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DESIGNING THE BOUNDARIES OF THE FIRM:

FROM "MAKE, BUY OR ALLY" TO THE DYNAMIC BENEFITS OF VERTICAL ARCHITECTURE

The concept of "vertical architecture" defines the scope of a firm and the extent to which it is open to final and intermediate markets. A firm can make or buy inputs, and transfer outputs downstream or sell them. Permeable vertical architectures are partly integrated and partly open to the markets along a firm's value chain. Increased permeability enables more effective use of resources and capacities, better matching of capabilities with market needs and benchmarking to improve efficiency. Partial integration promotes a more dynamic, open innovation platform and enhances strategic capabilities by linking key parts of the value chain. This permeable vertical architecture, accompanied by appropriate transfer prices and incentive design, facilitates resource allocation and guides a firm's growth process. Our longitudinal study of a major European manufacturer suggests that to understand how firm boundaries are set and what are their impacts, we need to complement the micro-analytic focus on transactions with a systemic analysis at the level of the firm. It also shows how, over and above transactional alignment, decisions about boundaries can transform a firm's strategic and productive capabilities and prospects.

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