International Marketing
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Module - 2
Lecture - 8
International Business, Entry Modes, and Theories

Good afternoon, welcome back. So, we will continue with the product life cycle.

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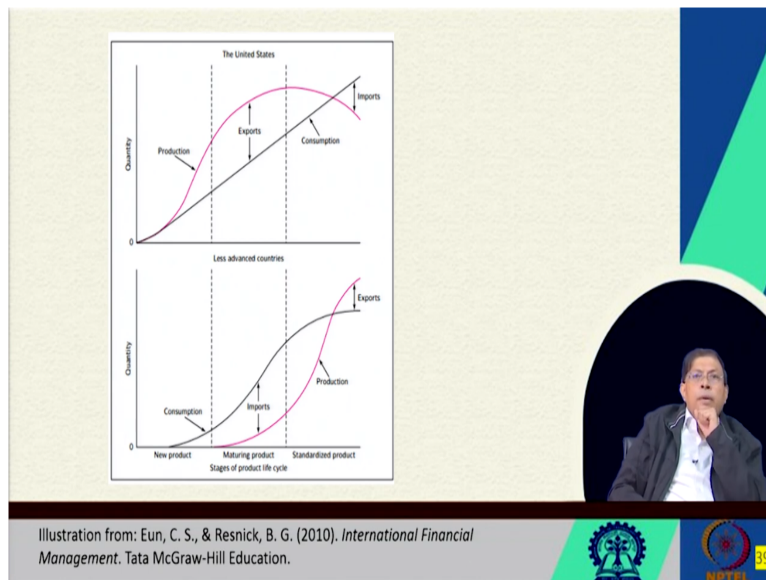

So, previously we have explained you the product life cycle in the domestic market. How was typically the production or how was typically the product life cycle? We have seen in the domestic market. Or typically, product life cycle in a domestic market, you have seen that the profit is initially in the; you are starting losing, you are not making any profit, there is a loss in investment.

And then slowly the product starts and the sales revenue starts, you start making money. And then the product slowly goes to the next phase in the growth phase, its profit also grows. And then you reach at the maturity; then the products also with profit also reach at a certain level. And then you reach decline, the product is no more accepted by your consumers; the product declines and then the profit also declines.

Then you take out the product from there and introduce a new product. That typically known as a product life cycle. I hope you understand product life cycle here. Now, the 2 different

product life cycles in 2 different economies; one is the developed economy, another is a less advanced country. So, how we will show you in the less advanced country. See, the quantity is in the y-axis and the size of the; if you look at the production, if you look at the with the time, the production increases and then there is a consumption and the imports.

So, see the difference here. Initially, the production increases and the difference; these two, if you look at here, the difference is the imports, the consumption and the production, there is a difference. Initially there is a difference which is basically the exports; and then in the last you see the difference, slowly the production is going down and then the consumption is steadily increasing; then it increases the import.

See, it is in a developed nation, like in United States. See this whole thing, the illustration in less advanced countries. See how that a new product has been launched. So, in the new product has been launched, the consumption slowly increases; you see how the, in the blue curve, they slowly increases in that; and then the mixing of the product stages and then the production also increases.

And then at a certain point, you see that the consumption and the production, you find there is a difference there and that is basically the exports. When there is a standardized product, the production increases and then you, then the company starts export that product once you standardize that product. You see the gap there as an export. So, red line is basically the production line and the green line is a consumption line.

In that same one, in the red line was typically the production line and the blue line is the consumption line in United States. So, this is illustrated from Eun and Resnick's International Financial Management book. This has been taken and to explain to you, in international in developed economy, typically the product life cycle looks like that, and in a less advanced country, product life cycle looks like this.

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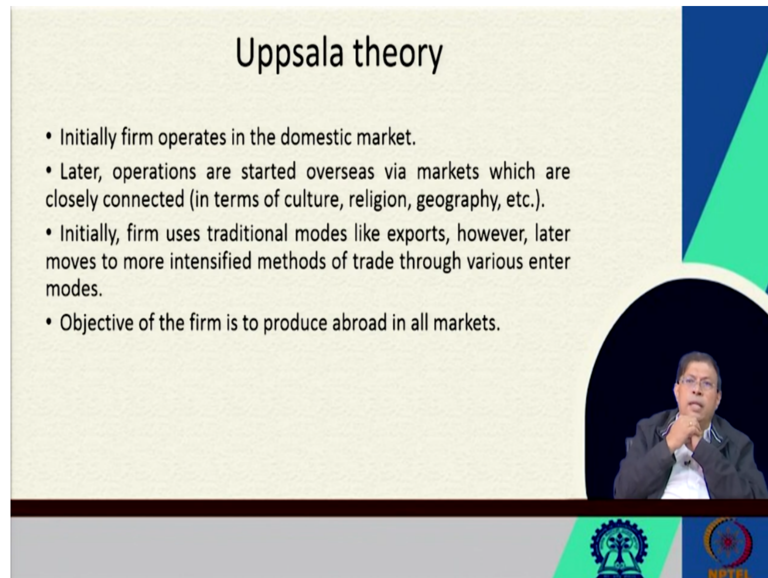

Then comes, now comes a pure marketing, international marketing strategy or international marketing, how we enter to various markets. So, there are certain theories which are very essential for you to understand. So, you have understood that international financial theories where the absolute advantage and all those and comparative advantage, you have learnt. And these theories are international marketing theories where using these theories you can take a decision which theory; there are several options for you and you can, based on this theory, you can take a decision to enter a market.

So, the theory, first one is a Uppsala theory. So, the Uppsala theory, Uppsala is the group of scientists; they are from the Sweden. They came out with this theory known as an Uppsala theory. So, what that Uppsala theory says? Uppsala theory says, initially firms operates in the domestic market. So, first the theory says that you first initially operate in the domestic market, build your market share there, grow the business there, then the later operations start to the overseas market, which are closely connected in terms of culture, religion and geography.

So, understand the fundamentally. The theory says, do start first at the domestic market. So, that means, you start building a domestic company, the product and the distribution and earn your brand, earn the market share in that, earn profitability, then you operate to the overseas market. Now, which overseas market? Uppsala says, theory says that you go to the market which is closely connected culturally or the religion or geographically to your country.

So, what does it mean to you? For you, if you are a company from India, if you have grown business, domestic business, sizeable domestic business, you should first go to the similar culture or the geography like India, Bangladesh, Myanmar, all these, Southeast Asian countries instead of going to Asia Pacific country or to Japan or to Europe and all those countries.

So, the theory tells you, venture first to the similar, the countries which has got a lot of similarity with the culture, religion and the geography. These things are very crucial for you. So, initially, firms use the traditional modes like export, what I have said, first you try with the export. So, first what thing as a domestic company should try? Whether a product is acceptable in the international market or not, try with the exports; see that if that market is accepting the product or not.

If the market is accepting the product, it has got export, but later moves to more intensified trade by the entry mode. Then you might go for which I explained in my previous classes today, that either you build an, give a licensing there or a franchisee there or you start your own subsidiary there, all those what we discussed. So, objectives to firm that to produce and abroad in all markets. Uppsala is typically a stage wise, is a movement the theory suggests.

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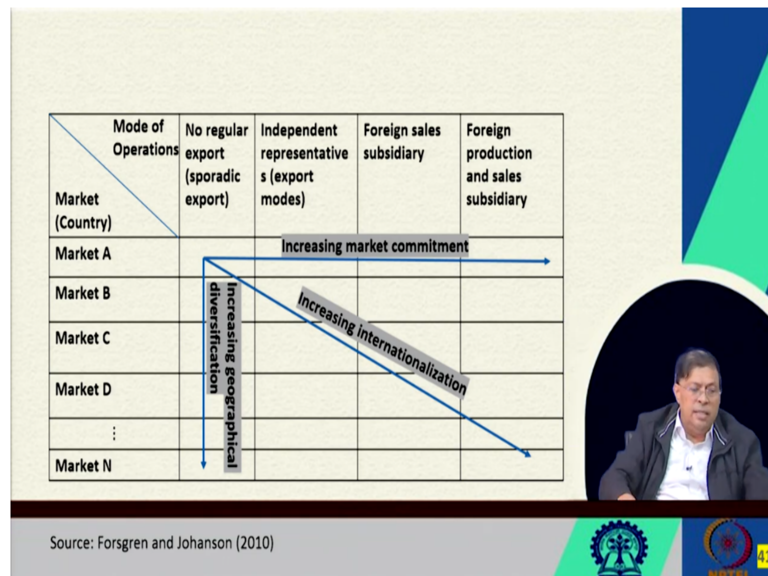

So, if you look at this, the source, I have mentioned the source of this slide. Here, I have given the market A, market B, market C, market D and various markets here. And on the right, on this axis, we have given the no regular export, independent representative, foreign

subsidiary, foreign production subsidiary. So, how you do? You see that in market A, you start and slowly go in the foreign production of the sales subsidiary.

In this, in the no regular export, in this, that is increasing the geographical diversification. So, you are increasing the geographical diversification in the market A, B, C. Slowly you are increasing the geographical dimension. So, slowly you are going from market A to market B, market B to market C, market C to D and this way, market N. And in this axis, you go from 0, first initial export, then you go for a representative there, you put an representative there who will approve, sell your product.

Then you put a foreign sales subsidiary, your own company's subsidiary. Then, also you finally you produce your product there. So, that is typically the way you increase. Either first you increase their geographical extensions, and then in this axis you increase from no export to full-fledged subsidiary. So, this is typically how you increasing the internationalization. I have picked up this slide from the Forsgren and Johnson's book.

And this is a very interesting slide, and thanks a lot for the allow this source to; thanking these researchers to prepare a brilliant slide which is very useful for the students to understand the Uppsala theory. So, this is the how the market countries and how these from no export or irregular export to build in to a full-fledged foreign subsidiary. So, how you do that? So, this is typically known as that.

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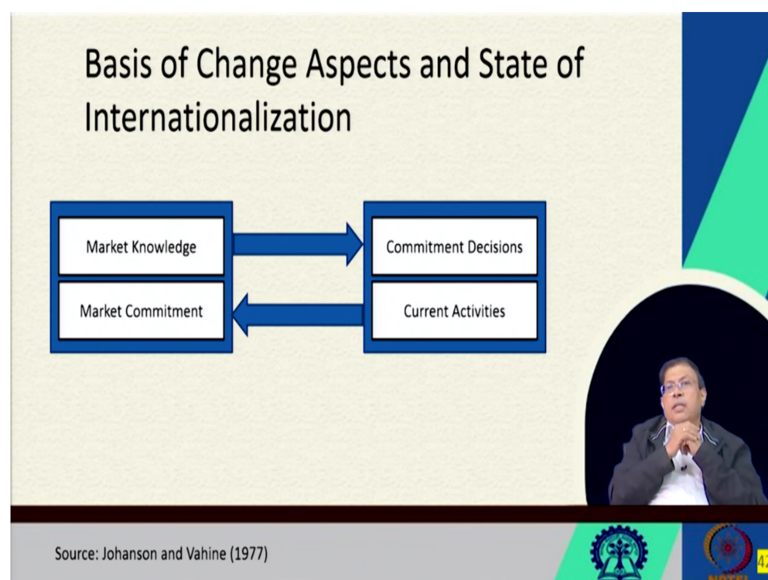

So, what is the basis of change of aspects and state of internationalization? First is the market knowledge. So, what is your knowledge about the market? How much you know about the market is very crucial in international market. Like how much, what is my knowledge about the market where I am operating, say a Bangladesh market. So, first of all, as I said that the PESTEL analysis what we have discussed, like the political, economic, social, technological and legal; all analysis we do and then we know the market.

Who are the competitors there? Which competitors are operating through a distributor? What competitors having their own manufacturing in that country? Which competitor is only importing, exporting in that country? All that market intelligence and how the consumers have accepted the market, the products? And what is typically the distribution? Is it a direct distributor or is it a direct sales people? So, how it is there?

So, knowledge of the market is very important for you. So, you see that in the domestic market, India being such a large country, a marketeer needs a huge knowledge, because these knowledge of the size and the dimensions, everything of a West Bengal market will be totally different than the market in Andhra Pradesh or market in Telangana or market in Karnataka. So, you should have in-depth knowledge about these markets before you start marketing your products to these geographies.

Similarly, in international market, you should have all sort of information, what you used to have in your domestic market for various states, you should have similar for various markets in that region. So, it is a very complex one. You can understand that within the country with a such varied culture, with a such very large geographical region, with a varied per capita income in the various states, we see so many different challenges; you have various challenges to market a product in the domestic market.

Now imagine you are going at the same time to 5 different markets, same. And then, each of these market, we should have the market knowledge what we have. Then, after you have the market knowledge, then you will look at the, your commitment decision; how much, what is your commitment? So, how much you want to go into that market? So, then you put all the markets there, market A, market B, market C, market D, and then you would say that in market A and B, I will go only with exports.

Market C, I will go with a distributor network. Market D, I will go with a sales subsidiary. So, this is the commitment decision you make based on the analysis of the market knowledge what you make. Then you come to the current activities. What is the current activity right now? And then you modify the current activity, then you make a market commitment that okay, I am committed to build this market based on the exports or based on the dealer network, distributor network or based on the sales subsidiary, building a sales subsidiary or I will only allow licensing or I will go for franchising or I might go only for the direct production there or maybe a joint venture.

So, depending on that, your commitment you have to decide. So, that is a very important slide. And I have referred the source here and this is beautifully presented in the slide that how this commitment, the aspects and state of internationalisation.

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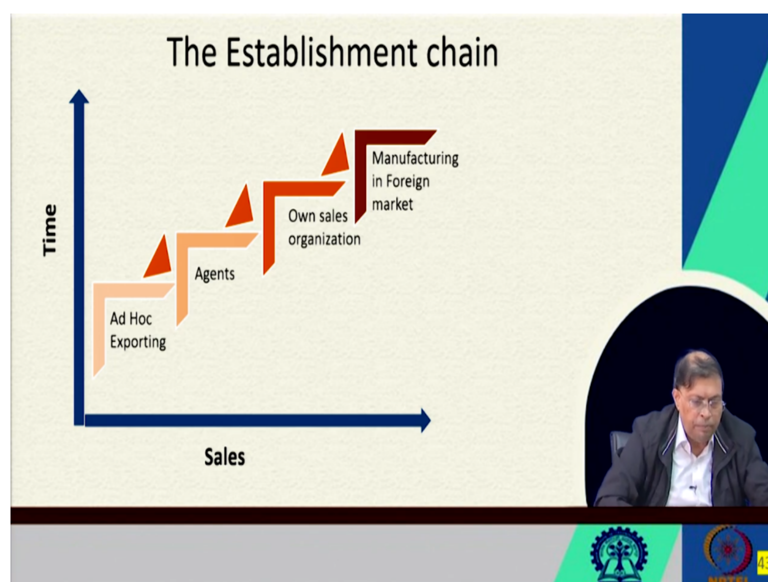

So, the establishment chain is first, as I explained, told you, first one is the ad hoc exporting, then you build the agents there, next step; then you build your own sales organization and then you build your manufacturing in the foreign market. So, that is typically an establishment chain. You do not go typically first to the manufacturing in the foreign market. Yes, there are couple of companies, like if you look at the Kia Motors, the example of Kia Motors coming to India, they first started manufacturing here in this country in 2000 and then started selling the product during 2020.

I believe they started in 2018 manufacturing their plants and all those. They started marketing the products in 2020 onwards and became; so, they followed one of the extreme the principal

here, manufacturing in the foreign market. So, they came here to manufacture the car instead of selling the car in this market through a dealer or a distributor. Now look at this situation here; very high end products, say Porsche car or Lamborghini car.

There is a few market, the size of the market for this type of very luxury products, very high cost products are very insignificant size of the market here. So, it is not really worth for the manufacturer like Porsche to manufacture the car here in India or the Lamborghini to manufacture the car here in India, because the volumes are not there. So, what they do? They have their, either the agents or the own sales organisation to sell the cars here instead of manufacturing.

So, that is one way of entering the market. So, when the demand is not sufficient, they do not really make an investment. So, I will give you a little bit of more heads up on the Porsche car. So, the car is a very high end sports car which is typically used by the, in the luxury segment by the very wealthy people. So, this car is manufactured only in one city in Germany, that is manufactured in Germany, and that car is produced based on the customized.

So, that means, the car, if I am buying a car of Porsche, I will put what should be the colour of the car, then the various accessories of the car and then the various, the stitching of the seats, seat covers and then the various instrument clusters, everything and then the various modes of driving; all those things can be customizable. So, there are 20 different things you can or 30 different things or accessories or 40 different things you can customize.

Now imagine an US customers or an Indian customer wants to buy Porsche. They have so much of customizable option. More customizable option means for you is that you have, you are landing up into the building more time in manufacturing and building more inventory. So, if you have a very customized approach, you will not really prefer to go and manufacture in these US, India and all these countries; instead of that, you continue to manufacture in Germany, and then you ship it from there either to US to India, based on the customer specification given to you.

That is the way how Porsche deals. So, Porsche might have their own sales organization in US who runs through a distribution, car distributors, who sells the car and helps the customers to procure the car. So, there is an organization there, but there is no manufacturing.

But on the other hand, you look at the Kia cars; they came to India and they started manufacturing and then marketing the car here in India.

So, how contrast between the Porsche and Kia Motors. Kia Motors started manufacturing from day 1 here and but here the Porsche is having a sales organization maybe in India; I do not know exactly whether they have a Porsche, but I am assuming they have a Porsche sales organization here or maybe agents or dealers here in India to sell that. So, typically, the slide gives you an idea that you may have only the ad hoc exporting or the agents; these are the step by step.

If you see how this slide has been prepared, so, these steps are ladder steps and you increase and then finally go into the manufacturing. So, that is the last stage where you go into that establishment chain. So, this is typically how, when see the sales starts growing, you move from ad hoc exporting, then to that agents, then to the own sales organization and then finally the foreign manufacturing.

Some company might go straight for the foreign manufacturing, some company might go up to an own sales organization, some company instead of joint manufacturing, some company may have the joint ventures there instead of a direct manufacturing. I have explained to you about these joint ventures couple of minutes ago. So, that is one establishment channel.

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Then comes the transaction cost theory. So, the transaction cost theory predicts when transactions will occur in a market or in organizations. Hence, when new organizations are

likely. So, this is the reference; I have given Williamson's, 91. The reference is given here; that is International Encyclopedia of the Social Behavioral Sciences. I have given the reference and also the reference too.

The 2 type of transaction: transactions to support dealing between the buyers and sellers and transaction to support coordinate within the firm. So, what is transaction cost theory? The first one we learnt that the Uppsala theory we learnt. So, Uppsala says that you first go to your similar culture or the nearing geographies and then slowly expand to the other geographies which is far away from your or different culture.

So, it goes step by step approach is typically Uppsala's approach. Then you first initially start with exporting, then you start with agent, then we start with your own subsidiary, sales subsidiary, then you start your manufacturing; that is a step by step. Transaction cost theory is little different.

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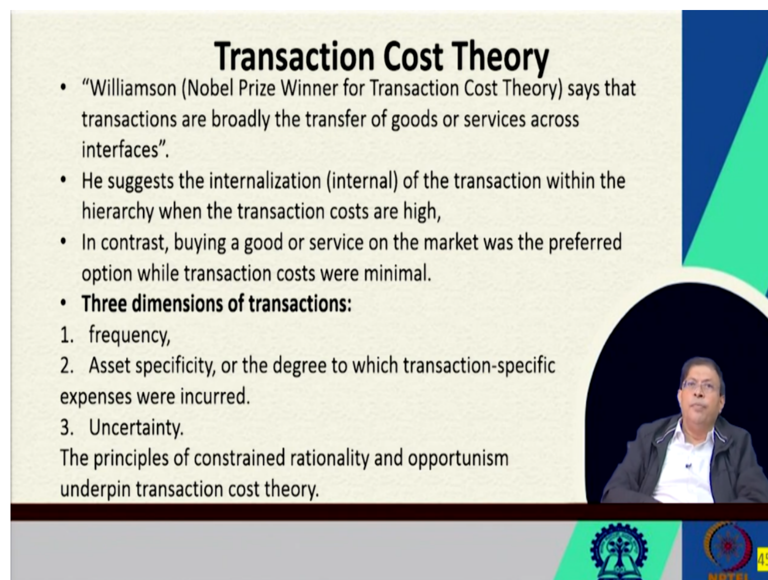

Williamson is a noble, respected Nobel Prize winner of the transaction cost theory; says that transactions are broadly the transfer of goods or services across the interface. I will explain to you. He suggests that the internationalization of the transaction within the hierarchy of the transaction costs are high. In contrast, buying a goods or service on the market was the preferred option while the transaction cost was minimal.

So, 3 dimensions of the; I will give you in a diagram, I will use one of the diagram to explain to you the transaction cost theory so that you understand much better. There are 3 dimensions

of transactions; one is the frequency, how frequently you buy; then asset specificity or the degree to which transaction specification expenses are incurred; uncertainty. The principles of constraint rationality and opportunism underpin the transaction cost theory.

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Four Types of Transaction Costs (2)

1. Search Costs
2. Contracting costs
3. Monitoring costs
4. Adaptation costs

(2) Wigand, T. Rolf, in Encyclopedia of International Media and Communications, 2003
Link to webpage: https://www.sciencedirect.com/topics/social-sciences/transaction-costs-theory

So, here comes 4 different types of transaction cost. So, what are these costs? Search costs: So, search cost means what? I am searching for the dealers, I am searching the distributors and dealers in that country. So, there is a huge cost there. Why? Because you have to go to that foreign market for 10 times, meet the various dealers there and then meet the various distributors; some of the distributors may be working for your competitors, some of the distributors may start to open a new business and some of these distributor may start talking with you.

So, there are enormous number of times a business manager or an international marketing manager has to travel. So, this is one of the transaction cost. So, we have to identify there are various costs and how these costs are very important and then how you analyze whether it is the right time for us to move from distributor model to a direct model; transaction cost theory will give you an idea on that. So, how is that?

So, one of the cost is a search cost is very crucial, which is search cost. Then is a contracting cost. How many times you have to go there and then legally you have to have a contract with that company, the legal; you may have 1 distributor; you may have a large country like US, you might put say 20 distributors; or large country like India, you might put 5 distributors, 4

regional distributors, 1 national distributor; a country like Singapore, you might put 1 distributor; in Malaysia you might put 3 distributors in Malaysia.

So, it all depends on the country. So, you see from here, the search cost is based on the geography, based on the size of the market; search cost for the distributor is very high. Contracting cost, because you have to have a legal contract with each of these distributors, you should have a legal contract with them. Then the monitoring cost. You need to monitor all these distributors.

That means, they are working for you, they are doing the, they are meeting their customer requirement, they are doing or following all the ethical practices in the business; all those things you have to monitor. They are delivering the product in right time to the customer, there is no delay in delivering the product, there is no delay in installation of the product, there is no delay in servicing the product.

If there is a breakdown of the equipment, your dealer or a distributor is going and providing the service. So, this monitoring cost is also enormous cost, because you have to put your own company's people at the foreign country, who will be there and their salary, their cost of staying, everything has to be borne by the company; so, monitoring cost is also very high. Imagine if you have 5 different countries and then you have 2 managers, they have travelled to 5 different countries and then monitoring is also very important. Then the adoption cost, how fast this whole thing is adopted and then the cost of this adoption is also very important here.

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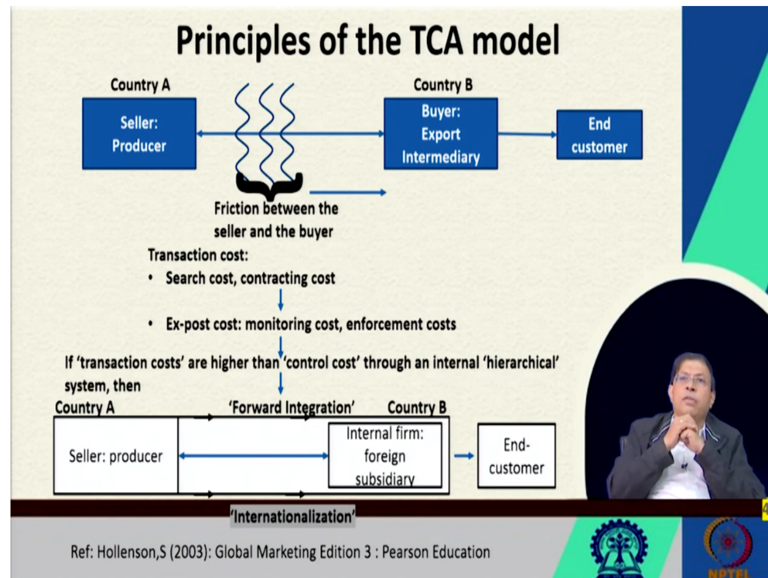

So, this is the principles of a transaction cost model. And this, I have taken this diagram is very widely used; I am also used for the students. This is very useful diagram and I am personally thankful to the researchers who had made this diagram which is very useful for the students. This researcher says Country A and Country B and there is a customer. Look at this situation here.

The country A is a producer; that means, say a country A. And Country B is an export or then maybe a buyer and where is an intermediary in the country B. And there is another one, is the end customer; the last is the end customer. So, there is always a friction, there is a first thing, there is always a friction between the seller and the buyer. Why there is a friction in the seller and the buyer?

Because the seller will always want to make it as much as gross margin or the profit possible and the intermediary will try to make, their objective is to make, they make more money and they buy at a less discounted price from you. So, there is always a friction; as you know, the frictions generate heat, it generates amount of heat here. What happens? The distributors will continuously or there will continuously negotiate with you and continuously try to reduce the price; there is always a friction between these two.

And then finally, there is an end customer who finally buys it from the distributor. So, what is the transaction cost? The cost of searching cost and the contracting cost. So, what is the pre ante cost? Typically, the search cost and the contracting cost. And post cost is the monitoring

cost and enforcement cost. So, there are 2 cost elements there. So, I will come back much more little bit much more detail in the next slide.

In my next presentation, I will come back to explain you the difference; when you understand and take the benefit of this transaction cost theory, then you can take a decision whether it is a time for you to move for the direct operation or to build up your sales subsidiary. Right. Thank you. Thank you very much.