RAISING PROCUREMENT'S GAME IN PMI

By Martin Högel, Dan Belz, Niamh Dawson, and Nino Mori

Despite record corporate valuations, mergers and acquisitions are continuing at a high rate. But high acquisition prices are putting extra pressure on post-merger integration (PMI) teams to realize substantial synergies. Among cost synergies, external spending—which typically accounts for 30% to 70% of a company's total expenditures—is increasingly getting the lion's share of attention. The procurement function generally orchestrates these external-spending synergies, regardless of whether the responsibility for meeting a target lies solely with procurement, a business unit, or both.

What can procurement managers do to step up their game? They should give more attention to preclose synergy preparation, substantially enhanced by digital technologies. They should also focus on change management. Those who do so will be in a much better position to meet shareholders' high expectations.

The Procurement Challenge

Companies that acquire another business typically reduce the total combined external spending by 2% to 5% within 18 months of closing the deal. The reduction in spending varies depending upon the degree of overlap in operations and in the associated spending categories. Procurement often achieves savings by pursuing conventional approaches—such as harmonizing or renegotiating contractual terms, combining spending to secure higher-volume discounts or to move to lower-priced vendors, and conforming spending policies to the more restrictive (and thus less expensive) terms—across the two companies. (See Exhibit 1.)

However, low single-digit savings are often no longer enough to satisfy investors. As a result, dealmakers are setting increasingly ambitious goals for synergies—in terms of both the size of the savings and the time frame for realizing them. Challenging goals are achievable, but only if procurement managers exploit the full set of levers that are available. Often procurement focuses only on the conventional approaches and neglects the gains that could be made from implementing more-advanced approaches.

Exhibit 1 | A Toolkit for Procurement Synergies in PMI

	Lever	Description	Implementation: Months
Conventional approaches	Supplier management	Renegotiate contracts according to the better price, timing, and other factors	1–2
	Bundling	Combine contracts and reduce the number of suppliers to secure volume discounts	3–6
	Demand management	Conform spending policies to the more restrictive terms	2–9
Advanced approaches	Process optimization	Implement better practices, such as tail-spend management and demand forecasting	6–15
	Source optimization	Adjust supplier structure (for example, by switching from a distributor to an OEM to eliminate the middleman), or change onshore-offshore ratios on the basis of higher combined spending	9–18
	Make-or-buy tradeoffs	Assess opportunities to insource, owing to higher volumes or new in-house capabilities	12–18
	Product standardization and redesign	Harmonize product specifications to reduce the number of SKUs across both companies	12–24

Ease: Easy / Hard

Source: BCG analysis.
Note: PMI = post-merger integration.

The latter include optimizing processes, adjusting the make-or-buy tradeoffs, and standardizing products.

To achieve higher-impact synergies, procurement needs to dig deep into the external-spending practices and details of the target company. Only with advanced analysis can procurement have the spending information it needs to capture synergies.

After procurement lays out a plan for capturing the synergies, it must also work on preparing and encouraging people to change, as these higher-order gains require more than negotiating new contracts; people must alter how they go about their work. Substantial efforts should start (provided there are no legal restrictions) prior to closing a deal. Such efforts will help secure buy-in for capturing synergies and serve as a general platform for managing the challenges that inevitably arise in PMIs.

Acquirers need to remember that even the most straightforward deals can bring a variety of procurement integration challenges. That's because on top of any differences in company culture, the procurement structures, practices, capabilities, systems, and data quality can vary enormously across companies, hindering integration. Yet differences can also offer opportunities. Anticipating and understanding these differences is therefore critical for a successful integration.

The greater the differences between two organizations, the more work is typically needed to win people's support for the integration. Employees in both companies are often too concerned about the future, or too busy with their regular duties, to spend much time on combining functions into a consistent whole. As a result, cooperation and productivity can drop. What looked like a straightforward task becomes complicated, owing to the lack of participation. The best-laid plans to capture synergies can quickly bog down, causing the acquirer to miss the synergy goals.

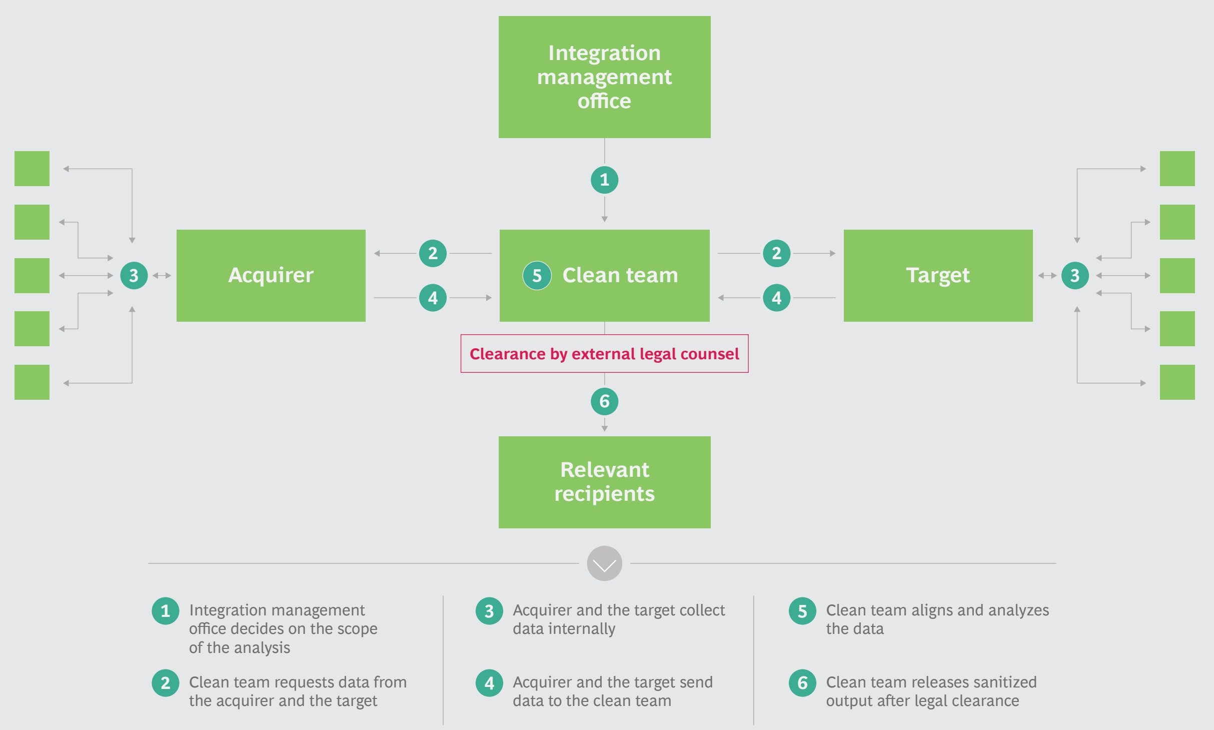
Preclose Synergy Preparation

More and more acquirers are realizing the challenges of meeting shareholders' expectations. Therefore, they are getting an advanced start on a deal's integration work by having the integration management office establish a clean team—a special group that is legally permitted to view and analyze detailed and sensitive information about a target company, such as granular data on external spending. (See Exhibit 2.) Clean teams can benefit from the help of implants—senior experts from both companies who are fully allocated to the team throughout the preclose phase—in addition to appointed external professionals. A clean team's analysis helps an acquirer to move quickly and begin integrating the companies on day one.

Having access to a target company's external spending and commercial contracts enables a clean team to chart areas of potential savings, such as price differences and disparate operating models. The team may also discover challenges (such as expiring supplier contracts) that could hinder capturing potential synergies. To preserve the company's ability to achieve future synergies, the clean team could induce procurement managers to seek short-term extensions instead of full-length contract renewals. In a recent merger in the steel industry, the two companies went even further. To ensure synergies on specific raw materials while also ensuring timely delivery of those materials in a capacity-constrained supply market, the companies received regulatory approval to jointly negotiate contracts with strategic suppliers before the deal closed.

In a recent health care merger, the two companies had minimal overlap in operations, but the acquiring company's procurement managers still sought hefty synergies in indirect spending categories. A clean team worked intensively to prepare detailed playbooks for each category, including administrative support, office supplies, transportation, IT services, and computer hardware and software. The team analyzed supplier prices for conventional procurement synergies, but it also prepared the way for integration leaders to seek advanced synergies. With the new company's printing needs, for example, the team promoted digital communication, which helped reduce total print costs by one-third. Elsewhere the team identified services that could be brought in-house, into the now larger organization, thereby reducing total costs.

EXHIBIT 2 | The Role of the Clean Team



Source: BCG analysis.

The Digital Opportunity

Thorough preclose synergy preparation requires bringing together granular procurement data from the organizations into a uniform *spend cube*—a three-dimensional baseline of the amounts spent by commodity, vendor, and cost center. Creating a spend cube can be a daunting task, yet it is necessary. Without a common spending taxonomy and line item granularity, purchases that are essentially the same can't be compared in order to determine the potential for savings.

Digital technologies can now greatly speed the work of combining purchasing data and identifying savings. That's because natural language processing can dig into purchase orders and other sources to classify spending. Typically, an integration team starts by establishing a single baseline taxonomy for the spend cube. Robotic process automation, boosted by artificial intelligence, then dives deep into the long tail of suppliers to match each purchased item with a category in the taxonomy. The team still needs to complement the machine work with manual allocations and crosschecks. But the level of automation and accuracy has improved substantially in recent years.

Such an approach isn't necessary for all integrations. If both companies have fairly clean and complete data sets, and the taxonomies are reasonably close, then a spend cube can be created manually. Otherwise, the digital approach is likely to be superior. In addition to gaining insights into savings opportunities, spend cube analysis enables companies to answer a wide variety of questions: How well are the various factories and offices complying with pan-regional contracts? Do fluctuating purchase prices for certain raw materials indicate flawed contracting strategies? Can operations planning reduce the hefty express-shipment charges for certain components? For a specific subcategory, can the number of SKUs at the target organization be brought in line with the number at the acquiring company?

Some advanced analytics may require more resources than are typically available prior to closing a deal. But even in these cases, digital tools can do much of the work automatically. For example, data crawlers (customized software bots that systematically probe databases) can carry out complex tasks such as similar-parts and parts-properties analysis.

Digital technologies thus enable procurement to carry out a much deeper and broader set of analyses than it can do manually, thereby gaining a head start on realizing synergies on day one.

Change Management

No matter how much procurement uses digital tools, synergies are still delivered by people—people who likely face uncertainty about the future and unfamiliarity with integrations. Especially with the greater demands for synergies and the likely need to change common practices, integration is a change management challenge for procurement.

Intensive communication goes a long way toward reassuring employees and engaging them in the integration. Acquirers don't need to convey all the details up front, but they should explain the objectives of the deal, the projected synergies, and the key integration activities, timelines, and governance structures. An integration is dynamic, so it is essential to have regular updates that provide more and more information as day one approaches. During an international merger of two equipment manufacturers, for example, the procurement leadership in both companies separately issued regular newsletters to keep their respective staffs informed. They also occasionally held town hall meetings for interactive discussions.

Retaining critical talent in both procurement organizations is also critical to encourage employee participation. Retention activities can include having senior leaders personally call key people, assigning important roles in the integration, making retention payments, and offering contingent arrangements.

One such key role is to lead a synergy task force. This is an interim execution body consisting of dedicated expert resources from both organizations; it is designed to achieve a procurement synergy quickly. (See Exhibit 3.) Each task force typically relies on the preclose analysis and planning of the clean team. The leaders of task forces must be able to engage and direct resources across both organizations despite the uncertainty surrounding procurement's future after the deal closes.

Putting It All Together

A recent international merger in the chemicals industry illustrates some of these dynamics.

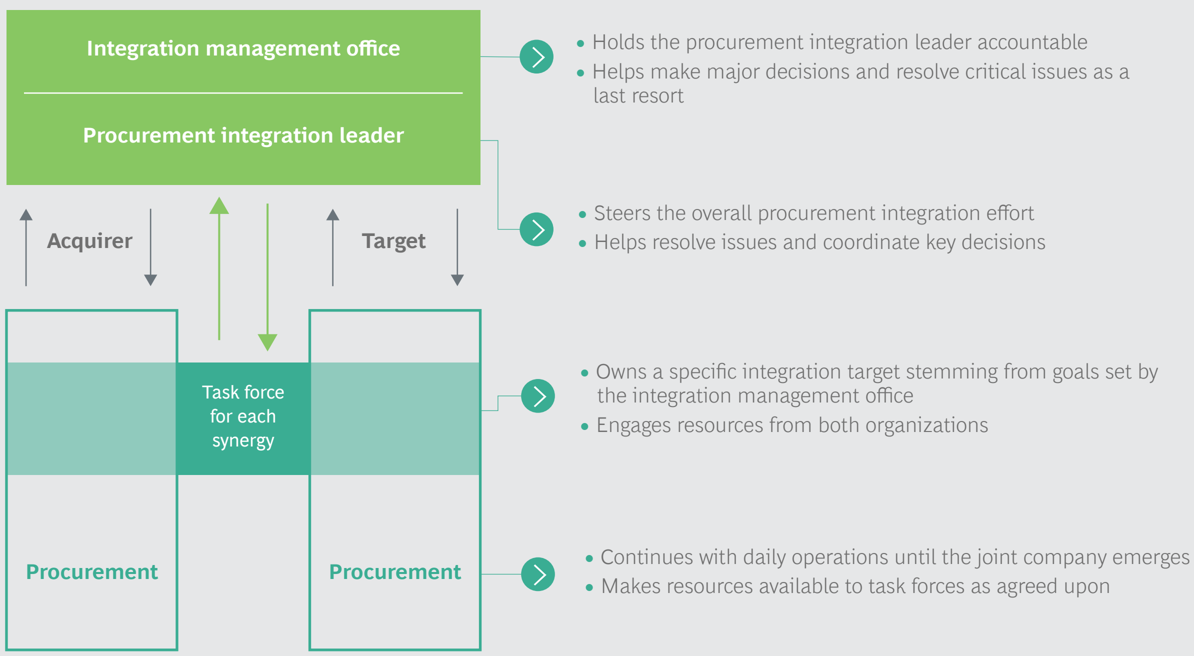
Preclose synergy preparation revealed significant differences between the procurement practices of the two organizations. For example, the acquirer's detailed spending data, which was supported by a unified IT system and strong quality control at the point that purchase orders were entered into the system, was in stark contrast to the target's spending data, which was in a myriad of IT systems and bolt-on software programs. Moreover, the spending taxonomies for the two organizations were very different, which further frustrated efforts to create a spend cube.

The clean team, therefore, used AI to classify the data. It categorized 93%, or 27,000, of the target's suppliers using the acquirer's taxonomy, which had 400 subcategories for single line items. Most of this data was classified automatically or semiautomatically. In that way the clean team gained a superb database for analysis and recommendations.

A second challenge arose on the organizational front: the procurement employees at the target company had been on edge from the start about the deal. The acquirer's procurement leadership soon found out why: another large company in the same region had recently been bought, and the acquirer had laid off most of the procurement employees within a few months of closing the deal.

To allay those concerns, the procurement integration team initiated two procurement leadership gatherings before finalizing the merger. The first was at the acquirer's headquarters, and the second was at the target's.

EXHIBIT 3 | Setting Up Task Forces to Achieve Synergies Early



Source: BCG analysis.

The companies devoted about three days to each event, giving procurement leaders from both companies ample opportunity to socialize and learn about the business and practices of their counterparts, within the legal constraints that govern exchanging information prior to closing a deal.

At those gatherings, the acquirer's procurement leadership also emphasized the logic of the deal, which was to improve the acquirer's capabilities and offerings in a growing area of the industry. Rather than be replaced, the target's procurement employees would play a lead role in the acquirer's future business.

It also helped that soon after announcing the deal, the procurement integration team identified a procurement area where the target had something to offer. The target had developed a program to find and integrate small and midsize vendors into its supply chain. The program worked to diversify the vendor base, which expanded the company's access to innovation, supported growth in the company's immediate region, and reduced the company's dependence on large suppliers. So the acquirer worked to extend those practices throughout the combined organization.

Another trust-building gesture addressed location concerns. The target's procurement employees feared that their responsibilities would move to the acquirer's headquarters. The acquirer said that some were slated to move, but most of them could stay at the target's location, owing to the small spending overlap. And the acquirer explained that it planned to fold its regional procurement office into the target's headquarters. These actions reassured the employees that the acquirer was committed to maintaining a strong procurement focal point at the target's offices.

Meanwhile, the acquirer's procurement integration team prepared its own procurement people for the integration during the preclose phase by sending out sensitive communications and conducting a variety of workshops. As a result, its procurement employees were ready to move quickly.

Although the acquisition closed in 2018, early results suggest that these stepped-up actions will pay off substantially.

Recommendations

Every deal is a journey with surprises along the way. Here are practices that procurement managers can adopt to meet expectations for a deal:

- Get an advanced start on the integration by investing in preclose synergy preparation. A clean team, which ideally includes procurement experts, can prepare a dossier for each synergy category.

- Consider deploying digital technologies to speed the work of combining detailed spending data and identifying savings across the two organizations. Acquirers will likely discover benefits immediately and over time that they would not see otherwise.

- Focus on change management. Reassure and engage employees by conducting intensive communication campaigns, facilitating talent retention programs, establishing task forces to quickly capture major synergies, and adopting some ways of working from the target organization.

- Invest in team-building across the two organizations early on. If employees see themselves as team members on a common journey, it's more likely that they'll adapt to the other organization's practices. Team leaders may need advanced coaching to anticipate and handle the sensitivities that may arise.

- Encourage stretch targets. Few managers welcome difficult goals, but some stretching will encourage procurement leaders to see themselves anew—as managers who are creating strategic value and not simply combining contracts for volume discounts. An integration can be a path for procurement toward a stronger role in the future organization.

- Clarify accountabilities for each synergy target. Higher-order gains—those achieved by applying levers such as make-or-buy tradeoffs and product standardization—are especially likely to require collaboration from other areas. Establishing shared synergy targets as needed between procurement and the business units will help. Integration leaders should also determine how to measure synergies and ensure sufficient transparency into their attainment.

- Take advantage of the pressure and excitement around day one. It will be a one-time opportunity to go to suppliers for better terms, not only on price and volume but also on other relevant parameters. Remember that suppliers are preparing for this discussion, so procurement needs to prepare even better. Managers need to energize and coach employees well before the deal closes.

This is an exciting time for procurement, because it is in a unique position to meet shareholders' heightened expectations. But to rise to the challenge, procurement managers must move well beyond conventional approaches.

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