

# The history of vertical integration economics essay



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Vertical integration is the corporate strategy which the firms take to gain the competitive advantages by of in multiple markets or industries simultaneously. Best strategy of the common ownership is the vertical integration where the supply chain is being united there by producing a monopoly termed as vertical monopoly. Vertical integration is the degree to which owner owns suppliers of upstream (towards raw materials) and the buyers of downstream (towards end customers).

Vertical integration is having important implications in a business unit with respect to its financial position, differentiation and other issues of strategic importance. In the corporate strategy the most important consideration is the vertical scope of a firm. In an organization the first strategic change is vertical integration.

Any company has its own centre of gravity. Any initial strategic move will never affect the centre of gravity because of any prior as well as subsequent changes as they are operated usually for the benefit of the centre of gravity.

## 2. Vertical Integration:

Based on the stream of integration it can be

Integrating Backward

Integrating forward

Integrating in balanced

### 2. 1. Integrating Backward:

Acquisition of control subsidiaries which is intended to create (produce) some inputs which could be used in the production of its products.

Integrating towards upstream or suppliers or raw materials.

Backward movement is done to guarantee in terms of supply as well as to secure bargaining leverage on vendors.

## 2. 2. Integrating forward:

Acquisition of distribution centres which can extend up to the retailers to reach the final or end customers directly.

Integrating towards downstream or buyers or end customers.

Forward movement can guarantee markets and volume for capital investments and it would become own customer thereby providing feedback regarding new products.

## 2. 3. Balanced Integration:

Acquisition is done both in upstream as well as downstream which is integrating in both forward as well as backward its towards raw materials and finished products.

## 3. Benefits due to Vertical Integration:

Cost reduction in terms of transportation can be done.

More co-ordination in terms of supply chain management is possible

Expansion could be possible in terms of core competitors.

Capturing the profit as well as maximising the profits both from upstream as well as from downstream.

More opportunity provision by differentiation through control over inputs.

Through vertical integration the barriers of entry can be increased for the potential competitors.

We can increase the access towards downstream distribution channels or else it may not be accessible.

In some specified areas we can go for high investment in which upstream and downstream players finding it difficult to invest.

#### 4. Drawbacks regarding vertical integration:

Building excess upstream capacity (more investment) so that down stream can have sufficient supply even under heavy demand.

There will be lack of supplier competition which will lead to low efficiency resulting in potentially higher costs.

Even though vertical-related coordination may increase. The flexibility may get reduced due to previous investments in both upstream as well as downstream.

If there is need for significant in-house requirements then it will reduce the ability to produce the product variety.

Sometimes existing competencies should be sacrificed to develop new core competencies.

Definitely the bureaucratic costs will get increased.

#### 5. Factors in favour of vertical integration:

Vertical integration is favoured by some of the situational factors like

Taxations as well as tough rules and regulations regarding market transactions.

Unexpected obstacles happening while formulating and monitoring contracts.

Vertical related activities many times have the strategic similarity.

Large scale of productions generally results in benefits like good economies of scale.

Hesitation from other firms for investing in some specific transactions.

#### 6. Factors opposing vertical integration:

Some factors make vertical integration less attractive like

The minimum efficient scale of production of the particular raw materials is much more than what is needed by the production department in that case the company must bear the loss happened due to this excess production which will increase cost of production.

Sometimes the activity needed is very different type of core competencies.

Very different types of industries like manufacturing retailing must carry out vertically adjacent activities.

The firm may be viewed as a competitor rather than as a partner as firm needs to co-operate for the addition of new activity places.

Technology of static importance:

There will be many internal gains like

Transaction costs could be reduced.

Supply and demand synchronization is possible along the chain of products.

Since there is less uncertainty there will be less risk involved hence high investment is possible.

Throughout the chain the market foreclosure is possible. This in turn gives the ability to monopolize the market.

At the same time there is a possibility to face the internal losses

In case of switching of the suppliers or buyers there higher organizational costs as well as monetary costs.

There are some benefits to the society like

1. Since there is reduced uncertainty which in turn result in more investment which will enhance the

growth

At the same time there are losses to the society as well

1. There will be monopolisation of the markets.

2. There may be a throwaway society due to monopoly on intermediate components.

Technology of dynamic importance:

1. In order to keep up with the competition the company would be forced to reinvest infrastructure. This indicates that some times vertical integration will eventually would hurt due to availability of new technologies.

The cost production will get increased due to reinvestment in new technology.

Vertical integration Vs Outsourcing:

In a firm when something is found it is not a core competency then it is liable to get outsourced, through outsourcing we can do more strategic use of scarce resources in a firm as well as cost saving with better productivity is possible.

Even though some of the gigantic oil companies like Standard oil as well as Exxon is completely under vertical integration.

In the current scenario until and unless if there is any compelling reasons for vertical integration the firms are going for non-integration or out-sourcing.

By product seller:

Among the strategic categories the poorest performer is the by-product sellers who are vertically integrated. Generally the by-product sellers are the

primary manufacturers of the raw materials which are the upstream business in process in any business.

The problem behind this is that there is no resource allocation across multiple products it got confined within a single business. Ultimately there is also no possibility for any change due to the fact that management skills partly technological as well as know-how whereas it do not transfer across the industries at the primary manufacturing centre of gravity.

By product diversification

Most of the vertically integrated company first sell by products as a move towards first diversification. But both the centre of gravity as well as the industry will remain unaltered.

Full Integration:

It generally exists between two stages of a production process both A and B. All the A's production sold internally and all B's requirement obtained internally.

For example in case of integrated steel plants the steel plant gets all Pig iron it is not purchased outside.

Tapered Integration:

It generally exists when two stages of production both A and B are not self sufficient internally.



For example a car company gets most of its spare parts externally even though the core component is been produced within the care company.

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