

Teaching Note

Case 2.2 Global Capacity Expansion Strategies of Two Korean Carmakers

Case synopsis

This case study was motivated by an empirical observation that two Korean carmakers, Daewoo and Hyundai, despite some of their structural similarities, have pursued very different globalization strategies. As chaebol companies, Daewoo and Hyundai have much in common in terms of structural characteristics: both are highly diversified conglomerates, heavily dependent on debt-financing, and have focused on exporting as their primary growth engines. But they have developed contrasting approaches in their globalization strategies. This case discusses how and why these different globalization strategies have emerged over time based on the global learning propensity model.

Suggested assignment questions

We suggest the instructor assigns the following questions or similar ones derived from them.

1. Why have the two carmakers evolved so differently?
2. Why is the way Daewoo achieved economies of scale different or unique?
3. What should the CEO at Daewoo have done to prevent the company's collapse?
4. What advice would you give to the CEO at Hyundai for the future?

Case analysis

We expect the students to be able to identify key concepts and theories in the chapters, which directly relate to learning propensity model, and apply them to answering the following questions.

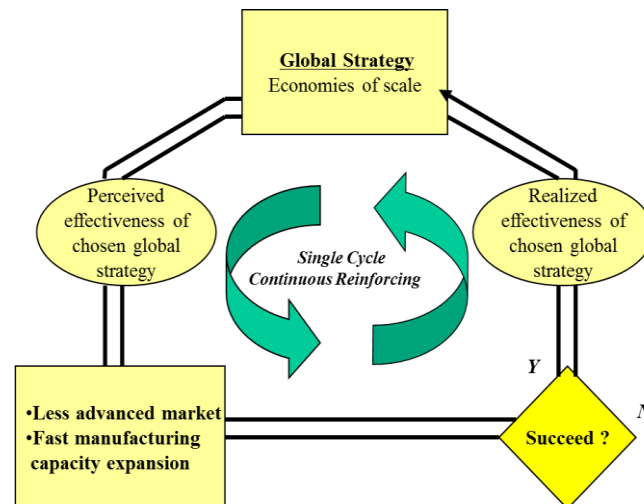
1. Why have the two carmakers evolved so differently?

Being direct competitors in the Korean automobile industry has affected the firms' globalization strategies to a great extent. Each company took into account its competitive position vis-à-vis the other's when forging its global strategy. For instance, Daewoo focused on expeditiously achieving economies of scale by targeting the East European markets for its overseas capacity expansion, in a way to overcome its manufacturing cost disadvantage in the domestic market vis-à-vis Hyundai's. Likewise, Hyundai's globalization strategy, exporting supported by technological advancement, was driven by an implicit assumption of its competitive advantage vis-à-vis Daewoo's. This initial pattern of decisions was formed mostly by such determining factors as top management's commitment to specific strategic decisions and resources, both managerial and financial, from each company's parent business group;

chaebol. Subsequently, it was altered or reinforced as each company accumulated different learning experiences in the global market.

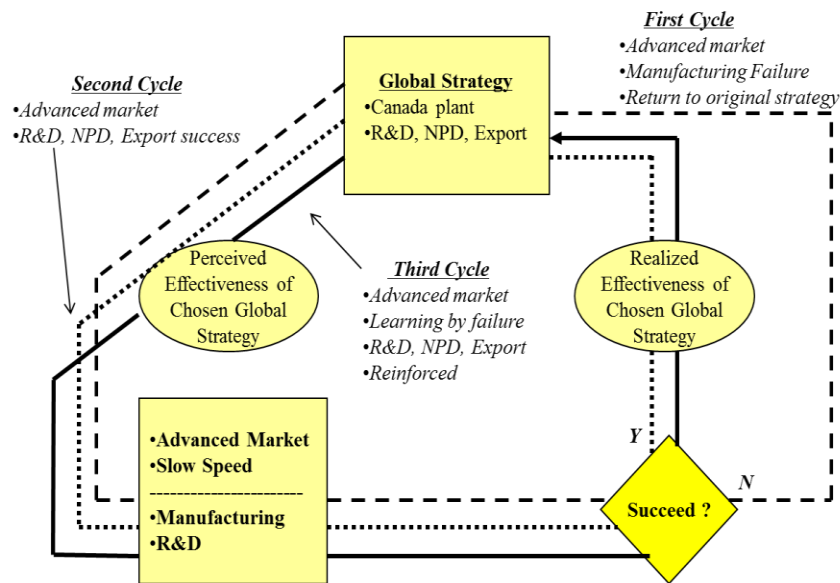
Figure A2.41 shows Daewoo's starting with a globalization strategy to pursue economies of scale, since the company needed to increase its capacity fast in order to overcome its cost disadvantage. Being consistent with the strategy, Daewoo entered Eastern Europe, where it acquired existing manufacturing capacity. During that process, the company seldom encountered any serious difficulty, and that lack of problems reinforced Daewoo's propensity to expand its capacity in the region. It was due to the self-reinforcing and thus accelerating nature of the learning propensity.

Figure A2.41. Global learning propensity dynamics – Daewoo



In contrast, Hyundai showed more complicated dynamics (Figure A2.42). Initially, the company focused on R&D and export. After its first export under its own brand name to the North American market became a success, Hyundai redirected its globalization strategy so as to expand its manufacturing capacity into Canada. This is the first cycle as shown in Figure A2.42. But, its operations in Canada were not successful. From its failed operations in Canada, Hyundai learned a valuable lesson and adopted a more cautious approach to expanding its capacity overseas (second cycle in Figure A2.42). Eventually, Hyundai decided to return to its original globalization strategy: developing technologically independent cars and exporting them to advanced markets. This started the accelerating reinforcement cycle, the third one shown in Figure A2.42.

Figure A2.42. Global learning propensity dynamics - Hyundai



2. Why is the way Daewoo achieved economies of scale different or unique?

Daewoo's economies of scale were initially pursued to overcome its competitive disadvantage in the domestic market. As of 1993, Hyundai enjoyed almost 50% market share in Korea, whereas Daewoo held only 20%. Faced with this hurdle in the domestic market, Daewoo sought other ways to evade this impasse and found globalization to be an answer.

Daewoo's economies of scale through globalization strategy was unique because Daewoo's globalization pace was quite fast: it took less than four years for Daewoo to increase its capacity of foreign operations and marketing, which more than quadrupled. Daewoo's overall capacity expansion occurred in a much shorter period and in a much more dramatic manner than Hyundai's. Daewoo's compounded rate of capacity increase from 1988 to 1997 was about 32%, whereas Hyundai's only 10%. Between 1989 and 1996, Daewoo's foreign production capacity increased from practically zero to more than 1.2 million cars per year, while Hyundai's remained almost unchanged at about 100,000 cars per year.

3. What should the CEO at Daewoo have done to prevent the company's collapse?

Daewoo seldom confronted a serious obstacle during its capacity expansion spree: its experience in overseas capacity expansion was self-reinforcing and accelerating. But as of late 1999, Daewoo went bankrupt mainly due to its debt-financed capacity expansion in Eastern Europe. Many competing explanations are possible. However, if we base our inference on the case studies in this chapter, Daewoo's globalization velocity was well beyond the speed limit set by its organization capability.

The top management at Daewoo should have discerned positive from negative learning, in order not to trap their organization in a vicious self-reinforcing cycle. According to learning propensity model, once a particular type of learning propensity has repeated for a relatively long period of time, it will be extremely difficult for the company to change the dynamics. As in most dynamic systems, the learning propensity model is also affected by such dynamic inertia as chaos, path-dependence, administrative heritage, and so forth. One of the most effective and promising intervention methods is to tackle the determining factors—to modify top management's will, the system's infrastructure or logistical mechanism, and/or other relevant factors of any fundamental belief systems. More ideally, the CEO should have checked

the validity of its determining factors from time to time when implementing its globalization strategy (refer to Chapter 2.1.3).

4. What advice would you give to the CEO at Hyundai for the future?

After the successful new car development based on its own independent R&D, Hyundai adjusted its globalization strategy and started operating a manufacturing subsidiary in Canada. But, it failed. This experience of failure, i.e., learning from failure, since became a powerful restraint on Hyundai's capacity expansion overseas. Rather, it returned to its early strategy to focus on perfecting technology and exporting.

Although Hyundai's learning from failure experience and adjustment in its globalization strategy has allowed the company to enter into the virtuous cycle so far, the CEO should be cautious that the virtuous cycle can always become a vicious cycle if the environment or market changes. Therefore, the CEO should keep nurturing company's learning capability in order to continuously strengthen its global competitiveness through globalization strategy.