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HEDGE FUND & PRIVATE EQUITY NEWS

Procurement 101 With A Twist

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Michelle Morgan**, **Pelorus Advisors -- It's no secret private equity models, which have traditionally relied heavily on leveraged capital and timely exit strategies, are under severe stress given today's liquidity crisis. Firms that once operated under the premise of being able to refinance highly levered deals are finding themselves surrounded by lenders that are either unable or unwilling to renegotiate terms.

Regardless of market conditions, the long term view is not all bleak for private equity firms willing to embrace new models for doing business. Firms that focus on creative ways to generate value within their existing portfolios, including portfolio expense optimization, will differentiate themselves from, and be better equipped to weather the existing economic environment. More specifically, firms that step-away from traditional portfolio expense management and take advantage of best-in-breed expense reduction processes will likely be viewed by their investors as "fit to survive" to the next round; when market conditions improve they will likely gain a significant advantage in their future fund raising efforts. Ultimately, firms that can excel at portfolio expense optimization stand to benefit from an increase in portfolio company cash flow and overall portfolio company value.

Avoid Replacing Like For Like

The savvy buyer knows there is a floor to pricing reductions and limited economies of scale for mid cap companies, even when combined across the portfolio. To garner significant savings requires a different approach to partnering with providers who service multiple categories of expense consumption. Only then do you start to obtain the appropriate economies of scale which make it viable for a large partner to come in and offer value-based pricing "solutions" versus buying a commodity. Think about consolidating all the expenses associated with external printing – or said another way, anyone who puts ink on paper on your behalf off of your premises. Most companies look at document servicing as the money they spend at the local copy center down the street. One company thought they were spending one million a year on printing or at least that is what their income statement said. But when they applied the new definition it was really seven and a half million, which one supplier could handle all of their needs. This starts to bring about economies of scale most mid cap companies do not realize they have.

Educate Need Versus Want

We always hope our employees are making the best decision when it comes to buying goods and services. The truth be told, their intentions are good, but they may not always have all the information they need to make the right decision. Educating them on their choices is a simple and straight forward way to ensure the most appropriate buying decision is made. Following the same example, the employees needed notices sent to their customers regarding account renewals. To do this they sent out multiple letters with comparisons to the competition and suggested up sell products, all in an attempt to retain customers and increase revenue. After meeting with the new supplier, who has a vertical in their industry, it was deemed that less is more with regard to retention strategies with this product; that most consumers will leave the renewal on auto-pilot mode unless prompted to research other products. So what the company really 'needed' was an inexpensive solution which maintained or increased their retention rate. Under the old method they spent $350,000 a year and had an 82% retention rate. Under the new method they spend $140,000 or a 60% cost reduction, but just as important, their retention rate went up to 86%. That equates to a 5% lift in sales, not bad when you can move both the expense and sales lever simultaneously.

Express The Problem, Not The Solution

When you partner with your new suppliers, be careful not to tell them how to solve your business objective. Be receptive to their suggestions, especially when they specialize in your vertical. Listen to how they are solving business challenges for your competition and figure out together how to do even better. Consider being a test site for their new products and services. Another area of the same company had to send out late fee notices. To do this they used 8 ½ by 11 stationary with the company logo, three color heavy stock paper and in similar weight and color envelopes. They planned to issue an RFP and hoped to save a few cents per letter or about $10,000 to $20,000. Instead, they expressed the problem – "regulatory bodies dictate notices to customers about late fees be sent within 5 days." Working with a creative supplier, they came up with a new and innovative solution that took advantage of a technology which semi-seals a post-card size folded notice. The cards are dot sealed at each quadrant and have perforated edges, giving the appearance of being fully sealed. Using this technology allowed the notices to be sent at the postcard rate and saved four hundred and forty thousand dollars a year or a 61% decrease in year over year costs. You don't have to try every new technology break through, but you will be early in the know for new developments. And if you don't want to be an explorer, you can be an early pioneer.

Don't Ask, Don't Tell

If you don't ask your providers for pricing on alternative goods and services, you may never know about the deals out there. Many times, we sign up with a supplier and put the relationship on perma-hold, thus missing out on the whole picture. How many times do you pass on the lunch offer from one of your suppliers, especially the ones not directly related to your core business? You may say, what exactly can my print supplier company do for me that is of consequence? Well what if they could eliminate print and postal costs on a third of your marketing material, plus customize it with the customer and salesperson personal information. Without regular updates from your partners, you may be missing out on new technology break-thrus. This company spent $1.2 MM on retail point of sale marketing material. Working with their new supplier, much of the material was converted to digital format and put on a shared intranet site. Not only were they able to customize the material and either print it on demand, but they could also email it to a client (zero print costs, zero postage costs). Because they ran large quantities in the past (their old vendor told them there were economies of scale on large runs), they often had up to 15% in waste due to the ever-changing regulatory footnotes, requiring re-runs and re-stocks at the retail outlets. Between the two they are positioned to save upwards to $400,000 or 34%, plus they have the ability to change their marketing material literally overnight to take advantage of new changes in the marketplace.

Use Scalpels, Not Machetes

To implement sustainable year-over-year results, and don't we all want annuity like savings, you must fully understand and plan for the risks associated with changing people, processes and technology. Courage is the ability to make good decisions with limited information and to do this effectively, you should run scenarios around failure situations and ensure you and your new partners are prepared with contingency plans. There is also only so much an organization can successfully assimilate in a given time period. Make sure you review all expenses and properly categorize them. Select the lower risk, higher return options first. Avoid the capital intense solutions, until you fully optimize the organization.

As many firms have learned firsthand, a hastily-implemented portfolio expense management program can do more harm than good. The mere consolidation of suppliers and across-the-board portfolio cost cutting is likened to losing 15 pounds by amputating your leg. Yes, the weight is gone, but it leaves you hobbling along. Taking a thoughtful and experienced approach to expense reduction will allow a firm to maintain its most precious asset – cash. If done correctly, best-in-class expense optimization should also yield an increase in portfolio company valuation and strengthen exit strategy opportunities. Given the economic issues of the day, it's good to know that professionally-implemented operational expense improvements can yield significant and rapid results.

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