

Discuss the Motivations and Risks Behind Microsoft's Acquisition of Activision Blizzard

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Abstract: With the rapid growth of the gaming sector and advancements in technology, the global gaming market has reached unprecedented heights, capturing the attention of millions worldwide. Simultaneously, the concept of metaverse has become a topic of intense discussion, holding the promise of transforming virtual experiences. This paper study thoroughly examines Microsoft's strategic move to acquire Activision Blizzard, scrutinizing its multifaceted impact from various perspectives. Motivated by the pursuit of synergy effects, market expansion, and preparation for the metaverse, Microsoft aims to harness the potential of Activision Blizzard's intellectual properties and fortify its gaming portfolio, potentially positioning itself ahead of Sony in the fiercely competitive gaming console market. Nevertheless, the integration of diverse corporate cultures and the ever-present specter of antitrust scrutiny pose significant challenges on the horizon. This compelling case study offers invaluable insights into the decision-making processes of major corporations, shedding light on the intricacies of the dynamic gaming industry and the unfolding metaverse landscape. As the gaming realm and technology continue to thrive, this landmark acquisition becomes a pivotal example in understanding and navigating strategic business decisions in the rapidly evolving digital era.

Keywords: M&A, metaverse, gaming industry, synergy

1. Introduction

Microsoft is a leader in the computer software industry and has also launched the Xbox series of gaming consoles, operating Xbox Game Studios that brings together multiple developers to create first-party games.

Activision Blizzard is a leading video game publishers over the world, with an estimated \$8.8 billion in revenue in 2021. Activision Publishing, Blizzard Entertainment, King, Major League Gaming, and Activision Blizzard Studios are the company's five business segments. American tech giant Microsoft officially announced its acquisition of American gaming company Activision Blizzard by approximately \$68.7 billion cash, at a price of \$95 per share on January 18, 2022. This acquisition set a record as the most expensive deal throughout history of the technology industry and the third largest in the entertainment industry. Microsoft becomes the world's third-largest gaming corporation with this acquisition, after only Tencent and Sony, and adds millions of additional active gamers while absorbing a substantial portfolio of high-quality intellectual property. The news caused

a seismic impact on the industry, with Sony's stock price experiencing a 13% drop on the following day, signifying the magnitude of the "industry earthquake." [1].

Based on the historical context mentioned above, this paper will explore Microsoft's acquisition of Activision Blizzard from different perspectives, including the motivations and strategic goals behind the acquisition, the business ecosystem of the gaming industry, and the existing risks involved.

2. Acquisition Motivation and Strategic Goals

2.1. Obtaining Synergy Effects

A synergy-driven merger occurs when two organizations combine to obtain greater efficiency or scale. The anticipated synergies from such a combination can be ascribed to a variety of causes, including improved revenue, combined skills and technology, and cost savings [2]. Horizontal mergers and acquisitions allows the new firm to increase efficiency while decreasing market rivalry, and minimize the costs of training new staff, all of which contribute to reaching economies of scale. [3]. Microsoft's acquisition of Activision Blizzard will lead to an expansion of the gaming industry's landscape and enhance profitability in emerging markets. For example, Blizzard's games can be directly released on Microsoft's Xbox platform, reducing distribution and promotional costs. Leveraging Blizzard's high-quality IPs (such as World of Warcraft and StarCraft) and patents will improve user experience and strengthen Microsoft's market competitiveness. Microsoft will also gain the expertise of Activision Blizzard's game development, which will help them launch their own games. With Blizzard's IPs on the Xbox platform, it will attract many gamers, enticing more game developers to join the platform and reduce their marketing expenses. Consequently, the merged company is expected to generate strong synergies.

2.2. Expanding Market Share

According to Figure 1, in 2022, PC games accounted for only 19% for Boxed PC games and 1% for Browser PC games, while console games constituted 27% of the market. In contrast, the value created by mobile games in the global market surpassed half of the total gaming industry output, reaching 53% [4]. Activision In recent years, Blizzard has grown to be the world's leading gaming companies., and its subsidiary, King, has the potential to grow Microsoft's foothold in the mobile gaming sector. King, known for developing the highly popular casual puzzle game "Candy Crush," has consistently ranked among the top games on the iOS charts in the United States [4]. With the inclusion of King's studio under its umbrella, Microsoft is poised to further increase its influence in the mobile gaming sector.

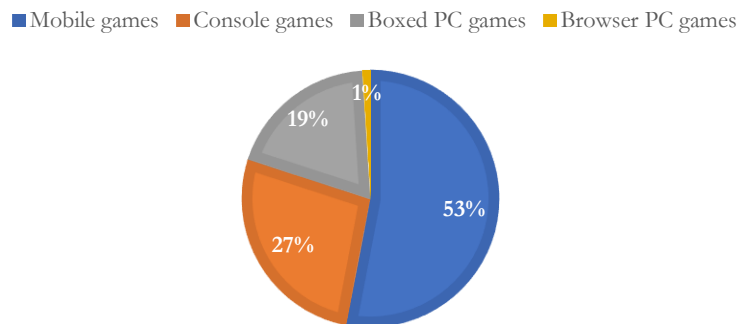


Figure 1: Global market share in 2022.

(Data source: [4]/Photo credit: Original)

As technology advances, more and more devices can store bigger amounts of high-quality game data. The advent of cutting-edge technology, such as VR and AR technology has rekindled debates over the "metaverse," a term widely used in the gaming world [5].

For Microsoft, building the metaverse would bring tremendous benefits. At its core, the metaverse is closely related to gaming, focusing on prioritizing user experience [5]. A good user experience leads to monetization, creating a virtuous circle. Microsoft has a complete gaming presence that includes hardware platforms, game content development platforms, industry distribution channels, and cloud platforms. Activision Blizzard's robust game IPs and game development capabilities will complement Microsoft's shortcomings in game production and development. The acquisition of Activision Blizzard will help Microsoft overcome the content shortage on the Xbox gaming console and establish a more complete integrated gaming industry chain.

With Activision Blizzard joining Xbox, the high-quality gaming platform will become Microsoft's best testing ground for cutting-edge technology in metaverse development. Hence, by acquiring Activision Blizzard, Microsoft will significantly enhance their competitiveness in the metaverse market.

3. Business Ecosystem Analysis

3.1. Competitive Landscape in the Gaming Market Before the Acquisition

According to figure 2, it is evident that Sony currently holds a leading position in the global market with a market proportion of 45%. Nintendo and Microsoft have similar market shares, accounting for 28% and 27%, respectively [6]. Xbox currently is unable to compete with Sony and Nintendo in the console game market. Although supply for PlayStation 5 and Xbox series consoles improved in 2022, Nintendo is likely to keep its sales dominance, with the new Switch OLED fueling console sales [5]. Therefore, Microsoft needs strong game developers to improve its game reputation and expand its market share.

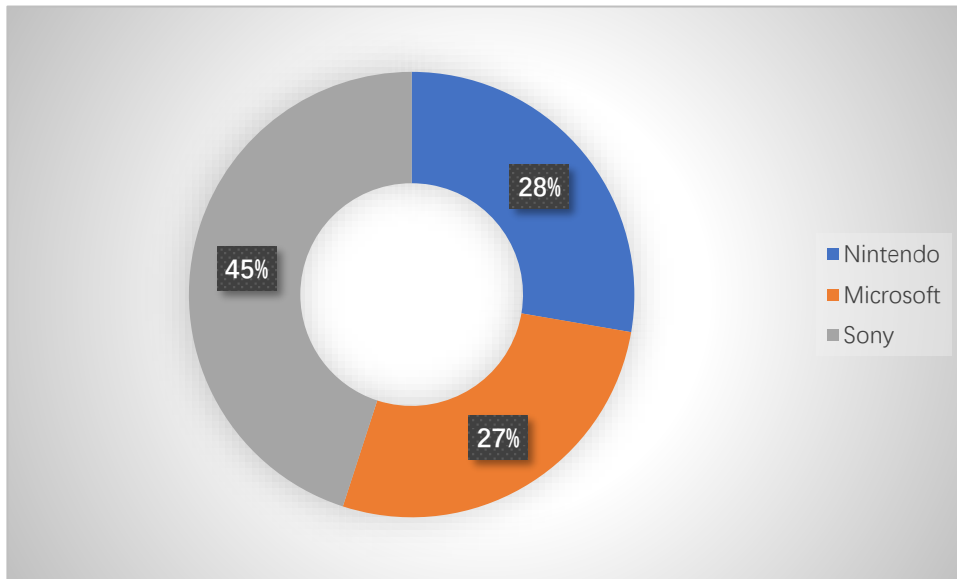


Figure 2: 2022 global console game market company share.

(Data source: [6]/ Photo credit: Original)

3.2. Competitive Outlook After Acquisition

Because of the strategic function of Xbox Game Pass (XGP), Microsoft has the potential to beat Sony and Nintendo following the acquisition. With XGP, their members can enjoy all Microsoft-owned games on the platform without having to purchase each game individually, significantly reducing the cost of playing games. Players no longer need to worry about wasting money on games they may not like. Additionally, the cost reduction is expected to attract new customers to the market, expanding Microsoft's customer base. XGP plays a crucial role in Microsoft's business strategy, enabling them to compete more effectively and gain a competitive edge in the gaming industry.

3.3. Financial Risk

The significant amount of intangible assets involved brings valuation risks and risks related to the liquidity of assets in a cash acquisition [1].

In addition, in a cash transaction, the acquiring company incur all of the risks associated with the anticipated synergies inherent in the acquisition premium [7].

According to the agreement, Activision will receive \$95 per share from Microsoft, and that is a premium of 45 percent over closing price of Activision on Friday, January 14 [8].

The subsequent investment by Microsoft in game development at Activision Blizzard may not always achieve the target profit expectations. This is because Activision Blizzard follows a game development approach that involves significant financial and time investments. However, if a game is unable to achieve their goal, they will not continue to invest in it, contributing to the company's prolonged game release cycles.

Furthermore, in recent years, Activision Blizzard's reputation has been declining, with many addicted players expressing disappointment in their games. These players believe that Blizzard's game quality is deteriorating. As a result, customers may question the future game quality from both Microsoft and Activision Blizzard.

These factors highlight potential risks for Microsoft in the post-acquisition phase, as they may face challenges in achieving the desired profit margins and maintaining a positive reputation in the gaming industry [5]. Therefore, in terms of financial risk, Microsoft needs to consider the acquisition at a 45% premium, as ultimately, Microsoft may bear financial losses due to the synergies not meeting expectations.

3.4. Managerial Risk

The strategic match between buyer and seller is another success element in corporate mergers [9]. Game studios are typically independent entities with their own general managers and profit and loss statements. They develop games of their own genres. Ramírez stated that, in general, studios tend to cultivate their own cultures. If a studio's culture includes inappropriate practices and the broader human resources team fails to actively address them, it could lead to issues [10]. Therefore, post-merger, whether the internal employee culture of the company can be unified will also be a factor that Microsoft needs to consider after acquiring Activision Blizzard.

3.5. Antitrust Risk

Over the years, Microsoft has faced another issue, which is the risk of monopolization. Activision Blizzard and other well-known gaming companies have been acquired by Microsoft. Microsoft faces the risk of being accused of antitrust violations by the federal government [5]. Microsoft's relationship with Activision Blizzard is not purely a vertical arrangement in the value chain, involving only upstream or downstream interactions. Instead, their association spans both vertical and horizontal

aspects, with involvement and overlaps in various aspects of their businesses [1]. Horizontal mergers and acquisitions have long been a source of antitrust concern in the United States [11]. If Microsoft is unable to complete the acquisition of Activision Blizzard owing to antitrust concerns, they may be required to pay hefty compensation to Activision Blizzard, depending on the deal's termination date. Failure to pass the antitrust examination impedes Microsoft's market strategy and results in significant financial losses.

4. Conclusion

The acquisition of Activision Blizzard by Microsoft has undoubtedly captured significant attention in the business world. This paper delves into Microsoft's motivations and strategic objectives for the acquisition, examining it from multiple perspectives to gain a comprehensive understanding.

Firstly, Microsoft's primary motivation for this acquisition was to strengthen its position in the highly competitive gaming industry. By merging forces with Activision Blizzard, a renowned gaming giant, Microsoft aims to capitalize on their diverse portfolio of successful gaming franchises and tap into their massive global player base. This strategic move enables Microsoft to bolster its Xbox Game Pass (XGP) subscription service, offering a more compelling gaming library, thus attracting a broader customer base, and increasing customer retention.

From a market landscape perspective, the acquisition holds the potential to reshape the gaming industry's dynamics. Microsoft's strengthened position through the collaboration with Activision Blizzard may challenge Sony's longstanding dominance in the gaming console market. By breaking Sony's grip on the market, Microsoft can anticipate a surge in Xbox sales, potentially leading to a shift in the overall market share.

However, this acquisition also brings inherent risks for Microsoft. Post-acquisition, the company may encounter cultural conflicts between the two organizations. Differences in work cultures, management styles, and values could hinder the smooth integration of the two entities. Addressing and bridging these gaps will be crucial to ensure operational efficiency and maximize the potential synergies between the two gaming giants.

Moreover, Microsoft's enlarged size as a result of this acquisition might attract antitrust scrutiny from regulatory authorities. To mitigate these concerns, Microsoft must demonstrate its commitment to fair competition and ensure that the acquisition does not lead to a monopoly in the gaming industry.

Despite the challenges, successful execution of Microsoft's metaverse strategy can open up new opportunities for the company. The convergence of gaming, virtual reality, and augmented reality can create a revolutionary gaming experience, potentially expanding Microsoft's reach beyond traditional gaming platforms.

In conclusion, the acquisition of Activision Blizzard offers Microsoft the chance to solidify its position in the gaming industry. By leveraging the synergies and effectively managing post-acquisition challenges, Microsoft has the potential to become a dominant force, breaking barriers and shaping the future of gaming. However, it will require strategic vision, cultural integration, and regulatory compliance to ensure a successful and transformative journey in the gaming landscape.

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