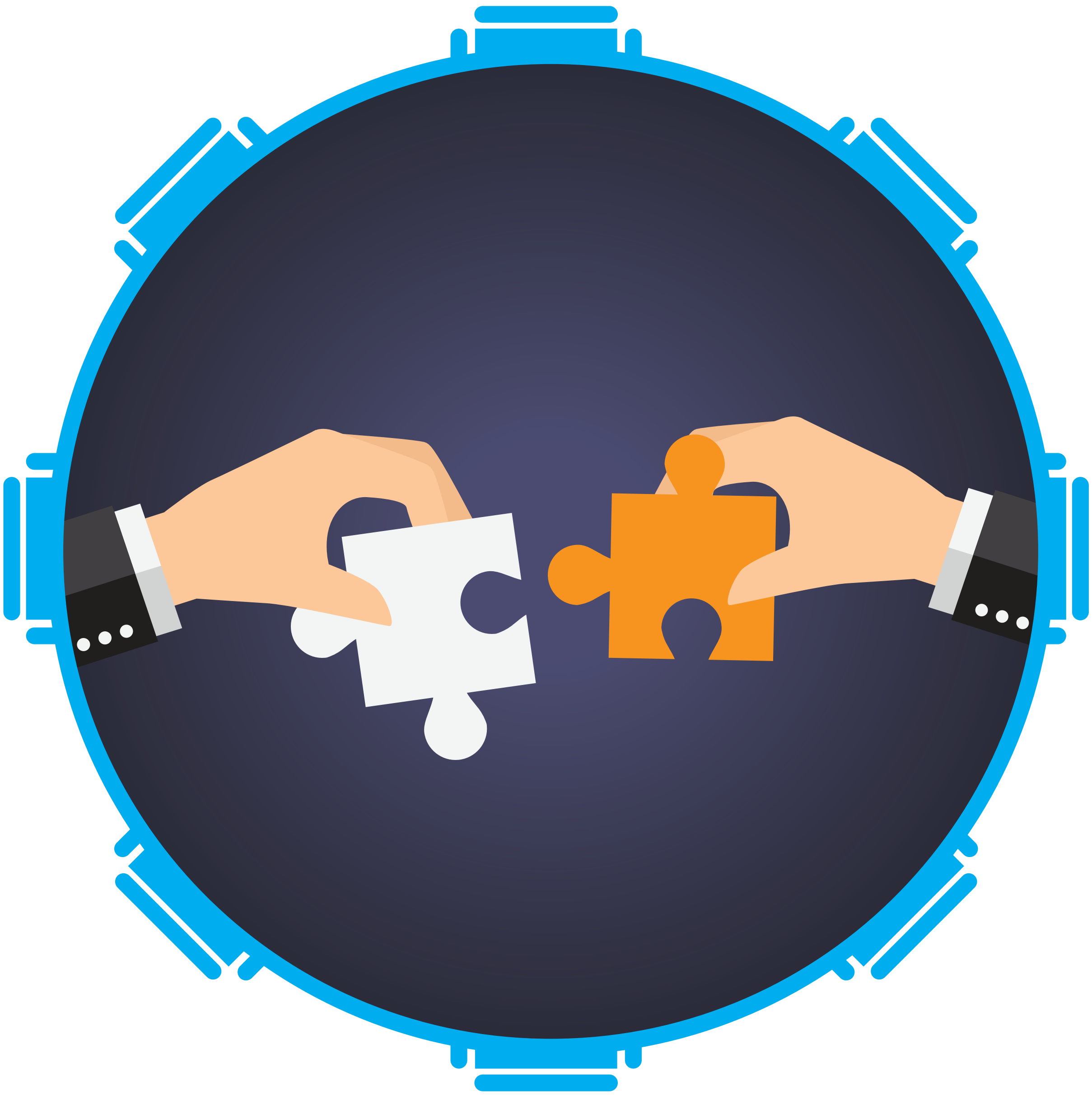


M&A matchmaking

Business model coherence

Business model convergence

A 2015 Deloitte study, *Business model innovation in consumer goods*, found that consumer products (CP) companies that demonstrate exceptional financial performance tend to have a strong alignment with a single business model—rather than simultaneously pursuing multiple business models. The study considered a sample of 97 CP companies and found that 25 of those companies with the highest coherence score delivered a total shareholder return (TSR) of 27.1 percent versus 16.8 percent for other companies in the sample set.[1] The authors of the 2015 study credit the superior financial performance to "business model coherence."

The previous study concluded that companies with coherent business models drive value from aligning to one of three types of business models (figure 1). This alignment helps the companies to make focused investments into areas where they choose to play and win. Operating with a hybrid (mixed) business model can create strategic and operational conflicts and lead to suboptimal performance.

Figure 1. Prominent business models in the consumer goods industry

Operational excellence

Consumer goods companies with an operational excellence business model mainly focus on creating distinctiveness in key areas such as operations, warehouse and distribution, and channel management.

Product/brand leadership

For companies with a product/brand leadership business model, market and customer insights, research and development, product development, and product testing capabilities are most important to create competitive advantage.

Customer solutions

Consumer goods companies with a customer solutions business model strive for distinctiveness in customer account management, market and customer insights, brand management, and marketing management.

Source: Deloitte University Press Publication, "Business Model Innovation in Consumer Goods"

As CP companies acquire others or merge together, the business model of the combined business is likely to be a hybrid of the legacy firms—at least for an interim period following the acquisition. As such, the process of M&A matchmaking can lead to lower coherence (alignment to a single business model) and may be accompanied with brand dilution, customer service issues, and market-share erosion.

Our current study expands on the 2015 research by comparing the M&A matchmaking behavior of the companies with high business model coherence scores (top 15 in the sample of 97 companies) against the behavior of the companies with low business model coherence scores (bottom 15). These 30 companies make up the sample set for the analysis conducted as part of this study.

[1] Jacob Bruun-Jensen and Kim Porter, Business model innovation in consumer goods: How consumer goods companies are configuring their businesses to deliver exceptional performance, Deloitte University Press, November 2, 2015, https://dupress.deloitte.com/dup-us-en/topics/business-model-transformation/business-model-transformation-consumer-goods-companies.html.

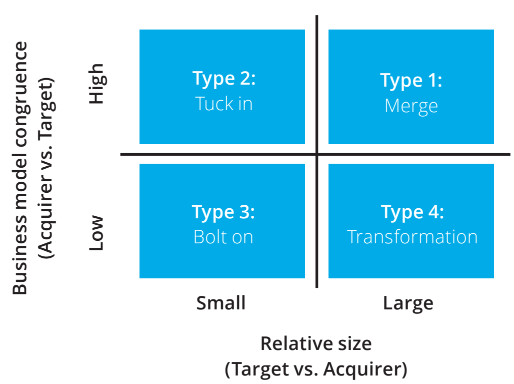
The impact of M&A on business model coherence

Although there are several factors that, over time, can blur a company's focus and cause it to deviate from its core business model, M&A transactions tend to have the most sudden and disruptive impacts on maintaining a coherent business model.

To explain this disruptive impact, we classified M&A transactions into four types based on the level of congruence (similarity in business models) between the acquirer and target, as well as their relative size (figure 2).

Type 1 and Type 2 transactions involve acquirers and targets with congruent (similar) business models. The result is a combined company whose overall business model coherence is relatively unaffected by the merger. In contrast, Type 3 and Type 4 transactions bring together companies with incongruent (dissimilar) business models, which can lead to a sudden and dramatic reduction in coherence for the combined company.

Figure 2. M&A transaction types



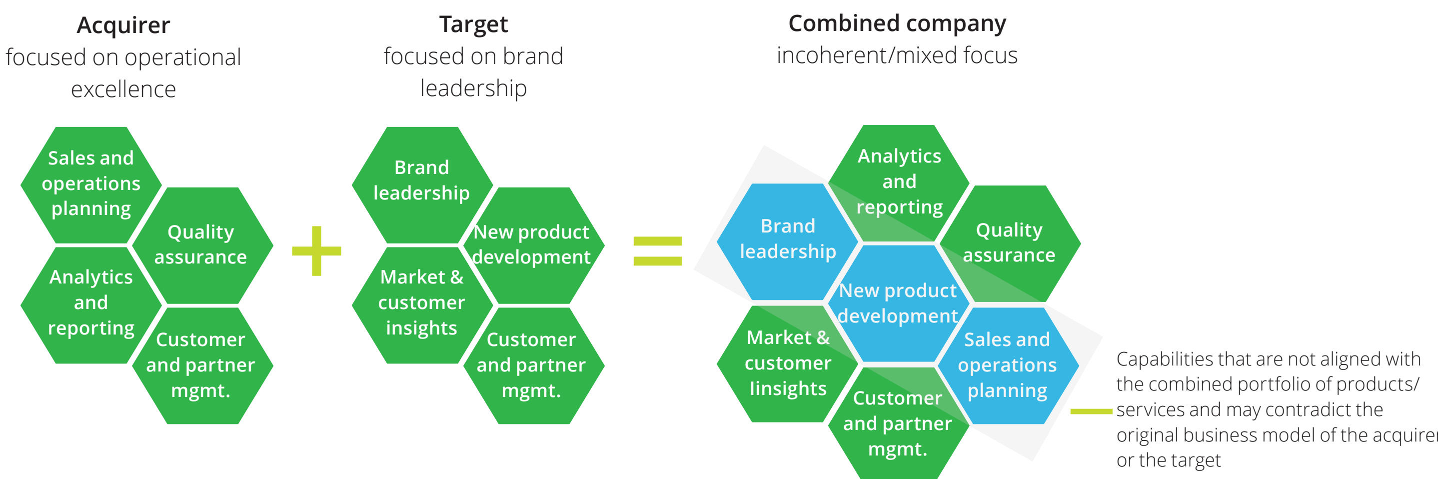
Deal type	Dominant strategy	Speed to integration
Type 1. Acquisition of a target of comparable size and business model	Merge	Fast
Type 2. Acquisition of a smaller target with similar business model	Tuck in	Fast
Type 3. Acquisition of a smaller target with different business model	Bolt on	Slow
Type 4. Acquisition of a target of comparable size, but different business model	Transformation	Fast

Source: Deloitte Consulting LLP

Incongruence can lead to low coherence

Figure 3 illustrates a representative scenario in the CP industry where the acquirer and the target have dissimilar business models. Without a deliberate effort to reconcile business model differences and achieve coherence, the combined company will likely end up with conflicting priorities that could be confusing to employees, customers, shareholders, and analysts—and have a detrimental impact on business performance and value creation.

Figure 3. Dissimilar business model M&A scenario



Source: Deloitte Consulting LLP

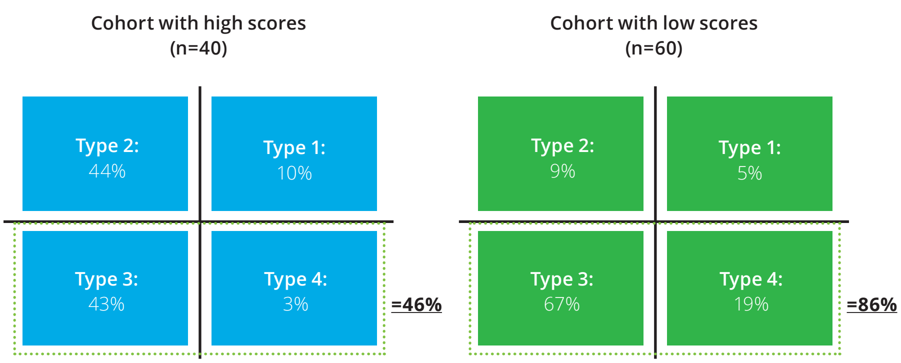
The size of the target relative to the acquirer is also an important consideration. A relatively large target (more than 20 percent of the size of acquirer) with a dissimilar business model will obviously tend to have a greater impact on the coherence of the combined company. Conversely, a relatively small target (less than 20 percent of the size of acquirer) will tend to have a relatively low—or at least less visible—impact on coherence. That being said, if a company acquires a number of small but incongruent targets (i.e., multiple Type 3 transactions), the total negative impact on coherence can match or even exceed that of a Type 4 transaction.

Companies with low coherence are much more likely to acquire incongruent targets

We analyzed approximately 100 acquisitions made by 15 companies with high and low coherence scores (within our sample set). Our analysis shows that companies in the cohort with high coherence scores are two times more likely to acquire a target with a similar or congruent business model. This suggests that highly coherent companies tend to preserve coherence or business model alignment during the course of M&A—and this was found to be linked with superior financial/value performance by the aforementioned study.

We recognize that it's possible to combine two companies with dissimilar business models and different levels of coherence into a highly coherent company. However, achieving high coherence requires deliberate strategies and actions to remediate coherence issues after the acquisition takes place. In our view, this ability to actively identify, pursue, maintain, and create coherence in M&A is one of the key differentiators of companies that are able to create higher value through M&A.

Figure 4. Distribution of M&A transactions by cohort



Source: Deloitte Consulting LLP

Companies with low coherence also tend to overlook the importance of coherence in M&A

We recognize that M&A decisions can't be guided by a single factor (such as coherence) alone. Scale, synergy, competition, and price should all be considerations in any transaction—and many successful deal makers don't limit their activity to targets with similar business models alone.

This is consistent with what we observed during our research: Companies with high coherence scores acquire incongruent targets (transaction types 3 and 4) in almost 50 percent of all transactions they do.

Our examination of the M&A practices of the 15 most coherent companies revealed that when these highly coherent companies (similar business models) make the bold move to acquire an incongruent target (dissimilar business models), they follow up with transformative changes that help align the business model of the combined company, thus helping to restore coherence. These acquirers identify potential incoherence issues early in the acquisition process—during target selection—and establish deliberate mitigation strategies.

Figure 5. Demonstrated integration behavior

Companies with high coherence scores typically:	**Companies with low coherence scores typically:**
Demonstrate strong adherence to the dominant strategies expected for a given transaction type (i.e., bolt-on for Type 3 and transformation for Type 4)	**Exhibit a lack of or inconsistent adherence** to the dominant integration strategies shown in figure 2
Engage in bold plays, such as acquisitions of incongruent targets, but follow up with transformative changes to their go-to-market models, back-office processes, etc., helping to restore business model coherence	**Prefer a strategy to embed rather than integrate** disparate businesses that they acquire
Leverage divestitures and spin-offs effectively to streamline business models	**Prolong their exposure** to an incoherent state

While the scope of our research is limited to the CP industry, there's sufficient anecdotal evidence that suggests that companies in other industries address incongruence by similarly simplifying their business models.

Making a match with M&A

According to the findings of this study, companies that deliver exceptional value for their shareholders tend to approach M&A differently—focusing not only on delivering the acquisition's expected synergies, but also making a deliberate effort to maintain business model coherence. Although business model coherence can't—and shouldn't—be the only consideration when evaluating an acquisition target, it is important. And can help make the match more successful.

Think about coherence at every step of the M&A process

Be ready for your next transaction

Business model re-alignment—subsequent to a significant M&A transaction—is a critical requirement for sustained and efficient value generation. And companies that don't do that are often forced into it by the board of directors and activist shareholders. Over the years, we've observed several CP companies spin off significant parts of their businesses (others have come to the verge of disintegrating) due to aggressive campaigns by activist shareholders toward restoring alignment to a single business model. Acquirers can take specific actions at each stage of the M&A life cycle designed to help preserve and enhance coherence—thereby enabling conditions for greater value creation (figure 6).

Figure 6. M&A life cycle checklist

M&A phase	Checklist items
Strategy development	☐ Based on your overall company strategy, develop hypotheses on what business model and capabilities are required to win in the marketplace.
	☐ Identify what capabilities should be acquired (versus developed) and then use that as input for target screening and due diligence.
	☐ Conduct an internal assessment to determine your business model type and current level of coherence.
Transaction readiness	☐ Conduct integration capability assessment (i.e., your readiness to perform Type 1–4 transactions). Know the risks and plan for mitigation.
Transaction diligence and execution	☐ Conduct high-level business model assessments for targets and identify transaction types.
	☐ Factor the impact of complex transaction types (Types 3 and 4 into the deal model).
Closing and integration strategy	☐ Complete a detailed assessment of the target's business model.
	☐ Develop an integration strategy that helps create the preferred business model (coherent or hybrid) for the combined organization.
Integration execution	☐ Track adherence to the integration strategy and make course corrections to address changes in the industry and competitive environment.

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