FAQs

1. Define vertical integration.

When the firm grows by expanding the business relating to its existing scope, through integrating into businesses either vertically for motives like cost savings, uncertainty, monopoly, technological interdependence etc., then it is called vertical integrartion. It can be upstream or downstream.

2. Enlist two growth strategies. Define them

a. Concentration: The firm grows by expanding the business relating to its existing scope, through integrating into businesses either vertically or horizontally or both. Cost savings, uncertainty, monopoly motives, technological interdependence etc. can be incentives to integrate.

b. diversification: The firm grows by extending its scope i.e. going into new businesses, or it can even enter into businesses that are totally unrelated to its existing scope.

3. How does vertical integration direct economic activities within a firm?

Market transactions are coordinated be price mechanisms. Entrepreneurial control supersedes price mechanisms. It allows the firm make the input and output both by themselves.

4. Why is vertical integration anticompetitive?

It is always anticompetitive as it shifts the production form the non-integrated to integrated firms. The dominant firm will always enjoy the competitive advantage and shrink the number of firms.

5. Which industries are more prone to vertical integration?

Generally it is seen in industries such as petroleum iron and steel, motor assembly, footwear, brewing, flour milling and baking, and man-made fibres.

6. Define vertical foreclosure.

Vertical integration (and long term vertical contracts) can be used strategically to soften competition in the short run by raising rivals' costs or in the long run by increasing the costs of entry to foreclose rivals that might otherwise enter the market.

7. Mention the vertical externalities to vertical integration.

They are referred to as a response to inefficiencies that arise when there is market power in both the upstream and downstream markets. This in turn implies that market prices will be greater than the marginal cost of production in both upstream and downstream markets as firms exercise market power.

8. What is the problem of double marginalization?

The upstream monopoly adds a monopoly markup to its production costs and then the downstream monopoly adds another markup to the price it pays to the upstream firm for its inputs. This phenomenon is known as *double-marginalization*.

9. Which costs are associated with vertical integration?

Market transactions incur transactions costs associated with writing and enforcing contingent contracts and costs related to inferior adaptive properties of bureaucratic hierarchies are included in costs associated to vertical integration.

10. How does vertical integration create entry barriers?

The more vertically integrated a business, the greater the financial and managerial resources required to enter and compete in it. Established companies in an industry may combine their operations as a way of raising the stakes and discouraging potential new entrants.