DISCUSSION

ROLAND N. MCKEAN: Williamson is undoubtedly correct, in my view, in urging that an important reason for vertical integration is the attempt to reduce transaction costs. Haggling, explicit contracting, and enforcement are costly activities. I am much impressed by the extent to which social intercourse and markets themselves rely on trust, tacitly understood contracts, and, for enforcement, latent social or retaliatory pressures. Transaction costs can explain much behavior that has been unexplained and can correct many explanations that have been at least partly wrong.

My only criticisms are that Williamson might have helped the reader by (1) showing more fully how the various points fit together and (2) looking more consistently at property rights and thus probing further into the reasons for the behavior he describes.

(1) The following way of presenting or summing up the ideas might help one see the way Williamson's points fit together. Without vertical integration there are deals that would be mutually advantageous at low transaction costs but are not carried out because of high transaction costs, and other deals that are carried out but at unnecessarily high transaction costs. These potential or actual deals include information exchange, product purchase, redistribution of risk bearing, elimination of inefficient input combinations by the processor because of monopoly prices charged by component manufacturers, and achievement of technological economies by arranging lower-cost transfer of components to the processor (e.g., molten iron to the steel mill). All of these deals would amount to internalizing externalities or taking interdependencies into account, so I see no reason for a separate category of that sort. They are all externalities because in each instance there is a cost being imposed on, or a potential benefit being denied to, one firm or the other without contractual agreement. Moreover, these interdependencies, i.e., ones involving high transaction costs, are especially pervasive in a dynamic world involving product redesign, durable investments, and numerous contingencies. (If there were zero transaction costs, it might be noted, all these potentially advantageous arrangements would be made—and, needless to say, at minimum transaction cost.)

Next one could explain the various ways in which vertical integration, up to a point, can reduce these transaction costs, making additional exchanges economical and making the old ones possible at lower cost.

(2) One could clarify this latter explanation by probing into the claim- or right-structures of the managers and other personnel involved. Why *is* haggling less prevalent (it is by no means absent!) within an integrated firm than between independent components producers and a processor? Basically, it is because the manager of an independent firm has a claim on part of *that* firm's profits, and lower-level personnel in turn have claims on (i.e., they are rewarded for contributing to) *that* firm's profits. If these personnel work instead for the integrated firm, they are rewarded (more than before, at least) for increasing the integrated firm's profits. The instruments of control mentioned by Williamson —hiring, firing, promotion, salary changes, transfer of personnel—amount to a reassignment of certain rights to the integrated firm. These instruments, or rights over the new employees, work to alter those employees' claims as noted and to enforce them.

Because of this altered claim structure, it is now less rewarding to management of the components division to haggle with the management of the processing division (and vice versa). It is less rewarding than before to exchange dubious information or to engage in strategic bargaining. It becomes more rewarding than before for personnel in all divisions to accept monitoring by overall management. Employees find that fiats by the new management are less costly and/or more rewarding to them than when their rights were linked to the profits of different firms. (All this is obvious, but the point is that it is not merely the "conflict-resolving machinery" or the "mechanisms" that have changed but also the effective claims held by the individuals involved.) Now that they are rewarded for veracity to the new management and contributions to overall profits, the divisions can trust each other and work harmoniously to a greater extent. Informal, tacitly understood contracts become enforceable and are efficient more often than before.

I do not mean that the changes in claim structures are the *only* variables at work. Contracting, information flows, or monitoring *may* become physically easier with integration. Such impacts are not obvious to me, however. The physical location of personnel and materials, and the physical flows, *could* have been adjusted before. As Williamson points out, the so-called technological economies were physically attainable all along; the obstacle must have been transaction costs. I would add that any economies in contracting, information acquisition, or monitoring were also physically attainable all along; the obstacle must have been something about incentives. In any event, I merely suggest that changes in rights with vertical integration constitute a major factor in the reduction of transaction costs. Even Williamson's suggestion that "common experience" (after a merger) may make it easier to communicate seems to hinge on cost-reward patterns, for typically the components people would still work in a separate location and not really have much additional "common experience." And when he writes that "the range of admissible intraorganizational behavior is bounded by considerations of alienation," one of the main *extra* reasons for avoiding alienation is the possible impact on promotion, salary, and so on. Even low-cost access to data is a matter of incentive: the files existed before integration and will probably be in the same location after integration, but the manager of the components division now finds it rewarding to give top managment access to his files.

Looking at these underlying claims is instructive also in that it suggests caution in appraising other organizational changes. If various factors, perhaps even bigness, attenuate the claims of personnel to a "share of profits," intrafirm transaction costs will go up. Also, where goals are diverse and claims are not linked to increased profits—as in government agencies—it does not follow that integration or conglomeration will markedly reduced transaction costs. It is also interesting to speculate about possible trends. If technological or other developments make information more valuable, externalities between firms more important, or internal monitoring less expensive, one would presumably expect the readjustment of incentives via integration to become more attractive and more frequent.

J. Fred Weston: The first part of Professor Lintner's paper is a summary of four major-merger movements. His judgments of the relative importance of three motivating influences are summarized in Table 1.

Table 1—Analysis of Four Major-Merger Movements

Relative Importance of Motivating Influences

Merger Movements	Market Power (h)	Operating Economies (s)	Leakages to Promoters (b)
Turn of the Century	large	small	large
1920's	moderate	moderate	moderate
1941–1947	small	moderate	small
Post 1950	small	small	small

The *effects* of the merger movements may have differed from the motives ascribed by Professor Lintner. The nearly 100% market shares of dominant firms at the turn of the century declined substantially and almost without exception. Thus the market position objectives motivating the mergers were not maintained in the ensuing decades. The oligopolistic market structures developed during the 1920's resulted in market share and profit trends consistent with operating economies rather than market power. Consequently the expected gains from mergers capitalized into increased market prices of securities were not generally realized as documented by the studies Lintner cites. Competition eroded market positions and imitation reduced differential operating efficiencies.

The second part of Professor Lintner's paper analyzed the post-1950 conglomerate merger movement. He evaluates potential sources of gains from the criterion of private advantage measured by increases in immedi-