International Outcomes of Venture-funded Companies: The Role of Acquisitions

Competition Policy Main Takeaways

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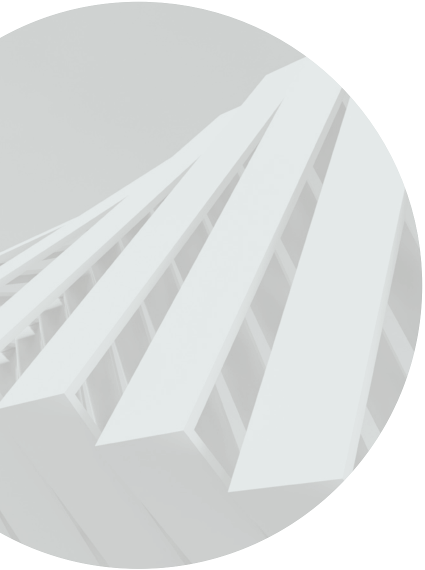

Competition Policy Main Takeaways

- **VC-funded companies' diverse outcomes call for a case-by-case regulatory review of acquisitions**

  Regulatory reviews of acquisitions should take into account the particularities of startup lifecycles and the diverse exit patterns that characterize each industry.

  The impact of a startup acquisition once the product has been developed is not the same in biotech as it is in the tech industry. While the market impact of the acquisition can be generally anticipated in the case of biotech startups (where the size of the affected market can be estimated and the number of competitors identified), the high degree of uncertainty facing tech startups makes it difficult to anticipate the impact of the acquisition. This calls for a deep, detailed and bespoke analysis of the circumstances and impact of each acquisition, taking into account how dynamic competition will be affected by each specific transaction.

- **Tech IPOs are seldom an alternative to tech acquisitions**

  Most startups looking to be acquired as an exit strategy are not candidates (neither now nor in the future) for an IPO. Tech startups with potential for an IPO are already at the product market phase and generate revenues. Startups going public are full-fledged businesses while startups being acquired range from early-stage ideas to mature products. Very few startups reach maturity and go public. Even those startups reaching maturity are often more valuable acquired than as an independent company. Most startups will not reach the IPO phase and will navigate between acquisition or failure.

- **Startup failures are bad for everyone, not just investors and founders**

  For everyone involved—consumers, investors, and acquirers—an acquisition is a better option than a failure. Stricter rules for approving acquisitions may aim to increase the number of

IPOs by making acquisitions more difficult. It may also increase failures. As a result, fewer startups could be started, decreasing innovation, entry and choice for consumers.

- **Stricter merger review standards could deter market entry, competition and innovation**

  Making acquisitions more difficult from a regulatory point of view will deter initial market entry. Regulatory burdens that make acquisitions more difficult, or even prohibit them from happening, will likely lead to more startups failing as only a few of them would successfully go public. In practice, this means that stricter M&A rules are likely to result in more failed startups and less market entry, with the consequent negative impact on competition and innovation that results from new entrants.

- **Inhibiting startup acquisitions does not necessarily promote competition, innovation or efficiency**

  Measures such as the 'balance of harms' competition test, less stringent standards of proof, and even reversing the burden of proof in certain circumstances may make regulatory approval of tech mergers more difficult and deter startup acquisitions. While regulators may believe these measures could reduce errors from approving mergers they come to regret, such measures also run the risk of prohibiting mergers that promote innovation and consumer welfare, and of discouraging the creation of some startups. Acquisitions are essential and are in fact the most common exit with value – roughly 2/3 – for VC-funded startups.

- **The venture outcome data does not speak to the issue of which mergers should be approved and which blocked. It does show that acquisitions are very important to venture innovation, and that changes to M&A policy could have consequences that are socially worse rather than better.**

  To assess how acquisitions in the tech industry affect competition and innovation, it is important to look at the data and understand the importance of acquisitions to venture startups. The data here does not speak to the issue of which mergers should be approved and which blocked. What it shows is that few acquired companies could have gone public instead.

  The adoption of stricter rules is not innocuous. Applying more burdensome rules for the regulatory approval of M&As might result in the blocking of some anti-competitive mergers, but it would come with a cost to innovation and competition. Some startups will not be started, others might not find their most valuable acquirer, and some firms might even fail when acquisitions are burdened.

  More sophisticated theories of harm with a focus on the effects of merger on dynamic competition and on innovation, rather than increasing the burdens for all startup acquisitions, seems a more promising avenue to improve the efficiency of merger review and encourage innovation. Finally, further empirical work to inform policy choices is crucial for a balanced approach to merger review that promotes competition and innovation.

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