

# Development and challenges of partnering in public-private relationship

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## 1. Background

Public sector organisations are more intensively considering collaboration with private companies in developing public sector operations. This is also the case in Finnish Defence Forces (FDF). FDF started a so-called partnership programme about ten years ago and it has some interesting outcomes. The basic idea of the programme has been to find out the possibilities of using private companies in production of supporting services.

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Partnering in the public sector and in services are both considered challenging. Integrating these two is mentioned being “mission impossible” (Bryntse 1996). Even though partnering in defence forces context is also challenging, there might be significant potential to develop the processes without endangering the basic task of defence forces.

## 2. Goal of the paper

The purpose of this paper is to discover the development of two partnership programme areas at FDF and to consider potential challenges for more intensive partnering. First, we go through the decision-making environment in general, and second, more specifically the development of partnering in two cases. We try to find out challenges for more intensive partnering inside FDF and in its external environment. As a result we get a more profound understanding of potential challenges in public-private partnering attempts, and also in other areas than researched here. The case study methodology is used in the study, and we go deeply through two partnership programme areas: 1) food supply and 2) repair shop activities. Data includes interviews and written material available about the cases. Data gathering interviews were done during the years 2003 and 2007. Research could be structured as a longitudinal case study, as the studied cases have been observed over the mentioned time period.

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## 3. Relevant theory

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Related theory come, from the fields of transaction cost economics (Williamson 1975, 1985), discussions in IMP group and purchasing literature. The organizations failures framework (Williamson 1975, p. 40) is used in analysing the specific problems in public-private context. This framework includes bounded rationality, uncertainty/complexity, information impactedness, opportunism and small numbers. These factors are the reasons behind transaction costs and affecting also to partnering structures since different relationship structures have different transaction costs. Also, the determinants of exchange orientation presented by Sheth and Shah (2003) are useful in analysis. These are industry structure, decision-making culture, decision-making structure, tolerance to risk, nature of purchase and transaction costs. Make-or-buy decisions are the basic question in management decision-making, and thus related theories to supply strategies are reflected in this study, as well. Specifically, the buyer-seller interaction model (Campbell 1985) is used in analysing the relationship characteristics in the chosen partnering areas. Cambell's model (see Figure 1) includes 1) product characteristics, 2) buyer's characteristics, 3) supplier's characteristics and 4) interaction process.

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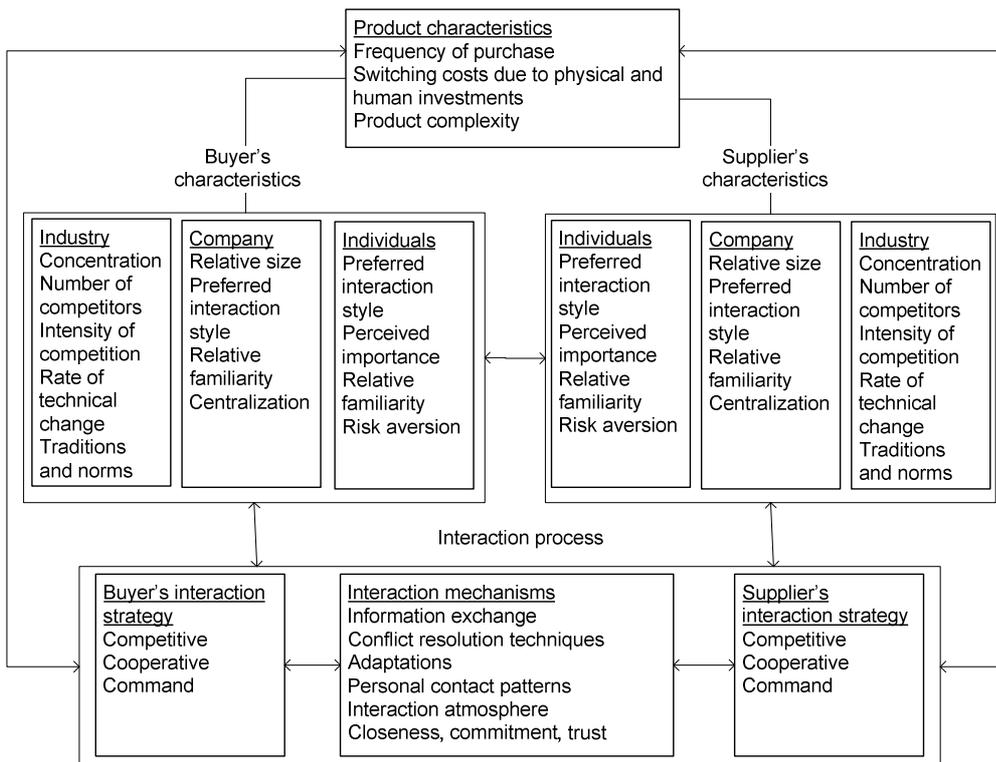


Figure 1. Buyer-seller interaction model (Campbell 1985)

Typical theory in collaboration, transaction cost economics (TCE) (Williamson 1975 & 1985), concentrates on the existence of the so-called transaction costs as a reason behind different ways of organising economic activity. These costs are the reason for creating firms. Transaction costs are results of searching, negotiating and contracting with potential partners. This theory is expanded for analysing different forms of collaboration and a continuum from hierarchy to market is introduced. Between the market and the hierarchy, there are different forms of collaboration (e.g Webster 1992).

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Transaction cost theory has been adapted in public private partnerships (PPP) in several studies (Smyth & Edkins 2007; Zitron 2006; Essig & Batran 2005). So-called transaction difficulties are especially useful when analysing collaboration. Six factors causing transaction difficulties are: 1) bounded rationality, 2) opportunism, 3) uncertainty and complexity, 4) small numbers, 5) information impactedness and 6) asset specificity (Williamson 1975).

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A basic assumption (and reason for the existence of PPPs) is the poor performance of the public sector, which is regarded as being bureaucratic and therefore inefficient and expensive (Nisar 2007). By partnering with companies, efficiency and cost reductions are pursued. Grimsey and Lewis (2005) describe three ways in which PPPs can achieve greater efficiency. First, it may resolve agency problems, which arise due to the divergence between ownership and control, and are easier manage in the private sector through managerial incentives and market disciplines. Second, the transfer of risk to the private sector provides an incentive for private entities to maximise efficiency. Third, resources are more efficiently allocated in cases where clear markets for property rights are established. Proper innovative partnering means that private sector management, commercial and creative skills are in use (Nisar 2007).

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The phrase Value for Money (VfM) is frequently stated. This means that by partnering with private companies, current level public services can be produced at lower costs, or better service quality could be achieved at the current costs. In theory this is easily achieved, but in practice there are several obstacles to estimate or assess, if value for money is really to be achieved. The problems of assessing VfM have been studied especially in the UK (Grimsey & Lewis 2005). PPP experiences are from short term; the true test of value for money is realised in the long term, and there seem to be many uncertainties whether VfM will be achieved or not (Grimsey & Lewis 2005).

Several possible benefits, such as cost efficiency, better quality and lower risks, from PPPs' are often mentioned, but these are not easily achieved. It has been claimed that public sector reforms require more market-driven incentives and microeconomic control mechanisms (Essig & Batran 2005). Still, in many cases the proper use of these mechanisms is difficult, and public procurement is controlled by strict legislation (Public Procurement Act 2007) and operational rules. According to Hurst and Reeves (2004) write that one key problem in getting value for money in PPPs is that private sector innovation is not, after all, delivered. Clifton and Duffield (2006) have adapted the alliance principles in PPP context in order to find appropriate governance structure. One problem in PPPs is that private companies are rarely interested in low impact, small investment opportunities (Nisar 2007). This is one critical issue and has been studied by Zitron (2006), who points out that the decision-making of private sector bidders has to be understood. In many PPP cases there are too few acceptable bids to be able to make good PPP contracts (Zitron 2006).

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The fairly short history (beginning from the 1980s in the UK) of PPP attempts in different countries show great potential, but may result in really poor decisions. It is surely important to understand the role of risk management in the process of evaluating both possible options to be outsourced during the relationship-building phase, where the efficiency goals should be met. In PPP and outsourcing, there are several people and organisations that act really pessimistically because of change resistance, etc. Risks are emphasized by Lawther & Martin (2005), Spackman (2002), Grimsey & Lewis (2002 and 2005), Loosemore (2007), Medda (2007) and Alonso-Conde et al. (2007).

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Smyth & Edkins (2007) adopt a relationship view of PPPs in the British context. Their message is that relational contracting and relational management should be of great importance in PPP projects. Critical relationships should be found, and trust should be built within these relationships. The study also finds that there may be some special characteristics likely to result in problems between public and private parties.

Theories about partnering, and outsourcing development and success, are also relevant to our topic. Doz & Hamel (1998) describe the phases in alliance development as well as possible paths and characteristics for success (Figure 2). The success is a widely studied subject (Mohr & Spekman

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Kelly et al. (2002) have studied the early stages of collaboration in alliances. They found out four themes were the problems usually were found:

- People / relationship issues involving problems related to communication, culture and roles
- Operations issues involving problems related to the technical details of implementation, e.g. technology transfer, scheduling etc.
- Strategic agenda issues or problems concerning the goals and objectives of the venture
- Results or problems related to the performance of the venture.

Mentioned lists can be analyzed also, in our case, in Finnish Defence Forces.

#### 4. Research method

Our research can be categorized as a case study (e.g. Yin 1994). The data has been gathered in in-depth interviews among case organizations. The data is gathered in two research projects during the years 2003 and 2007. In both projects we made ten interviews at key persons in partnership issues. Approximately half of the interviews in projects were made to buyer side, e.g. Finnish defence forces (FDF) and Ministry of Defence (MoD). Remaining interviews included the partnering companies' managers responsible for their customer interface towards FDF. The interviews were so-called theme interviews made with a semi-structured frame. This frame included questions about partnering goals and history, partnering risks and problems. In the latter project we also had a workshop concerning supplier relationship risk assessment and management. In this workshop, all representatives were from buyer's side. In addition to actual case data, we searched data in newspapers and on the internet about FDF's partnership programme and participated seminars where topic was discussed. These seminars enriched the view of topic as there were representatives from various parts of FDF and also companies.

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#### 5. Research results

This chapter includes the key results in our study. First, we introduce shortly the special characteristics of FDF environment and challenges in developing partnerships. Then, we go through two cases as examples from FDF partnering development. With these cases, we want to find out reasons for different outcomes and key challenges in partnering.

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The FDF partnering can be divided to two areas. First, FDF has some partnerships with a long history and slow evolution. These partnerships are initiated naturally, as in a small country there is a limited number of experts and firms in certain niche areas. In transaction, difficulties here can be referred to small numbers. In the real world, there are, in many cases, a limited number of potential partners. For example, Finnish Air Force has been collaborating with aeroplane manufacturers and aviation maintenance companies for decades. Especially in more technical areas, these kinds of partnerships are common. There is also deep collaboration with a national defence industry company and FDF in many areas.

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During the ten-year history of FDF partnership programme (PP), the seven areas are further studied in many pilots. No decisions are made without proper understanding of the problem. Sometimes decision making is considered slow because of this thoroughness. This development is understandable, as FDF has a tradition in internal service production, and clear and strict rules in it. Transition from this operations mode to more extensive use of private companies is certainly a great change, and will include significant change resistance. There has also been a significant interest to find out real and well-grounded analysis with which to base the decisions. One difficult fact in this is

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that change resistance is on many levels. FDF provides, of course, a critical and sensitive public service, which interests the general public. Political decision makers are also interested in FDF decisions. Some political parties are critical towards public-private partnering and general political directions may change after elections. This creates uncertainty to partnering development. Also, within FDF there are some risk-averse decision makers that support the internal service production. Sometimes these are worried about own jobs or unaware of possibilities in partnering. One typically mentioned issue in this discourse is the aspect of crisis, and preparation for it. Own service production is here seen as less risky compared to private companies. This crisis argument should not be made without proper groundings.

Following chapters deepen the understanding of two cases in FDF supporting activities. These both are a part of the partnership programme presented earlier. Development paths of the cases are first presented. Based on these development paths and mentioned risks in case interviews, these are then further analyzed to better understand why the development has been as described. Data presented in following chapters is basically from two sources, interviews and partnership programme internet pages (Kumppanuusohjelma 2009).

### 5.1 FDF Food supply.

Food supply was one area deeply studied during the partnership programme. It started with a preliminary study where the goals, risks and development options were discovered. This phase ended year 2003 and as an outcome there began two slightly different directions. First, the development of internal service development began. This, in fact, meant studying the service centres in food supply. Second, the piloting of a private company in food services in one small geographical area started. This included first a two year pilot project from 2005 to 2007, which is also extended and continuing today. This public-private relationship has been useful as a benchmark to the internal service centre. It has been a great learning experience to both FDF and the private company in many ways.

One important issue to FDF has been deeper understanding of cost structure and total costs in food supply. In some earlier cases, the food supply costs were considered to be the costs of raw material only. However, after the partnering program, it was found that the total costs of internal food supply were approximately three times the cost of raw material. Partnering has also increased understanding from the ways of operating and collaborating. From the private company perspective, the FDF ways of operating and FDF special characteristics have created challenges in organization cultures. Still, the comments from both FDF and the company's side are mainly positive. FDF is a reliable and well-organized partner that you can trust. Also, FDF has learnt that a private company can organize some services differently and even more efficiently.

The main critique from the private company in this collaboration dealt the strict rules and procedures for service production. It seems that strict rules kill all development potential. Strict rules and procedures are partly (mainly) due to FDF policy of being a reliable employee, but FDF also liked to test the private company. One of the primary concerns was the private company's ability to also supply food in field operations. According to a few years of experience, this has not been a problem. In fact, the quality evaluations have been truly encouraging.

If we analyse the food supply case according to the buyer-seller interaction model, we see that the product, which in this case is a service, is tested very frequently. The switching costs are rather low, as the physical facilities can be rented to a private company very easily. A product or service is not highly complex, but has some special characteristics compared to a traditional catering business. These characteristics, like field operations and preparation for crisis, are not considered too difficult. The positive effect of this pilot is also the better understanding of special demands, already in peace

time operations, and, in fact, better possibilities to prepare the organization for a crisis environment. FDF and the company also practise the operations in crisis simulations.

When we analyze the buyer's and supplier's characteristics, we see a collision of different organizational cultures on many levels. First, on the individual level, the personnel at both sides need to adapt and understand each other. Second, the organizational cultures are also quite different, as FDF is used to strict command and hierarchical structure. Third, in companies, the competitive and cooperative strategies are more traditional. Fourth, as a buyer, FDF is demanding and, for example, needs to get certain documentation and clear agreements with its supplier. This bureaucracy is sometimes considered as time-consuming and extra work without a clearly seen reason. Fifth, in general, companies are more used to fast decision-making and changes, and FDF makes changes slowly and after a profound analysis. Sixth, in food supply, the characteristics of industry and markets is such that on a small or local scale, there are large amounts of potential suppliers, but, for example, there are only a few companies to offer the FDF total national food supply. Seventh, the friction toward the public-private partnering ideology, on many levels, makes large scale supporting services challenging. Political and FDF top management are partly sceptical about the possibilities of public-private partnering. However, attitudes have changed thanks to some positive examples of partnering and realization of clear benefits. The interaction process itself has developed in partnering, and both parties have adapted to find out proper information exchange and contact patterns. Clearly, the sceptical tones and private company testing has turned to normal collaboration and development of interaction.

The greatest decision concerning the whole FDF food supply was a decision to establish an internal service centre called PURU, concentrating on FDF food supply. This organisation started its operations in the beginning of 2006. The basic idea of this organizational re-structuring was to gain benefits by creating a clearer internal structure of producer and buyer, and a better understanding of costs and service quality. One of the biggest concerns towards the service centre was that everything remains the same as before. By more focused concentration on the core competence in FDF food supply and its special characteristics, this organization is expected to provide significant savings. Savings come from organizing internal food manufacturing and delivery more efficiently, and developing better sourcing processes and practices.

When analyzing the PURU and FDF external relationship, it is clear that many of the earlier mentioned obstacles are not relevant. PURU and FDF have a long history together, and similar interaction styles and processes. Here, the main question is how to see the development potential, and develop operations? In both cases-PURU and private company partnering--the relationship is at its early phase and some positive results have emerged, which have resulted in a positive loop to further development (see figure 2).

## 5.2. FDF Repair and maintenance.

In FDF's repair shop activities, the partnership programme (PP) has lead to outsourcing a significant part of the activities to a private company. This company is a joint venture of a few companies that have collaborated significantly with FDF in the past. The PP road included many projects where the potential for outsourcing parts of repair shop activities was considered in smaller geographical areas. There were projects called KULPI, KUJA and AKKU. The first projects were more local and limited, but AKKU concentrated on the national level of developing repair and maintenance operations within FDF. As the result of this extensive study and piloting phase, FDF and Ministry of Defence decided to outsource a large part of ground force's repair shop activities to a private company called Millog. An alternative option of the development of internal service production was also analyzed in this case. In practice, this decision means that the majority of repair shops become part of the Millog, and approximately 700-900 employees from FDF become workers of Millog.

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When we analyze this development and decision based on the buyer-seller interaction model, we see some similarities and differences to the food supply case. In this case, the frequency of interaction is high, as services are needed all the time. In some areas, the need for specified technical expertise is high. In this case it is easy, as companies also work with different industrial partners and may use industrial expertise in FDF service development. In the organization culture aspect, we must underline that the companies that founded Millog had a long history in partnering with FDF in different fields. By this experience, they both know technical specialities in FDF services, but also understand and are familiar with FDF operations and practises. This has made this large outsourcing possible, as there is a clear trust and reliance on both parties. Transactions are already common and these are also developed during the relationship. This new joint venture also allows a better benchmark of individual companies' best practises in the FDF relationship. Switching costs are not problematic, as the operations and personnel are turned into workers of Millog. In this process, there have been many different and deep studies about the options. There also have clearly been many opponents to this outsourcing attempt. This is not a surprise, as the area is critical for both peace and crisis operations. Still, the possibilities for operational benefits and cost savings were considered greater than possible problems.

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Development and experiences from partnering are still difficult to say as the final agreement is made at June 2008 and the actual partnering started from the beginning of 2009. During the process of tendering and making agreement the relationship has already deepened. Here again, the past experiences have been in a great role and during the agreement process Millog's true interest and willingness is also tested. One difficult issue is the eight years agreements' strict line to personnel policy. Personnel's jobs are granted for four years. Still, the goals to reduce costs are rather high and at the same time rules limit the possibilities to achieve these.

## 6. Conclusions

Development of different areas has had several challenges on the way. Some of these are internal, and some external. The unique organization culture of FDF and risk-averse decision making are examples of internal reasons for partnering difficulties. External reasons are the legislation, political reflections and availability of potential suppliers. The concept of 'small numbers', for example, appears to be a true problem for more increased partnering. There are not many potential suppliers for providing the volume and quality of services needed by FDF, not even mentioning the need for preparedness for crisis and special needs of this kind.

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When analyzing the context with the buyer-seller interaction model, we see that differences between the buyer and supplier create clear tension in interaction procedures. Companies are, in general, more used to relational contracting and partnering, as FDF is used to hierarchical command and strict guidelines. One thing that may cause problems is public procurement legislation, which set some limitations to public procurement. There are sometimes conflicting interaction strategies for the buyer and the supplier. Both parties need adaptation in order to get beneficial interaction. Risk avoiding and unique traditions in operations are the main reasons for partnerships turning to "internal partnerships" and establishing service centers. In the repair and maintenance case the long history of partnering at joint venture companies and FDF is one of the most important reasons to this new partnership arrangement. Trust and reliance at both individual and organizational level were crucial.

All cases with public-private interaction have resulted in some positive results. It is important to get positive benchmarks in order to understand that in many public services there are possibilities to more intensive public-private partnering. Change resistance at many layers can be managed and a strong management is needed. This is even more important in public sector than in partnering between private companies. In many ways the cases at FDF included the ingredients mentioned at partnering success lists by Steele and Court (1996).

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When we reflect the results to buyer-seller interaction model we can say that product (or service) characteristics are at some FDF areas more important. This may include special technical knowledge and issues rising from crisis perspective. In general, the organization culture differences between buyer and seller can be demanding and difficult. Especially, this is true in cases where there is not interaction in the past with FDF. Organization culture issues are demanding to both companies and FDF itself. Political pressures also create an environment, where it may be difficult to make decisions fast and effectively. This needs determination and strong managers as well as patience and open communication to all important stakeholders. In many ways FDF has shown its abilities to act as a good example for other governmental organizations.

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