

*"Basic economics—sometimes the parts are worth more than the whole."*

Through strategic divestitures, your company can sharpen its focus—and clear a path to new growth

## Shrinking to grow

By David Harding and Charles Tilden

BAIN & COMPANY

**Shrinking to grow**

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Sometimes you have to shrink to grow. Just as losing fat while building muscle is the key to attaining peak physical fitness, companies need to shed underperforming brands while focusing on more promising ones. Leading consumer products companies—those that consistently manage their product categories for greater share and premium returns—understand that principle well. These companies also understand a related rule: one person's trash can be another's treasure.

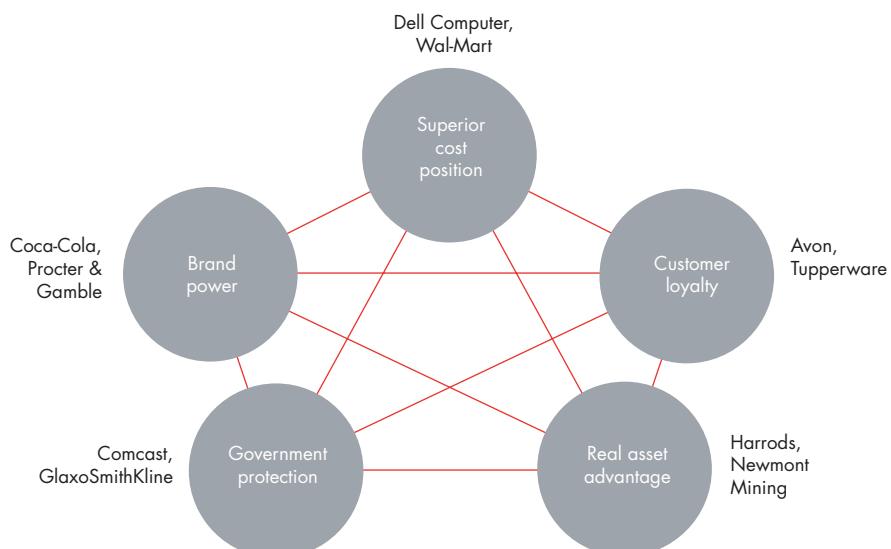
In more than 30 years of in-the-trenches work on mergers and acquisitions, Bain has seen that successful consumer products companies actively employ divestitures in their product portfolio strategy, selling noncore businesses to free up working capital. At the same time, they're always on the lookout for available businesses that would make a good fit. Like athletes toning their bodies, savvy firms practice this M&A discipline to gain the agility to acquire new brands and to strengthen their core by investing in their current brands.

**Brand building's four M&A essentials**

Companies that efficiently manage this method for renewal keep their eyes fixed on four basic tenets:

First, they base any M&A decisions around a deep understanding of the nature of their portfolio of products and the basis for their competitive edge. (For the five bases of competition, see Figure 1.) Such knowledge is grounded in how money is made in their industry and where emerging opportunities lie. Senior managers ask themselves: How can we invest to reinforce our basis of competition—be it cost leadership (the basis of competition for Dell), customer loyalty (the advantage of Avon), or brand power (the core strength of Coca-Cola)? Likewise, they ask themselves, Should I sell a business that's at odds with my basis of competition and thus draining resources from my core business? This hardheaded process yields strategic insights.

Figure 1: Five bases of competition



For instance, in 1997, when Peter Brabeck-Letmathe became CEO of Nestlé, he took over the largest food processor in the world, which made most of its money by selling innovative branded products at premium prices. Yet he found that some of Nestlé's most dominant brands, including its premium pasta brand Buitoni, lay in value categories that behaved more like cost-driven commodities and defied significant growth opportunity for premium players. Brabeck determined that the company should get out of dry pasta while saving the Buitoni brand for expansion into ready meals, a product it could innovate and patent to serve consumers willing to pay more. The expansion paid off. Nestlé grew the Buitoni brand into premium, microwaveable pasta dishes, which now lead their category in the fast-growing business of prepared meals.

Second, nimble companies understand not only their own capabilities and needs, but also those of other players. With that insight, they ask themselves: Is there a better home for my brand? This can create competitive advantages for companies on both sides of a divestiture.

A case in point was H.J. Heinz's 2002 merger of StarKist tuna into Del Monte Foods. Although StarKist was a leader in the US, the value category in which it was sold was not yielding the margins approaching 20% that Heinz, a brand-focused company, expected from its products. But StarKist presented an opportunity in creative marketing to Del Monte, which for years has been a nimble performer in the commodity world of canned fruits and vegetables. After the acquisition, Del Monte invested in Tuna Creations, marinated tuna in foil pouches that Heinz had created as an alternative to the can. Higher margins on the popular new line were a boon to Del Monte. Heinz, in turn, used part of the \$1.8 billion it got for StarKist and several other product lines to invest in its core brand, including

the creation of a new upside-down ketchup bottle, the Heinz Easy Squeeze. The transaction was win-win.

Third, successful divisors are not fainthearted about eliminating what can look like a cash cow. They get over their fear of dilution; they accept an interim decline in their credit ratings and earnings per share—and they move on. Both the Heinz and Nestlé deals mildly diluted earnings per share, for instance. Why would a company ever knowingly take steps to decrease its earnings per share? The answer, of course, is to invest for the future. As a rule, shareholders like to see their companies investing in growth. Look at Heinz: In the two years after its deal with Del Monte, Heinz has delivered total shareholder return of 30%.

Fourth, smart consumer products companies ensure that their corporate radar is scanning the horizon for a replacement that's a better fit. Let's look again at Nestlé. Its merger with Ralston Purina in 2001 topped a series of pet-food company acquisitions going back to 1985, including Friskies, Alpo, Spillers and Cargill Argentina. Together, those brands created the world's dominant pet-food producer, with \$6.4 billion in revenue in one of the highest-growth segments of the edibles industry. Consolidating costs and combining marketing muscle gave Nestlé Purina PetCare the resources it needed to capitalize on a deepening trend among pet owners to buy premium dog and cat food. Indeed, sales of the new high-end Purina One brand rose even faster than pet-food sales as a whole.

The lesson of these companies' successful M&A strategies is that they use divestitures to do two things: by continually eliminating brands that do not strengthen their core, they right-size their organizations in order to support new growth. In other words, they get small to get big. 

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