The Motivations and Performance Analysis of Cross-Border Mergers and Acquisitions: A Case Study of Tencent's Acquisition of Sumo Group

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Abstract. In recent years, with the substantial growth of China's economic power, the government has actively promoted the "going out" strategy, encouraging a growing number of Chinese enterprises to participate in cross-border mergers and acquisitions. Through these mergers and acquisitions, companies can not only take full advantage of both domestic and international markets and resources but also expand their global reach, thereby significantly boosting their international competitiveness. With the globalization of the gaming industry, Tencent Holdings, a leading domestic gaming company, has further strengthened its global leadership by acquiring the British gaming firm Sumo Group. This paper examines Tencent's acquisition of Sumo Group, analyzing the motivations, process, and financial data. The findings suggest that Tencent's merger and acquisition activities are primarily driven by market expansion and the desire to enhance its own competitiveness. Following the merger, Tencent achieved economies of scale and synergy through resource integration and market expansion, leading to improved profitability and greater market competitiveness.

Keywords: Cross-Border Mergers and Acquisitions, Market Expansion, Resource Integration.

1 Introduction

The primary objectives of Chinese enterprises' overseas mergers and acquisitions (M&A) focus on acquiring core technologies, brands, management experience, and market channels, as well as diversifying and globalizing their business operations. Through these acquisitions, enterprises can rapidly enter new markets, expand their international influence, and enhance competitiveness by integrating advanced technology and management expertise. Faced with fierce competition and the growing saturation of the domestic market, overseas M&A has become a vital strategy for enterprises to identify new growth opportunities and profit models. In the globalized economy, Chinese enterprises can better integrate into the global industrial and supply chains through M&A, optimizing resource allocation and mitigating risks. Additionally, overseas M&A aligns with China's "going out" strategy, fostering

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stronger interactions with the international market, and enhancing China's soft power and global standing. Thus, for Chinese enterprises, overseas M&A represents a strategic investment aimed at boosting international competitiveness and achieving long-term development goals.

In the context of cross-border M&A, Wan and Yang analyzed the impact of Chinese enterprises' M&A on collaborative innovation, based on a theoretical model. They found that such activities enhance collaboration between firms and R&D entities by increasing R&D investment, expanding into overseas markets, and establishing strategic partnerships [1]. Li and Fang emphasized that M&A can drive innovation within enterprises, particularly in boosting production efficiency and facilitating technological upgrades [2]. Xue argued that improving the global value chain is a major motivation for Chinese listed companies to pursue cross-border M&A, aiming to strengthen their global competitive positions [3]. Lee conducted an empirical study on China's M&A trends from 1985 to 2007, concluding that companies in developed nations are more likely to acquire firms in other countries to expand globally, especially to improve technological capabilities and market share [4]. Liu observed that in response to fierce competition, companies often pursue M&A to rapidly integrate resources and achieve large-scale development [5].

Yang et al. highlighted that with domestic resources nearing saturation, Chinese resource enterprises increasingly seek to acquire foreign resources through overseas M&A. However, due to recent challenges in cross-border acquisitions, the number of such deals has declined [6]. Huang et al., using Botten Shares' acquisition of J-STAR as a case study, demonstrated how technical cooperation following a cross-border acquisition allows firms to quickly absorb technical assets, enhancing competitiveness [7]. Ahammad and Glaister emphasized the importance of cultural compatibility in cross-border M&A. Their research shows that a thorough cultural assessment is critical to the success of such acquisitions, as it helps predict the degree of change or adaptation required post-acquisition. Without this assessment, poor decisions may lead to acquisition failures [8].

Liu, Wu, and Guo conducted a comprehensive study on cross-border M&A among Chinese listed companies from 2007 to 2018. Their findings indicated that while Chinese firms' governance capabilities may negatively affect short-term M&A outcomes, they can significantly improve the acquirers' long-term performance [9]. Lastly, Liang and Lin analyzed Tencent's acquisition of Sumo Group, finding that the target company's market performance improved significantly. Using the event research and financial indicator methods, they observed positive cumulative abnormal returns ten days before and after the merger, showing that Tencent's shareholders benefited and the market acknowledged the success of the acquisition [10].

2 Case Description: Tencent's Acquisition of Sumo Group

2.1 The Merger and Acquisition Parties

Tencent, founded in November 1998 and headquartered in Shenzhen, China, was co-founded by Ma Huateng and his partners. Over the years, Tencent has grown into one of China's leading internet companies. Its business spans various fields, including social networking, entertainment, financial technology, and cloud services, offering a wide range of products and services. Notably, Tencent has a strong presence in the gaming industry, which plays a crucial role in its portfolio. The company has built an extensive collection of game products through independent research and development, acquisitions, and investments. Tencent Games is a major player both in China and the global gaming market, owning several renowned game studios and publishing brands, such as Tianmei Studio Group and Photon Studio Group.

Sumo Group was originally formed in 2003 as part of Foundation 9 Entertainment. In 2014, its main studio, Sumo Digital, separated from Foundation 9 Entertainment and relocated to Sheffield, UK, to pursue independent game development. Initially, Sumo Group focused on "work-for-hire" projects. However, as it gained experience, the company evolved into a multi-project, multi-genre solution provider. By 2017, Sumo Group had been listed on the London Stock Exchange. As of 2021, the company had expanded to 14 studios across five countries, employing over 1,200 people.

2.2 The Merger and Acquisition Process

Tencent's acquisition of the British game developer Sumo Group can be outlined as follows:

(1) Initial Investment: In 2019, Tencent made its first move by acquiring 8.75% of Sumo Group's shares through the private equity firm Perwyn Bidco, positioning itself as the second-largest shareholder.

(2) Acquisition Announcement: In July 2021, Tencent announced its plan to fully acquire Sumo Group for £919 million, offering a 43.3% premium over Sumo Group's closing stock price on July 16.

(3) Regulatory Approval: In November 2021, the Committee on Foreign Investment in the United States (CFIUS) launched an investigation into the acquisition to evaluate potential risks to U.S. national security. After a month of review, the deal received approval.

(4) Court Approval: On January 13, 2022, the High Court of England and Wales officially approved Tencent's acquisition of Sumo Group.

(5) Transaction Completion: With both regulatory and court approvals, Tencent finalized the acquisition, becoming the sole owner of Sumo Group. Trading of Sumo Group's shares on the London Stock Exchange was suspended, and permission to trade was revoked following the completion of the deal.

3 M&A Analysis: Tencent's Acquisition of Sumo Group

3.1 M&A Motivation

Tencent's International Market Expansion. Tencent's strategy to increase its market share through the acquisition of Sumo Group is part of its global expansion plan. As can be seen from Table 1, Tencent's revenue in overseas markets is increasing year by year, and the recognition and influence of Tencent games in overseas markets are constantly improving, becoming an important player in the global game market. Tencent's global expansion plans are mainly in China and the United States, and Sumo Group used to be affiliated with Foundation 9 Entertainment in the United States, which shows that this merger can bring the development of two markets. Moreover, Sumo Group has studios in several countries, which provides Tencent with a ready-made international network to expand these markets more effectively. By integrating Sumo Group's resources, Tencent will be able to offer more diversified game products and services globally, increase its market share and strengthen its global footprint. Driven by the globalization strategy, Tencent can better integrate with the international market and participate in the global game industry competition through the acquisition of Sumo Group. Such cross-border mergers and acquisitions not only help Tencent enhance brand awareness on a global scale, but also enhance its competitiveness in the global game market through market and cultural diversification. Through such a strategic layout, Tencent's share in the global game market is expected to be significantly increased.

Table 1. Tencent's game revenue from 2019 to 2021.

	2019	2020	2021
Income (¥billion)	105.8	133.7	174.3
Overseas income (¥billion)	24.3	57.5	45.5
Share of overseas revenue	23%	43%	26%

Increase in Industry Competitiveness. Tencent's game innovation is insufficient, and Tencent's achievements in console games are basically zero. On the other hand, China has risen to a lot of competitive games, such as NetEase's "original God", as can be seen from Figure 1, Tencent is paying more and more attention to game research and development.

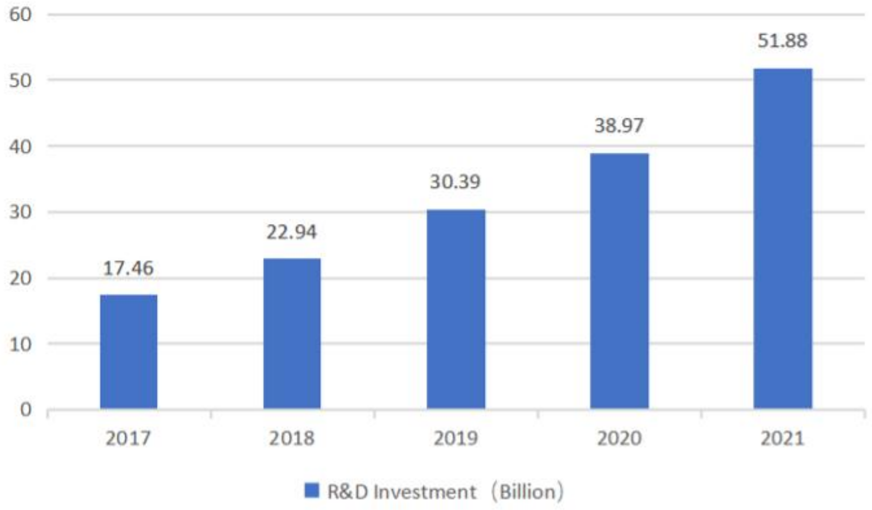

Fig. 1. Tencent's R&D investment from 2017 to 2021 (Photo/Picture credit: Original).

Through the acquisition of Sumo Group companies to make up for their own R & D resource allocation, improve R&D efficiency and innovation capabilities. The integration of Sumo Group's talent and technology will promote Tencent's continuous innovation in game design, technology development, user experience and other aspects, and enhance the market appeal and user stickiness of its products. This inherent innovation drive and the improvement of research and development strength is the key to Tencent's advantage in the fierce industry competition. Tencent has not only incorporated an international game developer with rich experience and excellent development capabilities, but also can use Sumo Group's professional skills and innovation in the field of game development to improve its product quality and market competitiveness. Tencent's acquisition of Sumo Group is an important measure to enhance its industry competitiveness.

Finally, through this acquisition, Tencent can also share market resources and customer base with Sumo Group, achieve synergies between the two sides in marketing, channel building and brand building, and improve market penetration and brand influence. This strategy of both internal and external repair will greatly enhance Tencent's overall competitiveness in the game industry.

3.2 Financial Performance

Tencent is buying Sumo Group for 0.9billion pounds, a 43.3% premium to the company's closing price on July 16. This shows Tencent's high recognition of Sumo Group and tapping its strength and potential in the field of game development. As can be seen from Figure 2, Tencent's net profit rate on total assets and net profit rate on sales will increase significantly in 2021. Although there will be a decline in 2022, overall, M&A will significantly improve Tencent's profitability.

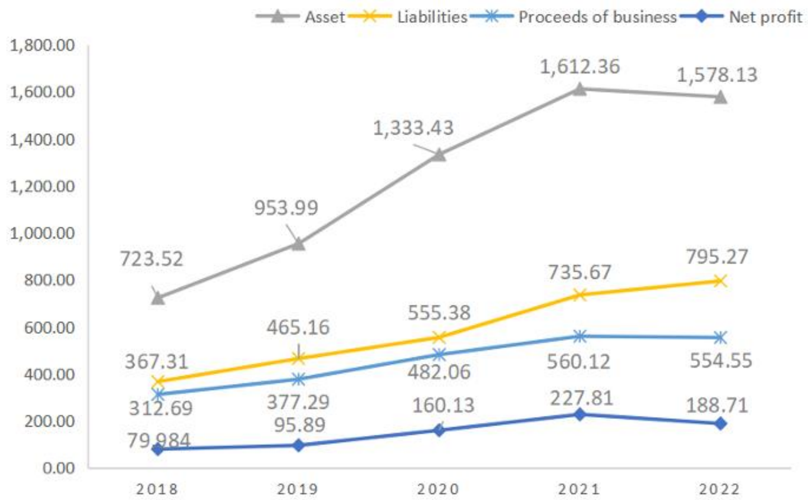

Fig. 2. Financial indicators of Tencent from 2018 to 2022 (Photo/Picture credit: Original).

According to Table 2, Tencent's current ratio exhibited a decline from 2018 to 2019, but then reversed course, showing an upward trajectory from 2020 to 2022. It increased from 41.65% in 2020 to 50.39% in 2022. In the short term, Tencent's acquisition of Sumo Group positively impacted the company's current ratio and also had a notable influence on its overall debt-to-asset ratio.

Table 2. Comparison of Tencent's solvency indicators from 2018 to 2022.

	2018	2019	2020	2021	2022
Current ratio (%)	1.07	1.06	1.18	1.20	1.30
Asset-liability ratio (%)	50.77	40.77	41.65	45.63	50.39

When assessing Tencent's profitability, the spotlight is primarily on two pivotal financial metrics: the return on total assets and the return on sales. These indicators provide insights into the company's ability to generate profits from its assets and sales, respectively. Table 3 shows that between 2018 and 2019, Tencent's net interest rate on total assets showed a slight downward trend, while the net interest rate on sales decreased slightly, but the overall change was little. This shows that Tencent's 8.75% share acquisition of Sumo Group in 2019 has had a positive impact on its profitability. By 2021, with the full acquisition of Sumo Group, Tencent's net profit margin on total assets and net profit margin on sales both achieved significant double-digit percentage increases, which marked a significant increase in the company's profitability and significantly improved its performance for the year. However, entering 2022, these indicators have fallen back, which may be partly due to the suspension of some game plates issued by Tencent in March of that year, resulting in the delay of its game products to the market until the end of the year, which has a certain negative impact on the company's profitability. In summary, Tencent's financial risk is basically reduced year by year after this merger and acquisition.

Table 3. Comparison of Tencent's profitability indicators from 2018 to 2022.

	2018	2019	2020	2021	2022
Net interest rate on total assets (%)	12.32	11.12	13.98	15.26	11.8
Net profit margin on sales (%)	25.58	25.42	33.22	40.67	34.03

4 Relevant Analysis of M&A

4.1 Strategic Layout and Market Expansion

Tencent's acquisition of Sumo Group shows the importance of strategic positioning in cross-border mergers and acquisitions. The acquisition not only helped Tencent expand the global gaming market, but also gained advanced technology and talent resources through Sumo Group, thereby strengthening its research and development and innovation capabilities. This proves that companies must ensure that M&A decisions are aligned with their long-term growth strategy, as well as having clear market expansion goals and plans. Through such strategic M&A activities, companies can more smoothly enter new market areas or consolidate existing market positions, while promoting business diversification and balanced risk allocation.

4.2 Financial Performance and Risk Management

The merger and acquisition activities have exerted a notably positive influence on Tencent's financial performance, particularly in enhancing the net profit margin on total assets and the net profit margin on sales. These strategic moves have been instrumental in bolstering the company's profitability and financial health. This shows that M&A, as a tool, can significantly improve the profitability of enterprises. However, M&A also comes with risks, such as market uncertainties and integration risks. Tencent has correctly and effectively managed and mitigated these potential risks in the M&A process, laying a good foundation for a smooth transition and the realization of expected financial benefits after the M&A.

4.3 Technological Innovation and Cultural Integration

The acquisition of Sumo Group by Tencent exemplifies the critical importance of technological innovation and cultural integration in the successful execution of mergers and acquisitions. This case underscores how these elements can be pivotal in achieving synergies and driving the overall success of such corporate transactions. The addition of Sumo Group has brought new innovation impetus and growth point for Tencent. Tencent's correct management of Sumo Group's culture and operation after the merger and acquisition, maintaining innovation spirit and independence, is also a key factor for success. In the realm of mergers and acquisitions, companies must focus on more than just the acquisition of technological innovation; they should also prioritize the cultural integration and team collaboration between the merging entities. This holistic approach is essential for sustaining the innovation momentum and enhancing the overall operational efficiency of the combined organization.

5 Conclusion

The case of Tencent's merger and acquisition of Sumo Group is a typical transnational merger and acquisition activity, which not only reflects Tencent's expansion strategy in the global game industry, but also shows its far-flung plans in technological innovation and market layout.

Tencent's acquisition of Sumo Group not only strengthens its presence in the UK and global gaming market, but also aligns with its strategy of actively expanding overseas markets. Through the integration of Sumo Group's resources, Tencent has been able to significantly expand its production scale, reduce operational costs, and thereby realize economies of scale. This strategic move has positioned the company to optimize its cost structure and leverage its market presence more effectively. After the merger and acquisition, Tencent's financial indicators showed a positive short-term effect, and its profitability, operating capacity and growth capacity were improved. Tencent's acquisition of Sumo Group deepens its globalization strategy and widens the game landscape from "the largest number of players" to "the broadest game landscape."

There is no doubt that Tencent's acquisition is a success, and research shows that it is a complex and multi-dimensional business activity, involving strategic, financial, cultural and legal layers. Successful cross-border mergers and acquisitions can bring scale economy, market expansion and technological innovation advantages to enterprises. However, cultural differences, political risks and regulatory challenges are also key obstacles to overcome during the M&A process. In addition, with the deepening of globalization, cross-border M&A strategies increasingly need to consider factors such as the stability and sustainability of global supply chains. Cross-border mergers and acquisitions serve not merely as a strategy for corporate expansion but also as a significant indicator of a company's global competitiveness and adaptability. This approach reflects a company's ability to navigate and thrive in diverse markets, showcasing its strategic vision and operational flexibility on a worldwide scale.

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