

Auction Design Could Streamline TikTok's US Asset Sale

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In August, President Donald Trump signed an executive order mandating that TikTok either: (1) sell its U.S. operations and transfer TikTok's American user data to U.S. servers by mid-September or (2) cease transactions within the U.S.

Prior to the executive order, the Chinese internet company ByteDance Ltd., the owner of TikTok, already had received inquiries to be acquired. According to The New York Times, "[p]rices for a potential deal have ranged from \$20 billion to \$50 billion."^[1]

In an additional twist, according to The Wall Street Journal, the Chinese government recently issued new restrictions that make it uncertain if the app's core algorithm can be included as part of the deal,^[2] which significantly changes the bidder's valuations of the offer.

The mechanics of this potential sale and the underlying bidding structure are cloaked in mystery, which is not unusual but likely will not maximize the value of the assets in play.

Business insiders often presume that the asset sales process they face, like the sale of TikTok's U.S. assets, does not lend itself to a structured auction approach and that the best results can be achieved only by conducting the sale in rounds of negotiations behind closed doors.

But the reality is that participants in a complex asset sale with multiple stakeholders and dueling government oversight can benefit from a streamlined, structured approach.

To encourage participation and to maximize the value of the portfolio, the bidding process needs to be fair, transparent and efficient, and the auction design needs to accommodate the different asset mix preferences of bidders. The auction approach should be structured to satisfy those key success factors.

TikTok's operations in the U.S. comprise a complex portfolio of assets that are related such that, in



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auctioning off the assets, the auction design matters greatly in maximizing value.

In our experience in similar situations, bidders will value different parts of the portfolio differently, with some willing to bid only on specific combinations of assets included in the portfolio. The preferred combinations, and the values placed on the assets, will vary by bidder.

For example, if assets A, B and C are part of the portfolio for sale, some bidders may want to purchase all three assets together (A+B+C) or nothing at all; some may want only assets B and C together (B+C) or nothing at all; some may want at most one item (A or B or C); and some may be bidding opportunistically and — depending on prices — are willing to take A, B and/or C. Of course there are other possibilities as well. In this situation, a combinatorial auction design will benefit all the participants and maximize the portfolio value.

A combinatorial auction allows bidders to place bids on single items and on combinations of items of their choosing. Following the example above, a bidder can name their price on asset A alone, or on a combination of assets (e.g., B+C), or on the complete portfolio (A+B+C).

Once bids from all the bidders are received, the auction algorithm finds a feasible combination that maximizes the value. A feasible combination here means that each asset is sold to no more than one bidder. Bidding continues round by round as long as the bidders are willing to increase their offers to improve the ultimate sales price.

The government's involvement in the TikTok sale likely means that some bidders might not be eligible to bid on certain parts of the TikTok portfolio. This and other constraints can be incorporated in the bidding platform to facilitate bidding.

A well-designed auction platform provides order, transparency and efficiency in what otherwise can be a hectic process of selling a complex portfolio:

- The allowed combinations of the assets can be prespecified or bidders can be allowed to create their own preferred combinations or packages.
- The bids are received and processed pursuant to the prespecified bidding rules.
- All the relevant parties can observe and review the bids remotely online.
- If allowed by the seller, the bidders can see the current standing high bidders on the assets and what price they need to offer to beat them.
- Once the bidding closes and the winners are announced, there is no confusion about who won and why. Winning bidders win simply because other bidders were not willing to bid higher prices.
- If applicable, the relevant regulators can review and approve the results as soon as the bidding ends.
- All transactions are electronically recorded and time stamped, facilitating auditing.
- All of this can be done remotely, as there is no need to travel or gather in the same location.

- The platform can be made user-friendly and secure to encourage participation.

Increased transparency and efficiency often lead to greater bidder participation. Bidders who trust the process are more likely to participate in the bidding and bid more aggressively. On the other hand, increased uncertainty around the deal often leads bidders to place bids that are less than their maximum willingness to pay.

Likewise, bidders need to be able to offer prices for their preferred combinations of the assets. Only a structured auction approach that accomplishes that will achieve the goal of maximizing the portfolio value. A sale of a complex portfolio, like TikTok's U.S. operations, lends itself well to a structured auction approach as outlined here.

Similar issues that can be solved by an appropriate structured auction approach may arise if and when other companies and portfolios come under scrutiny by governments.[3]

Such a structured approach as outlined here rarely is used because the same processes that have been used for so long do not seem to be broken, and the value foregone by not using the appropriate structured auction approach is not visible or understood.

Also, some participants believe they benefit from a bidding process that is less structured, enabling them to manipulate the process to their advantage through negotiations, side deals and other tactics that inject more subjectivity into the ultimate bid selection and that make it difficult to compare and evaluate different bids.

If all bidders believe they can manipulate the process just as well as other bidders and at least one bidder is allowed to engage in such tactics, then all bidders must do so as well.

The end result is a costly, time-consuming effort on the part of everyone involved that often leads to an outcome in which it is difficult to justify the winning bids, arguably money is left on the table, some bidders feel treated unfairly, and there are challenges to the process and outcome leading to further delays and costs.

However, increasingly, the advantages of well-designed auctions are being recognized and applied in more and more situations.

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[1] https://www.nytimes.com/2020/08/27/technology/walmart-tiktok-deal.html?utm_source=morning_brew.

[2] <https://www.wsj.com/articles/tiktok-deal-talks-are-snarled-over-fate-of-apps-algorithms-11598995674>.

[3] <https://www.nytimes.com/2020/08/17/technology/trump-tiktok-wechat-ban.html> and <https://foreignpolicy.com/2020/08/14/wechat-ban-trump-chinese-diaspora-china-surveillance/>.