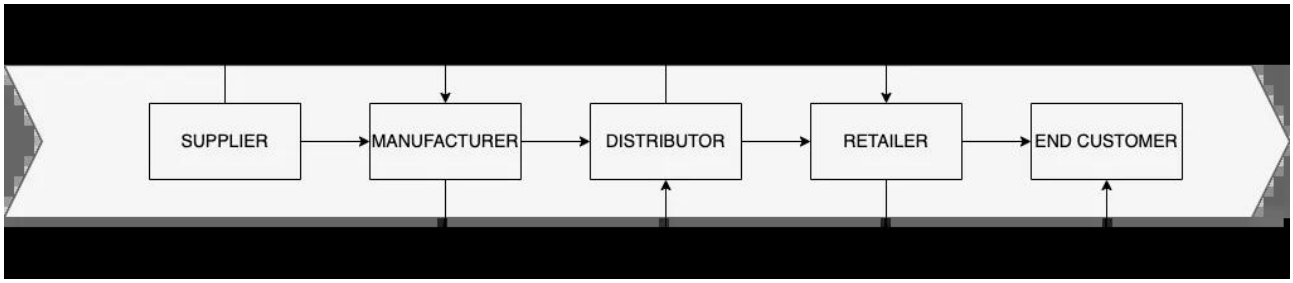
Forward Integration

Idea In Short

Forward integration is a type of vertical integration that extends to the next levels of the supply chain, aiming to lower production costs and increase the efficiency of the firm. In other words, it's a business strategy where a firm replaces third party distribution or supply channels with its own in an effect to consolidate operations, reduce costs, and become a step closer to the end consumer.

Forward integration is a business strategy to reduce production costs and improve a firm's efficiency by acquiring its customers, replacing 3rd party channels and consolidating its operations. This is a type of vertical integration of the supply chain and is also known as cutting out the middleman. The firm reaches the next levels of the distribution chain in an effect to synergize their total operations of the value chain ahead. An organization can integrate forward by acquiring or merging with business entities that were its customers. The ultimate goal of forward integration is to increase the power and ownership over the forward of their value chain. The company extends to the next levels of the supply chain in an effect to synergize the operations, reduce total expenses, and become more closer to the end consumer in the value chain. The implementation of forward integration with suppliers may be a strategic choice to address decreasing delegation to third parties.



Forward Integration

Case Study - Amazon

Amazon is a textbook example of Forward integration. The company has implemented

forward integration in various business functions since its inception. To give one example of the multiple forward integrations in Amazon's business, the company has built its delivery fleet directly controlling delivery to end users instead of relying on third-party services, making a move forward in the supply chain. Amazon introduced Amazon Prime in 2005 which customers can experience free two-day delivery service for the goods purchased in a comparatively lower price. This can be considered as a forward integration which is optimizing the delivery value chain.

Case Study - Nike

In 2011, direct-to-consumer sales accounted for 16% of Nike's revenue. By fiscal 2020, direct-to-consumer sales accounted for 35% of Nike's revenue. Nike reducing dependence on wholesalers, distributors & retailers, and prioritizing direct-to-consumer sales is an example of Forward Integration. The sportswear giant Nike has grown Direct-to-Consumer sales since 2011 which enables them to sell their products directly to their end customers, without selling through the value chain of the outlet, retailer, distributor, wholesaler. In this case, Nike is pursuing a Forward integration strategy without acquiring external players.

Case Study - Apple

Apple had been plagued with a decade of bad retail experiences at the hands of others. In 2001, Apple launched its first Apple retail store to enable its customers to buy Apple products directly from their outlets. Now Apple has many retail stores which increased customer satisfaction more.

Case Study - McDonalds

McDonald's acquired a tech company called Dynamic Yield in 2019. Company plans to improve their digital customer experience touch points with this acquiring. The technology allows menus at McDonald's drive throughs to change based on different factors, such as weather, current traffic, and more. This is an example of forward integration.

Advantages

Increase In Market Share

When a company moves forward in the supply chain, it helps eliminate various transaction and transportation costs. A by-product of this price reduction is a reduced final product cost, which ultimately helps increase the company's market share. Forward integration strategy helps optimize the entire process of production to distribution. This will eventually help the company to reach different geographies much faster with less dependency on another company. As a result, the company's market share increases.

Control Distribution

In some markets, there might be a shortage of qualified distributors. Or there might be a lack of distributors, giving the distributors the power to charge more. In such cases, forward integration in the supply chain helps increase control over the distribution channels, reduce product costs and ensure strategic independence from third parties. Prior to the forward integration, the company has to depend on another company for distribution. With forward integration, the company will have more control over its distribution network with fewer external dependencies and risks.

Competitive Advantage

Forward integration brings down the cost of distribution. This will result in a greater competitive advantage for the organizations over their competitor companies. The main competitive advantage will be greater control over their distribution network with less dependency on another company. With increased control over its supply chain, a company can reduce costs and target new customers, which can lead to a significant competitive advantage.

Increase Entry Barriers

Forward integration provides organizations the control over their distribution network. This means the company can conduct production and distribution both in their own company. The total operation from production to delivery will be optimized and will be in greater control. This will be a thread for the competitors outside to compete with a company like this.

Reduce Cost And Increase Profit

Operational synergies of the forward integration will reduce the distribution cost of the

company. The company can analyze the ways to reduce costs since the control is available in the distribution chain. This will increase the profit of the company.

Disadvantages

Failure To Realize Synergies

Forward integration requires a greater level of synergies between the two companies. There could be some situations where these synergies can not be realized practically. There could be problems in the strategy or else during the execution. This is the biggest risk and disadvantage of forward integration. We've all heard stories where acquisitions turned out to be a disaster. One common reason for such disaster stories is the inability of the companies to achieve synergy for the greater good. Even if done with positive intent, an acquisition based on capitalizing on the benefits of forward integration might turn out to be a disaster if the two entities fail to achieve synergy.

High Level of Cost

The company has to maintain two companies after forward integration. Those are the mother company with the original business and the distribution company. Failure of proper management could result in a higher cost of the total operation. The company should carefully analyze whether the benefits of forward integration exceed its costs.

Considerable Capital Requirements

Forward integration requires considerable capital. The main financial requirement is to acquire or merge with the company ahead of the value chain. Also, there will be cost involved in the first few months or a few years after forward integration to optimize the business activities.

Human Resource Issues

There could be unforeseen human resource issues that arise after forward integration. Certain pressures from union associations can arise unexpectedly. There could be management decisions for the lay-off of existing employees. These activities could result in labor issues.

Less Focus on the Original Business

After forward integration, management focus could shift to the new business, with losing focus on the original business. This will be a risk for the company because if the profitability of the original business is loose then the entire synergies will collapse.

Increased Bureaucracy

Acquisitions with the intent of integration forward in the supply chain also lead to increased bureaucracy, leading to inefficiency in the company's functioning in some cases.

Summary

Higher growth potential and greater control over distribution are the key benefits of forward integration. By eliminating third parties, the firm gains ownership of the distribution processes, thereby having an increased control over the flow of its products. Eventually, the firm can increase its potential markup and customer value.