Nonbanks in the Payments System: Innovation, Competition, and Risk

2007 Payments Conference
Federal Reserve Bank of Kansas City
May 2-4, 2007
Santa Fe, NM

Session 3: Competition: Vertical Integration
Introduction: Kenneth Posner, Managing Director, Morgan Stanley

Mr. Posner:

My name is Ken Posner. I am a research analyst at Morgan Stanley. I cover a variety of specialty finance companies, which includes payments-related companies. What we will do is talk about vertical integration.

I am going to just briefly introduce the topic. I am not an economist or an academic, so I can only give you some casual thoughts on vertical integration.

The first thought is that vertical integration is, in fact, a really dull topic. It is about “make or buy,” right? So, should manufacturer ABC buy subcomponent widget x or manufacture subcomponent widget x? It depends if they can squeak out a little bit lower costs—not really very interesting, I would think, to policymakers.

But there is another way to think of vertical integration. Under this way of thinking about it, it acquires somewhat sinister overtones. The first example of vertical integration I can think of was John D. Rockefeller’s Standard Oil. After cutting sweetheart deals with the railroad companies to consolidate refineries, he then built a pipeline and used that to squeeze the life out of the railroad companies. Standard Oil was the ultimate octopus of a corporate entity.

Another way of thinking about vertical integration is of a giant company that has tentacles into many different businesses, and it can use those tentacles to squeeze the life out of its competitors. But these are only casual views.

So, we have an expert with us, Professor Nicholas Economides from NYU's Stern School of Business, who will give us a more precise understanding of vertical integration.