Accelerated Internationalization of Late-comer MNEs: The Case of South Korean Electronics Companies

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ABSTRACT

This paper analyses the internationalization strategies of the three large Korean electronics companies: Samsung, LG and Hyundai, in the 1990s with a particular attention to the changes after the 1997 Asian financial crisis based on a new conceptual framework of firm internationalization. The analysis of the investment decisions of these three companies in 18 subsidiaries located in the US, the UK and Asia reveals that different internationalization strategies were used in different host countries according to the motivations and host country environment. The analysis of the changes in the strategies in each region after the 1997 Asian financial crisis reveals that the mismatch between the motivations of internationalization and the headquarter-subsidiary relations was one of the key factor determining the success or failure of subsidiaries examined in this study. The findings of this paper also indicate that the restructuring of the corporate sector after the 1997 financial crisis resulted in the revision of the internationalization strategies, contributing to the success in the 2000s.

1. Introduction

The globalization process of the multinational companies had been explained in the existing literature by three categories; the transaction cost internalization theory (Buckley and Casson, 1976; Hennart, 1982, Rugman 1981), the stages model by Scandinavian school (Johanson and Vahlne, 1977; Zaheer, 1995), and the resourced-based view and knowledge-based view (Kogut and Zander, 1993; Luo and Tung, 2007; Weerawardena et al., 2007; Moore 2001). These theories have been put forward as alternative explanations to firm internationalization. However Wang and Suh (2009) argue that none of the approaches alone can capture the internationalization process by the increasing number of late-comer MNEs from East Asia that engage in FDI rapidly in both developed and developing countries and that the three approaches are complementary to each other and only by combining them together can we fully understand the complex nature of the firm internationalization process, especially those late-comer MNEs from East Asia.

The main aim of this paper is to analyse the early stage of the internationalization process of the South Korean electronics in the 1990s and test whether the new conceptual model developed in Wang and Suh (2009) are supported by the empirical evidence. The 1990s are important for the South Korean Electronics companies, as they began the process of internationalization during this period and hence it provides an important testing ground of the new theory. In particular, the changes and revisions in the globalization strategies among the South Korean electronic companies after the 1997 Asian Economic Crisis, examined in this paper, support the accelerated process of internationalization identified in the new conceptual model.

Section 2 summarises the theoretical framework developed in Wang and Suh (2009) Section 3 explained the internationalization process of three major companies in the South Korean electronic industry. Section 4 analyses the performance of these companies in the 1990s and the restructuring process after the 1997 Asian Economic Crisis, followed by a conclusion.

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2. A New Conceptual Framework of Firm Internationalization

In the new conceptual framework of firm internationalization, Wang and Suh (2009) grouped the transaction cost theory and the stages model as the asset exploiting internationalization, and the resource based and knowledge-based view as the asset seeking internationalization and argued that firms can adopt both approaches simultaneously in different host countries. Most of the debates on firm internationalization can be summarized within the framework of asset-exploiting and asset-seeking, as these have been the foundations for the theories of firm internationalization strategies in the existing literature. As one of the main arguments was that firms adopt heterogeneous strategies of internationalization depending on the motivation and the host country characteristics, the new conceptual model attempts to depict both approaches in one diagram. Table 1 summarises the new model introduced in Wang and Suh (2009).

Table 1 Simultaneous Adoption of Multiple Strategies of Firm Internationalization

	Level of Importance of local market	Level of local resources availability	Motivations for FDI	Examples
Route 1	High	Low	Market Seeking	Western firms FDI into China
Route 2	High	High	Market Seeking and Asset Seeking	Korean firms FDI into the US
Route 3	Low	High	Asset Seeking	Chinese Firms' Entry into the US
Route 4	Low	Low	Market Seeking and/or Trade Seeking	Chinese Firms' Entry into LDCs, HK firms' initial Entry into China

Route 1 explains an asset-exploiting strategy for their international expansion and most early internationalization by MNEs from industrialised countries, which exploit their existing home-developed FSA in foreign countries (Dunning, 1981). As the host country is important as a market destination but there exist a relative low level of technological assets in the host country, the main motivation of this investment is a market-seeking strategy.

Route 2 represents a mix of asset-exploiting/market-seeking and asset-seeking motives in countries which are highly important both in terms of market and resource availability. For example, the United States is the largest single market in the world and at the same time, it is the international leader for capital, technology, know-how, R&D facilities, human capital, and managerial expertise across many industries.

Route 3 represents an FDI of which the main motives are to acquire technology or knowledge, which shows a pure asset-seeking strategy towards internationalization. The main aim of such FDI is to develop new capabilities and/or augment the current resource-base. This cell not only explains the recent accelerated internationalization of some late-comer 'dragon multinationals' since the 1990s but also captures some early outward expansion by 'third world multinationals' from the 1970s to the mid-1980s (Lecraw, 1977; Lall, 1984; Wells, 1983).

Route 4 captures new trends in firm internationalization. First, late-comer MNEs invest in other developing countries. Although they cannot compete in advanced countries due to the overall competitive disadvantages compared to Western MNEs, the low-cost position of late-comer MNEs allows them to offer a price that is very attractive to local consumers in less developed countries (Luo and Tung, 2007). Cell 4 also represents trade-seeking FDI (Dunning, 1993), which is undertaken by MNEs that are about to lose their international competitiveness due to increasing production costs in their home country. In both cases, the markets of the host countries are not important internationally, but provides important opportunities to late-comers' internationalization.

In Wang and Suh (2009) we showed that firms may expand into different countries or regions pursuing different strategies simultaneously. Therefore, our conceptualization of firm internationalization process distinguishes itself from asset-seeking and asset-exploiting perspectives both of which assume firms take one uniform strategic approach towards international expansion. Our conceptualization is also different from the stages model, the incremental nature of which has limited predictive value for accelerated internationalization of firms from the periphery countries, especially those from Asian emerging multinationals.

The integrated framework developed above explicitly acknowledges that the process of firm internationalization is best understood as a rapid and heterogeneous process of strategic development of overseas subsidiaries. Such a conceptualization has significant implications for our understanding of headquarters-subsidiary relationships.

There has been a substantial amount of research on headquarters-subsidiary relationships in international business studies, which can be classified broadly into two distinctive schools of thought; 'subsidiary role perspective' (Birkinshaw, 1997) and subsidiary strategy or subsidiary initiative perspective (Birkinshaw et al., 1998). Although there has been a shift in the level of analysis from subsidiary role perspective to reflecting the increasing autonomy and greater strategic choice of established Western MNEs' subsidiaries Since the mid-1980s (Birkinshaw, 1997), the subsidiary initiative perspective does not fit with the nature of rapid global expansion of East Asian MNEs, where parents tend to maintain tight control over the strategic development of their operational units overseas at the early stage of internationalization (Collinson and Rugman, 2007), as in the case of early internationalization of Western MNEs (Bartlett and Ghoshal, 1986). Therefore, we adopt the subsidiary role perspective to examine the discrete relationships between HQ and subsidiaries in the dragon multinationals' internationalization process.

In this HQ-subsidiaries relationship, the pattern of knowledge flow explains how the existing FSA of an MNE can be transferred to new subsidiaries, and also how the new knowledge/technology acquired at a subsidiary level can be integrated to the overall FSA of an MNE. Based on these two aspects of knowledge flow—the extent to which subsidiaries engage in knowledge transfer and whether subsidiaries are the provider or receiver of knowledge—Gupta and Govindarajan (1991) distinguish four types of generic subsidiary roles: *Local Innovator*, *Implementer*, *Integrated Player* and *Global Innovator*. Similarly, Birkinshaw and Morrison (1995) provided a three-fold typology of *Local Implementer*, *Specialized Contributor* and *World Mandate*. Focusing on R&D subsidiaries, Nobel and Birkinshaw and Hood (1998) developed a different classification of *Local Adaptor*, *International Adaptor* and *Global Adaptor*. More recently, Ambos and Reitsperger (2004) also focused on R&D subsidiaries and developed a typology (*Integrated Research Unit*, *Global Research Unit* and *Local Adaptor*) based on two dimensions, one concerned with the knowledge flow and another concerned with the task or the work flow. In addition, Ghoshal and Bartlett's (1998) suggested four potential subsidiary roles depending on the importance of the host market and local resources.

Despite their different emphases, these typologies are highly correlated with each other in terms of the patterns of knowledge flow they try to describe (Liang and Nicholas, 2007). Though the typologies of subsidiary roles are highly correlated, there is a lack of conceptual integration (Harzing, 2000; Macharzina and Engelhard, 1991). To remedy the problem, Wang and Suh (2009) integrate these typologies into a new taxonomy comprising the four subsidiary roles of *Implementer, Integrated Player*, *Contributor*, and *Local Adaptor* to derive mutually reinforcing characteristics that are linked to the firm internationalization process.

By linking the four different type of internationalization and its corresponding subsidiary roles, Wang and Suh (2009) developed propositions as summarized in Table 2.

Table 2: Internationalization Strategy, Subsidiary Roles and Knowledge Flows.

Route	Motivation	Subsidiary Roles	Knowledge flow
1	Marketing Seeking	Implementer	From Head Office to Subsidiary (Strong)
2	Market/Asset Seeking	Integrated Player	From Head Office to Subsidiary, From Subsidiary to Head Office, & From Subsidiary to Subsidiary
3	Asset Seeking	Contributor	From Subsidiary to Head Office
4	Market or Asset Seeking	Local Adapter	From Head Office to Subsidiary (Weak)

The established conceptual links between the firm internationalization and subsidiary roles also allow us to extend the framework to study the relationships between parent firms' internationalization strategies and subsidiary performance, an area that has been identified as one of those requiring further research in IB (Moore, 2001). In this paper, the performance of the subsidiaries is broadly defined by the extent to which they successfully fulfill the roles the HQ expects them to play.

By linking the motives of internationalization and the subsidiary roles, we can develop a set of propositions as follows.

> In countries where the parent pursues a particular route internationalization (Route 1, 2, 3, and 4), those subsidiaries that play the corresponding roles (*Implementer* the *Integrated Player Contributor & Local Adaptor* role respectively) will be more successful in achieving sales growth and market share

3. South Korean Electronic companies in the 1990s.

South Korean electronic companies entered the international market as late comers in the early 1980s. Among them, Samsung Electronics (SE), LG Electronics (LGE) and Hyundai Electronic Industry (HEI) were representative electronic companies. By the end of 1990s, they become major players in the international market, producing a range of various products from consumer and home electronics, to display devices, semiconductors and telecommunication and information systems products. For example, SE and HEI produced approximately 50 percent of DRAM (Dynamic Random Access Memory) products in the world in 2000. (Kwon et al, 2004)

It is worth noting that they began exporting without any distinct firm-specific advantage developed in the domestic market (Bang, 1992 and 1994; Moon and Roehl, 2001; Suh et al, 2000). For example, when Samsung exported microwaves in 1980, not even one unit was sold in the domestic market. Goldstar (former LG) exported colour television sets, broadcasting of colour television had not been introduced in the domestic market at all.

Within 10 years of exporting, all three companies established subsidiaries abroad and began off-shore production. In the late 1980s, all three companies began production in Asia, and in early 1990s all of them established subsidiaries in the US and UK as well. Therefore, their internationalisation process cannot be successfully explained by using any of the existing theories, such as the transaction cost theory, the stage theory or the resource and knowledge-based view. In this section, we aim to explain the internationalization process of SE, LGE and HEI using the new conceptualization developed in Wang and Suh (2009).

For the analysis, 18 subsidiaries of LGE, SE and HE were selected from three different regions. Table 3 lists the companies selected as case studies. The entry to the markets in Asia in the late 1980s was mainly due to a push factor. Since the late 1980s, these three companies have faced internal and external challenges. Among others, there was a sharp rise in production costs, including labour costs, fuelled by independent trade union movement. This directly undermined its competitive edge, especially in OEM business for labour intensive products. Furthermore, its heavy dependency on the domestic market for the sale of commercial and home appliance products caused a slow-down of growth as the speed of the domestic market expansion tapered off. In addition, the high protection of the domestic market was no longer sustainable in the context of growing international trade frictions with the major trading partners. Therefore, the foreign direct investment of these three companies in the Asian market in the late 1980s was mainly trade-seeking.

Table 3 Subsidiaries of LGE, SE and HEI in the US, UK and Asia

	US	UK	Asia
Subsidiaries	• Zenith Electronics (LG) • AST (Samsung) • IGT (Samsung) • SMS (Samsung) • Odeum Microwave Systems (Hyundai) • Symbios (Hyundai) • Maxtor (Hyundai)	• LGE North of England • LGE Wales • SE UK • HE Scotland	• LGE Shanghai (China) • LGE Thailand, Rayong, • P.T. LGE Display Devices (Indonesia) • SE Suzhou (China) • SE Thailand • HE Shanghai, • HE Tianjin
Motivation	• Market-Seeking • Technology-Seeking	• Market-Seeking	• Market-Seeking • Trade-Seeking

On the other hand, the motivations for FDI by the three companies in the US and UK reveal some similarities. In the early 1990s, fear of protectionism revived along with the progress of regional trading blocs, such as NAFTA, EU, and ASEAN Free Trade Area. In both regions, access to the host country markets was the principal motives as NAFTA and the EU were both perceived as opportunities for greater markets and as potential barriers to the market. However, there exist distinct differences as well. The entry to the US has another motive, that is, to acquire new technology. LGE tried to acquire new technology such as high-resolution colour TV including its manufacturing technology. SE wanted to acquire the technology in the areas of notebook production, telecommunication and semiconductor technology, and HE also tried to acquire technologies related to computer production (hard disk drive) and semiconductor. On the other hand, the entry to the UK was considered attractive due to its favourable investment environments as a regional production centre, compared with other locations in Europe. For example, high unemployment in the UK resulted in cooperative labour relations. Active policies were adopted by the UK government to induce foreign investment. Therefore, establishment of subsidiaries in Asia, the UK and the US reveal Route 4, 1 and 2 respectively as shown in Figure 1.

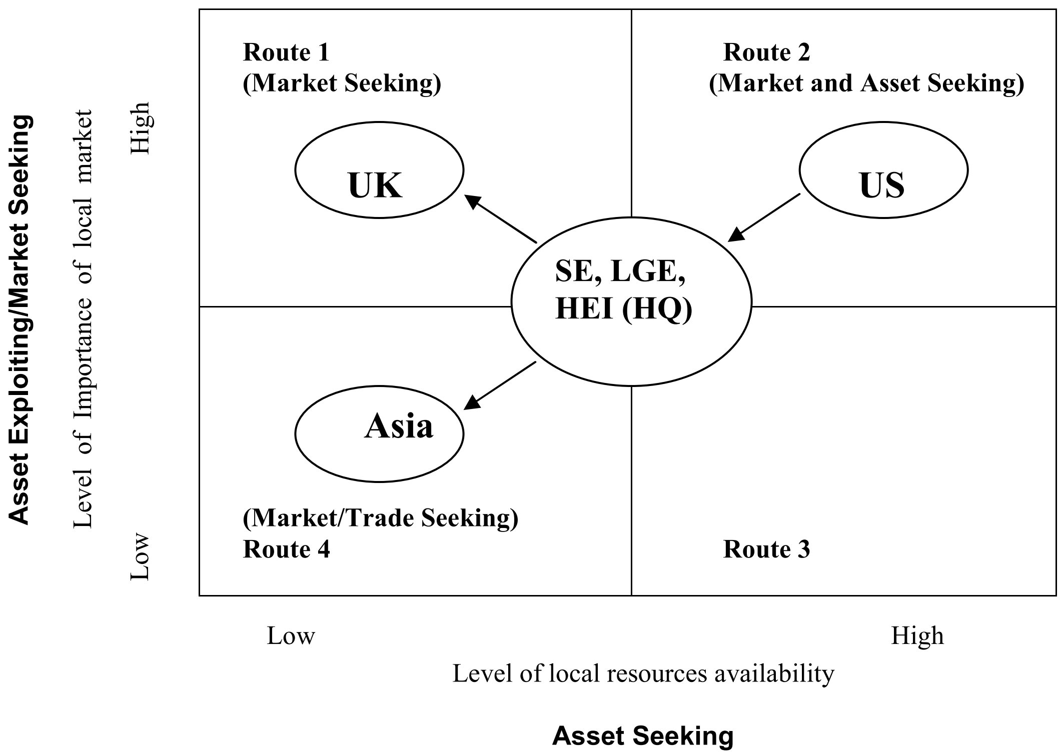
The mode of entry to each region reflects both the motivation of internationalization and the local characteristics. In the US, all companies acquired the existing leaders to gain a quick access to the market and to acquire technology. By acquiring the existing firms in the US, the Korean firms were able to secure the capacity to develop new technologies along with the manpower for such R&D. The acquisition of a leading firm such as Zenith would also strengthen the brand image of the parent company, LGE, as well. As the subsidiaries in the UK were established mainly through greenfield investments, other advantages, such as favourable production conditions and the customer image created by the place of production, played more important roles than the provision of opportunities to acquire state-of-the-art technology. As a result, subsidiaries in the US were in the areas of advanced communication technologies, and the production of critical inputs, whereas subsidiaries in the UK produced general household electronics and their components (SE and LGE), and semiconductors (HE). Table 4 and Figure 1 show the comparison of entry mode and the knowledge flows between the headquarter and subsidiaries.

As subsidiaries in the US had their own production systems, and since one of the most important motives was the acquisition of technology, the subsidiaries were allowed to operate through independent management. However, those in the UK needed to be closely controlled by the head office. First, as greenfield investments, the head office needed to transfer technology and management know-how for successful operation. Second, they needed to be more closely integrated with the head

TABLE 4. COMPARISON OF SUBSIDIARIES IN THE US, UK AND ASIA

	US	UK	Asia
Entry	• M&A (Large companies with losses)	• Greenfield •	• JV (except for HEI: for control)
Flow of Knowhow	• Subsidiaries to Head Office	• Head Office to Subsidiary	• Head Office to Subsidiary
Control	• Top Managers • Independent mgmt	• Direct Control	• Direct Control
R&D and Global Production	• OEM Export from HO • R&D Localized	• Assembly • Low R&D • Global Sourcing	• Low Quality Product

Figure 1. Korean Electronics Companies' Internationalization Strategies in the 1990s



office and other subsidiaries, as they were mainly production centres in the global operation and had more of the characteristics of assembly plants. Obviously, the role of R&D in the subsidiaries was more important in the case of the US subsidiaries, whereas those in the UK were not carrying out major R&D functions.[2]

Subsidiaries in Asia were markedly different from those in the US and the UK. When the competitiveness of the low-quality items was eroded, including those in the OEM market, the Korean companies neither gave up those segments of the market, nor outsourced such products.[3] East and Southeast Asia were the ideal destinations for the relocation of the production facilities for such items. Further, China and Southeast Asia emerged as one of the most important new markets in the 1990s. As the markets in China, Thailand and Indonesia are not as sophisticated as those in the US and Europe, they are ideal markets for the traditional low-quality products. The major items for production covered washing machines, TVs, VCRs, and other home appliances. Therefore, we can summarize them as both market and trade seeking investments. As market seeking investments, they were attracted by large markets of both the host and the neighbouring countries. And as a trade seeking investment, low wages and favourable host government policies, and the possibilities of bypassing anti-dumping measures by the EU and North America were important.

CHANGES IN GLOBALIZATION STRATEGIES AFTER 1997

The 1997 financial crisis provided the Korean economy with an important turning point. Combined with the support from the government since the 1970s and the rapid growth of the domestic market, Korean companies expanded without stopping. Vertical and horizontal integration was a source of competitiveness, especially during the first stage of growth in the 1970s (Kwon and O'Donnell, 2001). The expansion in the domestic market was accompanied by the expansion in the international market as well, and the globalization strategy adopted in the pre-1997 crisis era was in line with their domestic strategies. For example, the decision to retain most segments of the market and relocate the low quality production to Asia when the head office upgrades its products, and the decision to acquire the large US companies can be interpreted along this line.

However, after 1997, companies were forced to revise their overall pri-orities from 'expansion and growth' to 'efficiency and profitability'. For the first time since the creation of the Korean family conglomerates, efficiency in operation and profitability were given priority over market share and company size. All new investments, including FDI, needed careful scrutiny in terms of profitability. In order to reduce the debt equity ratio to a target level of 200 per cent, they needed to restructure not only the domestic operations but also the foreign subsidiaries. This resulted in two significant changes in their foreign subsidiaries. First, inefficient foreign subsidiaries were sold off to reduce the debt (Kwon & Suh, 2003). Second, foreign subsidiaries began to consider themselves as independent business units in terms of profitability, rather than mere service units of the head office. So, along with the rationalization of the head offices, the globalization strategies of the Korean companies began to be fine-tuned after the 1997 economic crisis. This was, therefore, an important turning point in the globalization of the Korean companies. Table 5 summarizes the changes in the subsidiaries of the selected companies after the 1997 economic crisis

All subsidiaries in the US selected for the case study did not perform well in the mid-1990s, due to high degree of competition in the US market, and the resulting slow-down of sales. When the Asian

[2] However, all subsidiaries, except for Zenith, were 100 per cent wholly owned by the head office. LGE only acquired 57 per cent of Zenith, due to the large amount of capital required.
[3] Korean firms by and large, use less outsourcing and more vertical integration compared with Japanese firms and Chinese firms in Hong Kong and Taiwan. (Suh and Seo, 1999).

TABLE 5. CHANGES IN SUBSIDIARIES OF KOREAN ELECTRONICS COMPANIES AFTER THE 1997 ECONOMIC CRISIS

	US	UK	Asia
Environment	• Losses (Except for Hyundai) • Urgent need to sell out	• Cost Pressures • Need to increase efficiency	• Decrease in Purchasing Power
Action	• All Sold Out	• Downsize & Relocation to Eastern Europe	• Restructure (except for HEI: Sold out)
Implication	• Technology Acquired • Other ways of serving the Market	• Moving from localization to Global Sourcing	• Diversification of the product Market.

crisis hit their head offices in Seoul, all subsidiaries were hard pressed by the shortage of funds. On the other hand, the synergy effect anticipated at the time of acquisition had not sufficiently materialized. Consequently, all subsidiaries included in the analysis of this paper were sold off after the initial restructuring of their managements. During the process of restructuring, the head office intensified the direct control over the subsidiaries.

Subsidiaries in the UK faced similar difficulties with regards to sales and available funds. Furthermore, the appreciation of the British pound increased the cost of production in the European market, hence undermining the competitiveness of the products. As the destinations of the low quality products were countries in Eastern Europe, the increase in transportation costs undermined the competitiveness further. Although these posed serious difficulties in the operation of subsidiaries, the European market still offered prospects for growth. Instead of disinvesting themselves of the subsidiaries, they decided to restructure, downsize and relocate to Eastern Europe, where they could decrease their production costs but remain close to the market.[4] Restructuring of the subsidiaries involved both tighter control from head office and the localization of management simultaneously.

The subsidiaries in Asia were affected severely, as the economic crisis hit most of the countries in Asia. Although China was not severely affected by the crisis, there was, nevertheless, a reduction of demand, resulting in sluggish sales. Consequently, companies needed to realign the target destination of the products from the host countries and the neighbouring countries in Asia to outside Asia. This called for diversification of the product market, and tighter coordination in the global operation. The economic crisis, however, created favourable environments as well. As the currencies depreciated, the cost competitiveness increased substantially, enabling the Asian subsidiaries to proceed with successful restructuring. Apart from HEI, all other subsidiaries in Asia managed to diversify their markets, focusing more on exports to a third country. The material management in the post-crisis era combined both local and global sourcing, with the critical inputs from the head office in Korea.

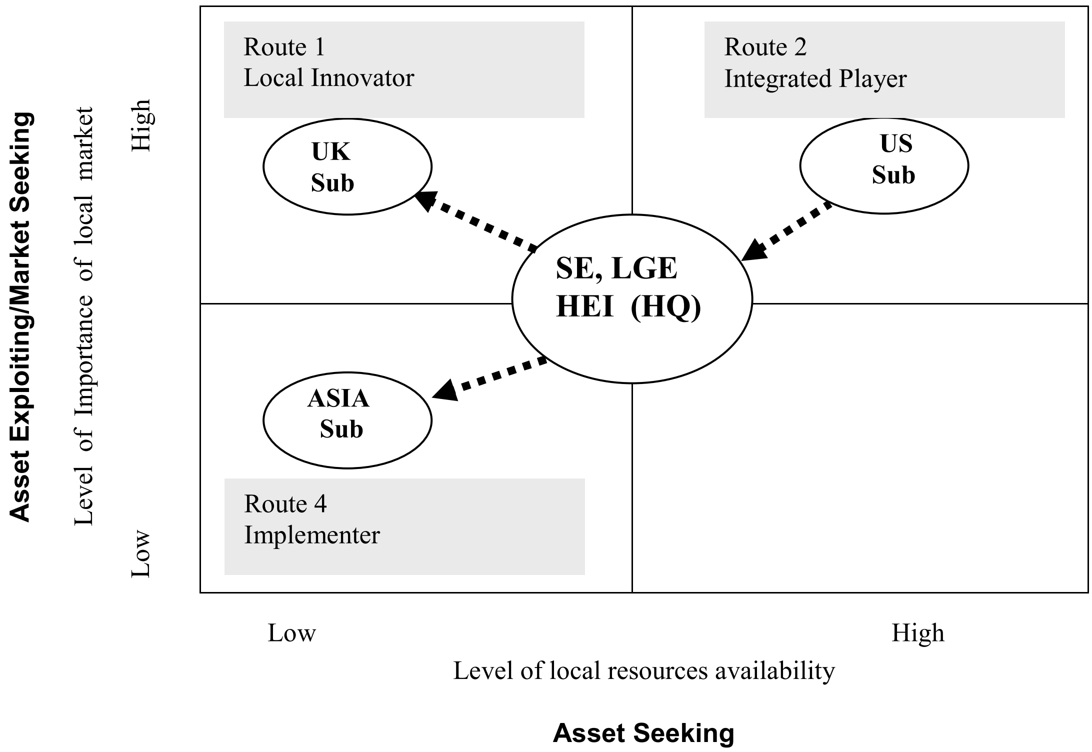
Then, how do we explain the relative failure with the US and UK markets compared with the subsequent success in the Asian Market after the 1997 Asian Economic Crisis? We turn to the proposition 1 and analyse the performance. As mentioned earlier, Korean companies began internationalization before establishing distinct firm-specific technological advantages (Bang, 1992, 1994 and Moon and Roehl, 2001, Suh et al, 2000). Therefore, the knowledge flow from the HQ to subsidiary in all three routes was rather limited as shown in Figure 3.

[4] Except for HEI. HE Scotland divested from the European market.

However, Shin and Chang (2003: 26-27) argue that the business group structure has contributed to competitiveness of the member firms and is one of the important sources of the firm specific ownership advantages. The business group itself was the mobilizer of the resources; financial, entrepreneurial, and human. In this context, the leadership of the top managers, especially in the initial phase of overseas expansion was also one of the important success factors of large business groups in Korea. (Shin, 1996)

When the 1997 Asian Economic Crisis broke out, the Korean business group underwent significant restructuring and the business groups which were the sources of competitive advantage were dissolved. Hence, the remaining competitiveness was very week. Furthermore, the intended knowledge transfer from subsidiaries in the US to the headquarter was also limited (Kwon et al, 2004), as shown in Figure 2.

Figure 2. Subsidiary Roles of Korean Electronics Companies in the 1990s



CONCLUSION

South Korean electronic companies were the new comer in the international market in the early 1980s but after 30 years they have become global leaders. This rapid growth of South Korean electronic companies can only be explained by its internationalization process. South Korean companies entered the international market without developing distinct firm-specific ownership advantages. This pattern of growth is different from the experiences of western manufacturing companies where firms internationalise after developing distinct firm-specific advantages at home. This is also different from the Japanese experience, where companies adopt growth strategy, which is gradual and path-dependent.

This paper demonstrated that the new conceptualisation of firm internationalisation put forward in Wang and Suh (2009). First, Korean electronic companies adopted heterogeneous pattern of internationalization, i.e. made market-seeking, trade-seeking and asset seeking investments at different locations simultaneously. Second, the roles of subsidiaries in the regions of the US, the UK and Asia were different respectively, befitting their motivations for establishing subsidiaries. Third, the investment and disinvestment in the US market by the Korean electronics companies supports our proposition that the performance of subsidiaries is determined by how effectively each subsidiary fulfil the roles defined in our model.

After the restructuring after the 1997 Asian Economic Crisis, the Korean electronics companies revised their global strategies substantially, moving from assembly with localized parts to global sourcing. Further relocation took place from Korea to Asia and to China in particular. Chinese internationalization also reveals fast growth. By 2010, the Korean electronics companies have managed to be placed at the forefront in the global market, equal to the Japanese companies, and in the case of Samsung and LG surpassing the Japanese companies. (Lim, 2009)

For future research, a careful comparison between the experiences in Korea and China will shed more light to the implications for Chinese companies. As this is a qualitative research, the findings in this paper need to be interpreted with due caution. Further quantitative research on this issue will strengthen the validity of the findings.

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