

# Supply

MANAGEMENT  
INSIGHTS

ISSUE 1 – 2021



Cost Optimization - how to get a

# FRESH START

**INVERTO**  
A BCG COMPANY



**Thibault Pucken**  
Managing Director INVERTO GmbH  
✉ [thibault.pucken@inverto.com](mailto:thibault.pucken@inverto.com)

## Dear Readers,

Current lockdowns are clearly slowing down the economy. It is currently difficult to predict when the real upturn will come. But experts agree on one thing: There will be no return to the conditions before Corona. To master a perfect fresh start, companies will have to adapt to the new circumstances.

Since many companies suffered revenue losses during the crisis, simply rolling over budgets will not achieve their goals. Companies should re-evaluate their cost structures in the context of the current economic situation and make use of professional measures to reduce costs in procurement. We explain how this works in practice in our cover story.

Another factor in gaining more financial freedom of movement is optimizing working capital management. An INVERTO study shows that there is often still untapped potential in this area.

Private equity investors have also recognized the value of large-scale optimization projects in companies. In our desk research, we found that portfolio companies are significantly better off than their competitors in terms of sales and operating profit.

Enjoy reading and stay healthy,

**Thibault Pucken**  
on behalf of the Management Directors





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Reducing costs in Procurement

# EMERGING

## stronger from the crisis

Politicians and thought leaders have been preaching it for a while: after the pandemic, the economy needs a fresh start. The first virtual World Economic Forum being held under the title "The Great Reset" is an example of this. But the new start can only succeed if companies set out sustainable cost management measures. A tour de force that the future of many companies rests on.



**T**he pictures that went viral around the world were astonishing yet frightening at the same time. Planes parked in hangars or on the tarmac. Freight trains halted at stations. And from a bird's eye view, the world's oceans looked in some places like a game of Battleships: row upon row of them, anchored in ports across this planet.

It is now as important as ever for companies to streamline their operations and drastically cut costs to protect turnover and ensure survival.

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The months of standstill and lockdown have led to some bizarre situations. What can an airline do if it is not allowed to fly? What can a factory do if it cannot produce anything because it is missing parts that it normally sources from all over the world? What can a restaurant do if no guests are allowed to dine? For many companies, this phase has been an economic disaster. For others, it has meant watching from the sidelines, hoping that their industry will not be impacted next. In either case, it is now as important as ever for companies to streamline their operations and drastically cut costs to protect turnover as well as margins. >

## Step 1:

### Determine and leverage your own position

The pandemic has impacted different industries in different ways. On the one hand, there are industries such as aviation, tourism, and gastronomy, which are suffering extremely from lockdown after lockdown. They depend on cutting costs quickly to survive the current phase reasonably unscathed. To make a 'fresh start' and be well equipped for the long-term, they need to implement both immediate measures (see step 2) and a sustainable strategy that must be continuously reviewed.

The winners of the crisis, on the other hand, include tech companies that are profiting from the home office boom, the food delivery trade and, to a certain extent, the automotive industry, which has proven through professional structures that even a difficult market can be mastered during the crisis. The automotive sector came through the crisis relatively well, because supply chains are already very transparent and companies can control not only suppliers but also sub-suppliers. Such professional structures and transparent information help to react quickly and effectively to a changing market situation and to avert possible crises through good risk management.

Similar reasoning applies toward the supply-base of each company, which also includes winners and losers from the current situation, and where the market situation has changed extremely quickly in some industries. While 2020 saw opportunities for reducing supplier prices in many areas for those who could provide a stable demand, the opposite has also been true in some categories in the beginning of 2021. Recent examples include spikes in steel and other raw materials, container freight, and packaging, as parts of the economy rebound, while supply is slow to catch up to previous levels. Ensuring an agile procurement department is key, acting on opportunities when they arise and protecting the business from increasing costs and supply disruptions when and where demand outweighs supply.

**Maryne Lemvik**  
CEO, Skanem AS

"We prepared the current annual reviews strategically and used them to strengthen the partnership with our suppliers. In addition to prices and quality, the main focus was on the further development of our product portfolio and the use of innovative materials. This and the fact that we can offer our partners security despite the crisis ultimately also had a positive impact on cost structures."

”





## Step 2:

### Managing demand and implementing immediate measures

Demand structures have changed massively due to the crisis, especially for indirect demands. Under the current conditions, IT departments in many companies, for example, have had to spend more to ensure their digital infrastructure fully supports working from home. Conversely, travel costs have dropped massively. In marketing, on the other hand, larger in-person events have been cancelled, but the costs for online communication have risen. In addition to such involuntary changes in operations and the associated costs, the crisis has forced many companies to implement budget cuts and spending freezes across the board to protect the core business. As the economy begins to recover, opening such budgets may seem reasonable, however this risks missing opportunities to stabilize costs at a more competitive level.

Many departments have had to question current practices and demands on suppliers, identifying ways to reduce requirements, volumes, or insource. As an example, budgets for printed sales materials went down in the pandemic, and now this is an excellent opportunity to cement the shift to digital, rather than fall back into old habits.

A company-wide re-evaluation of demand management should take into account the latest shifts in operations and customer behavior, as well as the best current view of the rebound for the company's market. Based on this, budgets should be re-distributed within the company, with the ambition to stabilize them between historical and lockdown levels.

The decisive factor here is to not leave this solely to the specialist departments such as IT, or the line business. Procurement can help identify concrete potentials for cost reduction and define measures to accomplish that. The best results will be achieved by combining reasonable top-down budget revisions, with a mandate for procurement to facilitate demand management exercises in relevant departments. >





## Demand & Budget Management

# How to avoid unnecessary expenses



### Demand guidelines

- Introduction or optimization of demand guidelines for certain materials & services
- Increase/sensitize cost awareness of employees



### Examples

4–6 h flights:  
Premium Economy instead  
of Business Class



### Demand control

- Define or adjust approval processes and thresholds for budgets
- Verification of expenses by responsible person



Order of big mobile phone  
plan has to be approved by  
department manager



### Operating life

- Reduction of ordering frequencies
- Optimization of operating life



Replacement of mobile  
phones after 3 instead  
of 2 years



### Elimination

- Reduction of required amount or cancellation of budget elements
- Goal: avoid unnecessary operating expenses



Back office: 3 GB  
Field service: 5 GB

After the pandemic, companies cannot simply dust off the old plans and pick up where they left off.



### Step 3:

#### **Re-evaluate your long-term supply strategy**

Once the tactical situation is under control in terms of reallocating budgets, optimizing prices with current suppliers, and ensuring stable supply, it's time to look ahead at your long-term supply set-up. Disruptions in supply chains such as steel and logistics have shown which suppliers hold firm under pressure and which ones don't, as well as which suppliers prioritize your business or not. Many European packaging producers have recently been prioritizing customers buying high-end products, cherry-picking to enhance margins while consumers order increasingly online. Revelations such as these have been painful for many companies and have taken up a lot of energy over the past year. But as supply and demand catch up with each other in various industries over the coming quarters, it's also time to broaden the perspective and think long-term based on the latest learnings. Procurement should analyze the current situation together with other departments in the company, such as logistics, production, finance and the specialist departments. The pandemic has made it clear like never before that processes in the company are interlinked and that a stable supply chain is at least as important as cost-effective procurement. In some areas, this will mean spreading supply among more suppliers and countries to lower risks, while in others, spending may need to be consolidated.

After the pandemic, companies cannot simply dust off the plans for 2020 and pick up where they left off. The past year has speeded up several pre-existing mega-trends, such as remote working and sustainability. As a result, the demands on products and suppliers are also changing, which calls for multiple fundamental changes for companies if they want to survive in the future.

As an example, companies should dovetail procurement and product development more closely. The earlier procurement knows which innovations the product development team is planning, the better it can take this into account when looking for a suitable supplier and thus reduce costs. And involving the right suppliers at an early stage of product development can shortcut finding cost-efficient solutions.

This is also a good time for CPOs and CFOs to reflect on the overall strategy, targets, and measurements for the procurement departments. Some of the recent lessons could be built into steering procurement's function and potentially the operating model vis-à-vis the business. The case for looking beyond savings and also accounting for total costs, supply chain security, risk exposure, and sustainability is as strong as ever. And ensuring these targets are mirrored in production and supply chain, for example, can help smoothen transitions between suppliers. >

Adopting a long-term perspective can balance the situation, as can digging into the specific circumstances of the supplier.



## Step 4:

### Optimizing costs throughout the supply chain in the long-term

Having set the long-term strategy, now you have to find the actual solutions, changes, and so on. The factors impacting the success of operational procurement are endless, but there are four which should apply to most companies.

#### Transparency is fundamental

Transparency in the supply chain is currently the most important factor. It allows companies to plan better and possibly even reduce costs they didn't even know about. Digital data pools make it possible not only to trace the supply chain, but even to control it. Let's look at one example: a large furniture maker purchases risers from one supplier. Procurement does not simply order them, but has also contracted tier 2 suppliers to supply edges, cardboard, and foils to the risers supplier. Orders are sent by the furniture company to both the tier 1 and tier 2 supplier at the same time.

During the last oil crash, many companies were persuaded by their suppliers that the savings would arrive later and settled for smaller price reductions, even though they could have secured more. This means it's a good year for granules manufacturers – at the expense of customers.

Suppliers have a tendency to cite rising indices in times of increases, but keep silent when they are falling. Adopting a long-term perspective can balance the situation, as can digging into the specific circumstances of the supplier. Labor costs are sometimes cited as a reason for pushing through price increases. This can look plausible based on country indices, but the supplier's specific situation may tell a different story, e.g. if they change the skill level of employees or shift their mix of permanent versus temporary workers. Companies that keep an eye on the relevant data and are willing to dig into their suppliers' annual accounts and other indicators can achieve a better negotiating position. Because knowledge is power. Digital solutions can help in this regard, such as a common approach for modeling suppliers' cost developments, based on raw material developments, energy, labor costs etc.



#### / Total Cost of Ownership (TCO)

is a method of cost calculation that takes into account all the costs incurred during the lifecycle of a product or service. This includes both acquisition cost, running costs such as maintenance and repair, and end-of-life costs. The goal is to identify all relevant and potentially hidden costs in order to make better business decisions.





### Be open to new solutions

Since the pandemic began, the downside of low-cost, but possibly long and vulnerable supply chains has **made itself painfully clear**. A fledgling electronics manufacturer previously sourced a large proportion of its parts from China, which was initially cost-effective. Considering the long supply route, some variability in quality, but primarily the uncertainty of sourcing from only one supplier, the company has since decided on a dual-source solution, with new suppliers in Eastern Europe. This has stabilized the supply chain, put the company in a better negotiating position with other suppliers, and had a positive side effect: not only is the new production **currently** more cost-effective **considering landed cost**, but the new supplier also actively plays a part in product development.

### Introduce new negotiation strategies

When it comes to procurement, the pandemic has once again underscored how important it is to engage in regular exchange with your own suppliers. Provided there is a high degree of transparency, both the winners and losers of the crisis can significantly improve their cost base and supply security. Procurement should see its own position as a strength. If, for example, retailers can guarantee their suppliers a certain level of demand or even increased sales, this can be mutually beneficial and will definitely be reflected in cost savings.

In addition to classic negotiations, auctions in particular are becoming increasingly important in times of remote working. They were sometimes frowned upon, unpopular or not accepted by suppliers in years gone by. In practice, however, it has been shown that companies that conduct auctions can save a lot of money. They also reduce the amount of time and travel costs spent on negotiations, and shorten the timeline to close a deal. The key is to do the proper preliminary work to ensure that the price is the final variable left to be closed, avoiding any potential counter-sourcing situation further down the line.

Here's a real-world example: a leading chemical company has achieved total savings of almost 7% through auctions compared to the traditional negotiation method. In other categories, savings can be as high as 40%, always depending on the number and density of suppliers. >



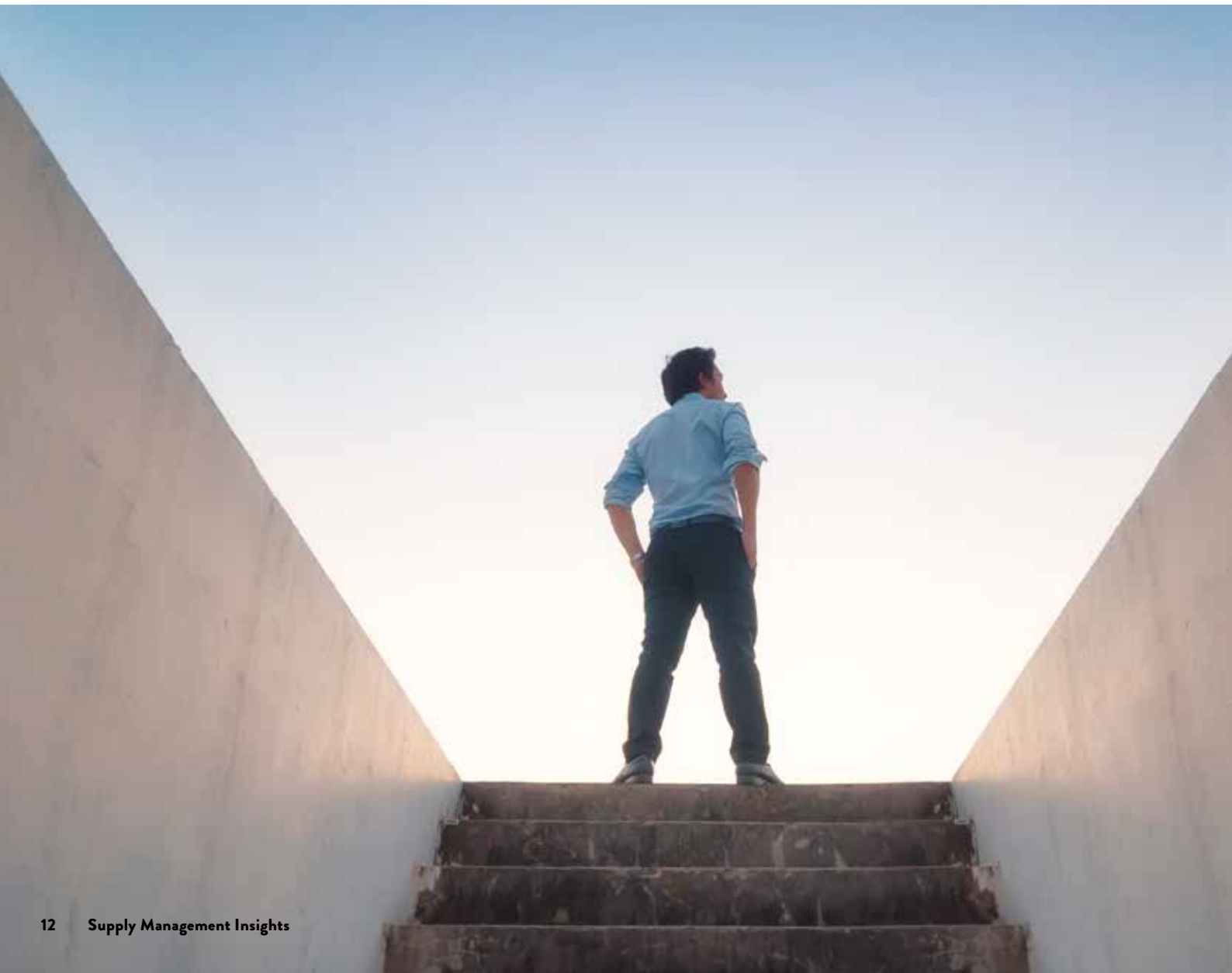
**Michal Svátek**

**Director Global Continuous Improvement,  
United Initiators**

"With the help of extensive auctions, we were able to stimulate competition between our suppliers and succeeded in breaking up previous structures. In addition, we were also able to win over new suppliers and integrate them into our portfolio."

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An extended form of auction is a so-called "Suppliers' Day". Instead of negotiating individually with suppliers, a Dutch healthcare company met with its suppliers on one day to explore potential cost savings. The product, which had risen sharply in price due to the pandemic, would have been too expensive in the long run. By negotiating simultaneously, the company wisely created a fair real-time situation in which suppliers had to react quickly in order to compete. This led to considerable savings.



### Sustainable results through regular follow-up and controlling

Even the best measures need to be reviewed regularly. Companies should frequently monitor and control its activities after implementation. In addition to regular supplier contact, procurement needs to stay close to the line and specialist departments. By following up performance and development activities, as well as re-negotiating, significant added value can be unlocked in the long-term. //



### Marcus Schwarz

is Managing Director of INVERTO's Copenhagen office. As an experienced procurement specialist with extensive product and industry experience, he primarily advises clients from the retail and consumer goods industries on cost reduction programs and procurement process optimization.

✉ [marcus.schwarz@inverto.com](mailto:marcus.schwarz@inverto.com)



### Daniel Gilek

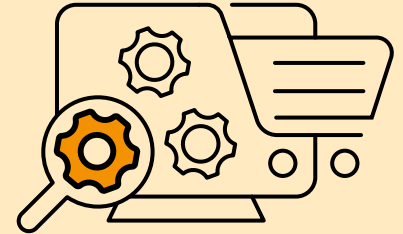
is a Principal at INVERTO in Stockholm with over a decade of experience in advising Nordic industrial and energy clients in comprehensive transformation and cost reduction programs.

✉ [daniel.gilek@inverto.com](mailto:daniel.gilek@inverto.com)

### CONCLUSION

The coronavirus pandemic has hit companies hard in some cases, either on top-line, on supply, or both. Whether a company has lost or gained from the crisis, now is exactly the right time to reorganize and optimize cost management. This includes immediate measures as well as long-term strategies. In addition to establishing a stable and cost-effective supply chain, procurement must also anticipate how markets will change in the future and take trends such as digitalization and sustainability into account. This is only possible if the internal arrangements are right, procurement is based on sound analyses, and the best possible use is made of the company's own position, for example through classic negotiations or auctions. Only those who position themselves correctly now can hold their own in the long-term.

# Experts on COST REDUCTION



## Spare Parts Management

# Spring cleaning that can pay dividends

**Many companies fail to organize their spare parts stock and either ignore or neglect key parameters for inventory management – even though structuring their spare parts management can save millions, as the following example from food production demonstrates.**

**T**here's nothing glamorous about spare parts. Not only do they cost money and take up storage space, but their owners actively hope that they will never actually be needed. So it's no wonder that many companies simply don't pay any attention to spare parts management. What they fail to realize is that implementing a coherent system to record their spare parts stock, manage it in the long-term and adjust it to suit changing circumstances can deliver significant savings potential and efficiency gains. This can involve huge sums, even in mid-sized companies.

### Spotting the problems on the balance sheet

The biggest problem in spare parts management is often the lack of an overview of what parts have been purchased and stored – as was the case at the major food producer in our example. Rather than one person in the company having overall responsibility, the managers at the individual production sites purchased the spare parts they required from different suppliers independently, without following a uniform standardization strategy. This resulted in spare parts with the same function but slightly different designs being stored in 30 locations across the six plants.

Although the company did record everything that was on the shelves, the overall system was rather informal and based on experience, instead of following a systematic plan. Once spare parts were purchased, the process was completed. But parts were not categorized by various criteria, even though this is essential for ongoing management of spare parts stock. This meant

the food producer was also missing the opportunity to sort parts by criticality; in other words, how important they were for keeping production running smoothly, as a shortage of highly critical parts could bring the entire operation to a standstill.

Although the high number of storage locations is understandable – given that production managers want short distances between the machines and the spare parts they need – managing spare parts by location increased the variety of parts and, in turn, the costs in the long run. And naturally, stock levels mounted higher and higher. A glance at the company's figures quickly identified the source of these inefficiencies. We linked the value of the spare parts in stock with the corresponding annual procurement volumes to give a rough comparison showing how many years' worth of annual spare parts requirements were in stock. If this value is significantly greater than 1, the company has more than a year's worth in stock – which usually means there is potential for optimization. This information is a quick and easy way for companies to estimate the rough potential for reducing their inventory.

### Getting your spare parts inventory in order

The first step is to identify the proportion of dead stock; the parts that are useless because the corresponding machines are no longer in use or parts that have been in storage for too long to be suitable for use. In total, this category was worth around 2,5 million euros.

The ideal stock level for each item depends on how often it is used, how easy it is to predict its use, and how important it is for production capability (criticality). Regular demand for wearing parts (maintenance parts) is typically easy to predict, so a comparatively low stock level is enough here. Items that fail without notice (repair parts) and that are critical for production capability, on the other hand,

## Procurement levers for effective spare parts management

- ↳ **Categorize** parts into product groups
- ↳ **Rank** parts by criticality
- ↳ **Assess** the predictability of individual parts (e.g. predictable maintenance)
- ↳ **Synchronize** consumption and ordering, taking delivery time and supplier risk into consideration
- ↳ **Standardize** parts to reduce variation

need to have higher stock levels. Optimizing stock levels here identified a further 4 million euros in potential savings. Comparing the actual and target stock levels showed which items wouldn't need to be ordered in the near future, as enough spare parts were in stock to cover the remaining run time for the corresponding systems. Procurement can be reduced or even halted for specific items until enough parts are drawn from stock to reduce inventory to target levels (cost avoidance). In tandem with that, the amount of capital tied in spare parts can be reduced on an ongoing basis.

### How to achieve long-term results

As well as optimizing operational processes, it is important to implement lasting processes and work instructions, so that spare parts procurement is transparent and traceable in the long-term. This involves a certain amount of centralization of spare parts management, as achieving the desired results will be harder if each site continues to manage stock itself.

That shouldn't be interpreted as unconditional support for centralization, however; having one central spare parts warehouse is often not the best solution for a company that has a high level of vertical manufacturing and operates a lot of different machines. A central warehouse typically only makes sense if a new plant is being planned, as implementing one retroactively is normally far too expensive. But the same or similar setups should already be managed centrally, so implementing virtual centralization for decentralized storage is an important step here. Simply bringing in "virtual pooling" reduced the inventory of standardized items used across locations by another 26%.

Centralizing how spare parts are ordered is another important step, as the fact that individual plants are no longer placing their own orders means there is no chance of them accidentally working against the overarching spare parts strategy. Implementing a new structure and assigning clear responsibilities enables staff to see what items are in stock and where they are held. They also now know when specific items have to be reordered for all storage locations and what quantities are required.

In addition, we have specified which parts should be used preferentially in the future and where they should be ordered from – in other words, a standardization strategy. Not something that was possible previously with 30 different storage locations, each with someone different in charge, with spare parts for the same machine purchased from different suppliers or even different manufacturers, making it impossible for the company to move parts between locations where necessary. Thanks to the new measures, the company is now in a stronger position to negotiate with suppliers, because it is placing orders in line with the standardization strategy and for larger quantities (as requirements are grouped centrally) delivering significant savings.

Reducing storage capacities has also freed up space that can be used to expand production capability and increase profit; yet another indirect positive effect of proper spare parts management. //

### CONCLUSION: Continuity is critical

**The final step in projects involving spare parts management is to make sure that new mechanisms are embedded in the long-term. Falling back into old habits is often a danger when external parties bring in new ideas and then leave the company again after a certain period. In order to avoid this, we have defined strict processes and rules, and implemented a stringent and transparent monitoring system for inventory management, in addition to setting up the spare parts strategy and determining ideal inventory levels.**

**Continuously following the procedure described here will identify dead stock and further inefficiencies at an early stage, to avoid stock levels gradually building up again.**



**Dr. Christoph Diermann**

is a Senior Project Manager at INVERTO in Cologne. The procurement and supply chain specialist supports manufacturing companies from a range of industries with extensive optimization projects in procurement, production, and logistics.

✉ [christoph.diermann@inverto.com](mailto:christoph.diermann@inverto.com)



## Restructuring and **Competitiveness**

# “The Partners in the Ecosystem Need to Pull Their Weight”

**Dr. Ralf Moldenhauer is a Managing Director and Senior Partner at BCG. He supports companies when restructuring and helps them to become more competitive. In this interview he discusses the best way forward for companies during the coronavirus pandemic and what that has to do with a North Star.**

**The IMF is already predicting setbacks for the global economy, with many countries still in the middle of a lockdown. What main problems are companies facing?**

That varies from sector to sector. The automotive industry and its suppliers are doing much better in the second lockdown than in the first, for example, while sectors like retail, hospitality, and services have lost the bulk of their income. So, companies in these areas are having difficulty finding financing and counterfinancing for their current and noncurrent assets.

**Does that mean companies can learn from the first lockdown?**

Generally speaking, companies were far better prepared for the second wave than for the first. Back in April, many companies had no idea of how to plan their liquidity against the backdrop of such a crisis. Cash management was the dominant topic on my projects. Now it's about more strategic questions, like how to maintain our supply chain in the long-term. Right now, companies need to make sure that they can access their goods quickly once the lockdown is lifted—ideally without tying up too much capital.





The actual restructuring takes place in the first year. The more steps a company works through in that period, the earlier it will achieve positive results.

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**You advise companies facing the challenge of completely restructuring. How exactly do you approach that?**

Here at BCG, we break down the turnaround into two phases—the first phase is about making sure the company can survive in other words, liquidity management. In the short term, having access to financial resources is the sole focus. Companies don't just become insolvent if they have negative equity or returns are poor; they have to declare insolvency if they are no longer able to finance or refinance themselves and their value creation.

Once this critical phase is over, the focus switches to becoming competitive; in other words, how companies can achieve good returns again in the long-term. In the current crisis, it's also important that companies don't simply look after themselves—the partners in the ecosystem needs to pull their weight. In an ideal situation, companies will reach separate agreements with each of their suppliers, which is why procurement also plays such an important role within the company. The objective of procurement is to communicate proactively, identify the current economic status of crucial suppliers, and find ways for the various parties to support each other. One potential strategy, for instance, could be to place an order and make an (partial) advance payment now but not purchase the goods until a later date, because these strategic suppliers will become vital once business picks up again.

**In other words, everything is scrutinized first?**

Exactly; nothing is sacred. On that point, far too many companies fall back on routine, whereas external consultants who step back and try to create necessary transparency can usually identify areas for improvement pretty quickly. Let's say a department orders the same quantity of components month in, month out. The obvious question is whether they actually need that level of stock, as every penny counts in this phase, so it can make sense to run stocks down initially. Another example is recruitment: New appointments might have to be put on the backburner for a while under some circumstances. Taking tough action right at the start is better for staff as well; there's nothing worse for them than a turnaround that drags on and on for years. They'll burn out and lose the will to actively support the transition.

**How long does a turnaround like this normally take?**

The actual restructuring takes place in the first year. The more steps a company works through in that period, the earlier it will achieve positive results. It has to implement 80% of the measures in the very first year, so that the effects are visible quickly. The second phase is then about looking further ahead, making the company competitive again in the long-term and setting overarching goals—we refer to that as a North Star.

**A North Star?**

Yes, it's all about shaping the strategy and communicating it, so that everyone in the company can be guided by it. On the one hand, it's important for motivating all the staff and, on the other hand, it's important for the financiers as well—after all, they have to believe in the mission, too. Specifically, the company must define what its future business model will look like and where performance improvements are required.

That then determines the products it will offer in the future and what organizational structure makes sense. We use standard competitive returns to predict a target balance sheet and give a top-down definition of what cost components can be generated and where. Then we lay the groundwork step by step, so that the company is successful and stronger when it emerges from its turnaround. //



## Investigating the performance of private equity investors

# A ‘swarm of locusts’ or nothing of the sort?

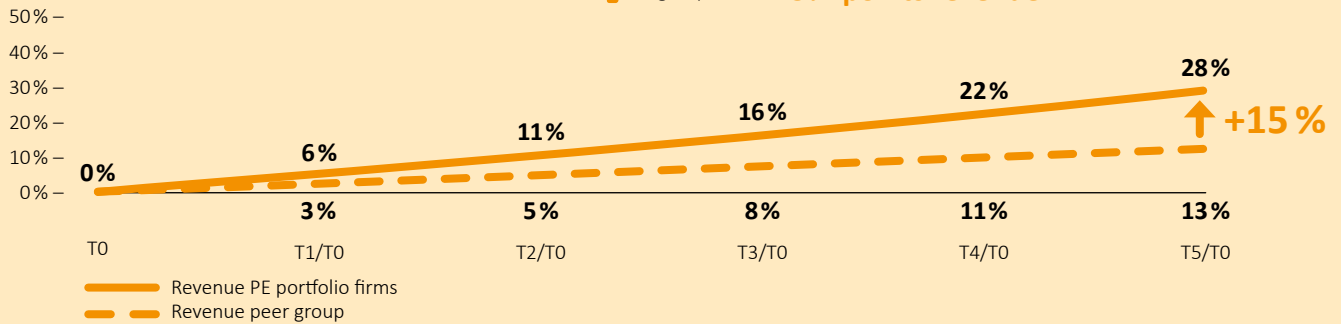
Private equity firms have long been seen as ruthless profit-seekers who are rarely interested in developing their portfolio of companies in the long-term. They may be derided as profit-seekers, but it seems that these financiers still create opportunities. Our desk research into the performance of portfolio companies proves that they significantly outperform their competitors without private equity involvement.

**G**erman politician Franz Müntefering of the Social Democratic Party lamented in an interview in April 2005 that: “Some financial investors never think about the people whose workplaces they destroy – they remain anonymous, faceless, descend like swarms of locusts on companies, strip them bare and then move on again.”

## Revenue Development

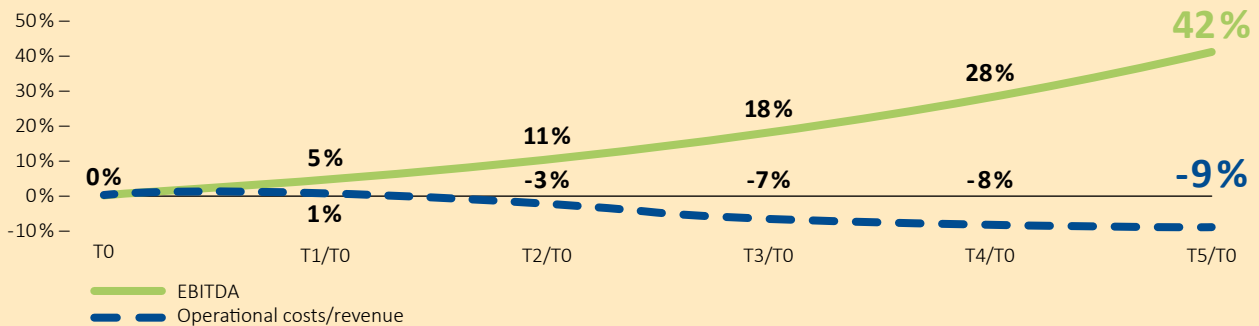
### / PE portfolio firms vs. peers

Portfolio companies in 'Industrial Goods' and 'Process Industry' perform strong compared to the industry peer group with **+15%-points revenue**



## EBITDA & Operational Cost Development

### / PE portfolio firms



They still have their critics, even today – for example, in the study published in January by the Hans Böckler Foundation on how companies owned by private equity firms develop in Germany, which focused on the negative trend of equity capital ratios and number of employees at multiple companies across all industries that had been bought by private equity firms since 2013.

We have found that these results do not apply to portfolio companies in the industrial goods or process industries, as they experienced a significant increase in value in the first five years after being acquired. Portfolio companies achieve more than twice the EBITDA and revenue growth compared to companies from these industries without PE participation.

This observation applies across the full five years and the gap widens from year to year. For example, the sales of portfolio companies grow by an average of 28% during the period under review, while companies without PE participation achieve 13%. The difference for operating profit (EBITDA) is even graver, with portfolio companies achieving 42% growth and other companies having to settle for 9%.

Portfolio companies experienced a significant increase in value in the first five years after being acquired.

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If we compare the number of employees, here, too, the portfolio companies are ahead: their headcount is growing faster than that of their sector peer group, at 12% compared with 9%. The only time we saw staffing levels fall was when we restricted the analysis parameters to portfolio companies where the focus was purely on restructuring. >

### Costs down, profit up

The disproportionate growth in EBITDA relative to revenue identified at portfolio companies – 42 versus 28% – demonstrates that gains are being achieved not only through accelerated revenue growth, but also through improved cost efficiency. In contrast, profitability in companies without a private equity stake falls as sales rise: while the rise in sales is 13%, the growth in EBITDA is just 9%.

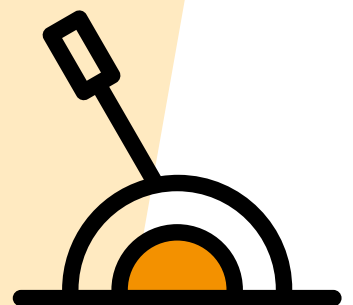
A closer look at costs reveals that private equity firms start optimizing costs soon after they acquire a company. The focus here is specifically on other operating expenses, relating to indirect demands such as facility management, IT and marketing expenditure, and so on. A significant reduction in other operating expenses is already visible from the second year (T2) after the acquisition of a portfolio company. Within five years, other operating expenses fall by an average of 9%. This optimization is a significant factor in the disproportionate growth in EBITDA.

## Actively identifying and applying levers to reduce costs

If companies want to increase their operating profit, they don't need to be taken over by a private equity firm before launching optimization projects. However, the significantly better results from portfolio companies do demonstrate that applying their strategies will pay off.

Below are some examples of promising approaches to reduce costs in the long-term:

- **Shifting the focus**  
from short-term supplier savings to holistic strategies for the various product categories
- **Consolidating suppliers**  
and bundling global demand across locations
- **Standardizing or re-specifying requirements**
- **Actively monitoring raw materials**  
at product level to continuously track price trends
- **Using index-based contracts**  
for products with a high proportion of raw materials





**The most successful almost double their operating profit**

We can see notable differences within portfolio companies when it comes to material costs. On average, the material costs per unit produced remain stable, while the most successful portfolio companies achieve a growth in EBITDA of 94 % by also reducing their material costs on an ongoing basis – by up to 8 % within five years.

Private equity firms drive cost optimization to create a sustained increase in value across their portfolio companies. The most successful ones take innovative and complex approaches to procurement, while also investing in digital solutions such as analytics tools and process automation. //

**CONCLUSION: Generating profit in the long run**

Looking at the industrial goods and process industries, our long-term analysis indicates that mistrust in private equity firms is largely unfounded. As our figures show, many private equity firms tend to take a long-term approach and are focused on sustainable business success. The challenges of the coronavirus pandemic have hit companies hard, so they are on the lookout for investors. At the same time, private equity firms have significant amounts of capital at their disposal (referred to as dry powder), creating promising opportunities for both sides.



**Study design**

For our analysis, we examined annual reports of 67 portfolio companies from 2013 to 2019. We compared the trends in companies from the industrial goods and process industries with those of companies from these industries that were not owned by private equity firms.

Most portfolio companies are based in Europe (a total of 89 %), with the majority in Germany, France, and the United Kingdom (45 % combined). We also looked at companies in Canada and the USA (11 %). The peer group data comes from public and private statistics providers. Of the portfolio companies we examined, 56 % are pursuing a growth course, while 44 % are implementing a restructuring program.

**You can download the study results and recommended actions here:**  
[inverto.com/pe-research](https://inverto.com/pe-research)



**Stefan Süßenguth**

is a Principal at INVERTO’s Munich office. His clients include international industrial companies and well-known private equity firms. As head of the Competence Center for Principal Investors & Private Equity, he is also an expert in due diligence, operational value creation and cross-portfolio optimization in procurement.

✉ [stefan.suessenguth@inverto.com](mailto:stefan.suessenguth@inverto.com)



**Torben Menzel**

is a Project Manager at INVERTO in Cologne. He mainly manages projects in the industrial goods and process industry sector, and also supports the Competence Center for Principal Investors & Private Equity. As an expert in quantitative methods, he played a significant role in analyzing the portfolio companies.

✉ [torben.menzel@inverto.com](mailto:torben.menzel@inverto.com)

Working Capital Management

# Using a compass is better than navigating only by sight



**“You don’t talk about money, you simply have it.” This culture was rooted in ten years of economic growth, but brought to an abrupt end by the coronavirus pandemic. The focus has now switched to liquidity. Companies taking the right measures can achieve or retain financial freedom, even during the crisis, so they can quickly get things up and running again when restrictions ease.**

**W**orking capital management is an area where several different departments intersect; it tends to fall under the remit of the finance department but variables are often affected by procurement, supply chain management, production, and sales – even though these departments are often unaware of the role they play. Efficient liquidity management is therefore only possible if all involved parties know where the overlaps lie and create clear areas of responsibility.

#### **No perspective without objectives**

Unfortunately, this is often a stumbling block, as is clear from our study on working capital management with 65 respondents from companies in Europe. Although many companies implement measures to manage liquidity, they often lack a binding company-wide foundation for measuring their success. Just 55% of the companies surveyed have defined objectives and KPIs for working capital management, which indicates that almost half of them are flying blind.

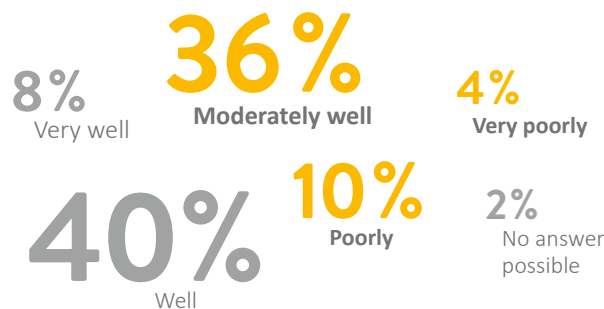
Our study shows that only just over half of all companies (52%) have standard payment terms and also apply them consistently. Having individually negotiated payment terms not only involves more administration for procurement, finance, and accounts, but also reduces the transparency and the room for maneuver for the companies along with it.

Our study also shows that many companies are aware of these shortcomings. It is apparent that employees in small and mid-sized companies are significantly less satisfied with working capital management in their company than those in large companies. Whereas just under 70% of respondents from companies with turnover of less than one billion euros rate their working capital management as “needs improvement” or even “poor”, 71% of respondents from companies with turnover of over one billion rate it as “good” or “very good”.

#### **Defining processes and roles precisely**

Not only does it appear that larger companies are more aware of liquidity management, but the larger the company, the more precisely defined the processes and roles become – something we frequently see in our projects. This clearer structure improves professionalism and the ability to take action, particularly for areas of overlap. >

### **/ In your opinion: How well is working capital managed within your company?**



Procurement and supply chain management directly affect liabilities and inventory; in other words, two out of the three variables.



If companies want to optimize their in-house structures and processes, they should start by analyzing the cash conversion cycle – which involves liabilities, receivables, and stock levels – and creating transparency over their in-house payment terms, terms that have been negotiated with suppliers, and stock levels. The next step is to drive forward the process of defining and harmonizing internal processes. Implementing consistent invoice management – for both receivables and liabilities – will noticeably improve liquidity within a relatively short period.

#### Agreeing payment terms and stocking the warehouse

Looking at the cash conversion cycle shows that procurement and supply chain management directly affect liabilities and inventory; in other words, two out of the three variables. Despite this, buyers and supply chain managers are not normally encouraged to actively get involved in liquidity management – quite the opposite, in fact. Targets set are usually dominated by making savings and reducing costs, and the easiest way to achieve this is by taking large quantities of items, bundling requirements, paying quickly, and, linked to that, using discounts.

All these measures reduce liquidity because holding large quantities in stock ties up capital and paying invoices early extends the cash conversion cycle. If companies have sufficient cash reserves, it may make sense to take advantage of discounts or buy large quantities at lower prices. If, however, liquidity is weak and subject to a certain level of risk, having a well-stocked warehouse isn't necessarily an advantage.

On the other hand, minimizing stock levels is not a general solution in uncertain times either. What companies actually need is an inventory strategy tailored to their requirements, with a buffer for key parts to safeguard against risks at all times or to be able to track extraordinary sales successes. Procurement, production, supply chain management, and sales all need to cooperate with each other to develop this kind of strategy.

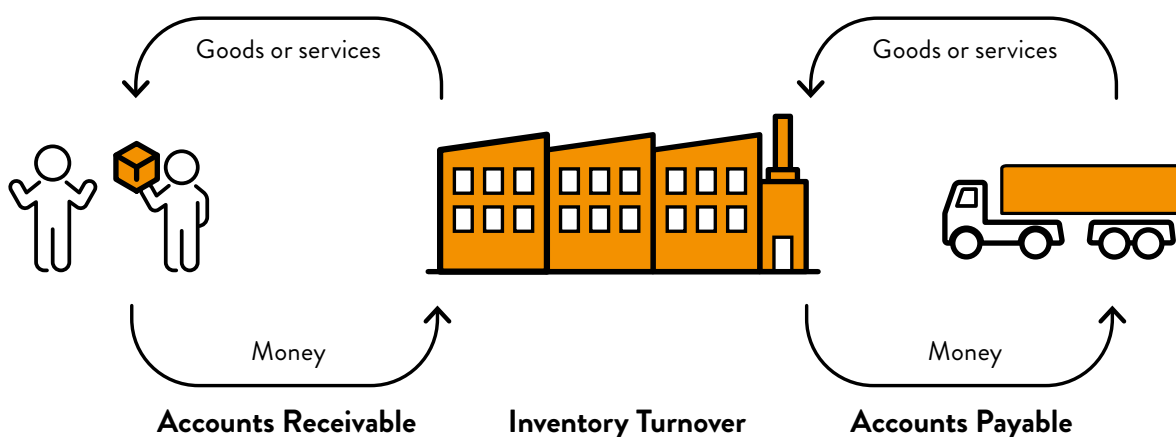
Shorter lead times, punctual deliveries, and batch sizes that are adjusted to the forecast demand can be achieved by working closely with key suppliers. Framework contracts serve two purposes: they boost flexibility so companies can respond to changes in demand and they also offer security so suppliers have a vested interest in being as supportive a partner as possible to their customers.

#### Taking suppliers' finances into consideration

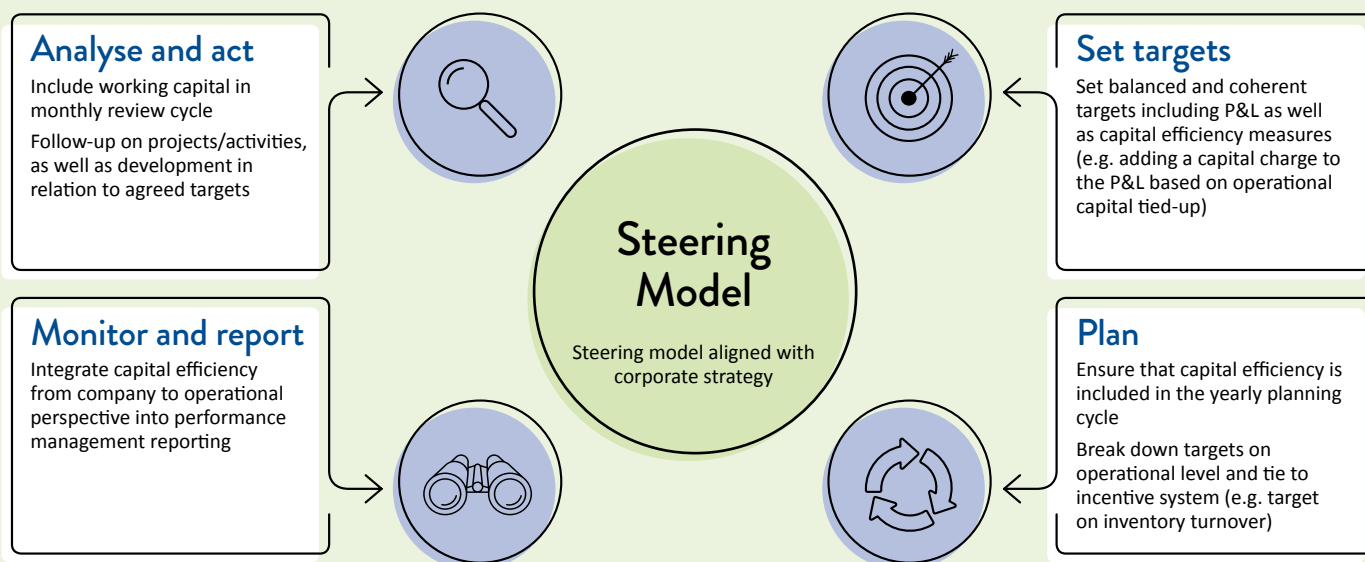
Procurement is responsible for drawing up contracts and collaboration agreements, and negotiating payment terms as well as quantities, prices, and delivery deadlines with suppliers. Having more time to pay frees up more operating capital, which can then be used to cover other financial obligations.

However, assessing the financial situation and strategic importance of suppliers remains an important step before deciding to extend payment terms. If a supplier is already facing difficulties, then having to wait longer to be paid may be the straw that breaks the camel's back, not only endangering the relationship of trust but also, in the worst-case scenario, the supply chain for components. That is why companies should assess each supplier and its current economic situation on a case-by-case basis.

## / The Cash Conversation Cycle



## / Working Capital Steering Model



### Offering incentives for liquidity management

Unlike other contractual conditions, payment terms are often something of an afterthought for buyers. Although working capital can significantly affect the variables, many procurement departments tend not to be particularly aware of it. If companies want to embed liquidity management across departments, then they need to include departments that significantly affect it in the incentives that they offer. Gamification elements can also be used to bring people on board; for example, giving out regular Working Capital Champion awards.

To improve working capital management in the long-term, KPIs should be included in the monthly review. The finance department can head up a steering group that provides ongoing monitoring and develops binding targets company-wide. Ideally, any department that can impact the cash conversion cycle will also have permanent representation in the steering group.

As well as setting overarching targets and coordinating them with management, another important task for this group is to translate these targets into specific tasks for individual departments. If the overall goal is to shorten the cash conversion cycle to increase liquidity, for example, then procurement needs to agree payment terms that are as long as possible instead of negotiating discounts for early payment. Targets can only be achieved in the long-term if every employee in the procurement department is aware of and familiar with these areas of overlap, not just the members of the steering group. //

### CONCLUSION: How to achieve financial freedom despite the crisis

**The coronavirus pandemic has demonstrated how quickly the healthiest of companies can get into difficulties through no fault of their own. In a situation like this, liquidity is top priority to ensure the stability of the company as a whole. Defining liquidity targets and ensuring they are implemented across all departments will allow gradual improvements to working capital management and, in turn, create more financial freedom.**



**Tobias Antefelt**

is a Principal at the INVERTO office in Stockholm. His areas of expertise include cost optimization programs, designing streamlined processes, and cash flow improvement.

✉ [tobias.antefelt@inverto.com](mailto:tobias.antefelt@inverto.com)



**Patrick Lepperhoff**

is a Principal at INVERTO in Cologne. As head of the Competence Center for Supply Chain Management, he primarily advises customers from the industrial and consumer goods manufacturing sector.

✉ [patrick.lepperhoff@inverto.com](mailto:patrick.lepperhoff@inverto.com)

Denis Di Vito will strengthen our management team as Managing Director. Previously, he worked for well-known consulting firms and has specialized in procurement for around 15 years. Most recently, he led challenging transformation and carve-out projects in a wide range of industries at BCG. He will now use his many years of broad experience to establish the INVERTO location in France this year.



## INVERTO Office **France**

"We want to redefine the meaning of cost optimization"

As a new face of INVERTO, can you first tell us something about your career?

After graduating in financial controlling, I had the opportunity to start working in an operational boutique consultancy in 2004. At that time, I was attracted by the opportunity to combine analysis, consulting and implementation. That was also my first point of contact with procurement, which was much less developed at that time than it is today.

The versatility and the fact that I could constantly expand my experience with new customers, topics and industries has kept me in consulting to this day. Over the years, I was able to continue climbing the career ladder until I then joined strategy consulting in 2011, which offered me a true end-to-end perspective – from very early problem identification to implementation, with all the analysis and change management activities in between.



**How did the decision come about to switch back to procurement consulting at INVERTO?**

Actually, INVERTO is the logical next step for me. It's true, to a certain extent I'm going back to my roots. But being part of BCG gives me the unique opportunity to drive strategy topics forward at the same time. The task simply appealed to me - to build up a new location from scratch, with an exceptional brand and a strong customer base in the background.

In addition, after a very international career, I can now focus on my home country, France. I believe there is a market for our INVERTO model in France. Our offering is unique – because we go beyond traditional consulting to deliver real results. There are simply no direct competitors currently on this scale for the combination of strategy and implementation in procurement.

**What do you see as the biggest challenges for French companies right now?**

As in other countries, the Covid crisis is omnipresent and is currently having a major impact on overall demand. As a result a few companies are thriving but most have been hit hard and are struggling with issues such as declining profitability, high fixed costs that hinder agility, and supply chain disruptions. This further exacerbates already increasing complexity.

In the longer term, the biggest challenge will be to counteract process slowdown and additional bureaucracy by transforming procurement into a driver for agility. Companies need to find more creative and intelligent ways, benefit from their suppliers' ability to innovate, and balance cost reduction while reducing their social and environmental footprint.

In this respect, the French market is not much different from other European markets.

**What steps does INVERTO plan to take this year to gain a foothold in this market?**

BCG's Paris office is the undisputed market leader and we already took the first steps together last year by adding a new level to projects with our implementation orientation. Bringing in additional expertise, quick intervention and leveraging our unique benchmark database is crucial in this set-up, especially for transformation projects as well as in the private equity sector. We intend to further strengthen this this year with our own local office.



In addition, we are taking a very ambitious approach to building up our French business: We want to redefine the meaning of cost optimization. Even though cost reduction is high on the agenda of all managers, the topic has a negative connotation, as something that is no fun and consumes resources. But if we use a smart approach to cost reduction, it is a real value driver and can become a project of heart, especially when combined with trending topics like smart design, waste and CO<sub>2</sub> reduction, agility and more.

**Those are big plans for INVERTO and for you personally – what do you do to relax after work?**

I try to create a balance between the fast-paced and intense workday and free time, what I call "slow life". I just try to spend a lot of time with family and friends, cooking dinner, reading books or comics, walking in the park or playing video games with my two kids.

My favorite place to spend my vacation is in the French Southern Alps, in all seasons. I love hiking and skiing, photographing nature and rural life, and enjoying the local food there.

And of course, I like to party with colleagues after work. It gives me a chance to blow off steam, strengthen working relationships with colleagues and create a sense of belonging. After all, the most important thing is that we enjoy what we do and appreciate the people we work with every day.

**On a trip to Paris, what should definitely be on our "bucket list"?**

It takes a lifetime to discover and appreciate this city. There is so much to do and my recommendation definitely always depends on the mood of the day. Today I would recommend you to visit the Marché des enfants rouges, the oldest roofed market in Paris, to enjoy the Parisian flair. Italian delicacies for lunch are offered by the Passerini Restaurant. And then perhaps a stroll through the Jardin des Plantes, the Quartier Chinois or along the Seine. To end the day, head to the trendy So-Pi district or the cocktail bar at Perchoir du Marais.

## Professional risk management:

# Prepared for future crises

The Corona pandemic, with its impact on global supply chains, caught companies in Europe cold a year ago, and many had little to counter it with. In order to be able to face future crises a little more calmly and counteract them in good time, professional risk management is essential. We explain how you can approach this and which factors are particularly important.



**Cover story in  
the next issue!**

## Risk management in procurement:

# systematically identifying and reducing risks

More than 65 decision-makers shared their opinions and current approaches to risk management in procurement with us at the end of last year. The result: Although risks are being managed much more systematically and digitally than in the previous year, there is still potential for optimization in terms of professional methods and digital tools to be able to act more quickly. Learn more in the current white paper.

## Download the white paper

[inverto.com/risk-management](https://inverto.com/risk-management)



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INVERTO GmbH  
Lichtstraße 43i  
50825 Cologne, Germany  
Phone: +49 221 485 687-0  
[insights@inverto.com](mailto:insights@inverto.com)

### Responsible for content:

Thibault Pucken, INVERTO GmbH

### Editor:

Melanie Burkard-Pispers  
Phone: +49 221 485 687-141  
E-Mail: [melanie.burkard@inverto.com](mailto:melanie.burkard@inverto.com)

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