Vertical integration in cannabis unites cultivators, extractors, manufacturers, and retailers under one umbrella. Business consolidation in cannabis and hemp may be inevitable, thanks to the COVIDcannab-19 pandemic and preexisting trends that were already carrying the industry in that direction.

On the eve of the New Year, before the coronavirus had made its presence known, industry analysts were forecasting a wave of consolidation in 2020. With stock prices down and capital funds beginning to dry up, many were convinced consolidation offered the only hope of survival for many struggling companies.

“Asset-heavy, cash-poor companies may need marriage partners in order to survive,” Beacon Securities analyst Russell Stanley told the Investing News Network in December 2019. He predicted a wave of M&As would dominate the news in 2020, driven by the desire of larger companies to control their own fates.

His concerns for smaller entrepreneurs with razor-thin profit margins were shared by other seasoned investment analysts.

“We could see some companies dying on the vine if they can’t raise capital through the equity market,” said Mark Noble, a senior vice president with Horizon Exchange Traded Funds. “I am worried that the growth of marijuana companies could be stifled, even though demand for marijuana and cannabidiol-related products will probably only increase over the next few years.”

Noble’s observation about the high demand for cannabis and hemp products predated the COVID-19 outbreak. But the prospects for cannabis and hemp remain bright, despite the current economic downturn. Demand for adult-use and medicinal cannabis products remains impressive, and CBD products promising therapeutic benefits are moving off the shelves in escalating quantities.

The apparent inelasticity in demand for cannabis and hemp products should be encouraging to companies that are considering vertical integration. Market shares are there to be gained, and companies that can afford to integrate vertically may be uniquely positioned to seize the day.

Why Vertical Integration Works for Cannabis

The idea behind vertical integration is to gain greater control over the supply chain, either by purchasing existing companies, forming partnerships with them, or launching brand new enterprises. Seed-to-sale chains in cannabis may incorporate interests in cultivation, processing, extraction, manufacturing, distribution, and retail, or some combination of the above. Vertically integrated businesses may operate in the same state, but increasingly cannabis companies are using vertical integration to spread their reach to multiple states or regions.

Having a retail arm is usually considered an essential part of a vertical integration plan. It is this aspect of the business that provides direct access to end-of-the-line consumers. With the major shift to online buying that is currently taking place, e-commerce platforms are an especially attractive option. Companies that choose to operate exclusively online may be the next big thing, as consumers change their buying habits and expectations as a result of the COVID-19 pandemic.

Regardless of the specific structure of the company, the advantages of the vertically integrated approach are many and myriad. They include:

- **Greater economies of scale**. Lower overhead costs and increased profitability are some of the expected results when a cannabis company vertically integrates. Better cash flow can, in turn, pay for increases in the number of crops planted. Increased profits can also finance the purchase of state-of-the-art equipment that will improve efficiency and output in processing, extraction, or manufacturing. Vertically integrated companies that find success may also choose to expand horizontally (buying or opening more facilities), further boosting their capacity to take advantage of economies of scale.
- **Guaranteed access to consumers and cannabis or hemp products**. When cultivation, manufacture, and retail are harmonized, the supply chain gains a level of reliability that is missing when operations are run independently. Retailers and processors are assured access to good quality raw materials or finished products, while cultivators don't have to worry about finding buyers for their crops.
- **Carefully coordinated supply and production plans**. In the vertically integrated sphere, parent companies can monitor sales trends in their retail outlets and plan their future planting and manufacturing activities accordingly. Manufacturers and retailers won't be dependent on the decisions of independent suppliers, as they search for products to purchase for processing or stocking.
- **The ability to fully leverage technology**. Digital communications networks facilitate instant data sharing and coordinated management and administrative functioning. In vertically integrated companies, decision-making is streamlined, overhead is reduced, and new levels of efficiency are achieved, thanks to the seamless blending of distant locations and real-time communications between company personnel.
- **In-house control over prices**. Companies that rely on non-affiliated suppliers for cannabis or hemp, in either raw or processed form, will be purchasing products at prices set by others. Unless the market is oversupplied, shifting all the leverage to the demand side, independent growers and manufacturers will enjoy a certain amount of autonomy in choosing how much to charge for their products. This power is eliminated in a vertically integrated company since the supply chain no longer necessitates the inclusion of third-party actors.
- **An ideal structure for creating, promoting, and selling branded products**. Many cannabis and hemp companies interested in vertical integration are hoping to launch their own lines of branded products. Breaking into a crowded marketplace can be difficult for companies trying to recruit independent retailers, but vertically integrated companies face no such barriers. Quality control is also assured in vertically integrated companies, which is essential to building the reputation of a new brand.

For companies that achieve success in any sector of the cannabis industry, vertical integration can make sense. However, there is one caveat.

Companies that plan to integrate vertically should be sound and robust enough to attract sufficient investors to fund their plans for expansion, or be able to complete their acquisitions using their own resources. Any debt they take on to finance expansion should be supplementary and not the primary source of funding. If substantial debt financing is necessary, it likely means a company is biting off more than it can chew.

Weathering the Storm

There will always be room in the cannabis industry for specialized companies. Inventive entrepreneurs and forward-thinking management teams will be able to find a market for their products if they are of high quality and occupy a unique and valuable niche.

Nevertheless, the advantages of vertical integration are undeniable. For companies that can afford it, adding new layers to their existing business should offer financial benefits that increase the odds of long-term survival. This is especially true in the current environment, where extreme economic challenges are pushing many smaller enterprises toward extinction.

Cannabis companies with control over their supply chains will likely be best suited to meet the demands of the post-COVID-19 marketplace. A decline in demand for cannabis and hemp is not in evidence despite the severe disruptions caused by the pandemic, revealing the excellent opportunities available for companies that position themselves to grab significant market shares.

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