



CHAPTER II

ECONOMIC GLOBALIZATION AND COMPETITIVENESS

2.1. Introduction

A new era of Globalization started in the middle of the 1980s. What has provided attractive force for this process is a liberalization of capital inflow. Progress has been made in the deregulation and liberalization of both visible and invisible service trades. The liberalization process has been going on both in the services and manufacturing industry sectors. Globalization today refers to those processes by which all human societies develop into a single system. It is a general process of reaching out and integrating variety—whether families into a village, villages into a tribe, tribes into peoples, peoples into cities, cities into states, states into empires. The key to, the cause of, globalization is development. Development is the integrated diversity, or scale, of a system. Developmental systems generate a new variety and integrate it. They also seek out variety, import it, and integrate it to make a new variety. Today it is a characteristic of a world system. World development, albeit requiring continuous mass production and distribution, has shifted from the production of abundance of the familiar to what is new and different. The globalization processes today facilitate and accelerate change in innovation driven economies.

2.2. Definition of economic globalization

The definition of economic globalization comes from several scholars. Anne Krueger, the first deputy managing director of the International Monetary Fund, in the John Bonython lecture, delivered in Australia in 2000, she defined globalization as: "A phenomenon by which economic agents in any given part of the world are much more affected by events elsewhere in the world' than before. There is, however, another more technically precise version of this process: the integration of economic activities, across

borders, through markets". Also, David Henderson, former chief economist of the Organization for Economic Co-operation and Development, defined globalization as: "Free movement of goods, services, labor and capital, thereby creating a single market in inputs and outputs; and full national treatment for foreign investors (and nationals working abroad) so that, economically speaking, there are no foreigners." (Wolf, 2005)

The globalization and innovation are linked to worldwide norms and values about exchange; common symbols and languages of communication; declining costs of "cross border" interactions. The recent focus on globalization has been economic: finance, capital flows, decentralization of production, and world markets. The beginnings of a new era of globalization were the oil crises of 1973, the creation of global capital markets, the opening of China in 1979, and the collapse of the Soviet Union in 1989. The most important change of this era was the decentralization of production and consumption and its integration in markets and new institutions of a global political economy, the most notable of which was the inclusive World Trade Organization. The newly emerging and strengthening world regions were also part of globalization, both decentralizing and integrating.

An end of the Cold War and change in information technology can be cited as two of the elements of globalization. It is the beginning of a new history in that the market globalization phenomenon resulted in the creation of a global marketplace. Nations of the world became increasingly interdependent, thus leading to the establishment of a global marketplace, forming one single market.

There are 4 aspects to globalization:

- a) Global Communication and information exchange
- b) Global transportation and travelling
- c) Global resource depletion
- d) Global spread of capitalism

There are 3 aspects to this: production, finance, and markets. There are many social and environmental impacts from this practice of producing goods in developing countries for sale in developed countries which are called the global integration of production. The second aspect to the global spread of capitalism is global financial

trading where stocks can be bought from a company anywhere in the world. The last one is a market in which the same goods can be bought anywhere in the world.

2.2.1. Factors driving Globalization

The globalization of market economies may conceivably require the following factors to exist: people, goods, foreign exchange, and information. Globalization leads to transactions in financial products. Financial products, however, move instantly in large quantities anywhere in the world. Globalization is important as it allows the transfer of business opportunities to overseas markets. It requires, however, a transnational minimum standard to be established. Three fundamental factors have affected the process of economic:

Improvements in the technology of transportation and communication have reduced the costs of transporting goods, services, and factors of production and of communicating economically useful knowledge and technology.

The tastes of individuals and societies have generally, but not universally, favored taking advantage of the opportunities provided by declining costs of transportation and communication through increasing economic integration.

Public policies have significantly influenced the character and pace of economic integration, although not always in the direction of increasing economic integration. These three fundamental factors have influenced the pattern and pace of economic integration through three important dimensions of economic integration: 1) through human migration; 2) through trade in goods and services; and 3) through movements of capital and integration of financial markets.

2.2.2. Interactions among the fundamental factors driving economic integration

Although technology, tastes, and public policy each have important independent influences on the pattern and pace of economic integration in its various dimensions, they clearly interact in important ways. The taste for the benefits of integration—is a key reason why it is profitable to make the innovations and investments that bring improvements in the technology of transportation and communication. Public policy has often played a significant role in fostering innovation and investment in transportation and communication both to pursue the benefits of closer economic integration. The

tastes depend on experience which is made possible by cheaper means of transportation and communication. It is clear that tastes for products and services produced in far away locations, as well as for investment in foreign assets, depend on an important degree of experience. Public policy toward economic integration is also, to an important extent, responsive to the tastes that people have regarding various aspects of such integration, as well as to the technologies that make aspects of such integration, and to the technologies that make the integration possible. The result of technological innovation is a new product and modern facility such as port—that develops and retains a considerable market.

2.2.3. Trade in goods and services

Trade in goods is seen as a substitute for mobility of factors of production. Trade in the outputs of production processes may be an essentially perfect substitute for mobility of factors. A key reason why the conditions for factor price equalization do not fully apply is because barriers to trade in outputs effectively prevent the equalization of relative output prices at different locations. These barriers take two forms: natural barriers to trade in the form of transportation costs and costs of information about product prices and availabilities at different locations; and artificial barriers to trade arising from tariffs, quotas, and other public policy interventions. In general, the higher the barriers to trade are, the lower the degree of international integration through trade will be, and vice versa. Thus it is relevant to consider what has been happening to barriers to trade as a means of assessing what has been happening to international economic integration through this important channel.

The two fundamental factors that appear to have driven this increasing global economic integration are continuous improvements in the technology of transportation and communication, and a very substantial, progressive reduction in artificial barriers to international commerce resulting from public policy interventions. Financial services (to be discussed below) are a particularly important area where modern communications technology is helping to transform the arena for international trade in services.

For developing countries, where infrastructure of modern transportation is generally less well developed, opportunities for reductions in transportation costs would

enhance economic integration (both within the domestic economy and internationally) at a greater level. A technological revolution is under way and likely to continue for some time. Costs of communication, both domestic and international, have fallen rapidly; and these declines also seem likely to continue.

2.2.4. International capital movements and trade in financial services

Capital markets in developing countries too are becoming more closely integrated with markets in the rest of the world, although they have progressed far less in that direction than the industrialized countries. The costs of gathering, processing, and transmitting information and of executing financial transactions will probably decline further with advances in technology; the pace of financial liberalization and innovation continues unabated in most industrialized countries; the pool of savings managed by professionals is growing and the same reforms that reduce systemic risk often also enhance the private sector's capacity to redenominate the currency composition of its assets and liabilities at short notice. Financial markets, especially wholesale markets for high-grade instruments, have tended to become more tightly linked internationally, especially among the industrialized countries and many important emerging market economies.

The flows of foreign direct investment (FDI) to developing countries have expanded considerably during the 1990s and have come to dominate net flows of private capital to these countries and the flows of FDI have also proved to be quite stable during recent financial crises. The rapid reductions in the costs of storing, accessing, analyzing, and communicating information are both dramatically reducing the costs of producing virtually all existing forms of financial services and creating new products and services (such as many OTC derivatives) that would have been prohibitively expensive with older technologies. As financial markets become globalized, the world is plunging into a "speed" economy. There is a large difference between the speed at which people and goods move and that of capital migration.

2.2.5. Advances in Information and Communication Technology

Advances in information and communication technology are the most important technological progress of the past and today. Technological advances in these areas

account for much of the rise in total factor productivity. As a result of these technological advances, the costs of processing and communicating all forms of information have been all declining very rapidly; i.e. by a factor of two or more within a two-year period. By nature, much of the activity in the financial services industry, has to do with the processing and communication of information. It stands to reason, therefore, that the financial services industry would be particularly strongly affected by rapid advances in information and communication technology.

As information and communication technology has advanced and the costs of doing virtually all forms of financial business have declined, the meaningfulness of the differences associated with different locations or with different sectors of the financial services industry appear to have eroded. This reflects the fact that it is much cheaper now than a few years ago to do financial business over a wider geographic range and over a wider scope of activities. As a consequence, there has been a tendency toward restructuring of institutions in the financial sector in the direction of broader geographic and functional scopes.

The revolution in information and communication technology involves a constellation of industries, such as computers, electronic components, and telecommunications. These are among the fastest-growing industries in the most industrialized countries. The new technology has not only resulted in the introduction of a wide range of new products but, more importantly, has produced a drastic fall in costs and vastly improved technical performance in many other sectors of the economy. Of equal significance, the new technology is bringing about fundamental changes in the organization and structure of firms and industries, and changes in factory lay-out and in the management structure, procedures and attitudes of large firms.

2.2.6. The particular importance of communications

In many discussions of international economic integration, the focus is on integration through trade and factor movement, both labor and capital. There is another important mechanism through which economic activities in different parts of the world affect each other—namely, through the communication of economically relevant information and technology.

The prospect is that the process of global economic integration—which is being driven by irresistible forces of technological advance—will take place through voluntary means. People around the world will decide to participate—through trade, through movements of people and capital, and through accessing information and taking advantage of new technologies. Consequently, this would provide the reasonable assurance that the fundamental forces that are driving global economic integration are, in fact, driving the world toward a better economic future.

The process of economic integration could have two conceivable end points. Firstly, technology remained roughly as it is today, but there would be no policy barriers to the movement of goods, services, information, capital or people. These would add to the barriers that distance and difficulties of communication continued to impose. The political preconditions for such a global economy could be either the unilateral abolition of barriers by what remained sovereign states, or a structure of restricted national sovereignty. In other words, a globalized economy could be combined with a number of different structures for global governance. The second one would be one in which, in addition to the abolition of politically imposed barriers to economic integration, costs of transport and communications were minimized. Distance would no longer matter and there would be the end of geography. Economically, the world would be reduced to a point that cyberspace would have come close to achieving but only for information.

2.2.7. Deregulation and Privatization

Globalization is one force driving the global economy, but so too is the coming of the information age, deregulation, privatization, service-based economy, the convergence of industry boundaries, and the knowledge revolution and pervasive information flows. The past decade has seen a dramatic shrinking of government influence in many industries like airline, communications, utilities and banking in the U.S. and in Europe. Fuelled by the new opportunities of information technology, organizations in these industries were able and forced to completely restructure their businesses and to look out for alternatives. Deregulation and privatization—two major trends in the new market economy—have generated numerous surprises for the many industries involved.

Increased liberalization will automatically foster competition, reduce prices, and generate service improvements.

2.2.8. Technological Innovation

In addition to the ever-growing integration of the international economy and changes in the nature of competition between nations and firms, the world is undergoing a new, far-reaching technical revolution as a result of the rise and spread of information technology. In addition to the new technology and associated organizational developments which are being rapidly adopted in advanced countries, other significant changes are also taking place in the production systems of these countries, involving new concepts such as flexible specialization and just-in-time production.

Firms are networking globally, not only in production, but also in innovation. The innovation process has moved from exogenous inventions to learning-by-doing to innovation endogenous at every level of global organizations. Development increasingly depends on this organizational innovation culture and the intensive networking within and across firms. The human capital intensive characteristic has become accentuated as innovation has become increasingly endogenous to firms and firm networks. The globalization of innovation, e.g. the production of information technology, depends on a knowledge-enhancing environment.

Globalization involves competition of how well costs can be managed. To face this competition successfully, there are three options available. The first step concerns how labor costs should be lowered. The share of labor cost in total costs must be decreased. The second action is a reform of the management process. Introducing new types of equipment, such as robots and computers, should reduce the proportion of personnel expenses to total costs. The third and last measure is to adjust prices through competitive policy. In the globalized environment, firms are in no position to fix prices. Enterprises have two options. Closing down business or doing business in overseas markets seeking lower personnel expenses. Private enterprises will also be required to build non-price competitive power by acquiring intellectual property rights concerning technologies, products and services.

Improvements in distribution logistics and communications have allowed nearly all firms to buy, sell and cooperate on a global level. Customers, meanwhile, have the chance to shop around and compare prices globally. As a result, even locally orientated mid-sized companies find themselves in a global market, even if they do not export or import themselves. Global and networked markets impose new requirements on organizations' strategies. As digitalization power of information technology grows, all firms in the market will have access to far more information. Thus, totally new business conducts will emerge in which even firms from outside the industry are able to vastly change the basis of competition in the market. The term "network effects" by Internet, which refers to situations in which a product becomes more valuable once many other people also use it, cause such rapid change in the global market.

2.3. Transaction cost economics (TCE)

TCE specifying the variables that determine whether "market or hierarchy" will have the lower transaction costs in various circumstances. There are supportive assumptions that put the variables to be valid; Bounded rationality, the fact that people have limited memories and limited cognitive processing power; and Opportunism, the possibility that people will act in a self-interest way.

Transactions can be internal or external to an organization. Internally, the transaction costs can include managing and monitoring personnel and procuring inputs and capital equipment. An external transaction can include the costs of source selection, contract management, performance measurement, and dispute resolution. Transactions can be frequent or rare; have high or low uncertainty; or involve specific or non-specific assets. Asset specificity can take a variety of forms, including: site specificity, physical asset specificity, dedicated assets and human asset specificity. These three variables will, according to the theory, determine whether transaction costs will be lowest in a market or in a hierarchy. It is easiest to consider these variables with respect to decisions about whether to integrate vertically.

These variables are in the context of bounded rationality and opportunism. Without opportunism, the transaction would take place within the market, rather than within a hierarchy. But bounded rationality is a precondition for opportunism. So, opportunism and bounded rationality are likely to give rise to internalization. 'Market contracting gives way to bilateral contracting, which in turn is supplanted by unified contracting (internal governance) as asset specificity deepens' (Williamson, 1985). Other things being equal, when transactions involve highly specific assets, transaction costs are likely to be lower in a hierarchy than in a market. A complete contract eliminates opportunistic behavior. It binds the parties to perform their responsibilities and rights for each and every course of action. There are three factors preventing a complete contract: bounded rationality, difficulties specifying or measuring performance and asymmetric information.

The core of the firm is production and/or distribution activity. Production-distribution objectives can be achieved by the use of organized inputs i.e. the organization of human and non-human inputs. Analysis of internal organization, within a bounded rationality framework, allows that each firm unique in terms of detailed objectives and characteristics which adds a dynamic either short-run or long-run perspective in nature to the firm. The short-run perspective refers to the operations of the firm whereas the long-run refers to the strategic direction of the firm.

The economic organization can be one of two forms; market or intra-firm based. The control of resource allocation leads to transaction and organization costs respectively. The transaction costs can be defined in terms of three factors:

- a) Search and information costs
- b) Bargaining and decision costs
- c) Policing and enforcement costs.

These factors can be recast in terms of the management costs associated with the construction and enforcement of contracts. The transaction costs occur over two time periods. In the short-run, the way, given the overall stock of managerial resources, to increase managerial input into any one activity is to divert resources away from other managerial activities such as negotiation of contracts, management of production-

distribution, and strategic planning, managerial slack reduction or intensification of effort. In the long-run, the overall stock of managerial and complementary resources can be increased. Thus greater management effort produces a more detailed specification and policing of responsibilities and / or more advantageous prices i.e. higher outputs and lower inputs. Obviously the nature of this contracting production function is complex, involving bounded rationality and human agency. The diminishing returns to contracting effort involved are appropriate because of bounds on information collection and processing capabilities.

In the long-run, the stock of managerial assets can grow or decline, depending on the nature of any contracting scale economies. Shifting organizational dynamics can impede or facilitate any scale effects, and in addition, can affect the trade-off between management input and bounds on information collection and processing. In short, long-run shifts inevitably endogenise organizational parameters. Parameters such as organizational technology, particularly the exploitation of advances in information technology, can enhance the information collection and processing abilities of an organization.

The short-run relationship between inputs and outputs for any one contracting activity can be transformed into the associated transaction costs. The resource costs of extra management input into any one activity is the opportunity cost of the management in terms of lost control activity. Therefore, managerial input can be priced in terms of an increasing opportunity cost function. The managerial input results in the specification or policing of intra-firm responsibilities involving not only production distribution but also control within a managerial hierarchy. In addition, internal management may involve the determination of transfer prices. And it can be thought of only in terms of organizational control. From a different transaction cost tradition, the developed internalization of multinational companies, suggests that the extent of any differences between transaction and organization costs will depend on the costs of monitoring performance within a hierarchy, cultural differences between superior and subordinate units, and managerial skills.

The analyses can be used where output is produced by factor services which are derivable from factor inputs. The link between factor inputs and factor services is relevant for contracting and organizational activity, and is the arena within which transaction and organization costs are determined. The link between factor services and production-distribution concerns the technical activity of production-distribution. Transaction cost economics assumes that managerial and technical activities are separable to maintain the exogeneity of benefits.

The concept of managerial resources can be briefly defined as administrative, technological, marketing and organizational know-how, the expertise and skills of workers necessary to run a firm efficiently, the boundary of the firm, and the market can be explained by the concept of transaction costs at a specific point in time and under stable external conditions.

2.4. Transaction Cost Economics and Globalization

Globalization is the idea that the world is a fully integrated market place. It involves liberalized, technologically facilitated, economic exchange of capital, raw materials, human resources, and intermediate goods; including knowledge, manufactured end products, and services. Firm-level selectivity in Globalization is the key issue in the relevance of the transaction cost economics approach. The study is intended to see how globalization, which is a Macroeconomic basic condition, plays a vital role in impairing the local Thai firms' competitiveness.

The Transaction cost economics (TCE) approach will be applied to assist the understanding of how variations in characteristics of transaction lead to the firms' performances, particularly in terms of differences in economic instability and efficiency among firms. At the firm level, governance implies that economic agents attempt to align transactions with governance structures efficiently in order to achieve economizing outcomes. In addition to TCE approach, selectivity in globalization requires the efficiency of some patterns at the macro-level such as international trade agreements as well as firm-level internationalization such as geographic scope of sequential entry

decisions and choice of entry modes. The impact of geographic scope choices to solve the bounded rationality and bounded reliability problems are critical to the firms' decision making.

It is implied that economic actors establish governance mechanisms to manage international transactions. At Macro-level, governance mechanisms have constraints that structure political, economic, and social interactions. The informal constraints include sanctions, taboos, customs, traditions, and the formal rules are constitutions, laws, property rights, which have effects on the comparative attractiveness. It structures the behavior of multinational enterprises (MNEs) to create a shift by toward setting up subsidiaries instead of working with market contracts.

They shift firm-level choices from one discrete governance structure toward another. It results from the transactional aspects of international business i.e. the difference between the arm's-length market and the internal markets of multinational enterprises (MNEs).

The firms are organisms which coordinate the activities. The problems of efficiency of the information, uncertainty of markets, imperfect market knowledge, and reduction of internal conflicts, move them toward vertical integration, which are the implications of market failure or structural market imperfections. The large MNEs cover widespread internal markets that cross industries and countries which take into account managerial resources at a specific point in time, and over time.

The selectivity is required when making product diversification decisions. The decisions might be incurred from hierarchical intervention, bounded rationality problems and sub-goal pursuit. Expected economies of scale and scope, as well as risk reduction benefits, are less likely to materialize, or more likely to be overcompensated by additional production and transaction costs, in the case of unrelated diversification. Firms often engage in unrelated diversification to capitalize on external opportunities. However, the successful exploration of such opportunities requires a match with the firm's internal capabilities. In addition, expanding geographic scope leads to additional costs from more bounded rationality constraints and the danger of increased sub-goal pursuit. The MNEs' management must determine the firm's "boundaries", which consist

of the make-or-buy decision, the choice of geographic scope of the firm's activities, and the choice of entry mode. They have to design the interface with the external environment and align the internal design of the organization to structure the foreign subsidiary network.

Anderson and Gatignon (1986) have developed the interactions between determinants of entry modes with maximizing economic criterion: long-term efficiency. A firm seeking to perform a business function outside its domestic market must choose the best mode of entry, which differs greatly in their mix of advantages and drawbacks. Mapping from governance structure to control is a progression from less integration to more integration. Degree of integration proceeds from complete non-integration, i.e. contracting between two parties, to complete integration i.e. one entity "contracts" internally to perform a function. Control, the ability to influence systems, methods, and decisions, has a critical impact on the future of a foreign enterprise. In addition, control, in an uncertain foreign environment, also entails commitment of resources, creates switching costs, and reduces the firm's ability to change its institutional arrangement. Control and integration are closely related in that the integration gives a firm legitimate authority to direct operations. The transaction cost analysis, combines elements to weigh the tradeoffs in vertical integration.

The efficiency of an entry mode depends on four constructs that determine the optimal degree of control, following a transaction cost analysis.

Transaction-specific assets: investments in physical and human assets that are specialized to one or a few users or uses. This includes proprietary products or processes, unstructured, poorly-understood products and processes, customized products and product class maturity.

External uncertainty: the unpredictability of the entrant's external environment. External uncertainty is the volatility of the firm's environment. The uncertainty leads to avoiding ownership. The combination of country risks such as political instability, economic fluctuations, and transaction-specificity of assets (proprietary content, poorly understood products, customization, and product class immaturity) has relationship with the appropriate degree of control.

Internal uncertainty; the entrant's inability to determine its agents' performance by observing output measures; Internal uncertainty exists when the firm cannot accurately assess its agents' performance. It has a relationship with the firm's cumulative international experience, socio-cultural distance, and the scale of foreign business community in the host country.

Free-riding potential: agents' ability to receive benefits without bearing the associated costs which include international goodwill and recognition and the value of a brand name.

Ahmadjian and Lincoln (2001) studied the Japanese Keiretsu, governance and learning the Japanese Automotive Industry about how shifts in markets and technologies were reconfiguring transactions between Japanese auto assemblers and suppliers. The study drew on the governance approach based on transaction cost economics (TCE) and the learning approach based on the resource-based view of the firm. There was a drift from a dominated hybrid or keiretsu governance modes toward the arms-length contracting and administrative control. In addition, macroeconomic crisis and business uncertainty eroded the cultural supports for the particular governance and gave a greater legitimacy to new forms and new partnerships. Consistent with transaction cost economics, the shift in purchase – supply relationships could be traced to changes in the nature of parts transactions and keiretsu governance structures. A learning perspective on alliance complemented and extended transaction cost theory, providing additional explanation of the sources of change and the specific governance choices being made. The firm had effectively internalized its transactions with the suppliers by taking a controlling interest. They built from the ground up an in-house capability in electronic components, buying less from and scaling down its dependence on the supplier. With the routine of quality, reliability, and speed in supply management, the need for keiretsu-style governance has declined. The withering of keiretsu obligations is also traceable to globalization and the continuing weakness of the Japanese economy.

2.5. Transaction Cost Economics and Competitive Advantage

2.5.1. Type of advantages

A firm has a competitive advantage when it outperforms (i.e. earns higher rates of profitability than) competitors who sell in the same market. The firm has a competitive advantage if it has an ability to distinguish its products in the eyes of consumers and is able to reap higher profits than other firms in the industry. In terms of value creation, the difference between the value that resides in the finished good and the value that is sacrificed to convert raw inputs into finished products, competitive advantage can be classified into three types:

- a) **Cost Advantage:** A firm that pursues a cost advantage strategy seeks to attain a lower cost, while maintaining a benefit that is comparable to competitors.
- b) **Differentiation Advantage:** A firm that pursues a differentiation advantage strategy seeks to offer a higher benefit, while maintaining a cost that is comparable to competitors.
- c) **Transaction Advantage:** A firm has a transaction advantage if it consistently creates more value than its competitors by developing innovative transactions. It obtains a transaction advantage by lowering transaction costs for its customers and suppliers or by making new combinations of buyers and sellers. To have a transaction advantage, the firm should lower fixed costs of exchange, search costs, communication costs, information costs, and monitoring costs for buyers and sellers.

Transaction cost theory as a predictive model argues that both the form and competitiveness of the international operations of a multinational enterprise (MNE) depend upon the configuration of three elements:

- a) **Firm-specific (or ownership-specific) advantages (FSAs)** – These include both proprietary know-how or unique assets and transactional advantages. The MNE's capabilities of economizing on transaction costs are the result of the multinational coordination and control of assets.

- b) Country-specific (or location) advantages (CSAs) – These benefits, associated with locating certain activities in particular countries, may arise from structural market imperfections such as government regulations and the potential to economize transaction costs by reducing risks and to create benefits from local opportunities.
- c) Internalization advantages – These include different entry modes which are crucial for internalization (e.g. market failure) and natural market imperfections (e.g. government-imposed market imperfections).

Conventional internalization theory suggests that international sales arise because firms possess firm-specific advantages proprietary knowledge, especially in the context of market-seeking investment, internalization advantages, efficiency of hierarchy vis-à-vis other entry modes. Country-specific advantages (CSAs) are important in explaining the precise location of international expansion and possess proprietary knowledge which is critical to successful market-seeking investment. According to the modern TCE theory of the firm, the scope of geographic expansion is determined by the MNE's ability to link its firm-specific advantages (FSAs) with location advantages abroad. International success does not simply follow from proprietary knowledge but from the MNE's ability to adapt successfully the deployment of its existing firm-specific advantages (FSAs) to the specific circumstances of foreign markets,

Transaction cost theory involves two managerial issues: non-location-bound firm-specific advantages (NLB-FSAs) and location-bound ones (LB-FSAs). The non-location-bound firm-specific advantages can be exploited globally, which lead to benefits of scale, scope or exploitation of national differences. Globalization typically implies that non-location-bound firm-specific advantages (NLB-FSAs) such as those on production operations, the potential to achieve scale economies, allow firms to be competitive on world markets, characterized by a concentrated configuration, coordination and control. The concepts of fit between environment, strategy and structure are now being replaced by the learning, national responsiveness and global efficiency which leads to modifications of firm-specific advantages (NLB-FSAs) and country-specific advantages

(CSAs) and a different optimal configuration of assets and use of coordination and control mechanisms.

2.5.2. Value added chain of activities

The value-added chain is defined in terms of each link's contribution to total cost. It is a technique for describing the vertical chain of production that depicts the firm as a collection of value-creating activities, such as production operations, marketing and distribution, and logistics. Each activity in the value-added chain can potentially add to the benefit that consumers get from the firm's product and each can add to the cost that the firm incurs in producing and selling the product. By comparing the costs incurred by each link against competitors, a firm can locate the "critical success factors", i.e. the skills and assets a firm must possess to achieve profitability in a market. A firm creates more value than competitors only by performing some or all of these activities better than they do. We can often categorize strategic positions into two broad categories, a cost advantage or a differentiation advantage. If a firm outperforms other firms in activities that generate superior differentiation or in activities that generate a lower cost, the firm's strategic position should rely on these activities.

In addition to analyzing global competitiveness in terms of costs, the value-added chain is useful for designing integrated strategies that address particular national characteristics while exploiting upstream competitive advantages in the chain. The key challenge of a global strategy is to determine which links are to be centralized or decentralized. Globalization can be achieved because of low transaction costs, associated with deploying and exploiting the MNE's firm-specific advantages (FSAs) in value added chain in distant markets.

In addition a broader geographic scope of globalization implies the selection of unique market segments. Bounded rationality problems and the danger of sub-goal pursuit, impose a trade-off between coordinating and controlling efficiently a geographically dispersed network of operations in the value added chain.

2.5.3. Path of industry change

The path of industry change can be from two types of obsolescence threats The first is a threat to the industry's core activities i.e. the activities that have historically

generated economic profits for the industry (McGahan, 2004). These activities might become less relevant to suppliers and customers because of some new, outside alternatives. The second is a threat to the industry's core assets which refers to the resources, knowledge, and brand capital that have historically made the organization unique. When mapped with the relationships between these two threats, the industry can have following four changes. Radical change occurs when an industry's core assets and core activities are both threatened with obsolescence. Under this scenario, the knowledge and brand capital built up in the industry and customer and supplier relationships erode. Second, progressive change occurs when neither core assets nor core activities are threatened. In those industries, the basic assets, activities, and underlying technologies remain stable. The firms can have smart insights about how to optimize efficiency. Further, creative change occurs when core assets are under threat but core activities are stable. This means that companies must continually find ways to restore their assets while protecting ongoing customer and supplier relationships. Finally, Intermediating change occurs when core activities are threatened with obsolescence – customer and supplier relationships are stretched and fragile – while core assets retain their capacity to create value. The challenge under intermediating change is to find ways to preserve knowledge, brand capital, and other valuable assets while fundamentally changing relationships with customers and with suppliers.