its key suppliers via its 'vendor accreditation scheme.'

Rather than being anonymous suppliers, ICL has repositioned them to be 'strategic partners', with these relationships managed by newly-created vendor managers.

Whilst ICL executives have said that the benefits have been difficult to quantify, they have noted that overall quality improvements have cut spending by £160million during the last five years, in part because increased quality from suppliers has enabled ICL to eliminate costly inspection. Additionally, management time has been reduced in overseeing suppliers.

Example: British Airways

In the late 1980s BA identified 300 small companies whose products were strategically important but of relatively low value. As a result it helped two distributors to set up local distribution centres to provide parts for the airline, sourcing from the majority of the other 298 companies. By these distributors acting as the purchasing agent, BA was able to free purchasing and other personnel for more value-adding tasks.

BA reported a number of significant benefits:

- lower costs
- reduced lead times and inventory holdings
- a daily 'jit' service with guaranteed quality
- reduced administration costs through contracting for a service, rather than purchasing individual parts

Additionally, the suppliers were able to enjoy:

- longer term deals
- lowered risk through the certainty of long-term business, and
- expanded levels of business

Example: Midland Bank & Securicor

In the late 1980s UK 'Big Four' bank Midland Bank decided to expand its strategic supplier programme and introduced the concept to its security carrier, Securicor.

Each month managers from both organizations met to discuss operational issues. From these meetings Service Level Agreements (SLAs) were agreed upon. Both companies found that they had to adopt a more structured approach to management information if the SLAs were to be properly monitored.

Additionally, executive management reviews were timetabled twice yearly and an annual strategic review at director level was arranged. These meetings go beyond the normal operational issues and give both organizations the opportunity to discuss not only current business but also outline future plans. Each partner can adapt and co-ordinate their activities to allow advantage to be gained by each other's development.

As a result of this proactive approach Securicor's business has grown — both within Midland and with other major customers and suppliers that Midland have introduced Securicor to.

The lessons seem clear — working in partnership with your suppliers or your customers can be extremely beneficial financially.

So What Makes A Partnership Work?

Assumptions challenged

The characteristics of effective inter-company relationships challenge many decades of Western economic and managerial assumptions. The Japanese model of long-term mutual gain relationships are anathema for many Western strategists. Yet, as we have seen, the benefits are there to be taken. But they should not be treated lightly. Only relationships with full commitment on all sides endure long enough to create value for the partners.

We have identified eight key factors that go to ensuring partnership success.

1. Value

Both partners are strong and have something of value to contribute to the relationship. Their motives for entering into the relationship are positive (to pursue future opportunities), not negative (to mask weaknesses or escape a difficult situation, such as a financial cost-cutting imperative).

2, Importance

The relationship fits major strategic objectives of the partners, so they want to make it work. Partners have long-term goals in with the relationship plays a key role.

3. Interdependence

The partners need each other. They have complementary assets and skills. Neither can accomplish alone what both can do together. Both value what the other can contribute, both to their own organizations and to their customers.

4. Investment

The partners invest in each other (this could be in time or fiscal terms, for example, or mutual board service, cross-ownership or other) to demonstrate their respective stakes in the relationship and each other. They show tangible signs of long-term commitment by devoting financial and other resources to the relationship.

5. Communication

Communication is reasonably open. Partners share information required to make the relationship work, including their objectives and goals, technical data, and knowledge of conflicts, trouble spots or changing situations.

Equally, all parties have considered the implications of ‘letting go’ of sensitive information. There is a danger of giving too much intellectual property away if one of the parties doesn’t commit to the partnership philosophy whole-heartedly.

6. Linking

The partners develop linkages and shared ways of operating so they can work together smoothly. They build broad connections between many people at many organizational levels. Partners become both teachers and learners. Processes are designed and implemented to ensure the accurate measurement of the activity of all of the parties.

7. Formal commitment

The relationship is given a formal status, with clear responsibilities and decision processes. It extends beyond the particular people who formed it, and it cannot be broken on a whim.

8. Integrity

The partners behave toward each other in honourable ways that justify and enhance mutual trust. They do not abuse the information they gain, nor do they undermine each other.

Complexity management

Like all living systems, relationships are complex. Whilst they are similar to manage when they are narrow in scope and the partners remain at arm’s length, relationships like these yield few long-term benefits. Tighter control by one partner or development of a single decision centre might reduce conflicts and increase the manageability of the contract. Many benefits, however, derive from flexibility and being open to new possibilities.

The effective management of relationships to build collaborative advantage requires managers to be sensitive to the organizations’ political, cultural, and human issues. In today’s rapid move to global economics, companies are often known by the company that they keep. Inter-company relationships are a key business asset, and knowing how to nurture them is an essential managerial skill.

How can I help?

From an organizational and management psychologist background dating back to 1995, I am able to help you at all stages of your relationship development programme:

- Selection of partners
- Development of key personnel relationships
- Joint-strategy facilitation and design
- Relationship management — overcoming the obstacles and sticking points that naturally occur when two different organizations work together towards common goals.

My input can be tailored to your specific needs and can dovetail into your strategic programmes.

Caution

I would suggest that any company approach the partnership method cautiously. Inherent in the partnership process is a change of attitude of key line management which, I know from experience, can be a long-term project and is very often not without some pain. The ‘carrot-and-stick’ adversarial method must give way to a less confrontational model.

Issues to consider

There are issues that need to be addressed before you start down the road towards partnership relationships:

- What level and sensitivity of information are you prepared to share with your partners?
- Are you prepared to accept blame? By its very nature partnership sourcing means that the buck can no longer be blithely passed on to suppliers. Both sides are fully accountable
- Is your organization’s culture one of partnership or demarcationist hierarchy. It’s very difficult to create an external partnership culture if one does not exist internally
- Are you prepared to challenge how you manage suppliers? Partnership sourcing involves sometimes significant changes in individual management approaches
- Are you aware of the risks involved in single-sourcing? What if the supplier goes bust or suffers industrial disputes? Siimilarly, suppliers are at risk if they reveal too much about their business to a less than committed partner

- Might multi-cultural factors come to bear? The increasingly internationalist flavour of partnerships sometimes throws up cultural obstacles, slowing the rate at which a close relationship can be built. In one Japanese-American partnership the first five years of their 25-year agreement were negated by cultural obstacles.

Working methodology

In the first instance, I would suggest working closely with you to identify those managers who might more rapidly take up this new way of working. Then in partnership with them I would look at the current contracts and see where possibilities exist for the development of a partnership.

Inviting those key suppliers to a meeting, I would help you outline the new way of working to them and seek their support and shared commitment. We would then agree with these management teams the best way forward and ways that I may be able to assist the development of the relationships.

To close

I know that highly productive partnerships with suppliers work — they work for the employees within those partnerships and they work for the organizations behind them. They bring benefits of increased commitment, loyalty, and trust as well as substantial cost savings. Much as the Japanese companies have enjoyed long decades of close-knit relationships with suppliers and have produced the cost benefits to prove the method's effectiveness, I believe that your company can share in this value-generating process.

I will be extremely pleased to help in whatever way I can.

Should you require further information about the services that I provide, please do not hesitate to contact me on:
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