Case Analysis of Tencent's Cross-Border Merger and Acquisition of Sumo Group

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Abstract. As the process of global economic integration continues to accelerate, more and more companies are beginning to implement global development strategies, and cross-border M&A are an important way to achieve it. This paper takes Tencent's cross-border M&A of Sumo Group as an example. It first introduces the two parties and the process of the M&A, then analyzes the motivations of the M&A from multiple aspects, and uses the event study method and financial indicator method to analyze the performance of the M&A. The research results show that the final value of the cumulative excess rate of return in the ten trading days before and after the M&A date on July 19, 2021 is positive, and multiple financial indicators have performed well in the long term, indicating that Tencent has achieved positive market performance and financial performance after the M&A. Based on the analysis and conclusion, this paper enriches the literature on cross-border M&A in the game industry, and also has certain implications for cross-border M&A of other game companies.

Keywords: Game Industry, Cross-Border M&A, M&A Motivations, M&A Performance.

1. Introduction

With the continued development of economic globalization and the in-depth implementation of China's "14th Five-Year Plan" and "One Belt, One Road" and other national development policies, Chinese enterprises have accelerated the pace of "going out" and made important progress in overseas investment and transformation and upgrading. At the same time, abundant foreign exchange reserves and the internationalization of the RMB have also created a good environment for enterprises to conduct cross-border M&A [1]. Nowadays, with the development of the digital era and the promotion of the "Internet +" national strategy, the game industry has attracted great attention from the whole society. In 2023, China's game market size was 302.964 billion yuan, accounting for 23.37% of the global game market size, and the number of game users was 668 million, accounting for 19.76% of the global game user size [2]. Although the Chinese market has become the largest game market in the world, with the improvement of technology and the saturation of the game market, players have increasingly higher requirements for the quality of games, and game products are showing a trend of high-quality and diversified development [3]. In the context of China's game license restriction policy in recent years, to achieve strategic transformation and disperse potential industry risks, cross-border M&A have become an inevitable choice for the development of current game companies [4].

Tencent has long begun to expand into overseas game markets and actively make foreign investments. M&A investment has become Tencent's main way to achieve internationalization [5]. Since 2020, Tencent has completed nearly 30 cross-border M&A investments in game companies, and the investment amount is huge, exceeding 1/3 of the total number of previous investments [4]. The US$231 million Tencent paid to acquire "League of Legends" maker Riot Games in 2011 was not much different from the company's market value at the time. In comparison, the US$1.27 billion it paid to acquire British game company Sumo Group in 2021 was less than the company's market value at the time. The closing price overflow was as high as 43.3%. On the one hand, high-premium cross-border M&A are because gaming companies present a seller's market in the cross-border M&A market, and target valuations are generally high; on the other hand, because there are many intangible assets in the asset structure of gaming companies, their true value often has a large difference from the book value, which leads to a high M&A premium [6].

At present, there are relatively many studies on cross-border M&A in the world, but most of them are concentrated in the fields of manufacturing, service industry, high-tech industry, etc., and rarely involve the game industry. As a result, there are few relevant research results on cross-border M&A of game companies. This study takes Tencent's cross-border M&A of Sumo Group as a case to analyze the motivations for Tencent's M&A of Sumo Group, and uses the event study method and the financial indicator method to analyze and evaluate the short-term market performance and long-term financial performance after Tencent's M&A of Sumo Group. Finally, it concludes the relevant enlightenment and experience are expected to enrich the motivation theory and performance theory about the cross-border M&A of game companies, and provides reference for the cross-border M&A of other game companies, thereby promoting the healthy development of the game industry.

2. Overview of Tencent’s M&A of Sumo Group

2.1. Introduction to the M&A Parties

Tencent was founded in 1998 and successfully listed in Hong Kong in 2004. Its headquarters is located in Shenzhen, China. During more than 20 years of development, Tencent has actively promoted the diversified development of its business and provided many products and services such as Internet value-added services, advertising services, financial technology and enterprise services to customers in the market. Today, Tencent has become China's largest Internet company and the world's largest game developer and publisher in game revenue. Tencent's operating revenue in 2023 was 609.015 billion yuan, of which game revenue will be was billion yuan. In recent years, Tencent has launched a number of popular electronic game products to the market, such as "King of Glory", "Game for Peace", "QQ Speed", etc., which have enhanced the entertainment and interactive experience of the majority of users. The proportion of Tencent’s main business revenue in 2023 is shown in Fig. 1.

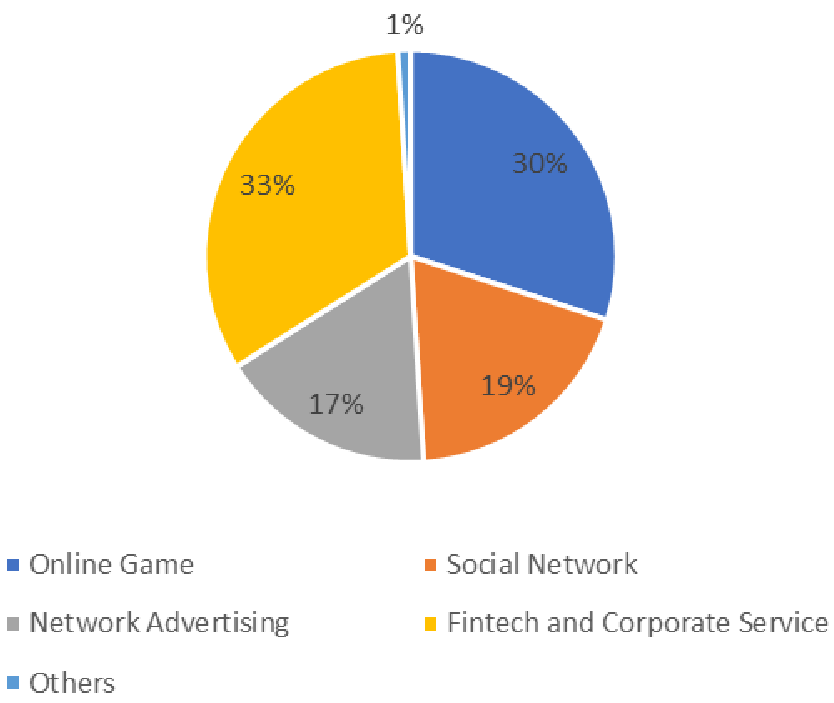

Fig. 1 Tencent’s main business revenue proportion in 2023.

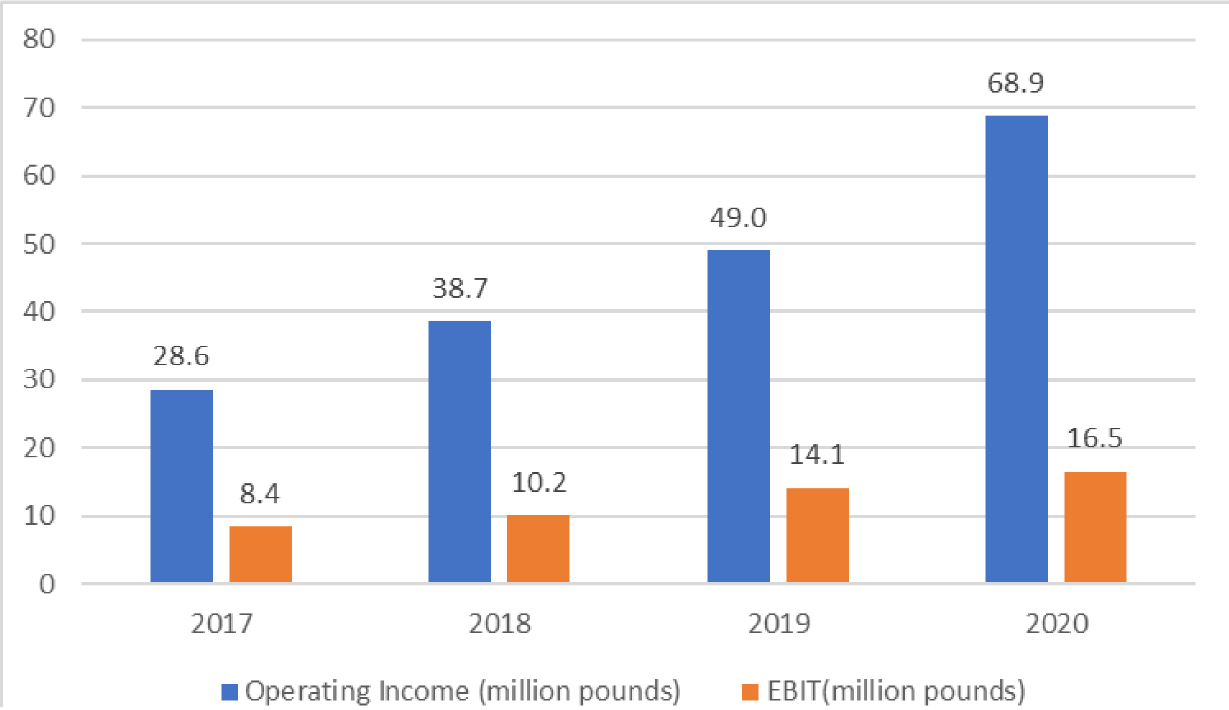

Fig. 2 Sumo Group’s operating income and EBIT from 2017 to 2020

Sumo Group was founded in 2003 and successfully listed in London in 2017. Its headquarters is in Sheffield, UK. As the world's largest third-party independent game company, Sumo Group has 19 studios in 5 countries and more than 1,650 employees. Sumo Group has participated in the production of more than 60 games, including well-known works such as "Hitman 2", "Crackdown 3" and "Forza Horizon". At the same time, Sumo Group has also reached strategic partnerships with Microsoft, Sony, Apple, Sega and other companies, and has cooperated with many well-known game developers to produce AAA game masterpieces. The operating income and EBIT of Sumo Group from 2017 to 2020 is shown in Fig. 2.

2.2. Introduction to the M&A Process

On November 15, 2019, Tencent acquired 8.75% of the shares of Sumo Group from private equity firm Perwyn Bidco through its wholly-owned subsidiary Mount Emei Investment Limited, becoming the second largest shareholder of Sumo Group. On July 19, 2021, Tencent relied on its game publishing company Sixjoy Hongkong Limited to fully acquire Sumo Group in a purely cash manner. Tencent completed the M&A at a price of 513 pence per share, valuing Sumo Group at approximately US$1.27 billion, a 43.3% premium to Sumo Group's closing price of 358 pence the previous day. On January 13, 2022, Tencent's M&A of Sumo Group was approved by the local court, and the M&A was officially completed. This transaction is Tencent's largest investment globally since 2021, and it is also the largest wholly-owned M&A of a listed company in the UK.

3. Analysis of Motivations for Tencent’s M&A of Sumo Group

Sumo Group was once part of the American company Foundation 9 Entertainment, which gave it a presence in both the UK and the US. In addition, Sumo Group has acquired numerous game studios and their original overseas markets through a series of M&A and expansion activities in the early stage, such as Polish studio Pixelant. Relying on the high-quality resources controlled by Sumo Group, Tencent can not only consolidate its overseas markets, but also open up new territories, strengthen its global strategic layout, and enhance its international influence [7].

According to the annual global game revenue list released by Super Data, a well-known international data statistics agency, Tencent's game "King of Glory" once again became the global iOS and Android mobile game revenue champion in 2023, with revenue of US$1.48 billion. Although

Tencent's game business revenue has become the world's largest, its game industry is mainly concentrated in mobile games, and its performance in console games is almost zero. Sumo Group has released a number of well-known products on the three major platforms of computer, console and mobile phones, such as "Hitman 2", "Crackdown 3", "Forza Horizon", etc. Sumo Group's advantages and capabilities in console game development and production can exactly fill Tencent's gaps in this area and enhance Tencent's competitiveness in the game industry [8].

In the early stages of development, many of Tencent's games were developed by imitating other similar games. Even "King of Glory", which accounts for a large proportion of Tencent's game revenue, initially developed by imitating "League of Legends". Compared with Tencent, which has weak independent innovation capabilities, Sumo Group has rich human resources and technical resources, and has produced a number of original AAA game masterpieces. In addition, Atomhawk, a British visual design company owned by Sumo Group, is a world-class digital art and design service studio that has provided design services for a number of movies and games. After Tencent’s M&A of Sumo Group, it can effectively make up for its shortcomings in technological innovation and improve its own game development level [9].

As a large international game company, Tencent has strong market control in game operations, distribution and other aspects. As a well-known British game company, Sumo Group can help Tencent reduce R&D, operations and competition in multiple markets. Market distribution and other costs, at the same time, Tencent can rely on Sumo Group's technology research and development capabilities and project management experience to achieve further division of labor and resource sharing, thereby enhancing global competitiveness and achieving economies of scale. In addition, multi-market and multi-product hybrid M&A can effectively diversify risks. After Tencent’s M&A of Sumo Group, it made up for the product shortcomings in the European and American markets and console games. By diversifying products, it improved profitability after resource integration and achieved synergy [10].

4. Performance Analysis of Tencent’s M&A of Sumo Group

4.1. Event Study Method

This article selects the M&A date July 19, 2021, as the specific event date. The window period is a specific period used to test whether Tencent's stock price will have an abnormal reaction to the M&A case. In order to more accurately detect the fluctuation of Tencent's stock price, the event date is positioned as 10 trading days before and after July 19, 2021, recorded as [-10, 10], excluding trading suspension days and holidays, the window period covers a total of 21 trading days from July 5 to August 2, 2021. The estimation period is selected as the 180 trading days before July 5, 2021, recorded as [-190, -11], which is used for subsequent evaluation. This article selects the stock price of Tencent (00700.HK) and the Hang Seng Index (HSI) as samples, and obtains the closing prices of the two during the event window through Sina Finance, and then obtains the return rates of the two. After obtaining two sets of return data, considering that the market model can better measure the effect of events by combining stock prices with market indexes, model (1) was selected to estimate the expected return rate, where Rit represents Tencent's stock return rate, Rmt is the return rate of the Hang Seng Index, t represents the corresponding time, αi and βi are the parameters in the model

$$Rit = \alpha i + \beta i \, Rmt \tag{1}$$

Based on the Tencent stock return rate and the Hang Seng Index return rate during the estimation period, use *Excel* to obtain the distribution status of the two sets of data during the estimation period, and the market model for the estimation period can be obtained, namely $Rit = 0.0257Rmt - 0.7812$. Based on the obtained linear regression equation, the expected return rate of Tencent stock within the window period [-10, 10] is calculated, as shown in Fig, 3.

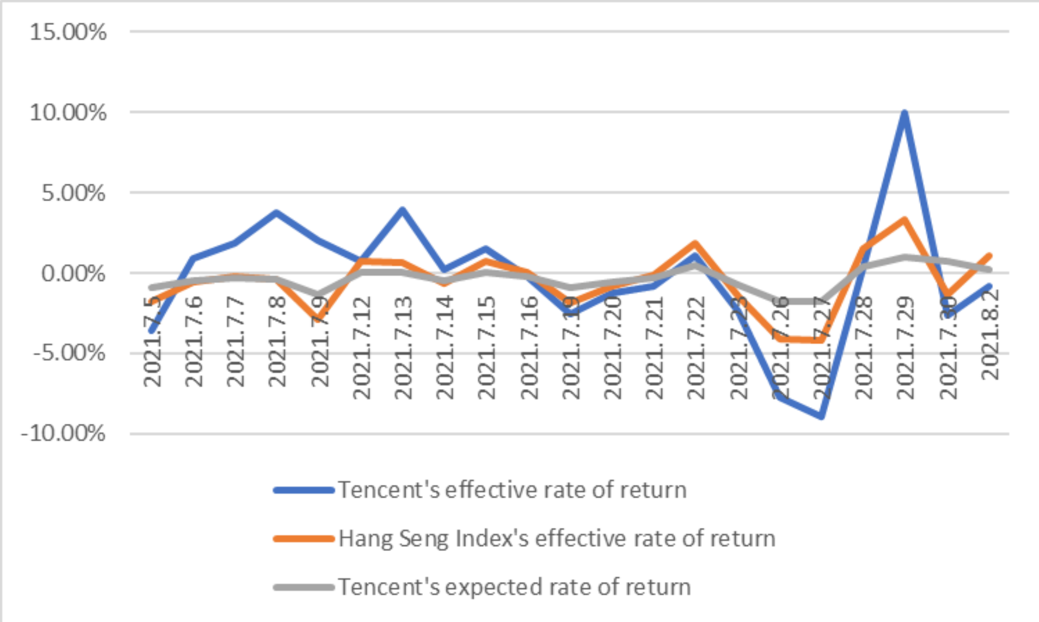

Fig. 3 Changes in actual and expected rate of return during the window period

The excess rate of return is the difference between Tencent's actual rate of return minus the expected rate of return. The calculation of Tencent's excess rate of return (*ARit*) on day *t* is as follows: Eq. (2):

$$ARit = Rit - (\alpha i + \beta i\ Rmt) \tag{2}$$

Tencent's cumulative excess rate of return on day *t* (*CARit*) is the sum of all excess rate of return before day *t*. Based on the above formula, the calculation results of the cumulative excess rate of return after the announcement of Tencent's M&A of Sumo Group are shown in Fig. 4.

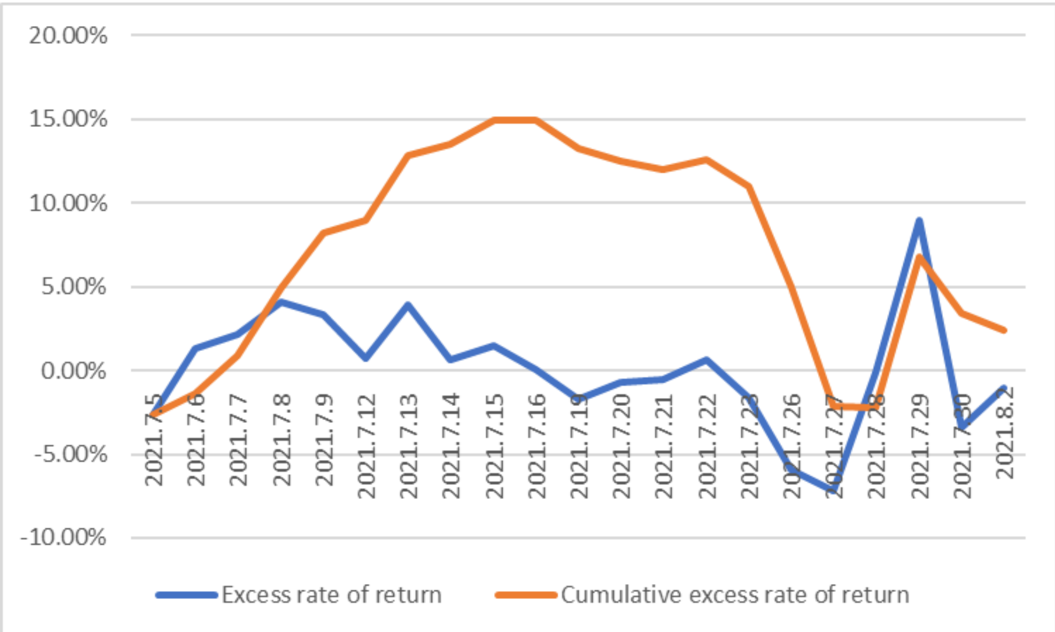

Fig. 4 Changes in excess and cumulative excess rate of return during the window period.

Judging from the window period of the event, in the first stage, that is, before the announcement (*t*=-10 to *t*=-1), the excess rate of return fluctuated slightly before the event, and the return rate was greater than 0 in eight out of ten days. Overall, it is relatively stable. Although there is a downward trend in the second stage, it shows a straight rise at *t*=7, so the overall trend is an upward trend. The cumulative excess rate of return was greater than 0 in the first stage before the announcement day, that is, the announcement day (*t*=-10 to *t*=-1) except for *t*=-10 and *t*=-9. Although in the second stage, there was a decline and even negative values for two days, but overall, its cumulative excess rate of return also showed an upward trend. The excess rate of return before and after Tencent’s M&A of Sumo Group was relatively stable, and the cumulative excess rate of return fluctuated slightly, but the overall trend was still growing. Judging from the reaction of the capital market, Tencent's M&A of Sumo Group was recognized by the market.

4.2. Financial Indicator Method

When analyzing changes in Tencent's profitability, net profit margin on total assets and net sales profit margin are selected as the main financial analysis indicators. As can be seen from Table 1, Tencent's net profit margin on total assets increased slightly from 2018 to 2019, and the net sales profit margin declined slightly, but not significantly, indicating that the acquisition of 8.75% of Sumo Group's shares in 2019 played a certain role. Since 2021, its total asset net interest rate and sales net interest rate have both increased by more than ten percentage points, both of which have made a qualitative leap. Although there will be a relatively obvious decline in 2022-2023, this full M&A in 2021 has already fully showed that it has greatly improved Tencent's profitability and performance in 2021. Furthermore, in March 2022, some of Tencent's game versions were suspended, and they were not launched online until late December. This incident undoubtedly has a certain impact on its profitability.

Table 1. Comparison of Tencent’s profitability indicators from 2018 to 2023

Items	2018	2019	2020	2021	2022	2023
Net profit margin on total assets	12.32%	11.12%	13.98%	15.26%	11.80%	7.48%
Net sales profit margin	25.58%	25.42%	33.22%	40.67%	34.03%	19.38%

Table 2. Comparison of Tencent's debt solvency indicators from 2018 to 2023

Items	2018	2019	2020	2021	2022	2023
Current ratio	1.07	1.06	1.18	1.20	1.30	1.47
Asset responsibility ratio	50.77%	40.77%	41.65%	45.63%	50.39%	44.61%

When analyzing changes in Tencent's solvency, current ratio and asset responsibility ratio are selected as the main financial analysis indicators. As can be seen from Table 2, Tencent's current ratio showed a downward trend from 2018 to 2019, and an upward trend from 2020 to 2023. It increased the most in 2023, rising from 1.30 to 1.47. Furthermore, the asset-liability ratio, which measures a company's long-term solvency, showed a downward trend from 2018 to 2019, then climbed from 41.65% in 2020 to 50.39% in 2022, but fell back to 44.61% in 2023. In the short term, the M&A have a positive effect on improving the company's current ratio, and play a certain positive role in its asset-liability ratio. After this M&A, Tencent's financial risks are basically decreasing year by year.

When analyzing changes in Tencent's operating capabilities, accounts receivable turnover rate and total asset turnover rate are selected as the main financial analysis indicators. It can be seen from Table 3 that during the period of 2018-2019, Tencent's accounts receivable turnover rate decreased, but in 2020-2021, both the accounts receivable turnover rate and the total asset turnover rate increased, and the increase is relatively large. Although the two have declined in 2022-2023, it still shows that Tencent has strengthened asset integration and accelerated asset turnover through this M&A.

Table 3. Comparison of Tencent’s operating capability indicators from 2018 to 2023.

Items	2018	2019	2020	2021	2022	2023
Accounts receivable turnover rate	13.90	12.74	13.53	16.57	13.25	13.23
Total asset turnover rate	0.49	0.45	0.43	0.50	0.48	0.39

When analyzing changes in Tencent's development capabilities, operating income, operating income growth rate, net profit and net profit growth rate are selected as the main financial analysis indicators. It is not difficult to see from Table 4 that in the past five years, except for 2022-2023, Tencent's operating income and net profit have shown a year-by-year growth trend, with the largest growth rate in 2020, and maintained a good growth rate in 2021. After Tencent's M&A of Sumo Group in 2021, its operating income growth rate declined in 2022 but returned to the track of growth in 2023, indicating that this M&A has brought huge technical support to Tencent. This M&A has achieved certain synergy effects, allowing Tencent to develop rapidly.

Table 4. Comparison of Tencent's development capability indicators from 2018 to 2023

Items	2018	2019	2020	2021	2022	2023
Operating income	312,694	377,289	482,064	560,118	554,552	609,015
Operating income growth rate	31.52%	21.54%	27.86%	16.24%	-0.99%	9.82%
Net profit	79,984	95,888	160,125	227,810	188,709	118,048
Net profit growth rate	10.37%	19.98%	66.99%	42.27%	-17.16%	-37.44%

Overall, the decision to acquire Sumo Group has caused Tencent's financial data to increase significantly in 2021 compared with previous years, indicating that compared with before the M&A, the company's capabilities have been improved in the short term. Although some indicators declined from 2022 to 2023, the percentage of decline was smaller, which shows that Tencent has done an excellent job integrating the company after the M&A, and has not negatively affected the company's various capabilities.

5. Suggestions and Implications

Through the case analysis of Tencent's cross-border M&A of Sumo Group, the following suggestions and inspirations are summarized to improve the performance of corporate M&A, providing reference for other Internet game companies to conduct cross-border M&A.

5.1. Clarifying the Development Strategy Layout

Before acquiring Sumo Group, Tencent had achieved good development results in the fields of computer games and mobile games, but its performance in console games was very weak and there were no representative game works, resulting in Tencent not forming a diversified source of value-added business income. To this end, Tencent has clearly defined its development strategy of rapidly entering the console game field through low-cost cross-border M&A. By acquiring high-quality target companies, Tencent can ensure that it can gain a good industry reputation in the global gaming industry, while also helping Tencent expand its international console game business market. Hence, enterprises should combine their own industry characteristics and development strategies to carry out M&A activities in a scientific manner. First, enterprises should formulate cross-border M&A plans based on their own actual and financial conditions and their own strategic layout in the future game industry. Secondly, enterprises should analyze their own international environment and the future development direction of the game industry, clarify specific M&A goals, and consider the synergy between M&A goals and their own development strategies, to achieve scientific development of cross-border M&A and reduce the risks of M&A[3].

5.2. Selecting M&A Targets Carefully

Before acquiring Sumo Group, Tencent fully understood the specific situation of Sumo Group and scientifically evaluated the acquisition value of Sumo Group. It believed that acquiring Sumo Group would help Tencent quickly expand its international market business and achieve rapid global expansion, and would also make up for Tencent's shortcomings in the field of console games, thereby bringing huge economic benefits to the company. For this reason, Tencent formulated a complete M&A plan and invested various resources to successfully achieve the M&A goal of Sumo Group. Thus, enterprises should have a deep understanding of the target enterprises for M&A and carefully select the targets. First, enterprises should accurately grasp the real situation of the target enterprises for M&A in light of their actual needs and evaluate whether they can achieve the expected goals after completing the M&A[7]. Secondly, enterprises should fully investigate and evaluate the real financial status of both parties to the M&A to ensure the smooth completion of the M&A work and the effective promotion of the integration work after the completion of the M&A.

5.3. Focusing on Resource Integration after M&A

After Tencent acquired Sumo Group, it fully granted Sumo Group the right to operate independently and allowed it to maintain its original organizational framework and operating model, thereby reducing the integration risk after cross-border M&A and promoting the coordinated development of both parties. To this end, Tencent has deeply integrated with Sumo Group in the fields of market development and operation management, giving full play to their respective resource advantages, ensuring that cross-border M&A achieve maximum benefits, and thus generating synergy effects of M&A. Therefore, enterprises should focus on resource integration after M&A and strengthen collaborative development. First, enterprises should focus on the deep integration of R&D resources and customer resources between the two parties to ensure that the two parties can make full use of their core resources and maximize their interests. Second, enterprises should attach importance to the effective integration of market platforms and operational management to ensure that the two parties achieve deep integration in development strategy, business development and corporate culture, so as to achieve collaborative development of the two parties[11].

5.4. Strengthening Risk Management

Enterprises should enhance their awareness of risk control and build risk control mechanisms. First, enterprises should do a good job of risk control before M&A. Before conducting cross-border M&A, enterprises should have a clear understanding of the pricing risk, financing risk, payment risk and other risks caused by information asymmetry, and accurately assess their own risk tolerance and risk control capabilities, so as to determine whether the enterprise has sufficient strength to successfully complete the M&A, and then make a scientific M&A decision. Secondly, enterprises should do a good job of risk control after M&A After completing cross-border M&A, enterprises are prone to integration risks due to inadequate resource integration, which may lead to serious financial crises and increase the financial risks of M&A[12]. Therefore, enterprises should enhance risk awareness and strengthen risk control in this regard.

6. Conclusion

To sum up, through the case analysis of Tencent's cross-border M&A of Sumo Group, it can be found that Tencent's market performance and financial performance after the M&A are both positive. First, Tencent's cumulative excess rate of return value is significantly greater than zero, indicating that the M&A has been recognized by the capital market, bringing short-term market benefits to Tencent and helping to enhance the wealth effect of shareholders. Secondly, Tencent's financial data shows that its profitability, operating capacity and development capabilities have all improved. Although its short-term solvency is insufficient, its long-term performance is improving. Finally, Tencent has effectively mobilized and managed its asset structure, integrated the resources of the two parties, optimized the efficiency of using current assets, and enhanced its operational performance and production efficiency. The game industry is the most dynamic modern cultural industry. It is the product of the integration of technology and culture, which has extremely high cultural and economic value. In the future, Chinese game companies represented by Tencent can develop new markets, acquire outstanding talents and technologies through cross-border M&A, and combine China's excellent traditional culture with advanced game technology to create game products with Chinese characteristics.

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