

Financial Risk Analysis of Internet M&A: Evidence from Alibaba's Acquisition of Ele.Me

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Abstract. The Internet economy has become an important force driving China's economic development. Through mergers and acquisitions, Internet companies have expanded their scale, reduced operating costs, and promoted the development of corporate diversification. Meanwhile, the disruptive development and innovation of Internet enterprises have added many risk factors to the road of Internet M&A. Therefore, it is necessary to take the Internet industry as the entry point to conduct a comprehensive and in-depth analysis of the financial risk prevention. In this case, one can control in the process of M&A, and seek the path and method that can promote the success of M&A. This study puts forward a series of management and control suggestions. Primarily, one needs to cooperate with third-party professional institutions to reduce information asymmetry and select a valuation method suitable for the target company. In addition, it should expand the company's financing channels and choose a reasonable capital structure. Last but not least, reasonable arrangement of payment time, flexible use of multiple payment methods ought to be presented. These studies provide enlightenment for the further exploration of Internet M&A.

Keywords: Internet companies; mergers and acquisitions; New retail; Alibaba; Ele.me.

1. Introduction

In the tide of the new economy, the Internet has officially become an important factor to promote the development of human society [1]. With the further development of the digital economy, investment and acquisition in the Internet field are becoming increasingly frequent. Mergers and acquisitions among enterprises have also become an effective way to enhance the competitiveness of enterprises and expand the business territory. Big enterprises join hands to establish the voice and leadership in the industry. Through the merger and integration of small companies in subdivided fields, large enterprises can derive business aspects, and rely on their own endowments to accelerate the layout of emerging circuits, so as to achieve corporate expansion. In recent years, faced with the tight economic environment in China, the capital market has gradually entered the winter, and it is increasingly difficult for Internet enterprises to operate with "burning money". In the context of increased investor risk and declining valuation of Internet enterprises, various enterprises in the Internet segmentation field urgently need to stay together for warmth, leading to frequent M&A cases [2]. Fig. 1 shows the number of M&A cases and M&A scale in the Internet leading primary market.

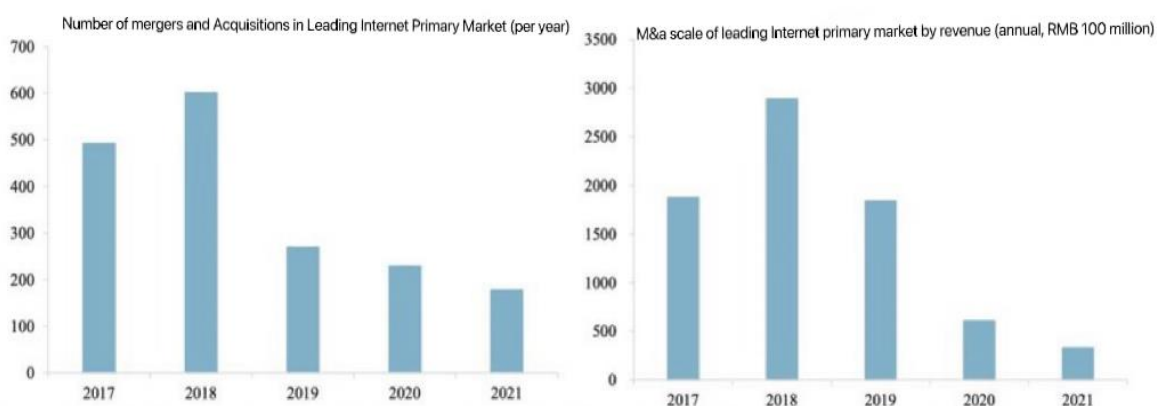


Fig. 1 Number of M&A cases and M&A scale in leading Internet primary market (Data sources: WIND, Soochow Securities).

Merger and acquisition is a double-edged sword. If the merger and acquisition is successful, the two enterprises can achieve both goodwill and performance. Whereas, of the merger and acquisition fails, it will hinder the development of the enterprise. When it fails, it will increase the financial burden for the enterprise, among which the financial risk is the most prominent. At the same time, the subversive development of Internet enterprises, the current environment is unstable and the policy guidance is not clear. Hence, one should further study the financial risks in Internet M&A.

The development of Internet enterprises has had an important impact on China's economic structure transformation and supply-side reform. With the formation of the Internet industry, the trend of Internet enterprise mergers and acquisitions is becoming more and more obvious. The types of mergers and acquisitions are not limited to the industry, but start to build the Internet ecosystem of diversified mergers and acquisitions [3]. However, mergers and acquisitions of Internet enterprises often involve relatively large capital amount operation. Thus, it is increasingly important to pay attention to hidden and latent financial risks. Therefore, this paper attempts to study the valuation risks, financing risks, payment risks and post-merger integration risks of Internet enterprises in mergers and acquisitions through case analysis. A normative elucidating research ought to be carried out in order to improve the success rate of Internet mergers and acquisitions.

Interests first is the common goal of all industries. Every enterprise should strive to manage its own brand and maintain good competitiveness to avoid the pressure caused by competition in the same industry [4]. At present, the enterprise merger and acquisition market is booming, so it is necessary to pay more attention to the systematic research on the existing enterprise merger and acquisition. This paper focuses on the study of Alibaba's acquisition of Ele. me company to discuss the financial risks in the merger and acquisition of countermeasures and preventive measures, so as to reduce or even avoid the failure of enterprise merger and acquisition. It also provides some practical significance for the successful merger and acquisition of enterprises.

2. Background

Alibaba Group, founded by Jack Ma in 1999, is an Internet technology company focusing on e-commerce and retail. Alibaba is currently the world's largest online trade market. During the 20-year development process, Alibaba mainly focuses on e-commerce. Through the continuous expansion of its own business, the continuous optimization of its industrial structure and the continuous improvement of its customer system, the whole Alibaba has formed a huge system and obtained more customer resources [5]. However, with the strategic needs of its development, Alibaba has gradually laid out a new track in recent years. So as to achieve the significance of expanding business territory. Fig. 2 is a list of some of the companies Alibaba has acquired in recent years.

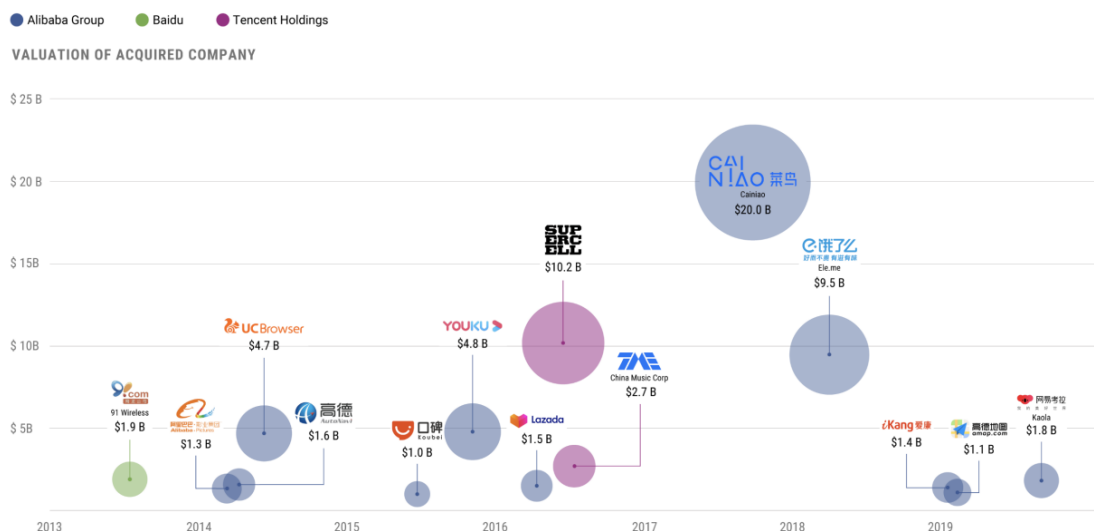


Fig. 2 Partial list of enterprises acquired by Alibaba in recent 5 years

Ele.me is a life service platform founded by Zhang Xuhao, Kang Jia and others in 2008, which mainly focuses on online delivery, new retail, instant catering and intra-city express delivery. Users can place orders through mobile terminals and enjoy food in a short period of time through a complete food delivery ecosystem and logistics distribution system. Over the past decade, Ele.me has amassed 260 million users, more than 2 million merchants and more than 3 million delivery workers, cultivating takeout as the third regular way for Chinese people to eat [6]. Meanwhile, Ele. me ranks first in the market among major food delivery providers.

3. M&A Motivation

Contemporarily, China's economy has been growing rapidly, and the number of Chinese netizens has also grown. By June 2022, the number of Chinese netizens has reached 1.051 billion, with the Internet penetration rate reaching 74.4%. It has accelerated the construction of digital wave and forced Internet enterprises to accelerate the construction of a new form of digital society. With Tencent choosing Jingdong and Meituan choosing Dianping, Alibaba has no choice but to seek a breakthrough and realize the construction of its own local life service ecosystem. In recent years, with the penetration of the Internet into people's lives, takeout has also become a consumption habit of the public. No matter at home or at work, takeout can quickly and conveniently meet people's dining needs. With the expansion of takeout market, takeout is no longer limited to the catering industry, and fresh food, snacks and desserts are diversified [5]. Seen from Fig. 3, the growth of the take-out industry in recent years is almost explosive. Therefore, as a leading industry, it is the demand of its business development to seize the take-out market and increase its voice in the take-out industry. The following table shows the development of China's online food delivery industry from 2011 to 2022.

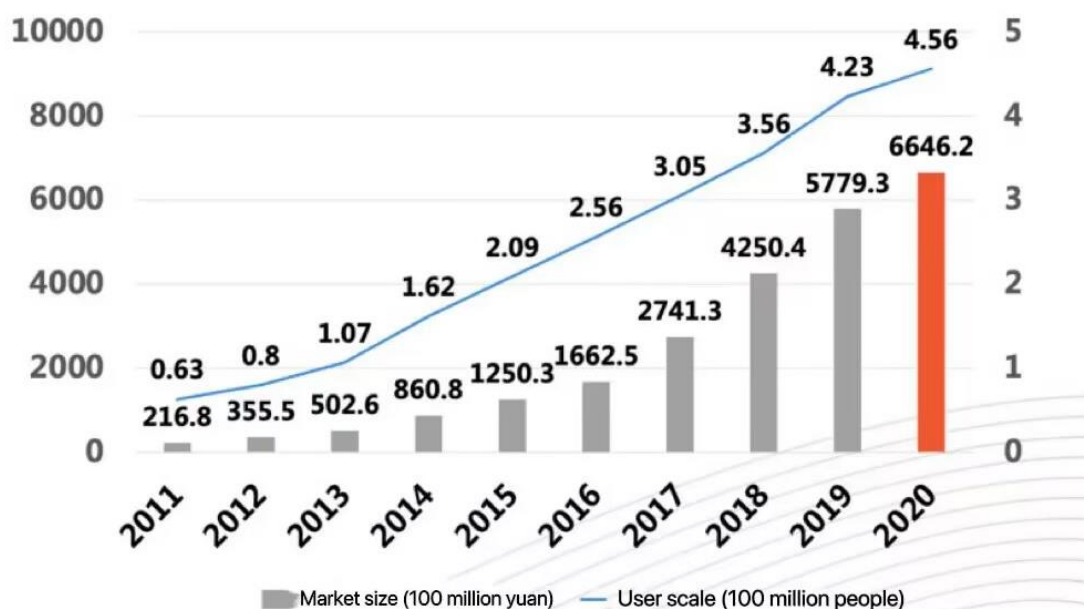


Fig. 3 Development of China's online food delivery industry from 2011 to 2022 (Data source: IIMedia Research)

Alibaba Group's strategic goal of creating new retail and opening up the last three kilometers of life circle is to bring customers a new life experience under the background of big data through the human-centered, big data supported basis and the interaction of people, goods, services and supply chains. Although it has a 24-hour delivery service including Cainiao, new consumption and new scenarios, take-out consumption upgrading trend is obvious, and the demand for quality upgrading is strong under the new situation. Therefore, to create catering retailing, retail localization and a perfect life circle is to build a "new retail" for Alibaba. A great opportunity to complement each other's

resources. In the meantime, Alibaba's huge traffic entry and stronger linkage between public and private domains have unleashed more interactive and social attributes. In addition, the acquisition of Ele. me can realize the resource integration and joint construction of the two, improve the scale of the enterprise itself, so as to realize the integration of the industrial chain layout and break the space boundary with the exchange of time. It is helpful to accelerate Alibaba Group's new layout in the food delivery industry.

Continuous mergers and acquisitions in the process of enterprise development are conducive to the integrated development of the industry and bring strong economies of scale to the acquirer. After the merger and acquisition, the user scale of the enterprise is increased, and the visibility of the enterprise will also be enhanced. Before the acquisition of Ele.me, Alibaba had already acquired the local lifestyle service brand "Koubei", but Koubei obviously could not meet Alibaba's ambition in local lifestyle service. However, Ele.me's takeout is an absolute firm demand and high-frequency business, which can provide a good diversion for other low-frequency businesses on Koubei platform. The high frequency of Ele.me food delivery can be used to promote the consumption of other low-frequency businesses such as hotels and air tickets. Therefore, the acquisition of Ele.me can create a new breakthrough for Alibaba's local life services and public praise. In addition, in the market, many brands including Meituan and Baidu Waimai have entered the food delivery industry, but one can notice that most of the market transaction shares have been divided by the leading enterprises, forming the two oligarchs led by Meituan and Ele. me. In addition, with the gradual maturation of the food delivery industry, consumers' loyalty and stickiness to the delivery software are gradually formed. Therefore, the fastest way for Alibaba to achieve economies of scale is to acquire it and reduce product costs and marketing costs. In addition, Alibaba can draw attention to Ele.me and Koubei through Alipay, which has a large number of users, and maintain Ele.me's absolute market share in electronic payment by using the high-frequency payment scene of Ele.me and Koubei.

4. Financial Risk Identification of M&A

4.1 Information Asymmetry

One of the biggest characteristics of M&A business is information asymmetry. Enron measured the degree of information asymmetry by the heterogeneous volatility of stock prices and found that the higher the degree of information asymmetry, the lower the M&A performance [8]. In the process of merger and acquisition, as an unlisted company, Ele.me cannot fully understand its financial information, organizational structure, customer information and other information, and the acquired company also deliberately beautify its financial information in order to maximize profits. Before the merger and acquisition, the acquirer cannot judge whether there is mortgage or violation through its basic financial information, and cannot specifically understand its net asset value. However, Alibaba had invested in Ele.me for many times before the acquisition of Ele. me. In 2016, Alibaba became the largest shareholder of Ele. me with 1.25 billion dollars. In 2017, in the first round of G1 financing of Ele.me, Alibaba invested 1 billion dollars to provide financing support for Ele. me to acquire Baidu Waimai. Although it is the largest shareholder of Ele. me, the original Ele.me team is actually responsible for the operation and management, which means that Alibaba cannot grasp all the information of Ele. me in all aspects.

4.2 Valuation Risk

If the valuation of the target enterprise is too high, it will undoubtedly increase the financial pressure of the acquirer, thus leading to financial crisis. While if the valuation of the target enterprise is too low, it will undoubtedly delay the merger and acquisition directly, and the delay period will greatly affect the original strategic layout of both enterprises. In 2016, Eleme was valued at \$5.5 to \$6 billion, and in 2017, after the acquisition of Baidu Waimai, the merger was valued at about \$6.5 to \$7 billion. In 2018, Alibaba acquired Ele.me for \$9.5 billion, among which the high premium of more than \$3 billion was mainly due to Alibaba's eagerness to build a new retail model. Nevertheless,

they value the perfect distribution and logistics service of Ele. me, so the actual valuation of Ele.me is biased.

4.3 Financing Risk

The main ways to seek financial financing in the capital market are issuing stocks, bonds, borrowing from banks etc. Any financing is likely to bring financial risks, owing to the different ways of financing, the capital structure is different, resulting in different degrees of financing risk. In the process of acquisition, Alibaba chose bank loan as the main cash financing means and equity financing as the auxiliary for effective financing. Conducive to financing risk control. As the Internet leader, Alibaba Group's goodwill and credit recognition in the market are guaranteed. Meanwhile, its rich financing experience also enables it to have a certain say in financing. However, ascribed to the relatively large acquisition scale, Alibaba Group's cash flow has been affected to some extent in the short term. According to the Table. 1, it is not difficult to see that the current liability ratio of the company increased significantly after the acquisition of Ele.me, and the total liabilities of assets also increased a lot. This has hindered Alibaba's investment and development in the short term.

Table. 1 Alibaba acquisition of Ele.me after cash flow statement (Data source: WIND).

| | Annual Report 2018 |
|---|--------------------|
| Current liabilities: | |
| Customer Deposits and Advances (\$) | 10,762,000,000.00 |
| Short-term Debt and Long-term Debt Portion of Current Period (\$) | 7,356,000,000.00 |
| Tax payable flow (\$) | 17,685,000,000.00 |
| Other payable and accrued expenses (\$) | 125,961,000,000.00 |
| Deferred revenue flow (Yuan) | 30,795,000,000.00 |
| Other Items of Current Liabilities (Yuan) | 15,110,000,000.00 |
| Total current liabilities (Yuan) | 207,669,000,000.00 |
| Deferred revenue non-current (Yuan) | 1,467,000,000.00 |
| Deferred income tax liabilities non-current (Yuan) | 22,517,000,000.00 |
| Other Items of non-current Liabilities (Yuan) | 118,021,000,000.00 |
| Total non-current liabilities (RMB) | 142,005,000,000.00 |
| Total liabilities (Yuan) | 349,674,000,000.00 |

4.4 Payment risk

Payment financial risks arise from the use of M&A funds. Direct transactions by cash, stock exchange merger, leveraged payment and mixed payment are generally used in China. Under normal circumstances, it can make the enterprise high efficiency to complete the merger and acquisition of payment have pay equity, debt financing and cash paid directly type, such as means of payment will affect the enterprise cash flow and financing ability [9, 10]. Alibaba acquired Ele.me with 9.5 billion US dollars, which was the largest cash acquisition in China's history at that time. When choosing the payment method, Alibaba made the previous evaluation and chose the cash payment method that could prevent the dispersion of equity based on its own payment ability and the best payment method.

5. Suggestions

The development of Internet companies is characterized by its particularity and stage development, so the valuation of Internet companies is more volatile than that of traditional enterprises. Therefore, it is more necessary to conduct systematic and detailed due diligence in the process of M&A, and employ a third-party evaluation agency to comprehensively grasp the financial status, profit status, operating system and corporate structure of the target company. The aim is to make the exact valuation of enterprise value, finally through the scientific evaluation way, get a relatively stable

valuation price. However, at present, there is no relatively perfect and scientific comprehensive evaluation system for the M&A behavior of Internet companies, so the risk of high valuation has always existed. Therefore, when evaluating such Internet companies, one should make value investment from the perspective of value, pay more attention to the potential value of the current and future development of the target enterprises. It is essential to carefully understand the profit logic of the target, and refer to some other aspects that cannot be quantified, such as the founder's ability, the management level of the company, the quality of the staff, to ensure the rationality of the valuation. At the same time, in the process of M&A of Internet enterprises, the valuation of Internet enterprises is often higher than that of traditional enterprises, which also means that the amount of acquisition is huge. Therefore, it is required that enterprises should determine the appropriate financing scale during the financing process. In this case, it makes a reasonable financing method according to the actual financing level of enterprises, so as to achieve the optimal financing method. Finally, in the implementation of merger and acquisition, if the enterprise chooses an unreasonable payment method, it will lead to a large payment risk. Therefore, it requires the enterprise to refer to its actual situation to use a reasonable and diversified payment time and payment method to prevent a significant reduction of corporate cash flow, so as to reduce the short-term capital pressure of the company and reduce the financial risk. Finally, one gets the result of maximization of economic benefits.

6. Conclusion

In summary, this paper takes Alibaba and Ele.me as cases to understand the possible financial risks in the process of Internet enterprise mergers and acquisitions based on in-depth research. Specifically, this study tracks the whole process of Alibaba's acquisition of Ele.me, and summarizes the important and common representativeness in the process of enterprise merger and acquisition from actual cases. In addition, a brief analysis of Alibaba Group's risk control methods is discussed, e.g., the selection of M&A targets, strategic development planning and M&A integration measures, and then puts forward detailed countermeasures before, during and after M&A according to the research conclusions. Besides, there are still many uncontrollable factors in the enterprise, so the M&A process still needs to be taken seriously. These results can provide reference for other Internet enterprises to manage M&A risk in the future.

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