

KILLER ACQUISITIONS: an exit strategy for founders

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tl;dr

Being acquired is how many startup founders and investors expect to make money. If you make that harder you'll get fewer startups.

The Debate:

Some allege that large tech companies acquire nascent competitors to prevent certain startups from competing with them later on, effectively “killing” potential competitors before they can be a serious threat to them.

But... founders still have an incentive to hold out and compete against incumbents, yet many startups are also founded and invested in only because of the possibility of being acquired by a bigger firm. Acquisitions additionally allow features to be added to benefit large existing user bases.

KEY TAKEAWAYS

BEING ACQUIRED IS AN 'EXIT STRATEGY' FOR INVESTORS AND ENTREPRENEURS.

Investors and entrepreneurs hope to make money from the products they are putting time and money into. That may come from the product becoming wildly successful, and

potentially displacing an incumbent, but that may be very difficult to achieve. The prospect of being acquired increases the possibility that these people can make a return on the product, and so increases their incentives to build and innovate.

ACQUISITIONS IMPROVE PRODUCTS THAT PEOPLE ARE USING.

When platforms acquire other products they typically intend to incorporate those products into their offering, giving their existing large user bases a better product. This may raise their welfare compared to a counterfactual without the acquisition where those users would have to switch away to the other product to enjoy the benefits of its innovation, especially if there are complementarities between the platform and the third-party product.

THE PROSPECT OF BEING ACQUIRED ALLOWS NON-MONETIZABLE PRODUCTS TO BE PROFITABLE.

Some innovations are not easily monetizable except by being incorporated into an existing product - they may require too deep an integration into the product to make contractual dealings feasible. In this case, the only way products like this can be viable for non-incumbents to be developed is for the product to be acquired by an incumbent.

ARGUMENTS THAT ACQUIRED BUSINESSES ARE POTENTIAL COMPETITORS OFTEN IMPLY THAT THERE IS A HUGE AMOUNT OF COMPETITION IN THE MARKET.

If Instagram was a potential competitor to Facebook when it was acquired in 2012, that implies that all the other differentiated social networks on the market today, like TikTok, Snapchat, and Twitter are also actual or potential competitors of Facebook – implying that Facebook faces a lot of competitive constraints on its actions.

MANY SUPPOSEDLY ANTI-COMPETITIVE ACQUISITIONS APPEAR THAT WAY ONLY BECAUSE OF IMPROVEMENTS MADE TO THE ACQUIRED BUSINESS BY THE ACQUIRING PLATFORM.

Instagram was a small photo-sharing app in 2012 and Facebook was widely mocked for overpaying when it bought it for \$1 billion; the enormous growth and success Instagram has enjoyed since then is at least partially (and maybe significantly) due to Facebook’s managerial skill and the integration of Instagram with other Facebook products. Youtube’s growth since its acquisition by Google for \$1.65 billion in 2006 has been driven by Google’s investment in improving search, video retrieval, and marketing on Youtube, which may not have taken place without the acquisition.

THE EVIDENCE AROUND KILLER ACQUISITIONS IS THIN AND FOCUSED ON PHARMACEUTICALS, WHICH HAS KEY DIFFERENCES WITH TECH.

The single paper cited to support the theory of harmful killer acquisitions is based on a study of the pharmaceutical market, and centers on problems that may arise when patent protections incentivize existing patent holders to buy drugs that are similar to their

own and shut down production. But patent protections are rare in the digital market acquisitions that critics allege are “killers”, and without them the “killer acquisition” strategy is likely to be unviable, because incumbents generally cannot prevent another business from copying the product of the acquired firm.

For a fuller explanation of these and related issues, see Geoffrey Manne’s recent submission to the U.S. House of Representatives Committee on the Judiciary, Subcommittee on Antitrust, Commercial, and Administrative Law, “[Correcting Common Misperceptions About the State of Antitrust Law and Enforcement.](#)”

CONTACT US



Sam Bowman
Director of
Competition Policy
sbowman@laweconcenter.org



Geoffrey Manne
President & Founder
gmanne@laweconcenter.org



International Center
for Law & Economics