

M&A Practice, Consumer Goods Practice

The next normal in consumer: Implications for Consumer Goods M&A

Lessons from the global financial crisis teach us that consumer goods companies should consider an active approach to M&A, adapted to the current context, to emerge stronger in the next normal

This article was a collaborative, global effort by Harris Atmar, Sara Hudson, Anish Koshy, Stefan Rickert and Rodrigo Slelatt



COVID-19 poses staggering health and humanitarian challenges ([link here](#)). In this rapidly evolving crisis, companies must act on multiple fronts to protect their employees, customers, supply chains, and financial results. All consumer sectors will feel the economic impact of COVID-19. This impact is likely to reshape short- and long-term M&A activity, as investors and organizations explore the implications and reassess how best to shape their business and deploy and/or shore up capital. To understand how Consumer Goods M&A may evolve, we draw on lessons from the global financial crisis (GFC) of 2008–2009 and explore the impact of trends in the consumer sector that COVID-19 has created, accelerated, or reversed.

M&A in the consumer goods sector before COVID-19

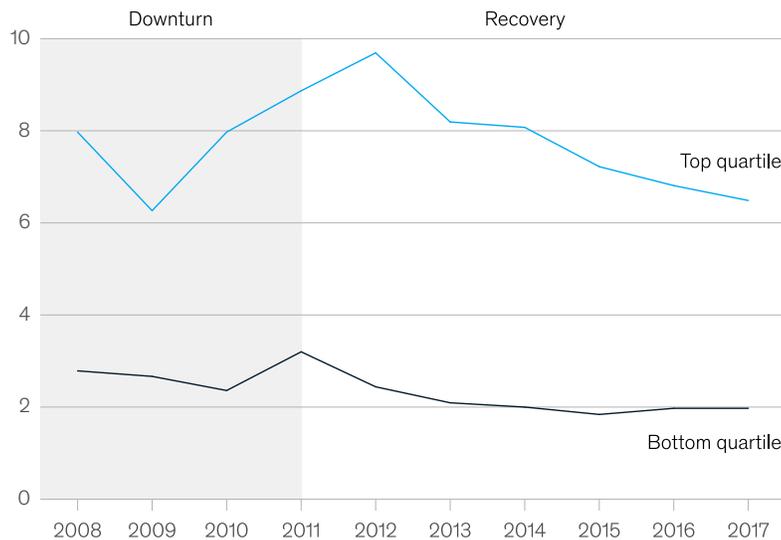
While recognizing the meaningful differences between today’s COVID-19 crisis and the GFC, we see lessons from the GFC worth considering today. Analysis of the GFC has shown that companies can drive value creation through M&A during downturns by pursuing active M&A programs (Exhibit 1). Similarly, private equity funds that were more acquisitive during the GFC outperformed their less acquisitive peers.¹

¹ Preqin Fund Data, <https://www.preqin.com/insights/2020>.

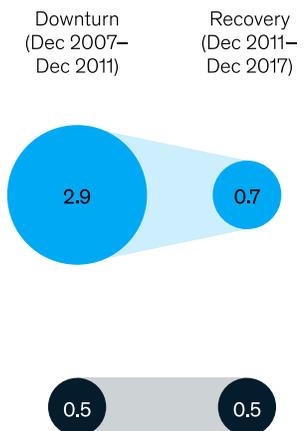
Exhibit 1

In the last downturn, the most active programmatic M&A acquirers outperformed their less active programmatic peers by about 6×

Average number of acquisitions per year for programmatic acquirers, by quartile¹



Average excess Total Shareholder Returns,²%



¹Based on deal volume.

²Calculated as the average excess total return to shareholders for each quartile. Source: CPA, Deal Patterns 2017, Thomson Reuters

All consumer sectors will feel the economic impact of COVID-19.

We evaluated Consumer Goods M&A activity from 2013-2018 in [“The next wave of consumer M&A: executing for value,”](#) which took an “archetype” view of deal activity during that five year period. We identified the three most common consumer goods deal archetypes, based on a review of 1,040 acquisitions completed by 119 companies between 2013 and 2018 (Exhibit 2). Our analysis found that companies focused on “snapping up challengers” achieved the highest median TSR (6.3 percent), while companies that “bet on adjacencies” had the lowest (0.4 percent), and companies that sought to “expand the portfolio” landed in the middle (3.3 percent). This was particularly true for those companies that took a programmatic approach to challenger acquisitions (that is, companies that did

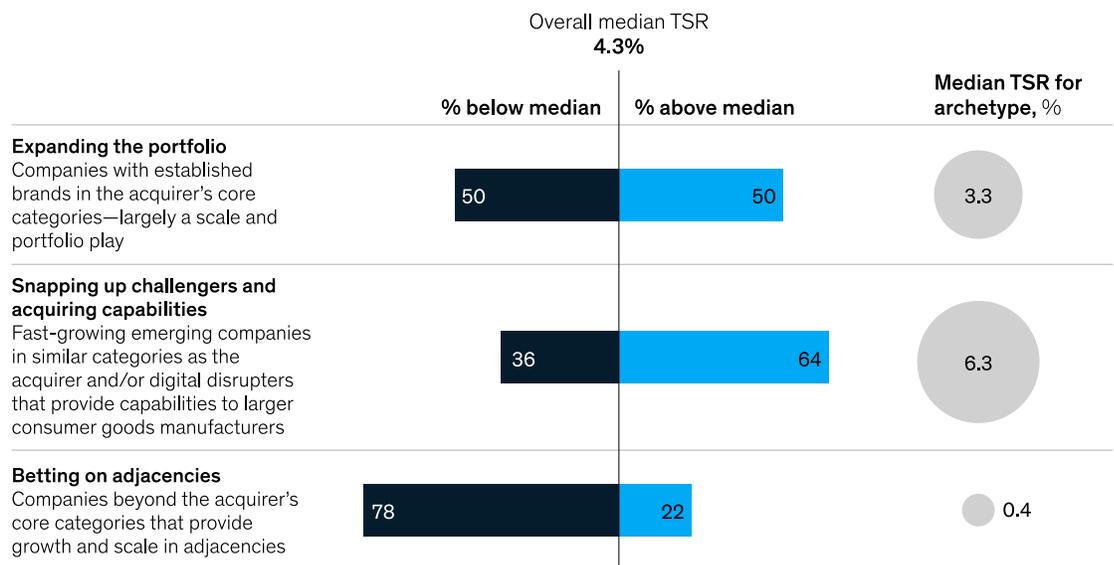
≥1–2 small to medium deals per year and primarily participated in “challenger deal” archetypes). Their corporate performance exceeded the industry substantially with 8.3 percent TSR.

Several trends that emerged during the GFC (such as shifting to value brands and channels) and after it (such as the explosion of small and challenger brands) influenced consumer goods companies’ strategies for the future. Similarly, we believe COVID-19’s impact on consumer sector trends, seen in our recent article, [“How consumer goods companies can prepare for the next normal,”](#) will help inform how these M&A archetypes will evolve.

Exhibit 2

There are three deal archetypes

Distribution of total shareholder returns (TSR) for consumer goods companies, by archetype, % (n = 119)



Impact of COVID-19 on consumer sector trends and implications for Consumer Goods M&A

COVID-19 has accelerated existing trends and created new realities that will affect the frequency of M&A activity and the types of deals in the sector.

Heightened consumer awareness of health and wellness is reinforcing the trend toward healthier foods and lifestyles. This should continue to pique interest in assets in this space and may accelerate large manufacturers' interest in smaller, more "natural" food brands across categories.

The financial uncertainty associated with an economic downturn is increasing consumer focus on value, leading some consumers to switch to private-label or value-oriented products. As companies look to protect category market share, they may consider acquiring value brands that help insulate them from a shift to private label.

This time of crisis has also led consumers to return to big brands they know and trust. While large consumer goods manufacturers represented ~50% of sales in 2018, they accounted for only 16 percent of growth in 2015–2018, that share of growth rose to 39 percent in 2018–2019 and reached 55 percent in the first three weeks of April 2020.²

This new strength will support large traditional manufacturers' pursuit of smaller brands that may not enjoy such tailwinds as a result of the crisis. Larger manufacturers may reassess their strategy for slower-growing heritage brands. They may take the opportunity to divest noncore heritage brands at more attractive valuations or allocate investment to foster innovation and growth of their heritage brands.

COVID-19's demand shocks have increased the importance of supply chain resilience as retailers actively manage product availability. This challenge has laid bare the shortcomings of smaller producers

that depend heavily on co-manufacturing. Large producers may look to purchase smaller challenger brands at lower valuations and/or shore up supply control through additional vertical integration.

Increased e-commerce penetration and in-home consumption likely will increase interest in digital and last-mile delivery capabilities across large manufacturers, leading large producers to participate in emerging ecosystems and seek acquisitions in data and analytics or last-mile delivery.

Evolution of Consumer Goods M&A deal archetypes post-crisis

As companies continue to navigate the crisis in the coming months, their focus on the health of employees, customers, and consumers and on financial resilience will remain paramount. After addressing these core issues, their focus will shift to emerging from the crisis stronger and to reimagining their businesses. We expect today's trends to encourage companies to undertake a holistic evaluation of their strategic ambitions, business models, categories, and brands.

As part of this re-evaluation, some companies will identify a role for M&A in their portfolios, which may mean acquisitions to pursue inorganic growth or divestitures to fuel growth elsewhere. M&A decisions, as always, will be company-specific, as a deal that's right for one company (for example, buying a challenger brand at a potentially lower multiple than last year) may not be the right deal for another. Financial stability, multiyear strategic direction, product and brand portfolios, and pre-crisis positions will all be important factors for companies to consider. The key for companies will be to take the time required to think about M&A strategy before rushing into deals. Finding the right asset is preferable to getting the wrong one at a lower cost than usual.

For consumer goods companies for which M&A can jump-start a new journey or course-correct a current one, we see multiple possibilities for each of the deal archetypes to propel growth—as well as the need in some cases for divestitures.

² Nielsen, nielsen.com. (52 weeks ending June 16, 2019) – (52 weeks, ending June 20, 2015); (52 weeks, ending June 15, 2019) – (52 weeks, ending June 16, 2018); seven weeks ending April 18, 2020.

Expanding the portfolio. First and foremost, **scale will matter again.** Across categories, retailers will have more confidence in the supply chains of larger manufacturers; big brands are again winning consumers' trust; and products from scaled consumer goods companies will be more readily available. While driven in part by COVID-19, the re-emergence of household brand names and growth in large manufacturers' portfolios were already happening before the crisis.³

While scale is coming back, it has changed. New types of scale in the form of data, platforms, and advanced analytics capabilities will provide a competitive edge in the future. As companies look to secure such scale, they will need to consider a wider range of partnerships.

With the right timing, companies with healthy balance sheets and debt ratios will find opportunities to acquire long-desired assets at a discount. Furthermore, deals to expand the portfolio are the clearest winners in reducing per-unit costs across the portfolio. Company executives will need to look seriously at the value of increased resiliency and ask how long the window of opportunity to shape their portfolio, while realizing incremental value, will last. Recent shifts in market sentiment demonstrate how quickly opportunities can disappear.

Large manufacturers with some combination of relatively low leverage, access to investment-grade debt, and a cash-heavy balance sheet will be particularly well positioned to capitalize on this deal archetype. They will, however, likely need to navigate increased scrutiny from shareholders on the size of synergies that can be achieved.

Snapping up challengers and acquiring capabilities. We believe that consumer trends will encourage companies to use M&A to **bolster their capabilities and build their next normal business model.**

While growth is likely to be tempered for some challenger brands, the original premise that made them attractive to large consumer goods companies still holds—bringing larger companies new capabilities, loyal fan bases, and innovative products.

The crisis has highlighted the structural disadvantages that many challengers face. Heavily co-manufactured supply chains mean less control over shifting production in a crisis, and smaller balance sheets highlight the cash-flow issues associated with highly variable demand. Both can cause retailers to prefer larger brands with greater supply reliability. Furthermore, large manufacturers have invested heavily in digital capabilities to close some of the gaps with their smaller peers. These dynamics will likely depress the valuations for many challenger brands and provide an opportunity for larger companies to build capabilities through acquisitions and/or partnerships.

The challenger-related M&A activity that we expect to see will probably mix partnerships and acquisitions. Some deals in this archetype have proceeded through COVID-19 (for example, Nestle Purina's acquisition of Lily's Kitchen,⁴ Puig's acquisition of Charlotte Tilbury⁵), and many of these smaller companies' attributes that attracted larger manufacturers in the first place remain—leading digital engagement capabilities and extremely loyal consumer bases (such as with Glossier) or e-commerce-related go-to-market advantages (such as with Pharmapacks). The shift to e-commerce, greater reliance on digital marketing, increased importance of ingredient transparency, decline in the food-service channel, and the critical role of last-mile delivery all suggest the need for stronger digital connectivity between consumers and manufacturers and emphasize the importance of e-commerce capabilities.

Consumer goods companies will have to answer several questions about building tomorrow's

³ Nielsen, nielsen.com. (52 weeks ending June 16, 2019) – (52 weeks, ending June 20, 2015); (52 weeks, ending June 15, 2019) – (52 weeks, ending June 16, 2018); seven weeks ending April 18, 2020.

⁴ "Nestle's Purina PetCare acquires natural pet-food brand Lily's Kitchen," Nestle, April 1, 2020, nestle.com.

⁵ Aaron Kirchfeld and Dinesh Nair, "Spain Perfume firm buys makeup brand Charlotte Tilbury," Bloomberg, June 4, 2020, bloomberg.com.

capabilities today. What downstream partnerships can you forge that will give you an advantage as e-commerce gains importance? What data, analytics, and digital marketing capabilities should you invest in and how? How can you boost your e-commerce capabilities quickly? What distribution or last-mile delivery investments should you make? What should you bring in-house to better prepare you to manage this new ecosystem?

Our past research indicates that a programmatic approach to snapping up challengers and building capabilities yields the best outcomes of the three deal archetypes. We believe that consumer goods companies at the forefront of acquiring and/or partnering with disrupters will likewise win down the line.

Betting on adjacencies. This is the hardest archetype for consistently extracting value, as these deals generate the lowest median TSR. Post-crisis, we expect most companies to hunker down and focus on their core business. However, it is helpful to distinguish between horizontal adjacencies (that is, primarily diversifying into altogether different businesses or categories) and vertical adjacencies (that is, making acquisitions up or down the value chain).

Companies with the means and intent to pursue a portfolio diversification strategy will find the opportunity less expensive in a time of depressed but varied valuations. The impact of COVID-19 and the lack of resiliency it has exposed in some consumer sectors may increase the need for diversification. In addition, the divergence in valuations across sub-sectors may make equity financing of some adjacent deals more attractive.

Consumer goods companies with heavily co-manufactured supply chains may look to increase long-term resiliency by integrating upstream with critical suppliers. The crisis is highlighting the value of direct control, and some reduction in efficiency may prove an acceptable trade-off. Owning these assets may also support longer-term strategies to satisfy consumer preferences like sustainability. Some suppliers may require a cash infusion or outright purchase to survive.

The downstream disruptions caused by COVID-19 and shifts in channel consumption habits will require consumer goods companies to think more broadly about how they engage their downstream partners. Partnerships with traditional retailers, food-service companies, distributors, and online delivery platforms (including logistics) likely will need to evolve in line with long-term industry trends.

As companies look forward to the next normal and reassess the role of M&A in their post-crisis corporate strategies, several questions can help them rethink their M&A strategies (Exhibit 3).

Private equity. As PE players [shift from managing their current portfolios in the crisis](#) to looking for investments, we expect the role of PE funds in Consumer Goods M&A to evolve. The current climate of uncertainty, state of the leveraged loan markets, and more limited ability to realize synergies (unless executing a buy-and-build approach) are likely to make would-be financial investors approach valuations cautiously.

However, the global PE industry has an estimated \$1.7 trillion in dry powder,⁶ and some players have indicated that they see the current situation as an opportunity to invest in traditionally inaccessible companies and brands.⁷ Furthermore, those who invested in consumer goods companies during the GFC saw slightly higher median exit multiples than in the prior or the following two years (Exhibit 4).

The financial impact of the COVID-19 crisis (for example, depressed multiples, scarcity of capital), coupled with the revival of large brands, provides the right conditions for PE investors to play a significant role in consumer goods deals, including in carve-outs of noncore assets, an area that has historically been of great interest to PE firms.

⁶ Preqin, May 13, 2020, <https://www.preqin.com/insights/2020>

⁷ K. Wiggins and M. Vandeveld, Financial Times, April 6, 2020 <https://www.ft.com/stream/ab70c42c-4d60-4851-89bb-16e2daedd1c1>

Implications of COVID-19 for deal archetypes going forward

	Implications of COVID-19	Questions to consider
Expanding the portfolio	<p>Scale matters again</p> <ul style="list-style-type: none"> ● Increased importance of resilient supply chains ● Consumer trust in big brands ● Breadth of product availability ● Long-term cost reduction 	<ul style="list-style-type: none"> ● What categories do I play in that would benefit from further scale? ● What categories and brands would be a source of strong growth? ● What dream deal may now be within reach? ● How will expanding my portfolio make me more resilient?
Snapping up challengers and acquiring capabilities	<p>Challenger value proposition remains relevant</p> <ul style="list-style-type: none"> ● Loyal fan bases and direct to consumer connectivity ● Innovative products, better-for-you appeal ● New capabilities <p>“Challenger” acquisitions to “capability focused deals”</p> <ul style="list-style-type: none"> ● Increased reliance on digital marketing due to shift online ● Greater importance of ingredient transparency ● Reduction in food service and the critical role of last-mile delivery 	<ul style="list-style-type: none"> ● What can I add to the brand that will help it survive and significantly grow in this environment? ● What downstream partnerships will give me an advantage as e-commerce becomes increasingly important? ● What data, analytics, and digital marketing capabilities should I be investing in and how? ● How can I quickly gain greater e-commerce capabilities? ● What investments should I make in last mile delivery?
Betting on adjacencies	<ul style="list-style-type: none"> ● Previously “outpriced” adjacent industries, sectors, subsectors may now be more affordable ● Potential increase in upstream integration to ensure supply-chain resilience ● Increased importance of downstream partnerships to reach consumers in new ways 	<ul style="list-style-type: none"> ● Are there adjacent industries I've wanted to enter but haven't been able to in the past? ● How resilient is my supply chain? ● Are there any upstream parts of my value chain that I should consider vertically integrating? ● Are there any downstream or go-to-market partnerships I should establish? ● Can my balance sheet now afford a measured bet?

Divestitures. By and large, we expect most consumer goods companies to weather the crisis well. That said, some distressed companies will need cash to secure business continuity and strengthen their balance sheets, and many companies were already conducting strategic reviews of their portfolios before the crisis. COVID-19 provides fresh impetus for portfolio review, as companies will be able to compare how different brands performed in a unique period of demand fluctuation and see which brands did and did not benefit from increases in category demand.

Some otherwise well-performing companies will use this opportunity to carve out and sell underperforming businesses, or businesses that do not align with their portfolio strategies, to free up cash and invest in growth. As the recession

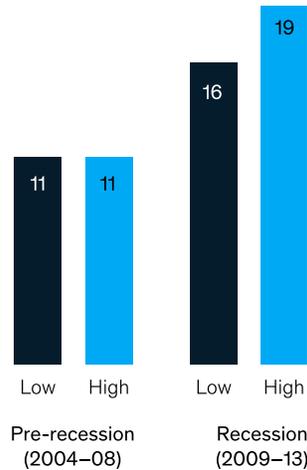
loomed in 2008, the most resilient companies divested underperforming businesses faster than their peers and reduced debt by about one dollar for every dollar of capital on their balance sheets, while less resilient competitors added more than three dollars of debt.⁸ TSR performance indicates that shareholders reward companies that take an activist mindset and use divestitures to dynamically manage their portfolio. Analysis from 2007–2017 indicates that companies that refreshed their revenue source by 10 to 30 percent outperformed those that did not on TSR by approximately four percentage points⁹

⁸ For details, see “[Bubbles pop, downturns stop](#),” *McKinsey Quarterly*, May 2019.

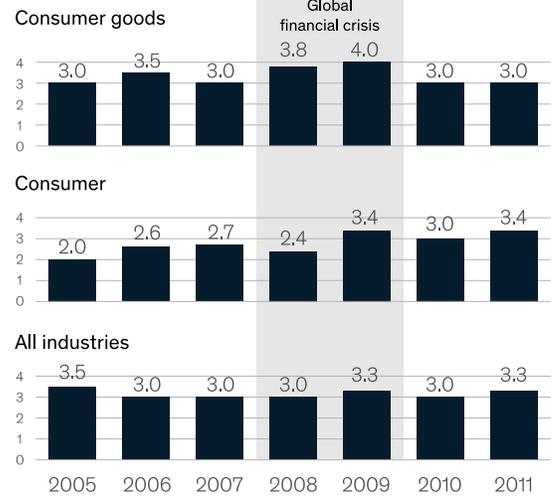
⁹ S&P Capital IQ, 2017; McKinsey analysis of 209 large listed companies.

Private equity funds that kept investing during the global financial crisis outperformed, as did investments in consumer goods assets that were done in this period

Average internal rate of return, by acquisitiveness level,¹%



Median PE exit multiple, by investment year



¹Firm's acquisitiveness was measured by proxy as total deal value divided by total fund size. Firms were then classified by top vs bottom half on this measure. Performance returns are calculated based on the firm's acquisitiveness in the same time period—eg, 2009–2013 vintage returns are split based on whether the firm had low or high acquisitiveness during 2009–2013
Source: Preqin fund data

Next steps for consumer goods companies

COVID-19 and the onset of an economic slowdown will likely reshape the landscape of consumer deals and partnerships in the sector. We encourage consumer goods companies to take three steps now as they contemplate M&A and partnerships going forward, all grounded in the three Cs of excellent M&A strategy—competitive advantage, capacity (financial and operational), and conviction.

Define the next normal—and where your competitive advantage lies. The first step in redefining M&A and partnership strategy is understanding what the next normal means for your company. The new reality will depend largely on the lasting impact of COVID-19 on your core consumer segments, including their behaviors and spending habits. Where are the growth opportunities today, and where will they be tomorrow? Where are consumers spending money—in which categories and channels? How have their tastes, preferences, and concerns changed, creating new opportunities for differentiation? In this context, how have your

competitive advantages changed, and what new advantages have emerged? How can M&A and partnerships accelerate your growth?

Assess your capacity to execute acquisitions and partnerships. A realistic assessment of balance sheet strength and your ability to make acquisitions independently, as well as your ability to secure financing in the post-crisis environment, will provide the critical foundation for your M&A strategy. Assessing the willingness of existing shareholders to accept dilution for attractive equity deals will also play a key role. Determining feasible acquisition targets will lay the foundation for prioritizing exploratory actions.

Build conviction with early exploratory actions in the M&A market. Consumer goods companies should generate data-supported perspectives on market trajectory, next normal scenarios post-crisis, and the risks of further disruption. Short-listing top priorities and securing executive and Board commitment to M&A will accelerate decision-making as markets thaw and potential targets emerge.

M&A due diligence during the crisis

The crisis is consuming management attention (for both the acquirer and the target), leaving little management mindshare to engage in due diligence. In this climate, most diligence activities must proceed without any physical visits to facilities or the relationship-building, face-to-face meetings that often clinch or nix the deal.

These are unprecedented times, but we believe diligence can proceed despite the obstacles. Most diligence analyses happen remotely, and we see limited impact on them. To compensate for the lack of physical access, we have seen companies deploying creative solutions. For example, a single employee conducted a virtual site visit, live-streaming an in-person plant visit to a team of experts. We also see the business world getting more comfortable with virtual conferencing and 1:1 video calls to continue to make key decisions. While not a full replacement for physical meetings, these substitutes can work well in our current circumstances.

In addition to the typical diligence checks, two areas warrant heightened scrutiny:

Company health and liquidity

- Reviewing the pre-crisis growth profile and financials of the target and understanding how strong the company was then. Was the company already struggling, or was it doing well?
- Assessing the pre-crisis brand strength of the target and understanding the potential impact of COVID-19. Is this a strong brand that will benefit from increased consumer scrutiny?
- Evaluating the security and stability of the supply chain. Is the target a priority client of its suppliers, and will it be at the head of the line if capacity falls short?
- Assessing the financial position of the target (including cash) to understand the company's current situation and resilience in an extended period of disrupted economic activity. How long can the target withstand the crisis, and how long can you support the company if the crisis is prolonged?

Growth outlook

- Understanding the impact on the target of expected structural changes in consumer demand and behavior. Which changes are temporary and crisis-related; which are permanent?
- Given the structural changes, is the target well-positioned to thrive in the recovery and the next normal (from sales to operations)?
- What is the conservative base ("bankable") case? This is particularly important if COVID-19 has had a positive short-term impact.

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