BOOZ·ALLEN & HAMILTON

Managing Procurement Through a Merger: Capturing the Value of the Deal

A Series of Viewpoints on Mergers, Acquisitions, and Integration

Executive Summary

Procurement consistently generates the bulk of near-term savings in merger-integration efforts. Since a high percentage of mergers fail to meet announced synergy goals, procurement has been — and will continue to be — a critical element that chief executives rely upon to deliver value from a deal.

To succeed, the CEO and the chief procurement officer must begin planning well before the consummation of the merger. Changes in the merged company's vertical integration, product line, and organizational structure will influence the direction taken by the new procurement function. Furthermore, the merger presents an opportunity for the procurement function to reinvent itself by quickly developing capabilities that will enable it to capture the required savings.

Procurement will be among the busiest functions during merger integration. While it has the same internal restructuring tasks as other units of the company, procurement also must dramatically accelerate its rate of performance to realize targeted savings. The best approach to managing the work is to follow a phased work plan that focuses first on critical operational issues, then on capturing synergies, and then on achieving the ultimate value of the merger after the dust settles.

Companies should organize for the merger using a team-based approach that separates procurement function design, synergy capture, and Day-One coordination. This distinction helps keep priorities straight and ensures that nothing falls through the cracks. A "clean room" can help the companies collect and use confidential information without violating laws or subjecting themselves to competitive disadvantage if the merger fails to close.

Carefully set and managed targets ensure both accountability and cooperation. While top-down targets are necessary, there are right and wrong ways to establish targets and measure results.

Savings in a merger come from three sources: price harmonization, economies of scale, and adoption of sourcing best practices. The first provides the "low-hanging fruit," while the second represents the value that was generally expected from the merger; however, the third is often the greatest source of opportunity. The best way to achieve savings is to use a well-structured sourcing methodology that pursues the opportunities in waves, starting with the easiest first. If procurement is managed well, companies will capture much of the merger's potential.

This *Viewpoint* is one in a series by Booz·Allen & Hamilton on mergers, acquisitions, and integration. We contend that "capturing the value of the deal" requires superior execution in addition to good strategic fit. This *Viewpoint* offers practical advice and a proven approach for effectively managing procurement through a merger.

Managing Procurement Through a Merger: Capturing the Value of the Deal

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One of the greatest challenges confronting chief executives today is making mergers work. Over the past decade, merger and acquisition activity has dramatically accelerated, overtaking entire industries and markets. In virtually every industry, large and small companies alike now struggle with the hard duties of post-merger integration. Not every company will succeed. In fact, if recent history is any guide, most mergers will fail to meet expectations.

However, for successful companies the spoils are substantial, particularly in the area of procurement. Whether the merged entity is a manufacturer or a service provider, sourcing synergies typically represent a substantial portion of the immediate savings expected from the merger. Moreover, the post-merger environment presents a rare opportunity for effecting step-change improvements in sourcing performance that allow procurement to play a broader, more strategic role in the merged organization.

Therefore, companies considering a merger would do well to focus on procurement before, as, and after the deal closes. This *Viewpoint* offers practical advice and a proven approach for managing procurement through a merger. It covers both the opportunities and the challenges and suggests how companies should organize to extract maximum benefit from procurement opportunities.

The Significance of Procurement in a Merger

For the past few years, worldwide merger and acquisition activity has averaged about US$2 trillion per year.[1] Often announced with great fanfare and celebrated by executives and analysts alike, many deals have transformed the competitive landscape of industries the world over. But did they work?

According to recent Booz·Allen research,[2] the answer is often no. Among the deals we analyzed that had closed at least two years previously, 47 percent had not achieved the expectations articulated in the merger announcement. The most common reasons for the lack of success were related to *poor execution*, rather than to poor strategic fit.

Regardless of the stated objectives, an acquisition may generally be considered to have been successful if cost-side synergies exceeded the acquisition premium. Even for mergers justified by revenue-side opportunities, cost reduction is often expected to pay for the deal by covering the merger premium.

Since outside expenditures can account for as much as 50 to 70 percent of a company's cost structure, procurement is particularly fertile ground for post-merger integration initiatives. Our research indicates that procurement synergies often approach 50 percent of the total value of all synergies realized in a merger (see Exhibit 1). Horizontal mergers (i.e., mergers between companies in the same industry) yield some of the largest and most straightforward procurement synergies because of similar spending patterns.

Procurement savings tend to include significant low-hanging fruit. It's a great deal easier, quicker, and less painful to compare supply contracts and negotiate new prices than it is to rationalize infrastructure. Closing plants can take years and cost millions, and layoffs exact a heavy toll on the morale (and sometimes the capabilities) of an organization.

Beyond immediate cost reductions, a merger provides the opportunity to drive step-change improvement in overall sourcing performance. The merger itself acts as a catalyst, spurring changes that might not otherwise occur and accelerating the rate of change. During merger integration, procurement managers expect a transformation in the way they do business. They anticipate going back to the drawing board and, in many cases, welcome the opportunity to expand and redefine their roles within the company.

That said, securing the benefits of sourcing synergies after a merger is not without its challenges. Because these synergies are often perceived as easy pickings, procurement often becomes highly visible in a merger context, as new senior management looks to extract immediate and considerable savings. Top-down targets will emerge, often driven by the due diligence efforts of investment bankers and consultants, who may lack detailed knowledge of complex supply relationships or insights into commodity-specific market conditions.

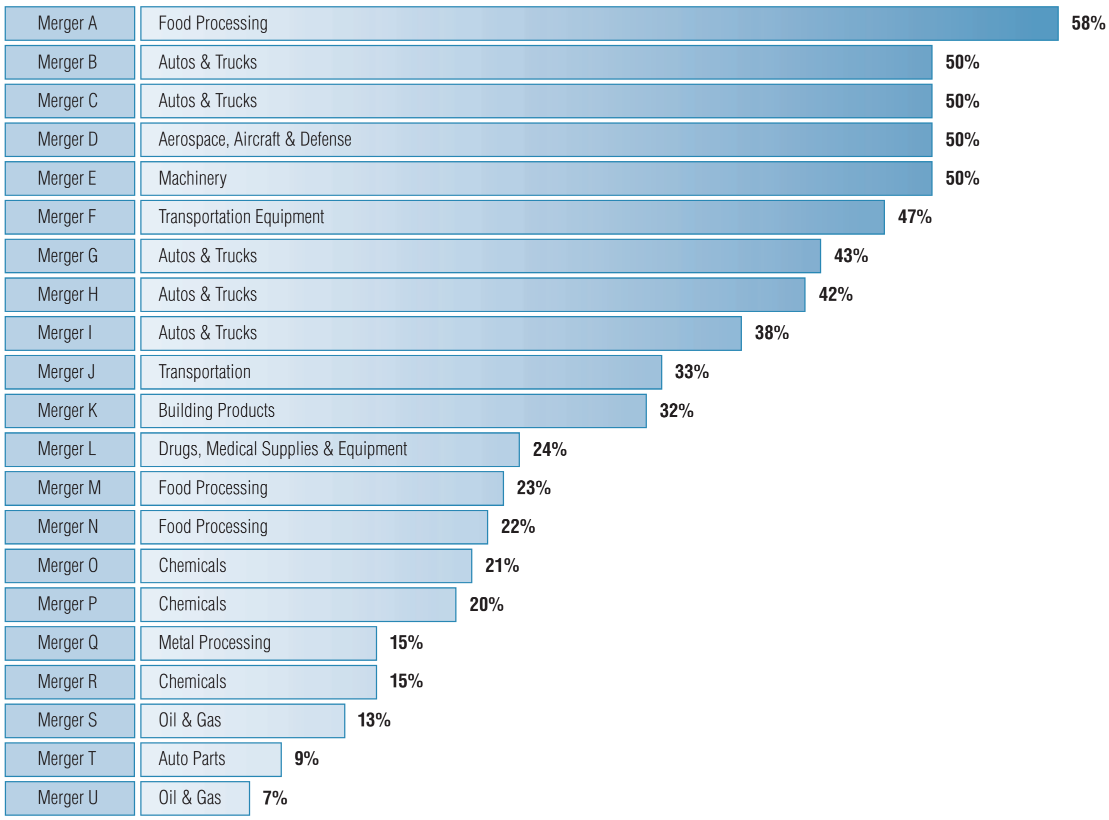
For a time, the extra workload will be overwhelming. In the merger environment, the procurement function must examine and recast every contract, dismembering suppliers' relationships with the old companies and forging new ones with the merged entity. In addition, there may be substantial incremental work associated with re-branding. In an airline merger, for example, procurement will need to provide new crew uniforms, deplete the entire inventory of branded consumables (e.g., cocktail napkins), schedule hangar space for repainting aircraft, and so forth.

Involvement at the CEO level will be critical to providing strategic priorities for procurement. The two companies may differ substantially in their degree of vertical integration, leading to make-versus-buy issues that must be resolved.

[1] 1999 through 2001 data from Thompson Financial Securities and Mergerstat

[2] *Merger Integration: Delivering on the Promise,* Research Summary, Booz·Allen & Hamilton, 2001

Exhibit 1. Procurement Savings as a Proportion of Total Merger Synergies



Source: Booz•Allen & Hamilton

The companies will also have to resolve differences with regard to procurement's role in the business and reporting structure. Merger-related business changes will also impact sourcing strategies. For example, since entire product lines may be spun off after the merger, it would make little sense to expend time and energy re-sourcing a product line that would soon be discontinued. In addition, site consolidation may lead to reallocating business among suppliers.

Managing Procurement Through the Merger

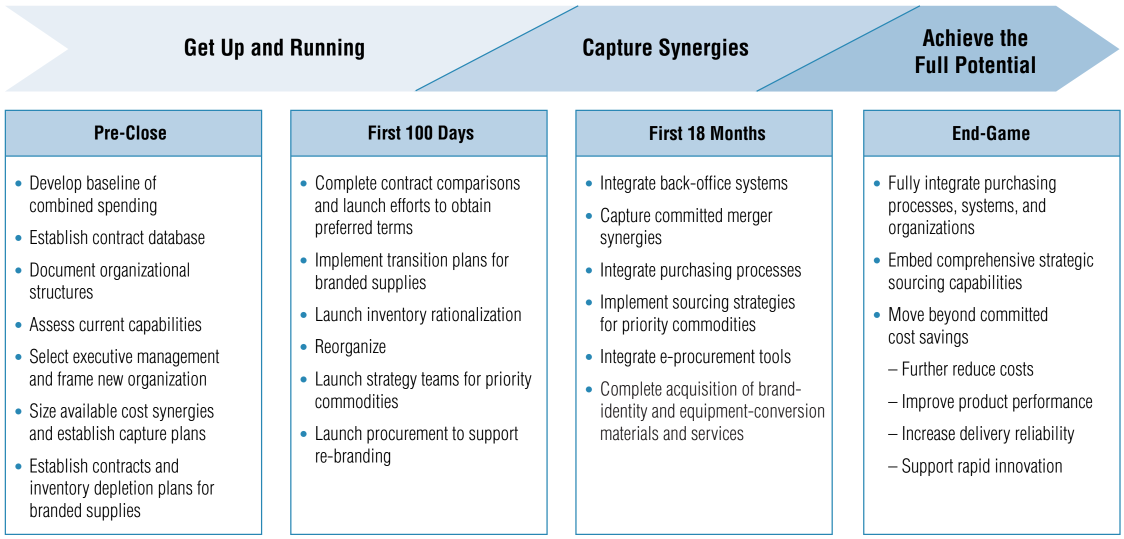
WORK PLANNING

Achieving the full potential of a merger is a lengthy and difficult process. Well-planned mergers are typically implemented in three phases, focusing first on the urgent matters of closing, next on capturing the easier synergies, and finally on achieving the full potential of the merger. Procurement's activities throughout the merger should follow this phased approach (see Exhibit 2).

The purpose of the first phase is to "Get Up and Running." During this phase, management takes stock of the future combined company, ensuring it will run smoothly through the deal closure while planning for subsequent phases.

Several critical activities must occur pre-close to allow operation on Day One after the closure. The first is to ensure that existing contracts will be effective for the new entity. Some contracts

Exhibit 2. Overview of Merger Work Plan for Procurement



Source: Booz•Allen & Hamilton

have *change-of-control provisions* that specify the contract will no longer be valid if the customer is acquired. *Sole-source agreements* could be in conflict across the two companies. In one airline merger, for example, each company served a different but exclusive brand of coffee in return for a low price from the vendor. Clearly this type of situation presents a problem on Day One.

Another critical pre-close task is to prepare for any operational requirements imposed by management on the new company. Buying supplies to support re-branding of acquired aircraft, crews, and supplies is an example of this.

As with all other functions within the new company, procurement may need a new organizational structure. At the very least, the individual who will serve as chief procurement officer (CPO), and those who will report directly to the CPO, should be selected before the close. Failing to identify leadership inevitably leads to an inability to make important decisions rapidly after close.

The pre-close phase is also a time to get a head start on activities that should be completed in the early days of the new combined company. Such activities include baselining spending, estimating sourcing opportunities, developing a contract database, and finalizing work plans for the merger-integration teams.

The “Get Up and Running” phase generally continues for about 100 days after close. During this period, the new organization will be fully defined, and all employees will know what their jobs will be. The high-priority operational changes will be implemented, and critical contracts will be confirmed or renegotiated and rolled out across the company. Teams will be launched to develop strategies for capturing savings for specific commodities.

In the second phase, the primary objective is to capture major synergies. This phase is typically 12 to 18 months long. During this “Capture Synergies” phase, many special merger-related teams are still in place and able to pursue opportunities aggressively. The synergies come from procurement savings as well as improved efficiency of the procurement function itself. Management will expect commodity teams launched after close to deliver significant savings — often amounting to more than a third of the total merger-related value-creation objective.

As the company enters the third phase, it should have already achieved substantial savings and laid the foundation for a first-rate procurement function. It will thus be positioned to "Achieve the Full Potential" of the merger by moving beyond committed cost savings and driving more challenging improvements in product performance, delivery reliability, and rapid innovation. These goals are in addition to further cost reductions. Activities include development of differentiated capabilities and the institutionalization of Strategic Sourcing throughout the company. Strategic Sourcing is a widely, yet inconsistently, practiced methodology for systematically finding and applying sourcing best practices for all important purchased goods and services.

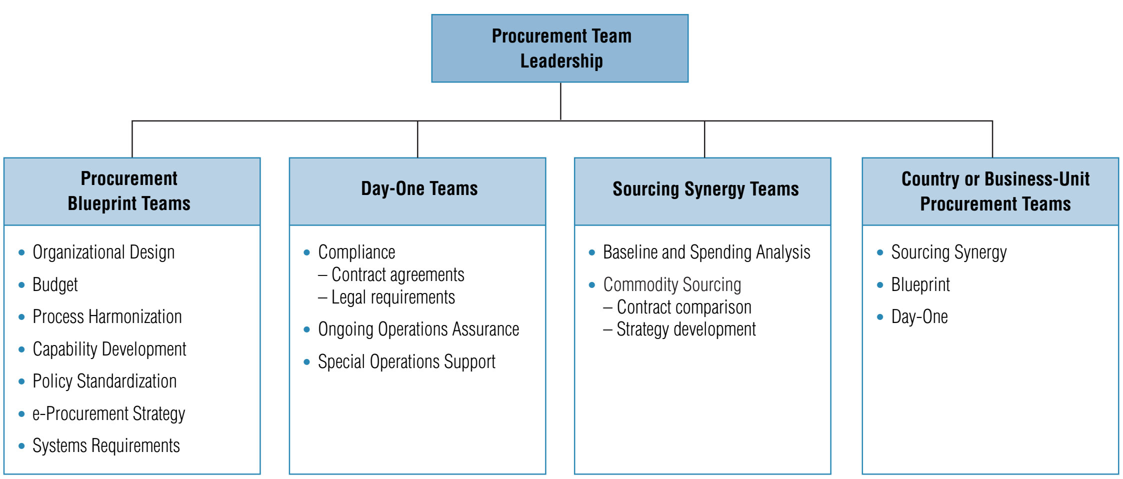
ORGANIZING

Large companies will often have many "Integration Teams" to carry out the work of a merger. For the procurement function, these teams typically fall into four categories (see Exhibit 3).

Procurement Blueprint teams design the new procurement function's organization, processes, and systems. Blueprint teams are responsible for identifying savings resulting from rationalizing the procurement function or systems; however, much of their effort will focus on procurement effectiveness. Day-One teams are responsible for ensuring that the companies operate smoothly through the merger close. Sourcing Synergy teams find the savings related to improved buying; they identify and quantify the savings opportunities that result from the merger. Commodity-by-commodity, they conduct the baseline and spending analysis, compare contracts, and establish sourcing strategies. These teams are responsible for capitalizing on the promise of the merger by developing specific plans to realize savings from scale economies and improved sourcing.

Because these three sets of teams have to set priorities for their work, they may tend to ignore smaller locations in which the company does business. Each country or region often has a different situation and set of challenges that require a focused effort for which global corporate-wide integration teams lack both time and knowledge. Experience has shown the best solution is usually to set up country-specific teams to handle issues related to those countries. These teams will coordinate with the corporate-level Blueprint, Day-One, and Synergy teams. Alternatively, some companies find that business-unit team segmentation works best.

Exhibit 3. Procurement Integration Teams



Source: Booz•Allen & Hamilton

BLUEPRINTING

Many acquiring companies begin the integration process with the idea that the acquired company will be folded into the acquirer, basically keeping the old ways of doing things. In our experience, capturing synergies in the efficiency and effectiveness of the procurement function requires a redesign of the function that takes the best of both companies and outside best practices. The first step in this approach is to blueprint the new procurement function.

The three key elements of the blueprint are the organizational structure, business processes, and systems (see Exhibit 4). Although blueprinting each element can be a major undertaking, speed will be critical to keep up with the overall corporate merger schedule.

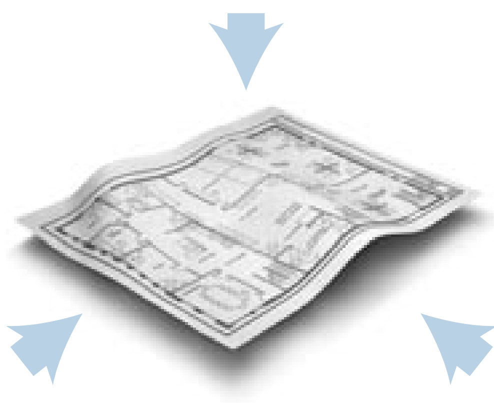
Organization: Most companies find that the procurement function in each of the two companies has a different role and scope of responsibilities within the organization. For example, one company's procurement department may report to manufacturing and have no responsibility for purchases such as advertising or travel. The other company's procurement department may report to the CFO and be primarily responsible for indirect purchases. If managers from the two companies have very different expectations for procurement, they must adapt to the CEO's expectations to form a common vision. As procurement works out its mission and role within the company, the organizational structure will have to be established, along with a transition plan to migrate to the new structure over time.

Process: People who have grown up in one company often do not realize how different the processes of other companies can be. Procurement procedures, relationships with internal customers, and performance metrics, for example, can differ dramatically from one company to another. These differences will have to be worked out quickly to ensure important work does not fall through the cracks after Day One. Policies such as spending

Exhibit 4. Elements of Procurement Function Blueprint

Systems

- Transaction processing
- Electronic sourcing and procurement
- Knowledge management
- Decision support



Organization

- New organization's scope of responsibilities
- New organizational structure
  - Positions
  - Locations
  - Key managers
- Transition plan to new organizational structure
  - Selection/hiring and naming
  - Severance and relocation
  - Timing
  - Payroll

Process

- New business processes
  - Strategic sourcing
  - Business-unit interface
  - Metrics
  - Transactional purchasing
- Capability development plan
- Procurement policies
  - Spending authority
  - Contract theme
  - Minority/woman-owned business

Source: Booz•Allen & Hamilton

authority, standard contract terms and conditions, and use of disadvantaged businesses also need to be brought together.

Systems: Information systems often emerge as one of the most contentious issues. Each company likely worked long and hard and invested considerable resources to develop its current systems. The transaction systems are likely integrated into larger enterprise resource planning (ERP) systems that are not easily replaced. Furthermore, corporate-level ERP decisions will usually trump any individual functional organization's desire for a particular system. Procurement will have to work to ensure their function is included as these decisions are made. Fortunately, there are systems decisions, such as those concerning e-sourcing, that procurement will typically be able to drive.

Booz·Allen has long advocated the philosophy described in *Balanced Sourcing*,[3] in which cooperation and competition are balanced in the company's relationships with its suppliers. Striking such a balance is not easy, because the more closely a company works with its suppliers, the more difficult it is to regularly evaluate each supplier's competitiveness in the marketplace. Companies who successfully implement Balanced Sourcing generally have competence in at least eight critical capabilities:

- Creating sourcing strategies
- Modeling total cost
- Building and sustaining relationships
- Integrating the supply chain
- Leveraging suppliers in innovation
- Evolving a global supply base
- Developing procurement professionals
- Leveraging procurement technology

As soon as possible, management should conduct a capability assessment that will drive the design of the new procurement function. As we noted, the merger presents chief executives with a one-time opportunity to revisit the basic assumptions upon which sourcing strategy rests. The work done by the Blueprint teams in the first several months after the merger will set the stage for a successful procurement function for years to come.

In assessing each company's current performance in the eight capability areas, teams should consider two performance measures: capability level and capability effectiveness.

Capability level measures the sophistication of the sourcing processes and the degree of implementation across a company. To aid in this assessment, Booz·Allen has developed a set of performance-level charts to provide objective benchmarks (see Exhibit 5).

Capability effectiveness is a measure of how well specific capabilities enhance the overall performance of the sourcing function, relative to their cost. Effectiveness should, in theory, follow from the capability level. However, the value of achieving each of the various capabilities depends on the relevance of the capability to the company. Honda, for example, has several hundred engineers engaged in the supplier development process. Although the cost of such a large team is steep, Honda has measured the financial benefits and the resource usage and determined that the return on investment for these engineers is high. Even though it is difficult to ascertain how one specific capability contributes to overall performance, some assessment of effectiveness is necessary to develop a case for adopting one company's practices over the other's.

Underlying many of the capabilities is the ability to capture and share knowledge. For example, a company has a clear advantage in sourcing if it understands sourcing strategies for various commodities, familiarizes itself with diverse suppliers' capabilities, and knows competitive pricing levels. Sourcing knowledge can be divided into three categories (see Exhibit 6). The first is data that are generally maintained internally, such as spending details. The second is data that are generally maintained by third parties, such as supplier data. The third is insights accumulated over time, such as commodity sourcing strategies. In many companies, insights reside primarily with individuals, and data are not readily available. Part of the merger-integration work is to take stock of the knowledge possessed by both organizations.

[3] *Balanced Sourcing: Cooperation and Competition in Supplier Relationships,* Timothy M. Laseter, Jossey-Bass, 1998

Exhibit 5. Performance-Level Chart for "Creating Sourcing Strategies" Capability

INCREASING CAPABILITY →

	Level 1	Level 2	Level 3	Level 4
Formal Knowledge-Capture Mechanisms in Place	No capture mechanism in place	Current supply base, technology capabilities, and quality assessments available and regularly updated	Supply-market history, spend history, supplier profiles, and some best practices capture	Comprehensive best practices and leverage points; forward-looking supply market trends
Understanding of Innovative Strategies for Commodity	No significant understanding of how other organizations, including competitors, buy the commodity	Some anecdotal understanding of the range of buying strategies of others	Regular dialog with other organizations on best-practice approaches; regular assessment of competitor sourcing strategies	Systematic process for collecting information to identify leading procurement strategies; capable of describing how strategy creates competitive advantage (evidence of tear-down analysis, competitive supplier benchmarking)
Multifunctional Effort	No multifunctional team exists	Teams with resources from limited disciplines; no full-time resource; no resources spend more than 20% of their time on the project; no formal top-management committee steering the team	All key disciplines represented; team leader 50% on team; other resources at 20% on team; top-management steering committee in place	All key disciplines represented; team leader 100% on team; other resources at 40%; all resources trained in strategy-development approach; top-management steering committee in place
Documentation of Commodity Strategies	No buying plan by category	Strategy document mainly describes transactions to be implemented and contains limited perspective on the rationale	Strategy document profiles the supply base and identifies the target supply structure and planned actions	Strategy document provides detailed understanding of the supply market structure and leverage points; describes all elements of the strategy (suppliers' capabilities, types of relationships, mission, and performance targets)
Targets for Improvement	No targets set for the category	Price targets only; no targets on total cost of ownership, delivery, or quality	Total cost of ownership targets plus targets on quality and delivery; no targets on development performance	Total cost of ownership targets, targets on quality and reliability, plus development performance targets

Source: Booz·Allen & Hamilton

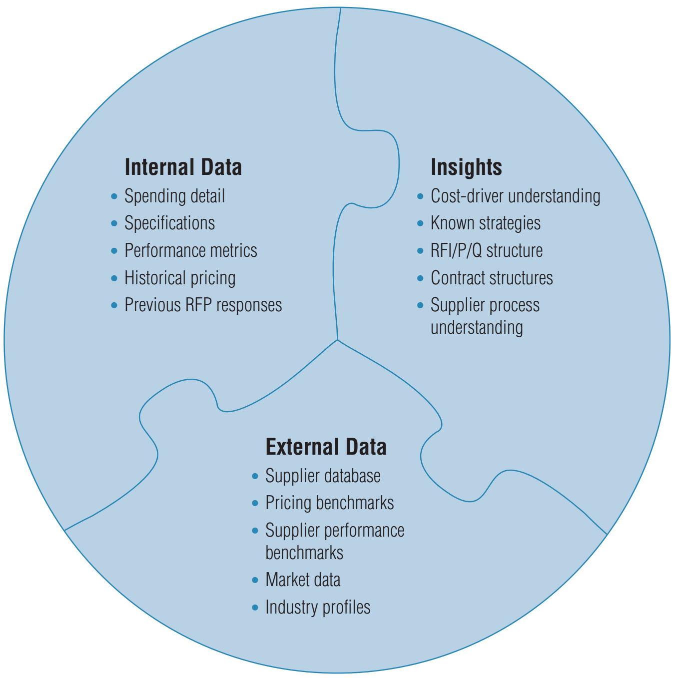
PREPARING FOR DAY ONE

Day-One teams are charged with ensuring that all required pre-close actions are performed. They review contracts for compliance issues, identify special operations support requirements, and generally smooth the transition to closure.

As all the merger-integration teams work, they continually identify issues that need to be addressed either before close or soon afterward. The Day-One team acts as the repository for these Day-One issues. For example, suppliers will need to know how to submit their invoices to the new company. In many cases, the team that identifies the issue will be able to resolve it. In such cases, the Day-One team's primary interest is to monitor status. The Day-One team's role becomes critical when the team that identifies the issue does not have the authority or responsibility to resolve it. The Procurement Blueprint team, for example, may identify the issue of changing spending-level signoff authority and recommend a plan, but the CFO will likely have to approve the changes.

The procurement teams are generally not burdened with the critical Day-One issues that could stop the merger if not quickly addressed. However, if there are significant operational changes that will occur soon after close, such as those we listed in the airline re-branding example, then the work required before Day One can be substantial. It is likely that the Day-One team will track these operational issues, but a dedicated business team will conduct the work.

Exhibit 6. Three Categories of Sourcing Knowledge



Source: Booz•Allen & Hamilton

ESTABLISHING A CLEAN ROOM

The formidable task of working through a merger is further complicated by constraints — both competitive and regulatory — on data sharing between the companies.

The Day-One, Blueprint, and Synergy teams will need access to several types of confidential data to complete their work. Suppliers' names and prices are critical to any assessment of savings opportunities. Contracts have to be examined for change-of-control and sole-source clauses. Yet most suppliers' agreements forbid the sharing of pricing and terms outside their customers' companies. National laws in various countries also impose restrictions because sharing data across competitors can be viewed as anti-competitive. Furthermore, since a planned merger can be stopped at the 11th hour, the potential mates may again find themselves fiercely competing — and wishing they had not shared so much data.

One solution to this dilemma is to create a "clean room" for the handling of all sensitive data until the day of the merger closing (see Exhibit 7). Independent consultants or "quarantined" employees will staff this room, reviewing confidential agreements, flagging items worthy of immediate attention, and recommending courses of action. They can also aggregate data and estimate potential savings, reporting back to senior management without disclosing competitively sensitive information. The extent to which companies share information will vary depending on the laws governing their respective markets, their attorneys' interpretations of pertinent regulations, and the overall sense of urgency surrounding the merger.

ESTABLISHING AND LIVING WITH TARGETS

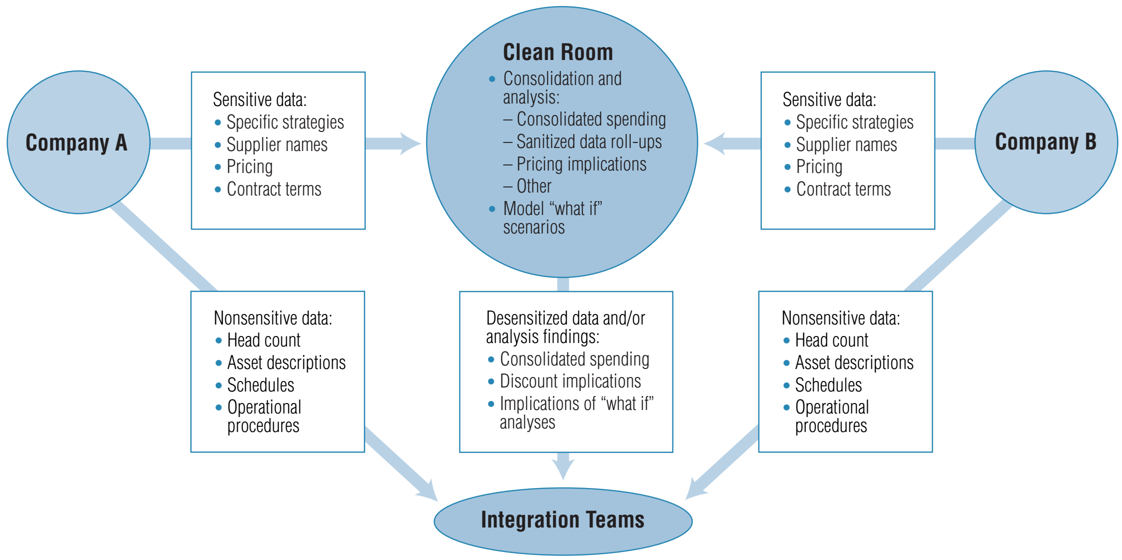
All executives should be prepared for aggressive merger-savings targets. Top-down generated targets are facts of life, because savings need to be budgeted long before data exists to validate opportunities. In spite of the lack of precision, the way in which targets are set can dramatically help or hinder the new company's success. The challenges in setting and managing targets include:

- Being aggressive, yet realistic
- Promoting both accountability and cooperation
- Setting rules for measuring results

Under-aggressive targets lead to low performance. However, over-aggressive targets undermine performance-measurement systems because people often will not accept accountability for targets that don't seem realistic. If people are held accountable for unrealistic targets, then good people will suffer.

How are appropriate target numbers determined for procurement? Should the target for a spending area be 5 percent, 10 percent, or 15 percent? The answer depends on at least two factors. First, what is the

Exhibit 7. Establishing a Clean Room to Share Sensitive Data



Source: Booz•Allen & Hamilton

expected cost improvement due to increased scale? Second, how good was each company at buying the particular goods or services to begin with? Although the second factor is a judgment call, the first is related to characteristics of the particular commodity. Some commodities (e.g., fuel oil) may drop very little in price as spending increases, while others (e.g., furniture rental) may drop much more rapidly (see Exhibit 8).

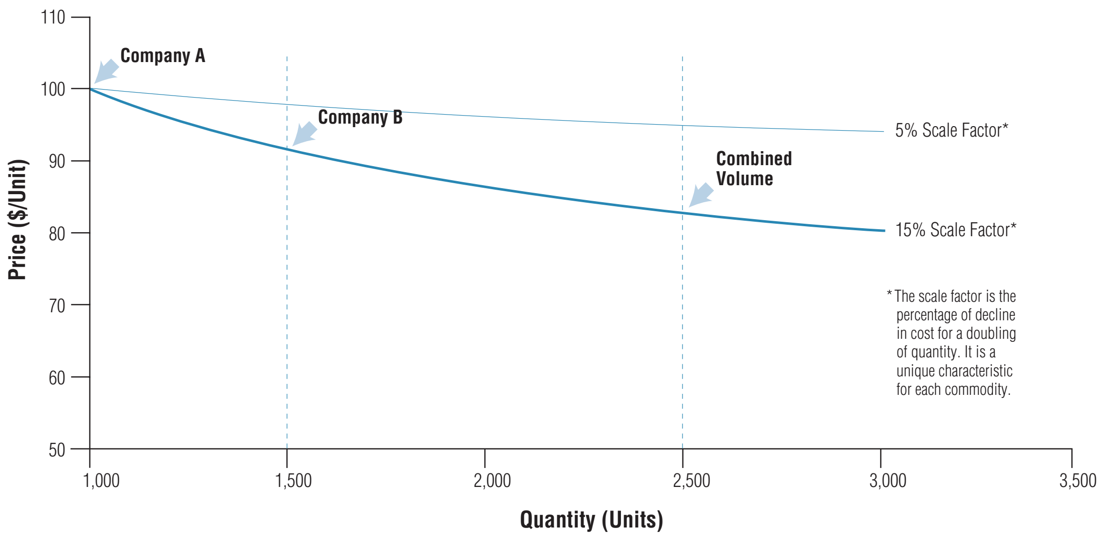
Targets are likely to be set early, but information improves over time. Rather than setting targets that are subject to change, executives will find it more advantageous to implement a process that pushes targets down into the organization as better information becomes available.

Targets should be assigned in a way that promotes accountability and cooperation. Where there is a strong central procurement function, the challenge is typically to encourage cooperation between procurement and business units. Where there is no strong procurement function, the challenge is often to get the businesses working together for the common good.

Consider a company with a strong procurement function charged with finding procurement savings across the entire company. Assigning top-level cost-reduction targets to each business unit and each function will ensure accountability for results. For example, presume that the procurement function is tasked with finding $45 million in savings, and the German business unit (BU) needs to find $26 million. One way to clarify accountability is to tell the German BU that it must find nonprocurement savings, because the procurement organization will be responsible for procurement opportunities. Accountability is clear.

The problem with this example is that procurement will usually need the cooperation of the German BU to achieve the savings. For example, the German BU may need to approve product-line rationalization decisions or specification changes. However, given the large nonprocurement target assigned to the German BU, the BU may not have time to invest in cooperating with procurement. An alternative could be to assign overlapping targets that specify a

Exhibit 8. Example of Commodity Price Declines Related to Increasing Quantity



Source: Booz•Allen & Hamilton

Exhibit 9. Promoting Cooperation Through Joint Accountability for Targets

Business Unit	Functional Area				Total
	Procurement	Engineering	Manufacturing	Other	
France	$ 10M				
Germany	**$ 10M**	$ 4M	$ 8M	$ 4M	**$ 26M**
UK	$ 20M				
Netherlands	$ 5M				
Total	**$ 45M**				

Source: Booz•Allen & Hamilton

$10 million target for procurement savings in Germany (see Exhibit 9). This encourages cooperation, although accountability becomes blurred. The best choice will depend on the companies' organizational structures, incentives, and cultures.

One difficulty that often emerges is how to account for savings initiatives that were under way before the merger. It is generally best to count these as if they were new ideas. Since the new cost target will be measured from a spending baseline established prior to the merger, whether or not the cost changes were already planned is irrelevant. Doing otherwise simply represents low-value "accounting" rather than a true value-added effort focused on the prize.

Finding the Savings

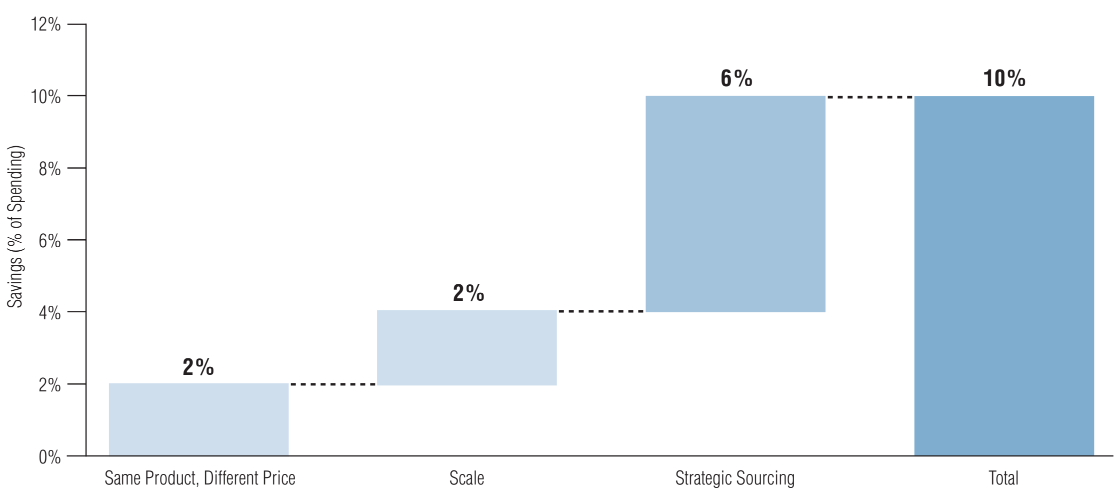
There are typically three sources of post-merger procurement opportunity. First, during post-merger integration, companies often find that they have been paying different prices for the same products and services. These are the easiest and fastest opportunities to capture. Second, there is an opportunity to re-bid, especially given the increased spending (see the scale effect in the earlier target-setting discussion). Note, however, that scale effects apply only where there is overlap in commodities within the relevant geographic scope. A doubling of volume in office furniture will not help if one company primarily does business in Europe and the other in Australia. Third, savings result from the companies' differing levels of sourcing sophistication. For any given commodity, we typically find that one company's sourcing strategy is superior to the other's. Furthermore, both companies can often benefit by adopting external best practices.

The three sources of savings are illustrated in an example taken from Booz·Allen's work on an oil company merger (see Exhibit 10). The teams found an opportunity to reduce cost by 10 percent: 2 percent due to different prices paid for the same commodities; 2 percent due to volume discounts that could be gained from the new size; and the greatest portion, 6 percent, from broader implementation of Strategic Sourcing.

Management needs a well-structured approach to identify, prioritize, and capture savings. Prioritization leads to a plan to capture savings in waves of sourcing activity. The Booz·Allen approach quickly reconciles targets with opportunities and then proceeds to "find the money" through assessment of supply-side and demand-side opportunities (see Exhibit 11).

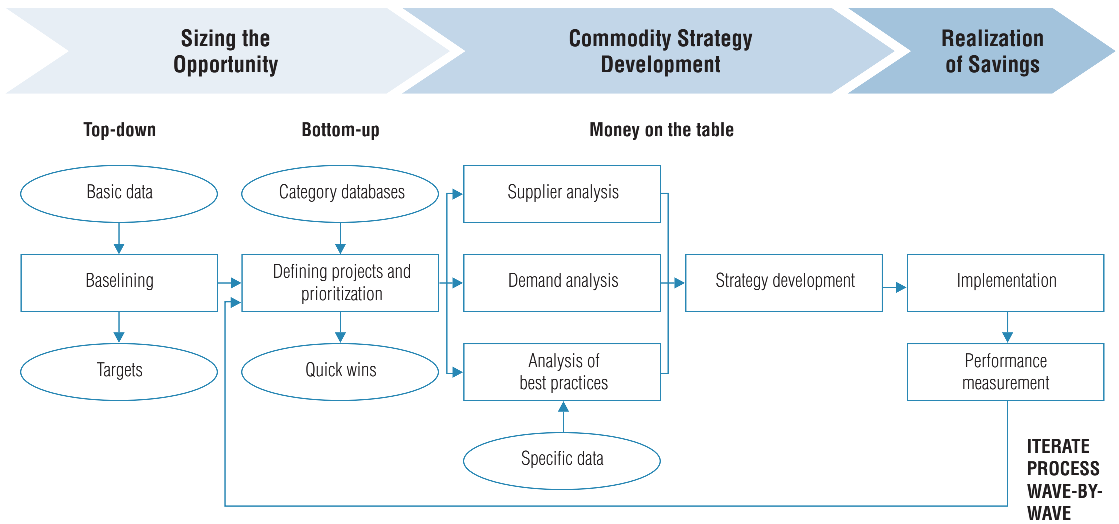
Although the waves may be planned around attacking the easier commodities first, the most efficient plan may be to structure around opportunities within commodities. For example, the first wave may include simple re-bidding among known suppliers. The second wave may involve some supply-chain restructuring and some demand-side opportunities. The third wave may involve complex changes in product design after reassessing value delivered to the end customer (see Exhibit 12). Note that, in the early waves, the sourcing teams must not lock the company into long-term arrangements that will tie the hands of the teams looking for much bigger opportunities in later waves.

Exhibit 10. Post-Merger Procurement Savings (Booz·Allen Client Example)



Source: Booz·Allen & Hamilton

Exhibit 11. The Booz·Allen Sourcing Approach



Source: Booz·Allen & Hamilton

SOURCING PRINCIPLES

Booz·Allen adheres to six principles in sourcing. These principles are designed to maximize benefit and achieve results as quickly as possible.

1. **Define scope broadly.** Target waste in the whole supply chain, focusing on total cost. For example, consider inventory cost, shipping, and how the purchased goods affect other costs. Focus on supply- and demand-side opportunities. Supply-side levers change how a company buys, whereas demand-side levers change what is purchased. For example, negotiating a volume discount at a hotel is supply side; staying at a more modest hotel is demand side.

2. **Organize for success.** Use multifunctional teams and suppliers' involvement to find the best ideas and promote buy-in for changes. Lead with senior management so that changes can be made outside of procurement.

3. **Use targeted, objective analysis.** Only collect data and conduct analyses that will support a plan that may work. Poorly focused data collection efforts are a waste of resources. Make sure to quantify the benefits of any idea, since many "good" ideas prove not so good after examining the net present value. Develop strategy based on cost-driver understanding. Cost drivers relate total cost to specific changes.

4. **Optimize across the extended enterprise.** Share information with suppliers if the opportunity to reduce cost exceeds any impact on negotiation power. Choose suppliers for specific roles based on capabilities and cost. Work with suppliers across multiple levels and functions, such as engineering and manufacturing.

5. **Balance cooperation and competition in supplier relationships.** In their efforts to collaborate with suppliers, some companies form very close relationships with them. These suppliers can become complacent and lose competitiveness in the marketplace. Maintaining a healthy competitive tension while

Exhibit 12. Capturing Procurement Savings in Waves

	Wave 1	Wave 2	Wave 3
Focus	Price and other quick wins	Drivers of cost	Drivers of value
Approach	Volume leverage and supply-base rationalization	Supply-chain optimization and demand management	Product redesign
Time Scale	0 to 6 months	4 to 18 months	6 to 24 months
Examples	• Price comparison • Price benchmarking • Bidding or auction • Credible threat of switching	• Finding cost-advantaged suppliers • Supply-base rationalization • Direct delivery • EOQ ordering • Just-in-time • Volume reductions • Service specification management	• Value engineering • Incorporating suppliers into product development • Joint R&D planning with suppliers

Source: Booz•Allen & Hamilton

working together is not easy. To keep market forces active, top companies build a set of advanced capabilities for working with suppliers.

6. Don't reinvent the wheel. Your company is not the first to source office supplies, long-distance service, or personal computers. Start with known best practices for each commodity. Capture and share insights across the company.

CONTRACT COMPARISON

The easiest savings to capture are those that come from resolving different prices paid by the two companies for similar products or services. Finding these discrepancies generally requires a comprehensive contract comparison. This work should be done in coordination with the Day-One team, because the team will be looking for contract terms that may cause difficulties after close (such as sole-source agreements or change-of-control provisions).

While price comparison seems to be a straightforward way of finding opportunities, making apples-to-apples comparisons is often difficult. Contracts may differ in terms of the degree of included services, discount structure, volume or investment commitments, and so forth (see Exhibit 13). For example, a comparison of handset prices after a telco merger found a variety of prices but also different marketing support packages and terms that had to be quantified to allow direct price comparisons. To add to the difficulty, sometimes these understandings are not written down. Suppliers have different standards of service, and they may have developed special working relationships over time. Therefore, some interviewing may be required to determine the true level of service.

e-SOURCING TOOLS

After a merger, a company will be revisiting the sourcing of almost all purchased goods and services. This can be the perfect opportunity to introduce an e-sourcing tool set, due to the need to rapidly re-bid many commodities. A good e-sourcing tool set will accelerate the sourcing process and facilitate the capture of knowledge along the way.

Exhibit 13. Contract Comparison Checklist

Contract A

Contract B

☑ Background data
- Name of vendor
- Internal contact information (e.g., buyer or user)

☑ Products provided

☑ Services provided
- Materials purchasing
- Inspection
- Transportation/warehousing
- Engineering: product/process design
- Maintenance
- Cleaning
- On-site support
- Disposal
- Other

☑ Scope of application
- Customer spending with this supplier
- Total customer spending on these products/services
- Customer facilities served
- Type of projects served (e.g., new construction, maintenance)

☑ Pricing structure
- Base pricing
- Discounts (e.g., volume)
- Incentives/penalties
- Rebates
- Warranty
- Price
  - Year-over-year reductions/increases
  - Pass-through pricing
  - Indexing
  - Target costing
  - Cost-reduction sharing

☑ Performance requirements
- Capability commitments
- Lead-times
- Volume/mix change accommodation
- Quality assurance

☑ Working relationship
- Contract length/expiration
- Volume commitments
- Inventory ownership
- Equipment ownership
- Supply-chain linkage (e.g., order processing, capacity planning)
- Information sharing (e.g., costs, cost drivers)
- Performance measurements
- Indemnification agreements and insurance

☑ Investment commitments
- Technology development
- Production capabilities (property, plant, equipment)
- Supply-chain integration

☑ Other key items
- Sole-source agreements
- Change-of-control provisions

Source: Booz·Allen & Hamilton

There are a variety of e-sourcing tools in the marketplace. Not to be confused with transactional e-procurement systems (which are often adopted as part of the implementation of a sourcing strategy), e-sourcing tools support the Strategic Sourcing process. These e-sourcing tools frequently include:

- On-line market research
- On-line Request for Information (RFI), Request for Proposal (RFP), and Request for Quote (RFQ)
- On-line auctions
- Knowledge management
- Sourcing project management
- Contract management

The market for e-sourcing providers is changing too rapidly to provide an up-to-date list. However, the large number of sourcing projects after a merger will provide a good forum for piloting e-sourcing software from one or more vendors.

Although it is extremely useful, e-sourcing cannot substitute for a sound Strategic Sourcing process. Even with the best Internet sourcing tools, buyers still need to define commodity strategies, consider demand-side issues, search out suppliers, and structure bidding and selection processes. The core competencies of procurement remain the same.

Conclusion

Procurement should be on the agenda of the CEO in any large merger. Procurement savings tend to be faster and larger than many other sources of value from the merger, so effective execution in procurement can often make or break the merger's success.

Beyond capturing savings, the merger presents an opportunity for the procurement function to reinvent itself. Management should think strategically about procurement's potential contribution to the new company. Only after determining procurement's role can the company make informed decisions about the appropriate capabilities to build.

Even the most experienced procurement executives will find it a monumental task to design and build this new organization while simultaneously achieving dramatic savings and keeping operations running. Fortunately, the numerous recent mergers have provided many lessons that will help today's executives capture the potential values of the deals.

What Booz·Allen Brings

Booz·Allen & Hamilton is a global management and technology consulting firm. In more than 100 countries, our team of 10,000 professionals serves the world's leading industrial, service, and governmental organizations. Each member of our multinational team has a single common goal — to help every client we serve achieve and maintain success.

As world markets mature, and competition on an international scale quickens, we are harnessing the strengths of our entire firm to address the needs of our clients. For over a decade, Booz·Allen has been helping clients achieve sourcing savings and build procurement capabilities. Booz·Allen has also guided some of the world's largest corporations through many successful mergers. This combined expertise uniquely positions us to help companies develop their merger procurement strategies and to achieve the potential that procurement has to offer.

We judge the quality of our work just as our clients do — by the results. Their confidence in our abilities is reflected in the fact that more than 85 percent of the work we do is for clients we have served before. Since our founding in 1914, we have always considered client satisfaction our most important measure of success.

Consistent with our position as a business thought leader, Booz·Allen sponsors *strategy+business*, a quarterly journal containing the best ideas in business. Visit the Booz·Allen Web site at www.boozallen.com and the *strategy+business* Web site at www.strategy-business.com.

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