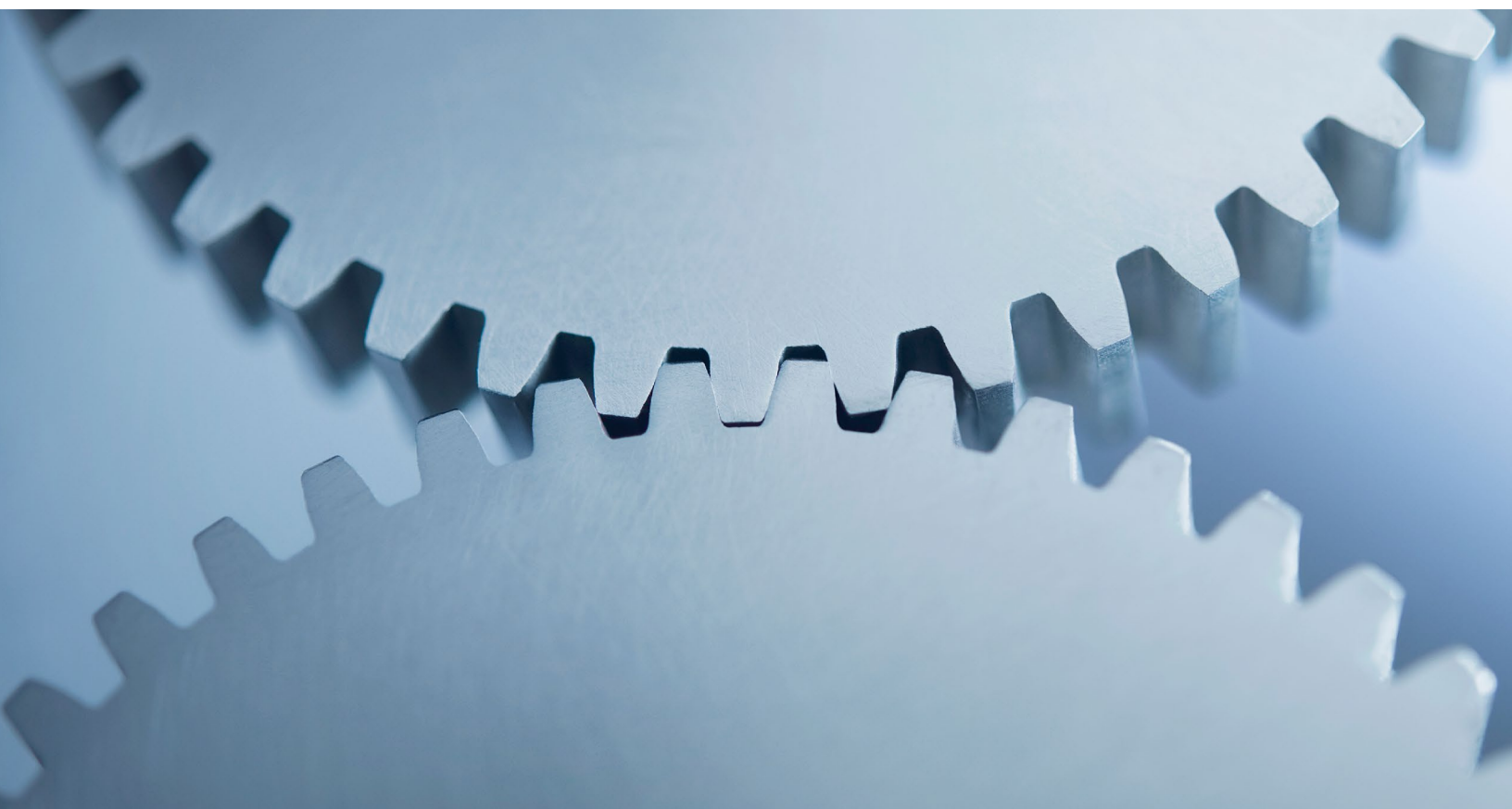


Consumer Packaged Goods Practice

The next wave of consumer M&A: Searching for growth

M&A has become more difficult of late. Consumer-goods companies need to rediscover why acquisitions succeed.

by Susan Nolen Foushee, Ed Little, Niall Murphy, Amaury Saint Olive, and Kandarp Shah



For the past 60 years or more, the consumer-goods industry has used a trusted model to grow and create value. Briefly, that model includes four elements for organic growth: brands with mass appeal, privileged trade relationships with large retailers, new ventures in developing markets, and a consistent operating model to reduce costs. M&A can supplement and accelerate organic growth by adding new brands to mighty marketing and manufacturing capabilities.¹

Today, however, growth is hard to come by, and the largest companies are encountering the stiffest headwinds. From 2013 to 2017, their real-organic-growth rate barely rose, by 1.7 percent annually, even as real GDP growth in their markets averaged 2.8 percent.

It isn't hard to find reasons why the behemoths are having trouble generating growth in their massive portfolios. Consumer preferences, especially those of millennials and Gen Zers, are shifting rapidly, and big companies are slower to respond than their nimbler, digitally savvy rivals are. Barriers to entry have come down, and newcomers find it easier to gain access to the shelf and to consumers—and they can outsource their manufacturing and supply-chain needs. Emerging brands that can use labels such as “craft,” “local,” and “authentic”—with the accompanying premium prices—evoke envy from incumbents and are proving to be worthy competitors.

The longtime accelerator of growth, M&A, has also become much harder. Acquisition multiples in consumer-goods companies have pushed higher: in six of the past eight years, earnings multiples have exceeded the longer-term (11-year) average. That's symptomatic of greatly increased competition for deals, especially from the private-equity sector: financial buyers (including both buyout and venture-capital firms) accounted for 16 percent of total value in 2015–18, up from 10 percent a decade earlier. Buyout fundraising has soared to roughly \$400

billion, on average, in each of the past five years. “Dry powder” in buyout firms has reached a record high of around \$1.2 trillion.

Despite all the available capital, a combination of higher multiples and a perceived lack of attractive assets has kept deal volumes down. In 2007, more than 2,300 consumer-goods companies were acquired. In 2018, that number fell to fewer than 1,800, and it's now in line with the level of deal activity typical of the first years of the century. Nor have these deals always met expectations. Some large, headline-grabbing deals have disappointed: after capturing cost synergies, they ceased to contribute to long-term growth. As the mix of M&A targets shifted to feature more “challenger” brands (fast-growing new companies in the acquirer's core categories), many incumbents purchased smaller targets in an unsystematic way and without enough scale to generate any momentum in their portfolios.

With both organic growth and M&A sputtering, industry performance has slid. From 2006 to 2011, total shareholder returns (TSR) of large, US-focused consumer-goods companies outpaced the S&P 500 by 6 percent. But from 2011 to mid-2019, these same companies underperformed the S&P 500 by around 3 percent a year.

Companies are on the hunt for a new model for consumer goods in which M&A will be a vital part of a resurgence of growth. But to find success, companies need to return to M&A fundamentals. In this article, we review our new research as it illuminates the results of recent M&A activities, shows how some companies have found success, and informs two of the three essential tasks for companies that want to improve their M&A work: figuring out what companies to buy (short answer: challenger brands) and how to buy them (programmatically, rather than ad hoc). (For information on how to integrate acquisitions, the third perennial question, see “The next wave of consumer M&A: Executing for value” on McKinsey.com.)

¹ Greg Kelly, Udo Kopka, Jörn Küpper, and Jessica Moulton, “The new model for consumer goods,” April 2018, McKinsey.com.

Winning M&A

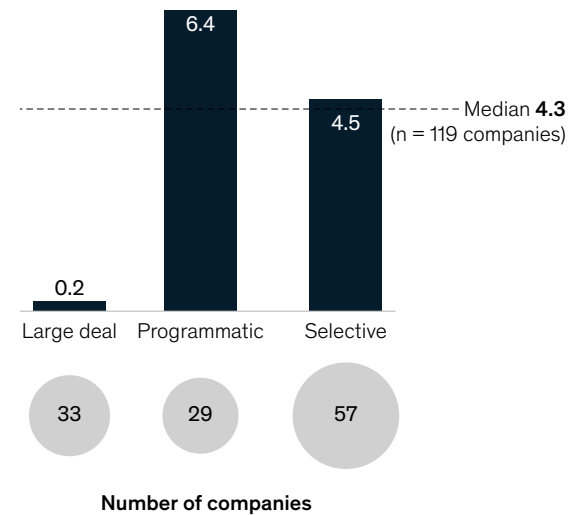
To explore how inorganic growth can be a platform for success, we studied the M&A records of 119 consumer-goods companies around the world; collectively, they acquired about 1,040 companies during 2013–18.² The research identified insights into the companies and deals that have done well in recent years.³ Thirty percent of the most successful acquirers use a programmatic⁴ approach to M&A, compared with 10 percent of the least successful companies. The least successful acquirers tend to invest sporadically, jumping on deals that seem attractive, then retreating to the sidelines. And many of the least successful acquirers show a penchant for one-off big deals.

By contrast, we see better returns for programmatic buyers whose dedicated teams follow a sequence of carefully chosen practices and behaviors, including disciplined approaches to target selection, valuation, and negotiation. Programmatic buyers generated 6.4 percent annual TSR, while large-deal buyers and selective buyers produced 0.2 percent and 4.5 percent TSR, respectively (Exhibit 1).

Exhibit 1

The programmatic approach to M&A outperformed other approaches by consumer-goods companies.

Total shareholder returns by M&A program,
compound annual growth rate 2013–18, %



What to buy: The search for growth in an overpriced world

In addition to looking at deal programs, we analyzed the types of companies that acquirers go after and found further lessons for success. In the quest to find value and portfolio momentum, consumer-goods companies have sometimes leaped into deals and found neither. Our research suggests a threefold mantra for acquirers: buy into companies and sectors that you know well; even better, buy faster-growing challengers; and go beyond your core competence into adjacent sectors only if necessary.⁵

Take the last point first. Shifts into adjacent markets were infrequent in our data set (nine of 119 companies primarily used M&A to expand into adjacencies)—and for good reason. In our research, companies that chose to “go with what you know” produced 3.3 percent TSR, while adjacent acquirers managed only 0.4 percent. Lower-performing companies sometimes made adjacent deals, perhaps reflecting their performance pressure.

Fundamentally, the move into an adjacent sector must be part of a strategy large enough to shift the needle,

² Analysis based on 119 public consumer-goods companies headquartered in the Americas, Asia–Pacific (Australia, Hong Kong, Japan, and South Korea), or Europe.

³ Our colleagues have recently conducted an overview of global M&A, using a dataset of 2000 companies. See Jeff Rudnicki, Kate Siegel, and Andy West, “How lots of small deals add up to big value,” *McKinsey Quarterly*, July 2019, McKinsey.com. Our research encompasses a larger number of branded consumer products companies with market cap exceeding \$300 million. It excludes companies in emerging Asia, as we have focused on M&A trends in developed markets. And given the meaningful changes in growth and customer behavior in the past five years, we have focused our analysis on 2013–2018 results.

⁴ Programmatic buyers did two or more small or midsize deals per year. Large-deal buyers made one or more acquisitions during the five years studied in which the purchase price represented 30 percent or more of their own market caps. Selective buyers did fewer than two deals per year.

⁵ We divided acquirers into three categories based on their approach. “Expanding the portfolio” primarily involved acquisition of brands in the acquirer’s core categories, often from direct competitors, largely in an effort to build scale. “Snapping up challengers” primarily involved the acquisition of up-and-coming brands in the acquirer’s core categories; challengers typically have strong growth prospects. “Betting on adjacencies” primarily involved entering or expanding in categories beyond the core to access new consumers or product segments in a bid to diversify the portfolio and boost growth.

as General Mills did when it bought Blue Buffalo; its sale of Green Giant also helped tilt the portfolio mix. Target companies prefer acquirers that can offer distinctive synergies, resources, or capabilities (such as access to Bel's international markets for MOM).

Challenger brands to the fore

Looking more closely at the much larger group of portfolio expanders, we found an intriguing result. The 88 acquirers that primarily bought assets or companies similar to their own produced 3.3 percent TSR. But the 22 companies that focused on challenger brands did much better, producing 6.3 percent TSR.

Small consumer-goods brands have exploded recently, helped by venture-capital firms and their astonishing \$7.2 billion investment in the past four years. Companies like Beyond Meat, Califia Farms, Caulipower, Hello Beverages, Impossible Foods, Kite Hill, Unreal Brands, and many others are setting the pace and have earned the title of legitimate challengers to the incumbents.⁶

However, acquisitions of challenger brands aren't a panacea. Their valuations often embed high growth rates. We examined transactions across categories in which enterprise value/earnings before interest, taxes, depreciation, and amortization multiples exceeded 20. And, in more than a few cases, we found that for such multiples to pay off, the acquired company would have to generate sustainable growth two times faster than the category. That said, if acquirers can pull multiple levers to generate value, even these expensive acquisitions can be worthwhile.

Portfolio-expansion deals are the most common by measures of both volume and value, except in the beauty and personal-care sectors. Such deals drive value through greater scale, often anchored in operational and overhead synergies. As advantages of scale have eroded and target companies are increasingly lean from extensive cost cutting, extracting value from these deals has become more challenging. Nor do portfolio expansions address the growth challenge consumer-goods companies

are facing. In our research, we found that only half of these companies outperformed median TSR of the total sample set (Exhibit 2).

For portfolio-expansion deals to be successful, acquirers must identify significantly greater potential for synergies beyond typical scale. We found a few examples that appeared to do so. Campbell Soup's acquisition of Snyder's-Lance strengthened its position in snacking. And Ferrero Group acquired Nestlé USA's confectionery business to gain access to strong legacy brands it could revitalize, and to manufacturing and distribution in the United States.

It's what you give, not what you get

In the search for growth within the portfolio, the focus for many companies will likely be on challenger brands. But which ones? Leading companies identify organizations for which they can be the best, most natural owners, understanding that the goal isn't to "harvest" the target but rather to bring additional capabilities or assets to bear that can steepen its growth curve and broaden market access.

Incumbents often have mature and well-resourced capabilities across the value chain, notably in long-established distribution channels, at-scale manufacturing, deeper innovation budgets, and sophisticated trade and pricing management. Using these assets can shift the growth trajectory of a target and possibly justify high valuations above and beyond cost synergies. The combination of an incumbent's capabilities and a target's fast-growing products can support an investment thesis built on momentum.

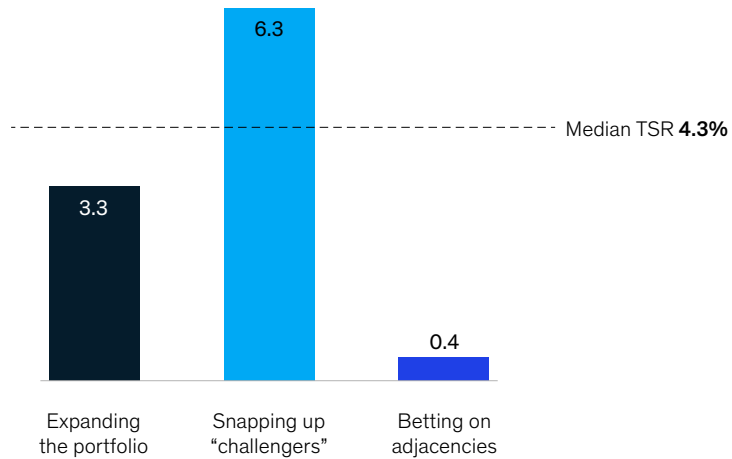
Consider distribution. In the US beverage industry, a few national companies have distribution systems that can lift challenger brands (such as craft producers or health and wellness brands) to new levels of growth. Coca-Cola has enjoyed success with the Honest Tea brand, providing national distribution, fueling innovation, and ultimately expanding the brand into a household name that straddles across categories. Similarly, a more recent

⁶ Greg Kelly, Udo Kopka, Jörn Küpper, and Jessica Moulton, "The new model for consumer goods," April 2018, McKinsey.com.

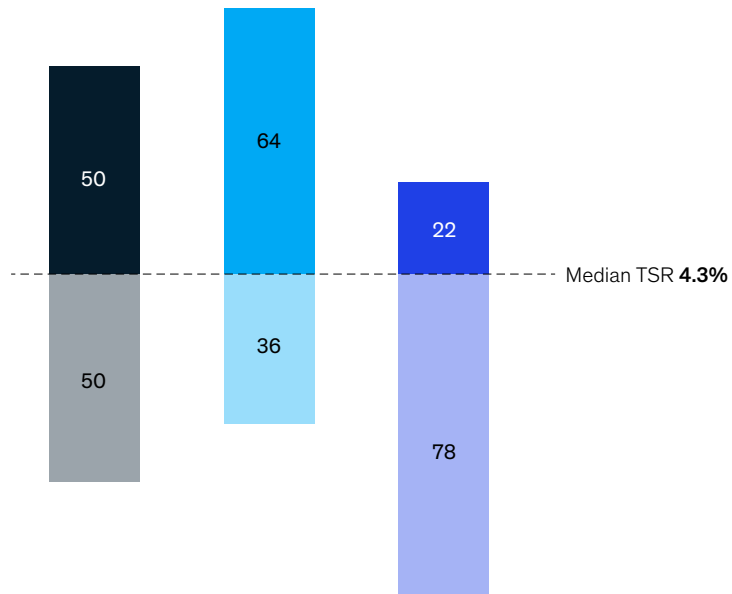
Exhibit 2

‘Snapping up challengers’ was most likely to lead to TSR above the median.

Median TSR for consumer-goods acquirers in 2013–18, %¹



Share of companies above and below median TSR, % (n = 119 companies)



¹TSR = total shareholder returns. TSR compound annual growth rate (CAGR) calculated from Dec 31, 2013, to Dec 31, 2018, with calculation adjusted if data were not available for full period. CAGR calculated based on US dollar value. Data from a sample of 119 consumer-goods companies across Australia, Europe, Japan, Latin America, North America, and South Korea; does not include retail, apparel, or durables.

investment in fairlife has fueled growth by adding broader distribution and marketing support to a strong brand and innovative product.

In beauty, Estée Lauder has achieved continuous dynamic growth by adding several brands with strong appeal to younger customers and offering them its repositioned distribution system, after it pivoted from

department stores to booming specialty retailers. The company has described M&A as a “high priority” and has used its distribution skills (especially in emerging markets and travel retail) and traditional marketing to turn several small and medium-size brands into global champions. Estée Lauder is a true programmatic acquirer, with a record of close to 15 deals in the past decade and ten in the past five years.

How to buy: Flexing the M&A muscle

In July 2019, our colleagues updated McKinsey's long-running research into the value of programmatic M&A. They confirmed two trends first seen in the early 2000s. First, a program of many deals is much more successful than other approaches. Companies using a programmatic approach delivered slightly more TSR than sector averages. Over time, the programmatic approach to M&A becomes ever more critical for growth. Of the 1,000 companies that remained in the top 100 during the entire period studied (2007–17), 60 percent used active M&A programs. Second, the research found that the “big bang” approach (in which companies make infrequent, large deals) had the worst TSR performance versus a broader index.

The beat goes on

Our research on the past five years confirms the relevance of both findings to consumer-goods companies. First, as shown in Exhibit 1, while some companies in each profile (programmatic, selective, and large deal) did well, the programmatic buyers continue to have the greatest success. The long-running trend here is that M&A is a muscle that must be built and exercised regularly.

Second, consumer-goods companies whose M&A emphasized the megadeal returned a meager 0.2 percent TSR from 2013 to 2018. It's evident that many of the largest deals in recent years have been primarily about cost savings rather than growth. And several have successfully chopped expenses. But there is a natural limit to cost reduction; if a deal doesn't also include new combinations of assets and capabilities that can stimulate growth, its returns will be capped. Of 33 companies that conducted large deals (in which the purchase price represented more than 30 percent of the acquirer's market cap) during 2013–18, 14 had a one-year TSR of negative 5 percent or lower. Some deals saw significant write-downs of the acquired companies' values in subsequent years as well.

In a way, the market may be correcting for this. We expect that large deals based on cost synergies will become harder to find because of industry

consolidation and the efforts that many consumer-goods companies are making to cut costs. And in those deals that do take place, cost synergies will become harder to realize.

How programmatic M&A works

Programmatic M&A also features prominently in McKinsey's research on economic profit and industry structure: it's one of the handful of strategic moves that can lift a company from an also-ran to an industry leader. What differentiates programmatic acquirers? We believe there are four main skills:

1. **Be strategic.** The primary strategic need for consumer-goods companies is growth. M&A has to support that strategy; it is a means, not an end. Winners use M&A to complement and reshape their portfolios; they don't let M&A dictate corporate direction. Rather, M&A is a part of an agile approach to dynamic resource allocation.
2. **Be proactive in identification and selection.** Prolific deal makers cultivate a broad range of relationships to increase deal flow and to help avoid costly auctions. They identify disruptive brands before others do, by attending trade shows, scanning social media, and collecting consumer research. Dialogue between the business and the business-development team is essential.
3. **Practice deal discipline.** This rings true across sectors but is especially meaningful for consumer-goods incumbents pursuing highly valued challenger brands. High growth rates and distribution gains ultimately face gravity. Small brands often benefit from both forces; once full distribution is reached, growth will slow. Successful acquirers walk away when valuations cannot be supported and sufficient value cannot be created.
4. **Adapt the integration approach to the target.** While integration fundamentals—a sharp focus on value creation, robust preparation, and rigorous execution—remain the same, new best practices are emerging for each deal type.⁷

⁷ For more, see Anish Koshy, Rocky Lipsky, Stefan Rickert, Rodrigo Sileatt, and Kristi Weaver, “The next wave of consumer M&A: Executing for value,” October 2019, McKinsey.com.

Constellation Brands, a leading US-based beer, wine, and spirits manufacturer, modeled these characteristics as its TSR grew by double digits annually over the past five years. The company used a programmatic approach to M&A to adapt its portfolio continually, entering or building scale in the fastest-growing categories while divesting or discontinuing lower-cost and underperforming brands. It made more than ten acquisitions and divestitures during this period. As the company's CFO said, "So everything that is not a 'power brand,' you can assume that we're either going to sell it, discontinue it, or milk it very quickly over the next year or so."⁸

As the evidence shows, M&A remains integral to growth in consumer goods. But with deal markets growing more challenging, companies must raise their acquisition game while bearing in mind three rules: go with what you know, buy faster-growing challengers, and go beyond your core competence into adjacent sectors only if necessary.

This article is a joint research effort with colleagues who studied recent post-merger integration practices in consumer-goods companies. See "The next wave of consumer M&A: Executing for value" on McKinsey.com.

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⁸ Leslie Gevirtz, "Constellation Brands to discontinue 40% of wine & spirits portfolio," *Wine Enthusiast Magazine*, February 21, 2019, winemag.com.