

THE ECONOMIES OF VERTICAL, FORWARD & BACKWARD INTEGRATION IN CONSTRUCTION

AND HOW YOUR PROJECT CAN BENEFIT
FROM THEIR IMPLEMENTATION



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INTRODUCTION

Not matter what type of business or industry, market value chain management can greatly impact the efficiency and the ability to successfully deliver a product or service to the customer. For commercial real estate, connecting vendors, materials, labor and distributors can be a daunting task. As a construction project becomes increasingly complex, the ability to streamline the process can be challenging. Integration is a potential solution that many commercial construction companies use to improve their efficiencies and deliver their projects in a more cost-effective and effective manner.

WHAT IS THE MARKET VALUE CHAIN OR SUPPLY CHAIN?

Market value chain, or supply chain describes the process of products or services moving from the manufacturer to ultimately the end customer. While some products can have relatively few chains in the supply, some can have several. Porter's Value Chain includes a chain of activities including, inbound logistics, operations, outbound logistics, marketing and sales and service. Companies should easily be able to determine where they are located on the market value chain and the type of "value" they provide to the market.

Businesses that are interested in expansion will identify competitive opportunities within the supply chain typically with existing suppliers or other business relationships. Often the impetus to integrate the supply chain arises out of a weak member who "breaks" the chain, due to problems such as poor delivery or defective products. The three main types of supply chain management include, vertical integration, forward integration and backward integration. The companies merging together all operate at different levels of the value chain in an attempt to strengthen the supply chain and reduce costs. These strategies are employed to obtain control over an industry or market.



VERTICAL INTEGRATION

Vertical integration is a business strategy that enables a company to expand while integrating some or all portions of the supply chain. One example of vertical integration would be a commercial general contractor that purchases an engineering design firm and a property management company to provide an end-to-end solution for their clients.

VERTICAL INTEGRATION PROVIDES THE FOLLOWING ADVANTAGES:

- Drawings, requirements, bill of materials, procedures, budgets and other documents
- Sources from corporate departments such as design, marketing, finance, manufacturing and others
- Other resources like, similar products, engineer standards and regulations

VERTICAL INTEGRATION PROVIDES THE FOLLOWING DISADVANTAGES:

- Reduction in quality due to minimal competition
- Loss of corporate focus on core competency
- Decrease in flexibility

Vertical integration is best used for companies that are not satisfied with the level of quality or service from existing vendors and have or want the ability to distribute products themselves. Bringing all of the services under one company, reduces costs, enhances efficiencies and maximizes profits. Companies should perform extensive due diligence before pursuing vertical integration as the learning curve on new businesses can be more time-consuming and more expensive than expected.



FORWARD INTEGRATION

This integration method is when a business takes on more of the downstream partners or operations to access end markets. These functions typically include marketing, sales, and after-sales services such as warranties and maintenance. A company can acquire, merge, start-up or partner with a distributor or marketing company to expand their product or service distribution, providing greater control of the supply chain. Often times, the desire to implement forward integration can arise out of frustration of how their products or services are being delivered or sold to the end customer. An example of forward integration for a commercial construction, would be a general contractor that buys out a real estate brokerage company to better market their completed projects.

FORWARD INTEGRATION PROVIDES THE FOLLOWING ADVANTAGES:

- Creates barriers to entry for other competitors
- Reduces transaction and transportation costs
- Better synchronization of supply chain
- Increases market share and independence

FORWARD INTEGRATION PROVIDES THE FOLLOWING DISADVANTAGES:

- Can produce monopolies
- Product quality and innovation can diminish due to lack of competition
- If downstream activities aren't properly managed, costs can increase

Forward integration is best used when existing end market retailers or distributors are too costly, are too few or don't meet the needs of a company. The company pursuing forward integration should have adequate resources and capital while integrating and streamlining the supply chain.

BACKWARD INTEGRATION

Like other integration methods, backward integration is when a business takes control over one or several steps in the production process towards a finished building. This can include partnering with an existing vendor or starting a new entity. One example would be a commercial construction developer that buys out a material manufacturer or architectural firm that they regularly use in their projects.

BACKWARD INTEGRATION PROVIDES THE FOLLOWING ADVANTAGES:

- Increased Profits
- More Control Over Supplies
- Stand Out From Competitors
- Become More Attractive to Customers

BACKWARD INTEGRATION PROVIDES THE FOLLOWING DISADVANTAGES:

- Significant investments
- Product or service quality can become diminished
- Can create some inefficiencies
- Increased company size and bureaucracy

Backward integration used in construction processes can take time to initially deploy and can require significant upfront investments. This extra capital and time allocation provides companies with overall lower expenses over longer durations. For owners, backward integration can make investments more affordable as the price of structures are lowered. This type of efficiency can help developers become more agile in a volatile market.

CONCLUSION

Whether a business implements vertical integration, forward integration or backward integration into their construction operations, the economics of any business will improve. Construction companies should always be on the lookout for opportunities to integrate with suppliers upstream or distribution companies downstream. They should carefully weigh the advantages and disadvantages of doing so and if they have the knowledge, capital and ability to streamline their supply chain. If vertical, forward or backward integration makes sense for the organization, they will increase their efficiencies and improve profitability.



ABOUT CIVE

CIVE is a premier upscale design build firm also specializing in state of the art residential & commercial design, leading edge engineering, high quality construction and elite project management.

Our strengths lie in a rich mix of talent, experience and ingenuity. Our clients can depend on CIVE to anticipate industry change and plan for the future, while providing most practical and cost effective solutions. CIVE devotes customized, individual service to all of its clients, whether large or small.

Specialties: Residential & commercial design, civil engineering, structural engineering, mechanical engineering, electrical engineering, construction management & project management.

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