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INTEGRATION AND COMPETITION – APPROPRIATE APPROACHES FOR ACHIEVING EXCELLENCE IN MANAGEMENT

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Abstract
The integration can be used in a strategic way to weaken the short-term competition, by raising the rivals' costs, or long term - by increasing input costs, to prevent potential competitors. It represents the unification of production, distribution, sales and/or any other economic processes within the same organization. The essence of the integration decision is not represented only by the financial calculation, but also by the qualitative analysis of the efforts and involved effects and by the competitors' analysis. This paper presents some appropriate approaches in this way, needed to be understood for achieving excellence in management.
Keywords: Integration, Competition, Excellence in management.

1. INTRODUCTION

Integration represents the unification of production, distribution, sales and/or any other economic processes within the same organization. Therefore, it is the decision of a company to use the internal resources to the detriment of market transactions in order to fulfil its purpose and objectives.

At a theoretical level, all the functions that an organization needs to fulfil can be accomplished through externalized activities, which imply concluding product delivery or services contracts.

In practice, companies consider that it is more profitable to realize a significant part of the administrative, production, distribution or marketing processes needed to obtain the product, and therefore the profit, by giving up the idea of concluding a contract with other firms. Companies consider that in this way they will be able to increase profits, to take risks and/or to coordinate more efficiently processes.

Actually, the integration decision becomes a "buying or purchasing" decision. This way, the emphasis is placed upon the financial aspects involved in such a decision by estimating the savings that can be made as a result of integration, and comparing them with the necessary investment that needs to be made.

2. THE INTEGRATION DECISION

2.1. Partial integration and full integration of a company

However, the integration decision is not defined merely by this calculation. The essence of the integration decision is not represented only by the *financial calculation*, but also by the qualitative analysis of the efforts and involved effects. In addition to measuring the costs of the investments, it is necessary to approach the strategically aspects of market and review efforts for an effective management of an integrated entity. The difficulty of this approach is given by the complexity of quantifying the factors involved in the integration process. In conclusion, the integration decision is taken according to the assessment, at a strategic level, of the advantages and the integration costs, both in direct and indirect economic terms (Porter, 2001a).

Furthermore, it is imperative to consider that the company is a system, which means that it has a dynamic character. This evolutionary valence makes the system to be characterized by its own time, consistent with its motion laws, and is subject to a multitude of contradictions, and internal and external actions, and by solving these he achieved the state of dynamic equilibrium (Ratiu-Suciu, 2000). The same author considers that in the area of systems theory it can not be applied the simple logic of mathematics, which explains the features of a system based solely on its components, but are considered the phenomena of synergy, which give the system stronger characteristics than those which would result from the simple "summation" of the characteristics of the parties. Integration is such an action that generates synergy components of a company. The synergistic effect is related to the appearance in the system of a series of features that occur only in the whole system, and don't appear in any of the component systems. The main reason for this is that the spiral of knowledge everlastingly expands due to the application of knowledge to knowledge (Plumb and Zamfir, 2011).

The synergistic effect includes the emergent effect (Ratiu-Suciu, 2000), as a phenomenon which appears together with the establishment of the system as a unitary whole. This determines the agglomeration, coupling, accumulation and concentration of elements effects, and is generated by the fact that the system, as a whole, has certain features that can't be found in its components.

It is also noted that a *company can opt for partial integration*, which in the specialty literature it is known under the name of *conic integration* (Porter, 2001b). This means that the company meets some of its needs internally, and for covering the rest it uses outside contracting. Consequently, there is the idea of a certain degree of integration in the activity. In this context, in order to find the most suitable integration degree for a company, it is appropriate to compare the economic and administrative advantages of integration with the economic and administrative costs.

Identifying the balance between advantages and costs will vary depending on the activity sector and the strategic positioning of the organization. Also, the benefits and costs are influenced by the type of policy that the company adopts: *full integration (or cvasi-integration) or partial inside integration (conic integration).* Even more, advantages can be increased without incurring all costs, even in the case of a cvasi-integration, by employing loans or by issuing shares. Conic integration means a *partial integration, upstream or downstream, but also purchasing the rest of needs from the external environment* (Porter, 2001a). The main risk, in the case of conic integration, *is that the small size of the company – generally and the integration – in particular, diminish the net benefit, or it can even generate losses.* From here it results the concern of the company to maintain the efficiency of its internal processes, and to only use the external resources for completeness.

Understanding the factors that determine which type of transactions are mediated through the market, and which transactions are mediated through vertical integration within the companies, has represented an important research subject, theoretically and in practice, in the microeconomics area within the last 25 years. In addition, vertical integration and vertical contractual arrangements, non-standard (so-called "vertical constraints"), have drawn the attention, over time, of the U.S. and E.U. Antitrust laws.

2.2. Theories of vertical integration

In the specialty literature (Joskow, 2006), *there is no unique theory of vertical integration.* Part of the vertical integration studies are focused on the *simple dichotomy between the decision "to make" inside and "to purchase" through the market*, but in reality these two types of behaviour are related. A comprehensive analysis of the root causes and consequences of vertical integration includes an examination of the factors that generate the boundaries between firms and markets and also, the origins of various non-standard contractual arrangements (or "hybrid forms") that stand in the way of simple, anonymous and spontaneous market transactions and internal organization. These hybrid forms include various types of long-term contracts, franchise contracts, non-linear pricing arrangements, agreements to maintain resale prices, demand contracts, joint ventures, dual supply and others. Depending on circumstances, these alternative contractual arrangements could represent a perfect or imperfect replacement for vertical integration, in situations in which is necessary to cope with issues that may arise if it is based on market relations – simple, spontaneous, repeated – between downstream companies and upstream ones. Practically, *all theories on vertical integration refer to any kind of market imperfections.* This orientation is in fact deviations from a long list of implicit and explicit assumptions that are associated with models of perfect competition and anonymous and spontaneous market transactions, performed under the principle of perfect competition. Neoclassical approaches on vertical integration had the tendency to focus primarily (but not exclusively) on vertical integration as a response to issues already in the market, or as a necessary strategic move to create or increase market power in ascending or descending markets.

Are not excluded the reasoning for vertical integration, the theories on vertical integration based on organizational economics (the economics of transaction costs), that are based on the recognition of the fact that companies which follow to perform transactions face a variety of potential transaction costs, contractual costs and organizational threats, which are related to transaction characteristics discussed. These transaction costs include direct costs of drafting, monitoring and enforcement of contracts, as well as investment costs associated with ex ante and ex post performance deficiencies, which may arise as a consequence of contractual risks associated with transactions conducted through market arrangements and bureaucratic costs associated with internal organization. The framework which includes the economics of transaction costs, bears in mind the fact that vertical integration, from the perspective of firms, has both costs and benefits. The chosen management structures, either vertical integration or vertical contractual arrangements, or simple market transactions, reflect the efforts of the companies involved to reduce inefficiencies that might otherwise be related to the investment decisions ex ante, as well as ex post performance, both as part of the exchange relationship.

Price discrimination: Opportunities to practice price discrimination by selling goods or intermediary services to downstream firms, from various industries, occur when the derived demand elasticity of intermediate goods varies from one industry to another. The differences in derived demand elasticity create the opportunity of a monopoly upstream to participate, in a profitable way, as a third party, to price discrimination - by charging a higher price to downstream companies in the industry, which have a lower elasticity derived demand, and a lower price to downward industry companies, which have a derived demand elasticity higher. However, the monopoly of the downstream tries to block the companies in the industry that pay lower prices, thanks to a profitable resale of intermediate good towards firms from the declining industry, which pay higher prices. This situation effectively blocks the price discrimination strategy by third party. Blocking resale is always a problem which a company that aims to engage in price discrimination by a third party faces. An effective way to block resale is: a downstream monopoly to vertically integrate into an industry with a higher elasticity derived for the intermediary good (Perry, 1978). Thus, the vertically integrated firm sells only the intermediate good to "external" buyers at a price that maximizes profit, and which reflects the lowest elasticity of demand from the other industry.

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In this case, the vertically integrated company can charge a lower price because it knows its marginal cost of production for the intermediate good, and can set a price that maximizes profit for the product they sell in the downstream industry, by taking into account a higher elasticity of demand for the product, which now is produced by vertically integrated company; this price is lower than the one perceived to other "outside" buyers. Unintegrated downstream firms that compete in an industry where the monopoly was integrated can buy the intermediate good price only at an "external" higher price, designed to integrate the monopoly taxes from the companies in the other industry, which have a lower elasticity than the request. If these firms aren't more efficient in the production process on a downstream market, where the companies have integrated linear, then the consequence will be that the companies from this market will not be able to compete with a vertically integrated company, because the costs will be much higher, due to high prices which they now have to pay for intermediary good. This is a classic way to impose a price. Despite the fact that the upstream company has expanded its monopoly in one of the downstream markets, the market prices could fall - compared to the level that it could have been if the upstream firm would have remained independent and would have charged a uniform price monopoly to companies in both industries. Similarly, price will increase in the industries with a low elasticity of demand, where the upstream company has not been integrated.

Another *possible argument for vertical integration is the "clandestine rider" issue related to providing pre-sales and after-sales information by retailers who are in competition* (Joskow, 2006). Here, the upstream companies produce differentiated or brand goods, so they face a downward demand curve for each product. In addition, the company's products demand is affected by final sales, disadvantages and associated costs, which are made by the retailers of their products. If retailers cannot fully realize the benefits of their own distribution service costs, but instead can learn the benefits of those with whom they compete, this "horizontal externality" will cause, from the manufacturer's point of view, the retailers to invest less in the distribution service. Vertical integration is a potential solution to this problem. This would allow the industry to internalize the value of upstream costs in the sales and distribution services. There are also various combinations of exclusive territorial arrangements, tariff resale price maintenance agreements, transfer of profits and other vertical contractual arrangements.

2.3. Vertical integration and competition

Vertical integration can be used in a strategic way to weaken the short-term competition, by raising the rivals' costs, or long term – by increasing input costs, to prevent potential competitors.

In this context, it is necessary not to confuse "vertical integration" with "closed market", which is sometimes associated with vertical integration. When a firm vertically integrates and *provides its own* *resources, other potential suppliers are, to some extent, "excluded" from providing those resources by the vertically integrated company.* According to this definition*, any vertical integration "limits (excludes) competition".*

The classic case of vertical anti-competitive exclusion occurs when there is a monopoly on the provision of an "essential facility" or "vital resource" input, to which the competitor or potential competitor firms need access, in comparable terms and conditions. This argument is dismantled in a series of cases. When the access price to an essential facility is regulated, the company which controls it may consider advantageous to restrict the access to it, in order to restrict the access to non-regulated markets (on which the owner of the essential facility also competes as a supplier) (Beard et al., 2001).

Arguments in favour of vertical exclusion occur often, because regulated, vertically integrated monopolies are subject to certain public policies that create opportunities for competitors to enter certain markets, on which operate only vertically integrated companies. For example, the development of competitive supplying electricity markets require that the generators that are in the competition, and their consumers, to have access to a distribution network, which naturally features a monopole (Joskow, 1997). A firm that controls the distribution network, and is also a player on the electricity market could be interested and could have the ability to impose terms and conditions relating to the access to that network in order to reduce competition on the competitive energy market. The price regulation continues, and in particular, subsidies which attract uncompetitive entries on the market, and which create extra complexities regarding the decision to enter a market and use strategies of exclusion.

3. CONCLUSION

How could a company increase the supply costs for another firm, without increasing their own costs? If a firm is vertically integrated with a supplier and can afford not to sell to another company, then the other provider, which is in the upstream and is independent, holds the supply monopoly. Consequently, it may increase the price it asks for the resources it sells to this company that is not integrated; at its turn this company will offset the price increase by increasing its own prices, leading the other company (which is vertically integrated) to increase the price. Prices rise, as well as the profits of the vertically integrated firm and the unintegrated company.

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