International trade analysis

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In microeconomics and management, the term vertical integration describes a style of management control. Vertically integrated companies in a supply chain are united through a common owner. Usually each member of the supply chain produces a different product or (market-specific) service, and the products combine to satisfy a common need. It is contrasted with horizontal integration. Vertical integration has also described management styles that bring large portions of the supply chain not only under a common ownership, but also into one corporation (as in the 1920s when the Ford River Rouge Complex began making much of its own steel rather than buy it from suppliers).

Vertical integration is one method of avoiding the hold-up problem. A monopoly produced through vertical integration is called a vertical monopoly. Nineteenth-century steel tycoon Andrew Carnegie's example in the use of vertical integration[1] led others to use the system to promote financial growth and efficiency in their businesses. Three types Vertical integration is the degree to which a firm owns its upstream suppliers and its downstream buyers.

Contrary to horizontal integration, which is a consolidation of many firms that handle the same part of the production process, vertical integration is typified by one firm engaged in different parts of production (e. g. growing raw materials, manufacturing, transporting, marketing, and/or retailing). There are three varieties: backward (upstream) vertical integration, forward (downstream) vertical integration, and balanced (both upstream and downstream) vertical integration. * A company exhibits backward vertical

integration when it controls subsidiaries that produce some of the inputs used in the production of its products.

For example, an automobile company may own a tire company, a glass company, and a metal company. Control of these three subsidiaries is intended to create a stable supply of inputs and ensure a consistent quality in their final product. It was the main business approach of Ford and other car companies in the 1920s, who sought to minimize costs by integrating the production of cars and car parts as exemplified in the Ford River Rouge Complex. * A company tends toward forward vertical integration when it controls distribution centers and retailers where its products are sold.

Examples One of the earliest, largest and most famous examples of vertical integration was the Carnegie Steel company. The company controlled not only the mills where the steel was made, but also the mines where the iron ore was extracted, the coal mines that supplied the coal, the ships that transported the iron ore and the railroads that transported the coal to the factory, the coke ovens where the coal was cooked, etc. The company also focused heavily on developing talent internally from the bottom up, rather than importing it from other companies. 2] Later on, Carnegie even established an institute of higher learning to teach the steel processes to the next generation. American Apparel American Apparel is a fashion retailer and manufacturer that advertises itself as a vertically integrated industrial company. [3][4]

The brand is based in downtown Los Angeles, where from a single building they control the dyeing, finishing, designing, sewing, cutting, marketing and

distribution of the company’s product. [4][5][6] The company shoots and distributes its own advertisements, often using its own employees as subjects. 3][7] It also owns and operates each of its retail locations as opposed to franchising. [8] According to the management, the vertically integrated model allows the company to design, cut, distribute and sell an item globally in the span of a week. [9] The original founder Dov Charney has remained the majority shareholder and CEO. [10]

Since the company controls both the production and distribution of its product, it is an example of a balanced vertically integrated corporation. Oil industry Oil companies, both multinational (such as ExxonMobil, Royal Dutch Shell, ConocoPhillips or BP) and national (e. . Petronas) often adopt a vertically integrated structure. This means that they are active along the entire supply chain from locating deposits, drilling and extracting crude oil, transporting it around the world, refining it into petroleum products such as petrol/gasoline, to distributing the fuel to company-owned retail stations, for sale to consumers. Telephone Telephone companies in most of the 20th century, especially the largest (the Bell System) were integrated, making their own telephones, telephone cables, telephone exchange equipment and other supplies. Reliance

The Indian petrochemical giant Reliance Industries has integrated back into polyester fibres from textiles and further into petrochemicals, beginning with Dhirubhai Ambani. Reliance has entered the oil and natural gas sector, along with retail sector. Reliance now has a complete vertical product portfolio from oil and gas production, refining, petrochemicals, synthetic garments and retail outlets. Motion picture industry From the early 1920s through the

early 1950s, the American motion picture had evolved into an industry controlled by a few companies, a condition known as a “ mature oligopoly”.

The film industry was led by the Big Eight major film studios. The most powerful of these studios were the fully integrated Big Five studios: MGM, Warner Brothers, 20th Century Fox, Paramount Pictures, and RKO. These studios not only produced and distributed films, but also operated their own movie theaters. Meanwhile, the Little Three studios: Universal Studios, Columbia Pictures, and United Artists produced and distributed feature films, but did not own their own theaters.

The issue of vertical integration (also known as common ownership) has been a main focus of policy makers because of the possibility of anti-competitive behaviors affiliated with market influence. For example, in United States v. Paramount Pictures, Inc. , the Supreme Court ordered the five vertically integrated studios to sell off their theater chains and all trade practices were prohibited (United States v. Paramount Pictures, Inc. , 1948). [11] The prevalence of vertical integration wholly predetermined the relationships between both studios and networks[clarification needed] and modified criteria in financing.

Networks began arranging content initiated by commonly owned studios and stipulated a portion of the syndication revenues in order for a show to gain a spot on the schedule if it was produced by a studio without common ownership. [12] In response, the studios fundamentally changed the way they made movies and did business. Lacking the financial resources and contract talent they once controlled, the studies now relied on independent

producers supplying some portion of the budget in exchange for distribution rights. 13] Apple Apple Inc. have been listed as an example of vertical integration, specifically with many elements of the ecosystem for the iPhone and iPad, where they control the processor, the hardware and the software. [14] Hardware itself is not typically manufactured by Apple, but is outsourced to contract manufacturers such as Hon Hai Foxconn or Asus Pegatron who manufacture Apple's branded products to their specifications. Apple retail stores sell its own hardware, software and services directly to consumers.

Problems and benefits There are internal and external (e. g. society-wide) gains and losses due to vertical integration. They will differ according to the state of technology in the industries involved, roughly corresponding to the stages of the industry lifecycle. Static technology This is the simplest case, where the gains and losses have been studied extensively. Internal gains * Lower transaction costs * Synchronization of supply and demand along the chain of products * Lower uncertainty and higher investment Ability to monopolize market throughout the chain by market foreclosure * Strategic independence (especially if important inputs are rare or highly volatile in price, such as REM) Internal losses

* Higher coordination costs * Higher monetary and organizational costs of switching to other suppliers/buyers * Weaker motivation for good performance at the start of the supply chain since sales are guaranteed and poor quality may be blended into other inputs at later manufacturing stages Benefits to society Better opportunities for investment growth through reduced uncertainty * Local companies are better positioned against foreign

competition Losses to society * Monopolization of markets * Rigid organizational structure, having much the same shortcomings as the socialist economy (cf. John Kenneth Galbraith's works) Vertical expansion Vertical expansion, in economics, is the growth of a business enterprise through the acquisition of companies that produce the intermediate goods needed by the business or help market and distribute its product.

Such expansion is desired because it secures the supplies needed by the firm to produce its product and the market needed to sell the product. The result is a more efficient business with lower costs and more profits. Related is lateral expansion, which is the growth of a business enterprise through the acquisition of similar firms, in the hope of achieving economies of scale. Vertical expansion is also known as a vertical acquisition. Vertical expansion or acquisitions can also be used to increase scales and to gain market power. The acquisition of DirecTV by News Corporation is an example of forward vertical expansion or acquisition.

DirecTV is a satellite TV company through which News Corporation can distribute more of its media content: news, movies, and television shows. The acquisition of NBC by Comcast Cable is an example of backward vertical integration. In the United States, protecting the public from communications monopolies that can be built in this way is one of the missions of the Federal Communications Commission Definition of ' Vertical Integration' When a company expands its business into areas that are at different points on the same production path, such as when a manufacturer owns its supplier and/or distributor.

Vertical integration can help companies reduce costs and improve efficiency by decreasing transportation expenses and reducing turnaround time, among other advantages. However, sometimes it is more effective for a company to rely on the expertise and economies of scale of other vendors rather than be vertically integrated. Investopedia explains ' Vertical Integration' Backward and forward integration are types of vertical integration. A company that expands backward on the production path has backward integration, while a company that expands forward on the production path is forward integrated.

Examples of vertical integration include: – A mortgage company that both originates and services mortgages, meaning that it both lends money to homebuyers and collects their monthly payments. – A solar power company that produces photovoltaic products and also manufacturers the cells, wafers and modules to create those products would be considered vertically integrated. – The merger of Live Nation and Ticketmaster created a vertically integrated entertainment company that manages and represents artists, produces shows and sells event tickets.

II. Horizontal integration In microeconomics and strategic management, the term horizontal integration describes a type of ownership and control. It is a strategy used by a business or corporation that seeks to sell a type of product in numerous markets. Horizontal integration in marketing is much more common than vertical integration is in production. Horizontal integration occurs when a firm is being taken over by, or merged with, another firm which is in the same industry and in the same stage of production as the merged firm, e. . a car manufacturer merging with another

car manufacturer. In this case both the companies are in the same stage of production and also in the same industry. This process is also known as a “ buy out” or “ take-over”. The goal of horizontal integration is to consolidate like companies and monopolize an industry. A monopoly created through horizontal integration is called a horizontal monopoly. A term that is closely related with horizontal integration is horizontal expansion.

This is the expansion of a firm within an industry in which it is already active for the purpose of increasing its share of the market for a particular product or service. Benefits of horizontal integration Horizontal integration allows: * Economies of scale * Economies of scope * Strong presence in the reference market. Media terms Media critics, such as Robert McChesney, have noted that the current trend within the entertainment industry has been toward the increased concentration of media ownership into the hands of a smaller number of transmedia and transnational conglomerates. 1] Media is seen to amass in centre where wealthy individuals have the ability to purchase such ventures (e. g. Rupert Murdoch). Horizontal integration, that is the consolidation of holdings across multiple industries, has displaced the old vertical integration of the Hollywood studios. The idea of owning many media outlets, which run almost the same content, is considered to be very productive, since it requires only minor changes of format and information to use in multiple media forms.

For example, within a conglomerate, the content used in broadcasting television would be used in broadcasting radio as well, or the content used in hard copy of the newspaper would also be used in online newspaper website. What emerged are new strategies of content development and distribution

designed to increase the “ synergy’ between the different divisions of the same company. Studios seek content that can move fluidly across media channels. [2] III. Economies of scale As quantity of production increases from Q to Q2, the average cost of each unit decreases from C to C1.

In microeconomics, economies of scale are the cost advantages that an enterprise obtains due to expansion. There are factors that cause a producer’s average cost per unit to fall as the scale of output is increased. “ Economies of scale” is a long run concept and refers to reductions in unit cost as the size of a facility and the usage levels of other inputs increase. [1] Diseconomies of scale is the opposite. Overview The simple meaning of economies of scale is doing things efficiently.

The common sources of economies of scale are purchasing (bulk buying of materials through long-term contracts), managerial (increasing the specialization of managers), financial (obtaining lower-interest charges when borrowing from banks and having access to a greater range of financial instruments), marketing (spreading the cost of advertising over a greater range of output in media markets), and technological (taking advantage of returns to scale in the production function). Each of these factors reduces the long run average costs (LRAC) of production by shifting the short-run average total cost (SRATC) curve down and to the right.

Economies of scale are also derived partially from learning by doing. Economies of scale is a practical concept that may explain real world phenomena such as patterns of international trade or the number of firms in a market. ” The exploitation of economies of scale helps explain why

companies grow large in some industries. It is also a justification for free trade policies, since some economies of scale may require a larger market than is possible within a particular country — for example, it would not be efficient for Liechtenstein to have its own car maker, if they would only sell to their local market.

A lone car maker may be profitable, however, if they export cars to global markets in addition to selling to the local market. Economies of scale also play a role in a " natural monopoly. " The management thinker and translator of the Toyota Production System for service, Professor John Seddon argues that attempting to create economies by increasing scale is powered by myth, in the service sector.

Instead, he believes that economies will come from improving the flow of a service, from first receipt of a customer's demand to the eventual satisfaction of that demand. In trying to manage and reduce unit costs, firms often raise total costs by creating failure demand. Seddon claims that arguments for economy of scale are a mix of a) the plausibly obvious and b) a little hard data, brought together to produce two broad assertions, for which there is little hard factual evidence.