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Delivering merger synergy: A supply chain perspective on achieving high performance

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After a quiet period of several years, merger and acquisition (M&A) activity has gained momentum across many industry sectors in 2005.

The interest in M&A activity never, of course, disappeared—and with good reason. Accenture research shows that high performance businesses pursue growth strategies that juggle the short-term priorities of today and the organizational and competitive demands of tomorrow. For many companies, M&As have an important role in the pursuit of that balance.

However, realizing the full synergy potential in a merger is an uphill battle. Some studies have noted that fully half of all mergers eventually fail to create shareholder value, and less than 30 percent create value that is noticeably higher than industry average returns.

Certainly, there can be many reasons why deals have not lived up to expectations. In Accenture's experience, one of the most critical reasons is that the companies involved typically did not pay enough attention to supply chain issues across the board—whether it was during the pre-deal M&A strategy process or during the actual merger planning and subsequent integration.

The importance of supply chain to a merger's success is supported by the findings of an international study team made up of researchers from Accenture, INSEAD and Stanford University, which was part of Accenture's High Performance Business research initiative. The research team found that supply chain excellence is directly tied to a company's financial performance, which is why top performers incorporate supply chain management into their business strategies.[1]

Overall results bolster Accenture's hypothesis that the mastery of core competencies like supply chain management is a critical component of high performance.

The emergence of the supply chain

While not applicable for deals that are focused solely on access to a new technology (such as those in the high-tech and biotechnology industries), supply chain excellence is particularly important for merging companies that seek to achieve high performance by expanding into new markets, rationalizing distribution channels and consolidating excess capacity. It is in these latter types of deals, often involving two large companies, that mastery of supply chain competency plays a critical role in determining the success or failure of a combination.

Thus, the supply chain has emerged as an area that can have a major impact on how a merger or acquisition performs—especially when it comes to costs. Indeed, the financial community evaluates mergers on their ability to deliver cost synergies to justify the deal because they are tangible and easily measured. Because a company's supply chain is in many cases the most significant source of cost synergies—in some deals, it has accounted for between 30 percent and 50 percent of synergies—effectively rationalizing combining companies' supply chains is more often than not a prerequisite to merger success.

Yet cost is not the only area in which the supply chain has an impact. Through our experience and analysis, Accenture has come to realize that the supply chain is one functional area that has a direct impact on all four major types of synergies that can result from a merger:

1. **Revenue.** A superior supply chain protects revenue during times of transition by ensuring customer orders are not interrupted and by enabling an organization to generate stronger top-line growth in new products, new markets and geographies.
2. **Operating expense.** How effectively the company procures goods and services and how efficiently the supply chain runs has a direct impact on net income and operating margins.
3. **Capital expenditure.** Because the supply chain often accounts for a significant portion of a company's physical assets (such as manufacturing plants, telecom network assets, warehouses and truck fleets), excellence in strategic sourcing and supply chain operations can strongly influence a company's cash outflow.
4. **Working capital.** The supply chain's ability to quickly turn raw materials or components into finished goods, get those goods into customers' hands, and receive payment for those goods plays a major role in a company's cash position.

Supply chain merger synergies

While many business combinations certainly have failed to live up to expectations, other deals have delivered promised benefits and resulted in a stronger combined organization. In studying numerous deals, Accenture found that a major success factor is the way the combining entities managed supply chain issues throughout the genesis, structuring and consummation of the deal.

Accenture's approach differs from others in that it emphasizes bringing supply chain and post-merger strategy expertise together during the pre-deal planning phase, rather than viewing supply chain integration as a post-merger activity. While specific activities will vary by company, this approach encompasses several essential steps:

Identifying leadership and team. The first step is actually taken by senior management of the merging entities: identifying the supply chain leadership and establishing a supply chain functional integration team with a clear charter and scope.

Identifying synergies. Estimating the value of synergies requires skillful blending of "top-down" and "bottom-up" methodologies. The deal execution team should consider top-down industry comparable benchmarks to determine the magnitude of the overall opportunity to reach industry-average levels or better in a variety of key operating metrics. The team should supplement this effort with knowledge, often provided from expert external advisors, of synergy opportunities achieved by comparable mergers. From the bottom-up, the team should identify specific opportunities, such as an opportunity to consolidate a redundant manufacturing facility for annual savings of $100 million. By marrying the sum of the bottom-up synergy summaries to the top-down benchmarks, the company can evaluate if the top-down estimates are realistic—and if the due diligence teams have been aggressive enough in outlining specific opportunities before making the announcement.

Determining requirements. The third important task the supply chain team must conduct is determining Day 0/ Day 1/Day 100 requirements specifically for the supply chain. Day 0 is defined as the target date when the deal is expected to be approved by the government's regulatory body, while Day 1 is a date established by senior management when the two merging companies are expected to begin operating as one integrated enterprise. It is critical to minimize the gap between Day 0 and Day 1. By identifying the specific supply chain initiatives that must be undertaken to deliver planned cost and revenue synergies—and prioritizing these initiatives on the basis of ease of implementation and speed at which they will create value—the team can help ensure that the merged organization is ready to begin generating value immediately upon closure of the deal.

Developing metrics. Finally, the team must develop a set of supply chain merger integration success metrics. Such metrics help the newly integrated supply chain organization gauge the success of merger integration, as well as keep the team focused on the most important priorities. Importantly, these metrics may be different from those typically used in internal supply chain scorecards, which measure and track the efficiency and effectiveness of internal steady-state operations. Key integration success metrics include percentage of Day 0/Day 1 requirements successfully met on time and the number of contracts re-priced and re-negotiated for cost savings.

Achieving high performance

As more companies increasingly depend on combinations to fuel a larger portion of their growth, it becomes even more critical for those deals to be successful and to deliver the promised synergies. Recognizing that the supply chain plays a critical role in the success of any deal—and indeed is fundamental to achieving high performance of the expanded company—can help ensure that the transition in this key functional area goes smoothly. This recognition in turn can help increase the chances that customers, shareholders and Wall Street will feel as good about the new entity a year after the merger as the constituent organizations' senior executives did the day it was announced.

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[1]The full report, "Connecting with the Bottom Line: A Global Study of Supply Chain Leadership and Its Contribution to the High-Performance Supply Business" is available at www.accenture.com/supplychain.