



In the conventional mergers and acquisitions (M&A) space, the driving value used to be the target company's products, services, brand, intellectual property, customer base, market share, plant, machinery or equipment. Now, in the **Fourth Industrial Revolution** and **era of technology**, the driving value of M&A has shifted.

### New focus of M&A

**Talent** is now the key asset for many companies, especially those in the tech industry. As such, we see a new trend of acquisitions whereby the employees of the target company now form the driving value of the M&A. This has inspired the term "**acqui-hiring**", which is a product of the words "acquiring" and "hiring" combined. Based on research cited in the *Harvard Business Review*, traditional scale deals only account for about half of the M&A deals.<sup>1</sup>

This new acquisition strategy acts as an effective and efficient method of recruiting a large group of talent.

It overcomes the delay caused by having to scout for individual candidates, convince each one to join the company and negotiate the terms for each new employee. In fact, one of the best acqui-hires is a target company which already has a **pre-assembled** fully functional team ready to hit the ground running that the buyer can deploy to run specific projects as a team.

### Global trend

It is a popular trend for **tech giants** to acquire tech startups because their key assets are usually their talent more than anything else, along with the technology that they have developed. As the tech industry continues to boom, competition for the best talent in the market keeps getting more intense, particularly for software engineers.

In 2016, **Twitter** acquired artificial intelligence (AI) company, Magic Pony Technology, for the substantial sum of US\$150 million, despite the startup being only 18 months old and fairly under the radar prior to the acquisition.<sup>2</sup>

1 David Harding and Andrew Schwedel, "Why Traditional M&A is Becoming Less Important" (25 May 2018) *Harvard Business Review* <<https://hbr.org/2018/05/why-traditional-ma-is-becoming-less-important>>  
 2 Victor Basta, "Artificial Intelligence Teams Being Acquired for \$2.5m/employee; Employee Value Often Far Exceeds Business Value" (7 July 2016) *LinkedIn* <<https://www.linkedin.com/pulse/artificial-intelligence-teams-being-acquired-employee-victor-basta>>; Ingrid Lunden, "Twitter Pays Up to \$150M for Magic Pony Technology, Which Uses Neural Networks to Improve Images" (20 June 2016) *TechCrunch* <<https://techcrunch.com/2016/06/20/twitter-is-buying-magic-pony-technology-which-uses-neural-networks-to-improve-images/>>

Other than its team of 11 PhDs, other employees and a few patents, the startup was not reported to have had any other noteworthy assets for the acquisition. In 2018, **Google** completed an acquisition of 2,000 members of HTC's design, engineering, research and development team for US\$1.1 billion.<sup>3</sup>

From 2007 to 2011, Facebook's acquisition of 13 startups was labelled as "acqui-hires", most of which cost **millions** of dollars each.<sup>4</sup> Facebook has publicly stated that these acquisitions were targeted at acquiring the talent and, in fact, as part of the acquisition terms, most of the employees of the target companies joined the Facebook team and many of the founders or key personnel were given senior roles in its organisation.

## Southeast Asia

In the **Southeast Asia** region, acqui-hires are also growing. In September 2017, McKinsey & Company, the global management consulting firm, acqui-hired VLT Labs, a digital product engineering and design startup based in Malaysia, for its team of designers, developers and product managers.<sup>5</sup> In 2018, Maxis acqui-hired Optima to amplify its e-commerce team.<sup>6</sup>

We also see Southeast Asian companies looking **beyond the region** for acqui-hires. In 2016, Go-Jek, the transportation and logistics company based in Indonesia, acqui-hired two startups based in India, C42 Engineering and CodeIgnition, for their engineering expertise to enable the setup of a research and development centre for Go-Jek in India.<sup>7</sup>

## Deal structure

**Transactional lawyers** must recognise this new acquisition strategy so that they are alert to the key issues and considerations in advising the client. The shift in the key driver for the acquisition has an impact on each stage of the transaction.

First and foremost, it has an influence on the **ideal structure** of the deal. In contrast with the traditional M&A, the acquired asset, which is the people, can choose to walk out the door if they are not happy with their new boss or they lose the incentive or motivation to remain. In fact, entrepreneurs are, by nature, driven by decision-making powers and prefer challenges over stability.

A deal structure which may maintain the seller's incentive in the company's business is a **share swap**, whereby the sellers are given equity in the buyer's organisation as consideration for the sale of their shares. However, this may raise a few issues, for example, the sellers may dispose of their shares to third parties which extinguishes the incentive for the seller to remain employed and may cause the buyer's voting rights to be diluted. To protect the buyer against these risks, the sale and purchase agreement should address voting rights and right of first refusal or an outright restriction on the seller's disposal of the shares to third parties.

The lawyer must also caution the buyer to consider whether giving a key management role instead of a share swap may be more commercially or operationally practical. The other alternatives are **partial acquisitions**

3 Ryan Whitwam, "Google Completes \$1.1 Billion Acquisition of HTC Design Team" (30 January 2018) *Forbes* <<https://www.forbes.com/sites/ryanwhitwam/2018/01/30/google-completes-1-1-billion-acquisition-of-htc-design-team/#777c6374cb1e>>

4 Alyson Shontell, "13 Startups Facebook Acqui-Hired for Millions of Dollars" *Business Insider* (21 May 2011) <<https://www.businessinsider.com/15-startups-that-got-gobbled-up-by-facebook-2011-5?IR=T>>

5 "This week, VLT Labs joins McKinsey Digital Labs" (20 September 2017) <<https://www.mckinsey.com/about-us/new-at-mckinsey-blog/this-week-vlt-labs-joins-mckinsey-digital-labs>>

6 "Maxis eCommerce Capabilities To Help Drive Its Enterprise Offering As End-To-End Solutions Provider" (28 June 2018) Maxis Newsroom <<https://www.maxis.com.my/about-maxis/newsroom/2018/june/maxis-ecommerce-capabilities-to-help-drive-its-enterprise-offering-as-end-to-end-solutions-provider/>>

7 Madhav Chanchani, "Go-Jek to set up development centre in India with acquisition of C42 Engineering, CodeIgnition" (19 February 2016) *The Economic Times* <<https://economictimes.indiatimes.com/small-biz/startups/go-jek-to-set-up-development-centre-in-india-with-acquisition-of-c42-engineering-codeignition/articleshow/51048406.cms>>

or a form of **joint venture or partnership** which may be more effective than a full acquisition.

## Retention

In the past, the purpose of the retention period of the employees in the target company was generally aimed at effecting a smooth transition of the operations from seller to buyer. However, it is now necessary for the retention period to be much longer because the very purpose of the acquisition is to retain the employees in the target company.

The **retention** of the employees in the target company can be a challenge. In 2017, Media Prima Berhad acquired REV Asia Holdings Sdn Bhd as part of its strategy to build a team for its digital media expansion. Two years later, an industry source is reported to have said that the senior staff, including the managing director and the financial controller, have left or were serving out their notice.<sup>8</sup> This may have happened earlier if not for a condition in the acquisition which required REV Asia's existing management team to remain for a certain number of years.<sup>9</sup>

In addition to a minimum retention period, the payment of the purchase price to the sellers who are also key management personnel may be structured in the form of a **deferred payment schedule**, which depends on the achievement of specific milestones or the period of retention (also known as an "earnout period").

It can also be structured such that the deferred payments

are only given if each of the employees in a specified group is retained, or it can be linked to a number or specification of the employees who must be retained. This will be especially useful if there are employees who were not equity holders in the target company, but are valuable assets of the acquisition.

## Intellectual property and non-competition

The laws of Malaysia generally deem any restraint of trade clause (also known as "**non-compete**") to be void. One of the exceptions to this is an agreement which includes the sale of goodwill of a business. Therefore, a non-compete clause against an employee in an employment contract will be void, but a non-compete clause in a sale and purchase agreement can be enforced against the sellers who may also be employees of the target company.

In contrast with only acquiring the employees, the acquisition of the company will also secure ownership over any **intellectual property** which the employees have developed for the company over time. This includes trademark, copyright, patents, industrial designs and confidential information.

In recognising these benefits of an acqui-hire, the lawyer must put in place well-drafted clauses on intellectual property and non-competition for the buyer's benefit.

## Termination and transfer

The buyer may not wish to retain every employee in the target company. Termination of employees can be tricky,

<sup>8</sup> Joyce Goh, "Media Prima Digital sees REV Asia senior execs leaving" (2 September 2019) *The Edge Malaysia Weekly* <<https://www.theedgemarkets.com/article/media-prima-digital-sees-rev-asia-senior-execs-leaving>>

<sup>9</sup> *Ibid*

especially since the employment laws of Malaysia are generally more favourable to the employees than the employers. The **termination cost** may be substantial, depending on the number of employees to be terminated and the termination benefits of the respective employees based on their employment terms and years of service. Therefore, the buyer may consider shifting the termination responsibility or costs onto the seller in the sale and purchase agreement.

In addition, it is common practice for the buyer to **transfer** the acquired talent to other related companies within its organisation, especially where the long-term goal is to shut down the acquired entity once all its valuable assets are transferred out. So, the buyer should consider, as early as the due diligence and negotiation stage, whether any of the target company's employees may need to be transferred to another entity within the buyer's group.

Under the laws of Malaysia, it is implied that employers have managerial prerogative to transfer employees within their group of companies, provided that the employment contract does not expressly prohibit it and the transfer does not result in the employment terms becoming any less favourable. Therefore, the buyer's solicitors must bear this in mind as it may affect the purchase price or other terms for the transaction.

### Due diligence and negotiation strategy

Transactional lawyers must recognise that, in contrast with the traditional M&A, the **due diligence** exercise for an acqui-hire would have a greater focus on the employment contracts and interviews of the target company's employees, which are conducted much like job interviews to ascertain their value.

The lawyers will be able to drive the best negotiation by being mindful of the parties' **key motivations** for the transaction. Acqui-hires are usually carried out on startups and SMEs whose founders and employees are also the shareholders.

If the financial status or business viability of their company is bleak, then an "acqui-hire" will look much better on their résumé than a winding up. So, they are likely to be more motivated to be acquired than traditional, passive shareholders.

Alternatively, if the sellers are motivated to finding an organisation that has the resources and support for the development of their products, or to support their fellow employees, then this should be the focus of the negotiation.

### Final takeaway

The ways in which this new acquisition strategy will affect the structuring of the deal will continue to change. The trend of the acquisition strategy will also continue to develop. As these continue to **evolve**, so must transactional lawyers. **LH-AG**

*\* This article is an extended write-up of the presentation by Raphael Tay for the panel session on "Recent Experience in Manoeuvring Corporate and Tax Intricacies in Malaysian M&A" at the Legal 500 General Counsel Summit: Malaysia in Kuala Lumpur on 28 March 2019.*