

A Case Series Of Today's Vertical Integration

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ABSTRACT

In today's business environment outsourcing attracts considerable attention. The general rationale is that anything that is not a core competency of the firm is a candidate for outsourcing. The touted benefits are generally considered to be substantial cost savings, better productivity and more strategic use of scarce resources within the firm. In contrast, vertical integration has to some degree come to be viewed somewhat negatively – the argument being that no single firm in today's competitive environment can possibly – or should – manage an extended enterprise. But as this series of case studies show, some firms are flourishing by going against prevailing logic and vertically integrating their supply chains.

Keywords: Vertical integration, forward integration, supply chain

INTRODUCTION

The degree to which a firm owns its upstream suppliers and downstream buyers is referred to as vertical integration. Due to the fact that it can have a significant impact on a business unit's position in its industry with respect to costs, differentiation, and other strategic issues, the vertical scope of the firm is an important consideration in corporate strategy. Vertical integration potentially offers many different advantages. Some of the most substantial benefits are as follows:

1. Reduces transportation costs if common ownership results in closer geographic proximity.
2. Improves supply chain coordination.
3. Provides more opportunity to differentiate by means of increased ownership over inputs.
4. Captures upstream and downstream profit margins.
5. Gains access to downstream distribution channels that otherwise would be inaccessible. [1]

Despite these apparent advantages, many firms actively outsource various functions within their supply chain. The argument in favor of such an outsourcing strategy is based around the idea of core competencies. That which you do well remains carefully guarded and nurtured within the firm, everything else becomes a candidate for outsourcing. Why perform those tasks that others can do more efficiently?

The reason is that there are still benefits in carefully applied vertical integrations. The purpose of this paper is to provide examples of how vertical integration in the present day environment can still be used to a firm's advantage. Using a case study approach, this paper examines three separate business entities that currently use vertical integration as part of their business strategy. The three companies are: Vizional Technologies Inc., Crown Equipment and Bank One Corporation. Each of these companies operates in a distinctly different industry – multi-enterprise solutions, material handling equipment and banking/insurance – and yet vertical integration has been successful.

Vizional Technologies, Inc.

Vizional Technologies, Inc., a provider of multi-enterprise solutions established 360-degree, real-time supply chain visibility by their recent vertical acquisition of Saltare, Inc. Saltare is a leading provider in the field of adaptive supply chain management solutions that was designed to manage supply and demand in real-time throughout the supply network. Supply chain management is a key everyday function of manufacturing as it is directly related to inventory management and keeping overall costs to a minimum. This example of vertical integration was a crucial move to purchase the supplier to help both improve their position in the business solutions marketplace. [1]

The acquisition of Saltare provides market-differentiated technology that will enable customers to synchronize multiple events like on-time delivery and production runs, which in turn adds business intelligence throughout the supply network and helps to minimize costs and avoid down time and also holding costs.

The main driver behind the acquisition of Saltare Leap's suite of adaptive supply chain management applications is that it addresses real-time inventory management and capacity allocation and has been deployed by leading high-tech manufacturers, including STMicroelectronics. By acquiring Saltare Leap, Vizional captured this market as they were already the leading provider of multi enterprise solutions, and Saltare's software suite enables them to take the next step and conquer the market. Not only does Vizional now own the software, but it also acquires all of the business from these companies such as STM and increases its wealth and position in the marketplace. Another encouraging aspect is that any updates or services that Saltare provides to these pre-acquisition customers now become profit to Vizional.

VizionalNet (TM) plans to use their existing system – the collaborative synchronization router (CSR) platform – to ease the implementation process. The system is designed to help retailers, logistics service providers, suppliers, and manufacturers increase the effectiveness of their existing supply chain management system. The Vizional/Saltare Leap technology will empower companies by minimizing complexities involved with supply and demand, while maximizing the velocity of working capital, aiding in the adaptation to change and acceptance process, and increase throughputs while maximizing profits. This integration of Saltare's highly innovative methods for adaptive supply chain planning with Vizional's real-time supply chain execution solutions, now enables companies to quickly and intelligently resolve and capitalize on unforeseen events dealing with inventory accumulation and on time delivery of crucial ingredients or materials involved with production. The process has been designed to improve upon supply chain innovation across industries by delivering true, end-to-end supply chain visibility and decision point intelligence. The decision for the integration of Vizional and Saltare Leap was based upon providing customers with the following list of services:

1. Improved customer service levels that minimize inventory liability while at the same time reduced costs.
2. Decreased holding and obsolescence costs as supply and demand variability is reduced and lack of information due to unforeseen events is eliminated.
3. Provide an event management engine capable of being fully synchronized with other transactional systems.
4. Complete supply chain solutions for semiconductor and chip manufacturers from order fulfillment to inventory and capacity management.

VizionalNet is a network of inventory synchronization and distributed order fulfillment solution software. It enables trading partners to dramatically reduce cycle times, eliminate excess inventory, and proactively manage fulfillment operations, handling exceptions as they are identified. With their recent merger they have positioned themselves high atop the business solutions market and continue to develop efficient methods for businesses to reduce costs and increase production so that these firms can someday achieve the success of Vizional.

Crown Equipment

Crown Equipment Corporation is the fifth-largest lift-truck company in the world, and the largest electric lift-truck company in the world. It is now a billion-dollar company. Crown Equipment is located in a small Ohio town of New Bremen. Crown has vertically integrated manufacturing facilities to produce products for the material handling industry. A core competency of Crown is their attention to the products they produce, along with the total attention to customers' needs. Crown signifies many aspects of USA's manufacturing future. They have ability to design, manufacture, distribute, and innovate high-end products where customers are willing to pay more money. The achievements of Crown are astounding. This company started as a privately held company that entered the materials handling industry late in the 1950's. The company excelled, and rose to become a \$1 billion dollar company. The financial success of this company is also complemented by its innovation. They have received many design awards, including an international award that ranks Crown ahead of the likes of Jaguar, Audi, and Porsche. Crown's vertically integrated manufacturing strategy has been another competitive advantage to achieving such high standards.

Crown plants produce 85% of the parts in its products because of the company's product focus, and passion for its work. Producing 85% of products' parts in house enables Crown to build a product that they know is top of the line with minimum defects. Crown's management does keep an open mind to outsourcing to make sure they are still competitive. But a key thought of Crown's management is that it would be difficult to achieve the brand promise when outsourcing and purchasing much of the components from another supplier.

An example of Crown's first break through product shows how an integrated manufacturing and innovation team can lead to a break through. Crown developed the first counter balance lift of its time. It developed a lift that was the first in its industry to combine a multi-function control with a side stance operating position. Crown could not find suppliers to supply components to the control device because the technology was not available. The key point here is that Crown could have had its components supplied all along, but they would not have discovered their break through product. This discovery was the result of an intense customer focus on the needs of the consumer, and a top notch in house innovation team. Crown's insistence that it produce most of the components of the final product led to this innovation that made them a global leader. Ultimately, the company's focus on providing the highest quality product leads the engineer and production employees to always innovate parts and components to be an industry leader – not a follower. If these engineers or the components manufacturers were outsourced or purchased from another supplier, the other supplier would be less inclined to sweat the details and innovate.

When a company buys most of its parts from another company the supplier is just content to receive the paycheck. They have no inclination to innovate. That is why forward integration is so important. Crown is an industry leader because these employees feel like they are part of something and their main focus is to make a technologically advanced product.

There is one ultimate question to be seen in the material handling industry: it is whether low cost overseas manufacturers will redefine competition in the industry. These overseas manufacturers could offer very cheap labor, which would lead to a giant reduction in costs. This may render Crown's approach obsolete, as in many other industries that cheap global labor has ravaged. Crown does compete at the high end of the price scale, but they may still struggle to compete with the cheap labor force offered internationally. The competitive advantage Crown has over cheaper overseas manufacturers is that they do have the vertically integrated product focus that leads to all of the innovations. These low cost overseas manufacturers are competent at mass-producing. However, they are not currently competent innovators of specialized products.

Crown's management speculates that it will survive, because it produces a highly specialized product that meets the customer needs better than anyone else in the world. This smallish company may represent the USA manufacturers' future of an in house vertically integrated production strategy. So far they have performed admirably and have been a high quality and ever-evolving corporation – leveraging their forward integration strategy.

Bank One Corporation

Vertical integration can take the form of a firm developing the ability to produce goods or services previously purchased or actually buying a supplier or a distributor. [3] The objective for this integration can involve acquiring a firm that is closer to the source of supply or to the ultimate consumer. In analyzing Bank One Corporation's announced acquisition of the US life insurance and annuity business of Switzerland-based Zurich Financial Group in May of 2003, the integration that took place is an example of forward integration motivated by a movement toward the consumer. In addition, Bank One gained immediate access to an insurance industry with significant barriers to entry. Zurich's financial management expertise (a valuable resource) will also provide Bank One an avenue to minimize its dependence on outsourced investment management advice.

The announced acquisition, detailed in an article titled "*Bank One sees big revenue potential in the Zurich Life deal*", highlights several advantages that Bank One Corporation expects to achieve by undergoing the acquisition. [4] Bank One feels the announced price tag of \$500 million offers much more than the opportunity to get into the insurance business. One advantage with the acquisition is the fact that Zurich Life is already registered in all fifty states for transacting life insurance and annuities business. These barriers to entry enhanced Zurich Life's value to Bank One by immediately providing avenues to solicit opportunities for life insurance business in all fifty states. Purchasing Zurich Life allowed Bank One to expand its insurance operations without incurring costly legal fees or spending endless time and resources filing state-mandated paperwork. From a financial perspective Zurich Life products include 490,000 brokered term life insurance policies in force, with 2004 revenue of \$280 million. Direct to consumer policies comprise 275,000 Zurich Life policies, with potential revenue of \$150 million in 2004. Another stated objective with acquiring Zurich Life is the combined firm's ability to offer a complete portfolio of financial and insurance products to consumers beyond Bank One's 1800 branch network.

Dave Kundert, Chairman and CEO of Bank One Investment Management Group, stated the acquisition will "give us the ability to be a manufacturer as opposed to a middle man, as well as additional distribution and product capabilities we don't have today." Bank One anticipates great opportunities for cross selling to each other's customers. As mentioned earlier, the bank's network includes 1800 branch offices – all with expanded access to life insurance and annuities products. Perhaps more important, Zurich Life's distribution system includes 40,000 representatives that will give the bank an important new marketing channel for the bank's own financial products. In addition to helping the bank increase sales of its financial products, Zurich agent networks will give Bank One instant access to the lucrative teacher's annuity market via Zurich's line of 403(b) retirement plan products. Dave Kundert points out that Zurich's retirement plan is distributed to almost one-third of the school district payroll systems in the United States - a market where Bank One has not been a competitor. Bank One has targeted a lofty 17% internal rate of return from the Zurich acquisition, based largely upon the Bank's ability to generate new sales from Zurich Life's products. Zurich Life's products will appeal to all ends of the bank's customer base, from low and middle income to affluent clients.

As mentioned in the opening paragraph of this section, vertical integration is developing the ability to produce goods or services previously purchased. In the case of Bank One, before acquiring Zurich, the company outsourced investment management to Deutsche Bank Group. Currently, Bank One outsources management of \$6.4 billion in assets to Deutsche Bank. This outsourcing of investment management is slated to be minimized – or completely eliminated – with the significant internal investment management expertise acquired through Zurich. Basically, Zurich Life employs financial analysts with expertise not currently resident within the confines of Bank One. The result to Bank One will be significant cost savings by moving the outsourced money management to in-house specialists. This acquired talent exemplifies Bank One's move upstream in the management of their services, as opposed to acting as the middleman.

Bank One's proposed acquisition of Zurich Life seems like a text book example of why firms choose to vertically integrate via acquisition. Bank One's goal of becoming a full service provider of financial service and insurance products is clearly advanced with the Zurich Life acquisition. The significant barriers to entry that exist for the insurance and annuities business were hurdled by Bank One targeting a firm already registered in all fifty states. The combined companies' network of bank offices and agents afford tremendous opportunities for cross

selling of products and additional channels for marketing and distributing insurance products. Zurich Life's major stake in the profitable teacher's annuity market also provided Bank One access to an industry in which they had no market share. Furthermore, Bank One's reliance on outsourced management expertise is eliminated by the investment expertise already in-house at Zurich Life. It may take years to determine if Bank One's financial performance was enhanced by the acquisition of Zurich Life. However, the motives are clear as Bank One provides a good example of vertical integration in the banking industry. Although this is the first US bank holding company to buy an insurance carrier since Citigroup bought Travelers Group in 1998, the outlook seems promising.

CONCLUSION

While outsourcing is designed, in part, to safeguard and leverage scarce resources, recent examples in the toy and pet food industries clearly illustrate the risks associated with this practice. Damage to carefully crafted firm reputations as well as the bottom line draw into question how much outsourcing actually saves an organization.

In contrast, vertical integration and its extension of the firm's reach is often portrayed as the lumbering giant wasting shareholder wealth by performing tasks that can be done – presumably – more efficiently outside the firm. But as these cases illustrate there is still a place for carefully considered vertical integration. Whether it be synergistic applications of complementary software or innovations by front line workers and engineers, vertical integration can still work in today's environment and boost the bottom line.

AUTHOR INFORMATION

Steven R. Clinton has many years of both professional and academic experience. With his experience as a warehouse manager and a licensed customhouse broker/manager, he brings to the classroom an understanding of how supply chain management supports and impacts the overall marketing effort. He holds degrees from the University of Wisconsin-Madison (BA), University of South Carolina (MIBS), University of Wisconsin-Milwaukee (MS), and Michigan State University (PhD – Major: Marketing; Minor-Logistics). Prior to joining Robert Morris University, Dr. Clinton previously taught at the University of New Orleans and Arizona State University. He has also taught in overseas programs and the United Parcel Service's "International Sales Training Seminar." Dr. Clinton has published in a variety of publications and conferences including *The Journal of Business Logistics*, *Transportation Journal* and *International Marketing Review*.

Dean Manna has consulted for private industry, government, and private organizations for twenty years in the areas of sales, management, customer relations, and personality awareness training programs. His wide base of clients gives him a wide variety of experiences from which to draw his seminar training and collegiate instructional activities. These include selling, marketing, and management strategies for more effective productivity in the workplace. Dr. Manna utilizes a pragmatic yet highly motivational and entertaining approach in his classroom instruction and seminars, maintaining a high level of interest, while transmitting valuable information with high levels of content. He has recently edited and published a complete instructional manual on professional salesmanship for use in the classroom. His quality of experience has resulted in the enhancement of the Continuing Education and Internship Program at Robert Morris University. He is past president of the Pittsburgh Chapter of the American Marketing Association and has instituted a continuing interaction with corporation executives from private industry as guest speakers and instructors in the marketing major. He holds his undergraduate degree in business from Gannon University, an MBA from the University of Cincinnati, and his Ph.D. from the University of Pittsburgh. He conducts ongoing research in the area of emotional intelligence and marketing education. He is a professor of marketing and Department Head of the Management/Marketing Department in the School of Business at Robert Morris University in Pittsburgh, teaching undergraduate and graduate marketing courses. He has recently published a college text on selling strategies. He also has been in Greece, teaching marketing and management courses to business executives from the health care and sport-management disciplines. Dr. Manna also continues to do research on the effects of emotional intelligence levels on productivity in health care and private industry and present results at many national and international Marketing and Healthcare Conferences.

Gayle J. Marco received her Ph.D. degree (Major: Marketing Education and Vocational Education) from University of Pittsburgh in 1984. Her research interest includes various areas of consumer decision making and buyer behavior. She has consulted for various companies in the Pittsburgh area. The consulting areas include product repositioning, market development for new products, needs assessments, and market plan development. She has published in *Journal of Global Business* and *The Journal of American Academy of Business* as well as numerous conference proceedings.

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