Acqui-Hires

Revolutionizing Strategy & Transforming Organizational Structures

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Table of Contents

Abstract

This paper explores the phenomenon of "acqui-hires", defined as acquisitions of early-stage startups made purely to acquire talent. Acqui-hires are prevalent among Northern California's high-technology companies, who use these to fill gaps in their strategic roadmaps. Taking the perspective of an acquirer, we examine the different ways acquirers approach acqui-hires relative to conventional acquisitions. We define how acqui-hired transactions and targets stand out from their conventional counterparts, namely shorter lifespans, less funding from institutional investors and concentrated in certain market focuses. Although acqui-hires are distinct from conventional acquisitions, they can be scored on the linear Acqui-hire Score Scale, which is based on the eventual fate of the target company's main product. We found that 83% of companies making an acqui-hire stop operating the target's product whereas 50% sell it off. Acqui-hires are a true hybrid between conventional acquisitions and conventional hiring. While acquisition integration is usually ineffective, acqui-hires ease this challenge by creating new organizational structures that integrate the target company while enabling it to function as a startup. We propose five essential prerequisites for acqui-hires in an industry: ease of independent work; high value attached to specialized, non-commodity capabilities; specificity of attributing success and failure; flexible hiring culture; and low externalities.

Keywords: acquisitions, M&A, startups, venture capital, Silicon Valley, acqui-hire, talent acquisition

Introduction

In the last five years, those who study mergers and acquisitions have seen a baffling phenomenon spread through Silicon Valley. Leading consumer Internet companies, such as Facebook, Google, Twitter and Zynga, have made a number of acquisitions reported widely in the technology press. The price tag for these acquisitions runs into the millions of dollars, but the target companies are typically very early in their life and do not have revenues. In fact, they frequently do not even have a finished product. If they do have a product, it often gets shuttered within the acquirer, leaving the employees of the just acquired company free to work on other projects. These acquisitions mystify experts who study corporate development and acquisitions because they have none of the hard assets that are conventionally valued in an acquisition. It would appear instead that these acquisitions are done in order to hire key employees of the target company. In Silicon Valley parlance, these acquisitions are known as "acqui-hires", a portmanteau of 'acquisition' and 'hire'.

Firms such as Google and Facebook wield acqui-hires as a key weapon in their corporate strategy arsenals in their quest for securing strategic advantage in the fast-paced Internet industry[1]. Upon inauguration as CEO of Yahoo!, Marissa Mayer, a former employee of Google, announced that acqui-hires would be part of her strategy to restore the ailing Internet giant to its former glory days[2]. The option to acqui-hire a young startup is transforming how these companies think about innovating and sourcing new capabilities in a dynamic market. In this paper, we will delve deeper into what makes an acquisition an acqui-hire and how these acquirers are using them as a means of growing faster, attaining new competencies and innovating differently.

Review of past literature

Being a relatively recent development in the high-tech industry, acqui-hires have not attracted extensive attention from the academic community. Most recently, Coyle and Polsky[3] state that acqui-hires come about as a result of a severe shortage of engineering talent in Silicon Valley and adherence to Silicon Valley's norms, which promote a cooperative, non-adversarial relationship between startups and their investors. These norms may trigger informal sanctions for founders and engineers who choose to defect en masse to a larger company rather than being acquired by that company. The latter outcome is more favorable to the target company's investors and also cements the perception that a founder takes investor interests into account. Coyle and Polsky further review divergent sets of interests that govern the split of the deal value into deal consideration (an immediate cash payout to stockholders of the

1 Makinen, Haber, and Raymundo, *Acqui-Hires for Growth: Planning for Success* (September 26, 2012). Lowenstein Sandler PC. Available at http://www.lowenstein.com/files/Publication/6118b183-d40e-4a5e-8b95-58236c063a10/Presentation/PublicationAttachment/ea0af508-0319-4e3a-86dd-6452b1b6f15d/AcquiHires%20for%20Growth.pdf
2 N. Carson; "Here is the Plan Marissa Mayer Just Announced to Yahoo! Employees"; Business Insider, Sep 25, 2012; URL: http://www.businessinsider.com/here-is-the-plan-marissa-mayer-just-announced-to-yahoo-employees-2012-9; Retrieved Jan 30, 2013
3 Coyle, John and Polsky, Gregg D., *Acqui-Hiring* (April 16, 2012). UNC Legal Studies Research Paper No. 2040924. Available at SSRN: http://ssrn.com/abstract=2040924

acquired entity) and a deferred compensation pool to the acquired engineers in return for their future services. Specifically, investors, non-engineering hires and others without a continuing relationship with the acquirer would prefer more of the deal value to be allocated to deal consideration, whereas engineers staying on with the acquirer would prefer more of it to be allocated to the latter, so that they have to share economic benefits of the acquisition with fewer people.

In a review of value captured in high-tech acquisitions in particular, Chaudhuri and Tabrizi emphasize the value of employees, and the technological capabilities they bring, to the long-term success of a high-tech acquisition[4]. They advise acquirers to broadcast their product roadmap and market vision on the day of the acquisition announcement, even if the organizational changes arising from acquisition integration may be implemented slowly. Chaudhuri & Tabrizi also advise acquirers against cherry-picking engineers from the target company and dispersing them throughout the organization; the structural continuity that arises from keeping an acquired team intact is likely to yield higher long-term dividends from the acquisition. Keeping teams intact is also cited by Coyle and Polsky as a common occurrence in (and indeed, a common motivation for) acqui-hires. Chaudhuri cites the transfer of tacit knowledge locked in employee behaviors as a core motivation for high-tech acquisitions. He lays out four dimensions that determine the successful integration of human resources from an acquisition: employee retention, the degree of human integration, the speed of human integration and the learning effort engaged in by the acquirer. Because acqui-hires focus on transferring knowledge and skills from the target to the acquirer, acquirers must formulate a strategy with the goals of high retention, high learning effort on the part of the acquirer, and a moderate degree and pace of human integration.

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4 S. Chaudhuri, B. Tabrizi; "Capturing the Real Value in High-Tech Acquisitions", Harvard Business Review, Sep-Oct 1999

Rappaport & Sirower[5] weigh the trade-offs between making cash and stock acquisitions. They advise acquirers to make cash-based acquisitions when possible because it signals confidence on the part of the acquirer while making the acquisition and clarifies the question of deal valuation by making it solely about the target, rather than about the target and the value of the acquirer's stock. A cash acquisition also sidesteps the possibility of the public markets retaliating against the issuance of additional acquirer equity, a response rooted in the market's general skepticism about acquisitions. Acqui-hire transactions are usually made in cash because in addition to the above reasons that favor cash acquisitions, they are also small enough in enterprise value that they can be paid in cash.

There is also prior literature related to the organizational aspects of an acqui-hire. Market incumbents can fall into a "competency trap"[6], i.e. a situation where it is hard to make changes to the very organizational structures that made them successful in their market. In this situation, one key element of an organization's strategic toolkit might be to use novel organizational forms to shake the organization out of this trap. Organizational forms can be organized along six parameters: organizational goals, strategies, authority relations, technologies, markets and processes[7]. New organizational forms depart from the traditional hierarchical form by perturbing one or more of these parameters. A high-tech incumbent can adapt to industry-wide changes by seeking new organizational forms arising from changes in the last three parameters in particular: technologies, markets and processes. Acqui-hires can be viewed as change-agents toward enabling these novel organizational forms.

5 A. Rappaport, M. Sirower; "Stock or Cash? The Trade-Offs for Buyers and Sellers in Mergers & Acquisitions"; Harvard Business Review, Nov-Dec 1999
6 Day, G.S. and Schoemaker, P. J. H.; Wharton on Managing Emerging Technologies; John Wiley & Sons; New York, NY (2000)
7 ibid

Acqui-Hires: Terminology and Conceptual Framework

In this section we advance qualitative and quantitative frameworks for thinking about acqui-hires and distinguishing them as a class distinct from conventional acquisitions. Media coverage about acquisitions usually mentions a unique rationale for an acquisition, such as acquiring products, teams or intellectual property. In practice, however, acquisitions are justified for several of these reasons, with some reasons being more important than others. Similarly, not all acqui-hires are the same.

In the rest of this document, we use the term acqui-hire when an acquisition transaction is known to exhibit any of a set of traits signaling that its primary motivation was acquiring talent. We use conventional acquisition to refer specifically to most acquisitions in practice; these are valued using hard assets (such as technology, intellectual property, distribution channels, equipment and customer relationships) as well as soft assets (such as salesforces, engineering talent and other human resources). We use the term acquisition transaction to refer to a conventional acquisition or an acqui-hire when the distinction between them is unimportant. The company making a conventional acquisition or an acqui-hire is referred to as an acquirer.

Motivations for an acqui-hire

To make sense of the acqui-hire phenomenon, we need to understand how the concept is relevant for both acquirers and acquisition targets. Specifically, we take the acquirer's perspective and examine how acqui-hires can affect the acquirers' business, such as a means of exercising innovation strategies, easily integrating whole teams and other exogenous factors.

In this paper, we propose adding acqui-hires to the array of corporate development options available to an acquirer. Acquirers may execute acqui-hires as an alternative to conventional acquisitions, for a number of reasons:

- **They reduce time to innovation**[8]. Time is the most valuable resource under the control of a corporation. A business can achieve its growth imperative to the extent that it innovates and brings new concepts to market efficiently and effectively. An acqui-hire is an inorganic growth option that can significantly reduce the time to innovation by bringing innovative high-functioning teams into an acquirer's organization in one fell swoop.

- **They enable an acquirer to gain new competencies rapidly**[9]. A dynamic capability is defined as 'the firm's ability to integrate, build, and reconfigure internal and external competencies in rapidly changing environments.' Unlike operational capabilities, which have to do with a company's current operations, dynamic capabilities enables an acquirer to use its core competencies to modify short-term competitive positions and gain competitive advantage over time. In rapidly changing industries such as high technology, acqui-hires enable an acquirer to gain new capabilities rapidly so that they can adapt to changing industry conditions.

- **They may be easier to integrate into the acquirer's organization**. The most important step in acquisitions is the post-acquisition integration for it is this step that extracts synergies, adds value to the acquirer's business and vindicates the capital and effort expended throughout the process[10]. Unfortunately, acquisitions have a poor record of integrating into the acquirer's organization. In contrast, acqui-hires come to an acquirer's organization with small teams, which, being highly reconfigurable assets, are likely to integrate faster into their acquirer's business. Because acqui-hires have few

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[8] G. Stalk; Competing Against Time: How Time-Based Competition is Reshaping Global Markets; Simon & Schuster, New York (1990) (p. 108)

[9] D. J. Teece; G. Pisano; A. Shuen (August 1997). "Dynamic Capabilities and Strategic Management". Strategic Management Journal (Wiley-Blackwell) 18 (7): 509–533

[10] M. L. Sirower; "The Synergy Trap: How Companies Lose the Acquisition Game"; The Free Press, New York (1997)

other assets to bring to an acquirer, they are unlikely to cost the acquirer the effort of eliminating redundancies.

- **They are a pre-emptive strategy against competitors**. Acqui-hires can be an efficient means of pre-empting competitors in a rapidly changing market. An acquirer can acqui-hire talented teams at low prices and remain tight-lipped when probed about the details of these financially insignificant transactions. For an acquirer dominant in its market, this technique can be a means of signaling its intention to enter a market niche without so much as making a formal announcement, similar to 'vaporware' techniques used by software vendors in the 1990s[11].

- **They are a low-cost means of innovation**. Incumbents from past generations of technology find it hard to keep innovating at a pace that would enable them to meet growth targets. Shortening product cycles in high technology mean that by the time an incumbent has hired an innovative team internally to introduce a new offering, a startup has already brought a similar offering to market. Acqui-hires, when executed right, enable an organization to source innovation from outside the boundaries of the firm. Acqui-hires bring much of the upside of outsourcing to the acquirer's innovation imperative without the downside. Acqui-hires can be used by acquirers as a way of outsourcing innovation, while still retaining the ability to absorb it directly into their business and appropriating all the benefits.

Yet, it is reasonable to observe that as far as corporate actions go, acqui-hires seem to be *prima facie* irrational. Acquirers pay an acquisition premium almost entirely for talent, when permissive labor statutes might easily permit them to pursue other means to the same end. Informal Silicon Valley norms may certainly have a role to play, but they are likely not the whole

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[11] G. S. Day, D. J. Reibstein (ed); "Wharton on Dynamic Competitive Strategy"; Wiley, New York (2004) (p. 257)

motivation for acqui-hires. We shall undertake a thorough examination of the motivations underlying acqui-hires in the rest of this paper.

Hypotheses

In this section, we will lay out a series of hypotheses concerning acqui-hires and how they are a distinct class of transactions from conventional acquisitions.

Hypothesis 1: Acqui-hires are not a binary category but rather a matter of degree.

Acqui-hires are a new phenomenon evidenced by their lack of representation in conventional sources of information about mergers and acquisitions. In addition, there has been little formal research into this phenomenon. Therefore, formulating a detailed definition of the term is a central task of this paper.

Dyer et al[12] advise that companies looking to generate synergies by combining human resources should avoid acquisitions and go for equity or nonequity alliances. According to these authors, employees of acquired companies are likely to become unproductive due to indifference towards the acquirer's interests or a perception of lost freedom. In contrast, acqui-hires buck this conventional wisdom by capitalizing upon 'soft resources'[13] of the target company through an acquisition transaction. As we examine acqui-hires, we will explore other potential motivations for these transactions.

Given the diverse motivations for acquisition transactions, we propose that acqui-hires are distinct from conventional acquisitions, a fact that is reflected in their treatment in the rest of this paper. However, certain transactions will have more acute traits of an acqui-hire than others.

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12 J. Dyer, P. Kale & H. Singh; When to Ally and When to Acquire; Harvard Business Review, Jul-Aug 2004
13 ibid.

We can infer the acuteness of the trait and relative importance of the team in an acqui-hire from the fate of the product and other assets. In particular, if a product was shut down post-transaction and no other assets were transferred to the acquirer, then it is a stronger indicator of an acqui-hire.

Hypothesis 2: Acqui-hires arise from a complex interplay of often conflicting interests from an assortment of actors, an interplay distinct from that of conventional acquisitions.

In a conventional acquisition, the following entities are involved in the transaction: the acquirer's CEO and corporate development team, the target company's management team, the target company's board that includes their investors, and service providers such as lawyers and investment bankers. The CEO and corporate development team begin the search for a target with a view to fill a specific gap in their strategic portfolio, such as an enabling technology, new customers or a full-fledged product. This process may be assisted by service providers such as bankers, who are incentivized by a finder's fee. Once a shortlist of targets has been created, the acquirer approaches the CEO and the management teams of acquisition transaction candidates. Target company management would evaluate the offer against other options on the table, including concurrent offers and potential enterprise value given future market conditions. If management is considering the deal, it is discussed with institutional investors, who may accept the deal in order to exit the business while achieving targeted investment returns for their investment funds. When there are larger numbers of institutional investors, they may have more sway and a pure acqui-hire would be more likely. Employees of the target company may have limited influence on the transaction as shareholders, but they are not the primary focus of the transaction. Lawyers are then brought in to structure, negotiate and execute the transaction.

In an acqui-hire, we hypothesize that many of the same actors are involved in the transaction. However, with the seemingly irrational basis of acqui-hires, these actors are

motivated with a different set of interests. We hypothesize that although the acquirer's CEO and corporate development team follow a similar search process, their primary comparable alternative is to hire a team and build those competencies in-house. Contact between the acquirer and target is usually not mediated by an investment banker or other service provider. Targets are more likely to be sourced opportunistically through personal connections and rapport because the (soft) assets being acquired are credence goods. In particular, a prospective acquirer is not pitting acqui-hire candidates against other candidates in a bakeoff. Acquirers are more likely to choose acqui-hire targets that have not launched a finished product, or have one with limited future value. At this stage, the acqui-hire candidate's management team and investors are more likely to look for an exit opportunity—even a financially unfavorable one—rather than face the prospect of shutting the company down. While employees of the target may not have significantly more say in their capacity as shareholders, they can exert inordinate influence on the transaction because they are the only valuable assets being acquired. If most internal hurdles to the acqui-hire within the target are lifted, lawyers are brought in to embellish what is most likely an asset acquisition with the favorable optics of an exit.

Although the same actors exist in conventional acquisitions and acqui-hires, they have different interests, motivations and levels of influence on the transaction.

Hypothesis 3: Deal value is set between the value of hiring the target company's employees and defraying the sunk costs of the venture.

The main purpose of acqui-hires is to bring on new talent, which is comprised of the number of new employees and their average quality of skills and knowledge. The benefits arising from the acqui-hire generally increase with the number of employees in the target company. We hypothesize that acqui-hired transactions would have higher deal values per employee as compared with conventional acquisitions since talent is the main focus of an acqui-

hire but number of employees is mostly irrelevant for conventional acquisitions. However, *engineers* hired through an acqui-hire hold particular value for an acquirer—more than their non-engineering coworkers. To assess the quality of a prospective acqui-hire target, one commonly used metric is the track record of the founding team.

The deal value must also consider the costs already sunk into the target company by its institutional investors and founding team. The greater the amount of funding raised by the target, the higher the bar for an acceptable deal value for an acqui-hire. Similarly, as the number of institutional investors increases, each investor's share of the target company decreases, thus driving up the acceptable deal value.

If the founding team and institutional investors feel more committed and optimistic about the product, then the deal value must be higher in order to get them to agree to it. Early in the life of a venture, the company is unlikely to have built much of a product or accepted as much funding from institutional investors, making founders and investors more amenable to an exit. Likewise, very late in its life, a product may have proven to be only marginally successful, and they may be looking to exit at any price. Therefore, we hypothesize that acceptable deal values are low early and late in the life of a target company, peaking somewhere in the middle. For the remainder of this paper, we will call this hypothesized trajectory of motivation to continue working on a startup over time "The Startup Motivation Curve".

"The Startup Motivation Curve"
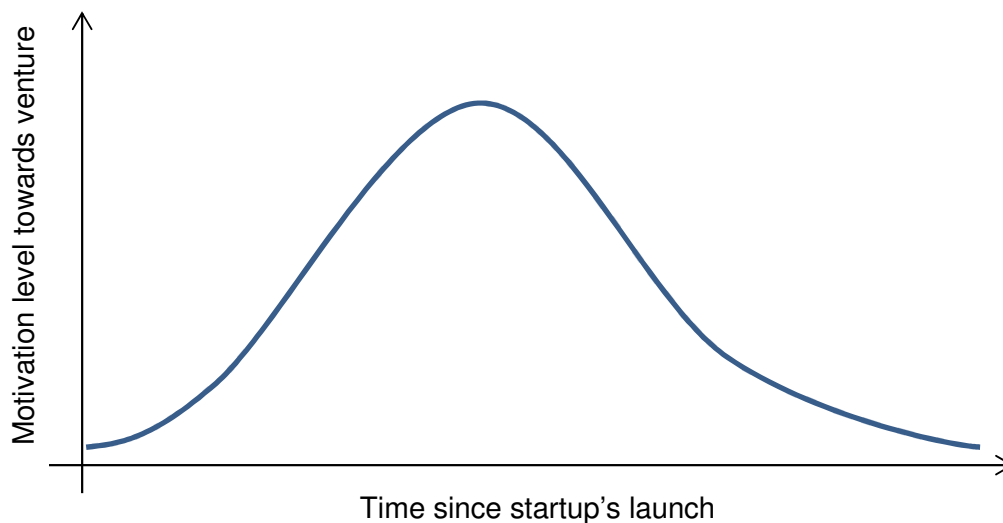
Hypothesis 4: In most cases, the outcome of an acqui-hire is that the product of the target company is shut down.

As stated in Hypothesis 1, acqui-hires as a category are distinct from conventional acquisitions. This difference stems from the disparate motivations behind the transactions; whereas conventional acquisitions are rooted in some combination of employees, customers, products and markets, acqui-hires are valued based on employees alone. Because an acquirer places no value on products gained through an acqui-hire and views the end result similar to hiring, the acquirer will cease investing in the product of the target company and reallocate incoming employees all over the acquirer's organization.

In such a case, what happens to the product? Here are possible outcomes we hypothesize for the product:

- The product is shut down immediately.

- The product is abandoned without further maintenance.

- The product is sold to a third party, who may continue operating it.

We further hypothesize that the above outcomes are listed in increasing order of rarity, with the product being shutdown, the commonest outcome in the vast majority of cases.

Hypothesis 5: Targets of acqui-hire transactions exhibit significantly different characteristics than those of conventional acquisitions in areas such lifetime and organizational size.

Hypothesis 1 states that acqui-hires are distinguishable from conventional acquisitions through underlying motivations and observable characteristics of the transaction. Here, we hypothesize that acqui-hired companies form a distinct class of target companies, with different observable traits, as compared to targets in conventional acquisitions.

Specifically, due to the dynamics of the Startup Motivation Curve, we believe that some acqui-hired targets may be particularly long-lived. Long-lived acqui-hired companies resemble targets of conventional acquisitions in age, except that they don't have a successful product. On average, however, acqui-hired companies will have a shorter lifespan in months between founding and transactions than targets of conventional acquisitions.

In addition to younger than average lifespan, acqui-hired companies are also more likely on average to exhibit characteristics suggesting a more rudimentary stage of development, such as fewer employees, lower amount of funding and fewer institutional investors. Additionally, we hypothesize that founders of acqui-hired companies, on average, have previously founded more companies.

Because acqui-hires bring new, specialized and versatile competencies into the acquirer, they are more likely in some product areas than others. Specifically, we believe that acqui-hired startups are more likely to have specific focuses, such as gaming, mobile or analytics, than targets of conventional acquisitions. We believe that acqui-hires are more likely

in these areas because in the current industry climate, these skills are more transferable and in more short supply than others.

Hypothesis 6: The presence of certain factors makes some industries more amenable to acqui-hires than others.

As we discussed in the *Motivations for an Acqui-Hire* section, an acqui-hire is a *prima facie* irrational transaction due to the premium that acquirers pay when they may not need to. One reason that an acquirer might choose to pay this premium is to overcome the limitations of traditional hiring processes. Traditional hiring processes fail to attract the best talent in industries where barriers to entry are so low that the best talent prefers to start their own companies rather than work at established firms. Whereas industries with low barriers to entry encourage the formation of startups, they also make it possible for the acquirer to shut down the startup with low opportunity cost and appropriate just the talent. The consumer Internet segment is currently a perfect embodiment of these attributes and therefore is ripe for acqui-hires.

As discussed in Hypothesis 5, we believe that the acqui-hires are likely to bring new, specialized and versatile competencies into the acquirer. Beyond these requirements for competencies, industries where startups create commoditized competencies are unlikely to be worth the premium paid for acqui-hiring.

We hypothesize that these are necessary but not sufficient conditions for industries with high occurrences of acqui-hires.

Hypothesis 7: Acqui-hires facilitate the creation of new kinds of organizational structure in the acquirer.

We hypothesize that acqui-hires promote organizational forms that are a departure from the hierarchical ones that dominate high technology and technology-enabled businesses. As described in the review of previous literature, acqui-hires are an emerging way for established

market participants to contend with the limitations of their own organizational structures. Organizational structure within market incumbents reflects the resource allocation choices that they make in their primary markets. A market incumbent may be blinkered by their current resource allocation practices when evaluating the fit of new technologies into existing strategic portfolios because these practices are driven by existing organizational structure. Acqui-hires give organizations the opportunity to overcome the limitations of their organizational forms by being an instance of an Internal Network form[14]. We believe that acqui-hires are executed to bring in new capabilities into the acquirer in the form of intact, functioning teams with a track record of building stellar products. For organizations paralyzed by sclerotic practices or obsolete resource allocation, acqui-hires can represent a highly modular internal network organization form that can inject them with innovative talent and make them adaptable to fast-moving technological change.

Methodology and Model Development

Our research methodology consisted of parallel qualitative and quantitative tracks. We conducted interviews with domain experts to gain a qualitative understanding of the essential features of acqui-hires and generate a framework for assessing to what degree a transaction was an acqui-hire. In parallel, we gathered a database with details of acqui-hire transactions and used this framework to perform quantitative analyses on them. From this data, we created models addressing two areas of inquiry: gaining a deeper understanding of acqui-hires and comparing them to conventional acquisitions.

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14 Day, G.S. and Schoemaker, P. J. H.; Wharton on Managing Emerging Technologies; John Wiley & Sons; New York, NY (2000)

Track A: Characteristics of Acqui-Hires

Through this model, we take a closer look at the mechanics of an acqui-hire, including the actors involved, their motivations, the outcome and predictive factors. The intended outcome of this track is to determine which traits endow a transaction with the quality of an acqui-hire.

To gain an exploratory understanding, we interviewed industry professionals who have been involved in acqui-hires in some manner. We gained particularly valuable insights from professionals in the following roles who agreed to speak with us under the condition of personal and professional anonymity:

- **Corporate Development professionals at a large, Silicon Valley-based Internet company**. These individuals were active in the end-to-end acqui-hire process, all the way from target sourcing to transaction announcement.

- **Corporate attorney at a major law firm**. This individual has represented all the actors in an acqui-hire transaction, including target companies, investors in them, and acquirers.

- **Seed investor and startup incubator**. These individuals lead corporate outreach efforts at Silicon Valley-based seed investors and startup incubators. The corporate partnerships inked by startups in these incubators frequently turn into acqui-hires.

Model A

We began our data gathering efforts by surveying conventional sources of data for corporate and mergers and acquisitions (M&A) information, such as Zephyr, Hoovers & VentureSource. However, these databases lacked the type of transactions we were seeking because the acquirers were privately held companies and/or the deal value fell under the prevailing reporting thresholds set by the Securities and Exchange Commission (SEC). We were compelled to turn to Web publications focused on the high-tech industry because they were the only available data sources that cover these transactions. We gathered a dataset of 42 transactions described as acqui-hires in the high-tech online media, including blogs such as

TechCrunch, Mashable, GigaOm and VentureBeat. These transactions occurred between 2008 and 2012. The acquirers are leading consumer Internet properties based in Silicon Valley, ranging from Google (over 53,000 employees) to AirBnB (130 employees). For each transaction, we collected the following data from online sources including the aforementioned blogs and CrunchBase:

- Name of acquirer

- Name of target

- Market segment of target

- Launch date of target

- Funding raised until date of transaction

- Number of institutional investors

- Total number of employees

- Total number of engineers

- Date of transaction

- Announced deal value

- Outcome of transaction (e.g. what happened to the product and other assets of the target?)

- Number of companies started by founder, excluding current one

We used only publicly available sources of data to collect the above information. In cases where no data were unavailable, we noted these as missing. Furthermore, when definitive point estimates were unavailable for any attribute of a transaction, we attempted to substitute for them with reasonable estimates on a best-effort basis (see the *Data Quality* section below for additional details).

As we prepared the above data for constructing a model, we gleaned certain patterns within the free-text responses, particularly 'Outcome of transaction and 'Market segment of target'. To include these responses as variables in the model, we added the following categorical binary indicators into the dataset:

- Outcomes of product post-transaction [1 = **Yes**; 0 = **No**]

    - Has the primary product of the target company been shut down?

    - Does the acquirer own or operate the product?

    - Does someone other the acquirer own or operate the product?

    - Have patents or technology from the target company been integrated into the acquirer?

- Target company's primary focus [1 (0) = **Market segment falls (does not fall) within category**]

    - **Mobile**. In this category, we included mobile app development as well as complementary tools and services.

    - **Social**. In this category, we included products and services that integrate with major social networks, such as Facebook and Twitter, in order to acquire a social aspect.

    - **E-commerce**. In this category, we included products and services that either directly sell or aggregate products for online sale.

    - **Analytics**. In this category, we included analytics platforms and other tools used by marketing managers, e.g. social media analytics and mobile loyalty.

    - **Gaming**. In this category, we included developers of video games, mobile games and social games.

    - **Travel**. In this category, we included travel-related products and services.

- **Communication**. In this category, we included products and services with person-to-person messaging capabilities.
- **Content & News**. In this category, we included products that assist with search, discovery, publishing and dissemination of content, including user-generated content.

We also added a computed field to indicate the lifetime of target, i.e. the number of fractional months elapsed between a target company's launch and transaction dates.

Data Quality

As mentioned above, point estimates for certain transaction attributes were not available in all cases. Below are the actions we took to mitigate data quality issues in certain variables:

- **Deal Value**. Announced deal values were only available for 43% of the transactions we tracked. When deal value was specified as a range, we took the midpoint as the best estimate.
- **Funding**. Venture funding information was available for 71% of the transactions we tracked. Of these target companies, 20% had raised no outside funding, including bootstrapped ventures and open-source projects.
- **Number of Institutional Investors**. When funding rounds included both institutional and individual investors, we counted only institutional investors for two reasons. First, individual investor lists are more likely to be incomplete than institutional investor lists. Second, institutional investors are more likely to have stronger preferences for, and more influence on, the transaction outcome.
- **Lifetime of Target**. We assumed that the transaction occurred on or close to the date of the public announcement that included official confirmation from the acquirer. When only portions of a launch date, e.g. a year or year and month were indicated, we defaulted to June 1 of that year, or the first of the given month and year, respectively.

- **Outcome of Transaction.** We made outcomes reflective of the *status quo* within a month of the transaction announcement. We coded for patent and technology integration outcome only when it was explicitly mentioned in the announcement.

- **Employees**. When employee and engineer counts of the target were unavailable in the transaction announcement, we attempted to ascertain these by counting the number of employees with job titles at the target company listed on LinkedIn. These may be underestimates because not all employees may report their affiliations on LinkedIn.

Acqui-hire Score

We began this investigation with the *a priori* supposition that acqui-hires are a distinct class of transactions that can be distinguished from conventional acquisitions. As we collected data, we generally found this to be the case. However, outcome of transactions were not identical even within the acqui-hire transactions, suggesting that different transactions may have been driven by different motivations. This observation suggested to us that acqui-hires are a matter of degree and can be plotted on a continuum, which we call the Acqui-Hire Score Scale. This Score is intended to quantify how acutely the details of a transaction embody the essential traits of an acqui-hire.

We wanted to fit a linear regression model that explained the influence of multiple covariates on the degree to which a transaction was an acqui-hire. As discussed above, we consider acqui-hires to be a matter of degree. We quantify the degree to which talent was the main goal of the transaction on a 0-10 scale based on the outcome of the product, which we coded into binary variables above. This score, called the Acqui-Hire Score of a transaction, is a convenient dependent variable that concisely captures the details of the outcome. When plotted on a linear scale, the order of the scores corresponds to our intuition of the acuteness of the acqui-hire traits in a transaction.

Taken together, the first three binary variables are categorical, i.e. exactly one of them is true for every acqui-hire. We define the purest form of an acqui-hire to be one where the product was sold to a third party, and assigned it a base Acqui-Hire Score of 10. This outcome exhibits the highest level of acqui-hire traits in that the product, despite being valuable, was repudiated by the acquirer in favor of the talent alone. On the other extreme, the least talent-focused acqui-hire—assigned a base score of 0—is when the product is active and owned by the acquirer. In this case, the main motivation is for acquiring talent but the product is still valuable enough to the acquirer to maintain into the future. The third categorical binary variable (the product has been shut down) occupies an intermediate position between these two extremes. We viewed this outcome as closer to the "pure acqui-hire" end of the scale, assigning it a score of 7.5. This outcome is closer to a "pure acqui-hire" because it follows from the same key decision by the acquirer, namely not investing in the product for the future.

The last binary variable for the product outcome indicates whether the technology and/or intellectual property of an acqui-hire target was integrated into the acquirer's offering, a condition that occurred only in cases with base scores of 7.5 and above. In these cases, we downwardly adjusted the base Acqui-hire Score by 2.5 points if a target's technology or intellectual property was integrated into the acquirer's offering because it was seen as valuable by the acquirer.

Regression setup

We wanted to start with the simplest and most predictive model to fit the acqui-hire transaction dataset. A multiple linear regression model is more appropriate than a logistic regression to allow us to finely weight the variables that constitute the acqui-hire score.

Track B: Comparison of acqui-hires and conventional acquisitions

In this track, we compare acqui-hires in our dataset with conventional acquisitions to determine whether the two kinds of transactions have distinct characteristics.

We interviewed Wharton Professors Saikat Chaudhuri, Karl Ulrich and David Wessels to gain a deeper understanding of the theoretical underpinnings of acquisition transactions and their implications for the distinctiveness of acqui-hires. The research interests of these professors span corporate development, technological innovation and venture capital finance. After explaining our initial understanding of the phenomenon, we asked the professors how they see acqui-hires, how acqui-hires compare with conventional acquisitions in motivations, mechanics, and organizational behavior, and how the phenomenon fits with conventional wisdom in academia.

Model B

To build an effective comparison model, we needed to analyze acqui-hires as well as conventional acquisitions. For the former, we used the same dataset of acqui-hire transactions as we did in Model A. For the latter, we began by consulting conventional sources of data for corporate and mergers and acquisitions (M&A) information, such as Zephyr, Hoovers & VentureSource. We quickly determined that these conventional sources systematically underreported conventional acquisitions because the data is based on SEC filings, which miss transactions by privately held companies and/or low-value transactions. We found that Crunchbase, an open database of startups, investors and corporate actions, offered the best coverage of conventional acquisitions and that these were most directly comparable to our dataset of acqui-hires. Our acqui-hire dataset relied heavily on TechCrunch, which uses Crunchbase to source its factual data. As a result, we happily found ourselves in the position of being able to compare acqui-hires and conventional acquisitions by the same acquirer.

Our dataset of conventional acquisitions contained 3,469 transactions that occurred between 1986 and 2010. We pulled conventional acquisitions from Crunchbase alone, and ensured that there were no overlapping transactions with our dataset of acqui-hires. We assumed that the remaining transactions are conventional acquisitions and not acqui-hires.

These transactions occurred in the high-tech, media and telecommunications industries, which are comparable to the industry focus of our acqui-hire transactions. Acquired companies ranged in size from tens of employees to 100,000, with published deal values ranging from under $1 million to $35 billion. For each conventional acquisition, we collected similar data as in our acqui-hire dataset with the following exceptions that we did not collect:

- **Number of Institutional Investors**. In Model A, we counted the number of institutional investors manually. For many conventional acquisitions, that could be decades old, the quality of this data was subpar. Instead, we relied on funds raised as a proxy for this variable because they are highly correlated ($r = 0.50$) in the acqui-hire data.

- **Number of Engineers**. In Model A, we gathered this data via a survey of LinkedIn. Because of data quality issues with historical conventional acquisitions, we relied instead on number of employees, which is highly correlated ($r = 0.99$) with the number of engineers.

- **Number of companies started by founder of target**. Conventional acquisitions are motivated by hard assets, such as product, intellectual property or transferrable capabilities. Given this assumption, caliber of talent—specifically a founder's track record—is unlikely to be a significant factor in conventional acquisitions.

Coding

We performed similar coding steps on this dataset as described above for Model A with the following differences:

- **Target company's primary focus**. These indicators were coded on the basis of keyword searches based on patterns in the acqui-hire dataset.

- **Outcome of Transactions**. We assumed these transactions were all conventional acquisitions, valued on the basis of product, intellectual property and other hard assets.

Accordingly, neither did we make more fine distinctions on outcomes nor did we calculate Acqui-hire Scores.

Data Quality

We also make the following notes on data quality in this dataset:

- **Announced Deal Value**. Announced deal values were only available for 36% of the transactions we tracked.

- **Funding**. Venture funding information was available for 18% of the transactions we tracked.

Model setup

We performed aggregate comparisons between all of the acqui-hire transactions, regardless of Acqui-Hire Score, and the conventional acquisitions along the variables common to both datasets. We also investigated differences between acqui-hires and conventional acquisitions by the same acquirer. Through comparisons of acqui-hires and conventional acquisitions across acquirers, we also looked into what insights we can glean about an acquirer's corporate development strategy.

Results & Analysis

Results A: Characteristics of Acqui-hires

To ensure predictive power in Model A, we trimmed the variable list to exclude variables exhibiting limited to no variation among the data points. Of the acqui-hires, the market focus variables exhibiting minimal variation were e-commerce, with only 9.5% of the companies falling within this primary focus, communications with 7.1%, and travel with 4.8%.

Furthermore, we grouped variables with high absolute-value correlations to minimize collinearity within a regression. The collinear variable groups are listed below; for a full correlation matrix, please refer to **Appendix 1**.

- **Target company's primary focus**. Startups with a social focus are less likely to have a mobile focus, but more likely to have a content & news focus. Acqui-hires with a content & news focus are more likely to be social and less likely to have an analytics or gaming focus. Acqui-hire transactions with a gaming focus also have higher announced deal values, longer lifetimes and launched earlier. Because there are no systemic coincidences among market focuses, we will continue using binary variables for all of them.

- **Funding until transaction**. Funding until date of transaction is positively correlated with number of institutional investors and announced deal value. We will experiment using one or two of these variables in each regression.

- **Number of employees and engineers**. Total number of employees and total number of engineers are highly correlated with each other. Total number of engineers is also very highly correlated with funding until transaction and announced deal value. We will generally use total number of employees in the models.

- **Lifetime of target**. Startups with longer lifetimes tend to have higher announced deal values, more funding until transaction, more institutional investors, more engineers and employees.

Although we will not use the date of transaction and launch date of target directly in the model, there are a few interesting trends related to these two fields:

- **Launch date of target**. Acqui-hires launched earlier tend to have higher announced deal values, more funding until transaction, more employees and have a longer lifetime. All of these findings are in line with our hypotheses.

- **Target company's primary focus**. Acqui-hires in the social realm tend to have earlier transaction dates. Acqui-hires with a gaming component more likely have earlier launch dates compared with transactions with no gaming component.

Key explanatory variables

We went through an exploratory phase where we attempted to explain variation in Acqui-Hire Score using combinations of explanatory variables based upon our hypotheses and collinearity findings. To our surprise, amount of funding, company lifetime and primary focus indicators for communications and analytics did not have significant explanatory power in our models. We believe the amount of funding raised is not as significant an indicator of the stage of a target company's product as other variables such as total employees. Similarly, target company lifetime is not as strong an indicator of a product's stage as originally hypothesized, because the target company may well have undergone multiple pivots or restarts in its business since launch. In addition, target companies who create communication and analytics have historically had skills that are less transferable and less in demand by companies contemplating an acqui-hire.

Fit

Model A shows a good fit to the data, with an adjusted R^2 value of 0.56 and a raw R^2 value of 0.72. Using at least a 90% confidence-level, the following variables have a statistically significant impact on an Acqui-hire Score, in decreasing order of impact (for a full set of parameter estimates and significance levels see **Appendix 2**):

- **Gaming**. Transactions with a gaming focus are very likely to be a pure acqui-hire as this binary variable is estimated to increase the Acqui-hire Score by 18 points. This is in line with our hypothesis that certain primary focus variables are more likely to be pure acqui-hires.

- **Deal value**. Higher deal values are likely to indicate transactions with lower Acqui-hire Scores. This is also in line with our hypothesis that transactions with higher deal values are more likely to involve a valuable product, making them less of an acqui-hire.

- **Social**. The presence of a social focus in a transaction tends to add 2 more points to its Acqui-hire Score. Being a transferable and rare competency, we had hypothesized that Social's effect on Acqui-Hire Score would be positive and smaller than that of a gaming focus because the former was less in demand over the period covered by the acqui-hire dataset.

- **Number of institutional investors**. For acqui-hires, each additional investor increases the Acqui-hire Score of a transaction by 0.4. This finding fits with our hypothesis that target companies with a larger number of institutional investors involved are more likely to be swayed by the investors who are looking for a financially favorable exit.

- **Number of employees**. For acqui-hires, each additional employee increases the Acqui-hire Score of a transaction by 0.06. This variable only has a noticeable impact for targets with a large number of employees (i.e. greater than 20 employees which is 17% of the examined acqui-hires).

Based on our dataset and hypotheses, deal value is an important part of our model and therefore we ran the regressions with this variable included. However, only some of the acqui-hire transactions examined include a deal value, because the acquirer is privately held or because they are low-value transactions. When deal value was excluded, we were unable to find a model with good fit. Accordingly, we believe that the subset of transactions with announced deal values may stand out in relation to other acqui-hires.

Results B: Comparison of acqui-hires and conventional acquisitions

Comparison of acqui-hire characteristics versus conventional acquisitions

Comparing conventional acquisitions with acqui-hires, we find statistically significant differences along the following variables (full results available in **Appendix 3**):

- **Target Company's Primary Focus.** Acqui-hires are significantly more likely to have a mobile, social, analytics, gaming or content & news focus than conventional acquisitions. Less than 7% of conventional acquisitions fall under each primary focus, whereas between 20% and 50% of acqui-hires fall under these categories ($p \leq 0.04$). This finding is in line with our hypotheses that acqui-hires are more likely within certain desirable market segments.

- **Announced deal value.** Acqui-hires have raised an average of $9.4 million at transaction versus $20 million for conventional acquisitions—a statistically significant difference ($p = 0.10$). This result is in line with our hypotheses that acquirers will target companies with less valuable products for acqui-hire, due to which targets are likely to have raised less money on average than conventional acquisition targets.

- **Lifetime of Target.** Acqui-hired companies have been in existence on average for 38.1 months versus 121 months for conventional acquisitions—a statistically significant difference ($p = 0.005$). This finding is also in line with our hypotheses because less valuable products are likely to have come out of a younger target company.

Contrary to our hypothesis, there was no statistically significant difference between deal value paid per employee between acqui-hires and conventional acquisitions. We believe that the conventional acquisitions represented in our dataset, with both deal value and number of employees, tend to be skewed towards very large companies. When exploring differences for total employees and deal value, we found that our dataset is missing too many values for a conclusive answer.

Comparison based on acquirer

When examining differences between acqui-hires with conventional acquisitions, specific acquirers tend to have patterns in what types of targets they purchase. Following are some distinctions, which, due to scanty data, were not provably statistically significant but are nevertheless of interest (see **Appendix 4** for more details):

- **Facebook**. Facebook's strategy for acqui-hires differs from their conventional acquisition strategy in that it focuses more on mobile, social and content & news-focused acqui-hires. Facebook's median acqui-hire transaction is valued at $6.5 million versus $10 million for a conventional acquisition. Acqui-hire targets tend to be 8 months younger than conventional acquisition targets, based on medians.

- **Google**. Google's strategy for acqui-hires differs from their conventional acquisition strategy in that it focuses more on mobile, social, content & news and gaming-focused acqui-hires. Google has had large acqui-hires as well as conventional acquisitions, with median deal values of $68 million and $59 million for conventional acquisitions and acqui-hires respectively. As expected, conventional acquisitions are still valued at a higher deal value. In addition, Google's conventional acquisitions also tend to have more funding at the time of transaction, more employees and a longer lifespan than acqui-hires.

- **Twitter**. Twitter's strategy for acqui-hires is focused on social, content and analytical tools. All of Twitter's transactions, conventional or otherwise, tend to be smaller companies with little funding (median funding less than $1 million) and few employees relative to other acquirers (median employee count less than 10).

- **Zynga**. Zynga's acqui-hires tend to be more mobile-focused and less social. All their transactions have a gaming focus. Relative to other acqui-hires, all of Zynga's acqui-hires tend to be smaller companies with little funding (median funding less than $1

million) and few employees relative to other acquirers (median employee count less than 10), but tend to have been active longer, i.e. with a median lifespan of five years.

Discussion

In this section, we will revisit the hypotheses we advanced in the *Hypothesis* section one by one and discuss whether our quantitative and qualitative findings support or refute them.

Hypothesis 1: Acqui-hires are not a binary category but rather a matter of degree.

The primary motivation behind any acqui-hire is the talent pool of the target company[15]. However, in the transactions we examined, additional secondary motivations, such as attractiveness of technology or intellectual property, also played a role. For instance, the founder of the target company occasionally has a say in the future of the product post-acqui-hire and may want to keep it alive[16]. We used the outcome for the product as a signal for the true motivation behind an acqui-hire.

Of the acqui-hires we examined, 83% of the acquirers did not operate the product post-acqui-hire in its original form, indicating that the target company's product was not a core asset to the transaction. As further support for our position, nearly half (45%) of acquirers sold the product to a different entity, indicating that although there was some value to the product, the acquirer's focus was solely hiring. Given that acqui-hires are a way of inorganically enhancing capabilities in a new area, we are not surprised that in 26% of acqui-hires, the acquirer used component technology or intellectual property from the target in their offerings.

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15 Interview 1. Corporate attorney at a major law firm. Conducted Dec 15, 2012.
16 ibid.

Hypothesis 2: Acqui-hires arise from a complex interplay of often conflicting interests from an assortment of actors, an interplay distinct from that of conventional acquisitions.

Our qualitative and quantitative analyses confirmed that several of the same actors are involved in an acqui-hire as in conventional acquisitions. Interviews with Corporate Development professionals at leading internet companies gave us a glimpse into how the search process for an acqui-hire is currently run.

One acqui-hire transaction at a large Silicon Valley Internet company began, like other acqui-hires that the company has done in the past, as a result of strategic introspection. Like many of its peers, this company maintains a 2 year strategic roadmap outlining the priorities for the firm, such as personalization and mobile. Based on the roadmap, the CEO and strategy team identify gaps in the firms portfolio. When appropriate, the mergers and acquisitions team identified how to plug these gaps and especially looks for potential synergies, particularly in the domain of talent[17]. For instance, a large Silicon Valley Internet company had good engineers but lacked a strong product design competency. Moreover, social-enabled applications were identified as a focus in their two year strategic roadmap. At this acquirer, attracting talent through conventional hiring methods was presumed to be difficult due to short supply of design-oriented engineers. In order to gain design talent and expertise in a strategically important area, the company looked for small startups with these competencies that might be open to a transaction. An acqui-hire would come with the added benefit of instantly acquiring a high-functioning, intact team that was worth more than the sum of the individual employees and would otherwise take time to build organically.

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17 Interview 2. Corporate development professional at large Silicon Valley internet companies. Conducted October 10, 2012.

The search ended with a promising candidate that fit the bill and was looking to sell because their future as an independent company was uncertain. This venture-backed startup also had investors who were motivated to exit. A significant input into the due diligence for this deal came from the results of hiring interviews with all employees of the target company, with a focus on technical talent as well team chemistry[18]. Approval from multiple business functions was a prerequisite to proceeding with the transaction. Experienced engineers at the acquirer were skeptical of the value of the acqui-hire, but as we had hypothesized, they did not have influence on the final outcome. Although all target company employees were interviewed, the acquirer was ultimately motivated to execute the acqui-hire solely for the sake of hiring the startup's engineers, rather than their business-facing employees.

Another account of an acqui-hire shared many similarities with the above. A large, multi-divisional software company tracks promising startups through informal contact with senior managers of its business units[19]. When a transaction seems appropriate, a formal courtship begins with meetings between the target company's CEO and the senior manager. The general counsel for that line of business is brought in as the process of vetting becomes more formal. Some of these transactions can be consummated in as little as two weeks while others may extend over as much as a year. Unlike the previous account, acqui-hires were used to soothe experienced engineers at the acquirer that would have been uncomfortable with the same aggregate sum being paid to new hires from the target company. Rather than inducing the employees of the target company to defect en masse to the acquirer, the acquirer executed an acqui-hire to placate the institutional investors of the target company and maintain cordial long-term relations with them. It was also noted that the greater the number of institutional investors, and therefore divergent interests, the harder it was to execute a transaction. This is further

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18 ibid.
19 Interview 3. Corporate development professionals at large Silicon Valley internet companies. Conducted December

reinforced by the fact that institutional investors are increasingly adding provisions to financing term sheets that stall potential acqui-hires and give the investor more sway over that potential outcome[20]. Pat McCarthy, founder of Fantuition, a startup in our database of acqui-hire transactions reflects that being acqui-hired was 'a bittersweet feeling' for him because he saw taking outside money as a serious commitment and he didn't want to 'let [them] down'[21].

Hypothesis 3: Deal value is set between the value of hiring the target company's employees and defraying the sunk costs of the venture.

Prof Chaudhuri mentioned a number of considerations when valuing an acqui-hire, such as stage of product, perceived potential, and comparable transactions[22]. The stage of product is signified by concrete indicators such as existing profitability, or, if unreleased, remaining time to market. The track record of the founder is incorporated into the valuation because it is a signal of perceived future potential for that individual within the acquirer's organization. In addition, if any portion of the acquired product or technology gets integrated into the acquirer's offerings, favorable founding experience may be a valuable leading indicator of success in a niche.

We had hypothesized that for companies looking to acqui-hire, there is an optimal age within a target startup's lifespan, where the founders and investors are more likely to agree to an acqui-hire. When looking to characterize the age of a startup, we initially calculated some literal indicators, such as the number of months between launch and transaction or number of employees. The number of months between the launch and transaction may have seen multiple business restarts, which also cause an ebb and flow of employees. As such, a point-in-time assessment of a startup's literal age or number of employees may not have been sufficient. A

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20 Interview 1. Corporate attorney at a major law firm. Conducted Dec 15, 2012.
21 P. McCarthy; "What It Feels Like To Be Acqhired"; Conversion Rater; URL:
http://www.conversionrater.com/2012/08/10/what-it-feels-like-to-be-acqhired/ (retrieved Jan 29, 2013)
22 Prof S. Chaudhuri. Personal interview conducted 10/03/2012

truer and more cumulative indicator of a startup's age is the amount of capital that has been invested in its business. As we expected, we found a statistically significant difference in the amount of funding raised between conventional acquisitions and acqui-hires.

Assuming that an acquirer decides to acqui-hire rather than execute a conventional acquisition, a higher deal value is likely to indicate a lower Acqui-Hire Score because the acquirer likely derived some value from the product or technology, and not just the employees of the target.

In keeping with the dynamics of the Startup Motivation Curve, Pat McCarthy of Fantuition initially intended to decline an acqui-hire offer because he did not want to 'give up on building [our] startup' because he was 'committed to the vision and team [he] had built.'[23] Given that an acqui-hire did occur, it is likely to have a lower Acqui-Hire Score if the commitment and optimism of the founding team are high. These factors are low at founding and transaction with a peak in the middle. The amount of funding, being a monotonically increasing quantity, cannot capture this pattern. On the contrary, our finding that the number of institutional investors has a statistically significant positive impact on the Acqui-Hire Score fits with our hypothesis that target companies with more institutional investors are more likely to be swayed by them as they seek a financially favorable exit. Those transactions with more funding raised tended to have a lower Acqui-Hire Score because the acquirer may have been paying a premium for a more valuable product.

Once a deal value has been determined, the structure of the deal arises from the tension between those employees of the target company joining the acquirer and employees and other stockholders, such as investors and departing employees. Deals are typically structured to give continuing employees a preponderance of acquirer equity over cash so as to retain them for the

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23 P. McCarthy; "What It Feels Like To Be Acqhired"; Conversion Rater; URL: http://www.conversionrater.com/2012/08/10/what-it-feels-like-to-be-acqhired/ (retrieved Jan 29, 2013)

medium-term while also giving them short-term rewards for recent effort[24]. Departing founders and employees may get cash but no equity in the acquirer.

The balance of cash and stock in a deal is a key point in the term sheet. Acqui-hires by nature are risky propositions where acquirers are betting on the value that the target company's employees will add. By compensating the target company's team in stock, the acquirer is able to align incentives and share more of the risk with joining employees[25]. Acqui-hires also enable acquirers to pay the new employees under the advantageous capital gains marginal tax rate[26]. This rate, previously 15% went up to 20% in the top tax bracket starting in January 2013. Although this will make acqui-hires slightly less advantageous, this individual believed they would continue to be a strong option for acquirers looking to reward their talent.

Hypothesis 4: In most cases, the outcome of an acqui-hire is that the product of the target company is shut down.

In our database of acqui-hire transactions, only 12% were "pure acqui-hires" as measured by their Acqui-Hire Score of 10, where the product was sold to a third party and no technology or patents were integrated into the acquirer's offering. 45%, the single biggest contingent of transactions, have Acqui-Hire Scores of 7.5, where the product was shut down and no technology was integrated into the acquirer's offering. For 26% of transactions, the Acqui-Hire Score was 5, denoting that the product was shut down and some technology or intellectual property was integrated into the acquirer's offering. In the remaining 17% of transactions, the acquirer operates the product after transaction, connoting that although talent was the main motivation for the transaction, there is some value attached to the product. Our

24 J. Constine; "Twitter Buys Personalized Email Marketer RestEngine to Deliver Best Tweet Digests"; TechCrunch, May 10, 2012; URL: http://techcrunch.com/2012/05/10/twitter-acquires-restengine/; Retrieved: Jan 29, 2013
25 Prof S. Chaudhuri. Personal interview conducted 10/03/2012
26 Interview 1. Corporate attorney at a major law firm. Conducted Dec 15, 2012.

hypothesis was partially validated in that the product was shut down in the plurality, if not the majority of cases.

The drastic step of shutting down the product was emphasized even on the day the transactions were announced, with articles stating outright that snippets of code will not be reused[27], or that shares of the target company would not be purchased[28]. One TechCrunch article also added that Google usually shuts down the acqui-hired products because "it costs money and time and it distracts the acquired team from working on things that Larry Page and Google's senior management want them to work on"[29]. At a large Silicon Valley Internet company that acqui-hires frequently, there are no metrics to measure past success and outcomes of acqui-hires beyond anecdotal evidence[30]. In one of this company's acqui-hires, the product was left running for testing purposes only, with no plans to continue maintenance in the future.

Hypothesis 5: Targets of acqui-hire transactions exhibit significantly different characteristics than those of conventional acquisitions in areas such lifetime and organizational size.

Our analysis showed statistically significant differences between acqui-hires and conventional acquisitions, in general characteristics as well as market focuses.

Target companies ranged in size from having two employees to 173 employees, with a median size of 7. On the other hand, target companies in conventional acquisitions had up to 100,000 employees, with a median size of 28 employees. Targets of acqui-hire transactions

27 A. Ha, "Groupon Acqhires Uptake To Build Out Palo Alto Office" ; TechCrunch, Feb 28, 2012; URL: http://techcrunch.com/2012/02/28/groupon-acqhires-uptake/; Retrieved Jan 30, 2013
28 E. Schonfeld, "Q: Why Did Twitter Acqhire Fluther? A: Search Is Mature, Social Q&A Is Still Wide Open"; TechCrunch, Dec 21, 2010; URL: http://techcrunch.com/2010/12/21/fluther-twitter/; Retrieved Jan 30, 2013
29 K. Cutler, "Meebo Product Shutdown"; TechCrunch, Jun 9, 2012; URL: http://techcrunch.com/2012/06/09/meebo-product-shutdown/; Retrieved Jan 30, 2013
30 Interview 2. Corporate development professional at large Silicon Valley internet companies. Conducted October 10, 2012.

exhibited statistically significantly shorter lifespans and less funding until transaction, relative to their conventional acquisition counterparts. As we hypothesized, these are consistent with the dynamics of the Startup Motivation Curve. For other indicators hypothesized as important, we lacked sufficient data to draw a definitive conclusion.

Acqui-hires tend to cluster in trendy market focuses, including mobile, social, analytics, gaming and content & news because they are emerging technological competencies that acquirers would be less likely to have internally. Acquirers, reacting to intense competitive rivalry, are engaged in an arms race to incorporate these competencies into their organizations. As such, it is difficult for acquirers to conventionally hire skilled professionals in these areas through the broader labor market. Although mobile, social, gaming etc. are presently trendy, the most sought-after competencies leading to acqui-hires are likely to morph over time.

Different companies approach and execute conventional acquisitions differently; in much the same way, they target different types of companies for acqui-hires. In fact, the CEO of a startup approached by Facebook for an unsuccessful acqui-hire said that he turned down the offer because he was upset at the 'systematic M&A formula' being applied by Facebook in order to quash competition from upstarts[31]. We also observed patterns in how Zynga acqui-hires startups. For a sufficiently comprehensive database of acqui-hire transactions, we are confident that we would be able to uncover systemic patterns in acqui-hiring behavior on the part of individual acquirers. Eventually, the patterns for acqui-hires will become more codified within an acquirer.

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31 R. Lawler; "App.net's Dalton Caldwell Turned Down A Facebook Acqui-Hire Offer Before Rebooting His Company"; TechCrunch, Aug 1, 2012; URL: http://techcrunch.com/2012/08/01/app-net-facebook-acqui-hire/; Retrieved Jan 30, 2013

Hypothesis 6: The presence of certain factors makes some industries more amenable to acqui-hires than others.

In our dataset of acqui-hire transactions, acquirers belong to a broad range of profiles, ranging from 130 to 53,000 employees, and in various sub segments of the software and internet markets. Our data also show that the frequency of acqui-hires is increasing year over year. A corporate attorney mentioned that although the phenomenon is common in the high-tech industry now, it can also spread to other markets that support the phenomenon[32].

To understand which other industries are likely to be affected, we assessed the unique factors about the technology sector that encourage acqui-hires, and interviewed professionals in other industries to explore whether these parallels would apply in those industries. After speaking with professionals in pharmaceutical, clean energy and medical device sectors, we believe there are five necessary conditions within any industry that encourage the occurrence of acqui-hires:

- **It must be easy to perform independent work in the industry**. The original form of this statement was that an acqui-hire friendly industry must be one that supports the formation of independent startups. In discussions regarding the pharmaceutical industry[33], we generalized the original hypothesis to account for Centers of Excellence in that industry. These offer shared infrastructure to enable independent work to be carried out more easily than before, even obviating the need for a formal organizational structure. Some of the projects in these Centers of Excellence may be turned into capital-efficient startups which can then be acqui-hired. In the energy industry, startups exist solely to bring R&D innovation to market often with ideas and technology formed during the scientists' time at an academic institute. Unlike in the high-tech industry, these

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32 Interview 1. Corporate attorney at a major law firm. Conducted Dec 15, 2012.
33 Interview 4. Pharmaceutical industry R&D professional; Conducted Jan 29, 2013.

startups are unlikely to have a desirable team uncoupled from hard assets. Accordingly, acqui-hires are less likely in the energy industry[34]. The energy industry structure also exemplifies why it is important to evaluate the functions done by the independent work (for the energy industry, it is bringing to market).

- **Acqui-hired startups must bring specialized, non-commoditized competencies to acquirers**. In the high-tech industry, the market focuses of acqui-hires are more likely in trendy market segments, which represent specialized competencies. In high-tech, 'the best designers, engineers, and product people usually aren't out applying for jobs, they're working for interesting startups'[35], and thus are unavailable in the commodity labor pool. In contrast, the most specialized and non-commoditized competencies in pharmaceutical companies lie with experienced drug discovery chemists, who are more likely to be working at universities or other large pharmaceutical companies than at small startups. The pharmaceutical industry is less hospitable to acqui-hires on this dimension. The energy industry exhibits similar behavior, whereby those with the most specialized knowledge of chemicals and materials can only obtain sufficient funding for innovation at resource-rich settings such as large companies or academia[36].

- **It must be easy to tie success or failure to specific individuals or teams**. Through Hypothesis 2, we established that rapport between prospective acqui-hire targets and the acquirer plays a pivotal role in the deal sourcing process. Professional rapport is built on the basis of publicly known track records. Industries where it is hard to link success or failure to specific individuals or groups are likely to inhibit acqui-hires. In discussions involving the energy industry, we learned that unlike in the high-tech industry, where the

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34 Interview 5. Energy industry professional; Personal interview; Conducted Jan 31, 2013
35 J. Constine; "Twitter Buys Personalized Email Marketer RestEngine to Deliver Best Tweet Digests"; TechCrunch, May 10, 2012; URL: http://techcrunch.com/2012/05/10/twitter-acquires-restengine/; Retrieved: Jan 29, 2013
36 Interview 5. Energy industry professional; Personal interview; Conducted Jan 31, 2013

original inventor or founder of an idea may be a desirable part of an acqui-hire, the energy industry rewards the person who successfully commercializes R&D output rather than the original inventor of the idea with a positive track record[37].

- **Acquiring organizations must have a culture that tolerates departure from traditional hiring processes.** High-tech acquirers will go to any lengths to attract the best talent possible, including paying a premium for hiring good talent from acqui-hired startups. For instance, the culture at Facebook views acqui-hires positively as most of their acquisition transactions have been to buy small startups at relatively low deal values, largely to add their talented employees to Facebook's staff[38]. In contrast, acquirers in more conventional industries are likely to dismiss acqui-hires in favor of building teams in-house, unless the fundamental paradigm in those industries changes.

- **Acquisitions must involve the consent of a small number of stakeholders.** Acquisition transactions in any industry are a delicate balancing act among complex and often conflicting interests of a variety of actors. Industries that create significant externalities are likely to involve more stakeholders, thus increasing uncertainty and coordination costs. For instance, innovations in the energy industry have to account for significantly more stakeholders, including utility companies, mass consumers and all levels of government, than do innovations in the high-tech industry.

Hypothesis 7: Acqui-hires facilitate the creation of new kinds of organizational structure in the acquirer.

Because hiring is the primary motivation behind an acqui-hire, the post-transaction fate of an acqui-hired team within the acquirer is a crucial question for investigation. As mentioned in

37 ibid
38 C. Taylor; "With Instagram Buy, Facebook Officially Pushes M&A Strategy Beyond The 'Acqui-hire'"; TechCrunch, Apr 9, 2012; URL: http://techcrunch.com/2012/04/09/facebook-instagram-m-and-a-strategy/; Retrieved: Jan 29, 2013

Hypothesis 2 above, acqui-hires run counter to the conventional wisdom of avoiding acquisition transactions for soft resources. Given the already poor track record of acquisition transaction integrations, acqui-hires must be particularly careful in how they integrate into their acquirer's organization.

In the case of a Silicon Valley acqui-hire described by a corporate development professional, the Human Resources department was involved throughout the transaction. The target company's team was concerned that they would be split up when acquired, but the most influential individual from that team ensured that the team would survive as a single, autonomous unit post-transaction[39]. The professional discussed that based on anecdotal evidence from past transactions, standalone teams worked best because they maintained the same motivated and independent culture that served them well in the startup. Moreover, intact teams maintained a productive team dynamic with proven professional chemistry.

Furthermore, several anecdotal instances of acqui-hired teams staying intact within the acquirer's organization were uncovered in LinkedIn searches during the data gathering process for our acqui-hire transaction dataset. Specifically, entire acqui-hired teams mentioned the name of their recently acqui-hired startup in their current job title at the acquirer. At face value, we take this to mean that the teams continue to be professionally linked post-transaction. However, we would need additional data to corroborate the details. From the CEO of Fantuition, acqui-hired by AppNexus, we learned that his motivation at being acqui-hired and integrated arose from being given new responsibilities in a prominent role in a prior acquirer. He contrasts this with the frustrations that arose when people from acqui-hired teams were buried in the acquirer organization and not given prominent roles[40].

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39 Interview 2. Corporate development professional at large Silicon Valley internet companies. Conducted October 10, 2012.
40 P. McCarthy; "Getting Acquired By and Working at Yahoo"; Conversion Rater; URL:http://www.conversionrater.com/2010/08/31/getting-acquired-by-and-working-at-yahoo/; Retrieved Jan 30, 2013

Taken together, these instances confirm our hypothesis that acqui-hires are a true hybrid between conventional acquisitions and conventional hires. In a conventional acquisition, Human Resources professionals are brought in after the deal has been inked and the integration process has begun. In an acqui-hire, however, they are part of the decision-making process in the transaction. The involvement from Human Resources begins when a target team is evaluated for its cultural compatibility with the acquirer as well as positive cultural aspects that may transfer to the acquirer through the acqui-hire. Later in the execution of the transaction, Human Resources assists with finding the right level of seniority for the target company's team and integrating them into the acquirer while still maintaining some of the elements that made them effective as a startup. These elements included understanding and maintaining the culture that made them a productive team and the chemistry that kept them cohesive. In addition, certain employees (who may or may not be founders) that act as cultural keystones for the team are heavily incentivized against leaving the acquirer to enforce the cohesiveness of their team and motivate team members to stay on.

Implications & Future Work

In this section, we briefly outline the implications of acqui-hires for the different industry actors and directions for future inquiry into this rapidly growing high-tech industry trend.

Implications

As acqui-hires become more common, they are likely to have repercussions for many of the players along the innovation value chain. Here are some of the more notable implications:

- **Acquirers**. Acquirers can use acqui-hires to gain a real option on new and speculative markets. For existing markets, acqui-hires can be a source of cheap, rapid innovation with low transaction costs. An acquirer who might have engaged in corporate venturing

in a prior era can now make strategic and financial bets on markets by acqui-hiring startups.

- **Hiring Managers**. Human capital is not explicitly accounted for on corporate balance sheets. Yet, today's hiring managers know that human capital is the scarcest commodity in a knowledge economy. Acqui-hires expand the universe of possibilities for a hiring manager and can give them access to pools of labor and talent that were previously inaccessible to them. On the flip side, hiring managers must carefully manage hiring, termination and compensation practices for acqui-hired teams because they imply a new model of hiring.

- **Startups**. As acqui-hires become standard practice among high-technology acquirers, high technology startups can increase the likelihood of a successful exit by studying the public statements of large companies and uncovering their strategic roadmaps. By specifically building towards the priorities expressed in these roadmaps, entrepreneurs can repeatedly reap the benefits of acquisitions and more easily build a blue-chip track record that marks them as successful serial entrepreneurs[41].

- **Service providers**. As acqui-hires become more common, they will likely be systematized by service providers such as lawyers and bankers, who will begin to incorporate these types of transactions into their service offerings. Lawyers will write contracts, financing agreements and asset sale agreements that account for the contingency of acqui-hires. Bankers will make the process of acqui-hire selection more efficient for acquirers by bringing more rigor and coverage to trendy market segments.

- **Incubators and technology investors**. Incubators can act as nurseries for innovation by incubating innovative startups, inking corporate business development partnerships and facilitating pro-forma acqui-hire transactions that give startups an opportunity to exit

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[41] Interview 2. Corporate development professional at large Silicon Valley internet companies. Conducted October 10, 2012.

and acquirers an opportunity to acquire innovative, high-functioning teams. Using standardized acqui-hire transactions, incubators can make organizational boundaries at their corporate partners more permeable to innovative teams and help resolve the innovation crisis at large incumbents in high tech and other industries[42].

Future Work

While we now have many key takeaways and conclusions, our research revealed other analyses that we would want to perform to further understand the acqui-hire phenomenon. While our existing data sets were helpful in this learning process, it would be ideal to add:

- **More data points.** It may verify or deny our unresolved hypotheses as well as validate our conclusions if we perform the analyses on a larger set of both acqui-hire and conventional acquisition transactions.

- **Better data quality.** Certain fields (for example, announced deal value) had a significant percentage of transactions with no data. If we were able to fill in these gaps, we could achieve better results with higher confidence levels and test additional hypotheses.

- **Additional transaction variables.** With our additional knowledge, we would now want to add other variables including deal structure, additional indicators regarding market segment of target, and relationship between acquirer and target's market segments.

- **Exogenous factors.** Transactions may be highly impacted by other external factors including labor market conditions, tax considerations, anti-trust regulation and capital market conditions.

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[42] Head of Corporate Partnerships at High-Tech Incubator; Personal Interview; Sep 25, 2012

- **Further qualitative data.** We found qualitative inputs arising from our interviews to be a valuable guide in designing our research study. As acqui-hires become more common, more interviews with similar roles to our past interviews as well as additional actors in the transaction process.

Acknowledgements

Appendices

Appendix 1: Correlation matrix for potential explanatory variables acqui-hire deep dive (Results A)

	Date of transaction	Target focus - Mobile	Target focus - Social	Target focus - Analytics	Target focus - Gaming	Target focus - Content & News	Announced deal value	Launch date of target	Funding until transaction	# of institutional investors	# companies by founder	Total number of employees	Total number of engineers	Lifetime of target
Date of transaction	1													
Target focus - Mobile	0.15	1												
Target focus - Social	-0.38	-0.41	1											
Target focus - Analytics	0.20	0.04	-0.12	1										
Target focus - Gaming	-0.05	0.15	-0.17	-0.25	1									
Target focus - Content & News	-0.12	-0.22	0.38	-0.42	-0.45	1								
Announced deal value	-0.10	-0.08	0.20	-0.16	0.84	-0.20	1							
Launch date of target	0.17	0.18	-0.05	0.29	-0.43	0.04	-0.45	1						
Funding until transaction	0.05	-0.19	0.28	-0.21	0.16	0.09	0.81	-0.60	1					
# of institutional investors	0.30	0.11	0.08	-0.10	-0.12	0.22	0.26	-0.23	0.50	1				
# companies by founder	0.23	0.17	-0.03	-0.13	0.04	0.01	-0.10	-0.04	0.21	0.28	1			
Total number of employees	0.14	-0.11	0.21	-0.17	0.06	0.18	0.58	-0.39	0.86	0.46	0.12	1		
Total number of engineers	0.16	-0.14	0.15	-0.11	-0.06	0.18	0.78	-0.26	0.97	0.40	-0.06	1.00	1	
Lifetime of target	0.14	-0.13	-0.07	-0.23	0.42	-0.08	0.36	-0.95	0.66	0.39	0.12	0.44	0.33	1

E-commerce, travel, and communications are not included since there are such few transactions within these components.

We also calculated correlation values between our Acqui-Hire Score and the same variables to prioritize our variable list:

	Correlation with Acqui-hire Score
Does the acquirer own or operate the product?	-0.87
Does someone other the acquirer own or operate the product?	0.52
Has the primary product of the target company been shut down?	0.23
Have patents/tech from target been integrated into acquirer?	-0.06
# of Institutional investors	0.30
Date of transaction	0.25
Target focus – Mobile	0.23
Target focus – Gaming	0.23
# companies by founder	0.21
Lifetime of target	0.21
Funding until transaction	0.20
Total number of employees	0.14
Announced deal value	0.09
Total number of engineers	0.08
Target focus – Analytics	-0.04

Launch date of target	-0.13
Target focus – Content & News	-0.14
Target focus – Social	-0.22

The first four values are the inputs to the Acqui-Hire Score, so are expected to be highly correlated with the Score. Mobile, gaming, and social may be some of the more useful target company focus areas to use in the regression. Number of institutional investors, number of companies by founder, lifetime of target, and funding until transaction may also be especially useful for our model.

Appendix 2: Regression model of Acqui-Hire Score (Results A)

Summary of Fit

RSquare	0.722
RSquare Adjusted	0.555
Root Mean Square Error	2.163
Mean or Response	5.147
Observations	17

Parameter Estimates

Term	Estimate	Prob>|t|
Target Focus – Mobile	3.17	0.238
Target Focus - Social	2.24	0.097
Target Focus – Gaming	17.80	0.012
Announced Deal Value	-0.119	0.008
# of Institutional Investors	0.427	0.088
Total # of Employees	0.061	0.030
Intercept	2.64	0.063

Appendix 3: Comparison of acqui-hires and conventional acquisitions (Results B)

	Conventional Acquisitions	All Acqui-hires	Acqui-hire Score of…			
			0	5	7.5	10
Proportion of transactions	99%	1%	0.20%	0.31%	0.54%	0.14%
Count	3,468	42	7	11	19	5

Focus of Target

	Conventional Acquisitions	All Acqui-hires	Acqui-hire Score of…			
			0	5	7.5	10
Mobile	**7%**	**21%**	0%	9%	42%	0%
Social	**4%**	**50%**	71%	55%	42%	40%
E-commerce	4%	10%	14%	9%	5%	20%
Analytics	**6%**	**19%**	14%	36%	11%	20%
Gaming	**7%**	**21%**	0%	18%	32%	20%
Travel	0%	5%	14%	0%	5%	0%
Content & News	**3%**	**43%**	71%	27%	37%	60%

Red, bold values indicate there are statistically significant differences between conventional acquisitions and all acqui-hires at a 90% confidence level. Statistics between different types of acqui-hires were not compared due to small sample sizes.

Comparison of quartiles for conventional acquisitions versus all acqui-hires

	Announced Deal Value (in M's)		Funding until transaction (in M's)		Deal Value Per Employee	
	Conventional Acquisitions	All Acqui-hires	Conventional Acquisitions	All Acqui-hires	Conventional Acquisitions	All Acqui-hires
Minimum	0.0	0.5	4.2	0.7	0.0	0.0
25th percentile	12.0	5.4	186.0	78.0	0.3	0.6
Median	45.3	15.0	0.0	-	0.8	1.1
75th percentile	202.0	34.5	10.0	1.7	1.9	2.5
Maximum	35,000	182	24.7	6.7	22.5	8.3
n with data	1,255	18	622	31	184	18
Average	361.4	29.6	**20.1**	**9.1**	1.8	1.9

Red and bold values indicate a statistically significant difference between conventional acquisitions and all acqui-hires at a 90% confidence level. Deal value per employees does not show a statistically significant difference. We believe there is a bias in deal value per employee because fewer companies in the conventional acquisitions have this data present and these tend to be larger companies.

Comparison of quartiles for conventional acquisitions versus all acqui-hires

	Total number of employees		Lifetime of Target in months	
	Conventional Acquisitions	All Acqui-hires	Conventional Acquisitions	All Acqui-hires
Minimum	0	2.0	0	0
25th percentile	9.0	4.0	47.9	16.0
Median	28	6	94.2	33.0
75th percentile	100.0	11.5	147.6	47.7
Maximum	99,999.0	173.0	1,205.8	134.0
n with data	445	43	1,526	43
Average	949.2	15.0	**121.1**	**37.7**

Red and bold values indicate a statistically significant difference between conventional acquisitions and all acqui-hires at a 90% confidence level.

Appendix 4: Comparison of acqui-hires by Acquirer (Results B)
Count of transactions in dataset by Acquirer

Acquirer	Conventional Acquisitions	All Acqui-hires	Acqui-hire Score of...			
			0	5	7.5	10
Facebook	7	14	3	4	5	2
Google	75	4	-	1	3	-
Twitter	6	10	2	3	4	1
Zynga	6	7	-	2	4	1

Statistics between different types of acqui-hires were not compared in following tables

due to small sample sizes. We did not check for statistical significance due to small sample

sizes in conventional acquisitions and/or all acqui-hires. We also compared medians to

minimize effects of outliers with the small sample sizes.

Focus of Target

Acquirer	Facebook		Google		Twitter		Zynga	
	Conventional Acquisitions	All Acqui-hires	Conventional Acquisitions	All Acqui-hires	Conventional Acquisitions	All Acqui-hires	Conventional Acquisitions	All Acqui-hires
Mobile	0%	21%	9%	25%	17%	10%	0%	43%
Social	29%	50%	3%	50%	0%	70%	67%	14%
E-commerce	0%	7%	1%	0%	0%	0%	0%	0%
Analytics	0%	14%	7%	0%	0%	40%	0%	0%
Gaming	0%	0%	5%	25%	0%	0%	100%	100%
Travel	14%	7%	0%	0%	0%	0%	0%	0%
Content & News	29%	57%	4%	50%	0%	60%	0%	0%

Comparison of median statistics by Acquirer

Acquirer	Facebook		Google		Twitter		Zynga	
	Conventional Acquisitions	All Acqui-hires	Conventional Acquisitions	All Acqui-hires	Conventional Acquisitions	All Acqui-hires	Conventional Acquisitions	All Acqui-hires
Announced Deal Value (in M's)	10.0	6.5	68.2	59.0	5.2	11.3	20.5	-
Funding until transaction (in M's)	1.1	2.5	6.0	37.3	0.5	0.8	8.5	0.8
Total number of	2.0	6.0	15.0	42.0	2.0	6.0	13.0	7.0

employees								
Lifetime of Target in months	24.3	16.0	40.0	57.5	42.1	27.0	26.6	59.0