Knowledge Summary

CIPS KNOWLEDGE

Mergers and Acquisitions

CIPS considers that the procurement function has a key role to play in effecting and maximising savings, both before and after amalgamation/ takeover.

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CIPS Positions on Practice

CIPS views, opinions and beliefs are stated throughout the document; however the broad practice statements which underpin the text are as follows:

- CIPS considers that the procurement function has a key role to play in effecting and maximising savings, both before and after amalgamation/takeover.
- CIPS believes that mergers can help buyers to act strategically and work more closely with the Board. Even when the procurement function is not directly involved in the merger plan, purchasing and supply management professionals are still in an ideal position to identify and exploit business opportunities.
- The purchasing and supply management function will often have a key role to play in the due diligence process within the acquiring organisation.
- CIPS recommends that all members of the new purchasing team within the new and larger organisation should be sent a clear message as to the key role they are expected to play.
- CIPS believes it is important for the head of the merged purchasing and supply management function to possess a wide range of abilities and skills, covering change management, communication, persuasion and human resources.
- CIPS considers it is vital that the threats and opportunities within the newly formed purchasing and supply management function are managed/controlled quickly and effectively.
- CIPS would draw attention to the additional care which needs to be exercised when international factors and considerations are involved.
- CIPS sees it as important that the purchasing and supply management function ensures that the supply market is kept abreast of the changes, decisions and initiatives impacting upon it.
- CIPS takes the view that purchasing and supply management professionals need to minimise any disadvantages created through diversification (as in their organisation being sold away from the parent company, for example).

When their employing organisation merges (through acquisition or take-over) with another organisation, purchasing and supply management professionals can be involved in:

- the strategic and commercial process of the merger
- the business of fusing two or more separate purchasing and supply management functions
- vertical integration e.g. the buying organisation taking over a key supplier in order to secure supply and manage the business more effectively.

Opportunities for Raising the Profile

There are three key stages at which the procurement function may wish to become involved.

1. Undertaking the covert analysis of potential savings synergies before the other company is approached. This uses a range of analytical tools to estimate key parameters such as spend profiles.
2. The joint analysis of savings potential as part of the due diligence process before amalgamation, once the other company has been approached.
3. Combined working rationalisation alignment and delivery of defined benefits, once 'consolidation' of the companies has taken place.

It needs to be borne in mind that the analysis should focus on process and system strengths as well as estimating potential specification similarities which would facilitate spend leverage and hence price reductions. It is also worth remembering that after the merger goes ahead senior management will invariably ask for more than was originally promised by the procurement function; in this connection it should be noted that quoted procurement savings can often be based on limited analysis and may therefore be challenged. Mergers give purchasing and supply management professionals an opportunity to be really strategic and work directly for the Board. CIPS encourages purchasing and supply management professionals to be proactive in offering their commercial, management and legal services to senior management to help in the process of agreeing the merger with the organisation concerned.

Purchasing and supply management professionals should proactively consider the implications of bringing together two or more purchasing spends and devise an appropriate plan for this process. They can assist the Board in making sensible recommendations to shareholders about the likely commercial benefits e.g. savings that can be expected. Colleagues working in Guinness when it merged with Arthur Bell to form Diageo had their status elevated because of their contribution at this stage. Another example is the Royal Bank of Scotland and NatWest merger.

Delivering Value to the Merger

Where, for whatever reason, the purchasing and supply management professionals are not involved with the merger plans, they can nevertheless react to the situation and identify business opportunities (e.g. the acquired company could provide a supply base that enables the potential for a new product to be brought to market) and additional benefits and use these to raise their contribution and influence in the organisation.

Where purchasing and supply management professionals have not managed to influence the Board in time, Chairmen often pronounce, for example, that savings of £20m will be delivered as a consequence of the merger. These figures are often guesses based on no substantive facts, leaving the merged purchasing and supply management functions to work out how they can best deliver these savings.

Purchasing savings are often used as a way of securing shareholder approval for the premium paid for the business being acquired. Sometimes these savings can mask the real reason for the merger, such as penetrating the US market through the vehicle of the acquired company. However, to an increasing extent mergers are about knowledge intangibles as opposed to tangible assets and benefits. Even so it is worth remembering that savings often arise from reduced headcount or rationalised manufacturing facilities, rather than through the purchasing function.

One way in which the purchasing and supply management team at the acquiring organisation can assist the Board is to offer to be involved with the due diligence process. There appears to be no standard for this process in acquisitions but broadly the following types of issues need to be examined:

- How do they resource their purchasing and supply management - number of people, structure?
- What are the top ten by suppliers by value?
- What are the top ten suppliers by risk?
- What is the size of the supply base? Has this been managed?
- What are the top ten contracts by strategic importance?
- What partnering arrangements are in place?
- What contractual commitments exist?
- Where is the organisation exposed - e.g. in terms of security of supply, reputation etc?
- What inventories are held, how are these managed?
- What terms and conditions are used e.g. payment terms?

- What assets do they have - have these been subject to life cycle analysis?

Additionally there is a need to consider whether the company being acquired retains its own legal identity as this could affect novation of contracts. Additionally, on 6 April 2006, the revised Transfer of Undertakings (Protection of Employment) Regulations 2006 (the "TUPE Regulations") (S.I. 2006/246) and the Service Provision Change (Protection of Employment) Regulations (Northern Ireland) 2006 (the "2006 Regulations") (S.R. 2006 No. 177) came into force.

The TUPE Regulations make provision, in respect of Great Britain and Northern Ireland, for the treatment of employees, and related matters on the transfer of a business or undertaking while the 2006 Regulations make corresponding provision related to service provision change in Northern Ireland. These Regulations replace the previous 1981 TUPE Regulations, and the 2006 Regulations widen the scope to cover cases where services are outsourced, insourced or assigned by a client to a new contractor (described as "service provision changes").

Service provision changes concern relationships between contractors and clients who hire their services. Examples include contracts to provide such labour-intensive services as office cleaning, workplace catering, security guarding, refuse collection and machinery maintenance There are also possible TUPE implications if staff changes are involved. It is not always easy to obtain useful management information from merging companies but this needs to be done in order to establish a baseline for improvement. Reference can be made to the CIPS publication 'How to Assess the Maturity of Purchasing and Supply Management'.

Due Diligence

When evaluating the value for money of contracts during the due diligence process it is often difficult to determine whether it is a good contract or not without being able to benchmark with a similar contract from the acquiring organisation's portfolio.

There are also differences between service and manufacturing companies when it comes to due diligence. Manufacturing companies are often focused on issues of quality, compliance and warranties, for example, where a piece of plant or capital equipment is used in the business - the contract that supports it needs to be checked for security of supply e.g. of maintenance parts. On the other hand, due diligence in service companies is often more concerned with MRO issues, software/IT contracts and issues of overheads. It is rather like looking into the future in terms of requirements as opposed to looking at equipment already being used.

Bringing Together the Purchasing and Supply Management Teams

The merged purchasing and supply management function should have a central role in recapturing the merger premium. A clear message should be given to employees/ colleagues about the critical role purchasing and supply management has to play and the importance of a collective effort in this regard.

An integration team is required to integrate the purchasing and supply management teams quickly and effectively. Purchasing and supply management professionals are adept at bringing together appropriate cross-functional teams and facilitating planning discussions on the purchasing and supply management consequences of mergers. They do this when 'Make versus Buy' analysis and similar decisions take place. An integration team requires a leader with excellent communication and facilitation skills - and ideally two synergy managers representing the value that both teams can bring to the new function. The leader of this team need not necessarily be the future leader of the purchasing and supply management function.

However, organisations often appoint a new head of purchasing and supply management to take on this integration role. Integration team meetings need to take place in quick succession with actions taken in between meetings. As an example, when Racal and Thomson merged there were ten integration team meetings in two months. The problem of having too many purchasing and supply management professionals in the merged organisation also needs to be addressed. This is the basic question of determining the skill sets required to support the new purchasing and supply management key performance indicators and then assessing the skills residing in the merged function. The head of purchasing and supply management needs to have change management skills, communication and persuasion skills, empathy, understanding and appreciation of the human resource responsibilities of bringing the teams through the transition from two (or more) purchasing and supply management teams to one.

It is a mistake to try and benchmark the merging supply functions, since one function may be about buying castings, in a hard-nosed manufacturing supply market, and the other might be polished service buyers working in partnership with long-term value-add suppliers. Both approaches may be appropriate for the supply markets they work in - but not directly comparable with each other.

Merging two purchasing teams can create many new opportunities - new skills may become available, new markets open up etc. but there can also be conflicts due to power struggles, different ways of working and culture clashes. These issues all need managing quickly and efficiently so that optimum value is extracted whilst problems are dealt with immediately rapidly and efficiently.

When Caterpillar bought Perkins, the former were in a much stronger position in terms of their spend and the natural assumption could therefore be that the smaller organisation of Perkins would have complied with the larger company's ways of working. However, this was not the case, as Perkins had established sophisticated supply management capabilities from which the whole organisation benefited. Another example of such a scenario was when Lucas took over Varity - the Varity employees' approaches survived and prospered. The moral of these stories is that the purchasing and supply management profession should be open-minded and evaluate all the approaches, skill sets, methodologies and experiences that they have at their disposal. They should then be sufficiently objective to extract the best from the merged purchasing and supply management functions which can then be used as the base line for further improvement.

An additional factor is that international considerations are sometimes involved; this was certainly the case in the Lucas and Varity merger; another example is that of Racal and Thomson.

Impact on Supply Markets

A merger creates uncertainty among both companies' suppliers, particularly if they might have to compete with each other. Although some suppliers may be able to look forward to winning more business from the combined organisation others will lose out. Too much emphasis is often put on the savings that should come out of mergers. Savings can be difficult to achieve if the two merging companies both have high standards as far as their purchasing and supply management activity is concerned. Equally, cost savings can be pursued at the expense of quality or security of supply and can damage a relationship with a key supplier when the latter is forced to work on an unrealistically slender margin. Quite often savings are generated through headcount reductions in the purchasing and supply management team or as a result of process improvements through the implementation of pCards or eProcurement.

The purchasing and supply management function must ensure the supply market is kept abreast of changes and decisions that impact upon them. This can be achieved through supplier conferences, emails/newsletters and the media.

Suppliers may also be averse to dealing with the newly acquired company - and so customer preferencing analysis needs to be undertaken to determine how different suppliers perceive the new purchasing entity. Where perceptions are negative, the purchasing and supply management function must undertake conditioning of the supplier using techniques such as reverse marketing.

There is also the assumption that bigger is better i.e. two spends creating greater leverage and power in the marketplace. Where two large global organisations try to join forces in this way, this could be prohibited by the Competition laws.

The supply base can also react negatively - they might not offer international pricing and insist that subsidiaries of the buying organisation in France buy from their French division, contracting with them accordingly. Similarly, local manufacturers may require local suppliers that cannot supply other parts of the business e.g. a whisky distillery in Scotland may require locally made bottles only. This is an interesting example in that the distillery has to be where it is because the local water is a key part of the product; locally produced bottles are an attractive choice for brand profile and economic reasons, glass having a high transport cost/factory value ratio.

The purchasing and supply management function should also be mindful of the longer term consequences of aggregating spend into large contracts that can only be serviced by large suppliers e.g. smaller businesses failing to flourish and so competition is not created and the buying organisation becomes dependent on the powerful supplier. Another long term effect could be the movement of an entire supply chain out of the country as happened with steel in the UK.

Changing Conditions and Contracts

Where the two merging companies have similar requirements and have different contracts in place with different suppliers, a value for money analysis must be undertaken in order to determine the best option. When there is no clear best option it is good practice to go out to the marketplace again with the amalgamated requirement of the two companies. It can be argued that this creates buy-in by the new purchasing and supply management function rather than some buyers having to use a contract set up by their peers whilst their own has been terminated.

Purchasing and supply management professionals need to minimise any disadvantages created by the possibility of diversification e.g. their organisation being sold from the parent company. One way to minimise disruption is to ensure that the contracts they are party to before being sold off are still available to them to use for a sensible period of time. This can be achieved through the use of clauses in contracts such as those on contract assignment. Equally, where the purchasing and supply management function prefer, they should be released from contracts where, for example, they prefer to source locally from smaller suppliers.

The same issues are encountered not just in the merger/acquisition arena but also where a company may win an outsourcing contract from another company (e.g. a third party supplier to provide call centres previously provided in-house). In this case there is a greater pressure as the customer can of course choose to bring such service provision back in-house so there is a prime need to get everything running as efficiently and cost effectively as soon as possible.

International, Multicultural and Taxation Issues

When a company takes over or merges with another company in a different country and assumes responsibility for its contracts with third party suppliers there are many legal and tax issues to be considered as well as all the cultural, political and even language issues. It is likely to prove beneficial to retain at least a small local purchasing and supply management team in the country concerned to assist with the pitfalls of legal entities, non- reclaimable VAT or Sales Taxes and the implications and ramifications of contracting in local laws.

It is likely that, in the immediate short term at least, to maintain continuity of supply, contracts from the merged company will be novated to the acquiring company. Expert advice should be sought to ensure the acquiring company does not expose itself to unnecessary tax exposure (which in certain cases can impact individual product/solution pricing thereby affecting potential bid scenarios the acquiring company may be involved in and/or may also directly affect customers as some charges may have to be paid by the local in country recipient not the provider).

Where purchasing and supply management teams from different cultures are merged there will need to be strong leadership, management and guidance as well as education to overcome entrenched loyalties and supplier preferences together with all the different historic attitudes and working practices.

Where one company's purchasing and supply management department effectively takes over another from a different global region great care must be taken to understand cultural differences, methods of working and local issues.

The challenge of working across significantly different time zones cannot be overestimated (finding convenient times for conference calls between the west coast of the US, the UK and Asia-Pacific is not easy). Email becomes the normal method of communication. English tends to be the international business language but care must be taken to communicate clearly and concisely, particularly with people whose first language is not English and the subtleties of a contractual clause can easily become confused in translation.

Conclusion

Synergies between companies and the economies of scale generated through mergers are prime sources of value creation. Purchasing and supply management professionals are equipped with the skills to maximise this value creation and not just through savings. Mergers provide purchasing and supply management professionals with an opportunity to deliver real and highly visible business benefits to the Board. They are complex commercial projects and are a minefield of risks which need to be managed through careful change management. However, they can also create new career opportunities for purchasing and supply management professionals, such as a two year stint in the US offered by Caterpillar to its employees. CIPS encourages purchasing and supply management professionals to view mergers as positive experiences and to proactively offer their services to achieve success.

CIPS KNOWLEDGE

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