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Achim Neumann, President, formed A Neumann & Associates, LLC in early 2003 with focus on the mid-sized business Mergers & Acquisitions market.

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UNDERSTANDING HORIZONTAL MERGERS

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This post was provided by A. Neumann & Associates, LLC, a professional mergers and acquisitions advisory firm with multiple offices across the Northeast.

What are Horizontal Mergers?

In business, companies that operate in the same space tend to compete for resources as well as market share. However, companies that once competed against each other in an industry can decide to come together for the sake of gaining better synergies and market share. When an alliance of this nature occurs, it is known as a horizontal merger.

Horizontal mergers typically occur between bigger organizations on the same point of a supply chain who wish to obtain better economies of scale. On the other hand, when two or more firms that operate on different points of a supply chain come together to achieve the same purpose, it is known as a vertical merger.

How Do Horizontal Mergers Work

Companies that conduct horizontal mergers gain significant advantages over their competition. One such advantage is the increase in market share which a new company gets when it is born from two companies that already had significant shares of the market.

Also, if the company conducting the merger also manufactures other products that complement the main, then it benefits from the merger by having an increased number of people to present its products to.

Comparing Horizontal Mergers and Vertical Mergers

The differences between horizontal and vertical mergers lie in their purpose; vertical mergers are conducted with the purpose of reducing a company's operating costs or improving its efficiency. It usually occurs when a company buys over the company it used to purchase a particular product from. It can also happen when a producer merges with one of its distributors.

Horizontal mergers, on the other hand, are aimed at increasing the company's revenue by reaching a larger market and being able to offer that market another range of products.

While horizontal mergers mostly seek to simply tap into a hitherto inaccessible portion of the market, vertical mergers help provide businesses who need key items for their operations with a more affordable and reliable supply source. With a reliable supply source in-house, there is no need to seek out external suppliers or have to pay the same price the regular market does. When a vertical merger is well executed, production teams on both ends of the companies are able to efficiently work in tandem so that needed products are supplied when they are required. In the face of a skillfully executed merger, competition may find it hard to cope as they will not be able to secure supply fast enough to produce at the same pace of the merged company, and will eventually face receding profit margins.

Some Special Considerations

When two competing companies in an industry are performing excellently, it may be more expedient for them to merge horizontally and work together to develop products and services, instead of attempting to individually outperform one another. The merger might improve the range of products that can be offered to customers, hence increasing company revenue.

With control over the new, larger entity, the company may decide to sell pieces of the business off if they do not align with the functions that are to be carried forward. Horizontal mergers also provide the benefit of neutralizing competing threats in the market and give newly formed entities enough market share to be able to exercise more control over pricing.