Chapter Two

WHY IS THE AIR FORCE INTERESTED IN BUNDLING SERVICES INTO LARGER CONTRACTS?

During the 1980s and 1990s, a revolution began in the way commercial firms purchase goods and services. For many commercial firms, purchased goods and services account for 50 to 80 percent of their total expenditures. As firms recognize the strategic importance of purchasing, they are changing their purchasing and supply management (PSM) practices to improve the performance, quality, and cost of their products and services, and thus their competitiveness. One of the keys to implementing these new PSM practices is strategic supply-base reduction. Appendix B gives examples of this trend. Buyers are reducing the number of providers that they do business with, shifting from smaller contracts with many providers to much larger bundled contracts with fewer providers.[1] Contracts are expanding in scope to include many different complementary services, and they are expanding in scale to accommodate today's global business operations.

In parallel, to meet these expanding desires of commercial buyer firms and to create economies of scale and scope, many service industries are consolidating. Through mergers and acquisitions, provider firms are gaining expertise across a greater breadth of services and encompassing a much larger scale of operations, with ex-

[1]In a 1999 survey of purchasing professionals, 80 percent of respondents indicated they are taking steps to consolidate their purchases with fewer suppliers (Fitzgerald, 1999).

panded geographical presence.[2] This consolidation is occurring across a wide range of industries, including third-party logistics and facility management services that are of primary importance to the DoD. In addition, in automotive, tobacco, accounting, advertising, soft drink, music, wireless phone, and many other industries, fewer than five companies essentially own their domestic market and are moving toward market preeminence.[3] First-tier suppliers of goods and services to many of these firms are also consolidating.[4] Appendix C provides details on industry consolidation trends.[5]

By strategically reducing their supply bases, forming partnerships with larger, more integrated service providers, and implementing other new PSM practices, commercial buyer firms are leveraging their purchases and taking advantage of continuous improvement opportunities to capture significant benefits, such as simultaneous improved performance and reduced cost associated with the services they purchase.[6] Strategic supply-base reduction is a necessary first step to accessing these benefits, because it is virtually impossible for buyers to form close partnerships with many providers that allow buyer and provider to work together to improve performance and cut costs over time. Buyers' purchasing infrastructure simply cannot

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[2]See Cavinato and Kauffman (2000), Chapter 1, "The Future of Purchasing and Supply."

[3]See Mulligan (1999).

[4]Top candidates for further consolidations are telecommunications, internet, cable, and broadcasting services, financial services, metals mining and processing operations, utilities, food processing, and retailing (Kiplinger, September 1999).

[5]The driving forces behind many mergers are both numerous and powerful: technological change, deregulation, excess capacity, an inability to boost profits through price increases, robust stock prices, and the perceived need to grow global marketing muscle (Deogun et al., 1999). Investment requirements for sophisticated management information systems and subsequent leveraging opportunities are also contributing to this consolidation. For example, coordinated full-service global logistics services are difficult to achieve because of the heavy investments required (Bowman, 1998).

[6]For example, one facility management services provider estimates that most companies can achieve 20 percent savings by having a single company handle all services (e.g., from budgeting of building management to cleaning and technical operations) (Keyes, 1998). A survey of U.S. logistics managers who identified themselves as having significant logistics outsourcing experience found that firms outsourcing all supply chain functions achieved average first-year savings (21.3 percent) and annual second-, third-, and fourth-year savings (15.1 percent) that were more than twice as high as savings cited by firms outsourcing any of the individual logistics functions (Boyson et al., 1999).

support the effort.[7] Chapman et al. (1998) note that companies that have simultaneously achieved the greatest performance improvements and cost reductions generally have reduced the number of their suppliers by 40 to 50 percent. A *Supplier Selection & Management Report* survey noted that, for the sixth consecutive year, reducing the supply base topped the list of practices readers say have been most effective in controlling costs (Mazel, 1998).

The Air Force wants to adopt selected best commercial PSM practices, in the form of performance-based services acquisition (PBSA), where appropriate, so that it can begin capturing the potential performance and savings benefits that characterize the experiences of innovative commercial buyer firms. Recent acquisition reform legislation is enabling many of the desired changes in federal government purchasing practices. However, it is important to keep in mind that the Air Force's goals are not the same as those of typical commercial firms. In particular, the Air Force has socioeconomic goals that are likely to require adjustments in any best commercial practices examined. From this perspective, best commercial PSM practices offer examples the Air Force can consider and then modify to make them fully compatible with the Air Force's full set of military capability, quality of life, cost, and socioeconomic goals.

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[7]Michael Hammer notes that "[t]he consolidation of suppliers is, in fact, a common aspect of supply chain reengineering" (Latamore, 1999). Womack and Jones (1996) argue that it is not feasible to extend lean thinking throughout the value chain unless organizations winnow down their list of upstream and downstream supplier partners.