Mergers and acqisitions as a form of development of the technological industry

Anzhela Litvinova
Ulia Onokhova
Peoples' Friendship University of Russia, Moscow, Russia

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Abstract

In the context of globalization and internationalization of the world economy, effective functioning of any country's business environment becomes one of the most important factors determining the competitiveness of such country. In order to constantly evolve and be a leader in the context of fierce global competition, countries need companies which are able to bring the relevant sector to the highest level and take care for the continuing improvement. Therefore, companies in telecommunications, media and high technology sectors must seriously think about ways and strategies for development and expansion. One of the most urgent ways is mergers and acquisitions.

Introduction

Global integration processes happening in all sectors of economic activities could not have touched Russia. After Russia's accession to the WTO, the level of competition has increased and become more global. Against this background, many Russian companies started to search for the ways to improve effectiveness and get competitive advantages. It became the matter of course to use foreign experience and focus on development strategies of global leaders. Therefore, the share of M&A transactions, as a form of integration, increases in the Russian market as well. Integration processes improve the company's value and its competitiveness.

Mergers & Acquisitions are such transactions where ownership rights to any company or its organizational units are assigned to other companies. M&A are a general term to name any possible integration processes which involve transition of corporate control from one group of shareholders to another, such as: debt financing transactions, repurchase by the management, repurchase by company employees, merger, acquisition, "hostile acquisition", recapitalization etc.

As a matter of law, the term is construed in different ways under applicable laws of each country, by virtue of which fact it is important to find out its definition established in the Russian legislation. Federal Law "On Joint-Stock Companies" No. 208-FZ as of December 26, 1995 identifies the following five forms of reorganization: merger, accession, division, spin-off and transformation. That law considers the transformation as a change of ownership form of a company into a limited liability company or a production cooperative. According to that Law, merger of companies is considered to be a new company formed through assigning it all rights and obligations of two or more companies, with termination of the latter. Such M&A form when two or more companies lose their legal entity statuses by establishment of a new company is known as the "corporate consolidation" in foreign sources.

In the Russian legislation, the accession of companies is considered to be the winding-up of one or a few companies with assignment of all rights and obligations thereof to another company. This form is one which defined as the "merger" in foreign literature.

Discussions

In Russia, "acquisition" is defined in the Russian Presidential Dcree No. 1392 dated November 16, 1992 as a purchase by one company of the controlling stake in another company. Along with that, the acquiring company is considered to have become a holding company (if it did not take place earlier), and the target (being acquired) company is considered to be its subsidiary.

Now let's consider the foreign definition of this term. Corporate acquisition is considered to be the assignment of all ownership rights to the company's shares or assets to the buyer. Acquisitions can be friendly and unfriendly; the latters are also known as hostile.

Mergers and acquisitions are classified based on several main criteria: reasons, nature of integration, and national identity of the company.

According to classification of S. V. Savchook, mergers and acquisitions can be divided into transactions made to reduce a resource outflow (primarily financial resources being the business costs), to increase/stabilize a resource inflow, and those the reasons of which are neutral in relation to the resource flow.

The first group includes the "economy of scale" effect arising due to centralization of functions and allocation of fixed costs among a larger number of product units and elimination of duplicative tasks. This group also includes efficiency gains due to cooperation in R&D, the opportunity to obtain cheaper loans and reduction of fiscal charges (reduction of the tax base and customs duties, tax exemptions).The first group of reasons is generally aimed at elimination of inefficiencies of the company's management, what sometimes means improvement of management methods and sometimes – reduction of staff and reorganization of the company.

The second group includes the reasons associated with an increase in revenue and profit, in particular, mergers done to receive complementary resources, increase the production capacity and subsequently the ability to provide larger contracts, expansion of the potential for lobbying own interests, and increase of the market influence. This also includes the product diversification, and, therefore, a customer database increase and an access to new information and business processes.

The third group involves, first of all, the difference between the market value of the company and its replacement value (it occurs when the market value, i. e. the fair value, is less than the value of replacement of the company's assets, i. e. its book value). Second, this group includes transactions made due to any difference between the liquidation market value and the current one, what is relevant when the company is purchased and driven to bankruptcy for more beneficial sale thereof by pieces. Personal reasons of the company's managers can be among reasons of mergers and acquisitions, as it is deemed that there is a correlation between salaries and the size of any company. And, finally, the reason which is called "too big to fail" and characterizes the protection degree and confidence of the company's management in the concept that the bigger company is, the more difficult for it to go bankrupt and easier to protect itself from hostile acquisitions by competitors.

By its nature, M&A transactions are divided into vertical, horizontal and conglomerate transactions.

Vertical merger means acquisition of a company which is located in the same production chain as the acquiring company is. This merger allows to quickly reduce production and product costs, thereby resulting in a rapid increase in profits. Such type of mergers is commonly applied in the steel industry.

Horizontal merger means acquisition of a company which produces the same product as the acquiring company does or is at the same stage in the production chain of the industry as the acquiring company is. Such type of merger allows to expand opportunities for development and apply any successful experience of both companies in the new production, as well as it reduces competition in the market and increases the share of the merged company. A large part of transactions of this type is carried out in oil-and-gas and food industries, as well as in telecommunications. Horizontal mergers prevail in the Russian M&A market.

Conglomerate merger means acquisition of a company which is not associated with the industry or the production chain of the acquiring company at all. Such type was most common in the 1990s; approx. 80 % of all mergers being performed are conglomerate.

By the national identity, transactions are divided into national (companies are within one country) and transnational ones.

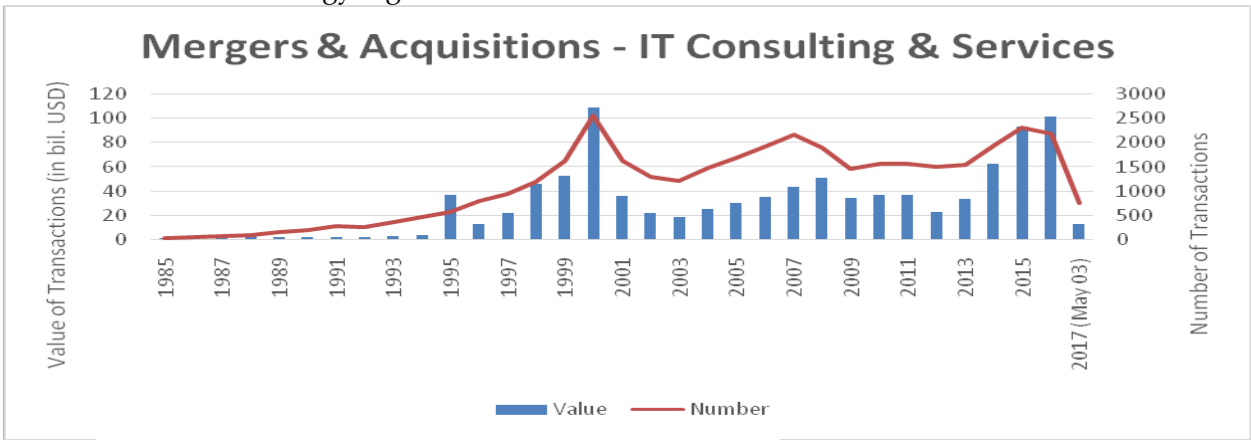
Let's emphasize one main factor of M&A influence in order to consider the M&A process as a form of development of any industry. As mentioned at the beginning of the article, the integration process is one of the strategies of efficient operation for a company, under fierce competition. The main reason for this is the synergistic effect. The synergistic theory suggests that merger brings operating and financial benefits. Due to savings on operational costs, as well as on R&D, increase of the market share, creation of tax shields and diversification, the M&A process generates the new value added effect which is called the effect of "1+1>2". It means that the result of such company's activity after the M&A process is greater than the result which the companies could achieve separately.

Within the technology sector, the problem of competition becomes more acute due to the fact that the industry's development pace significantly declines. The decline is associated with the achievement of market saturation both in the Russian and global markets. Mary Meeker, an expert of Kleiner Perkins Caufield & Byers, has said in the "Internet Trends 2016" report that India, Indonesia and Nigeria became new leaders in terms of audience growth. The growth of users in these countries has increased by 10 % and reached USD 2.6 billion. And in the coming years, this trend will only be increasing. Over the past decades, the level of products and services offered increases, and the cost annually decreases by 30 % on average.

Therefore, telecommunications, media and high technology companies have to think seriously about the ways and strategies of development and expansion. Entry into M&A market can prove to be a solution for the current situation.

Analysis of mergers and acquisitions in technology sector

Annually specialists from McKinsey, Deloitte, KPMG conduct international research, in which they interview top managers from different industries and regions of the world. The purpose of these surveys is to determine the expert opinion of market development and to forecast trends for the future. Technology industry are discussed in all the reports as the key trend. In Deloitte 2016 M&A trend acquisition of technology assets is seen as top pick by 26% of respondents. The third part of the respondents surges that TMT companies expected to merge. TMT stands for Technology, Media and Telecommunications and is an industry sector. It is usually divided into two subsectors: The High Technology & Innovations and The Media & Communications subindustries. The main characteristics of technology segment M&A deals were discussed in this section.



Graph 1. M&A – IT Consulting & Services (since 1985)[1]

Based on tech M&A market analysis from 1985 year can be concluded that TMT sector had two distinctive peak periods. These peaks effected by industry boom and have nothing to do with economic cycles. In March 2000 the average deal value was 380.7 million. Top deals in 2000 were

[1]Source: Institute of Mergers, Acquisitions and Alliances (IMAA), Statistic

AOL with Time Warner, JDS Uniphase with ETek, VeriSign with Network Solutions, Veritas with Seagate and Alcatel with Newbridge. In next year, the average deal value decreased by half and almost have not change for 7 years. But in 2016 it set a record with 416 million dollars as average deal value by year. Deal volume slightly increased by 5 % in 2016. Overall deal value set second record in tech M&A history with 101,2 billion dollars. Top M&A deals of 2016 consists of four deals in TMT industry. Mean driver of the industry is megadeals that are presented in the table below.

Announced Date	Bidder Company	Target Company	Disclosed value ($m)	Premium offered
27 Oct	Qualcomm Inc.	NXP Semiconductors NV	$39,187	33%
18 Jul	SoftBank Group Corporation	ARM Holdings plc	$32,434	61%
13 Jun	Microsoft Corporation	LinkedIn Corporation	$26,200	54%
26 Jul	Analog Devices Inc.	Linear Technology Corporation	$14,880	32%
28 Jul	Oracle Corporation	NetSuite Inc.	$9,300	58%
7 Sep	Micro Focus International plc	Software business division of Hewlett Packard Enterprise	$8,800	N/A
21 Jun	Tencent Holdings Ltd.	Supercell Oy	$8,568	N/A
14 Nov	Samsung Electronics Co. Ltd.	Harman International Industries Inc.	$8,000	37%
17 Feb	Tianjin Tianhai Investment Co. Ltd.	Ingram Micro Inc.	$6,000	43%
24 May	Computer Sciences Corporation	Enterprise services division of Hewlett Packard Enterprise	$6,000	N/A

Table 1. Top M&A deals in technology sector of 2016[2]

Looking at the tech sector in 2016, cross-border CB value grew up to 63%. As in previas years, it caused by high investment activity of Asian companies that make acquisitions in promising segments of the digital market and consolidate with other players. As a result, the number of cross-border M&A deals will grow in next years.

Over the past decades, the volume of products and services in technology is increasing, and the cost falls on average by 30% annually. This fact with reaching the limit of market saturation in some branches of TMT industry will led to grow in M&A. Because merge and acquisition deals helps companies to get competitive advantage, increase market share, educe transaction costs and enter a new market.

JEGI M&A ACTIVITY BY SECTOR						
Sector	**2015 January - September**		**2016 January - September**		**Change**	
	Deals	*Value (mil)*	*Deals*	*Value (mil)*	*Deals*	*Value*
B2B Media & Technology	75	$ 5,705	77	$ 32,777	3%	475%
Consumer Media & Technology	159	$ 17,066	161	$ 14,927	1%	13%
Database & Information Services	41	$ 6,325	38	$ 39,235	7%	520%

[2]Source: EY, Global technology M&A report

Exhibitions & Conferences	59	$3,345	49	$ 2,498	17%	25%
Marketing Services & Technology	463	$ 19,625	471	$ 32,695	2%	67%
Mobile Media & Technology	121	$ 6,208	88	$ 2,184	27%	65%
Software & Tech-Enabled Services	1,091	$ 58,120	1,009	$ 85,801	8%	48%

Table 2. M&A by sector in 2015-2016[3]

First feature is prevalence of the Software & Tech-Enabled Services including application software (with h accounted for nearly one-third) M&A. Even though as we can see from the Table the database and information services and the b2b media and technology showed exponential growth in deal value, due to Quintiles Transnational Holdings $13.5 billion acquisition of IMS Health, IHS and Markit for approximately $11 billion and Microsoft's $29.5 billion acquisition of LinkedIn accordingly.

Another distinctive feature of tech M&A is that technology firms are doing deals outside their own sector. Over 40% of respondents from tech top management are looking beyond organic development to meet needs of customers' changing behaviors to grow their marker share. Secondly deal making outside their sector aimed to attract new product or service innovation.

Massive digital transformation derived by low rates of economic growth, emergence of new technologies, erosion of industry boundaries and change in consumer preferences. Despite fell in other sectors of M&A market, TMT drove to a second consecutive all-time value record in 2016. Experts are convinced that the most important segments in tech industry is disruptive cloud, mobile, social and big data analytics technologies.

Examples presented below enables us to estimate the M&A impact.

One of the biggest M&A deal in 2000 - AOL and Time Warner turned out the worst merger of all time. But at the time, it seemed the perfect fit. Competitors were afraid not to withstand. AOL was at the head of the pack as the 'dominant' player which could give Time Warner millions of new subscribers. AOL, in turn, would benefit from access to Time Warner's content and cable network. Unfortunately, a few months after the deal closed, the dot com bubble burst and the economy went into recession. As a result, in 2002 the total value of AOL stock subsequently went from $226 billion to about $20 billion. If not that, successful merge of AOL and Time Warner would lead to usability of internet-related company not only in cyberspace, but also in the offline world for the first time in the history. But it was not meant to be.

In other hand, the Disney-Pixar merger that gave the world not only "Wall-E" as first and last product. Over the ten years by Pixar were made 13 feature films and more than 10 original short films. The Walt Disney Company had creative crisis when it purchased Pixar for 7,4 billion dollars in 2006. Not only this deal helped to overcome difficulties, the pries of the Disney company grown from 52.8 to 171.48 billion dollars in 10 years. The Walt Disney Company occupies a leading position in the animation market and have significant influence on the industry.

Mail.ru Group is one of the examples of using this strategy in Russia, demonstrating its positive effect on development of companies. Since 2000s, Mail.ru started to acquire shares in gaming companies, and the M&A transaction with Pixonic was announced in September 2016. Even foreign publications mention Mail.Ru Group as the largest Russian Publisher of multiplayer and mobile games. The company's portfolio includes more than 50 game projects the total audience of which exceeds 100 million users worldwide.

First, the positive effect from the acquisition of game developers is observed in financial indicators. Over the past year, the company's revenue from popular multiplayer online role-playing games increased by 21.2 % and reached RUB 11.39 billion. Second, not less important effect included

[3]JEGI Transaction Database and 451 Research LLC / Notes: Software & Technology Services Transactions are also duplicated in some of the other sectors

diversification of the company's revenue items due to involvement of the B2C segment. As far as a large portion of the company's profitability is made by sale of advertisement on its resources (B2B sales), it makes the company dependent and vulnerable.

Conclusions

The results of analysis indicate that though in history of mergers and acquisitions was ups and downs, the influence of M&A deals on the industry development is undeniable.

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