Driving M&A value through the supply chain

Eight levers for an enhanced procurement strategy

If you're embarking on a transaction, be sure to outline a strategy for some of the most important partners in the journey — your suppliers.

The procurement function typically delivers 50%–70% of cost synergy targets, according to an EY analysis of 10 years of M&A transactions. Yet, this area often is not considered until late in the deal life cycle.

A thoughtful and tightly executed plan to capture this value in the supply chain can help not only deliver on short-term cost synergy targets but also set up the organization for long-term profitability. In this article, we suggest ways that CFOs, corporate development leaders and supply chain executives can extract more value from the procurement function during a transaction.

Eight value levers for procurement in mergers and acquisitions:

1. Set expectations with the executive team and establish an aligned, common spend baseline
2. Focus on sustainability
3. Identify "critical" partners
4. Establish an engagement timeline
5. Tailor supplier engagement tactics
6. Balance short-term priorities and long-term goals
7. Drive operating model effectiveness (OME)
8. Futureproof your supply base

1

Set expectations with the executive team and establish an aligned, common spend baseline

Supply chain leaders should leverage operational due diligence reports and external announcements to determine what has been internally estimated and communicated publicly. Reconciling top-down estimates with bottom-up analysis can help identify any material gaps in spend and savings assumptions, and prevent downstream surprises. Setting reasonable targets for the operational team also helps maintain sustainable savings and supplier partnerships.

CFOs cite lack of spend visibility as a key supply chain management issue. Examples range from fragmented decision rights to lack of effective master data management and data availability. Direct spend typically has effective controls and reporting but is generally complex and resource-intensive when it comes to extracting savings. Indirect spend is plagued with limited visibility but often presents double-digit cost-savings opportunities if executed correctly. Current software applications that analyze spending help make this task significantly easier than it was a few years ago.

2

Focus on sustainability

Several organizations cite savings erosion as a common issue within the first two years of undertaking an integration effort. The most common risks include service-level reductions and price increases. In extreme cases, suppliers may face financial insolvency. These risks can be appropriately mitigated by:

- Assessing the financial health of supplier partners in early stages and driving transparency in value-capture negotiations — this helps account for viable supplier margins, and should align to industry benchmarks
- Implementing a governance process with key supplier partners on a predefined cadence to drive joint accountability, usually executed via supplier performance reviews
- Fostering finance-procurement collaboration for benefit tracking and measurement

Capturing savings in M&A integration
In a $50b+ deal that involved integration of two large health care providers, the EY team identified an aggressive target of ~$200m in procurement synergies. Key focus areas included driving operating model changes, demand management improvements, and sourcing strategy development and execution across the entire spend base — including corporate services, business process outsourcing (BPO), facility management and real estate, IT, professional services and other categories. A procurement synergy project management office (PMO) was also established to track synergy capture performance across the M&A life cycle.

3

Identify critical partners

Mature organizations typically have thousands of suppliers and are often unable to focus on the select ones that deliver 80% of the synergy target. After classifying spending, it is critical to stratify suppliers and identify the ones that will be instrumental in delivering NewCo's business strategy. It is especially important to identify long-term contractual commitments and the degree of vertical integration at this step. In a recent effort, roughly 85 suppliers were identified (out of 10,000+) that could potentially deliver on most of the synergy targets. This allowed the team to focus time and resources on a finite set of suppliers and revisit long-term partnerships.

Planning together for the long term
In a recent value creation effort for a manufacturing company, an incumbent supplier of 40+ years was facing the risk of losing the business due to perceived inflexibility over pricing. Over a period of six to eight months, the buyer and supplier engaged in joint strategic planning and were able to renew a five-year agreement while taking out 10% from the cost base jointly without adversely impacting each other's P&Ls.

4

Establish an engagement timeline

Identify critical points of engagement with select suppliers and lay out plans of 90, 180 or more days. In our experience, engaging critical partners early correlates highly with yielding target synergies and identifying big obstacles in the transaction life cycle. For example, during a recent telecom equipment merger, the procurement teams on both sides established a three-way nondisclosure agreement (NDA) to advance strategy discussions with the supplier for IT spending. The use of clean rooms (virtual data rooms set up by a third party to enable exchange of confidential information in the diligence period) helps to enable data analytics on synergy potential and strategy setting. Note that there are rules governing participants in a clean room setting because of implications on future roles in case the deal is not completed.

5

Tailor supplier engagement tactics

Traditional negotiation techniques can yield targeted results in categories where demand power is much higher than supply power. However, in situations where demand and supply power are balanced or where B2B relationship issues exist, traditional negotiation techniques may not succeed. Joint strategic planning with suppliers in these cases warrants a different approach that relies on open and transparent communication between buyer and supplier and a commitment to mutual profitable growth. Customers are better served sharing their vision for NewCo and supplier growth opportunities and then working toward identifying non-value-added areas that are increasing costs for both sides. Strategic partners can provide a rich pool of expertise and bring leading practices from other customers to help deliver sustainable results. In joint strategic planning, suppliers are viewed as an extension of the customer in the value chain rather than being kept at arm's length and treated as an external party.

6

Balance short-term priorities and long-term goals

A common pitfall in renegotiating contracts with suppliers is a heightened focus on capturing savings in the near term (one or two years). Companies instead could adopt a longer-term "partnership" view that accounts for the buyer's total cost of ownership in longer-term horizons. This helps achieve the right balance between market expectations and long-term value creation. Most organizations also place a high emphasis on supplier pricing and often overlook the hidden elements in total cost of ownership (TCO). A combination of levers — managing demand, managing supply and improving processes, compliance and controls — help increase value delivery. In categories such as telecom, IT and travel, for example, policies and compliance controls can make a significant difference in total external spend. For direct spend categories, technical levers such as demand standardization and material substitution can yield more savings compared to pricing reductions. Analytical tools can rapidly identify "similar" or "same" specifications. A proactive dialogue between the CFO and the supply chain organization can enable alignment on a common target, maximize value capture and limit savings erosion after the initial stabilization period. Transactions also provide a good inflection point to review NewCo's working capital strategy in coordination with the finance team and reset supplier payment terms to align with industry benchmarks.

7

Drive operating model effectiveness (OME)

OME involves reviewing the tax efficiency of the supply chain operating model by locating cost and profit centers in strategic jurisdictions. This assessment is often initiated in the executive office with cross-functional leadership. OME, if executed correctly, can help extract significant deal value, while setting the future business up for long-term strategic success. Critical decisions and principles include:

- Insourcing vs. outsourcing, based on core competencies
- Nearshoring vs. offshoring, based on tariff and tax efficiencies
- Identifying fixed vs. variable elements of cost structure such as IT development, transportation and payroll
- Aligning the operating model to industry benchmarks (e.g., spend per FTE)

8

Futureproof your supply base

Customers are increasingly conscious of suppliers' impact outside the core value chain. For example, as you develop your NewCo supplier strategy and external spend, you must consider factors such as carbon footprint, fair trade practices, diversity and other nontraditional concerns. A transaction can also be a great opportunity to revisit or institute a "Preferred Supplier Partner" program. To enhance compliance with the program, successful organizations take the time to review supplier master data and flag or remove noncompliant suppliers from the system.

In conclusion

An M&A transaction can be a critical inflection point, not just to deliver synergies but also to revisit the operating model of the supply chain function, enhance supplier partnerships and realign supply chain priorities to the business strategy. Empowering and training teams to engage in the right conversations internally and externally can enable organizations to deliver sustainable shareholder value.

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EYG no. 001312-19Gbl
1902-3052896
ED None

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