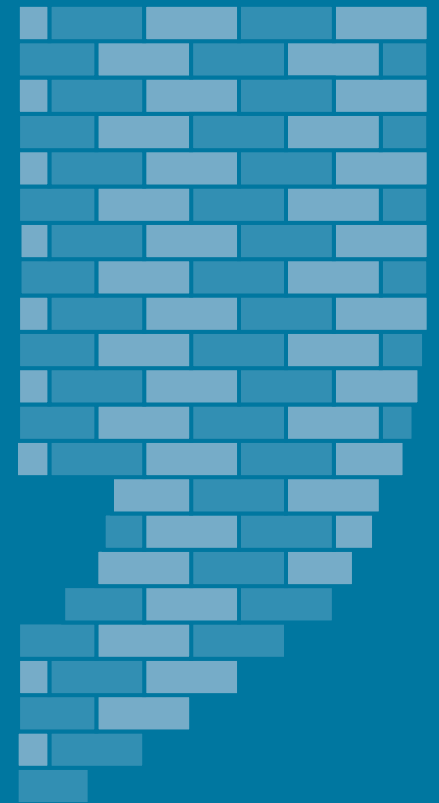
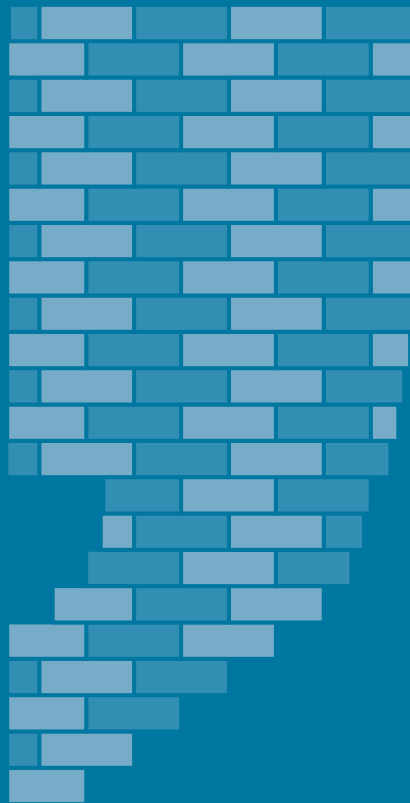


UK's Private Equity community: the verdict on Procurement



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About Associated Procurement Limited

Associated Procurement lets companies make the most of their suppliers through outsourcing the management of non-core spend categories or by providing seasoned procurement experts on an interim basis. We can enable better leverage and improved performance.

We work alongside managers as part of their team. Our objective is to deliver bespoke support to match the precise demands of your business. As doers, not consultants, our vision is unashamedly pragmatic, long-term and focused on creating sustainable benefits with an attractive return.

We have a good understanding of the private equity operating environment and have a strong track record of procurement delivery to a number of companies backed by private equity.

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About the BVCA

The British Private Equity and Venture Capital Association (BVCA) is the industry body for the UK private equity and venture capital industry. Our members come from venture capital, through mid-market, to large buyout houses from all over Britain. We provide a growing list of services and best practice standards for our members, and aim to promote understanding, clarity and transparency around the activities of our members, promoting the industry to entrepreneurs, investors, Government and the general public. The BVCA has over 450 member firms, representing the overwhelming number of UK-based private equity and venture capital firms and their advisers.

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Executive summary

Private equity and venture capital managers aim to build better businesses by working with business managers to improve performance and profitability. Given that procurement typically represents a sizeable proportion of cost, it is an obvious area for active company managers and owners to focus on.

This report details findings from a recent survey of managers at portfolio companies and individuals in the private equity and venture capital industries. The results suggest that private equity and venture capital managers are relatively detached from procurement in their portfolio companies, other than as part of the overall business strategy or financial plan.

Instead, procurement is typically the responsibility of the portfolio companies themselves. This study finds that procurement practices are very important for those companies, and it is possible that small changes in procurement practices could have a significant impact on company performance and profitability. In addition, there may be the potential for private equity managers to exploit the potential economies of scale across the full range of their investment portfolios, thereby lowering costs, increasing profitability, and boosting returns.

1. Introduction

Private equity and venture capital are all about good business. The fundamental role of the asset class is an active management model, where the industry invests in businesses around the world over long horizons. This involves private equity and venture capital managers providing capital and funding to businesses, as well as working with management to build business value, before then selling those companies on and delivering returns to investors. As such, private equity and venture capital managers typically take a more hands-on approach than alternative ownership models, such as publicly listed firms. They are closely tied to investee companies, often serving on the board, and are in close contact with business managers.

When examining the impact and role of private equity (PE)¹ ownership, previous studies have tended to focus on changes in management practices or similar developments. These studies often find evidence of broad-based improvements in operational management, which act to increase both current and future profitability and hence enterprise value. But, to date, relatively little work has been done to examine the role that procurement practices

play in boosting business performance. Procurement is an important business function, but one that is perhaps sometimes overlooked. Across the UK economy as a whole, procurement – spending on intermediate and capital inputs – represented 60% of gross output in 2008. Furthermore, gross operating surplus in the same year was less than a quarter the size of procurement (measured on the same basis). As such, small changes in procurement practices can have a big impact on company performance and profitability.

In light of this, the BVCA and Associated Procurement decided to investigate the role of procurement in private equity, via a survey of private equity and portfolio company managers in Spring 2011. The BVCA has specific experience in this area via its Insurance Services arm, which offers savings on insurance costs to BVCA members and their portfolio companies. Associated Procurement is a specialist operational service company which helps businesses manage supplier spend and procurement operations, providing interim management and procurement outsourcing services to a variety of clients within listed markets, private equity and the public sector around the globe.

Given that procurement typically represents a sizeable proportion of cost, it is an obvious area for active company managers and owners to focus on.

¹ Throughout the rest of this report, we use 'private equity' to refer to the whole universe of investments, including both venture capital and buyout investments.

Sampling methodology and survey design

Procurement is a highly specialised area, yet can be just one of many responsibilities for managers at smaller firms. Ownership tends to be diffused throughout the organisation, with resulting gaps and inconsistencies. Furthermore, hard data on business spending at the company level is hard to source on a consistent basis.

Ownership tends to be diffused throughout the organisation, with resulting gaps and inconsistencies.

2. Methodology and design

In light of these factors, our investigation was based on a qualitative survey of private equity managers at BVCA member firms, and senior managers at their portfolio companies. After collecting some broad data on the companies in question, the survey asked respondents about their experience and views of procurement in the private equity sphere, either at the PE house or portfolio company level. Some questions asked respondents to rank involvement or satisfaction on a five-point Likert scale, which indicates how strongly respondents react to certain statements. Other questions took the form of one-option responses. The precise wording of survey questions is available in the Appendix.

The survey was conducted online using Zoomerang. The format was based on a previous BVCA Research report from November 2010, which in turn was based on the types of surveys that the Bank of England's Regional Agents frequently conduct with their business contacts. The web-based survey was launched in April 2011, and publicised both on the BVCA website and via emails to BVCA members and investee companies. Individuals' details and responses were kept entirely confidential at the BVCA, to ensure both that respondents felt free to give their honest views, but also ensure that the prospect of potential future emails did not dissuade participation. It closed on 13 May 2011, after receiving a total of 113 replies. The results presented here are not weighted by firm size; however, with a couple of notable exceptions (discussed in Sections 3.3 and 3.4), the unweighted and weighted results were broadly comparable.

Survey results

Before asking respondents their views on procurement, the survey questionnaire gathered some basic information about the companies they represented.

3. Survey respondents

Overall, the bulk of respondents (77%) who answered the survey were from portfolio companies – managers at PE-backed businesses – rather than investors or advisors who were directly involved in the PE industry. The survey respondents also incorporated a wide range of firms, based on both turnover and employment (Figures 1 and 2), suggesting it was broadly representative of the wide range of different venture capital and buyout investments by BVCA members.

“procurement is one area where small changes can have a significant impact on margins and profitability”

Fig. 1

Survey respondents by annual turnover

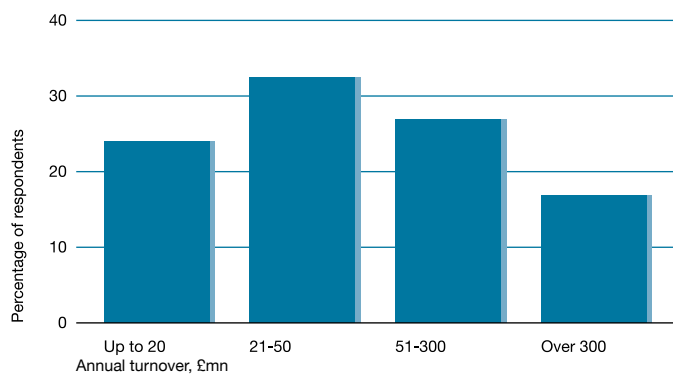
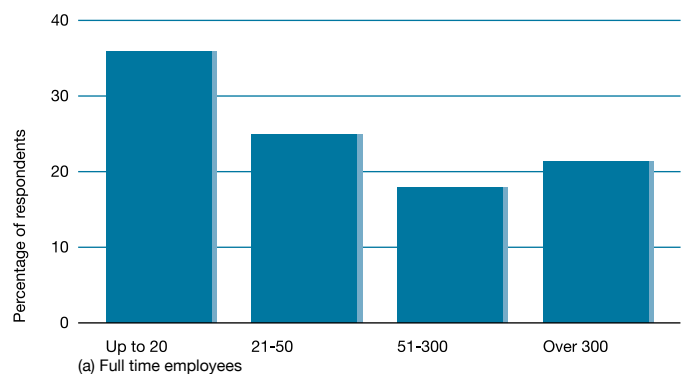


Fig. 2

Survey respondents by FTEs (a)



3.1 How involved are private equity General Partners in procurement and supplier decisions?

The first survey question asked how involved General Partners (GPs) – those individuals who identify and manage investments for PE houses – were in procurement and supplier decisions. In particular, the survey asked about involvement across four aspects of procurement: as part of overall strategy; part of financial planning and savings; operationally, as part of the decision-making team; and operationally, but through a third-party consultancy or other organisation. Respondents were asked to rank from 1 (no involvement) to 5 (always involved).

The most striking result was that, whilst procurement is one area where small changes can have a significant impact on margins and profitability, GPs typically only had some involvement in procurement as part of strategy or financial planning, but were much less involved in operational decisions, with at least 60% of respondents indicating no or minor involvement. Figures 3-6 show responses across the four aspects of this question. This result is consistent with previous BVCA research on interactions between PE houses and portfolio companies, which found that GPs were much more likely to be involved with the strategy and financial structure of a business, but were more removed from day-to-day decisions.

Fig. 3

GPs' involvement as part of overall business strategy

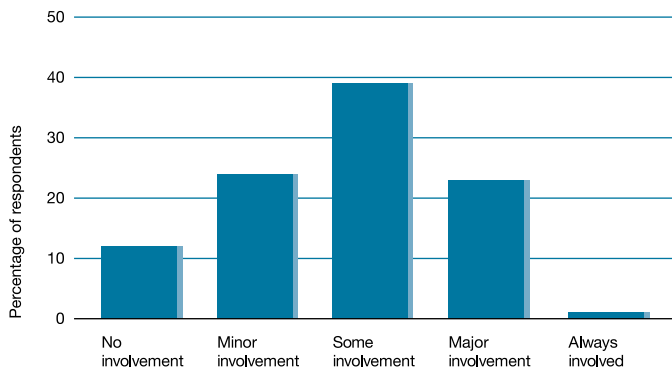


Fig. 4

GPs' involvement as part of financial planning/savings

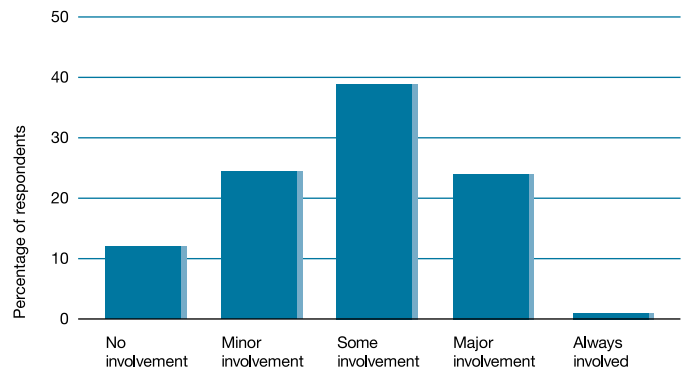


Fig. 5

GPs' involvement as part of decision making team

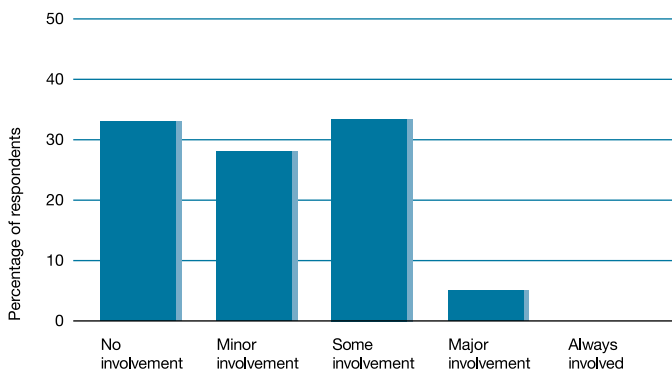
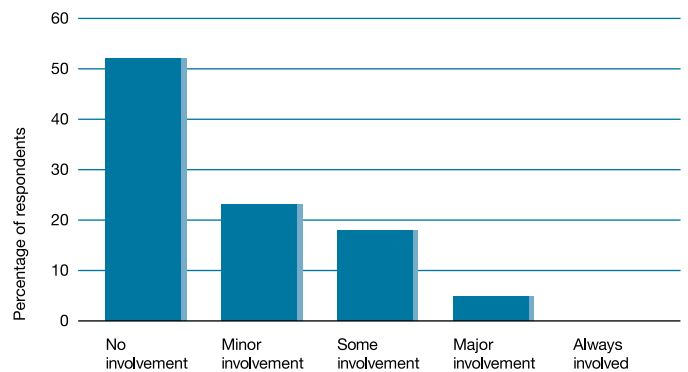


Fig. 6

GPs' involvement through third-party organisation



Survey Results Continued

3.2 How important is the procurement function in adding value to private equity portfolio companies?

The second question in the survey sought to gauge how important respondents thought procurement was in adding value to portfolio companies. As with the first question, this was split across different aspects of the business, in particular: large capital spending; core spending on strategic/direct goods and services; non-core or indirect spending; ongoing supplier management; and long-term strategic planning.

The results here were again mixed across business aspects. Most respondents rated procurement as very important or critical for both large capital expenditures and spending on core products, but other aspects were generally seen as less important to the business. In part, this may reflect the fact that non-core spending is, by definition, less critical for businesses than other forms of spending. However, this suggests that large savings opportunities are most likely being overlooked. Surprisingly the importance of procurement for ongoing supplier management is not seen as a key role, indicating an area of potential exploitation from suppliers. The breakdown of responses across different business aspects is shown in Figures 7-11.

Fig. 7

Importance of procurement for large capital spending

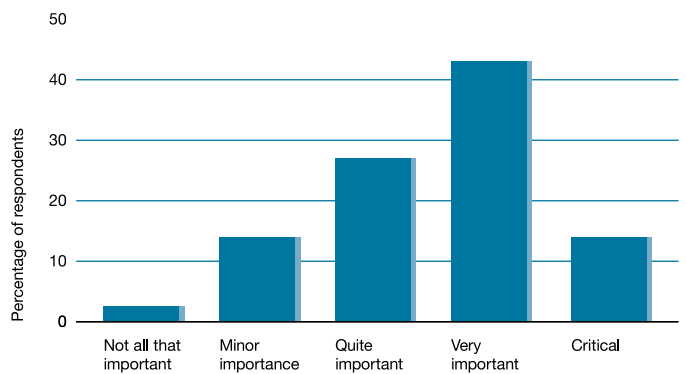


Fig. 8

Importance of procurement for core goods and services

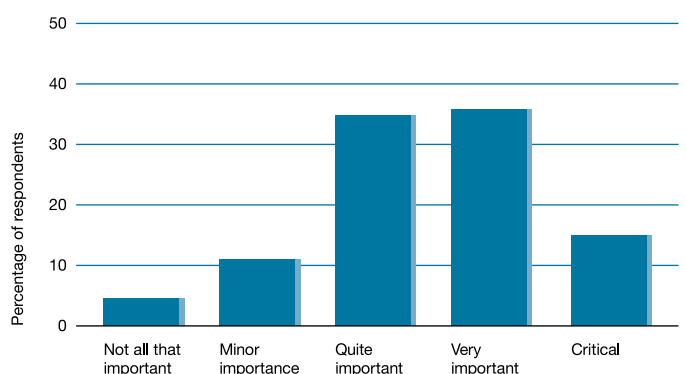
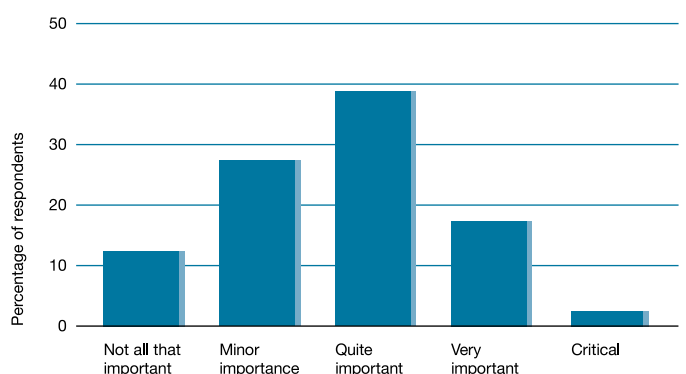


Fig. 9

Importance of procurement for non-core goods and services



Surprisingly the importance of procurement for ongoing supplier management is not seen as a key role, indicating an area of potential exploitation from suppliers

Fig. 10

Importance of procurement for ongoing supplier management

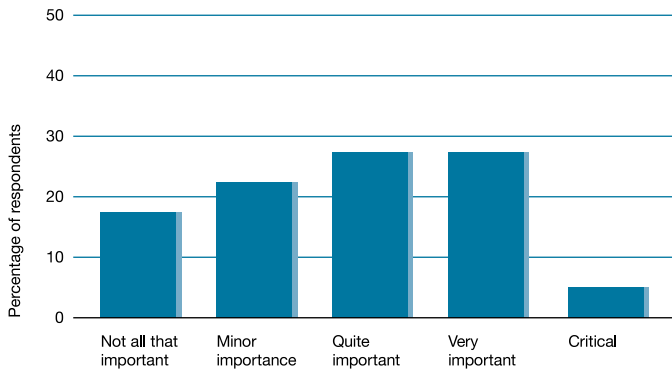
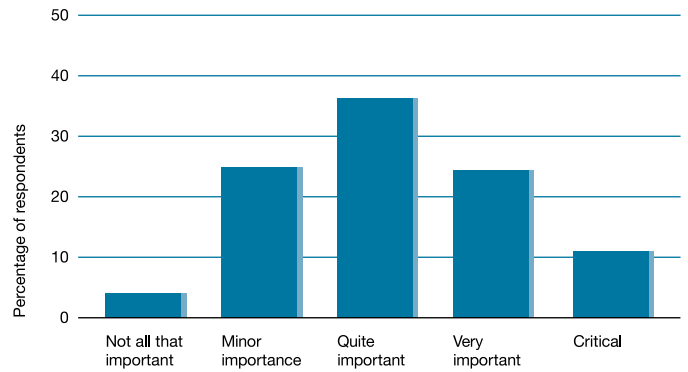


Fig. 11

Importance of procurement for long-term strategic planning



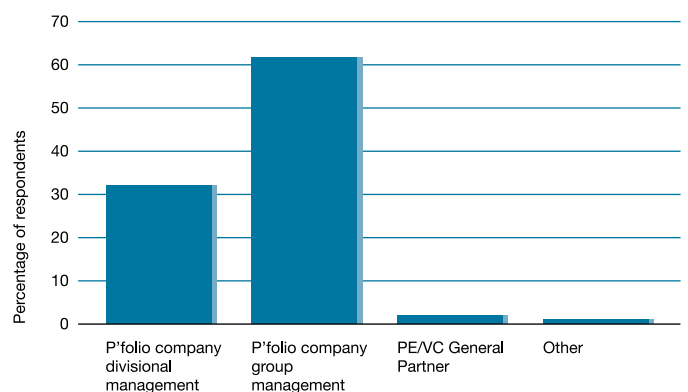
3.3 Who is responsible for effective procurement at portfolio companies?

Having asked about GPs' involvement, and respondents' views about the importance of procurement across different aspects of the businesses, the next two survey questions focused more directly on responsibilities and procurement delivery. Across all respondents, procurement is primarily led by individuals at portfolio companies, rather than GPs facilitating within or across their portfolios to take advantage of the broader scale and other supplier opportunities. Figure 12 plots results for the four options that survey respondents were given. There is a distinct split between divisional (33%) or group (63%) management being responsible for procurement at portfolio companies. Upon inspection, it was apparent that group management was generally responsible for smaller firms, as gauged by employment or turnover. By the same token, those firms where divisional management was responsible for procurement tended to be somewhat larger. This meant that the weighted and unweighted results were correspondingly different.

At the same time, this result is consistent with smaller firms having more compact management structures, and therefore needing group managers to take on responsibilities that may be delegated to other layers of management in larger/more developed firms.

Fig. 12

Primary responsible for procurement



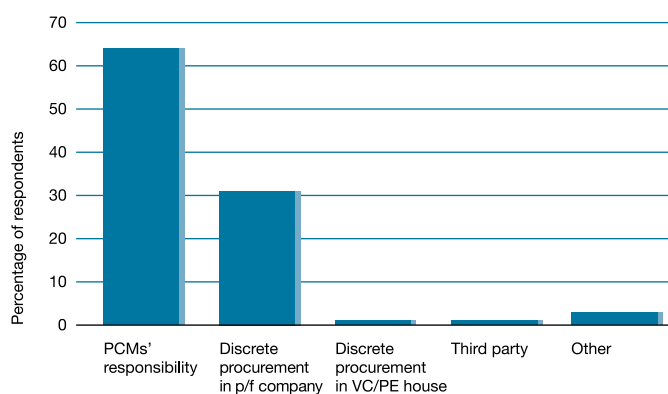
Survey Results Continued

3.4 What model of procurement delivery is most commonly practised?

The survey then also asked which model of procurement delivery was practised in respondents' own companies. In light of the previous section, it was not surprising that the majority of respondents indicated that procurement was kept in-house within the company, rather than discrete procurement functions within PE houses coordinating procurement within or across portfolios. Most respondents noted that procurement was the responsibility of portfolio company managers, with a sizeable proportion indicating that procurement was a separate function within portfolio companies. Consistent with the previous section, company managers were more likely to be responsible for procurement at smaller companies, while larger companies were more likely to have distinct procurement functions. Once again, this led to the weighted and unweighted results to this question being somewhat different.

Fig. 13

Models of procurement delivery



by coordinating procurement across portfolio companies greater savings may be achievable

The fact that procurement is conducted at the portfolio company level is consistent with the observation that GPs tend to step back from the ongoing management of portfolio firms, which is left to company managers. However, at the same time it represents a potential missed opportunity. Scale can often be an important factor in delivering procurement savings, and by coordinating procurement across portfolio companies greater savings may be achievable than would otherwise be the case.

It is quite practical to work in collaboration with 10-30 companies in a portfolio, identifying opportunities across 8-10 spend categories within both individual and common spend. Typically the payback can range from 2.5x to 6x cost. Examples of common spend categories include healthcare, plastics, fleet, insurance & financial services, IT and telecommunications. All of these can deliver substantial savings when applied across a portfolio of investee companies.

3.5 How satisfied are respondents with existing procurement functions?

Finally, the survey asked respondents to rank how satisfied they were with their existing procurement functions. Here respondents were asked to rank from 1 (very dissatisfied) to 5 (very satisfied) across a range of business activities, namely: contract negotiation; purchase-to-pay transaction management; building relationships within the business; delivery of business management information; and post-contract supplier management and benefit realisation.

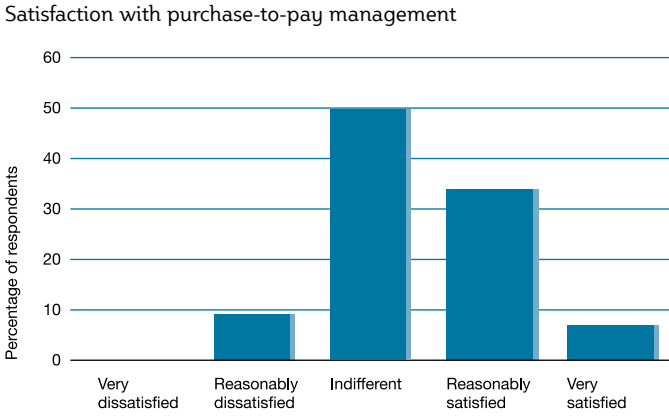
The most striking result here was that, with the exception of contract negotiation, the largest single group of respondents across other categories thought that their existing procurement functions were

unremarkable. Furthermore, although the balance of respondents was typically more satisfied than dissatisfied, given the uncoordinated nature of procurement across PE portfolios, it may simply be that survey respondents are unaware of the potential savings that a different approach could offer. As such, there could well be scope to improve existing procurement arrangements. Figures 14-18 show percentage responses across the different business activities. For transaction management and building relationships, the balance of respondents tended to be more towards satisfied than dissatisfied; but that tendency was less pronounced regarding business information and post-contract dealings.

Fig. 14



Fig. 15



the largest single group of respondents thought that their existing procurement functions were unremarkable

respondents are unaware of the potential savings that a different approach could offer

Fig. 16

Satisfaction with building relationships

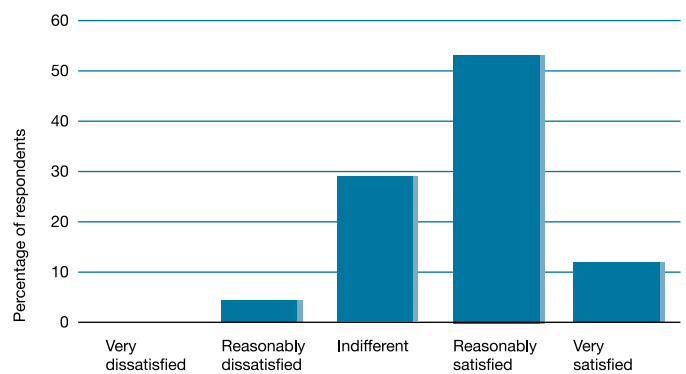


Fig. 17

Satisfaction with delivery of management information

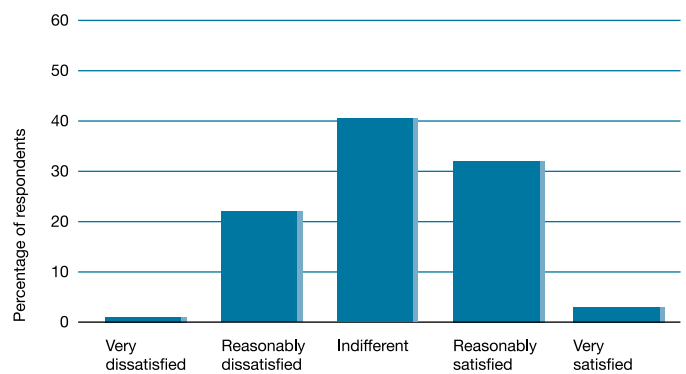
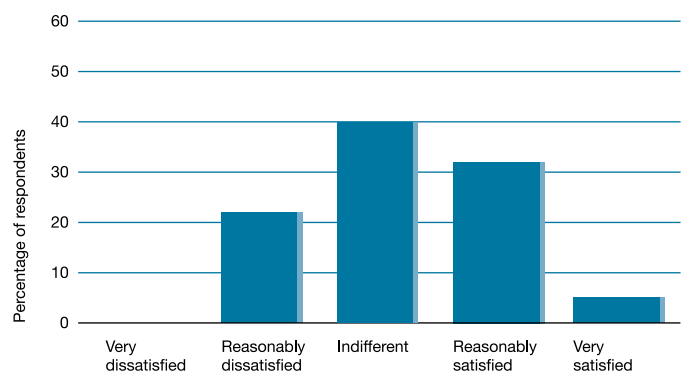


Fig. 18

Satisfaction with post-contract management and benefit realisation



Conclusions

Private equity and venture capital managers aim to build better businesses by working with business managers to deliver improved performance and profitability over a number of years. Procurement is one area of business strategy where small changes can have a significant impact on margins, profitability and enterprise value.

improved procurement could make an important contribution to generating enterprise value and boosting PE fund returns in the years ahead.

Consistent with previous research, on the basis of the results to this survey PE managers appear to be more involved in procurement decisions where they are part of financial planning or overall business strategy. In contrast, they are less likely to be involved in the day-to-day decisions facing business managers.

One interesting finding is that procurement is typically managed individually by the various companies within a PE portfolio, either at the divisional or group management level. This suggests that there may be significant savings that are available both to companies and PE managers, by exploiting the potential economies of scale that may exist across the portfolio as a whole, rather than individual portfolio companies buying goods and services by themselves. If these opportunities were successfully exploited, improved procurement could therefore make an important contribution to generating enterprise value and boosting PE fund returns in the years ahead.

Survey questionnaire

This appendix details the precise wording of the questions that survey respondents were asked.

Q1 In your experience, how involved are private equity General Partners in procurement and supplier decisions?

- As part of overall business strategy
- As part of financial planning and targeting savings
- Operationally, as part of the decision making team
- Operationally, but through a third-party consultancy or organisation

Respondents were asked to rank from 1 (no involvement) to 5 (always involved)

Q2 In your view, how important is the procurement function in adding value to private equity and venture capital portfolio companies, in particular via:

- Large capital expenditures
- Core spending on strategic or direct goods and services
- Spending on non-core or indirect goods and services
- Ongoing supplier management
- Long-term business and strategic planning

Respondents were asked to rank from 1 (not at all important) to 5 (critical)

Q3 Who is primarily responsible to ensure that effective procurement is in place at portfolio companies?

- Portfolio company divisional management
- Portfolio company group management
- PE/VC General Partner
- Other (please specify)

Respondents were asked to pick one option

Q4 What model of procurement delivery is most commonly practiced in your company (or portfolio of companies)?

- Procurement is portfolio company managers' responsibility
- Discrete procurement function within portfolio company
- Discrete procurement function within VC/PE house
- Third party procurement (eg consulting/outsourced)
- Other (please specify)

Respondents were asked to pick one option

Q5 In general, how satisfied are you that procurement is fully integrated with and supporting business operations within your business or portfolio regarding:

- Contract negotiation
- Purchase-to-pay transaction management
- Building relationships within the business
- Delivery of business management information
- Post-contract supplier management and benefits realisation

Respondents were asked to rank from 1 (very poorly) to 5 (very well)

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