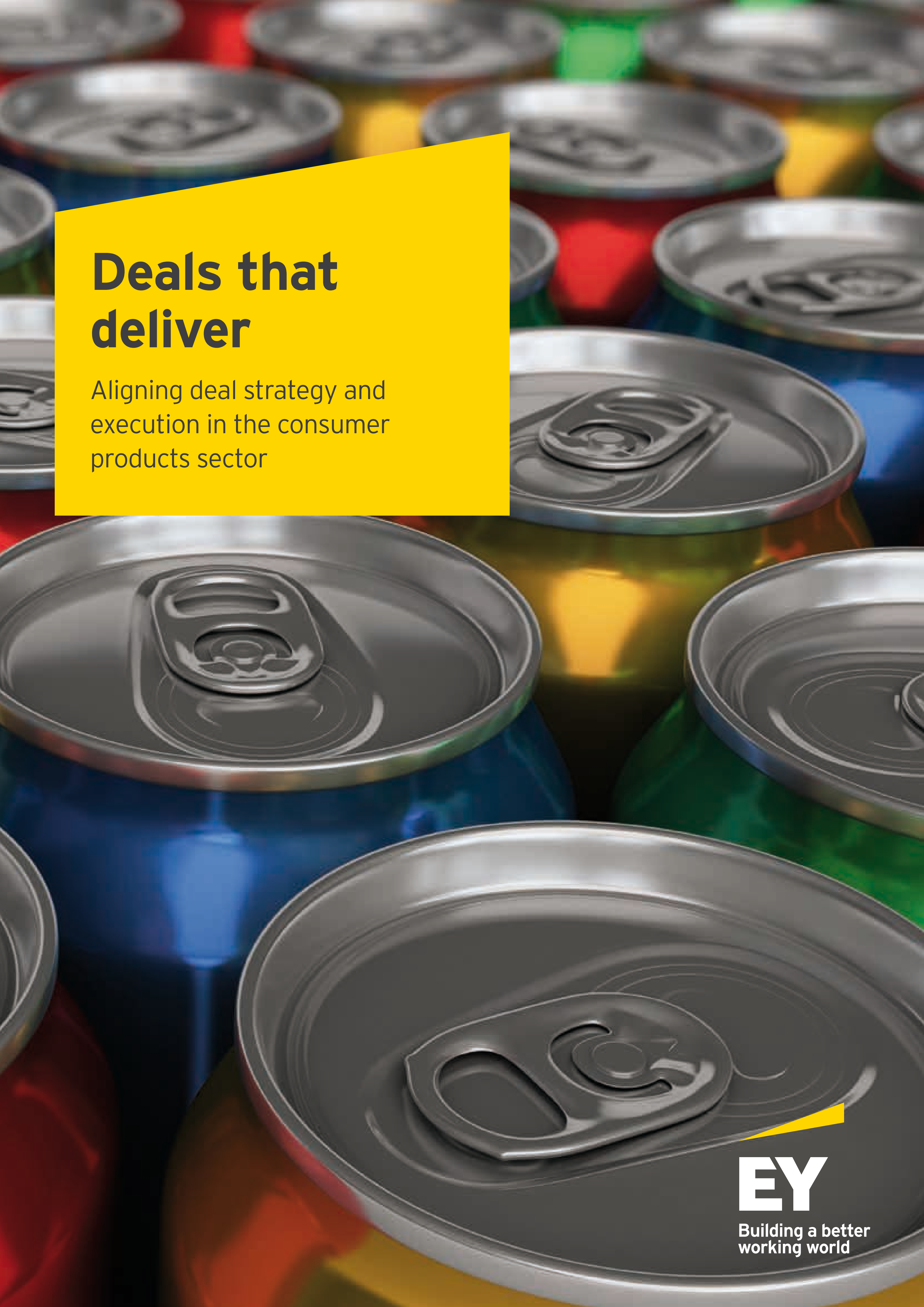


Deals that deliver

Aligning deal strategy and execution in the consumer products sector

EY

Building a better working world

Delivering on the promise ...

Introduction

Consumer products companies currently face enormous opportunities and constraints to growth: the ballooning middle class in Asia, Latin America and Africa versus the anaemic growth in tougher, more regulated developed markets with depressed consumer spending.

Winning in this challenging world requires consumer products companies to make careful choices about where to play and how to win. They need to exploit both organic and inorganic means to develop their brands, categories and geographic portfolios. Speed is of the essence, both in terms of identifying the right opportunity and seizing it. In this article, our lens is entirely on inorganic plays.

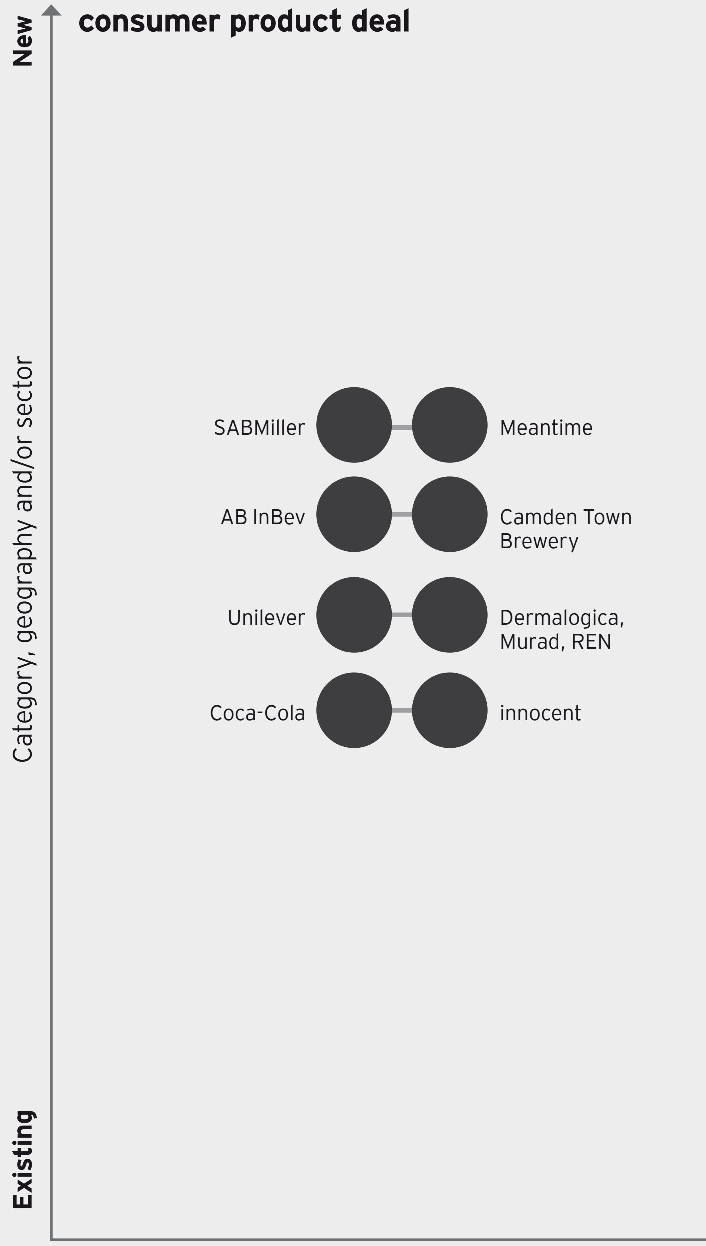
It is our experience that whilst most companies are clear on the logic behind their acquisitions or divestments, the same clarity is not always demonstrated in the way the deal is implemented. Deal value can often be compromised as a result. We've drawn on our experience to present the three distinct acquisition rationale driving deals in this sector, and introduce the implementation approaches that we believe are most likely to deliver value in each case.

Three types of consumer product deal

Deals in the consumer products (CP) industry come in many shapes and sizes. But look more closely and key patterns emerge. We've analysed M&A activity in this sector (see Figure 1) and identified three distinct acquisition rationale behind the deals taking place (many of which we've advised on). Each rationale has different operational implications and integration challenges for the companies involved if deal value is to be maximised.

Because even the best conceived M&A strategies and clearest deal rationale can only take them so far, CP businesses need to recognise these fundamental differences and reflect them in deal execution. Failure to do so will undermine the deal's objectives and dissipate value.

Figure 1: Three types of consumer product deal



Source: EY analysis

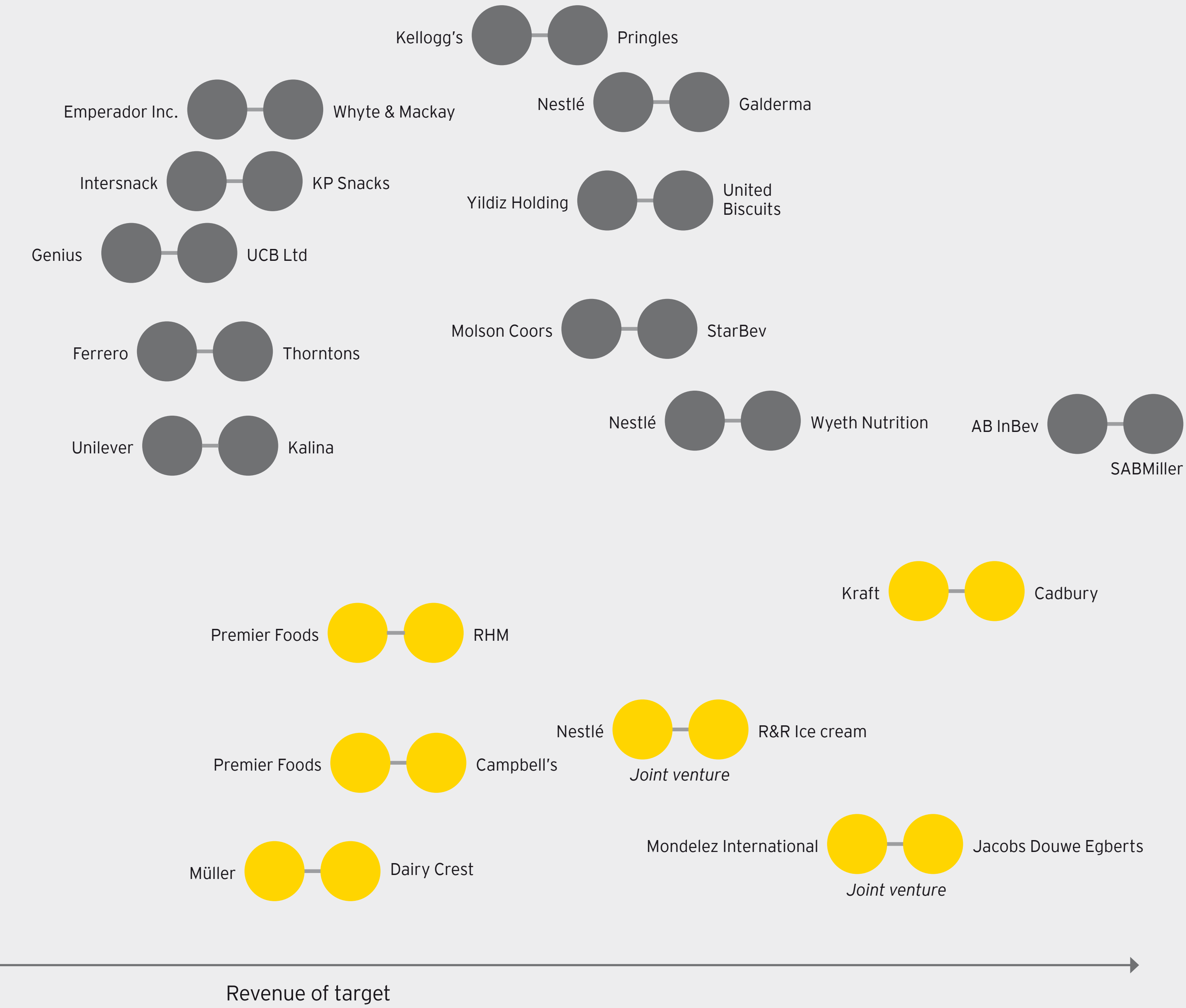
So what are these three distinct acquisition rationale? Shown in Figure 1, we've labelled them as **Incubate** (typically smaller-scale deals), **Innovate** and **Accumulate** (both usually undertaken at scale).

Incubate

These relatively small-scale deals take place when larger businesses acquire successful niche players in existing or new categories or routes to market, supporting them and helping them to accelerate growth. Often this is with minimal interference, but with increased investment and leverage of the larger business's strengths along the way.

Examples include Coca-Cola's acquisition of Innocent Smoothies, and Anheuser-Busch InBev's string of eight deals (and counting) in the craft brewing space.

A similar ambition has led some CP companies to launch their own venture capital funds (e.g., Unilever Ventures, Nestlé's Venture Capital Fund) to invest in young, promising companies, accelerating growth by providing access to their global ecosystem, assets and expertise. The difference here is that the targets are not integrated into the parent.



Innovate

Generally undertaken at scale, these deals enable companies to enter new markets – whether these are new geographies, new categories of product, or new consumer groups. Having identified complementary value-drivers in a target business, acquirers use these deals to build new competencies.

Examples include Ferrero's acquisition of Thorntons (Thorntons was both a confectionary manufacturer and retailer), Kellogg's acquisition of Pringles (an opportunity for the cereal maker to enter the snacks market), Nestlé's acquisition of Wyeth Nutrition (a chance to further expand into the infant nutrition market in China) and, most recently, Anheuser-Busch InBev's acquisition of SAB Miller (completing their global footprint by entering the high-potential African market).

Accumulate

Acquirers use a large transaction to achieve a step change in their market share, achieving greater scale in their existing markets and categories. Examples include Kraft's £11.5 billion takeover of Cadbury (vastly expanding markets for confectionary sales for the combined business), Dowe Egberts and Mondelez forming a joint venture to achieve consolidation of their coffee businesses, and Nestle and R&R taking a similar approach for their ice cream businesses.

In Figure 2 opposite, we've highlighted the strategic drivers for each of these three classes of deal (for buy-side and sell-side companies), along with the implications that these have for the integration/divestment execution approach. The bottom line? Deals deliver maximum value when their implementation is closely aligned to the strategic rationale that drove them from the outset. That may sound obvious, but our experience is that, in the fast-paced, fluid environment of these strategic deals, this alignment is often compromised.

Incubate

Acquisition (Buy-side)

Strategic Rationale

Acquire to gain access to fledgling business with new and high-growth potential.

Execution approach

Preserve value-drivers and unique competencies whilst learning.

Disposal (Sell-side)

Strategic Rationale

Early stage exit to realise investment or if not strategically important to core portfolio.

Execution approach

Flexible approach to meet specific buyer requirements — fully standalone vs. Brands/IP/core technology.

Figure 2: Unique implications for integration/divestme

Innovate

Strategic Rationale
Acquire target with scale in new category, route to market, consumer group or geography.

Execution approach
Preserve the value-drivers whilst leveraging scale – potentially review and transform operating model.

Strategic Rationale
Corporate restructure, realise value constrained by cultural or historic factors, exit business outside of portfolio strategy or due to competition authority ruling.

Execution approach
Flexible approach to optimise value: trade off maximised EBITDA vs. minimised stranded costs.

Accumulate

Strategic Rationale
Acquire target to grow market share and achieve scale in existing category and/or market.

Execution approach
Leverage economies of scale at pace.

Strategic Rationale
Divest or sell to buyer with larger scale, greater ability to leverage synergies or due to competition authority ruling.

Execution approach
Maximise value by focusing on optimisation of synergies for buyer.

ent execution approach

Making the right operating model choices

Before the transaction is completed and integration begins, both parties have their own distinct operating model (encompassing the organisation, its processes and its systems). There may well be similarities between each businesses' core business functions (e.g., Sales and Marketing, Supply Chain, Manufacturing, Finance), but they'll never be the same. In every case, how successful a deal eventually plays out hinges on the execution: how effectively these two operating models are brought together and managed over the short and long term.

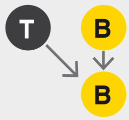
Whatever the motivation behind the deal, acquirers have four choices to make function by function where their post-integration operating model is concerned:

1

Target's function absorbed fully into buyer operating model.
When there is minimal added value in acquired business function.

Before

After

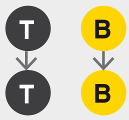


2

Maintain parallel business functions.
When there is unique, differentiating value in acquired business that needs to be protected.

Before

After

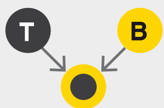


3

Merge functions but adjust operating model to protect value in target.
When there are some capabilities in target with value that should be preserved.

Before

After

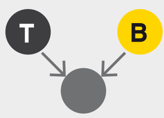


4

Actively transform the function as part of the integration.
When the acquired function has considerable additive value or because the integration is the best opportunity to improve current business practices.

Before

After



Key:

T Target
B Buyer
Retained competencies
New

If there's minimal added value in the target's business functions, the acquirer will likely choose to fully absorb those functions into their own operating model. For example, if the target's finance function is less effective than the acquirer's, it can be subsumed entirely. Alternatively, if there's some unique, differentiating value in the target's business that needs to be protected and leveraged (an outstanding digital sales capability, perhaps), the acquirer may choose to keep these core business functions running in parallel to their own until they are replicated in the acquirer's business.

Of course, our experience shows that it won't always be so clear cut. Often, the target business will have some capabilities that the acquirer wants to preserve, and some that it does not. In these cases, functions can be merged, but adjusted so that the new operating model retains the most valuable core competencies. For example, the target may be particularly strong in New Product Development, with faster speed to market – capabilities that the acquirer wants to leverage in the combined business.

In other cases, the acquisition may provide the impetus (and business case) for active transformation of a business function (or set of functions), perhaps a specific finance transformation, an outsourcing initiative or even an enterprise-wide ERP implementation.

Post-acquisition operating model examples from previous integrations

Figure 3 highlights how these operating model choices have played out in three recent consumer goods deals across the 'Incubate – Innovate – Accumulate' spectrum where EY has been involved. The graphic shows how there will often be short and long term outcomes for each core function, as the newly-combined business evolves over time. These are not template solutions but illustrative examples that worked for these particular integrations.

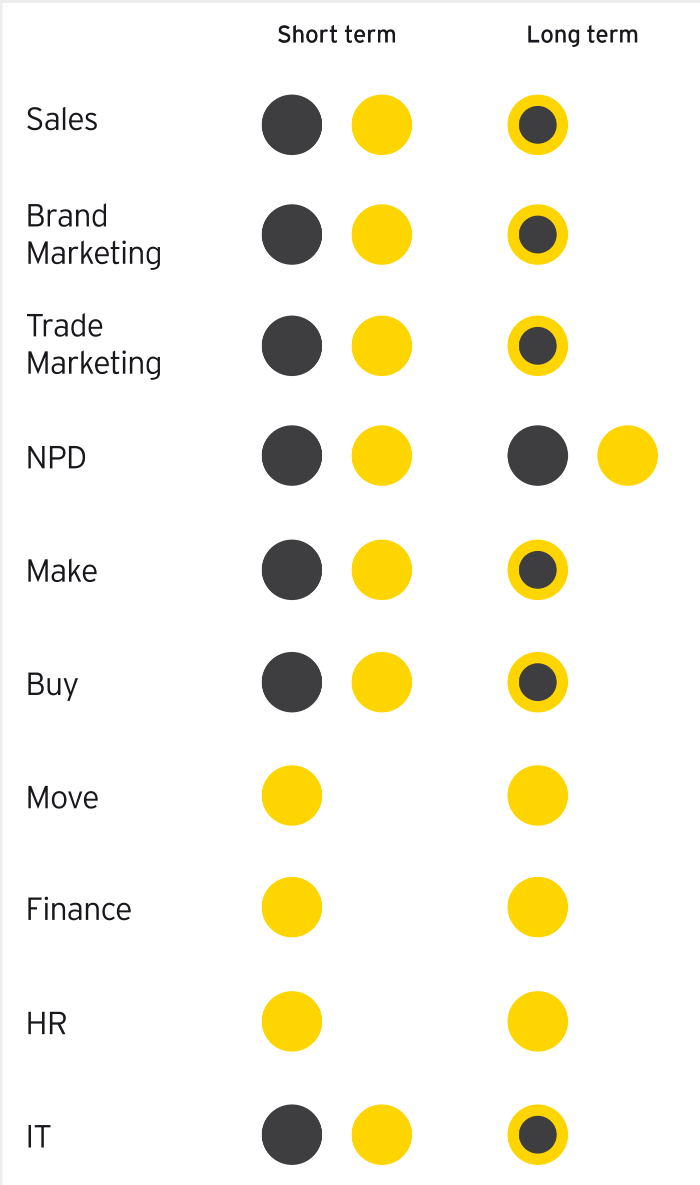
Bearing in mind the complex matrix of operating model choices confronting acquirers in any integration, it's no surprise that we sometimes see deal value compromised by issues in execution. The following section examines **Incubate**, **Innovate** and **Accumulate** deals in greater depth to highlight key success factors that we see driving successful outcomes for each one.

Incubate

It makes sense that 'Incubate' deals are more likely to maintain separate core competencies in the short term (certainly in marketing, NPD and Manufacturing functions). After all, the rationale for these deals is typically for the acquirer to secure access to a fledgling business with high growth potential and a differentiated customer offering. Maximum value is created when the target's key value drivers and competencies are understood, preserved and leveraged (even if they are ultimately subsumed into the acquirer's overarching operating model).

Figure 3: post-acquisition operating model examples f

Deal 1 Incubate



Key:

Keep separate operating models

Adjust buyer's operating model

Transform operating model

Innovate

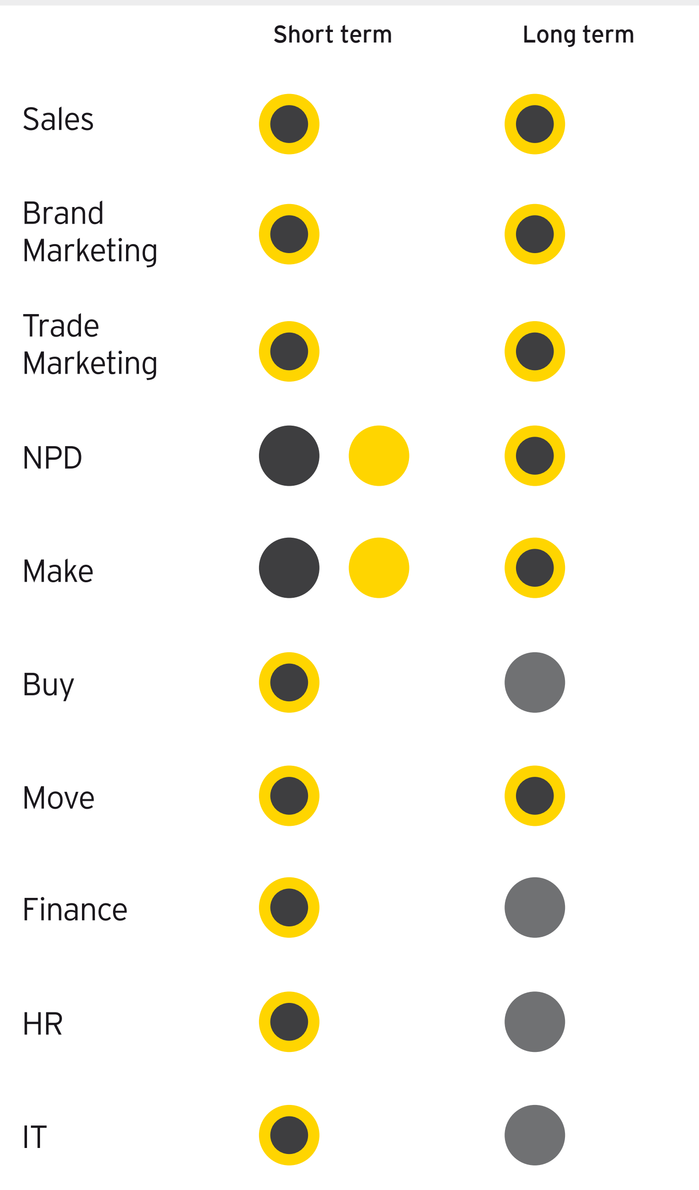
'Innovate' deals, geared to building scale in a new market, are likely to retain a certain amount of the target's core competencies in the long-term operating model, certainly where Route to Market, Marketing, NPD, Manufacturing and Logistics are concerned, in order to protect and increase revenue. In all likelihood, after all, it's precisely these functions that made the target attractive in the first place. These deals are also the most likely to involve a level of operating model transformation over the long term, with the buyer often using them to catalyse broad-based change within the business.

Accumulate

In 'Accumulate' deals, scale-based goals are often best achieved when the combined business opts to retain minimal competencies from the target (e.g., specific NPD and Manufacturing), while applying its own operating model and disciplines on the combined business from the outset. Whatever the operating model choices here, rapid integration to deliver economy of scale synergies will be critical.

from previous integrations

Deal 2 Innovate



Deal 3 Accumulate

Executing for value (and why it matters)

The shape of the post-integration operating model is a core consideration in any post-merger integration (PMI), but it's far from the only consideration. How outcomes are driven, the way people and culture are managed, and planning and governance approaches are also high priority. The way in which these various factors are executed will differ from deal type to deal type – but whatever the deal, our experience shows that it's how they're addressed, holistically, that is the overriding determinant of success.

To put this into perspective, let's take a closer look at the interplay between strategic priorities and execution success factors in each of the three classes of deal we've identified (as well as highlighting what's at stake if execution misfires).

Incubate

With the overall objective of ensuring they can compete with disruptive new entrants that use ecosystems of partners to scale at speed and securing access to fledgling markets with new and high growth potential, Incubate deals involve a number of core strategic priorities. At a high level, acquirers will be focused on maximising the impact of this one-off opportunity to reposition themselves in the marketplace.

To achieve this goal, the following priorities stand out:

Priority	Execution success factors
Brand Maximise the impact of the "one-off" opportunity to reposition in the market, changing consumer and market perceptions of the buyer and reassuring the target's loyal customer base.	Work closely with the target's leadership and sales and marketing functions to ensure the right messaging (directive/information) reaches the market from day one – reinforcing positive messages for the future of the target and explicitly demonstrating how their unique value will benefit existing customers.
Growth Work out the key factors underpinning growth, learn from the acquired business to nurture and accelerate that growth; create opportunities for cross-selling to more/bigger markets, customers and channels by leveraging the buyer's route to market; meet increased demand by using the buyer's larger-scale manufacturing and supply base capacity.	Orientate the synergy case towards growth; be very precise in identifying value drivers and ensure they're nurtured and protected; determine very clear objectives for the new business unit linked to the deal's rationale.
Talent Keep the leaders and specialists who best embody the target's unique acquired value; ensure they feel motivated to be part of the future (and are not simply financially locked into the new organisation).	Take time to understand the target's culture and account for this in everything you do; communicate to all staff early, frequently and consistently about objectives, timing, delivery plans and status against delivery of those plans.
Innovation Ensure that the large company mindset and their quality, compliance and regulatory processes don't strangle innovation; supplement the acquired business with knowhow from the buyer to learn and help accelerate high-growth NPD.	Develop an objective, agile and insightful governance framework that protects value drivers, understands culture and can facilitate delivery of deal objectives.
Costs To begin with, only take cost reduction measures where the target agrees that they provide opportunities for unburdening the business from inefficient legacy processes.	Be precise and clear when integrating 'non-value driver' functions to improve effectiveness and achieve cost savings.

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Consequence of failure:

The buyer damages the acquired business, destroys value and fails to gain any competitive advantage.

Innovate

CP companies are challenged to keep pace with the rapid rate of innovation in their marketplace. It's not just a matter of maintaining the performance of existing product categories while creating the must-have products of tomorrow. In this environment, Innovate deals are geared to acquiring targets as gateways to innovation via new markets, consumer groups and/or geographies. As well as driving growth for the business, these deals create opportunities for 'back-flushing' value into other areas of the companies' combined market footprint.

Key strategic priorities (and the execution success factors underpinning them) are:

Preserve position/consumer sentiment in new markets	Execution success factors
Quickly understand the critical factors that have driven historical success in the market (e.g., brand equity, product quality, manufacturing standards, marketing/sales approaches, customer/channel relationships, corporate reputation) and treat them all as 'non-negotiable' when developing the integration approach.	Apply extra rigour to impact assessment of integration plans in the valued markets where access has now been gained; local management should always be challenged but make sure they are not marginalised in decision making; invest in early customer and supplier communications in these markets.
Drive growth as well as efficiency	**Execution success factors**
Help the target business to become even more successful in new growth markets/segments and cross-fertilise opportunities across the combined business (e.g., by taking the acquirer's brands into new geographies) and/or the acquired segment into all geographies whilst understanding some of the cultural challenges – at least in the short-term.	Identify short and long term synergies, develop a robust business case and track its progress; the synergy case should be a mix of growth, performance improvement and cost reduction; create joint integration teams to ensure value is fully understood on both sides; explicitly reward leaders on both sides for delivery of medium to long term value.
Use the deal as a catalyst for improvement/transformation	**Execution success factors**
Rapidly assess value-drivers, innovation (external and internal), and differences in operating models and outcomes between buyer/target; objectively question the buyer status quo and be ready to transform/innovate across the business to drive new value (not just synergies) from a 'best of both' approach.	Define the Target Operating Model by function, be explicit about when it's a legacy buyer, legacy target, hybrid or new model; assess which functions/customer relationships/countries should not be integrated at first in order to protect acquired business value or minimise regulatory exposures; implement a portfolio approach to projects, mixing integration projects with transformation projects, and balancing complexity, risk and value; communicate a vision, not just a rationale, and do so by function as well as for the whole business; communicate to all staff early, frequently and consistently about the timing, delivery plans and status against delivery plans.

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Consequence of failure:

Miss a one off opportunity to transform outdated processes and operations, destroy value 'under the covers' in the target, under deliver on top line and bottom line synergies.

Accumulate

CP companies are finding it harder than ever to achieve year-on-year growth. This challenge lies behind the surge in Accumulate M&A deals across the industry. These deals can create new opportunities to expand market share and achieve scale, and they're getting bigger all the time.

Key strategic priorities for these scale-deals include:

Identify and deliver economies of scale without destroying value	**Execution success factors**
Expect significant cost reduction options; speed to value is essential, but risk assess all measures first.	Integrate early and focus rigorously on maximising synergies between the two companies as fast as possible across the entire value chain, including the customer trade terms. There's never a 'perfect time' to restructure and cut overheads so, if it needs doing, do it quickly and minimise any period of uncertainty for critical staff. Especially in sales and marketing, these functions are key to protect business as usual and win market share from competitors, so ensure they're integrated into the new organisation's culture and values as soon as possible. Communicate to all staff early, frequently and consistently about timing, delivery plans, and status against delivery plans.
Drive growth as well as efficiency	**Execution success factors**
Accumulate deals can provoke offensive and defensive reactions from competitors and customers. Where possible, plan for them and be ready to react when needed.	Monitor market trends closely; develop analytics capabilities to enable trend prediction and proactive decision-making; pay particular attention to customer communications and explicitly plan and manage the customer trade terms integration. Done well, this can deliver tremendous value and mitigate significant risk.
Manage the competition authorities' regulatory processes and the integration to avoid any unnecessary delay in realisation of deal value	**Execution success factors**
Right from deal announcement, be ready with a well-developed strategy for navigating the regulatory process; lean towards solutions that will enable rapid approval (provided they don't undermine the core deal rationale).	Inform your dealings with regulators with as much 'real life' insight from integration planning teams as possible; leverage 'playbooks' from earlier acquisitions; change management planning is key; where possible, 'lift and shift' buyer's operating model into the target and allow deviation only where there's a proven business case for doing so.

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Consequence of failure:

Deal value reduced by not delivering the integration synergies, miss a one-off opportunity to transform outdated processes and operations.

The vendor perspective – identifying the right execution approach

Vendors in these deals have their own strategic priorities. How effectively they execute divestments will govern how much value they can realise. At a high level, the strategic rationale and execution approach for each of the three classes of deal is summarised in the graphic below. We also provide more detailed recommendations based on our experience advising sell-side clients in the CP industry.

Incubate

Strategic Rationale

Early stage exit to realise investment or if not strategically important to core portfolio.

Execution approach

Flexible approach to meet specific buyer requirements - fully standalone vs. Brands/IP/core technology.

Recommendations

Present a credible, motivated leadership team with a history in the business of setting strategy and running the business without a high level of 'owner' intervention.

Present a clear strategy for how customer relations and route to market is secure and could be leveraged.

If a carve out, be clear if the business is fully functional as a standalone – show some history. Think through how to present non-core value chain operations (support services) which a buyer may want to replace with their existing functions, e.g., Finance, HR.

Have a TSA (transitional service agreement) strategy that is low distraction and easily supported but provides buyers with feasible options. Mobilise a dedicated TSA management office.

Innovate

Strategic Rationale

Corporate restructure, realise value constrained by cultural or historic factors, exit business outside of portfolio strategy or competition authority ruling.

Execution approach

Flexibile approach to optimise value: trade off maximised EBITDA vs. minimised stranded costs.

Recommendations

Be very clear what the value drivers are and how they can be leveraged by an 'Innovative' acquirer focussed on value creation e.g., new geography or category implications, 'leading practice' capabilities or competencies.

Present a clear strategy for how customer relations and route to market is secure and could be leveraged.

Ensure there is clear strategic leadership of each critical function inside the divestment perimeter, e.g., CIO and CMO, so acquired business has required capability to drive the business under new owners.

If a carve out, establish how to present independence of key value drivers e.g., New Product Development, Route to Market, Intellectual Property and Supply Chain, even though this may result in some dis-synergies.

Have a TSA (transitional service agreement) strategy that is low distraction and easily supported but provides buyers with feasible options. Mobilise a dedicated TSA management office.

Accumulate

Strategic Rationale

Divest or sell to buyer with larger scale or ability to leverage synergies.

Execution approach

Maximise value by focusing on optimising synergies for buyer.

Recommendations

If a carve out, decide early on how to present the standalone, e.g., maximum EBITDA, and if so what to do with stranded costs.

Maximise the opportunity for buyer synergies – present a view as to what seller considers achievable. Cost synergies are 'bankable'; revenue synergies are strategically important.

Present a clear strategy for how customer relations and route to market is secure and can be integrated.

Anticipate pre-deal uncertainty from senior staff as roles are most at risk. Consider incentives linked to deal completion to retain high performers and protect business performance.

Be clear on how the business would be most efficiently integrated into acquirer and present the business in this way.


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Next steps

This short paper reflects EY's insights and experiences across hundreds of deals, big and small, in the consumer products industry. The impacts of globalisation, and disruptive use of technology and innovation in particular, have meant that consumer products organisations need to look beyond market dominance through scale alone. This is reflected in the complexity of the deals they are doing, requiring an increased focus on the alignment of the deal's strategic objectives and its execution.

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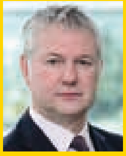

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