

Mergers & Acquisitions and Strategy & Corporate Finance Practices

Using M&A to transform procurement

A merger creates an opportunity to reinvent the procurement function, turning it into an innovation engine and strategic partner to business leaders.

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Companies navigating integrations must manage competing priorities across all functions, from business continuity to value capture to organizational and operating-model redesign. However, the current period of supply chain disruptions and spiking inflation makes procurement a particularly important function to get right.

In our experience, procurement typically contributes a third or more of the total synergy value in an integration, most of which can be captured within 12 months of deal close. Further, those synergies usually don't require workforce reductions that can affect company morale. By promptly delivering benefits, procurement can help set the pace for the overall integration and quickly demonstrate the value of the combined company to shareholders.

Most companies today focus on stabilizing the procurement function and capturing synergies directly related to the merger, such as price harmonization, deferring decisions about a larger functional transformation until the full integration is complete. By contrast, leading organizations seize the opportunity an integration provides to reinvent

the combined company's function, advancing procurement along the spectrum of functional maturity within the first two years of deal close. Our experience working with clients suggests that such early action can double the value of procurement synergies while laying the foundation for the procurement organization of the future.

Spectrum of procurement maturity

To understand the potential of transforming the procurement function during an integration, corporate leaders need to first evaluate the maturity of the legacy procurement organizations. Functional maturity can be thought of as a spectrum, spanning five stages that range from cost-focused order taking at one end to a cross-functional, digitally enabled innovation engine at the other (exhibit).

Basic order taking. In some organizations, procurement operates primarily as a back-office support function. Spending on large categories is often siloed or managed by individual business units, while small or indirect categories may receive little or no central management. Procurement professionals in these organizations typically focus

Exhibit

The maturity of procurement organizations can typically be categorized by one of five archetypes.



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on optimizing purchase price as well as providing basic service levels and efficient execution. Processes are largely manual, with few controls and limited visibility into spending. These organizations typically rank in the bottom quartile of procurement value delivery.

Functionally advanced. In this archetype, which characterizes most large companies today, the bulk of spending is managed centrally. Category strategies (including some demand and specification management) are refreshed regularly, and the organization uses standard processes for sourcing (such as requests for proposals and negotiations) in collaboration with other functions. Digital tools may automate some basic reporting on metrics such as spend and unit price by supplier, but more sophisticated analytics are performed manually.

Integrated corporate focus. In top-quartile procurement organizations, the function is tightly integrated with all other business functions. It acts as a strategic partner, going beyond price to provide business leaders with a total cost of ownership view, and creates a robust set of demand and process controls around specs, spend-limit approvals, and other procurement elements. As a steward of all spending, procurement applies sophisticated systems and compliance processes to maximize cost efficiency.

End-to-end continuous improvement. Top-decile performers go further, working directly with vendors and customers to uncover new sources of value. For example, procurement may use its advanced analytics capabilities to help suppliers identify new formulations or manufacturing efficiencies that deliver benefits both can share. Procurement professionals may also work directly with customers to better understand their needs and use that input to influence corporate decisions on product design, service levels, and pricing. The function is a consistent source of innovation, making it a draw for top talent.

Digital innovation engine. Cutting-edge procurement organizations go further still,

leveraging digital technologies to optimize the full value chain. These organizations lead the pack in the use of predictive analytics and forecasting to enable the business, its suppliers, and its customers to take a proactive approach to value creation and risk management. Whereas most organizations are opportunistic about identifying interventions or improvements to the procurement process, organizations in this category employ formal mechanisms such as annual customer surveys and quarterly ideation sessions with suppliers to generate insights and innovations. In these organizations, procurement becomes the training ground for the future leaders of the company.

As procurement organizations move up the maturity scale, their ability to deliver value to the business, both financially and strategically, grows.

Levers for transforming procurement

Given the focus on rising costs and supply chain disruptions today, many companies are looking at ways to maximize the effectiveness of their procurement functions. Such transformations typically include a combination of four self-reinforcing changes: redesigning procurement's operating model, elevating the organization's role, digitizing the function, and raising the team's capabilities. Since many of these levers come into play during integrations, transforming procurement at the same time can lead to faster value delivery, lower overall investment, and less organizational pain than launching the process after the integration is complete.

Redesign the procurement operating model. The procurement operating model needs to be set up to deliver maximum value at the right scope of spend. The organization must decide what role the procurement function will play in each category of spending, from merely providing counsel on topics such as supplier negotiations, to recommending potential savings opportunities, to leading overall spend management and purchasing. Once that role is defined, the function needs the right operating model—along with the necessary governance,

processes, tools, and people—to play that role effectively. The operating-model redesign might address issues such as centralizing or decentralizing specific tasks (purchase order placement, for example), hiring to gain new capabilities (in “should-cost” modeling, for instance), and clarifying roles and responsibilities (for example, assigning strategic and tactical efforts to separate roles).

Elevate the role of procurement as a strategic partner. In practice, this usually means giving the procurement function a seat at the table in operations, product development, and commercial discussions that may impact the supply base. For smaller or less functionally mature organizations, this step may also include creating or expanding the indirect procurement function that looks for savings in categories such as office supplies, IT, or maintenance, repairs, and operations.

The spotlight on procurement synergies created by the integration, along with the broader reorganization necessitated by the merger, can also be an opportunity to elevate the procurement leader to a more senior level of the organization, perhaps reporting directly to the CEO rather than to the COO or CFO. This sends a signal to the organization that procurement is a core strategic function rather than an administrative center.

Embed digital in every aspect of the function. This can not only accelerate integration planning and execution but also lay the groundwork for a long-term digital strategy. For example, digital tools can enable each legacy organization to validate its own data pre-close while a clean team analyzes the combined data set. When selected thoughtfully, these same tools can become part of the combined company’s long-term digital tool kit, providing real-time visibility into spending data, contract information, and savings opportunities. Since integrations typically require significant changes to core IT systems, these are opportune times to evaluate the full suite of procurement tools and upgrade existing technology—especially since recent years have seen significant advances in digital procurement tools.

Upskill the team. For the function to realize its full potential, its employees need to assume new responsibilities, many of which will require different capabilities than they already have. Top procurement organizations typically have strong capabilities in areas such as predictive analytics and automated supplier management. They engage in joint innovation with suppliers, backed by should-cost modeling and technical expertise. They also drive end-to-end category management, influencing decisions around pricing and product innovation. Having aligned on the future role of the function, business leaders must identify the key capabilities required and decide which to build internally and which to recruit externally.

Putting transformation levers to work

To maximize value creation during the integration, companies need to pull several of the transformation levers. For example, a large industrial distributor took advantage of the integration effort to transform procurement from a function mostly concerned with cost efficiency into a digital innovator focused on margin expansion. The company created an industry-leading tool for recommending SKU substitutions that the sales team could use to identify near-identical products that priority suppliers offered or that had better margin profiles. The procurement function also played a role in all footprint decisions, helping to consolidate orders from vendors, optimize inventory positions, and shorten customer delivery times.

Additionally, the distributor expanded the procurement function’s role to include some customer-centric elements of the business (such as product specs and pricing) and embedded cutting-edge technology to support this scope. Successfully executing on this vision also required rethinking procurement’s operating model, training the legacy team, and bringing in new talent with more digital capabilities. The procurement transformation, which moved the organization from maturity level 2 (functionally advanced) to the high end of level 3 (integrated corporate focus), helped

the company realize almost double its three-year goal for cost synergies, including exceeding the first-year target within six months of deal close.

Similarly, a midsize chemicals company used a merger to elevate the role of the procurement function. The legacy companies, each with revenue of about \$500 million, had historically used procurement solely for basic order taking and vendor relationship management. While procurement developed strategies for some spending categories, the teams rarely had seats at the table when operational and commercial decisions were made. The integration gave the combined company the scale to leverage the procurement function more effectively. The company elevated the chief procurement officer from an N-2 (level-two leader) to an N-1 (level-one leader), ensuring a voice for the function in key decisions. At the same time, it created a team to manage indirect procurement, tapping both internal and external talent to develop a purchasing strategy and support negotiations in categories where procurement previously had limited involvement.

Within the first six months of deal close, the company also invested in more than one hundred hours of training to enable procurement employees to fulfill the function's expanded responsibilities. Through the transformation, the procurement function went from the lowest maturity level to one that was functionally advanced and achieved almost twice its synergy target, sustaining the value it had captured over the long term.

Keys to success

Elevating the maturity of the procurement function during an integration requires a commitment from the full organization. C-suite support, in fact, is the single most important determinant of a transformation's success. The most senior leaders need to convince their teams of procurement's vital role in future value creation and to invest in the capability building and talent acquisition required to achieve that vision. Further, incentivizing support from functional and business unit leaders through joint accountability for savings targets can help to ensure that procurement is brought into the right conversations.

The tone for the integration is set even before the deal closes. To determine whether to embark on a procurement transformation during the integration, companies should start with comprehensive pre-close assessment of the legacy companies' procurement organizations, typically performed by a clean team. This assessment includes building and analyzing a combined spend database to estimate the value at stake, evaluating the maturity of the legacy company operating models, and defining the aspiration for the future-state procurement function.

If a company decides that a bigger transformation is the right move, creating a comprehensive road map pre-close can clarify the steps required and help accelerate value delivery. Both greatly enhance the likelihood of successful integration and procurement function transformation.

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