Vertical Integration in Theory.

By O. P. Blaich. Institute of Agriculture, University of Minnesota, St. Paul. 82 pages. 1961.

SINCE vertical integration problems caught the interest of the profession 6 or 7 years ago, enough has been written to conclude that (1) changing vertical interfirm market relationships raise some problems, (2) alleviate others, and (3) the historical novelty of such changes has been exaggerated. A review of the material also shows that the conceptual apparatus which has been used to approach the subject is piecemeal and particularistic. Blaich's report deserves attention as an attempt to overcome this difficulty.

Blaich sets the task of explaining limits to horizontal and vertical growth of a firm under the restraint of a "fixed" supply of managerial talents. These talents are required to achieve coordination of the diverse activities of the enterprise. Alternative extremes for achieving coordination are the market price mechanism and managerial direction; various intermediate techniques such as forward contracting are assumed available to the enterprise.

The firm is defined conventionally, complete with a profit maximizing entrepreneur who has perfect knowledge of his alternatives and their profit consequences. Under the assumptions of eventual constant costs for each minimal activity, that is, an economically feasible stage in a chain of production, perfect interactivity markets, and fixed supply of management, a long run equilibrium is discovered. At some compounding of vertical stages under a single management, the ability to coordinate and supervise breaks down so that the average costs of an integrated firm became greater than those of non-integrated firms. The limit to vertical growth, under perfectly competitive exchange conditions, are set thereby.

This analysis is extended to situations in which interactivity competition is imperfect. Since marginal gains from integration of either complete or intermediate forms are greater under imperfect competition, firms will tend to extend their vertical control more than when faced with a "perfect" market mechanism.

Blaich eschews application to real industry problems, although he examined integration possibilities in hog production within the lines of his approach in an earlier paper (*Journal of Farm Economics*, December 1960). The paucity of refutable hypotheses means that we have here a "model," not a "theory."

This is more than a quibble. It leads Blaich to assert more generality for his approach than is shown by his evidence. If we take his as a first effort toward developing models of firm growth under varying sets of restraints, it can find a place to stand. It is particularly difficult to believe that a model which assumes away the vexing influence of uncertainty has very great explanatory or predictive power.

There is still a question whether the marginal approach is likely to produce the best conceptualizations of vertical and horizontal firm growth problems. Organizational analysis, after all, attempts to deal directly with the problem of specialization and coordination within the firm. More help for the tool users may be forthcoming from this workshop than from our old suppliers.

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