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Top Five M&A Deal-Killers for Social Commerce Start-Up Companies

While acquisitions fail to close for a variety of reasons, the five situations outlined below are some of the most common deal-killers for software-oriented social commerce companies.

1. An important constituency — company investors, management, or key employees (usually key technology builders/developers) — does not support the exit plans.

The critical first question to answer in this regard: Are your key developers/technologists or other key co-founders prepared to continue to work with the company and the acquirer post-acquisition? Where early-stage exits are involved, the inventors/developers/visionaries of the acquired company's technology are typically viewed as a "must have" by the acquirer.

2. The company's "IP house" is not in order.

In other words, the company has done a poor job in one or more of a number of critical areas relating to its intellectual property or, worse, does not have rights to the IP it is using in its products. The company must obtain signed agreements assigning IP created in the course of their work for the company from all existing and former employees (e.g., invention assignments and confidentiality agreements), all founders, and, critically, founders no longer with the company (often obtained in consideration for their founding equity), and independent contractors (the language should be in the consulting or development agreement). It also is critical to maintain a record of consistent use of non-disclosure/confidentiality agreements with third parties to protect the company's trade secrets, which for social commerce companies, is typically software.

- » **Best case:** There is nothing to disclose against the IP representations and warranties given by the company to the acquirer in the definitive purchase agreement or, if there is something to disclose, a thoughtful explanation is provided.
- » **Worst case:** During due diligence, the acquirer discovers significant problems unknown even to the company.

For social commerce companies, it is unlikely that patents will have been pursued or, if filed, have progressed very far or are attributed much value at any early-stage exit, so a software-oriented company will primarily rely on trade secret and copyright protection for its IP. As such, an acquirer will want well-documented software code that can be integrated with the acquirer's own technology and understood by the acquirer's technology team. The acquirer will expect the company's developers to have tracked and complied inbound IP licenses (open source, freeware, "copyleft," off the shelf, and so forth). Note that free software and open-source software often create the most concern, as compliance with the complex license terms can be difficult, and poor documentation can possibly be a "show stopper" for a large enterprise-acquirer due to risk.

Similarly, the company's compliance with well-thought-out and implemented information privacy, processing, and security practices and policies is particularly important to an online business.

3. The company's capitalization table, which is supposed to be a reflection of the company's current ownership and rights to acquire ownership, is incomplete and inaccurate.

Issues arise where undocumented promises of equity to contractors or employees have never been reduced to actual grant or purchase documents, approved by the company's board of directors, and signed by the grantee. A failure to get the "paperwork in order" can be a serious issue for the company, leaving verbal discussions (or worse, email exchanges) open to interpretation, and risking claims by the employee or contractor of greater "promised" equity, better vesting terms, and so forth. Former disgruntled co-founders, contractors, and employees can only compound these complexities during an intensive due diligence process.

4. Assignment/change-in-control provisions in key company material contracts require third-party consent.

If consent is required and the contract is material to the target company's business, the acquisition can be put in jeopardy; approaching a key customer or strategic partner, for instance, ahead of the acquisition can be tricky and generally is not favored by the selling company. Where the material contract involved company IP, the conventions regarding assignment are intricate, uncertain, and often counterintuitive (unlike, for example, the case of a customer contract where the absence of an express assignment provision is interpreted to mean the contract can be assigned; it is the opposite with licenses for instance).

> Regarding Nos. 2, 3, and 4 above, each situation involves the selling company identifying potential problems and working to remedy them ***before*** engaging in the sale process. Once the letter of intent or term sheet is offered up by acquirer, negotiated, and finally accepted by the selling company board and shareholders, issues noted above that are left outstanding can become problems exposed during due diligence that potentially put the deal in jeopardy.

5. The company engages, sometimes unwittingly, with a single potential acquirer or builds its technology and/or business with a single acquiring company in mind, often due to an early key strategic partnership.

A company wanting to sell (emphasis on "wanting") and embarking on serious acquisition discussions with only one realistic acquirer is often bound for disappointment. Certainly it can end up that a company may initially be approached by the ultimate acquirer, but it's often in the context of some variety of strategic partnership, customer, or other commercial arrangement. A great exit for the selling company's shareholders does not typically result from acquisition discussions being initiated by the selling company, however; it's much more likely that the acquiring company is doing the chasing after getting a better look at the team and the product. If a company founding team wants to sell, it can sometimes engage a financial advisor (e.g., boutique bank) who can help create a competitive environment, but this is not common in sales of early-stage companies (where "team and technology" are the principal assets) that we are discussing here. In spite of the best and often good-faith intentions of the acquirer's corporate development sponsor, the acquirer CFO/deal-approval committee is prepared to push back hugely on price if they think they can, so a more competitive environment can help offset that.

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