Best Practices in the Formation and Implementation Of Strategic Alliances

Jay D. Anderson  
Supply Manager  
Technical Purchasing  
BASF Corporation

Gail Kutin  
Supply Manager  
Technical Purchasing  
BASF Corporation

Howard A. Hill  
National Manager  
Strategic Industry Sales  
Cutler-Hammer, Inc.

Abstract

With the objective to reduce their "total cost of ownership", major corporations are making significant changes in traditional purchasing practices. Whether for raw materials, MRO goods, engineering design services, or capital equipment, they are developing and implementing supplier partnerships, many of which take on the name and structure of a strategic alliance.

Increasingly, top management at large manufacturers and engineer/constructors have come to believe that reducing their supplier base, and thereby increasing the relevance of the relationship between themselves and the remaining suppliers, will achieve their goals of lowering overall costs while improving service and quality.

Encouraged by consultants and supported by case studies at a number of business schools, company executives have declared that their purchasing departments will pursue strategic alliances as another element in a growing effort to change “business as usual” mentalities within their companies.

This paper reviews the rationale for the formation of a strategic alliance between a major industrial manufacturer and a supplier of engineered electrical products. It focuses on the internal processes that were developed to change the culture within both organizations, and the methods of implementation which help insures success in meeting the goal of reducing the total cost of ownership.

Introduction

In early 1995, a major electrical equipment manufacturer and a multi-national user company opened discussions on a unique new idea for supplier and customer relations. Discussions of a potential strategic alliance broke new ground for both companies. Over the ensuing two years, much has been learned about the implementation of the process. Today, this relationship is considered to be both successful and growing in value for both partners.

This paper describes the philosophy which customer and supplier partners have grown to share during the course of the implementation of our alliance, as well as our common objectives for the future, as we move forward to mature and improve our relationship.

Change as a Business Imperative

The concepts of focusing on the right issues, having a willingness to change, and realizing the great importance of speed and agility in today's business world, are keys to a successful alliance implementation. This philosophy is the underpinning of the strategic alliance. The changing relationship between supplier and customer represents a significant departure from the old way of doing business.

Change is a part of doing business in the 1990's. It is what prepares us to deal with the competition that we all will face as we move forward into the 21st century. In fact, change is really a business imperative for those who want to be competitive in the future.

Someone once offered this definition for insanity: "Doing what you've always done and expecting different results."

Suppliers and customers need to find different ways of doing business, because today's competitive pressures demand different results.

This changing environment in the supply management area has been an evolutionary process.

- Traditional customer and supplier relationships had been adversarial in some cases, based mostly on price with no guarantee of a continuing relationship.
Moving up the evolutionary scale, the pricing agreement essentially establishes competitive prices for the supplier’s product, but again, with no mutual investment or long-term commitment to purchase on the part of the customer.

The blanket agreement extended this commitment through some defined time period, so that both pricing and a commitment to purchase became a part of the contract.

The strategic alliance carries this pricing and commitment to a higher level. There is a mutual dedication on the part of both customer and supplier to lower the total cost of installation and ownership for the customer by effecting change in both organizations. At the same time, there is a mutual understanding that maintaining good suppliers as partners means keeping price levels attractive enough to allow reasonable profits under changing cost environments.

### Types of Alliances

Alliances normally fall into 3 categories.

- The **MRO product alliances** are usually distributor agreements for integrated supply or individual commodities.

- Engineering alliances are being formed by many large industrial corporations with engineering design companies, engineer/constructors, and architect engineers. This enables the user customer to optimize his own engineering force to meet his needs for operation and upgrading the facilities without having to maintain a large staff in anticipation of major project work.

The engineered product alliance typically includes partnerships with manufacturers for electrical power distribution and control, as well as process control and other major equipment types.

### Attacking the Total Cost Issues

Regardless of the type of alliance, the singular objective of a strategic alliance is to lower the customer's total cost of installation and ownership. This is the hallmark of a true alliance, where both customer and supplier work together towards this goal in a pro-active and aggressive fashion.

To properly attack this situation, the real elements of total cost must be well recognized. Total cost can be considered in five categories:

- The first category considers the product life cycle costs such as length of service, maintenance, and replacement.

- The second of these categories is process failure costs including cancellation charges, price premiums, expediting, lost production, equipment downtime, special inspections, and duplication of resources among others.

- The third category relates to processing costs. These fall into 3 categories and they include design, quality, and logistics. In the area of design, these include the cost of the design, testing and the installation. Quality issues relate to scrap, damage, and warranty, while logistics include such things as material handling, inventory and obsolescence.

- Procurement costs are another significant element of total cost. These include supplier certification and development, proposal and quotation work, purchase order processing including contractual terms, accounts payable, materials management receiving, inspecting, and value engineering.
• And the last category making up the total cost of ownership is the **supplier's selling price**.

Recognizing that there are many categories of costs is an important first step in the alliance process. Also important to realize is that the supplier's selling price or probably better said, the *difference* among the selling prices from the various suppliers, really represents a small percentage of the overall potential for cost reduction.

Experience has shown that in an alliance, the supplier's price may vary a few percentage points depending on volume and other considerations, but other "hidden" costs represent a potential for **double-digit percentage improvements** in the total cost of ownership.

**Rationale and Decision Process for Implementation of Alliance**

Initial top management buy-in and support was obtained by making a formal appropriation request to the Executive Committee for initiation of a three-year project in Supply Management. The project rationale included anticipated savings and necessary costs for implementation. A conservative 5% savings estimate for ongoing yearly business was used as a basis, with implementation costs estimated at a single digit percentage of cost savings.

Results achieved so far with the three Supply Management steps of Consolidation of the supplier base; Optimization of products specifications and customer/supplier processes with the remaining suppliers; and Innovation through enhanced supplier relationships, bolster the expectation of yearly ongoing savings reaching 20%-30%, with an ultimate vendor reduction exceeding 75%.

After the initial three-year project appropriation period, Supply Management was incorporated as an ongoing feature of the Technical Purchasing Department’s budget and strategic plan.

To ensure a successful implementation, the Technical Purchasing Department formed a cross-functional team with Engineering. Both departments’ Vice Presidents were chosen as co-leaders for the Supply Management initiative. In turn, this leadership team had regular contact and mentoring support from three members of the Corporation Executive Committee, and met regularly with a Supply Management Council comprised of Director or higher representatives from each operating division to discuss strategic direction and issue resolution.

Technical Purchasing was reorganized along commodity supply lines and began to develop and recruit personnel with the necessary skill sets to affect the change to Supply Management. Under this scheme, Supply Managers have become the principal stewards and contacts for each supply stream commodity, such as “engineered electrical equipment”, and report upward in the hierarchy to the Supply Leaders responsible for major supply stream clusters such as “Equipment”.

**Implementation**

There are several initiatives that can aid in reducing procurement costs, processing costs, and process failure costs. Two areas where the partners have worked closely are:

• Establishing the **alliance manager** as a new position within the supplier organization.
• Establishing an **alliance process** for the implementation phase of the alliance.

The supplier’s alliance manager performs a key role in the success of the ongoing relationship. A strategic investment was made in dedicating an alliance manager to this relationship. His responsibilities include coordinating the communication with many factory personnel who design and engineer the various elements of the electrical distribution and control systems.

Dedicated factory personnel in each major product line can improve their individual efficiency and accuracy as they take advantage of the learning curve in engineering multiple projects for the same customer.

The alliance manager also coordinates among the many sales engineers that serve both the headquarters and various plants within the customer’s operations. Over 40 plants in North America are covered by 25 sales engineers. Providing the same level of service at each location is a challenge for the alliance manager. He performs the key role of communicating and maintaining that consistency of coverage.
The second key element in a successful alliance is the **process** itself. This process consists of four unique steps. They are **commercial**, **communication**, **teaming**, and **implementation**. It has been developed together by customer and supplier. Both partners recognize that it matures and evolves over time, as together we learn more about what works and what doesn't.

The **commercial** aspects of the alliance are typically the up-front work pursued by supplier and customer. Once the mutual decision has been made to pursue an alliance, earnest efforts are made to draft an alliance agreement which includes: the purpose of the alliance, a mutual commitment toward process **streamlining** and other cost cutting measures, and a series of metrics or measurements of the **progress** of the alliance.

General conditions of sale are basically **terms and conditions**. The exercise to arrive at long-term, mutually agreeable terms in itself represents a major effort, but is also a major contributor to lowering the cost of both companies in a multi-year, multi-project contract.

Detailed pricing agreements and price adjustment mechanisms must be developed which allow the supplier and customer to be comfortable that changes in market conditions will be reflected in equipment pricing.

The second step in the process is **communication**. This is certainly one of the key elements in the pursuit of a successful alliance. **Recognizing that both the supplier and customer organizations will resist the changes** that are required by the alliance process, communication becomes critical to the ultimate success of the alliance.

Therefore, **rollout programs** are developed for both supplier and customer plants. For the **customer**, these rollout sessions are held for stakeholders at each plant, the headquarters, purchasing, and engineering.

In the **supplier** rollout meetings, the supplier and customer management visit supplier plants to review the details of the alliance with product line, plant, and manufacturing management. This insures that each of the parties involved with supplying equipment under this contract will be aware of the importance of the alliance to the customer, and that the corporate goals of the supplier are tied to the success of the alliance.

In addition to these formal presentations at customer and supplier plants, efforts must be undertaken to broaden communication channels at the executive, management, engineering, R&D, and commercial levels.

As the strategic alliance moves forward, **teaming** becomes a critical item if change is to be implemented in the processes that affect total cost.

The formation of an **alliance steering committee** appears to be the best mechanism to ensure that process improvement opportunities are identified and pursued with enthusiasm.

The alliance steering committee includes both customer and supplier representatives. It should be a cross-functional team such that purchasing, engineering, and other disciplines are included as appropriate. The steering committee is probably
best sized at about six to eight people. They have the responsibility for the overall direction and success of the alliance. They need to meet at least quarterly through the first 12 to 24 months after signing the alliance agreement.

The formation of a local alliance team at each plant is recommended. The local team consists of the local sales engineer, the local distributor representative, and the local service representative. The customer's membership to the local alliance team includes both plant purchasing and plant engineering. The formation of a local alliance team is critical to the success of an alliance since this team is on the front line when it comes to implementation of change. They are also in the best position to recommend the priorities for those items of process improvement that should be attacked first. Active involvement from the local alliance team therefore becomes important to the success in the implementation phase of this process.

Implementation of the alliance may be simply stated as, “the proactive involvement of both supplier and customer personnel in process improvement activities”. The organization of those activities falls under the responsibility of the alliance steering committee. Committee members are empowered to create various action teams which are applied in an ad hoc fashion to assure that issues are raised at both the national and the local plant level.

Typically, several process improvement opportunities are uncovered in the area of purchasing and engineering. New teams to attack new issues are formed as required and staffed from the appropriate disciplines in both organizations. In all cases, there is a proactive pursuit of continuous improvement, and that needs to be the primary objective of all teams formed under the alliance steering committee.

Summary

The objective of the alliance process is to lower the customers total cost of installation and ownership. The benefits of these activities can include:

- Process streamlining to reduce purchasing and engineering costs
- Value engineering
- Design for installation and start-up
- Accuracy and quality of manufactured products
- Shorter lead-times
- On-time deliveries
- Joint development of new technologies
- A continuous improvement culture

The key for activities in all these areas is that both supplier and customer recognize that this is accomplished through a mutual investment in time and people resources. The idea of mutual investment is where the real strength of a strategic alliance is felt. Supplier and customer working together as joint owners of a process that delivers quality at the lowest possible overall cost, will reap the rewards of continuous improvement.

Currently there are several joint initiatives under way in the area of process streamlining and continuous improvement.

- Working with the customer's other alliance suppliers to eliminate costs of duplication in the interface with their equipment, and to improve the reliability of the overall system through simplification and streamlining.
- Developing techniques for predictive maintenance using the embedded measurement and communication technologies that the electrical equipment manufacturer has pioneered.
- Expanding the use of electronic data interchange or EDI media for purchasing functions, drawing transmittals, and other communications.
- Expanding the use of personal computer resident pricing, configuration, and engineering tools that the customer can use for estimating and designing the
preliminary phases of new projects.

- Obtaining customer’s direct input into the design phase of new products via focus group activities and beta site installations to bring the right products to market for industrial process customers.

- Promoting an environment of continuous improvement using both the national and local alliance teams as vehicles to implement that improvement to the benefit of both partners.

It is believed that the strength of a successful alliance rests on three elements. First, the **products** available from the supplier must be reliable, of high quality, state of the art, and constantly being improved through a significant investment in research and development.

Second are the **people** involved in the alliance. They must be competent in their discipline. In addition, there must be an element of trust and flexibility that is second nature to each of them. There must also be a team mentality in their approach to work. There is little room for big egos in the alliance process.

The last element of the alliance platform is the **process** itself. A major element in the process is a mutual commitment to continuous improvement. This must be built into the process and emphasized continually. In addition, the willingness for both customer and supplier to invest in the time and the people resources is crucial since without that time and without those people, the alliance process cannot continue and be successful.

**Conclusion**

It is clear that the strategic alliance is not "business as usual" for either the supplier or the customer. There must be a willingness to embrace change in the way we do business.

Earlier, *insanity* was defined as "doing what you've always done and expecting different results". It is clear that pursuing the same old paths produces the same old results and that is definitely not what a strategic alliance is all about. It is also clear that for both the customer and the supplier, we are treading on virgin territory in many cases. We need to be both patient and willing to work together to find the best solution to each one of the situations that we encounter along the way.

Alliance partners must believe in the basic alliance philosophy and be willing and able to fulfill the mutual commitment to work together in a very proactive and enthusiastic manner. Through this process trust and respect grow, and the success of the alliance is assured.