

Paper Title

Purchasing's impact on postmerger performance: Effects of interaction with other business functions and suppliers

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Abstract

Mergers and acquisitions have become more and more important over the last years, however, still facing a relatively high failure rate. The discussion about factors for a successful merger or acquisition is still an interesting field not only for practitioners, but also for researchers. Increasing academic interest in this topic mainly focuses on cultural integration, organizational fit, while the contribution of purchasing to postmerger performance has not received much attention to date. This work-in-progress paper aims to close this gap, by addressing the question as to how purchasing integration contributes to postmerger performance. These questions will be analyzed in one case study, which will provide several insights into purchasing's role for and impact on mergers and acquisitions.

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Merger, Acquisition, Postmerger integration, Purchasing, Supplier Relationship, Supplier Interaction, Business Relationships

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Introduction

In 2007, the global volume of mergers and acquisitions amounted in 2007 to more than US\$ 4.38 trillion, signifying an increase of 21% compared with 2006 (Hall, 2007). Between 45% and 82% of the mergers and acquisitions, however, are not expected to reach the postulated objectives or even fail (Anwin, 2007). Therefore, the discussion of factors for a successful merger or acquisition is still an interesting field of research, not only for practitioners, but also for researchers.

The objective of this paper is to analyze the role of purchasing in postmerger situations and its contribution to postmerger performance. This paper will set up on existing literature and theories, and one case study will be used in order to develop propositions for further research.

In this paper, we want to address the following two main research questions:

First, does the extent to which purchasing functions of merged companies are integrated contribute to postmerger performance and does the interaction with suppliers and other company functions have positive effects on it?

Second, does the extent to which purchasing functions of merged companies are integrated contribute to the competence of the purchasing function (i.e. purchasing capabilities and the strategic interaction of purchasing), and thus, indirectly, to postmerger performance?

This paper is structured along five sections: after this first introductory section, we will conduct a literature review in the second section. In the third section, we will provide a description of the method applied. This is followed by the fourth section, in which we will describe the results and the deducted propositions for further research. This paper will conclude with a discussion of the findings.

Literature review

Within the research field of success factors for mergers and acquisitions, postmerger integration has attracted growing interest in the academic world over the last few years. Most of research, however, has focused on an overall corporate perspective by addressing questions of cultural integration

(DiGeorgio, 2003) or organizational fit (Shrivastava, 1986; Datta, 1991). Recently, in academic research the discussion has shifted from this overall corporate perspective to a function-specific perspective, addressing the contribution of specific functions to postmerger performance. The analysis of effects on postmerger performance of marketing (Homburg & Bucerius, 2005) and R&D (Gerpott, 1995; Grimpe, 2007) has been a recent contribution to academics, indicating this trend.

The contribution of the purchasing function to postmerger performance has received limited attention in the academic discussion so far. This is surprising, since the role of purchasing as an important contributor has already been recognized at a very early stage – mainly through its contribution of cost synergies (Robinson, 1933). Several publications which deal with merger motives have also confirmed that cost synergies as well as economies of scale and scope are still valid motives for conducting mergers and acquisitions (Angwin, 2007; Mukherjee, Kiymaz & Baker, 2004; Berkovitch & Narayanan, 1993).

Additionally, purchasing's impact on business performance has recently been the subject of a broad academic discussion (Day & Lichtenstein, 2006; Gonzalez-Benito, 2007; Schiele, 2007; Yeung, 2007).

For the analysis of purchasing's contribution to postmerger performance, we will build on existing literature and will use one case study in order to develop propositions. By applying the theory of Gonzalez-Benito (Gonzalez-Benito, 2007) and of Homburg & Bucerius (Homburg & Bucerius, 2005) purchasing's integration can, in two ways, lead to an improved postmerger performance – in which interaction in both cases might play a role. In the first way, purchasing's integration might lead to a realization of material cost synergies (e.g. through bundling), which requires interaction with suppliers, and, consequently, the management of supplier relationships. In the second way, realization of purchasing synergies requires interaction with other functions in the company (e.g. R&D, manufacturing). Gonzalez-Benito further mentioned that purchasing competence (i.e. skills) has a direct impact on purchasing performance. Postmerger integration might lead to a selection of best purchasing practices of the merged companies. This could result in an increase of purchasing capabilities, and, thus, in an overall enhanced postmerger performance.

We will build on those theories in this paper and use one case study to develop propositions for further research. In this paper, we will use the terms mergers and acquisitions synonymously.

Applied method

In this paper, we applied the case study methodology to develop propositions. For this purpose, we considered the case study as the most appropriate methodology for two reasons: First, the analysis of mergers and acquisitions as well as postmerger integration through case studies is widely used and accepted (Quah & Young, 2005, Öberg & Holtsröm, 2006). Second, the case study research is ideal to initiate the development of a theory which has not been fully elaborated yet (Eisenhardt, 2007), since this methodology enables us to obtain detailed information about a new setting, which might not be able to be obtained in a large-scale field study.

This paper has been based on one case study. In this case study, we conducted semi-structured interviews with persons in three different companies, which have been acquired by the same parent company. The case study was based mainly on two type of sources of evidence which Yin recommended using to create sound case studies (Yin, 2006): documentation and interviews. The documentation was based mainly on press, annual reports and other relevant documents which have been provided by the interviewees. The documentation was mainly used to compare and validate the interviewees information. In addition, we conducted semi-structured interviews with relevant persons in the companies involved in the acquisition. Relevant persons were employees who were involved in integrating the acquired company into the overall company. Additionally, those people have made

experience in particular with the role of purchasing in the integration due to their position. In the case study, the relevant persons interviewed were a purchasing manager, a general manager and an operations manager. In order to ensure the quality and reliability of information obtained in the interviews, we transcribed the interviews and sent the transcripts back to the interviewees for them to review. For this paper the case study included the following companies, which all have been acquired by a leading international manufacturer of construction equipment based in the US. Due to sensitivity reasons, we cannot disclose the companies' real names.

Company 1: Company 1 is a manufacturer of mobile and lattice-boom cranes. The company is based in Germany with two manufacturing sites. The parent company acquired company 1 in 2002 from a European steelmaker.

Company 2: Company 2 is a manufacturer of screening, washing and recycling equipment for the construction industry. The company is based in the UK with one manufacturing site. The parent company acquired company 2 from a capital investor in 1999.

Company 3: Company 3 is a manufacturer of mobile excavators, based in Germany with one manufacturing site. The parent company acquired company 3 in 2001 from family owners.

The parent company has acquired several companies over the last ten years. The major reason for choosing interviewees in those particular three companies was that those companies differed in the success of the acquisition, despite being acquired by the same company. Two other differences between the companies were to which extent integration of those companies was intended after the companies have been acquired and the ownership structure prior to the acquisitions.

We will elaborate on this in the results section, but would already like to mention it briefly at this stage: When acquiring company 2 and company 3, the major objective was to manage them as independent units, i.e. without any integration. Although a few years later the corporate strategy changed towards integrating former acquired companies, so that those two units were integrated as well, when executing the acquisition and in the first years after, those companies were treated solely as financial investments. In contrast, the acquisition of company 1 was conducted with the intention of fully integrating it into the acquiring company.

Last but not least, the third criterion by which we chose the respective companies was whether they belonged to corporate entities or to private families before the acquisition: Company 1 and company 2 belonged to corporate entities prior to the acquisition, whereas company 3 was a family-owned business.

In each of those companies, we interviewed one representative per company who was actively involved in the integration process.

Company 1: At company 1, we interviewed the current Chief Financial Officer (CFO). He has been with the company since the acquisition and was responsible for leading the integration of company 1 into the parent company.

Company 2: At company 2, we interviewed the current Director of Operations. He has been with the company since 1984, and, thus, already at company 2 prior to the acquisition. He was actively involved in the acquisition process of company 2 and later on in the integration process.

Company 3: At company 3, we interviewed the current Chief Executive Officer (CEO). He has already been with company 3 prior to the acquisition and became CEO of the company 3 after the acquisition. He was highly involved in the acquisition and also in the later integration of the company into the parent company.

We conducted semi-structured interviews focusing on the following topics: Motives for acquiring the company, evaluation of the acquisition's success, contribution of purchasing to acquisition's success, and lessons learned for future acquisitions.

Results

As already mentioned in the previous section, one of the major criteria to select the different acquired companies for the interviews was the perceived success of the acquisitions. For this purpose, we asked the interviewees, how they evaluated the acquisitions's success. Although there are more objective ways to assess the success of a merger or acquisition (e.g. through profit or market capitalization measures), we opted for this subjective assessment. Schoenberg compared several metrics and came to the conclusion that managers' subjective assessments may provide a valid measure of the merger success (Schoenberg, 2006).

Subsequently when asking the interviewees for their subjective assessment of the merger's success, we received different answers:

At company 2, the answer was that the success of the acquisition received a "boost" after the actual integration started. Previously, the acquisition of company 2 had already been a success, (company 2: "[...] mainly due to its relatively low acquisition price [...]"), but as an independent unit it did not leverage the full potential.

Company 3, however, that went through a situation similar to that of company 2, i.e. which was initially acquired for financial purposes but later began to be integrated, did not confirm incremental success of the integration. In order to verify the disparate answers of both companies, we discussed those different statements with both interviewees in order to get an explanation. The major reasons for the difference in success was that company 3 did not have a lot of operational similarities to the remaining parent company organization. This was reflected in purchasing, e.g. since they had a high share of specialized parts, which other business units rarely used, so that potential from integration was relatively low.

Company 1, which had already undergone a high degree of integration right from the start of the acquisition, confirmed a considerable success.

Summarizing: The success of acquisitions at the parent company was evaluated differently. It appeared that the acquisition of company 1 was the one with the highest success, followed by company 2's acquisition and company 3 was the least successful.

When asked for motives of the acquisition, all three companies mentioned that purchasing was not a decisive factor when deciding on the acquisition. The parent company's acquisitions were mainly driven by market aspects. The interviewees confirmed that major motives behind the acquisition were related to enabling market access or product portfolio diversification. The acquisition of company 1, company 2 and company 3 was mainly driven by market aspects, namely by the objective of enlarging the product portfolio. This corresponds to previous research on M&A motives (Ansoff, 1965;Walter & Barney, 1990). We also asked the interviewees to which extent the companies were planned to be integrated into the parent company. Company 2 and company 3 were not acquired to be integrated, but to be led as separate entities. The parent company, however, initiated an integration program for company 2 a few years after the acquisition. Company 1 was already in the focus of integration right after the acquisition, but – at the beginning – the focus of integration was on marketing and at a later stage extended to purchasing.

Based on those findings, we developed the following proposition:

Proposition 1: Postmerger performance is not influenced by the merger motives of the acquiring company prior to the acquisition.

When describing the role of purchasing in the integration of the acquired companies, company 2 and company 1 – both companies which were acquired to be integrated into the parent company – underlined that purchasing played a vital role, especially due to its “P&L effects.” In both companies, material cost reductions were predominant. However, purchasing synergies were not simply realized by concentrating the volume on existing suppliers. Instead, in both companies purchasing began to search for new suppliers on a global basis and to allocate the existing purchasing volume to new suppliers. That is why the number of suppliers had often not been reduced during the first few years, but rather, new suppliers were introduced.

At company 3, however, the direct contribution to postmerger performance through material cost savings has been neglectable, which is why the interviewee at company 3 considered the acquisition success as relatively low. The interviewee mentioned that the specialized products they offered made it impossible to bundle the purchased products to a large extent. Additionally, company 3 was not planned to be integrated operationally into the parent company to the same extent as the other companies.

This finding leads to the following proposition:

Proposition 2: The extent of integration of purchasing affects the achieved material cost synergies, and, thus, the postmerger performance.

In addition to the “hard” purchasing synergies, namely material cost reductions, the interviewees mentioned several other topics, where purchasing had an impact on postmerger performance. The realization of material cost reductions required a higher interaction with other business units. At company 1, where integration has been a strategic objective right from the start of the acquisition, this interaction was structured and steered from the beginning as well. In company 2 and company 3, however, the interviewees still observed some interactions across BU and functions. The interviewees stated that purchasers at company 2 and company 3 started to cooperate and exchange experience and information about suppliers with purchasers of other business units. This “loose” interaction was limited in company 2’s and company 3’s case to their regional boundaries, i.e. company 2 only focused on interacting with purchasers from other UK units, while company 3 focused on interacting with purchasers from other European units. This loose interaction had several limitations, specifically with regard to two aspects: firstly, it depended on the motivation of individual persons in purchasing, rather than on a systematic process. Secondly, it was mainly done on an ad-hoc basis rather than on a continuous basis. Nevertheless, the interaction between purchasing across different acquired companies was apparently higher in those companies, where the postmerger performance was higher.

At company 2 and company 3, interaction intensified as soon as the integration became a strategic objective of the parent company. The improved interaction across the acquired business units was mainly facilitated by two mechanisms: creation of corporate-wide transparency through a database so that every purchaser could get information about all suppliers within all business units. In addition negotiations and meetings with key suppliers were conducted by joint teams including members from several business units.

This finding leads to the third proposition:

Proposition 3: The interaction between purchasing of the acquiring company and purchasing of the acquired company affects the postmerger performance.

In addition to the interaction between purchasers of different business units, another type of interaction was named. The interviewees of company 1 and company 2 mentioned that the interaction between purchasing and other functions improved during the integration of purchasing.

Company 1 and company 2 mentioned an increase of interaction between purchasing and R&D. This interaction was mainly created by the fact that in order to realize material cost synergies, purchasing had to obtain technical information in order to compare purchased parts and components across different units. The interaction was done systematically through organized meetings and steering committees with other functions, as well as during the daily routine. Company 3, however, did not encounter any significant change in interaction between purchasing and R&D since they already had a high level of interaction across functions prior to the acquisition. The interviewee mentioned that company 3 had formerly been to be a family-owned enterprise with “short communication channels” from one function to another. R&D, purchasing, logistics and production as business functions had always worked together; there had always been someone on the board with a focus on purchasing. The interviewee at company 3 described the impact of acquisition on the interaction between purchasing and other functions, and thus on postmerger performance, as neutral.

Based on those findings, we can formulate the following two propositions:

Proposition 4: The interaction between purchasing and R&D does not have an effect on postmerger performance.

Proposition 5: The change in interaction between purchasing and R&D affects postmerger performance.

Besides an increase in interaction between purchasing and other functions, all interviewees described an improvement of skills in their purchasing departments after the acquisition by the acquired company. This was also the case at company 3, which had not been integrated to the same extent as the other companies. The skill which predominantly improved in the three acquired companies was mainly the internationalization of purchasing. This was reflected, firstly, in the capability to search for suppliers outside of their original regions. Prior to the acquisition, all interviewees mentioned that their supplier base was very regional and that this was mainly due to the lack of capabilities to search suppliers on a global basis. Secondly, in line with this an improvement in language skills was observed. In all acquired companies, purchasing employees were not required to have specific language skills prior to the acquisition, but were forced to obtain them after the acquisition. Company 2 also mentioned an improvement in their purchasing employees’ financial skills. Before the acquisition purchasing employees’ knowledge about the financial impact of purchasing was relatively limited. After the acquisition, the interviewee at company 2 noticed an improvement in the financial knowledge of their purchasing employees, resulting in what the interviewee called “even better purchasing and negotiation results.” The improvement of skills and the observed relationship led to several changes in the training and selection process of new purchasing employees.

The resulting proposition derived from these answers is:

Proposition 6: A merger or acquisition leads to an improvement in purchasing skills and, thus, to a better postmerger performance.

A final aspect confirmed in the interviews was that the linkage between purchasing and strategic decisions has increased. A remark from the interviewee with company 2 is representative: “The management noted that success in purchasing had a direct impact on the P&L.” This financial effect led to a shift in the attention to purchasing, leading to stronger interaction with the top management. This was reflected in several situations. In each interviewed company, purchasing’s involvement in defining the strategic objectives did increase, which was reflected in annual strategy meetings in which purchasing started to participate. Another aspect was what company 2’s representative described as “a balance of power between purchasing and engineering.” The representative stated that before the acquisition, engineering’s decisions dominated the company, leading to highly sophisticated, but costly product solutions. After the acquisition and specifically through the

achievement of purchasing synergies, the influence of purchasing on strategic decisions and especially the influence on engineering decisions increased significantly. Even in the case of company 3 which did not generate the same synergies as the other acquired companies, interaction of purchasing with top management increased. The reason can be described by an interviewee's statement: "If every business unit delivers material cost savings, it is also expected that our purchasing will deliver that, too."

The last proposition, therefore, is:

Proposition 7: A merger or acquisition leads to a higher management attention of purchasing even if integration is not a major objective.

All acquired companies stated that for future acquisitions, purchasing would already play a dominant role in driving the integration at an earlier stage. In particular, the interaction with other functions and with other business units has been described as a natural integration process, which could have saved a lot of "costs for team-building seminars".

Another major lesson learned for future acquisitions which every interviewee mentioned was a change in the way purchasing employees are recruited. The improvement in skills of purchasing employees in the integration process had an impact on future strategies to recruit people from universities and colleges. In all companies, focus would also have been on acquiring people who have preferably multiple language skills. Company 2 stated that future purchasing employees should already bring in financial knowledge already from the university or at least obtain it through structural trainings.

Discussion

The case mentioned above provided some evidence on the contribution of purchasing to postmerger performance. We developed a total of seven propositions indicating that purchasing can make a contribution to postmerger performance through different facets: Purchasing has a direct impact on performance through the realization of material cost reduction (e.g through bundling). However, in addition to those direct material cost reductions, purchasing can have other effects on postmerger performance: the interaction between purchasing and other functions, which were primarily engineering/R&D, the interaction with other business units as well as the improvement of skills and purchasing and the increase in strategic interaction of purchasing. There are some indications that interactions across functions improves least in cases, in which the acquiring companies used to be family-owned businesses.

This paper still has several limitations. All developed propositions are based on one single case. Further analysis on a larger sample might be a solution out of this. Another limitation is that the cases belong to exclusively to the manufacturing industry. An analysis in service industries could elaborate on the effects during the integration. This paper also needs some elaboration on the impact of supplier interaction.

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