

FOREIGN DIRECT INVESTMENT FROM DEVELOPING COUNTRIES: THE CASE OF KOREAN FIRMS

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I. INTRODUCTION

THE multinational corporations (MNCs) are an industrial system nurtured by the international conditions especially in the United States and Western European countries after the Second World War. The value of all product originating from the MNCs surpassed the total export of all market economies in the early 1970s while the MNCs exports accounted for as much as a quarter of the total for the market economies. Thus the world trade mechanism was expected to be replaced by MNC expansion and the international trade theory more frequently deals with the movement of commodities and production factors through the MNC framework.

Although the MNCs originated in the strong, advanced market economies, firms from a number of developing countries have been increasing their overseas direct investment, signaling the initial stage of multinational operations in the wake of expanded exports and enhanced industrialization. Third World multinationalism, a contradiction in terms until recently, is now a serious force in the development process. Especially firms from Asian NICs, the Republic of Korea, Hong Kong, Singapore, and Taiwan, are increasingly making foreign direct investment (FDI)—a phenomenon Vern Torspra [28] calls "the Asian challenge." Present theories on FDI are based on analyses of advanced countries' FDI behavior, especially the United States. Firms from developed countries tend to use high marketing and technology input to produce new, high-quality products that are not very sensitive to price competition. These firms also maintain close relationships with their subsidiary. The developing countries' FDI, however, differs from advanced country FDI because the special conditions of the home market do not seem to play an important role in generating advantages that the advanced country MNCs exploit. It is, therefore, doubtful that these theories can explain FDI behavior of LDC firms, whose environments are not similar to MNCs' based in advanced countries.

Existing theories of FDI start from an assumption that a multinational firm

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operating in a foreign country is faced with certain additional costs that the local competitor is not. These costs arise from cultural, legal, institutional, and linguistic differences; lack of knowledge of local market conditions; increased expense for communications; and the possibility of misunderstanding because of operating from a distance. The MNCs must also bear additional costs caused by discriminatory attitude toward them born out of the host country's nationalist fervor. The MNCs therefore must see some factors of comparative advantage to counter-balance the cost of foreignness which is the sum of the costs mentioned above. In other words, for investment to be profitable, the firm entering from abroad must have some advantage that its local competitors do not have.

This is the first principle of the FDI theory. To be exploitable, these advantages must be, at least in part, specific to the firm and readily transferable within the firm and across distance. The existence of such firm-specific advantages represents a necessary, but not a sufficient, condition for foreign direct investment. The fact that a foreign firm possesses some monopolistic or oligopolistic advantage over indigenous competitors gives the MNC its unique character but does not explain why the production process needs to be located abroad. The foreign firm could exploit its advantage by producing at home and exporting or by licensing a foreign producer. To explain the choice of foreign direct investment over alternatives of exporting and licensing, it is necessary to take into account internalization and location-specific factors such as relative costs of production, trade barriers, market characteristics and the like (Figure 1).

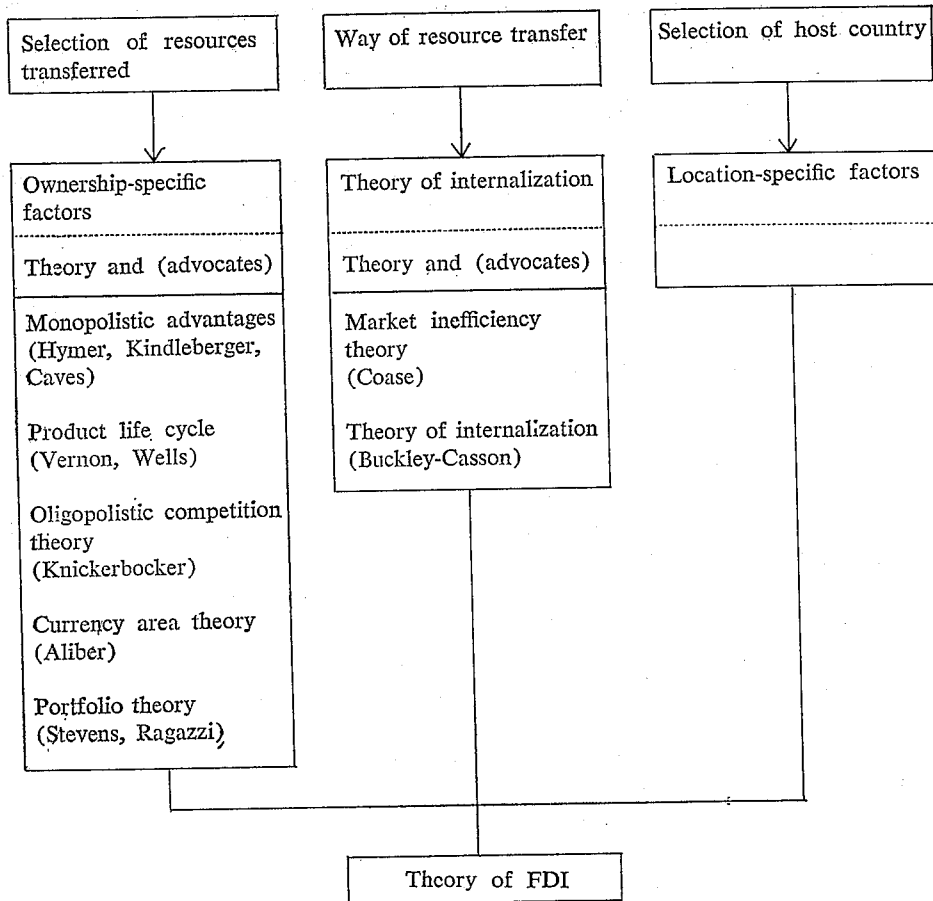
FDI theories, as seen from the above framework,¹ well explain the advanced-country type, but do not explain the developing-country type.² The "pecking order approach" has been suggested to complement the insufficiency of existing theory.³ The pecking order approach views the internationalization of developing country firms simply as a technology-gap model or as a stage in the product life cycle. Countries can be ranked according to when they first produced a particular product. The countries currently manufacturing the product export down the "pecking order" to those countries that do not yet have plants. Not only might the source of exports in world trade move down that order as a product matures, but the source of foreign investment might follow a similar pattern. This pecking

¹ For the detail discussion of the theory of "ownership-specific factor," see [14] [24] [10] [15] [31] [4]; for the theory of "internalization," [5] [25]; and for the theory of "location-specific factors," [5].

² K. Kojima divides foreign direct investment into an American and a Japanese model. American direct investment abroad made to maintain monopolistic position or avoid trade barriers is anti-trade oriented so that it weakens comparative advantage and worsens the balance of payments, bringing about a distortion in industrial structure. In contrast to the American model, the Japanese model is trade-oriented which is complementary to Japan's comparative advantage. Its use of the host country's comparative advantage will promote an upgrading of industrial structure on both sides and thus accelerate trade between the two. Accordingly, he argues that foreign direct investment, being based on the theory of international division of labor, should be undertaken in industries becoming comparatively disadvantageous in the investing country but have the potential of becoming comparatively advantageous in the host country. See Kojima [16].

³ For a comprehensive discussion of this theory, see Hufbauer [11].

Fig. 1. Framework of Theory of FDI



order approach is based on the availability of technology plus the difference in production costs.

Along with the pecking order approach, Wells [32] contends that FDI from developing countries tends to flow from newly industrializing countries (NICs) to smaller and poorer LDCs. In particular he contends that firms in NICs have acquired technology from industrial countries and adapted it to the special needs of their home markets. When products are later demanded in sufficient quantities in poorer and smaller developing countries, the production site is shifted to those countries from the NICs. Wells points out several characteristics in the internationalization of LDC corporations. First, potential buyers do not have information about the manufacturing technologies of LDC corporations because they tend to be less well known than advanced country firms. Secondly, LDC firms' technologies are often not patented. Thirdly, the LDC firms' managers and technicians are not as qualified.

The analysis of MNC in Latin America and Asia justifies Wells' contention. White [35], in his study of Latin American firms, found such a pattern of FDI flow. Firms from larger and relatively wealthier countries like Argentina, Brazil, and Mexico are major investors in smaller and poorer countries such as Ecuador, Paraguay, and Uruguay. Agrawal [2] also found that most Indian FDI is in Asia and Africa.

Dunning [8] has attempted to explain the emergence of LDC multinationals by reference to his eclectic theory of international production. He postulates that the propensity of a country's firms for engaging in FDI is determined by ownership, internalization, and location advantages that are available to them as compared to firms of other countries. Dunning also contends that a country's investment position as measured by its "net foreign investment" (FDI inflow minus FDI outflow) is related to its level of economic development. He shows that net outward FDI from Brazil and Korea has increased over time, and attributes this trend to a rising ownership advantage rather than a falling locational advantage of the countries.

Locational factors, however, may also have an effect on outward FDI from LDCs. LDC investors sometimes have their plants in poorer LDCs to exploit lower wages and lower managerial costs, and to avoid quota restrictions imposed by some advanced countries on imports from selected LDCs [9]. Chen [6] found that most Hong Kong firms were motivated by these factors. Jo Sung-hwan [12] also argued that Korean FDI should be viewed as a means to increase the competitiveness of export industries which are under increasing competition from other LDCs and are experiencing "changing factor endowment." FDI by manufacturing firms from Hong Kong and Taiwan was characterized by the need to increase or at least maintain their present level of exports to industrial countries. Ting and Schieve [29] have also included resource-based FDI in their study of foreign direct investment by LDC firms. They have noted the motivation to secure vital resources in the midst of surging resource nationalism.

The purpose of this study is to empirically analyze the FDI behavior of Korean firms with special reference to their competitive advantages, method of evaluating FDI, and criteria for selecting the host country. It is to be noted, however, that this study does not cover all sectors of FDI by Korean firms. Rather it confines itself only to mining, lumber, and manufacturing sectors.⁴

Statistical evidence on which this study is based is taken from data released by the Bank of Korea, the central bank. The foreign direct investment as defined in the data covers not only equity investment but also loan and real estate investment by Korean residents. It should be noted here that this definition may appear a bit different from the commonly accepted definition, i.e., FDI is investment in enterprises located in one country but effectively controlled by residents of another country.

Apart from Bank of Korea data, we use extensively the results of a survey on

⁴ Agricultural, fishery, and service sectors such as trading, warehousing, transportation, and construction are included. This is because the scope of the research is confined basically to the manufacturing sector.

TABLE I
HISTORICAL CHANGES IN FDI REGULATIONS

Stage I: Incipient stage (1968–April 1975)
No FDI by Korean firms until 1968.
New regulations on outward FDI appear in Foreign Exchange Control Law.
Stage II: Stage of streamlining FDI system (April 1975–October 1978)
Stipulation of “Guidelines on FDI permit and follow-up procedures.”
(a) Responsibilities on FDI permit and follow-up procedures are assigned to Bank of Korea.
(b) FDI firms should file report on overseas activities.
(c) Governmental representatives, such as consulates, in the respective foreign countries assigned to supervise the FDI operations.
Stage III: Stage of strengthening the supervision of FDI (October 1978–October 1980)
Strengthening supervision on FDI permit and follow-up procedures.
(a) Qualification for FDI has been tightened.
(b) Prior approval system has been adopted on the operation budget of FDI business.
(c) Classification of FDI permit is divided into three categories, i.e., prohibition, suppression, and encouragement.
Stage IV: Stage of vitalization of FDI (October 1980–)
Need for FDI vitalization have been increased.
(a) Protectionist measure of importing countries.
(b) Expansion of resource nationalism.
Strategies of FDI vitalization.
(a) Ease of FDI qualification.
(b) No limit on host countries.
(c) Abolish system of prior approval on the operational budget of FDI business. Instead of prior approval, a FDI screening committee has been installed.
(d) The category of FDI suppression business lines are deleted.
(e) Regulations on withdrawal of principal within ten years are deleted.

FDI behavior of Korean firms which we carried out in 1984. Of the seventy-three firms to which we sent questionnaires fifty firms answered: thirty-one manufacturing, nine mining, and ten lumber firms. To supplement information from the questionnaire, some well-known big investors were also interviewed.

II. MOTIVATIONS AND COMPETITIVE ADVANTAGE OF KOREAN FIRMS

A. *Overview of Overseas Korean Direct Investment*

According to data released by the Bank of Korea, Korean firms as of December 1984 made direct overseas investment in 432 projects for a total of U.S.\$445 million. Foreign investment by Korean firms began in 1968, but FDI at early stages was small in scale (the annual average investment at this stage was only U.S.\$6 million during eight years from 1968 to 1975) and limited mainly to forestry development in Indonesia to provide lumber for the Korean plywood

industry and construction activities in Indonesia and Guam. There were also several investments in high ocean fishing bases and trade agencies. During the early 1970s, additional FDI was made in forestry development, fishing, construction, and trade agencies. The first overseas investment in manufacturing was during this incipient period for food seasonings in Indonesia.

In April 1975 the Korean government stipulated "guidelines on FDI permit and following procedures," which set up a governmental system of streamlining FDI (Table I). With these new guidelines the government took positive steps to encourage Korean firms to invest abroad. Those steps included significant tax incentives, low cost finance, double taxation agreements, and other supportive measures. The result was that since 1976 foreign direct investment by Korean firms grew at a faster pace, except for the two years of 1979 and 1980 when the second oil price increase severely affected Korean firms and the government devalued Korean currency by 19.8 per cent. As Korea's exports continued to increase, many firms began to set up trade agencies in various countries. The number of trading agents reached 218 and the amount of their investment totalled U.S.\$56 million by the end of 1984. In terms of the number of investments, these trade agencies accounted for 52 per cent of total FDIs by Korean firms. In terms of cumulative value, they accounted for only 12 per cent.

It was not until the late 1970s that mining investment began to emerge as a major FDI area. Investments also began in transportation and warehousing activities during this period. In addition, FDI continued in the areas of forestry, construction, trade, and manufacturing.

Table II shows the distribution of Korea's FDI by region and industry. Overseas resource development is a major field of concentration. FDI in fisheries, forestry, and mining fell into this category, and together accounted for 53 per cent of cumulative FDI value by Korean firms at the end of 1984. Investment in forestry development to gain access to timber supplies for the Korean plywood industry was exclusively confined to the Southeast Asian countries. Investments in mining are concentrated in North America and Oceania. The other major Korean FDI areas were in the fields of construction and trade. To support construction activities, mainly in the Middle East and more recently in Southeast Asia, many Korean construction firms set up subsidiaries in those countries. In addition, as noted earlier, many trade agencies were established in trading partner countries, especially industrial countries, to promote sales.

Manufacturing investments by Korean firms have been relatively small, only 16 per cent of total FDI as of December 1984. Investments in manufacturing were dispersed over a number of sectors. But the major manufacturing investments so far have been in cement, textiles, metal products, and lumber and plywood industries. Several Korean firms invested in manufacturing in developed regions such as North America and Europe. About 50 per cent of all manufacturing investments was in Southeast Asia, 15 per cent in North America, 12 per cent in the Middle East, and 8 per cent in Africa.

FOREIGN DIRECT INVESTMENT

TABLE II
KOREAN OVERSEAS INVESTMENT BY REGION AND INDUSTRY, DECEMBER 1984
(U.S.\$1,000)

Industry	Region								Total	Share (%)
	Asia	Middle East	North America	Latin America	Europe	Africa	Oceania			
Mining	Cases 3 Amount 2,541		4 63,648	1 48,894			3 53,605	11 168,688	37.9	
Forestry	Cases 8 Amount 33,806		1 1,050				2 23,018	11 57,874	13.0	
Fishery	Cases 1 Amount 90		4 271	14 3,635	1 40	5 5,211	2 73	27 9,320	2.1	
Manufacturing	Cases 30 Amount 36,838	7 7,583	9 15,820	4 1,385	1 275	5 7,896	4 2,486	60 72,283	16.3	
Construction	Cases 13 Amount 3,297	21 21,669	7 8,210			5 1,690		46 34,866	7.8	
Transportation	Cases 7 Amount 932	1 147	9 1,235	1 0.2	2 218			20 2,532	0.6	
Trade	Cases 58 Amount 6,491	2 458	107 33,293	4 2,050	38 9,551	5 3,529	4 369	218 55,741	12.6	
Real estate	Cases 4 Amount 17,215	—	2 2,066	1 155	1 210		1 461	9 20,107	4.5	
Others	Cases 3 Amount 385	7 2,094	13 19,065	4 51		1 400	2 1,290	30 23,285	5.2	
Total	Cases 127 Amount 101,595	38 31,951	156 144,658	29 56,170	43 10,294	21 18,726	18 81,302	432 444,696	100.0	
Share (%)	22.8	7.2	32.5	12.6	2.3	4.2	18.4	100.0		

Sources: Bank of Korea, *Foreign Investment Status* (Seoul, 1984) and Ministry of Finance's unreported data.

TABLE III
MOTIVES FOR FDI

	Motive	Point
Market seekers	Growth potential of local market	2.38
	Exporting to third country market	2.21
	Defence of local market from third country's firm	1.69
	Quota and other import restrictions of local country	1.69
Product-efficiency seekers	Use of cheap and abundant labour resources	2.10
Raw-material seekers	To secure needed natural resources	1.79

Note: Maximum of 3 points connotes the most important motive. Points were provided by the managers on a scale of 1 (least important) to 3 (extremely important).

B. *Motivation for Investment*

Forces leading an organization to launch a project outside the home country are those arising within the organization and those arising exogeneous to it, out of the external environment [3, p. 50]. In the first category we may include the strong interests of one or several high ranking executives in the organization. Included in the second category are outside proposals such as those from government and distributors of the company's products, fear of losing a market, the "band wagon" effect, and strong competition from abroad in the home market. According to one study [36], more than 50 per cent of Korean FDI were suggested by top managers, then by managers of departments in charge and, in some cases, on proposal of the Korean government. But in any specific case it is generally very difficult, if not impossible, to pin down one reason for a decision to invest abroad and to find out precisely who was the initiator of a project. This study did not analyze the initiating forces arising within the organization.

Our questionnaire survey inquired, among other things, into management's opinions on the motives for making direct investment abroad. The results of the survey are shown in Table III, where the higher the number in the rank column, the more important the factor is considered by management. In general, Korean manufacturing firms largely invested abroad to serve the growth potentials of the local market, to export to third country markets and to exploit cheap and abundant labor resources in the host countries. This means that Korean manufacturing firms are market seekers and set up plants in labor-abundant and underdeveloped countries, which conforms to the "pecking order approach."

Many developing countries have pursued policies of attracting direct investment from abroad in order to promote economic development through industrialization. For example, heavy investment by Korean firms—42 per cent of the total in ASEAN countries—is mainly due to the policies pursued by these countries. Although there are some differences between the countries, their policies in the early 1980s can be briefly stated as follows.

(a) Tax exemption on incomes of foreign subsidiaries for two to ten years. Some countries also offer tax reduction for market development expenses and

education and training expenditures for local employees.

(b) Protection such as tariff exemption for machinery and raw materials imported by firms approved.

(c) Policies to promote export, use local materials, local employment, and technology transfer by investing companies.

Also Korean firms set up plants in developing countries, especially in the Asian area, to export to third country markets as well as to serve a growing local market. Labor-intensive products such as textiles, clothing, and footwear have been major Korean exports. But industrial countries imposed trade restrictions such as import quotas and high tariffs on these goods. By locating their plants in the countries where there are no such restrictions, the Korean firms could avoid the trade barriers. This is in accordance with Chen's finding that Hong Kong firms promoted FDI in order to avoid import quota restrictions imposed by its major importing countries [6].

A few Korean firms invested in industrial countries. For example, Gold Star and Samsung Electronics Company, two largest consumer electronic producers in Korea, established their manufacturing facilities, largely for assembly operation, in the United States to avoid American quota restrictions and antidumping suits. Samsung Electronic Company also made foreign investment in Portugal, a single case of manufacturing investment in European area. Desire to gain access to a large market was the most important motive for investment in Western Europe.

In recent years, Korean firms have set up wholly-owned R&D firms in the United States as an overseas base for development and import of appropriate technical knowledge, new processing, and new product design to serve the Korean market with sophisticated technology. Overseas direct investment for R&D is different from investment in overseas manufacturing. Whereas overseas manufacturing investment involves export and overseas assembly of low-cost technological components to serve overseas markets, overseas R&D investment involves overseas assembly and import of sophisticated technical components to serve the home market [12, p. 74].

Like Japan and other resource-scarce developing countries, Korea imports most its natural resources and technical know-how. As already mentioned, investment in overseas resource development, especially forestry development, by Korean firms started relatively early. The most important motive for the investment was to secure access to needed natural resources that would serve the home market. Wells argues that raw material ventures account for a large portion of the overseas investments of state-owned enterprises in the developing countries. But Korea was not in this category. Overseas natural development by Korean firms was largely undertaken by general trading companies and resource development firms. Only two out of nine cases in mining and four out of ten cases in timbering were undertaken by real users of raw materials.

C. Competitive Advantages of Korean Firms

The firms that venture abroad from a developing country must have assets or skills that are competitive with both the firms indigenous to the country in which

they are investing and the multinationals from the industrialized nations [33, p. 14]. The firms from developed countries produce new, high-quality products with high-marketing and high-technology inputs which are not very sensitive to price competition. Over time, the products and processes typically find growing market abroad, as increasing incomes and labor costs make foreign markets similar to the home market served by the firms. Thus the innovation firms have an opportunity to profit from their advantages in foreign markets. A similar story can be applied to the firms from developing countries. The markets of the developing countries, however, remain quite different from those of the industrialized nations. The differences lead to identifiable types of innovations by the firms in the developing countries.

As expected, the results of our survey are largely in line with a priori interpretation of the competitive advantages which Korean firms might possess. Six factors,⁵ including factors regarded in recent foreign investment theories as specific to firms from developed countries, were ranked by managers in the same manner as before and found to be insignificant because the average rank of each factor was less than 1.6.

Most of the overseas manufacturing investment by Korean firms produced labor-intensive and standardized products, such as textiles, footwear, plywood, and electric instruments. But Korean firms originally secured manufacturing technologies of these products from an industrialized country through licensing, outright purchase, or even joint venture arrangement. For example, an investing firm, which established its plants in Thailand to assemble watt-hour meters, was itself a joint venture between a Japanese partner and a Korean manufacturer. The Korean partner company bought the technology from Japan for the first three years after which no technical assistance from Japan was required. Another firm, which produces solder used in the assembly of electronic and electrical goods, was a joint venture between a Korean firm and a Japanese solder producer. For the first three years, the Japanese partner provided technical assistance. As suggested by theories regarding multinationals from developing countries, it is reasonable to conclude that an ownership-specific factor of Korean firms, which have been successful in applying their imported technologies in small scale in their home markets, lies in their possession of labor-intensive and standardized technology. A semi-industrial technology producer, such as Korea, plays an intermediary role, exporting a technology that is originally imported from an industrially more advanced country and then adapted through experience to suit its own circumstances in the first instance, and later other countries industrially less advanced than itself.

Another competitive advantage of Korean firms is abundant human resources and high productivity. A survey [17, p. 50] has concluded that Korean executives often observe that their overseas expatriate staff are highly committed to their work and are prepared to do everything within their capabilities to keep the name of the company and of Korea high in the international business community. In

⁵ Six factors are R&D capacity, marketing skills, product differentiation, managerial systems, band wagon effect, and availability of licensing contracts.

TABLE IV
CRITERIA FOR SELECTING A HOST COUNTRY

Subject	Response Ratio (%)
Credit risk of local partners	76
Exchange fluctuation and inflation	60
War risk	52
Nationalization and confiscation	60
Remittance control	68

addition, overseas expatriate staff seems to be content with relatively low remuneration. Compared to the salary and benefits in Korea, of course, expatriates receive better treatment. However, the salaries they receive are lower than what European and American overseas employees receive.

Adoption of a market segmentation strategy was also a competitive advantage of Korean firms. A firm in our sample which manufactures ink, assembles pens, color markers, and related stationery in Thailand, produced these products in intermediate quality. Local producing is of low quality whereas firms from advanced countries, especially Japan, produce high quality goods. The firm from Korea is competitive in the middle range of these products. Another firm established its plant in Saudi Arabia to produce steel pipe falls into this category.

III. THE BEHAVIOR OF FDI BY KOREAN FIRMS

A. *Criteria for Selecting a Host Country*

Aharoni [3, p. 93] has found that all respondents in his research asserted as a matter of course that the first thing they considered was political and economic stability of the host country. Nehrt [20, p. 51] also pointed out that in developing countries, particularly those which obtained their independence recently, the political climate was often the key factor in the foreign investor's decision. These studies show that the decision to invest abroad is contingent on the economic, political, administrative, and social climate in the host country.

Although most Korean firms, according to our survey, have tended to invest in the developing countries similar to or less developed than Korea and have taken into account such location-specific factors as labor cost and availability of raw materials it may be of interest to understand how the firms evaluated the risks while selecting host countries.

Yoo [36, pp. 60-1] confirmed that the credit risk of local partners was regarded as the most important environmental condition by the Korean firms (Table IV).

As will be mentioned in detail in a later section, local partners bring principal benefits to the joint venture: managerial, technological or productive, financial, and what might broadly be called political. But compatible local partners may be the key to the success of joint ventures in another aspect. Compatibility may help resolve difficulties arising out of conflicts of interest over various aspects of management and profit sharing.

According to a study on Korean investment in Thailand [13, p. 40], all Korean executives suggested that a compatible local partner is a key to success of their joint venture in Thailand. In all projects where production ceased or heavy losses were incurred, conflicts with local partners were suggested as one of the difficulties. For instance, in one mining project where the joint venture was dissolved, the local partner was unwilling to continue with the second phase which was a smelting operation and went into smelting business with other foreign investors. Without a smelting operation, mining alone could not be profitable and the mining joint venture came to an end. In another manufacturing joint venture, partnership was terminated as a result of profit sharing conflicts between local and Korean partners.

Other major environmental factors were the possibility of repatriation control and the risks involved in exchange rate fluctuation and inflation. Exchange controls, imposed in a number of countries around the world and particularly in the less developed countries, were a formidable obstacle to multinationalization.

In general, the imposition of exchange controls can have two kinds of effects: it can restrict the freedom of business decision making in certain types of transactions and increase the cost of conducting business.⁶ Exchange control may often lead to devaluation that places the currency in question in a more realistic relationship to those of the rest of world. Devaluations have serious implications for financial management abroad. Devaluation will immediately increase the cost of production by increasing the local currency cost of imported items. It will also increase the cost of foreign indebtedness in local currency, whether borrowed from financial institutions or through intra-company loan.

All countries experience nationalism to some degree. However, the most intense expression of economic nationalism today is found in the developing countries. Nationalists in these countries tend to suppose that the purpose of FDI is to perpetuate economic and political dependence on the industrial countries or other investing countries. Governments in some developing countries consciously exploit nationalism to build loyalty to the state: political parties try to ride to power on anti-foreign sentiments, pitting "us" against "them." Frustrated by widening gaps between economic expectations and economic performance, governments are eager to use multinational firms as scapegoats for their own policy failures [24, p. 515]. For these reasons, the firms from Korea might consider the possibility of nationalization or confiscation in the host country as a major environmental factor.

B. *Fund Sources for Equity Investments and Loans*

In general, multinational firms have a wide range of alternative sources for financing foreign operations. These sources range from the internal sources of the parent company, domestic sources of the partner company, and local sources of foreign subsidiaries to many regional and international sources. But in any period, the financing decisions are influenced by a complex variety of external regulatory, environmental and cultural factors, as well as the company's own

⁶ For more detail analysis, see Prasad and Shetty [22].

TABLE V
SOURCES FOR INVESTMENT FUNDING, 1983

Type & Industry	Source						Repatria- tion	Balance
	In Cash		In Kind	Local Fund	Total	Total		
	Korea EXIM Bank	Internal						
Equity investment								
Manufacturing	18.1	67.3	3.3	11.3	100	—	100	
Mining	59.6	38.1	—	2.3	100	—	100	
Timbering	27.0	38.2	6.5	28.4	100	—	100	
Others	2.3	76.5	4.8	16.3	100	—	100	
Sub total	17.6	64.4	3.9	14.1	100	—	100	
Loan investment								
Manufacturing	—	6.1	—	93.9	100	68.5	31.5	
Mining	75.2	21.1	—	3.8	100	2.2	97.8	
Timbering	46.0	16.0	—	38.0	100	20.5	79.5	
Others	36.5	34.5	7.8	21.1	100	67.5	32.5	
Sub total	59.3	20.8	1.0	18.8	100	18.8	81.2	
Total	36.2	44.9	2.6	16.2	100	8.4	91.6	

Source: Bank of Korea: *Foreign Investment Status* (Seoul, 1984).

business practices. Included in these factors are government regulations, availability of funds, the assets to be financed, sensitivity to host country concerns, and the effective cost of funds to a borrower.

Table V shows the sources of funding for investment by the Korean firms as of December 1983. From this table it can be seen that 82 per cent of the total equity was paid in cash, 14 per cent was raised through local financing, largely guaranteed by Korean banks, and 4 per cent was contributed in kind (equipment and materials from Korea). In particular, 64 per cent of equity investment in cash was made from internal funds of the parent company and 18 per cent was financed by credit commitment of the Export-Import Bank of Korea (a government-sponsored institution), popularly known as the Korea EXIM Bank, which started its operations in 1978. Loan investments were also in many cases undertaken in cash; more than 80 per cent of total loan credit was in cash and only 1.0 per cent in kind.

However the sources of funds in the mining sector indicated a characteristic phenomenon. Sixty per cent of equity investment and 75 per cent of loan investment in that sector was paid in cash supplied by the Korea EXIM Bank. Forty-six per cent of loan investment in the lumber sector was also provided by this bank. In the manufacturing sector, however, most of the equity investment was financed by internal funds from the parent company and a large amount of loan investment by local credits.

The Korea EXIM Bank took a series of measures to step up support for overseas investment projects by small- and medium-sized companies and to

TABLE VI
OWNERSHIP PATTERN OF OVERSEAS KOREAN FIRMS, 1983

Industry	Ownership				Total
	100%	99.9-50%	49.9-25%	24.9-1%	
Manufacturing	18.0	32.0	42.0	8.0	100
Mining	80.0	10.0	10.0	—	100
Timbering	27.3	63.6	9.1	—	100
Others	69.7	14.5	13.6	2.1	100
Total	62.3	18.0	17.0	2.7	100

Source: Bank of Korea, *Foreign Investment Status* (Seoul, 1984).

encourage natural resource development overseas in order to secure strategic raw materials. There were increased credit commitments and enlarged insurance activities for overseas direct investment by Korean firms. For example, the Korea EXIM Bank furnished U.S.\$187 million of funds to foreign investors until the end of 1983, of which 12.4 per cent was offered to the firms in the manufacturing sector and the remaining to resources development projects. In addition, commitments for overseas investment insurance in 1983 was more than double the previous year to a record 161.8 million won (U.S.\$1 = 827.4 won, as of December 1984), reflecting the trend of increasing investment for resource development.

According to the Fifth Economic and Social Development Plan (1982-86), the Korean government is scheduled to invest 515 billion won in resource-oriented FDI during that period. Eighty-one per cent of the planned investment is likely to be paid by public institutions such as the Korean EXIM Bank, and only the remaining 19 per cent is to be met by the internal sources of the parent company. This policy will reduce the difficulties in financing overseas resource development investment, which the firms in our survey identified as the most difficult problem.

C. Ownership and Control of the Subsidiaries

The ownership of foreign affiliates and the control exercised over them by the parent company are influenced by a number of considerations internal to the firm. These are also directly affected by the policies of host governments. Both joint venture and wholly-owned subsidiaries present special advantages and disadvantages. Local partners can bring to the MNCs benefits such as management, capital, and access to markets. They are also needed to provide knowledge of the local economic and political environments. The absence of partners, however, offers freedom from interference by outsiders in making critical decisions.

The ownership pattern of overseas direct investment by Korean firms according to the Bank of Korea is presented in Table VI. As the table shows, about 62 per cent of the overseas direct investment, as of December 1983, went into wholly-owned subsidiaries, 18 per cent for joint ventures with Korean majority ownership (more than 50 per cent) and 20 per cent for joint ventures with

minority ownership. It is noteworthy, in particular, that wholly-owned subsidiaries were concentrated in such industries as trading and other on-site services and mining; joint ventures with majority ownership concentrated in timbering and joint ventures with minority ownership, in manufacturing.

The Bank of Korea figures, however, need correction because the bank in its calculations ignored the chains of ownership of affiliates. Affiliates for resource development were in fact joint ventures with minority ownership by the holding company located in the host country, which was wholly owned by the parent company. We have discovered that, out of ten cases of investment in mining sector as of December 1983, eight cases were by joint ventures with minority ownership (less than 50 per cent), one case of joint venture with Korean majority ownership, and one was wholly-owned subsidiary.

The multinational enterprises based in Korea prefer joint ventures to wholly-owned subsidiaries for obvious reasons. In manufacturing the first reason was limitations on foreign ownership by the host countries. Fifty-two per cent of the firms we surveyed indicated this as the major reason. Constraint on ownership is the most widely used means of controlling multinational corporations. Most LDCs wage a constant struggle to wrest as much equity and control as possible from foreign firms retaining as many as benefits accruing from the investment. The ability of a government to force its way in this respect depends upon its bargaining strength.

The advantage that local partners provide is yet another factor in favor of joint venture. In general, the reasons why some firms insist upon unambiguous control fall into two broad categories [27, pp. 51-2]. The first set of reasons relate to the nature of the business and the strength of the firm. Leadership in a technology-based industry where frequent transfers of information to affiliates are needed to ensure continued competitiveness is an example. Second, there are business where the only resources a partner could bring to a joint venture are those that the parent system already possess in abundance. Marketing-intensive businesses and very large, long established affiliates fall into this category.

As mentioned earlier, Korean firms that offered capital as well as managerial and technical know-how in the production of undifferentiated goods using labor-intensive technology might not have much to offer in the bargaining for ownership share and managerial control. Thus they needed local partners to provide the required technologies, know-how, and financing. Diversification of risks is another reason for joint ventures with local partners.

Korean firms in overseas resource development were in a similar position to that in manufacturing. The joint venture with local partners was necessitated by constraints on foreign ownership placed by local government and the advantages of a local partner. Fifty-three per cent of the responding firms in this sector said that limitation on foreign owners was the principal factor behind choosing the joint venture road.

Our survey identified one case of a Korean joint venture with a third country firm in mining only. The reason behind this was the facility that the third country firm offered in financing the project and diversifying the risks. In addition three

TABLE VII
PLANNING AND CONTROL OF SUBSIDIARIES

Nature of Decision	Place of Decision Making		
	Parent Company	Subsidiary	Coordination between Parent and Subsidiary
Overall long-range planning	50	15.4	34.6
Operational planning			
(a) Financial planning	25.6	37.2	37.2
(b) Investment planning	28.6	9.5	61.9
(c) Personnel planning	23.0	38.5	38.5
(d) Organization planning	19.2	53.8	27.0
(e) Production planning	16.0	64.8	19.2
(f) Procurement planning	7.4	66.7	26.9
(g) Marketing planning	15.4	65.4	19.2

cases in that sector were undertaken through joint venture with other Korean firms. The reasons were also to finance the projects and to diversify risks. One explanation for this result is that overseas resource development projects, compared to other sectors of FDI by Korean firms, are fraught with a high project risk and need a large volume of capital investment.

D. *Operation Profiles of the Subsidiaries*

1. *Planning and controls*

Planning in the multinational context is concerned with determining major goals for the company as a whole as well as for its affiliates, and adopting essential courses of action in terms of policies, programs, and action plans throughout the enterprise to achieve the predetermined goals. Planning can be divided into strategic or long-range, and operational or short-range in terms of the kinds of problems confronted. The former is related to the decisions involving issues that are basic to multinational firm's long-range well-being and vitality. The latter contends with operational problems. Strategic and operational plans are interdependent, and both are important for multinational companies. In contrast, control activities are related to the process which measures how well the plans are being carried out, and which signals the corrective action to be taken. This study, however, does not cover all aspects of planning and control system due to the limited available data.

According to our survey, 50 per cent of the respondents in manufacturing sector projected their overall long-range planning of the subsidiaries through the parent company, 35 per cent through coordination between the parent company and the subsidiaries, and only 15 per cent through the local subsidiary. This shows that strategic planning was integrated, while the operational planning was mainly projected either through the coordination between the parent company and the subsidiaries, or through the local subsidiary. For example, investment

TABLE VIII
PROCUREMENT (Sourcing) OF MATERIALS AND COMPONENTS

Source of Procurement	Ranking in Importance			
	1 (most)	2	3	4 (least)
Parent company	11	7	1	—
Other Korean firms	—	3	6	3
Local firms	12	7	5	3
Third country firms	8	7	4	3

planning was effected dominantly by coordination, financial and personnel planning by the local subsidiary or through advance coordination, and organization, production, procurement, and marketing planning with half of the local subsidiary (Table VII).⁷

The Korean multinationals receive reports from their affiliates or subsidiaries abroad on operating data such as the balance sheet, income statement, and other financial information. Fifty-two per cent of the firms were provided with such data on a monthly basis, 44 per cent on an annual basis and 28 per cent on a quarterly basis. Some firms reported monthly as well as annually. However, the majority of managers of the Korean multinationals seem to favor decentralization of control of the parent company on the operations of the subsidiaries. Asked what would be the policy for controlling foreign subsidiaries and affiliated companies in the future, 63 per cent of the respondents answered that the parent company would decentralize its control and delegate authority to foreign subsidiaries and affiliates as much as possible. In contrast 38 per cent responded that the parent company would maintain its control.

2. Procurement and production

Lecraw [18] has argued that the developing countries' MNCs use less imported raw materials than other MNCs and local firms. LDC firms are not part of a multinational source network which may give them access to cheap raw materials, but which would also necessitate the purchase of input from other firms in the network. In addition, MNCs from developing countries produce mostly for the local market and all export demand for their products is supplied by the parent company's operations in the home country.

Our study shows that the procurement pattern of the Korean firm were different from Lecraw's findings, but the target market was similar. The subsidiaries of Korean firms were supplied raw materials and product components equally from the parent company or local manufacturers. For example, eleven of the responding firms procured the production materials from the parent

⁷ According to N. Kurabayashi Japanese multinationals are less ethnocentric in planning and control. Only 14 per cent of parent firms establish the overall long-range plans, and 78 per cent of multinational firms establish plans through coordination between parent and subsidiary. See N. Kurabayashi, *Nippon no takokuseki kigyō* [Japanese multinationals] (Tokyo: Chūō-keizai-sha, 1980).

TABLE IX
MARKETS OF MANUFACTURED PRODUCTS

Markets of Products	Ranking in Importance		
	1 (most)	2	3 (least)
Korean (parent) market	3	—	—
Local market	14	2	—
Third country market	5	—	1

company and twelve firms from the local manufacturers as their most important sources of procurement. In addition, eight purchased materials and components from third countries other than home country, especially Japan, on their primary procurement sources (Table VIII).

On the other hand, fourteen of the responding firms supplied the products which were manufactured by the foreign units to the local market and five firms to a third country's market, as their primary markets. Only three provided products to the Korean market. These facts were in accordance with the motivation of overseas investment by Korean firms as mentioned earlier (Table IX).

IV. SUMMARY AND CONCLUSIONS

Korea's extreme dependence on foreign natural resources and raw materials was the initial inducement for Korean firms to secure stable supplies at reasonable prices through direct investment abroad. Restrictions by advanced countries on imports from Korea have also motivated foreign direct investment by Korean firms as shown in the cases of electronics firms, which have placed plants in America and Europe to escape quota restrictions.

The major advantage for Korean firms in international operations lay in their ability to apply the imported technology primarily for standardized products to Korea's demand structure and then to transplant it to other developing countries. This finding confirms the "pecking order approach" to explain FDI originating from developing countries. Like firms from Hong Kong, India, and Brazil, Korean firms could derive considerable advantage in adapting imported machinery and equipment to suit small-scale economies. As many developing countries implement economic development plans, Korean firms could find growth potential in them and share Korea's past development experiences.

Korea's manufacturing investments were clustered in her neighboring Asian countries and bundled together in relatively labor-intensive or technologically standardized products such as textiles, and the unsophisticated product lines of electric and electronic appliances. The proportion of direct investment in extractive venture is higher for Korea than for other industrialized country except Japan. There is evidence that Korean firms on the whole are more inclined to accept minority ownership than other countries' firms. Korean firms are highly

dependent on external sources of funds to finance their direct foreign investment.

Notwithstanding the rapid growth of foreign direct investment, the multinationalization of Korean firms is still at the early stage. Further strides toward multinationalization face challenges such as lack of managers with global strategic experience, insufficient domestic capital, and underdeveloped methodology for evaluate foreign direct investment. Thus, the successful multinationalization of Korean firms, like most other firms from developing countries, will depend upon accumulating managerial experience and deepening international management techniques.

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