

9E

International Business

COMPETING IN THE GLOBAL
MARKETPLACE

Charles W. L. Hill

UNIVERSITY OF WASHINGTON

McGraw-Hill
Irwin

Hyundai and Kia

For several years Hyundai and its affiliate Kia, Korea's fast-growing carmakers, have benefited from export-led growth. Hyundai sells 60 percent and Kia 80 percent of its production in foreign markets, particularly the United States, where they have been gaining share recently. By 2006 the two companies had about 4.3 percent of the U.S. market, and they hoped to double their market share there to 8.6 percent by 2010. Their success in foreign markets has been attributed to good product quality, reasonable design, and aggressive pricing. In the United States and EU, they price their cars below the prices of both domestic firms and the major Japanese companies such as Toyota and Honda. This low-price strategy has enabled the two affiliated companies to grow foreign sales, but their profit margins per car are low—as low as 3 percent on cars sold in the United States. This makes them very vulnerable to changes in the value of the Korean currency, the won, against the U.S. dollar.

In 2006, the won rose in value by about 7 percent against the U.S. dollar. It continued to appreciate throughout 2007, hitting a 10-year high against the dollar in October 2007. A stronger won means that Hyundai and Kia vehicles sold in the United States for dollars are recorded at a lower value when translated back into won, which has hurt the financial performance of both companies. In 2006, despite rising unit sales, profits at Hyundai fell 35 percent, and those at Kia fell some 94 percent. Kia had to sell 15 cars on average in the United States in 2006 to make the same amount of revenue and profit that it got from 14 cars in 2005. If the won continues to gain in value against the dollar over the long run, as many analysts predict, Hyundai and Kia may be forced to abandon their low-price strategy and start to raise prices in the United States.

Partly as a hedge against currency movements, Hyundai opened its first U.S. automobile plant in Montgomery, Alabama, in 2005, and also announced plans to build an engine plant close by. There is speculation that Hyundai will further expand its U.S. manufacturing presence in the near future, once the automobile market recovers from the severe slump it encountered in 2008 and 2009. Kia, too, is expanding its presence in the

United States as a hedge against currency movements. In 2006 the company broke ground on a U.S. manufacturing plant in Georgia, which was scheduled to open in 2009. Although Hyundai and Kia saw their profits slump by almost 30 percent in 2008, sales of their cars held up relatively well despite the steep recession in the global auto industry. In fact, sales of their small cars in the United States actually increased in 2009, making the companies the only ones to register an improvement.¹

Case Discussion Questions

1. Explain how the rise in the value of the Korean currency, the won, against the dollar affects the competitiveness of Hyundai and Kia exports to the United States.
2. Hyundai and Kia are both expanding their presence in the United States. How does this hedge against adverse currency movements? What other reasons might these companies have for investing in the United States? What are the drawbacks of such a strategy?
3. If Hyundai expects the value of the won to strengthen appreciably against the U.S. dollar over the next decade, should it still expand its presence in the United States?
4. In 2008 the Korean won depreciated 28 percent against the U.S. dollar. Does this imply that Hyundai and Kia were wrong to invest in the United States? How does this explain the relative strength of car sales from Hyundai and Kia in the U.S. market during early 2009?

Sources

1. Evan Ramstad, "Won's Rise Hurts Korean Car Makers," *The Wall Street Journal*, December 13, 2006, p. B3; S. Jung, "Call to Cap Strength of Won," *Financial Times*, October 10, 2007, p. 15; W. Diem, "Hyundai Suffers Growing Pains While Seeking Solutions," *Ward's Auto World*, August 2007, p. 9; and M. Degen, "Hyundai, Kia Are Lone Bright Spots," *Orange County Register*, February 4, 2009.

Anatomy of a Currency Crisis: The Collapse of the South Korean Won

In early 1997, South Korea could look back with pride on a 30-year "economic miracle" that had raised the country from the ranks of the poor and given it the world's eleventh-largest economy. By the end of 1997, the Korean currency, the won, had lost a staggering

67 percent of its value against the U.S. dollar, the South Korean economy lay in tatters, and the International Monetary Fund was overseeing a \$55 billion rescue package. This sudden turn of events had its roots in investments made by South Korea's large industrial