How do you integrate start-ups?

Study

April 2021

Building a better working world

How do you integrate start-ups?

In recent years, large incumbent companies in a wide range of sectors have increasingly targeted start-ups and small but fast growing entrepreneur-led companies in their acquisition activity. Start-ups represent an efficient way to enter attractive niches, experiment with new business models, or access promising technologies and know how. However, they also represent a major integration challenge. Their cultures, processes and systems are inherently different from those of large companies, and often the acquisition was made with the understanding that little will change, driven also by the fear by the acquirer of overwhelming the target with the burden of a heavy integration.

But acquirers will have their strategic objectives to achieve, their internal and external compliance satisfy, their own internal processes to sustain.

These opposing forces often generate friction between the two companies and ultimately can result in unmet strategic objectives and loss of value.

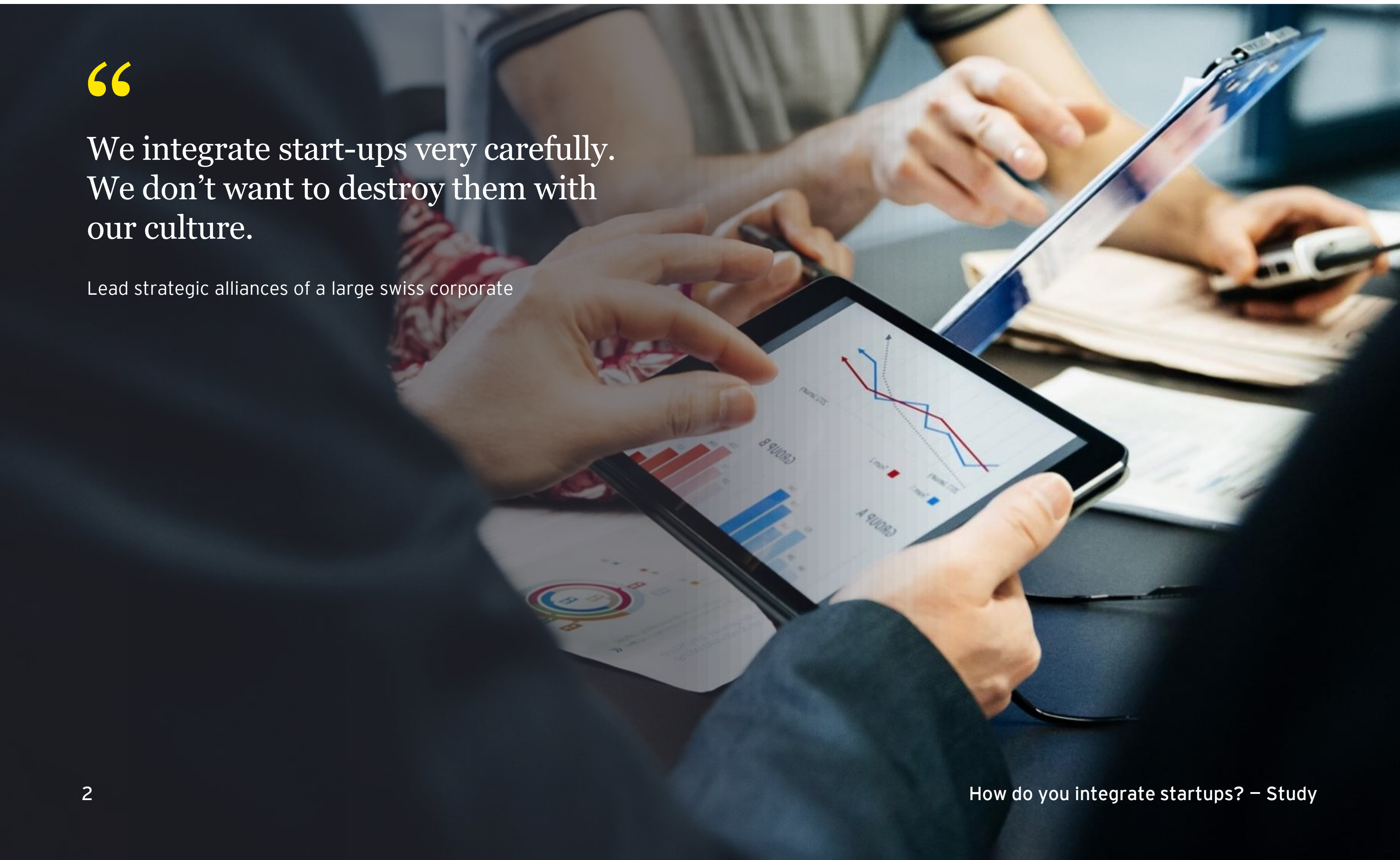
EY can provide the experience, the knowledge and the tools to navigate through the integration of start-ups and small entrepreneur-led companies into larger organizations, helping them achieve their strategic objectives and realize the acquisition's full potential.

The challenges

As large companies look at start-ups and small entrepreneurial companies for their M&A pipeline, businesses need to decide how to integrate these targets in their structures and unlock value without suffocating the agile small companies with complex processes and systems.

The answer

Companies acquiring a start-up should be clear from the beginning about their strategic objectives and translate them into the appropriate integration approach, which must be disclosed early in the process to the Target, in order to align on the needs and constraints of both parties. Strategic objectives should be translated into quantifiable targets, aligned with the integration model, so that the lack of full integration does not prevent their achievement.



"

We integrate start-ups very carefully. We don't want to destroy them with our culture.

Lead strategic alliances of a large swiss corporate

Why are large companies attracted to start-ups?

Recently, large incumbent companies in a wide range of sectors have increasingly targeted start-ups and small but fast growing entrepreneur-led companies in their acquisition activity.

These companies can range from a handful of employees to a few tens and possibly approaching the hundred people workforce in some cases, have been in operation for a few years at best and are often far for reaching a profitable scale.

Until recently, it would have taken years for a new company to even register on the radar of large players, but venture capital funding, e-commerce, social media, the digitalization and automation of business processes, and the availability of third party providers for design, manufacturing, and logistics services have allowed start-ups to bring to market innovative services and products in record time compared to the past.

Start-ups represent an efficient way for larger incumbents to enter attractive niches, experiment with new business models, or access promising technologies and know how.

The attractiveness of startups

- **Innovative route-to-market** (direct to consumer, subscription models, peer-to-peer, online and mobile commerce replacing brick and mortar)
- **Digital and automation capabilities** (smartphones apps, e-commerce, Internet of Things, robotics, drones, blockchain)
- **'Born Pure' brands** (e.g., local, organic, or natural consumer products, sustainable and traceable sourcing)
- **End-user engagement** enabling the creation of business platforms and the leveraging of consumer and user data

Here below are some of the many examples of large companies acquisitions in the startup space:

Sector	Buyer	Target	Target description	Transaction year
Consumer goods	Gidor	Beneva International	Beauty products E-Commerce	2020
	Zalando	Fision	Body scanning tech startup	2020
Pharma	Boehringer Ingelheim	NBE-Therapeutics	Antibody drug conjugates for cancer	2020
		Amal Therapeutics	Biotechnology company	2019
	Pfizer	Therachon	Biotechnology company	2019
Healthcare	Waters Corp.	Andrew Alliance	Robotics for the life sciences	2020
	Swiss Medical Group	CoreMedica	Biotechnology company	2020
	Precision for Medicine	SimplicityBio	Healthcare AI company	2019
Financial	Lucht Probst Associates	AAAccell	AI-based solution in asset & risk mgmt.	2020
	CreditGate24	Advanon AG	Online financial services platform	2020
	Bâloise Holding	Bubble Box	Online laundry & dry cleaning services	2019
	Die Mobiliar	Buildigo	Web platform to search local craftsman	2020
Technology/ media	CH-Media	3+ television	TV broadcaster with AI based advertising	2019
	DSP Group	SoundChip	Active noise cancellation technology	2020
	Snyk Ltd.	DeepCode	AI software development	2020
Mobility	Bond Mobility	Roll2Go	Software for visualization & monitoring	2020

Integrating start-ups can be difficult for large companies

It should be perfect combination: a large, resourceful company can offer funds, talent and assets to a small, agile, innovative start-up with a product or business model already tested at small scale.

Alas, things don’t always go as planned.

Start-up		Large corporation
Growth	Focus	Profit
Small, few resources	Scale	Large, many resources
Lack of formal processes	Processes	There’s a process for everything
Flat, overlapping roles	Organization	Pyramid, clear roles
Get things done, fail fast	Culture	Do things well, manage risk
Change the world	Vision	Be the leader in the sector

Differences in vision, culture, focus, scale, speed and processes make start-up integration very challenging for large companies

The difference in size, culture, and the often limited cost synergies, typically discourage full integration initiatives, but often the two companies try to avoid integration altogether. In fact, 'independence' may be offered in the negotiation phase to the start-up leadership team, as an incentive to agree to the deal. The plan is to leave the small target autonomous, without transferring its people to the large headquarters, avoiding changes in the leadership team, and promising funds in exchange of keeping up with what the start-up does best: innovating and growing.

However, both sides have a different interpretation of what independence means. The start-up may interpret the relationship with the new corporate owner similarly to that with a Venture Capital investor, which provides funds in exchange of a future pay-out as the result of an IPO or a strategic sale, with relatively limited interest in how the start-up arrives to that objective.

For the Corporate, instead, the start-up business and operations will be part of a wider portfolio, with the need of capital planning, financial reporting and budgeting, and compliance with many of the processes that run modern companies, and as such, the promise of independence must be interpreted within the stricter requirements of corporate governance.

Deal rationale provides the basis for integration approach

The decision of how deep and how fast to integrate (or whether to integrate at all), should be linked to the deal rationale. We distinguish three main types of deal rationale, each with direct consequences on the type of integration to pursue:

Disrupt

Focus: protect the start-up culture, organization and business model

- Minimal integration (e.g., compliance and financial processes, quality …)
- Develop tailored processes for interaction (e.g., for investment planning and approval)
- Identify clear interfacing roles with the new parent for each function

Build portfolio or capabilities

Focus: integrate selectively to enable collaboration

- Selective integration areas: only those bringing value in line with the deal rationale (e.g., product development, sales network, R&D)*
- Leave other areas for long-term integration

*in addition to minimum integration areas like reporting

Consolidate and scale up

Focus: integrate fast and deeply to leverage economies of scale

- Associated with leveraging economies of scale
- Synergies require harmonization of processes, organization, systems and products to enable back-office and network optimization

Disrupt

The deal rationale is that of transforming the existing business model. In these cases, the focus should be on protecting, rather than integrating the target. A new business model, even if minimal in size compared to that of the incumbent, can generate friction with the acquirer's management, because of fear of cannibalization, cultural clash, or limited understanding of the new business. In some cases, managers of the buyer can be too eager to 'get to work' with the target, proposing a multitude of business ideas on how the two entities can leverage their strengths, but making it difficult to focus on a single plan.

Build portfolio or capabilities

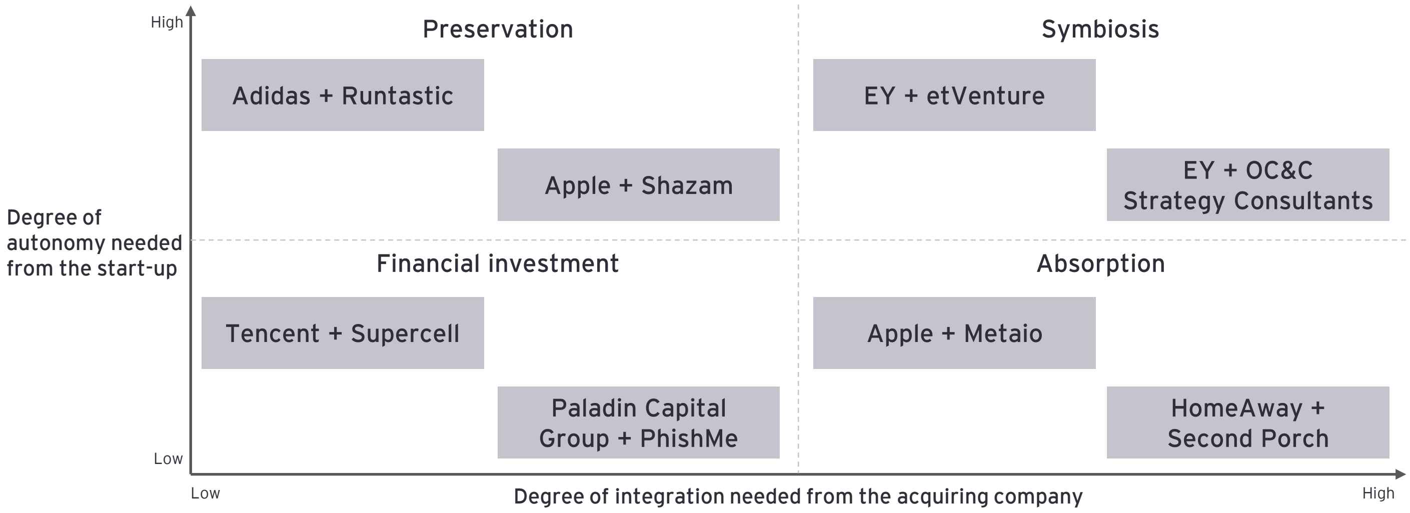
The deal rationale is to expand the current business model, by filling the gaps in either product portfolio, technologies or geographical reach. These deals have as main aim to increase sales, by leveraging cross – sale opportunities, local know-how and presence. The integration should be selective, affecting mainly the key functions involved in the design and commercialization of products or services, avoiding disrupting processes for the sake of a harmonization that would not generate additional revenues. Only after the initial objectives are realized, some gains can be achieved by focusing on optimization and efficiency, leveraging the incremental scale.

Consolidate

The deal rationale is to improve the performance of the acquirer's business model. This type of deals is what is often associated to economies of scale and is translated in optimization of the manufacturing footprint, performance improvement of the back-office functions, better purchasing conditions, etc. Integration should be fast and deep, harmonizing processes so that resources can be shared. It is rare that start-ups acquisitions fall in this case.

Start-up integration archetypes

The degree of integration and autonomy that the acquired business needs, allow us to define four basic integration archetypes



Financial investment

This is the realm of Venture Capital and similar financially driven investors. The target is effectively left independent in running their day-to day operations, however a strict control on strategic decisions is enforced at board level, including on targets, budgets, hiring etc. The level of integration is extremely limited, barely beyond a process for reporting business and financials results, and funding needs to the parent company. Large corporations may operate in a similar way when they invest in a start-up at a very early stage (often before there is a proven business model) or when they create start-up incubators.

Absorption

This model is employed when acquirer and target have similar products or services and competencies, and complementary customer bases (e.g., the two companies are competitors or active in different geographies). The target is fully absorbed in the parent company: the brand is sometimes discontinued, as products or services are fully transferred to the buyer’s portfolio, the target’s legal entities may be dissolved and employees are transferred to the parent company. Integration is pursued in full: all processes are expected to fall in line with those of the buyer within a very short period of time. A subset of this approach is represented by 'acqui-hires', used by the buyer to hire a talented and proven full team rather then a scalable business.

Symbiosis

When buyer and target have similar business model, complementary capabilities and are perceived each with their own unique brand and offer by customers, it may make sense to retain a certain level of independence in client facing areas like branding and advertising, but pair it with strong integration to enable an enhanced product offer, strengthen go-to-market initiatives and optimize costs. Likewise, the integration of R&D capabilities might be useful, if the acquired company has specific skills that can be leveraged group-wide. Which functions to integrate or leave separate is a decision that follow from the clear understanding of the acquisition rationale and the mid-to-long term objectives that the buyer wants to achieve with the deal.

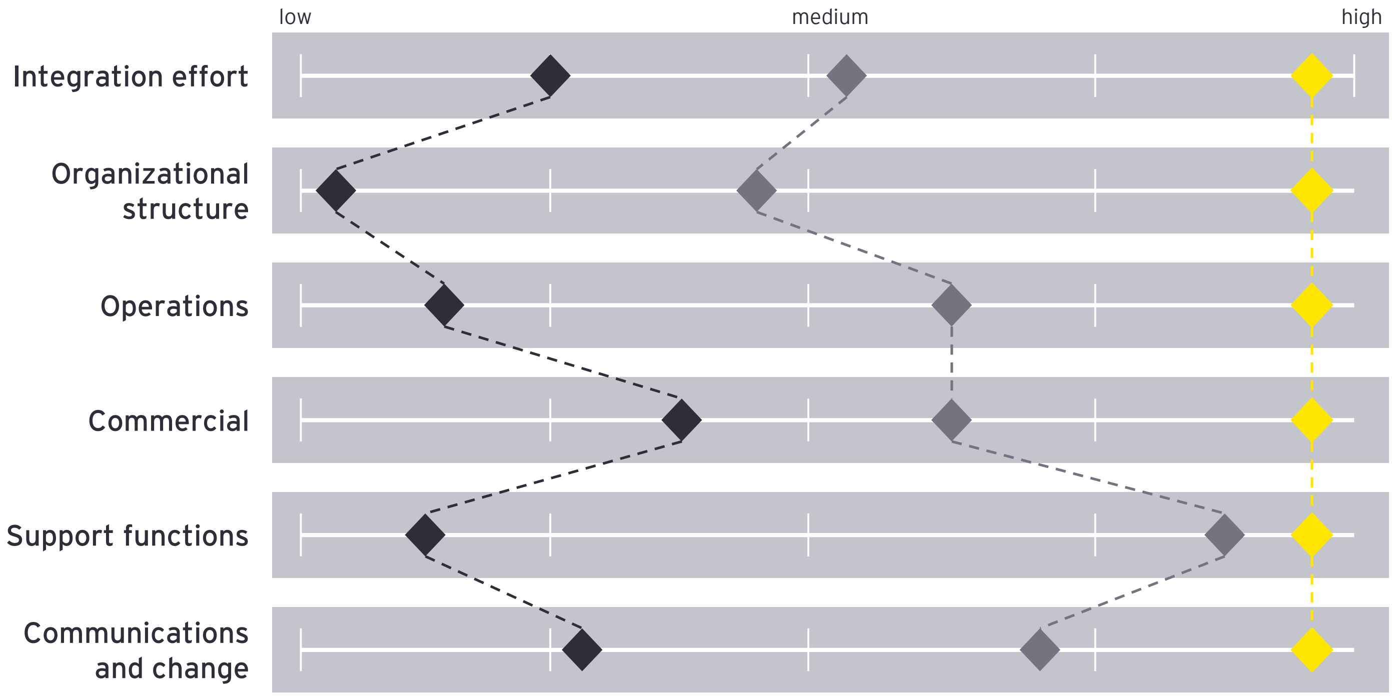
Preservation

This model is best applied when the target operates in a very different segment or with a new business model compared to the buyer. The new parent company often wants to gain an early presence in this new frontier, with the strategic objective of growing this business, of leveraging cross-sale opportunities or even of disrupting its own model. Independence help preserve the target novelty, culture and perception with consumers. Nevertheless some integration is necessary to allow coordinated initiatives and strategies.

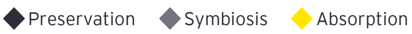
Integration approach

	Preservation	Symbiosis	Absorption
	Run acquired start-up autonomously, almost as a standalone business	Perform selective integration of some functions and processes	Fully integrate start-up into acquiring company
Characteristics	▸ Mainly statutory, regulatory and mandatory requirements addressed ▸ Some quick-win actions in commercial and operations (e.g., cross-sales) ▸ Existing functions, organization retained, with none to minimal changes	▸ Selected overhead and back office functions integrated ▸ Selected processes integration, to enable some synergies (e.g., sales, R&D) ▸ Arms length relationship ▸ Possible 'partnership model' for some areas/activities	▸ Corporate and administrative functions consolidated ▸ Alignment/integration of business strategies, processes, tools ▸ All core functions integrated
Benefits	▸ Retains existing culture ▸ Speed to transaction close ▸ Minimum business disruption	▸ Ability to pursue deal value drivers by tailoring the integration to relevant areas ▸ Certain cost synergies realized	▸ Ability to realize all synergies ▸ Avoidance of multiplication of operating models within the Group (particularly in case of frequent acquisitions)

Each model implies different levels of intervention and effort



Each integration will be different from the others, nevertheless, we identified some general rules that can help frame the process.



Some general rules to help frame the integration process

Know **why** you buy	Acquisitions should always follow a clear strategy. The rationale for a deal should be well defined and framed before the transaction is signed, and preferably even before the scouting is initiated.
Be clear, early	During the negotiation phase the parties should agree on a vision on what the integration strategy should aim for, clarify the scope for must-do integration areas (e.g., accounting, quality, compliance …).
Prepare a **plan**	The integration initiatives should be translated into an actionable plan, distinguishing between Day 1, the first 100 days, and long term tasks.
Nominate a **champion**	Nominate a champion, high enough in the buyer's organization, and with aligned targets and incentives, who will support the target's leadership team within the parent company, helping them navigate the new organization and processes, but also raising their concerns with the acquirer's top management.
Keep the **team …**	Unless serious reasons for change exist, keep the original leadership team, who likely had a major positive impact in making the target attractive in the first place. This helps communicating that the target's culture is valued and will be protected.
… but **be ready to let go leading figureheads**	Often startups and small companies have leading figureheads at the top, usually founders. They forged the company in its current form, and may be an obstacle to changing the way of working. Be ready to negotiate a way out for them (they might be happier starting something new rather than be part of the new organization).
Start with the **must-do**	The must-do integration areas, like financial reporting, compliance, quality procedures, etc. should be aligned as soon as possible, even if this means implementing some manually intensive processes or adding some complexity.
Focus on the deal **value drivers**	Once the non-negotiables are taken care of, attention should be put in the real value drivers of the deal: how to roll-out the acquired portfolio globally, how to expand the new business model, how to leverage the Intellectual Property across the parent organization …
Create **touchpoints**	Establish formal and informal touchpoints and forums for functional and cross functional teams to share knowledge and 'ways of working'.
Protect the **target**	The target's culture, agility, innovation spirit should be protected from the burden of the buyer's processes. The buyer should be willing to take on board some new approaches, up to, in the case of new products, cutting part of its own portfolio or innovation pipeline to fully commit behind the target's one.
Appoint a **joint integration team**	Create an integration team with resources from both companies, ensuring that each part brings its strength to the table, in line with the objectives of the acquisition

Synergies and value creation and managing the integration process

Synergies and value creation

As we have noted, the deal rationale should guide the definition of the integration approach and the prioritization of the activities linked to it. In the case of acquisitions of start-ups or small entrepreneurial companies, the deal rationale is generally linked to top line value creation, whether by exploring new products or services, or accessing new customers. Cost synergies, also given the overall small size of the target, may not be a priority. Whichever the type of synergies, value creation should never be ignored.

The deal strategic objectives should be translated into a set of quantifiable targets (e.g., incremental sales, new product launches, reduction in procurement costs ...). These should be assigned to the relevant functional or cross-functional team and should be incorporated
into individual performance objectives. These teams are responsible for developing a roadmap for successfully realizing the synergies.

These initiatives should be aligned with the chosen integration approach: it will be difficult, for example, to a achieve a big reduction in administrative costs if the integration does not call for a deep alignment in IT systems, so that processes can be fully automated and resources shared. But in such case, it should still be possible to share some ways of working or best practices and in general support the acquired small company moving towards more rigorous and standardized processes. The lack of IT integration should not be an excuse for avoiding synergies realization. It may be often beneficial to change the target's processes, potentially adding some manual steps, to enable some interfaces between systems and triggering further optimization.

Managing the integration process

Independently from the integration archetype that is chosen, managing the integration activities can be a challenge. The buyer should not use the small size of the acquired business as a reason to underestimate the integration effort and not dedicate the necessary time, resources and management's attention.

While the integration of a small company in a large organization can seem like a small project, the vast number of detailed tasks that go beyond the usual day to day activities and the many functional interdependencies will often overwhelm any integration team that is not supported by strong program management.

Start-ups and entrepreneur-led companies tend to have lean and flat structures, and organizational models in start-ups tend to be fluid, with multiple empowered teams forming and dissolving based on ongoing projects, rather than clear functions within a strict hierarchical system. In practical terms, this often means that one person in the start-up organization can have multiple counterparts in the buyer's one, covering the same areas o tasks. A common consequence is that even the leaner integration programs can result in a multitude of data requests reaching the same small group of people, overwhelming the target organization and quickly grinding the process to a halt. Filtering the flow of information requests through one or very few managers can avoid confusion and duplication of requests.

Sharing early on a clear integration vision and objectives and building a shared roadmap with the target leadership team can certainly help to anticipate some of these issues and find the appropriate solutions.

Summary

Start-ups represent an efficient way for larger companies to enter attractive niches, experiment with new business models, or access promising technologies and know how, but they often imply hard choices when it comes to integration, between the impulse of gaining control and share resources, processes and systems and the need to sustain the target's agility and innovation capabilities.

While this dilemma is in a way engrained in the essence of the transaction, there are ways to mitigate the integration challenges.

First of all the buyers should not use the often small size of the deal or of the business as a reason to not dedicate the appropriate resources and time to the integration phase.

Buyers should have maximum clarity of what are the strategic objectives of the deal, and translate them in quantifiable targets.

They than should understand what levels of autonomy and integration is needed to achieve these targets: for example, what level of IT roll-out is needed to enable the sales team to include the target's portfolio in their offer?

The acquirer should also be transparent with the target organization about the benefits but also the needs and constraints of being part of a large, often listed, company.

There should be no doubt that some initiatives related to compliance and regulatory requirements must be undertaken, trying to minimize the burden of the small target organization by defining clear touchpoints and roadmaps.

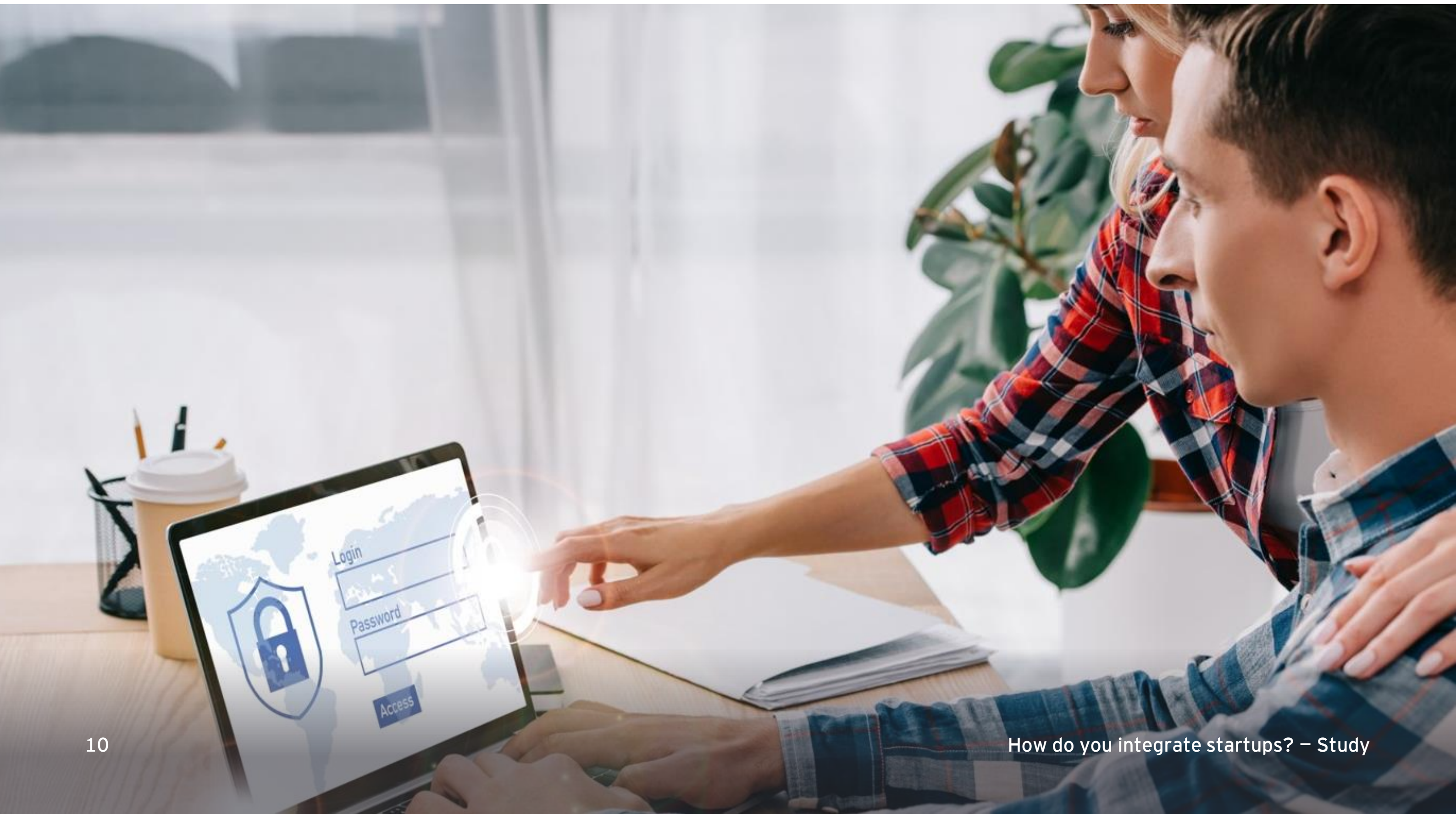
The strategic objectives, translated into value targets, need to broken down into functional tasks and roadmaps, overseen by an integration team where both companies contribute resources.

In the pursue of the strategic objectives, the buyer should not be afraid of changing their ways of working and pre-deal initiatives showing that the integration does not need to be a one-sided game.

A small, young organization may find it difficult to navigate the complexities of a global company, therefore efforts should be made to create functional touchpoints and possibly a champion for the target in the acquirer's organization, who, with aligned incentives, should act at the same time as a counsellor to the target's management and as their sponsor towards the acquirer's.

Project managing the integration programme need to be done with a focus on results rather than process and templates, to avoid overwhelming the small organization.

Often in M&A deals, much of the value is generated, or lost, in the integration phase and while the price paid for a small start-up might be a few order of magnitude smaller than big news-worthy deals, its value generating potential can be disproportionally large in the long term. This is a compelling reason to invest time and resources to make such integrations a success.



Our team

Why EY?

- **Connected team:** We have assembled a team that combines experts across borders, who are also accustomed to work together as an effective team
- **Cross-functional experience:** Our team has a strong background in Operations and IT, TAX, financial, legal/ accounting and shows a proven track-record in advising our clients regularly on complex integrations
- **Local swiss experience**: We have all relevant capabilities covered in our Swiss team. Our Swiss consultants know the market and the specificities for transactions involving Swiss companies
- **Wide sector experience:** Our team have expertise in all major business sectors, including Life Sciences, Consumer Products and Retail, Technology, Media and Telecoms, Industrial Products and Services, Automotive, Private Equity
- **Market leading:** We have the global critical mass to access niche expertise across the team
- **Approach:** Our approach is flexible and practical, and our methodologies are built to drive high quality results in a time pressured situations

EY key contacts

Dr. Robert Kendzia

Partner EY-Parthenon/Zurich

Lead Buy and Integrate CH

Transaction Strategy & Execution

+41 79 712 39 51
robert.kendzia@parthenon.ey.com

Dr. Georg Beckmann

Partner EY-Parthenon/Munich

Lead Buy and Integrate GSA

Transaction Strategy & Execution

+49 160 939 224 01
georg.beckmann@parthenon.ey.com

Reto Seibold

Senior Manager/Zurich

Buy and Integrate CH

Transaction Strategy & Execution

+41 79 158 05 84
reto.seibold@parthenon.ey.com

EY | Assurance | Tax | Strategy and Transactions | Consulting

About the global EY organization
The global EY organization is a leader in assurance, tax, strategy transaction and consulting services. We leverage our experience, knowledge and services to help build trust and confidence in the capital markets and in economies all over the world. We are ideally equipped for this task – with well trained employees, strong teams, excellent services and outstanding client relations. Our global purpose is to drive progress and make a difference by building a better working world – for our people, for our clients and for our communities.

The global EY organization refers to all member firms of Ernst & Young Global Limited (EYG). Each EYG member firm is a separate legal entity and has no liability for another such entity's acts or omissions. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information, please visit www.ey.com.

EY's organization is represented in Switzerland by Ernst & Young Ltd, Basel, with 10 offices across Switzerland, and in Liechtenstein by Ernst & Young AG, Vaduz. In this publication, "EY" and "we" refer to Ernst & Young Ltd, Basel, a member firm of Ernst & Young Global Limited.

ED None

ey.com/ch