

# ***The Acquisition Effect of Internet Enterprises and the Impact of Transactions: Taking Tencent's Acquisition of Sogou as an Example***

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**Abstract:** As the number of people using the Internet is increasing, and the competition between Internet companies is more intense. Rapid technological innovation and more efficient talent requirements have made acquisitions the main way for Internet companies to improve their overall strength. This paper uses the literature review method and the comparative research method to analyze the case of Tencent's acquisition of Sogou. The study covers the connections and conditions of the two companies prior to the acquisition and the possible impact of the transaction on Tencent after the acquisition, in order to comprehensively evaluate the value of the transaction and make recommendations to Tencent for future development. This article mainly finds that Tencent can use the value that Sogou brings to Tencent to strengthen these advantages and develop new Internet revenue channels, but how to integrate these resources has become the focus of Tencent's next development. The significance of this research is to evaluate the transaction based on data and relevant literature and put forward theoretical suggestions to help Tencent and relevant investors make decision-making suggestions and development plans. The innovation point of this paper is to take the logic of time as the research idea and make a comprehensive judgment from the effect after the acquisition and before the acquisition, and the conclusion is more specific and more reliable. This article suggests that Tencent's leaders should rationally integrate and use Sogou's resources, which is an opportunity and a challenge to expand the company's capital.

**Keywords:** Tencent, Sogou, Internet, opportunity, challenge

## **1. Introduction**

### **1.1. Research Background**

Today's era belongs to the era of the Internet, and Internet products have involved all aspects of our daily lives. Based on China's huge population advantage and the blessing of 4G technology, Internet technology and market have become the world's top existence. According to the data from Statistical report on Internet development in China, in recent years, there have been more and more Internet users in China, and the growth has increased exponentially almost every year [1]. There is no doubt that China has become a treasure trove for the growth of the Internet. The Internet has had a profound impact on daily life, industrial manufacturing, commodity import and export, etc., which also forces

Internet companies to need more mature technology and innovation capabilities. This has also greatly accelerated the M&A development and M&A opportunities of Internet companies. The development potential of China's Internet market is still huge.

However, Tencent, Alibaba, and Baidu, as the three leaders in China's Internet play market, have a more profound impact on our products including shopping, search, music, video and so on. In China, according to data released by CNNIC, the three most popular social software are WeChat, QQ and Sina Weibo, while the usage rate of WeChat has reached 80%, QQ has reached 60%, and Weibo has increased to 40% [1]. Among them, WeChat and QQ are both products researched and developed by Tencent. These data are enough to show Tencent's position in the minds of the majority of netizens and its unshakable position in the Chinese market. On the other hand, search engines are also an indispensable category in the Internet. According to the data, the number of search engine users in China has exceeded 700 million, accounting for 80% of mobile phone users [2]. This development trend has also directly promoted Tencent's mergers and acquisitions in the search field, and also promoted Tencent's acquisition of Sogou, a meaningful transaction. Tencent's foundation in the search engine field is relatively weak, but Sogou has a research history of 17 years [2]. On September 24, 2021, Tencent and Sogou completed the merger, and Sogou officially became an indirect subsidiary of Tencent and completed its delisting.

## **1.2. Purpose and Significance of the Study**

The purpose of this article is to analyze the acquisition of Sogou by Tencent, how Tencent has achieved a higher status in the search field and the impact of this event on Tencent, and to analyze the opportunities and challenges brought to Tencent by this event, in order to explain the changes in Tencent's position in the Chinese search engine market after the completion of this transaction. By analyzing the pre- and post-stage of the transaction, we can determine why this acquisition has had an impact on the entire Chinese search engine market and analyze the significance and impact of this transaction on Tencent and Sogou.

## **1.3. Structural Arrangement**

Starting from the relationship between Tencent and Sogou, this article analyzes the purpose of Tencent's acquisition of Sogou from both internal and external perspectives. Using the SWOT theory analysis model, the transaction is interpreted from multiple perspectives. Finally, the financial data before and after Tencent's acquisition is used to compare its financial changes, and then combined with the SWOT model analysis conclusions used before to draw conclusions and summarize the situation after the acquisition.

# **2. Origin and Motivation of the Acquisition**

## **2.1. Origins**

In 2013, Sogou received a tender offer from 360, but at Sogou's development stage at that time, Sogou judged the deal to be a hostile takeover. In order to solve this difficulty, Sogou sent a letter of help to Tencent. Tencent acquired a 36.5% stake in Sogou for US\$448 million, becoming one of Sogou's largest shareholders, but the deal also created a potential opportunity for Tencent to acquire Sogou in 2021[3]. Tencent also created its own self-researched search engine, SOSO, but SOSO did not bring Tencent the results it wanted, so in this transaction in 2013, Tencent not only used 448 million US dollars as consideration, but also dismantled related assets and technologies to Sogou as a condition to become one of its largest shareholders.

Ma Huateng, chairman of Tencent, pointed out that the basic logic of Tencent's investment is that in addition to communication social and content, everything else is handed over to partners. Tencent will not pursue a controlling position, or even require a large shareholder, but will invest by holding a small percentage of shares [3]. After that, Sogou took advantage of the investment advantages previously gained in Alibaba, as well as the capital conditions and technical support of Tencent's stake and became one of the largest search engines in the Chinese market.

## 2.2. motivation

### 2.2.1. Internal Motivation

The first aspect is that Tencent aims to increase mobile traffic and traffic monetization capabilities. According to Metcalfe's law, the value of a network is equal to the square of the number of nodes in the network, and the value of the network is proportional to the square of the number of users connected to the network [4]. Tencent is an Internet company, and its profitability mainly depends on its ability to attract customer traffic and constantly update its products. So far, Tencent's traffic monetization methods mainly rely on the huge user base accumulated by QQ, and the means to monetize traffic through game platforms and B2C business platforms are relatively single. Expanding traffic monetization channels has become the most important thing for Tencent [4].

Secondly, Sogou not only has a relatively stable market position in the field of search, but also Sogou also has a series of Internet products such as Sogou Music and Sogou Input Method. Tencent can use this to expand its own Internet products. Use this advantage to develop your own new income model to expand your capital gains.

Finally, the Internet industry has a fast pace of technological updates and a short product life cycle, so the requirements for the technical level are very high. Therefore, the acquisition of external resources in the whole process has become the main reliance of Internet companies to maintain updated products. If Tencent, which relies on the development of the PC side, wants to maintain its competitive advantage in the Chinese Internet market, it must complete the update and improvement of technology and personnel in the shortest period of time. In addition, Tencent has a mature profit model and structure (please see Figure 1), which mainly focuses on online games (29%), social networking(21%), online advertising(19%) and fintech and corporate servicing (28%).

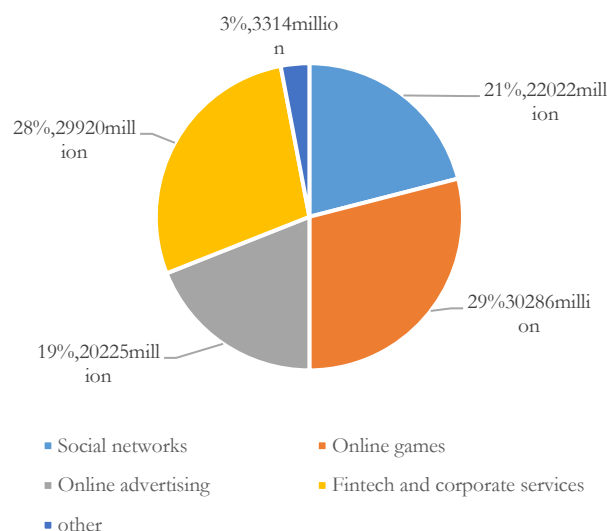


Figure 1: In 2019 Q4, Tencent's main sector revenue accounted for a proportion.

Data source: Sina Technology/ Photo credit: Original

Therefore, the acquisition has become the best choice for Tencent to achieve this goal. At the same time, it has to be mentioned that Tencent has greater ambitions in the Internet field and is likely to participate in AI technology in the future to upgrade Tencent's various Internet products. The acquisition of Sogou also provides more efficient development conditions for Tencent's grand Internet development strategy.

### 2.2.2. External Motivation

According to data released by the government, by the end of 2020, China's Internet users reached nearly one billion, becoming the country with the largest number of Internet users in the world. In recent years, there have been more and more Internet users in China, and the growth has increased exponentially almost every year, from 73125 million in 2016 to 98899 million in 2020 (please see Figure 2).

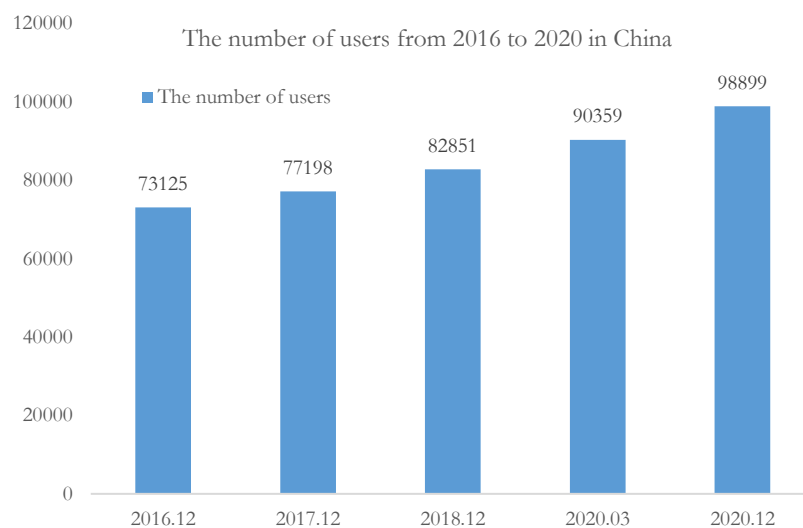


Figure 2: The number of internet users between 2016 to 2020 (in million).

Data source: Statistical report on Internet development in China / Photo credit: Original

The Internet industry has become the trend industry of the times, and Internet acquisition is also the most effective and fastest means of operation born in this environment. It also indicates that China's Internet market has great potential opportunities and competitive pressure.

More and more new Internet companies have begun to continuously launch their own products and seize Tencent's Internet market, such as Douyin, Kuaishou, etc., which has brought great pressure to Tencent [4]. Tencent needs to continuously absorb customer traffic to consolidate its market position and competitive advantage, which is what Tencent must do in the external competition.

## 3. SWOT analysis

### 3.1. Strengths

In 2020, Tencent's WeChat launched the expansion of search business, and more than 20 kinds of information such as official accounts, games, and medical treatment were included in the scope of WeChat search. However, compared with the huge search volume of Baidu (766 million) and ByteDance (1.9 billion globally) from Sina Finance, there is still a big gap. However, compared with Baidu, Tencent is involved in a wider range of businesses, such as: Tencent Video, Tencent Music,

QQ and other Internet products that are familiar to zero people and can attract huge traffic. These products will become Tencent's advantage in the search field [4]. Tencent has become the Internet company with the widest range of business and the highest usage rate of Internet products in the Chinese market, and the huge user group is the biggest card for Tencent to break Baidu's monopoly in the search engine field.

Tencent can use a large user carrier to make a more detailed side description of the pushed content, in order to push content that meets the user's taste to users more accurately. Through this method, Tencent will retain the usage rate of users and maintain the freshness and dependence of users on Tencent's Internet products. And after the acquisition of Sogou, Sogou's technical conditions and user traffic in search engines can be used to enhance the search engine capabilities, with the aim of broadening the scope of its search engine application and traffic monetization ability.

### 3.2. Weaknesses

Tencent's main weakness lies in users' habits and ways of using software. For most people, when users want to search for some information, the first thing that comes to mind is to open the search software, and the WeChat search promoted by Tencent is often ignored. Tencent does not yet have a search engine software with wide attention, and in most cases, in the Chinese market, the first search software that comes to mind is Baidu. Although Sogou is the third largest search software in China, its market usage accounts for only 1.3%, and the third largest is Shenma Search with 2.2%, while the aforementioned Baidu accounts for 94.72% (please see Figure 3) [5]. This very exaggerated gap also shows Baidu's position in the Chinese market and the habits of Chinese users for search engine software. Although Tencent has extremely large Internet traffic and has obtained Sogou's advantages in all aspects, it has become Tencent's biggest challenge and weakness to change users' usage habits to compete with Baidu in the field of search engines.

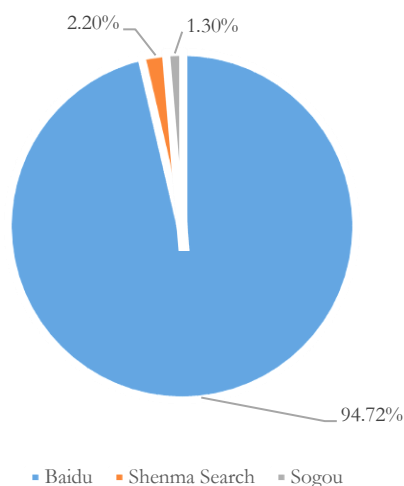


Figure 3: The proportion of search engines in the Chinese market.

Data source: Zhihu column/ Photo credit: Original

### 3.3. Opportunities

For Internet companies that can monetize advertising, search is extremely valuable [4]. When users use search engines, it is equivalent to telling them about their needs in certain aspects. Internet companies can use this information to push relevant products to customers, and if they meet the needs of customers, then customers will place orders on the platform and realize the possibility of

monetizing advertising traffic. Big data push has undoubtedly become the most efficient way to monetize ads and traffic. However, Tencent itself has an extremely large customer traffic, and only needs to solve the problem of information use and push, and it has a great opportunity to expand its own revenue scale. After the acquisition of Sogou, these problems can also be solved. From the perspective of Sogou itself, Sogou's main business is the search engine business based on big data. This provides Tencent with many opportunities in terms of traffic monetization and user data push.

In addition, Sogou has industry-leading technical conditions in intelligent, multi-dimensional collection and mobile applications. Tencent's platform traffic is huge, coupled with its large-scale stable service and bandwidth infrastructure. Tencent can use Sogou's advantages in these areas to develop its own other business sectors, with the aim of building a series of Internet systems that belong to Tencent. This will involve not only industries that already exist such as video and games, but also new businesses such as input methods and search engines. This is in line with Tencent's development plan and strategic ambitions. This acquisition provides an opportunity for the ambitious goal of "building a complete Internet ecosystem"[6]. And through the integration of Sogou's technology and customer resources, it provides competitiveness and opportunities for competition with Baidu in the field of search engines. iMedia consulting analysts believe that other players (outside Baidu) are using new technologies and services to continuously improve product experience, and the gap with Baidu is narrowing [3].

### 3.4. Threats

In recent years, not only Tencent has begun to deploy in the search engine field, Alibaba, ByteDance have produced a series of business plans in the search field. Coupled with Baidu's dominant position and resource conditions in the search engine field, if Tencent wants to achieve achievements in the search engine field, it will face not only the pressure of its old rivals, but also the great challenge of new Internet forces. Now the software operating model in the Internet field is very mature. Mobile messaging business Tencent is undoubtedly the most advantageous, WeChat and QQ have become the main choices for Chinese Internet users. In terms of online shopping, Alibaba's Taobao is the leader. In the field of search engines, Baidu undoubtedly occupies the largest market share. ByteDance, a new Internet company, has become a monopoly on short videos [3]. This distribution of the Internet industry has reached a balance, and the opportunity for other Internet companies to share the market with these Internet companies is still relatively small. However, although Tencent can have a lot of advantages and support in acquiring Sogou, this does not mean that other Internet companies will bring less threat to Tencent.

Second, China's capital market restricts monopoly far more than capital markets in other countries. Since December 2020, relevant authorities have classified the concept of "anti-monopoly" as one of the eight key economic tasks in 2021 [7]. It is well known that in the Internet industry, Tencent receives the most anti-monopoly fines. The threat of interference and restrictions at the government level is irreversible, which will also lead to Tencent being limited in its own areas of strength. In other words, Tencent must not only compete with other Internet companies, face the threat of technological and market expansion brought by them, but also intervene by local government departments in the monopoly trend caused by possible commercial expansion.

Finally, the Internet industry has strong product iteration, fast technological innovation, product life period, strong substitution, and it is extremely difficult to maintain its own technical advantages [8]. Even Internet giants such as Tencent will inevitably encounter problems in this regard. If these problems are not solved quickly and efficiently, then they may face the embarrassment of being replaced in one area (Figure 4).





Figure 4 Industrial distribution in China's internet field (representative companies).

Photo credit: Original

#### 4. Tencent's Situation after the Acquisition

After Tencent acquired Sougou, it integrated Sougou's technology, personnel and market customer groups in related fields. According to the financial report, Tencent's online advertising revenue in the first quarter of 2021 was 21.8 billion yuan, a year-on-year increase of 23%; In the Q2 quarter of 2021, online advertising revenue was 22.8 billion yuan, a year-on-year increase of 23% [9]. From the data point of view, Tencent after the acquisition of Sougou, combined with its big data advantages, is formulating corresponding push plans for different target customer groups, with the blessing of Sougou's mature big data push technology, Tencent has a strong improvement in online advertising monetization capabilities.

Compared with QQ, it is obvious that WeChat will now be favored by more Internet users, and the combination of Sougou search and WeChat search has become Tencent's focus in search engines. However, the integration of resources between Sougou and WeChat search is still a problem that Tencent still faces. On the one hand, it is necessary to make Sougou search's technology reflected, on the other hand, the integrated user experience is also a key point, especially the balance between user experience and advertising business.

The change in the input method is also extremely obvious. In 2021, Zhang Xiaolong, the head of the WeChat section, launched the WeChat input method when he already had Sougou input method, in order to ensure the security of WeChat users in terms of input content. And Zhang Xiaolong made it clear: "We never analyze users' chat records, even if they lose a lot of advertising revenue." So, when our technical team, the team of machine semantic understanding, says that we might do better by doing input methods ourselves, of course I'm in favor of it. "However, whether it is necessary to strengthen the promotion of WeChat input methods and how to solve the balance between the two input methods is still a problem that Tencent must consider."

After the merger of the two companies, Sougou's big data information technology also had a positive impact on Tencent's information flow business. As of the first quarter of 2021, Tencent's daily active users have reached 240 million, and the number of contents consumed daily has reached 9.6 billion [9].

The integration of enterprise resources of large Internet enterprises is very complex and cruel, and if the integration is not good, they will face the situation of enterprise failure. Such negative conditions are very compensative, such as: shrimp and daily sound. We cannot determine whether Sougou will

continue to exist in a separate form in the future, but regardless of the outcome, it is the most important thing to ensure Tencent's own interests. In this acquisition transaction, Tencent pays more attention to the synergy between Sogou and Tencent. Whether Sogou's contribution to Tencent can become a puzzle piece and help for Tencent's business sector has become a top priority [10]. With Sogou's strong search engine, Tencent's online advertising business is also more attractive. In the Q2 quarter of 2014, Tencent's online advertising revenue was only 2.064 billion yuan, and in seven years, Tencent's single-quarter advertising revenue exceeded 20 billion yuan, a growth rate of nearly 10 times [9]. It can be seen that in this sector, Sogou has brought many benefits to Tencent.

## 5. Conclusion

Overall, judging from the current data performance, Sogou has indeed brought a lot of benefits to Tencent. Sogou's strong technical support has helped Tencent provide great help in information consultation and advertising monetization capabilities. Tencent has also used the advantages of these big data technologies to update its ability to drive and paint a portrait of customer preferences. Sogou's contribution to Tencent in this regard can be reflected from the advertising monetization data. Input method is also a topic that has to be talked about, although there are still many unknowns about whether Tencent has the ability to balance WeChat input method and Sogou input method. If Tencent wants to occupy more market position in the input method market, the technical capabilities of Sogou input method will also provide Tencent with a lot of help.

But there are still many problems and challenges that need to be addressed. Industrial resource integration is one of them, and if Tencent does a good enough job in this regard, the possibility of competing with powerful Internet companies such as Baidu to seize the search engine market position will also increase. In addition, there are anti-monopoly sanctions that they have to face, and if Tencent wants to continue to do business in its advantageous industries, then this is the problem they have to face. Although the impact of relevant regulatory bodies cannot be avoided, Tencent can mitigate the harm to enterprises in this regard through effective commercial means. Especially after the acquisition of Sogou, there is no doubt that Tencent has once again become the focus of relevant departments.

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