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Firms' Global Expansion and Sustainability

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Abstract

Firms globalize when their domestic market can no longer offer growth opportunities. But, there is always a delicate tradeoff between growth and sustainability. How fast can a firm grow and still be profitable? Should the firm pursue growth before profit? How can a firm determine when its growth strategy is no longer sustainable? These are the questions as well as motivations of our research. In this paper, we first present the case studies on two firms that have expanded into global markets, following their globalization strategies. The two firms are very similar except for their *'strategic intents'* for globalization and their domestic market positioning: the two firms are in the same industry, and headquartered in the same country. One company with a relatively strong domestic market position has pursued its globalization based on the profit-first strategic intent, while the other with an inferior domestic position has chased a growth-first strategy. Using the conceptual framework of system dynamics, we formulate the firms' globalization dynamics and derive managerial implications for the issue of firm's sustainability and its growth strategy via globalization.

Subjects: Globalization, Firm's Sustainability

Methodology: System Dynamics Reasoning

1. Introduction

Globalization has become one of the most important business strategies (Yip 1995). As such, it is critical to understand different aspects of the globalization process: for example, companies' globalization motivations, strategic intents, and resulting competitive dynamics. But, these aspects are not separate: in fact, all of them are closely linked with each other (Bartlett and Ghoshal 1989).

In the literature, extensive research has been done on studying the globalization motivation. The particular perspective we are taking here regarding the globalization motivation is, however, slightly different from the mainstream literature: we focus on the domestic market condition where the company is headquartered. More specifically, we consider two factors in the domestic market, *company's competitive position in the domestic market* and *domestic market saturation*. We will also make a link between the firm's globalization motivation and its strategic intent, i.e., strategic goals or objectives the company wants to pursue via globalization (Ghoshal 1987). These two factors, *globalization motivation* and *strategic intent,* interplay with each other to influence the firm's performance of its globalization. In addition to the simple cause-and-effect dynamics, we consider a sort of balancing mechanism: we propose that the firm's learning process based on its experience in the global market could shape the path of successive strategic choices made by the firm.

Using the case studies for two global carmakers and building up conceptual models based on system dynamics, we develop a dynamic model that can encompass the critical factors and their systemic relationships concurrently. The issue of 'global firm's sustainability' will be naturally melt into our investigation.

In the next section, we briefly review relevant literature, describe the case studies, and suggest propositions. Then, we set up a dynamic model, which provides logical explanations for the empirical observation from the cases. Finally, we close this paper by discussing managerial implications of this study and possible future direction for further research.

2. Literature and Propositions

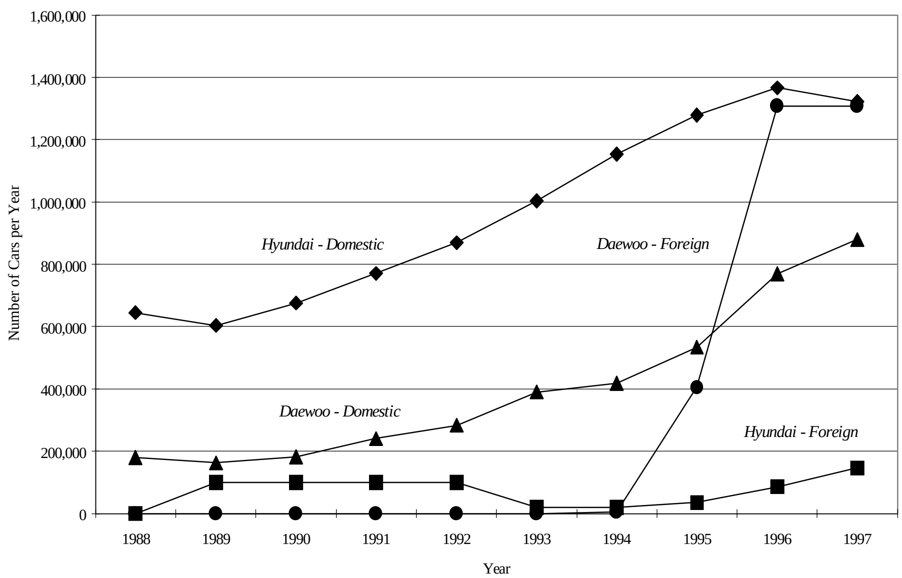
Firms have different motivations for globalization. For example, Ghoshal (1987) proposed three objectives of globalization: firms globalize in order to gain global competitive advantages through *achieving efficiency* in current operations, *managing risks*, and *learning*. Others suggested that the global integration be the most important objective for global firms (Kobrin 1991, Birkinshaw, et al. 1995).

As alluded earlier, globalization is a process. Johanson and Wiedersheim-Paul (1975) suggested a four-stage model for entering foreign markets: *no regular export*, *selling via independent agent*, *sales subsidiary*, and *production subsidiary*. See also Root (1987) and Anderson (1993). Therefore, it is necessary to utilize dynamic methodologies when analyzing firms' globalization.

Based on Jaikumar and Bohn (1992), we infer that it is more effective for the global company to learn and/or innovate in its home country, i.e., domestic market, than in foreign markets (Johanson and Vahlne 1977). Suppose we also accept that the globalization is by nature a form of international transfer of technology from the home to the foreign market (Tsang 1997). Then, in order to fully grasp the global strategy employed by a global company, we need to ask about the fundamental relationship between the global company's headquarters in its domestic market and its subsidiaries in the foreign markets. In this regard, we are concerned with the effect of the global firm's competitive position in its domestic market on its globalization strategy (Ito 1997).

Building upon the literature, we now develop our research propositions. The outcome in this paper is part of the research result from a larger study on the Korean carmakers' globalization and global strategy. For the research, we conducted case studies on two carmakers in Korea, *Daewoo* and *Hyundai*. These two companies have followed very different paths for their globalization. *Hyundai* was the dominant player in the Korean market and pursued more tamed globalization strategy: it targeted advanced markets and globalized its manufacturing function in a measured way. In contrast, *Daewoo* was a minor player in the domestic market, struggling to attain capacity large enough to provide the 'much sought' economies of scale. Its competitive position in the domestic market has confined *Daewoo*'s global strategy within a narrow range, mainly concentrated on growth at the expense of profitability, at least for the time being, they thought. The upshot was to target less developed markets and add capacity aggressively. Figure 1 shows the capacity expansion patterns pursued by the two companies. It clearly indicates that *Hyundai* has been very cautious about acquiring capacity overseas, but increased its domestic capacity gradually, whereas *Daewoo*, especially after around 1994, has increased its foreign manufacturing capacity quite rapidly. The primary motivation of this research was how to explain such differences in the two firms' strategies for globalization despite their similarities in many other aspects.

Figure 1. Domestic versus Foreign Manufacturing Capacity Expansion



We suggest the following linked propositions. Figure 2 depicts the cause-and-effect relationship among propositions.

Proposition 1. Firm's organizational capability along with its resources, *managerial, financial, and technological*, determines its competitive position in the domestic market. The more capable, the more competitive in the domestic market.

Proposition 2. As the domestic market saturates, e.g., supply exceeds demand, firms become more interested in globalizing their operations. That is, globalization becomes an important corporate strategy.

Proposition 3. A firm's competitive position in the domestic market affects the firm's decision on globalization. Suppose there are two broad strategic objectives for globalization, *growth* and *profit* orientation. The more competitive the firm's domestic market positioning, the more likely the firm pursues 'profit-oriented' global strategy. In contrast, the firm with a weak competitive position in the domestic market tries to follow a 'growth-pull' global strategy (Patel and Vega 1999).

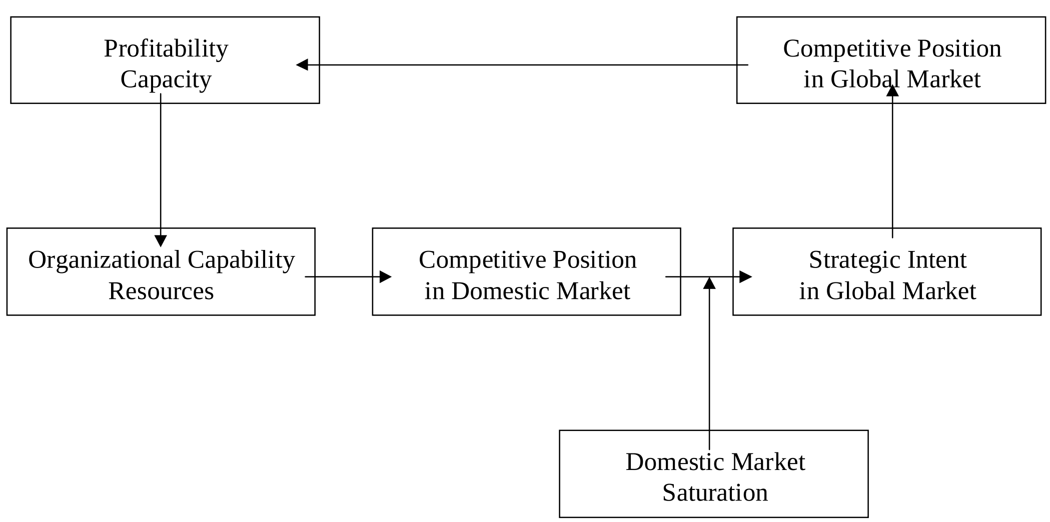
Proposition 4. The firm's strategic intent, i.e., either growth or profit-oriented, shapes its strategic choices for globalization. When the firm focuses on the growth-oriented strategy, it is more likely to target less developed countries where it is relatively economical to acquire capacity. On the contrary, the firm pursuing the profit-oriented strategy, in general, wants to enter more advanced markets with marketing and/or R&D function rather than manufacturing.

Proposition 5. It is more likely for firms to face challenging environments in the advanced countries than in the less advanced. The more challenging the business environment, the less successful the firm's global strategy. Thus, the firm entering an advanced market is more likely to face a challenging environment and to fail accomplishing its global objectives. On the contrary, a firm entering a less advanced market would be more likely to attain its strategic objectives.

Proposition 6. When firms make successive decisions on globalization, they take into account their experiences of successes and failures in their previous globalization attempts. When firms experienced severe failures before, they would make ensuing globalization decisions in a gradual and/or measured way. On the other hand, firms without serious failures in their previous efforts would be more likely to reinforce their current strategies for globalization. That is, firms are likely to pursue the same strategies unless they experience failures that attest against the strategies in use.

Proposition 7. For sustainable development, a global firm must improve its organizational and/or managerial capability to the extent that can meet the demand from expanding physical capacity in the global markets.

Figure 2. Cause-and-Effect Dynamics of Globalization



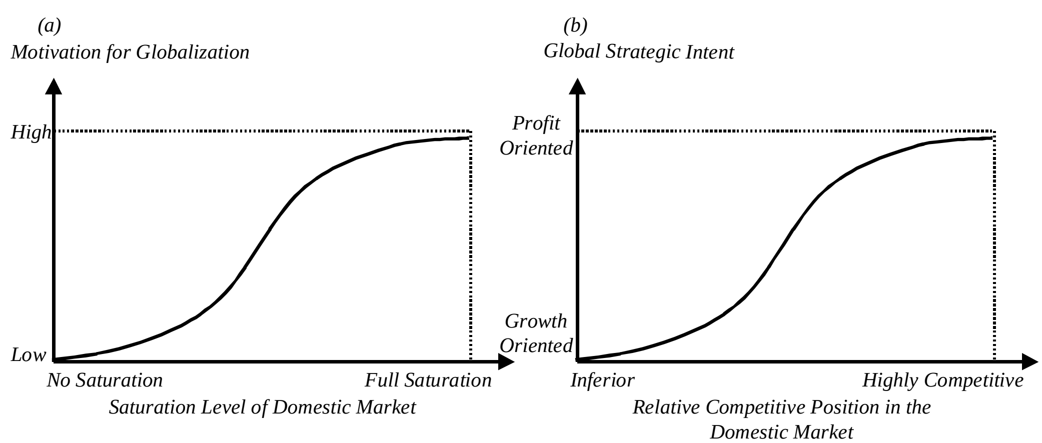
3. Modeling and Analysis

In this section, we conceptually derive 'system dynamics' for each of the propositions. Once we complete developing each and every element of the proposed dynamics, we suggest an integrating framework, which systematically connects all of the proposed dynamics, and also a conceptual analogy to explain the sustainability of global expansion.

Domestic Market Condition – Globalization Motivation: As suggested already, as the domestic market becomes more saturated, firms want to globalize their operations, that is, the level of firm's globalization motivation increases. The more saturated the market, the less the marginal return from expanding in the market. Thus, in a saturated domestic market, a firm may not find it profitable to grow its operations beyond a certain extent. An alternative way for the firm to grow is to enter the global market.

Competitive Position in the Domestic Market – Global Strategic Intent: The second causal link we want to consider is that between a firm's competitive position in the domestic market and its global strategic intent. As mentioned in the literature review, we deliberate two such intents, *profit-oriented* and *growth-oriented*. We postulate that when a firm wants to globalize, it usually takes into account its domestic competitive position: the less competitive the firm, the more growth-oriented its global strategic intent. We suggest that this proposition be valid when the firm's competitive position in the domestic market is largely determined by the economies of scale. The *less competitive* domestic player perceives that its weakness in the domestic market stems from its lack of economies of scale, and tries to compensate for this by getting more capacity, i.e., being *growth-oriented*, through globalization. These two relationships are depicted in Figure 3.

Figure 3. Domestic Market Conditions and Globalization



Fit between Target Market and Global Strategic Intent: For successful globalization, a firm must achieve 'fit' between its strategic intent and target market. We already reasoned that the company in a less competitive position in the domestic market would globalize in order to gain more capacity. The ensuing reasoning could imply that the firm probably need target a less advanced or emerging market as opposed to an advanced one since it could be much easier to acquire cheap capacity in an emerging market than in an advanced one. We might establish a similar logic for the firm in a better competitive position in the domestic market (Figure 4a).

Fit between Target Market and Functional Globalization: Likewise, we have to consider the fit between the target market and the function that is globalized. It should be relatively straightforward to say that the advanced market would fit better with globalizing R&D and marketing functions, whereas an emerging market with manufacturing (Figure 4b).

Figure 4. Global Market Fit

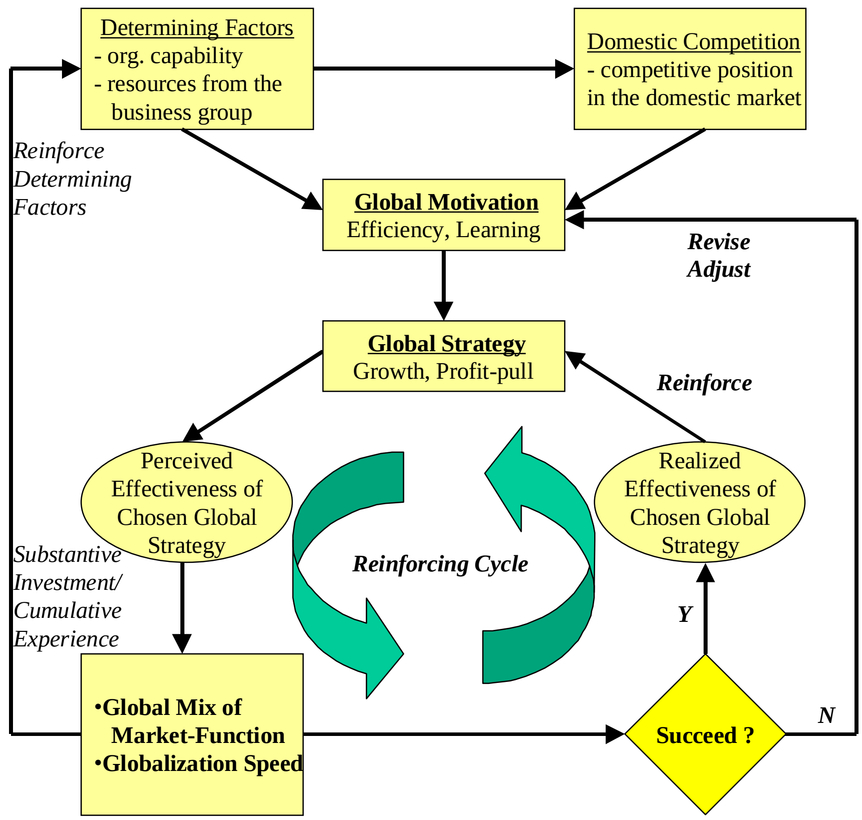
(a) Market and Strategic Intent

	Advanced Market	*Emerging Market*
Growth Motive	Unfit	Fit
Profit Motive	Fit	Unfit

(b) Market and Functional Globalization

	Advanced Market	*Emerging Market*
Manufacturing	Unfit	Fit
R&D Sales Marketing	Fit	Unfit

Figure 5. Globalization Propensity Model – Influence Diagram



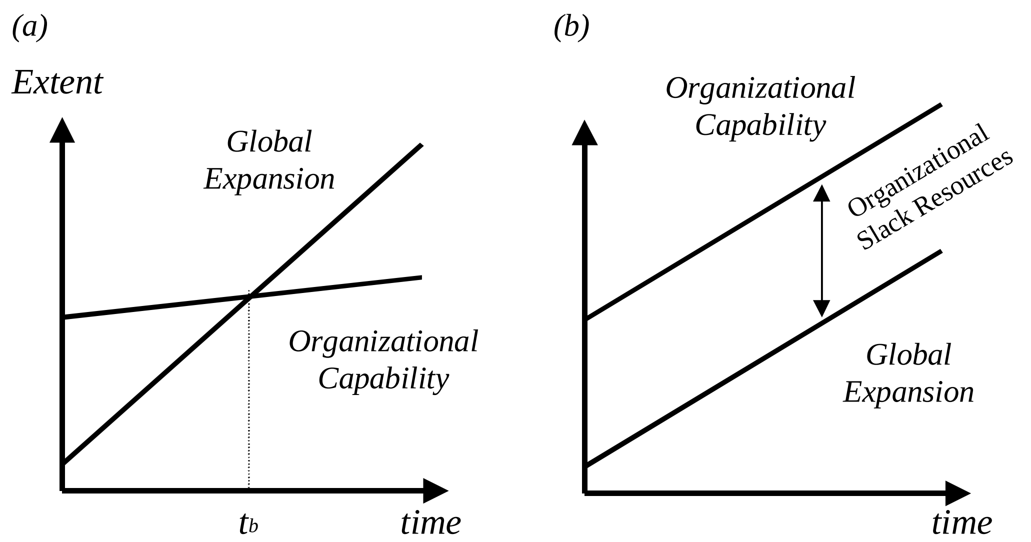
An Integrated Model: Based on the propositions along with relevant conceptual reasoning striven above, we build up an integrated model by applying Kim (1998)'s learning propensity model. This integrated model is depicted in Figure 5, which can explain the dynamics observed from the cases.

It is an extension of Kim (1998)'s model in that the reinforcing cycle now has a balancing mechanism which can accelerate or deter the self-reinforcing cycles. For instance, *Daewoo*'s case is the first situation. As *Daewoo* targeted and entered the emerging markets in order to gain more capacity, it did not have to face difficult challenges mainly because the target markets are less sophisticated technologically and managerially than *Daewoo*. This lack of challenges has further reinforced *Daewoo*'s globalization strategy, eventually resulting in a destructive state, e.g., out of control.

On the contrary, Hyundai suffered severe losses as it globalized its operations into advanced markets, where *Hyundai* had competitive advantages *neither* technologically *nor* managerially. Due to these initial obstacles, *Hyundai* refrained from growing its global operations haphazardly. That is, the set of initial challenges became a constructive balancing force for *Hyundai*.

Sustainable Global Expansion: Finally, the reasoning so far enables us to say something about the sustainability of globalization. We put forth that the firm's globalization is a major commitment of resources, *not only financial, but also* *managerial and/or organizational*. Thus, in order for the firm to grow into the global market in the long run, it must raise its organizational capacity and capability to the extent that the global expansion can be controlled by the firm itself (Figure 6).

Figure 6. Sustainable Globalization



4. Discussions

Firms globalize with different motivations and pursue different strategic paths. In this paper, we have tried to identify dynamic causal relationships among firms' competitive positions in the domestic market, global motivations, strategic intents, target markets, functions globalized, and globalization intensity. In doing so, we have utilized the conceptual reasoning based on system dynamics.

We recapitulate the outcomes as follows. The firm's strategic intent, i.e., either *growth* or *profit*-oriented, shapes its strategic choices for globalization. When the firm focuses on the growth, it is more likely to target less developed countries where it is relatively inexpensive to acquire capacity. On the contrary, the firm pursuing the profit-oriented strategy wants to enter more advanced markets usually with marketing and/or R&D function rather than manufacturing.

The choice of target markets affects the firm's globalization intensity, e.g., speed, to a great extent. The reasoning follows. When firms make successive decisions on globalization, they take into account their experiences of successes and failures in their previous globalization attempts. When firms experienced severe failures before, they would make ensuing globalization decisions in a gradual and/or measured way. On the other hand, firms without serious failures in their previous efforts would be more likely to reinforce their current strategies for globalization. That is, firms are likely to pursue the same strategies unless they experience failures that attest against the strategies in use. Attributes of the selected markets influence whether the firm is more or less likely to experience successes or failures (Arino and de la Torre 1998).

Finally, for sustainable development, a global firm must improve its organizational and/or managerial capability to the extent that can meet the demand from expanding physical capacity in the global market.

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