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Trends in Postmerger Integration VII

PMI for Consumer Goods

Finding the Opportunities

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AT A GLANCE

As most of their markets have matured, many consumer-goods companies have turned to acquisitions for growth. Yet these deals often fall far short of delivering the expected value because of the complexities of bringing companies together.

Focusing on the Value Drivers

To cut through that complexity, it's best to maintain a disciplined focus on the areas that will drive the expected gains. Detailed planning and information gathering well before the closing date can ensure that those areas get proper attention.

Challenging Assumptions

While acquirers need to stay focused, they should also be open to learning about the specifics of the value drivers. The acquired company may have lower costs or superior processes. Scale economies can generate unexpected savings in areas such as working capital.

Balancing Costs and Growth

When the key drivers are in marketing or selling, integrators need to be careful about cutting costs that will hinder the expected sales gains. Often that depends on training the marketing and sales teams to better coordinate their efforts.

Acquisitions are an important strategic lever for many industries, and this certainly holds true in consumer goods. With organic growth slowed in developed markets, executives are looking to ramp up their business through purchases. Yet we've seen numerous examples of acquisitions failing to deliver much of a boost. Some failures are caused by inadequate discipline—weak strategic logic or overpaying—during the deal-making phase. But many more deals fail when pursuit of the underlying rationale gets lost in the ordinary complexities of the integration and the integration is run poorly.

Some companies have certainly succeeded with integrations, as we can see in The Boston Consulting Group's research into the "value creators." These are the companies that created the most value for shareholders, in absolute dollars. Looking at consumer goods, the 30 greatest value creators made numerous acquisitions from 2002 through 2011. Nearly all the nondurable-goods companies, in fact, were serial acquirers, and many companies in durable goods acquired frequently as well. (For more on this research, see *The 2011 Consumer Value Creators Report: Gaining a Value Creation Advantage in Volatile Times*, BCG report, November 2011.)

Many deals fail when pursuit of the underlying rationale gets lost in the ordinary complexities of the integration.

What makes for a well-run integration? To find out, we undertook a lengthy research project examining 25 integrations of consumer goods companies. This report, the seventh in BCG's series on PMI, examines the drivers of success that we observed in the project. We focus on the special challenges and opportunities that consumer goods companies face in tying acquisitions together. We look at durable-goods companies as well as nondurables, but not at service companies.

Value Drivers and Risk Factors

To understand those challenges and opportunities, let's start with why acquisitions have become so popular in these sectors. Perhaps the biggest driver has been the benefits of scale within categories, especially for fast-moving nondurable consumer goods. Improvements in logistics over the past 15 years have reduced the cost of complexity, enabling companies to handle a much greater volume and scope without escalating costs.

Complementing this trend has been the reversal of the earlier trend toward broad diversification. In the 1980s and 1990s, companies such as Altria and General Mills sought growth and stability with acquisitions in a variety of consumer sectors. With narrower diversification now preferred, companies are selling those divisions to acquirers looking to consolidate their existing categories.

Separately, companies are seeking growth in countries that were once closed to them, especially in emerging markets. Most sectors in the affluent countries are mature. Liberalization has created an instant opportunity, and many players are buying and integrating operations rather than building their own. Of the 30 companies creating the most value for shareholders, all but 4 made cross-border acquisitions. More than half of all acquisitions were in this category. Given the slower growth rates in home markets, these opportunities are especially important.

Clumsy integration can not only drain brand equity but also provoke a mass exodus of talent.

At the same time, consumer goods integrations often face unique challenges. Consumers and employees tend to take great pride in consumer brands and can react strongly against tinkering by acquirers eager to achieve scale economies or growth. Merging companies can also have significant cultural differences.

Loyalty to brand and culture is an asset to organizations and must be respected. These intangibles can make an acquisition worth far more than the value of the underlying hard assets. Clumsy integration can not only drain brand equity but also provoke a mass exodus of talent, as has happened in some recent large deals. Proceeding too cautiously, however, can leave potential gains on the table and erode the deal's original rationale.

Acquirers can best manage that balancing act by clarifying their goals for the deal. Before jumping into the integration, they'll want to specify where they expect to create value. In addition, key sources of risk should be clearly identified and prioritized, and mitigation actions should be developed. These value drivers and risk factors should determine much about how an integration should be organized and executed. (For the basics of postmerger integration for any industry, centered on the value drivers, see *Powering Up for PMI: Making the Right Strategic Choices,* BCG Focus, June 2007.)

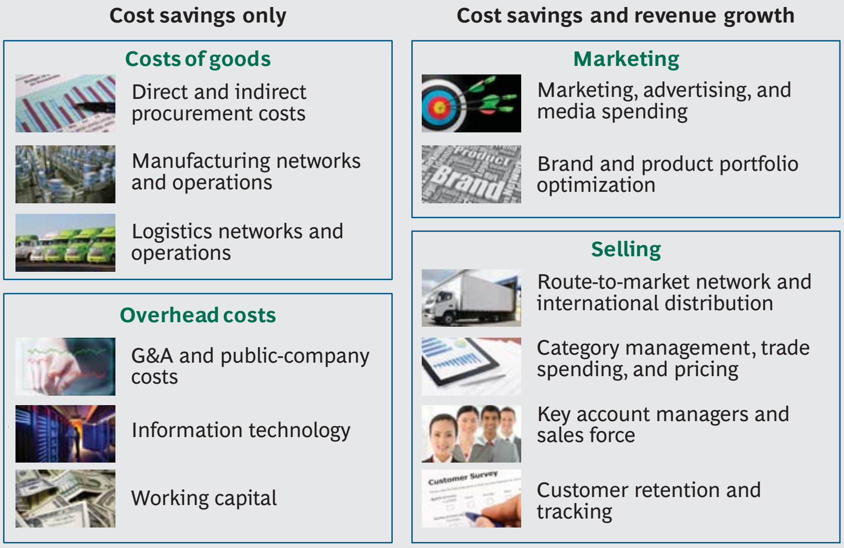
In this report, we'll explore the four areas where value drivers can be found—costs of goods, overhead costs, marketing, and selling—and the associated implications for integration. (See the exhibit "Twelve Value Drivers for Consumer Goods Integration.") For each area, we'll examine an integration in depth to suggest how the dynamics can play out.

Reducing Costs of Goods

Costs of goods sold are typically a large part of the overall cost structure for consumer goods manufacturers. As long as there is some overlap in categories, an acquisition provides scale in production and distribution. Acquirers gain leverage in procurement as well, so they can work to equalize supplier prices around whichever company has the better deal. Scale brings some advantages for product design and production methods as well. (For a broader look at manufacturing and procurement savings for companies in all industries, see *Trends in Postmerger Integration II: Thinking Laterally in PMI,* BCG Focus, January 2008.)

The challenges and opportunities in the effort to reduce costs of goods are opposite sides of the same coin. Potential gains are often far more than expected—but to

Twelve Value Drivers for Consumer Goods Integration



Source: BCG analysis.

realize those gains, the acquirer needs to be truly open to learning from the acquired company. Close collaboration and creating an environment of engagement in the integration-planning phase are fundamental. A key enabler is selecting and empowering leaders from both organizations to lead the integration synergy-planning teams. The goal is to create a clear, fast-paced, and intensely interactive approach with weekly meetings, frequent workshops, and readouts to the integration steering committee.

Acquirers must be willing to think big. Stretch targets for synergies will help here but aren't enough. Project managers need to challenge assumptions on both sides—assumptions that often arise from pride in their own operations.

What does this mean for integrations? Especially where the expected reductions in costs of goods are large, acquirers will be under pressure to move quickly. They'll want to focus the integration on these value drivers. At the same time, they'll need to learn a great deal early on in order to realize the full opportunity. Otherwise, they'll leave value on the table.

A major durable-goods manufacturer discovered this when it acquired a smaller rival. The acquirer expected $350 million in synergies, largely from shifting production of overlapping product lines from some of the target's small factories into the acquirer's much larger and underutilized plants. Together, the two companies were spending $6 billion on purchased goods and services—yet the acquirer expected only $80 million in gains there. Most of those estimated gains would come from the lower prices the target would receive after the integration.

The acquirer's engineers were confident to the point of arrogance that their own operations would gain little in procurement. But the company's leaders decided to push harder, especially in one product category. Before the closing, they assembled a "clean team" to analyze manufacturing data from both companies.

Like most clean teams, this one enabled the acquirer to get a jump-start on integration planning. A team of outside analysts went over the target's information on production and design and recommended how to proceed. The acquirer also set up internal teams to start work on other aspects of the integration—sketching out plans and organization charts beforehand.

The acquirer's people were stunned: in several important areas, the target was getting lower prices from suppliers!

When the deal went through, the clean team emerged with detailed analyses showing the possible gains. Within hours of the closing, managers from the different manufacturing groups were jointly poring over the clean team's analysis. The acquirer's people were stunned: in several important areas, the target was getting lower prices from suppliers! The target also had some superior product designs that saved money in production. But the managers couldn't argue with the data. Bigger wasn't necessarily better.

With the clock ticking, the integration teams quickly incorporated the clean team's analysis, adjusting their plans and charts accordingly. Much of their work depended on harmonizing product lines—achieving efficiencies without disrupting offerings for retailers and consumers.

They also went beyond the usual project-management processes and set up detailed road maps for the major synergy gains. Road maps add rigor to the work and are useful for long and complex integrations, which the factory and supply chain consolidations certainly were. This extensive discipline kept the gains on track even when most of the integration was done and the combined organization had otherwise moved on.

As a result of all this advance work and discipline, the actual cost savings amounted to $550 million. Procurement savings totaled $200 million, or more than double what was expected.

That was only during the main phase. The merged company soon realized it could also consolidate factories for production lines with only slight overlap. Yet the acquirer realized with some regret that the savings would have been a good deal greater if the integration teams had been more ambitious from the start.

A broader and more aggressive effort to discover cost savings—the key value driver for the merger—would have generated savings much earlier than actually happened, boosting the net present value of the acquisition even further. Targets and incentives that might have seemed ambitious at the start turned out to be unduly conservative.

Reducing Overhead Costs

Acquisitions provide opportunities to reduce a variety of overhead costs as well. These include the straightforward gains in making one company out of two. One of the headquarters can usually be closed and much of its financial and legal functions eliminated almost immediately, generating a quick gain as well as avoiding confusion in the new organization. Other corporate costs usually fall with consolidation, and staffing levels can be reduced. Those costs include spending on information technology.

Most acquirers are well aware of these kinds of savings and are able to realize them already. IT spending involves special considerations, because information technology reaches far into operations. But even here the opportunities are easy to grasp. More important are the less obvious areas, which can lift value creation from satisfactory to superior.

Though working capital doesn't directly affect the income statement, it can be a major drain on cash flow for consumer goods companies. These companies usually work with powerful retailers that demand generous terms. Merged companies can often use their new leverage to save substantially here, extracting cash to invest in growth, pay down debt, or fund dividends. As with cost savings, early preparation is important in order to understand the possibilities for renegotiating sales terms.

That's what a fast-moving-packaged-goods giant found when it integrated a rival. The two companies had much less operational overlap than the companies in the durables acquisition described above. So the immediate cost savings appeared to be relatively small, and the deal's rationale focused on growth. But the acquirer believed it could reduce working capital at the target by trying out some new ideas.

Although the product overlap was small, the two companies had big accounts with many of the same major retailers. The acquirer compared the terms each company enjoyed with the retailers and developed customized negotiation plans that enabled both parties to obtain a favorable outcome. The acquirer won agreements with nearly all the accounts, reducing days-sales-outstanding (DSO) for both the target's and the acquirer's brands. Both the new scale and some ingenuity helped.

Key to making the new trade terms work, however, was a series of workshops with the target's salespeople. They were wary of disturbing relationships they had built over time with the retailers, and the new approach was a big change for them. But the acquirer had prepared for the workshops and painstakingly went over the numbers to convince the salespeople that the approach made sense. Otherwise, the sales force might well have reverted to the old approach whenever negotiations stalled on future orders.

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The integration team assigned to reduce DSO also knew that it would take a long time for savings in this area to materialize. As a result, the team became part of a center of excellence that focused on the continued implementation of best-in-class net-working-capital practices.

All of the diligence paid off. The gains in working capital turned out to be enormous. Including some savings in business process optimization, the integration teams extracted total gains approaching $500 million.

Freeing up this cash was a major boost for the acquisition. It did a lot to maintain investor confidence and fund the investments necessary to realize the acquirer's plans for growth, not to mention pay down some debt from the deal. The lesson is clear: even growth-oriented deals can benefit from cost savings, as long as those efforts don't jeopardize the unique assets that the target company brings to the table.

Focusing on Marketing Costs and Revenue Growth

In marketing, by contrast, creating growth is usually at least as important as reducing costs. There are certainly many areas of cost savings. The acquirer can centralize marketing production, market research, and media buying; and major agency accounts can often be consolidated. Each organization can also benefit from sharing the other's knowledge and practices. But there's often more payoff from focusing on the value drivers from growth.

The main work is usually in optimizing the overall brand and product portfolio. Acquirers typically aim for a new lineup that adds scale and broadens the new company's reach into the marketplace, while also promoting synergies across complementary brands.

The scale advantages can play out in several ways, as a major worldwide liquor distributor found when it filled a gap in its portfolio with a popular brand. The target was essentially a one-brand company that had achieved impressive success worldwide despite having few, if any, people stationed outside its core markets. Yet that brand had recently come under pressure from new rivals, particularly on the premium side.

Because the acquirer was so much larger and had a diverse portfolio of brands, it expected to create substantial value from scale. The plan was to marry the acquired brand's central marketing organization with the acquirer's heavy local presence in most markets. The brand seemed to be highly complementary to the acquirer's portfolio.

Even growth-oriented deals can benefit from cost savings, as long as those efforts don't jeopardize the unique assets that the target company brings to the table.

The first area for synergy was in distribution, where the acquirer would work to reach the hundreds of thousands of small bars, clubs, and restaurants that accounted for much of the sales in most countries. Costs per sale would fall and sales would rise as the acquirer's existing distribution engine pushed the brand to outlets that the acquired company had not been able to reach before without expensive third parties.

The second was through a portfolio play. Unlike the acquired company, with its single brand, the acquirer could shift resources within any given market from stagnant brands to rising stars, improving the return on marketing investment.

The most important scale advantage, however, would come through the marketing plan itself. The acquired company's organization had developed a single plan and pushed it globally with little variation. But consumers' attitudes to the liquor category in question varied enormously around the world. In one country, for example, it was popular among young people meeting strangers on a high-energy dance floor. In another, it was the drink of choice for friends relaxing over food.

The acquirer looked to rejuvenate the brand by combining the central brand-marketing team brought over in the acquisition with the acquirer's marketing organizations for each country or region. The local teams would learn the distinctive attributes of the brand and then adapt them to consumer preferences in their market.

By keeping its focus on the key value drivers—especially the anticipated gains from localized brand positioning—the acquirer was able to realize the deal's potential.

The scale advantages from distribution and portfolio investment were fairly easy to achieve because the local marketers could work largely on their own. But developing appropriately local positioning for the brand was possible only in close cooperation with the central brand team.

To achieve that cooperation, the acquirer set up a separate "brand development team." One-third of its members came from the central brand team, one-third came from local marketers and others at the acquirer, and one-third were outside recruits. Each member handled a single market or cluster of markets and traveled there regularly. On those trips, he or she would work closely with the local marketing team to study the brand's potential for that market—drawing on the central brand team's work as needed.

With both sides represented, this work yielded marketing plans that honored the brand's core attributes while providing what local consumers expected from the category. The local campaigns that followed gave the brand renewed momentum in most of the world—and reassured investors worried about the cost of the deal.

What promised to be a seamless integration of global and local teams had proved more complicated than expected. But by keeping its focus on the key value drivers—especially the anticipated gains from localized brand positioning—the acquirer was able to realize the deal's potential. In the largest market, the brand reversed its slide and gained share for the first time in six years. In most other markets, sales accelerated from single- to double-digit growth.

Focusing on Selling Costs and Revenue Growth

The balancing act is similar on the selling side. Acquirers stand to gain from savings in category management, trade spending, and pricing, but those savings should not distract them from pursuing growth possibilities where they exist. In some cases, an integration can result in revenue drops, as skeptical trade customers react defensively to the acquisition. Some accounts will inevitably shift their total spending away, to regain leverage with the combined company. The losses could overwhelm gains from direct savings and from sharing best practices. It is critical to understand these risks up front and to create contingency plans against them.

Acquirers may be tempted to refrain from aggressive integration to minimize the reaction from the trade. But that could result in a substantial loss in value from the deal, as well as create confusion in overlapping sales teams. Rather than water down the changes, smart acquirers will keep their eye on the deal's value drivers and push forward, while aggressively communicating with trade customers. They'll emphasize how these customers will reap benefits from the merger—benefits that, in the case of larger deals, the trade often underestimates in its concerns over market power. In fact, a combined company can usually improve overall category management and innovation—areas where retailers stand to benefit. At the same time, acquirers should listen to retailers to understand their needs, which could then create opportunities for additional gains.

A sales force with declining productivity is the largest destroyer of value possible in an integration.

Also essential here is communication with the sales forces—and giving them a clear structure for the new sales organization as soon as possible after the deal closes. Salespeople can often achieve higher productivity through a broader portfolio. But that depends on persuading them to put energy and ingenuity into cross-selling. If instead they focus on the strongest products in a category and those with which they are most familiar, the acquirer will lose the benefits of the broadened product line. A sales force with declining productivity is the largest destroyer of value possible in an integration, so smart integrators will put extra effort into winning over the salespeople to the key objectives.

That's what a large food company found when it bought an adjacent product line that required a specialized distribution network. It expected substantial savings in distribution by combining all the specialized deliveries to grocers and convenience stores. Trucks could then deliver nearly twice the products at each retailer, with less time spent on the road.

The savings would come in two ways. In denser markets, where each company had its own trucks, the savings were direct. In sparser markets, where the companies had relied on third-party distributors combining shipments from multiple players, the new entity could now justify its own trucks and save the middleman expense.

The acquirer quickly realized, however, that reconfiguring those distribution networks was enormously complicated. It set up a clean team in order to compare routing data and generate proposals as early as possible. After the deal's closing, the project manager laid out a highly structured process with close oversight. The route integration team met weekly to go over the plans, scout the locations, and set up a prioritized schedule of route conversions. It decided to go first for the easier conversions, in order to demonstrate the concept with small pilot routes, and then move quickly to the routes with the greatest size and impact. As with the other integration teams, the routing team had a base target and a stretch target, with a sizable performance incentive. Time, after all, was money.

The preparation here and elsewhere in the integration was so strong, however, that an unexpected problem arose. So much was decided so quickly that when the acquired division's managers came onboard, they wondered if their input was really heard. Time pressures had led the various integration teams toward unilateral decision-making rather than seeking consensus. Roles were uncertain, and the new routes raised anxieties. There was quite a bit of friction, but soon the project management office got on the issue. It served as an intermediary between the integration teams and the acquired organization, helping to address all the back-channel chatter.

These and other issues came up early during the integration, as the teams had worked on strengthening communication in order to surface just these kinds of problems. A detailed initial survey revealed cultural differences and highlighted those that needed alignment. Monthly pulse checks served to assess progress and identify "hot spots."

The route integration ended up working so well that the combined company realized an unexpected single-digit percentage gain in sales in most markets. It also saw a drop in sales costs of 40 percent more than estimated during due diligence. By spending less time on the road and more time in stores, and by eliminating the third-party distributor, the truck drivers could now do much more selling. They were visiting the stores frequently—far more often than rivals' conventional sales forces. That enabled them to push hard for extra shelf space or an endcap tied to a special promotion.

The Balancing Act

Acquisitions in consumer goods can add a great deal of value, but only if the integration teams stay sharply focused on the key sources of value and risk that the integration brings. (For estimates of the potential value from integrations, see the sidebar "Likely Gains for Consumer Goods Integrations.") They need to prepare extensively, move quickly, and follow a rigorous process. At the same time, they must be open to the opportunities that may emerge, while also tackling organizational and cultural issues head-on with the same rigor they use to tackle opportunities for synergy.

LIKELY GAINS FOR CONSUMER GOODS INTEGRATIONS

Just how much can consumer goods companies expect to gain from integrating an acquisition with a focus on the key value drivers? Every acquisition is different, but we can start to give an answer by looking at past examples. BCG tracked the gains from 25 acquisitions and collected them in its synergy database in 2010. Let's look at the range of gains from cost reductions and revenue growth.

Costs of Goods. These costs accounted for an average of 70 percent of total spending, which is why this is the first area most acquirers look at. We calculated the savings for each value driver as a percentage of the smaller company's costs in that area. Excluding outliers here and in the other areas, we found that savings in direct and indirect procurement costs amounted to 3 to 8 percent, savings in manufacturing networks and operations were 3 to 15 percent, and savings in logistics networks and operations ranged from 0 to 40 percent. As we saw in the example of the durable-goods manufacturer, those savings arose from a mix of near-term quick wins and longer-term restructuring.

Overhead Costs. Here we focused on G&A, IT, and public-company costs,

LIKELY GAINS FOR CONSUMER GOODS INTEGRATIONS
(Continued)

which represented about 8 percent of total cost structure. (We left out reductions in working capital because they were one-time gains.) These three cost areas are hard to separate when calculating savings, so we combined them and found that the gains amounted to 40 to 80 percent of the smaller company's costs. Most gains came in the near term, within 24 months of the deal's closing.

Marketing and Selling Costs. Combined, marketing and selling accounted for an average of 22 percent of total costs. Savings varied enormously, from 2 to 25 percent of the smaller company's costs. Acquirers achieved them from a mix of quick wins and longer-term restructuring.

Adding up the three major categories of costs, we found that total savings from deals ranged from 2 to 17 percent of total costs for the smaller company.

Revenue Growth. As expected, results varied enormously here. We found that many deals led to little if any growth, while others achieved as much as a 45 percent increase in revenues over the smaller company's number. Most of those gains took longer to achieve than cost synergies—usually three years or more.

One way to do that is to make an effort to learn from the target. In each of the case studies, one company was the driving force for the deal. But people from both organizations were usually able to work closely together on the key teams. They reached a higher level of value by doing something fundamentally different, instead of just consolidating two organizations.

Balancing rigor and clear objectives with openness is important not just for discovering unexpected gains. It will also make the acquirers more sensitive to the concerns of the new people coming onboard—and more likely to benefit from their talents. When done well, this balancing act can lead to substantially higher integration synergies and a higher-performing organization.

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