



EBAY'S ACQUISITION OF SKYPE WHY DID IT GO WRONG?

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ABSTRACT

In the year of 2005, eBay had acquisitioned Skype with the motive to improve the mode of communication between the participants in the auction site as the usage of VOIP (Voice Over Internet Protocol) services can be used in such a way that it provides the participants a convenient way to communicate rather than using email. However, even though there is not a large portion of successful Merger and Acquisition deals that gave taken place, there was a fair assumption that this deal would be of great success considering the rationale as to why such deal is being pulled through. It was intended for the people to use video chat and Skype as a platform for communicating with the sellers and buyers. It was predicted they would combine their synergies and introduce a change to online buyers and seller's communication. However, the deal had backfired due to certain reasons such as the lack of synergy between the companies, failure to grab the attention of the customers, the difference in company culture and style of management and overpricing of stock/shares/assets. Most of the customers did not take up that mode of communication and one of the reasons that the project did not work is due to the lack of synergy between both the companies during the Acquisition. The users had not picked up the idea as projected by eBay as they considered it as unnecessary for the communication and there are other ways which can be used to get in touch with the participants. It was also noted Skype did not have a conservative version unlike eBay. One of the crucial reasons as to the failure was the overpricing of shares and there were negative returns which caused the investors to pay a heavy sum which had led to one of the worst M/A deals ever taken place.

Keywords: Ebay, VOIP, Skype, merger



THE BEGINNING TO AN END

eBay, a global online e-commerce site, acquired Skype SA, a European voice over Internet protocol provider, in September 2005. The rationale behind this accession, possibly exceeding USD 4 billion, was to promote the synergies between eBay's alliances and to perform user growth engine asset. However, eBay had a reputation of being successful in the past with dealing with businesses such as PayPal however, the participants had not preferred the way put forth by skype and had arrived at a conclusion that the communication via mail had been more convenient and the VOIP service had been unnecessary. It was calculated 17% of deals had added value to the combined company, 30% produced no discernible difference. In other words, 83% of mergers/acquisitions were unsuccessful in producing any business benefit as regards shareholder value¹. There are four reasons that can be carved out to determine why the acquisition did not go as planned and had caused the acquisition to be one of the worst ever in history of Mergers and Acquisitions. The four are as follows:

- The lack of synergy between the companies
- The attempt to grab the attention of the customers
- The difference in company culture and style of management
- The overpricing of stock/shares/assets

THE LACK OF SYNERGY BETWEEN THE COMPANIES

Synergy is the power of merging together in a way which helps the organisation to work in an effective and efficient manner which would aid all the departments. eBay and Skype had expected to work together in a way that would build up a connection to help them work in an efficient way. eBay had pictured the synergy between them and skype was to be the platform in which the customers can converse and get into decisions regarding the sales that were taking place in the site, however, the most of the customers did not take up that mode of communication and one of the reasons that the project did not work is due to the lack of synergy between both the companies during the Acquisition. Skype had become one of the most chosen platforms for online

¹ KPMG, 'Unlocking Shareholder Value: Keys To Success' (KPMG 2020) <https://pdfs.semanticscholar.org/9bf7/0c71d633d0e1657b7f5a4aadb4f78508cf22.pdf?_ga=2.150277247.890152571.1587835029-1853799550.1587835029> accessed 4 May 2020.



communication by most of the applications during that period of time, so, the assumption and calculations done by eBay were to be justified due to the popularity of the usage of skype being the online mode of communication for customers to contact themselves for multiple purposes. The companies while merging their activities they had taken their previous performance into importance and they both had set up a decent portfolio but as stated earlier, the synergy had lacked and there had been a lack of meeting of minds thus only the fellowship had to be looked upon to help the organisation to work in a way which is cooperatively effective and efficient for the entire organisation involved. It can be financially indicated that the merger had not been useful in way which could aid either of the companies and there are statements released by employees during that period claiming it had not been efficient in either way. Having bought Skype for 2.6 billion USD back in 2005 and sold it off for 1.1 billion USD later, indeed depicts the loose of interest of the unified organisations .The go around of eBay and Skype to come across on the similar platform was not found to work in harmony about the buyers and the seller ultimately leading to the value addition.²

One of the statements released by the employees had come from eBay's CEO and President John Donahoe where he had stated that "Skype is a great stand-alone business with strong fundamentals and accelerating momentum. But it's clear that Skype has limited synergies with eBay and PayPal. "He stated that operating Skype as a stand-alone publicly traded company was the best way to maximise its potential and at the same time allow eBay to focus what it does best. "This will give Skype the focus and resources required to continue its growth and effectively compete in online voice and video communications." Thus, the lack of meeting of minds and convergence of the organisational functions had led to the limited connection between the companies that are involved.³

² Yamini Verma, 'Inadequate Synergy Betwixt The Unification Which Resulted In The Tragically Flawed Failure.' (*Inventiva*, 2020) <<https://www.inventiva.co.in/stories/yamini/inadequate-synergy-betwixt-the-unification-which-resulted-in-the-tragically-flawed-failure/>> accessed 2 June 2020.

³ 'Lack Of 'Synergy' Pushes Ebay To Spin Skype Off' (*Campaignlive.co.uk*, 2020) <<https://www.campaignlive.co.uk/article/lack-synergy-pushes-ebay-spin-skype-off/898336>> accessed 2 June 2020.



THE ATTEMPT TO GRAB THE ATTENTION OF THE CUSTOMERS

The idea of buying Skype, explained Aapo Markkanen, telecoms analyst at IHS Global Insight, was to increase the number of people buying and selling on the website by improving communication between bidders and auctioneers. Rather than emailing each other they would be able to talk, using the website itself for their free calls. This direct connection, meanwhile, would help eBay reduce the amount of fraud in its auctions, helping to reduce costs and attract more buyers. But he said: "In practice, the users simply still preferred emails to calls. Communication in voice also compromised some of the anonymity of bidding, which to many users is a significant upside in online auctions."⁴

eBay had purchased skype for 2.6 billion dollars which was said to be of huge quantum as the revenues of skype had not been proportionate to the reason as to why the company was being purchased. The Chief Executive Officer had tried to explain the reasoning as to why Skype had been purchased as the respective participants and customers can have an improved channel to communicate. However, the users had not picked up the idea as projected by eBay as they considered it as unnecessary for the communication and there are other ways which can be used to get in touch with the participants of the site. These are a few of the reasons as to why the connection of the users of both the companies did not work. They had projected that VOIP services would improve the mode to communicate to the participants of the auction site.

THE DIFFERENCE IN COMPANY CULTURE AND STYLE OF MANAGEMENT

To merge in together and form a connection which would aid the operations the organisations must merge their company cultures and to come to a consensus which could aid in the operational efficiency. If companies cannot seem to merge and adapt to each other's environment and culture, the acquisition and merger would turn out to be a failure and are on the multiple reasons as to why most of the mergers have difficulties in producing an increase in shareholder value. In the case, the cultures of eBay and skype had not phased together in a compatible. way and thus to integrate the operations had been extremely difficult. eBay had a culture that could described in way which

⁴ Richard Wray, 'Generation Gap: How The \$3Bn Marriage Of Ebay And Skype Ended In Divorce' (*the Guardian*, 2020) <<https://www.theguardian.com/technology/2009/sep/06/ebay-skype-recession-donahoe>> accessed 2 June 2020.



shows the operations and the functioning had not been democratic and the suggestions taken comes from the official board of directors and thus showing a difficulty for employees to voicing out their opinions but Skype had been the opposite and due to the contradicting cultures, the process of integration had not been good enough to phase the operations.

Ben Matthews who is the head of the department of the strategic communication at ebay had stated in an article in the International Association for business communications that during pre 2014 that ebay had been lacking on producing an effective company culture and the employee sentiments, received through ad-hoc surveys, Q&A sessions and one-on-one sessions with managers, had not been identified as an issue in a previous annual colleague engagement survey. These factors gave the communication team only a six-week window in which to identify whether an issue existed⁵. As stated there had been a problem of communication between the hierarchy between the employees of the company involved.

Niklas Zennström a cofounder of skype had stated that they wanted to change the way people communicate and Tomas Rehor an engineer manager in skype had stated that it's a culture where everybody is self-motivated and passionate about the work they do. In a dramatic deal in 2006, eBay acquired Skype for \$3.1 billion, hoping the technology could help its users validate the authenticity of their transactions.⁶ Skype did not have a conservative version where there is a bureaucratic style of management and there was a freedom in the taking of decisions. When a company tries to merge their functions with a company that has been purchased, there will be a conflict between the employees as there is a difference in the style of how both the companies have been managed and the culture that they had followed prior to the acquisition or merger that has taken place which can be seen in this case, where there were multiple conflicts between the management of the both the companies involved.

⁵ "The Ebay Intervention: Gauging A Company's Culture" • International Association Of Business Communicators IABC' (*International Association of Business Communicators IABC*, 2020) <<https://www.iabc.com/ebay-gauging-company-culture-2/>> accessed 18 May 2020.

⁶ 'Skype At 10: How An Estonian Startup Transformed Itself (And The World)' (*Microsoft News Center*, 2020) <<https://www.microsoft.com/en-us/stories/skype/skype-chapter-3-skype-is-in-the-dictionary.aspx>> accessed 20 May 2020.



THE OVERPRICING OF STOCK/ SHARES/ ASSETS

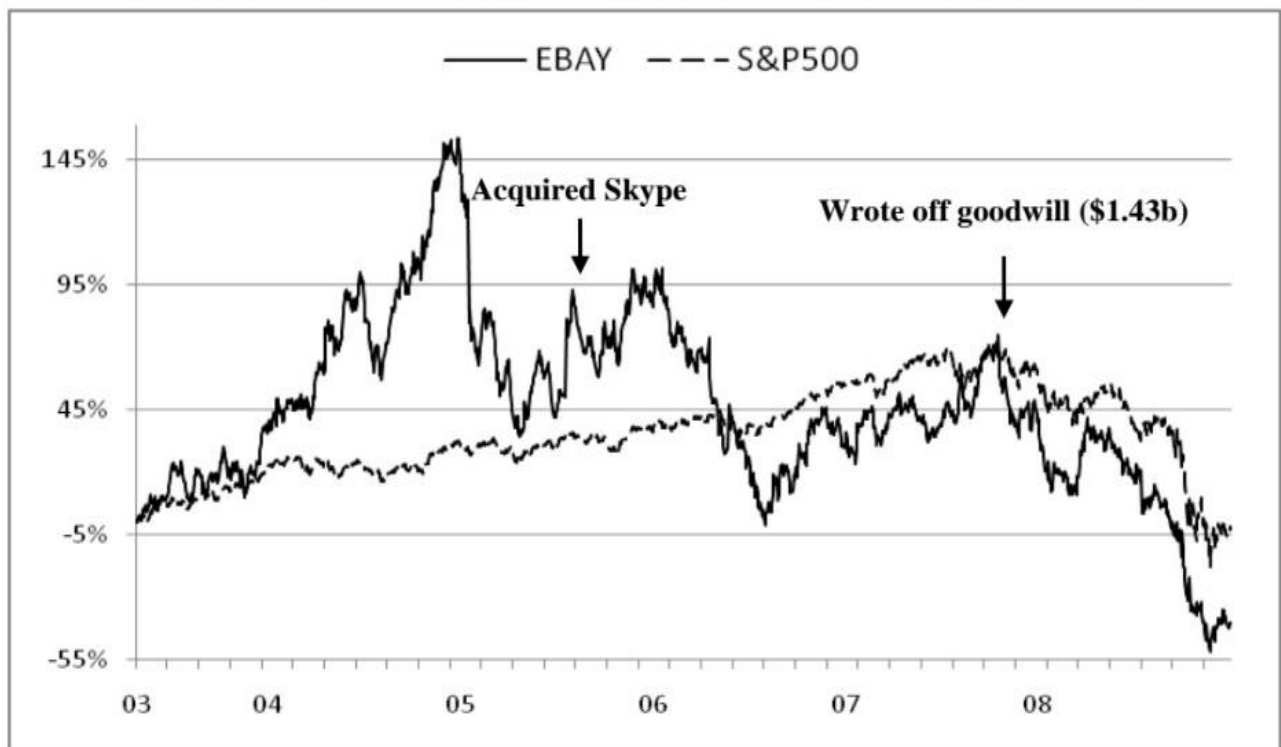
While a company is being acquired, the value of the assets and stocks to ensure that the company is worth being acquisitioned. To calculate the Intrinsic Value of a company stock, there are multiple methods to come to conclusion and the two methods which are focused are the DCF and DDM (Discounted cash flow method and Dividend Discount Model). Discounted cash flow involves the calculating the value of the asset to determine the value of the cash flows being generated and Dividend discount involves the assumption and theory that is to be taken that the value of stock is worth of the entire present value and payment of dividends. The limitations to these methods are the assumptions and the lack of input that are included. Even though the values shown must be taken into importance, the DCF method is taken to calculate the Net Present Value. In this case, one of the reasons as to why eBay had acquisitioned Skype is to improve their cash flows as even though Skype had unsatisfactory cash flow and there had been a lack of operational efficiency, they had projected that with two companies involved there would be an increase in the cash flows and increasing operational efficiency. When eBay had purchased Skype, Skype had a positive NPV of 600 million dollars. As stated earlier, companies must always invest in companies which have a positive NPV and taking other necessary parameters into importance and even though Skype had

looked like a good company to acquisition with its intrinsic value to be satisfactory, more factors should have been taken into importance

Source: Feng Gu and Baruch Itamar Lev, 'Overpriced Shares, Ill-Advised Acquisitions, And Goodwill Impairment' [2008] SSRN Electronic Journal.

At the time of acquisition, eBay's stock advanced over twice the S&P 500, and with the benefit of hindsight, eBay's steep stock price decline in 2006 and its stagnation thereafter its shares seem to have been substantially overpriced at the time of the Skype acquisition. Things soon turned ugly for the online auctioneer, and on October 1, 2007, it announced a massive goodwill write-off of \$1.43 billion (55% of the acquisition price) related to the Skype acquisition.⁷ Generally goodwill are written off if the money and time put into the investments are not providing the expected goals set by the companies and there are acquisitions made by large scale companies so there is a reason to increase the shareholders wealth by overpricing and this is done to justify the entire process of

Figure 1
eBay vs. S&P 500: The Skype Acquisition—Cumulative Stock Returns



⁷ Feng Gu and Baruch Itamar Lev, 'Overpriced Shares, Ill-Advised Acquisitions, And Goodwill Impairment' [2008] SSRN Electronic Journal.



the purchasing companies. However, this process is ill advised and there is only time that is being bought which in this case had caused the shareholders to pay more than the negative returns. These schemes majority of the times lead to extreme increase in debt but in this case, there had been a profit of 1.4 billion dollars as Microsoft had acquired Skype.

CONCLUSION

To invest in a company that has a reputation of decent performance standards, there should be multiple factors that must be taken into importance. One of the first steps is to check the company's financial compatibility and flexibility. They must check whether both the companies can merge their operations in a way which is effective and efficient. The company cultures must be accepted in a way where there can be a consensus brought between both the cultures and the merged organisation must have a phased culture which suits both the styles of management. The synergies of the organisations must be evident to connect them which aids them in achieving their combined goals. The question of why the targeted company is pursued is to be answered initially as to how their future projects can be shaped and how the other company can aid the company that is targeting. The Net Present Value must be calculated and the NPV must be positive to make sure there is a sufficient cash flow. eBay had invested into skype so that their operations can be merged which could improve their auction site with a convenient communication channel and to increase their profits. However, there had been no grabbing of attention of the customers and their style of management had not suited eBay. In 2007, there had been a massive goodwill write off which indicated their investment strategy was not effective. Even the overpricing of shares after there had been no signs of profits by the manager had led to the shareholders paying amounts more than the negative returns that they were liable to pay. Thus, several factors must be taken into importance to check whether the merger/acquisition has the power to produce a sufficient quantum of returns over the years.