

A Study on the Impact of Cross-Border M&A on Firm Performance -- A Case Study of Tencent's Acquisition of Sumo Group

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Abstract. With the advocacy of the strategy of "bringing in and going out" in recent years, cross-border mergers and acquisitions in the game industry have become a major way for the development of the game industry. Chinese Internet company-Tencent is one of the largest leaders in the whole China's game industry. In recent years, Tencent has made many attempts to acquire overseas game companies to help them with the market competition. Among them the most important one must be Tencent's acquisition of the UK's sumo group in 2017. This paper uses the case study method to study the performance development and overall revenue changes of Chinese Internet company Tencent after its acquisition of UK-based sumo group game studio in 2021. This paper analyzes the motivation of Tencent's acquisition of sumo group, performance impact analysis, development prospects and other aspects, and finally draws a conclusion. At the same time, it puts forward suggestions for Tencent's future development strategy.

Keywords: Cross-border; M&A performance; synergies.

1. Introduction

With the rapid development of the digital entertainment industry in recent years, the game industry has entered a new era. Video games have become the primary choice for young people around the world to socialize and entertain themselves online. As one of the earliest companies to develop the game industry in China, Tencent was founded in 1998, and Tencent Games began in 2003, capturing the most rapid development of the Chinese game industry in time. In recent years, cross-border mergers and acquisitions have been an important strategic means for Tencent to expand overseas markets. Tencent Games has completed nearly 30 overseas investment mergers and acquisitions since 2020, and the investment amount is huge, more than 1/3 of the total number of its previous investments. Among them, the acquisition of overseas independent game studio Sumo Group in July 2021 was the largest premium acquisition, with a total price of £919 million (about 8.2 billion yuan).

According to the *China Game Industry Report 2023*, China's domestic game industry will pick up in 2023. In last year, the actual sales revenue of China's game market was 302.964 billion yuan, an increase of 13.95% year-on-year, breaking the 300 billion mark for the first time. The revenue scale of the overseas mobile game market in 2023 was 571.8 billion yuan, down 1.79% year-on-year. This makes people have to wonder why Tencent still insists on acquiring sumo group at such a high price. However, even if the domestic market picks up and the international game market revenue is still declining in 2023, Tencent can still maintain an astonishing 21% growth in game revenue in the international market than the domestic revenue growth rate of about twice, which undoubtedly shows that its strategy in overseas markets in recent years has had initial results. What impact does this have on corporate performance after? In order to explore these issues, this paper uses the case study method to study the impact of Tencent's merger and acquisition of sumo group on the performance of enterprises.

2. The Motivation of Tencent's Acquisition of Sumo Group

2.1. Explore Overseas Markets and Improve the Overseas Visibility of the Enterprise

Tencent, as the biggest game manufacturer in China, takes the lead in similar game manufacturers to have the strength and vision to look at the world market. Xie Hongming et al. found that although Tencent was not the pioneer in China's game industry, it was very forward-thinking. It began to layout overseas game markets and actively invested in foreign countries at a very early time which greatly promoted the development of Tencent's game business and helped it become the first game enterprise in China [1]. As a member of the well-known Tencent brand, Tencent Games is backed by strong funds and advanced technology. When other domestic major game companies are still trying to rely on their own "go out" stage, Tencent games has already begun to think about how to "introduce" so that those foreign better games into their own industry and then in their own name to the world. In this process, the acquisition of overseas enterprises has naturally become an important means for Tencent games to enter overseas markets.

Founded in 2003, Sumo Group, the acquired owner of the world's largest third-party independent game studio, has the world's most cutting-edge concepts and technologies. It has strategic partnerships with Microsoft Studios, Sega, Apple and other famous companies to provide terminal vision and development solutions for the world's leading publishers, platforms and entertainment brands. Many of the world's most famous games are based on the creative ideas developed by Sumo, and its CEO Ian Livingstone is known as the "father of British games". Tencent first announced the acquisition to the outside world in July 2021 and according to the financial report data before Sumo Group was acquired, the company's operating income reached 68.9 million pounds in 2020. With an increase of more than 40%, it is quite sure that the business is in a rapid growth stage.

Although Tencent's acquisition of Sumo Group seems to be a strong combination, it is obviously not the best time to choose a merger in its rapid growth stage from the perspective of cost control. It is worth mentioning that before the merger, Tencent was the second largest shareholder of Sumo Group, owning 8.75% of its shares in 2019. With Tencent's stake in Sumo Group, the company's market value has nearly tripled in the following three years, when Tencent's acquisition of the company is clearly not the most cost-friendly option. However, this is undoubtedly a powerful attempt for Tencent to get new resources to help it and open up visibility in the overseas game market.

2.2. Strengthen Human Resources and Improve Innovation Capability

The game industry iterates rapidly and new technologies also require new concepts and talent to be created. Human capital is an important core competitiveness of enterprises, especially for the Internet game industry, talent and technology could be their hearts. However, outstanding talents are not as easy to get as money to buy things, but also need to cultivate and develop. For enterprises, time and resource costs will have considerable loss. For Tencent, which already has a certain scale, acquiring the desired talents and organizational management resources directly through the acquisition of the target company does not necessarily cost more resources than cultivating new talents. Mutual learning within the organization after the successful acquisition will also be of great benefit to the future development of both companies.

Tencent relies on Sumo Group's creative research and development capabilities to achieve further division of labor within the enterprise. Both sides share resources in IT infrastructure, game project management experience and many aspects, so as to achieve innovation in management, research and development. In this case, the period expenses will be shared among more products and markets, which will greatly enhance the global competitive advantage of the merged company [2]. These resources controlled by Sumo Group will not only strengthen the foreign business controlled by Tencent, but also expand new business areas and strengthen its international influence [3].

3. Performance and Impact of Tencent's Acquisition of Sumo Group

3.1. Impact Analysis of Tencent's High-Premium M&A

Since 2020, Tencent Games has completed nearly 30 overseas investment mergers and acquisitions of game companies. The amount of investment is more than 1/3 of the total number of previous investments, including the acquisition of the remaining equity of the British game company Sumo Group for \$1.27 billion and the investment of 2.3 billion yuan in the American game company Crytek. Because there are many intangible assets in the asset structure of game enterprises, the real value is often larger than the book value, resulting in a high merger premium. However, Tencent's acquisition of League of Legends manufacturer Riot Games in 2011 paid about the same amount of consideration as the company's market capitalization at the time, while its July 2021 acquisition of UK-based game maker Sumo Group represented a 43.3% premium over the company's closing price and generated goodwill of 6.7 billion yuan. For Tencent, the phenomenon of high premium mergers and acquisitions may bring greater risk of goodwill impairment, as well as the economic impact and consequences on the merger and acquisition enterprises [4].

3.2. Changes in Earnings after Tencent's Acquisition

After Tencent acquired Sumo Group in 2021, its revenue in the overseas gaming sector has been growing steadily. According to the Tencent game 2023 report, in the first half of 2023, Tencent's local market game revenue finally reversed the downward trend and the growth rate of international market games also rebounded. The business revenue was 92.8 billion yuan, an increase of about 8% over the same period last year. Among them, the game revenue in the local market was 66.9 billion yuan, an increase of about 3%; Game revenue in the international market was 25.9 billion yuan, up 22% year-on-year. The details are shown in Figure 1.

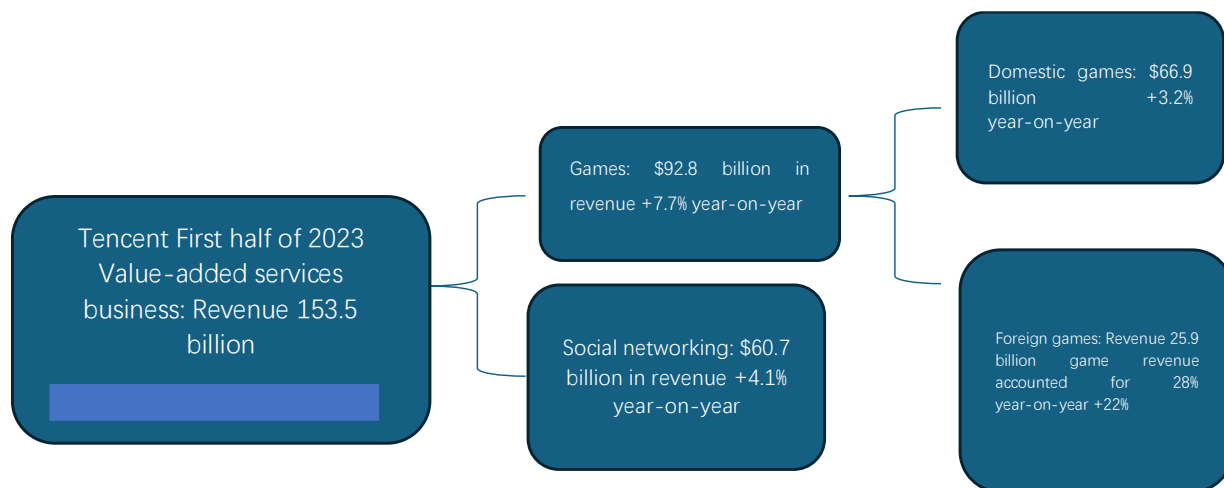


Figure 1. Tencent 2023 the first half of the value-added service business revenue composition

Revenue from the value-added services business in the third quarter of 2023 increased 4% year-on-year to 75.7 billion yuan. International game revenue grew 14% to 13.3 billion yuan, or 7% excluding the impact of currency changes. In terms of individual games, PUBG Mobile's revenue recovery, as well as Goddess of Victory: Nikki, VALORANT and Triple Match 3D also contributed to the revenue growth, while Tower's revenue declined year over year compared to the same launch quarter last year. Game revenue in the local market grew 5% to 32.7 billion yuan, helped by higher revenue from the recently released Ark Destiny and Fearless Contract, as well as evergreen games such as Honor of Kings and DnF. Revenue from social networks was broadly stable at RMB29.7 billion, helped by higher revenue from paid music membership, small game platform service fees and mobile game virtual items sales, offset by lower revenue from live music and game streaming services.

Tencent's acquisition was completed in July 2021, and the financial statements from 2022 to 2023 can clearly see that in the two years after the merger, although the local revenue of Tencent games still far exceeds the international revenue, the local quarter-on-quarter growth rate has been declining. On the contrary, Tencent has shown a thriving state in the international game market, although the international game market in general is indeed recovering in form (the global game market size in 2023 is about 1,177.379 billion yuan, an increase of 6%), but compared with Tencent's international growth trend is still lower than its growth rate. From the first quarter of 2022 to the third quarter of 2023, the quarter-on-quarter growth rate of Tencent's international market revenue has been positive, reaching up to 25%, indicating that its M&A strategy choice has indeed brought more obvious positive effects to the enterprise in the short term. The details are shown in Figure 2 and Figure 3.

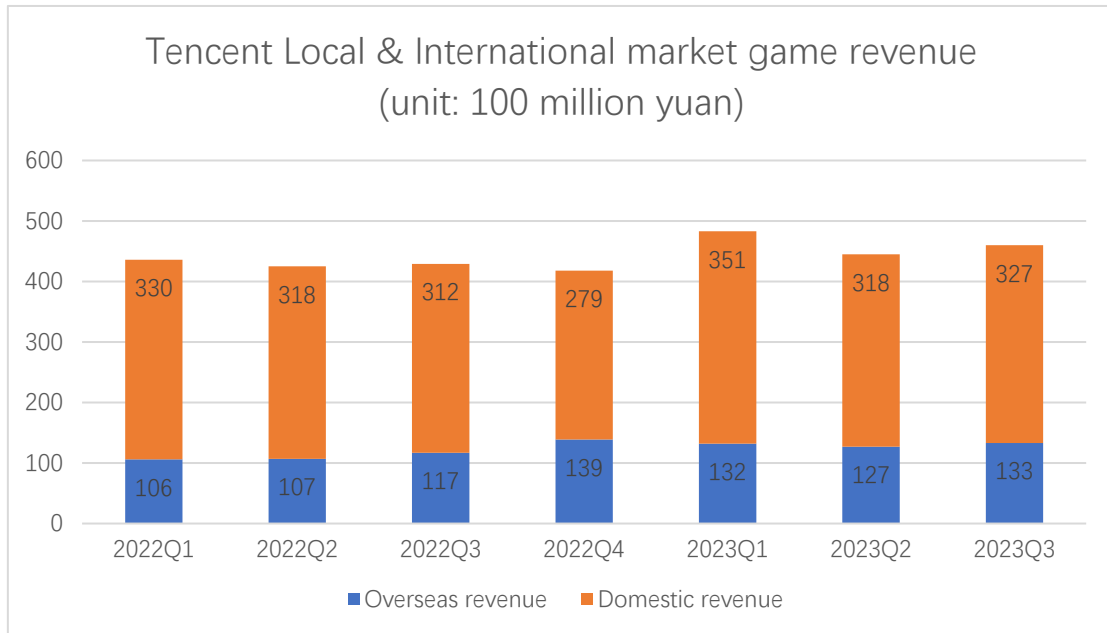


Figure 2. Revenue of Tencent's local and international markets (unit: 100 million yuan)

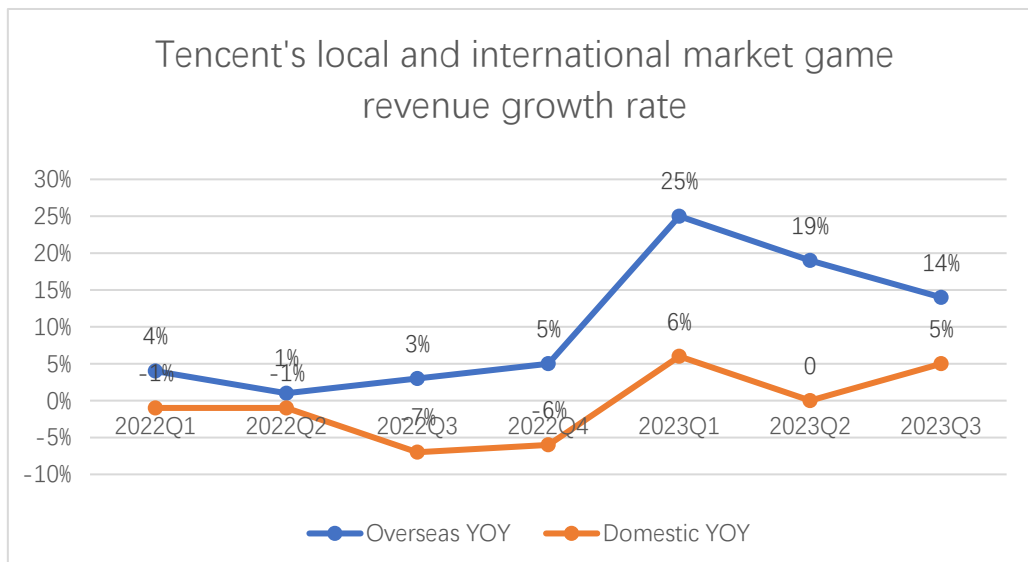


Figure 3. Growth rate of game revenue in Tencent's local and international markets

3.3. Synergies after the Merger

Research shows that many mergers and acquisitions are driven by technology synergies [5]. After company merger, higher value creation can be achieved through the production efficiency generated by rationalization of production and economies of scale, such as reducing research and

development costs or reallocating production factors to more efficient organizations to improve production and operation efficiency [6, 7]. Production rationalization of enterprise resource capacity generated by synergies has always been an important link for M&A to create new wealth. Tencent, as an enterprise dominated by investment strategy, has a high proportion of cash in its current assets. Non-current assets accounted for more than 2/3 of the total assets, of which foreign investment related assets accounted for about 1/3. As the number of mergers and acquisitions has increased in recent years, so has the number of non-current assets related to staying in business, such as intangible assets, construction in progress, and plant and equipment (see Table 1).

Table 1. Partial financial data of Tencent Holdings

Amount (million Yuan)	2018	2019	2020	2021	2022
Current assets	2170.80	2539.68	3176.47	4848.12	5659.89
Cash and cash equivalents	978.14	1329.91	1527.98	1679.66	1567.39
Non-current assets	5064.41	7000.18	10157.78	11275.52	10121.42
Which property, plant and equipment	350.91	468.24	598.43	619.14	539.78
Construction in progress	48.79	39.35	49.39	59.23	92.29
Goodwill and intangible assets	566.50	1288.60	1594.37	1713.76	1618.02
Total assets	7235.21	9539.86	13334.25	16123.64	15781.31
Game revenue	1043	1147	1561	1743	2074
Operating income	3126.94	3772.89	4802.64	5601.18	5545.52
Core profit margin	101931	1.337	1.100	0.662	1.094

The changes in the values in the table indicate that M&A activities have a positive effect on optimizing Tencent's asset structure. A large proportion of circulating cash is easy to cause instability. Through mergers and acquisitions, enterprises increase long-term assets conducive to operation and production, which makes long-term operation have the most basic guarantee. However, whether these long-term assets can bring good market benefits to the subsequent development of the enterprise is still unknown, and the manager needs to make efforts, especially the large amount of goodwill and intangible assets generated by the high-premium merger and acquisition, and the future impairment treatment will directly affect the enterprise's benefits.

According to the 2022 annual report, Tencent had 8.713 billion yuan of goodwill and other intangible assets impairment provisions generated by the acquisition that year, of which the asset impairment provisions related to the game live business were 4.012 billion yuan. Therefore, Tencent needs to effectively integrate the high-quality resources of Sumo Group through structured and pioneering reorganization in the future, so that the long-term assets generated by this merger can produce good market benefits and create value for the merged enterprise. As can be seen from Table 4, Tencent's 2022 operating income has declined, but game revenue is growing. The core profit margin brought by operating assets also increased significantly in 2021 and maintained growth in 2022. It shows that the long-term business assets (intangible assets, construction in progress, plant and equipment, etc.) acquired through mergers and acquisitions have achieved good market returns. From the perspective of core profit cash rate, before the merger and acquisition, it declined year by year, from 1.338 in 2019 to 0.662 in 2021, indicating that the cash capacity of operating assets to promote games and other businesses is declining. However, after the merger and acquisition, the core profit cash rate in 2022 has been improved. It shows that the cash capacity of core businesses such as games has been enhanced after the merger, and the market benefits of the merger have begun to appear.

3.4. Tencent Acquires New Strategic Opportunities after Acquisition

After the merger, executives of both sides said that Tencent would not interfere with Sumo Group's product decisions in game development and production, and Tencent's acquisition of Sumo Group at a high premium made up for the shortcomings of the European and American markets and console

games, achieved greater market competition by merging multiple product markets, and generated higher synergistic merger value. This gives Tencent a greater say and a higher priority for information access in terms of overseas market size. According to the correlation studies, the process analysis of the positive effect of cross-border M&A is mainly based on the resource-based view and resource arrangement theory, emphasizing that the M&A process and related enterprise capabilities have an effect on the M&A result through the process of producing synergistic effect, and the integration of relevant resources and reverse learning transfer are important mechanisms of M&A value generation [8-10]. By acquiring Sumo Group at a high cost, Tencent can learn the essence of developing console games from Sumo through reverse transfer of knowledge, make use of Sumo's experience in the development of 3A high-quality game products and the accumulation of talents and experience in the field of visual design, and continue to try to add new gameplay to 3A and console games, so as to leverage the next trend of the industry. To achieve the growth target of super profit [11].

4. Conclusion

From the development situation after the acquisition in 2021, Tencent's acquisition of sumo group in 2022 after the self-repair and adjustment, the first half of 2023 annual report of Tencent games overseas market has shown Tencent's strong vitality and strong growth momentum, even better than the domestic growth trend. By analyzing the three steps of "motivation - process - reflection", this paper analyzes the background, motivation, and enterprise performance and development after Tencent's acquisition of sumo group. The research results are summarized as follows:

In the analysis of the economic effect of M&A, accounting research method is adopted to investigate the asset structure and profitability of the merged company. After the merger and acquisition, the proportion of Tencent's long-term operating assets has increased, the corresponding overseas game market scale has also been expanded, and part of the period expense ratio has been optimized. The economies of scale generated by the merger and acquisition have created value for the enterprise. These improvements confirm that the synergies of the merger and acquisition have produced better market benefits. However, although M&A has produced better economic benefits, risks still exist, reflected in the unit production cost is still high, the scale economy effect of M&A has not been fully released, and a large number of goodwill and intangible assets may face impairment in the future. Therefore, Tencent needs to continue to make efforts in the effective use of merged resources and the behavior of managers in the future, and create value consistent with the premium for the merged company through the cultivation of corporate resources and capabilities of both sides.

Whether the acquisition of Sumo Group can have a positive impact on Tencent's future performance and achieve the above motivation goals depends on whether the resources and capabilities of both parties can bring better economies of scale and synergies, and ultimately contribute to the outcome of the merger.

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