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Three Mechanisms to Enter Under-Developed Markets: The Case of Investment in Mongolian Market by Korean Firms

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Abstract

This paper analyzes processes of market entry and business development of an under-developed market from the perspective of three mechanisms. When entering an under-developed market, a different set of strategies is required, compared to when entering a developed or developing markets. In this study, we suggest three mechanisms that are needed to enter an under-developed market for FDI while seeking competitive advantages: selecting, learning, and coordinating. We have explored a dynamic market exploiting process through Sky Group, a joint venture (JV) between Tai-Han Electronic Wire and SK Telecom in Mongolia. The selecting mechanism helps firms identify local market chance and proper mode of entry. The Skytel, a Korean telecommunication service provider in Mongolia shows the selecting mechanism by establishing a JV with Tai-Han in order to reenter the Mongolian market. After selecting an entry mode, according to a business opportunity, the learning mechanism is needed for efficient market exploitation. The learning mechanism closely related to Multinational enterprise (MNE)'s absorptive capacity in a market. The Sky Group case shows the learning mechanism through its international operations to absorb the local market knowledge. In case of under-developed country, they have various constraint factors that shrink business activities. To overcome this efficiently, the coordinating mechanism is needed. The coordinating mechanism is essential for networking and integrates each firm's absorptive capacity. The Sky Group case is a good example that shows synergy effects through the coordinating mechanism.

Keywords: Selecting mechanism; Learning mechanism; Coordinating mechanism

1. Introduction

The term 'internationalization' is usually used to describe 'the developmental process of increasing involvement in international business by the firm' (Young et al., 1989). Albeit with this fairly broad definition, the emphasis in literature has been on a narrow range of issues, usually the mode of entry and country choice. Among them, the theories on foreign direct investment (FDI) had mostly been focused on the developed strategies among the industrialized countries or from developed countries to developing countries. That is, current foreign direct investment (FDI) is understood as a company that has a core competence in entering other countries for internalizing their own capability.

This trend had been useful in explaining developed countries' FDI patterns. However, it fell short of explaining those of less developed countries. These less developed countries, or under-developed markets are mostly at the early stage of economic development. These markets are increasingly recognized as Multinational enterprises' (MNEs') new markets that can survive within intensive competition, and it seems to have a different FDI form compared to the developed or developing countries. The FDI pattern in these under-developed markets can be characterized by reentry of the firms that already found local market opportunities, but did not recognize the other firms and exploring a monopolistic advantage through FDI.

International expansion provides more opportunities to exploit distinctive resources that may be underutilized in a home market. When firms invest and operate internationally, they must develop certain strategic and organizational capabilities to counteract the natural advantages unique to local businesses (Luo, 2000). It is right, but sometimes, even though a firm does not have monopolistic competence for local business it does not mean the firm does not have any competence in their business. They can make a new business and create a stronger competitive position in under-developed markets if they can find local market opportunities and realize those opportunities.

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FDI in this region was set out as part of structural reformation and also considered as an alternative for the maintenance of competitive advantage. In the course of this, emerging markets came to observe their unprecedented economic growth. We have noted this in many under developed countries: these markets are usually placed in Asia, such as Myanmar, Cambodia, Mongolia, etc. There are common characteristics of under-developed markets such as lack of market information, under-developed financial markets, problems of closing government procurement systems, lack of clear and fair legal systems, and strong government regulations and interference.

As economic developments of under-developed market would serve as a driving force of the world's economic growth for the coming centuries, under-developed markets deserve an extensive and thorough research.

Therefore, this paper will focus on distinctive FDI patterns in under-developed market that is much different from previous studies. The paper will also try to discuss the details of these from a more systematic perspective.

2. Limitations of Traditional FDI Theory

Multinational enterprise (MNE) theories in the international business literature, be they the theory on monopolistic advantage (Hymer, 1976), internalization theory (Hennart, 1982; Rugman, 1982) or the eclectic paradigm (Dunning, 1988; 1993), have addressed the importance of ownership-specific resources in international production but has not systematically explored other significant factors, especially in case of emerging markets.

Meanwhile, it seems that FDI can contribute to establishing its own foreign branch with only one direct investment. The actual FDI is fundamentally a long-term investment and many of recent studies on FDI emphasize a sequential process of direct investment. As a matter of fact, FDI is not finished one time but going through the sequential process (Kogut 1984, Johanson and Vahlne, 1977). In addition, Davidson emphasizes that when MNEs enter a foreign market, they enter in a sequence of countries that have similar cultural, linguistic and economic environment better than simultaneousness (Davidson, 1980)

Although a firm could advance to an under-developed market, the market immaturity and the poor infrastructure in less developed countries may prevent them from earning profits. In this case, a firm should adopt itself to the characteristics of the region and develop innovative measures in a new field rather than search for a particular region where it can have an exclusive comparative advantage in a traditional way. In addition, if the corporation finds its incapability and big risks in the area, it tends to form a coalition with another company, which possesses the comparable advantage in that field, in order to re-enter the market. An under-developed market like Mongolia, most MNEs do not have enough local information and market knowledge to compare with American and European Market, so local information and market knowledge are most important factors in under-developed market. Moreover, these characteristics make a unique phenomenon. This is suggested by the new FDI theory. Namely, FDI is not the result of a monopolistic advantage but it is the process acquiring monopolistic advantage.

Basically, the new FDI theory is suggested by two points of view. First, during FDI in a developed or developing countries, a firm acquires a monopolistic advantage from those countries with high technology. For example, many Korean firms entered Silicon Valley, for acquiring technical advantage. This is an example of new FDI that argues against the existing cascade (Cho, 1988). Secondly, as we suggested earlier, a firm gets a monopolistic advantage from local information and market knowledge. This is especially true for under-developed markets. This unique phenomenon is due to insufficient infra structure and inadequate market knowledge. These under-developed markets' given conditions have applicable uncertainty of their core confidence. So, when a firm enters first, the firm seeks an applicable monopolistic advantage through FDI. This research focuses on latter view.

We suggest three mechanisms to explain this phenomenon more efficiently. They are composed of the selecting mechanism, the learning mechanism, and the coordinating mechanism. The selecting mechanism identifies the dimension of time, and the learning mechanism is learned through the process of the business subject utilizing resources in response to environmental changes, and it is through this learning mechanism that the mechanism evolves. The coordinating mechanism suggests that a business is essentially composed of mechanisms for coordinating various economic activities instead of the marketplace.

3. Theoretical Background of Three Mechanisms

A mechanism is formed as a result of the subject's efforts to leverage or generate resources in response to environmental changes (Choi, Cho and Moon, 1997). A mechanism is created over the course of the subject using resources in response to the environment at a certain point of time, and it evolves over time as firms accumulate experience and knowledge. In each evolutionary stage, a new environment selects a mechanism to be evolved. According to this model, firms that start under identical conditions in the same industry may develop a widening gap in performance over time as they undergo the process of learning and selection.

Especially, under-developed market case effectively explains a monopolistic advantage acquiring process through FDI. We suggest three mechanisms in a framework for understanding under-developed markets; selecting, learning and coordinating.

3.1 The Selecting Mechanism based on Resources

The selecting mechanism identifies the essence of a mechanism in terms of the dimension of time. While acknowledging that a mechanism is formed over the course of the business subject using resources to adjust to environmental changes, and that it evolves through learning, this theory argues that the ultimate determinant of a mechanism is the environment.

A resource-based view can support the selecting mechanism in under developed markets. The RBV focuses upon the ability to acquire and maintain resources as the key to competitive advantage and organizational survival. Applied in the field of strategy in the seminal articles of Wernerfelt (1984) and Rumelt (1984), it highlights the importance of firm-specific factors in explaining performance and suggests a wide variety of ways in which an organization can obtain the supply of resources critical to its survival and growth.

A firm's resources and capabilities may derive from either inside or outside the firm. In respect to the latter, networks represent a way of competence leveraging or competence building. Easton and Araujo (1996) have stressed the role of the industrial network approach in enriching the resource-based perspective. The former focuses upon the role of firms as one category of actor in an industrial system that comprises a network of actors, resources, and activities. The industrial network approach is helpful in a consideration of new way of building or leveraging resources and competencies and in recognizing the blurred distinction between resources internal and external to the firm, although its fundamental approach is quite different (Young, Bell, and Crick, 2000).

3.2 The Learning Mechanism Based on Dynamic Capability.

Learning mechanism is learned through the process of the business subject utilizing resources in response to environmental changes, and it is through this learning mechanism that the mechanism evolves. The learning mechanism is kind of external knowledge acquisition through setting up alliances that has become pervasive and is an important vehicle for upgrading capabilities. Hamel & Prahalad (1994) notes that the desire to learn and absorb new types of firm-specific knowledge is a primary driving force behind many alliances, particularly those between Japan and the United States.

The learning mechanism can support the view of dynamic capability. Dynamic capability can be defined as an MNE's ability to create, deploy, and upgrade organizationally embedded and return-generating resources in pursuit of sustained competitive advantages in the global market place. Dynamic capability requires the capacity to extract economic benefits from current resources and to develop new capabilities.

Luo (2000) suggests the three essential ingredients of dynamic capability – capability possession (distinctive resources), capability deployment (resource allocation), and capability upgrading (dynamic learning) – have become increasingly fundamental to international expansion and global operations.

Learning is a key building block for new capability building. This learning is the process by which organizations encode experiential inferences into behavioral routines (Levitt and March, 1988). Competitive advantages are possible when firms continuously reinvest in building resources. New inputs to the resource base of a firm are imperative for permitting flexible responses in a changing environment.

3.3 The Coordinating Mechanism based on Networking

The coordinating mechanism suggests that a business is essentially a mechanism for coordinating various economic activities in the marketplace. Since corporations vary greatly in terms of the environmental factors they must deal with, the business subjects that make decisions, and the resources they possess or can leverage, the mechanisms that are formed over the course of the interactions between these three types of elements vary accordingly. The differences in mechanisms are interpreted as the result of differences in the level of efficiency with which firms coordinate their economic activities. As the competitive threat intensifies, product life cycle shortens, and innovation requirement amplifies, however, capability exploring and enhancement play an increasingly decisive role in determining the outcome of geographically dispersed yet globally integrated operations.

As inherent mechanisms of corporate activities, Chung (2000) postulates other mechanisms to explain enduring business success, namely the mechanisms of networks. The network mechanism explanation contends that the competitive advantage of a firm lies in the network of relationships to which the business belongs, going beyond the distinction between the inside of a firm and its outside. It has been argued that a business is essentially a social network that can include buyers, competitors, regulatory institutions, and research institutes; thus, business success factors should be found in the way the business relates to its network. As discussed earlier, mechanisms are formed over the course of the subject leveraging or generating resources in response to environmental changes. Here, the resources do not necessarily have to come from within. Firms that are capable of tapping into resources that come from its external relations will likely create a competitive advantage over firms without such capability. Thus, the networks businesses build with other firms enable them to capitalize on or develop knowledge or capabilities needed to create a competitive advantage, and to enhance their adjustability to environmental changes (Powell, 1990).

This study is based on three mechanisms that exploit monopolistic advantages by FDI in under developed markets: selecting, learning, and coordinating mechanism. Especially each mechanism has developed as a result of the interactions among the subject, environment, and resources. The mechanism is an interaction process between them. As a result, three mechanisms cover theories of RBV, dynamic capability, and the networking.

Along with introduction of the Mongolian market, we will suggest an acquiring monopolistic advantage process in an under-develop market through three mechanisms; selecting, learning and coordinating mechanism.

4. Characteristics of Mongolian Market

Mongolia's geographic location, the trend toward regional integration, including growing links between North China and the Russian Far East, places Mongolia in a strategic position for firms doing business in the region.

Foreign investment in Mongolia has grown steadily since the country turned toward a market economy in 1990. The liberalization measures taken by the government, low business costs and the country's immense resources have attracted US$208.8 million, invested in the equity of 1016 newly incorporated companies. The breakdown of foreign investment by country of origin reveals a major involvement of the People's Republic of China, followed by Japan and Russia. While investors from the two neighboring countries have established mainly small enterprises, Japanese, American, and Italian firms have invested an average of between US$350,000 and US$1 million per project.

Mongolia signed treaties on Bilateral Investment Promotion and Exemption of Double Taxation with Belgium, France, Russia, China, Germany, Italy Great Britain, USA, South Korea, Turkey, Kazakhstan, etc.

The tendency of foreign investors to put capital in food-processing, trade, construction and service sectors has been changed since 1996, towards investment in mineral exploration, cashmere and wool processing, transport and telecommunications. Present foreign investors by sectors are: USA-oil, gold exploration, cashmere processing, Japan-mobile communication, tourism, restaurants, cashmere processing, export of horse meat, Russia-exploration of minerals, construction, building materials, transportation, China-construction, building materials, restaurants and South Korea-textiles, transportation, restaurants, tourism, education and telecommunications.

We suggest Sky Group by SK Telecom & Tai-Han Electric Wire Co., LTD. is the most representative FDI case to an under-developed market.

5. The Case of Investment in Mongolia Market by Korean Firms

This is an alliance case by Korean firms, SK Telecom and Tai-Han Electric Wire Co., LTD.

SK Telecom and Tai-Han Electric Wire Co., LTD were exploring a monopolistic advantage through FDI.

As in under-developed markets like Mongolia, most MNE does not have enough local information and market knowledge to compare with American and European Market, so local information and market knowledge is very critical. Moreover, these characteristics produce a unique phenomenon. Consequently, a decision to engage in FDI by a firm is not the result of a monopolistic advantage; monopolistic advantage is acquired through the FDI process.

5.1 Stage1: Selecting of Wire Business by Tai-Han Electric Wire

Tai-Han Electric Wire Co., LTD. is one of Korea's leading cable manufacturers established in 1955. Its annual sales worth 1.35 trillion won (1.35 billion US $) based on the most competitive extra high voltage and optical fiber cables. They try to get optimum results through concentrating management resources on their core business and as part of their globalization scheme, they operate subsidiary companies in China and Mongolia.

When Tai-Han Electric Wire Co. LTD. first received a call from Mongol suggesting the company to open a cable network business in the country, they were reluctant to invest $ 170 million to the foreign market for a business field that had been already idle in Korea. Meanwhile, they received information that Sumimoto and NTT of Japan would establish JV with Mongolian corporations and there would be an opening for a license for mobile service business that has been monopolized. Tai-Han examined a cost-benefit analysis for mobile service business in Mongol and found a new market that has more potential profits than the cable network business.

5.2 Stage2: Learning of Mobile Service by Skytel

Skytel's capital is five million dollars. It composed of Tai-Han Electric Wire's share 35%, SK Telecom's Share is 25% and Univcom's and Mongolian private investor's share was 40% and it was established on July 1999.

Tai-Han Electric Wire Co. LTD. successfully captured the possibility of big marketization in mobile service business, but Tai-Han's comparative advantage in cable network cannot be applied to mobile market. Therefore, they decided to establish a Joint Venture with SK Telecom that had a monopolized comparative advantage in domestic market in order to advance in mobile service business in Mongol. Mobicom, a JV of Sumimoto and KDD of Japan and MCS of Mongol, launched the first mobile service in July 1999 and earned about 10,000 customers. Although there was a competitor who took the market first, Tai-han saw the potential of future profits in the field since they noticed that a high cost of mobile service that can be only be afforded by the upper class of Mongol society. It would not be matter to the general public who considered

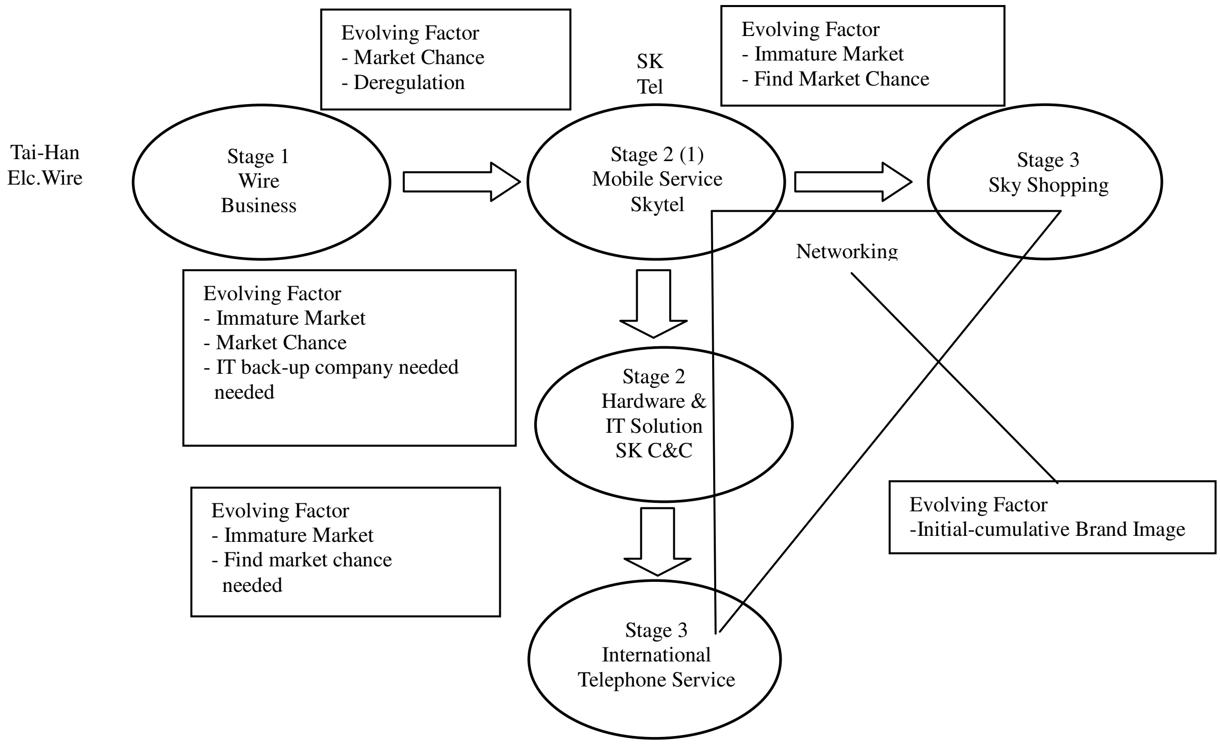

Figure 1. Stage Evolution of Dai-Han Electronic Wire and SK Telecom

a possession of expensive, rare goods as a way to show one's own social status.

5.3 Stage3: Coordinating by SK C&C and Sky Shopping

Sky C&C vs. Mongolia Telecom

Sky C&C, an affiliate company of SK C&C, was established on January of 2001. Its holding was composed of SK C&C and Sky Tel, each held 40%, Korea Company Unageltk's 10%, and local investors' 10%. Its capital was fifteen million dollars.

SK C&C, a subsidiary company of SK Telecom, established on October of 1990, and business areas included IT sourcing, system integration (SI) and e-service.

At the early stage, Sky C&C has been providing SI services in Mongolia, such as the project with Skytel, in the telecommunications industry, in developing and operating the IT services and WAP system. However, the solution business doesn't have customers, even if there're some demands, the price is a big problem, so they did business in hardware and IT Education, but it was not successful.

Sky C&C decides to change an Internet–Based International telephone service to utilize the core competences in Telecommunication. Sky C&C initiated the country's first Internet-based international calling service, "World Call 002". C&C established and operated the Voice over Internet Protocol (VoIP) that uses a satellite Internet. The World Call 002 service uses the network of Skytel.

The president of Sky C&C in Mongolia stated that the World Call 002 in order to increase its brand recognition.

It is expected to bring in over KW3.9 billion ($3 million) of sales in the third year. Sky C&C is strategically expanding its business operations to areas such as ISP services by utilizing the satellite Internet related technology that was gained through its international Internet phone service, along with its original IT outsourcing and SI business.

Sky Shopping vs. Nomin

Sky Shopping is another case of finding a market chance. Tai-Han Electronic Wire and Bat Bold, Sky Tel's stake holder and owner of Chinkis Hotel, a Altai Holding Group affiliate, made a joint venture for using Chinkis hotel's idle space, and turned it into a shopping center. But the big problem lack of population. After a minute market survey, they found a market potential. They launched the first business in July 2001.

Initial investment cost was one hundred and eighty dollars, and it was only one tenth of the total amounts of doing a business in Korea. There are two reasons to make a JV in Mongolia, even though Tai-Han was capable investing in a wholly owned company. One reason is Mongolians' strong pride rooting from their old history. Thus

Table 1. The Major Characteristics of Sky Group

Characteristic	Dai-Han Electronic Wire.	SK Telecom
First-year of doing business in Mongolia	1995.7 Wire Business	1997.7 Sky Tel
Product or service	- Sky Tel: Mobile Phone Service - Sky Shopping: Shopping Center	- Sky Tel: Mobile Phone Service - Sky C&C: Hardware & IT Solution Internet-based International Telephone Service
Current status	- 1997.7 ~ now, Sky Tel In business: Non-profitable - 2001.5 ~ now, Sky Shopping In business: Profitable	- 1997.7 ~ now, Sky Tel In business: Profitable - 2001.1 ~ now, Sky C&C In business: Profitable
Stage Evolution		
Stage 1	Tai-Han Electronic Wire: Wire Business	Sky Tel: Mobile Service Business
Evolving Factors	- Market Chance - Deregulation - Find the national Character	- Immature Market - Market Chance - IT back-up company needed
Stage 2	Sky Tel: Mobile Service Business	Sky C&C: Hardware & IT Solution
Evolving Factors	- Immature Market - Market Chance	- Immature Market - Find Market Chance
Stage 3	Sky Shopping	Sky C&C: International Telephone Service

they have very negative feeling towards foreign companies. A JV with a Mongolian company can alleviated these negative elements during an FDI process.

Sky Shopping's business result was unbelievably successful. Sky Shopping's only competitor is a privatized Nomin. At first, Nomin kept their market share as mimicing the Sky Shopping's Strategies, but they could not complete with Sky Shopping's know-how. Sky Shopping already noticed the best shopping mall in Mongolia, antotally discriminate against Nomin.

Skytel through Sky C&C expanded a business and earned a support-company at a time. Tai-Han also expanded its business into Sky Shopping. As a result, Skytel, Sky C&C, and Sky Shopping comprises a network of Sky Group and derives huge synergy effect from each other.

6. Analysis: Three Mechanisms

We will analyze the case by deployment of three mechanisms that we already suggested; the selecting, the learning, and the coordinating mechanism.

6.1 The Selecting Mechanism

The degree in which the same critical capability contributes to a firm's competitive advantage is generally not homogeneous across national markets. A particular infra structure, for instance, may have a strong negative influence on a firm efficiency and effectiveness in one country, but not in another, especially in under-developed market. Managerial skills and international experience are two major elements of organizational capability (Luo, 2000). Experience represents knowledge that could be turned into a capability. Among them, knowledge about local business practices is fundamentally important for foreign companies when they are seeking a market position and power in emerging markets. What we should take a note here is Tai-Han Electronic Wire's motivation and method of penetration into the market. Tai-Han's entry to Mongolian markets illustrated a case that a coalition of companies that expect the possible profits of a new field of business in the future penetration into a foreign market although they do not have a comparative advantage in that field. Mobicom, the first mobile service provider, also showed the same case because Sumimoto of Japan recognized their comparative inability to guarantee a success in Mobile service business and pursued a joint venture with KDD, a Japanese telecommunication company after it received the right way of doing mobile business in Mongol. The Sky Group case shows that although a firm just finds a local market chance but doesn't have a core competence in that part, it can re-enter the foreign markets through co-work with the other firm having a monopolistic advantage in which they needed.

6.2 The Learning Mechanism

Learning enables a business to expand or transform its basic capabilities and in many cases, aid in undertakings of greater strategic implications, such as innovations in existing core capabilities or even the creation of new core capabilities.

External knowledge acquisition occurs through several stages. The first stage is formation of the alliance and interactions between individuals from two or more firms. The second stage is transfer of knowledge from the alliance to each of the partners. We can refer to this as "grafting": the process by which organizations increase their store of knowledge by internalizing knowledge not previously available within the organization.

Most of Sky Group's units are in a form JV between

SK Telecom, Tai-Han, and Mongolia. SK Telecom and Dai-Han's JV was intended for absorbing local knowledge and industrial knowledge. JV with Mongolia was designed for absorbing local specific knowledge. These characteristics are the results of acquired local experiences, local knowledge and internalized dynamic learning.

6.3 The Coordinating Mechanism

To ensure survival and growth in the global marketplace, MNEs must be able to successfully transfer critical capabilities within their international networks to give their operations in a foreign country a competitive advantage or to fulfill a strategy derived from local operations.

The network enabled them to acquire the tactic. through networking, corporations can get a synergy effect or create new tacit knowledge by combining their specific capabilities with those of other organizations.

SK Telecom, which is evolving from a stage 1 as Skytel, a stage 2 as Sky C&C and to a stage 3 as Sky C&C that changed the business model, and Tai-Han Electronic Wire finally got a huge synergy effects to make a network, and at the same time, they will also get more advantageous position to compete with each competitor; Skytel vs. Mobicom, Sky C&C vs. Mongolia Telecom and Sky Shopping vs. Nomin.

7. Conclusion

International expansion furnishes new opportunities for a firm to extract returns from current resources and to build new capabilities. As the competitive threat intensifies, under-developed market is perceived to MNE as an alternative and a chance for expanding their business and exploring certain strategy.

However, conventional theories fell short to cover the characteristics of under-developed countries. From this perspective, this research sought to discover the factors based on the assumption that market characteristic of under-developed countries have different phenomenon from developed and developing countries'.

MNEs need to continuously build and upgrade their capabilities and apply their firm selection, learning, and coordinating. A MNE with limited dynamic learning capabilities is less likely to seek new opportunities in the uncertain international marketplace, whereas an MNE with a well-developed repertoire of learning capabilities should have superior ability to deal with uncertainty that would make international markets attractive (Tallman, 1992). The effort needed to extract returns from current resources whereas pursuing new capabilities for their future return-earning potential seems to affect the accomplishment of sustained competitive advantages in international expansion.

To support this argument, we suggested three mechanisms that are the selecting, the learning, and the coordinating mechanism. We applied these mechanisms to the case of Sky Group for explaining more detailed things. This is a peculiar study compared with the existing studies on FDI. This case has significance in the explanation of a new FDI phenomenon and a business process in under-developed markets such as Mongolia, Myanmar, Cambodia, Laos and various Africa's countries. These cases show, through the three mechanisms, that a FDI can be an effective mechanism to find a monopolistic advantage.

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