

FOREIGN DIRECT INVESTMENT BY KOREAN FIRMS: PROFILE, THEORY, AND IMPLEMENTATION

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ABSTRACT

This research investigates the current state of foreign direct investment by firms from South Korea. Korean FDI is found to be increasingly diverse in location and purpose; small and medium sized firms are investing primarily in Asia in search of cheap labor, while large firms are investing in major markets worldwide to secure market share and to acquire and develop technology. The applicability of Dunning's eclectic theory to Korean FDI is discussed, and theoretical refinements concerning ownership advantages are suggested. Implementation challenges involve HRM, and vary according to whether the labor an investment requires is commodity-like or skilled.

Key Words: Korea, FDI, chaebol, eclectic theory

INTRODUCTION

The nature of foreign direct investment (FDI) has changed dramatically over the past three decades. Today, FDI is carried out by a broader range of firms, in greater amounts, in different places, and for different reasons than it was in the past. Increasingly active in the FDI arena are companies from developing or newly developed Asian countries. Relatively little research has been done on the characteristics of and motivations for these countries' FDI, and how these may differ from the FDI of traditional multinational corporations. This new Asian FDI also presents challenges for traditional FDI theory, which has been built primarily upon more widely available data on FDI by large Western, mainly American, MNCs (Root 1978, 508-509).

This paper examines these issues through an investigation of foreign direct investment by firms from South Korea. Beginning in 1968 with a \$6 million forestry development project in Indonesia, Korean FDI had grown to a cumulative total of \$25.83

billion in over 11,000 projects by the end of 2000 (see Exhibit 1), even though the pace of increase has been slowed down by the 1997-98 foreign exchange crisis. Carried out by firms both large and small, driven by a variety of external and internal forces, and taking various forms, Korea's outward FDI is representative of the current and changing state of foreign direct investment. As such, it also offers a valuable perspective on FDI theory development and on important implementation issues.

Exhibit 1: Foreign direct investment by South Korea firms, 1968-2000

Years	Net Investment		Outstanding Investment	
	Cases	Amount (\$ mil)	Cases	Amount (\$ mil)
1968-80	279	127.0	279	127.0
1981	36	21.9	315	148.9
1982	32	97.6	347	246.5
1983	44	102.6	391	349.1
1984	33	48.2	424	397.3
1985	9	63.8	433	461.0
1986	31	158.3	464	619.3
1987	59	320.1	523	939.4
1988	139	156.2	662	1,095.6
1989	246	392.4	908	1,488.0
1990	319	812.7	1,227	2,300.7
1991	421	1,026.9	1,648	3,327.6
1992	460	1,098.2	2,108	4,425.9
1993	618	1,016.4	2,726	5,442.3
1994	1416	2,029.9	4,142	7,472.2
1995	1214	2,760.7	5,356	10,232.9
1996	1371	3,595.1	6,727	13,828.0
1997	1208	2,992.6	7,935	16,820.7
1998	518	3,441.7	8,453	20,262.4
1999	959	2,074.3	9,412	22,336.7
2000	1792	3,493.9	11,204	25,830.6
Total	11,204	25,830.6	11,204	25,830.6

Source: Export-Import Bank of Korea. Overseas Direct Investment Statistics Yearbook, 2001

FDI by Korean companies was investigated through extensive use of secondary materials, and through the researchers' access to information and interviews with managers from a major Korean conglomerate. The research has three basic aims. The first is to understand the nature of Korean FDI: What kinds of firms are investing overseas, where are they investing, for what reasons, and in what types of operations? The second aim is to consider the implications of Korean foreign investment for FDI theory: Does Korean FDI call into question any tenets of existing FDI theory, or can it help us refine theory to better explain foreign direct investment in the 1990s? The third aim is to examine implementation issues: What are these, and how might they be addressed to

make FDI more successful for both investor and host country?

A PROFILE OF KOREAN OUTWARD FDI

Geographical Distribution

Significant Korean FDI is found in all of the world's major economic regions: Asia, North America, Latin America, and Europe.

Exhibit 2: Korean FDI by regional in 2000 (outstanding value in millions of dollars)

Region	No of cases	Total value	Average amount/case
Asia	7,643	10,670	1.4
Middle East	45	229	5.1
North America	2,149	7,744	3.6
Latin America	366	2,602	7.1
Europe	539	3,461	6.4
Africa	93	481	5.2
Oceania	369	644	1.7
Total	11,204	25,831	2.3

Source: Export-Import Bank of Korea. Overseas Direct Investment Statistics Yearbook, 2001

In terms of project size, there is significant variation among the regions, with the average investment amounting to \$1.40 million in Asia, \$3.60 million in North America, \$6.42 million in Europe, and \$7.2 million in Latin America in 2000 (The Export-Import Bank of Korea 2001). This is indicative of the differing nature of investments across the regions. The smaller average investment size for Asia reflects smaller Korean companies' focus on labor-intensive, assembly-oriented investments in Asia, while the larger average investment figures for North America, Latin America and Europe reflect larger Korean corporations' more capital-intensive global manufacturing and technology-development investments within the EU and NAFTA trade blocs (see below).

Before the 1997-1998 financial crisis, a trend of increasing Korean investment in China and the US, and decreasing investment in Europe was evident, as Exhibit 2 shows (*Korean Herald* 1996 (a) March 31)

Exhibit 3: Location of Korean FDI: Jan-Feb 1995 vs. Jan-Feb 1996

	Jan.-Feb. 1995		Jan.-Feb. 1996	
	No. of cases	Total value	No. of cases	Total value
Total Korean FDI	245	\$738 million	266	\$956.5
Korean FDI in China	135	\$152.7	148	\$240.9
Korean FDI in US	25	\$43.1	31	\$322.7
Korean FDI in Europe	20	\$323.3	16	\$183.6
Korean FDI in Latin America	6	\$16.5	8	\$41.2

Source: Bank of Korea

Particularly striking was growing Korean investment in China before Korea was hard hit by the financial crisis in 1997. Korean FDI in China began in 1989, and by 1990 there were 52 investment projects worth \$68 million. Since then it had increased dramatically, facilitated by the establishment of diplomatic relations between Seoul and Beijing in 1992. According to the Korean Foreign Trade Association, in 1994 there were almost 2000 Korean investment projects in China, worth \$1.7 billion. This represented 55% of total overseas investments, though only 23% of capital. Low-wage seeking smaller Korean companies had been most active in China, as the relatively small average investment size of \$850,000 indicates. Korea's larger firms have been slowed by the greater difficulties large companies face in negotiating China's bureaucratic maze and by Chinese demands for technology in exchange for access, but are now following the lead of the smaller firms and making major investments in China (Paisley and Kiernan 1994).

FDI by Small and Medium Sized Firms

Korea's smaller companies began investing in overseas operations in the late 1980s. Investments by small and medium sized firms accounted for 78.8% of the cases of Korean outward FDI in 1992, 81.8% in 1993 (Paisley and Kiernan 1994), and 64% (just 24% by value) in 2000 (The Export-Import Bank of Korea 2001).

Exhibit 4: Cumulative Foreign Direct Investment by Korean Small- and Medium-sized Firms.

	1990	1995	1996	1997	1998	1999	2000
Total FDI (A)							
Amount	2,301	10,233	13,828	16,821	20,262	22,337	25,831
Cases	1,227	5,356	6,727	7,935	8,453	9,412	11,204
Ave. amount/case	1.9	1.9	2.1	2.1	2.4	2.4	2.3
Small/Med firms (B)							
Amount	405	2,156	2,853	3,314	3,502	3,993	6,111
Cases	489	3,624	4,442	5,168	5,447	6,021	7,187
Ave. amount/case	0.8	0.6	0.6	0.6	0.6	0.7	0.9
Ratio B/A (%)							
Amount	17.6	21.1	20.6	19.7	17.3	17.9	23.7
Cases	39.9	67.7	66.0	65.1	64.8	64.0	64.1

Source: Export-Import Bank of Korea. Overseas Direct Investment Statistics Yearbook, 2001

Note: Numbers indicate total accumulated net investment by the end of a year; amounts are in millions of US\$.

The driving force behind small firms' overseas expansion is the search for cheap labor. Korea's small and medium sized companies differ greatly from the country's large conglomerates, or *chaebol*. Unlike the *chaebol*, which have been the Korean government's chosen engines of economic growth and the beneficiaries of privileged access to capital, technology, government contracts, and protection, Korea's smaller companies are relatively underdeveloped and capital-poor. They have been particularly hard hit by the steep rise in manufacturing wages in Korea since democratization in the late 1980s. While larger firms have been able to respond to rising labor costs by increasing capital intensiveness through automation, small firms in labor-intensive light industries such as textiles, toys, and footwear have had little choice but to try to remain competitive by using cheaper labor offshore. In textiles, for example, an industry populated by smaller firms, Korea's offshore textile and apparel plants numbered 1,752 in 60 countries at the end of 2000; 79% of these were in Asia (The Export-Import Bank of Korea 2001).

Asia has been and continues to be the preferred destination of FDI by smaller Korean firms. In 2000, 76% of small firms' foreign investments went to Asia (The Export-Import Bank of Korea 2001).

The smaller companies initially focused on low wage Southeast Asian countries like Indonesia and Thailand, more recently moving into Vietnam and China as those countries have become more open to foreign investment. The overriding attraction, as mentioned above, is low wages; according to a survey by the Ministry of Trade, Industry, and Energy, the average monthly wage paid by South Korean companies was \$70 in Vietnam, and \$74 in China in 1994. In 2000, China alone accounted for 3,665 investments by small Korean firms worth \$1,663 million (The Export-Import Bank of Korea 2001).

There were around 100 Korean firms in Vietnam in 1996, mostly small and medium sized companies centered around Hanoi (mainly in heavy and chemical industries) and Ho Chi Min City (mainly in light industries like footwear, bags, textiles) (*Korean Herald* 1996 (b) March 23). The number has increased to 139 investments, worth \$120.6 million by 2000 (The Export-Import Bank of Korea 2001).

FDI by Korea's Chaebol

Korea's *chaebol* (conglomerates) are among the largest companies in Asia. In 1995, the overseas presence of the *chaebol* remained relatively small; only 5% of big four's (Samsung, Hyundai, LG and Daewoo) assets were overseas. (This compared with 28% for Japanese electronics firms, which had moved most of their low-end production offshore.) This picture was expected to be changing rapidly, as the Korean big four planed to invest a total of \$20 billion on overseas expansion by the year 2000 (*Korean Economic Daily* 1995 April 12). However, some of these plans were not materialized because of the 1997-1998 financial crisis. In 2000, the outstanding value of FDI (more than \$10 million each) by the four conglomerates was \$10.4 billion. The outstanding value of FDI by SK, currently the third largest *chaebol* in Korea, was \$746 million in 2000 (The Export-Import Bank October 2001).

The overseas expansion of the *chaebol* is driven by a different set of forces than that of Korea's smaller companies. During the 1980s, *chaebol* invested abroad primarily for defensive reasons. Manufacturing was set up overseas to lower production costs and to defend established market share via local production or indirect exports (from third countries). At the same time, vertical foreign investments were made to secure raw materials needed for production at home. In the 1990s, however, FDI has been increasingly aimed at capturing opportunities for growth in emerging markets such as China and Southeast, at securing market position inside major trading blocs, and at obtaining advanced technology and marketing know-how from advanced countries through mergers and acquisitions and strategic alliances. A researcher at the Korea Institute for Industrial Economics and Trade explains: "For larger firms, cheap costs are no longer the primary motive for going abroad; aggressive scouting for overseas market shares and smoother technological absorption are the emerging reasons" (*Korean Herald* 1996 (a) March 23).

Market Development Investment

Ambitious to grow by building and maintaining strong competitive positions in both established and emerging markets, the *chaebol* consider establishing a solid production base and market position inside each of the "triad" regions—Europe, North America, and Asia—to be essential, particularly with the trend toward the formation of economic blocs such as the European Union, NAFTA, and the ASEAN Free Trade Area (AFTA).

For example, Samsung, the largest and most globalized chaebol in Korea, has accelerated its plans for Europe in response to European economic unification. Beginning with a TV plant in Portugal in 1982—the first overseas production facility to be set up by a Korean manufacturer—the Samsung Group has been operating an electronic components plant in Portugal, a VCR plant in Spain, and TV plants in the UK, Hungary, and Turkey. It also has joint ventures in the Czech Republic and Turkey. In 1994, Samsung made a number of large scale investments, including a \$30 million semiconductor assembly plant in Portugal, a \$120 million color picture tube factory at Berlin, Germany, and a \$700 million industrial park at Wynyrd in the UK, the largest investment ever made in Europe by a Korean firm. In addition, Samsung produces refrigerators in Slovakia, watches in Switzerland. It has acquired a majority stake in Rollei, the German camera manufacturer (*Korea Herald* 1996 March 5, Dent and Ranerson 1997).

Examples of North American market-oriented investments by *chaebol* include two \$1.3 billion semiconductor plants built by Hyundai in Oregon and Samsung in Texas (*Korean Herald* 1996 February 28, *Korea Herald* 1996 March 30), and a \$231 million consumer electronics complex established by Samsung in Tijuana, Mexico (*Korean Herald* 1996 (c) March 31). These supply the North American market from within the boundaries of NAFTA.

LG Group investment activity in Asia exemplifies the *chaebol* approach to growth opportunities in that region. Indonesia has been the focus of much of LG's Asian investment. LG's first manufacturing investments in Indonesia were refrigerator and color TV plants built in 1990, followed by a household pump factory. A TV picture tube plant in Jakarta (yearly capacity: 2.2 million tubes) started operation in 1996; this facility also started producing monitors and TV components in 1998, at a total investment cost of \$514 million. Lee Si Yong, Head of the Business Planning Department's Overseas Investment Team explained that Indonesia was chosen as the site of these investments "in order to avoid collision with Japanese manufacturers which had rushed into Malaysia and Thailand in response to yen appreciation" (Sakai 1995). Indonesia's size (population: 190 million) and rising income levels also make for a lucrative domestic market. LG sales in Indonesia have grown rapidly; the company is number two in color TV market share, and number three in refrigerators, and is rushing to increase capacity at its existing Indonesian TV and refrigerator plants (from 400,000 to 1 million color TVs and from 100,000 to 200,000 refrigerators). Another important factor is the ASEAN Free Trade Area, which will further increase the attractiveness of Indonesia (and other within-ASEAN nations) as production bases for export to neighboring countries.

LG was expanding aggressively into the rest of Asia as well, as part of a policy, announced in 1995, to increase the amount of overseas production from 10% to 45% of total LG Group production. Eight new overseas manufacturing plants were scheduled to begin operations in 1996, including air conditioner and microwave oven plants in Tianjin, China (\$99 million invested), and a color TV plant in Vietnam (Sakai 1995). By the year

2005, the LG Group plans to invest an additional \$5 billion in new Asian operations, including: two lease banks, a housing complex, and an oil refinery in Vietnam; an electronics complex, a housing complex, and a resort in Indonesia; a semiconductor plant in Penang, Malaysia; and in India a software center in Bangadore and an oil/chemical refinery and electronics complex in Delhi. The location decisions for these investments were made at the top: by the LG Chairman's Office. LG envisions these not as independent operations but as interrelated investments with significant synergistic effects for the LG Group. Most recently, LG Electronics plans to make a \$1.5 billion investment in Netherlands, which would make the European country the largest beneficiary of overseas investment by a Korean firm (Korea Herald 2002 January 22)

Daewoo's market development investments are notable for their particular focus on emerging markets in developing countries such as China, India, Iran, and the former Soviet Bloc countries. Under its ambitious "Vision 2000" plan, the Daewoo group intends to boost its foreign subsidiaries from 42 in 1994 to 330 by the end of the decade (Ahn 1994). In Eastern Europe, the company will have auto plants in operation in the Czech Republic, Uzbekistan, Poland, and Romania by 1998; these will not only provide cars to the local market, but will serve as sites for exports to neighboring markets as well.

Combined with other overseas auto plants in India, China, Indonesia, Vietnam, the Philippines, Iran, and Peru, these will raise annual overseas capacity to one million units (Korean Herald 1996 March 13). Other major Daewoo investments in developing country markets include audio and video plants in Brazil, Poland, and Vietnam, and a \$1.5 billion car parts factory and \$300 million cement works in China's Shandong province (Nakarmi 1995). The company has also won a \$5.2 billion contract to build a theme park near Beijing (Korean Economic Daily 1995 April 12), and plans to set up a large industrial estate in India exclusively for smaller enterprises (Korean Herald 1996 (b) March 31).

In connection with their market development-oriented investments in overseas production facilities, the *chaebol* are also setting up supply and marketing support operations abroad. Samsung, for example, opened a purchasing office in Shanghai in 1996 to secure raw materials and parts for production at its Chinese camera plant; a company spokesman commented: "We're looking at an upwards of 30% reduction in production costs by buying from the Chinese market" (Korean Herald 1996 April 21). On the marketing side, Daewoo was investing \$500 million in 40 exhibition centers, 15 new branches and sales companies, and 100-odd after-sales service centers for its products in Russia (Korean Herald 1996 February 18).

Technology-seeking Investments

In addition to FDI for overseas market development, the *chaebol* are investing heavily in technology acquisition and development operations abroad, mainly in Europe and the United States. Upgrading of technological capabilities is imperative for the *chaebol* as they, and Korea as a whole, strive to move up the ladder of comparative advantage. With

Korean labor costs the second highest in Asia after Japan in 1994, the challenge for *chaebol* is to move away from a reliance on selling mass-produced, low-level goods, which developing nations can now produce and sell more competitively, toward strength in high value-added products in high-tech industries (Rappleye 1994). *Chaebol* investments for this purpose take two basic forms: (1) the setting up of research laboratories overseas, and (2) acquisitions of and joint ventures with foreign companies that possess valuable technology and/or innovative capabilities.

By end of 1992, the big four *chaebol* had set up 17 overseas research centers in electronics alone: nine in the US, five in Japan, and three in Europe. More recent R&D investments include an automotive R&D center opened by Hyundai near Detroit, and a personal computer research center in Taiwan and a design research institute in Ireland set up by LG. At the latter, LG conducted joint design projects with one of the world's leading design institutes, Britain's Royal College of Art (*The Economist* 1994 November 5, *Korean Herald* 1996 February 22, *Korean Herald* 1996 February 9).

Technology-seeking mergers and acquisitions by Korean *chaebol* are taking place mainly in North America and Europe. Hwang Young-kye, managing director and treasurer of Samsung Electronics, states: "In the US and Europe there are two reasons for acquiring existing companies: technology and market" (*Business Korea* 1995 February 1). Samsung in 1995 paid \$378 million for AST, one the America's largest personal computer makers (*Korean Economic Daily* 1996 April 12). In 1994, Hyundai bought a semiconductor division of AT&T (for \$340 million) and a 40% stake in Maxtor Corporation of the US (for \$165 million), which had 12% of the world hard-disk drive market; the Maxtor investment, besides guaranteeing exports of Hyundai's computer memory chips, involved cross-licensing of the two companies' technologies and shared development of hard-disk drive parts and components (Paisley and Kiernan 1994). In 1995, LG Electronics paid \$351 million to acquire US TV maker Zenith. In addition to increasing LG's share of the US television market from 2% to 12%, this investment gave LG access to key Zenith technology in the areas of high definition television—HDTV signal transmission technology developed by Zenith has been adopted as the HDTV standard in the US—and interactive cable TV signal transmission devices (Glain 1995).

Capital investment in smaller technology developing companies in places like California's Silicon Valley is another method Korean *chaebol* are employing to develop and access leading-edge technology.

Natural Resource Access FDI

Another type of FDI being carried out by larger Korean companies is investment for the purpose of gaining access to key natural resources. South Korea is a relatively small and natural resource-poor nation; at the end of the Second World War, the South was primarily agricultural while the North (today's North Korea) possessed most of the natural resources and heavy industry established by the Japanese during their 35-year

occupation of the Korean peninsula (Il 1993, 2). This, coupled with the devastation caused by the Korean War, has forced South Korea (not unlike Japan in the early post-war period) to look outside its borders for the capital, technology, and natural resources needed for economic development. The history of Korean outward FDI therefore includes numerous investments aimed at securing natural resource access. One example is a London-based joint venture between two Korean firms, Petroleum Development Corporation (PEDCO) and Hanwha Energy Company, which acquired a 15% stake in a Texaco oil exploration project in the North Sea; the project was expected to yield 60,000 barrels of crude oil a day beginning in 1996, and includes additional exploration in the area expected to result in oil output over a 22-year period (*Korean Herald* 1996 March 12). Another case is a 34-year, \$474 million investment by Hansol Paper Company (a company spun off from Samsung in 1993) in a forestry project in New Zealand, which will ship lumber to Korea beginning in 2023; a similar project in Australia by the same company will begin lumber shipments 2003 (*Korean Herald* 1996 February 17). Closer to home, abundant natural resources available in North Korea, China, and Russia have been and will continue to be targets for resource-seeking FDI from South Korea (Il, 1993, 160). For example, the Korean government has recently announced that it will map out a comprehensive strategy to secure a stable supply of energy from the Northeast Asian region, including a plan to complete the introduction of natural gas into Korea from a gas field in the eastern Siberian Irkutsk between 2008 and 2010 (*Korea Herald* 2000 (b) January 22).

Korea's Shifting FDI Picture

Apart from its variety, and from the question of its fit with traditional FDI theory, one of the most striking features of Korean outward FDI is the degree to which it has changed and continues to change in response to trends in the international business environment and to the economic development and shifting comparative advantages of Korea as a nation.

External trends which have influenced Korean FDI decisions include:

(1) Shifting trade barriers. The global trend toward free-market economic policies has reduced restrictions on FDI and facilitated the building of overseas export platforms in favorable locations by easing restrictions on cross-border shipments of inputs and finished products. At the same time, the development of trade blocs is pressuring MNCs to establish more self-sufficient production systems within bloc boundaries.

(2) A maturing domestic market. The home market for many of the products Korean firms make is at or near saturation point, causing companies to increasingly look to overseas markets for growth opportunities.

(3) Deregulation at home. In 1993, administrative restrictions on the number of Ko

rean firms from one industrial sector that could invest in a particular foreign country were eased, causing a sharp jump in FDI (Paisley and Kiernan 1994). In addition, the Korean government has promised its trading partners that it will open up the domestic market, cutting red tape for investors and easing restrictions on imported goods (McGrath and Ahn 1994).

(4) International politics. Closer economic ties with China, including FDI in that country, is politically advantageous for South Korea as China is the only country with any leverage over unpredictable North Korea.

(5) Changing competitors. Squeezed at the lower end by growing competition from the next wave of newly industrializing countries such as Thailand and Malaysia, and faced with the loss of protection and government patronage at home, Korean firms are increasingly having to compete not only with each other but against major Japanese and Western corporations. The gaps *chaebol* face vis-a-vis these competitors in reputation and market position—Korean producers have a reputation outside Asia for variable quality, much of their revenues come from low margin, down-market items, and a high percentage of their exports are OEM—as well as in technology, are driving to a large extent both their market- and technology-seeking FDI.

Laid across these external changes is the continuing evolution of the Korean economy from a low wage economy producing shoes, textiles, small TVs, and cheap cars to one trying to become one of world's leading producers of high-tech goods. With expanding exports and growing economic prosperity in the 1980s, organized labor demanded and won wage increases between 1986 and 1992 that surpassed gains in productivity, resulting in a shift in Korea's comparative advantage as a nation; Korea has lost its edge in the export of labor-intensive goods to developed markets, and now must make the difficult transition to technology-intensive industries. As the data reported in this paper show, much of Korean outward FDI is connected with making this transition.

The shifting profile of Korean FDI and the changing external circumstances which underlie it fit comfortably within the framework of FDI theory discussed above; all involve changing internalization, ownership, and location advantages. These changes serve as a reminder, however, that FDI is not static. FDI patterns and the forces underlying them are constantly evolving, and at a faster rate today than they did in the more stable economic environment of earlier decades. This dynamic aspect of FDI deserves continued study.

THEORETICAL IMPLICATIONS OF KOREAN FDI

The sheer variety of Korea's outward FDI, one of its most striking features and a reflection of the growth and diversification of the Korean economy, poses difficulties for

any single theory which strives to explain all or most cases of foreign direct investment. On the other hand, Korean FDI offers a valuable opportunity to update and refine FDI theory to better fit today's foreign investment realities. In the sense that Korea's FDI diversity is representative of the diversity that characterizes FDI in general in the 1990s, it provides a useful case study for refining theory to better explain and predict FDI as it is today. In this section, we look at four distinct types of Korean FDI from a theoretical perspective: (1) manufacturing investments, (2) supply and market support investments, (3) natural resource access investments, and (4) technology acquisition and development investments. For each, we consider how well Korean investments are explained by existing theory, and suggest how theory might be modified to enhance its explanatory power. We also consider how a dynamically changing external environment and Korea's economic development have changed and continue to change the profile and nature of Korean firms' foreign investments.

Manufacturing FDI

Traditional FDI theory has focused most heavily on overseas *production* investments by MNCs, and has sought to explain (1) why firms go abroad as direct investors, (2) how these firms can compete successfully in foreign markets given the disadvantages they face as vis-a-vis local companies operating in a familiar business environment, and (3) why firms choose to enter foreign countries as producers rather than as exporters or licensors (Root 1978, 518). Work in this area has culminated in Dunning's unified "eclectic theory" of FDI (Dunning 2000), which holds that three conditions are necessary for production FDI to occur. First, the firm must have some unique "ownership advantage," such as a well-known brand name, superior technology, or scale economies, which allows it to overcome the disadvantages of competing with foreign firms in their home countries (Hymer 1976). Second, there must exist an "internalization advantage" which makes *internalizing* international production (producing in the foreign market) more advantageous than exporting products or licensing technology or a brand name. Such is the case when the transaction costs of using a market, i.e., the costs associated with negotiating, monitoring, and enforcing a contract, are high (Williamson 1983). Third, there must be a "location advantage," some factor that makes undertaking the business activity in a foreign location more profitable than doing it domestically.

Location and internalization advantages clearly underlie much of the manufacturing FDI carried out by Korean firms. Important location advantages include low labor costs, reduced tariffs inside trade blocs, and geographic closeness to overseas markets. Proximity to previous investments by the same firm in the same region can also be considered a location advantage. This works in two ways. First, when buyer-supplier and synergistic relationships exist among subsidiaries in a region, these can be conducted at low transport cost and with fewer of the other difficulties that come with coordination

over long distances. Second, through its initial investments in a foreign country, a firm gains country-specific operating knowhow and builds useful business and political relationships; subsequent operations set up in that country by the same firm can gain access, thanks to their corporate connection to the prior investments, to that knowhow and those relationships, thus reducing the disadvantages inherent in operating in an unfamiliar environment. These proximity advantages help explain the grouping pattern seen, for example, in the LG Group's Asian investments.

Internalization advantages are present when trade barriers (which can block or increase the costs of exporting) exist, and when difficulties inherent in packaging for sale and transferring "intangible" competencies such as management skills rule out their sale through markets.

The one element of Dunning's eclectic theory that does not match well with Korea's overseas manufacturing FDI is the ownership advantage, particularly the idea that an ownership advantage is necessary to compete successfully against foreign firms on their home turf. In fact, host country firms are irrelevant, or non-existent, in many of the foreign production investments made by Korean companies. For low wage-seeking FDI, the relevant product markets and competition often lie outside the host country. Firms setting up production in cheap-labor locations are in many cases not selling locally, but exporting to third countries or back home. This is particularly true of FDI in the special economic zones which many developing countries have set up. For example, Korean textile companies have a strong presence in export processing zones in Sri Lanka and Guatemala, via which they can circumvent quotas on exports to Western markets under the multifiber agreement (*Korean Economic Daily* 1995 April 12). Likewise, the competition for Korean firms building overseas production facilities is often not indigenous firms but other Korean firms or MNCs from other developed or developing economies. This point applies, of course, not just to Korean FDI, but to FDI in export platforms by other nations' MNCs as well. Theoretically, this issue can be partially handled by differentiating between domestic market-oriented and export-oriented FDI. While an ownership advantage over domestic firms, if they exist, may be necessary to explain the former, it is not a necessary condition for the latter. Indeed, a United Nations study has found significant differences between the host country features that attract domestic market-oriented FDI and those that attract export-oriented FDI: firms investing to sell in the domestic market were concerned with protection from domestic and international competition and with basic market conditions, while firms investing to export were influenced more by factor-based incentives such as labor costs (Lall 1995).

Even in the case of domestic-market oriented FDI, however, including investments to produce for the broader "domestic market" of a trade bloc, a firm's main competition is likely to come not from local companies but from global ones. This underscores a gap between traditional FDI theory and today's FDI practice that the globalization of the world economy has created. In a world in which high trade barriers produced isolated and

protected country markets, and indigenous firms enjoyed strong competitive positions bolstered by clear home market familiarity advantages over potential foreign entrants, the “ownership advantage” element of Dunning’s theory was a necessary condition for FDI. Today, however, decades of steady trade liberalization have produced a world in which goods and components travel much more freely across borders, and both markets and competition are increasingly global. Ownership advantages are still, of course, essential for success, but they differ little from the non-FDI-specific concepts of “competitive advantage” or “distinctive competency”; they have less to do with overcoming disadvantages vis-a-vis home country firms in local market familiarity, and more to do with providing an edge in competition with firms from anywhere, in markets all over the world.

Supply and Market Support FDI

Supply and market support FDI, such as Samsung’s Shanghai purchasing office and Daewoo’s sales companies and exhibition and after-sales service centers in Russia, have received less theoretical attention than production FDI. These FDI types are clearly tied to overseas production and sales activities, and can be treated as ancillary investments positioned upstream and downstream from foreign production (or from domestic production in the case of foreign marketing channel investment to support exports).

For efficiency reasons (e.g., input availability, lower transport cost) and political reasons (e.g., trade barrier avoidance, host country demands for increased local content), firms manufacturing abroad are under pressure to procure inputs locally. Overseas purchasing offices facilitate this by helping build a base of low-cost, high-quality supply sources. Some overseas R&D departments of Japanese firms similarly contribute to local procurement by serving as testing centers for local components (Craig 1995). Overseas investments in marketing channels and after-sales service centers also follow (or lead) products to foreign markets, whether those products are exported to the host country or produced there. Because of their relation to foreign manufacturing and sales, these support investments need no special theoretical treatment apart from understanding the role they play in promoting more efficient production (through better local inputs) and more effective sales (through enhanced marketing support). In this sense, they are well explained by Porter’s concept of the firm as a value chain of value-creation activities (Porter 1985, 36-52); like other activities in the chain, materials management and marketing are areas of opportunity for increasing competitiveness by adding value or reducing the costs of value creation. The reasons these are *foreign* investments is simply that the production and sales they support occur abroad. In terms of Dunning’s eclectic theory, this can be considered a location advantage, with the qualification that the primary advantage of the location is proximity to the firm’s overseas production and sales activities, as opposed to locating due to some special feature of the host country per se.

Natural Resource Access FDI

Korean foreign investments aimed at gaining access to natural resources, such as the oil and forestry projects mentioned above, can be explained by a combination of necessity (as noted above, South Korea is poor in natural resources) and the advantages of control. Among the latter are avoidance of the uncertainty associated with relying on purchases of key resources from foreign producers who are likely to be oligopolists, and the opportunity to build barriers that prevent the entry of new firms into the industry. There may also be technical efficiency advantages generated by the internalization of sequential production stages as compared with the coordination of independent producers through a price system. This is consistent with established vertical foreign investment theory as presented, for example, by Root (1978, 128-129).

Technology Acquisition and Development FDI

The type of Korean FDI that presents the greatest challenge for existing theory is that aimed at acquiring and developing technology. As noted at the beginning of this paper, traditional FDI theory has been based largely on data on foreign investments made earlier in this century by large, successful US multinationals. Because these MNCs typically possessed strong competitive advantages in size, brand name, technology, and so on, the main theoretical focus was on the question of why they chose to employ their advantages as overseas producers instead of as exporters or licensors. In other words, possession of strong competitive (or ownership) advantage was assumed, and the choice of *mode* for applying that advantage abroad was the issue.

The Korean *chaebol* that are making technology acquisition and development investments in the 1990s are quite different from those US MNCs. Though they clearly have strong competitive advantages—this is why they too have grown large and successful—they do not possess the technology nor the innovative capabilities that their large Japanese and Western rivals possess, which they desperately need if they are to make up for the loss of their labor cost advantage by moving successfully into higher valued-added and higher-tech fields. Thus theory that explains Korean technology-seeking foreign investment must focus not on how to *apply* an ownership advantage in a foreign country, but how to *gain* one. Moon and Roehl (2001) argued that such unconventional FDI from less developed countries like Korea was driven by the concept of imbalance, where as conventional FDI was driven by advantage.

As with production FDI theory, a central question that must be answered is: Why not use markets? Korean firms have in fact relied heavily on markets, buying technology through licensing agreements with Japanese and Western companies. They have only been able to gain older technologies in this way, however; MNCs possessing more

advanced and leading-edge technologies are generally unwilling to license these, especially to potential competitors such as Korean *chaebol*. This situation, an extreme form of the high transaction costs that are generally associated with the sale of technology, can make *internalization*, through buying the company that possesses the advanced technology, the best option for technology-hungry *chaebol*. This option, along with strategic alliances to jointly develop technology, is feasible for Korean companies today because they increasingly have something to offer companies possessing high-level technology: production expertise, supplies of DRAM chips and display screens, Korean-developed technology in some niches, and plenty of money (Holstein and Nakarmi 1995).

The other means that *chaebol* are using to acquire technology, in addition to buying or creating strategic alliances with technology-rich firms, is to set up overseas research laboratories. A question that these investments pose is: Why have these research facilities been established abroad, instead of at home? There are several reasons: to be close to overseas customers to design products which match local needs; to employ skilled scientists and engineers, which are in short supply in Korea; to keep abreast of overseas technological developments and benefit from the innovative atmosphere of research locations such as Silicon Valley; to respond to host country pressures to perform more value-added activities locally, and to perform technical evaluation of locally available parts and components. These are consistent with findings concerning the reasons other countries' firms have set up R&D laboratories overseas (e.g., see Serapio 1993). In terms of theory, these investments can be explained by a combination of location advantages (including nearness to foreign production and marketing activities) and value chain considerations.

FDI IMPLEMENTATION ISSUES FOR KOREAN COMPANIES

Foreign direct investment is not merely an international transfer of capital; it is an extension of a firm from its home country into a foreign host country. Successful *implementation* of FDI thus requires that friction or mismatches between firm and host nation characteristics and resources, primarily *human* resources, be minimized, so that the objectives of both sides can be achieved. This requires adjustment and learning on the part of both firm and host, but more so on the part of the firm, for firms can be more flexible, at least in the short run, than nations or peoples.

Of the implementation issues that arise in the case of Korean firms' outward FDI, some are a function of the investment-receiving country. In China, for example, Korean companies, like other foreign firms, have experienced difficulties with legal uncertainties, power shortages, and labor unrest (*Korean Economic Daily* 1995 April 12). In the United States, laws and attitudes concerning equal opportunity and sexual harassment differ from those found at home, and must be studied, understood, and adjusted to by Korean and other foreign investors.

Other implementation issues are a function of FDI type. In the case of Korean direct investments aimed at reducing production costs by using cheap overseas labor, successful implementation means managing that labor to obtain maximum work for minimum cost. Pushing overseas workers too hard, on the other hand, can be counterproductive. Small Korean companies operating in Asia have given Korean investors a bad name by trying to squeeze as much “comparative advantage” as they can out of low wage laborers in Indonesia, China, and Vietnam (Paisley and Kiernan 1994). The temptation and opportunity to do this is understandable, given that unskilled, job-hungry labor is an abundant commodity in these countries. Over-exploitation of that labor, however, as is the case with over-exploiting any resource, can lower its value. As a result of poor treatment of workers by some companies, Korean companies have become the first targets of labor agitation in these countries. A key for successful cheap labor-seeking FDI is therefore to balance expectations of hard work with fair worker treatment, thus gaining the value of low-wage labor without risking its loss via worker unrest. It would also benefit Korean firms to work together toward this end, for the exploitative behavior of some Korean firms can tarnish the reputation of all, and deny them favorable reputation benefits and access to human and other resources available in a host country.

Another issue related to low wage-seeking FDI is the fact that wages rise, and today’s cheap-labor country is likely to be a higher labor cost country tomorrow. This presents a difficult dilemma for investing firms, particularly when setting up foreign production is costly: Should they continue to relocate to cheaper-wage countries as labor costs rise where they have previously invested, or is there a better approach? One option, best suited for non-complex production operations, is contract manufacturing instead of FDI; Nike, for example, produces most of its athletic shoes through contract manufacturing in Asia, moving relatively easily from location to location in search of low labor costs. A contrasting option, one better suited to firms whose products and manufacturing processes are more complex, is to sink deeper roots in a country as local wages rise, investing in more capital-intensive technologies rather than relocating. This is what Matsushita Electric has done in Malaysia, for example, as labor costs in that country have climbed with economic growth (see Craig 1995). This second strategy is welcomed by many host countries, which are actively trying to attract export-oriented FDI by offering not just low wages but also literacy, discipline, physical infrastructure, and a stock of local technical and managerial talent, and are also continually upgrading these to stay competitive with other investment-seeking countries (Lall 1995). The point raised above concerning worker exploitation is relevant here; if poor labor relations and unfavorable reputation develop as a result of poor worker treatment, these can hinder the building and effective operation of more complex, higher value-added activities carried out in the same country in the future.

A different set of implementation challenges is connected with Korean firms’ market- and technology-oriented FDI, especially in North America and Europe. A critical

difference is the type of human resources required for success. In contrast to cheap labor-seeking investments, in which the sought human resources are an abundant commodity, market- and technology-oriented FDI requires more skilled and scarce human resources such as experienced marketers, top scientists and engineers, and capable general managers. In order for these kinds of investments to produce desired results, Korean companies must overcome weaknesses they have in recruiting and managing skilled foreign human resources.

The employment systems that Korean companies have traditionally used at home rely on internal labor markets and seniority-based promotion and reward. In order to recruit and keep skilled foreign specialists and managers, however, Korean firms are finding that they must develop employment systems that are radically different. They must actively recruit the best people available from outside the company, regardless of their nationality. In the case of critical experts, such as non-Koreans with proven abilities as general managers of international operations, this means offering competitive and attractive compensation packages. People must also be rewarded and promoted more on the basis of performance, and in an organizational climate in which innovation and achievement are recognized regardless of age or title. These represent a sharp break from the traditional Korean organizational culture with its emphasis on harmony and hierarchy. Not to make such adjustments, however, is to risk losing the very benefits sought by much Korean FDI. Concerning LG's acquisition of Zenith, Stephen Marvin, former head of research at Ssangyong Investment and Securities Ltd., said: "The Zenith deal has great potential for a clash because of Korea's autocratic style. If LG tries to run the company their way, there could be an exodus of junior managers from Zenith" (Glain 1995).

The so-called "glass ceiling", real or perceived limitations faced by non-home country nationals in promotion opportunities and decision-making authority, is also an issue that Korean companies will need to face. Japanese firms operating abroad have experienced difficulties in attracting and keeping top foreign managers because of this problem, and this could obstruct Korean companies as well, due to the Japan-like importance of language (the ability to speak Korean) and within-company connections in gaining and exercising influence in Korean companies. In order to avoid this problem, Korean firms are trying to eliminate the distinction between home- and foreign-country employees by developing equal compensation and promotion plans for both locals and expatriates, and by rotating foreign managers between local operations and headquarters in Seoul.

HRM adjustments are needed not only for the foreign employees of Korean subsidiaries, but also for Koreans managing abroad. Strong international management skills are not found in abundance in Korean firms, even in the large and relatively experienced *chaebol*, and these can only be developed if more Korean managers are posted abroad for longer periods of time, and if incentive and training systems are put in place which evaluate and reward managers based not on seniority but on their effectiveness as international managers, and which promote the development of international

management assets such as knowledge of local legal systems and business customs, understanding of the thinking and behavior of foreign employees and customers, a global perspective, a global information network, and solid communication ability. In the words of Samsung Group Chairman Lee Kun-hee, Korean managers must increasingly “be armed with innovation, information, intelligence, and international sense to become managers most suitable for the coming global village” (*Korean Herald* 1996 April 7). Achieving this will be a continuing challenge for Korean companies as they continue to expand abroad, and a key to the successful operation of their overseas investments.

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