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Leveraging Procurement To Extract Untapped ROI from the Private Equity Portfolio

For years, well-managed organizations have been increasing operating margins and shareholder returns by simply reducing the cost of their indirect purchased expenses. They have achieved significant results by eliminating redundant people and processes related to procurement and by consolidating and then leveraging their otherwise disparate buying power. Firms that have been most successful at achieving financial improvements have been medium to large organizations and conglomerates with decentralized operating and purchasing structures.

The next wave of expense management will apply these same sourcing techniques to large diverse private equity portfolios whose buying structures are quite analogous to conglomerates. Whereas today each portfolio company operates independently with its own purchasing group and contracts, the well managed portfolio would instead coordinate its buying efforts and leverage the full purchasing power of the entire portfolio group. By utilizing a coordinated process the private equity firm can: (1) avoid duplication of effort and incremental dollars spent on the contracting and legal review process, (2) reduce the investment in people and infrastructure needed to procure goods and services and (3) create a hyper-competitive bidding market that leverages the portfolio's entire volume to yield significant reductions in the price of the goods and services purchased. Simply put, just because there are twenty portfolio companies does not mean that one needs to have twenty individual company contracts to purchase the same type of PC. The redundancy in contracting, processing, and procurement today is staggering.

> *"Most of our portfolio companies are pretty inefficient at buying some secondary materials. As an example, a plastics molder may be able to buy resin very, very efficiently but it might not buy parts and office supplies and things of that nature very efficiently. Many manufacturing businesses incur an extraordinary amount of needless hard and soft costs in procurement, creating big opportunities to reduce expenses."*
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> *Steven C. Graham, Graham Partners, Private Equity Firm TIFF Forum*

The business case to leverage procurement across the private equity portfolio starts with a simple premise: *Every dollar saved is an incremental dollar of return on investment* or, at the very least, *one less dollar of required fundraising*. However, the private equity industry has been slow to recognize the procurement function as a source for bottom-line improvement. The potential for reducing purchased expenses of an acquisition is powerful, and the potential for harnessing and leveraging the buying power of *multiple* acquisitions to extract significant value is even more potent.

There are three basic models that a private equity firm can utilize to increase return on investment as a function of purchasing. First, the firm can conduct in-depth strategic sourcing in each portfolio company that has sufficient independent buying scale to reduce vendor prices. While this is the least committal approach and is sure to yield some improvements, its main disadvantage lies in the fact that cross-portfolio buying leverage is not achieved and replication of procurement opportunity abounds across the portfolio. The second model calls for the establishment of a centralized procurement organization within the private equity firm. While this model eliminates repetition of process and people, and takes advantage of volume scale across the portfolio, it can only be successful if staffed with strategic sourcing experts who know how to find and utilize key levers to maximize and implement savings opportunities. Many firms have been reluctant to embark on this path, seeing it as external to their core competency. The third model is closely linked to the second, but addresses the concern of competency and administrative burden. Here, the private equity firm can establish an independent procurement entity that centralizes purchasing across the portfolio and which

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can be outsourced, wholly owned, or partially owned. In any case, the entity must be staffed with strategic procurement specialists. A key advantage of this model is the inherent ability to extend scale by offering procurement services to other private equity firms. Also, this structure can become a source of continuing revenue as holdings that spin off to become independent firms lose their purchasing scale and wish to continue to procure through the structure.

If managed correctly, leveraged procurement can extract untapped ROI from the private equity portfolio with surprisingly strong results.

Think your private equity firm has maximized profit? Take the test:

Using data from each of your portfolio companies, compare a sample of expenses from various categories.

What is the low, high, median, and average price that your portfolio companies pay for a PC or laptop? For a copy? For a courier package delivery? Of the total courier packages sent, how many were sent overnight next day AM? How many were sent next afternoon delivery? Second-day delivery?

You need help with your procurement if:

- You don't have the answers to these questions readily available.
- There is price disparity across holdings.
- Your firm is overbuying services (e.g., next morning package delivery when second day delivery would be sufficient).
- You have already negotiated seemingly great deals with your vendors but your usage never seems to qualify for the discount.

SSI Advisors is a management consulting firm specializing in Total Spend Management. SSI combines deep industry expertise, sourcing experience, technical knowledge, economic modeling capability, and vendor neutrality to bring to market a proven process that yields sustainable best-in-class pricing, measurable contracts, and improved product and service quality.