

# Joining forces: How to integrate start-ups into large corporates



**Acquiring a start-up is becoming a popular way for large corporations to modernize internal practices, buy in technology and connect with younger customers. Integrating a start-up into a large conglomerate, however, needs to be done with care to deliver results.**

In July 2005, News Corporation acquired social network Myspace for US\$580 million. A year later it became the most visited website in the US and at one stage was valued at US\$12 billion. Yet for all its initial success, Myspace would never deliver on its potential. In 2008, Facebook overtook Myspace in web traffic rankings and by 2011 the site had shed nearly a third of its users. A few months later it was sold for an undisclosed sum, said to be around US\$35 million.

Corporate history is littered with similar examples of large corporates acquiring fast-growing start-ups, only to see them flounder post-acquisition because of misunderstandings, unrealistic expectations and cultural incompatibility.

In the case of Myspace, various factors led to its demise. At one point, News

Corp predicted that the site would generate annual revenues of US\$1 billion when its takings were only a tenth of that amount. With such a large target to hit, Myspace installed aggressive advertising and pop-ups to increase revenues, but this compromised user experience and audiences moved away. The number of users on Facebook, by contrast, which was not focused on monetization early and had the space to be subtler with its advertising, continued to grow rapidly.

But have large companies learnt from past mistakes when it comes to buying and integrating fast-growing but culturally different start-ups?

Technology giants Facebook and Microsoft have certainly looked at what has gone wrong in the past. Facebook, for example, has seen WhatsApp and

Instagram thrive after acquiring them. The social network giant has made a point of giving its acquisitions autonomy and positioning itself as a partner that supports a start-up's growth strategy rather than trying to change it. Microsoft has taken a similar approach with LinkedIn, giving the business space to set its agenda, but sending Microsoft engineers to work with the LinkedIn team to foster collaboration and best practices.

So, what are the biggest risks faced by both start-ups and large corporates when undertaking such transactions? What does a success story look like? And how can both sides prepare to make the most of such a combination? In order to answer these questions and gain insight into the secrets of successful start-up integration, we spoke with three leading experts in the field.

## The experts

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**Dawn Belt**  
Partner,  
Fenwick & West



**Jamie Leigh**  
Partner, Cooley



**Arnaud Leroi**  
Partner,  
Bain & Company

**Mergermarket** ● **What are the most important things start-up owners should know about being acquired by a large company? How can they determine whether it will be a good fit?**

**Dawn Belt, Partner, Fenwick & West** ● I've worked with a number of start-ups who have been or are looking to be acquired. In evaluating potential sale opportunities, startups need to do their "reverse diligence." Sellers shouldn't just be lured by the 'sexy' name or big brand of a buyer. When sellers are evaluating potential opportunities, they need to ask themselves a series of key questions: Will the team find a good home? Is the buyer interested in particular assets, IP, customers or something else? Is this an acqui-hire (buying a company for its talent rather than products or services)?

The start-up needs to know if the buyer is going to take the time to develop an existing project and if they are going to deploy enough resources. They also need to know if they are going to run the company separately or absorb it into the buyer's operations.

**Jamie Leigh, Partner, Cooley** ● Start-up companies are generally thinking about selling themselves all the time. They're trying to build a distinguished

product or a distinguished team in a market. In the tech industry, most large companies have some sort of playbook for how they like to do M&A, so if a start-up company is being built with an exit as the goal, it's really good to start thinking about the acquisition phase early. Craft a theory for your company early on and lay out a vision for what the ultimate exit is, both internally and externally.

That process starts with partnering and investor discussions, going to conferences, kicking the tires and meeting people. Listening to what people say in these early conversations is really important because you start to pick up the way that certain acquirers view you or the landscape generally. Often people love to talk about their core development program or their successful acquisitions. They will discuss the partnering arrangements they've made that worked. The feedback the industry ecosystem gives you is readily available, but it is one of the things that is most often overlooked.

With regards to good fit, it is all about people. Assessing a good fit should happen way before any term sheet or price gets put on table. Obviously, price is king, but where a company ends up

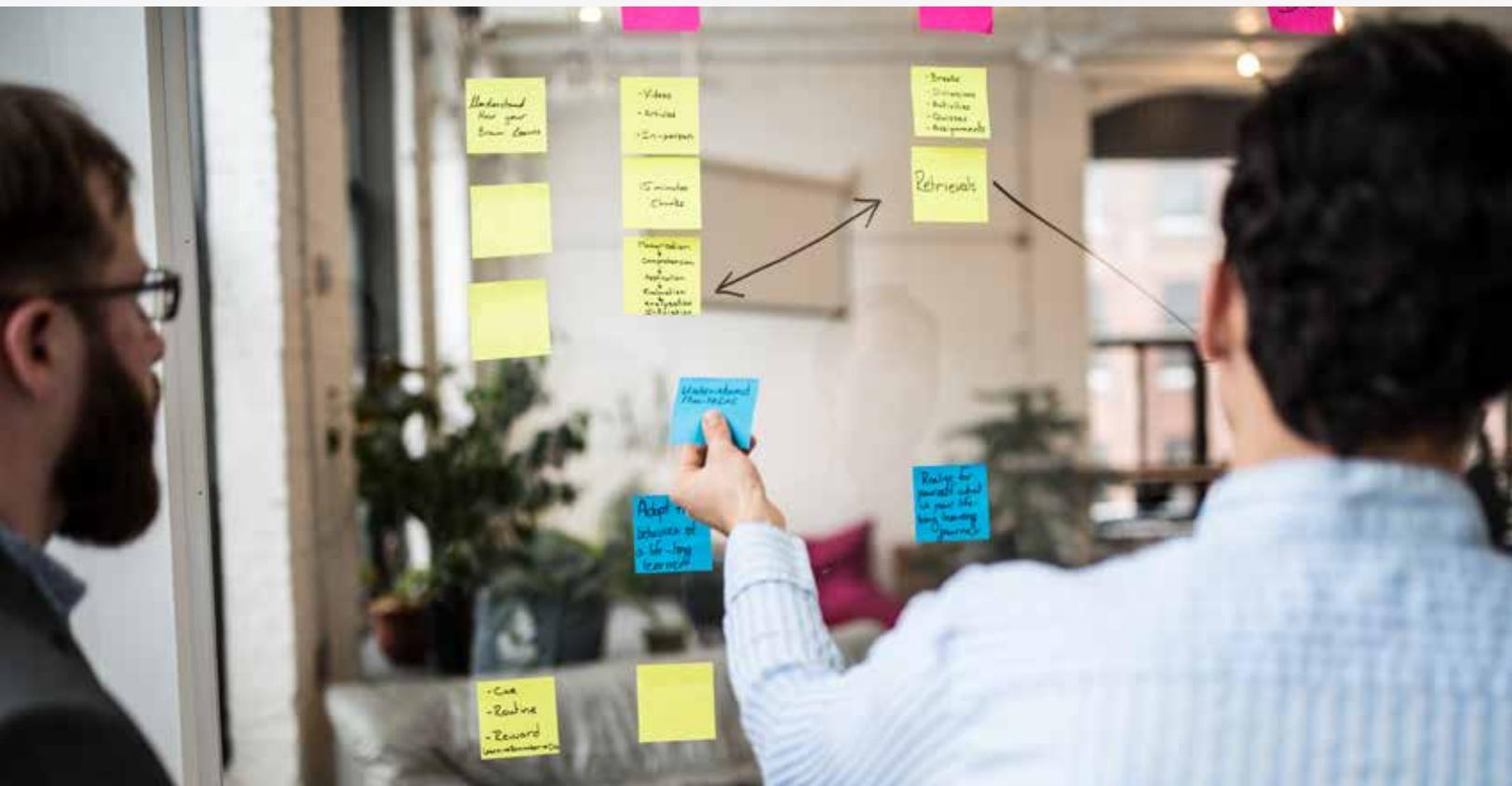
is becoming more important to investors from a marketing and performance perspective. Entrepreneurs who have exited two or three times already are also really only interested in selling to a company where they think their people will be taken care of. If you are a founder and you know that you never want to sell to a particular buyer, then you have to explain that very clearly and very often to your board of investors. It's either that or you are going to have to be willing to really put the hammer down if that particular entity comes calling.

**Arnaud Leroi, Partner, Bain & Company** ● Any founders or start-up investors need to ask whether the large acquirer is able to be a good parent and drive the

profitability and vision of the start-up. When attempting to answer that question, a good starting point is to look at it from the other side, and ask why a large company is buying a smaller one.

Large companies recognize that they don't have a monopoly on intelligence and that start-ups, which are not bound by the same processes and internal governance, are more agile and able to bring products and technology to market significantly faster.

Large corporates have become more attuned to what entrepreneurs want from their owners. There has been a shift in approach from buying and then obliging the start-up to follow the corporate strategy,



to corporates asking what they can do to help a start-up grow faster and execute its plans better than if it was still independent. Once the founder of a start-up understands why the corporate is pursuing a deal, the picture on fit becomes clearer. There is visibility on integration. Will the company be left to continue operating independently or will there be a formal integration?

Key team members can ask what their future role with the company is. Is there a chance to run the digital channel of the business or take on a wider executive position? Is the focus to make sure that that the smaller, acquired company becomes a meaningful part of a bigger entity, or is the aim to maximize the earn-out and then move on to the next venture.

**Mergermarket** ● **In your experience, what are some of the most successful models of large companies and acquired start-ups working together?**

**Jamie Leigh** ● **Partner, Cooley** The most successful model is one where everyone in the entities has bought into the merger. No matter what theory you have for the integration, if everyone isn't on board, or if people are confused and don't know the plan, then a lot of time and energy is wasted.

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What we have seen in the market, interestingly, is different methods for integration emerging. We used to see the same company using the same playbook for everything, but now we see companies starting to do more interesting things. You won't just see acquirers shutting down the brand or shutting down the engineering team. Different models have been used and these strategies have been given enough time to prove themselves.

One approach that is standing out is leaving the team alone. In a rapidly changing and highly-competitive landscape what seems to work well is to give the company more bandwidth and overhead support and just see what that it can do underneath the umbrella of the larger organization. It does feel like it's an easy way to transition long term.

I would also say that acquirers are becoming more comfortable with taking multiple steps over a number of months to figure out the right way to integrate.

It's really inspiring to watch some of these larger companies try different models to see if they can get a little more return for everyone in the cycle.

**Arnaud Leroi** ● **Partner, Bain & Company** There is the light integration, where you effectively leave the company to continue developing its products and sales, or a full integration into the larger acquirer. Personally, I have seen the former method deliver good results, but there is no right or wrong way. The model should be informed by the strategy of the acquirer.

If the corporate buys a jewel and wants the jewel to shine, then a lighter integration is more appropriate, because

the start-up retains autonomy and can avoid any internal bureaucracy. A full integration is a good option when the deal rationale is to acquire some technology or particular capability, like a retailer investing in digital.

Good parents to start-ups are extremely selective during the integration process. There needs to be someone who stands between the large corporate and start-up, who can say no to the corporate when it wants to implement some kind of company process in the start-up.

Good integration comes with experience and sometimes companies learn the hard way and make mistakes before doing things right.

**Dawn Belt,** **Partner,**  
**Fenwick & West**

There are a number of ways of looking at this and different models will work for different businesses. Parent companies need to understand that they are buying centers of innovation and treat them accordingly. The start-up business needs to be given a clear idea of what is expected. Even if the rationale for the bid is a talent play or acqui-hire, the company needs to understand they have a team of talented engineers and needs to plug them into the right part of the business.

As part of a larger organization, the start-up employees that move to the bigger company may have to change their mentality too. For many, it can be a very exciting time. They may suddenly find that they have a lot more resources to deploy. But they might also find that they have less autonomy in pursuing the projects they are most passionate about, or in defining the direction a particular product or technology may take. They have to think about the impact that they



can make on the organization. They need to get a good sense of a business model, as there may be less room for experimentation. If they are integrated into the business, they need to think about moving the product forward – they should be looking at optimizing and growing it.

On the other hand, if the parent company is looking to keep the business separate, then they need to give the start-up team more autonomy. Businesses need to think carefully about which approach is the right one and which one is going to be successful in any particular case.

**Mergermarket** **What are the most common points of tension between a large company and a start-up after acquisition? What are the best ways of resolving conflicts when they arise?**

**Jamie Leigh** ● I am a broken record on this point. People are the reason that we do deals for the most part, and so aligning expectations with respect to integration is, of course, the number one, two, three, four, and five priority. So clear communication channels, clear reporting channels, clear integration and onboarding of employees are the main areas where we see hiccups.

There are sometimes simply just inevitable clashes between the way a former exec team wants to continue and the way the acquiring company sees the future; and sometimes you just can't know that until you actually start working together.

I think a healthy acknowledgment that not everything can be planned for or knowable up front, and having some confidence in the flexibility that it will take to get through that first few months of integration from a human resources perspective is really important.

Sometimes start-up companies are either way too optimistic or way too defeatist. Instead of bringing that really creative spirit and problem-solving mentality into the larger company, the attitude can be: "Well, I don't get to do my own thing anymore so I'm not even going to try" or "These people want me to do my start-up thing and also have 42 layers of reporting." Displaying some real tenacity and flexibility at this stage is crucial.

I think you also want to provide your people with some marketing tools to talk about the acquisition. What gets out in the street is hugely important for the buyer, the seller, the investors and the former stockholders. Everybody wants to be able to rally around the good parts of the deal. Thinking about the key talking

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points and putting these front and center for all participants is important.

**Arnaud Leroi**, ● One big element is really the relationship between the top executives. What kind of relationship has the owner of the start-up maintained with the corporate team now that they are in control? If trust breaks down between the start-up's senior people and the new company then you start to encounter difficulties, because those founders are the people who are going to be able to solve 90% of the problems during the initial period of integration.

The former owner needs to feel empowered to make strategic decisions, put forward ideas and recommend acquisition targets. If that channel of communication is not open, you can easily end up in a situation where the former owner checks out and does the minimum to secure the earn-out.

On the point about earn-outs, both the acquirer and the owner need to start the earn-out before there are deadlines. Earn-outs can be a barrier towards the execution of a better strategy. For the buyer, get on the front foot with earn-outs and be ready to renegotiate earn-outs, or pay them earlier, if you realize that

keeping a former owner locked in is not helping the objectives of your company.

**Dawn Belt, Partner, Fenwick & West** ● Buyers need to think about the existing workforce and how they feel about these “new kids.” They may have had big payouts as a result of the sale transaction. These new employees may also be seen as favored citizens compared to the incumbents – who are on different financial and incentive packages – and this can cause tension within the employee base. The parent company needs to make sure that everyone feels valued.



I also agree that earn-outs, despite being popular, can cause tension and leave nobody happy. Acquirers use them if they are looking to bridge valuation, but implementation does not always match expectation. The former start-up team may feel that it didn't get enough backing from the parent company to achieve the earn-out, while the parent believes the team didn't execute on it properly. The devil is very much in the details.

**Mergermarket** ● **Traditionally, acquisitions of start-ups and young companies have been most common in the tech industry. Do you think we will see more activity of this kind in other sectors going forward? If so, in which sectors do you think deals are most likely to happen and why?**

**Arnaud Leroi, Partner, Bain & Company** ● What has been happening in the pharmaceutical industry is a good illustration of this dynamic. Pharmaceuticals companies still do a lot of their own R&D but have been very good at acquiring smaller life sciences businesses. These smaller companies have been able to develop compounds at a faster pace and the big pharma companies have acknowledged this and turned to M&A to buy in this R&D.

We are also seeing a lot in the retail industry, with retailers investing in smaller digital companies. Business-to-business and healthcare groups are doing the same. Technology is changing the way all companies engage with clients and deliver services, and it is faster to buy in this expertise than build it from scratch organically.

**Jamie Leigh, Partner, Cooley** ● I totally agree with the point on life sciences. There are always these small

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## "Cross-sector acquisition from more traditional sectors into technology will continue to be a big part of the business world."

**Dawn Belt, Fenwick & West**

deals that happen to take innovative teams or innovative drugs, or early pipeline products. That industry will always keep doing those kinds of deals, in the same way they've always done, because that pipeline of talent and science is so important.

Overall, I would say tech gets a lot of the press, but some of our less sexy industries are probably copying what tech companies are doing without us being attuned to it.

We are seeing patterns in other sectors mirror what happened in tech with the early disruptor companies. We are seeing the most parallels in transportation, health & wellness and commercial retail.

We're seeing a lot of innovators and a lot of entrepreneurs decide that they want to go and apply the same process to something that matters to them. Maybe it's food production and delivery or green and clean beauty. Maybe it's a move away from fast fashion. The tech model is being used in other sectors.

is now a huge industry with US\$30 billion deployed in 2017, and some large, well established players like Intel Capital and Comcast Ventures really lead in this space. In some ways, despite its size, it's flying under the radar. More tech companies will continue to make significant investments.

And I think we will see other sectors using CVC to enter the tech market, alongside more traditional deal activity. These companies may be seeking return on investment, but generally have more strategic reasons for pursuing CVC activities. This is particularly notable in the fintech sector, but we're seeing companies in the transportation, food and other traditional industries engaging in this activity as well. CVC can be a very effective way to get a foothold in the tech sector and learn more about how technology can enhance their existing businesses.

And, of course, cross-sector acquisition from more traditional sectors into technology will continue to be a big part of the business world. This is particularly true of the consumer sector, for example. We've seen Walmart buying Bonobos and Flipkart and there will be more deals like this. Different industries will continue to look at the technology and pick up start-ups to enhance their businesses.

**Dawn Belt, Partner, Fenwick & West** ● This is definitely going to happen and not just with traditional M&A or joint ventures, but also with the growth of corporate venture capital (CVC). Corporate venture

# Capital Markets

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Toppan Vintage provides software and services to handle mission-critical content that enables our clients to communicate more effectively and efficiently. We provide these services for capital markets transactions, financial reporting and regulatory compliance filings, investment companies and insurance providers.

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