NICO Asset Managers

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INVESTOR'S GUIDE

A guide to the financial markets, investments and the economy
10 August 2018

Topic 277: Business Mergers

1. Introduction

This week we would like to begin a new topic under business mergers. In simple terms, a business merger is the combining or uniting of two or more companies into a single entity. As a starting point of our discussion, we will look at some of the reasons why companies merge and the types of business mergers.

2. Reasons why firms merge

i. For profit making

Companies merge in order to increase performance with a large number of resources and also to decrease the amount of costs. This may enhance the chances of making great profits.

ii. To eliminate competition

Merging, particularly for firms in the same industry, does eliminate competition as the number of suppliers providing a similar service or good reduces hence merging of companies creates a large market share gain.

iii. Growth and diversification

Mergers give the acquiring company the opportunity to expand without having to do so much work. For example, when a large bakery merges with a smaller one, it helps it grow. Merging also Reduces risk by diversifying as it decreases the risk of relying on one or a few sources of income. Different products have different demand cycles and you may be assured that when one product slides back, then you may count on the other for income.

3. Types of business mergers

i. Conglomerate

A merger between firms that involve in totally different business activities. For instance, if a radio station was to merge with a bank, then it would be conglomerate.

ii. Horizontal

A merger that occurs between firms in the same industry or involved in the same business activities. An example would be the merge of two banks.

iii. Vertical

This is a merger between companies in the same industry but at different levels of production. For example, if a cotton supplying company was to merge with a cloth manufacturer then it would be a vertical merge because they all are aiming to produce a similar finished product which are clothes, however, the cotton supplier is at an early stage of production whereas the cloth manufacturer is at a later stage.

iv. Market extension

This merger takes place between two companies that deal with the same products but in different markets. This is done so that the merging companies may have access to a large market share and maximize profits. For example, FMB merging with major shareholder of Barclays Zimbabwe.

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