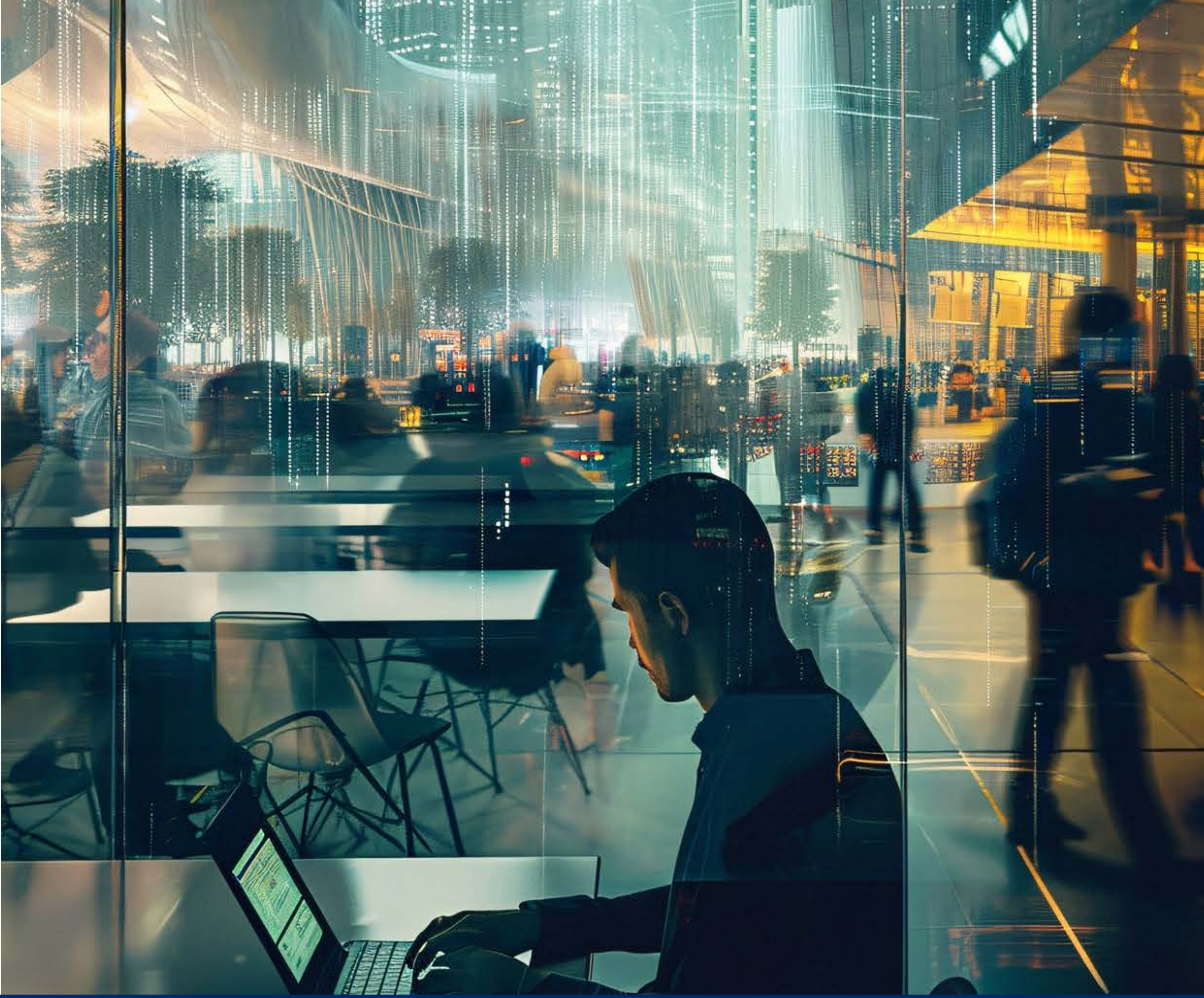

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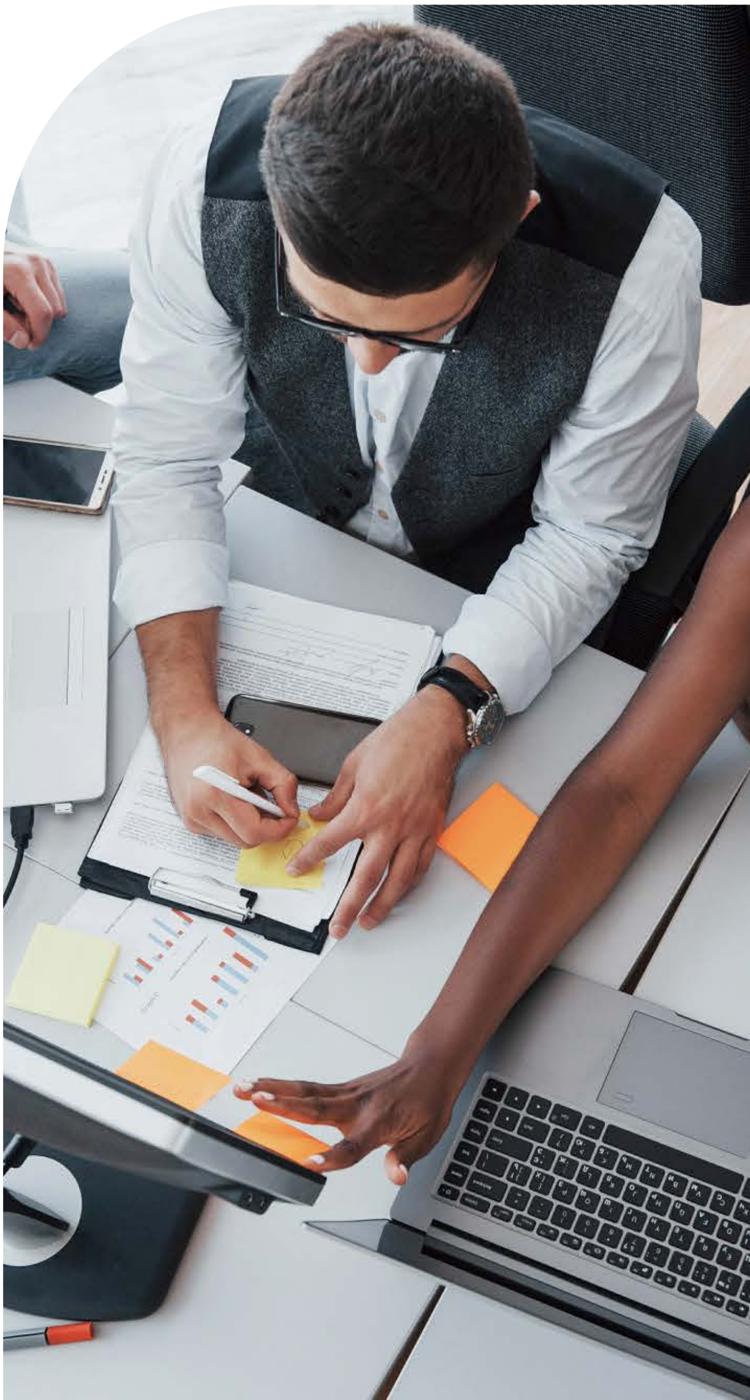
THE EFFECT OF BIG TECH ACQUISITIONS ON VENTURE CAPITAL FUNDING FOR TECH STARTUPS

INTRODUCTION

In recent years, the technology industry has experienced a notable surge in high-profile acquisitions by major tech giants such as Apple, Alphabet (Google), Microsoft, Amazon, and Meta (formerly Facebook). These companies, with their massive market valuations exceeding a trillion dollars, have increasingly leveraged their immense financial power and market dominance to acquire startups. For instance, Microsoft has completed 210 acquisitions with an average deal size of $3.85 billion, and in 2018 alone, it acquired 20 companies. Over the past decade, the five major U.S. tech companies have collectively acquired over 800 startups. This aggressive acquisition strategy not only bolsters their portfolios but also allows them to capture emerging market opportunities. However, these acquisitions have a profound impact on the startup ecosystem, particularly on venture capital (VC) funding. This article explores the effect of Big Tech acquisitions on VC funding for tech startups.

BACKGROUND ON BIG TECHS ACQUISITION

The term 'Big Tech' refers to a group of technology companies distinguished by their size, influence, and financial success. These companies are characterized by their capacity to gather, process, and monetize vast amounts of data, along with their substantial global reach. The primary entities typically categorized as Big Tech include Amazon, Apple, Facebook (Meta), Google (Alphabet), and Microsoft. However, other large technology firms like Alibaba, Tencent, Tesla, Salesforce, and Oracle also fall into this category. Startups, by their nature, face uncertain futures. While some grow into successful enterprises, many end up being acquired by established tech giants. The focus on these acquisitions has attracted significant attention from media and policymakers, especially given the concentration of the tech sector. Based on available data from the U.S. Federal Trade Commission, from 2010 to 2019, the major Big Tech companies acquired over 600 smaller firms.



Recent notable acquisitions include Google's purchase of Raxium in 2022, a five-year-old startup specializing in microLED display technology for augmented reality (AR) and virtual reality (VR) headsets, with the deal valued up to $1 billion[1]. Another major acquisition by Google was Mandiant, a leading cyber defense and response firm, for $5.4 billion, aimed at enhancing its cloud security services. Apple also acquired Credit Kudos, a UK fintech startup, in March 2022. Credit Kudos uses advanced machine learning and real-time data to offer a modern approach to credit scoring. The financial details of this deal were not disclosed. Additionally, in April 2020, Oracle acquired Sauce Video, a company specializing in video content creation and collaboration tools, to expand its digital video content capabilities. These acquisitions reflect the strategic moves by Big Tech companies to broaden their technological and market reach, influencing the venture capital landscape and the dynamics of tech startups.

On the African frontier, there have also been notable acquisitions by leading tech companies. Andela, a global tech network that nurtures IT talent in Africa and connects it with top global technology firms, acquired Qualified, a platform specializing in technical skills assessment for developers and engineers. In 2020, Stripe, a company that builds economic infrastructure for the internet, acquired Paystack in a $200 million deal, strengthening its foothold in Africa. In 2021, Flutterwave, Africa's leading payment technology company, acquired Disha, a platform that enables digital creators to curate, sell digital content, showcase portfolios, and receive payments from a global audience. These moves underscore the growing importance of Africa in the global tech landscape and the strategic interests of major tech players in the region.

OVERVIEW OF VENTURE CAPITAL FUNDING FOR STARTUPS

Venture capital (VC) is a form of private equity financing that provides startup companies with substantial funding in exchange for equity or ownership stakes in the business. This financing is accompanied with high risks and potential rewards for both the investors and the startups. Unlike traditional loans, venture capital does not require monthly repayments, but it often involves giving up a portion of control over the company's operations and creative direction. In addition to financial support, venture capital also offers valuable benefits such as mentorship and access to talent.

Startups typically seek venture capital at different stages of their development. There are three main types of venture capital funding startups may pursue, depending on the newness of the business: Pre-seed funding for budding startups still refining their ideas, Seed funding for businesses ready to launch their product or service, and Early-stage funding for companies that have achieved initial success and are looking to scale up their operations. Types of required funding often correspond to the specific needs and growth phase of the concerned startup.

1 Google Buys Hardware Startup Raxium to Fuel AR Ambitions — The Information

IMPACT OF BIG TECH ACQUISITIONS ON VENTURE CAPITAL FUNDING

The acquisition of startups by Big Tech companies presents a wide range of effects on venture capital funding, influencing both investor behavior and market dynamics.

On the positive side, Big Tech companies possess extensive information about consumer markets and industry trends, which enables them to effectively assess the market potential of early-stage startups or an industry segment. In this case, when a Big Tech firm acquires a startup, it often signals to venture capitalists that the industry segment or technology is valuable, potentially attracting further investment into startups within the same field. Moreover, the presence of a resourceful, large-scale digital platform can stimulate venture investment in startups that offer complementary innovations, as these new ventures can enhance or integrate with the existing platforms. Additionally, the expectation that Big Tech might pursue future acquisitions can enhance the appeal of startups to venture Capitalists. This anticipation of successful exits through acquisitions, portrays investing in startups as more attractive, as it increases the likelihood of a profitable Return on Investment (ROI) However, there are also significant negative impacts. Big Tech's have the ability to rapidly imitate successful innovations. This potential to rapidly replicate innovations can deter venture capitalists from investing in startups that are seen as direct competitors. To this extent, there is a likelihood that VCs will be hesitant to back companies that operate in the same space as established tech giants.

Furthermore, acquisitions by Big Tech can lead to reduced market competition. By acquiring potential competitors, Big Tech companies can eliminate threats and reduce the overall competitive landscape. This strategy may stifle innovation among incumbent players, as the removal of potential challengers diminishes the competitive pressure to innovate.

Additionally, there is the risk that startups might have their innovations imitated by competing Big Tech firms, which could discourage venture investment. The large scale and network effects of Big Tech platforms render it challenging for new entrants to succeed, as the value of competing platforms diminishes when users are already committed to incumbent platforms.

Lastly, once a Big Tech company acquires a startup in a particular business area, it can create a "kill zone" where subsequent startups offering similar products become less attractive. This reduction in market viability can discourage other startups from entering the space, as they may struggle to find opportunities for investment, ultimately stifling competition and innovation.

CASE STUDIES AND RESEARCH FINDING

Research sheds light on these dynamics. Kamepalli et al.[2] (2020) found that when a big tech company is expected to integrate a new startup's product, tech early adopters are less likely to switch to that startup's product. This reduces the startup's revenue potential and market position, creating "kill zones" where it's harder for startups to get venture capital funding after a big tech acquisition in their field. Their study shows that the share of venture capital investment in industries targeted by major Facebook and Google acquisitions has dropped compared to overall investment in the software industry. This conclusion is based on examining nine large startup acquisitions by big tech companies over the past twenty years.

Gautier and Lamesch[3] (2021) examined 175 startups acquired by major U.S. tech companies and noted that many of these startups were in their early stages and had their products discontinued under their original names. While the exact motivations for these acquisitions were unclear, the discontinuation did not necessarily imply a negative impact on innovation.

Callander and Matouschek[4] examined the relationship between startups' innovation and the possibility of being acquired by a larger firm. They found that startups anticipating acquisition by Big Tech often focus on making their startup more valuable before the sale, leading to less disruptive but potentially profitable innovations. While this type of innovation may not be as groundbreaking, it can still have significant benefits, especially if a Big Tech company helps it reach a wider audience.

Another study found that initially, Big Tech companies improve the acquired technologies positively right after the acquisition. However, about 1.5 years after the acquisition, the pace of these improvements slows down. One possible reason being that the technology may have reached its full potential due to the combined resources and expertise of the Big Tech and the startup. Interestingly, the development of these technologies continues to progress at the same pace within the rest of the industry, indicating that their potential for improvement has not been exhausted. This suggests that the slowing down observed in Big Tech firms might not be due to the technology's maturity. Instead, it could be driven by competitive motives, as improvements slow down mainly for technologies where the Big Tech is also focusing its own innovations. This could indicate that Big Tech companies acquire technologies not just for their development but to protect themselves from competition[5].

2 Kamepalli, S. K., Rajan, R., and Zingales, L. (2020). Kill zone. National Bureau of Economic Research Working Paper No. w27146. Available at SSRN: https://ssrn.com/abstract=360377

3 Gautier, A., and Lamesch, J. (2021). Mergers in the digital economy. Information Economics and Policy, 54.

4 Callander, S., and Matouschek, N. (2021). The Novelty of Innovation: Competition, Disruption, and Antitrust Policy. Management Science, 68(1), 37-51

5 Big Tech Acquisitions and innovations: An Empirical Assessment CESifo Working Paper no. 11025

CONCLUSION

There is no doubt that Big Tech acquisitions have a complex and multifaceted impact on VC funding for tech startups. On one hand, these acquisitions can validate and stimulate investment in certain sectors, providing new opportunities for startups. On the other hand, they can discourage investment by creating competitive risks and threatening market opportunities for new entrants. The effects of these acquisitions reflect the broader dynamics of the tech industry, where large firms' strategic moves can shape the ecosystem for innovation and investment. Understanding these impacts is necessary for startups and VCs navigating the evolving tech landscape.

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