Product life cycle theory by vernon economics essay

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Vernon's international product life cycle theory (1996) is based on the experience of the U. S. market. At that time, Vernon observed and found that a large proportion of the world's new products came from the U. S. for most of the 20th century. It was concluded that U. S. was the first to introduce technological driver products.

Vernon theory was used to explain certain types of foreign direct investment made by the U. S. companies after the Second World War in the manufacturing industry.

The U. S. has become a major importer of many of the goods that had once developed, produced and exported. Vernon's international product life cycle is used to attempt to explain why this happened.

According to Vernon, in the first stage the U. S. transnational companies create new innovative products for local consumption and export the surplus in order to serve also the foreign markets.

According to the theory of production cycle, after the Second World War in Europe has increased demand for manufactured products like those proposed in USA. Thus, America firms began to export, having the advantage of technology on international competitors.

In the first stage of production cycle, manufacturers have an advantage by possessing new technologies. However at these early stages of production, the products were not standardized as the nature of the goods has implications such as price elasticity, the communication throughout the industry and also the location of the product itself.

As the product starts to mature, the conditions also start to change. A certain degree of standardization takes place and the demand of the products appeared elsewhere. As demand has increased, overseas markets were imitating those products at a cheaper labour and overall cost. The U. S. firms were forced to perform production facilities on the local markets to maintain their market shares in those areas. Consequently the U. S. exports were limited.

As the markets in the U. S. and these other developed countries mature, the product became standardized. The developments of the life cycle were once again changed. There were more demand and cheaper labour costs from overseas countries, the pricing became the main competitive tool and cost became more of an issue than previously. The producers internationally based in advanced countries then had the opportunity to export back to U. S. This has led to the undeveloped countries offering competitive advantage for the location of production and finally they became exporters.

This evidence suggests that the more a product is standardized; the location of production is more likely to change. At the same time there is also evidence that unstandardized products will maintain their location in more phosphorus location.

This also explains; between 1950 to 1970 there were certain types of investments in Europe Western made by U. S. companies. There were areas where Americans have not possessed the technological advantage and foreign direct investments were made during that period.

To resume, Raymond Vernon believes that there are four stages of production cycle:

Introduction

Growth

Maturity

Decline

And the location of production depends on the stage of the cycle.

Stage 1: Introduction

New products are introduced to meet local needs, and new products are first exported to similar countries i. e. countries with similar needs, preferences and incomes.

Stage 2: Growth

A copy product is produced elsewhere and introduced in the home country to capture growth in the home market. This moves production to other countries, usually on the basis of cost of production.

Stage 3: Maturity

The industry contracts and concentrates and the lowest cost producer will win.

Stage4: Decline

Poor countries constitute the only markets for the product. Therefore almost all declining products are produced in LDCs.

Vernon's product life cycle model can explain both trade and FDI. By adding a time dimension to the theory of monopolistic advantage, the product life cycle model can explain a firm's shift from exporting to FDI. Initially a firm when innovate a product, it produces at home enjoying its monopolistic advantage in the export market, thus specializes and exports. Once the product becomes standardized in its growth product phase, the firm may tend to invest abroad and export from there to retain its monopoly power. The rivals from the home country may also follow to invest in the same foreign country's oligopolistic market.

Vernon's theory implies that overtime the main exporter may change from exporter to importer. This leads to the low cost producers becoming exporters.

One weakness of this theory can be that Vernon's view is ethnocentric. It can also be said that many new products are now produced in advanced economies such as Japan.

Globalization means that there is more dispersed and simultaneous production of comparative advantage.

The final weakness of this theory is that this study was carried out in the 60s. The world's trading importing and exporting has changed immensely over the years.