Baker Pacific
Corporate Development and M&A

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## Should We Make That Strategic Investment?

As a large technology company, is investing in a smaller commercial partner a great opportunity strategically and financially, or is it a distraction and a waste of resources?

I've seen quite a bit of discussion on the subject of whether a small, growing technology company should take a strategic investment from a larger company in the same industry. However, I've seen much less that addresses the pros and cons from the standpoint of the potential strategic investor. For that matter, looking at the issue from their perspective should be informative for both sides.

Assume a scenario where the "strategic investor" is planning to enter into a commercial partnership with a "growing company" (as I'll refer to each of them throughout). Frequently, the growing company is in need of funding, visibility, and credibility, all of which the strategic investor can provide. The subject may turn to whether it makes sense to pair an investment and deeper relationship with the commercial partnership.

In evaluating the pros and cons of such a transaction to the strategic investor, there are several factors that weigh on each side of the decision.

The benefits to the strategic investor are:

**1. Realize some of the value it is helping to create**

Financially, the investment allows the strategic investor to capture some of the value that it adds by directing business to the growing company and due to the "halo" effect the growing company receives by virtue of being associated with a more significant player.

**2. Achieve a closer relationship due to an ownership interest**

If the strategic investor is interested in developing a closer relationship with the growing company, an ownership position and board seat / board observer is an ideal way to accomplish this. This may be beneficial as a form of due diligence for a future acquisition, or it may be helpful from the standpoint of technology learnings and cooperation.

**3. May provide an "inside track" for an acquisition in the future**

While this type of investment is unlikely to provide a legal path to control or much in the way of preemptive rights, it can provide an easier path to an acquisition in the form of practical benefits. The strategic investor will have greater knowledge of the status of the growing company's progress, and may become aware of other potential suitors at an earlier stage.

**4. May act as a slight deterrent to competitors as partners or acquirers**

While restrictions on partnerships or acquisitions by competitors may not be part of the legal agreement, there may be a practical benefit here as well. Competitors may assume that the growing company is firmly connected to the strategic investor and may therefore focus elsewhere. (Of course, this type of issue could be of concern to the growing company.)

The downsides to the strategic investor are:

**1. High-risk and non-core investment**

From a purely financial standpoint, venture-type investments are typically outside of the strategic investor's core business, and small investments are unlikely to produce meaningful returns on an absolute basis.

**2. Growing company can become a distraction**

Access to a new partner is a two-way street, and it's likely that the growing company will be interested in speaking to and working with various divisions within the strategic investor. While the exchange can be helpful for both sides, it can also become a drain on resources relative to the core mission of the strategic investor.

Taking all these factors into account, I believe that this type of strategic investment can be useful in select situations where it is important to establish a deeper relationship with a growing company, possibly in preparation for an acquisition in the future.

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*Baker Pacific specializes in corporate development strategy and M&A transactions for technology companies. Baker Pacific is especially well-suited for situations where a company finds itself contemplating or facing a significant transaction (such as a sale of the company or an acquisition) and needs additional expertise and bandwidth to be successful.*

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