

An Analysis of the Risks and Rewards of Merger and Acquisition Strategies in the Gaming Industry

Jianze Xie^{1,a,*}

¹*Nord Anglia Chinese International School Shanghai, Shanghai, 201107, China*

a. j_xie@nacis.cn

**corresponding author*

Abstract: In the dynamic landscape of the gaming industry, companies strive for growth and competitiveness through strategic means, including mergers and acquisitions (M&A) for diversification. This paper examines the risks and rewards inherent in such strategies, focusing on their implementation within the gaming sector. Through case studies like Microsoft's acquisition of Mojang and Activision Blizzard's purchase of King Digital Entertainment, it explores the complexities of M&A diversification and its impact on long-term gains. Drawing from literature on M&A theories and diversification strategies, it delineates the nuances of M&A execution and integration, crucial for success in the fast-paced gaming environment. While successful diversification can lead to market expansion, technological advancement, and risk mitigation, failures like Activision Blizzard's struggle with King Digital Entertainment underscore the importance of strategic alignment, resource integration, and market foresight. By dissecting these cases, this paper offers insights for industry stakeholders to navigate the challenges and capitalize on the opportunities presented by M&A diversification in gaming.

Keywords: Mergers and Acquisitions, Diversification Strategy, Gaming Industry

1. Introduction

In the current fast-changing gaming market, companies are under constant pressure to find ways to grow in order to remain competitive. A mergers and acquisitions (M&A) diversification strategy, as part of a company's strategic planning, can not only help a company to rapidly expand its market share, but also help it to gain access to new technologies and resources. However, the success of M&A activities relies on the integration and foresight of the strategy, which is particularly prominent in M&A activities in the gaming industry. Because the gaming industry tends to be highly innovative and have rapidly changing market dynamics, firms need to constantly innovate and evolve to adapt to the rapid changes in the industry. This study focuses on exploring the implementation of M&A diversification strategies in the gaming industry and the challenges and opportunities they present. By analyzing case studies such as Microsoft's acquisition of Mojang and Activision Blizzard's acquisition of King Digital Entertainment, it provides insights into the effects of M&A diversification strategies. Through these analyses, it aims to provide insights for academics and practitioners to understand the application of M&A diversification strategies in the gaming industry and to suggest effective management and implementation recommendations for successful M&A activities.

2. Literature Review

In the literature review examining M&A and diversification strategies in the gaming industry, it is first necessary to understand the basic theories of M&A activities and how diversification has been applied in the gaming industry to enhance competitive advantage and mitigate business risks. In corporate finance, M&As are often viewed as a way for firms to grow and expand rapidly. According to Jensen and Ruback's study, through M&A, firms can realize economies of scale, reduce competition, and gain new market share [1]. In addition, Haspeslagh and Jemison emphasized that post-merger integration is the key to a successful M&A strategy, and that the success of integration directly affects the final value of the M&A [2]. In turn, diversification investment strategies can be categorized into two types, one related and one with unrelated. Correlated diversification refers to the expansion of a firm into new areas that are related to its existing business, while unrelated diversification involves entering areas that are not related to its existing business. Rumelt found through his research that correlated diversification is more likely to create value than unrelated diversification because correlated diversification can better utilize a firm's existing resources and capabilities [3]. However, in the gaming industry, non-correlated diversification can sometimes be an effective strategy for risk diversification due to rapid technological developments and changes in consumer preferences.

It can be seen that the factors to be considered for M&A in the gaming industry are different from those in other industries. Due to its high reliance on innovation, including technological and design innovation, M&A is often used to acquire new technologies, expand product lines, enter new geographic markets, or increase market power. For example, Tencent's acquisition of Riot Games strengthened its position in global eSports markets such as the League of Legends series of leagues, which has a lot of buzz around the world, as well as the emerging Valorant series of tournaments. Another example is Microsoft's acquisition of Mojang (the developer of Minecraft). Such a strategy not only strengthens its gaming portfolio, but also enters the education market with the educational version of Minecraft, providing Microsoft with a technology and user base for market development.

3. Analysis

The M&A diversification strategy is one of the most important tools for companies to expand and increase their competitiveness in the market, with the aim of expanding their business scope, entering new markets or enhancing their existing business through mergers and acquisitions of other companies. This essay will focus on how this strategy is utilized in the gaming industry.

The theoretical basis of the diversification strategy can be traced back to Ansoff's product/market matrix, which suggests that firms can grow through market penetration, market development, product development and diversification. In particular, diversification strategies can be further subdivided into horizontal diversification, vertical diversification and pure diversification (unrelated diversification). One of these, pure diversification, refers to firms entering entirely new industries that are not directly related to the firm's current business, which is how diversification can help firms expand their markets in a significant way. Although a diversification strategy is often realized through M&As, it differs significantly from ordinary M&A acquisitions in terms of objectives and execution: in a diversification strategy, the goal is usually to diversify the company's risk or find new growth areas by entering completely new business areas. Such strategies may involve completely different industries and require companies to develop new markets and skills. General mergers and acquisitions, on the other hand, are more geared towards improving a company's ability to compete or increase its share in an existing market. These types of mergers and acquisitions usually involve the same or similar industries and aim to achieve economies of scale or market dominance.

Understanding the rationale for M&A diversification strategies requires analyzing a number of dimensions, including their motivation, the way they are executed, and the expected strategic benefits. The main motives for M&A diversification usually include economies of scale, economies of scope, increased market control, and risk diversification. Diversification is viewed as one of the strategies for firms to achieve growth through new markets and products, which appears in the Growth Matrix Theory proposed by Ansoff [4]. Through M&A activities, firms can quickly acquire new technologies, new product lines and new customers, thus accelerating their market expansion and product innovation. In addition, according to Porter's theory of competitive strategy, through M&A it is possible to establish a spectacular market position in a new industry and increase its control over the market through consolidation, thus improving its overall industry competitiveness [5]. In addition to this, mergers and acquisitions can help firms to reduce their dependence on a single market or product, thus protecting them from greater market risks during economic fluctuations.

Usually, careful planning and execution are required to effectively realize the diversification strategy of M&A and restructuring. First, firms need to select appropriate M&A targets. This is usually based on a comprehensive assessment of the target's financial performance, market position, technological capabilities, and strategic fit with the acquiring firm. As Jemison and Sitkin's study points out, successful M&As are often the result of a combination of strategic fit and organizational culture fit [6]. According to the absorptive capacity theory of innovation economics, the post-merger integration process is the most challenging part of executing a diversification strategy, and a firm's absorptive capacity determines the uplift it receives after a merger and acquisition, which determines the magnitude of the resources that can be accessed from the merging and acquiring firms. This stage requires an effective integration plan that includes cultural integration, integration of systems and technology, and optimization of operational processes. Haspeslagh and Jemison emphasize three main types of integration: "absorption", "preservation" and "fusion", which are applicable to different types of M&A situations [7]. In high-tech and fast-changing industries, such as gaming, rapid changes in technology and markets can lead to rapid devaluation of M&A targets. Dynamic market analysis and ongoing strategic adjustments are critical to sustaining the benefits of an M&A. A diversified M&A strategy that can help companies make the shift can be a good way to help them face these challenges.

The expansionary benefits of M&A and acquisitions based on diversification strategies can be discussed in several ways. At the market level, M&A strategies allow gaming companies to capitalize on the existing resources of the target company, including its brand power, user base, and market knowledge, to rapidly increase market share and help the company reach a broader user base and game genres. At the technology level, the strategy of acquisitions can help companies integrate complementary technologies and accelerate the process of product development and innovation. For example, by acquiring Insomniac Games, Sony not only obtained its unique technology in animation and graphic design, but also accelerated the development and promotion of new games by integrating Insomniac's innovative culture and Sony's resources. This technology integration has opened up additional gaming innovation opportunities for Sony, such as utilizing Insomniac's expertise to develop virtual reality games that enhance the player's immersive experience. This integration of new technologies has helped Sony to consistently deliver market-leading gaming products in the highly competitive gaming market. It can be seen that the diversification of technology allows for the diversification of products, and the diversification of products enhances the competitiveness of products and helps companies to expand their markets and further promote market diversification. Examining the case of Activision Blizzard's acquisition of King Digital, it can be seen that Activision Blizzard not only gained direct market expansion, but also utilized King's strong influence in the mobile gaming field to enhance the company's overall market diversity. This expansion is not only

limited to geographic expansion, but also includes horizontal expansion of products and services, enabling Activision to cover more game types and user needs.

The M&A diversification strategy is based on resource integration. Successful resource integration can enhance the flexibility and efficiency of the company in responding to market changes, and can make the company's competitiveness more flexible and diversified. In the case of Microsoft's acquisition of studios such as Ninja Theory, Microsoft strengthened its expertise in specific game areas (e.g., action-adventure) by pooling its high-quality game development resources. This focus and optimization of resources at the management level enables Microsoft to reduce time and costs in the product development cycle while maintaining high product quality standards. In addition, Microsoft combines its own original resources to promote game subscription services, using this approach to attract and retain users, quickly layout in new market trends, and strengthen user stickiness and brand loyalty.

From this, it can be seen that the diversification strategy based on resource integration can bring enhancement to enterprises in three aspects: technology diversification, product diversification and market diversification. Through the integration of the resources of mergers and acquisitions, continuous investment can bring long-term resources and technological enhancement for the enterprise.

4. Case Study

In 2014, Microsoft acquired Mojang, the Swedish game developer that developed the globally popular game Minecraft (My World), for \$2.5 billion. Minecraft is particularly well known for its broad appeal across all age groups, especially among younger users. This provides Microsoft with a unique opportunity to reach out to an established community with billions of hours of gameplay each year. Minecraft's extensive user engagement is integrated by Microsoft into its own platforms and services Windows and Xbox. By 2021, Minecraft had sold more than 176 million copies across different platforms, making it one of the best-selling ever game of all time. But it is versions such as Minecraft: Education Edition that best exemplify diversity in this case. As further developments by Microsoft based on Minecraft, these new products expand Microsoft's position in the education industry in terms of marketing and gaming.

Analyzed in terms of diversification, three levels can be summarized; diversification of technological innovation, diversification of products and diversification of markets. As a cross-platform game, Microsoft maintains and expands the feature of supporting multiple operating systems and devices, ensuring that the game is playable on platforms such as Windows, Xbox, PlayStation, iOS and Android. This not only increases the game's accessibility, but also strengthens the synergy between Microsoft's platforms, and the number of Minecraft users is no longer confined to a system with fixed operations, further increasing the number of players. With the advancement of technology, the diversification of technology acts on the product, Microsoft applies the technology in the field of AR to Minecraft, giving birth to Minecraft Earth. This diversified product utilizes augmented reality technology to increase user interaction experience, making the gameplay expand further. The launch of Minecraft: Education Edition made Minecraft no longer just an entertainment game, but also an educational tool, and this diversified product helped Microsoft to expand the education market and increase its influence in the field of education. Various derivatives of the game, such as Lego sets, toys, books and more merchandise, further enriched its product diversity, not only creating new revenue streams for Microsoft, but also deepening the brand's market penetration. Through the acquisition of Mojang, Microsoft strengthened its foothold in the gaming industry and has successfully extended the market reach and brand value of Minecraft through subsequent diversification of its products and services. Through this diversification strategy, Microsoft was able

to better capture the needs of different markets and consumer groups, thus enhancing its overall market competitiveness and brand influence.

In contrast, Activision Blizzard's acquisition of King Digital Entertainment is a negative example. The gains from this acquisition were quickly outlawed in the gaming industry due to strategic challenges resulting from a lack of true business diversification. The acquisition was completed in 2016 for \$5.9 billion, and Activision Blizzard originally intended to capitalize on King's strong position in mobile gaming to bolster the company's presence in this space. In the short term, the decision brought Activision Blizzard a huge number of mobile gamers thanks to King Digital Entertainment's technological expertise in the mobile gaming industry. However, this seemingly beneficial acquisition didn't end up boosting the company in the long run as expected, and the reason for this can be attributed to the monolithic nature of the business.

King Digital Entertainment is best known for its Candy Crush Saga franchise, which has a large player base and high market recognition worldwide. However, King's portfolio is highly concentrated, with little breakthrough in other types of mobile gaming. When player activity and revenue from "Candy Crush Saga" began to decline, King lacked other strong products to maintain its market position and revenue stream. In fact, the decline of "Candy Crush Saga" was not directly caused by the emergence of a single game, but rather by a combination of factors. Although there was no specific competitor that directly caused the decline of Candy Crush Saga, the rise of many similar match-3 games in the market diversified the choices of players, which led to the diversification of the original player base to other emerging games, such as Bejeweled, Bejeweled, Bejeweled, Bejeweled, Bejeweled, Bejeweled, Bejeweled, Bejeweled, and so on. Bejeweled, Township, and Gardenscapes, all of which offer similar gameplay mechanics to Candy Crush Saga, but with their own unique characteristics. While King has continued to update the levels and features of Candy Crush Saga to keep the game fresh and engaging, the core gameplay has not changed significantly over the years, while new games released by other game developers often contain innovative elements that are more appealing to players looking for a fresh experience. At the same time, advances in technology have led to newer ways of playing games, and with the rapid iteration of smartphones and mobile devices, players' gaming habits and preferences are constantly changing. Many players are turning to games that offer deeper gaming experiences, social interactions or AR/VR elements, and simple three-dimensional games are no longer as competitive as they once were. This was not helped by the two companies' resource consolidation strategy, which prevented Activision Blizzard from focusing its core business on massively multiplayer online role-playing games (MMORPGs) and first-person shooters, a far cry from King's lighter, more casual game design and marketing strategy. This difference led to significant integration hurdles in terms of operational efficiency, product development strategy and corporate culture between the two companies after the merger. In addition, King has maintained a high degree of autonomy since the merger, which, while helping to maintain its innovation and agility, has limited Activision Blizzard's potential for resource integration and synergies.

The case of Activision Blizzard's acquisition of King Digital Entertainment reveals the potential risks of a lack of true diversification and resource integration in an M&A strategy. Short-term benefits from M&A are not enough to sustain long-term gains in the rapidly changing gaming industry. The direct result of short-term benefits is inadequate resource integration. If companies are only satisfied with the short-term gains from M&A without sustained resource integration, they will eventually be eliminated in the fast-changing gaming industry.

5. Discussion

Studies have shown that while M&As can bring short-term financial benefits and market expansion, their long-term success relies on effective integration and true business diversification. This is in line

with Haspeslagh and Jemison who argue that post-merger integration is the key to determining the success of an M&A [7]. Integrating the technology and innovation resources of both parties and transforming the technology resources received into their own resources can only lead to increased innovation capabilities. This is in line with Cloodt et al.'s study, who believe that M&A is an effective way for firms to acquire new technologies and innovative capabilities, and the acquisition of these capabilities requires long-term bonding and training [8]. When doing M&A, then, enterprises should focus on how to use M&A to strengthen their innovation ability and inject new impetus for long-term development, and also focus on how to achieve long-term strategic goals through M&A, not just short-term financial growth. This is reflected in the case of Activision Blizzard's acquisition of King Digital Entertainment.

On the other hand, as far as diversification is concerned, even though diversified mergers and acquisitions can lead to expansion of markets and product lines, they may also introduce new risks. Uncertainty in the market and rapid changes in technology are important risk factors in the diversification strategy of mergers and acquisitions. The market demand in the gaming industry is volatile, and the emergence of new technologies may rapidly change the industry landscape. As mentioned by Dranove et al.'s study, technological and market uncertainty may lead to complex and risky business integration after M&A [9]. Most of the time this is emphasized in Kumar's study where he states that diversification M&A requires firms to have the ability to operate across industries [10]. Firms should carefully assess their core competencies and market conditions when adopting a diversification strategy to ensure that they can effectively manage the new business area. For example, Microsoft's decision to acquire Mojang adapted to its own business capabilities, allowing Mojang's resources and its own technology to complement each other, thus contributing to the success of Minecraft.

6. Conclusion

In the conclusion section of this study, it summarizes the application of M&A diversification strategy in the gaming industry and its impact on corporate strategy development. Through detailed case studies and theoretical discussions, it derives several key insights that not only contribute to theoretical research but also provide guidance for practical business operations.

Through the case study, M&A diversification can bring market expansion and technology acquisition to enterprises, and technological diversification promotes product diversification, which makes products more competitive and pushes enterprises to carry out market expansion, thus bringing technological growth and market diversification to enterprises. Effective integration of resources largely determines the success of an M&A. Case studies have shown that a long-term oriented strategy can lead to closer integration and better utilization of the strengths of both companies. M&A diversification is not only a short-term financial investment, but also part of a long-term strategic layout.

In summary, although the M&A diversification strategy has its obvious advantages in the gaming industry. To cope with the ensuing risks, enterprises should conduct in-depth market and internal analysis of both sides before M&A, formulate a thorough integration plan, and continue to optimize the management and operation after M&A, so as to maximize the access to the resources brought by M&A and give full play to the maximum value of M&A. Through this strategy, companies are not only able to expand into new business areas, but also maintain sustained growth and innovation in the highly competitive gaming market.

References

- [1] Jensen, M. C., & Ruback, R. S. (1983). The market for corporate control. *Journal of Financial Economics*, 11(1–4), 5–50.

- [2] Haspeslagh, P. C., & Jemison, D. B. (1991). *Managing acquisitions: Creating value through corporate renewal*. New York, NY: Free Press.
- [3] Rumelt, R. P. (1974). *Strategy, structure, and economic performance*. Boston, MA: Harvard Business School Press.
- [4] Ansoff, H. I. (1957). *Strategies for diversification*. *Harvard Business Review*, 35(5), 113-124.
- [5] Porter, M. E. (1985). *Competitive advantage: Creating and sustaining superior performance*. New York, NY: Free Press.
- [6] Jemison, D. B., & Sitkin, S. B. (1986). *Corporate acquisitions: A process perspective*. *Academy of Management Review*, 11(1), 145-163.
- [7] Haspeslagh, P. C., & Jemison, D. B. (1991). *The challenge of renewal through acquisitions*. *Strategic Management Journal*, 12(S1), 75-88.
- [8] Cloudt, M., Hagedoorn, J., & Van Kranenburg, H. (2006). *Mergers and acquisitions: Their effect on the innovative performance of companies in high-tech industries*. *Research Policy*, 35(5), 642-654.
- [9] Dranove, D., Shanley, M., & Simon, C. (1998). *Do mergers improve performance? Evidence from deregulated markets*. *Health Care Management Review*, 23(4), 9-22.
- [10] Kumar, R. (2009). *Managing risks in a post-merger integration process*. *Strategic Risk*, 22(1), 76-81.