

A Stigler-Smith-Young Approach to Vertical Integration

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Objectives

- Present a new approach to vertical integration
- To recast Young's insights into the division of labor into externalities from the perspective of a commons
- To establish the value of the division of labor as a way to analyze productive activities
- To re-introduce classical economic notions of dynamic change where firms innovate to enter and survive

Key elements

- Theory of the firm
- Theory of competition
- Division of labor
- Growth
- Externalities

The division of labor explains how production activities are reorganized through ever greater specialization

- Implies increasingly narrowly defined activities
- In a modern process it need not imply more separate labor activities because of non-linearity of organizational forms

Division of labor

- Two processes
 - At input level:
 - Labor with new training
 - Production of new machines
 - At transformation level
 - New organization
 - New technology
- Innovation
- Evolving (generally increasing) number of steps

Smithian competition

- Suppliers need to be accountable to buyers
 - Few suppliers promote necessary trust relations
 - Those suppliers are known either by
 - Locality
 - Branding
- Suppliers compete through innovation

Theory of the firm

- Multiple activities
- Activities have to be efficiently performed
- Activities determined by division of labor
 - Internal
 - External
- Set of activities evolves through division of labor

Structure of the model

- Competitive Cycle

Innovation

Implies:
Some inputs are unique
Small scale of activity

Innovation

Firm internalizes what is not available exogenously
Not necessarily efficiently, but creates a vertical structure

Other firms enter on innovations applied to a subset of activities

Those other firms take advantage of subsets of activities that they can do more efficiently

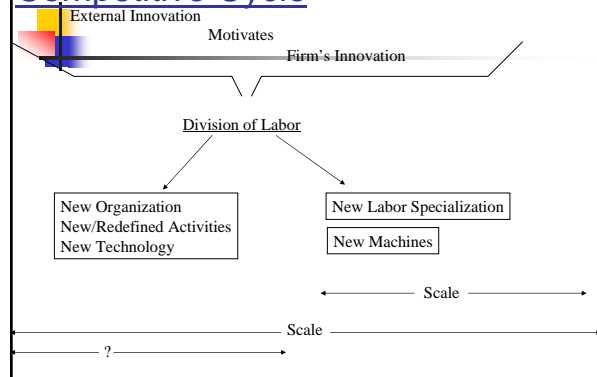
This creates a dynamic process
Which repeats itself, fostering continuing innovation

Where there is competition,
the innovator has an incentive to become a mercantilist
who creates externalities that affect other sectors

The effect:

- Some integration at the innovation stage
- Disintegration follows

Competitive Cycle

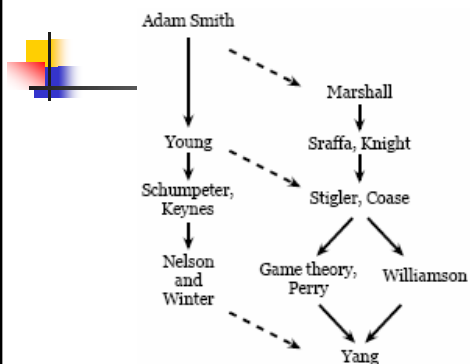


Utility

- Shows ephemeral character of monopoly
- Vertical integration not a generic issue
 - Innovation based
 - Portfolio
 - Anticompetitive strategy
- Analyze the layering of vertical structures

Distinctiveness

- A dynamic model
- Division of labor gives an ex ante view
- Differentiation between the transformation of inputs and the use of those inputs
 - Demonstrates the layering vis. activities
 - Distinct from a neoclassical production function



Value gained from reconsidering Smith and Young

- Critique of Stigler
- Reconsideration of division of labor
- Introduction of "Smithian" competition



Coherence with a commons approach

- A global view with the market subsumed within a greater view; i.e. the commons
- Focus on:
 - Governance
 - Dynamism
 - Externalities



end
