

Research and Suggestions on Financing Ways of M&A Transactions in China's Internet Industry

Qianwen Wei

School of Information and Business Management
Dalian Neusoft University of Information
Dalian, China

Abstract—For listed companies, mergers and acquisitions (M&A) is one of the important ways to achieve quick development. From the perspective of corporate development, in order to keep continuous scale expansion and adequate funds, companies should choose reasonable financing ways, which have important practical significance for listed companies' long-term development of production and operation in the future. From the perspective of corporate growth, M&A can bring multiple performance to a company compared with internal capital accumulation. The effectiveness of financing channels, the amount of financing scale and the financing options all play important roles in M&A market. Therefore, this paper combined with the current economic environment in China, analyzed the pros and cons of different financing ways in the M&A transactions of IT industry to find out the causes of present situation, and target to solve related problems in corporate's financing area with important practical significance.

Keywords—Internet industry; Mergers and acquisitions (M&A); financing ways

I. INTRODUCTION

M&A refers to the merger and acquisition between enterprises. All enterprises need certain funds for production and operation activities, and the process of obtaining these funds through various channels is called financing. M&A is a main way of assets reorganization of listed companies, which plays an important role in the capital operation and expansion of enterprises. With the promotion of market economy, M&A financing has become an important way for enterprises to develop themselves. The financing methods of M&A in the asset reorganization of enterprises mainly include internal financing and external financing (debt financing and equity financing).

"China is still active in the global M&A market with a volume of \$4.1 trillion" J.P. Morgan Chase & Co. said in its "The Outlook of global M&A market in 2019" report. In 2018, because of the trade frictions between China and the United States and the increased scrutiny by the Committee on Foreign Investment in the United States (CFIUS), China's outbound purchases fell by 23% for two consecutive years since a "super peak" in 2016. However, the total value of outbound mergers and acquisitions is still about a third higher than it was before in 2016. In the context of the c

trend of cross-border cooperation, Chinese acquirers will continue to be active in strategic cross-border mergers and acquisitions market in 2019, the report said. Now, M&A financing of enterprises is a major project, each step of financing process will affect whether enterprises can successfully carry out the M&A transaction or not, so a growing number of enterprises attach great importance to the choice of M&A financing method.

II. THE PRESENT SITUATION OF M&A MARKET IN CHINA'S INTERNET INDUSTRY

A. Development of M&A Transactions in Internet Industry

Internet enterprises mainly take internet technologies as the core elements of operations in the internet platform and the main business of IT companies are information services, data services, online processing services and so on. They provide the operational foundation for internet industry. The characteristics of internet industry are high asset-light ratio and rapid enterprise iteration, especially with the core competitiveness of technology and talent. With the development of capital market and economic globalization, M&A has become an important way for IT companies to enhance their competitiveness, increase their market share and optimize capital structure. In recent years, M&A transactions of internet industry are very active. According to the statistical data analyzed by PWC just as "Fig. 1" and "Fig. 2", it can be seen that from 2013 to 2015, the Internet industry developed rapidly, there was a substantial increase on the amount of M&A transactions and the number of M&A cases.

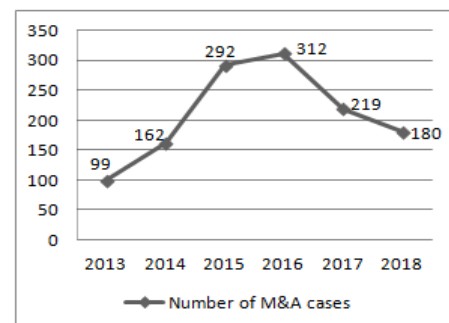


Fig. 1. The number of completed transactions of M&A in China's internet industry from 2013-2018.

From 2015 to 2016, compared with previous years, the growth rate of the total number of M&A cases has slowed down because of the winter in capital market and the impact of the economic downturn, but M&A market of internet industry is still on the rise, and the M&A transaction amount growth rapidly to nearly ¥268 billion. The market is stable and the M&A transactions are becoming more rational and pragmatic.

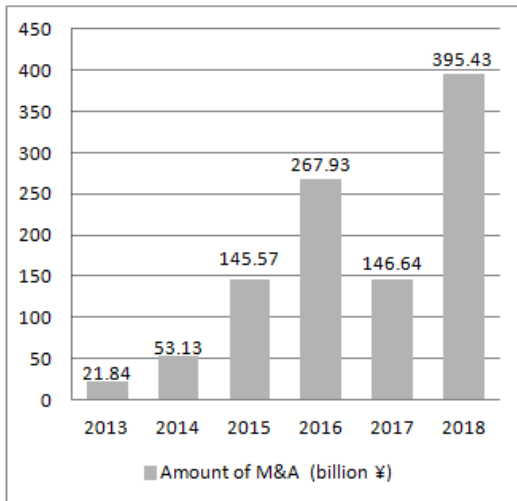


Fig. 2. The amount of completed transactions of M&A in China's internet industry from 2013-2018.

From 2016 to 2018, the development of the Internet industry has entered an inflection point and financing activities are gradually returning to rationality. At the same time, the investment institutions have tightened their purse strings. Although there was a drop of M&A cases and amounts in 2017, from the overall environment of the M&A market, the downtrend was only temporary, from the perspective of industry distribution, IT industry is still the most active area in China's M&A market and the industrial structure is more optimized. In 2018, the number of completed M&A transactions in Internet industry was 180. Although the number was down from 2017, the total amount of mergers and acquisitions reached nearly ¥396 billion; it is an increase of nearly 170% compared with 2017.

B. Hot Areas of M&A Transactions in Internet Industry

Financing scale of hot areas also rose in recent years, such as e-commerce and big data in segmented areas. "Fig. 2" shows the proportion of transaction scales in Internet M&A market of 2018. The left side of the ring chart was listed in order from high proportion to low proportion.

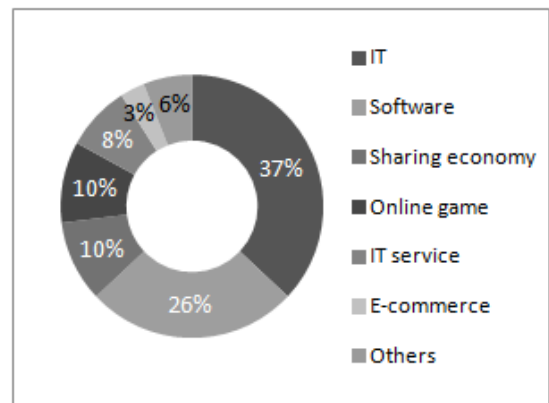


Fig. 3. The ring chart of transaction scales in China's internet M&A market of 2018.

The amounts of mergers and acquisitions in the Internet industry are getting higher, and many giants such as Baidu, Alibaba, Tencent, Microsoft, Google and Amazon are involved in it, also covering many fields, as can be seen from the ring circular diagram of proportion of transaction scales in china's internet M&A market of 2018, the largest proportion area is internet technology, other areas such as software, sharing economy, online game, IT service and E-commerce, also developed gradually.

III. ANALYSIS ON FINANCING WAYS OF CHINA'S M&A MARKET IN INTERNET INDUSTRY

Recent years, the M&A market of IT industry is active with continuous development, but the capital market is not mature, and the financial system is not innovative enough. Companies' selections of financing quantity, control of financing risks, expansion of capital channels and the M&A financing costs could all affect the final success or failure of M&A. There are three types of financing ways of listed companies in China, which are internal financing, debt financing and equity financing (debt financing and equity financing belong to external financing ways). Companies can receive asset payment or cash payment when choosing Internal financing methods. For debt financing, companies can receive bonds payment or loan from banks, also stock payment is used for equity financing.

The internal financing ability has a significant impact on the choice of financing methods of listed companies in China. It shows that the more undistributed profits and surplus reserve the listed company hold, the stronger its internal financing ability will be and the more preference it will have for internal financing. Growth factors also influence the choice of financing methods to some extent. Listed companies in IT industry have potential on growth and development. Therefore, when enterprise has financing needs, internal funds can no longer meet its development needs, so it will prefer to choose external financing.

This paper collected data from the CSMAR Research Database, and obtained financial data through the merger announcement and annual financial statements from Juchao Information. This paper selects 155 representative listed

companies of IT industry; finally 120 samples were screened eliminating the missing data and outliers. The calculation of asset-liability ratio can reflect the approximate proportion of the above three financing methods.

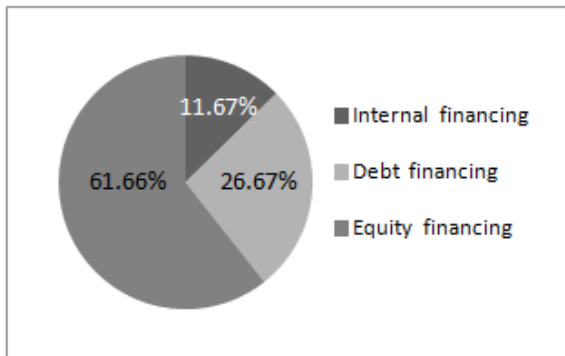


Fig. 4. Pie chart of financing options of listed companies in IT industry.

As data analysis shows, in the M&A financing market, 61.66% companies choose equity financing as the main financing way, although financing cost is high, equity financing still occupies the primary position with advantages of no repayment pressure, followed by 26.67% debt financing with advantages of tax shield effect and financial leverage effect. However, bank loan and financial intermediary loans may increase financial risks of companies. Also, for debt financing, the company can retain control rights and interests of the shareholders and avoid the dilution of its control rights. Moreover, the financial leverage effect of the company is increased. But the liquidity of the acquiring company must be strong for successful debt financing, or the conditions for issuing bonds need to be met, and the company should hold a certain debt tolerance. Therefore, Internet companies seldom use bond financing methods.

Most M&A transactions of China's IT industry aims to achieve economies of scale effect and to expand operations, so companies should be more cautious in choosing financing methods. IT companies which are in the initial stage of development need high growth, but the retained earnings are insufficient, so most IT companies tend to choose external financing. However, when IT companies accumulate more undistributed profits and surplus reserves with stronger internal financing capacity, they will prefer internal financing.

IV. SUGGESTIONS FOR M&A FINANCING WAYS IN INTERNET INDUSTRY

As can be seen from the research of this paper, when China's listed companies in IT industry choose M&A financing ways, the proportion of external financing is much higher than internal financing. Comparatively, the proportion of equity financing is relatively larger than the proportion of debt financing; the following suggestions are put forward to optimize the financing structure.

A. Improving the Profitability of Enterprises and Expand the Scale of Assets

The scales of most IT companies in China are not very large; also the profitability and development capacity need to be raised, so they can only choose external financing way when making financing decisions. Therefore, companies should find the profit points and improve the profitability. Then, they should appropriately expand the scale of enterprise operation, optimize the industrial structure, expand the scale of enterprise, so that to improve the ability of internal financing.

B. Exploring New Financing Channels and Methods

To reduce the financial risks and optimize the capital structure, we can actively expand new financing channels and choose the most appropriate financing way. With larger scale, companies could get higher credibility and find new financing channels in M&A market, so that enterprises can minimize the possible financing risks. Meanwhile, companies should pay attention to further development of the bond market and unify the interconnected bond market to support bond financing. So, choose reasonable financing method of M&A transaction is important. When making financing decisions, the decision-makers or managers must have a clear understanding of the gap in leverage ratio, and deeply analyze the reasons for the deviation of leverage, also they should consider the financing objectives and the status of capital structure to select appropriate financing ways, so that they can optimize the leverage ratio and enhance enterprise value.

C. Investigating and Budgeting the M&A Transaction Before Making Financing Decisions

Company should estimate and verify the capital required for the M&A transaction before, and work out the financing proportion according to the amount of capital required and the economic conditions of the company. When making M&A financing decisions for Internet enterprises, it is necessary to reasonably arrange the ratio between the cost of equity and the cost of debt.

D. Handling the Financing Process and Reasonably Controlling the Cost of Capital

Acquirers of M&A transaction should analyze internal operating cash flow and future profitability according to the whole environment of IT industry. Then they choose the most suitable condition of financing and payment policy, strictly control the financing process and avoid unnecessary cost of capital.

E. Strengthening the Optimization of Corporate Governance Structure

For further development of M&A financing of listed companies, it is necessary to pay attention to the perfection of corporate governance structure, the improvement of professional managers and also the entrepreneur market. We should attach great importance to the prompt settlement of non-tradable shares and actively promote the development of

full circulation of shares. In addition, companies should improve the internal governance mechanism in combination with the actual situation to strengthen the reform of the independent director selection mechanism and introduce the mandatory accumulative voting system. By rationalizing the definition of the authority of independent directors and the board of directors, and further strengthen the incentive and restraint mechanism of managers' behavior. In a word, corporate governance structure optimization should play a positive role in M&A financing.

V. CONCLUSION

In summary, under the current situation of global economic development, listed companies of IT industry are faced with many challenges in M&A financing market, and there are still many problems to be solved. By analyzing the development status and problems of M&A financing from the theoretical level, and combining with practical problems, this paper puts forward several constructive measures as above, hoping that the research can make some contributions in promoting the further development of M&A financing of listed companies.

Only by recognizing the trend of market development and strengthening risk analysis, companies can reduce unnecessary financial losses and successfully complete merger and acquisition financing activities. Also they can effectively allocate the resources and realize continuous development.

Last but not least, companies should define the target capital structure. With the changes of macro-economy, capital market, legal system and industry characteristics, enterprises should establish their target capital structure according to the internal operating situation and external financing environment, then they should design the corresponding mechanism to manage the capital structure dynamically, so that they can establish and improve the internal control, combined with enterprise strategy, effectively control the enterprise leverage ratio and form a reasonable capital structure of the company.

REFERENCES

- [1] Hu Jingjing. Research on the problems and countermeasures of M&A financing of listed companies in China [J]. *Times Finance*. 2017, (11): 203-204.
- [2] Jiang Xue, Hu Jia. Research on M&A financing of listed companies [J]. *Market weekly*, 2017, (05): 29-30.
- [3] Shen Xiangyang. Research on successful merger and acquisition mechanism of listed companies [J]. *Finance and Accounting Communication*. 2015, (05): 55-62.
- [4] Martynova, M. and L. Renneboog. What determines the financing decision in corporate takeovers: Cost of capital, agency problems, or the means of payment? [J]. *Journal of Corporate Finance*. 2009, (15): 290-315.
- [5] Baker, Malcolm P., Joshua Coval and Jeremy C. Stein. Corporate financing decisions when investors take the path of least resistance [J]. *Journal of Financial Economics*. 2007, (84): 266-298.
- [6] Dong, Ming, David Hirshleifer, Scott Richardson and Siew Hong Teoh. Does Investor misevaluation drive the takeover market? [J]. *Journal of Finance*. 2006, (61): 725-762.