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Integrating purchasing in M&A: An interview with Lenovo's chief procurement officer

The chief purchasing officer of Lenovo explains how he helped to create the operational basis for its continuing evolution from a Chinese powerhouse into a global one.

James R. Hexter

Article at a glance

Chinese computer maker Lenovo's 2005 acquisition of IBM's PC division created a giant operational challenge for Qiao Song, Lenovo's chief procurement officer.

The task? Manage the rapid integration of two purchasing groups with different processes, management systems, and cultures—and save the new company more than $150 million in direct-spending costs within 18 months. The team not only exceeded the target but also successfully created a new unit to manage nonproduction-related spending.

Qiao Song recently spoke with McKinsey about the challenges of integration, his approach to managing talent, and how the procurement function in the technology sector may change.

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The Chinese computer maker Lenovo's 2005 acquisition of IBM's personal-computer division heralded the birth of a global technology giant. Behind the scenes, however, the deal created a giant operational challenge for Qiao Song, Lenovo's senior vice president and chief procurement officer. Qiao Song, who has worked at the company since 1991, was asked to manage the rapid integration of two purchasing groups with different processes, management systems, and cultures. Moreover, three months before the deal was to close, Lenovo's board gave him an aggressive target: save the merged companies more than $150 million in direct-spending costs within 18 months.

Qiao Song

Vital statistics

Born May 8, 1968, in Beijing; married

Education

Graduated with BS in engineering in 1991 from the Department of Computer Science and Technology, Tsinghua University, Beijing

Career highlights

Lenovo (1991–present)

- Senior vice president and chief procurement officer (2004–present)
- Senior vice president, corporate IT (2001–04)
- Vice president, general manager of notebook division (1998–2001)

Qiao Song's new team came together and exceeded that target. He also oversaw the successful creation of a general-procurement function responsible for managing expenditures in nonproduction-related areas (IBM had done so on Lenovo's behalf for a time following the merger). Together, these efforts helped to lay the operational foundations for Lenovo's continuing evolution from a Chinese powerhouse into a truly global one.

Recently, Qiao Song talked with James Hexter, a director in McKinsey's Beijing office, about the challenges of integrating the two purchasing units, his approach to managing talent in purchasing, and his views on the way the procurement function in the technology sector will change in coming years.

The *Quarterly*: What procurement challenges did Lenovo's acquisition of IBM's PC business present?

Qiao Song: Procurement was a big priority for both sides. Everyone realized that while other aspects of the new business might overlap for awhile, the amount of money at stake meant that purchasing needed to be the first team fully integrated by the new Lenovo. But the two original purchasing teams, IBM's and Lenovo's, were quite different. Everything was different, from processes to IT to management systems, key performance indicators, and cultures. Additionally, about three months before the deal was to close, I met with the board and received an aggressive target: I had about 18 months to bank $150 million in savings from direct materials and to achieve $300 million in annualized run-rate savings.

So the challenge was to do two things in parallel: to really understand the production costs involved for each side and to identify savings opportunities that we could work on immediately after the deal closed while also successfully integrating the purchasing team, getting the process management right, and so on. Additionally, I was tasked with creating a general-procurement unit to handle spending in nonproduction-related areas, such as airfare and office supplies.

The *Quarterly*: How did you begin to identify the cost-savings opportunities?

Qiao Song: During an acquisition, everything obviously has to happen according to strict legal requirements, and there are a lot of restrictions on doing cost comparisons. So first we established a "clean room," made up of selected people from Lenovo and IBM, where we could open up all the cost data from the two sides and analyze this in detail.

We looked at the numbers across three dimensions, starting with the low-hanging fruit in categories where we shared suppliers with IBM, allowing straightforward price arbitrage opportunities. The second step was to capture synergies from Lenovo's new, global scale across the categories where we would be significantly increasing our procurement volumes. This was another place where the savings were relatively straightforward to get.

The third layer was direct-materials optimization. The idea was to look at all the products of the new company and to use a set of tools to analyze the cost structure of each part. Then we worked with our design team to decide whether we could choose better designs to replace the older ones or whether we could rationalize excessive specifications that customers aren't willing to pay money for. In many cases, this involves very subtle specification changes to things that customers can't see and don't necessarily value—reducing the thickness of an internal component to reduce costs, for example. This process also allowed us to standardize across our product range, which in turn enabled us to offer fewer suppliers higher volumes and therefore to get lower prices.

Once we had broken down our targets in this way, we looked at each commodity—for example, motherboards or hard drives—to determine which approach would yield the greatest impact. This meant that soon after the deal closed, we had a very clear picture of what savings we needed to get, the approach we were going to take, and the time that would be required.

The *Quarterly*: How did you approach the task of integrating the two purchasing groups?

Qiao Song: First of all, each side had to fully understand what the other was doing. And to be honest, Lenovo's procurement people had no experience with IBM's processes or culture and vice versa. Everyone had a lot to learn. Therefore, we needed to create a very open-minded environment, with extremely candid discussions, so we could pick and choose the best practices from each side. That was our operating principle. Of course, at the same time, we were researching industry benchmarks to have something to compare ourselves against.

The *Quarterly*: How were the two purchasing cultures different?

Qiao Song: I think it was really a reflection of the differences between the two company cultures overall. Both had significant strengths—and each was good in its own way—but those strengths came from very different places. Lenovo, for example, has a very entrepreneurial culture, but we perhaps had less of an orientation around tightly defined processes and structure than IBM did. IBM is very analytically oriented, very systematic, and we needed more of that in order for the new Lenovo to get to the next level.

The *Quarterly*: Can you give an example?

Qiao Song: Take the qualification cycle, where you define the parameters for a given component. IBM, I would say, was at one extreme, in that everything took a long time. Too long, I'd argue. To qualify a hard-disk drive, for example, took perhaps nine months, when the life cycle of the product itself is about one year. Lenovo was much faster—maybe three or four weeks. While our old approach may have worked when we were a much smaller company, we recognized that our rapid increase in size meant we would need additional structure and more stringent processes in order to handle greater volumes. We could no longer afford to be as informal about such things.

At the same time, there were situations where the best way forward was to use a process largely based on the one used by Lenovo. For example, IBM's approach to direct-materials costs was essentially to set cost baselines once a year and then to drive down suppliers' prices over the following year, using that baseline as the starting point. By contrast, Lenovo adjusted its baselines much more frequently to get the savings from fluctuating parts costs. In the end, we didn't think an annual system would get the best results given the size of the new company.

Finding the balance between the extremes was very important, and the process of picking and choosing took a lot of effort. Early on, this really stretched everyone to the limit.

The *Quarterly*: Given the stress involved, how did you ensure that the group came together as a team?

Qiao Song: Again, I think that balance was the key. I wanted to make sure the new group had time to integrate culturally and to learn from each other. In many cases of M&A integration, one company imposes totally new approaches from the very beginning, and I think this kind of revolutionary change can be very risky with respect to talent. You risk losing both good people and good ideas.

It's perhaps natural in a merger that one of the first things either side thinks about is who should be replaced. But this is the wrong way to think. It is better, in my view, not to force difficult people decisions too quickly. We had several people—including a fairly senior one—who initially had difficulties adapting to the new culture we were creating and weren't necessarily performing well as a result. But we were gentle with them and gave them time, and today those same people are still with us and performing very well.

However, we were extremely tough on the results. When the deal closed, we began reviews every two weeks for each individual commodity. We required team members to report on their progress toward getting the savings we'd targeted, as well as the progress of their team's development. I think this balance between being tough on performance but gentle with people really helped the two teams become one team. In fact, during the period before the deal closed we found that both sides, deep down, were very similar in that both have the same willingness and eagerness to win—and this helped us create a shared vision. This was very important because from day one of the new company, we needed to be running smoothly and without interruption.

The *Quarterly*: You've mentioned the mandate to create a new unit, for general procurement, focused on nonproduction-related spending. How did you approach that task?

Qiao Song: IBM didn't transfer its general-procurement unit—the group with responsibility for all the money spent on things that support production indirectly, such as office supplies or airfare—to us as part of the deal. IBM provided us with a transition service as part of a preferred-supplier agreement, and this gave us time to create a general-procurement unit to support our international operations.

Doing this presented challenges. For one thing, many of the spending categories in this area—for example, airfare—are very personal to people, so there is often much more resistance to changes than would be true of costs directly related to production. And a category like airfare was now, with our new global reach, much more complicated than it was when we were just a Chinese company. What's more, IBM's general-procurement spending was many multiples of Lenovo's, so we were concerned that we wouldn't get such good terms with suppliers. Finally, Lenovo runs a very tight budget, so we had limited resources to establish the team. For example, IBM had more than 1,000 people handling general procurement, whereas I had fewer than 30. And of course, we had extremely rigorous targets: we were asked to achieve $17 million in savings in the first year.

The *Quarterly*: How did you overcome these challenges?

Qiao Song: We chose our own people to manage this, people with credibility within the organization. We could have gone out and hired experts, but I think having insider experience proved to be very important. At the same time, we wanted to overcome any potential sensitivity by demonstrating the facts about how large the savings opportunities were in these nonproduction areas. So our general approach was to go after commodities that were somewhat sensitive—airfare, for example—but where a lot of money was at stake, so we could demonstrate the savings quickly and get a consensus, with our executive team, to fully support what we were doing.

There was one moment fairly early on that stands out. The team was on the phone with a senior executive, and everyone was really getting into issues such as changing from this or that airline, and there was a sense of caution. Are we going to do this or not? Will we lose support if we push too hard? And the executive said, "Let's settle this; I'm calling the CEO." And less than an hour later, the executive called back with the CEO's unwavering approval. Such support was crucial—particularly since in general procurement, one of your key levers is compliance. The biggest source of leakage is people getting around the rules and doing their own thing. We found that reinforcing travel policies represented a sizable opportunity—perhaps one-third of the savings.

Of course, there's also commercial leverage. By doing detailed studies of our usage patterns and understanding our demand, we were able to work with vendors to lower costs on the commercial side. Interestingly, we discovered that the scale differences—our size relative to IBM's—weren't as much of a factor with vendors as we'd anticipated. We had the minimum scale required to apply powerful techniques.

The *Quarterly*: How did you do against the targets?

Qiao Song: We exceeded them. On the general-procurement side, by the eighth month we'd reached an agreement with the CFO that everything was in place to exceed the target, although we needed the remaining four months to actually accrue the full savings. On the direct-materials side, we also exceeded our targets.

The *Quarterly*: Were there nonfinancial benefits as well?

Qiao Song: Absolutely, particularly on the materials side. Looking back, I think that during this period, we brought the design team and the procurement team much closer together. This led to important changes in our decision-making processes—changes that have had a real impact. Early on, honestly, everyone was a little skeptical about whether top executives would support some of the bigger changes we would have to make. But the facts, assembled jointly by the design and procurement teams, helped us achieve some real breakthroughs that added significant momentum to the effort.

The *Quarterly*: What skills are required to succeed in Lenovo's procurement unit?

Qiao Song: People must have an excellent understanding of the industry and of the particular commodity that they manage—whether it's LCD panels or plastics—and of course they must have very good negotiation skills. They must also have sharp instincts. In the PC industry, you sometimes need to make purchasing decisions very quickly, and there isn't time to do an in-depth analysis. You just need to act.

To help develop these skills, we look for ways to bring our procurement people together so they can learn from one other. For example, we don't handle our commodity-sourcing strategies on a commodity-by-commodity basis but instead bring the executives who manage commodities together so that they can get ideas from colleagues to apply to their own situations.

The *Quarterly*: How do you see the procurement function changing in your sector over the next few years?

Qiao Song: The global high-tech industry has very good growth potential. Winning new customers and gaining global market share will, I think, require many new products. Companies will have to differentiate their products in new ways—especially on the outside, in the look and feel of the product, as opposed to the inside, where there are fewer and fewer differences between competitors' offerings. Coming to terms with the additional complexity and product diversity therefore will be the central challenge for procurement in the technology sector in the next few years.

Another challenge is speed in the supply chain. Customers want everything to be faster and faster, and this creates challenges for supply continuity. This is an area I'm working on now—to become even faster in our international operations. Speed is very much the tradition of Lenovo. If you cannot run faster than your competitor, you will die. Q

About the Author

James Hexter is a director in McKinsey's Beijing office.

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