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Introduction

The exceptional space among the perceptive of a product being sent to the user who purchases further it has some mandatory firms to participate & cooperate. “The procedure of cooperation vanquished the costs at time when they face at individual procedure of the production and delivery proceeding” (Charles & Gareth, 2009). “Despite, firms or organisation not only cooperate but they also elaborate by consolidating other firms or organisation that are inclusive of an activity affiliated to a greater (upstream) or minimal (downstream) level in the production procedures as compare to the original firm or organisation, this is acknowledged as backward or forward Horizontal integration respectively” (Miller et al, 2010). This is called as the ‘horizontal integration’ and it is narrated as the concept of “the combination of technologically distinct production, distribution, selling, and/or other economic processes within the confines of a single firm.

Discussion

Our concentration will be depended upon the effects of horizontal integration regarding performance of firms; hence, it will be excogitate as the advantages it includes for the firms, although its internal costs to the company would be based upon the flexibility, management and performance, as classified to demonstration whether horizontal integration is a competitive solution in imperfect markets. As such, it represents a decision by the firm to utilise internal or administrative transactions rather than market transactions to accomplish its economic purposes" (Handfield & Nichols, 2002). Field of industrial organisation for its model infrastructure is associated to the field of industrial organisation.

Firstly it would be acknowledged as the benefit of horizontal integration for firms in terms of uncertainty, production and costs. Secondly, the concentration would be on the risks involvement in the horizontal integration and the disadvantages would be elaborated upon the factors of flexibility, management and performance (Shane, 2007). Ultimately the usage of the information gathered to resolve whether horizontal integration is a turning out to be a beneficial solution or not.

Benefits of Horizontal Integration

Increasing Firm's Size and Reducing Uncertainty

As a matter of fact, integrating more companies in a single firm increases its size. A larger company usually performs better than a small one, it is more stable and faces less risks. Within horizontally integrated firms, all activities are under total control, so that the uncertainty associated with the outsourcing disappears.

Consider a firm that uses a vital input in its production process, it has few power over its activity as far as it is supplied by another firm for that vital input. Therefore, any change in price decided by the supplier will affect the firm's total costs, and the price it charges to customers. This kind of problem does not arise in a horizontally integrated firm which coordinates the activity of the supplying firm that delivers the input to the next stage which uses it in the production process.

As explained by Charles & Gareth, (2009) horizontal integration is helpful for reducing uncertainty and for avoiding problems linked with vital inputs. With good synchronisation, firms can produce more efficiently in order to perform better than the competitors.

Optimising Production and Making Economies

With good management, horizontally integrated firms have the ability to optimise production and make economies. The firm will be able to calculate its marginal costs more easily since it has access to all the relevant information from every producing department it owns. The benefits of the availability of information were shown by Goldschmidt, (2005).

Thanks to its marginal cost function, which shows the additional costs associated with the production of one more units, the firm is able to determine the optimal production level. The production will stop a point where the costs of producing one more unit will be higher than the revenue that comes from this unit.

The more precisely one knows about his firm, the more performance these firms have. Such factors seen by Miller et al, (2010) show that horisontally integrated firms usually outperform their competitors.

We can consider that economies are realised faster in such horisontally integrated firm.. Consider for example, costly internal management that would regard many production units, such as scheduling. If these costs are divided by a larger number of departments, the cost per department of the firm’s management is lower and economies are realised.

This is explained by Shane, (2007) “adjacent location facilitates coordination and control and changes in production may be easier to coordinate internally or coordination may occur more rapidly”. Note that these economies are not economies of scale, which are based on the allocation of fixed costs to a larger number of units produced. Actually, the amount of fixed costs per unit tends to be higher in horizontally integrated firms that own many plants.

Diminishing Transaction Costs

The main reason why firms usually choose horizontal integration is to reduce their transaction costs. These costs can be seen as search costs, or contracting costs associated with the outsourcing of an activity. It is defined as “the negotiating, monitoring, and enforcement costs that have to be borne to allow an exchange between two parties to take place” by Goldschmidt, (2005).

However, it is always better to make than to buy and this is why horizontal integration is a good response to outsourcing. As shown by Walker, (2003), a number of factors make it difficult to lower the transaction costs of cooperating firms. Such factors are: complexity and uncertainty, opportunism, bounded rationality, asymmetric information. The purpose is not to analyse these factors but to show that outsourcing carries more complexity than horizontal integration, and that complexity has a cost which can be reduced by integrating the activity.

The following example illustrates this idea. Some years ago, Airbus first decided to outsource the production of a component of their small planes to China. After contracting with a local firm, it took some time before they noticed that the component was defective. However, this was not because the Chinese firm did not produce the item well; it was just the wrong one.

Such problems of communication can always occur and they can involve very high amounts of money. The complexity of the outsourcing market is a difficulty that horizontally integrated firms do not face. Handfield & Nichols, (2002) found that larger firms usually have more incentives to use horizontal integration as far as their outsourcing network is often very complex.

Disadvantages and Risks of horizontal Integration

Less Flexibility in Investment Allocation

When competing in markets with high need for differentiation and with frequently changing demand, it is often required to adapt the products to obtain customer satisfaction. The ability to react quickly and easily to changes in demand is called flexibility.

Horizontally integrated firms have many production departments cooperating in order to make a final product; each department is responsible for a different component, therefore, many plants are involved which means a lot of capital is required as well. Such a network of plants needs investments in capital to run properly, otherwise the whole firm's performance is affected. The problem is that the money invested is not available for investment opportunities, such as a profitable segment of the market that is not fully satisfied yet. The opportunity cost of satisfying this demand is running the main activity.

Shane, (2007) argues that "in order for horizontal integration to be a sound choice financially, it should turn a profit greater than the firm's opportunity cost of capital". This means that the firm must have available capital as well as the ability to finance its production departments. Even though horizontally integrated firms have a higher aggregate profit they also face higher expenses.

In a similar way, horizontally integrated firms also face more fixed costs because of their structure size and their number of operating plants.

Difficulties in Managing Different Types of Businesses

A strategic problem may occur in horizontally integrated firms because the objective of each department differs. Indeed, manufacturing has a different purpose and a different objective than retailing. On one side, the focus is to efficiently produce a good, whereas on the other side the objective is to be responsive to the demand.
Note that even if these activities cooperate within the firm, they still have a different objective that they need to attain on their own.

As a result, more management teams are required, and each of these teams needs to have the skills that fit with the activity. Finding managers with knowledge is costly.

Miller et al, (2010) found that the costs that arise from coordinating different stages of the production process are “inversely related to the similarity of processes and the possibility to share innovations”. This means that the more differences there are in the processes, the more costly it is to manage them.

Goldschmidt, (2005) argues that integrated firms should not apply the same managerial style to all stages of the production because the requirements are different and the firm takes more risk in doing so. However, skilled management teams can prevent from problems that occur in such companies.

Less competitive pressure and the “bad apple” problem

Integrated firms do not face any competition when it comes to selling their production. On the one hand this can be seen as an advantage, but on the other hand it is a threat for the company. The situation of certainty reduces the pressure that arises from competition in open markets, leading to weak performance from integrated firms. As the firm does not need to innovate until requested to do so by the whole company it will not perform as well as its potential competitors. Management can prevent such issue but it might not always be the case.

It happens that an integrated unit is not competitive enough. Handfield & Nichols, (2002) showed that managers may be given the freedom to buy from external suppliers, or to sell to outside buyers. Such situation can cause trouble to the upstream or downstream firm and to the entire company in the long run. Miller et al, (2010) refers to this as the “bad apple” problem; he argues that if a unit performs worse than what is required, because of the low level of competition for example, then it can affect the whole production process. If healthy units try to cope with a sick one, meaning that they still exchange products, trying to rescue the sick unit, their performance will decrease since they will be supplied with inferior quality products, or charged with higher prices.

From an economic point of view this is inefficient as far as there is a deviation from the equilibrium price and quantity, this occurs even in a business to business situation. Inefficiencies lead to higher costs and less performance, so that in the long run the whole company is affected (Goldschmidt, 2005). To conclude, we have seen that horizontally integrated firms experience low uncertainty regarding its flow of production, thanks to a strong structure, but on the other hand it faces flexibility issues as far as reorganising the production involves a large number of modifications affecting many units. Moreover, it may be difficult to find the capital required to improve or modify production, indeed, the amount of capital that is necessary to run the production is unavailable for other purposes.

Another finding is that even though integrated firms have more ability to collect data about their performance in order to produce more efficiently, they still encounter difficulties in managing correctly the diverse production units. It appears that skilled management teams are rare and costly so the extra profit that would come from efficient production is reduced by the costs related to management.

In addition, integrated firms have less transaction cost. Thus, they save on the costs related to elaborating and maintaining a contract within the outsourcing network, which is subject to competitive pressure. However, this situation is not especially an advantage. Integrated firms facing low uncertainty will tend to perform worse, and even if only one unit is defective, the whole company can be affected in the long run (Miller et al, 2010).

It is difficult to determine whether horizontal integration is an optimal solution; nevertheless, we can get an idea of the context in which it leads to higher performance for firms. We can infer that horizontal integration is beneficial in a sector of activity with certain demand, meaning a low need for innovation and flexibility. According to Goldschmidt, (2005), it is also a profitable solution when the production stages have similarities in order to create synergies, although it depends on the managerial competences and objectives.

These days, international competitive areas have shifted to the global supply chain management. The success of companies like DELL and Wal-Mart proved that it is critical for corporations to enhance core competency with a well-organised, tightly integrated supply chain. Although supply chain integration is not a simple task which requires companies to transform overall marketing strategy and detailed operation, its reward is very generous (Shane, 2007). Once added some new ideas, the whole supply chain will be demonstrated stronger vitality in future.

Conclusion

It is concluded that horizontal integration reduces the complexity arising from the outsourcing network of a firm; therefore a company dealing with a lot of external suppliers will prefer to integrate some of its activities. It has been found that horizontal integration can improve firm's performance under specific conditions. If these conditions are not met, horizontal integration may be a threat for the company. From this assumption, we can say that some industries might have more incentives to use horizontal integration; this could be the topic of further analysis.

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