Vertical & Horizontal Integration

- Merger generally refers to a circumstance in which the assets and liabilities of a company (merging company) are vested in another company (the merged company). The merging entity loses its identity and its shareholders become shareholders of the merged company.

Amalgamation

- An amalgamation is an arrangement, whereby the assets and liabilities of two or more companies (amalgamating companies) become vested in another company (the amalgamated company).
- The amalgamating companies all lose their identity and emerge as the amalgamated company; though in certain transaction structures the amalgamated company may or may not be one of the original companies. The shareholders of the amalgamating companies become shareholders of the amalgamated company.

Why integrate?

- Eliminate Transaction costs

1. Contracting costs
2. Opportunities for "holdup"=opportunism* by one party to a relationship when other party is in a weak bargaining position (e.g. auto manufacturer buys parts from specialized parts supplier. Key: part supplier has invested in "relationship-specific capital")

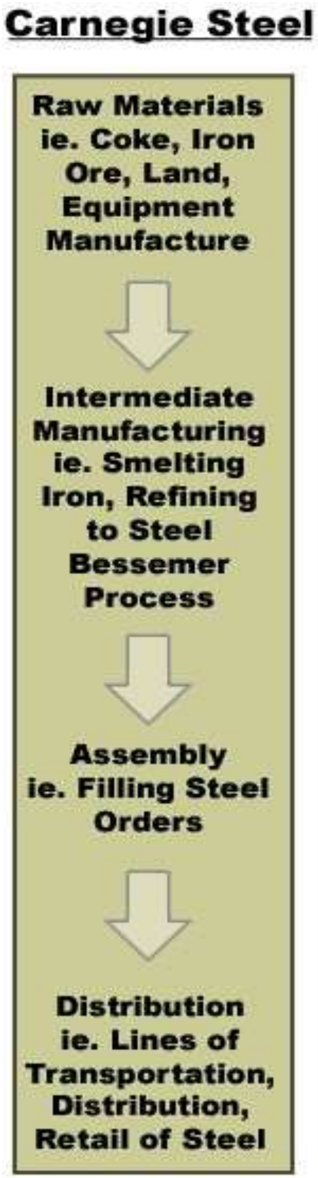
- Coordinate production

1. Physical condition issues
2. Avoid inventory costs ("just in time production")

- Exert markets power in the downstream market

- Vertical integration is the degree to which a firm owns its upstream suppliers and its downstream buyers. It has a significant impact on the business with respect to cost, differentiation and other strategic issues.

CARNEGIE STEEL



- Andrew Carnegie
- Originally smelting iron
- Differentiation from competitors
- Cheap steel-American rail road
- Major stakes in local steel mill
- Major stake in Frick coke company-coke as fuel in steel furnace.
- Land for mines-iron production

- Allegheny Bessemer Steel Company-refine iron to steel.
- Carnegie steel had a significant stake in every step of the steel production process, from mining, to refining, to milling, to smelting, to transportation, and even retail.

Summary of the issue

Pros

- Expansion of *core competencies*.
- Lower cost
- Lesser dependence
- Increased stability and efficiency

Cons

- Need to build excess capacity
- Lack of competition,innovation

- There are 3 types of vertical integration
- Backward vertical integration
- Forward vertical integration
- Balanced vertical integration

- Vertical integration is where a company controls multiple elements of the sourcing, production, and distribution process.
- controlling the entire process from raw materials extraction to distribution and sale of the final product, or just some part of it.

- in theory a single company could extract or produce raw materials, refine these materials, manufacture intermediate products and finished goods, then transport these goods to wholesalers or retail outlets and through these outlets sell the goods to the consumer.

types of vertical integration

- Backward vertical integration refers to ownership and control of the inputs into the production process, like a chocolate manufacturer owning the cocoa-growing plantation.
- forward vertical integration involves owning and controlling the distribution and retail elements of the value chain

- When a company controls subsidiaries that produce some of the inputs used in the production of its products it exhibits backward vertical integration.It indicates the expansion of activities upstream.For example an automobile company may own a tyre company, a glass company, and a metal company.This is to ensure stable supply of inputs and good quality of final goods.

- Vertical integration offers scale advantages and allows companies to be monopolists or pretend to be monopolists. Because they own all stages of the value chain, there is no competition until the final stage, sales to the consumer.

- the car manufacturers, such as Olds and Ford, were little more than small start-ups. These companies were vertically integrated to the extent that they made their own tool parts, finished products and then were involved in the sales and distribution of those products. But this vertical integration was more a product of circumstance than intentional corporate strategy.

forward vertical integration

- When a company controls distribution centers and retailers where its products are sold it becomes forward vertical integration.In other words expansion of activities downstream is called forward vertical integration

- And when a company controls all the components from raw materials to final product it is said to be balanced vertical integration.

- In the case of Ford, however, as the development of mass production and the assembly line got underway, it became clear that Ford required specialized tools and machinery. Naturally enough, Ford decided, given the specialist nature of the equipment, that it would be easier for the company to make the tools itself.

- So, for example, initially Ford struck an agreement with the John R Keim Mills, a producer of pressed steel, which by 1908 was supplying various parts for Ford's vehicles.

- Ford cooperated closely with the mill, eventually purchasing it in 1911. Then, following a strike at the Keim Mills, he removed all the machinery to Ford's Highland Park plant. Effectively, Ford's main competitor, General Motors, would take vertical integration even further in the period up to the Second World War.

- An example of another sector that took up an extremely high level of vertical integration is the oil industry, where large vertically integrated companies like Exxon, Shell and BP explore and then drill for crude oil, refine that oil and then even own many of the pumps through which they retail their products. Governments also tend to be very vertically integrated.

- Apple computers, for example, is one of a few successful tech companies designing its own products, controlling marketing, even selling through Apple stores.

Examples

- Acquisition of Skype by e-Bay (Initially &later by Microsoft)
- The formation of Brook Bond Lipton India Ltd. through the merger of Lipton India and Brook Bond
- The merger of Bank of Mathura with ICICI (Industrial Credit and Investment Corporation of India) Bank
- The merger of BSES (Bombay Suburban Electric Supply) Ltd. with Orissa Power Supply Company
- The merger of ACC (Associated Cement Companies Ltd.) with Damodar Cement
- Acquisition of Corus by Tata Steel
- Reliance and BP
- Nokia Mobiles and Microsoft