

MODULE: STRATEGIC CHANGE LCDB7005

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ARM and its Acquisition by Softbank: Imperatives, Implications and the Adopted Corporate Level Strategy

A Strategic Change and Organization (SCO)

Coursework One

EXECUTIVE SUMMARY

One of the commonly adopted strategies to enter a market, either vertical or horizontal, is mergers and acquisitions (M&A) (Baker, 2012). Softbank has used this strategy a lot with lots of acquisitions with varying proportions to its name (Meyer, 2016) With this being said, the review of ARM acquisition by Softbank provided the fulcrum of this report. It looks at the strategic imperative towards the acquisition, review the acquisition itself using various lenses; strategic, organisational culture, structure, financial and other key performance indicators as requested.

TABLE OF CONTENTS

EXECUTIVE SUMMARY	2
TABLE OF CONTENTS.....	3
1 INTRODUCTION AND REPORT CONTEXT	4
2. ARM HOLDING’S SITUATIONAL ANALYSIS AND THE STRATEGIC IMPERATIVES FOR ITS ACQUISITION	5
3 ARM’S ACQUISITION AND THE CHANGE IMPLICATIONS	11
STRATEGIC CHANGES:	11
STRUCTURAL CHANGES:.....	13
CHANGES IN ORGANIZATIONAL CULTURE:	14
ACCOUNTING-BASED AND OTHER KPI CHANGES:.....	14
4 SUMMARY AND CONCLUSION	15
5.0 REFERENCES	16

1 INTRODUCTION AND REPORT CONTEXT

“All organisations are faced with the challenges of strategic direction: some from a desire to grasp new opportunities, others to overcome significant problems, as at Yahoo!” (Gerry, et al., 2008, p. 2)

Technology changes fast, and successful companies must always adapt to remain relevant. This is the undertone surrounding the submissions of Gerry, et al. (2008) when he emphasized the need for continued strategic direction while reviewing the Yahoo case study. At the height of Yahoo technological boom in 2000, for instance, the company was worth a whopping 125 billion US dollars but twelve years after, it worth a meagre 20 billion US dollars before it was eventually sold for 4.3 billion US dollars. In a leaked memo in 2006, tagged Yahoo Peanut Butter Manifesto, Brad Garlinghouse, a Senior Manager and the writer of the memo, argued that all is not well with the strategic direction of the company and as such reflecting negatively on the company's outcome (Gerry, et al., 2008). The Yahoo story epitomizes the stories of several fortune five hundred companies which occur due to their failure in making provisions for the rapidly changing technological advancement and strategically navigating the resulting technological disruption.

Besides the human resources issues highlighted by the Yahoo Peanut butter manifesto, one of the failures of Yahoo is in her (entry) strategies to different horizontal markets as well as its acquisitions. Yahoo acquired and invested in a couple of organisation; besides its stake at Alibaba which was successful, its \$.1.1 billion acquisition of Tumblr, its \$5.7 acquisition of broadcast.com from Mark Cuban and its \$3.6 billion acquisition of GeoCities were all part of the five worst acquisitions of all time (Kopytoff, 2013).

Summarily and having noted the strategic importance of acquisition to business success and continuity, this report provides a critical look at ARM's acquisition by Softbank. Would it be another example of those listed and sad Yahoo acquisitions or be like Google's acquisition of YouTube which has proved to be very successful? To answer this lingering question, this report looked at the imperatives of the acquisition, the resulting implications and other associated corporate strategy outlook as it pertains to this discourse. For levity and brevity, this report is organized along this way; besides this section, section 1 which is the introductory section, section 2 presents an overview of the strategic imperatives of the acquisition and section 3 details the review of the implications in several facets. The conclusion and summary of the report is denoted with section four.

2. ARM HOLDING'S SITUATIONAL ANALYSIS AND THE STRATEGIC IMPERATIVES FOR ITS ACQUISITION

Right from time immemorial, the importance of strategic (re-)direction cannot be overemphasized to companies' survival (Baker, 2012; Contractor, et al., 2003; Di Guargo, et al., 2016; Saralaa, et al., 2019). One of the commonly adopted strategies which doubles as an entry mode is mergers and acquisitions (M&A) (Baker, 2012). Ruiz-Moreno (2007 cited in Di Guardo, et al., 2016) rightly posited that M&A is an important strategic corporate initiative that enables firm in extending their businesses, leveraging their capabilities and diversifying into often related markets.

In practical business world, M&A can be used either to strengthen one's horizontal market as well as vertical market, it is one Softbank has learnt and used over the years (reference). As depicted in table one, Softbank's acquisition, for instance, include Line Mobile, Schaft, Boston Dynamics, Drama Fever, Drama fever, ARM, and Supercell among others while her investment include those in GymPass, Grofers, TalkSpace, the \$250 million investment in India's Ola Electric Vehicle, \$100 million in Globality, \$102 million in Alibaba, \$104 million in Brain Corp, \$121 million in light, and \$151 million investment in Cybereason among others (Horwitz, 2016; Leskin & Ghosh, 2019). Each of these acquisitions has distinct strategic imperative associated with it. Considering Di Guargo, et al.'s (2016) position that "firm's decision control-wise depends to a considerable extent, on the level of external uncertainty in the target country" and the brewing uncertainty associated with Brexit, why would Softbank go for the UK-based technology company, ARM holdings, and at that uncertain time?

In order to understand the imperatives behind the Softbank's acquisition as well as the evaluation of the associated changes, there is need to look at the situation of ARM Holdings before the acquisition and the opportunities presented by it. This will help us ascertain if the opportunities presented by Softbank corroborates the acquisition imperative statement credited to Softbank's CEO. However, it is pertinent to say organisation's strategic situational review is not just good for this work, it is foundational to every process of strategic evaluation and building. Gerry, et al. (2008) argued that to position an organisation, there is a need to strategically understand the situation of the company. This position is also shared by many a researcher (Dueck, 2016; Hooper & Pham, 2014; Schweizer & Nienhaus, 2017). As such, this position informed Gerry, et al.'s (2008) work in which he opined that building a healthy corporate level strategy would need three strategic processes and/ or classifications thus: the strategic position, strategic choices and strategy in action.

Table 1: SWOT Analysis of ARM Holdings Prior to Acquisition by Softbank (Using 2015 data)

STRENGTHS ❖ Have largest share in microchip for mobile phones devices. For instance, total addressable market (TAM) for mobile applications processors in 2015 is \$18bn. ARM has 85% of this. Category King. ❖ Doing considerable well in Networking infrastructure too which has a TAM value of \$13bn in 2015 and a projection to reach \$16bn in 2020. ARM has a 15% market share and a projection of 45% in 2020. ❖	WEAKNESSES ❖ Has low market share of servers' microchips with less than 1%. However, there is a projection this could jump to 25% in 2020 because of the intention of companies to build application specific chips which is the domain of ARM Holdings.
OPPORTUNITIES ❖ Ability to diversify into the hardware internet of things (IoT) market. ❖ Opportunities for embedded chips in that by 2020, embedded chips would have about 25% market share in embedded computer chips – smart home wit, smart city, industrial and other -	THREATS ❖ Brexit uncertainty. Can legislation change in such a way that it would be difficult to trade with companies in Europe and/ or other western countries. Considering

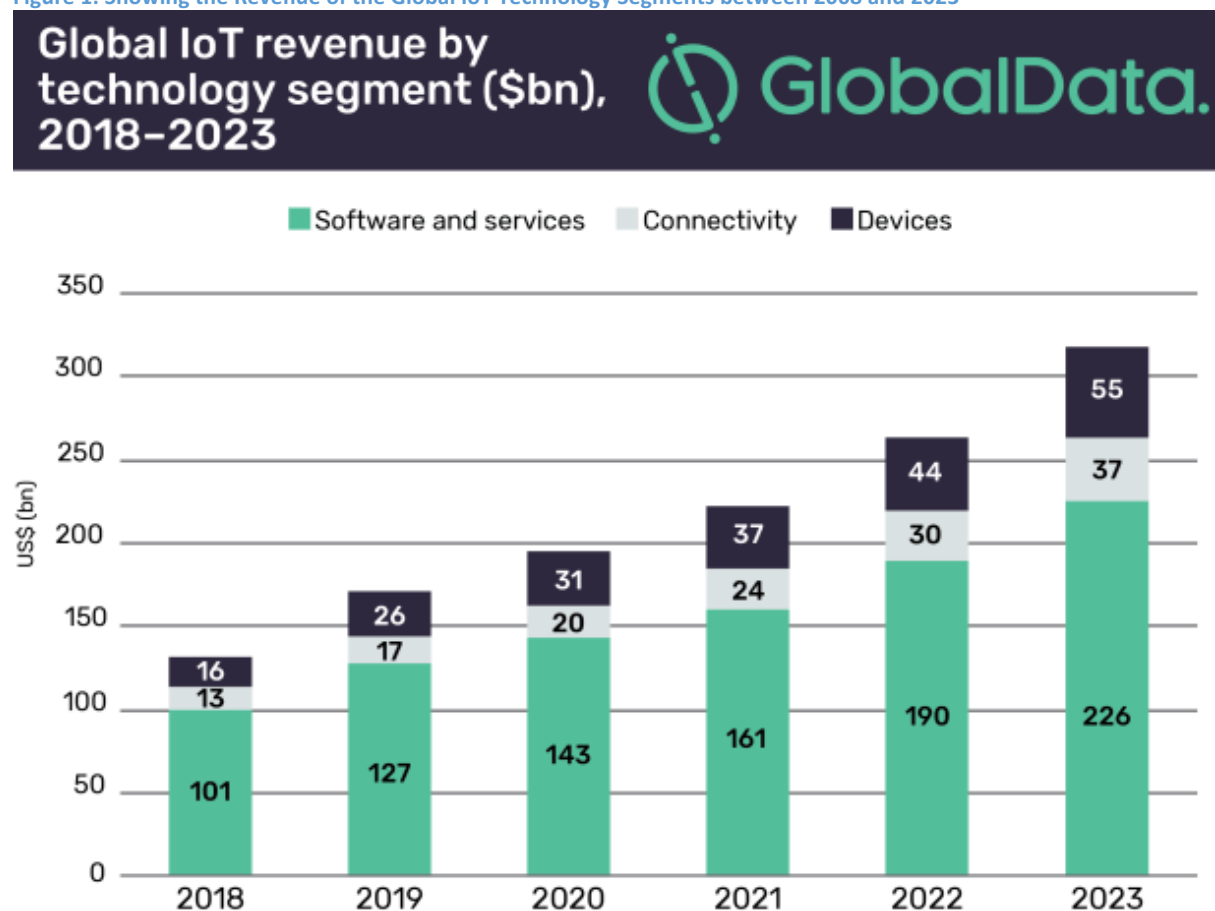
SOURCE: Own analysis table with data from different sources.

From strategically analysing the position of ARM Holdings to look at the opportunities there-in, using the popular internal environmental analysis tool, SWOT (an acronym for Strengths, Weaknesses, Opportunities and Threats) as depicted above, it has become obvious that there are opportunities for ARM holdings in global Internet of Things (IoT) market. In analysing the strategic imperative behind the acquisition of ARM from Softbank's perspectives, it is easy to see why. In fact, the statement credited to Masayoshi Son, Softbank's Chairman and Chief Executive, just a day after the acquisition below give a clarity on the strategic imperative behind the acquisition:

“ARM will be an excellent strategic fit within the SoftBank group as we invest to capture the very significant opportunities provided by the Internet of things ... [It is as such] one of the most important acquisitions we have ever made.” (Meyer, 2016)

With this, it's safe to say Softbank is not just looking at an entry into the UK market rather she's looking at an opportunity to dominate the internet of things (IOT) market which is forecasted to be around 1.7 trillion US dollars in 2019 and which has a potential to generate between \$4 trillion to \$11 trillion in economic value by 2025 (Petrov, 2019). In fact, according to the data from Global Data (Froese, 2018), the revenue, not market, from global IoT market is predicted to reach \$318 billion at a phenomenal CAGR of 20.3% by 2023 as depicted in the chart below thus:

Figure 1: Showing the Revenue of the Global IoT Technology Segments between 2008 and 2023

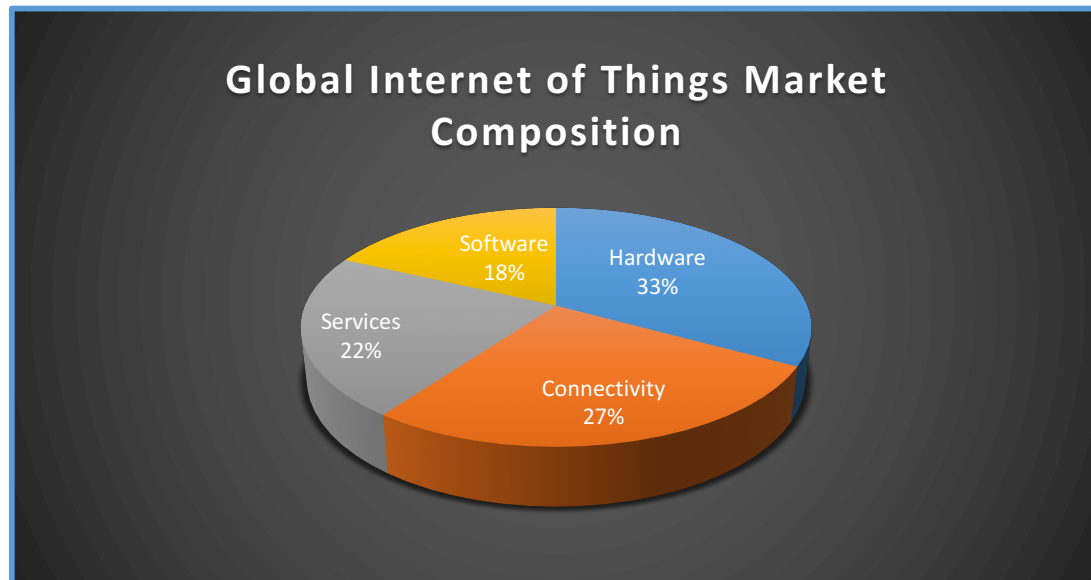


SOURCE: Froese (2018)

Though data from different technology intelligence firms are not uniform on the exact value of the IoT market, there are however uniformities on the huge potentials of the market as with the adoption stage (both in enterprise and personal) and the associated complexities. According to PwC, while the

global internet of things market is 1.7 trillion USD, according to data from PwC, hardware and sensory sector is leading the industry with a market base of about \$585 billion as depicted below thus:

Figure 2: Showing the Global Internet of Things (IoT) Market Composition



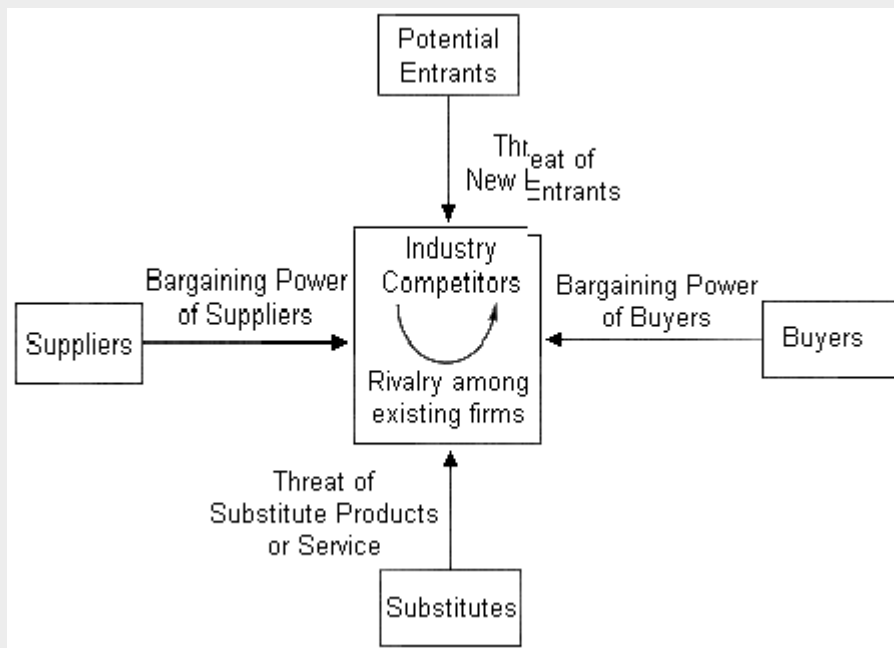
SOURCE: Inferred from Froese (2018)

Looking at the graph above, it is easy to see that hardware sector of the global Internet of Things market is even huge. This also corroborates the information from the SWOT analysis of ARM as detailed earlier. This provide the needed incentive to focus on the hardware market of the global IoT market.

Despite the present huge market of Internet of Things, the potentiality is far more. This is because of the relatively infant stage the company is and the unfathomable use case of IoT.

Having emphasized the need for the microchip company towards an Internet of Things market, another lingering question would be why buy Arm Holding with a whopping £24 billion if you can easily set up a similar microchip processor company? Without sounding simplistic considering this is more nuanced, the answer may not be far-fetched but would be looked at from two different perspectives: one is to review from, and as such continue with, strategic positioning tools like PESTLE analysis and the Porters' five forces which represent the micro and macro external environmental tools respectively. The other is just to look at other nuanced intricacies in support of such decisions in practical business world. Hints from the Porter's five forces of ARM Holding and the larger mobile devices memory chip industry is detailed below thus:

Porter's Five Forces of ARM and Mobile Device Semi-Conductor Manufacturing Industry



Threats of New Entrants: There is limited threat of new entrants because of the resources needed to enter. This include intellectual know-how, a lot of research and development, and a huge amount of financial resources among others.

Verdict: Limited Threat

Threats of Substitute Products: The main competitor is not mobile device chip maker but desktop system chip maker in Intel. As such, The threat of substitute product is as such low

Verdict: Low

Bargaining Power of Suppliers: In ARM's case, the adopted method of licensing design blueprint for organizations to develop the microchips means the bargaining power of supplier is low in that ARM do not need supplies for manufacturing. They are mostly engaged in research and development (RD) to come up with better design to give. With this, ARM collect royalties and licences from organizations.

Verdict: Low

Bargaining Power of Buyers: The bargaining power of buyers is high though. This is because it has to be buyers that have the capacity to develop the given microchip design.

Verdict: High

Industry Competition: The industry competition can be regarded as moderate. In this industry, most organization tends to create different niche for themselves, i.e. ARM Holdings with Mobile microchip and Intel with Computer microchip among others. Nevertheless, while it is difficult to easily venture into each niche because of the required deep technical know-how, the competition would still be regarded as moderate ad technology industry is so volatile any industry could be disrupted in months.

Verdict: Moderate

PESTLE (Macro Environmental) Analysis of ARM

POLITICAL

- ✓ While ARM is located in United Kingdom which is faced with Brexit's uncertainty, that the company is owned by Softbank gives it a soft landing in case of any sad eventualities.
- ✓ The present trade war between US and China should not affect this considering Softbank is not from either of those countries. In fact, if anything, it might benefit positively from it considering Huawei which is faced with US sanctions is one of its competitors.

ECONOMICAL

- ✓ No substantial effect from the change in economies of some of the countries.

SOCIAL

- ✓ At the moment, social like the increasing need for global warming do not have much effects on IoT market.
- ✓ With the rapidly increasing population, there is however increasing potential customers which is a positive.

TECHNOLOGY

- ✓ The increasing diffusion in innovation of the global word would help positively.
- ✓ The increasing use of artificial intelligence, machine learning and 5G is driving the need for IoT faster than never before

3 ARM'S ACQUISITION AND THE CHANGE IMPLICATIONS

Mergers and acquisitions have gained enormous importance over the years. Despite the popularity, owing to practical importance and the increasing number of deals – in numbers and dollar value, majority of research findings have shown high failure rate between 40 and eighty percent (Wang & Moini, 2012). This raised many lingering questions thus: how are the performances measured? Would it be regarded a success or failure if different yardsticks or methods were adopted? Despite these huge failure rate, why are organizations still engaged in it? Can an acquisition be described as a success in short-term from a monetary perspective and a failure in long-term from a strategic perspective? These are lingering questions that revolve around comparing and evaluating the change implications of the ARM acquisition.

Evaluating mergers and acquisitions (M&A) performance and the studies around it, however, is often a nexus between strategy, corporate finance, international business and organizational behaviour for decades. (Wang & Moini, 2012). From a review of 88 empirical studies of M&A deals between 1970 and 2006, Zollo and Meier (2008 cited in Wang & Moini, 2012 pg. 1) identified 12 different approaches for evaluating the performance of M&A deals and the approaches have five different dimensions upon which they are done (Wang & Moini, 2012). Of the aforementioned twelve, there are five main commonly used methods below thus: (1) accounting-based measures; (2) expert informants' assessment; (3) event studies which is otherwise regarded as the stock-market-based measures; (4) managers' subjective assessment; and (5) divestiture. And while large percentages of the researchers argued that event studies and accounting-based measures were often used for reviewing post M&A deals (Cording, et al., 2010; Wang & Moini, 2012), this work is mainly based on the yardsticks (strategy, structure and organizational culture among others deemed appropriate) set above on the given criteria which falls across different approaches.

STRATEGIC CHANGES: The below quote, Tom Godwin's often cited aphorism, summarily explains the business operation and strategic direction of ARM Holdings prior to Softbank's acquisition.

Uber, the world's largest taxi company, owns no vehicles. Facebook, the world's most popular media owner, creates no content. Alibaba, the most valuable retailer, has no inventory. And Airbnb, the world's largest accommodation provider, owns no real estate. Something interesting is happening. (Savov, 2016)

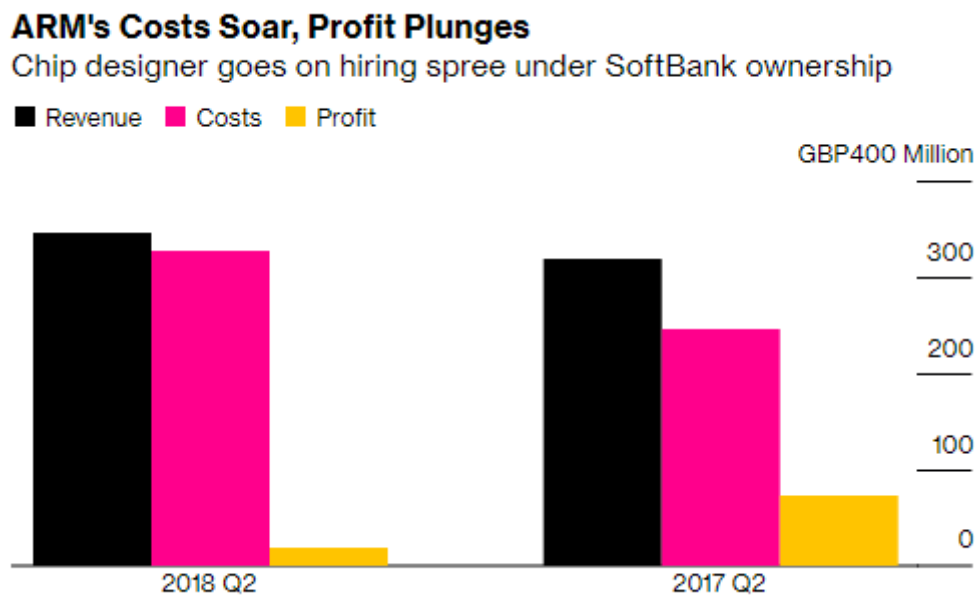
Savor (2016), while linking the aphorism to the business operation and the strategic direction of ARM holdings, argued that the “something interesting is happening” is applicable to ARM’s situation in that the core mechanic of obtaining valuable information, securing the control of it and selling it to a willing purchaser to make a huge profit is still the same with the aforementioned companies. ARM does not make microchip, it simply invests in research and development, get new knowledge, patent the system design blueprints and sell these blueprints to willing buyers who make the designs for licensing fees and royalties. With more than 4500 granted or pending patents, ARM is an intellectual powerhouse with no added spending as cost of production. This is before the acquisition and while this remains largely true – at least in getting licensing and royalties, the strategic direction has considerably changed to meet up with Softbank’s aim of being a market leader in the Internet of Things (IoT) market. ARM is moving towards software and services, away from information and blueprint designs (King & Kahn, 2019).

ARM’s intention is not just to make profit in the present market. ARM executives, under Softbank, are moving towards investing for growth and worrying about profits later with the direction of breaking into high-end computing and becoming central to self-driving car technology (King & Kahn, 2019).

While the intention and direction towards the IoT market is well known, Arm however have two major problems towards realising this. One is that the connected future seems not to be dawning as quickly as everyone had hoped for because managing all these connected devices present huge management hassles. While technical complications and huge potential expenses from this are well documented, ARM didn’t have much expertise in the IoT and has always been two steps removed from the actual end users of the devices that made use of the architectural designs. In order to solve this problem, ARM, in August 2018, spent \$600 million for a US based data analytic start-up, Treasure Data Incorporation to shore up its connectivity expertise in the internet of things devices.

Summarily, the strategic direction has changed considerably: from making immediate profit to quickly gaining market in place of profit; from selling information in the form of microchip blueprint to moving to services and softwares; from only investing in R&D for new microchip designs to acquiring companies that could develop this.

Figure 3: Demonstrating how ARM's profit plunges



SOURCE: King & Kahn (2019) citing ARM Holding's filings.

STRUCTURAL CHANGES: While the ownership of ARM has changed, the structure has not changed considerably except in cases where additional staff are added in anticipation for IoT business. Alongside the structure is the leadership and location among others which have remained the same post acquisition period. In fact, one of the gentlemanly agreements made before the acquisition is that the company would remain in UK to have a direct contribution to the UK economy. This was made when the Chairman of the acquiring company, Softbank, spoke to the UK prime minister. This was also made known by ARM when it claimed "Softbank intends to preserve the UK term firm's organisation, including its existing senior management structure and partnership-based business model, ARM said".

However, while the organisational structure remained almost the same, the company was on hiring spree to meet up with one of the promises made by Masayoshi Son that ARM would increase its workforce considerably. As at January 2019, the company has added additional 2,000 employees bringing its headcount to slightly below 6,000. In fact, the chief technology officer (CTO) in an interview at the company's headquarters in Cambridge said the company is so short of space for new hires that even his office "has become a meeting room [in such a way that he has] to book it when [he's] there because [they've] run out of space" (King & Kahn, 2019). They've have however built a new 48 million pounds new headquarter building on the Cambridge campus.

CHANGES IN ORGANIZATIONAL CULTURE: The often most important thing after merger and/or acquisition is imbibing the organizational culture of the acquiring company. This is more difficult for most organization with intent to start paying dividends. However, the organizational culture is being shifted from one which has to make instant profit to one who is re-investing it massively so as to be able to achieve market leading status in its IoT segment. Like Paju (2016) also emphasized, that the culture of ARM holdings before acquisition as mostly “short-termism” is slowly giving way for the Softbank-induced “long-termism”. The financial reports of the company also show increasing spending on manpower among others and reduced profit.

ACCOUNTING-BASED AND OTHER KPI CHANGES: As said earlier that the organizational culture and strategic direction have changed from one which make instant gratification to one which quickly make re-invest those profits. Considering the constant huge investment and spending, the profit has dropped as well but measuring the success of the merger and acquisition process on this would defeat the purpose upon which the acquisition was done in the first place. To buttress this while the revenue from royalties has increased from USD 833 million from 2015 to USD 1098 million and revenue from software and services has increased from USD 124 million to USD 191 million, the total cost has increased drastically between this time too than more than 200% - total cost of USD 716 million in 2015 to USD 1557 million in 2018. This drastically dropped the adjusted Earnings before interest, tax, depreciation and amortization (EBITDA) from USD 843 million to USD 279 million. It is worth noting that the revenue did not decrease (in fact, it is increasing) but the amount for research and development (R&D) as increased drastically – from USD 321 million in 2015 to USD 655 million at the end of 2018 financial year. These figures from the official company financials made available for download on their official website (ARM Limited, 2019).

Other non-financial KPIs from 2015 to 2018 are depicted in the table below thus:

Non-financial KPI	2015	2016	2017	2018
Employees	4064	4852	5886	5987
Royalty Unit Analysis	15.1	17.7	21.3	22.9
Total number of licenses signed	1348	1442	1577	1694

SOURCE: Arm Limited (2019).

4 SUMMARY AND CONCLUSION

From a layman's perspective, Softbank's acquisition of ARM would not make sense. In fact, the financial figure might even give credence to it when you factor in and compare the EBITDA and profit of the organization before the acquisition and afterwards. The profit has reduced, and a detailed look has shown that the money is being used for enhanced research and development (RD) whose budget has more than doubled over the last few years. Concurrent with this is the increasing cost on more employees who were hired towards the IoT dream. But a market that's already worth USD 1.7 trillion despite being at the infant stage of its lifecycle and global diffusion is definitely worth being a market leader. This is what Softbank recognized and a lot of companies – like Microsoft (George, 2019), Huawei (Huawei, 2019) and Dell (Dell, 2019) among others – are recognizing too.

Evaluating mergers and acquisitions of this kind is nuanced and it reflected on the adopted methods. Wang & Moini (2012), for instance, having reviewed 88 empirical studies of M&A deals argued that there are twelve (12) different approaches often used in evaluating performance but posited that five of these are common. That these five are accounting-based measures, expert informants' assessment, event studies, stock-market-based measures, managers' subjective assessment divestiture shows that accounting-based measure is not the ultimate in evaluating deals. More importantly, the revenue of the organization has not dropped, in fact it has increased, but the cost has only increased because of the shift in strategic direction and focus on the long-term goal of the USD 1.7 trillion internet of things market. Looking at this from a somewhat expert perspective, one can deduce this is not a failure. And while the expectations might be huge, the end will still justify the means as they are still on the right direction owing to the infant stage of the global IoT market.

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