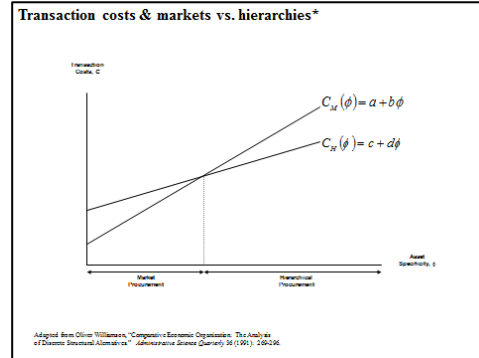


## 1.6: Vertical Relations

Transaction cost economics offers an economic explanation for vertical integration: economizing on transaction costs. Key concepts:

- Governance costs
- Transaction costs (types of ...)
- Asset specificity
- Spot market



### Williamson's vertical integration schema

Adapted from Oliver Williamson, *The Economic Institutions of Capitalism*.

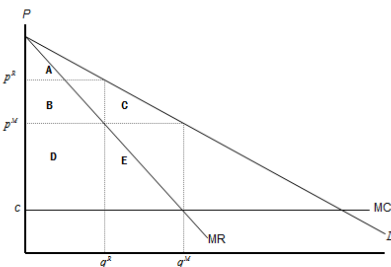
"To be sure, as with most complex forms of organization, vertical integration can and sometimes does serve a variety of economic purposes. I focus here on what I consider to be the main purpose served: economizing on transaction costs." (pp. 85-86)

		Asset Specificity	
		General Purpose	Highly Specific
Transaction Frequency	Occasional	Spot Market	Tri-lateral Contracts
	Frequent	Spot Market	Long-Term Contracts Vertical Integration

Vertical integration key concepts:

- Upstream (backward) v. downstream (forward) integration
- Dilution of market power
- Double marginalization
- Vertical foreclosure
- Resale price maintenance (investment externalities)

### Vertical Integration and Double Marginalization



### Vertical Relations

- Long-term contracts, Exclusive dealing
- Franchising and licensing
- Territorial restraints
- Vertical foreclosure, refusals to deal
- Resale Price Maintenance: A practice whereby a manufacturer imposes a minimum price on retailers.
  - Nature of competition at the retail level
  - Investment externalities

Relevant exercises: Problem Set 1, exercises 8 – 9.