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One-size-rarely-fits-all: Tailoring procurement synergies to the deal

In mergers, a traditional one-size-fits-all approach for procurement synergies takes too long and leaves too much money on the table. To deliver more value sooner, match the levers you use to the deal archetype.

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Procurement is typically one of the largest contributors to cost synergies in a merger, especially during the early years. The highest-cost line items on the P&L are usually for external spending, and squeezing money from suppliers is almost always easier on the organization than cutting internal costs.

But too many companies don't go about extracting procurement synergies in the right way. In the intense pressure of a merger, they start looking for all types of synergies, without first thinking through which procurement synergies are most likely to be important or easiest to capture.

Our review of more than two dozen mergers, in industries ranging from consumer goods and pharmaceuticals to energy and high tech, shows that knowing which synergy levers to pull (and in which order) can unlock significantly larger procurement synergies. By better aligning scarce resources and focusing management attention, companies that focus on the most relevant synergies for their deal archetype deliver value about six months sooner on average than those that try to find every type of procurement synergy, ignoring the deal rationale.

The deal archetypes

The first step involves defining the deal archetypes and typical sources of procurement synergies. There are many ways to classify deals, based on everything from the nature of the partners' businesses (similar or different) and the degree portfolio overlap (low or high) to whether expansion is more likely to depend on strategic growth, or on unique assets or capabilities.

From a procurement perspective, the most relevant classification is based on two variables: the relative sizes of the two companies and the similarity of their spending. Note that our focus is on direct spending categories, meaning for items that are directly incorporated into the company's products and services. Indirect spending categories—which overlap heavily with sales, general, and administrative (SG&A) costs, such as marketing, IT, or employee benefits—tend to be mostly similar across deal types.

From this, four broad deal archetypes emerge (Exhibit 1).

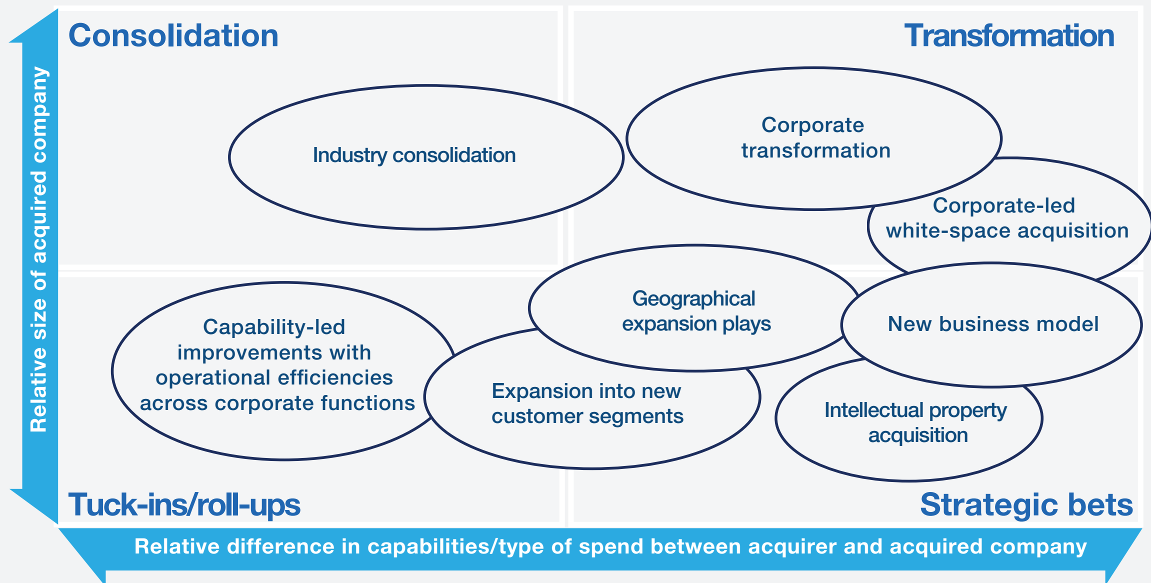
Tuck-ins or roll-ups: Smaller target, similar spend. The primary goal of these deals is often to expand the acquirer's geographic footprint, with minimal increases in management effort or SG&A costs. In these instances, the acquirer's spend is much larger than that of the target, but in similar categories.

Consolidations: Similar target, similar spend. With industry consolidation, the usual goal is to increase capacity utilization or reduce SG&A costs for the combined company. From a procurement perspective, they spend on similar categories and may even buy from same suppliers.

Strategic bets: Smaller target, different spend. This archetype includes intellectual-property (IP) acquisitions and new business models. In growth bets, the acquirer is often buying the target's IP, or access to a new market or product segment. As a result, the acquirer's spend is both larger than the target's, and often on different spend categories.

Transformations: Similar target, different spend. The final archetype includes corporate-led white space acquisitions. Strategic transformation is the impetus for a merger between similarly-sized companies with different spending patterns—perhaps with the goal of entering a new or underserved market. While each company typically enjoys scale advantages, the categories often don't overlap.

Exhibit 1 **Mergers can be classified into four broad archetypes.**



Sources of procurement synergies

The four-part segmentation has direct implications on the types of synergies that will be most relevant. Ranked in order from the most basic to the most complex, the most important synergy types include:

Price alignment: This is the simplest procurement synergy. The two companies pay a different price (or have different commercial terms) for a similar product or service, and move to the better of the two. The impact of this synergy generally depends on the degree of supplier and product overlap between the two companies.

Scale leverage: The second most common source of savings comes from using scale to obtain higher discounts from suppliers. The impact depends on the relative increase in spend, and whether scale contributes much to the category's economics.

Sourcing strategy alignment: An underappreciated lever is to share sourcing practices across the two companies. Where one party's strategic-sourcing capabilities in a particular area are more mature than the other's, lifting the combined team up to a common standard can be one of the most powerful sources of value.

Policy alignment and demand management: Standardizing specifications often drives more than half of the total procurement synergy. The focus is not on price, as covered above, but on what the merged company buys and how much. Examples include moving to a common travel policy, standardizing benefits, and imposing uniform service-level agreements for services contracts.

Make versus buy opportunities: This question becomes relevant when one company buys a

service that the other performs in-house, and is particularly important when the combined scale changes the economics of the decision. For example, a larger acquirer may have a marketing team with substantial in-house capabilities, while the other may rely on outside agencies. Expanding the in-house team may be the right decision. When applicable, these opportunities can be a big (though complex) driver of impact.

Insights on what drives value capture in a merger

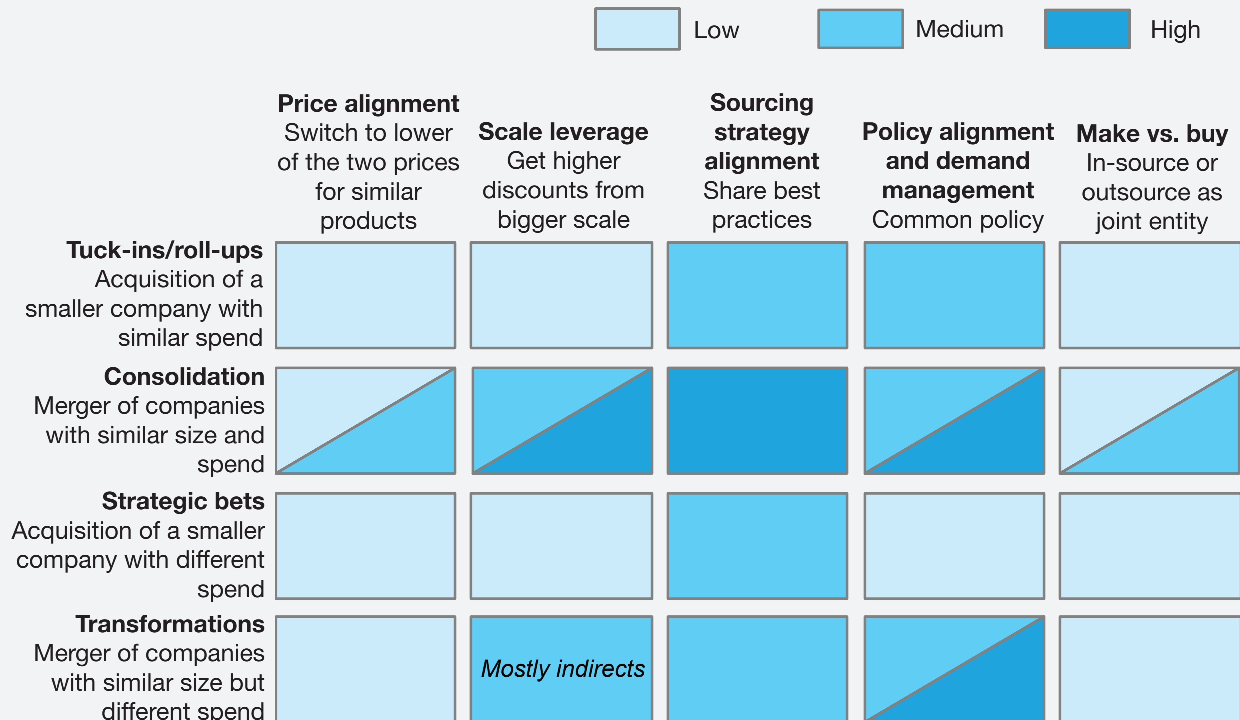
Which synergies matters more in which deals? Exhibit 2 sheds some slight on these perspectives.

But several additional insights emerge from a deeper examination, and some are more intuitive than others.

What's 'obvious' is less important than you may think

Insight 1: Price alignment is a relatively small source of synergy for most deal` types. For tuck-ins and strategic-growth bets, spend of the smaller company is relatively low. Meanwhile, for transformations, the spend overlap is too low to offer much opportunity.

Exhibit 2 **The relative importance of procurement synergies depends on the deal archetype.**



The partial exception is for industry consolidation, where price alignment may indeed drive some synergies. But even in these cases, its impact is limited by the degree of supplier and product overlap. For example, even a 5 percent price difference (a realistic estimate) that applies to 10 percent of the combined company's spend still translates to savings of only 0.5 percent.

Insight 2: Scale leverage matters, but mostly for industry consolidations. Similar to price alignment, the impact is limited for tuck-ins and strategic-growth bets because of the target's low spending levels. And for transformations, the impact is mainly for indirects, which by definition are more likely to overlap between the two parties.

For industry consolidations, scale can be a major source of synergy, depending on the category's scale curve. For commodities such as metals or grains, where most companies are price takers, the scale curve is flat. The combined leverage of the merger entity may not be meaningful. For categories with higher value-add and higher share of fixed costs (such as for R&D, professional services, or advanced equipment), scale could be a relatively big driver of savings.

Lesson: Both of these insights are important because in our experience, most companies overinvest (in both financial and human terms) in finding price-alignment and scale-leverage synergies. The explanation is simple: these two synergies are the easiest to understand, so people naturally think, "Of course we will get higher discounts if we are a bigger customer." In practice, however, the actual savings depend on the deal archetype, and may only amount to significant value in industry consolidations.

What's important is less obvious than you might think

Insight 3: Sourcing-strategy alignment is actually the biggest area of synergy across all deal types. Identifying instances where one company is using better tools (such as should-cost modeling to inform supplier negotiations), better pricing mechanisms, or alternative, low-cost suppliers, will likely have a much bigger impact that other levers.

There's a very human reason that companies miss this source of synergies. To find them, they must admit that one company is more mature in certain sourcing practices than the other. Most leaders don't want to acknowledge this possibility because it comes across as a criticism of their procurement people at a sensitive time. But if leaders acknowledge up front that the merger is a great opportunity to learn, and make it clear that they're willing to support their procurement people in the process of learning from another, sourcing-strategy alignment can deliver more than short-term savings. It can also create habits of problem solving and capability building that lead to longer-term improvement.

Insight 4: Policy alignment and demand management can be as big a source of savings as the other levers. This idea will not be a surprise to most procurement practitioners. But other stakeholders may be new to the idea that a common personal-technology policy, or harmonized standards for IT helpdesk support, can become a significant saving source.

In fact, industry consolidations and transformations often end up being a pivotal point for companies to drive an important mindset shift. Top-performing companies use a merger as a trigger to elevate procurement's role in setting more effective and

efficient policies and instituting better compliance. Procurement should therefore be identified as the objective source of truth for this source of synergy—which is meaningful in most deal archetypes. Aggressive synergy targets, demand from business and function heads, and a quantified business case then create the right conditions to make these ideas real.

Insight 5: While the range of potential synergies is highest for industry consolidations, their impact can be highly variable across deals. Despite the parties' similar size and spend, synergies can be low (for example, if spend is primarily on commodities with flat scale curve, or the two companies had already adopted similar policies and follow sourcing practices of similar maturity). It's critical for leaders of these mergers to test for these factors before assuming high procurement synergies.

In closing, companies can do better than a one-size-fits-all approach for procurement synergies in a merger. This tailored approach—based on the deal archetype—helps companies deliver more value sooner, and focus energy and resources on areas where it matters most.

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