Stanford eCorner

Building Resistance to Acquisition

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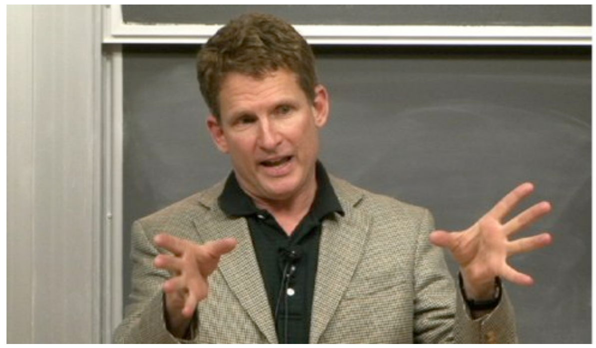
To build an enterprise that can surely go the distance, Pacific Biosciences' Chairman and CEO Hugh Martin suggests a short list of strategies. Among them, the board must have confidence in a strong management team uniquely qualified to make the decision to sell. In addition, don't staff your board with young VC's, as they are self-centeredly building a reputation and seeking quick and profitable hits. Also, the enterprise should strive to take money from funds that are stable and flush, else the firm backing them will be more likely to sell. This combination, advises Martin, will make a board less likely to cave.



Transcript

The other thing I just want to talk a little bit about is how do you build in resistance to being acquired? So I thought a lot about this. There are many entrepreneurs who said, my company is going to go all the way, we're never going to have to sell, we're in great shape, we're not going to sell. That was me prior to ONI. Once I saw how this worked, I deliberately structured PacBio in a couple of ways to make sure that the chances we'd have to sell were minimal. The best way to think about how you do that is to think about what actually happens when the company is going to get sold. So the first thing that has to happen is the management team has to decide that they want to sell. If the management team wants to sell, in general, the company will be sold. It's very difficult for the board to force the company to keep going if the management team wants to bail. But if you have a situation where the management team says, "We can do it. We're 100% confident that we want to move forward," and the board says you want to sell, then you've got a problem.

So the most important thing to consider if you're going to build in immunity to being acquired is to think about that board because that's where all the power for a private company resides as to whether you're going to sell or not. Now, let's think about what happens when a board does this. So the first thing that will happen, I'll get a letter from Affymetrix and they'll say, "Dear Hugh, congratulations. We've done extensive valuation of your technology and your company and we want to buy you. We're willing to give you so much per share valuing the company at $1 billion." So we'll look at it and if we want to keep going and we don't want to do this, I have an obligation to take this letter and present it to the board. It has one other thing usually. At the bottom, it says, "P.S. If you don't take this offer, we're going to buy your next nearest competitor and we will crush you." They do that because they know that I have to take this letter and bring it to my board. And so they want to create as much anxiety in the board's mind as they possibly can to encourage them to sell. So now, you're a board member and you got this letter, what do you do? Here's the first thing the board member is going to do.

He's going to say, do I think this management team can go all the way? Because the single biggest risk in all of this right now is really do we have the CEO and the staff that can get the company all the way to being public and continue to grow? Because if you don't, changing out the CEO is a very tricky thing, or if the management team is not that good, it may tell you something about the CEO or the team, and they may stumble and you don't want to be in a position of taking the risk of having a stumble, you'll probably say sell. So the first thing you can do as a CEO to make sure your board doesn't decide to do this is to actually build the very best management team you can and one that has the credentials and the ability to go all the way. So you may have your buddy who is your co-founder and he wants to be VP of R&D but if you make him VP of R&D when that letter comes in, you've dramatically increased the chance that the board is going to say, "This CEO is not going for the big guns that can really grow this thing. He's going for his friends. We may want to bail." So the first thing is build a great team. The second thing the board member is going to do as he's looking at this letter is he's going to get very, very selfish. He's going to start thinking about himself. If he's a young new venture capitalist, young new venture capitalists don't want grand-slam hits. What they want is a series of singles that are always there reliably. They want to build a reputation for being a thoughtful, fairly conservative, smart venture capitalist.

They don't want to miss five times taking big risks and then hit it out of the park. So you want a very senior venture capitalist because the young guys are going to say, let's sell. So go after very senior guys. The next thing the venture capitalist is going to do after he says, "I've hit five singles. I could really go for this. I'm feeling aggressive." The next thing he's going to do, he's going to say, "Okay, where is my partnership right now? Is the fund that we currently have, like KPCB 10, is it under water? Do we need to show some liquidity because the limiteds are getting a little antsy? Harvard wants their money back, whatever." So it's important to look at the status when you take venture money, not only look who the board member is going to be and the get the most senior guy you can, look at the status of how the funds are that you're going to be in. So they have various numbered funds and you should ask them, what fund am I going to be in? If they say KPCB 10, you say, how much of that fund has been spent and where is it from a status perspective? Because that is going to affect how the individual firm votes because if in fact KPCB 10 is way under water, it may be better, not for the company, for Kleiner that they get a little liquidity and pass it on to the limiteds. So if you do those three things, build a great management team, make sure that the board member is senior, and make sure that the fund is in reasonably good shape, the chances that the board member is going to say, maybe we should sell this for reasons that are beyond the reality of whether the sale makes sense are much, much lower.