Leveraging Distribution Network Convergence to Maximize M&A Value

Abstract

The life sciences industry experienced over $402.9 billion worth of closed deals in 2015[1], far exceeding the $169.3 billion in 2014. Given this dramatic surge in Mergers and Acquisitions it is imperative for organizations to maximize business value from these deals within a short span of time.

While supply chain offers tremendous potential for optimization, it spans multiple areas. Consolidating the distribution networks of the two merging organizations can lead to a quick wins with minimal risk.

The industry recently witnessed large pharma deals such as Teva's acquisition of Allergan[2] and medical supply mergers such as that of Medtronic and Covidien.[3] Various forms of collaboration are expected, with over 90% of life sciences companies planning M&A activity. [4]

Mergers and Acquisitions Dominate the Life Sciences Landscape

The life sciences industry is currently undergoing a wave of consolidation due to competitive pressures, portfolio expansion, and diversification. Through M&A, leaders expect the combined talent and technology, along with reduced costs and increased revenues to produce the much needed synergies and financial benefits for the resulting organization.

Defining a Supply Chain Operating Model to Drive Synergies

While it is not necessarily the driving force behind the mergers, the supply chain is among the first areas expected to achieve synergistic goals for the new entities. To leverage the power of the combined entity, it is essential to develop a supply chain operating model without losing sight of the need for cost reductions.

The operating model can help:

- Objectively assess the key processes and capabilities to determine strengths and opportunities for economic synergies resulting from the M&A.
- Account for industry specific challenges and trends such as end-to-end patient care, digital transformation, and advanced logistics to ensure competitive advantage.
- Connect the dots between the action plans and the strategic goals of the merger.

A typical tactical requirement that emerges from this exercise is the need to develop a roadmap to close existing gaps and revamp processes. Fulfilling this need requires consistent operational and IT focus within the new entity.

Deriving Value from Distribution Network Convergence

When the merger process begins, supply chain executives attempt to gather relevant data that can provide valuable insights into the challenges ahead. However, they often have to contend with meeting aggressive synergy goals, and get limited time to make complex decisions that might have long term implications on the success of the merger.

Segmentation provides a meticulous approach to understanding the complexity and capabilities of Distribution Convergence (DC) operations.

The initial focus is usually on the company's manufacturing and distribution network. The challenge with driving manufacturing and sourcing synergies is that they are potentially more disruptive and represent a higher level of risk to the business. In comparison, information on distribution networks is easier to obtain. It is possible to evaluate assets and their capabilities to determine quick wins and gain enough insights to develop a long term approach to total network optimization.

Taking a Structured Approach to Distribution Network Convergence

While converging distribution networks can expedite the value derived from merger synergies, the process can be hindered by logistical challenges. To implement network consolidation successfully, organizations must:

- Perform operational profiling and segmentation using two evaluation parameters—scale and process.
- Compare activity-based costing of the two merging organizations based on current KPIs to gain a comprehensive view of the companies' operational efficiencies.
- Develop a distribution network strategy by examining the current facility footprint, operational capabilities, and utilization rates.
- Decide whether to insource or outsource distribution based on financial, operational, risk, and cultural considerations.

The Five Point Checklist to Identifying Best Fit Partners

By identifying the strategic core competencies within an enterprise, it is possible to determine the non-core capabilities and functions that serve as potential candidates for reassignment to third parties. Such an approach provides a strong opportunity for companies to maintain their flexibility, while enabling them to convert fixed expenses into variable ones.

1. Define Guiding Principles to Mitigate Outsourcing Risk

These principles should be communicated globally and strictly monitored to ensure compliance. For instance, identifying what type of business to outsource, defining contract type, and determining whether to use regional or global providers.

2. Develop Global Templates and 3PL Playbook for Procurement

A structured global template can help:

- Navigate the challenges posed by complex distribution and fulfillment requirements, and the nuances of contracting 3PL services.
- Standardize the request for proposal (RFP) process, facilitating rapid execution and response analysis.

3. Perform Detailed Operational Profiling

The operational profile is a snapshot of the 3PL business that the merging organizations can use to compare and assess service providers. It provides the information required for the 3PL provider to bid accurately and for organizations to evaluate each bid. Since operational profiles drive the size and scale of distribution functions, it is important to clearly communicate the actual operational challenges.

4. Enable Cost Modeling and Analytics

This key step defines a standardized method for calculating cost to serve. It helps companies to quickly analyze the 3PL provider's responses and identify potential errors in bid responses during the convergence of distribution networks. Merging companies often utilize different methods for costing, and the new entity's cost model can have a significant impact on reporting and analysis.

5. Develop Standard Quantitative Response Template

A standard response template provides explicit instructions to the provider to furnish activity-based operating costs. Combined with the operational profile, the response template enables organizations to calculate monthly operating costs for effective comparison when analyzing bid responses.

Conclusion

As the life sciences industry moves to collaborate and consolidate, managers must take a high level view of the supply chain infrastructure with a focus on distribution network convergence. This will lead to quick wins and a profitable new merged entity.

Leveraging strategic partners can alleviate the strain on organizations that are stretched thin because of M&A activities. By working with partners who offer the right expertise, companies can drive distributed network convergence and realize business benefits early in the M&A cycle.

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