CHAPTER 2
LITERATURE REVIEW

2.1 THEORETICAL BASE

2.1.1 Comparative Advantage Theory

This research centers upon a variety of theories elucidating the mechanisms underlying international trade. David Ricardo developed a doctrine known as 'theory of comparative advantage' which argues that countries should specialize in manufacturing goods and services for which their opportunity cost is low when compared with other nations (Ricardo, 1817). This concept propounds that nations can gain from transactional exchange by dispatching commodities and services for which they possess an advantage over others and accepting those for which they have comparatively poorer conditions in return. Hence, Indonesia has been endowed with comparative benefit in terms of natural resources such as palm oil, coal, and gas among others.

2.1.2 Heckscher-Ohlin Theory

Lastly, Eli Heckscher and Bertil Ohlin's famous Heckscher-Ohlin Theory postulates that a nation's comparative advantage is determined by its abundance in particular elements such as capital, labor, and natural resources aptly named factor endowment (Ohlin & Hecksher, 1933). According to this principle, it will export products which make use of factors that are plentifully present in the country for production and import those commodities whose manufacture requires relatively rare components from other parts of the world. By way of illustration, Indonesia primarily exports coal and palm oil for their intensive utilization of land and labor but augments them by procuring high-tech items needing more advanced machinery or more skilled laborers largely unavailable domestically.

2.1.3 Porter’s Five Forces Model

Figure 3.1 Porter’s Five Forces Model

Michael Porter, a prominent professor at Harvard Business School, developed a model that he named the Porter's Five Forces Analysis. This framework is utilized to evaluate the competitive environment of an industry, and it contributes to the process of determining the industry's potential for profitability. The threat of new competitors, the bargaining power of suppliers, the bargaining power of consumers, the threat of substitute goods or services, and the intensity of competitive rivalry are the five forces that are examined in this framework (de & Waalewijn, 1999).

However, due to the circumstances of the topic of this paper, the author will be using a modified Porter’s Five Forces Model that will not take into account the bargaining power of suppliers as pictured in Figure 3.2 below.

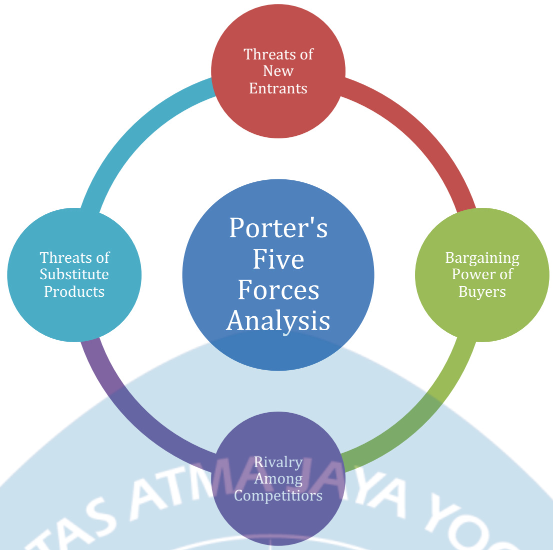

Figure 3.2 Modified Porter's Five Forces Model

2.1.3.1 Threats of New Entrants

The threat that is posed by new rivals is one of the five elements that are taken into consideration in Porter's Five Factor Analysis. It is a reference to the possibility that brand-new competitors would enter the market and jeopardize established competitors who are currently present.

When there are less barriers to entry into a market, it is simpler for new competitors to enter the market and compete against established players. The potential effects of this include increased levels of competition, decreased levels of profitability for existing participants, and lower pricing overall. However, if there are high entry barriers, it may be more difficult for new competitors to enter the market. This reduces the threat that new entrants provide to established parties and makes it easier for established parties to maintain their market position.

There is a wide variety of forms that a barrier to entry might take, including the following:

1. Economies of scale: Existing competitors may benefit from financial advantages that make it difficult for newcomers to compete, such as lower production costs as a direct result of extensive operations. This might make it difficult for newcomers to enter the market.

2. Name recognition: Established big players may have a good reputation that newcomers find difficult to match, making it more difficult for newcomers to bring in customers. This can be advantageous for established significant players.
3. Capital Requirements: The international trade industry, in particular, has certain very stringent criteria regarding the amount of money that must be invested.
4. Regulation by the government: Regulation by the government can make it more difficult for new competitors to enter a market by requiring them to get licenses or authorizations.

Established players are able to decrease the threat that is provided by new competitors if they cultivate solid reputations, achieve economies of scale, and make investments in research and development.

2.1.3.2 Bargaining Power of Buyers

The bargaining power of buyers in international trade refers to the ability of buyers (importers) to influence the terms of trade with sellers (exporters) in a given market. This power can be influenced by various factors, such as the number of buyers in the market, the availability of substitutes, and the relative size and bargaining power of individual buyers (de & Waalewijn, 1999). In general, buyers have more bargaining power when there are few sellers and many buyers in the market. This is because the sellers will have to compete with each other for the buyers' business, which can drive down prices and increase the bargaining power of buyers. Similarly, buyers may have more bargaining power if they have access to multiple suppliers or substitutes, as this gives them more options and leverage in negotiations.

Other factors that can influence the bargaining power of buyers in international trade include the size and relative importance of the buyers in the market, as well as their ability to leverage political or regulatory influence. For example, large multinational corporations may have more bargaining power than small businesses or individuals, as they may be able to negotiate bulk discounts or use their market share to influence prices.

Overall, the bargaining power of buyers in international trade is an important consideration for both buyers and sellers, as it can have a significant impact on the terms of trade and the profitability of businesses involved in the global marketplace.

2.1.3.3 Rivalry Among Competitors

Rivalry among competitors in coal export international trade occurs when different countries compete for the same market and customers. This competition can be fierce and intense, as countries try to outdo each other to gain a competitive advantage and increase their market share.

There are several factors that can contribute to rivalry among competitors in the international trade of coal, including:

1. Price competition: One of the most common forms of competition is price competition. A country may offer lower prices than their competitors in order to attract customers and gain market share. This can lead to a race to the bottom, where exporters keep lowering their prices in order to stay competitive.
2. Government policies: Government policies such as tariffs and trade barriers can also contribute to rivalry among competitors in international trade. These policies can make it more difficult or expensive for countries to trade with each other, which can lead to increased competition.

Overall, rivalry among competitors in international trade can be both beneficial and challenging. While it can lead to innovation and better products for consumers, it can also create intense competition and make it difficult for countries to thrive in the market.

2.1.3.4 Threats of Substitute Products

Substitute products in international trade refer to alternative goods or services that can be used as a replacement for the original product or service. The threat of substitute products is a significant challenge that can impact the success of international trade. Here are some of the ways in which substitute products can pose a threat:

1. Price Competition: When there are substitute products available, buyers may compare the prices of different products and opt for the cheaper option. This can lead to price competition between substitute products, which can lead to reduced profit margins for exporters and potentially cause them to lose market share.

2. Market Saturation: If substitute products are widely available and popular, they can saturate the market and limit the demand for the original product. This can be especially problematic for niche products that rely on a smaller customer base.
3. Technological Advancements: Substitute products can become more appealing than the original product if they offer superior features or benefits. Technological advancements can make substitute products more attractive to customers and lead to a shift in demand away from the original product.
4. Trade Barriers: Substitute products may be produced in countries that have lower trade barriers or production costs, making them more affordable and attractive to customers. This can make it harder for exporters to compete in the international market and reduce their market share.

Overall, the threat of substitute products can have a significant impact on international trade. Exporters need to be aware of the potential challenges and take steps to mitigate the risks, such as improving their competitiveness in the market.

2.2 FACTORS AFFECTING COUNTRY'S EXPORT PERFORMANCE

The extent to which a nation is able to fulfil its ambitions of economic success through export sales can be significantly impacted by various elements which influence its aptitude in selling commodities abroad. This passage will analyze some of the predominant components that shape a country's export performance.

2.2.1 Economic Factor

Economic factor has been recognized as being of great importance in the analysis of a nation's export success. Subramanian and Wei articulated that economic factors account for a considerable portion, estimated at roughly 70%, of the dissimilarity in sales performance between countries (Subramanian & Wei, 2003).

2.2.1.1 Level of Economic Development

The level of economic development is an influence sufficiently discernible to generate consequence on the export figure of a specified state; broadly, developed nations tend to seem more dominant on global platforms and their ability to trade greater than developing nations(Lall, 2000). Nevertheless, it must also be noted that there are some cases wherein developing nations might find favorable conditions in sectors such as textiles or agribusiness.

2.2.1.2 Exchange Rates

Exchange Rates: Exchange rates are a fundamental factor for a country's success on the global marketplace, as their rate of fluctuation can appreciably impact import/export operations. A notable instance of this was seen in China, when both its 1994 and 2005 devaluations raised their exporter output (Subramanian & Wei, 2003).

2.2.1.3 Inflation Rates

Inflation Rates: Inflation can adversely affect the viability of any given nation’s exports due to higher prices brought on by increases in currency value. Conversely, should inflation remain at bay then export performance could thusly be maintained or even improved; an example being Japan whose subdued inflation has granted them such benefits (Subramanian & Wei, 2003)

2.2.1.4 Trade Policies

A country's trade policies, be it through the use of tariffs or subsidies, can have an immense impact on the export capabilities for that country. Through allowing for unhindered trade, those nations in favor of free commerce will witness their exporting performance increase; whereas those looking to protect their markets from outside forces may well find themselves restricted in their access to global trading partners ultimately leading to decreased export revenues. A salient example could be seen with India whose embracement of liberalized trading laws during the 1990s exponentially augmented its exportation success (Subramanian & Wei, 2003)

2.2.2 Political Factor

The importance of political factors in a nation's export performance cannot be underestimated, for it is essential that the prevailing environment remain one that produces a sense of safety and hope for foreign investors

2.2.2.1 Political Stability

Political stability and security of a nation engenders greater investment and encourages overseas trade. However, according to World Trade Organization, if this expected stability fails to exist it will be detrimental to a nation export performance. As it was seen in Nigeria, where the political circumstanced failed to maintain its stability and impacted its export performance negatively (WTO, 2019).

2.2.2.2 Government Policies

Government policies can either mitigate against or thrive upon export capability depending on their nature. For instance, China were able to expand their international commercial success through the implementation of 'Made in China 2025' (Subramanian & Wei, 2003).

2.2.2.3 International Relations

The effect of global diplomatic on a nation's export endeavors can be profound. Invariably, constructive ties between states can lead to prolific gains in the realms of foreign trade and capital monetary investments. Conversely, unfavorable diplomatic connections will drastically reduce any prospective advantages in the domain of exportation. Such is notable by the economic penalty experienced throughout both The United States of America and China as a result of their frayed exchange engagements (WTO, 2019)

2.2.3 Socio-Cultural Factors

The influence of socio-cultural factors upon a nation's export capabilities is of great significance, with various aspects from language to religion and culture having the potential to contribute or detract from the success a nation may receive.

2.2.3.1 Language

Language barriers, in particular, can certainly inhibit operations; inadequate proficiency in foreign tongues may impede communication and diminish prospects for beneficial commerce. As an example, this obstruction has impeded Japan's performance when it comes to exporting goods (Subramanian & Wei, 2003)

2.2.3.2 Religion

Faith and religious norms may also affect trade outcomes; certain cultures often impose restrictions on items due to their faith which could consequently limit available markets for such products. Muslims usually forbid ingestion of pork, restricting exporters of such foodstuffs while other states might prohibit importation of items deemed culturally inappropriate or offensive (Ferdousy & Binti, 2020).

2.2.3.3 Cultural Differences

Cultural differences can have a substantial influence on the export operation of any nation. Different consumer inclinations and customs can be troublesome for exporters attempting to deliver goods internationally. To this end, appreciating these disparities in preferences and modifying products and offerings to cater to local necessities and likings could elevate a country's ability to export their wares effectively. Moreover, disparity in business methods such as dealing and communication styles may detrimentally affect a country potentiality capability in doing international trade with foreign markets (Adamczyk, 2017).

2.2.4 Impact of COVID-19 and Russia-Ukraine Conflict

The ravages of COVID-19 and the Russian-Ukraine conflict have likewise taken a heavy toll upon the world economy, manifesting in widespread disruption to global trade and exports. In 2020 alone, the World Trade Organization (WTO) noted a precipitous 5.3% plunge in worldwide merchandise trade due to recent upheavals; this followed with intermittent complications reverberating across international supply chains, plummeting demand for goods and services as well as increased tariffs on imports (WTO, 2021). For those countries predominantly reliant on exports - whose primary sources of income derive from external trading networks - exporting has become an ever-more difficult endeavor to pursue without detriment. One such region impacted acutely is Ukraine: toppled by its own conflict with Russia which recently brought about an approximate 30% decrease within Ukrainian coal exports according to the research conducted by the World Bank – resulting in significant financial losses for all involved parties (World Bank, 2022).

CHAPTER 3
RESEARCH METHODS

3.1 FRAMEWORK

Nowadays, Indonesian coal exports have plenty of factors affecting their competitiveness in the international market. It is advised that a framework be used as a tool to identify the various elements affecting the competitiveness of Indonesian coal exports, since this will aid in the process of determining which of these significant aspects are at play. A supporting structure around something is what the Cambridge Dictionary refers to when it uses the term "framework." The author of this study makes use of Porter's Five Forces Analysis as the basis for the theoretical framework that underpins this research. The author will have an easier time identifying some elements with the assistance of Porter's Five Forces Analysis. These factors include the threat of new entrants, the bargaining power of suppliers, the bargaining power of buyers, the level of