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July 8, 2023

Growth Strategy: Horizontal Integration or Vertical Integration, which is Better?

This paper aims to examine a company's growth strategy, achieved through horizontal and vertical integration in the supply chain process. I will analyze both approaches, considering their strengths, weaknesses, and to offer insight into how companies can develop their operations and achieve sustainable growth.

Horizontal integration is strategy businesses use to expand their market presence, where a company partners with another in the same industry. Instead of competing, these companies combine their resources, products, and services to increase their sales and dominance in the market.¹ A company can integrate horizontally in **three** different ways. This includes **merging** with another company, which involves two separate companies coming together to create a newly combined organization. Another method is **acquiring** another company, where one company buys and takes over the operations of another company. Finally, a company can **expand internally** by deploying in-house capital to expand its presence at the same value chain level.²

The strengths and weaknesses of horizontal integration can be seen in Exhibit 1 below:

Exhibit 1. Horizontal Integration Strengths & Weaknesses (Not an exhaustive list)

Strengths	Weaknesses
Increased market share	Antitrust issues and legalities
Access to new markets	Reduction in flexibility
Cost savings	Leadership and cultural indifferences
Increased bargaining power over suppliers	Negative value
Increased differentiation	Regulatory issues
Reduced competition	Operational challenges
Increased economies of scale and scope	Management and critical staff turnover

Source: Compiled from (Tarver 2021)

¹ (Kenton 2022)

² (Luther 2023)

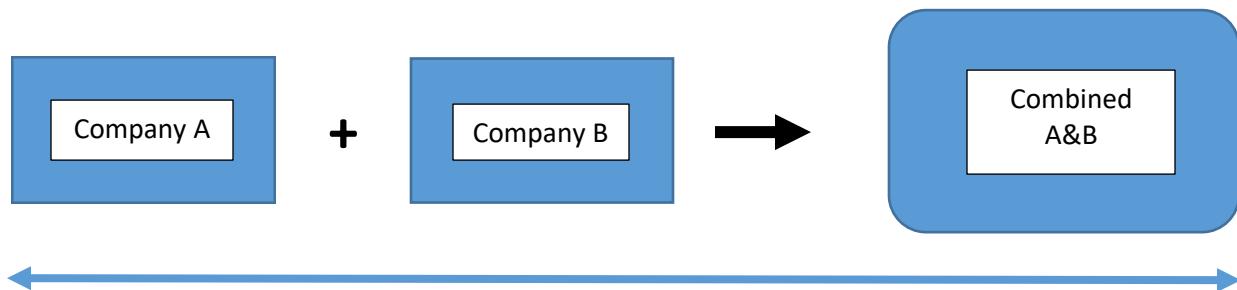
The following are examples on companies that incorporated horizontal integration along their production or distribution stage:

Facebook's (Meta) acquisition of Instagram for \$1 billion in 2012, both are in the social network business. This enabled Facebook access to new talent, and to 30 million active mobile device users.³

Kraft Foods Group and H.J Heinz Company merger in 2015, created Kraft Heinz, one of the largest food companies in the world with annual revenue of \$28 billion. The merger enabled them to grow their global footprint.⁴

United Technologies and Raytheon merger in 2019, created Raytheon Technologies, the largest deal in the sector combining commercial aviation business with military equipment and supplies.⁵

Figure 1. Horizontal Integration illustration



Source: Own depiction

Vertical integration is a business tactic that streamlines a company's operations by directly owning each aspect of the production process rather than relying on external contractors or suppliers. Companies can achieve vertical integration instead of outsourcing through acquisitions or the establishment of suppliers, manufacturers, distributors, or retail locations.^{6 7} There are several ways companies can vertically integrate during one of the four relevant stages of the supply chain. The type of integration depends on the company's position in the supply chain. A company is **integrated forward** if

³ (Tausche and Bergman 2012)

⁴ (Trefis Team 2015)

⁵ (Brumpton and Duguid 2019)

⁶ (Hayes 2023)

⁷ (Kim 2023)

it controls stages farther down the supply chain from its starting point. **Backward integration**, on the other hand, is when businesses at the end of the supply chain undertake activities upstream of their products or services. A company that merges with other businesses to control upstream and downstream activities is said to have achieved a **balanced integration**.⁸

The strengths and weaknesses of vertical integration can be seen in Exhibit 2 below:

Exhibit 2. Vertical Integration Strengths & Weaknesses (Not an exhaustive list)

Strengths	Weaknesses
Improved quality control	Cultural challenges
Improved access to technology	Increased responsibility
Improved product delivery	Increase complexity of operations
Increased control of value chain	Expensive
No reliance of suppliers	Loss of focus
Economies of scale	Long-term process
Lower lead time	Potential underperformance

Source: Compiled from (Hayes 2023)

The following are some examples of vertical integration for better understanding:

Tesla has successfully implemented a vertical integration strategy, which has proved to be highly efficient compared to its competitors in the automotive industry. The company produces most of the components required for its vehicles and has established sales and service operations, including charging stations, that are managed in-house. The integration of these forward and backward supply chain activities has allowed Tesla to achieve improved performance and a significant competitive advantage.⁹

Google's acquisition of Motorola Mobility in 2012 for \$12.5 billion, enabled an integration of Android operating system with Motorola's hardware to create a more seamless user experience.¹⁰

⁸ (Hayes 2023)

⁹ (Nanninga 2018)

¹⁰ (McCarthy and Golvin 2011)

Walt Disney's acquisition of Pixar in 2006 for \$7.4 billion, Pixar would benefit from Disney's financial strength and distribution network, while Disney would own the world's most innovative animation studio.¹¹

CVS Health's acquisition of Aetna in 2017 for \$69 billion, resulted in the largest acquisition in US Healthcare history. In addition to CVS Health as a pharmacy benefit manager with 90 million members, clinics, and drug stores, the acquisition also gave them access to Aetna's 45 million medical benefit members.¹² This allows the expansion into new areas in the healthcare supply chain for further control.

Figure 2. Vertical Integration Illustration

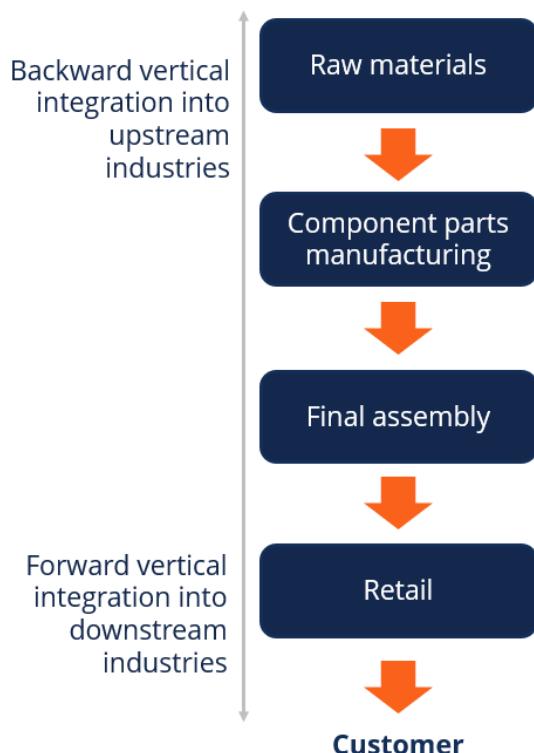


Image: (CFI Team 2020)

¹¹ (Holson 2006)

¹² (Pifer 2018)

In summary, both horizontal and vertical integration offer benefits and drawbacks. **Horizontal integration** can grant wider access to customers, more significant revenue, and reduced costs through economies of scale. It can also eliminate competitors. However, it only brings synergy without self-sufficiency. On the other hand, **vertical integration** can lead to cost savings, efficiencies, and greater control over the supply chain. Nevertheless, it may result in higher overhead costs and lower flexibility. Ultimately, the decision to pursue either depends on industry and company-specific factors, including goals and available resources. Companies should consider a combination of horizontal and vertical integration to meet their objectives.

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