

# **Bridging the Gap**

How procurement can add value  
in a post-merger situation

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Recent times have again seen mergers and acquisitions (M&As) on the rise. Though M&As are often driven by financial considerations, whether or not the acquisition or merger proves to be a winner depends on the success of the post-merger integration effort.

Though often overlooked in the pre-merger and due diligence phases, procurement can play a critical role in ensuring a successful post-merger integration (PMI). PMI procurement can offer rapid savings and deliver a wealth of critical information on incumbent contracts and practices. Moreover, a procurement initiative can hit the ground on day one after the deal is closed and is an ideal means of encouraging people to work together and generate a new company culture.

Efficio has extensive experience in performing procurement transformations in post-merger situations for both blue chip corporations and private equity houses. In this white paper we explain the value of involving procurement in the pre-deal phase, explore the specific procurement challenges surrounding post-merger integration, and propose an approach for effective PMI procurement.

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# Introduction

**Virtually all companies will be confronted with mergers and acquisitions at some point in their life cycle. The decision to merge or acquire is generally based on financial and strategic considerations. Changing circumstances may require greater efficiency and economies of scale and new technologies may demand that a company gains ownership of critical expertise.**

Sometimes companies merge to gain entry into new geographies and markets and sometimes it is a matter of survival in an environment of larger competitors. Nonetheless, however compelling the strategic vision may be and however tempting the synergies may appear on paper, a merger or acquisition's success or failure is driven by the degree to which the merged companies successfully manage to integrate.

Post-merger integration is a complex process that needs to take account of a wide number of aspects and issues. Not only do the post-merger companies need to restructure their organisations and align their processes, key aspects such as culture and managing expectations need to be addressed as well. All of this is easier said than done. The sad fact remains that over 80% of newly-merged businesses fail within 18 months of closing the deal and the reasons for this failure often lie in unrealistic expectations and a breakdown as a result of cultural differences.

Given these difficulties, companies are increasingly looking to find ways of enhancing the merger process. At the same time, the increased role of private equity means that pressure for mergers to rapidly deliver concrete financial benefits is higher than ever. Though traditionally it is rarely taken into consideration when the numbers are prepared and the plans are drawn up, procurement is increasingly coming to the fore as a key function for facilitating integration and maximising a merger's chance of success.

For those familiar with procurement transformation, this will not come as a surprise. Procurement has been steadily rising on the boardroom agenda as a means of delivering strategic advantage rather than just as a means of reducing cost. The advantages that procurement initiatives bring in a non-merger situation, such as relative ease of implementation, rapid realisation of bottom-line savings and the development of clear structures and processes that cut across internal company boundaries, prove to be even more beneficial in the frantic and often uncertain post-merger environment.

# Opportunities and Benefits

Maximise opportunities and benefits by involving procurement up-front

With investors generally looking to earn back the acquisition premium in an 18 to 24 month time-span, it still remains surprising that the purchasing function is rarely taken into consideration in the pre-deal phase. In a typical process industry company, procurement spend (both direct and indirect) can represent up to 60% of total cash outflows, while

for a mass manufacturing company this may even be as much as 75%. Procurement thus represents well over half of the newly acquired prize. With its ability to deliver savings, both in terms of quick wins and long term performance improvement, procurement is one of the most powerful levers for earning back the M&A investment.

Unlike the efforts required to integrate functions like production or manufacturing, which may involve painful headcount reductions and expensive write-downs, procurement transformation can be relatively “pain free” and only requires limited up-front investment. Critically, procurement transformation can take place rapidly and start generating bottom-line savings soon after the deal has closed. This not only allows companies to quickly demonstrate the merger’s benefits to their shareholders, but also delivers critical momentum internally. Shareholders will be pleased to see that the price of the acquisition is beginning to be repaid, while employees will see that combining forces generates positive results, which in turn encourages cooperation and commitment to successful integration.

**Cultural differences account for the majority of failed mergers and can be exacerbated by employee dissatisfaction and uncertainty.**

the cultural issues involved in a merger should never be underestimated. Cultural differences account for the majority of failed mergers and can be exacerbated by employee dissatisfaction and uncertainty. CPOs and other procurement professionals have long known that their function has an impact right across the organisation. Addressing procurement will therefore involve a cross-company effort and will need to be carried out by multidisciplinary teams drawn from various parts of the company. In a post-merger situation this means that people are called upon to work together and start bridging the culture gap by building a shared procurement function.

The need for extensive operational information, interdisciplinary collaboration combined with the satisfaction of rapid synergies and the pride in developing unified, world class processes, make procurement an effective spearhead for cultural change. Ultimately, it should be about creating real joint ownership of the successful transformation.

**Procurement’s impact on a company’s performance and day-to-day operations make it an excellent place to start obtaining in-depth information on an organisation’s processes and structure.**

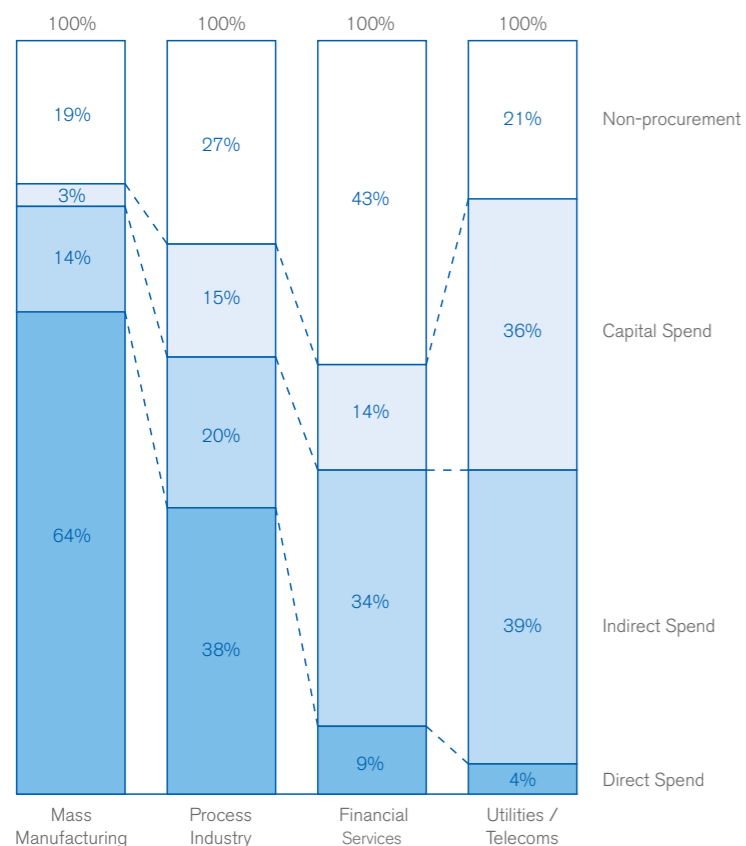
Failing to address procurement in time may also result in the added complexity of a mismatch between the high-level figures projected at a merger strategy level and the actual achievable savings on the ground. The process of reviewing supplier contracts from a procurement perspective and creating a combined spend baseline and contract database makes particular sense in a due diligence phase. Procurement’s impact on a company’s performance and day-to-day operations make it an excellent place to start obtaining in-depth information on an organisation’s processes and structure. Almost every part of a company sources materials, products or services, whether these are directly or indirectly related to the organisation’s key offering. This means a procurement review can reveal vast amounts of information and provide clarity on a company’s internal processes and external contracts. This information can be used to create more realistic targets and identify viable quick wins. Most importantly, this kind of up-front approach makes it possible for synergies to be unlocked on both sides of the merger, both from within the target and the acquirer.

**Concentrating volumes, pooling buying power and harmonising company-wide specifications are all familiar strategies that sophisticated purchasers deploy, and such measures are particularly appropriate in the wake of a merger.**

It will be clear to CPOs and other procurement professionals that M&As are a natural trigger for pursuing procurement synergy. Concentrating volumes, pooling buying power and harmonising company-wide specifications are all familiar strategies that sophisticated purchasers deploy, and such measures are particularly appropriate in the wake of a merger. Compared to the changes that other parts of the company may need to undergo, such measures are relatively easy to implement and help to establish long-term value for the organisation. Additionally, the overall shake-up generated by a merger or acquisition provides a good trigger point to refocus complacent supplier relationships and generate easy savings to the bottom line.

The pre-deal phase also offers an opportunity to select and line up key purchasing personnel and build a dedicated core team that will drive the post-merger activities forward. Not only does early involvement generate a degree of ownership for the numbers that need to be delivered, it also kick-starts the crucial process of having people from both sides of the acquisition intensively working together and building a new corporate culture. It means that there is a team primed and ready to get started the moment the deal is closed. In this way the transition process can get underway smoothly and efficiently as soon as the core team hits the ground. Additionally, procurement transformation offers an excellent platform for driving through a strong company culture. Procurement, with its many interfaces within the company as well as its external relationships with suppliers, is particularly sensitive to cultural issues. As already noted,

Efficio Fig 1 - Procurement Spend as a % of Total Cash Outflows



## Benefits

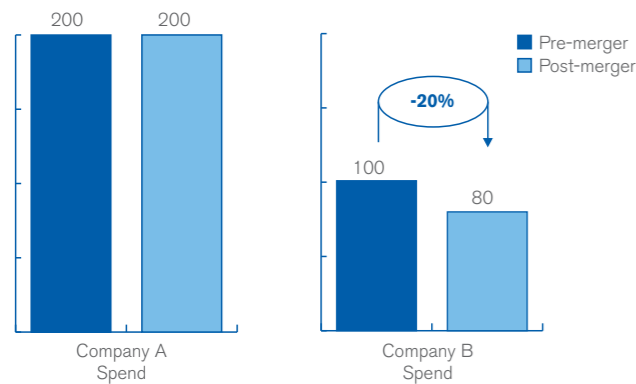
- No headcount reduction & associated write-downs
- Limited up-front investment
- Most savings flow straight to the bottom line
- M&A is a natural procurement synergy trigger (volume concentration, etc.)
- M&A event is an “excuse” to shake up complacent supply relationships

# The PMI Methodology

## Maximise opportunities and benefits by involving procurement up-front

Efficio Fig 2 - Unidirectional vs. Bidirectional Benefits

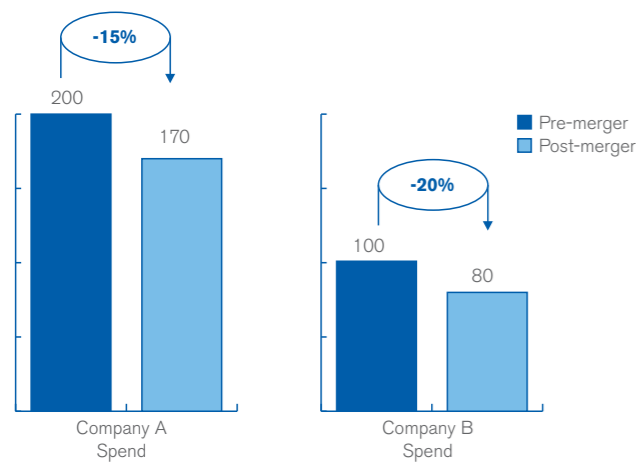
### Unidirectional benefits



### Key Learnings

- The larger party does not necessarily have better pricing!
- Don't play "our contracts v your contracts" – it is likely BOTH can be further harmonised
- The merger provides a very powerful trigger to put the whole spend out to bid... with much to gain and lose for both suppliers
- "Just bolting B's volumes onto A's contracts" sounds simple, but isn't... suppliers will argue that differences in spec and service level make price harmonisation impossible
- The larger incumbent must be presented with a threat, not just with an opportunity to gain more

### Bidirectional benefits



Basing synergy assumptions on only one company's procurement insights raises the risk of overlooking the potential gains to be generated by the other company's processes or supply chain relationships. Particularly in the situation in which a larger company acquires a smaller one, it may be tempting to simply bolt the smaller company's volumes onto the larger company's. Also, a perceived hierarchy between the acquirer and target may prompt the expectation that the target company will simply have to conform to its new owner's practices. Additionally, it may be too easy to assume that quick wins can be obtained by simply bolting the volumes of the one company on to the other as suppliers may argue that the new situation adds complexity to specifications and service levels. Loss of momentum and becoming bogged down in unforeseen details can be a critical danger in a post-merger situation, leading to frustration in the workforce and impatience among investors and owners while companies run the risk of missing

out on bidirectional synergies. There is no hard and fast rule that a larger company's contracts or processes will be stronger than those of a smaller one. On the contrary, it is most likely that both offer ample opportunity for further harmonisation. This is why it is crucial to obtain a clear picture of the pre-merger situation, to identify critical differences in taxonomies, spend classifications, processes, organisation structures, cultures and means of communication. The sooner that unequivocal processes and governance can be put in place the better. Last but not least, a combined procurement effort driven by a multidisciplinary team drawn from both the target and acquirer brings the added benefit of rapidly getting people to work together under a single set of processes and rules. A well-structured PMI procurement transformation thus reveals the bidirectional synergies and shows both sides that they can learn from one another and build value together.

Though the opportunities are clear and the potential benefits sizeable, transforming the procurement function in the process of an M&A event will always be a particularly complex task.

Aside from the customary complexity, uncertainty and unrest that tends to accompany mergers, procurement will need to perform a number of challenges in parallel and deliver to a tight schedule. Firstly, there is the task of transitioning day-to-day procurement operations without impeding the post-merger company's business processes, and secondly, there is the need to capture the obvious synergies and deliver savings towards repaying the merger investment. Thirdly, there is the challenge of building a new best-practice procurement function to deliver long-term value to the new company.

Efficio Fig 3 - Procurement's Multi-faceted Task in PMI



These specific challenges require a dedicated, methodological approach. This should be a quick scan methodology that delivers clarity with respect to the overall scope and opportunity, as well as the process and steps necessary

to achieve the transformation and savings. Additionally, this clarifies these opportunities and processes in both the acquirer and target organisation.

## Mapping the current situation

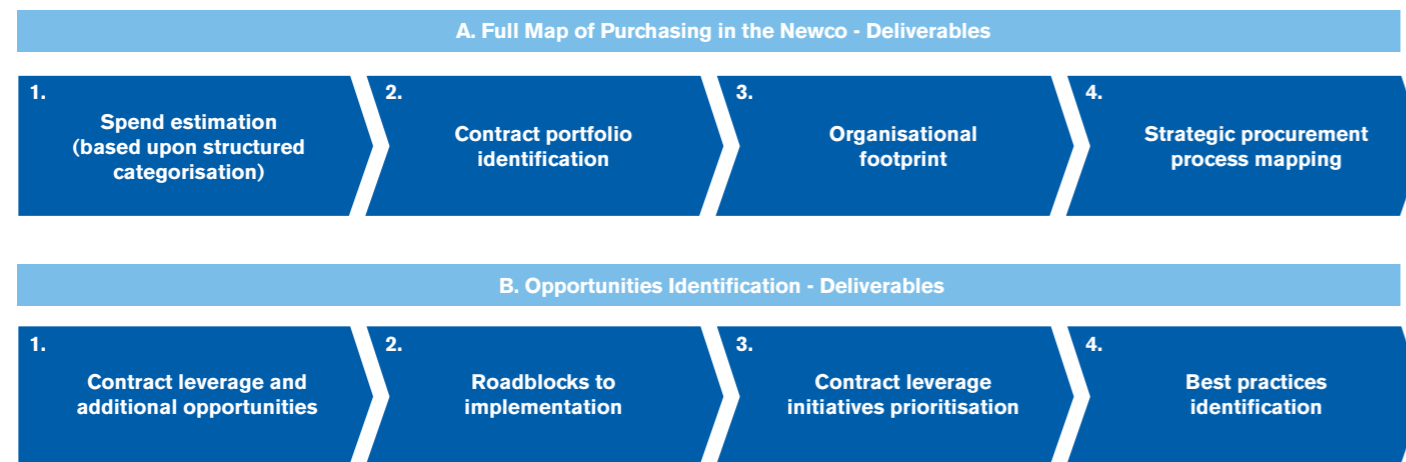
The initial steps are all about gathering and structuring information in both the acquirer and target companies and creating a full map of the purchasing situation. It is only possible to estimate the spend once apples-to-apples comparisons can be made between the target and acquirer's outlay. The first step is to extract the spend and supplier information from the target's A/P systems and map this in terms of the acquirer's taxonomy and categorisation. This is necessary to make the information analysable and create a "spend cube" database in which spend and contracts are matched to suppliers, categories and business units.

The next step in the mapping process is an extensive analysis of the portfolio of contracts. Because there is rarely a reliable database of contracts in place, this often requires tracking down contracts throughout the organisation and custom building a database. Besides the effort of collecting all the existing contracts, it is critical here to select the right parameters against which contracts are to be compared. Once this is done, the information from the contracts can be extracted and reviewed. Specific attention needs to be paid to price and pricing systems, but also to possible M&A opt out clauses, which may constitute either an opportunity or a risk in the wake of the merger.

Having mapped the spend and set up the contract portfolio, the next area of attention is organisation. Here it is not only necessary to draw up a detailed organisation chart, but also to determine how categories are defined and how procurement is structured within the organisation. At the end of the day, an organisation chart remains an abstract picture; to determine the true organisational footprint of procurement it is necessary to spend extensive time talking first hand to people in the procurement teams. Conducting interviews using a consistent structure allows you to draw a clear picture of the organisation that not only shows its theoretical functioning, but the way it works in reality too. Besides interviews, conducting workshops can deliver clarity on category governance models, procurement scope and the allocation of roles and responsibilities.

It is also important to map the existing procurement processes. Here it is possible to identify the current strengths and weaknesses and outline the key issues that need to be addressed. A lot of the information can be gathered in workshops, which have the added benefit of getting people from across the organisation to intensively work together – thus contributing to the formation of a new company culture.

Efficio Fig 4 - The Efficio PMI Quick Scan Methodology



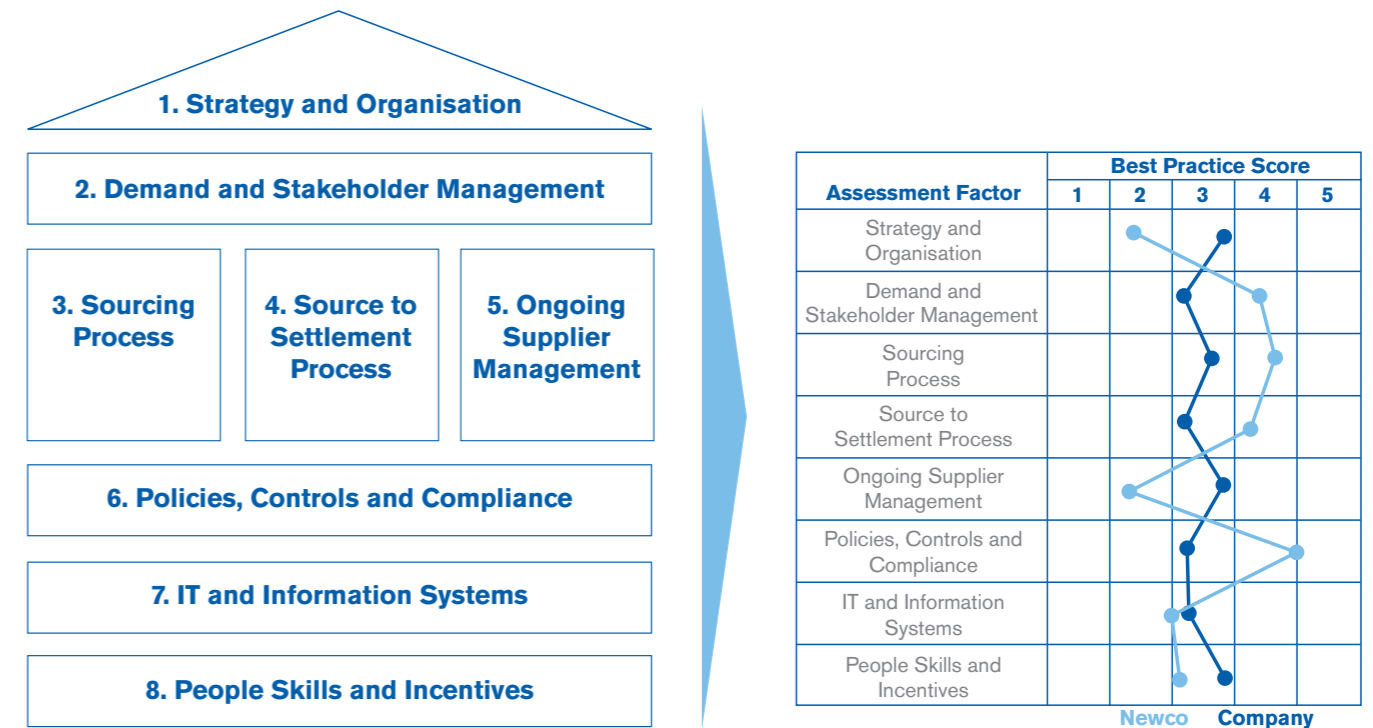
## Identifying opportunities and threats

The wealth of detailed information generated in the mapping process forms the basis for identifying the opportunities and threats as well as the steps towards best practice. In this process it is key to be aware of the potential for bidirectional synergies and how both the target and acquirer can benefit from each other's best practices.

The apples-to-apples comparisons enabled by the contract database mean that it is possible to determine the degree of contract leverage that can be obtained in the new organisation. A structured approach ensures that it is possible to estimate the potential savings which cover many levers besides volume and also scores the category performance in both the target and acquirer company against category-level best practices. This makes it possible to fully size and define the opportunity.

It is also important to recognise the threats and roadblocks. For each category it is necessary to pinpoint contract issues, switching costs, organisational sensitivities, technical complexities and other possible constraints. Mapping these issues makes it possible to grade categories in terms of ease of implementation. This means that it becomes possible to phase the purchasing opportunities by the potential savings and implementation complexity. Quick wins to build momentum and drive the merger forward can be identified alongside long-term opportunities to build value for the future. This can be used as the starting point for activity plans.

Efficio Fig 5 - Effectiveness Rating & Best Practice Plan



Finally, the analysis of the organisation, processes and people conducted in the mapping phase allows for the scoring of the target's and acquirer's effectiveness against industry best practices. This is a powerful way of identifying synergies as well as for making a start to designing the new

processes and practices in the post-merger organisation. This analysis reveals the steps that the organisation as a whole will need to make towards achieving these best practices and provides greater accuracy when predicting savings estimates.

# Bridging the Gap

## Parallel processing - Moving forward together

Deploying multiple teams to enable the parallel processing of target and acquirer information allows quick scan data to be analysed while additional, granular information is gathered in face-to-face interviews and workshops.

For any post-merger integration, change management is key and it is critical to address this in advance. Once it is clear where the gaps and bottlenecks lie, a clear vision of a new shared company culture is needed. It is important to bear in mind that a successful post-merger integration will involve change and learning for both sides. This requires the courage and vision of those involved to clearly present the case for procurement transformation including the opportunities and threats that both sides face. It also requires an open-minded approach that is willing to challenge assumptions and thoroughly investigate the realities of the situation, rather than merely assume theoretical synergies. However, with a clear understanding of the initial situation, a realistic estimation of the quick win synergies and a compelling vision of the best-practice procurement organisation to be built for the long term, it is possible to move forward sequentially, capturing both quick wins as well as building for the future.

**“It is important to bear in mind that a successful post-merger integration will involve change and learning for both sides. This requires the courage and vision of those involved to clearly present the case for procurement transformation including the opportunities and threats that both sides face”.**

**Whether the reasons for a merger or acquisition are financial, strategic or tactical, the proof will remain in the post-merger entity’s ability to compete at an operational level and repay the M&A investment. Though the challenges are considerable, procurement represents a major source of relatively painless solutions that allow the rapid realisation of substantial PMI benefits. Procurement’s many interfaces within an organisation, as well as its extensive connections to the supplier environment, mean that it can play a key role in positioning the new organisation towards the future.**

Procurement professionals can seize the opportunity to step up their profile and significance within a newly merged entity. Demonstrating the ability to rapidly and efficiently deliver significant merger savings can be the first step towards positioning procurement as a powerful force in the business. The overall shake-up brought about by the merger or acquisition offers procurement the opportunity to structure the new organisation according to best practices and world-class procurement processes. In this way, the benefits extend far beyond the quick-wins achieved by leveraging post-merger buying-power. Instead we see procurement delivering a sustainable, positive, long-term impact on the company’s profitability.

The earlier it is involved in the process, the greater the clarity that procurement can provide on the opportunities and the risks that procurement offers in the post-merger situation. This is why experienced M&A players are increasingly recognising the value of involving procurement up-front, in the pre-deal and due diligence phases. As the overall discipline of procurement becomes increasingly sophisticated, so too has awareness risen among boards and investors that PMI procurement does more than capture cost synergies: it can deliver the critical structure and momentum to successfully drive a merger from the abstract financial vision – overcoming uncertainty and cultural change – to its concrete, day-to-day realisation at all levels of the new organisation.

## Case Study

**When a global high tech consumer organisation acquired a wide range of companies to help support its strategic vision, Efficio was engaged to map existing non-product related purchasing and to identify the opportunities for post-acquisition savings.**

Our initial encounter with the newly acquired companies (Newcos) was characterised by the typical uncertainty and confusion of a post merger situation. Though procurement savings targets had been forecasted, no detailed up front due-diligence was conducted. Nor was there any rigorous methodology in place to map the current procurement practices and to realise the expected savings. Besides the lack of detailed project planning, management direction and dedicated resources, the situation was marked by an overall lack of transparency on spend data and a vast complexity of contractual agreements.

Efficio organised and deployed dedicated resources in a “flying squad” approach. We conducted a series of quick scan visits to all Newco sites and spent intensive face-to-face time with global and regional managers to assess current practices. We also extensively interacted with the Newcos’ procurement and operations managers and initiated a drive to reveal the existing spend and contracts data.

After this rapid process of information gathering, we deployed our structured PMI methodology to fully define and prioritise the savings opportunities. This enabled us to fully map the Newcos’ spend in a detailed database using their own categorisations and create visibility across multiple dimensions. We also built a detailed contracts database (for all the companies involved) which could be used as a baseline for assessing the degree of existing contract leverage.

In the process, we forged strong multidisciplinary teams that melded the new company culture and helped to drive the post-acquisition vision forward. The full map and transparency of the Newcos’ procurement practices and organisational structures allowed us to identify a substantial savings opportunity on a category level, with full buy-in from Newco management.

# About Efficio

Efficio is a results-focused procurement consultancy, with a track record of helping leading organisations achieve more value from their procurement. Whether the challenge is delivering significant savings to the bottom line or managing suppliers to create value for the longer term, Efficio provides a range of client-tailored services including:

- Procurement Transformation
- Strategic Sourcing Execution
- Supplier Relationship Management
- Private Equity and Post-Merger Integration Support
- e-Procurement Strategy & Implementation

Comprised of experienced professionals with a blue-chip consultancy heritage, Efficio combines the credentials of a top tier firm, with the depth of expertise and execution of a flexible niche player. With offices in the UK and Germany, and a growing operation in the USA, we service clients from a broad range of sectors throughout Europe and the United States.

To learn more, please visit [www.efficioconsulting.com](http://www.efficioconsulting.com) or call **+44 20 7553 6900**

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