

6.17: Mergers and Acquisitions

Learning Objectives

- Define merger as a business strategy
- Define acquisition as a business strategy
- Explain why companies undertake horizontal mergers and acquisitions
- Explain why companies undertake vertical mergers and acquisitions

Integration Strategies: Mergers and Acquisitions



When businesses acquire other businesses or operations that were previously competitors, suppliers, buyers, or sellers, they are engaging in a strategy known as **integration**. This strategy is based on the possibility of *synergy*, the idea that the sum of two entities will be greater than their individual parts—often expressed as $1 + 1 = 3$. Integration can be accomplished in two primary ways: through mergers or acquisitions. A **merger** is the consolidation of two companies that, prior to the merger, were operating as independent entities. A merger usually creates one larger company, and one of the original companies ceases to exist. Mergers can be either horizontal or vertical.

A **horizontal merger** occurs between companies in the same industry. This type of merger is essentially a consolidation of two or more businesses that operate in the same market space, often as competitors offering the same good or service. Horizontal mergers are common in industries with fewer firms, since competition tends to be higher, and the synergies and potential market-share gains are much greater in those industries.

✓ Facebook + Instagram = Horizontal Merger

When Facebook acquired Instagram in 2012 for a reported \$1 billion, Facebook was looking to strengthen its position in the social-media and social-sharing space. Both Facebook and Instagram operated in the same industry and were in similar positions with regard to their photo-sharing services. Facebook clearly saw Instagram as an opportunity to grow its market share, increase its product line, reduce competition, and access new markets.

A **vertical merger** is characterized by the merger of two organizations that have a buyer-seller relationship or, more generally, two or more firms that are operating at different levels within an industry's supply chain. Most often the logic behind the merger is to increase synergies by merging firms that would be more efficient operating as one.

✓ Apple: The King of Vertical Integration

Apple Inc. is famous for perfecting the art of vertical integration. The company manufactures its custom A-series chips for its iPhones and iPads. It also manufactures its custom touch ID fingerprint sensor. Apple opened up a laboratory in Taiwan for the development of LCD and OLED screen technologies in 2015. It also paid \$18.2 million for a 70,000-square-foot manufacturing facility in North San Jose in 2015. These investments (i.e., mergers) enable Apple to move along the supply chain in a backward integration, giving it flexibility and freedom in its manufacturing capabilities.^[1]

An **acquisition**, on the other hand, occurs when a company purchases the assets of another business (such as stock, property, plants, equipment) and usually permits the acquired company to continue operating as it did prior to the acquisition. *Acquisition* usually refers to a purchase of a smaller firm by a larger one. Sometimes, however, a smaller firm will acquire management control of a larger and/or longer-established company and retain the name of the latter for the post-acquisition combined entity.

? Practice Questions

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Reasons for Mergers and Acquisitions

There are many good reasons for growing your business through an acquisition or merger. These include:

1. Obtaining quality staff or additional skills, knowledge of your industry or sector, and other business intelligence. For instance, a business with good management and process systems will be useful to a buyer who wants to improve their own. Ideally, the business you choose should have systems that complement your own and that will adapt to running a larger business.
2. Accessing funds or valuable assets for new development. Better production or distribution facilities are often less expensive to buy than to build. Look for target businesses that are only marginally profitable and have large unused capacity that can be bought at a small premium-to-net-asset value.
3. Your business is underperforming. For example, if you are struggling with regional or national growth, it may well be less expensive to buy an existing business than to expand internally.
4. Accessing a wider customer base and increasing your market share. Your target business may have distribution channels and systems you can use for your own offers.
5. Diversification of the products, services, and long-term prospects of your business. A target business may be able to offer you products or services that you can sell through your own distribution channels.
6. Reducing your costs and overheads through shared marketing budgets, increased purchasing power, and lower costs.
7. Reducing competition. Buying up new intellectual property, products, or services may be cheaper than developing these yourself.
8. Organic growth (i.e., the existing business plan for growth needs to be accelerated). Businesses in the same sector or location can combine resources to reduce costs, eliminate duplicated facilities or departments, and increase revenue.

? Practice Questions

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1. Kenton, Will. "Vertical Integration." Investopedia. August 21, 2019.
<http://www.investopedia.com/terms/v/verticalintegration.asp#ixzz4PRMbV5zm>←

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