THE TEAM WITH THE BEST PLAYERS WINS……. Jack Welch

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Growing Business Profits by Vertical Integration

By William York, VP of Marketing

Vertical integration is defined as when a company controls more than one stage of the supply chain. It is a competitive strategy employed by a company that takes control over one or more stages in the production or distribution of a product…….a company opts for vertical integration to ensure more control over the supply chain resulting in a more effective methodology to bring a product or service to the end user.

Vertical integration makes sense as a strategy, because it allows a company to reduce costs across various parts of production, ensure tighter quality control, and ensures a better flow and control of information across the supply chain.

Usually each member of the supply chain is engaged in a different stage of the development process of product or service, and the multiple components of the supply chain integrate to satisfy a common need. As many businesses grow and mature, they look for more effective and efficient means to grow revenue, boost profits and accumulate wealth.

Vertical integration is a common approach to ensure these results!

Vertical Integration works because all the components of the supply chain currently serve the core business. Moreover, it is effective because the supplier or service provider is already making a profit serving the core business. It's therefore logical, since the core business is knowledgeable about the service providers that the core business takes this action.

As an example, when a manufacturer chooses to purchase a business within its own supply chain, this action actually solves two issues, not only does this give the manufacturer greater control of its supply chain, it also enables the manufacturer to earn additional profits. From our experience, an additional benefit is that the core business also gains better control of his or her risks, including the risk of a key supplier folding or choosing to sell to a competitor.

The biggest disadvantage of vertical integration is expense!

In today's business environment, businesses face numerous risks. Our function at Independent Captive Associates is to deal with these real risks, think about potential risk and serve as advisors to our mid-market clients through the use of creative planning utilizing Captive Insurance Companies. Unlike other groups working in the Captive Insurance area, we believe that a Captive Insurance Company is one of the most versatile business tools available to a mid-market business today. It is not a rogue to avoid taxation!

Utilizing years of experience and knowledge we understand this tool protects and allows the creation of asset reserves that can be employed to expand and strengthen the core business enterprise.

Over time Captive Insurance Companies have served multiple purposes and have been used to:

1.) Replace a businesses' commercial insurance and turn this expense into a profit. This is the basis of insurance, and unused premiums that are not used for claims are captured by insurance companies and used to create capital. Ask yourself, "how much P&C insurance you've paid" and then ask yourself, "what claims have been paid'! Warren Buffet understood this and stated on many occasions that insurance is the best business.

2.) Insure the multiple risk that is currently self-insured. Create additional needed insurance coverage not available in the commercial market place (expanded cyber, reputation risk, etc.) This ensures the insurance expense is tax deductible.

3.) Lower healthcare cost and enhance other employee benefits allowing the business to attract and retain needed talent. Talent is critical and often monies are paid with little return on investment. Integrating commercial and private insurance permits the accumulation of profits based on unused distribution of claims.

5.) Generate additional working capital to enable the insurance company to grant mortgages, purchase alternative assets and other related activities to increase the core business reserves. The assets generated through this private insurance company are exempt from creditors and receive favorable tax treatment when applied properly.

A successful business can turn its current risk management program (which is essential for all successful businesses to thrive in our current complex society) into a successful, stand-a-lone business that operates parallel to their core business, so that it functions as an additional profit center. Millions of dollars can be accumulated to overcome and assist the core business in this Vertical Integration strategy.

Vertical Integration of this nature requires cooperation and oversight of the appropriate state insurance department. However, when selective steps are taken this opportunity allows surplus assets of the Captive to be employed beyond the normal investment management function utilized by most Captives Insurance Companies. This technique will also provide the core business with greater stability and more control over its' future.

Most mid-markets businesses utilizing a Captive Insurance Company understand that their accumulated surplus assets in these Private Insurance Companies (Captives) will, over time, represent a substantial amount of assets that the core business should be utilizing to strengthen and build even more surplus capital.

Leverage in business is a term that refers to how a business employs current assets to multiply results. When a business leverages a purchase, it means the business borrows assets. This technique is the ultimate leverage.

Captive Vertical Integration can be defined as converting an expense into a profit and using it to acquire and expand leveraging growth. This leveraging effect is compelling when done properly with the appropriate oversight. Moreover, it reinforces the inherent value of Captive Insurance companies.

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