Consumer Products Companies Are Consolidating -- *Now* Why?

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WE SIMPLY MUST BE AT THE START OF A NEW CONSOLIDATION WAVE IN CONSUMER PRODUCTS. Procter & Gamble buys Gillette. Wrigley swallows Life Savers and Altoids. H. J. Heinz acquires HP Foods. Taken together, this seems a lot like the beginning of something we've seen before. **After all, bigger is always better in this industry.** *ISN'T IT?*

A merger's or acquisition's strategic imperative is of tremendous importance in this industry today. Yet, too frequently, shifts of this sort are missed early on –– and the result can be disastrous.

NOT QUITE. Peer beneath the surface of these three transactions and we think you'll see something quite different going on. In each of the mergers mentioned on the preceding page –– and, we believe, in many more to come –– size was *not* the key driver. These combinations have far more in common with the *"buys," "sells"* and *"holds"* of a Wall Street portfolio manager than a typical consumer products company looking to gain massive scale –– which was the common thread of transactions in the `80s and `90s.

COHERENCE IS THE WATCHWORD. Today's deals are being driven by the desire to build and manage product portfolios in a way that complements a company's competitive strengths –– and these can vary greatly from organization to organization.

For example, product development expertise for over-the-counter items such as vitamins and sunscreen is fundamentally different than for carpet cleaner and dish soap. Thus, an OTC provider that wants to leverage its strength in product development would be unlikely to buy a home-care products company. Looking to the future, this quest for coherence has significant implications.

Yes, it may suggest further acquisitions. But it also may portend divestitures. This is not about consolidation but, rather, a reshuffling of assets. There will be activity, but companies may not always get bigger. Smaller may, in fact, end up being better in some cases.

THIS SEEMS COUNTERINTUITIVE, BUT ONLY IN THE CONTEXT OF RECENT HISTORY. For some time now, the growth formula in consumer products was relatively straightforward. Beginning in the 1970s and rolling through the `80s, consumer products companies advanced by expanding geographically and by extending their brands –– which ushered in an era of large-scale consolidation. The transactions of the day are still etched in our memory: Nabisco merging with Standard Brands in 1981, Philip Morris buying General Foods in 1985 and then acquiring Kraft just three years later.

This consolidation continued in the 1990s, with cost cutting becoming a key component of making these deals work. But fast-forward to the middle of our current decade and the environment has changed dramatically. The mergers of the past created companies that were, in reality, *portfolios of loosely related businesses.* They often had different competitors and consumer bases, unrelated customer preferences and different drivers of success. Once all the advantages of scale were wrung out of these operations, they needed to look elsewhere for growth.

At Booz Allen, we like to view all transactions as a three-step process. Each begins with a strategic imperative, which is the underlying reason a prospective merger or divestiture makes sense in terms of a company's overall direction and environment. Next are transaction design and then post-merger integration.

CLEARLY, IF THE STRATEGIC IMPERATIVE IS OFF THE MARK, the merger will not address current realities and the company will not perform. Most successful coherence-driven mergers balance cost savings with building or combining core capabilities.

Bigger simply isn't better anymore; COHERENCE is the key.

IN THE CONSUMER PRODUCTS TRANSACTIONS WE SEE TODAY, THIS STRATEGIC IMPERATIVE HAS BECOME A CRITICALLY IMPORTANT ISSUE. It has, as we described above, shifted from the idea of synergy through scale to the new concept of *coherence*. Those companies recognizing this will have a distinct advantage. Those that miss it will do the wrong deals with the wrong partners, and eventually pay the price.

P&G'S ACQUISITION OF GILLETTE PROVIDES A GREAT EXAMPLE of a transaction that fits the new environment. One of the best-run consumer products companies –– and a major participant in the earlier hunt for scale –– P&G acquired Gillette as part of an effort to reinforce the coherence of its brand portfolio. The transaction lets P&G leverage its own capabilities and push Gillette products through a stronger and even more global distribution network. This represents a large, high-stakes step toward increasing coherence.

Over the past few years, P&G has moved more heavily into personal care and beauty products and essentially exited the food business. The company views its own competitive strengths as innovation, marketing and globalization. Thus, it stands to benefit from a more highly focused grouping of brands, allowing the company to leverage its strengths across these brands, as opposed to simply achieving greater power through scale. Given P&Gís positioning in personal care, Gillette is a perfect fit.

WRIGLEY'S ACQUISITION OF LIFE SAVERS AND ALTOIDS ALSO MAKES PERFECT SENSE from a coherence perspective. Wrigley is intensely focused on the chewing gum and mint business; this singular mindset has brought it tremendous success. Purchasing the Life Saver and Altoids brands augments its existing product line, which is built around Wrigley's expertise in the front end of the store. This was not scale for scale's sake. It builds upon and complements a coherent portfolio strategy.

Similarly, the Heinz purchase of HP Foods continues a move toward coherence the company had already launched. Heinz has been focusing on the prepared food and condiment business, having exited tuna and pet food. HP Foods brings Heinz the HP and Lea & Perrins sauce brands, which are very big in Europe. Not a bad match for the maker of Heinz ketchup, which also has a large European business.

LOOKING PAST THESE TRANSACTIONS AND INTO THE FUTURE, THERE IS AN IMPORTANT LESSON for prospective buyers and sellers. As consumer products companies are increasingly forced to operate as portfolio managers, nimble and sensitive to what the marketplace is making available, management must make sure it has properly assessed its company's core strengths in order either to acquire brands that build on these capabilities or divest those at odds with its competitive advantages.

As we said earlier, the strategic imperative is of tremendous importance in this industry today. Yet, too frequently, shifts of this sort are missed early on –– and the result can be disastrous. Imagine completing a pure scale deal in today's environment. This could compound a company's problems by creating an ever-more-unrelated brand portfolio.

The bottom line is this: Bigger simply *isn't* better anymore; coherence is the key. It is critical to grasp this idea, and make sure it is reflected in your own transaction strategy. ■

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