



# USER FRIENDLY

## Does your billion-dollar unicorn have post-merger integration blues?

Marco Sguazzin, TMT Industry leader for Mergers & Acquisitions

Joost Krikhaar, High Technology M&A Integration and Divestitures leader

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**Marco**

**Heidi:** As the pace of technological innovations quickens, mergers and acquisitions appear to be providing a fast track for companies to accelerate product roadmaps, gain access to new tech and new markets, and fend off competition. In 2017 the technology, media, and telecommunications industry recorded an all-time high of close to 3,400 M&A transactions globally, worth a total of nearly \$500 billion. Some of these deals involved well-funded unicorns—companies that are valued at more than \$1 billion. So while these transactions can yield big dividends, they clearly present unique challenges. On today's episode of User Friendly, we'll dive into the

hurdles that a company must overcome to conduct successful deals in the TMT industry. Welcome to User Friendly.

Hello, this is Heidi Rataj and today I'm joined by Marco Sguazzin and Joost Kirkhaar, two of Deloitte's preeminent M&A leaders for technology, media, and telecommunications. Marco and Joost, welcome to the show!

**Marco:** Hello, Heidi. Thanks for having us on.

**Joost:** Hey Heidi, I'm excited to be here with you to talk today about unicorns and M&A.

**Heidi:** You recently published a paper that discusses M&A transactions involving unicorns. Joost, can you briefly explain the terminology here?

**Joost:** We all became familiar with the term unicorn, a start-up company that's valued at \$1 billion or more. And in the early 2000s, actually not that long ago, this was almost an elusive goal, to be a start-up funded by private money yet topping a billion dollars in valuation, whereas now estimates of companies having achieved this status runs in the hundreds. TechCrunch currently estimates that there are 278 unicorns in existence with an estimated value of just shy of a trillion dollars. And as unicorns become more valuable, we've introduced a new term called a Decacorn for unicorns that have a value over \$10 billion. What's important for today is that the number of unicorns has risen and the IPO market has been challenging over the last few years, and as a result, we're starting to see more unicorns become part of an acquisition. And that's what our paper was about, so we reflected a little bit on what's different about unicorns and acquisitions and integration, and how we think about that.

**Heidi:** It seems that companies pursue mergers and acquisitions for a lot of reasons: to acquire specific technologies, to access new markets, to broaden a product or service portfolio and, of course, to gain new talent. Many of these transactions, though, can be doomed from the start. Marco, could you explain this phenomenon?

**Marco:** Most of these transactions eventually fall short of their expectations. The single biggest factor for this is that management didn't really understand the drivers of value in their respective deals.

**Heidi:** Where would they fall short?

**Marco:** I think you really have to enter the M&A life cycle with the end goal in mind and use that to inform every decision that you will ultimately make in the integration process that goes forward from there.

You really need to ask yourself, what is the investment thesis? What are we in fact trying to achieve? What is the value proposition that presents itself with this unique acquisition, and can we ultimately articulate it in a manner that everyone can understand and, therefore, line up behind and execute upon. I'd say those are really the keys. If you're able to focus on those, you're on a great start to your integration journey.

**Heidi:** Joost, how do you think these mistakes can be avoided?

**Joost:** Well, I think Marco sort of alluded to what really are the keys to the solution, which is unpacked deal rationale. There is a reason why a buyer is interested in adding a unicorn or, quite frankly, any acquisition (it's just that unicorns are a special breed of companies) to the portfolio. And if you're able to unpack that deal rationale to value drivers and understand what really matters to create value, that is the path to understanding what to do with that unicorn and how to treat that organization. Now, obviously there are many other elements to keep an eye out for, such as culture, how the unicorn came about, and leadership. There's a lot to be said about the unicorns, but the starting point is what Marco alluded to, which is to start with the end in mind.

**Heidi:** In terms of these different types of acquisitions, can you talk a little bit about how these deals are different in nature?

**Joost:** Tech and talent tends to refer to smaller start-up acquisitions that typically get acquired for either technology that the company has developed or is developing, or a small group of people that have a very advanced level of thinking and knowledge about a particular product, market, or solution, or a combination. Often the customer base and the revenue volume of this type of start-up is small and not usually the focus of the acquisition. The acquirer quickly assimilates the people and products into their roadmap and their organization, and oftentimes does not



even care that much about the potential early revenue or early customers. We see that happening in sort of the next wave of growth: cognitive computing, machine learning, and artificial intelligence. On the other side, the unicorns tend to be a little bit more strategic in nature, where the acquired organization already has a proven business model and ability to rapidly grow, hence the high valuation. It comes with a substantial customer base, with an ecosystem, sometimes partners, channel partners, or companies that add value in the ecosystem to the unicorn. And after the acquisition, the unicorn continues to operate. Sooner or later, the acquirer will need to decide what to do with the unicorn and how to best integrate the unicorn or allow it to operate autonomously.

**Heidi:** Marco, in terms of the acquisitions of unicorns, what are some tips for addressing these kinds of challenges?

**Marco:** The expectations on unicorns are often quite different. They come with lofty growth expectations that often come with a singular or homogeneous vision, or they come with a business model that differs from the acquiring company. How you add those assets of the buyer to those unique strengths so that you can accelerate their progress as you move through this integration process goes back to really understanding what you're buying and why you're buying it, where value will be created, and then trying to create a unique integration strategy.

**Heidi:** In the unicorn paper, you described this specific framework, addressing the integration dilemma that arises in purchasing unicorns. What are some specific examples of how this framework has been applied in the real world?

**Marco:** I think this framework basically maps an acquisition on two different axes: the first axis being how similar the two companies are in size and how some of their respective business models are. For example, if you consider smaller acquisitions of the tech and talent type,

you have typically a large disparity in size, but often similar business models and, as such, these integrations are less complex because integration of the target company will simply be the adoption of the acquirer's process. But when you have a large similarity in size and a dissimilarity in business models, you are now dealing with the proverbial merger of equals and the clash of business models. And in this example, it isn't really clear what the eventual organization will look like when you first set out. We often map transactions on these two axes. And for us that helps categorize the acquisition into a few different archetypes: tech and talent deal, or a bolt-on type of deal or consolidation type of deal, or perhaps even a transformation type of deal.

**Heidi:** I thought we could play a quick rapid-fire game, thirty-second debate.

**Marco:** Let's get it on.

**Joost:** Let's do it.

**Heidi:** Okay, so I'm going to give you thirty seconds to present your side of the argument. Joost, we'll start with you. Why is integration a better play? Timer starts now.

**Joost:** I'll give you three simple reasons: one, the unicorn is not a collector's item. To meet the strategic reasons and earn back to purchase premium, the core will have to do something to make the unicorn grow faster than it did by itself. Two, synergies do not happen by themselves. It takes work and smart integration. Third, once the unicorn is caught, it's not independent anymore. It needs a new goal to achieve growth, and the acquirer will have to replace autonomy with a new vision that brings the question—so what now?

**Heidi:** All right, Marco, handing it over to you. Tell us why autonomy is best.

**Marco:** Number one, I think the acquired company may be smothered by the larger acquiring company's processes or bureaucracy or overheads or slowness.

“Synergies do not happen by themselves. It takes work and smart integration.”

**Joost**

The second reason it can be very hard to mix newly acquired business models into the fabric of an established company is that buyers simply don't have the capability to manage different business models very often. Another reason is the acquired unicorn more often than not has a very different culture than the acquirer. Typically it follows and is very loyal to its evangelical founder, and the mission and culture is notoriously hard to integrate. And maybe lastly, the unicorns are typically structured for speed. Decisions are fast, R&D is very focused and fast, the whole structure is set up for speed and agility, and that can really be matched by large acquirers.

**Heidi:** Excellent. Great job, gentlemen, on both parts. I will give a little bit more credit to Joost who did finish his answer in thirty seconds. Marco, you were over by 12 seconds, but that's okay. It's our first game, and I really appreciate your participation, so we'll do a little ding ding for the time period. Well done. So, moving back to our show, of course, there is an alternative to acquiring a company. You can invest in a unicorn instead of acquiring it. Marco, would you talk a little bit about the benefits of this approach versus an outright acquisition?

**Marco:** It preserves the agility, it preserves the focus, it preserves the incentive and the independence that has created value up until that point for the unicorn, so you definitely retain those things. It also provides a way

to place multiple bets, if one needs strategic flexibility in the marketplace. In an acquisition you're basically placing one bet, but with investments you can place multiple bets and see which ones really pan out. And it can often be a more acceptable move to accompany ecosystem partners. It may not redraw the lines of competition very much, and it doesn't upset the ecosystem quite as much as an outright acquisition.

**Heidi:** Joost, final thoughts about the benefits of this approach versus an outright acquisition.

**Joost:** Unicorns exist, at least in an M&A landscape. Acquisitions are here to stay. What we're doing here is trying to provide a perspective and a framework about the challenges of bridging the different business models—the one vision that the unicorn brings, the passion that the employees bring into the larger organization and that the buyer has—rather than owning a unicorn and leaving it alone and hoping it continues to grow. What do you do with these unicorns? We have to continue to think about that with this framework, how to tackle it.

**Heidi:** Before I turn over to closing remarks, Marco, did you have any final thoughts?

**Marco:** Despite arguing the “do not integrate” case, at the end of the day I actually do believe that in the long run, integration is better than not integrating.

Not integrating just simply leads to incompatible systems, incompatible technologies, no economies of scale. Integration is often best done in a way that is unique to that particular deal, where only certain elements are integrated at first, which are typically those that create value when measured against the original deal thesis.

**Heidi:** That wraps up this episode of User-Friendly, your go-to podcast to navigate new trends in tech, media, and telecom. I want to thank my guests, Marco Sguazzin and Joost Kirkhaar, for sharing their insights on mergers and acquisitions, or how to care for your unicorn.

**Marco:** Thanks very much, Heidi, and thank you, Joost. Always a pleasure to share ideas with you.

**Joost:** Yes, thanks and looking forward to continuing the conversation on or off podcast.

**Heidi:** Join us for the rest of season two, as we cover everything from artificial intelligence, to the future of home entertainment, to the continued digital revolution. Thanks for joining us.

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