

By Louis Lehot, The State of the Acqui-Hire in 2021: the good, the bad, the why and what's next

By Louis Lehot, the founder of L2 Counsel, P.C. and the video blog series
#askasiliconvalleylawyer When you are acquired for your team, not your product.



Palo Alto, Jan 14, 2021 ([IssueWire.com](https://www.issuewire.com)) - In the technology industry, whether in Cupertino or elsewhere in the Global [Silicon Valley](#), the competition for the top talent required to grow to scale can be fierce. For decades, there have not been nearly enough STEM graduates to fill open spots. The road from #garage2global is tortuous, and a key ingredient to becoming #bigtech faster than the next #startup is hiring engineers. For #bigtech companies to stay on the cutting edge, they often find that acqui-hiring a startup with ten engineers is a faster, better return on investment than hiring onesies on a drip-feed basis.

What is an acqui-hire?

Acqui-hiring refers to a merger, acquisition, or asset purchase whereby the buyer seeks to secure the target's talent, engineers and personnel, rather than to develop or monetize the target's technology, products, or services. It can be a very efficient way to grab talent in groups. When a #bigtech company acquires a group of highly-skilled engineers who have a strong working relationship, they can hit the ground running seamlessly and with gusto, which benefits all. Especially the bottom line.

This "recruitment" process can cut costs and potentially prevent possible legal action relating to non-compete clauses, I.P. infringements, and breach of contract. An acqui-hire can also be tidier than a failing company's wind-down process but often signals a distressed sale. Many of these companies could not get additional funding needed to continue, and often, the entity acquired is shuttered post-closing.

History of acqui-hires – a threat to the competition?

The tech sector phenomenon of acqui-hires is not new: Google has made 200 acquisitions since being founded in 1998 by Sergey Brin and Larry Page, the vast majority of which have been acqui-hires. Facebook has acquired more than 80 companies. In a 2018 interview with CNBC, Tim Cook, CEO of Apple, bragged that Apple acquires a company every 2 or 3 weeks, either for talent or intellectual property. Amazon has acquired over a hundred companies, and Microsoft many multiples of this number.

Early in 2020, the Federal Trade Commission made public a probe into possible market abuse by #bigtech by demanding information on all acquisitions not already reported to antitrust authorities in the past decade. While investments over a statutory threshold are reported in a government filing before closing, acqui-hires are typically for amounts well below the threshold and have flown under the government's radar. In its special orders issued to the big five #bigtech companies – Amazon, Apple, Facebook, Google, and Microsoft – the government asked for details on terms, scope, structure, and purpose of each transaction consummated between January 1, 2010, and December 31, 2019. Within

the purview of the orders was a wide variety of transactions, no matter how structured, from minority investments to licensing deals to board designation rights.

By December 2020, the FTC had sued Facebook, alleging that the company had “illegally maintain[ed] its social networking monopoly through a year-long course of anticompetitive conduct.” The lawsuit was joined by the elected [attorneys](#) general of 46 states, the District of Columbia and Guam. The complaint alleges, notably, that Facebook used acquisitions as part of a systemic strategy to eliminate threats.

Structures and value

Structures can vary, but typically it's an acquisition of stock or assets, with the bulk of the purchase price being held for employee packages. If the buyer only wants the team, they may sign a release agreement where the company agrees to release the buyer for hiring the employees and include a defensive license agreement of the company's I.P.

When it comes to pricing, buyers frequently express the price on a “per head” basis, and the rate can be a few hundred thousand or two million dollars per head.

There are no set rules for an acqui-hire, which are often a combination of stocks or assets. These agreements are often light on terms since the real value is the employees, not the company, and to do an acqui-hire successfully, the buyer must get the team to agree to join the new company. An annual contract is standard, and sometimes, the employee is enticed to join with a signing bonus. However, there is a risk they leave the moment the contract is up and use their experience to begin another company.

For buyers considering an acqui-hire, consider:

- Will there be post-merger liabilities?
- How will obligations to creditors be satisfied?
- What structure will the new employee's compensation take?
- Have you completed a rigorous due diligence process, ensuring you and your stockholders are getting value for money?
- Have you considered the liabilities of terminating existing employees?
- Have you thought about a deal structuring where the company, not just the people or assets, are acquired, avoiding a separate wind-down process?
- Have you consulted with tax advisors early in the process on complicated tax questions, such as

parachute payment tax considerations

Buyer keys to success

The keys to the success of an acqui-hire typically can be traced back to three key drivers:

- **Retention.** To obtain a positive return on investment, a buyer needs a target talent to remain with the buyer. Structuring payments to target talent over time can motivate teams to stay in their seats and achieve results. Should payments be linked to the passage of time, the achievement of milestones, or have some incentives for each?
- **Non-competes.** While California and some other jurisdictions have rendered illegal the use of non-competition and other restrictive covenants, the exception is for covenants given in the context of the sale of a company's business. They are usually less scrutinized when made in connection with an acqui-hire. Nevertheless, they need to be carefully drafted to be enforceable. In addition to non-competes, there can be non-solicits, no-hires, confidentiality, and invention assignment agreements.
- **Personalization.** When buyers spend enough time with targets and their teams, they can identify some key ingredients to their success. The deal should be personalized to the circumstances of each target. Employment agreements, offer letters, equity awards, and other deal elements should not merely be standard forms rolled out of the buyer's H.R. department, but rather, narrowly tailored to capture the target's value.

Paying attention to these key deal drivers will often be outcome determinative as to ultimate success.

Buyer benefits

With the completion of an acquihire, a company may now be better able to develop new technology, enter a new market, or support an existing technology function or market position thanks to the recent influx of talent. The new hires may bring with them new ideas and processes. An acqui-hire can inject new blood into an engineering team that has become bureaucratic, bringing innovation, new ways of doing things, new products, or improving existing products.

Drawbacks

The negative aspects of an acqui-hire are not always apparent. Distance between buyer and seller offices and the question of where the seller's team will sit post-closing can be disruptive. Additionally, working for a larger company comes with different rules that are more restrictive than most startup environments.

For the buyer, what if the target's talent does not join or departs shortly after? Hopefully, the buyer has smartly crafted a deal where the target's talent feels incented to stick around and make things happen.

Another hidden danger of an acqui-hire for the buyer is the morale of current workers. Bringing in a new team from the target can cause resentment among the buyer's existing workforce, especially if the target's team parachutes into the buyer's team with elevated positions.

Why sell in an acqui-hire?

So, if you are a startup looking at an acqui-hire term sheet, what to do? Let's face it: most startups will fail with the first two to five years of their existence. A startup is a gamble in the best of circumstances. What if you can't build the product? What if the market isn't there? What if you can't raise the funds that will be required for startup capital? What if someone comes in and does it faster, better, cheaper? What if you can't raise scaling capital? The unexpected is always expected. For the seller, an acqui-hire on the right terms can be the safest crash landing, or it can be a home run.

Outlook for 2021

While the global pandemic has been lethal to the hospitality and travel sectors, it has not been catastrophic to the technology industry. The stock market is at record highs. A new administration is arriving in Washington. A natural question is whether we can expect the acqui-hire to survive and thrive in 2021. While the acquisition programs at the five #bigtech companies under FTC investigation can be expected to slow down, there is no reason to think that the rest of the technology industry won't carry on with this tried and true growth driver.

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