

An Empirical Analysis on Performance of M&A of Chinese Internet Companies Based on Balanced Scorecard

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Abstract -With the arrival of the information age, the Internet is increasingly important in economy development, and M&A is a necessary way for the development of enterprises. In order to balance development after M&A, An increasing number of enterprises use the balanced scorecard for performance assessment. But for now, the balanced scorecard applied to Internet companies in mergers and acquisitions research also is not very deep, and Literatures mainly introduce the balanced scorecard as an implementation tool, instead of templates for reference. This essay takes the merger of Youku and Tudou as an example, trying to analysis the performance of M&A of Internet companies based on balanced scorecard, aiming at providing Chinese Internet companies' future mergers and acquisitions with useful information.

Key words - balanced scorecard; Internet companies; mergers and acquisitions; performance

1. Case Description

Youku Inc. ("Youku") and Tudou Holdings Limited ("Tudou") announced on March 12, 2012 that they have signed a definitive agreement for Tudou to combine with Youku in a 100% stock-for-stock transaction. On August 20, 2012 the Company's shareholders voted in favor of the merger proposal, and the combined entity named "Youku Tudou Inc." After the merger of Youku and Tudou, both sides can jointly share operating costs, be more optimal in technology, share resources such as users, make breakthrough in advertising revenue, maintain rapid growth and faster to profitability. However, the combined team of integration, new companies must work together to face it.

As the Internet enterprise merger and acquisition events, the merger of the two China's leading Internet television companies, has received widespread attention, at the same time, is typical and representative.

2. Theoretical Reviews

2.1. Internet Companies

As one of the great inventions in the 20th century, Internet is gradually becoming a strategic infrastructure in the information age, promoting production and profound lifestyle changes. *The 31st Statistical Report on Internet Development in China* shows that by the end of December 2012, China has had 564 million Internet users, with a total of 50.9 million new ones.

The Internet penetration rate of 42.1%, a growth of 3.8% compared with the end of 2011. The number of websites registered by the registrants of website domain names is reaching 2.68 million.

Generally, the Internet companies include the IT industry, e-commerce companies, software development companies, etc. In 2010, the income of the whole industry was over 200 billion yuan, has sprung up numbers of backbone enterprises with annual revenues of more than 5 billion YUAN like Sohu, Tencent, Baidu, Alibaba. Internet service enterprises directly employed nearly 800,000 people in 2010.

In the field of commerce, in 2011 the total e-commerce transactions have reached 5.88 trillion yuan, equivalent to 12.5% of GDP. The scale of the Internet economy and its leading role, making it important growth poles of national economy.

2.2. Merger and acquisition

Mergers and acquisitions (M&A) is an aspect of corporate strategy, corporate finance and management dealing with the buying, selling, dividing and combining of different companies and similar entities that can help an enterprise grow rapidly in its sector or location of origin, or a new field or new location, without creating a subsidiary, other child entity or using a joint venture.

M&A is an important way to achieve enterprise transformation, restructuring of property rights, adjustment of industrial structure and product structure, but also to reach efficient allocation of resources. Seeking the development under the economic globalization, through

mergers and acquisitions, become the inevitable choice for enterprise development.

2.3. Performance management

Performance refers to the behavior and results of the work of employees in the job, reflected employees' all comprehensive factors such as skills, abilities, and their contribution to the organization and value.

Performance management is a process in order to achieve organizational goals more effectively, that performance management specialists use human resource management knowledge, technology and methods together with employee do performance plan, performance communication, performance evaluation, performance feedback and continuous improvement of organizational performance.

2.4. Balanced Scorecard

Balanced Scorecard (BSC) is a set of ideas and methods of performance appraisal indicators proposed by Harvard University professor Robert Kaplan and Renaissance Worldwide Strategic Group President David p. Norton after one-year project research to 12 leading companies of United States in performance assessment such as General Motors, DuPont, Hewlett Packard, called "one of the most important management practices over the past 75 years" by *Harvard Business review*.

BSC is a combination of strategic management and performance management strategy performance management system, which breaks the traditional performance management approaches that focus only on financial indicators, but through financial, customer, internal processes, learning and growth drive causality between the four dimensions indicators show the organization's strategic trajectory, and achieve performance appraisal - Performance Improvement as well as the implementation of the strategy - strategic amended target. Assessment has a very important significance for M & A enterprises, and performance evaluation can clearly understand whether the purpose of mergers and acquisitions, compliance with the enterprise development strategy and implementation of the strategy.

3. M&A Status of Internet companies

Since the 1970s, the world has set off a wave of mergers and acquisitions, achieved operational and financial synergies, for themselves opened up a broader space for development. Since the 1990s, the domestic M&A activities has become a strategy-oriented restructuring often choose between enterprises.

With the arrival of the information age, the Internet is increasingly important in economy development, and M&A is a necessary way for the development of enterprises. China M&A Market Statistics & Analysis 2012 shows that from 2007 to 2012, the announced transactions of Chinese M&A market is on a steady rise, has increased to \$ 307.79 billion in 2012 from \$ 103.47 billion in 2007, accumulated growth rate rose to 197%. In 2012 the Chinese M&A market completed deals with 2458

cases, among them, the Internet significant increase in trading volume of M&A, the highest level for ten years to the amount of Internet M&A transactions for the same period. From the transaction size distribution, the Internet financing scale ranked second by reaching \$14.03 billion, accounting for 11% of the total.

Internet companies in China beginning in 1998 for a series of mergers and acquisitions, has some of the same characteristics with the traditional industry, such as the fierce competition in M&A, employee turnover problem in M&A, but at the same time, there are its characteristics, such as the small number of transnational M&A, the potential value of the M&A side, M&A in overseas listing enterprises, mergers and acquisitions tend to diversification, Internet mergers involved traditional enterprises. At present, China's Internet enterprise M&A present foreign capital leads and frequent acquisitions of domestic enterprises. The market focus on horizontal M&A, vertical M&A increasing, which means that China's Internet companies are transforming from pursuing scale to the integration of industrial chains and diversifying. However, during the merger process, there are problems such as blind acquisitions, poor integration, lacking of M&A strategy, of which poor integration is particularly prevalent.

4. Analysis on performance of M&A of Chinese Internet companies based on BSC

M&A generally includes plans, transaction and integration of the three stages. Merger integration is a systematic project, relative to plans and transactions, is more complex and important. Numerous research and case studies shows that integration is the key to successful M&A, KPMG's global merger and business partner Jack Prouty summarized the seventy-seventieths rule from today's M & A phenomenon: 70 percent enterprise fail to achieve their desired business value after M&A, 70% fails due to integration after merger and acquisition management. Actually, successful merger integration can make up for losses caused by the improper target and the too high transaction price, while fragile merger integration will ruin the success of other aspects. Besides statistics indicate that Internet mergers succeed only a proportion of 23 percent, the relatively high failure rate mainly results from the failure of integration between acquisition and takeover enterprise. For this reason, the evaluation of corporate performance in the post-merger integration process is very necessary.

However, current M&A transaction is increasingly complex and increasingly widespread and the corporate strategy is increasingly clear, which form a new challenge to the previous mergers and acquisitions performance evaluation methods and indexes. But the balanced scorecard is an effective method and tools to solve the above problems, which is exalted enterprise strategic objectives, with multiple index comprehensive evaluation system analysis method combined with the strategy.

4.1 Financial dimensions

Financial dimensions of the balanced scorecard performance measurement indicators are mainly divided into three main areas: profitability, solvency and operation capacity.

Profitability is the ability to gain profit by the enterprise assets, often manifest as the size of the enterprise income amount or Level of income. The rate of return on total asset, net assets return and profit margin are commonly used indexes, and are the representative indicators of profitability, the higher these indicators show that the higher the efficiency of asset utilization, the stronger the profitability and the higher the level of assurance on the interests of corporate investors and creditors.

Solvency is the ability to show the enterprise to use their assets to repay the short-term debt and long-term debt. It reflects whether the enterprise can guarantee to repay maturing debt and determines the healthy development of enterprises. The indicators such as asset-liability ratio, current ratio, quick ratio, cash flow, debt ratio can well evaluate the solvency of an enterprise.

Operation capacity is to evaluate business operation ability, asset turnover and accounts receivable turnover ratio is representative indicators to measure the ability, which characterized with enterprises make full use of talents to increase the level of enterprise value.

For M&A companies, the first task is to the direction of corporate investment and development priorities, at the same time to overall resources configuration and control the balance of input and output, also need to clearly strengthen the integrated enterprise asset management, thus improving asset utilization.

On March 1, 2013 Youku Tudou Inc., China's leading Internet television company, announced its unaudited financial results for fourth quarter and fiscal year 2012, which was the first full quarter for the merged. The results shows that after the merger, the company's consolidated revenue in the fourth quarter of 2012 continued to grow. In the fourth quarter of 2012, the consolidated net revenues were 635.8 million yuan (US\$102.1 million), a 30% increase from the pro forma combined net revenues for the corresponding period in 2011. Consolidated gross profit was 116.3 million yuan (US\$18.7 million), a 62% increase from the pro forma combined gross profit for the corresponding period in 2011. Consolidated net loss was 113.6 million yuan (US\$18.2 million), a 43% decrease from the pro forma combined net loss for the corresponding period in 2011. In terms of cost structure, the fourth quarter results reflect early synergies resulting from the merger, especially in bandwidth and personnel related expenses.

In fiscal year 2012, Consolidated net revenues were 1.8 billion yuan (US\$288.2 million). Consolidated gross profit was 296 million yuan (US\$47.5 million). Consolidated net loss was 424 million yuan (US\$68.1 million). The revenue growth, largely due to merger synergies and economies of scale.

4.2. Customer dimensions

This dimension is to answer "how do customers see us". Customer is a profit source of modern enterprise, their attitude toward enterprises become the focus of concern of

the enterprise. The customer dimension indicators of corporate performance evaluation, mainly select and design from market competition, customer satisfaction, and other aspects.

For market evaluation, there are three main indicators, respectively for the customers, sales growth and market share rate. Customer satisfaction is the direct evaluation of the product or service provided by the customers. Customer satisfaction, customer loyalty and customer complaint rate are three main indicators of evaluation of customer. Of course can also be supplemented by other indicators, such as customer retention rate and the level of customer profitability, sales of the target market (or market share), and the rate of new customer development and profitability.

For Internet companies after the merger, re-analysis the customer lies first, as the internal and external situation changes, the company's target customers and strategic customers may great changes, therefore, it's necessary to re-clear the target customers and repositioned customer value, then analysis the company's existing market, customer and product, and form integrated solutions of market, customer and product, creating value through synergies in customer's perspective.

Due to Youku and Tudou are two video website in strong homogeneity, therefore, the merger between Youku and Tudou undoubtedly belongs to a horizontal merger.

The horizontal merger between the two sides makes it immediately to eliminate the most threatening competitors, reduce unnecessary internal friction, and occupy an absolute advantage in market share, as the new company brings market forces. Youku, Tudou announced that after the merger, the two platforms covering almost 80% of video users, daily play amounted to 400 million.

In the process of merger, both sides follow the principle of "ancestor of things, and orderly", to optimize the business adjustment, the crucial of which is through advertising background, two web sites on the overlap and waste are resolved, to arrive synergy in user coverage, frequency, advertising, effects and create greater value for advertisers and return. Up to the fourth quarter of 2012, Youku Tudou Inc. had approximately 480 advertisers, the average quarterly advertisers invested about 1.5 million yuan. Youku Tudou Inc. gets the recognition and attention of domestic and foreign advertisers.

4.3. Internal processes dimensions

The internal processes dimensions focus on the core competitiveness of enterprises, to answer "What is our advantage?". Actually, whether delivery to the customer on time and create profit for our customers, all are based on enterprise's internal business.

Enterprises should select out those business processes which have the greatest impact on customer satisfaction (including factors affecting the timing, quality, service and productivity), to clear their own core competitiveness, and put them into a specific evaluation indicators. Internal processes is the focus of companies to improve business performance, which makes to be important to note that staff group structure, more attention should be paid to protect backbone staff's enthusiasm. The integration of the

departments must adhere to a high level of development direction and both the original characteristics of each unit.

Management cost, financial cost, as expenses for the period, to a certain extent, the growth rate of changes reflects the efficiency and risk of internal operations, so the growth rate of management expenses, management fees accounted for sales revenue ratio and growth rate of financial expenses is the representative indicators of this dimension. Additionally, product life cycle and product qualified rate are auxiliary indicators to measure this dimension.

In fiscal year 2012, in content costs of Youku Tudou Inc., the cost of comprehensive content is 258.2 million yuan, accounting for 41% of overall revenue, keep balance basically with the same period in 2011. The difference is that the company tries to diversify content cost structure optimization, further reducing the dependence on copyright content, increased the content of homemade spending, greatly improving the ability to resist risks and differentiation competitive company.

In 2012, the cost for comprehensive purchasing fixed assets and equipment amounted to 90.2 million (\$14.5 million), Comprehensive purchasing intangible assets amounted to 362 million yuan (\$58.1 million). Consolidated operating expenses in the fourth quarter of 2012 was 245 million yuan (\$39.3 million), compared with 2011 consolidated operating expenses are expected for 273.4 million yuan (\$ 43.9 million), a reduction of 10% in the same period. The cost reduction is mainly from lower bad debt charges, from the merger of Tudou cause traffic cost reduction, comprehensive sales and marketing and advertising costs a one-time from cost outcome for comprehensive content costs.

4.4. Learning and growth dimensions

The goal of this dimension is to solve this kind of problem like "whether we can continue to improve and create value?" Only constantly to develop new products, create more value for customers and improve management efficiency, enterprises can enter a new market, ultimately increasing dividend and shareholder value. Learning and growth dimensions mainly reflect the company's innovation ability and its success rate, while research and development expenses are important indicators to measure the innovation capability of enterprises, so the growth rate of R&D and the rate of sales income can be used as a representative indicator of this dimension. Rate of successful innovation is the auxiliary indicators to measure this dimension.

Consolidated product development expenses of Youku Tudou Inc. were 64.1 million yuan(US\$10.3 million) in the fourth quarter of 2012, as compared to 44.6 million yuan (US\$7.2 million) of the pro forma combined product development expenses for the corresponding period in 2011. The growth mainly from areas such as wireless, search, social networking, and pay the personnel-related cost increases.

5. Conclusion

The balanced scorecard as a new performance

evaluation system, including not only financial indicators, but also the customer dimension, internal processes and organization innovation and growth for business metrics. For the M & A business on the Internet industry, it is feasible to use the balanced scorecard for performance evaluation, the new company after the merger can quickly integrate imperfect areas and take appropriate measures to strengthen the operation of these areas. However, application of the BSC to the M & A performance management is a complex task, of which the biggest problem is that in addition to financial indicators, most of the other scoring indicators are lack of accurate and reliable analysis of data. Therefore, it is necessary to set those important indicators and detailed plan to track before the merger.

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Vitae

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