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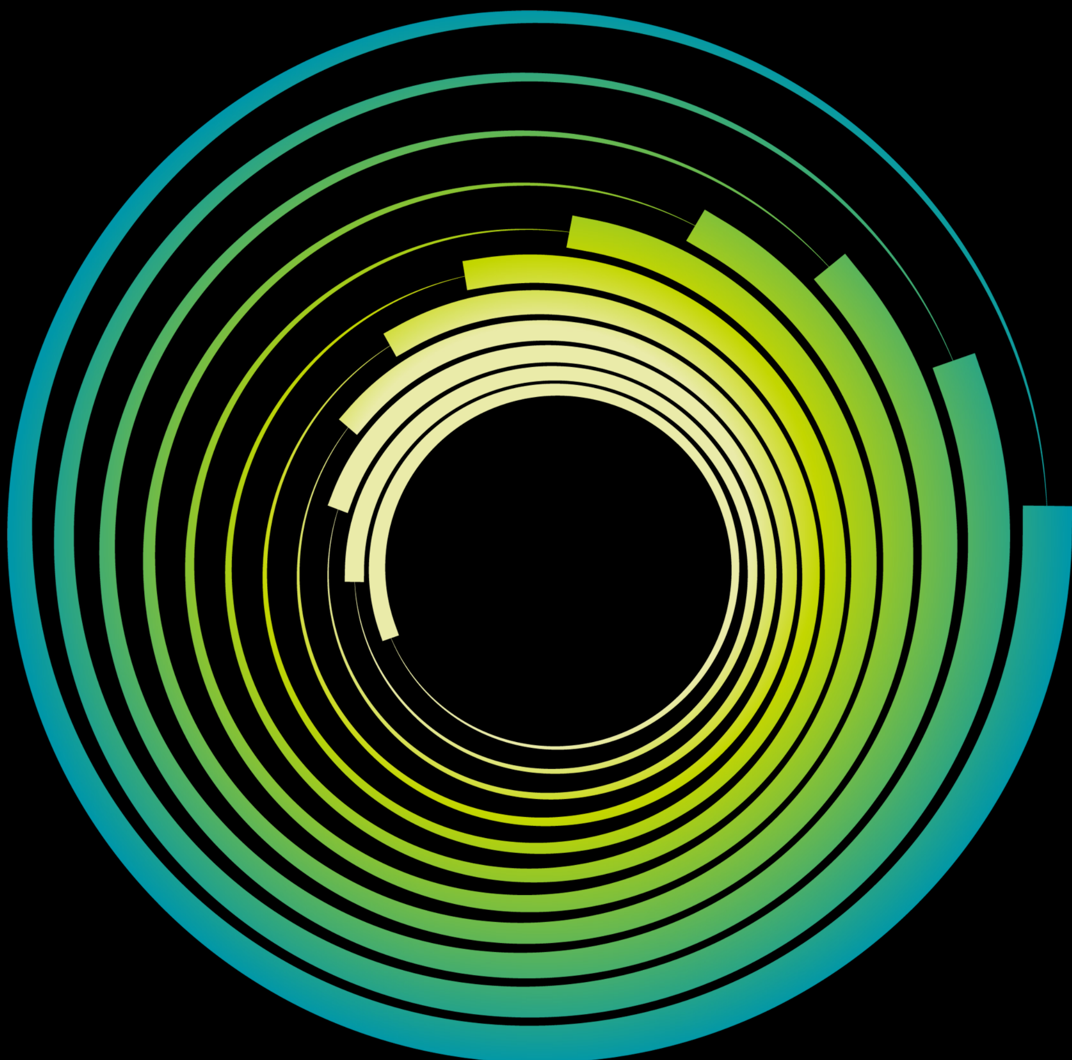


Transforming through external innovation in life sciences

Using technology acquisitions to thrive in a time of convergence and disruption

Size is in the eye of the beholder—a small acquisition for one organization could be a mega-merger for another. This difference in perception is at the core of many challenges of an M&A transaction, yet even more important is the relative size difference between the buyer and target company (whether based on ratios of revenues, assets, or the number of employees). Deal theses focused on acquiring new capabilities outside the core business of the buyer, particularly when the target is focused on deep technological expertise and innovation, can add even greater layers of complexity. The challenges faced may range from balancing the level of management attention to give the target (from a financial perspective they can often be treated as rounding errors), managing and retaining key talent (especially the founder and leadership team), and mitigating cyber and physical security threats (which tend to be a much lower priority for smaller organizations).

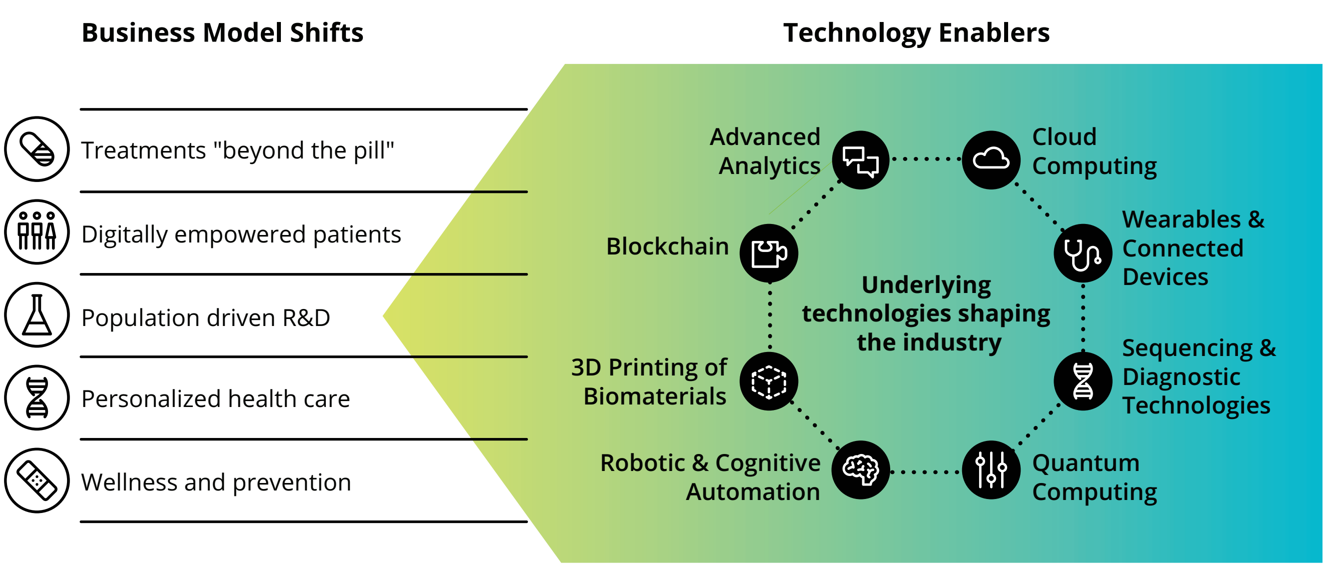
As the volume and strategic importance of these smaller, technology and capability-focused acquisitions continue to rise, a central question corporate leaders tend to ask is: “What is the most appropriate integration strategy for integrating a small technology company?” Although there is no silver bullet solution, there are commonalities and key considerations that can help inform and enhance your company’s approach to different small technology acquisitions.

Small technology acquisitions in life sciences

Small tech acquisitions in life sciences have become more prominent as technological innovation outside the lab and clinic are becoming a competitive advantage (see figure 1). For example, many life sciences companies are considering the use of AI to augment research and development, digital biomarkers to validate clinical efficacy, and virtual patient engagement tools as foundations for patient-centered health care delivery.[1] As a result, many business leaders are eagerly searching for ways to turn this new environment from a cause for concern to a way to reshape their business model; in fact, in a survey of strategic drivers, a cross-industry panel of senior executives cited technology acquisitions as the most important.[2]

In response, companies are increasingly acquiring small technology companies to obtain the technological experience, talent, and products needed to harness the potential in the high-growth corners of the industry. Globally, buyers from different industries spent around $877 billion between 2015–2018 on advanced technology and cross-capability deals; one-third of these deals fell in the $50 million to $1 billion range.[3] Hence, M&A and alternative deal structures (such as strategic alliances and ecosystem investments) can provide a fast track for life sciences companies to drive growth, create value, and disrupt the market.

Figure 1. Business model shifts and technological innovation driving small technology deal activity



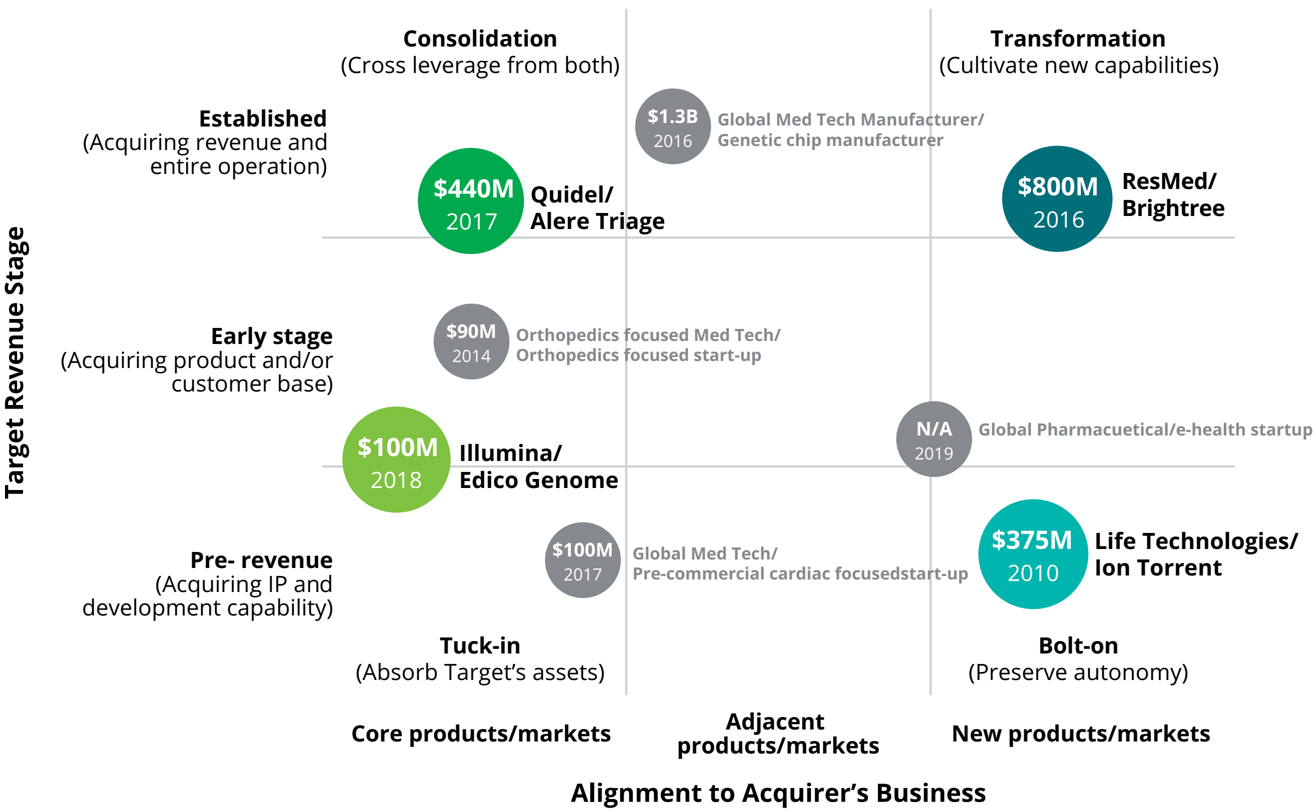
Source: Deloitte Consulting LLP, 2019.

When executing these small entrepreneurial technology deals, even companies with historically strong M&A experience can face novel and unprecedented challenges. From deal strategy through integration, unique strategic, operational, human capital, and technology stumbling blocks can hinder performance and reduce the deal's return on investment. Through our experience, Deloitte has observed several recurring patterns across deal integration strategies that can be useful for M&A leaders when exploring integration strategies.

Integration strategies for small technology acquisitions

When considering recent market deal activity and trends, the revenue stage of the target and degree of alignment between the buyer's and target's businesses appear to be the most prominent factors influencing the chosen integration strategy (see figure 2).

Figure 2. Integration strategy matrix



Source: Deloitte Consulting LLP, 2019; company press releases.[4, 5, 6, 7, 8, 9]

1 Tuck-ins

Targets whose offering is close to the acquirer's core business while being at an earlier revenue stage have most commonly been integrated following a "tuck-in" strategy—where the target is fully integrated within the buyer's existing operations and business unit. These are typically deals that focus on a very specific technological advancement that complements the buyer's product offering—breakthrough technology acquisitions. For example, Illumina, a biotech company in the genetic sequencing market, acquired Edico Genome, a novel bio-informatic startup, to leverage its proprietary software algorithms to reduce both data footprint and time to results of Illumina's sequencing offering—the technology was fully integrated in their product offering.[4, 5]

Tuck-ins of small technology organizations have unique challenges. Foremost, fully integrating the nimble target organization into a much larger, bureaucratic, and political buyer organization tends to subsume the culture that ultimately allowed the target to build its value proposition. In turn, this may harm the nimbleness that is required to achieve the entire deal thesis. Many would, rightfully, argue that the bigger challenge is managing talent retention. The founder being the most challenging—why would someone that thrives on entrepreneurship stay in an organization with much more structure? Retaining the founder in the near term is critical as they often have significant followership—why would leadership and staff stay without the visionary leader that brought them to where they are today? As a mitigation, some buyers have made sure the founder (and critical talent) is coached by executive mentors, providing guidance on how to grow and succeed in the buyer organization. Alternatively, founders (and critical talent) are often given milestone-based incentive packages to stay on, similar to the incentive plans of a private equity buyout.

It is clear these are not the only challenges one might face integrating a target; however, for the sake of brevity, we have summarized several of the most common and critical challenges as well as leading practices in figure 3.

2 Consolidations

When the target has an established revenue stream and the products are core to that of the buyer organization, consolidation of the target and buyer has been a common integration strategy—harmonizing operations into a restructured business unit. These deals are often technology portfolio acquisitions. For example, Quidel, a provider of diagnostic testing solutions, acquired Alere Triage, a provider of cardiovascular point-of-care (POC) diagnostics, to diversify its business by seasonality and geography, while strengthening its position in the POC market[4]—consolidating Alere Triage's portfolio into Quidel's operations.

As these deals have a different strategic rationale, they have challenges that are different from tuck-ins. First, there is often a (cost and/or revenue) synergy component that is critical to the deal value. If synergy capture incentives are not established across the target and buyer organization before close, value leakage becomes a common issue. Furthermore, integration activities tend to hamper the target's operations (in terms of efficiency and morale) as the target organization typically does not have spare capacity to manage the integration in addition to its daily operations; individual employees at the target organization often have responsibilities that span multiple roles within the buyer organization. To address this, companies should prioritize integration activities, focusing on markets or development programs most vital to deliver deal value. Phasing the integration can reduce the impact on the target and minimize business disruption.

Again, these are not the only challenges one might face integrating a target—see a summary of several of the most common and critical challenges as well as leading practices in figure 3.

3

Transformations

When the target company focuses on products and markets outside the buyer's core operations and has existing revenue streams, a transformation integration strategy is often pursued—overhauling the combined buyer/target organization by establishing a new business unit or entity. These kinds of integrations are often acquisitions where the acquirer is looking to enter a new market. For example, when ResMed, a global leader in connected health care solutions, acquired Brightree, a software solution developer for the post-acute care industry, it augmented and expanded Brightree's offering with capabilities to connect to ResMed's products—transforming the combined ResMed/Brightree portfolio and operations.[7]

By definition, these integrations are more disruptive to the organization, restructuring the combined entity's efforts and operations to achieve the goals and benefits laid out in the deal thesis. To be able to establish the deal thesis, among the first challenges when considering a transformation is identifying the "secret sauce"—the capability, cultural archetypes, people, or IP, that is core to the deal value—and striving to ensure this is retained while transforming the business. Secondly, a common pitfall is losing the acquired technology in the shuffle—starving it from the requisite attention, investment, and resourcing of management. In response to these challenges, consider establishing scenario-models that help identify the components critical to the success of the deal and to generating material incremental value. To avoid losing the "secret sauce," one potential approach for deal sponsors to consider is ring-fencing the technology and people in the near term, helping ensure sufficient resources and attention are provided.

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4

Bolt-ons

When the target company focuses on products and markets outside the buyer's core operations and does not yet have a revenue stream, a bolt-on integration strategy is often pursued—keeping the target organization at arm's length as a separate business entity. These are often acquisitions where the acquirer is looking to establish an innovation hub for product development. For example, Life Technologies, a leading DNA sequencing platform company, acquired Ion Torrent, a startup developing an alternative sequencing platform, to establish a foothold in next-gen technology to compete with the market leader—keeping the target as an independent scientific and development entity.[8]

This integration strategy is most different from the others and may be considered "value destroying" in certain scenarios. One of the most significant challenges for a bolt-on integration strategy is therefore identifying the way in which the buyer can deliver incremental value while keeping the business stand-alone. In turn, the buyer will need to find the right level of support to provide for corporate coordination and establish ways to effectively work together with the target—creating knowledge-sharing opportunities for both target and buyer employees. Similar to tuck-in acquisitions, many companies use milestone-based incentive structures to maintain momentum and realize deal value. In addition, companies should consider placing significant focus on understanding talent needs from a workplace, culture, and total rewards perspective to help ensure the target's employees truly feel they can maintain their identity.

Again, these are not the only challenges one might face integrating a target—see a summary of several of the most common and critical challenges as well as leading practices in figure 3.

Figure 3. Summary of several observed challenges and leading practices for different integration models

TUCK-IN

Ineffective synergy diligence due to lack of buyer's technology expertise
Rigorously evaluate technology

Finding right speed of integration without harming nimbleness
Develop integration approach during diligence phase

Subsuming the target culture into more traditional ways of work
Engage target's team early on to build integration efforts

Considering cyber security as a one-time investment
Conduct cyber diligence and build it into valuation model

TRANSFORM

Identifying the 'secret sauce' to realize deal value
Perform scenario modeling to assess implications of different business models

Losing the acquired technology in the shuffle and starving it of investment
Keep the target's platform ring-fenced in the near term

Balancing decision rights across buyer and target leadership
Align sponsors during pre-close stage at key intervals

Avoiding data breaches stemming from disgruntled employees
Allocate cyber due diligence budgets up front

CONSOLIDATE

Inadequate synergy-capture diligence before deal close
Estimate revenue and cost synergies early on to accelerate decision-making

Limited prioritization of integration efforts leading to value leakage
Phase the integration to minimize disruption

Lack of clarity on path forward leading to loss of talent and business disruption
Set up interim operating model with right incentives for target

Under-developed data security capabilities of target leading to delayed integration
Conduct cyber security assessments starting Day 1 to ensure smooth scaling up

BOLT-ON

Identifying ways to deliver incremental value whilst keeping business stand-alone
Use a milestone-based incentive structure

Inadequate support for corporate coordination
Keep functions core to value (e.g., R&D) at an arm's length

Failure to establish ways of working together and knowledge-sharing
Understand location and talent needs using a holistic lens

Inadequate review of security capabilities to ensure most critical data is protected
Manage 'network connections' in terms of physical and electronic data transfer

KEY:
Bold = **Observed challenges**
Italic = *Leading practices*

Deal Strategy | Deal Operations | Human Capital | Technology and Cyber

Source: Deloitte Consulting LLP, 2019.

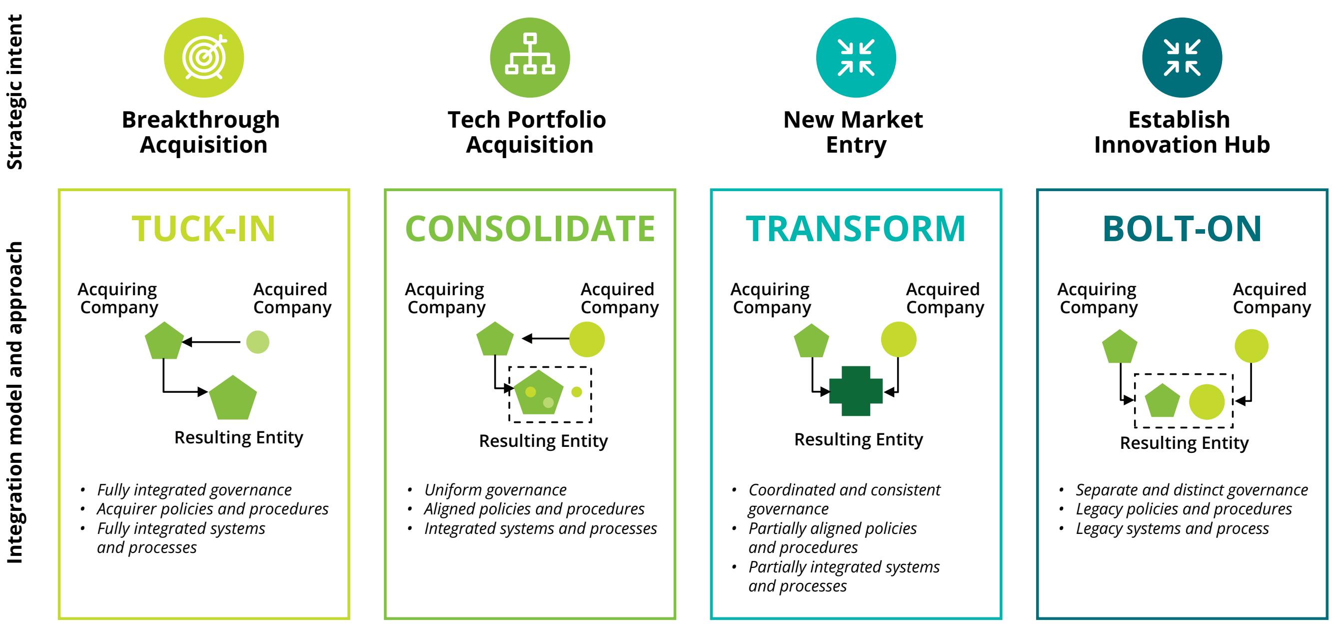
Choosing the right integration strategy

We appreciate that there is no one-size-fits-all strategy for any acquisition, let alone the diverse set of small technology acquisitions that life sciences companies are undertaking. What is clear is that these acquisitions require unique integration strategies and approaches, different from what many experienced M&A and corporate development teams may be used to. Deloitte previously published perspectives outlining several challenges and leading practices related to small technology acquisitions, including: (1) maintaining the "secret sauce" from a people standpoint[10]; (2) minimizing disruption to business operations[11]; and (3) managing the risks associated with cybersecurity.[12] In addition to these, this paper provides a case study-based framework to help inform decision making, summarized in figure 3.

For life sciences companies planning or actively pursuing small technology transactions, they should consider posing the following questions to themselves early in the deal life cycle:

- What additional **due diligence topics do we need to consider when evaluating a small technology target**? Do we need to adjust our due diligence approach?
- What does our **past experience** as a buyer demonstrate? What are our **reference points** for the success or lack thereof for various approaches?
- How do we **identify, prioritize, and amplify the value drivers**? Do they receive equal weight for integration planning?
- What is realistic for retention, and how do we **price in the cost of retention** and the cost of turnover?
- What **variations from our standards are acceptable** for integration (e.g., policies, processes, systems)?

Figure 4. Summary of integration strategies



Source: Deloitte Consulting LLP, 2019.

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Endnotes

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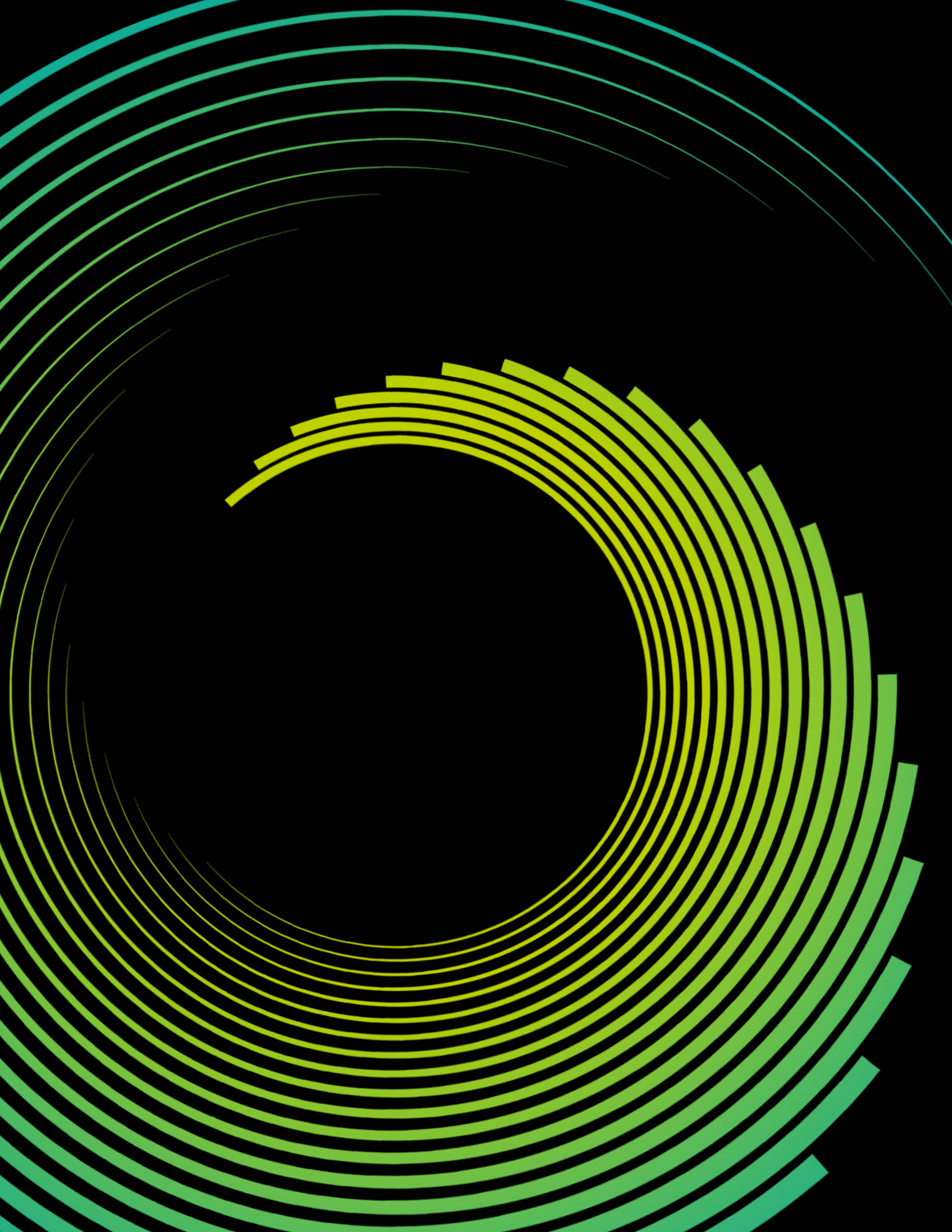

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