ATLANTIS PRESS

Advances in Social Science, Education and Humanities Research, volume 523

Proceedings of the 2020 International Conference on Modern Education Management, Innovation and Entrepreneurship and Social Science (MEMIESS 2020)

Analysis on the Motivation of Internet Enterprise Strategic Mergers and Acquisitions and Financial Synergies—A Case Study of Tencent's Merger and Acquisition of China Music Group

Yuguo Yang[1], Yaer Ba[2,*], Jiayu Huang[1]

[1]*School of Accounting Guangzhou College of Commerce Guangzhou, China 511363*
[2]*School of Accounting, Guangzhou huashang College, Guangzhou, Guangdong 511300, China*
[*]*Corresponding author. Email: 472012470@qq.com*

ABSTRACT

In recent years, mergers and acquisitions (M&A) of Internet enterprises have gradually increased. The main strategic goal is to pursue the synergies of enterprises after M&A. Among them, financial synergy is the main concern and also an important indicator to measure the success or failure of M&A. Taking Tencent's M&A of China Music Group as an example, this paper draws conclusions through literature review, theoretical definition and case analysis, and puts forward Suggestions on the risk avoidance of M&A and coordinated sustainable development of Internet enterprises.

Keywords: *Internet enterprises, strategic M&A, synergistic effect, financial effect*

1. INTRODUCTION

With the development of the Internet economy, Internet enterprises, especially giants, are increasingly resorting to mergers to rapidly integrate resources, expand business scale, increase market share and enhance their market position in the industry. Why are M&A so popular for capital expansion? The main reason is that enterprises pursue the synergistic effects after M&A and the final financial synergies. As a highly theoretical concept, financial effect is an important component of synergistic effect. Therefore, it is necessary to fully pay attention to and analyze the financial effects before and after M&A, so as to predict and prevent risks before M&A and analyze benefits after M&A. Financial synergy has become an important analysis indicator to measure the feasibility and achievement of strategic M&A.

This paper introduces the main theories of financial synergies on the basis of sorting out relevant literature, and analyzes the current ways and motivations of Internet enterprises' M&A. Then taking Tencent's M&A of China Music Group as an example, it analyzes the strategic intentions of this M&A, conducts an in-depth analysis and financial diagnosis of the operation synergies and financial synergies after M&A, and draws the conclusion from the analysis. What's more, it puts forward countermeasures and suggestions for enterprises to achieve financial synergies through mergers, so as to have positive reference significance for Internet enterprises' M&A.

2. RESEARCH SUMMARY AND MAIN THEORIES

2.1. Research Summary

Ansoff (1965), an American scholar, first proposed the concept of synergy. He believed that the synergistic effect of M&A was the optimal integration achieved after M&A. He divided the synergistic effect into operation synergy, investment synergy, sales synergy and management synergy. Gennaro Berniley (2013) analyzed the synergistic effect of M&A by using the event study, and concluded that free M&A of similar companies could achieve effective competition in the industry, which is conducive to industry development. Chinese scholar Zhu Hongjun (2005) believed that an company that has only made one acquisition could earn more than 70% of excess returns within five years after the merger, which is the increased value of M&A, that is, the connotation of synergies, which can lead to long-term wealth growth. Liu Suzhen (2014) discussed the financial impact of M&A. He believed that M&A not only enhanced the company's core competitiveness, but also brought some financial risks to the company. In order to avoid crises, companies need to better understand the needs of financial integration and attach importance to the integration of financial personnel. Chinese scholar Wang Shanshan (2015) believed that M&A would increase the financial risk of the company, but it would also reduce the cost of capital and increase the rate of return of some objective factors. Cheng Yan and

Wang Xiaomei (2016) studied the M&A and restructuring of China's Internet business from 2011 to 2015. They analyzed the reasons and characteristics of M&A in China's Internet industry, predicted the direction of future M&A, and put forward some factors that should be paid attention to.

In conclusion, in the past, the research object of M&A was mainly traditional enterprises, and the strategic purpose of M&A was mostly based on the analysis of general financial effects. Specific cases on how to understand and use financial synergies to analyze M&A of Internet technology enterprises are still rare. This paper is to make efforts and breakthroughs in these two aspects, that is, the research object is Internet enterprise, and the research perspective is financial synergy.

2.2. Main Theories

2.2.1. Definition of internet enterprise

Internet enterprise refers to an enterprise based on computer network technology that uses network platforms to provide services and thus obtain revenue.

2.2.2. The concept and category of M&A

Enterprise M&A refers to mergers and acquisitions of related or complementary enterprises. Merger usually refers to the merger of two or more companies into one company, and will only use one legal person name when the merge is completed, furthermore, the strength gap between the two sides is not particularly large. Acquisition usually means that a company purchases stock or assets from another company, trades cash or securities, and thus owns a long-term equity in another company. Most of the time, the two legal entities will continue to operate independently.

There are three types of M&A: The first type can be divided into merger by controlling interest, merger by absorption and merger by new establishment according to the changes in legal person status of the two companies. The second type can be divided into vertical M&A, horizontal M&A and mixed M&A based on industry relevance. The third category can be divided into goodwill M&A and hostile M&A according to the intention of enterprise M&A.

2.2.3. Financial effects of enterprise M&A

Synergistic effect refers to the complementation and sharing of resource advantages between enterprises on both sides through M&A. The overall effect is greater than the sum of the effects when the enterprises operate independently, including external synergy and internal synergy. Financial synergy means that the low capital cost of the acquired company's internal capital invested in profitable projects to improve the efficiency of the business capital after the merger. Merging two types of companies into a small capital market, on the one hand, it can improve the efficiency of the company's capital, and on the other hand it can obtain sufficient capital at a low price and seize great investment opportunities to use capital more rationally and scientifically, which is the purpose of financial effect. The financial synergies in the merger are mainly as follows:

2.2.3.1. <u>Reasonable tax avoidance effect</u>

The reasonable tax avoidance effect is that enterprises use different enterprises and different tax rates to reduce taxes. Some large loss-making companies have become targets for M&A by companies with large capital and good operations. According to the relevant provisions of the tax law, enterprises use the losses after the merger to exempt taxes, and even deduct taxes for the next year, so as to legally reduce the company's tax expenditures and legally increase the company's cash flow. Some companies will adopt stock exchange transactions for M&A, with neither cash flow nor capital flow, in order to be exempt from taxes during this period.

2.2.3.2. <u>Financing synergy</u>

For some start-ups or growth companies, financing is a big issue. Without enough capital, the business will not develop better, but for companies with sufficient capital, they must use their benefits to earn more money. Companies with different operating and capital conditions can obtain extra benefits through M&A, so that the merged company can obtain capital and financing at low cost.

2.2.3.3. <u>Capital cost synergy</u>

Enterprise financing methods can be divided into internal financing and external financing according to their sources. Internal financing comes from the retained earnings of enterprises. The capital expansion is slow and capital interest is measured by opportunity cost, which is suitable for enterprises with spare money and no investment for the time being. External financing is to attract extra-enterprise capital to the enterprise in the form of creditor's rights or equity by all means. This method usually comes faster and has significant financing benefits, but the capital cost rate is slightly higher.

3. BACKGROUND ANALYSIS OF TENCENT'S M&A OF CHINA MUSIC GROUP

3.1. About Tencent

Tencent Holdings LTD. (HKEx: 700), simply known as Tencent, is one of China's top four Internet web portals, founded by Ma Huateng, Xu Chenye and others. Its social tools Tencent QQ and WeChat have had a great impact on Chinese netizens, as a result, they have a large number of customers. What's more, Tencent's third-party payment platform Tenpay has also matured and gained a high market share in recent years. Tencent's valuation increased 116 times from HK$3.7 in 2004 to HK$430 in November 2016. As of September 5, 2017, Tencent's market value was around HK$3.056 trillion (about US$390 billion), ahead of American technology giants such as Intel, Cisco and HP, as well as China's top three Internet giants Sina, Sohu and Netease. Among them, Tencent's music entertainment group holds 53.39% of the shares and owns the "Kugou" and "Kuwo" platforms.

3.2. M&A Process

The Chinese pop music market is widely regarded as an undeveloped industry with unlimited potential. According to iMedia, in the first quarter of this year, China's mobile music service users reached 449 million, and both QQ music and Kugou claimed that the users had exceeded 800 million. On July 15, 2016, Tencent and China Music Group jointly announced the merger of digital music to form a new Tencent Music Group. The value of the M&A transaction reached US$2.7 billion. According to industry data company iMedia,, the market shares of Kuwo music, QQ Music and Kugou music were 13%, 15% and 28% respectively after the merger. Consequently, Tencent had 56% of market share in the online music market in mainland China, more than half of the market (see Figure 1 for details).

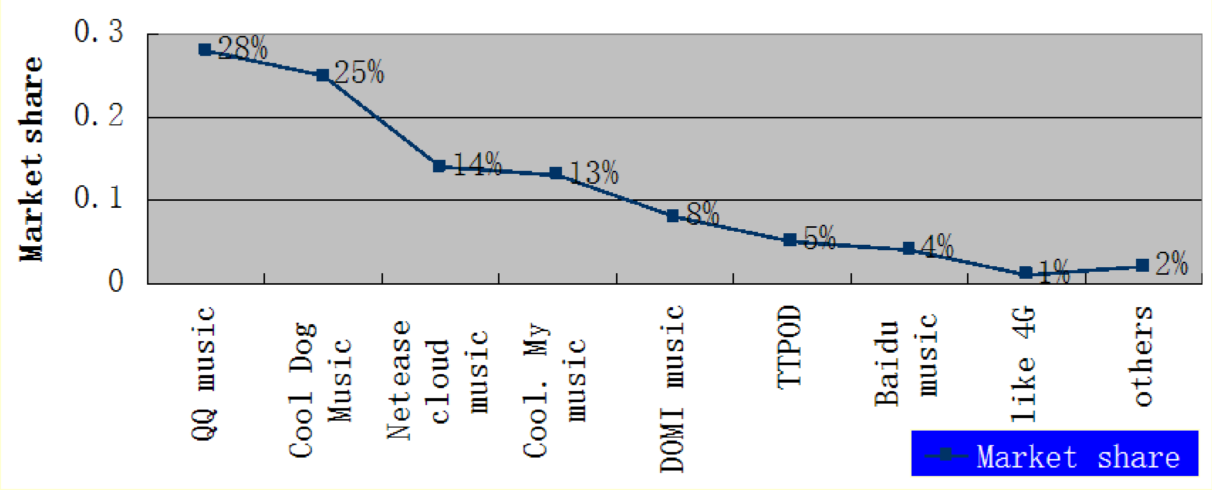

Figure 1 Market share statistics of major brands in the digital music industry

Note: Data comes from iMedia, an industry data company

3.3. Tencent's Strategic Purpose and Motivation for the M&A of China Music Group

Enterprise strategy refers to the achievement of the company's strategic goals through M&A, rather than achieving simple goals of financial returns. Tencent's acquisition of China Music Group is mainly to increase its market share in the online music market. Its main strategy is to achieve the following financial effects:

3.3.1. Achieve synergies

Synergies are complementary resources that are compatible with markets or products under development, which are usually achieved through technology transfer and sharing of commercial activities. Analyzing synergies can be divided into two levels. Firstly, optimize the time and space arrangement after the merger of two enterprises. For example, the integrated development of production and marketing of two enterprises after M&A can achieve operation synergies. Secondly, the different "power" within the company will reposition, diffuse and complement each other after the merger, which will change the overall functional status of the company. For example, this effect is reflected through the company's internal transfer pricing, information, personnel, advanced technology and management, product types, brand names, distribution channels, capital channels, as well as other additional resources. Tencent's M&A of China Music Group is a strong alliance. The new music groups have had each other's platforms and traffic since the M&A. Therefore, Tencent's revenue and profits have been improved, as well as its financial performance, and have eventually achieved financial synergies.

3.3.2. Expand market share

After the M&A of China Music Group, Tencent surpassed Alibaba's Xiami Music, with a market share of 56%. Therefore, M&A can at least reduce negative external factors, and the original competitive consumption no longer exists among shareholders. This kind of market synergistic effects and operation synergies verify a truth: M&A strategy can reduce the resource consumption due to competitions, save competitive costs, maximize market benefits within the merger organization, and obtain market position in the industry.

3.3.3. The Influence of the Matthew Effect

The so-called Matthew effect is to make the strong stronger and the weak weaker. If you want to maintain an advantage in a particular area, you need to deploy it quickly in this area. In addition, if there are strong partners in the target area, you need to find a new way to identify the opponent's weaknesses and strengths. Tencent's acquisition of China Music Group also adapts to the Matthew effect.

4. ANALYSIS OF THE FINANCIAL EFFECT OF TENCENT'S M&A OF CHINA MUSIC GROUP

4.1. Analysis of Solvency

Solvency refers to the ability of a company to repay debts with its own assets. Due to the merger of the company, the capital increases substantially, which may increase the financing capability through M&A. The increase in capital reduces the risk of creditors' losses caused by company bankruptcy. For this case, the current ratio of short-term solvency indicators and asset-liability ratio of long-term solvency indicators are respectively used for analysis. The data are shown in Table 1 and Table 2.

Table 1 Tencent's 2015-2017 Enterprise Current Ratio (Unit: RMB 100 million)

Year	Current Assets	Current Liabilities	Current Ratio
2015	753.21	500.35	1.5053
2016	1553.78	1244.06	1.2490
2017	1491.54	1011.97	1.4739

Table 2 Tencent's 2015-2017 Enterprise Asset-Liability Ratio (Unit: RMB 100 million)

Year	Total Assets	Total Liabilities	Asset-Liability Ratio
2015	3068.18	1847.18	0.6020
2016	3958.99	2096.52	0.5296
2017	8655.13	4391.15	0.5137

Note: Data comes from the financial statements of Tencent's official website from 2015 to 2017

As can be seen from Table 1, Tencent's current ratio dropped from 1.5053 in 2015 to 1.2490 in 2016, a decrease of 25.63%, and rebounded to 1.4739 in 2017. The current ratio is an important indicator to measure the short-term liquidity of an enterprise. The internationally accepted ideal current ratio is 2, in other words, as a guarantee for current liabilities, current assets should preferably be more than twice the current liabilities. In this way, even if half of the current assets are lost or can not turn into cash in the short-term, the remaining half of the assets can still guarantee the payment of current liabilities. After Tencent completed the merger of China Music Group in 2016, the current assets ratio had decreased relatively. It can be predicted that capital assets may increase accordingly. The data in Table 2 just confirms this speculation. Tencent's asset-liability ratio decreased in 2016 compared with 2015, indicating that the merger did not use excessive financial leverage, and it must have fully utilized and played the role of idle assets, which is a good example of financial synergies. It can be seen from Table 2 that Tencent's asset-liability ratio in 2017 did not change significantly compared with 2016. Once again, it can be proved that the integration of enterprise resources is ideal, and the positive financial effects have been brought into play. Total assets have risen nearly three times, but the asset-liability ratio has reached the lowest level in the past three years, close to the ideal standard of 50%. Tencent's market influence and social image have also been improved, and the competitiveness in the industry has been enhanced, which once again shows that the financial effects of mergers are fully realized in terms of financing capability.

4.2. Analysis of Earning Capacity

Earning Capacity is the primary indicator to measure the survival and development of an enterprise. In addition, when evaluating projects or major investment behaviors of an enterprise, we will also pay attention to the net profit margin, return on equity, gross profit margin, net asset rate and so on. The following is the analysis of Tencent's earning capacity in the past three years to determine whether it has achieved financial effects. The first is the gradual increase in operating income. It can be seen from Table 3 that the operating income from 2015 to 2017 has shown a growth trend, which once again shows that the financial effect of M&A has achieved synergistic value-added.

Table 3 Comparison of Tencent's operating income from 2015 to 2017 (Unit: RMB 100 million)

Year	Operating Income	Operating Costs
2015	1028.63	416.31
2016	1519.38	674.93
2017	2377.60	1208.35

Note: Data comes from Tencent's 2015-2017 financial statements

Tencent's operating income has shown an upward trend from 2015 to 2017, in which the increase rate was relatively fast from 2015 to 2016, but the increase rate of operating costs was relatively slow. The operating costs have risen after M&A, which should be attributed to the increase of costs and expenses caused by the large amount of money invested after M&A. Tencent's 2017 data showed a net profit margin of 32%, an increase of 3% compared with 29% in 2016. It can be seen from Table 3 that the total income in 2017 was RMB 237.76 billion, an increase of 56.48% over 2016. The increase in operating profit margin and net profit margin in Table 4 also fully reflects the financial synergies after the merger from this indicator.

Table 4 Operating profit margin and net profit margin from 2015 to 2017

Year	Operating Profit Margin	Net Profit Margin
As of December 31, 2015	40%	30%
As of December 31, 2016	39%	29%
As of December 31, 2017	40%	32%

Note: The data is calculated based on Tencent's 2015-2017 financial report

4.3. Analysis of Capital Management Efficiency

Due to the particularity of the music industry, the traditional stock turnover is not needed here. We only need to analyze the receivables turnover and total asset turnover. Both of them can reflect Tencent's utilization efficiency of resources, as well as the operation efficiency. Receivables turnover is the ratio between the average balance of accounts receivable and the average balance of main business income. Total asset turnover is the ratio between net sales and total assets, reflecting the company's utilization efficiency of all assets.

Table 5 Comparison table of Tencent's main turnover indicators from 2015 to 2017

Year	Receivables Turnover (times)	Total Asset Turnover (times)
2015	14.56	10.31
2016	14.96	10.93
2017	14.36	10.07

Note: The data is calculated based on Tencent's 2015-2017 financial report

It can be seen from Table 5 that in the year of the merger in 2016, the company's receivables turnover was 14.96, with a decrease from 2015. Meanwhile, the total asset turnover was 10.93, which was also 0.62 percentage points lower than that of 10.31 in 2015. It shows that in the year of merger, product sales were in the adjustment period due to the influence of Chinese music. What's more, accounts receivable in 2017 was 14.36, a decrease of 0.60 percentage points from 2016, and the total asset turnover was 10.07, which was also a decrease of 0.86 percentage points from 2016. It shows that the strategic effects of mergers are gradually reflected, and the financial synergies of mergers are also proved to be successful from the perspective of operation capacity.

4.4. Analysis of Development Capacity

Development capacity is an important indicator to measure an enterprise's continued operation. The sales growth rate, asset growth rate, and profit growth rate are relatively representative in this respect. According to the data calculated from Table 3, the sales in 2016 increased by 47.76% compared with 2015, and the sales in 2017 increased by 56.48% compared with 2016. It shows that the sales increase after the merger was 9 percentage points more than before the merger, which fully reflects a good development trend after the merger. It can also be calculated from Table 2 that the assets in 2016 increased by 29% compared with 2015, and the assets in 2017 increased by 118.67% compared with 2016, which was 89 percentage points higher than that in 2016 compared with 2015. Similarly, it can be found from table 4 that although the profit margin of the merger year in 2016 was only 29%, lower than the previous year, but it quickly rebounded to 32% in 2017, which fully shows the good development and growth rate after the merger. Therefore, after the merger, Tencent Music Group has occupied half of the online music market, with a market share of 56% (see Figure 1 above for details), which also shows its strong development momentum.

4.5. Analysis of Reasonable Tax Avoidance Effect

Reasonable tax avoidance, the common way is to avoid income tax by legally over-calculating the costs and expenses. In this merger, Tencent's asset-liability ratio has increased, but the financial leverage it used was not particularly large, indicating that it used the depreciation of some idle assets and the accrual of asset impairment loss of China Music Group to legally avoid the income taxes. In addition, some of the increased financial leverage was also used to legally avoid taxes through interest. From Tencent's income tax expenditures from 2014 to 2016, it can be seen that the income tax expenditures were increasing year by year, and the range was getting larger and larger. The increase in tax was mainly due to the substantial increase in income after M&A. Without proper tax avoidance, it would increase faster.

Table 6 Tencent's 2015-2017 income tax expenditure (Unit: RMB 1 million)

Year	Income Tax Expenditure
2015	7108
2016	10193
2017	15326

As shown in Table 2 and Table 4 above, total assets and total income have increased by more than twice, but the paid income tax in Table 6 has not increased by the same proportion, indicating that only part of the effects of legal income tax avoidance have been played in this merger.

5. CONCLUSIONS AND M&A ADVICE

5.1. Research Conclusions

Based on the relevant theories of Internet M&A and financial synergies, this paper analyzes the financial effects of the three years before and after Tencent's M&A of China Music Group, and reaches the following conclusions:

Firstly, the financial effects of the enterprise can be achieved through M&A, and the financial effects can be divided into positive and negative, the synergistic financial effect is beneficial to the development of the enterprise as a whole. In this merger, we have analyzed five aspects of financial effects through six tables and a chart. All of them showed that 2017 was more optimized than before the merger in 2016. The most obvious of which was the sales income and the market share, which brought the greatest financial synergies into play.

Secondly, the M&A have weakened the financial effect. After Tencent's M&A of China Music Group, the main business has increased significantly, but its net asset return has begun to decline, which was not strong enough in its net asset return capacity. The ability of enterprises to convert surplus assets into income remains to be improved. Tencent still needs to find new profit growth points after the realization of the extended strategy. Generally speaking, after the offset of advantages and disadvantages, the merger has achieved good financial synergies and achieved the strategic goals of M&A.

5.2. Advice on M&A

Firstly, in the early stage of M&A, prudently choose the targets of M&A. Tencent should establish a risk evaluation system in the early stage of M&A. In terms of risk control, it should investigate and know the target enterprise before M&A, select the target enterprise consistent with its long-term development strategy, and establish a financial evaluation system. If the amount of capital for M&A is large, the enterprise should formulate a financing plan based on its own operations and financial conditions to minimize the financing costs and risks of M&A.

Secondly, in the mid-term of M&A, the time point and method of payment should be accurately grasped. The enterprise should reduce the use of cash and adopt the stock exchange payment with tax planning effects. Meanwhile, do the preliminary work for resource integration after M&A.

Thirdly, in the later stage of M&A, integrate resources to find new profit points. After the completion of M&A, enterprises must pay attention to the subsequent comprehensive resource integration, such as cultural integration, business integration, human resource integration, financial integration, strategic integration, etc. Through effective coordinated resource integration, after M&A, the main body can use the remaining productivity to generate new income, create financing synergies, such as financing effect, income effect, operation effect, profit effect and development effect, so as to optimize the financial synergies.

ACKNOWLEDGMENT

Fund project: Research results of the excellent school-level course "Financial Management" of Guangzhou College of Commerce;
Achievements of the 2019 school-level teaching achievement cultivation research project of Guangzhou College of Commerce.

Profile of the author: Yuguo Yang(1969-), male, from Luxi, Hunan, associate professor of management at the School of Accounting of Guangzhou College of Commerce, director of the Institute of Accounting and Auditing, and his research direction is corporate financial management. Jiayu Huang (2000-), male, from Jieyang, Guangdong, student at the School of Accounting, Guangzhou College of Commerce.

REFERENCES

[1] https://www.tencent.com/zh-cn/dynamic_timeline.html (Tencent's official website)

[2] Yin Aizhen, Ma Xiaoli, Yu Peng. M&As performance evaluation based on M&As motivation: a case study of China Eastern Airlines' M&A of Shanghai Airlines [J]. Finance and Accounting Monthly, 2018, (11), 107-114. (In Chinese)

[3] He Luling. Financial analysis of synergies in M&As: a case study based on Hanwei Electronics [J]. Communication of Finance and Accounting, 2018, (04), 3-8 [J]. Communication of Finance and Accounting, 2018, (05), 83-86. (In Chinese)

[4] Xu Yufang. Analysis of financial risks in M&As of Internet enterprises [J]. Communication of Finance and Accounting, 2017, (17), 109-111. (In Chinese)

[5] Gao Ensheng. Correlation between tax avoidance and M&As performance: based on the moderating effect of legal action [J]. Finance and Accounting Monthly, 2018, (03), 28-34. (In Chinese)

[6] Xing Zheng. Analysis on the prevention and control of financial risks in enterprise M&As [J]. Finance and Accounting, 2018, (04), 77. (In Chinese)

[7] Xu Min, Wang Wen. Executives' risk preference, M&As characteristics and performance [J]. Friends of Accounting, 2018, (15), 113-120. (In Chinese)

[8] Su Yamin. Analysis of M&As Effects of Internet enterprises: a case study of Alibaba's M&A of AMAP [J]. Financial Supervision, 2015, (32), 3-7. (In Chinese)

[9] Zhang Dan, Gao Cong. Analysis of the motivation of the M&As of Tencent, Alibaba and Baidu [J]. Accounting Research, 2014, (09), 68-70+78. (In Chinese)