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Get more procurement value from M&A—even before closing

Most companies wait until after a merger closes to pursue procurement synergies. But time is money, and several companies have shown how to get a head start on capturing value.

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With acquirers paying an average premium of 40 percent over targets' market value, delivering on promised synergies is critical to the success of most mergers. And because external spending so often represents the largest share of a company's costs, the procurement function is typically the single largest source for potential synergies.

Yet even as investors anxiously await news of synergy capture, most companies delay pursuing the promised savings until after the deal closes. Companies cite various reasons for holding back. They may think that legal-compliance or contractual issues limit the sharing of relevant information between the merging companies before the closing, even when a clean team has been established to collect and analyze sensitive information from the parties in aggregate or disguised form. Decision makers, lacking important data on procurement costs across the companies, may shy away from setting explicit synergy targets or starting negotiations. Some leaders may assume that until the deal closes, suppliers won't be willing to have preliminary conversations about new rates. And it may not be clear yet which leaders in the merging companies will be responsible post-merger for negotiating with suppliers.

The resulting delays are costly. Fortunately, as several recent mergers have demonstrated, companies can devise creative solutions that allow them to take at least modest steps toward achieving procurement synergies before the deal closes.

Getting a head start pays off

For large, complex acquisitions in which completion may take several months, the value created by identifying and initiating synergies before the closing can be significant. Simple math suggests that accelerating first-year savings capture by three months would allow a company to report approximately 25 percent of total savings sooner, increasing the odds of satisfying investors.

Getting a head start can help business leaders clarify just how much savings can be captured. The estimation of synergies requires a mix of art and science: The sooner companies can test their assumptions in the market, the sooner they can narrow the range of the estimated savings and make the right decisions about how to achieve them—such as whether to outsource specific activities or keep them in-house.

Additionally, companies may benefit from initiating the pursuit of synergies in the relative calmness of the pre-closing period. Once closing occurs, leaders may be distracted by operational fire-fighting—that is, communicating with vendors and customers, finalizing new procurement policies and procedures, reassuring staff, and knitting together disparate management practices. All those demands can make it hard to focus on capturing synergies.

Find creative work-arounds

In our experience supporting procurement transformations, we have found that companies can overcome myriad challenges by developing creative solutions. The insights presented here are broadly applicable, regardless of a company's sector or size, the regions in which it operates, and the deal archetype. An important caveat: Because every deal is unique, it is critical for a company's leaders to seek input from the legal department on the right way to pursue synergies before closing; companies will have their own context-specific concerns about competitive dynamics, the use of proprietary data, and the complexity of contracts.

Insight 1: Focus first on demand management.

In the case of a recent merger, our analysis indicated that improved demand management could unlock approximately 50 percent of the total procurement synergy for indirect categories—for instance, travel, IT, marketing, facility services, and maintenance, repair, and overhaul (MRO). In our broader experience, we have found that this savings potential applies to most indirect categories.

The companies in this merger can therefore promote savings by focusing on "what we buy" instead of "what price we pay," with much of the potential savings coming from reconciling demand-management policies across the two organizations. Each company can make many of the required changes independently before the closing. Examples include standardizing policies related to travel expenses, device eligibility or replacement, or the frequency and level of facility services.

To align demand-management policies, it is preferable for the two companies to share relevant data with each other. Because data on indirect categories typically is not a source of competitive advantage, sharing it is less likely to run afoul of legal or contractual prohibitions than would be the case for sharing data on direct categories. But if sharing data is not practical or legally possible, each company can adopt demand-management policies that reflect best practices for their indirect categories. The merger then simply becomes a trigger for the adoption of best practices.

By pursuing demand-management changes prior to the closing of their merger, the companies in this merger accelerated savings (approximately 10 percent of procurement spending) by six months. The faster pace allowed the merged company to exceed, rather than merely meet, investors' expectations for capturing value.

Insight 2: Look to tiered price structures

Companies often use simple pricing mechanisms in their supply contracts—each product or service has a single associated price. However, moving toward a tiered pricing structure, which adjusts prices for different thresholds of volume or spending, can be effective in renegotiating rates before the closing. This is especially the case when negotiations have historically focused on discounts or rebates. The approach is most relevant for products for which it is easy to switch suppliers (such as traded commodities) or for spending with common suppliers.

For two companies in a recently announced merger, combined MRO spending totaled more than $100 million. Tiered pricing allowed each company to negotiate discounts for specific categories (such as safety products, hand tools, and electrical components) at different spending levels. In essence, each company asked its suppliers, "What would the discount be if our spending were to double?" Without having to share any information, the companies were able to switch to new pricing levels with their common suppliers as of Day 1 after the closing. The companies negotiated discounts of more than 10 percent, which went into effect several months sooner than if they had waiting for closing.

Insight 3: Consider a three-way non-disclosure agreement (NDA)

A creative way to enable information sharing is to enter into a three-way NDA among each merging entity and the supplier. This approach brings suppliers into the dialogue that already exists between the merging companies and their procurement clean team.

A three-way NDA was crucial for enabling two IT services companies to complete negotiations with a supplier before their merger's closing date. The procurement clean team forged an NDA with an IT hardware vendor (a direct category for these companies) and completed multiple rounds of rigorous negotiations. The vendor was motivated to participate to preempt its competitors. It negotiated jointly with both merging entities, accelerating discussions that would have occurred after the closing.

Relying on fallbacks

If there are no other viable alternatives, companies can undertake the heavy lifting to prepare an RFP for each procurement category before the closing, but wait until Day 1 to pull the trigger. In many cases, the time required to prepare an RFP determines when companies initiate a competitive bidding process or negotiation. Preparing an RFP usually entails gathering a variety of information, including specifications, drawings, service levels, locations, and terms. The time-consuming work of collecting and making this information usable can be done before the closing. Similarly, other important activities—including a supply market scan, supplier should-cost modeling, and drafting supplier communications—can be completed pre-closing. Doing this preparation in advance of the closing generally saves companies at least a few weeks of work that would otherwise happen after Day 1.

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Given the ever-increasing expectations for procurement synergies, every dollar—and every day—saved makes a difference. By thinking creatively about how to overcome the challenges, companies can expand the possibilities for accelerating value capture and reap significant rewards. ■

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