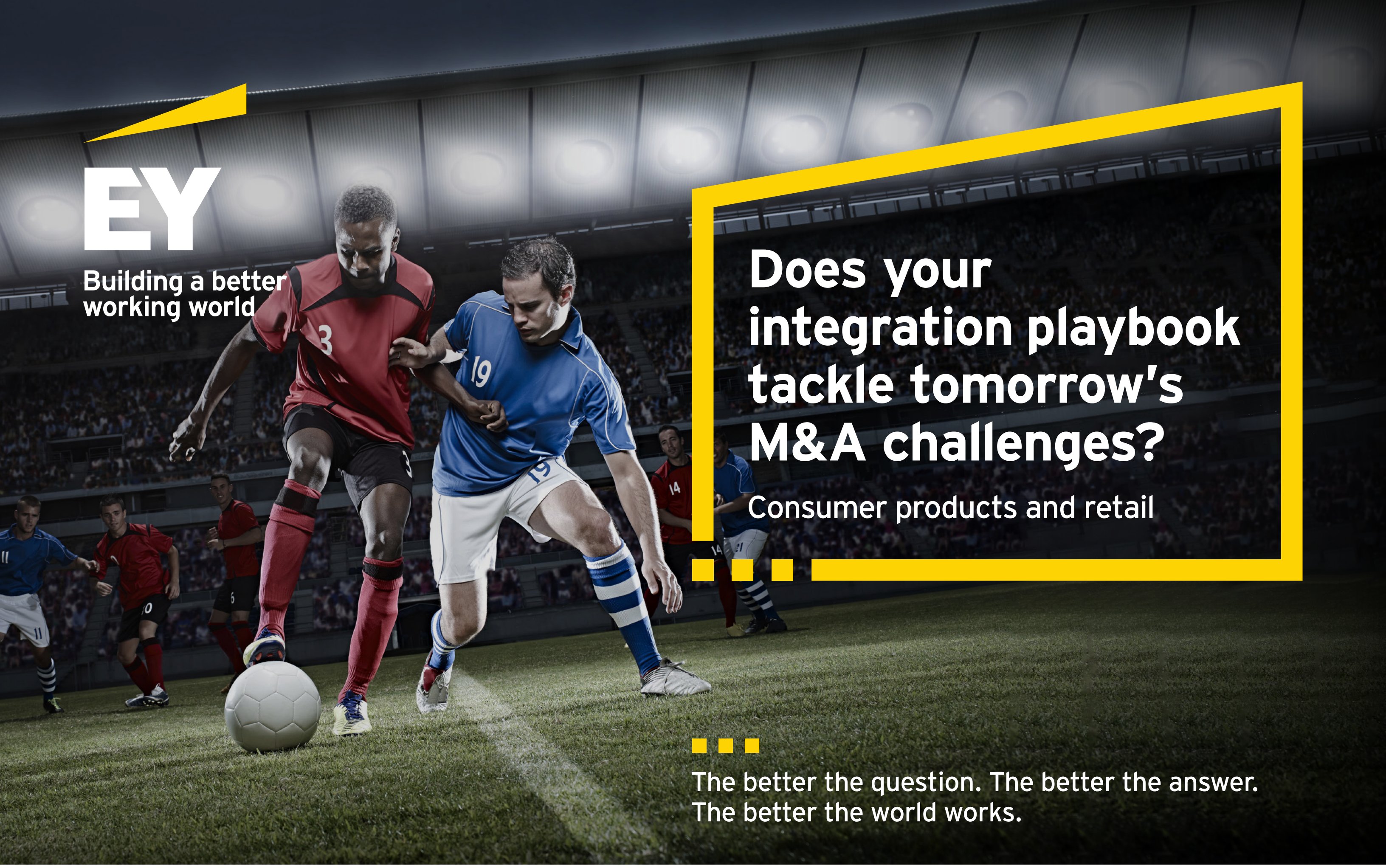

Does your integration playbook tackle tomorrow's M&A challenges?

Consumer products and retail

The better the question. The better the answer.
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Different playbooks for different goals

The consumer products and retail (CP&R) sector has seen strong M&A activity, with the biggest household names hunting for revenue growth after years of cost cutting. Many targets are fast-growing, entrepreneurial companies that have built a close bond with their consumers. The methods and metrics for integrating these companies without diminishing what makes them attractive are far different than in the integration of a larger acquisition built on potential cost synergies.

The traditional consumer packaged goods (CPG) model is coming under significant pressure as the success levers once seen as competitive advantages are now being eroded. The scale economics of the traditional company-owned supply chain are diminishing as highly efficient contract manufacturing is readily available. Traditional mass media channels that once held sway are being displaced by digital and social media. E-commerce is replacing the traditional distribution channels. Retailers are responding to consumers with products from smaller manufacturers that are more on trend. The infrastructure and corporate culture that has built up around decades-old megabrands no longer attracts the talent and skills it once did — and digital natives taking their first career steps are drawn to different career paths.

Companies like Kind Healthy Snacks point to the future of the consumer sector: small, nimble businesses offering niche-focused products — in this case, gluten-free whole nut, fruit and granola bars that meet consumer demand for healthy, convenient food.

Rent the Runway is another example: an online high-fashion dress rental and subscription service, delivering a rotating selection of high-fashion brands to consumers. This is a tech-driven business model built on analytics, and carefully measured and monitored metrics.

About this report

This report is part of the EY 2018 *Buy & Integrate* series of sector-specific reports that encourage CFOs, CDOs and transaction leaders to take a fresh look at how they identify and capture synergies during M&A. In the reports we suggest leading strategies to improve your M&A and integration playbook.

For more EY *Buy & Integrate* perspectives, see the reports:

- Advanced manufacturing
- Health care
- Life sciences
- Technology, media and entertainment, and telecommunications

One-size integration playbooks don't fit all

In many CPG categories, small players are capturing the bulk of the volume growth, appealing to consumer trends while being asset-light — many outsource manufacturing, back-office functions and other traditional CPG capabilities — and are using social media as their main marketing tool.

This growth, and the potential to drive it even further, is attracting buyers. Often times they are looking for access to unique brands that are winning with a new consumer trend, access to new channels, and/or new ways to reach consumers. Growth can be the key driver, rather than cost synergies. In an EY analysis of deals from 2010 through 2018, CPG companies reaped average realized cost synergies of 5.7% of target revenue and announced cost synergy of 9.9% of combined sales, general and administrative (SG&A) expenses on average. These figures are in the low-to-middle range of the sectors examined.

CPG CEOs and CFOs need to be clear on how the strategic rationale for any acquisition should drive integration plans. The degree and pace of integration may differ whether the deal is in the context of a merger for growth or cost synergies. The solution isn't rewriting the integration playbook for all deals. Instead, it could be having two different playbooks — one for smaller deals focused on growth and one for larger acquisitions focused on cost or consolidation. Below are some integration considerations depending on the type of acquisition.

Acquisition rationale leads to distinct integration plans

Large acquisitions tend to generate cost synergies because they can get pulled into the buyer's operating model quickly. Smaller acquisitions don't necessarily focus on cost synergies.

Two deals involving the same large US consumer products company highlight different approaches that demonstrate flexibility. In one deal, the acquirer bought a majority stake in a startup with distribution though a peer-to-peer e-commerce platform and a stated social mission. It let the founders keep a minority stake and kept them in place to run the company. At the same time, the buyer said it planned to deploy its R&D facilities and its supply chain capabilities to help grow the business, bringing scale advantages to boost new product development. In this case, merger integration was very focused on specific elements of the value chain, allowing the acquired business to maintain the flexibility to continue its successful relationship with its consumers.

> "Buyers are often looking to acquire a unique, fast-growing brand that has a strong bond with consumers. The key is to not crush what makes the brand unique when integrating it into the organization."
>
> **Greg Stemler**
> EY Americas Consumer Products & Retail Transactions Leader

In a more transformative deal, the company merged its business with a large CPG portfolio. Its public messaging about the deal included large cost synergies, distribution rationalization and margin improvement — employing the traditional merger integration playbook.

Therefore, in a larger deal, cost synergies can be paramount and integration plans need to focus on capturing them as soon and efficiently as possible. In a smaller deal that could be predicated on buying a growing business, or acquiring even capabilities, such as e-commerce and social media expertise, there is more room to let the acquired business operate outside of the main organization, at least for a time.

Aside from buying other CPG companies to add capabilities, EY research shows that between 2008 and 2018, big consumer products and retail companies bought up nearly 350 tech firms in deals worth more than US$76b. Tech-driven capabilities, such as same-day delivery, were a big draw. US retailer Target's acquisition of both transportation technology company Grand Junction and same-day delivery specialists Shipt underlines the allure, and also the need to understand what aspects of an acquisition are most important to integrate.

Communicate for talent retention and business continuity

Larger deals can cause uncertainty for employees of both companies — employees can be worried about how the deal will affect them and whether they will continue to be part of the larger company. Communicating the integration plan, developing an associated change management and communication plan for all employees, and then executing quickly can help make things more clear.

When a smaller company is purchased, however, the uncertainty falls almost completely on the employees of the target company. The buyer needs to be clear that the acquisition target will stand alone, and that sales incentives and performance metrics will remain the same in order to help alleviate concerns and retain talent. For example, when Mondelez announced it was acquiring cookie maker Tate's, it made clear that it would operate Tate's as a standalone business in order to "nurture its entrepreneurial spirit and maintain the authenticity of the brand," while simultaneously helping expand Tate's distribution.

Case study: capturing synergies while maintaining a target's unique attributes

Challenge

A multinational retailer acquired a competitor to expand its store footprint. This complex carve-out situation required transition services. EY developed an integration plan that balanced the need to preserve the target's unique business model as both a quick service restaurant and retailer, while aiming to provide synergy delivery with no business disruption on Day One and that the target business continued to show top-line growth.

Approach

The integration plan was custom built to the situation since the acquirer wanted to keep the two companies separate until it was sure there was no disruption to the acquired business after the transaction closed. In this differentiated integration approach, services were being provided by both the seller through a transitional services agreement (TSA) and by the buyer to the separate, standalone business, while at the same time the buyer was looking to ensure that synergies were realized. Detailed bottom-up synergies in areas such as marketing and maintenance were examined to develop a targeted view of synergy realization through resource reallocation, vendor renegotiation and price differentiation. An online reporting platform and underlying analysis were used to measure the progress of integration plans, synergies, TSA costing and exit plans.

Result

The company was able to reduce costs by exiting the TSA early, realizing cost savings through merchandise procurement, assortment changes and general and administrative optimization — including marketing spending and logistics. More importantly, there was no business disruption at the target on closing of the deal, supporting a strong foundation for growth of the combined businesses.

Decide who you need to retain

The aura of a smaller, growing brand could be centered on its founder. So, the buyer needs to figure out how to keep that founder involved even though the founder may have just reaped a financial windfall and, therefore, has less motivation to work. For example, the acquirer could give the founder creative responsibility for the acquired brand, or maybe a retention bonus or other incentive. But it is also important to find out who beyond the founder has key relationships, be they with consumers, suppliers or others. It could be somebody in marketing, R&D or sales. In one particular deal, the buyer discovered one employee who had connections across the business, but whose job title would never have indicated the employee's importance. So, it is incumbent upon the buyer to look past the obvious.

Don't destroy a small acquisition with heavy integration monitoring

When integrating a larger deal, arduously tracking synergies against a well-defined road map and issuing weekly updates to keep the integration on pace to deliver the promised value is essential.

But that same rigorous measurement and communication can shock and stifle the spirit of an entrepreneurial company. The business likely had its own success metrics, such as revenue growth or distribution points. If the company is operating as a standalone, focus on those metrics when monitoring performance.

A related issue is who is in charge of the newly acquired business. In a larger deal predicated on cost synergies, the target will typically be woven into the existing management structure.

For an acquisition that is being set to run on its own, a rising star from the buyer could be put in place as a general manager. This person will be familiar with the acquirer's practices and can make sure the new acquisition is meeting requirements like potentially stricter quality standards. But that person also likely is fresh enough to not feel completely bound by the acquiring culture and can still let the new acquisition have some flexibility.

Conclusion

Value creation comes from tailoring an integration plan to the specific deal. Is the goal cost reduction or enabling the burgeoning growth of a newer business? The playbook used in the large deals that produce major synergies could stifle the growth of a smaller addition. Having different playbooks for large and small deals could be the key to realizing the biggest benefits from any type of deal.

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