

## Capturing Near-Term Merger Value through Procurement

**Procurement can deliver at least one-third of the synergy value in successful mergers. Here are four steps leaders can take to achieve effective procurement integration.**

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While strategic mergers and acquisitions (M&A) activities cooled somewhat during the recent economic downturn, "mergers of necessity" have continued at a steady pace. The heightened sense of urgency that typically surrounds such deals makes it especially important for business leaders to ensure business continuity, capture all possible synergies, and effectively integrate the post-merger organization.

McKinsey & Company's experience shows that in the post-merger period, companies identify a significant amount of value – typically one-third of total synergies – by aggressively capturing procurement opportunities. The bulk of the procurement savings doesn't come from headcount, but rather from total cost of ownership (TCO) reductions in the external spend base. McKinsey's work in merger management reveals that success or failure in capturing procurement savings often signals the broader success or failure of the overall merger. For example, failed mergers (i.e., those that destroy value) typically under-deliver in terms of procurement savings, while successful mergers over-deliver (Exhibit 1).

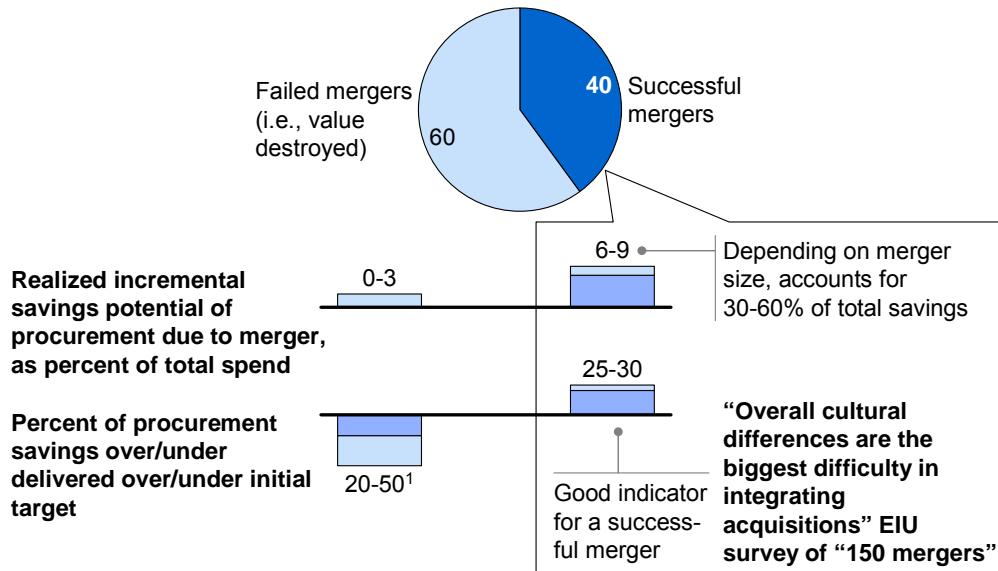
Merger procurement integration creates value in four ways. First, through "re-pricing" as buyers negotiate better contract terms and volume discounts to achieve best-practice pricing parity. Second, companies use strategic sourcing to generate value by implementing a rigorous, fact-based TCO sourcing approach in high-priority areas, addressing product/service specification standardization, global sourcing, demand management, and supplier development. The third value source is transformation of the procurement organization into a world-class operation by optimizing headcount, implementing global category management, and establishing a true procurement center of excellence. Finally, companies can avoid costs and maintain value by ensuring business continuity – effectively working with suppliers and key stakeholders to eliminate potential supply disruptions on "day one" and beyond.

Exhibit 1:

**Shortfalls in procurement typically indicate the failure of the merger**

**Merger performance**

Percent



<sup>1</sup> Even if a successful turnaround is achieved, 5-10% of the initial merger value proposition is lost

SOURCE: Economist Intelligence Unit, McKinsey

**Four Steps to Achieving Procurement Integration**

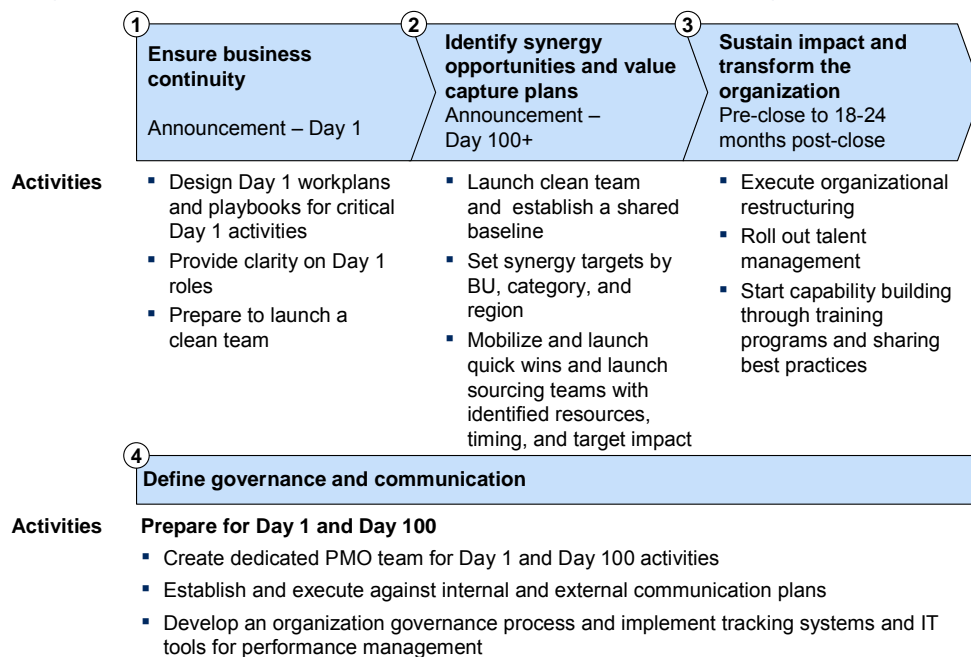
McKinsey experience suggests that leaders can initiate four merger workstreams to achieve effective procurement integration (Exhibit 2): first, ensure business continuity; second, identify synergy opportunities and value-capture plans; third, sustain impact and transform the organization; and fourth, define governance and communication.

**1) Ensure business continuity.** Leaders ensure that day-to-day business activities continue running and are not hindered or disrupted by merger-related initiatives. McKinsey recommends several specific steps to ensure business continuity. Teams can first define the integration approach in terms of a high-level work plan along with team structures and charters, and the process that the company will use to manage the preparation phase. They can also establish a "clean team" tasked with accelerating the company's ability to capture savings quickly once the merger is complete (Exhibit 3). This team can also provide key business stakeholders with "clean" insights about likely priorities and

opportunities following the merger<sup>1</sup>. A significant amount of external spending overlap often exists between merging companies. The clean team's role<sup>2</sup> is to speed up and highlight the potential opportunity to consolidate, and to aggregate spend across suppliers.

Exhibit 2:

## Integration approach based around 4 elements with clear goals



After setting up a clean team, leaders should identify risks and develop a mitigation plan. The business continuity risk management plan should identify and prioritize potential risks and then create contingency plans to address them. Leaders should also develop a day one plan that prioritizes activities that will take place up to and including the first day of the merger, with an emphasis on staging any work that can be done prior to day one (e.g., agreeing upon one travel policy) in order to jump-start the integration process during the first 100 days. Teams then develop a plan for the first 100 days after the merger that identifies any interdependencies that the new company will need to manage. Finally, they

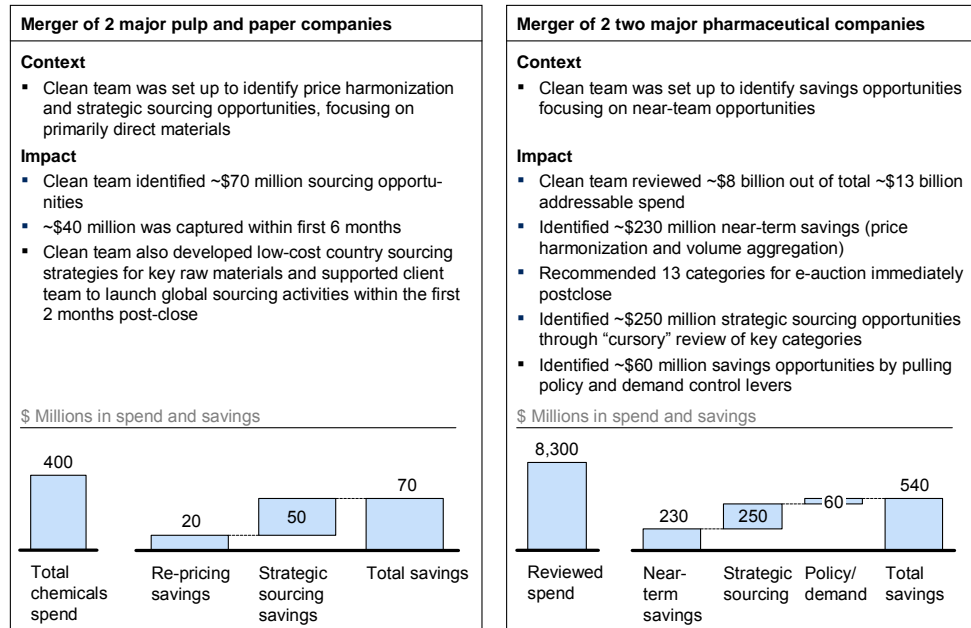
<sup>1</sup> A clean team is a separate team, set up with legal approvals and guidelines, to collect, analyze, and synthesize procurement data, including current prices and contracts from both companies in a merger.

<sup>2</sup> Because the clean team deals with sensitive data, it should remain separate from other integration teams. If the merger does not close, clean team members cannot return to procurement with either company for a significant time period (possibly three years or more).

clarify the day one organization and communicate the changes that will occur within the merged company going forward.

Exhibit 3:

## Savings identified and captured by clean team – case examples



**2) Identify synergy opportunities and value-capture plans.** During this stage, leaders identify and define value-capture synergy targets at the business unit, category, and regional levels, and launch the clean team. They will define and agree upon a procurement spend baseline and develop preliminary top-down savings targets based upon procurement benchmarks and other indicators, as well as define sub-category targets in order to refine results and allocate the opportunity. One client used workshops to set its initial targets, relying upon historical per-category performance and results from McKinsey's procurement database. For each procurement category (e.g., travel, direct materials), the client highlighted existing and potential projects, noted the gap to benchmark performance, identified the suppliers involved, and defined an estimated opportunity value.

A clear goal of procurement integration should be to reduce external spend. Teams should separate this task into tactical near-term efforts (i.e., 3 to 6 months) focused on opportunities such as price harmonization and volume discounts across common suppliers, and strategic opportunities (i.e., 6 to 24 months) that address opportunities such as TCO optimization and global

sourcing. Combined, such actions can often reduce external costs by 10 to 25 percent. In pursuing this goal, one client focused on its information technology opportunities, consolidating its spending across services, and standardizing hardware and software to reduce costs. Another client realized it could take advantage of the weakness in the labor market to negotiate better terms regarding temporary labor. At the same time, it changed its vehicle fleet policy to achieve better vehicle utilization, thus trimming cars – and costs – from the fleet.

Teams then define a sourcing roadmap that aligns stakeholder goals and identify "quick win" opportunities such as rapid re-pricing. A typical roadmap lists the potential value to be gained from rapid re-pricing, the capture of tactical quick wins and strategic sourcing, as well as the timing of each set of initiatives. It further describes key activities, such as plans to hold one-on-one re-pricing discussions with selected suppliers in the post-close period.

Companies should also launch value capture teams quickly (pending legal approval) to accelerate efforts and develop savings ideas. Several considerations should be kept in mind regarding these teams. Value capture rates will likely vary by country and company, since operations in some markets will be more advanced and/or supply market dynamics will be different in various parts of the world. Training and talent levels will also differ between the two newly merged organizations from region to region.

Regional differences could also impact procurement effectiveness. While the Americas could have similar categories and supply markets, other regions, such as Asia and Western Europe, are often more complex based upon regulatory and trade requirements, resulting in a more fragmented sourcing spend and the need to manage a higher number of suppliers.

**3) Sustain impact and transform the organization.** Leaders need to maintain the energy and momentum generated by the merger in order to drive higher long-term procurement performance. Objectives during this phase include defining the structure of the new organization, implementing the new standard sourcing process, and developing related training materials. Leaders should also work to upgrade the merged company's procurement capabilities, and positively influence mindsets and behaviors in the new organization.

To establish an effective procurement function, a number of key success factors should be in place. Leaders should systematically implement design changes to the organization, following a corporate-level view – announcing senior leader roles and gradually naming direct reports to minimize disruptions to the business. Also, the merged company should agree upon a common set of policies for day

one and a common sourcing process, ideally, training the entire sourcing team in the approach in-advance of day one. This will enable team members to work together more effectively immediately upon close.

Leaders should not underestimate the importance of changing mindsets in both organizations and should look for opportunities to hold town hall meetings and bring teams together for planning sessions (with legal approval). Working through HR and allocating time for each team to express thoughts and concerns about what they think about the new organization and their role will at least create an open environment and potentially surface underlying concerns that will need to be addressed post-close. These working sessions should also provide an opportunity for leadership to observe and assess talent as part of an overall retention planning effort.

Successful mergers achieve sustainability through a combination of focused change leadership and role modeling. Leaders work to foster understanding and conviction, develop the talent and skills needed in the merged procurement organization, and put formal mechanisms in place, such as planning processes and standardized problem-solving approaches. They should also ensure that teams have clear roles, charters, and mandates.

**4) Define governance and communication.** Finally, successful procurement leaders, working closely with the integration management office (IMO), establish the governance policies and communication strategies of the newly merged procurement organization. They should define the merger's "pre-close" governance structure in order to ensure successful completion of the integration planning. They should also establish the governance structure that the organization will rely upon after the merger takes place. This "post-close" design focuses on four areas: developing the procurement leadership team, defining the sourcing roadmap, establishing a robust performance management process, and focusing on communication, training, and talent management.

In communicating the new operating model and day one organization, the CPO should have a detailed internal and external communication plan that addresses the procurement organization, key stakeholders, and suppliers to ensure that all employees and suppliers clearly understand the new operating approach, objectives, and senior reporting relationships.

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Success in this four-step process requires leaders to engage key stakeholders in order to understand all business continuity concerns, define interdependencies, and create a sourcing roadmap to capture TCO opportunities. Given the pivotal role procurement plays in merger value capture, senior leaders should pay close attention to integration progress and insist on having the right integration leader to oversee the program.

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