

Analysis of the Benefits and Risks of M&A -- Taking Google's Acquisition of YouTube as an Example

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Abstract. There are many companies integrated together as they want to increase the market share of their own company. However, the background of this essay will be their action may not be wise as they do not have clear valuation and they do not analyze the competitive advantage of another company so they may not able to manage it and the cost of it will be very high. My research will utilize the case of Google's acquisition of Youtube to analyze the merit and disadvantages of M&A. This research will use current ratio, total assets turnover rate and return on equity to assess the debt repayment ability, operational ability and profitability respectively after the acquisition. Apart from that, i will give a list of the potential risk that may happen in the process of valuation and payment such as overpayment. Suggestion will also be given to those problems and i will conclude my research comprehensively by explaining the point that need firms to attention when they are integrating. This research may help people have a greater understanding of M&A, this will also notice that importance of making valuation and assessment in a detailed way.

Keywords: M&A, Example, Risks.

1. Introduction

1.1. Background of Investigation

The economic structure during the beginning of Google was the time that most of the big companies set. The technology was not well-developed, so many start-up businesses were likelier to focus on one area rather than launch different product development. In this case, they are not very good at other areas of development, but some big businesses need distinct resources to develop the company in a comprehensive way to find more opportunities to gain more market share and help the business with its major works. For example, a restaurant wants to take over a supplier because this will help the restaurant to have control of the price of supplies. Therefore, the M&A will make up for the lack of experience and channels such as taking over a search engine company to make online advertising realization.

1.2. Literature Review

Merger and takeover have brought extra experience and benefits for different companies and it also brought drawbacks if a company has not prepared well to indicate the return on this. Previous investigation has established the many benefits of a company's acquisition by the data that those companies were launched [1]. More and more investigations have more likely to get a result to show whether an acquisition will be worth it. They have spent a lot of time writing based on basic definitions and knowledge or introduce several methods of checking the acquisition [1]. Some papers held different perspectives. For example, some individuals have asserted that there are more problems than benefit for a company to integrate, while other do not agree as they clarify all the potential problems have a solution theoretically. However, the author wrote this paper mainly because the data analysis can only show whether this acquisition will be profitable and the results of different indicators. The limitation of cost problems after the acquisition is increasingly apparent as there has been very little investigation about conflicts in culture and their objective customers. In this case, the paper takes Google's acquisition of YouTube as an example to analyze the process and the reason they integrated there are studies about the extra cost for Google to change the content and how they spend time and money to create a system called Content ID. Therefore the limitation of previous

investigations have been less analysis of sunk cost as they assert the good response of indicators such as the current ratio showed a company behaved rationally and well-considered before the acquisition [2]. However, that acquisition by small companies have showed a disappointing value of payback as their profit cannot compare to those of big companies as the amount of profit made by bigger companies remains higher [2]. Unfortunately, few people notice that and they have clarified all the huge acquisitions by large companies perform well.

2. Analyze Google's Acquisition of Youtube

2.1. Introduction of Google and YouTube

Google is a search engine company and it occupies the majority of its market share as it has the most internet users experience, this company was founded in 1998 by Sergey Brin and Larry Page [2]. Search engine company means they are focused on generating different information together, Google received 1 million dollars from different kinds of investors and it got a further 25 million dollars by venture capital in mid-1999 [2]. Then, Google utilized those funds to make Google the most famous website in 2000. And in 2004, Google was mature enough in the search engine field. Additionally, Google's acquisition of Motorola Mobility let Google gain one of the biggest market shares of mobile phones which were similar to Apple, Microsoft, and Apple in 2012 [2]. After that, Google tried to become a subsidiary of the holding company Alphabet and Alphabet earned nearly all of its revenue from Google company in 2016. The chairman Schmidt stepped down in 2018 and both Brin and Page left their positions as president and CEO respectively in 2019 but they both stayed on Alphabet's board of directors. Pichai gained the position of CEO of Google finally. Until now, Google has been involved in BackRub, blogs, search, engine, browser and e-mail [2].

YouTube is a company that enables distinct people to share videos through this platform with the whole world. This company started in February 2005, and that was the golden period because the market of online videos began in 2001, just two months later google uploaded an 18-second video and this video got 1 million views [3]. The growth of this company is so fast and the acquisition with Google happened in October 2006. After that, Google started to publish some full-length movies and TV shows which was free to access with a suitable amount of advertisement. This attracted a lot of people to watch those free videos online. Therefore, starting in 2009, YouTube videos have become very important, even there were some videos on YouTube gained over a billion views [3]. YouTube increased the attention to checking all the content of videos, especially those sexually explicit, animal abuse, and hate speech in terms of videos that are strictly prohibited until now. YouTube's effort to improve usability and keep up with the latest developments has led this big company to become a convenient platform to get information or for entertainment purposes.

2.2. Why Google Takeover Youtube

2.2.1. Acquisition reason analysis

This paper discovers that this acquisition occurred because Google wanted to obtain a foundation of the lucrative display advertising industry, Google wanted to gain internet traffic, to monetize it through advertising.

Although Google had its own Google Video, the popularity of YouTube was much higher than Google Video. Based on the share of visits, Google had 10.25% of total visitors and YouTube had 45.46% of total visitors which was approximately 4 times compared to Google Video [4]. This paper clarifies that Google asserts Youtube will continue to show a good trend in the video-sharing industry and its development speed seems to be very fast, so Google took over Youtube because Google thought Youtube had a promising future and could bring extra internet traffic to change it into real value. Additionally, this paper found another reason for this acquisition was because YouTube had a more active and loyal consumer base than Google Video [4].

2.2.2. Main competitive advantage of Youtube

After all, Google didn't start as a video-sharing company, so the experience could not compare with YouTube. The first competitive advantage was also the most interesting thing if the author searched a word for its video, this paper could find many more results on YouTube than on Google Video. This phenomenon happens because there are many copies of one video on YouTube, and it is fascinating that each copy of the same video has different viewers, which means there is a larger probability that more people will browse the content on YouTube [4]. That will lead people to utilize this platform to share, upload, and comment, so this will create a positive circle that it was a good way to do advertising. Google also got 100% of the future profit of YouTube, therefore, it would be a win-win situation.

The second competitive advantage was YouTube using the method of giving the reward to encourage video makers to upload the content with high quality. This is an incentive and YouTube could get superior content to have more viewers watching videos on YouTube.

2.3. The Process of Acquisition

To take over Youtube, Google spent 1.6 billion dollars and it is the first time Google spent that much finance on an acquisition. Google made this decision after analyzing the videos will become the most important gathered information in the 21st century. The first step to take over Youtube is to consider huge financial affordability and it is relatively easy for Google to spend \$16 billion as it has been a successful search engine company for 8 years [2]. Secondly, Google needs to consider the problem of the User-generated content not being commercialized because of the risk of infringement of the defendant, this will resist the plan of using internet traffic to monetize into real value. Therefore, the basic solution was Google chose to create an intelligent identification system. The main purpose is to distinguish which works are copyrighted, thus preventing the loss of huge infringement fines and negative effects on Google [5]. The Figure 1 explained how content ID work.

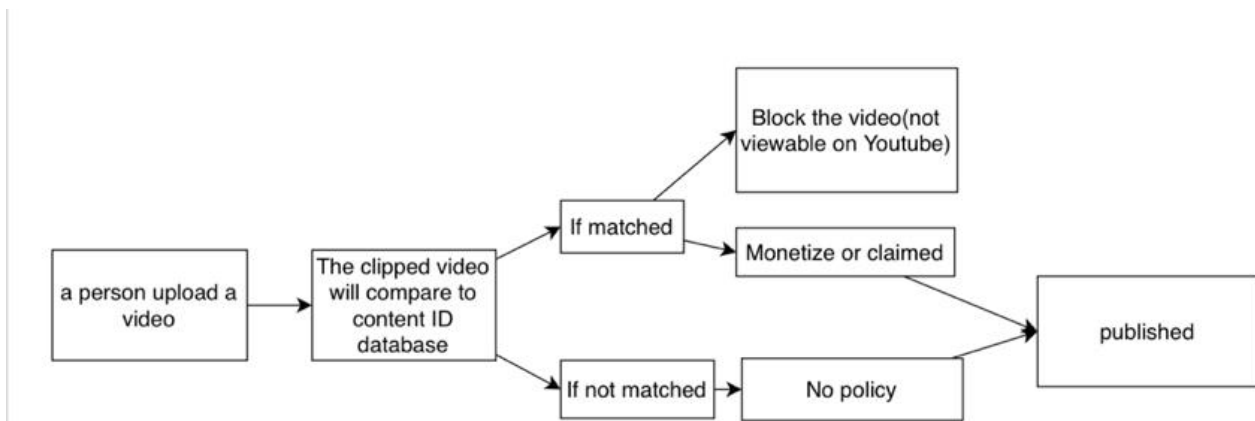


Figure 1. Explanation of content ID [5]

The second step for this acquisition will be improving the video quality of YouTube to let YouTube be accepted by most people. In the beginning, this paper analyzed how it was hard to monetize the traffic because the content of videos on YouTube was more of a funny style and the audiences for this content were not very wide, basically young people [6]. The method that can help Google execute advertisement could start by changing the content of part of the video. These contents came from these original video producers, and most of these people were for profit, so This paper clarifies that Google's idea at that time was to encourage these authors to create better output by raising the share of original video producers. However, the proportion of money that the video producer gets needs to be divided differently by video category, which becomes difficult. YouTube has started to split AD revenue with content producers, with the latest model giving 45 percent to YouTube and 55 percent to YouTubers [5]. Therefore, this paper clarifies it is already a very powerful reward and that will be very effective in improving the video content of Youtube. The process of

acquisition considers a lot of possible trouble. Although this acquisition seems to be successful, the analysis of the benefits of this event and Google’s comprehensive capabilities will be indispensable.

3. Acquisition Benefit Analysis

Why firms do acquisitions is because they assert that another company will bring extra benefit to them now. For example, they want to increase the market share or gain monopoly power or gain help to their existing apartment. There are three different analysis below to assess the possible benefit for the acquisition of YouTube by Google.

3.1. Solvency Analysis

To assess whether this acquisition will be profitable, this paper divided the whole evaluation process into three parts, which are analyzed in terms of debt repayment ability, company operating ability, and profitability. By analysis of debt repayment ability, the current ratio is very important. This data is suitable when it is over 1, which means the company will have more ability to repay the debt. The bigger this data is, the better situation the company will be [7]. The current ratio is calculated by the formula: $\text{Current assets}/\text{current liabilities} \times 100\%$. According to the annual report of Google, this paper can know that the total current assets and liabilities of Google before and after the acquisition. In 2006, which before the merger, the current ratios were around 10%. That was a pretty high value as it is far away from 1 so that means the ability for Google to monetize and repay the debt was very high. This value came to 8.5% in 2007 and this little decrease. The reason may be that when the acquisition was completed, the current liabilities were increased due to the leveraged buyout, or the cash acquisition method reduced the capital flow. However, the current ratio began to recover in 2007 and 2008. The current ratio between 2006 and 2009 can be seen in Figure 2.

Current ratio of Google(2005-2008)

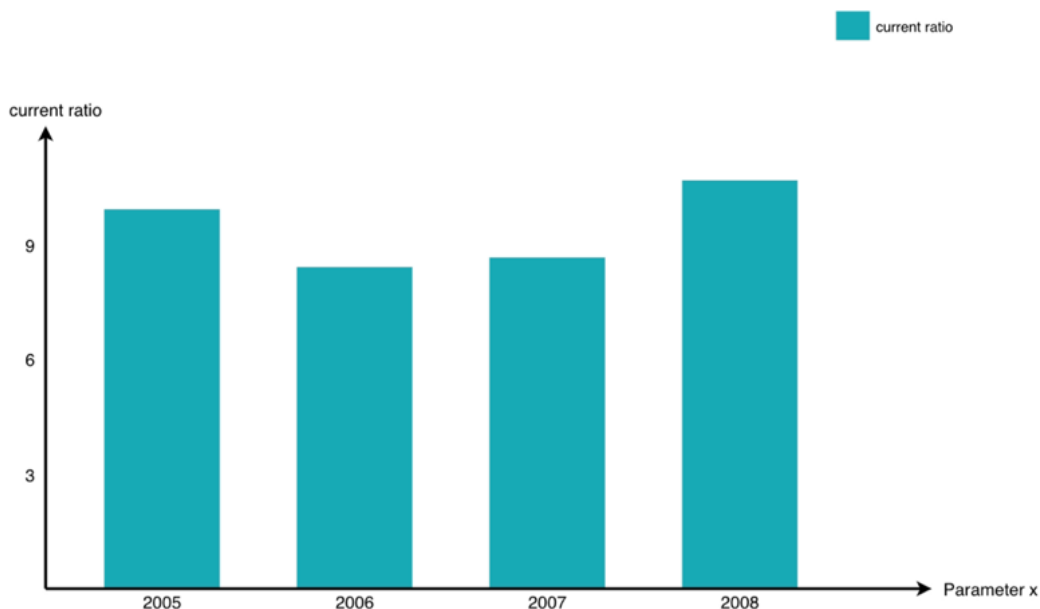


Figure 2. The current ratio of Google from 2005 to 2008²

This phenomenon shows that the acquisition of YouTube does not have a large negative impact on Google’s work about monetizing advertisements and repaying the debt, even though this acquisition helped Google to have a better ability to control its cashflow as the current ratio of about two years after the acquisition of the Google was constantly increased. In the following years, Google always showed a good trend of the current ratio which was around 4. Although the current value

decreased after 2009, there may be other variables that affected the current ratio in the years after the acquisition of YouTube. Therefore, increase in the current ratio between 2006 to 2009 has verified that Google’s acquisition of YouTube was a successful case of acquisition.

3.2. Operational Capability Analysis

Another perspective is through the operation ability of Google. In 2005, Google's total operating income reached \$2, 017, 278 thousand, and its total assets reached \$10, 271, 813 thousand, which indicated that its total assets turnover rate was 0.196. In 2006, when Google just acquired YouTube, at this time, its total operating income reached \$3,549,996, and its total assets reached \$18,473,350, indicating that its total assets turnover rate was 0.192. One year after he bought the company his total operating income was \$5,084,400 and his total assets were \$25,335,806 so this paper can calculate that the total asset turnover at that time was 0.2. Then this article can utilize the same analogy, as of 2011, the total asset turnover in 2008 was 0.208, the total asset turnover in 2009 was 0.205, the total asset turnover in 2010 was 0.179, and the total asset turnover in 2011 was 0.161. Then this paper can utilize the same analogy, as of 2011, the total asset turnover in 2008 is 0.208. The total asset turnover rate can be summarized in Figure 3.

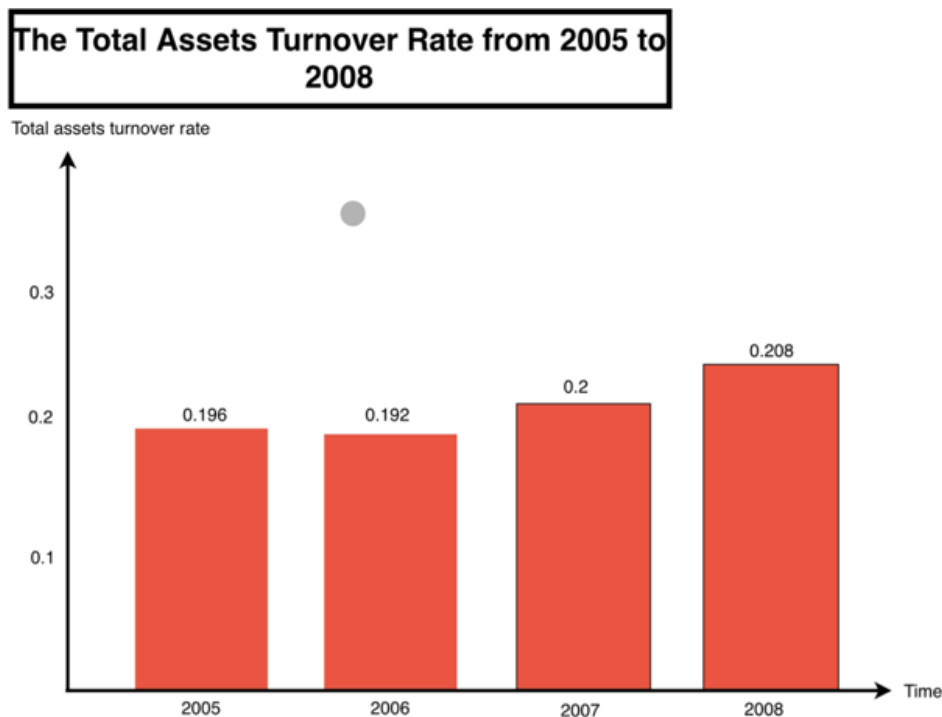


Figure 3. Total assets turnover rate between 2005 and 2008

The total asset turnover in 2009 was 0.205, the total asset turnover in 2010 was 0.179, and the total asset turnover in 2011 was 0.161.

From this data, this research can see that in the first four years after the acquisition, the situation that Google's asset turnover rate showed an upward trend, but the good times did not last long. After 2009, Google's benefit was not very good, because the total asset turnover rate has been on a downward trend. Therefore, this paper has a reasonable doubt that Google did not make a lot of money by acquiring YouTube before 2015. However, since 2006 Google had a lot of long-term liabilities which this led to a vast amount of assets accumulated. This will determine the total asset turnover because TAT (total asset turnover) = operation income/total asset, so if the total asset increases, the TAT will show a downward trend [8]. Therefore, to be clear, this paper cannot utilize this metric to assess whether it was the right decision for Google's acquisition of YouTube because this indicator is not unique, which means that more than just earnings can influence this figure which creates uncertainty.

3.3. Profitability Analysis

Additionally, to find how profitable was the Youtube after the acquisition by Google, the paper mainly focuses on Google's return on equity, which is used as an indicator of the profitability of the acquisition of YouTube. This is calculated by a formula that divides net profit by the average total shareholders' equity [9]. In 2006, which was the year of acquisition, the return on equity was 29.7%. This was a very suitable value that shows Google in 2006 had a good ability to earn profit. After that, this figure increased a lot in 2007 maybe because Google had monetized advertising on YouTube. This project was successful mainly depending on the full preparation of the Content ID system that avoided the punishment of copies. Therefore, the return on equity of Google in 2007 became 34.3%. There is a comparison of 2006 and 2007 can be seen in Figure 4 below:

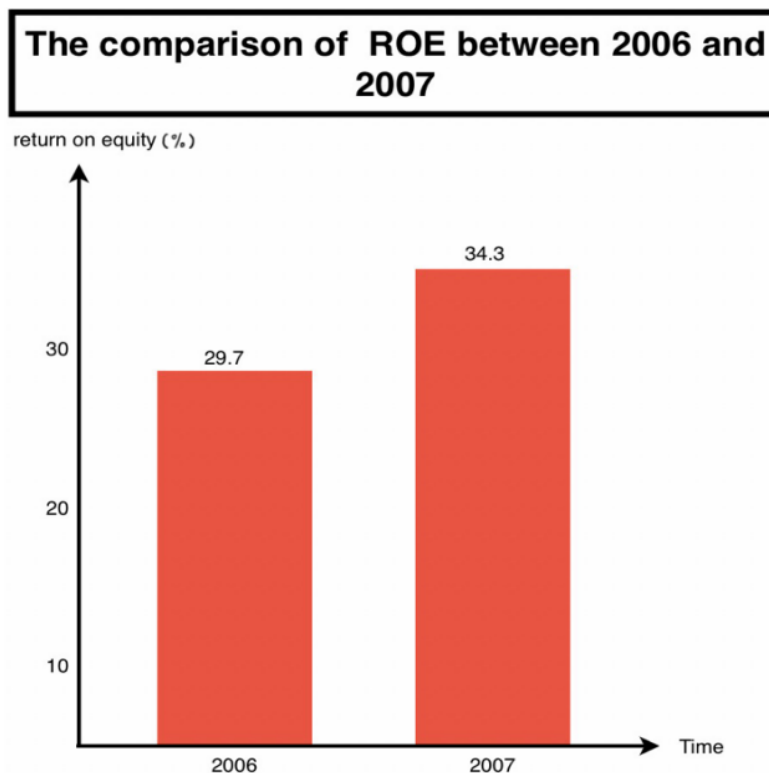


Figure 4. The comparison of ROE between 2006 and 2007

After that, the ROE of Google always reflects the profitability above 20% and this showed that Google had a promising profitability until now. Why this part does not have the return on equity after 2007, is because other external activities or projects may also determine the return on equity in a negative way. Therefore, the paper only extracts the values that compare the profitability with the year just before the acquisition and the year just after the acquisition.

4. Analysis of Potential Problems of This Acquisition

As all the indicators around the time before the acquisition showed YouTube had brought a lot of profit to Google. However, the decrease in all the indicators of Google 4 years after the acquisition could not be ignored because mistakes were possibly made during the acquisition to determine the value of the current ratio, total assets turnover rate, and return on equity.

4.1. Pre-merger Valuation Risk

First of all, the existence or lack of investigation may have problems as the sellers in mergers and acquisitions always have much more information than the buyers [10]. Google's main service was a search engine and the main service of YouTube was providing a platform for people to launch videos at that time. Therefore, Google must know comprehensive information, such as the financial data,

business culture, objective customers, operation, and so on to indicate the future development of YouTube and assess whether it is valuable. Although Google found it will be a good tool for monetizing the advertisements on YouTube, they clarify YouTube will be much more valuable than they predicted so this may lead to higher expectations because they do not realize the problems of copyright and tax matters. Those problems may generate huge litigation fee and tax payables so the cost of a takeover increase a lot. Take Content ID as an example this paper mentioned this system in Part 2.3. The creation of this system needs high-cost specialists and expensive IT systems.

Apart from that, Google was also not sure of the probability of success and there may be systematic risks as this technology was not sophisticated at that time. The increase in cost and risks will be an extra burden that the ability of debt repayment Google will be narrower so this could be a reason for the decreasing value of the current ratio after 2009. There is a Figure 5 below to illustrate the decrease in the current ratio between 2009 and 2014.

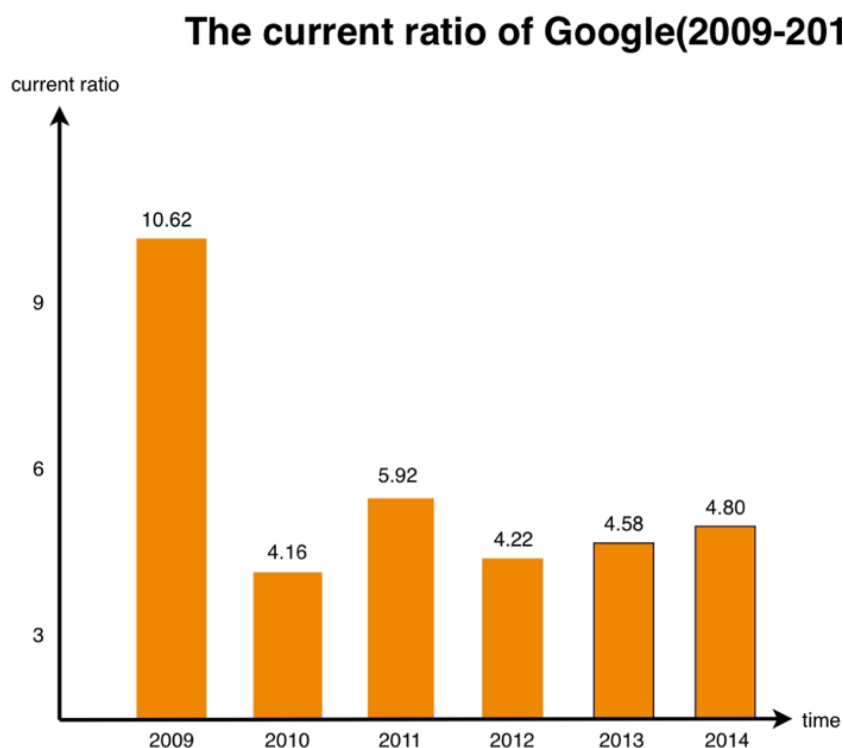


Figure 5. The current ratio of Google between 2009 to 2014

4.2. Payment Risk in M&A

During the process of acquisition, there could be risks of overpayment. The acquisition of YouTube by Google company was a very large transaction and the pressure on both companies was quite heavy, especially Google as it was the passive party, once YouTube proposed to stop the deal, Google's plan completely failed. In this case, YouTube was holding the initiative as they were also considering to merger with Yahoo; the second large video company at that time. This paper analyzes that YouTube may have an incentive for Google to pay as much as possible through the method of putting pressure on Google by pushing the speed of transactions. This paper found out that the reason why Google spent 1.65 billion dollars on a company that was set just one year at that time was the discovery of the potential profitability of YouTube [10]. However, YouTube had the largest market share at that time. Therefore, if Google was willing to spend a larger amount of money to takeover YouTube, they may drop into the preset trap as the aim of pushing Google was probably to organize the overpayment rather than make an arrangement in advance.

5. Conclusion and Future Work

5.1. Conclusion

The acquisition of YouTube by Google will be inevitably one of the most successful cases in the world and this paper conclude the impact on companies by M&A. First of all, acquisition can help a company to analyze the problems in a single area and it is possible to solve this problem by M&A with another company that is more technical in a single area. This company needs to be seriously considered because it must test its financial performance, technology, market share, and so on. To make sure this company will be worth buying.

Secondly, the acquisition may help a company in its main operation. For example, the purpose of Google's takeover the YouTube will initially be to help Google to do advertising and monetize it rather than just develop it as a video branch. This had an impact on Google's search engine area because this had attracted many people to visit and find answers on the Google website.

Lastly, problems are possible to figure out in different areas, it is possible to have extra problems related to copyright problems with need a huge amount of expenditure to find a method to avoid those kinds of punishment, this problem will happen especially in small companies because those company may facing debt questions because the cashflow will be very limited after the acquisition so those company who do not have much confidence on their ability on the debt repayment, operation, and growth with should consider the possible problems after the acquisition and if they clarify the potential profit will far exceed the cost, that may be suitable for small firms to do M&A.

5.2. Suggestions

In the case of valuation, most of the firms do a clear valuation before they do an M&A to each other about how much profit can be generated in the future and simply say they just looking forward to how much this company is worth. However, they are not aware of potential problems within the acquisition such as cultural conflicts and employee relationships. Apart from that, there are also some internal problems with business operations such as Copyright issues and Resource problems. Therefore, this paper suggests the company needs to indicate those external and internal possible uncertainties to keep calm when they encounter those kinds of problems so this will minimize the loss.

In the aspect of payment risks, this paper suggests the company who wants to takeover or merge with another company, it is important to negotiate with that company and better to make a contract to ensure the price of this would not be overpaid. This also allows the other company to protect their rights legally.

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