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Start-up Mergers: Friend, Foe or just a Fantasy?

Conventional wisdom says that merging two young start-ups isn't a smart strategy. Why add complexity to the management team, future financing deals, or the exit strategy? However, two local companies may be on the cusp of a new trend that questions the 'old way'. As venture capital, buyout and IPO markets continue to shrink now may be a great time to consider merging with another start-up. Given the right combination, two early stage businesses may be more attractive to both potential prospects and buyers as a single company. The trick is making sure that the new whole is more valuable than the sum of the parts.

This was precisely the intent that founders Pete Parsons of Fyreball and Ben Straley of Reach Machines had when they merged their young start-ups in December 2008. At a recent Northwest Entrepreneur Network meeting Parsons and Straley discussed the challenges and opportunities they faced when they joined together to create Meteor Solutions, a Seattle-based internet software company that helps advertisers track and ignite online word-of-mouth marketing.

The driver behind why Fyreball and Reach Machines united is fairly typical: Their market, online advertising, was rapidly changing. Independently, both companies offered part of the solution. This made engaging buyers difficult. Both understood that by combining technologies and offerings they could engage buyers with a complete solution and a more compelling value proposition.

The Thorny Issues

Statistics show that three out of four mergers never achieve their desired financial and strategic goals. Worse, productivity during the process can drop as much as 50%. So even with the best laid plans, the odds are stacked against a success story. How then did Parsons and Straley achieve what they refer to as the "Reese's peanut buttercup" effect when they brought their two organizations together? Their advice: Any smart merger requires a lesson in humility from all participants. Here is how the founders, their investors, and employees came together.

Executive Insights

Cheryl Isen

First founders Parsons and Straley each had to honestly answer: What are we lacking? Although each liked the concept of coming together at the macro level, they had to dive deep into the details of each others business to understand the precise fit and value. This required honest discussion about what each business wasn't doing well. The dialogs centered on understanding how as a united company they could improve a client's return on investment. Understanding precisely how they would make money was secondary.

Deciding who will take the lead on which parts of the business is often a challenge. This wasn't the case for Straley and Parsons. It was clear to both that Straley would be the CEO. However, this decision was less obvious to some employees. It took time for staff to accept the decision because trust needed to be established first. This was achieved overtime as people began working together.

Uniting as One

Long before any deal gets done, investors need to sign-off. This process is often a minefield of issues. For example, it's rare that two companies will have the same type and amount of debt. This was the case with Fyreball, which had Series-A angel investment, and Reach Machines which raised convertible debt from friends and family. Fortunately both companies had strong, honest relations with their investors regarding the pros and cons of their respective businesses long before deciding to merge. Understanding these gaps helped investors quickly grasp the logic of combining organizations. Once it was understood what value each company was bringing to the table, negotiating what the combined company would look like and the respective equity made sense to investors on both sides.

With the deal signed off, the reality of working as a single company set it. This required a cultural shift for staff on both sides. Interestingly, the combined company didn't adopt either of the original company cultures, but instead gave birth to its own new culture. A key strategy in uniting the teams was an out-of-the-gate effort focused on figuring out and executing on a single mission. Straley and Parsons say that early success was predicated on focusing all discussions on the singular goal of how to drive value. This focus was especially critical given the company's early stage and limited resources. Without a united, singular mantra, even a winning strategy will fail in execution.

So will the newly minted Meteor Solutions beat the odds and become that one in four of mergers that really does work? Only time will tell. However, combining at such an early stage certainly seems to be working in their favor.

These "Executive Insights" are based on monthly presentations provided by leading entrepreneurs at the Northwest Entrepreneur Network (NWEN.org), a non-profit organization dedicated to helping entrepreneurs succeed. The column is written by Cheryl Isen, founder of Isen & Company, a strategic marketing and public relations firm that helps emerging companies increase corporate visibility and brand awareness Contact Cheryl at (425) 222-0779, Cheryl@IsenandCo.com or on the web at www.IsenandCo.com.