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Unlocking deal value in supply chain product flows

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Deals that involve complex supply chains often leave additional value on the table by overlooking the importance of product flow analysis. Dealmakers need to collaborate with supply chain leaders to fully understand the future-state supply chain network design, infrastructure, and product flows. Doing so can improve profitability, reduce working capital needs, and achieve deal value realization timelines.

The supply chain is a critical deal component that can create meaningful deal benefits and help the business deliver value on an ongoing basis. Potential acquirers of businesses with complex or global supply chains need to understand the importance of both predeal due diligence and postdeal integration as a way to streamline the supply chain and product flow, lower supply chain costs, and protect against postclose value erosion. In addition, acquirers will be well equipped to deal with common pitfalls such as underestimating the capital intensity of the merged entity's supply chain, inaccurately projecting the impact of changes in demand, and missing the complexities of local legal and regulatory requirements.

Uncovering value through diligence

Early in the deal cycle, acquirers should devote adequate resources to conducting diligence focused on identifying synergies in the existing supply chain and on future-state product flows. Supply chain focused due diligence can help companies gain a thorough understanding of both their own and their target's current manufacturing and distribution footprint, which will give buyers the ability to identify both synergy opportunities and potential risks. Typical supply chain diligence efforts have a high-level focus on strategic sourcing, reducing supply chain headcount, and divesting infrastructure.

However, only focusing on these traditional "cost out" levers can result in a suboptimal overall operating model because other levers, such as tax and working capital, are not considered. By going even deeper to analyze product flows, buyers can better validate typical cost hypotheses and ensure that they align with the business priorities.

This type of diligence can unlock additional synergies in areas such as:

Working capital – Reducing cycle times can lower the working capital required by the supply chain.

Tax and legal structures – Aligning the supply chain with the merged entity's strategy to meet regulations and optimize tax efficiency with the newly proposed legal entity structure posttransaction.

Product flows and supply chain footprint – Consolidating manufacturing and distribution footprints and aligning supply chain product flows to meet the needs of the combined entity.

In addition, the product flow mapping process can help acquirers avoid some of the most common supply chain challenges and pitfalls:

Underestimating capital intensive infrastructure complications – Companies that devote the necessary resources will be able to respond to local market demands before the supply chain is disrupted.

Inaccurately assessing the supply chain impacts from changes in demand – Companies will be better able to meet customer needs and avoid delivery disruptions.

Aligning interdependencies with other enterprise functions and processes – Companies can reduce risk to close, minimize timely manual work arounds, and avoid value destroying disruption to the business.

Lacking the expertise to comply with the local regulatory and legal requirements concerning manufacturing and shipping – Companies will be able to more quickly move goods and services globally, ensuring product availability and delivery to customers.

By taking a rigorous bottom-up approach to diligence and assessing each of these value-creating and value-eroding activities, companies will be better positioned for a successful supply chain integration.

Case study

After a major acquisition, a global consumer packaged goods manufacturer needed to quickly expand its distribution.

Challenge

A consumer markets company acquired a competitor's packaged foods business to broaden its portfolio and move into the liquid flavoring market. The deal included the target's manufacturing facility, but the distribution infrastructure would remain in the parent company. The acquirer needed to determine how their legacy supply chain infrastructure could absorb an additional 12 percent of product flow, requiring the company to rethink how it would flow product through its operation to customers.

Approach

During due diligence, the company determined that it would need to establish facilities to increase capacity—and to quickly build up inventory to avoid customer disruption. From a fulfillment perspective, three areas required focus:

1 Securing warehouse space near existing facilities to leverage order and freight consolidation opportunities

In order to streamline the supply chain and minimize excess handling, the production plant and its warehouse served as the hub for much of the country, leveraging its highly experienced operational team. At the same time, the company developed a long-term solution based on both network modeling and a make/buy analysis to leverage complementary manufacturing capabilities within all legacy plants.

2 Building buffer inventories to avoid customer disruption

A company needs a robust planning process to optimize inventory systems during the transition and avoid supply chain erosion. Two independent sales and operational planning processes were utilized until the systems were integrated, and there was one unified information source for data and reporting. An additional two weeks of inventory was produced and forward-positioned to accommodate the inventory transition to the company's distribution centers. The company also adopted a blackout period during which no replenishment shipments were delivered, to ensure a smooth system transaction. To minimize customer impact, extra inventory was stocked in advance, leading up to the SAP go-live.

3 Merging sourcing facilities—especially imported raw materials—kept the company's plant running and able to keep up with the extra demand during the transition

The procurement group needed to address both the product and financial flows during this period. International supplier contracts and terms and ocean transport planning were aligned to the buyer's corporate standards. The group was challenged to balance the need for product with the payables' terms to keep the deal case intact. To increase efficiencies and lower costs, vendors (including transportation carriers) needed to be swapped out with new ones, requiring accelerated sourcing events to maintain stable raw material flow.

Result

The supply chain transition—including a SAP go-live—was able to successfully transition carriers and customers to the new network and merge planning and sourcing processes into the merged organization. The company plans to finalize the long-term network structure to identify a single location to serve the Eastern United States that will provide consolidated ordering and fulfillment and realize roughly 40 percent of identified deal synergies through supply chain initiatives.

Improving the supply chain operating model by designing efficient product flows

After gaining an understanding of key supply issues during diligence, acquirers need to design and map an optimal product flow early in the deal for a successful integration and optimal supply chain function. This postsigning step is a key component for deals involving companies with multiple products, produced and sold across multiple regions. A mapping exercise can identify synergies across sourcing, manufacturing, distribution, and customer fulfillment, as well as pinpoint cost savings while meeting customer product demands and delivery windows.

During this process, a buyer can gain a better understanding of the connections between customer fulfillment, manufacturing, and materials sourcing and will then be able to make better decisions concerning demand planning, inventory levels, and customer management.

To optimize integration and deal results, it is crucial for companies to avoid any disruption of their supply chains at, and beyond, close. This is especially important for companies with capital intensive infrastructure requirements. Mapping the supply chain minimizes the risk of service disruptions by defining the key levers and the interconnectivity of sourcing, manufacturing, and shipping activities, as well as the currency flows, legal entities, and financing of intercompany transactions that support the product flows. As the company further integrates the supply chain postclose, this cross-functional end-to-end view of supply chain product flow requirements should minimize procedural disruption and any negative effects on customers.

Additionally, complex global legal and regulatory requirements necessitate a coordinated approach across the newly merged entity. Operations and global trade, as well as IT, tax, and local legal requirements should be assessed and accounted for in the product flow, and a system needs to be put in place to quickly address any local reporting needs or compliance issues that may arise.

A coordinated approach led by a dedicated product and financial flow team is recommended to help maximize returns. The team should take the following mapping steps:

Key mapping steps

Documentation: Document the current state of both the legacy and acquired supply chain, including manufacturing locations, distribution centers, replenishment lanes, and legal entity structures.

Assessment: Capture and summarize key supply chain data and share that data across the integration team. This step will expedite communication across functions, identify areas of uncertainty, and help minimize data request rework across operational teams.

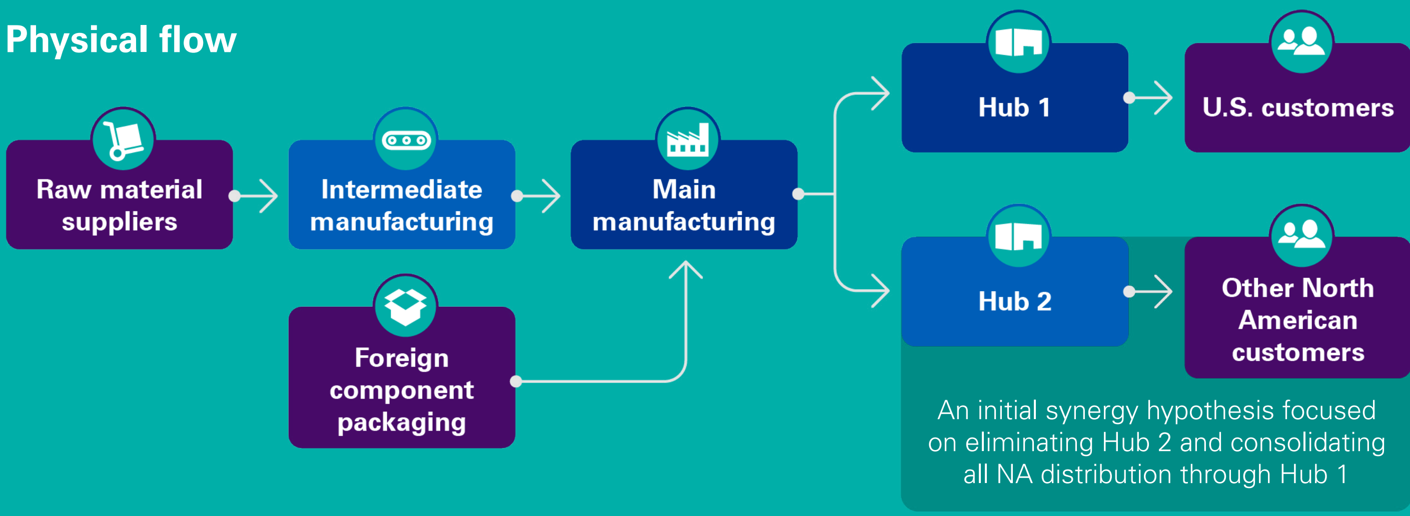
Alignment: Align the current supply chain understanding and develop integrated supply chain guiding principles across cross-functional leadership.

Implementation: Review and test interim and future supply chain models both within functions and across broader cross-functional teams to uncover additional synergies or breakages in the integrated product flow.

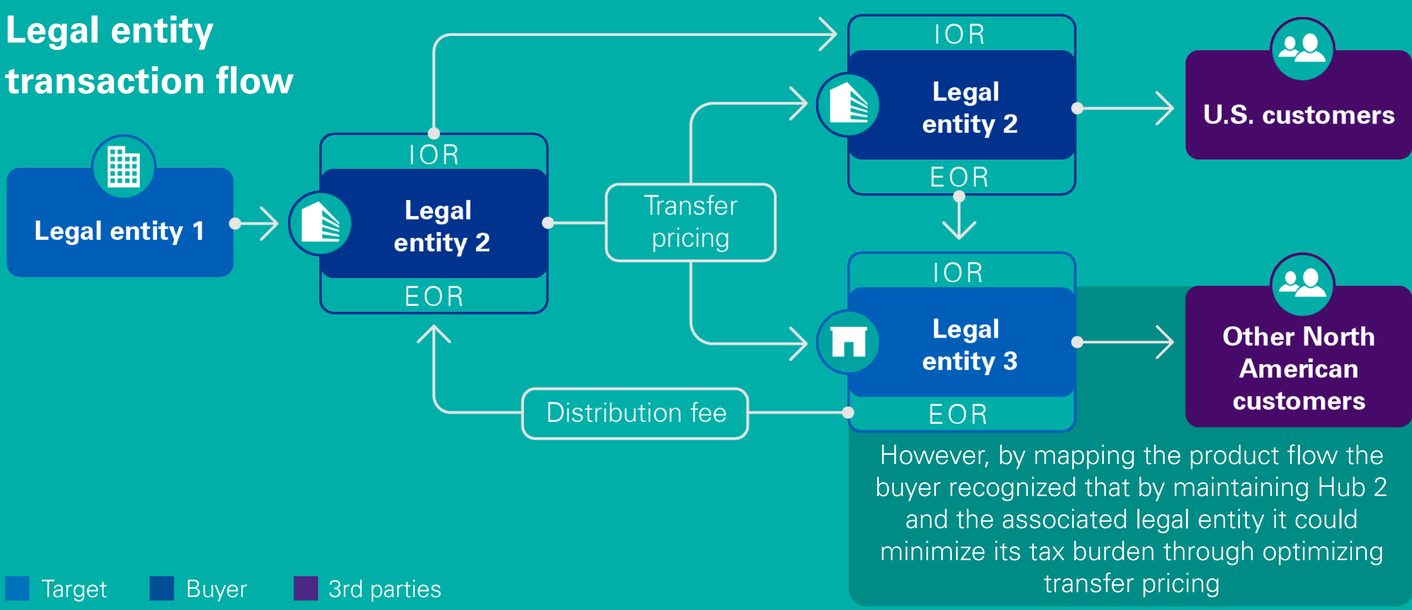
How to identify improvement opportunities using a supply chain flow

Typical deal integration efforts focus on generating synergies in parts of the physical flow; establishing a full picture of the supply chain enables the optimization of the entire system.

Physical flow



Legal entity transaction flow



"it could minimize its tax burden"
Getting all legal entities up and running on Day One can be complex. Companies that develop an operational readiness plan early in the deal cycle are able to improve the integration process and deal results.

See our piece focusing on Legal entity operational readiness for insights into this process.

advisory.kpmg.us/deal-advisory/legal-entity-operational-readiness.html

Case study

A healthcare services company sought a more effective supply chain postmerger

Challenge

A global healthcare services company operating in the pharmaceutical and medical distribution segments purchased a global division of a large multinational conglomerate. Before the acquisition, the buyer had robust domestic supply chain operations but less exposure to international manufacturing, warehousing, and distribution. How could the company best integrate the target's custom-built supply chains to maximize deal value?

Approach

Assisted by KPMG, a quickly mobilized functional team mapped the supply chain and was able to:

1. **Inventory** the current landscape of manufacturing locations and distribution centers and identify key replenishment lanes of both the legacy and acquired supply chains. The team obtained data inputs from the operations and distribution staff at each acquired manufacturing and distribution facility, which was used to create a detailed view of the acquired supply chain.

2. **Understand and communicate** the sources of value within the acquired supply chain that would underpin the success of the integrated supply chain. In this case, legal entities, systems utilized (warehouse, logistic, freight, global trade, etc.), and the consolidation of freight management were identified as important drivers of deal value.

3. **Develop** guiding principles of the integrated supply chain governing interim and future state models. For example, the company committed to two objectives: that the acquisition would not negatively impact customers, and that global, as opposed to local, solutions should be utilized.

4. **Document** an understanding of the interim and future supply chain with a cross-functional team, ensuring minimal supply chain disruption, optimal systems usage, process alignment, and common understanding of functional responsibilities.

5. **Revise and test** integration models as needed within and across functions, ensuring optimal interim and future-state supply chain processes while minimizing risk to implementation.

The cross-functional team meeting these needs included members of the global trade, finance, tax, IT, legal, and operations groups.

Result

Bringing together a dedicated team to map the product flows of the supply chain early in the process was critical to minimizing supply chain disruption, leading to a successfully integrated global supply chain. The integration was executed in a phased approach by country, continually operationalizing new product flows and processes. This successful acquisition allowed the company to quickly move its legacy domestic products into the global supply chain and quickly achieve top line growth, improve profitability, and capture deal benefits of 10 to 15 percent.

Conclusion

Companies pursuing deals, especially those with a global component, should understand the importance of the supply chain in deal success. Diligence can help identify value and expedite synergy realization. A preclose mapping exercise can improve integration results and create a more effective and efficient supply chain. Focusing on these preclose analyses and execution steps should maximize deal results.

How KPMG can help

M&A Services

KPMG advises clients on operational integration or separation of businesses across all corporate functions to deliver value in a timely manner. Our team takes an enterprise-wide view in the form of integration/separation due diligence, synergy and cost assessments, TSA development and management, Day 1 planning, integration execution, change management, and performance tracking.

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