Global Marketing Management
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Module - 1
Lecture - 2
Globalization - Part II

Let us talk about the second module of this course on Global Marketing Management. That is on globalization. In the first module, we have seen why this global marketing is so difficult or so complex process, because the external environment uncontrollable environment is different in different countries. As a company move from 1 country to another country, more and more number of foreign uncontrollable environment gets into a decision making process.

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So, in the second module we will talk about the various theories of international trade and the multinational enterprises.

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Module Overview

1. Introduction
2. Theories of International trade and Multinational enterprise
   i. Absolute Advantage
   ii. Comparative Advantage
   iii. Factor Endowment Theory
   iv. International Product Cycle theory
   v. Internalization/Transaction Cost Theory
   vi. Porter's Diamond Model

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Why does, when it is so difficult, why do companies undertake international trade? And how does a multinational enterprise develops over a period of time? How does a company move from a purely domestic company to a global company over a period of time? So, this is what we will be talking about in this module. Then, these are the various theories that, that we will talk about it this module.

First is absolute advantage theory, comparative advantage theory, factor endowment theory, international product life cycle theory, internalization or transaction cost theory and the last one is the Porter's diamond model.

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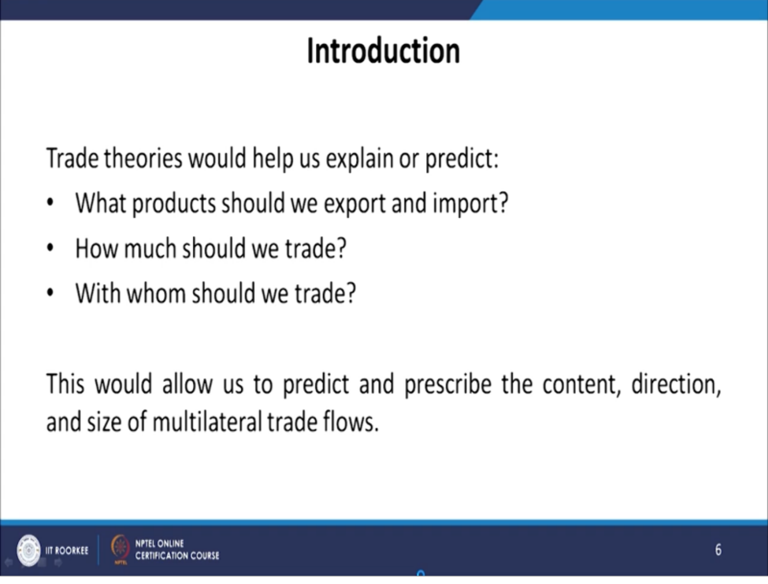

I will give, first give an introduction to this theory. And then, we will move on to understanding each theory. So, what these theories explain is: What products should we

export and import? How much should we trade and with whom should we trade? So, these are the important, 3 important components that these theories will try to explain. Let us, to look at how international trade has developed over a period of time, let us go through, down the memory lane. So, in 1776 Adam Smith in his Wealth of Nation;

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He said that a country's wealth is based on its availability of goods and services. So, how much goods and services a country has, that used to define the company's, the country's wealth. And each country should specialize in those products that give it a competitive advantage leading to specialization, greater efficiency and higher global output. And a county's advantage can either be natural or it can be acquired.

Natural advantages consist of climate, natural resources, the labor forces available in that country and acquired advantage consists of products and process technology that this country builds over a period of time. In 1817, David Ricardo in his book on the Principles of Political Economy and Taxation.

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Comparative Advantage Theory

1817: David Ricardo's *On the Principles of Political Economy and Taxation*

- The theory says a country can gain from engaging in trade even if it has an absolute advantage or disadvantage.
- In other words, even if a country is more efficient than another in the production of everything, both countries will benefit from mutual trade by specializing in what each country can produce relatively more efficiently.
- Specialization and trade should occur according to the relative opportunity costs of production in each country, measured in terms of the alternative production given up to produce a tradable good.

He said that, a country can gain from engaging in trade, even if it has an absolute advantage or disadvantage. Now, keep in mind that, Adam Smith had said that the country's wealth is based on availability of goods and services. And the country's advantage can be acquired or natural acquired natural or the natural resources and acquired is what it is able to develop how and how many products and process technologies it has been able to develop over a period of time.

In 1817, David Ricardo said that, a country can engage in trade even if it has an absolute advantage or disadvantage. So, even if it has some kind of advantage or it does not have any kind of advantages, still a country can engage in trade. In other words, even if a country is more efficient than another in the production of everything, both countries will benefit from mutual trade by specializing in what each country can produce relatively more efficiently.

So, now, what he demonstrated and I will show it in the moment, that even if a country does not have a absolute advantage in production of anything; still, if 2 countries they do trade, the both countries when can be better off. Specialization in trade should occur according to relative cost of production in each country, measured in terms of alternative production given up to produce a tradable good.

Now, the demonstration for this theory of comparative advantage is based on certain assumptions. The first assumption is that, there is no transportation cost for goods. The second assumption is costs are constants or costs are constant.

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That is, they do not increase and decrease over a period time and there are no economies of scales. So, it does not matter how many products you produce, the cost will remain the same. And there are only 2 economies producing 2 goods. Factors are of production are assumed to be perfectly mobile. There are no tariffs or other trade barriers. And there is a perfect knowledge so that all buyers and sellers know where the cheapest goods can be found internationally. So, these are certain assumptions based on which we will, David Ricardo demonstrated the theory of comparative advantage. Now, look at this figure.

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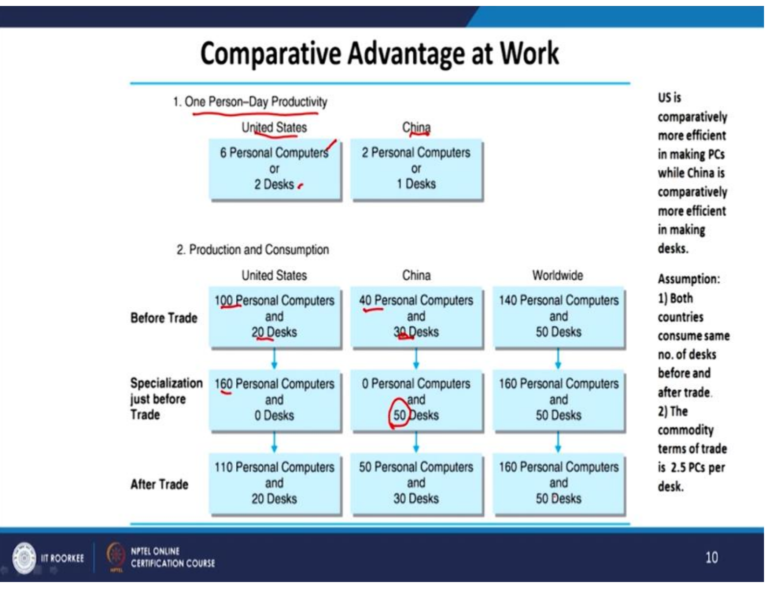

This first shows 1 person per day productivity. In, so there are only 2 countries, United States and China. And there are only 2 products. 1 is personal computers, another is desk. 1 person in 1 day in United States can produce 6 personal computers or 2 desk. And in China, 1 person

in 1 day can produce 2 personal computers or 1 desk. Now, you see that U.S. has absolute advantage in production of both these goods.

So, it produces, it can produce more personal computers or it can produce more desk as compared to China. Now, what happens? According to David Ricardo both the countries will be better off, will be well off if they, if the trade happens. So now, before computers, United States, before trade, United States is making 100 personal computers and 20 desk. And they are consuming them.

And China is making 40 personal computers and 30 desks. When we add both of them we get 140 personal computers and 50 desk. So, this is the total production of personal computers and desk in these 2 countries. Then what happens is, specialization just before trade. Now, instead of making desk, United States put all its people, all the labor in production of personal computers.

So now, those 1 person who used to make 2 desk; and they were producing in total 20 desk, these people are also put to make personal computers. So, the number of personal computers that United States will produce is 160. Similarly, China it puts all its labor force in production of desk and not in personal computers, because personal computers were, are being already made by U.S.

So now, all these people in China involved in making of personal computers and desk. They now concentrate on making on desk only. So, they produce 50 desks. Now you see, when we add them, now we have 160 personal computers and 50 desk. After trade, what happens is that, U.S. it starts making 110 personal computers and 20 desk. China makes 50 personal computers and 30 desks. So, now we have 160 personal computer and 50 desk.

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Factor Endowment Theory

1935: Bertil Ohlin's *Interregional and International Trade*, based on earlier work by Eli Heckscher

- According to this theory, a country should excel in the production and export of products that use their abundant and hence cheaper factors of production than factors in relative scarcity
- **Example**: A capital abundant country (U.S) should specialize in capital intensive products like automobiles, and
- A labor abundant country (China) should specialize in labor intensive products like clothing and apparel.

Now, we are moving on to the next theory that is called as factor endowment theory. In 1935, Ohlin book that was called as Interregional and International Trade. It says that, a country should excel in production and export of products that use their abundant and hence cheap factor of production. For example, a capital abundant country, the U.S. should specialize in capital intensive products like automobiles and a labor intensive country like China should specialize in labor intensive products like clothing and apparel.

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International Product Cycle Theory

- When business practitioners think of competition, they usually refer to intra-industry competition.
  - Why and how does competition tend to evolve over time and across national boundaries in the same industry?
  - How then does a company develop its marketing strategy in the presence of competitors at home and abroad?
- International product cycle theory addresses all these questions.

The next theory is international product life cycle theory. We have seen the life cycle theory in domestic marketing also. This is the international version of that product life cycle theory and it is now called as international product life cycle theory. So, when come, when business thinks of completion, this usually refer to intra-industry competition. But why and how does competition tend to evolve over time and across national borders in the same industry?

How and why does competition evolve over time and across national borders in the same industry? How then does a company develops its marketing strategy in presence of competitors at home and abroad? So, international product life cycle theory address all these questions.

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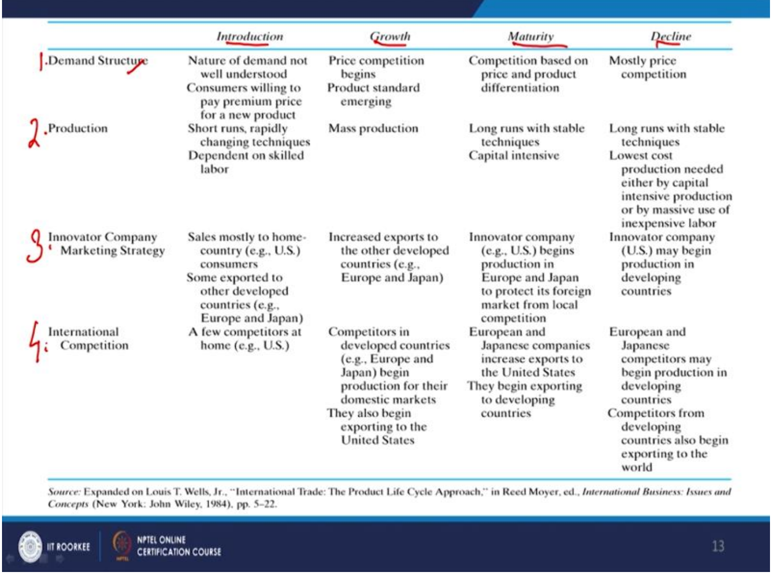

	Introduction	*Growth*	*Maturity*	*Decline*
1. Demand Structure	Nature of demand not well understood Consumers willing to pay premium price for a new product	Price competition begins Product standard emerging	Competition based on price and product differentiation	Mostly price competition
2. Production	Short runs, rapidly changing techniques Dependent on skilled labor	Mass production	Long runs with stable techniques Capital intensive	Long runs with stable techniques Lowest cost production needed either by capital intensive production or by massive use of inexpensive labor
3. Innovator Company Marketing Strategy	Sales mostly to home-country (e.g., U.S.) consumers Some exported to other developed countries (e.g., Europe and Japan)	Increased exports to the other developed countries (e.g., Europe and Japan)	Innovator company (e.g., U.S.) begins production in Europe and Japan to protect its foreign market from local competition	Innovator company (U.S.) may begin production in developing countries
4. International Competition	A few competitors at home (e.g., U.S.)	Competitors in developed countries (e.g., Europe and Japan) begin production for their domestic markets They also begin exporting to the United States	European and Japanese companies increase exports to the United States They begin exporting to developing countries	European and Japanese competitors may begin production in developing countries Competitors from developing countries also begin exporting to the world

Source: Expanded on Louis T. Wells, Jr., "International Trade: The Product Life Cycle Approach," in Reed Moyer, ed., *International Business: Issues and Concepts* (New York: John Wiley, 1984), pp. 5–22.

Now, you see that these are the 4 stages of international product life cycle. That is, introduction, growth, maturity and decline. Let us see what happens to the demand structure; that is 1. Second is to the production, the third is innovator's company's marketing strategy and the fourth is international competition. So, when the product is in introduction stage, the demand is obviously not well understood.

Consumers are willing, some consumers are willing to pay a premium price for new products. Now, this product, as it enters growth, price competition begins. More and more competitors starts coming in and the price competitor, competition begins. And in introduction stage, there were no standards, while in growth stage product standards this they emerge. As the product enters the maturity stage, competition is now based on price and product differentiation.

In decline, the competition is mostly based on price. What happens to production in the introduction stage? Thus, there are short runs because there are not many consumers, 1. Then, there are no standards or minimum number of standards. So they, so the production happens in short runs, the technology is rapidly changing and it depends on skilled labor. In growth stage, as we have seen that the price competition has already begun.

So, now we enter into mass production. In maturity stage, there are long run with stable techniques. And now it becomes capital intensive. And in decliner stage what happens to production is, low cost production is needed either by capital intensive production or by massive use of inexpensive labor. The third dimension of product life cycle theory is what happens to innovator company's marketing strategy.

So, sales mostly at, in the introduction stage, the sales is mostly in the home country, but they also start exporting to some other developed countries. As it enters the growth stage, more exports start happening. As the product enters maturity stage, innovator company begins production in; the innovator company was in U.S. Now, it is starts production in Europe and Japan to protects its foreign market from local competition.

And in decline stage, this innovator company, the U.S. company, it may begin production in developing countries so that the cost is reduced. Let us look at how international competition develops over these 4 stages. In the introduction stage, there are a few number of competitors in the home country. Then as the product enters the growth stage, competitors, they start increasing and they also start exporting from the United States from where this innovator company started.

Then they become a, they also begin exporting to developing countries. And then, competitors from developing countries also in the decline stage competition, competitors from developing countries, they also start manufacturing products and exporting it worldwide. The next theory is internalization or transaction cost theory.

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Internalization/Transaction Cost Theory

- According to International PLC theory, the primary objective of foreign direct investment for the exporting companies is to keep their market positions from being eroded.
- Are there any proactive reasons for companies to invest overseas?
- To address this issue, a new strand of theory has been developed. It is known as internalization or transaction cost theory.

The basic understanding of this transaction cost theory is that, companies will carry out only those activities themselves within the company where the cost of doing that is less. Otherwise, they will outsource all those activities which they are not able to do at a lesser cost. So, keep in mind that this transaction, the basic assumption of this transaction cost theory is that a company will perform only those activities within itself which it is able to do better or at a lesser cost than the competitors.

And any activity that someone else can do better than this company, it will be outsourced to it. So, this is what this transaction cost theory does. So, this theory explains what a company will do itself and what it will outsource to other companies. So, according to this international product life cycle theory, the primary objective of foreign direct investment; now you see that the company has moved from 1 country to another country, to the third country.

First it was manufacturing for the domestic market and then it has started exporting and then it has moved the production to low cost countries, etcetera, etcetera. So, according to this product life cycle theory, the primary objective of foreign direct investment for the exporting countries is to keep their market positions from being eroded. So, they want to become, they want to remain as leaders or the second leader or the first leader or the biggest company.

That is why the primary objective of, they keep on investing in foreign market so that their positions are safeguarded. But, the question is, are there any other proactive reasons for company to invest overseas. This was a reactive reason, because the company, they want to

safeguard their position. So, they keep on investing across the world. So, that was a reactive reasons.

Now, let us look at, are there any proactive reasons why company, why should companies invest overseas. To address this issue, a new strand of theory has been developed. It is known as internalization or transaction cost theory. So, product international product life cycle theory gives reactive reasons of why company move from 1 country to another country, to another country, to yet another country. And now, we will talk about, are there any proactive reasons also for a company to move from 1 country to another.

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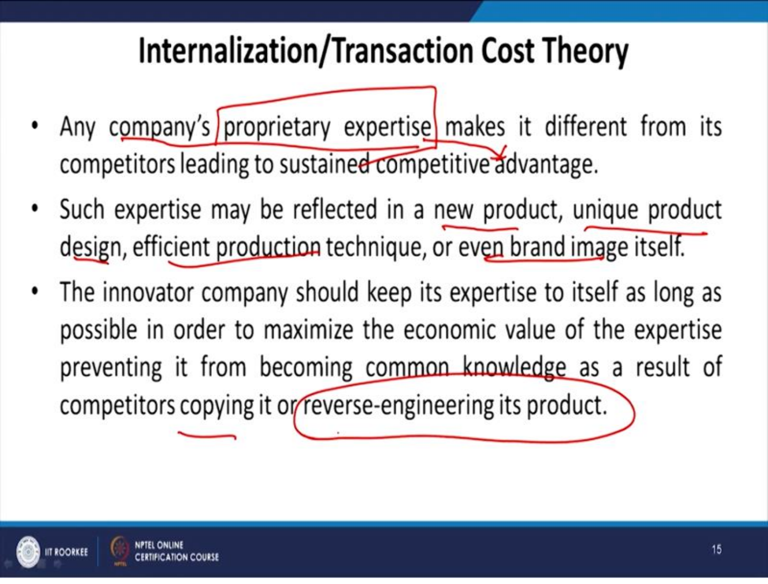

According to this theory, any company's proprietary expertise makes it different from its competitor leading to sustainable competitive advantage. So, any company any company's proprietary expertise leads to its sustainable competitive advantage. So, any company will survive, will have a sustainable competitive advantage only if it has a proprietary expertise. Such expertise may be reflected in a new product, unique product design, efficient production technique or even the brand image itself.

So, all these proprietary expertise, they are reflected in the new product that it comes up, unique product design, efficient production techniques and even the brand image. The innovator company should keep its expertise to itself as long as possible in order to maximize the economic value of the expertise preventing it from becoming common knowledge. As a result of competitors copying it or reverse-engineering it, the idea is that innovator company should keep this property expertise within itself.

And this proprietary expertise is a source of sustainable competitive advantage. As soon as this proprietary expertise goes to the competitor; and it will certainly over a period of time, will go to competitors because they will copy it or they will reverse-engineering it. So, ultimately this source of sustainable competitive advantage will also be lost. This theory, internalization or transaction cost theory, it says that innovator company should keep its expertise to itself for as long as possible, so that it maximize the economic value of the expertise.

As soon as this expertise becomes common knowledge or competitors are also able to do the same thing, then your competitive advantage is lost. Generating this expertise or knowledge requires the company to invest in research and development.

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Internalization/Transaction Cost Theory

- Generating expertise or knowledge requires the company to invest in research and development.
- The motive to internalize knowledge is generally strong when the company needs to invest in business assets (e.g., manufacturing and marketing infrastructure) that have few alternative uses, uses those assets frequently, and faces uncertainty in negotiating, monitoring, and enforcing a contract.
- Such a situation suggests a high level of transaction costs due to specific assets and contractual uncertainty involved.

How this expertise or knowledge, proprietary knowledge will come? By investing in research and development. The motive to internalize knowledge is generally strong when the company needs to invest in business assets. For example, manufacturing and marketing infrastructure. That have few alternative uses; uses those assets frequently and faces uncertainty in negotiating, monitoring and enforcing a contract.

Such a situation suggest a high level of transaction cost due to specific assets and contractual uncertainty involved. So, that is why this company will keep all these, all this knowledge within itself. And that will become; let us go back to the previous slide and that will, that is a proprietary expertise that this company have and that will lead to sustainable competitive advantage.

If it gives this proprietary knowledge to other companies, then that will become a common knowledge and this company which has invested lots of sums in marketing and manufacturing capabilities will not have this proprietary expertise and it will not have any sustainable competitive advantage. The last theory is that of Porter's, which is called as Porter's diamond model. Michael Porter tried to answer the following question.

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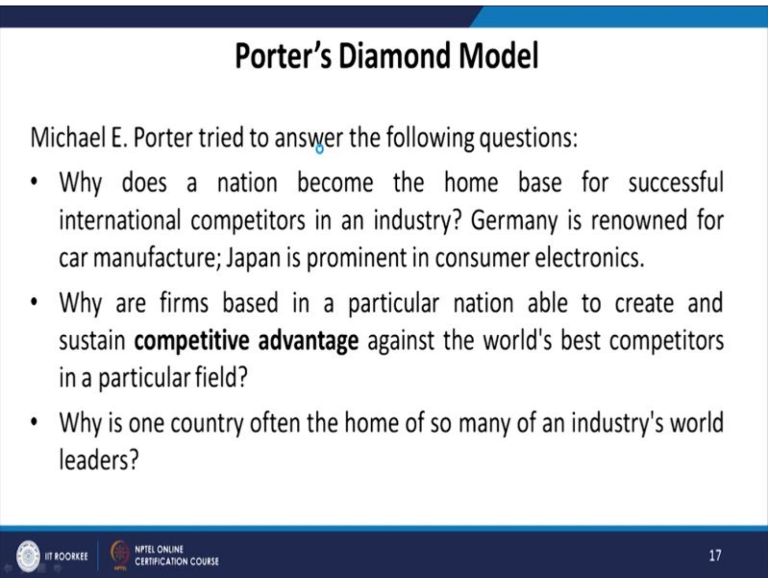

The first question is: Why does a nation become the home base for successful international competitors in an industry? Why is Germany known for car manufacturer? Why is Japan prominent in consumer electronics? Why this champagne has to come from France and why this all this high fashion comes from France and Italy? Why are firms based in a particular nation able to create and sustain competitive advantage against the world's best competitors in a particular field? Why is 1 country often home of so many of an industry's world leaders? So, all fashion houses are there in Paris or in Italy.

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Porter's Diamond Model

- Porter called the answers to these questions as determinants of national competitive advantage.
- And, suggested that there are four main factors which determine national competitive advantage and expressed them in the form of a diamond.
- He argued that a nation can create new advanced factor endowments such as skilled labor, a strong technology and knowledge base, government support, and culture.

Porter called the answer to these questions as determinants of national competitive advantage. Now, you see that what Porter did was, to talk about national competitive advantage. Earlier we had talked about the company's competitive advantage. This Porter's diamond talks of the national competitive advantage. Why does a particular set of industry gets developed in a country?

So, as suggested that there are 4 main factors which determine national competitive advantage and express them in the form of a diamond. He argued that a nation can create new advanced factor endowments such as skilled labor, strong technology and knowledge base, government support and culture.

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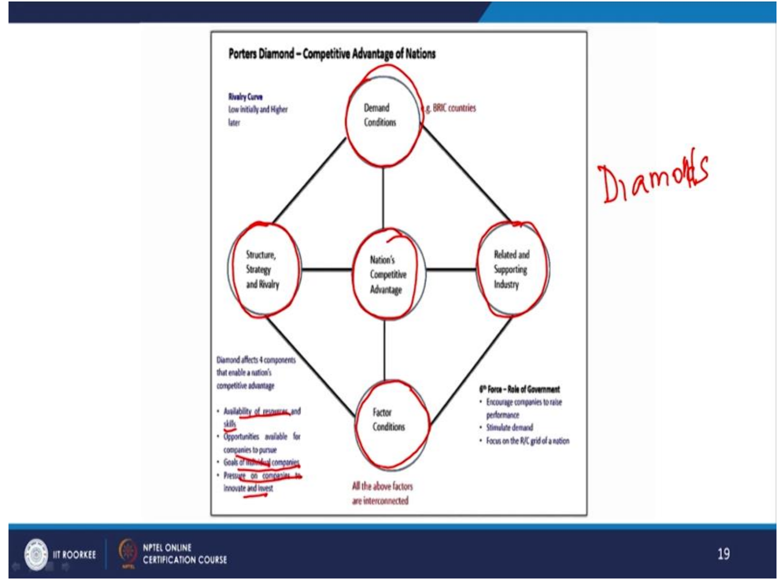

This is what the Porter's diamond looks like. And this is why it is called as a diamond. So, we have demand conditions, related and supporting industry, the firm's strategy, structure and rivalry and factor conditions. These are the 4 determinants of a nation's competitive advantage. And because they are placed like this, so that is why it is called as a diamond. In this model, we are talking of the competitive advantage of nation and we are not talking of a competitive advantage of a company.

These are the 4 dimensions of this competitive advantage. So, diamond affects 4 components that enable a nation's competitive advantage. The first is availability of resources and skills. Second is opportunities available for companies to pursue goals of individual companies and pressure on companies to innovate and invest. So, all the factors, they are interrelated.

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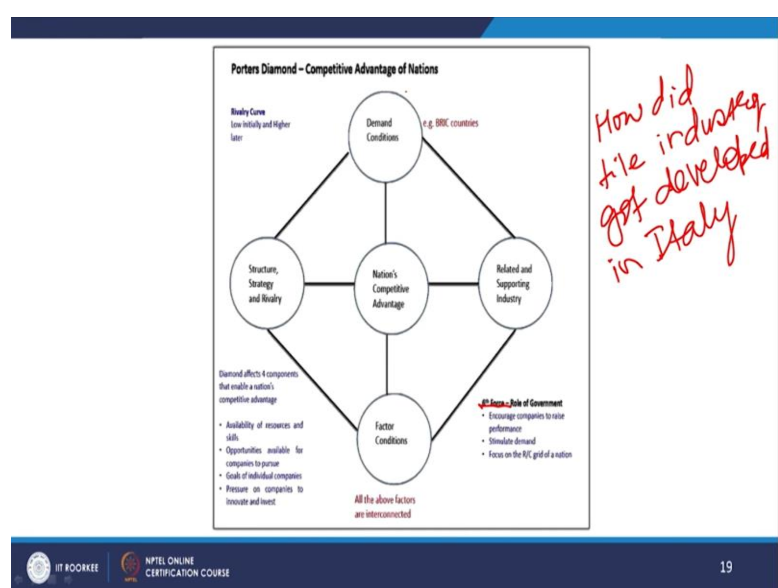

So, now we can use this Porter's diamond to understand how did tile industry got developed in Italy. So, this is a very important model that can tell countries, how can the countries work to make a industry develop in their boundaries. So, the sixth force, that is the role of government. And so, government can encourage companies to raise their performance. They can give various kind of incentives to compress to raise performance.

Then they can also stimulate demand by giving various kind of subsidies. So, this will help the countries in understanding how they can develop a particular kind of industry in their, within their national borders so that their exports increases because every country wants to increase, export more and import less. So, this is a very important model in that context. So, how India became a software hub.

So, this theory explains how does a industry develops in a country and the sixth force in this model, that is the role of government. The government will play the very vital role in development of a industry in, within their national borders. Because they can encourage companies to raise performance, they can give various kind of incentives to companies to raise performance. They can stimulate demand by giving various kinds of subsidiaries and they can focus on the grid of that nation.

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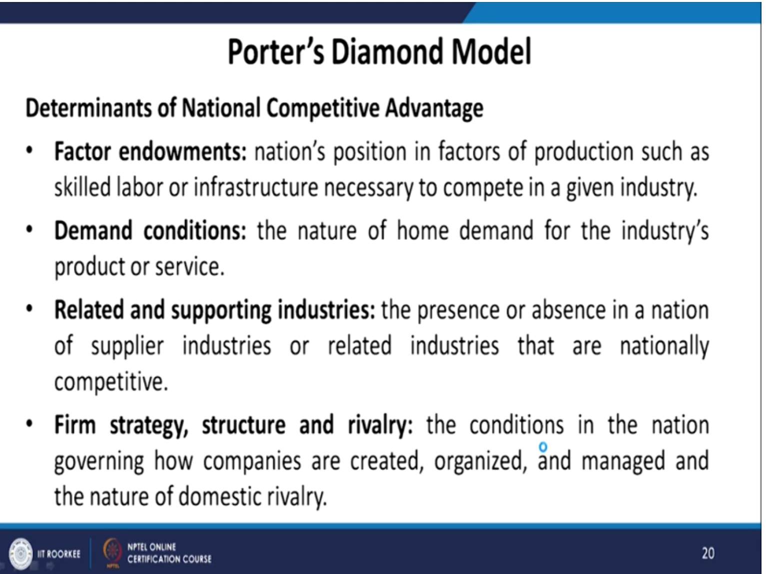

So, in this, these are the various determinant, the factor endowments, demand conditions, firm's strategy structure and rivalry.

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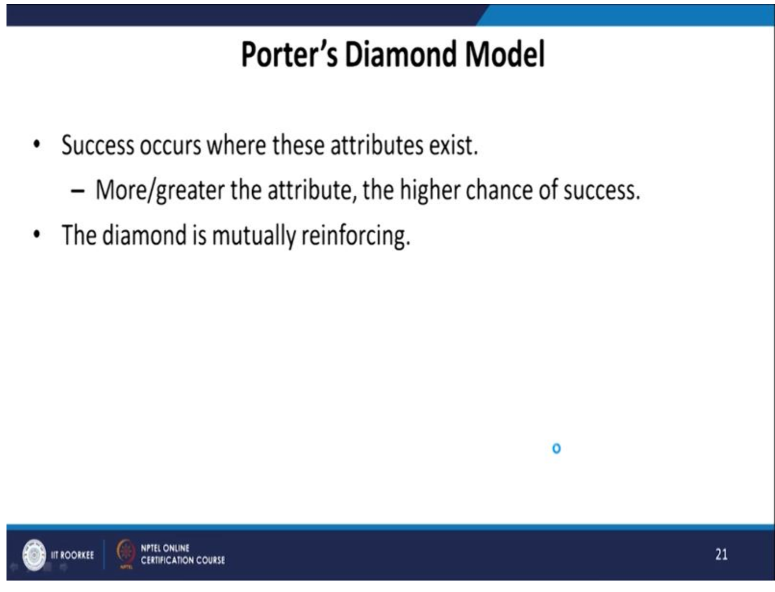

The success occurs where these attributes exist. More or greater the attributes, the higher chance of success. And the diamond is mutually reinforcing. That is, better demand

conditions leads to the development of related and supported industries. And then, the factor conditions, factors can be there or they can be acquired from different countries from other countries. So, these 4 forces, they are mutually reinforcing. And the more or greater 1 particular attribute is, the better it is.

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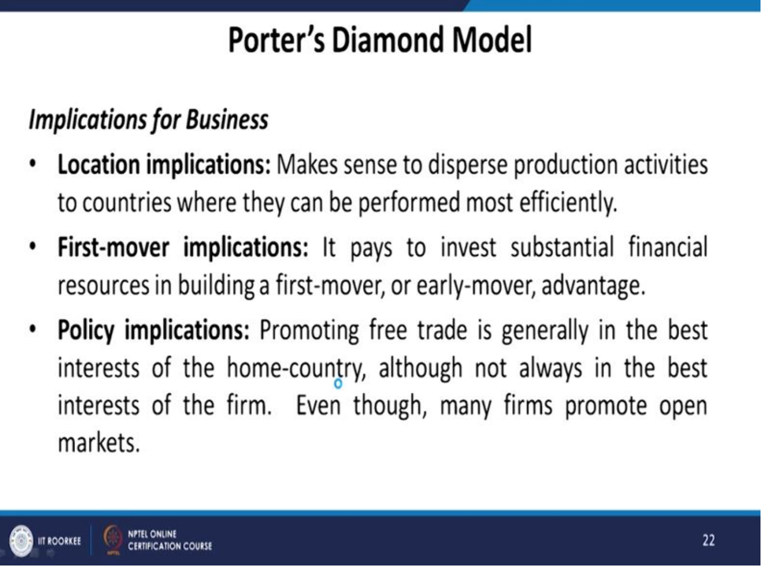

What are the implications of this Porter's diamond for business? The first implication is the location implication; makes sense to disperse production activities to countries where they can be performed more efficiently. Another implication for business is first-mover advantage. It pays to invest substantial financial resources in building a first-mover or early-mover advantage.

The third policy implication is promoting free trade is generally in the best interest of the home country, although not always, in the best interest of the firm. Even though many firms promote open markets. So, with this we finish off with the second module. So, I will run through what has been done in module 2. We have talked about the various theories of international trade. These theories explains why international trade happens and how does a multinational enterprise develops over a period of time.

The first 2 theories, the theory of absolute advantage and comparative advantage. They are related to the advantages. Then we have talked about international product life cycle theory, how does the production and the marketing and production changes, moves from 1 country to another. Then we have talked about international transaction cost theory. That is, that tells

that a company should do all those activities within itself, that are a source of sustainable competitive advantage.

The sixth theory that is the Porter's diamond. It tells, how can a country develop a particular industry within its national boundaries. So, these are the various theories that we have talked about in the second module. And then, we will move on to the third module in which will talk about the global marketing environment. Thank you.