

## The Relationships That Create Successful Acquisitions



By Laurence Capron , INSEAD

**A study of start-up acquisitions shows important patterns on both sides lead to a successful integration.**

With a constant need to grow and innovate, established firms often look outside for novel products by collaborating with and acquiring start-ups. For start-ups, a tried-and-true exit strategy is acquisition, but it's often a perilous journey as between **70 and 90 percent of M&As fail**. In a recent article for *California Management Review*, Nir N. Brueller and I found that start-ups seeking an incumbent sponsor are more likely to succeed if they keep certain patterns in mind.

We created a multiple-case, inductive study of seven Israeli start-ups that were acquired by two incumbents in the IT industry to uncover the different approaches pursued by the start-up firms and their acquirers to manage pre- and post-acquisition processes. Any start-up working with an incumbent

must build a kind of synergy or combined value together. It doesn't just come about the day that the deal is signed; this combined value can be created well ahead of the acquisition itself.

### **Competition or collaboration/integration?**

When it comes to exit strategies, start-ups have two main routes to consolidate further resources: either an IPO or an alliance/acquisition with a larger firm. An IPO, or even the search for private investors, is a competitive route. The second route is collaborative or integrative, allowing the start-up to scale up more quickly with a form of collaboration with an incumbent.

A collaboration could entail licensing, or an alliance, or an alliance plus equity, to start. An incumbent might consider a minority equity investment and move towards full acquisition. Handled well, it can be a kind of journey in which the start-up and incumbent work well together, upgrading the relationship and moving towards a more substantial strategic alliance. When there is a synergistic value, it may lead to a full acquisition or integration.

### **The 3Cs of co-specialisation**

Together, with the right steps and relationship-building, the partnership's value can add up to more than the sum of the parts of the two firms. The development process of targeted start-ups includes mastering three aspects of the relationship while enhancing co-specialisation with the acquirer, what we call the 3Cs: establishing a **C**omplementarity of offerings, generating **C**ustomer endorsement, and attracting an acquirer executive **C**hampion.

#### *Complementary offerings*

Start-ups need to decide if their model will be competitive or compatible when working with larger firms. With competitive overlapping, a start-up's activities are not necessarily relevant for the incumbent. A more complementary offering, on the other hand, can bridge a needs gap between start-up and incumbent, allowing for deeper information about the market, the product or customers.

This pattern moves in both directions, from the incumbents as well as the new firms. Incumbents considering new trends, like sustainability, digitalisation and so on, need to join new ecosystems, like organic brands for established food conglomerates or AI for an incumbent IT firm. The more engaged in the ecosystem of the target firm, the more investment the

incumbent has in building a relationship with the right firm that will complement current offerings.

### *Customer endorsement*

Recommendations from existing customers are an excellent support for the start-up pursuing acquisition. Ideally, a client straddles both the new firm and incumbent for a time. An existing customer may endorse the start-up's product, leading to product bundling with the larger firm, then perhaps an alliance and finally an acquisition.

The incumbent, having worked extensively with their customers and the new firm, has a much clearer idea of the target price.

When incumbents consider combinative value, e.g. how the firms add value to one another, they can also identify which out of a field of start-ups is the best target. Using more refined criteria, an incumbent can select which products will work well within their current portfolio and will be endorsed by their current customers.

### *Champion in-house*

For a seamless post-merger integration, an executive champion on the incumbent side is necessary. Without a champion, there is a lack of accountability on the part of the acquirer.

A champion is critical for successful absorption of the start-up, aiding people from the new firm and the established one to implement shared targets. Excitement from within the incumbent firm translates into better conditions for the acquired firm.

These three conditions increase the odds of success, but they don't guarantee it. There are a multitude of reasons for an acquisition to fail, but start-ups and incumbents can increase the odds of a rewarding integration.

## **Benefits for start-ups and incumbents**

A synergistic value, the combined value of a start-up and incumbent, can be created well ahead of the acquisition deal. Because usually they are embedded in the same ecosystem, there is a rich set of interactions that encourage co-specialisation.

Start-ups created for acquisition can consider an integrative route, from inception through to the post-merger integration. The combinative value created from this collaborative process benefits all.

A short video summary of the CMR article is available [here](#).

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#### About the research

**"Acquisitions of Startups by Incumbents: The 3 Cs of Co-Specialization from Startup Inception to Post-Merger Integration"** is published in *California Management Review*.

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#### About the series

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