Chapter 7
PURCHASING

7.1 CONTEXT AND STAKES

Purchases represent a considerable expense for the Altrad Group. The addition of previously independent structures with their own purchasing arrangements makes the improvement of the purchasing function essential:

- shared sourcing of many references to achieve synergies between the Group's subsidiaries;
- purchasing in low-cost countries (China, Malaysia, Tunisia…) particularly via the dedicated subsidiary Altrad Asia, based in Hong Kong, in order to have the lowest production costs.

These objectives are the responsibility of the Procurement Department.

Improving the procurement function is complex owing to its fragmentation in nature and space. Needs are heterogeneous and there is a geography-related dispersion effect. The logic of standardization is not easy to envisage comprehensively, and the subsidiarity principle dear to the Group can penalize cash management and EBITDA*. The question "make or buy" is posed by the Industrial Department.

The stakes and geographic fragmentation are significant: markets are different, just like business cultures. Purchases are relocated while sales are made on the local market. The size of the Group, although growing, does not allow it to count for much when faced with certain suppliers of raw materials. Some markets, such as steel and aluminium, are totally global. Producers are few and huge in size (e.g. Rio Tinto Alcan for aluminium) and the Group represents nothing for them in purchase volume. On the other hand, market criteria apply to all: it is a good or a bad time to buy for everyone. In this context, one of the first issues of the Procurement Department is to federate company heads behind a common approach, in spite of their entrenched habits.

Volume buying is a natural and simple, but sometimes simplistic, reflex. The first risk is to think in terms of basic price and to forget the problem of total cost. The experience of the Group shows that an economy (for example, low-priced tyres) can have a significant impact in the cost of non-quality and loss of image for the Group. A second risk concerns delayed effects on cash management, the standardization driven by the Procurement Department and the mechanisms of the cultural integration of best practices.

To buy in bulk, it is necessary to buy together. This logic works well in certain geographical areas like South-East Europe, where there are quarterly cycles of negotiations and meetings in the subsidiaries. It also works well for some materials such as steel. In other areas, like the North-East zone, everything is yet to be put in place and cultures need to evolve.

The strategy of conquest exacerbates the paradoxes by sometimes highlighting the inter-company difficulties of the Group:

- Two or more competitors become sister companies.
- These companies buy from the same suppliers, and differentiation has previously come from the ability of one or the other to control purchases and prices. Standardization

eliminates this difference in the interest of the Group but in the end, it favours the company that had not controlled its purchases so well compared with the one that had, because its productivity is significantly improved.

- This is not easy to resolve because it is an issue of competitiveness for one of the companies and of recognition for both their leaders that the incentive system* should foster.

It is therefore necessary to learn to manage the principle of subsidiarity jointly, thus promoting joint competition and volume purchasing.

The pooling of procurement is simpler for overheads (e.g. insurance policies) because they represent spending that companies often considered secondary.

It is still true that an alignment of subsidiaries and all staff is imperative in order to implement a pertinent purchasing policy. Combating the fragmentation of procurement is to be driven by the subsidiaries.

7.2 ORGANIZATION OF THE PROCUREMENT FUNCTION

The procurement function involves everything from sourcing suppliers, negotiating and supply through to payment of invoices. Buyers on production sites are in direct connection with the scheduling, production and supply chain teams. For sales companies, purchases are instead, managed by marketing and sales teams (logic of introducing products into a catalogue). In general, the procurement organization is mainly decentralized, modelled on the general organization of the Group. It is based on the three organizational principles of the Group, as described below.

7.2.1 The subsidiaries

Each subsidiary has established its own organization on the basis of its activity and the criticality of supplies. The size of the companies, the diversity of their activities and their markets have dimensioned their purchasing/procurement organization.

The number of staff dedicated to purchasing and supply corresponds to about 5% of the workforce of the Group; they often share their time with other missions: stock control, vehicles, operation, planning, etc. In most cases, company heads are heavily involved in negotiations, particularly concerning raw materials. Rental companies do not always have staff dedicated to purchases; in general business leaders and heads of agencies manage negotiations.

7.2.2 The holding company

In parallel, a Procurement Department has been created in the holding company. Its mission is to take charge of certain categories of strategic purchases and to support the needs of subsidiaries.

The Procurement Department organizes meetings of purchasing progress units and directly manages certain categories:

- negotiations for raw materials;
- the operational management of insurance and vehicles.

Quarterly meetings are held with production companies.

7.2.3 Progress units

The Procurement Department participates actively in various progress units: production/stock, services, overheads and vehicles. Sub-progress units (temporary or not) have been created to deal with specific subjects: agency staff, motors, etc.

This work has led to the structuring of the procurement function and a family of buyers (who will provide coordination by market area) have been or will be appointed. This family could be extended to leverage and sustain coordination.

The resulting procurement "community" is therefore quite broad and involves the leaders of subsidiaries on a regular basis.

7.3 OBJECTIVES AND BUDGETS

During the preparation of budgets, procurement objectives are discussed with the subsidiaries, including in particular:

- raw materials (particularly steel): market data is analysed and discussions with subsidiaries allow budget prices for each subsidiary to be determined, depending on its requirements and the market in which it operates;
- working capital (suppliers): objectives for the payment terms of providers are determined and then integrated into the calculation of WCR* for each subsidiary;
- taking account of new contracts in the budgets.

7.4 PURCHASING POLICY AND MAIN LEVERS OF ACTION

The stakes in the procurement function are considerable given the volume of purchases and their impact on the results of the Group. Enormous savings are possible and lead directly to an improvement of the EBITDA (1% saving is equivalent to 4 million euros EBITDA).

The Procurement Department therefore has two major types of mission:

- short-term missions intended to improve cash flow quickly by reasoning in terms of cash management. These missions answer the question "What is the financial impact of a purchase?";
- missions with medium and long-term effects to streamline and optimize the system and secure supplies. The effects on cash management are indirect and longer term.

7.4.1 Short-term levers

Action was initiated early in 2011 to significantly increase the supplier credit terms obtained. Market peculiarities and various country-specific regulations have led to differential treatment:

- In France, the application of the Law of Modernization of the Economy (LME) has had a negative impact on the WCR by reducing deadlines for payments.
- Outside France, rebalancing has been carried out. Discounts offered by suppliers in return for short payments have been eliminated in some subsidiaries (particularly in Germany).

All payments are validated by the holding company. This has helped generate a substantial improvement of the WCR.

The average period for payment is 73 days. Despite the application of the directives reducing the time for payment coming from the LME in France, this indicator has not deteriorated. The objectives given to subsidiaries have been followed and applied perfectly. On the other hand, certain subsidiaries have had to arbitrate between purchase price and payment terms; this shows the importance of grouping purchases (see below).

The adoption of the standards of the Group by recently integrated companies leads to specific actions based on priorities and carried out as quickly as possible (e.g. at Atika the average payment has gone from 13 to 51 days in 8 months).

7.4.2 Levers engaged in the medium/long term

7.4.2.1 Methodology implemented

A mapping of external expenditure was initiated in 2012 to obtain a global oversight of expenditure and to initiate purchasing actions in that accounting year.

As the perimeter of the Group is constantly evolving through regular acquisitions, this mapping is updated periodically (twice yearly). This portfolio analysis allows priorities to be readjusted dynamically during the year.

On the basis of this analysis, purchasing policies, like commercial policy, are determined by category, taking account of category-specific issues. For example, the purchase policies for steel, engines, agency staff and insurance are formalized. This is being extended to other categories (aluminium, wood, etc.). Policies are based on an analysis prior to any action (SWOT analysis, identification of suppliers, monitoring prices and their evolution compared with official price indices, measuring the cost of over-quality and, where applicable, benchmarking). This analysis then allows the identification of levers to be engaged.

This method has been established and made robust because of the feedback about purchase categories that have already been treated.

7.4.2.2 Levers of action

Eight levers are engaged within the Group:

1. Sourcing and competition: subsidiaries usually negotiate with their established suppliers. A search for alternatives is performed; this is indispensable in cases such as tariff increases, suspension of delivery or unsatisfactory service.
   Suppliers for a given process are pre-qualified. The stakes, costs of industrialization and the risks arising from modifications hinder changes in suppliers. The result is that competitive tendering is not always carried out. On the other hand, several initiatives have been launched and managed jointly by subsidiaries and the holding company as part of a dedicated progress unit; on global tenders (insurance of persons in the United Kingdom, the car fleet in France, electric motors and agency staff).
2. Grouping purchases: this has been initiated for several families (steel and motors) but needs to be strengthened.

The 745 most important providers account for 80% of the expenditure (data 2011-12).

3. Standardization of processes, products and removal of overquality: historically competing subsidiaries focused on the differentiation of their products. A standardization effort is required and many actors are involved (commercial staff, design offices, production). This work is carried out when required according to the stakes and the costs of reengineering*. A project to standardize cement mixer motors has initiated this process.
4. Productivity: productivity plans have been imposed on vendors. This is limited at present but will increase gradually on the basis of the stakes involved.
5. Passing on the impact of customer requirements: the constraints imposed by customers on the subsidiaries are rarely passed on to suppliers or formalized in contracts. If problems arise, negotiations are initiated to resolve the situation.
6. Improving supplier relationships: the supplier relationship is often informal and there is often no contract to secure it. Good practices exist, such as the establishment of explicit specifications with providers (e.g. Atika for Chinese imports).
7. Group contracts: a specific action has been engaged to negotiate annual discounts with providers with whom the Group spends more than one million euros per year.
8. Quality and service: subsidiaries do not systematically assess their suppliers; only steel providers have been tracked (monthly assessment) since early 2013. There is no specific logistics convention with vendors. A project was initiated in 2013-14 to assess the deliveries of major suppliers (OTIF indicator*).

7.4.3 Management and reporting tools

The Altrad Group does not have an integrated information system or a control tool built into all of its companies. Reporting is done through spreadsheets that are consolidated manually and updated monthly. Several indicators have been determined (e.g. raw materials), but these indicators still do not give a global vision of procurement performance.

An Intranet procurement system has been implemented and is increasingly used by subsidiaries that need to be able to share a large volume of information. The deployment of this Intranet is a priority.

Reporting has been structured:

- Raw materials purchasing performance is measured against reference indices.
- An index of performance purchases called PPV* (Purchase Price Variance) has been defined and will be deployed gradually. Over coming years this tool will allow detection of items that have suffered the largest price increases.

The completeness and reliability of purchasing reporting are major issues for the Group. The General Management also wishes to focus the overall guidance of the purchasing system on a more financial view, prioritizing short-term results.

7.5 ALTRAD ASIA

About a quarter of the Group's purchases come from low-cost countries (China, Malaysia, Tunisia…). This share is growing constantly and the impact of these purchases on the EBITDA is considerable. Consequently the Altrad Group has had to structure its procurement activities in this region of the world.

The Altrad Asia subsidiary was established for this purpose, with offices in Hong Kong and Suzhou (a suburb of Shanghai). Altrad Asia is now the anchor point of the Group in Asia. It allows direct access to the low-cost players of the region. It helps also to secure and optimize the supply chain through internal quality control and logistics functions.

The teams that have been formed are mature and their expertise has built up over the past eight years. They are valuable in the Altrad Group's external growth policy, because in the eyes of new companies joining the Group, they give credibility to the volume purchasing policy regarding supplies "made in Asia".

Altrad Asia has proved to be one of the finest achievements of the Altrad Group in terms of procurement policy.