

July 1994

PARTNERSHIPS

Customer-Supplier Relationships Can Be Improved Through Partnering



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United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-257414

July 19, 1994

The Honorable John Conyers, Jr.
Chairman, Legislation and National
Security Subcommittee
Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we conduct a study of various cooperative, private sector business relationships called "partnerships."¹ Some company officials and consultants used the analogy of a marriage to differentiate a partnership from a traditional business relationship. That is, a partnership among organizations is a relationship that requires an understanding of each other's needs, common goals, commitment, trust, communication, and a willingness to work through problems.

Specifically, you requested that we identify (1) the decisionmaking process for forming partnerships, (2) the practices used in managing these relationships, including the contract terms that govern these relationships and the safeguards needed to ensure accountability and minimize risks, and (3) the benefits achieved from private sector partnerships and the potential for benefits in the Department of Defense (DOD). We also determined whether companies in successful partnerships have common characteristics.

Background

Companies today are facing a competitive environment characterized by global competition, shortened product life cycles, increased customer demands, and technological innovations. The transition from transactional, adversarial business relationships to partnership-oriented, cooperative, longer term relationships is one strategy companies are pursuing to remain competitive in this new environment. We have previously reported that U.S. firms do not have a lengthy history of forming long-term relationships with suppliers, but in recent years some

¹Relationships based on cooperation and mutual benefits are often referred to as partnerships or alliances. These relationships are not the same as a partnership defined as a business firm of partners. Other terms associated with cooperative relationships may focus on the function or purpose of the relationship and include shipper-carrier alliance, shipper-distributor alliance, partnering, logistics alliance, strategic alliance, buyer-vendor partnership, and customer-supplier partnership. This report uses the terms "partnership" and "partnering."

U.S. firms have started developing these closer relationships with major suppliers.²

Companies have become increasingly aware that they cannot do everything on their own, including reducing costs. Therefore, companies are rethinking their business relationships, such as developing closer relationships with strategic suppliers and evaluating the possibilities of contracting out non-core functions. Companies have found that cooperative business relationships improve their ability to respond to the new economic environment by allowing them to focus on their core businesses and reduce costs in their business processes.

Partnership relationships are occurring in all areas of a business, including logistics, manufacturing, and research and development. The companies we visited that had successful partner relationships in a variety of areas were Bose Corporation, E.I. du Pont de Nemours & Company, Eastman Kodak Company, FedEx Logistics Services (a division of Federal Express), Ford Motor Company, Hewlett-Packard Company, Integrated Systems Solutions Corporation (a subsidiary of IBM), Levi Strauss & Co., McKesson Drug Company, and Roadway Express, Inc. In a series of reports on comparing DOD's logistics practices with those of the private sector, we found that building more cooperative relationships with suppliers was an important element of improving logistics management in the private sector. (See app. I for a list of these reports.)

Results in Brief

The decision to use a partnership approach in a business relationship is based on whether the potential partners believe they can benefit from such a relationship and the benefits outweigh the costs. Partnerships are not developed with every supplier and are carefully considered to ensure the factors that can lead to success are present. These relationships require an investment of resources and may not be appropriate for obtaining goods and services, for example, when price is the primary selection criterion. Also, companies that have achieved benefits from partnerships demonstrate common characteristics, including strong top management support, an organizational culture that values cooperative behavior (such as open communications, information sharing, and trust), and a commitment to work toward mutual benefits and longer term goals.

²Competitiveness Issues: The Business Environment in the United States, Japan, and Germany (GAO/GGD-93-124, Aug. 9, 1993)

These relationships, however, can pose risks, such as becoming too dependent on one or two suppliers or complacent in upholding the relationship to its goals and accountability standards, which could result in noncompetitive prices. The companies we visited stated that it is necessary to develop strong management practices to ensure the relationship is meeting its goals and minimize the risks. These practices include contract terms, intensive management involvement, performance monitoring, internal controls, problem solving procedures, and periodic evaluations.

Partnering that has been successfully implemented by some companies has resulted in reduced costs and improved service and quality for both parties. For example, Levi Strauss & Co. developed partnerships with retailers, including Mervyn's department store and J.C. Penney, to solve and prevent transportation problems and cut days out of the order-to-delivery cycle.

Within DOD, the Army Corps of Engineers has implemented a partnering program with its contractors and has achieved improved cost, schedule, and performance goals. Under certain conditions and with appropriate management practices, partnering has potential for expansion in DOD. An April 1994 DOD report by the Military Specification and Standards Process Action Team has recommended the use of partnering in DOD contracts and program management to improve relationships and communication between government and industry.

Companies Evaluate Needs and Goals Before Forming Partnerships

Companies are forming closer, collaborative partnering relationships only when they believe they will benefit from investing in the relationship in terms of reducing cost and improving quality. The process for selecting partners is based on obtaining a clear understanding of the needs and capabilities of the potential partners to help ensure that the parties meet the goals of the relationship. Furthermore, we were told that partnerships were more likely to achieve benefits if partners exhibited certain management characteristics.

Companies Weigh Benefits and Costs When Deciding to Partner

The choice between a partnership and a traditional relationship depends on a company's business strategy and a comparison of potential benefits from a partnership to the investment of time and money. The companies told us that partnering relationships should not be developed with every supplier or customer because partnerships require an investment of

resources. Also, a closer relationship is not always appropriate for obtaining goods and services.

The companies we visited assess the benefits of a partnership by first analyzing the impact of the relationship in the context of an overall business strategy. For example, we were told partnering could help companies streamline business processes and focus on core businesses. A DuPont official suggested that partnerships might be more appropriate for (1) services, such as contract logistics and (2) items strategic to the buyer's goals in which the supplier's input from design to production could add value in terms of cost savings and better quality. Ford Motor Company decided to develop closer, collaborative relationships with its suppliers, since 65 percent of its automobiles is made by its suppliers. With this dependence on suppliers, Ford recognized it would have to move beyond internal improvements to reduce costs and improve quality. Ford's suppliers have been willing to enter into closer relationships to gain a longer term business commitment and the opportunity to increase business with Ford. Bose, a manufacturer of audio products, has chosen to avoid partnerships in its proprietary areas, which are acoustics and electronics.

We were told companies should also weigh the potential benefits of a partnership against the investment of resources needed to form and manage these relationships. When price is the only criterion for purchasing a commodity or service, such as petroleum, we were told that a partnership would not be worth the investment. McKesson Drug Company chose partnership arrangements for a limited number of its suppliers by analyzing its supply base and determining that partnerships with a few strategic suppliers would be worth the extra investment of resources needed for these relationships. McKesson has 2,200 suppliers with 300 providing 80 percent of the business, but the company's closest relationships are with only 25 to 30 suppliers. McKesson's most developed partnerships are even fewer, numbering between 5 and 10. Because these closer relationships address strategic goals by analyzing both McKesson's and its partners' business processes to reduce costs and increase market opportunities, both companies must devote more time and resources to the relationship. For example, senior management officials are usually involved in the decision to form a partnership as well as the management of the relationship.

Partners Need to Be Carefully Selected

Once a company decides a partnership approach would be beneficial for obtaining a particular good or service, the process for selecting a partner

begins. We were told that the process for selecting a partner should be structured to ensure the relationship will meet its intended goals. Some of the selection methods include up-front discussions with potential partners, unique selection criteria reflecting the goals of the relationship, and cross-functional input to the decision-making process.

Some companies have up-front discussions with potential partners to determine whether a supplier will be able to contribute to the goals of a partnership. Hewlett-Packard's logistics division asks its suppliers to provide a proposal rather than a competitive bid, and then they meet with suppliers to develop a clear understanding of Hewlett-Packard's needs and the supplier's capabilities. Some company officials told us that selecting a supplier through the traditional bidding process was not sufficient for establishing a partnership because the bidding process does not allow for discussions that help determine whether the potential partner can satisfy the company's needs. Also, if suppliers have to compete on price, they have no incentive to make long-term investments for the relationship that can lead to reducing costs and improving quality and service.

The criteria used to select partners reflect the needs of the buyer, the capabilities of the supplier, and the potential to achieve benefits. Criteria can range from quality and service standards to more unique criteria such as a compatible corporate culture, business reputation, and willingness to invest resources in the relationship. Hewlett-Packard officials said price was still an important but not the sole criterion. The company also evaluates suppliers on technology, quality, responsiveness, delivery, costs, and environmental concerns. Bose asked its engineers for input into selecting the best supplier for metal and plastic parts and Bose used criteria, such as electronic data interchange capability, for its logistics operations. McKesson selected suppliers based on greater opportunities to reduce transaction costs.

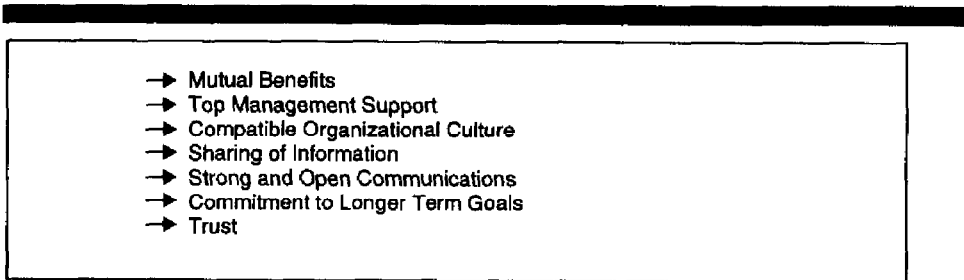
Some companies use cross-functional teams to obtain input from engineering, purchasing, quality, and other relevant departments to ensure the selected partner meets their needs. Ford and DuPont use cross-functional teams to select partners from a quality as well as financial standpoint. The use of cross-functional teams not only helps to ensure that a partner satisfies the company's needs but also increases the credibility of the selection with employees in the field. When DuPont and Roadway Express formed their partnership, DuPont told all of its facilities that Roadway was the transportation provider, since some sites had been using other carriers and therefore might have been more comfortable with

another carrier. A Roadway official told us the importance of the credibility of the decision to choose Roadway had to be clearly evident to get all the sites to work in line with the goals of the partnership.

Companies in Successful Partnerships Have Common Characteristics

We were told that partnership arrangements were more likely to achieve benefits if the partner companies had top management support for partnering, an organizational culture that values cooperative behaviors such as open communications and sharing of information, and a commitment to mutual benefits and long-term goals. Achieving these benefits requires a different approach from traditional relationships. For example, Ford officials told us that in a partnership environment, the customer and supplier work together to reduce costs to lower price rather than beat down the supplier's profit margin. In both the formation and operation of partnership arrangements, companies have to be willing to share information and openly communicate their concerns and needs to achieve the benefits from cooperation. For example, DuPont shares data with its prime pump supplier on why and when pumps fail in the field, which helps the supplier improve its product and service to DuPont. As this behavior occurs and companies can see some mutual benefit, trust among partners grows. Trust, in turn, nurtures further sharing of information and open communications, which lead to further mutual benefits and a commitment to longer term goals. (See fig. 1 for a list of common characteristics associated with partnerships.)

Figure 1: Common Characteristics of Successful Partnerships



Management Practices Keep Partnerships on Track and Minimize Risks

The companies we visited stated that strong management practices, which also provide continuous oversight of the relationship, help to ensure accountability of the relationship and minimize the risks of partnership arrangements. The specific management practices used by companies vary, but generally include contract terms, intensive management

involvement, performance monitoring, internal controls, problem solving procedures, and periodic evaluations.

We were told that the possible risks faced in partnership arrangements included becoming dependent on one or two suppliers and complacency, which can result in noncompetitive prices or reduced quality of product or service. For example, some companies have reduced their suppliers to reduce the costs of interacting with a large number of suppliers and to gain more influence over their remaining suppliers, but they now face the risk of dependence on fewer suppliers. Another recognized risk of these closer relationships is complacency in which one or both partners become lax in upholding the relationship to its goals and accountability standards. Companies are also concerned that these relationships can lead to noncompetitive prices, since the relationship is intended to last for a longer period.

The management practices discussed below and listed in figure 2 help to reduce the risks associated with partnerships. In addition to these practices, some company officials said that a big incentive that helps prevent fraud and abuse from occurring in partnerships is that a company's reputation would be severely damaged if the company has violated the integrity of a partnership.

Figure 2: Management Practices Used in Partnering

- Contract Terms
- Intensive Management Involvement
- Performance Monitoring
- Internal Controls
- Problem Solving Procedures
- Periodic Evaluations

Contract Terms

Companies in partnership arrangements use contracts to guide the relationship and ensure both parties understand each other's needs and goals, rather than to dictate and restrain the relationship. Contracts and agreements that guide partnering relationships last for at least a year, but they more commonly last for a longer period, such as 5 years. Typically, both parties agree to renew the contract as long as the performance and benefit goals are being met.

The form of the contract depends on the service or commodity, and some are more detailed than others. Kodak's contract with IBM for computer support services is only about 11 pages long and contains general guidelines, which allows for changes to occur in the relationship, particularly in the area of information technology. A traditional business contract can be up to 30 pages and contain many contingency clauses and specifications to prescribe action for every conceivable event. Experts and company officials said these more traditional contracts could hinder a partner-oriented relationship because too many specifications could discourage open discussion, which could lead to initiating and making changes that reduce costs or improve quality. However, contracts may contain clauses to safeguard information or resources. For example, FedEx Logistics Services includes a nondisclosure clause in each contract to protect sensitive and proprietary information.

Intensive Management Involvement

Successful implementation and operation of a partner relationship depend on having in place a supportive management framework that includes participation by all parties impacted by the relationship from top management to front-line employees. Most of the companies we spoke with had organized cross-functional teams that may include representatives from the partner organization. These teams, which are similar to the cross-functional teams used to select partners, ensure that all functions impacting a partnership, such as logistics, purchasing, finance, and production, are coordinated to maximize benefits from the relationship. For example, Ford Motor Company's use of cross-functional teams has resulted in Ford's sales personnel providing consumer feedback to Ford's buyers who, in turn, provide this data to the relevant supplier. This kind of exchange benefits both partners by improving the product sold to consumers. The teams may manage the day-to-day operations of the relationship, solve problems as they arise, and address strategic aspects of the relationship.

Top management involvement varies depending on the strategic importance of the concerns that need to be addressed. Because of the importance of a firm's data processing function, Kodak and IBM created a management board that includes top management officials from both companies to oversee their outsourcing arrangement. Roadway Express appoints an executive to each of its partners for the life of the partnership to provide accountability and continuity. In a transportation partnership, Roadway and DuPont have formed an Executive Board that meets three to four times a year, switching the location of the meeting between the two companies to send the message that they are equal partners.

Performance Monitoring

Company officials stressed the importance of having performance monitoring systems to ensure that the relationship's goals are being met, prevent problems, and identify opportunities for additional benefits. Performance measures can include quality checks, service standards, and price and cost comparisons. Kodak and IBM use service-level agreements that establish daily service-level goals, such as number of outages and response times, and these measures are reported monthly to Kodak. Ford monitors its suppliers based on quality standards, price comparisons, and financial condition.

Monitoring the relationship minimizes the risks of dependency on fewer suppliers, complacency, and noncompetitive pricing. Ford has a cost estimating group that compares suppliers' manufacturing costs with manufacturing standards available throughout the industry. Hewlett-Packard checks profit margins of its suppliers by making comparisons with industry averages. Bose periodically checks the profit margins of its suppliers by checking prices in the marketplace against cost information provided by the supplier.

Even though companies face a risk in depending on one or two suppliers for a particular good or service, companies also can better monitor a smaller supply base and identify suppliers with problems. With ongoing monitoring, companies have more time to develop a remedy, such as assisting the supplier or identifying an alternative source. For example, Bose's initial partner for less-than-truckload carrier transportation was facing financial problems and eventually went out of business. Because Bose had a close relationship with the carrier and was well aware of its problems, Bose was able to plan for a replacement without any harm to its business. When Kodak contracted out its desktop computer support services, the company providing these services was facing financial

difficulties and the prospect of new ownership and management. Kodak has responded to this situation by developing a plan for either keeping the desktop computer service with the company under new ownership or soliciting new proposals.

Internal Controls

Internal controls are used to protect information and resources. FedEx Logistics Services has clients that are competitors, so it has created an information system that segregates each client's shipping and inventory data. Companies are selective with the data that is shared and only share data that is relevant to improving the relationship. Bose's continued use of traditional internal controls in its partnerships protects the company from fraudulent or questionable use of its resources. For example, a purchasing requisition requires approval from the user and accounting departments before a supplier is paid for an order.

Problem Solving Procedures

Company officials and experts said problem solving is accomplished faster with less animosity in a partnership. In traditional relationships, a problem created a confrontation that hindered the individual firms in reaching a solution. In the past, distrust was usually due to miscommunication because each company was looking out for themselves, suspecting the other company would take advantage of the situation, and not seeing the impact of the relationship on each other's bottom line. In a cooperative environment, the buyer and the supplier work together to solve problems. A Ford buyer worked with an axle supplier whose poor inventory management caused performance and other problems in a Ford plant. According to a Ford official, this supplier might have been dropped in the past, and the parts would have been resourced without a concerted effort over an extended period of time to correct the suppliers' deficiencies.

Company officials said employees are encouraged to communicate problems as they arise and work toward resolving the problem together rather than pinpointing blame. Furthermore, recognizing a problem and finding a solution are often left to the people directly involved rather than passed on to a third party, unless the problem requires attention from upper management or another department. When Roadway Express formed a partnership with DuPont, they developed a cascading management structure in which DuPont sites are aligned with Roadway sites through teams that work on improving quality. Regional teams receive information from the site teams and try to be the last stop for resolving problems.

Periodic Evaluations

The companies we visited said it was important to periodically evaluate the need for continuing, changing, or ending the relationship because relationships evolve over time and face unforeseen changes in conditions. Companies usually continue the relationship as long as both continue to benefit. Hewlett-Packard conducts annual performance reviews of its carriers in place of rebidding the business every year. Carriers that meet Hewlett-Packard's performance criteria continue their relationship with Hewlett-Packard, whereas poor performing carriers get two opportunities to improve performance before the relationship is terminated. In general, when one or both companies no longer continue to benefit from the added investment needed to maintain a partnership relationship, then the companies may choose either to continue in a more traditional, transactional arrangement or end the relationship.

Partnership Arrangements Can Produce Benefits

Under appropriate conditions, such as an environment of cooperation and strong oversight practices, a partnership arrangement can produce benefits. The companies we interviewed said they had achieved many benefits from their partnering relationships, including reduced costs, improved service, better quality, and increased business opportunities.

We were told that because partnering encourages a better understanding of the costs from interaction among firms and of an organization's own needs and capabilities, a company is better able to gain benefits through streamlining business processes and focusing on core businesses. For example, some company officials and experts said when companies outsourced a function or used a third-party provider for a non-core business function, a partnership arrangement provided significant benefits. A company official told us that FedEx Logistics Services' business was successful in providing broad-based logistics services because it used a partnership approach with its clients. Laura Ashley, a British fashion and furnishing company, and National Semiconductor have handed over their entire logistics operations to FedEx Logistics Services. Both of these companies believe logistics is a business process that could be better managed by a company such as FedEx Logistics Services whose core competency is logistics. Figure 3 contains more detailed examples that companies cited to demonstrate how benefits are achieved from partnership arrangements.

Figure 3: Examples of Companies Achieving Benefits From Partnership Arrangements

<p style="text-align: center;">Eastman Kodak Company</p> <p>Kodak has been able to focus on its core businesses by outsourcing its data processing function to IBM. Kodak has achieved cost savings through reducing personnel and reducing assets and capital expenditures by shifting the construction and maintenance of its computer center to IBM. To create a partnership orientation, Kodak supplied the land for the computer center. IBM benefits from using the relationship with Kodak to build a new business enterprise in computer support services.</p>	<p style="text-align: center;">Ford Motor Company</p> <p>A clutch supplier for Ford was losing 5 percent on an old clutch but had to keep the price down to win Ford's business. Since Ford changed the way it works with its suppliers to a more cooperative approach, it invested time and effort with the supplier using value engineering to reduce the supplier's costs by 20 percent. In the past, a Ford buyer would have required a lower price that would have cut into the supplier's profits, and neither firm would have benefited from reducing costs. With the use of this partnership approach, Ford was able to maintain one of its preferred suppliers and help to ensure a quality product.</p>
<p style="text-align: center;">Levi Strauss & Co.</p> <p>Levi Strauss & Co. implemented an Account Partnership Program to work closer with its customers to improve the order to delivery cycle. The program has allowed Levi's and its retailers to better understand each other's business processes and work together to reduce costs. Levi's has learned that when it ships items in a manner inconsistent with the retailer's requirements, it not only costs Levi's in terms of claims but can also incur costs for the retailer. For example, a retailer's distribution conveyors may not accept the size of box shipped by Levi's, forcing the retailer to disrupt its process to receive Levi's shipment. With this knowledge, Levi's can make changes to satisfy the retailer's needs. As a result, the goods are not delayed in the retailer's distribution network and are made available to the consumer sooner.</p>	<p style="text-align: center;">E. I. du Pont de Nemours & Company</p> <p>DuPont has substantially reduced the costs of purchasing maintenance and repair supplies from \$120 to \$16 per order by working closer with fewer suppliers and implementing a paperless order, receipt, and payment process. DuPont was paying a high transaction cost for the purchase of these items because it was using numerous suppliers and distributors, with some suppliers involved in 20,000 to 30,000 transactions per month. DuPont now deals with just one distributor in each region in a partnering relationship. This approach has not only reduced transaction costs but has also resulted in decreased inventory by 50 percent at its maintenance and repair facilities.</p>
<p style="text-align: center;">McKesson Drug Company</p> <p>McKesson Drug Company worked together with one of its major suppliers, Johnson & Johnson, to reengineer the order process. As a result, McKesson receives better service delivery from Johnson & Johnson, which, in turn, helps McKesson provide better service to its customers. The reengineered process allows McKesson to place orders every week. Both partners benefited from reducing costs in the system; for example, backorders were eliminated, and the number of transactions were reduced by about 75 percent. The success of this initial joint project led McKesson and Johnson & Johnson to jointly develop a computer system linking both companies together. Johnson & Johnson is now able to manage its inventory better because it receives inventory, point of sale, demand, and customer information electronically from McKesson. As a result of the financial savings achieved by working together more closely, Johnson & Johnson turned over millions of dollars in distribution business to McKesson.</p>	<p style="text-align: center;">Bose Corporation</p> <p>Bose Corporation has taken partnering one step further by working with its suppliers to eliminate buyers and sales personnel and bringing supplier personnel directly into its plants. The supplier representatives have access to Bose's data, employees, and processes. They are empowered to make purchases directly on Bose's purchase orders and to work concurrently with Bose engineers on projects that involve their company's products. Bose's benefits include reduced personnel and material costs, improved communications and order placement, and a consistent quality level. The supplier's benefits include reduced personnel, increased business volume, and more secure business in the future.</p>

Benefits of Partnering Demonstrated in DOD

We identified two examples in DOD in which a partnering relationship or characteristics of a partnership appeared to be beneficial: the Army Corps

of Engineers partnering program and features of the Fleet Ballistic Missile program identified in our 1990 report.³ An April 1994 DOD report by the Military Specifications and Standards Process Action Team has suggested the use of partnering in DOD contracts and program management to improve relationships and communication between government and industry.

The Army Corps of Engineers has adopted a partnering approach to improve its business relationships with contractors. Implementing partnering in the Corps has not required any changes in government regulations. The Corps issues requests for proposals that specify that the Corps would like the project to use a partnering approach, but partnering is not a contract requirement. A dollar threshold does not dictate whether the project will be a partnered project, and not every project uses a formal partnering approach. However, the Corps has a policy to develop, promote, and practice partnering in all construction projects and to apply the concept in all other relationships, such as internal relationships and relationships with professional societies.

If the winning contractor agrees to the partner concept, then the Corps and contractor take steps to build a partnership environment that encourages open communications and sharing of information. Usually one of the first steps is a 2- to 3- day meeting at which all those involved with the project come together to (1) agree on roles, responsibilities, and objectives; (2) identify critical issues; (3) develop an action plan, including procedures for dispute resolution; and (4) develop a partnering agreement that everyone signs. The Corps uses a joint questionnaire filled out every 3 months, throughout the duration of the project, by the contractor, the Corps, and the end customer to catch problems.

The Army Corps of Engineers believes it is changing its culture from an adversarial setting to an environment in which contractor and government employees openly communicate problems and work together to find solutions. (See fig. 4.) The Corps has reported that projects under the partnering program have succeeded in (1) reducing cost growth, (2) reducing claims and avoiding litigation, (3) reducing accident rates, and (4) encouraging contractor suggestions to change the requirements that can produce cost savings and prevent future problems.

³Defense Acquisition: Fleet Ballistic Missile Program Offers Lessons for Successful Programs (GAO/NSIAD-90-160, Sept. 6, 1990).

Figure 4: LTG A.E. Williams, Commander, U.S. Army Corps of Engineers, Policy Memorandum 4, March 31, 1993

"Because partnering develops positive and mutually beneficial relationships, it creates a climate characterized by trust and cooperation. It creates a relationship between two or more parties and promotes teamwork. Partnering seeks to eliminate the 'us' versus 'them' mentality, and to form a 'we' approach for the mutual benefit of the project user, the taxpayers, and the contractor."

Several features contributing to the success in meeting cost, schedule, and performance goals of the Fleet Ballistic Missile program are similar to the characteristics and practices associated with private sector partnerships. Particularly, a long-term view and open communications, characteristics of private sector partnerships, were found to be features related to the success of the Fleet Ballistic Missile program. The program's management emphasized a long-term view because the program office was responsible for supporting the system after design, development, and procurement. Long-term performance incentives in the contract reinforce the long-term view. Open communications meant that a problem was recognized and addressed rather than hidden and that progress was regularly reported to upper management in DOD and the Congress.

The Fleet Ballistic Missile program established a good working relationship with the contractor by (1) using the same prime contractor for more than 30 years while promoting extensive competition at the subcontractor level and (2) devoting considerable time and effort in negotiating the incentive structures for the contracts to force the program office to sort out and quantify program objectives and priorities. Contractors were encouraged to make the needed tradeoffs during their development and design work to achieve performance or production incentives during later stages of work. Other management practices used by the Fleet Ballistic Missile program that are also present in some form in private sector partnering are (1) regular internal evaluations, (2) on-site management representation in field offices at its contractors that report monthly to the project manager, (3) team orientation to problem solving, and (4) top management involvement in significant program changes as well as problem solving sessions as needed.

An April 1994 DOD report by the Military Specification and Standards Process Action Team recommended, among other things, expanding the use of partnering in DOD contracts and program management. The report describes partnering as a concept that is built on trust, teamwork, and timely communication between the government and the contractor. Components of the partnering concept include creating an environment that (1) encourages the government and contractors to work together toward the common goal of providing quality equipment and services in a cost-effective and timely manner and (2) allows the resolution of contract and program problems before they reach the level of conflict, dispute, and litigation.

Scope and Methodology

To understand why and how partner relationships are working in the private sector, we reviewed literature on partner relationships. We also discussed the procedures, benefits, and risks associated with partnering and examples of partnering experiences with 8 academics, 5 consultants (see app. II) officials from 10 companies, and 1 or more of their partners and the Army Corps of Engineers. The organizations selected were cited in the literature or by the experts as having successful partnerships and do not represent a scientific sample of all organizations that have successful partner relationships.

We performed our work between April 1993 and March 1994 in accordance with generally accepted government auditing standards.

We plan no further distribution of this report until 30 days from the date of this letter unless you publicly announce its contents earlier. At that time, we will send copies of this report to appropriate congressional committees; the Secretaries of Defense, the Army, the Navy, and the Air Force; the Director, Defense Logistics Agency; the Director, Office of Management and Budget; and the academics, consultants, and company officials that commented to us on partnerships. We will also make copies available to others on request.

Please contact me on (202) 512-8412 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink, reading "Donna Heivilin". The signature is written in a cursive style with a large, stylized initial "D".

Donna M. Heivilin
Director, Defense Management
and NASA Issues

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Abbreviations

DOD	Department of Defense
IBM	International Business Machines

Prior GAO Reports on Best Management Practices

The following are prior GAO reports that mention partnering as a best management practice. A summary of the reports' findings and an excerpt from the report that highlights the use of cooperative, partnering relationships is provided.

Commercial Practices: Leading-Edge Practices Can Help DOD Better Manage Clothing and Textile Stocks (GAO/NSIAD-94-64, Apr. 13, 1994).

The Department of Defense (DOD) continues to store redundant levels of clothing and textile inventories throughout its wholesale and retail system, and for much of this inventory there is 10 years of supply on hand. This is significantly different from practices used in best managed private sector firms. Competition has forced private sector firms to cut costs by moving to "just-in-time" inventory concepts that help keep inventories low, turn stock frequently, and fill orders quickly while maintaining good customer service. Further, many private sector firms and some federal agencies with uniformed employees are relying on prime vendors to manage their clothing inventories.

"Just-in-time and quick response . . . feature tightly integrated supply chains . . . Information is shared throughout the chain, sometimes extending all the way to suppliers and carriers. The success of companies using these philosophies depends on the responsiveness of both their suppliers and carriers. This pushes them to develop closer, longer term, and, to some extent, interdependent relationships with suppliers. These relationships become more like partnerships than traditional buyer-seller arrangements." (p. 29)

Defense Transportation: Commercial Practices Offer Improvement Opportunities (GAO/NSIAD-94-26, Nov. 26, 1993).

Commercial shippers have integrated their transportation functions with the entire logistics process, limiting the number of carriers they use to those that provide high-quality service at a competitive price, expanding the use of information technology, and contracting out certain logistics operations. DOD has acknowledged that it can benefit from transportation practices performed in the commercial sector and has made some progress in improving transportation management.

"Shippers are establishing 'core carrier' or 'preferred carrier' bases to reduce costs while improving service. Shippers that we talked to believed fewer carriers improved their ability to monitor and provide the stability and leverage needed for better carrier relations." (p. 13)

Defense Inventory: Applying Commercial Purchasing Practices Should Help Reduce Supply Costs (GAO/NSIAD-93-112, Aug. 6, 1993).

DOD's replenishment formula used to compute optimum order quantities for secondary items is not conducive to today's business operations because it is based on some assumptions that are rarely met, such as constant demand. Private sector companies are using alternative purchasing methods such as quick response. Even though DOD's reasons for holding inventory differ from that of private sector companies, it must find a balance between inventory depth and supply cost. Commercial replenishment strategies offer better opportunities for DOD to meet this balance.

"Company officials said that the shift to alternative purchasing methods depended heavily on the cooperation of suppliers. Companies share inventory data with suppliers and actively orient them to company operations so they can better match production to company needs." (p. 6)

Commercial Practices: DOD Could Save Millions By Reducing Maintenance and Repair Inventories (GAO/NSIAD-93-155, June 7, 1993).

DOD can reduce maintenance and repair inventories by adopting commercial practices, such as the use of supplier parks and direct delivery programs. These practices could reduce unnecessary inventory requirements at military industrial centers and eliminate the need to store supplies in the Defense Logistics Agency's depot system.

"A key step in developing new inventory management practices is to establish mutually beneficial agreements and close relationships between suppliers and users. The users entrust the suppliers with control of the inventory management function by sharing key inventory data, such as a history of the demand for items and usage patterns." (p. 24)

DOD Food Inventory: Using Private Sector Practices Can Reduce Costs and Eliminate Problems (GAO/NSIAD-93-110, June 4, 1993).

The military food supply system, which is generally outmoded and inefficient, offers the opportunity to achieve cost savings by using private sector food distributors. Many of the costs DOD incurs for holding, handling, and transporting large quantities of food are unnecessary because the existing network of private sector full-line distributors can supply food to DOD much more efficiently. Because of heavy competition

within the industry, distributors have a financial incentive to cut their costs, keep their prices low, and provide excellent customer service.

"In response to this competition, distributors must be extremely cost conscious and responsive to their customers in order to stay in business. Achieving these goals depends in large part on lowering inventory levels and developing a cooperative relationship with end users." (p. 24)

Organizational Culture: Techniques Companies Use to Perpetuate or Change Beliefs and Values (GAO/NSIAD-92-105, Feb. 27, 1992).

An organization's decision to change its culture, the underlying assumptions, beliefs, values, attitudes, and expectations shared by an organization's members, is generally triggered by a specific event or situation, such as a change in the world situation or severe budget reductions. It usually takes a company between 5 to 10 years to make a complete cultural change and involves using a combination of many techniques. The two key techniques are top management commitment and training that promotes and develops skills related to desired values and beliefs.

"Ford stressed creating an atmosphere of partnership with its suppliers and its automobile dealers [to change its organizational culture]." (p. 4)

DOD Medical Inventory: Reductions Can Be Made Through the Use of Commercial Practices (GAO/NSIAD-92-58, Dec. 5, 1991).

DOD's health care system can save millions of dollars by increased use of inventory management practices pioneered by leading civilian hospitals. These practices include standardization of supplies, electronic ordering, and just-in-time and stockless delivery programs.

"Manufacturers and distributors of medical supplies have also changed their operations in response to rising health care costs. They are working with medical facilities to provide better services, including new distribution practices that minimize inventory costs. One civilian medical center official has characterized these new practices as requiring a 'partnership' between the center and the supplier with the common goal of better patient care at lower costs." (p. 10)

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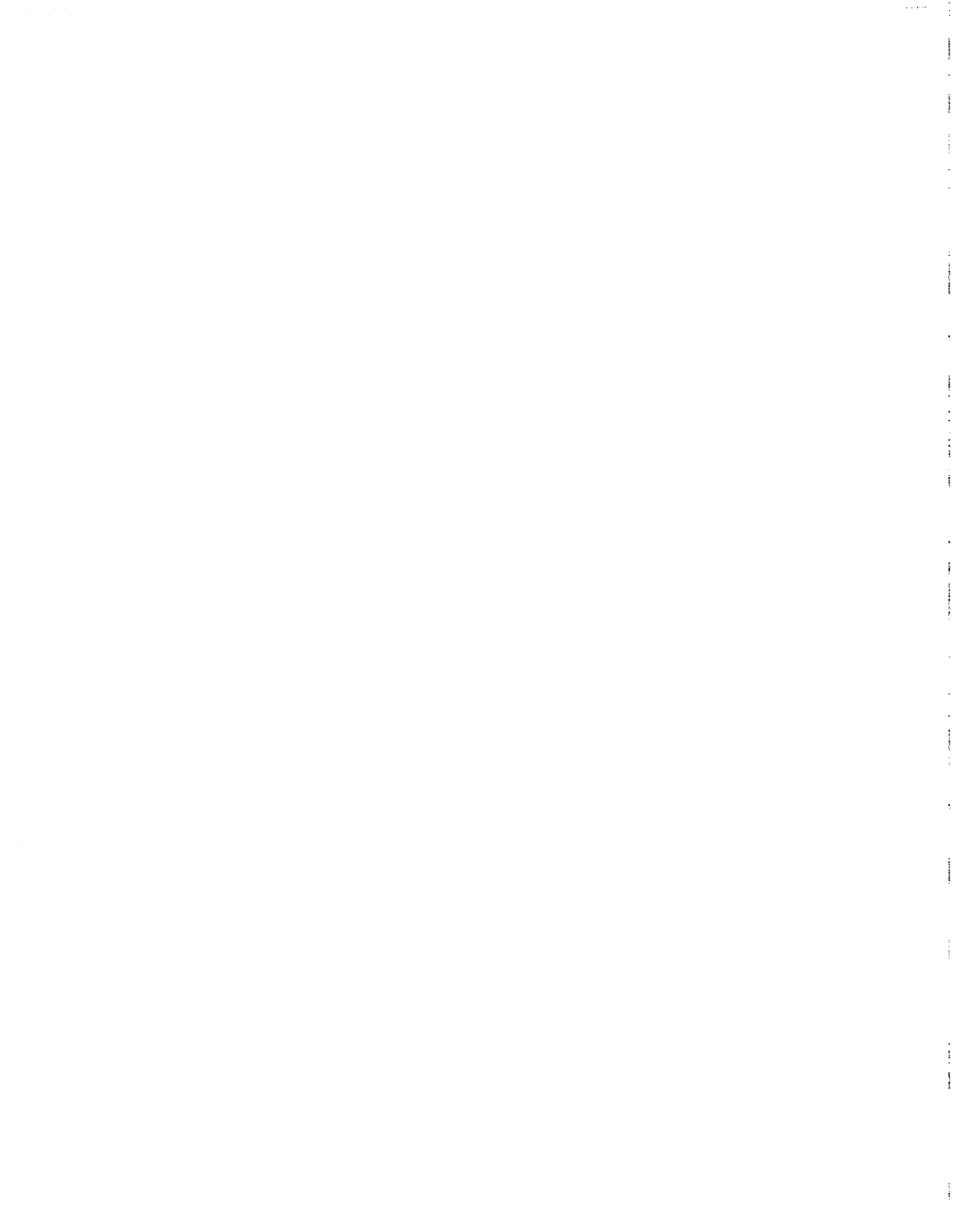
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