Strategic Management
John D. Macomber

Lecture Notes:
Savannah West
(HBS 9-381-081)

Vertical Integration
Analytical Framework # 1: The Real Estate Value System

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AEC/EPC Supply Chain: Owner/Sponsor Isolating Risk

Consultant → Engineer → Labor → Material

Permanent Finance → Owner/Operator

Design and Construction Risk

Finance Risk

Market Risk

End User

Distributor → Labor → Material

Building Product Manufacturer

Project Finance → Land and Permissions

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## Analytical Framework #2: Market Segmentation

### Market Segmentation Example: Engineered Concepts

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<th>Non US</th>
<th>US</th>
<th>Gov't Owner</th>
<th>Private Owner</th>
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<tr>
<th>Property Management</th>
<th>Property Ownership</th>
<th>Real Estate Development</th>
<th>General Contracting</th>
<th>Design</th>
<th>Specialty Contracting</th>
<th>Mortgage Brokering</th>
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- Proven [Orange]
- Trying [Yellow]
- Could [Red]

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= proven
= trying
= could
Vertical Integration: 

Benefits (Competitive Strategy, Ch. 14)

• Economies of combined operations
• Economies of internal control and coordination
• Economies of avoiding the market
• Economies of stable relationships
• Assure supply and/or demand
• Enhanced ability to differentiate
Strategic Costs of Integration

- Increased operating leverage (more fixed costs)
- Reduced flexibility to change partners
- Higher overall exit barriers
- Maintaining Balance (capacity and throughput)
- Dulled incentives
- Differing managerial requirements
Illusions in Vertical Integration Decisions

• A strong market position in one stage can automatically be extended to another
• It is always cheaper to do things internally
• It often makes sense to integrate into a competitive business
• Vertical integration can save a strategically sick business
• Experience in one part of the value chain automatically qualifies management to direct upstream or downstream units
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