MAY 2003

Public-Private Strategic Partnerships: The U.S. Postal Service-Federal Express Alliance

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New Ways to Manage Series

IBM Endowment for
The Business of Government

N E W W A Y S T O M A N A G E S E R I E S

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FOREWORD

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On behalf of the IBM Endowment for The Business of Government, we are pleased to present this report, "Public-Private Strategic Partnerships: The U.S. Postal Service-Federal Express Alliance," by Oded Shenkar.

The report tells the story of how the United States Postal Service (USPS) and Federal Express created a unique partnership alliance. In 2001, the Postal Service signed an agreement with Federal Express to carry its mail. In addition, Federal Express agreed to place collection boxes at post offices across the nation.

In future years, we anticipate an increase in the number of partnerships and alliances between public and private sectors organizations. In this report, Professor Shenkar describes the continuum of types of alliances that are possible, ranging from loose contractual arrangements to joint ventures. The USPS-FedEx alliance provides a model of a contractual venture. There is much that other organizations in both the public and private sector can learn from the USPS-FedEx experience. Professor Shenkar describes the history of the alliance and what has been learned to date. He also sets forth recommendations for public sector organizations to consider in the future as more organizations consider the option of partnership-type ventures.

We trust that this report will be both informative and helpful to all government executives as they consider new approaches to procurement and public-private partnerships. There is clearly much to learn from the experience of the Postal Service and Federal Express in their pioneering alliance venture.

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EXECUTIVE SUMMARY

The contractual alliance between the United States Postal Service (USPS) and the Federal Express Corporation (FedEx) is designed to achieve complementary strategic objectives such as leveraging scale and efficiencies. The alliance is a culmination of the dramatic increase in the number and scope of strategic alliances across the globe, including those established between competitors and those involving public and private organizations.

The USPS-FedEx alliance is both a result of these trends and a potential catalyst of more to come. Due to its magnitude and visibility, the alliance is likely to have a considerable impact on the future of public-private alliances, and will be closely monitored not only by private and public sector firms but also by other constituencies—for example, competitors (e.g., United Parcel Service, commercial and cargo airlines), other postal services around the world, and the businesses and public-at-large who rely on the Postal Service and its competitors for their everyday business and personal needs.

This study examined a number of key issues, including the strategic motivations of the partners, compatibility of objectives and potential for conflict, challenges associated with setting up and running a public-private alliance, and alliance performance, including the yardsticks employed by the two partners. The findings, obtained through archival sources as well as interviews with key executive in both partner organizations, were compared to those available in the academic and practitioner literature. Insights from other postal alliances around the world have been added where appropriate. The review and analysis led to the identification of "best practices" for public-private alliances.

The best practices identified in this study include:

- Identifying and maintaining strategic and objectives fit
- Leveraging partners' competencies
- Maintaining and cultivating cultural fit and balance
- Focusing on implementation and detailed planning
- Developing and nurturing inter-partner trust
- Leveraging prior alliance experience
- Devising and maintaining open communication channels
- Synchronizing performance goals and yardsticks
- Leveraging "alliance champions" from negotiation through implementation
- Maintaining an ongoing partner commitment
- Convincing and co-opting "alliance skeptics" in both organizations
- Setting conflict resolution mechanisms

Both partners rate the alliance's performance as excellent, exceeding all expectations. Given the early age of the alliance, insights have been sought from the literature on problems that could derail it in the future (please note that this last section is based strictly on a review of the literature and does not reflect the current status of the alliance in any way):

- A material change in the business environment
- A change in bargaining power
- Learning completion or cessation

- Opportunistic behavior (seeking “private gain” at the expense of “joint gains”)
- Turnover of alliance champions
- Regulatory changes
- Labor problems

Finally, the following recommendations were made to other public sector organizations contemplating alliances, including:

- Consider strategic options: Is the alliance a substitute to privatization, a vehicle to privatization, or an element in a post-privatization scenario?
- Ensure learning from the alliance is disseminated throughout the organization
- Recognize contingency factors—for instance, how close to the public-private continuum the agency is

Introduction

Recent decades have seen a dramatic increase in the number of strategic alliances that can now be found in virtually every industry—in both manufacturing and services—and across the globe. Growth in public-private alliances has also been substantial. The trend has encompassed postal providers around the world, many of which use alliances either as a stand-alone strategy to improve competitiveness and service quality or in conjunction with a broader shift toward privatization or semi-privatization.

Research shows that alliances are not easy to establish, steer, and manage. The record of alliance performance is quite dismal, with many found to be fragile, unstable, underperforming, and prone to failure. Public-private alliances seem to fare even worse than private sector alliances. While no precise numbers are available, a number of studies suggest that public-private alliances are especially problematic due to fundamental differences in strategic orientations, cultures, and modes of operation between the two sectors. There have been quite a few instances in which private sector firms refused alliances with public sector organizations (or withdrew from an alliance when a government took over a private sector entity) out of fear of a clash of cultures and incompatible objectives.

The USPS-FedEx alliance is of special importance not only because of its large scope, but also as a model for future alliances. While not the first alliance of the United States Postal Service (USPS) and certainly not the first of its kind on a global scale (for instance, the German post office has a much greater number of alliances), its importance rests with its tremendous visibility and informal status as a model of cooperation watched closely by other government agencies and private firms alike. Thus, while the alliance will have repercussions for USPS's profitability, its semi-monopoly status, and the often debated option of privatizing the service, it may well herald things to come in other government and quasi-government agencies. For instance, it could serve as a model for cooperation between the Social Security Administration and private-sector financial institutions, should a decision to privatize some of its operations be made; or for cooperation between the Internal Revenue Service and private collection agencies, as has been recently suggested.

The USPS-FedEx alliance brings together one of the largest government agencies (and one of the biggest employers) in the country, one that counts virtually all U.S. residents as it customers, and a private firm who has become legendary for its entrepreneurial spirit and business success and is listed among *Fortune's* rankings of most admired companies. So far, the alliance has performed above expectations.

Study Methodology

This study was based on the following elements:

- In-depth review and analysis of the literature on strategic alliances
- Review of various media sources covering the USPS-FedEx alliance
- Interviews with a key senior officer in each of the two organizations: on the USPS side, Paul

Vogel, vice president of network operations; on the FedEx side, Paul Herron, vice president.

Industry Background

Postal services are one of the oldest public services. While private competitors emerged as alternative providers in most developed nations, government postal services continue to dominate core mail delivery to date in the United States. Here, the Postal Service retains a monopoly over the delivery of First-Class Mail, though it faces stiff competition from the private sector for the provision of other services. The postal monopoly is underpinned by antitrust exemption, and devised to guarantee mail delivery to rural locations (universal service) and to equalize postal rates for basic service regardless of distance or location (uniform rates).

In recent years, postal services have been transformed, adopting private sector operational modes and efficiencies. Postal operations around the world (e.g., the British and French) acquired for-profit firms in delivery, logistics, and freight forwarding, and established strategic alliances with others. Deutsche Post, AG, the German postal agency that is in the process of being privatized, acquired 30 firms in the last three years, mostly in Europe but also in the U.S. and other world regions. Recently, it gained control of DHL, one of FedEx's main global competitors, with whom it was aligned before.

USPS is a $70 billion quasi-government enterprise employing close to 800,000 people and operating about 38,000 retail outlets across the country. The Postal Service defies the public-private designation. It is owned by the government and is protected by a monopoly over the delivery of First-Class Mail, yet is obligated to provide universal service. Unlike most government agencies, it is not provided a budget by the government but rather operates through the revenues it generates from providing its services. Consequently, it is held to commercial yardsticks of revenue growth and profitability, yet is not allowed to freely price its services (rates must be approved following a lengthy regulatory process) or set different pricing structures by location or distance.

In recent years, there have been calls for changing the status of the USPS. While a number of government officials and businesspeople have called for privatizing the Postal Service, the postmaster general recently called for its transformation into a "commercial government enterprise," which would give it new flexibility while retaining its First-Class monopoly and universal distribution commitment.

Regardless of the governance structure that will eventually be retained or adopted, it is clear that the USPS is facing increasing pressure to improve its performance in the face of intense competition at home and abroad. The events following September 11, 2001, including an unprecedented drop in First-Class Mail volume, have further increased the pressures to reduce costs and improve efficiency. This has not only produced huge losses, but has also called into the question the business model on which the agency operates. It is in this context that the USPS alliance with FedEx needs to be considered.

The USPS-FedEx Alliance

The USPS-FedEx alliance constitutes a contractual agreement between the two entities for the transportation by FedEx of USPS First-Class Mail, Priority Mail, and Express Mail. The contract also includes a retail agreement to install FedEx drop boxes at USPS retail post offices. The box at right describes details of the alliance.

While often described as narrow, the alliance is significantly broader in scale and scope than anything undertaken before by either of the two organizations. The deal has been estimated at $7.2 billion and was initially expected to carry 20 percent of USPS air cargo shipments (Miller, 2001; Thompson, 2001a).

Such a broad alliance between a government monopoly and a private competitor triggered substantial opposition. United Parcel Service (UPS), FedEx's main competitor, objected to the alliance on antitrust as well as "public policy" grounds. A legal challenge was filed by Emery, whom FedEx replaced as the air contractor for USPS. The chairman of the House Judiciary Committee asked the Justice Department to investigate antitrust concerns emanating from the deal. Consumer advocates and other constituencies questioned the premise of a public-private cooperation underpinned by a government monopoly and wondered aloud about who was the "real beneficiary." Nevertheless, the alliance was launched and was soon on its way, but not before the two parties had taken extensive preparatory work.

Legal and policy issues notwithstanding, the USPS-FedEx alliance holds the promise of significant benefits for both organizations. The benefits should come from synergies and scale efficiencies that will reduce operational costs and increase geographic spread and scope of services. For the USPS, close cooperation with the private sector should allow for effective transfer of work practices and techniques, which may precede deep-seated change amounting to no less than a transformation of organizational

Overview of the Alliance

- **Retail agreement**
  - FedEx has installed approximately 8,000 drop boxes at USPS retail locations
  - In exchange, FedEx pays annual fees to USPS
- **Transportation agreement**
  - FedEx carries USPS Express Mail, Priority Mail, and First-Class Mail
  - In exchange, USPS pays per-unit fees to FedEx for volume transported
  - Mail is tendered to FedEx at origin airstops and received back from FedEx at destination airstops
  - Mail flows throughout the FedEx network
  - Agreement provides for specific on-time service performance standards from tender at origin to receipt at destination
  - Network handles over 4 million pounds of product a day

culture. FedEx, for its part, gets scale economies, better utilization of existing equipment and staff, reduced risk through a guaranteed shipment volume, as well as a potential front row seat should the USPS ever be privatized in part or in full.

Strategic Motivations

The strategic alliance literature lists a number of reasons for entry into strategic alliances. Among them are scale economies, new market entry, vertical integration, diversification, cost reduction, risk reduction, and various synergies—from technology to distribution. These goals vary by industry and sector; for instance, alliances among competitors tend to be more focused on risk reduction, while alliances involving developed and developing economies often emphasize technology transfer.

A major goal in many alliances is learning. This means that firms enter into alliances to obtain knowledge and develop skills and capabilities that could not be accrued independently or that their development would be more costly and time-consuming than under an alliance scenario. Alliance sponsors join forces for acquiring each other's tacit knowledge (e.g., technology and know-how). Hamel (1991) notes that partners, especially those who are competitors, often engage in a "race to learn," trying to outdo each other. The winner in this race is the company that learns faster and more effectively.

USPS is characterized by fixed costs relating to its "last mile" commitment (the obligation to make physical delivery to every U.S. household), constraints on business practices such as procurement, and the civil service status of most of its employees. This is especially true in an environment of low volume growth (which only later worsened to negative). USPS's Paul Vogel confirms that the alliance was formed to benefit from scale economies to be triggered by service combinations of the two players. USPS conducted a strategic assessment of its core strength, which he identified as delivery capability: "We are a delivery company, not an air transport company." Given its core, USPS looked for a complementary partner in the air transport business.

FedEx wanted to leverage its scale and related logistic and processing capabilities, which were developed at substantial cost and could be amortized across a broader market. Its capacity for overnight delivery service has been saturated, but it had untapped capacity for two- to three-day deliveries as well as technological capabilities that could be leveraged across higher volumes. Says Herron:

> USPS offered a large and consistent flow of volume requiring transportation during the day. We could offer not only our transportation services, but also our advanced scanning and information technology systems.

Why the Alliance?

For USPS

- Previous USPS air networks were fragmented
  - Multiple carriers and hand-offs
  - No centralized information technology
  - Assets were fully dedicated to USPS products
- Reduce cost and improve service
  - Shared use of FedEx air networks provides more efficient solution
  - FedEx guarantees high levels of consistent service performance across the entire network
  - FedEx information technology provides superior capability to manage the network and track shipments

For Federal Express

- Improve utilization of existing assets
- Expand day network size and reach
- Provide significant growth opportunities
- Provide consistent revenue stream
- Pave the way to collaborate in other areas

From FedEx's perspective, USPS's commitment of leasing space and FedEx aircraft could be viewed to significantly lower its risk considering the vagaries of customer demand and the potential for unforeseen contingencies (such as 9/11). Some observers go as far as suggesting that the agreement is one-sided in that it bestows all the benefits on FedEx while the USPS retains the risk exposure (e.g., Del Polito, 2002).

Partner Selection

The strategic alliance literature (e.g., Geringer, 1988) highlights the key factor of having the "right" partner to ensure successful alliance operations and outcomes. Partner selection is even viewed by some as the single most important ingredient in alliance success. An "appropriate" selection can be assessed, on the one hand, from a strategic perspective (i.e., "strategic fit" such as complementary resources and capabilities) and, on the other hand, from an organizational perspective (e.g., culture compatibility). It is worthwhile to mention that these two perspectives often produce inconsistent outcomes—for example, a partner that has different capabilities is also likely to have a different culture and operation mode. The same differentiating factors that make a partner attractive in the establishment phase may become a drag during the operational phase.

In this alliance, it seems that USPS, being the monopoly provider of "the last mile," is the one who initiated the search and made the selection. Such situations have occurred in private sector alliances (for instance, Xerox selected Fuji from among some 30 Japanese candidates), but are not very common. USPS has been very thorough in its partner selection process. The Postal Service started by reviewing 36 cargo carriers as potential partners. The search included six "filters" such as size, global reach, and financial health. The two finalists were FedEx and UPS, and USPS compared them in detail, including the range of competing products, before reaching its final decision. Federal Express was determined to be the only company that met all of the Postal Service's requirements. It is not known if the compatibility of cultures, managerial styles, and the like played a major role in the choice. In many respects, the two partners are quite different from each other, but they can also be seen as complementary to each other.

USPS-FedEx Alliance Time Line

1971: USPS becomes a quasi-government agency

1973: FedEx begins continuous service

Jan. 2001: USPS-FedEx alliance announced

Aug. 2001: Alliance begins operations

Sept. 11, 2001: Terrorist attack, weight limits on delivery by passenger aircraft imposed

Conflicts between Parties

Conflicts between parties are unavoidable in alliances. While the literature recommends reducing potential conflict by selecting a partner compatible in terms of its strategic objectives, it is recognized that hidden objectives and/or changes in the business environment are likely to destabilize the equation over time. Hence, an emphasis is put on having mechanisms in place to identify, monitor, and diffuse conflict. This view is echoed by Vogel of the USPS, who notes that the Postal Service and FedEx "delved into the issue in great depth" as they were negotiating the contract. The two parties scheduled several meetings per year to discuss each other's needs and issues and have kept communication channels open as a way of identifying potential conflicts at an early stage so they could be diffused. The parties also found more similarities in the problems each of them was facing than they initially assumed, which helped in information sharing to resolve those problems and perhaps lowered the tendency to attribute problems to the other party.

FedEx's view is that conflicts are not very likely in this alliance thanks to the detailed planning conducted up front, which included a detailed implementation schedule and structure, as well as the opening of communication lines at all levels of the two organizations. Says Herron of FedEx:

The Alliance Continuum

Strategic alliances have been defined in numerous ways, for example, as "long term relations among organizations which represent value added to the partners."

Alliances can be classified into a number of basic forms:

1. **A non-written understanding.** Such understandings have typically been internalized and embedded in organizational routines. Examples are supplier relationships that give a first refusal right to a long-term partner without any contractual obligation to do so.
2. **A loose contractual arrangement.** Such arrangements are anchored in a contract and typically cover only a small scope of operations. Examples are airline agreements to provide mileage credit to a member of a different frequent flyer program.
3. **Licensing.** Licensing deals are contract-based and limited in scope, but unlike loose contractual arrangements involve a legally defined property right such as a trademark or a specific technology. Since they involve property rights, licensing deals also tend to be more specific regarding time frame since exiting the alliance would still leave the recipient with a valuable asset.
4. **A contractual venture.** These ventures represent detailed contractual formula governing a flow of resources between the partners. Unlike the previous types, such contractual ventures are more likely to have a managerial or steering committee staffed by both (or all) partners that govern the alliance operation. Examples are turnkey (design-build-operate) agreements in the utilities industry. The USPS-FedEx alliance most closely approximates this type of relationship.
5. **An equity joint venture.** An equity joint venture involves the formation of a legally independent entity that, while owned and controlled by its parent organizations, is independently registered and run. Examples include the NUMMI venture between General Motors and Toyota to build cars for both firms in California, and the Fuji-Xerox venture in Japan.
6. **A partial acquisition.** A partial acquisition involves taking a stake in another company. Ford taking a partial (yet controlling) stake in Mazda is an example.
7. **A merger/acquisition.** This involves relinquishing ownership and control and the disappearance of the target entity as a going concern. In a public sector environment, that would also include full privatization as well as the acquisition of private companies by semi-privatized Postal Services (e.g., acquisitions made by Deutsche Post).

> FedEx will treat USPS product the same way as any other FedEx product. Both firms spent a great deal of effort and time outlining the expectations, the process flow, the contingencies, etc. Extensive planning and testing had been carried out at the time between contract signing and implementation. Lastly, communication is kept open through committees at the local, national, and executive levels to ensure the expectations of both organizations are being achieved.

USPS's Vogel agrees, noting that the potential for conflict is lower due to the commonalities that have been uncovered: "We have found that we have much more in common than we thought."

Finally, the strategic alliance literature notes the importance of past relations between parties as a precursor to the alliance. From the USPS perspective, a problem in this alliance has been a history of rivalry, whereby USPS used to view FedEx as a fierce and aggressive competitor, developing some antagonism toward the company in the process. This may partly explain the emergence of opposition in the form of "alliance skeptics" in the USPS organization. Whether such opposition also existed in the FedEx organization is unknown.

Alliance Experience and Capabilities

The strategic alliance literature emphasizes the importance of gaining partnering experience and developing alliance management capabilities. Given the complexity of this organizational form, it is believed that the accumulation of partnership experience, if properly done, will lead to greater alliance success. Some related assumptions (e.g., regarding the most appropriate sequence of experiences with different alliance types) could not be tested in this report due to lack of sufficient data, but it is worthwhile to consider them in the future.

By the time it negotiated its alliance with FedEx, USPS had delivery alliances with a number of private sector operators, such as Airborne, DHL, and Emery International. The Emery alliance, for one, has not been successful, judging by the legal proceedings involving the two organizations. It is not clear whether this experience provided a drag on the negotiations with FedEx in terms of suspicion toward private sector firms, or was rather a catalyst in the sense that USPS was able to learn from past mistakes. (There is some preliminary evidence to suggest that alliance partners learn more from past failures than from past successes.) In addition to DHL, USPS also had alliances with foreign commercial carriers such as Lan Chile, and hence accumulated experience in international alliances, which are typically more complex than domestic partnerships. the Postal Service also has an alliance with Mailboxes, Inc., and, as a result, is familiar with extensions of its collection services. These alliances may have prepared USPS for the much more complex task of running a broad alliance with FedEx.

FedEx, for its part, has had and continues to have alliances with both private and public organizations. For instance, it has an agreement with the French post office, La Poste, which involves FedEx's handling of La Poste's Express Mail while using La Poste's ground services for delivering FedEx packages in several European markets.

FedEx also had a variety of alliances with various organizations, for instance, a five-year alliance with United Airlines for the conversion of United's passenger DC-10 to cargo aircraft in return for "hush kits" (equipment to reduce noise in older aircraft to enable landing in airports with stringent noise standards) for Boeing 727 aircraft.

A FedEx official who previously worked for McDonnell-Douglas, the DC-10's manufacturer, noted that the partners to the alliance have learned to handle contingencies not written into the contract, a key capability in any alliance (Financial News, 2002). In that regard, it can be said that by the time FedEx entered into the alliance with USPS, it had accumulated substantial experience in establishing and running alliances, including those involving public agencies, and had experience in operating international alliances, which are usually more complex. The company notes that its USPS alliance is the largest and most successful alliance it has had so far, and that is where FedEx has learned the most. "We hope to use this learning in future alliances, both public and private," says FedEx's Herron. Such incremental learning is strongly supported by both learning and alliance theories.

The substantial alliance experience of both organizations with entities within and outside their industry seems to have been at least, potentially, a contributor to the success of their alliance. The incremental growth in alliance capabilities also bodes well for a future that may entail further broadening of the alliance.

Alliance Performance

As noted earlier, the alliance literature highlights the low success rate of alliances. It also notes that alliance performance is in the eyes of the beholder, that is, an alliance may be considered high performing in terms of the objectives and yardsticks of one partner but not necessarily of the other.

So far, the USPS-FedEx alliance seems to be doing well for both partners. FedEx attributes some of its relatively bright profitability picture in a poor industry environment to the alliance with USPS, which is now its largest customer (Thompson, 2002). Indeed, it appears that USPS business made up for a decline in other volume in the FedEx network (*Aviation Week*, 2002). FedEx's Express saw its volume up 127 percent in the fiscal year ending May

31, 2002, from the year before, with both volume and yield rising substantially (Krause, 2002a).

While I did not have a breakdown estimating the contribution of the USPS contract, it is safe to assume that such performance in a down year had much to do with it. Various sources reported a yearly payment of $800-$900 million paid by USPS to FedEx to carry its mail and FedEx's payment of $100-$300 million to USPS over the term of the agreement for placing its collection boxes at its branches (Brooks, 2001). USPS, which lost $1.68 billion in 2001 and has been under financial pressures for a number of years now, suggests that the loss would have been considerably bigger without the alliance. The alliance literature confirms, however, that attitudinal measures tend to closely correlate with financial performance and can hence be considered a reliable performance measure (Geringer and Hebert, 1991).

In general, both parties expressed satisfaction with the way the alliance was doing and were equally optimistic about the future. The USPS's Vogel noted in an interview with the *Journal of Commerce* (Krause, 2002b):

> No one thought we'd be able to come under budget, considering the numbers were cast in a pre-Sept. 11th environment. But we did it. You can't beat it. The costs are lower and the Postal Service is better.
>
> We struggled in the first few months, but we've balanced that all out. The proof is in the pudding, and last year's transportation budget was less than the year before.

One success indicator for the Postal Service has been the considerable increase in the on-time performance of Priority Mail, which the USPS has been faulted for in the past. (This was often brought up as an example of how noncompetitive the Postal Service was.)

The alliance literature also notes that alliance success often comes in the form of numerous byproducts. Here, too, the two organizations are quite upbeat about their alliance. Says FedEx's Herron, "We are already benefiting from shared best practices. There are always byproducts from a successful alliance such as this."Indeed, many of the potential benefits of the alliance, e.g., organizational learning, will only become apparent in due course. The alliance is too young for me to come up with a fair assessment of such long-term benefits. This is especially true in light of the potential contribution of unforeseen circumstances to the success of the alliance so far.

These benefits notwithstanding, there remains the possibility of detrimental effects of this alliance to other constituencies, be they commercial airlines or the country's airports that find volume diverted to Memphis International, FedEx's hub. "First-Class Mail is being diverted to FedEx at levels far beyond the initial contract," says Jack Boisen, vice president of cargo for Continental Airlines (Krause, 2002b) who, together with his counterparts at American Airlines and other carriers, complains about the loss of business.

Future Alliance Development

The view of USPS is that FedEx has helped it through the learning curve of using its network and was a tremendous asset during the turbulent times following 9/11. "I believe that the relation will continue to grow and prosper," USPS's Vogel said, adding:

> We are both in the material handling business and have bonded around moving product. That bond has led to respect, which in turn has allowed us to establish new dialogues on other creative initiatives.

FedEx also sees many ways in which the alliance could grow beyond the scope of the initial agreement. It notes that USPS has a presence virtually all over the United States. FedEx is the leader in transportation of goods and information intensity required by today's shippers and is looking for ways to build on those strengths or the strengths of other partners.

In the meantime, some signs of enhanced cooperation are already apparent. For instance, the two partners negotiated an extension of the existing cost structure to cover extra shipping during the heavy pre-holiday season in December, which was customarily divided among many carriers. Here, too, savings could be quite substantial, since USPS will not have to set up the very expensive dedicated network it would otherwise have (Krause, 2002b). The partners also extended a provisional agreement for FedEx to carry incremental pounds of mail at higher volume through the end of the FedEx fiscal year on May 31, 2003 (Thompson, 2002).

Establishing and Managing Public-Private Alliances

Challenges

USPS's Mr. Vogel emphasized the difference between how the two organizations approached the alliance:

> I have never negotiated a private-private agreement. In the public sector there are many governmental rules and guidelines. An alliance is certainly feasible, however. It depends on the individual negotiation and support. FedEx relied on their lawyers, while we think more of contractual provisions (Congress), procedures, contract/procurement, laws and regulations.

The USPS executive expressed the hope that FedEx was learning more about USPS—its capabilities but also the constraints under which it was operating as a public agency:

> I hope they have learned that we are a public/customer-minded organization that has many unusual obstacles.

FedEx concurs that, other things being equal, public-private alliances are more difficult to establish and manage than other alliances. They mention the different legal and regulatory environments and the cultural differences that need to be overcome in public-private partnerships. They also note that the public sector has many more constituents, which all must be considered.

These reports are quite consistent with the strategic alliance literature that views private/public sector alliances as especially unstable. This is because partners to such alliances vary on a number of key features, among them culture and operational mode. For instance, the Conference Board finds that culture is one of the major reasons for alliance failure.

Best Practices

It is not easy to come up with a generalized list of best practices for alliance management given the variations across alliances on everything from industry to parent sector and a variety of other contingency factors that have been identified in the alliance literature, such as alliance size, scope, governance, control, and structure. Nevertheless, at the risk of oversimplification, those practices that the parties have identified as having contributed to the success of their alliance are outlined.

Identifying and maintaining strategic and objectives fit

In discussions with the interviewees, this factor came up early in the discussion of strategic rationale on the part of the two partners. Says FedEx's Herron:

> First, the basic alliance needs to be good for all parties. Second, needs, expectations, goals, and objectives must be clearly laid out and understood by all.

Vogel puts strategic and objectives fit as the number one factor in terms of contribution to alliance success, stating that it is crucial for each party to know its objectives and what it expects to get from the alliance. These statements are very much in line with the alliance literature, which identifies compatibility of objectives as a key determinant of alliance success.

Leveraging partners' competencies

The alliance literature notes that a key reason for forming alliances as well as a key explanation of their success is the ability to leverage the partners' respective competencies. This element can be considered complementary to strategic fit in the sense that the benefits of such fit would be limited unless the two partners developed an ability to develop capabilities that are important to their partners, and the partners developed the "absorptive capacity" to learn and benefit from their allies. This seems to have been the case in this alliance: Being able to "draw on each other's strengths" was the expression used by Vogel of the USPS.

Maintaining and cultivating cultural fit and balance

This factor, too, was not explicitly mentioned but came up in such expressions about the (unexpected) commonalities between the partners. Says Vogel:

> A relationship such as this should not be quickly formulated. It is important to understand each other's cultures.

Culture has been identified as critical to alliance success in both domestic and international alliances. In some respects, the cultural differences between the semi-government agency and the private, publicly traded firm can be compared to those apparent in international alliances: While in this case the partners speak the same language and share national culture, their modes of operation, including management style, operational procedures, and decision-making routines are substantially different. It is interesting that it is the USPS, more than FedEx, that emphasizes the commonalities uncovered by the partners, though the revelation of such commonalities does not negate the existence of different cultures. As the relationship between the two organizations grows, they will become more familiar with each other, yet cultural friction may yet develop as more organizational facets come into contact with one another. In this respect, a very rapid expansion of the scope of this alliance is somewhat risky.

Focusing on implementation and detailed planning

The USPS view is that "the devil's in the details," a saying that has been corroborated by findings from other alliances. Interestingly, or perhaps predictably, the academic literature does not sufficiently focus on implementation issues, though practitioner literature, such as Conference Board reports, invariably show its tremendous importance. In this regard, FedEx's Herron emphasized the importance of solid preparation. There have been multiple reports about FedEx making test runs of USPS shipments prior to the due date and providing training for USPS employees on how to fill mail containers to be flown by FedEx (Thompson, 2001b). As Herron noted, a "key to the success of this agreement was the initial planning and organizing which went into the launch." While this principle seems simple, it is not. Many alliances collapsed because one or all partners failed to appreciate the importance of the detailed preparation necessary for the cooperation to work.

Developing and nurturing inter-partner trust

A trusting relationship between partners has been found to be critical to alliance success. While not explicitly mentioned, it was clear from the interviews that a trusting relation indeed developed in this alliance between the organizations and, in particular, between the alliance champions. A key challenge in alliances is expanding such trust to the broader staff and organization. It is not clear if this has been achieved in this alliance, though statements made by the interviewees implicitly suggest that trust has been extended.

Leveraging prior alliance experience

This factor too was not explicitly mentioned as a "best practice," but it was clear from the answers—and especially from other information collected on this alliance—that prior alliance experience played an important role in this alliance. Similarly, it seems that the experience with this alliance would carry over to other alliances that will be undertaken in the future by both organizations. Both USPS and FedEx have had alliances in the past. Importantly, this included alliances established outside their industry and sector, which may have prepared them for the challenges of running a mixed-sector alliance. Although the success record of prior alliances appears to vary for the two partners, it seems that both have learned important lessons about alliance establishment and operation that have been implemented in the current alliance and were instrumental in its launch and success.

Devising and maintaining open communication channels

Both Vogel and Herron emphasized the importance of open communication, stating that ongoing communication at all levels is critical to ensuring the alliance stays on track. Says the USPS's Vogel:

> Alliances are like marriages—there are good days and there are not so good days; but good communications and trust can keep a relationship on track. However, both partners need to be satisfied in the relationship. When one of the alliance partners decides to capitalize on a relationship, the relationship will inevitably fail.

The recommendation is very much in line with those of the alliance literature. However, another communication aspect that the partners did not elaborate on—whether because it was absent in this alliance or due to its sensitivity—is the tendency of alliance partners to limit communication flow, especially when the partners are competitors, as is the case in this alliance. Such tendencies make open communication even more important as a best practice.

Synchronizing performance goals and yardsticks

According to the alliance literature, agreeing on and synchronizing performance evaluation criteria is fundamental to alliance survival and success. Having divergent performance yardsticks might not be an obstacle as long as the achievement of one yardstick does not jeopardize the achievement of the other. However, this is not always tenable. When performance yardsticks are incompatible, the maximization of one party's yardstick will be detrimental to the other, undermining cooperation. In addition, having incompatible yardsticks might lead one party to conclude that the alliance is working well while the other remains convinced that it does not. Differences in performance yardsticks can also spill into the human resource domain, creating tension among executives both within and across the parties.

A brief look at the performance yardsticks shows a low level of incompatibility. Vogel says USPS will use two primary yardsticks to measure the success of its FedEx alliance: network utilization and contractual service performance. Neither of these yardsticks is incompatible with those of FedEx. While FedEx is guaranteed a minimum volume by USPS, it has every interest to maximize both network utilization and service performance. Vogel notes that numerous other measures are often suggested during monthly meetings, but they are more biased toward one or the other company. Hence, it seems that the possibility for a conflict regarding performance measurement exists but is constrained by compatibility on key yardsticks and by ongoing communications between the parties, which mitigate it.

Herron notes that "metrics and milestones must be identified to ensure the alliance is fulfilling its purpose." Performance yardsticks were developed jointly during meetings, because it was critical to have both organizations involved, given the magnitude of the alliance. Experts from both sides were brought in to ensure that the planning, including performance measurement, would work through the life of the agreement, rather than through its starting phase alone. The result was a reporting system that FedEx would provide, with monthly updates and a framework for handling exceptions.

Leveraging "alliance champions" from negotiations through implementation

The alliance literature often notes the important role of "champions"—individuals who play a key role in the formation of the alliance and are often called upon to assist in resolving conflicts when those inevitably arise. Both parties seem to have recognized the importance of those champions, probably a result of their prior alliance experience. They especially noted how important it was to "maintain the key members who crafted the alliance on both the implementation team and the alliance management team" so as to make sure that "the learning both organizations had from the development of the alliance was not lost."

Maintaining an ongoing partner commitment
The alliance literature emphasizes the importance of partner commitment to the alliance (e.g., Tomlinson & Thompson, 1977; Beamish, 1984; Hebert, 1994). This is also emphasized by the two partners in this alliance, who emphasize the commitment of their organizations to the success of this alliance. It is important to note that the alliance already has faced an important test of commitment stemming from the 9/11 crisis and aftermath.

Convincing and co-opting "alliance skeptics" in both organizations
Vogel of USPS explained the importance of overcoming the opposition of "alliance skeptics" and bringing them on board:

> We needed to get support from our head agencies and from those parties who were skeptical about this alliance. The data we provided them with convinced them, along with the opportunity they had to interact with FedEx after our internal meetings.

Herron of FedEx did not mention alliance skeptics, possibly because there was no such opposition in FedEx's ranks. Such lack of opposition, if indeed it is an accurate reflection of the situation at FedEx, could be the product of a number of factors. First, there is the possibility that indeed this alliance was perceived to benefit FedEx greatly, and hence there was general consensus within the organization to support it. Another possibility is that FedEx, as a private company, is free from close government oversight and has a culture that is more open to change vis-à-vis the "civil service mentality" that characterizes portions of the USPS.

Setting conflict resolution mechanisms
A potential weakness of many contractual alliances is the lack of conflict resolution mechanisms. In the absence of a board of directors, which buffers many conflicts in an equity joint venture, a contractual alliance renders all important non-programmable decisions subject to inter-partner negotiation, ranging from arranging venture capital, designing payoff schemes, and determining the level of involvement of the partners in operating and managing the venture, to making changes to the ownership or control structure. A contractual alliance requires complex ex ante specification of ongoing activities and behavior, and hence is considered deficient where monitoring is vital, as investors may not be entitled to access independently verified financial information and may be unable to observe operations directly (Kogut, 1988; Osborn & Baughn, 1990). In the absence of such monitoring, inter-party trust is even more important than the case would be in an equity alliance.

Future Risks

Finally, this is a relatively new alliance. While both partners are happy with the alliance's performance at this point, insights have been sought from the literature about problems that could derail it in the future. Among the potential problems:

A material change in the business environment
A major change in the business environment could clearly pose a challenge to the alliance. The 9/11 tragedy posed a clear challenge to the alliance, but that challenge was met and overcome by the alliance.

From a transaction cost perspective, a highly uncertain environment does not support loosely defined inter-firm arrangements, but favors more tightly coupled organizational forms, such as an equity joint venture (EJV). While an EJV ties the partners by joint ownership and payoff schemes that are aligned with the structure of equity holdings, a contractual arrangement has limited flexibility since it is impossible to incorporate all potential contingencies in a contract.

A change in bargaining power
A change that would alter the power equation in the alliance—for instance, alter the strategic symmetry between the partners—would put the alliance at risk. Harrigan argues that unsuccessful joint ventures may result from the absence of inter-partner "strategic symmetry," which occurs "when partners possess complementary missions, resource capabilities, managerial capabilities, and other attributes that create a strategic fit in which the bargaining power of the venture's sponsors is evenly matched" (1988, p. 206).

Opportunistic behavior
Opportunistic behavior by one or both partners—that is, the possibility that the parties will be

seeking "private gain" at the expense of "joint gains"—is a possibility in any alliance. For instance, negotiations on the part of one or both parties with potential partners abroad who would undermine the existing alliance and/or the other partner could quickly destabilize the alliance.

Turnover of alliance champions

Changes in alliance leadership—for example, the key executives involved in setting the alliances will leave or move to other positions—are a potential risk. The literature suggests that a turnover of key people in both organizations, especially those involved in the negotiations and initial phase of trust building, can upset the delicate balance on which an alliance stands. This is the flip side of having alliance champions as a "best practice" and has been observed in numerous alliances across the globe.

Regulatory changes

Changes in the regulatory environment, such as the setting of limits on cooperation resulting from lobbying by competitors, represent a risk to this as to all alliances. For instance, a worsening economic environment may lead FedEx competitors to double their lobbying efforts to limit the scope of the alliance, thus undermining scale benefits.

Labor problems

Labor problems, in particular those resulting from friction between a civil service and a private sector workforce, could derail the USPS-FedEx alliance. Cooperation between two different systems make pay and work conditions more visible to each other, and could bring feelings of relative deprivation either on the part of USPS employees and/or on the part of FedEx employees.

The above risks make it all the more important that such best practices as open communication lines and structural adaptability are not only maintained but continually developed and nurtured.

Recommendations to Public Sector Organizations

As noted earlier, the USPS-FedEx alliance is carefully watched by government agencies and other public sector organizations. If successful (and so far it has been), this alliance may serve as a model for public and private sector cooperation. If eventually unsuccessful, it may be used to oppose change in the current manner the government and related entities run their business. Here, we delineate a number of recommendations for public sector organizations that may be derived from the USPS-FedEx alliance. These recommendations raise a number of questions and possibilities to be considered by public organizations as they work to improve their productivity and service delivery. No less important, a number of key contingency factors that should be taken into account before an alliance portfolio is considered and set by public sector organizations are offered. Finally, as is true for the entirety of this report, it should be noted that the alliances referred to are between public and private (or publicly traded) entities. While alliances between organizations within the public sector are definitely a necessity, and while some alliance capabilities are transferable across organizational types, such alliances are not the focus of this report.

Recommendation 1: Determine Strategic Options (vis-à-vis privatization)

Alliances are a hybrid arrangement and should be considered within the broader context of the privatization of public services. The intention here is not to enter into the debate of whether and which public services should be privatized, but rather to note that any discussion of public sector alliances must take into account the role they are likely to play in privatization now or in the future. Essentially, there are three strategic options available to public organizations who want to play the alliance card: Using alliances as a substitute for privatization, using alliances as an intermediary step toward privatization, or using alliances by a privatized entity to enhance competitiveness and meet strategic and operational goals. Each organization should determine its strategic choice since it will greatly affect the kind of alliance it would want to establish, its partner selection, its mode of operation, and its linkages to the rest of the organization. Public organizations should also determine whether a given alliance would not constrain its repertory of responses should their strategy shift. Indeed, these options are not exclusive of each other and may evolve over time.

Option 1: Alliances as a substitute for privatization. In this option, alliances are established by public organizations that do not intend to proceed toward privatization now or in the future. This is a form of outsourcing, except that in the case of alliances, it is of a long-term nature and is not necessarily unidirectional (i.e., the supplier to the public entity may also obtain services and inputs from the public organization). Where privatizing a portion of the organization's operations is not politically, socially, or legally feasible, alliances enable the public organization to, in effect, privatize those elements that are most costly or lie outside the core competency of the organization. This is as true for the air transport portion of the USPS as much as for, say, food service in schools or debt collection by the IRS. In this option, the rest of the organization is not directly affected by the alliance and not much learning is likely to take place (with the possible exception of limited contact points between the alliance partners).

Option 2: Alliances en route to privatization.
In this option, public organizations use alliances as preparation toward some form of privatization in the future. This is done, for instance, by shedding unwanted service elements that lie beyond the public organization's core competency and/or core obligations to the government and citizenry. If the alliance is successful, the public organization has made itself more attractive by enhancing its performance in a given area and preventing a need for further restructuring as part of the privatization process. More importantly, if learning from the alliance has taken place, the organization has by now changed its culture and improved other facets of its operation, making it more attractive to potential bidders and more amenable to eventual privatization. Should the alliance partner be involved with the privatization, an added benefit would accrue as a result of the familiarity and trust established between the two organizations. Indeed, public organizations that pursue this option need to consider this possibility when making their partner selection.

Option 3: Alliances as a portfolio of a privatized entity.
In addition to all the benefits from alliances that potentially accrue to organizations, newly privatized public organizations can draw other benefits. The newly privatized organization is often vulnerable, with the transition having taken a considerable portion of its time and resources. Having alliances can take some of the pressure off, since the partners carry a portion of the operational responsibilities. It can also add capabilities that are critical in the private sector and need to be acquired (e.g., logistic expertise in a postal service). Alliances can also serve as a source of expertise and learning for the newly privatized public organization, which faces the formidable task of converting systems and training former civil servants to work in a more competitive environment.

Recommendation 2: Ensure Learning from the Alliance Is Disseminated Throughout the Organization

Spreading the potential benefits of alliances requires an organization that enables and encourages information sharing and learning across departmental boundaries. At USPS, for instance, if learning from the alliance with FedEx remains limited to those units and people in the USPS who deal directly with the private sector firm, the potential benefit to USPS will not be maximized. Public organizations that establish alliances for learning purposes (or where learning is an important objective) would do well to establish learning mechanisms to facilitate cross-learning. Such mechanisms include, for instance, rotation (so different people from different units are exposed to the private organization and its operational mode), broader participation in meetings and forums, and training. Training may include a seminar where alliance managers discuss their experiences and a scenario exercise where other staff members consider a hypothetical alliance involving other units of the public organization.

Recommendation 3: Contingency Factors

All organizations have entity-specific characteristics that impact their amenability to alliances, their probability of alliance success, and the benefits they are likely to draw from their alliances. For instance, if we were to draw a public-private continuum, the USPS would be placed farther away from the public pole than most U.S. government agencies. This is because the organization is a quasi-government entity that in essence funds its operations from its own revenues. By comparison, most government agencies operate with the resources assigned to them by the executive and legislative branches through the budgeting process. While the USPS is impacted by regulatory decisions (e.g., postage rates), the same may be said about private sector organizations. This implies that the USPS is more amenable to alliance formation and that the cultural differences it has from the private sector are not as large as those faced by other public entities. This does not mean that alliances cannot be useful for other public organizations, but rather that the type of alliance chosen, partner selection, and benefit-drawing mechanisms must all be adjusted. For example, learning mechanisms in an entity closer to the public organization pole will need to be more formal and more numerous, and may take longer to work than was the case in the USPS-FedEx alliance.

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