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What You Should Know About Company Mergers

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- A company merger is when two companies combine to form a new company.
- Companies merge to expand their market share, diversify products, reduce risk and competition, and increase profits.
- Common types of company mergers include conglomerates, horizontal mergers, vertical mergers, market extensions and product extensions.
- **This article is for business owners who are considering merging their company with another business.**

A company merger can happen for many reasons. Although very few business owners build their business in anticipation of one day merging with another company, the right business mergers can be very beneficial. Learn about the different types of mergers and their benefits.

What is a company merger?

A company merger occurs when two firms come together to form a new company with one combined stock. Although a merger is typically thought of as an equal split in which each side maintains 50% of the new company, that's not always the case. In some mergers, one of the original entities gets a larger percentage of ownership of the new company. **[Read related article:** You Bought a Business … Now What? 5 Post-Acquisition Steps**]**

Key takeaway: **A merger is when two companies come together to form one company with new stock.**

Why do companies merge?

Mergers are a great way for two companies with unique experience and expertise to come together and form one business that is more profitable than the two entities were on their own.

There are several reasons why two companies might want to merge. Sometimes, it is out of convenience, and other times, it is out of necessity. Regardless of the specifics, the goal of a merger is to take advantage of opportunities in the marketplace that benefit both businesses.

"The companies may be looking to take advantage of financial synergies, opportunities for efficiencies, new market dynamics or a chance at product diversification, to name a few things," James Cassel, chairman and co-founder of Cassel Salpeter & Co., told Business News Daily. "The companies may see opportunities by merging product lines or by cutting redundancies, like having two CFOs when one will suffice for both companies if they come together."

Key takeaway: **A merger can benefit companies by increasing profits, enhancing expertise, expanding market share, diversifying products and minimizing redundancy.**

How does a company merger work?

A company merger occurs when two businesses with similar synergies decide that being one company together will yield more profits than being two separate entities. During a merger, the companies involved are likely to undergo quite a bit of restructuring in terms of corporate leadership and operations.

When a company merger happens, the two equal companies can convert their previous stocks into one new, combined company stock. First, they must decide what each company is worth, and then they split the ownership of the new company accordingly. **[Read related article:** How to Calculate Your Business Valuation**]**

"For example, it may be determined that company A is worth $100,000,000 and company B is worth $200,000,000, making the combined value of the new company worth $300,000,000," said Terry Monroe, founder and president of American Business Brokers & Advisors. "Therefore, the stocks from each of the companies will be surrendered, and new stock will be issued in the name of the new company based on the valuation of $300,000,000. The stock owners from company A would get one share of stock in the new company, and stock owners from company B would get two shares of stock in the new company."

Although the creation of a brand-new stock with the new entity is ideal in theory, it is not always what happens. In fact, oftentimes, when two companies merge, one company chooses to buy the other company's common stock from its shareholders in exchange for its own stock.

Key takeaway: **When entities merge, both companies can convert their current stock into one new stock and divide it among the new owners based on previous worth.**

What is the difference between a merger and an acquisition?

Mergers and acquisitions are often confused as interchangeable terms, but there are a few differences. Although both involve combining two entities, an acquisition is when one company buys and controls the other, whereas a merger is when two companies come together to form a new entity.

"A lot of the time, no money is involved in a merger, whereas an acquisition is when one company pays to purchase another company, either with money or the issuing of stock or assumption of debt or a combination of all of these methods," Monroe said. "With an acquisition, the acquiring company will remain in business, and the company that was acquired will no longer be in existence."

Since an acquisition, or a takeover, involves one company consuming the other, the leadership in both companies often stays the same. Mergers, on the other hand, frequently involve the restructuring of corporate leadership, which can cause problems when both companies have headstrong leaders with different ideas on how to run the new organization.

For example, you will likely have to decide which CEO or president of the two merging companies will run the newly merged company. Although some merging companies attempt to have the CEOs of both companies share leadership through a co-CEO structure, this strategy rarely works out well, Monroe said. This is something business leaders should keep in mind when considering mergers versus acquisitions.

***Key takeaway:* A merger is when two companies combine to form one new company; an acquisition is when one company buys out and controls another company.**

What are the different types of company mergers?

There are five main types of company mergers: conglomerate, horizontal, vertical, market extension and product extension. The merger type is based primarily on the industry and the business relationship between the two merging companies.

Conglomerate merger

A conglomerate merger is the combination of two companies from different industries and unrelated business activities. The benefits of a conglomerate merger include diversifying business operations, cross-selling products and minimizing risk exposure. A well-known example of a conglomerate merger was when The Walt Disney Company merged with the American Broadcasting Company (ABC).

Horizontal merger

A horizontal merger is the combination of two companies from the same industry; these companies can include direct and indirect competitors. The benefits of a horizontal merger include greater buying power, more marketing opportunities, less competition and a larger audience reach. Monroe said this type of merger is common in the restaurant industry, where different brands of restaurants merge to reach a wider customer base and gain greater buying power from the same vendors.

"For example, in 2019, Papa Murphy's, a company in the pizza business, merged with a company called MTY Food Group – which owns restaurants such as TCBY, Cold Stone Creamery and Planet Smoothie – which would allow the new company to have a centralized marketing and advertising department and franchised sales department," Monroe said.

Vertical merger

A vertical merger is the combination of two companies that operate in different stages of the same supply chain, producing different goods or services for the same finished product (e.g., one company sells something to the other company). The benefits of a vertical merger include a more efficient supply chain, lower costs and increased product control. An example of this type of merger is when The Walt Disney Company merged with Pixar Animation Studios for its innovative animations and talented employees.

Market extension merger

A market extension merger, similar to a horizontal merger, is the combination of two companies from the same industry; however, in this merger, the two companies are from separate markets. The primary benefit of this merger is to expand and increase market share. Monroe said this type of merger is commonly seen with banks.

"With the government implementing more regulation and compliance from banks, it sometimes behooves smaller bankers to merge with other banks of similar size to reduce the cost of operations and regulatory compliance and increase their market share, since they all offer essentially the same product," Monroe said.

Product extension merger

A product extension merger, also known as a congeneric merger, is the combination of two companies that sell similar, but not necessarily competing, products. The benefits of a product extension merger are expanding customer reach and increasing profits. Monroe said this type of merger is very common in the software industry, where one company may offer a virus protection software and another company may offer financial protection software for your personal financial data.

"The idea of these two companies merging would be a good idea, as both of their products would be applicable to the same customer," Monroe said. "The product merger can continually be extended with add-on services and products once a customer has been acquired."

Key takeaway: **There are five main types of company mergers: conglomerate mergers, horizontal mergers, vertical mergers, market extension mergers and product extension mergers.**