

Strategic analysis of Microsoft's acquisition of Activision Blizzard

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Executive Summary

This report analyses the proposed strategic context, potential benefits, risks and recommendations of the Microsoft- Activision Blizzard merger, to maximise the wealth of Activision shareholders.

This deal is driven by Microsoft's goal to strengthen its position in the gaming industry by expanding its portfolio with the Acquisition's popular franchises.

The benefits of the deal would include an increase in the market share of the companies, enhanced technological advancements, cloud services, multiple revenue streams, and growth of the subscription model.

However, the deal does not come without risks and needs to be carefully analysed and mitigated. It is essential for Activision to negotiate favourable terms for this deal.

By focusing on the expansion of existing franchises and merging with Microsoft in a strategic partnership, Activision can maximise shareholder value, which is one of its main goals. This will ensure that Activision remains competitive and continues evolving in the gaming industry.

In conclusion, considering all the factors, it is recommended that Activision Blizzard shall proceed with the deal.

Industry Overview

The gaming industry has been rapidly growing over the past decade. It has become one of the largest and most profitable segments of the entertainment industry with an expected revenue of \$211 billion and a global market metaverse of \$280 billion in 2025 (Porter et al.,2022).

Soni, Tencent, Nintendo, and Microsoft, are among the major players competing for dominance over emerging platforms like cloud gaming, artificial intelligence, augmented reality, esports, and virtual reality. However, the gaming industry also faces some significant challenges such as intense competition, high production costs, and regulatory issues which affect their work.

Activision Blizzard's portfolio includes world-renowned games like Call of Duty, World of Warcraft, and Candy Crush. Additionally, Microsoft's subscription model, Game Pass, is highly in demand.

Let's have a look into the strengths of the gaming industry:

- High growth potential- The gaming industry is subjected to quick growth due to factors like expansion of customer base, increased use of the internet, and the rising popularity of digital gaming platforms.
- Multiple sources of revenue and risk mitigation- The industry has benefited from its diverse sources of revenue, including video game sales, purchase of subscription models, and in-game purchases. These varied streams of operations help the companies mitigate their risks and secure a diversified structure of income generation and growth.
- Technological innovations- The sector is currently at the peak of technological advancements in the fields of virtual reality, cloud gaming, AR, and AI, which would enhance the gaming experience for players and help gaming companies stay competitive.
- Global reach- It has a significantly large global reach with major growth opportunities in developing countries due to its openness to new advancements for fostering economic growth. Gaming companies can effectively tap into these markets to gain a competitive edge in the industry.

Some weaknesses of the gaming industry are:

- Regulatory and antitrust challenges- The growing trend of mergers between large and powerful companies in the gaming industry has attracted scrutiny from regulators who are genuinely concerned about possible hostile practices which out to happen in the process of these mergers. This is to prevent companies from gaining excessive control over the operations in the industry, which could stifle competition and unfair practices.
- High development cost and the associated risk- Developing AAA games is a tremendously expensive and risky venture. The budgets often surpass hundreds of millions of dollars.

- Market saturation and competition- This industry is highly competitive and even has a saturated market for specific genres. The companies have continuous pressure to stay in the game and attract new users.
- Concern about data privacy- As games are becoming more digital, the risk of cybersecurity breaches and data privacy concerns have increased. Companies in this sector should invest heavily in protecting their users' data and ensuring the security of their platforms. Any negligence in this area could lead to heavy reputational damage.

The comparable transactions are:

To assist the strategic context of the Microsoft-Activision Blizzard merger, it is essential to compare it with other similar transactions in the gaming industry. Here are the comparable transactions:

- Disney's acquisition of 21st Century Fox:

In 2019, the acquisition made by Disney of 21st Century Fox for \$71.3 billion was among the biggest deals in recent history. This helped Disney to improve the quality of their content and compete with other streaming platform giants like Netflix. It provided Disney with the necessary content to launch Disney Plus.

This deal was driven by the rising importance of exclusive content in this industry, where owning intellectual property over exclusive content provides a significant competitive advantage (The Walt Disney Company, 2019), the same way Microsoft aims to compete with Sony and other leading companies in the gaming industry.

- Tencent's acquisition of Supercell:

In 2016, Tencent acquired Supercell for \$8.6 billion. Supercell is a leading developer of mobile games; this is one of the major reasons for the merger, as it highlights the importance of acquiring gaming companies that are successful and have strong IPs.

This allowed Tencent to strengthen its position in the mobile gaming market (Shuai, 2024). Like the Microsoft-Activision merger, Tencent's acquisition was focused on securing popular gaming titles like Clash of Clans and expanding its hold in the gaming sector.

- Microsoft's merger with ZeniMax Media:

Microsoft acquired ZeniMax Media, the parent company of Bethesda Softworks, for \$7.5 billion in 2021. This deal is directly comparable as it was also a major acquisition done by Microsoft in the gaming industry, like Activision.

This was a key part of Microsoft's strategic plan to support its Xbox Game Pass content by securing some popular franchises like The Elder Scrolls, Fallout, and Doom (Kadirov, 2024). This reflects the

broader strategy by Microsoft of acquiring other strong companies to secure a dominating position in the gaming market.

➤ Sony acquiring Bungie:

Sony acquired Bungie in 2022 for \$3.6 billion, through which Sony secured ownership over the Destiny franchise. The experience of Bungie in developing and maintaining live-service games was a key driving factor for Sony regarding this merger, as the gaming industry is rapidly shifting to live-service models for generating continuous revenue (Hatmaker, 2022).

This reflects the growing trend of strong and major gaming companies merging with established developers to gain a competitive edge in the sector.

➤ Zynga's acquisition by Take-Two Interactive:

In 2022, Take-Two officially completed the acquisition of Zynga for \$12.7 billion and strengthened its position in the gaming industry by expanding in the mobile gaming market.

Both deals reflect the importance of the increasing trend of mobile within the industry (Peters, 2022a).

Corporate activity in the industry post-COVID-19

As companies are trying to adapt to changes in customer behaviour post-COVID, digital content consumption has increased. This has led to increased mergers and acquisitions in the gaming industry. COVID-19 accelerated the trends of remote play and cloud gaming, making companies invest heavily in advanced technologies.

This environment makes it more favourable for Microsoft to acquire Activision Blizzard to dress the competition pressure from its rivals.

Merger	Year	Value
Disney - Century Fox	2019	\$71.3 billion
Tencent - Supercell	2016	\$8.6 billion
Microsoft- ZeniMax Media	2021	\$7.5 billion
Sony - Bungie	2022	\$3.6 billion
Take-Two Interactive- Zynga	2022	\$12.7 billion

Logic and rationale of the proposed deal-

The acquisition allows the integration of Activision's operations along with the resources and existing infrastructure of Microsoft, which would lead to operational synergies leading to cost savings, improved distribution channels, a larger user base, an extensive portfolio of popular franchises, and

enhanced marketing strategies. This would also allow both companies to compete directly with rival giants.

Advanced technology access and boosting sustainability –

This deal for Activision has increased access to Microsoft's technology. Microsoft is leading in cloud computing and is becoming increasingly important in the gaming industry. Activision may use these resources to create more compelling and cutting-edge games. This is a chance for Activision to align more closely with sustainability and ESG. Microsoft is renowned for its strong commitment to decreasing its carbon footprint. By collaborating with Microsoft, Activision can boost its ESG incentives, making the company seem more attractive to players, especially young customers concerned about social responsibility. It also allows Activision to align its operations with UN Sustainable Development Goals, enhancing its reputation.

Benefits -

- Synergy and cost efficiency- This merger allows cost savings and synergies between both companies through which Activision might benefit from Microsoft's capabilities, such as optimising its delivery and development process.
- Enhance user experience- It might help improve its gaming features, enhancing the gaming experience for the users.
- Increased market share- This merger will enhance the bargaining power of Microsoft and Activision with distributors and retailers, which could result in increased sales.
- Valuable Intellectual Properties- Due to the diverse portfolio of both the companies, it would enhance the quality of games and the variety as well.

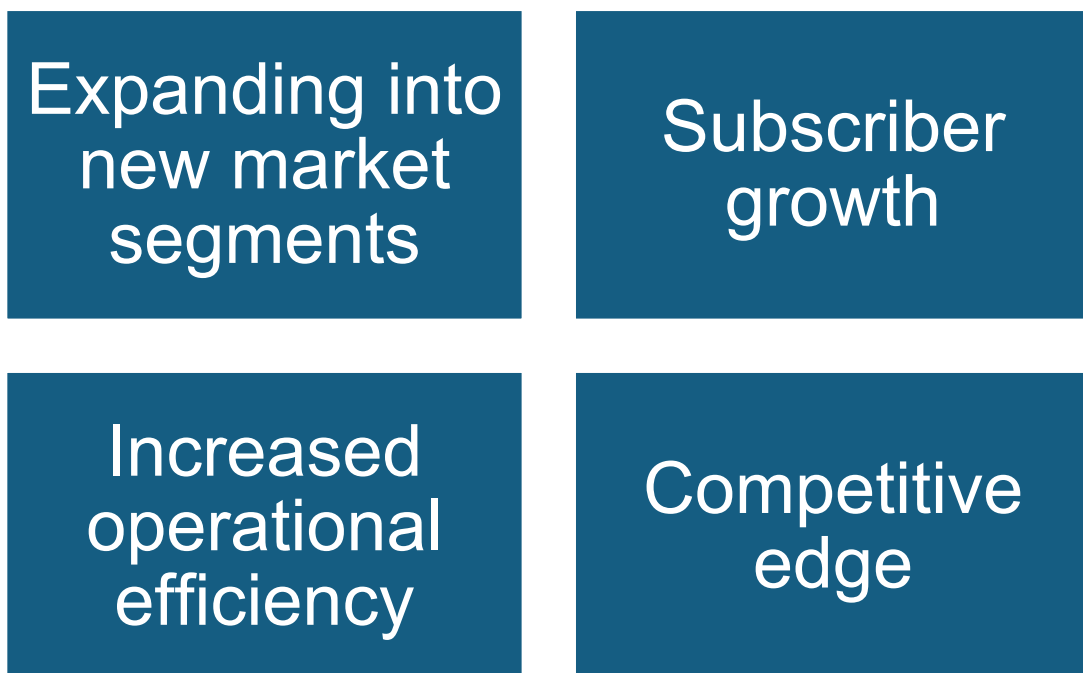
New opportunities-

- Entry and growth in cloud gaming- Azure, Microsoft's cloud gaming platform, provides Activision with new opportunities for reaching a larger audience through X-box.
- Synergies with the Microsoft Ecosystem- Activision can increase its market reach by accessing Microsoft's Azure, Windows and X-box platforms. This can also help Activision cut costs, save money and increase profits by streamlining its game development process.
- Entry in mobile gaming- Activision already has a good market captured in the mobile gaming field, but with the help of Microsoft's resources, it can be taken up to the next step.

Potential Risk-

- Cultural integration challenges and regulatory security- Integrating Activision Blizzard and Microsoft's different business cultures might create difficulties as both businesses run differently. It can lead to lesser efficiency and dissatisfied staff. Regulators are concerned about reduced competition and anti-trust challenges in the gaming industry as the size of this transaction is significant. If the scrutiny takes place, some of the benefits expected by Activision might be hindered.
- Dominance by Microsoft- Activision might lose some of its autonomy by being a part of a more prominent organisation; it may be required to follow Microsoft's strategic reaction, which might create conflict with its objectives.
- Competition- The merger could trigger aggressive responses from its competitors, notably Sony. As a result, the competition might face an increase from other industry players who use similar strategic practices.

Potential value enhancements-



- Expanding into new market segments- Blizzard has the chance to expand into new segments of the markets where it has less sales and customer base. With Microsoft's help, it can tap into trending and fast-growing markets to enhance its revenue.
- Subscriber growth- With Activision having games on X-box and cloud gaming platforms, it will likely experience significant growth. Making these available subscriptions will attract new users and generate profit.

- Increased operational efficiency- This merger would accumulate company resources, leading to shorter game development cycles and free up resources for other projects.
- Competitive edge- Merging with Microsoft will allow Activision to compete with strong gaming giants like Sony and Nintendo. This will help it to secure its domination in the gaming sector.

Bid timing- The timing of the bid is strategic, given that the competition in the gaming industry is rapidly growing along with technological advancements. Acquiring Acquisition in the given timeframe would allow Microsoft to stay in the game and ahead of trend.

Nature and structure of the Bidder (Microsoft)

Microsoft is one of the world's largest and most influential companies, known for its software and hardware products. It has its headquarters in Redmond, Washington. Microsoft dominates various markets, such as cloud computing (Azure), the gaming industry (X-box), and office software (Wikipedia Contributors, 2019).

The management team of Microsoft includes Satya Nadella (CEO), under whom Microsoft converted into the first Cloud and mobile company; Phil Spencer (Head of Xbox), who has extensive experience in the gaming industry and played a crucial part in Xbox department growth and Amy Hood (CFO) who manages the company's financial strategy and ensure acquisition are considered carefully.

Microsoft's efficient management team has enabled it to make successful acquisitions like LinkedIn for its growth (Nitesh Shrivastava, 2024). Its robust financial structure delivered a solid fiscal year 2023, with \$211 billion in revenue and \$88 billion in operating income (Microsoft, 2023). This and many more previous acquisition experiences equip them to handle any complexity that might arise during the acquisition of Activision Blizzard.

Risk Microsoft might face-

- Reputation risk- Activision has faced many controversies, including workplace culture and discrimination lawsuits. Microsoft could inherit these issues from this merger, affecting its brand reputation. This might lead to potential backlash from consumers, investors, and company employees.
- Cultural differences- When two companies merge, handling their distinct cultures can be challenging. Activision might have its way of doing things and handling things, which might conflict with Microsoft's corporate culture.
- Financial risks- Although Microsoft has vast financial resources, there is always a risk that the expected synergies and revenue growth need to materialise. The economic return on this investment could be less than anticipated.

Next steps-

- Conduct due diligence and engage with regulators- Microsoft must perform due diligence on Activision's financials, operations, and legal matters to assess risk and potential synergies. It should also engage with authorities to address competition and concerns about legal requirements.
- Communicate with shareholders- Clear communication with the company's stakeholders will maintain peace and harmony.
- Monitor market conditions- Keeping an eye on market trends and competitor's actions will help Microsoft adapt to the market during the merger.

Alternative strategies

Activision Blizzard-

Activision can focus on its independent, organic growth by developing sequels or expansion of its existing popular franchises like Call of Duty and World of Warcraft. It can also pursue the development of new titles to drive growth. It can involve investing in high-quality content to attract and retain players. By expanding into AI-advanced emerging platforms like virtual reality and mobile games, it can broaden its revenue streams.

It can additionally form strategies for inorganic growth, like forming alliances with tech companies and other gaming firms with promising IPs to leverage shared expertise, technology and resources that can enhance user experience.

Activision can also opt for a restructuring process which would streamline operations and reduce costs. Selling off non-core assets would maintain quality and improve profitability. Moreover, it can implement a more efficient strategy for capital allocation. Fostering an inclusive workplace environment can enhance employee morale and harmony, which would, in turn, improve productivity.

Microsoft -

Microsoft could consider proposing a revised offer for the deal with more favourable terms, such as increasing the bid offer to make it more appealing to Activision shareholders. This will relax the shareholder's concern about the undervaluation of the company. If full acquisition proves to be challenging, it can form a strategic partnership with Activision, which would benefit both companies without proceeding with the full merger. Microsoft can also proactively engage in a proxy fight to replace Activision's board members with those who are more amenable to this merger. If Activision's management remains unwilling to negotiate, it can pursue a hostile takeover by going directly to shareholders to purchase their shares at a premium price (CFI, n.d.). It should also address anti-trust concerns with the regulatory bodies and present a case to them about how this merger would benefit

customers and enhance innovations. It should develop an integration plan that would prioritise retaining key talent and maintaining brand reputation.

As a last resort, Microsoft can also explore alternative acquisition targets in the gaming industry that would enhance its gaming portfolio to gain a competitive edge against rivals like Sony.

Recommendation for Activision Blizzard-

According to the analysis conducted for this deal, the recommendation is that Activision Blizzard shall proceed with the merger with Microsoft, as it offers many benefits and possibly enhances the value of the company's shareholders. The advanced technology of Microsoft, such as the Cloud and integration into its broader ecosystem would create great opportunities for Activision to expand its range across new platforms like Xbox and Windows. Additionally, the synergies of this deal could lead to reduced development costs and increased operational efficiency.

Activision should carefully ensure that its independent autonomy is maintained, maximising shareholder satisfaction. It should also focus on addressing issues like cultural integration and navigating regulatory difficulties.

In conclusion, Activision Blizzard can leverage Microsoft's resources to strengthen its market position, which would benefit shareholders in the long run. This can actively be done by Activision negotiating its favorable terms with Microsoft for the merger.

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Appendices

Timeline of events for Microsoft's acquisition of Activision Blizzard

- On 18th January 2022, Microsoft announced to the world its intention to acquire Acquisition Blizzard in an all-cash deal for \$68.7 billion, or approximately \$95 per share (Microsoft News Center, 2022b). This marked the start of the acquisition process.
- On 1st March 2022, regulatory investigations were initiated.
- From July 2022 to September 2002, regulatory scrutiny intensified.
- On 26th April 2023, the U.K. CMA provisionally blocks the deal.
- On 13th October 2023, Microsoft gains conditional approval.
- On 16th October 2023, Microsoft officially completed its acquisition of Activision Blizzard after the approval of regulations. This, in turn, solidified Microsoft's position as a leader in the gaming industry with a stronger portfolio (Movement, 2023).