Staying healthy

Integrating niche acquisitions without eroding value in Consumer Products
Integrating niche acquisitions without eroding brand value

Consumer Products (CP) companies are increasingly acquiring niche brands; an example of this is in the health and wellness space.

Most often, acquired brands are often kept stand-alone and not integrated with the parent to minimize business disruption.

With the stand-alone model, acquired brands fail to meet revenue and earnings growth expectations.

What’s needed is an operating model that balances brand equity with commercial growth.

Keep the true drivers of brand value stand-alone and integrate everything else.

Be objective about what truly drives customer and brand value.

"We know we are going to make additional niche acquisitions: that’s our growth strategy. Yet we don’t have a clear picture of the long-term operating model."

Head of global M&A, Fortune 100 CP company
Are you driving the most value from your niche acquisition?

In a bid to capture the next generation of growth, large consumer products companies are acquiring niche brands. For example, in Food, healthy or organic food brands are attracting significant interest. Although the food market has been relatively stagnant, the organic segment has enjoyed robust growth in recent years. Sales in the sector are set to top US$100b in 2015.

Similarly, M&A activity in the health and wellness industry remains strong, with deal volume doubling between 2009 and 2013. Most deals are focused on niche targets. With the overall M&A market set to improve steadily, according to nearly two-thirds of the consumer products respondents to EY’s April 2015 Capital Confidence Barometer, food majors are well placed to pick up the pace of niche acquisitions.

The challenge, though, lies in driving value from these deals. Without a balanced operating model, niche acquisitions can go wrong. So far, the most prevalent strategy has been to keep the acquired brands as stand-alone entities, with little or no integration with the parent. But major food companies are re-evaluating this strategy. Revenue and earnings for niche acquisitions haven’t always lived up to expectations.

“The conventional wisdom of keeping the niche brand acquisitions stand-alone doesn’t seem sustainable over the long term. How do we integrate without eroding the brand?”

CFO, Fortune 50 CP company
The 1-2-3 of integrating niche brands

We believe that the key to making niche acquisitions work is to integrate them effectively without destroying the essence of the acquired brand. There are three basic steps to getting a niche brand acquisition right: understand and articulate the deal rationale, protect and preserve the target’s key success drivers, and integrate everything else.

The areas that drive the creative success of the acquired entity are what make it unique and are the ones that you probably don’t want to integrate. Whatever your intent, however, make sure that you communicate it right at the start of the transaction. The longer you wait, the more difficult the integration. It is also essential to work with the target to answer key integration questions and try to retain the important elements of the target’s culture. This way, you will preserve the essence of the company. “Sell” the benefits of integration by communicating its importance to creating value, and link integration-driven value to performance bonuses.

A rule of thumb is to integrate all functions that haven’t been identified as driving the creative success of the acquisition. And integrate quickly. It’s like pulling off a Band-Aid - the faster the better. Ideally, you would have your integration plans finalized ahead of closing the deal and begin executing those plans on Day One.

**Set the stage**
- Identify what drives the creative success of the acquired entity
- Clearly articulate guiding principles

**Protect and preserve**
- Collaborate on governance
- Retain the culture

**Integrate everything else**
- Sell the benefits of integration
- Integrate non-critical functions
- Integrate quickly

“What is the ideal balance of protecting the brand equity of our niche acquisition, integrity of the supply chain, and, more important, driving value from the deal?”

Business Unit president, Fortune 500 CP company

“Keeping that brand stand-alone was intended to be part of its growth strategy. Yet we have lost market share, and what is worse, our margins have reduced as well. I want to think beyond integrate vs. don’t integrate – what’s the silver bullet?”

CFO, Fortune 100 CP company
What’s the best target operating model?

There is a wide spectrum of possible operating models for niche brand acquisitions, but no matter which one you choose, your objective should be to balance brand equity with commercial growth. Alternatives range from a decentralized stand-alone model to a fully integrated functional model. Each model has distinct features, with varying strategic and decision-making roles played by the acquirer, and each has specific advantages and disadvantages.

For example, a decentralized stand-alone model increases strategic and operational flexibility, fosters an entrepreneurial culture and improves value capture in a fast-growing environment. But it also requires a high cost structure, hinders technology and infrastructure standardization, and is not suitable in sluggish market conditions.

Similarly, a fully integrated functional model improves synergies and efficiencies across all business units and divisions and promotes stronger market influence. On the downside, though, it limits the company’s flexibility and may increase the risk of establishing a “bureaucracy.” It is also more difficult to apply this model to companies with different business portfolios.

Questions to ask

What drives the niche brand’s success in the marketplace?
Which capabilities are critical to drive that success?
What functions/processes do those capabilities reside in?
Is it possible to give operational flexibility only to those functions/processes and integrate everything else?

Target operating model spectrum for the acquired niche brand

- **Decentralized “stand-alone” model**
  - Established acquirer
  - Niche brand business unit
  - Commercial functions
  - Operations functions
  - General & Administrative support functions

- **Operational flexibility**
  - Established acquirer
  - Niche brand business unit
  - Commercial functions
  - General & Administrative support functions
  - Operations functions

- **Operational control**
  - Established acquirer
  - Niche Brand business unit
  - Commercial functions
  - General & Administrative support functions
  - Operations functions

- **Fully integrated “functional” model**
  - Established acquirer
  - Niche brand BU
  - Commercial functions
  - Operations functions
  - General & Administrative support functions

Staying healthy Integrating niche acquisitions without eroding brand value
Case study: effectively integrating niche brands into an established portfolio

A fundamental change to its operating model allowed a leading international diversified food and beverage company to stop erosion of shareholder value.

Between 2004 and 2007, the company grew through a series of niche premium acquisitions. The acquisitions were managed as stand-alone businesses, primarily to prevent brand dilution. In 2008, however, declining sales and operating margins led the company to re-evaluate its business model and go-to-market strategy. The critical question to answer was: “Given that we will always be looking to expand our premium brand portfolio, what should be our target operating model?”

The company addressed this issue by using five strategic business imperatives to guide the operating model of current and future niche acquisitions. These imperatives were to “premiumize” the portfolio to yield higher margins, grow cash flow and return on invested capital, grow sales faster than expenses, build brands, and improve organizational effectiveness.

Using these guiding principles, the company adopted a hybrid operational control model that included creating a COO role to oversee all the business units. This model allowed brands to maintain control over the functions that drive creative success. Since adopting this model, the company has shown healthy growth, with Selling, General & Administrative (SG&A) dropping to 18% in 2014 from 22% five years earlier and share prices improving considerably in 2011.

Defining the guiding principles to review the target operating model options

The client wanted to use its strategic business imperatives to guide the target operating model of its existing and future niche acquisitions.

| 1 | Imperative #1: Premiumize the portfolio to yield higher margins |
| 2 | Imperative #2: Grow cash flow and return on invested capital |
| 3 | Imperative #3: Grow sales faster than expenses |
| 4 | Imperative #4: Build brands |
| 5 | Imperative #5: Improve organizational effectiveness |

Key evaluation criteria

- Alignment with overall strategy
- Flexibility to adapt to shifts in strategy
- Responsiveness to market needs
- Balance of CEO focus (internal versus external)
Using guiding principles, management chose to adopt a hybrid “operational control” model …

... to allow brands to maintain control over functions that drive “creative success”

Core value chain activities

- **Creativity and product development**
  - Creative delegated to individual brands
  - Office of the COO manages R&D
  - Product strategies are coordinated to minimize overlap

- **Advertising and promotions**
  - Advertising is prepared by the office of the CMO, in consultation with the brand leaders
  - Brands adapt to specific market needs

- **Sales and distribution**
  - Wholesale managed by brand with centralized key accounts management
  - Retail management by brands

- **Operations and supply chain**
  - Center-led procurement, logistics and inventory management
  - Manufacturing and production at niche brands driven by individual brand teams

- **Customer**
  - Centralized development of consumer intelligence reports

Corporate and supporting

- **Finance, risk, M&A**
  - Centralized financial consolidation, audit, risk, reporting, investor relations, etc.
  - Centralized Business Development and M&A

- **Human resources**
  - Centralized development of procedures and managerial tools
  - Brands manage recruiting and development of resources per corporate guidelines

- **Facilities and real estate**
  - Centralized management of corporate Real Estate
  - Retail space is managed by brands

- **IT**
  - Centralized development of technologies and solutions
  - Integrated Enterprise Resource Planning platform

- **Legal and corporate affairs**
  - Centralized legal department, licensing agreements, support to M&A, etc.
Keeping it simple: six critical success factors

We believe that the key to making niche acquisitions work is to find the right operating model to balance brand equity with commercial growth. The guiding principles are simple: keep the true drivers of brand value stand-alone, and integrate everything else. More important, exercise objective judgment regarding what truly drives customer and brand value. The following are some strategies that will improve the chances of niche acquisition success:

1. **Establish clear ownership and accountability for each initiative or project.** This also means aligning executive goals and incentives with program objectives and benefits.

2. **Focus on benefits.** Place a relentless focus on business value and link this value to financial statement line items. Define processes to sustain benefits and conduct follow-on audits. Prioritize and implement initiatives to deliver value early, create momentum, and partially or entirely “self-fund” the program.

3. **Identify unique capabilities.** Concentrate on building a priority set of business capabilities that will help differentiate the brand in the market.

4. **Set up a clear governance structure.** Create a multi-tiered governance structure and decision-making rights, from boardroom to break room and make sure to focus on milestones and outcomes.

5. **Develop a change management plan.** This will involve rigorous executive alignment up front and throughout. Define program-specific HR/talent processes, policies and infrastructure right from the beginning.

6. **Staff the acquisition appropriately.** The right people and teams will make all the difference. Pick the “best of the best” in the context of clear career and leadership development paths.
Balancing scale with focus and agility
Analysis of 2014 key deal themes and 2015 outlook in the global consumer products sector

Capital Confidence Barometer
Innovation, complexity and disruption define the new M&A market

Global Corporate Divestment Study
Closing the deal: strategies to increase speed and value

Changing gears
Volvo Cars’ Hans Oscarsson on growth, change and building a unique brand identity

For more information
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Consumer products companies are operating in a brand-new order, a challenging environment of spiraling complexity and unprecedented change. Demand is shifting to rapid-growth markets, costs are rising, consumer behavior and expectations are evolving, and stakeholders are becoming more demanding. To succeed, companies now need to be leaner and more agile, with a relentless focus on execution. Our Global Consumer Products Sector enables our worldwide network of more than 17,500 sector-focused assurance, tax, transaction and advisory professionals to share powerful insights and deep sector knowledge with businesses like yours. This intelligence, combined with our technical experience, can assist you in making more informed, strategic choices and help you execute better and faster.

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