Samsung Electronics and Apple, Inc.: A Study in Contrast in Vertical Integration in the 21st Century

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Abstract

Samsung Electronics and Apple, Inc., two of the largest technology firms in today's world, provides a new paradigm on how vertically integrated firms today operate. Technology has been changing how value chains and markets work, so much so that how vertically integrated structures are viewed today are changing, too. While both Samsung and Apple control much of their value chains, they, too, outsource some of the chains to other. This business model allows them to build on their proficiencies and, at the same time, to minimize transaction costs, which allows them to meet the demands of a very dynamic consumer electronics market.

Keywords: Apple, Samsung, Vertical Integration, technology,

1. Introduction

A firm's structure affects how it performs in the market. Ultimately, a firm's bottom line is to maximize its profit—which is why firms carefully choose which structure to undertake. In economics, this means that a firm carefully selects from a "transactional menu of choices"—that is, the value chains or processes that are required to create its product. Traditionally, firms have been seen to either choose to perform all or most of the processes—thereby making it vertically integrated, or to specialize on certain processes only and outsource the other value chains to other firms.

Firms choose to vertically integrate to achieve transaction cost economies—that is to say, to minimize several risks involved in transacting with many parties. These risks include (1) the difficulties in enforcing contracts with many different parties;(2) the challenges of ensuring the quality of raw materials, component parts and/or service reach the required level of standards; and (3) the risks of asymmetric information and opportunistic behavior aimed against the firm. This traditional model of vertical integration, however, assumes two things: (1) that vertical segments are well defined, and (2) that firms operate in existing markets. The problem with these assumptions is that they rarely exist in the real world today.

2. Vertical integration in the 21st century

Technology, for example, has changed how value chains work and blurred the lines separating these segments. Further, technological advances and changing demands have brought about new markets—and as these markets emerge, new products are developed that give way to newly specialized buyers and sellers. But while this may be an argument supporting the need for firm specialization, Cacciatori and Jacobides (2005) points out that, in some sectors, particularly in the services industry, this specialization of segments results in the creation of new products and services that also result in the final buyer abandoning "procurement from a host of specialized suppliers," and instead purchasing a "packaged solution" from an integrated player. They further posit that integrated solutions came about when buyers "used their increasing influence to enforce major changes in order to reduce the time and costs."This type of structure became necessary, particularly for the British building industry, where too much specialization contributed to project delays and cost inefficiencies.