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Foreign Direct Investment in Korea: A Foreign Perspective

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Preface

Although it is well established that foreign direct investment (FDI) can enrich a host country's economy in a number of ways, the Korean government restricted and controlled FDI, particularly up to the 1997 financial crisis. Since then, however, the Korean government has undertaken a paradigm shift in FDI policy from "restriction and control" to "promotion and assistance", and undertaken a series of policy measures and all-out efforts to improve the business environment and attract FDI. Nevertheless, the magnitude of FDI inflows is still small in comparison to other countries, and furthermore, has been declining sharply in the recent past.

How, then, would the relatively low magnitude of FDI in Korea and a recent sharp decline be explained? What additional policy measures should Korea undertake to increase FDI inflows to a level comparable internationally? To answer these vexing questions, based on the first-hand experiences of foreign investors, a comprehensive survey was conducted in 2002 of foreign companies that had undertaken FDI and have been operating business in Korea.

According to the survey results, foreign companies undertake FDI in Korea to capitalise on the emerging business opportunities and do not enter Korea to gain market access to other Asian countries. Survey findings indicate that the FDI process and the business operational environment have not improved significantly in the recent past. According to the survey respondents, the challenges of establishing and operating FDI projects arise not only from excessive, complex and opaque government regulations, but also from inept labour relations, unfair advantages held by domestic firms, inefficient corporate governance of Korean companies, and cultural and societal differences.

The present study demonstrates convincingly that, despite the recent improvements in the FDI environment, there is substantial room for improvement in the areas of government regulations and business environments. To further attract FDI, therefore, not only should Korea undertake an across-the-board liberalization of the FDI regime, but it should also improve the operational environment for foreign businesses. To improve the poor quality of the domestic business environment, not only should excessive government regulations and bureaucratic power be removed, but unfair advantages bestowed on domestic firms, continued rigidities in the labour market and living conditions of foreign expatriates should also be improved. Added to this is the need for Korean society to become more amicable to foreign business operations in Korea.

I am hopeful that this study will contribute to a better understanding of the issues underlying sluggish FDI in Korea and stimulate more research on the ways to further attract FDI to Korea.

Dr. Sung-Hee Jwa
President
KERI

Contents

List of Tables

Foreign Direct Investment in Korea : A Foreign Perspective

Oh Yul Kwon

1. Introduction

1.1 Background of the Study

International trade of South Korea(hereafter Korea) has expanded rapidly and played the role of engine in its economic development over the last three decades. In contrast, inward foreign direct investment(FDI) in Korea has remained sluggish and failed to contribute significantly to its economic growth. It is now accepted widely that FDI enriches the host country's economy in a number of ways. It provides stable long-term foreign capital without requiring interest payments, and increases domestic production and employment. FDI in the form of M&A facilitates economic restructuring by providing the capital to buy out the business lines or assets of poorly performing companies. FDI introduces into the host country advanced management and marketing skills as well as high technology that improve productivity of the host country. It enhances efficiency and competitiveness of domestic firms through increasing competition. Finally, FDI opens new windows for exports through the strong global networks, marketing skills and experiences of multinational corporations that bring their investment into the domestic market.[1)]

1) A number of studies such as UNCTAD(2002: 3-22) demonstrate the benefits of FDI for host economies. For discussion of Korea as the host economy,

Despite the strong likelihood that FDI would bestow these economic benefits on the host economy, an historical obsession with protecting domestic industries and management control and the perception of FDI as an outflow of national wealth inclined the Korean government to restrict and control FDI, particularly until the 1997 financial crisis. Western business people generally perceived Korea as a difficult place to do business before the Korean financial crisis in 1997(Kwon, 2001). Korean government policy restricted and discouraged inward FDI with a heavy burden of business regulations. A number of sectors were closed to FDI by law until the early 1990s and, even in those areas where FDI was permitted, the administrative regulations and processes for FDI were complex and lacked transparency. Other economic conditions were also not conducive to incoming foreign investment. The labour market was not flexible in the sense that laying off workers was impossible and labour relations were inefficient. This caused labour costs to be one of the highest among the Asian NICs. Because of restrictive zoning laws, real estate prices were extraordinarily high, and foreigners were prohibited from purchasing land and real estate for business purposes.

The formal restrictions on FDI and environmental disincentives were reflected in the flagging level of FDI in Korea. According to UNCTAD's World Investment Report 2002, inward FDI in Korea over the 1990-1997 period amounted to less than one percent(0.96 percent) of its gross

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see, for example, Kim and Choo(2002: 33-34), Kim and Kim(2001), and Lee B.K(2002).

fixed capital formation, while the proportions for the world and East Asian countries were 4.7 percent and 7.4 percent, respectively. The inward FDI stock in Korea as a percentage of current GDP in 1995 was 2.0 percent, as compared to the proportions of 10.0 percent and 18.9 percent for the world and East Asia respectively(UNCTAD, 2002).

After the 1997 financial crisis, Koreans have changed their perceptions of incoming FDI. They have come to appreciate the value of FDI for its economic development, and its role in the recovery of the economy from the crisis.[2] Since the 1997 crisis, the government has switched its policy toward FDI from "restriction and control" to "promotion and assistance". The government has opened to incoming foreign investment a number of industries that were closed to FDI prior to the crisis. As of 2002, 99.8 percept of all business sectors were open to foreign investment - a level on par with that of other OECD economies(Bishop 2001; Sohn, Yang and Kim 2002: 28). The labour market was reformed to improve its flexibility and increases in wage rates have slowed markedly. For the first time in history, foreigners are now allowed to purchase real estate in Korea for personal and business purposes. The government has streamlined the complicated administrative procedures for FDI by dismantling or relaxing more than 50 percent of restrictions(Kwon, 2001). In addition, it has introduced the so-called "one-stop" service system for inward FDI. Mergers and acquisitions(M&A), which were prohibited

2) There are numerous studies that demonstrate benefits of FDI in Korea for its economy. See, for example, Lee, B.K(2002), Kim and Kim(2001).

before the crisis, have been highly promoted in conjunction with liberalization of the FDI regime. As a result of these measures and promotion of FDI together with an improved business environment, inward FDI in Korea increased from US$2.8 billion in 1997 to US$5.4 billion in 1998, and further to US$9.3 in both 2000 and 2001(UNCTAD, 2002).

Notwithstanding the rapid increases in FDI over the three-year period(1998-2000), the magnitude of FDI in Korea is still small by international comparison. In 2000, FDI in Korea amounted to 7.1 percent of the nation's gross fixed capital formation in contrast to 22.0 percent and 14.0 percent, respectively, for the world and East Asia(UNCTAD, 2002). In the same year, the ratio of FDI stock to GDP was 13.7 percent in Korea, while 20.0 percent and 18.9 percent, respectively, for the world and East Asia. Furthermore, in 2001, FDI in Korea fell sharply and further declined in 2002(KOTRA, 2003).

As noted above, the Korean government has undertaken a series of policy measures in an apparent all-out effort to attract FDI. How, then, is this relatively low magnitude of FDI in Korea and recent sharp declines explained? What additional or alternative measures should the Korean government undertake to increase FDI inflows to a level comparable internationally? This paper attempts to address these vexing questions. Although a number of studies are available in the literature on FDI in Korea(Kim and Choo 2002; Kim and Kim 2001; Kim 2003; Sohn, Yang and Kim 2002), most of these were undertaken by Korean scholars in Korea. There is no in-depth study of the issue from a foreign perspective. It is thus timely to investigate the latest developments of FDI in Korea from the perspectives of foreign investors and business expatriates.

1.2 Objectives and Methodology of the Research

The objective of this study is therefore to identify and explain the factors underlying sluggish FDI in Korea from the perspective of foreign investors and business people. The study also attempts to explore issues that concern foreign companies conducting business in Korea. On-site management, particularly as perceived by foreign business people, has an important bearing on FDI, although earlier studies of FDI have paid little attention to this factor. Korean business has been in transition particularly since remedial measures were pursued in response to the financial crisis late in 1997(Kwon, 2001). Thus, how foreign business people understand the transition of Korean business and the place of foreign business in this new context will be important in setting up new strategies to attract FDI to Korea. Specifically, therefore, the study attempts to: (a) examine the salient characteristics of FDI in Korea, (b) assess the motives and difficulties in undertaking FDI projects in Korea, (c) evaluate the issues confronted by foreign companies in operating their projects in Korea, (d) assess the perceptions held by foreigners of the transition of Korean business, and (e) provide some suggestions to explore ways to promote FDI in Korea.

The above tasks are undertaken in the following manner. Section 2 examines recent trends and major characteristics of FDI in Korea in light of global trends in FDI to put the recent performance of FDI in Korea into perspective. To provide theoretical underpinning of the present study, a brief literature survey of FDI is undertaken in Section 3. This literature survey is not intended to be comprehensive; rather, it is to provide the essential features of existing models that are judged relevant to this study. Section 4 provides an overview of Korean government policy and regulations on incoming FDI and their changes after the 1997 financial crisis. Any viable strategy either by governments or by private firms to attract or undertake FDI must be based on relevant, accurate market information. One of the most effective sources of information is companies with first hand experiences of undertaking FDI and operating overseas businesses. To this end, a comprehensive survey, which has been undertaken of foreign companies that have undertaken FDI and have been operating in Korea, is discussed in Section 5. It is anticipated that the living conditions of foreign expatriates have important bearings on FDI, and thus the survey also attempts to assess the living conditions for foreign business people in Korea and the improvements they have perceived and experienced.

Specifically, the survey attempts: (a) to analyse the most important factors for foreign firms in determining direct investment undertakings in Korea, (b) to assess difficulties these firms encountered in undertaking their investments in Korea, (c) to examine foreign expatriates' perceptions of the transition of Korean business since 1997, (d) to assess difficulties in on-site management of business in Korea from the perspective of foreign business people, (e) to analyse foreign business people's perceptions of Korean companies(chaebols), workers, and changes in the Korean management system as perceived by foreigners, and (f) to assess difficulties and recent improvements in the living conditions of foreign expatriates. The findings of the survey provide information useful in developing strategies to attract FDI and businesses to Korea for both the Korean government and the private business sector. The findings are also useful for foreign companies considering Korea as a destination for their FDI project. Finally, Section 6 briefly reviews the major findings in summary form and recommends strategies for attracting FDI to Korea.

2. Recent Developments in FDI in Korea

2.1 Recent Trends of FDI in Korea from a Global Perspective

In order to grasp a clear perspective of the seriousness of the issues under consideration, FDI inflows to Korea are examined in contrast to global flows of FDI. Over the past 20 years there has been a marked increase in the flows of FDI in the world. A number of important driving forces have accelerated this growth. The first is the liberalisation policy of national governments, opening national markets and allowing FDI in most business sectors. The second is rapid technological change with its rising costs and risks, which makes it imperative for firms to tap world markets and to share these costs and risks. Alongside this, rapid development of information, telecommunications and transportation technology lowers communication and transport costs, facilitating FDI and international operations of firms. The third force is increasing corporate competition arising from globalisation of the world economy. Heightened competition compels firms to explore new ways of increasing their efficiency, including FDI (UNCTAD, 2002: xv). The fourth driving force is privatisation of public enterprises in the recent past by governments in many countries. The fifth force is liberalisation of international financial markets particularly during the 1990s. All these five forces stimulated MNEs to undertake FDI in an attempt to develop a significant presence in every region of the world as part of their global strategy.

As a result, during the 1990s FDI accelerated much faster than growth in the world economy and trade, until it declined sharply in 2001. As shown in Table 2.1, FDI inflows in the world increased from US$209 billion in 1990 to US$1,492 billion in 2000, or 21.7 percent annual growth over the period. In particular, world FDI inflows increased remarkably over 1998-2000, recording 47 percent annual growth(UNCTAD, 2002) despite the numerous unfavourable conditions in the world economy such as the economic recession in Asia and instability in financial markets. In 2001, however, FDI inflows in the world dropped sharply by 51 percent to US$735 billion. This sharp decline was ascribed to the slowdown of major industrialised economies and sharp decreases in their stock market activities(UNCTAD, 2002: 3). Yet despite the sharp decline in FDI in 2001, FDI flows expanded much faster than the world economy and trade. For the period 1982-2001, for instance, FDI inflows and FDI inward stock in the world increased 12.5 fold and 9.3 fold respectively, while the world economy and exports increased only 3.0 fold and 3.6 fold respectively(UNCTAD, 2002: 4). As a result, the ratio of FDI inward stock to world GDP increased from 6.1 percent in 1980 to 20.0 percent in 2000(Table 2.2).

The increases in FDI flows support the expansion of international production that is a major part of the process of globalisation.[3] International production continues to grow in importance for both developed and developing countries. Sales of foreign affiliates rose rapidly in the recent past, amounting to US$18.5 billion in 2001, and the ratio of sales by foreign affiliates to world GDP increased from 25 percent in 1990 to 58 percent in 2001. The global value added by foreign affiliates was more than US$3.5 trillion, which was 11.0 percent of global GDP in 2001 compared to 6.6 percent in 1990. Global exports by foreign affiliates were estimated to be worth US$2.6 trillion in 2001, which accounted for 35.0 percent of world exports, compared to 26.7 percent in 1990 (UNCTAD, 2002: 4). These developments suggest that the expansion of international production through FDI has deepened the interdependence of the world economy beyond that achieved by international trade alone, that the growth of the world economy is derived substantially from FDI, and that the proportion of world trade related to FDI is rising rapidly.

<Table 2.1> FDI Inflows in Korea and Other East Asian Countries

(units: US$bill, %)

	1990-1995 (annual av.)	1996	1997	1998	1999	2000	2001
FDI in Korea($bill)	1.0	2.3	2.8	5.4	9.3	9.3	3.2
World	225.3	396.1	478.1	694.5	1088.3	1491.9	735.1
E. Asia*	44.6	87.8	96.3	86.3	100.0	131.1	94.4
FDI/GI**, Korea(%)	0.8	1.2	1.7	5.7	8.3	7.1	n/a
FDI/GI, World	4.1	5.9	7.4	11.0	16.5	22.0	n/a
FDI/GI, E. Asia	6.7	9.1	10.0	10.5	11.5	14.0	n/a

*E. Asia includes South, East and Southeast Asia.
** GI denotes gross fixed capital formation.
Source : UNCTAD(2002)

3) International production refers to that part of the production of goods and services of countries that is controlled and managed by firms headquartered in other countries.

Inflows of FDI in Korea have increased remarkably since the financial crisis in response to the liberalisation of the FDI regime, as examined later in Section 4, and improvement in the business environment. As shown in Table 2.1, FDI in Korea leaped from US$2.8 billion in 1997 to US$9.3 billion in 2000, although it declined to US$3.2 billion in 2001. As a result, FDI in Korea has recently become an increasingly important component of the Korean economy. However, the magnitude of FDI in Korea is still small when compared to other countries. In 2000, FDI in Korea accounted for 7.1 percent of gross fixed capital formation, while the corresponding figures for the world and East Asia were 22.0 percent and 14.0 percent respectively(Table 2.1). As shown in Table 2.2, the ratio of FDI stock to GDP in Korea was 2.0 percent in 1995, as compared to 10.0 percent and 18.9 percent, respectively, for the world and East Asia. Although the ratio increased to 13.7 percent in Korea in 2000, it fared poorly vis a vis the world and East Asia, for which the ratios increased to 20.0 percent and 36.4 percent respectively. FDI in Korea played only minor roles in increasing value added and employment. In 1999, value added of foreign affiliates as a percentage of GDP was 3.1 percent in Korea compared to the 18.4 percent average of 33 developing countries. In the same year, employment of foreign affiliates accounted for only 2.2 percent of total employment in Korea, while the ratio was 4.8 percent for the average of 33 developing countries(UNCTAD, 2002: 275).

Korea has attracted less FDI than could be expected given the size of its national economy. In recent years UNCTAD has put forward an inward FDI performance index, which is the ratio of a country's share in global FDI flows to its share in global GDP. Countries with an index value greater than one attract more FDI than may be expected on the basis of relative GDP. According to this index, Korea scored poorly - one of the lowest scores in East Asia. The values for Korea were 0.5 and 0.6, respectively, for the 1988-1990 and 1998-2000 periods, ranking it 93rd and 87th among 140 countries over the respective periods(UNCTAD, 2002: 25). In the 1998-2000 period, Korea ranked the third lowest among East Asian countries, followed by Taiwan with an index number of 0.3 and ranking of 112 and Japan with an index number of 0.1 and ranking of 131.

Korea has clearly failed to attract FDI to its full potential. According to the UNCTAD inward FDI potential index, estimated through a set of key measurable factors that are expected to affect inward FDI, Korea fared reasonably well, ranked 19 and 18, respectively, among 140 countries in the periods 1988-1990 and 1998-2000.[4] By comparing rankings on the performance and potential indices of inward FDI, UNCTAD designates Korea as one of the "below-potential economies", with a weak FDI performance because of govern-

4) The factors used in estimating the UNCTAD inward FDI potential index included: the rate of growth of GDP; per capita GDP; share of exports in GDP; telephone lines per 1000 inhabitants; commercial energy use per capita; share of R&D expenditures in gross national income; share of tertiary students in population; and country risk. The index is an unweighted average of the normalized values of these variables(UNCTAD, 2002: 24).

ment policy, a tradition of low reliance on FDI, political and social factors, or weak international competitiveness(UNCTAD, 2002: 32).

How is this relatively poor performance FDI in Korea explained? Since the 1997 crisis the Korea government has undertaken a series of policy measures to attract FDI. What additional measures should be undertaken in Korea to improve FDI inflows to the levels comparable with most other nations? Let us first examine the characteristics of FDI in Korea, as this information is essential to addressing these questions.

<Table 2.2> Inward FDI Stocks as a Percentage of Gross Domestic Product

(unit: %)

	1980	1985	1990	1995	2000
Korea	2.1	2.3	2.3	2.0	13.7
World	6.1	7.8	8.9	10.0	20.0
East Asia	21.1	19.5	17.4	18.9	36.4

Source : UNCTAD(2002)

2.2 Main Characteristics of FDI in Korea

FDI in Korea started to increase remarkably after the 1997 financial crisis, largely because of the changes in the FDI regime. As shown in Table 2.3, FDI in 1997 rose to US$7.97 billion from US$3.2 billion in 1996 and continued to increase annually to US$15.7 billion in 2000. It then declined significantly to US$11.87 billion in 2001 and further to US$9.1 in 2002(KOTRA, 2003). Cumulative FDI in Korea from 1962 to

2001 stood at US$77.6 billion(Table 2.3). It should be noted that FDI data in Tables 2.3, 2.4, 2.5, 2.6, 2.7, and 2.8 are from the Ministry of Commerce, Industry and Energy(MOCIE) of Korea - not from UNCTAD, and FDI values in these tables are on approval(or notification) basis, rather than the realisation basis of UNCTAD's FDI data in Tables 2.1 and 2.2.

Decreases in FDI over the two-year period 2001-2002 were attributable to a variety of factors. Economic stagnation in the world and particularly in the United States and Japan has contributed to the decline of FDI in Korea. The 11 September 2001 attack that brought about a setback in global investment was also instrumental. The Korean economic slowdown to 3.1 percent growth in 2001 and to 6.3 percent growth in 2002 (Bank of Korea, 2003), after brisk growth over the preceding two years, also contributed to the FDI decline in those years as well. After the 1997 crisis, M&A of Korean firms by foreign firms surged due to "fire sale" transactions over the 1998-1999 period as part of the restructuring process. However, after the initial surge in M&A transactions, criticisms arose in Korea on the fire sales of Korean firms, and attitudes towards M&A of the Korean government and chaebols have changed, thereby decreasing M&A transactions.

Some observers argue that Korea's FDI and business environments have not improved as compared to other neighbouring countries. Disadvantages of Korea as an investment destination include complex and opaque regulations and policy making and implementation, complex foreign exchange regulations, lack of the labour market flexibility, high wage relative to productivity, and an inefficient funding system. On the contrary, China's accession to the WTO and its relatively low production costs have contributed to the attraction of FDI into China at the expense of Korea. According to a recent survey undertaken in December 2001 by the American Chamber of Commerce(AMCHAM) in Korea on the overall investment environment, Korea ranked last among the cities surveyed, behind Hong Kong, Singapore, Shanghai and Tokyo(Kim, 2002). This relatively poor investment environment in Korea would have contributed to the decline in FDI in Korea after the spurt of "fire sales" of Korean firms was over.

<Table 2.3> FDI in Korea on Approval Basis

(unit: US$bill)

Year	1962–1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Value(US$bill)	7.87	1.40	0.89	1.04	1.32	1.95	3.20	7.97	8.85	15.54	15.70	11.87
No of projects	5337	509	444	458	646	872	968	1055	1399	2102	4141	3341

Source: MOCIE(2002a)

By type of investment, statistics of FDI in Korea are separated into three forms: (1) acquisition of newly issued shares of new or existing companies, (2) acquisition of outstanding or existing shares, and (3) by long-term(longer than five years) loans.[5] FDI may also take the form of greenfield investment or M&A of existing companies. The

5) Acquisition of assets and business units of Korean companies is dealt with the same as acquisition of new shares.

major form of FDI in Korea in the past few years was the purchase of newly issued shares, accounting for about 80 percent of acquisitions(Table 2.4). Soon after the financial crisis, a large portion of FDI was undertaken in the form of M&A, indicating domestic firms were taken over by foreigners as part of business structural reform. As shown in Table 2.4, M&A accounted for about 60 percent of FDI in Korea over the 1998-1999 period, but declined to 45.9 percent in 2000.

<Table 2.4> Investment Patterns of FDI in Korea on Approval Basis

(unit: US$bill and %)

		1962-1994	1995	1996	1997	1998	1999	2000	2001
Equity acquisition	New	12.53 (100.0)	1.95 (100.0)	3.20 (100.0)	6.21 (89.1)	6.53 (73.8)	12.57 (80.9)	14.07 (89.6)	9.35 (78.8)
	Existing	0.0	0.0	0.0	0.7 (10.9)	1.24 (14.0)	2.33 (15.0)	1.28 (8.2)	1.90 (16.0)
	Long-term borrowing	0.0	0.0	0.0	-	1.08 (12.2)	0.64 (4.1)	0.35 (2.2)	0.62 (5.2)
M&A	By M&A	n/a	n/a	n/a	n/a	5.10 (57.6)	9.30 (59.9)	7.20 (45.9)	n/a
	Others	n/a	n/a	n/a	n/a	3.75 (42.4)	6.24 (40.1)	8.49 (54.1)	n/a
Total		12.53 (100.0)	1.95 (100.)	3.20 (100.0)	6.97 (100.0)	8.85 (100.0)	15.54 (100.0)	15.70 (100.0)	11.87 (100.0)

Source : MOCIE(2002a). Information of M&A was from Kang(2001)

The home countries of FDI in Korea are shown in Table 2.5. Until the mid-1990s, the United States, the European Union and Japan accounted for about 90 percent of FDI in Korea. However, for 2000 and 2001 the share from these three regions declined to two-thirds, while FDI from countries in other regions, including Australia, expanded more rapidly.

<Table 2.5> Incoming FDI by Country or Region on Approval Basis

(unit: US$mill and %)

	1962–1994	1995	1996	1997	1998	1999	2000	2001
U.S.	3571 (28.5)	645 (33.0)	875 (27.3)	3190 (45.8)	2973 (33.6)	3739 (24.1)	2922 (18.6)	3889 (32.8)
Japan	4893 (39.1)	424 (21.8)	255 (8.0)	265 (3.8)	504 (5.7)	1750 (11.3)	2448 (15.6)	772 (6.5)
EU	2667 (21.3)	461 (23.7)	892 (27.9)	2306 (33.1)	2885 (32.6)	6261 (40.3)	4391 (28.0)	3062 (25.8)
Others	1394 (11.1)	417 (21.4)	1181 (36.8)	1210 (17.4)	2490 (28.1)	3792 (24.4)	5936 (37.8)	4147 (34.9)
Total	12525 (100.0)	1947 (100.0)	3203 (100.0)	6971 (100.0)	8852 (100.0)	15542 (100.0)	15697 (100.0)	11870 (100.0)

Source: MOCIE(2002)

Another noticeable change is that since 1996 the share of FDI from Japan has declined significantly, averaging less than 10 percent. One overriding reason is the continuing stagnancy of the Japanese economy from the early 1990s.

In terms of industries, more than 60 percent of FDI in Korea was traditionally undertaken in the manufacturing sector (Table 2.6). However, since the 1997 financial crisis the FDI share in the manufacturing sector has declined, while that in the services sector increased. In 2001, in particular, the service sector accounted for 69 percent of FDI. It should be noted that decreases in FDI in the manufacturing sector over the 2000-2001 period accounted for almost all the decreases in FDI in Korea. This may reflect the structural change in the Korean economy and the opening of the service sector after the financial crisis. At the same time, the decline in FDI in the manufacturing sector may indicate the loss of international competitiveness of the sector that has been the main source of Korean economic growth. The primary industries - agriculture, fishery and mining - have continued to attract an insignificant amount of FDI.

<Table 2.6> FDI by Industry on Approval Basis

(US$mill and %)

	1962–1994	1995	1996	1997	1998	1999	2000	2001
Primary industries	42 (0.3)	–	18 (0.6)	55 (0.9)	179 (2.0)	54 (0.3)	3 (–)	9 (–)
Manufacturing	7797 (62.2)	889 (45.7)	1930 (60.3)	2348 (33.7)	5735 (64.8)	7129 (45.9)	7129 (45.4)	3643 (30.7)
Services	4687 (37.4)	1057 (54.4)	1254 (39.1)	4568 (65.6)	2938 (33.2)	8359 (53.8)	8565 (54.6)	8193 (69.0)
Total	12525 (100.0)	1947 (100.0)	3203 (100.0)	6971 (100.0)	8853 (100.0)	15542 (100.0)	15697 (100.0)	11870 (100.0)

Source: MOCIE(2002a)

<Table 2.7> FDI in Korean Manufacturing on Approval Basis

(unit: US$mill)

Sectors	1995	1996	1997	1998	1999	2000	2001
Food processing	15	253	851	719	315	44	623
Textile & cloths	58	21	85	18	47	53	46
Pulp & Timber	83	83	196	1644	24	16	65
Chemicals	174	389	235	756	771	656	474
Pharmaceutical	65	32	44	134	41	97	26
Petrochemical	45	215	3	1	511	–	12
Ceramics	20	47	54	279	50	99	238
Metals	8	13	14	7	601	695	41
Machinery	102	159	166	588	648	1593	231
Electrical & electronics	234	436	291	1377	2998	2409	1593
Transportation equipment	72	271	395	180	662	840	65
Others	13	12	16	33	462	628	256
Total	889	1930	2348	5735	7129	7129	3668

Source : MOCIE(2002a)

Since the 1997 financial crisis, FDI in the manufacturing sector was undertaken mainly in chemicals, metals, machinery, and electrical and electronics(see Table 2.7). This reflects the structural reform imposed by the government after the crisis as a way of consolidating industries so as to enhance international competitiveness. Part of the increase in FDI in electrical and electronics would be ascribed to the government's promotion of IT industries.

Soon after the financial crisis, FDI in the service areas expanded more rapidly than in other areas(Table 2.6). For the service sector, FDI in banking and insurance increased remarkably with the liberalisation of the financial sector and its structural reform(Table 2.8). Structural reform compelled

<Table 2.8> FDI in the Korean Service Sector on Approval Basis

(unit: US$mill)

Sectors	1995	1996	1997	1998	1999	2000	2001
Electric & gas	–	34	45	344	368	218	432
Construction	12	32	65	5	15	10	32
Wholesale & retail	138	297	891	474	876	1063	388
Foreign trade	107	126	233	284	424	280	167
Restaurants	9	8	3	18	46	27	14
Accommodation	216	228	2596	303	817	1151	2436
Transport & warehousing	3	150	33	12	259	544	12
Banking	378	250	321	506	2266	1612	1650
Insurance	56	16	15	74	507	455	156
Real estate	–	1	–	2	60	355	217
Others	138	112	366	916	2721	2850	2397
Total	1057	1254	4568	2938	8359	8565	8193

Source : MOCIE(2002a).

commercial banks to attract foreign investment.[6] Once the reform of the financial sector is completed, FDI in this sector is expected to decline. This might have been already reflected in a drastic drop in FDI in banking and insurance(Table 2.8). It should be noted that FDI in the wholesale and retail sector and real estate sector has also increased in response to the liberalisation of these sectors.

As examined above, although inward FDI has become an increasingly important component of the Korean economy in recent years, the FDI inflow is below the level that policy planners consider to be ideal. We have also considered above how the characteristics of FDI in Korea reflect changes in the FDI regime and the business environment. Before examining these changes and how to address Korea's poor performance in attracting FDI, we will briefly consider the theoretical underpinning of the task from the FDI literature in the following section.

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6) Lee, B.Y(2003) argues based on his empirical analysis that the improved financial environment in Korea after the 1997 crisis attracted FDI to the Korean banking sector from countries with well-developed financial systems.

3. Literature Survey of Foreign Direct Investment

Although a number of models have been put forward to explain FDI, most of them appear to share two premises. The first is that FDI is undertaken largely by MNEs and the second is that the output and factor markets are characterised by imperfections(Agarwal 1980; Rugman 1980; Teece 1983; Hill and Kim 1988). Thinking on FDI in this direction, known as the ownership advantage theory, was initiated by Hymer (1960) and refined by Kindleberger(1969) and Caves(1971). This theory argues that, in establishing and operating plants in a host country, foreign MNEs necessarily have some disadvantages when compared with local firms. Thus, if foreign MNEs choose to invest in that country, despite these disadvantages, it is because MNEs' advantages over local firms will more than compensate for these disadvantages. According to the ownership advantage theory, MNEs have firm-specific monopolistic or oligopolistic advantages such as superior technical knowledge, well-known brand names, managerial and marketing skills, special access to markets, cheaper sources of financing, economies of scale, and differentiated products.

A firm's possession of monopolistic or oligopolistic advantages is, however, a necessary but not sufficient condition for

FDI, because the firm can also serve foreign markets with exports or by licensing, renting or selling these advantages. To explain why a firm chooses FDI rather than these alternatives to best exploit its ownership advantages internationally, further explanatory models, including the product life-cycle model and the internalisation model have been proposed. The product life-cycle model, proposed originally by Vernon(1966), argues that there is a sequential relationship between product innovation, exportation and FDI, and that firms undertake FDI at a particular stage in the life cycle of a product they have pioneered. Recently, however, the conditions of technological leadership have changed markedly from those proposed by Vernon(1966), and the life cycles of many products have reduced and typically no longer pass through the sequential relationship. Accordingly, the power of the product life-cycle model to explain the causes of FDI has weakened, as Vernon (1979) admitted.

The internalisation model, which was first proposed by Buckley and Casson(1976), argues that key intermediate inputs such as technology, knowledge and expertise, and managerial and marketing skills are held by MNEs as their firm-specific advantages, but that the international markets of these inputs are imperfect. These market imperfections involve the so -called transaction costs such as time lags, uncertainties about the prices of intermediate products, difficulties in negotiating, monitoring and enforcing related contracts, and government intervention.[7] Hence, when the transaction costs associated

7) Uncertainties arising from tariff and non-tariff barriers and changes to these

with these intermediate inputs are high, MNEs replace these imperfect external markets with their own internal markets. The internalisation of markets across national boundaries leads to FDI - internalising international production within the firm.[8)]

Creating an internal market facilitates the transformation of intangible intermediate inputs such as technology invented by a firm into valuable properties specific to the firm, retention of the exclusive right to use the innovation, and the exploitation of monopoly rent from these inputs. Expanding their operation through FDI, MNEs may also achieve internal and external economies of scale. Although the internalisation model can be applied to any type of MNE with firm-specific advantages, empirical studies available conclude that the process of internalisation is concentrated in industries with relatively high R&D expenditures(Agarwal, 1980).

Although the internalisation theory addresses why firms choose FDI as a mode for entering the international market, it ignores the question of why production should be located in a particular country.[9)] Here the question is whether there is a location advantage in producing in a particular foreign country. Dunning(1981, 1988 and 1998) incorporated this issue in his

are also part of the transaction costs.

8) Rugman(1980) further argues that internalization is a general theory of FDI and a unifying paradigm of the theories of the MNE.

9) The theory cannot explain the timing of FDI. Given the uncertainty in international transactions, the theory does not indicate at what point of time or at what extent of uncertainty(or transaction cost) MNEs should undertake FDI.

eclectic theory. According to Dunning, firms will undertake FDI when they have three types of advantages: (a) ownership advantage, (b) location advantage, and (c) internalisation advantage. Ownership advantage is where the firm has a competitive advantage that allows it to overcome the disadvantages in competing on foreign turf. Location advantages refer to the advantages that arise from using resource endowments or assets that are tied to a particular foreign location and that a firm finds valuable to combine with its own unique assets. Internalisation advantage is where the firm itself finds it cheaper to produce the product rather than hire a foreign firm to do so, because of high transaction costs. This eclectic theory thus combines the ownership advantage theory of Hymer(1960) and the internalisation theory of Buckley and Casson(1976) with a theory of location advantages to form a unified theory of FDI.

Dunning's theory of FDI, arguing that firms need to have the three advantages to undertake FDI, is comprehensive. However, this theory only lists the advantages in the FDI decision-making process - it is silent to the disadvantages. Thus, it is deficient as a theory of FDI decision-making behaviour. Furthermore, this theory does not mean that all foreign firms undertaking FDI in different countries have these three advantages to the same extent, nor does it indicate that firms' motives for pursuing FDI are the same across countries or companies. Not only Dunning's theory but also other theories reviewed above do not specify explicit strategic motives in pursuing FDI other than implicit profit maximisation.

Given the complexity of the global economy, the diversity of characteristics of firms and the different opportunities that individual firms face in different countries, it is not surprising that different strategic motives influence firms' decisions to undertake FDI in different ways. For instance, firms can capitalise on location advantages from various countries, and the location determinants of FDI differ depending on the strategic motives of firms undertaking this FDI. Strategic motives for undertaking FDI are classified as 'supply-seeking' or 'market-serving'. A firm's supply-seeking motives for undertaking FDI are to minimize its own costs and secure supplies by capitalising on the location advantages of a foreign country. This includes lowering production and/or delivery costs, acquiring raw materials and gaining access to key technology in the host country. A firm's market-serving motive for undertaking FDI is to take up local production in order to establish new national markets for its products. This move, in general, is to explore new markets, circumvent prohibitive trade barriers, establish a local presence as a way of gaining local visibility, accompany its mobile customers, and respond to the strategic rivalry from competitors in host countries.

Associated with the supply-seeking motive, the model proposed by Kojima(1978) argues that FDI originates in the home country's comparatively disadvantaged(or marginal) industry, which is potentially a comparatively advantageous industry in the host country. This was the case for Japanese FDI in East Asian NICs(South Korea, Taiwan, Hong Kong and Singapore) in the 1960s and 1970s, and FDI by the East Asian NICs to ASEAN countries, China and Vietnam in the 1980s and 1990s. This type of FDI improves not only trade by generating comparative advantage but also the industrial structure of both the home and host countries.

Related to the market-serving motive, Knickerbocker's model of FDI(1973) argues that FDI reflects strategic rivalry among companies in oligopolistic industries. A critical competitive feature of oligopolistic industries is the interdependence of major players in the sense that what one firm does can have an immediate impact on the major competitors, forcing a response in kind. Recognising this feature of oligopolistic industries, Knickerbocker argues that the same kind of imitative behaviour characterises FDI, so that as one of the competitors in an industry undertakes FDI in a foreign country, other competitors tend to follow suit to ensure that competitors do not gain dominant positions in the foreign market. Knickerbocker's theory can be extended to embrace FDI undertaken by the imitative behaviours of a few competitors within oligopolistic industries in the world. However, this theory cannot explain the initial FDI of the leader in an oligopolistic industry.

In the literature reviewed above, we find useful explanatory tools for examining FDI in Korea. Some of these models surveyed will be employed in analysing the survey results of foreign companies that have undertaken FDI in Korea.

4. Korean Government Policy on Inward FDI

4.1 FDI Policy before the 1997 financial crisis

In order to put Korean FDI policies into perspective, it is useful here to review changes in FDI policies in other nations. Most countries have changed their FDI policies remarkably over the last four decades. In the 1960s and 1970s, most national governments, including those of advanced countries, perceived that direct investment by foreign multinational enterprises would damage their economies and hence they spurned FDI. In the 1980s, policymakers in developed countries began to realize the economic benefits of FDI and started to liberalize their FDI regimes. In the 1990s, developing and newly emerging countries joined advanced countries in liberalizing their FDI policies, streamlining FDI procedures and providing incentives to attract FDI. The liberalizing trend in FDI has maintained momentum into the 21st century.

As shown in Table 4.1, 1393 changes in FDI regulatory regimes were made by 652 countries over the period 1991-2001, with 94.4 percent of these changes in the direction of creating a more favourable environment for FDI. In 2001 alone, 208 regulatory changes were made, of which 93.3 percent were in favour of FDI. At the same time, the network of bilateral investment treaties(BITs) is expanding, incorporating a framework of rights and obligations with respect to investment. In 2001, 97 countries, both developed and developing, were involved in concluding 158 BITs, increasing the total from 1941 at the end of 2000 to 2099 by the end of 2001. These developments indicate clearly that to attract FDI, most countries in the world have liberalized their FDI policies, streamlined FDI procedures, and provided incentives to prospective investors. In the absence of a world governing body for FDI, the network of BITs is expanding to minimise possible conflicts arising from FDI.

<Table 4.1> National Regulatory Changes, 1991－2001

Items	1991－1996	1997	1998	1999	2000	2001	1991－2001
No. of countries that changed FDI regimes	313	76	60	63	69	71	652
No. of regulatory changes	599	151	145	140	150	208	1393
More favourable to FDI (% of total changes)	572 (95.5)	135 (89.4)	136 (93.8)	131 (93.6)	147 (98.0)	194 (93.3)	1315 (94.4)
Less favourable to FDI	27 (4.5)	16 (10.6)	9 (6.2)	9 (6.4)	3 (2.0)	14 (6.7)	78 (5.6)

Source : UNCTAD(2002)

It is unquestionable that Korea restricted incoming FDI for many decades. Unlike for trade, where international rules existed under the GATT and WTO, there has been no significant progress made on investment-related multilateral rules for FDI. In the absence of international guidelines, Korea pursued a singular FDI policy that discouraged and restricted inward FDI. The principles of Korean FDI policies were contained in the Foreign Capital Inducement Act enacted in 1966 and the Act remained effective until 1998 when it was replaced by the Foreign Investment Promotion Act. During the 1960s and the 1970s, Korea relied mainly on foreign commercial loans instead of FDI to attract foreign capital for economic development. This policy enabled the government to allocate foreign borrowings to the priority sectors that it nominated and facilitated government control over the private sector. When Korean economic policy makers recognised the need for FDI to obtain foreign technology and managerial know-how, to enhance the industrial structure and to promote exports, they insisted on joint venture forms of FDI between foreign and domestic investors, with an investment ratio of 50:50 across all industries to facilitate control over the foreign investors.

During the 1980s, Korea began to change its attitude toward FDI as it became more difficult to raise foreign commercial loans from international capital markets after the second oil crisis. It was in the mid-1980s that the government began to seriously liberalise the FDI regime under rising pressure from trade partners, opening more business categories for FDI and relaxing the investment ratio restriction of 50:50 for joint ventures. Also, the FDI permission system was changed from a “positive system” to a “negative system”, whereby FDI could enter any industries except for those with specific prohibition.

Over the period 1990-1997, Korea further liberalised its FDI regime with the launch of the WTO and its admission to the OECD in 1996. Korea also saw FDI as a way to improve the competitiveness of its industries and as a way of restraining the economic power concentrated in a limited number of chaebols. The approval system of relevant government organizations for FDI was replaced by a reporting system. Non-hostile M&A were allowed and long-term offshore borrowings with terms of five years or longer were liberalised. However, the basic position of the government towards FDI was passive and restrictive, except for high technology areas that needed to attract foreign technology. Under the anti-FDI policy, a number of sectors were closed to FDI by law until the mid-1990s. These included most service industries(distribution, including wholesale and retail industries, communications, transport, banking and financing, insurance, trust, real estate, and investment consulting and business services), the agricultural sector, and heavy and chemical industries. Even in those areas that permitted FDI, the administrative regulations and processes for FDI were complex and lacked transparency. In essence, the government permitted FDI only to attract high technology investment in the form of joint ventures in selected industries.

Beyond the difficulty of entry, businesses undertaking FDI in Korea experienced difficulties arising from factor inputs. Because of restrictive zoning laws, land and real estate prices were extraordinarily high, and foreigners were prohibited from purchasing land for business purposes. A well-educated and industrious labour force was one of Korea's major advantages, but the labour market was not conducive to foreign business. Socio-cultural and legal conditions rendered the labour market inflexible in a sense that workforce retrenchment was virtually impossible. Korean unions were renowned for their militant tactics. There were numerous incidents in which unions resorted to militant tactics against foreign subsidiaries in Korea. For socio-cultural reasons, Koreans in general preferred to work for domestic rather than foreign firms. Foreign firms were not well received within Korean society as exploiters of short-term economic benefits. These circumstances rendered labour expensive and further discouraged the operation of foreign businesses in Korea.[10)]

Korea also prevented foreign firms from financing their operations from Korean sources. Foreign firms could not raise funds from the Korean securities market, as they were prohibited from floating stock issues in this market. Korean capital markets(stocks and bonds) remained closed to foreign participants until mid-1997. The government also controlled the foreign exchange market, restricting foreign participation.

Another aspect of the Korean business environment unattractive to FDI was the heavy concentration of the Korean economy in a handful of large chaebols. Chaebols originally developed and expanded under government policy that sought to achieve industrialisation and export promotion through specialised production, where the government selected enterprises and provided them with incentives, protection and benefits from economies of scale. The government also provided chaebols with institutionalised privileges such as cross-subsidiary loan guarantees, cross-subsidiary ownership,

10) By 1995 Korea had the second highest labour costs among all Asian countries, following Japan(Kwon, 1998).

protection against take-over through hostile M&A by domestic and foreign firms, and a lopsided corporate governance system favouring primary shareholders. This arrangement induced entrenched collusion between government and chaebols. These privileges for chaebols within the Korean economy, bolstered by the chaebols' collusive relationship with government, markedly disadvantaged foreigners seeking to enter the Korean market.

Further disadvantage was management of on-site operations, which has an important bearing on FDI and involves a number of important issues. Until the post-crisis reforms, one of the most difficult tasks for foreign subsidiaries in on-site management in Korea was recruiting and retaining personnel. Korean workers were closely aligned with their employers and took pride in their identity as company employees. A person's prestige and social status in Korea's hierarchical society depended heavily on his or her employer, their job title and position at the company. Personal status followed the status of companies, with chaebols at the top. Hence, graduates from prestigious universities aspired to work for established domestic chaebols rather than for foreign companies. Since business networking was critically important for business success in Korea, companies sought to hire graduates from prestigious universities who were likely to be well placed with alumni connections. Clearly, this type of business culture disadvantaged foreign companies in recruiting talented male workers from prestigious universities. It should be noted, however, that the availability of talented females with degrees from prestigious universities, who had been subject to gender discrimination by Korean companies, presented strong recruitment opportunities for foreign companies. Yet, although female workers may be at least as efficient as their male counterparts at work, women were disadvantaged in developing valuable personal networks because of entrenched social prejudices against women. Furthermore, in this male-dominated society, Korean male workers, imbued with notions of male superiority, were unprepared to adjust to female bosses.

In sum, from the viewpoints of those who supply foreign investment, the restrictive FDI regime, the incongruous business culture for foreign investors and other economic conditions were not conducive to attracting their investment funds. The 'location advantages' observed by Dunning(1988 and 1998), such as the availability of inputs, quality of infrastructure, institutional competence and cooperative government policies, were not adequate in Korea. In effect, until the 1997 crisis, Korea was regarded as the worst place to invest among Asian countries(*Far Eastern Economic Review*, 1998: 30).

As discussed earlier, the anti-FDI policy and unattractive investment environments in Korea were reflected in a level of inward FDI that was very low by comparison with other countries, and in particular neighbouring countries in East Asia. Although FDI was permitted specifically to attract foreign technology, it was an insignificant channel for foreign technology acquisitions. In 1991, for instance, only 6.5 percent of Korean firms that attracted foreign technology relied on foreign investment, while the remainder utilised licensing agreements or undertook technology training and reverse-engineering of imported capital goods as a way of learning foreign technology(Bishop, 1997: 132).

From this brief survey of government policy toward incoming FDI and the business environment in Korea prior to the 1997 crisis, we have observed both structural and social impediments to foreign investors that sought to enter the Korean market. Acute sensitivity to keeping the home market in Korean hands drove the government to intervene extensively in the national economy to foster and protect domestic industries, and led the chaebols into powerful partnership with the government. These developments led to an anti-FDI policy and disadvantages for foreign companies. A paternalistic employment system interwoven with nationalism and complex social norms helped to embed the unique business structure and management system, to the disadvantage of foreign subsidiaries interested in market entry. The consequences of Korean policy toward FDI, the perceptions of FDI held by the general public, and the business environment have been huge. Korea's sudden economic crippling from the 1997 financial crisis was an inescapable watershed, signalling unmistakably that both the structure and the principles that supported the Korean economic performance could not be sustained. Korea had to make a shift in policy principles not only for FDI but also in other areas. The business environment and business management also had to undertake fundamental changes. From here we turn to consider these changes that are related to foreign interests seeking to enter the Korean market.[11)]

4.2 Liberalization of the FDI Regime after 1997

4.2.1 Paradigm Shift in the FDI Policy

Many observers see that the IMF saved Korea from defaulting on its foreign debt at the end of 1997, but there were strict conditions attached to the IMF bailout. These conditions required the Korean government to implement a package of policies that the IMF deemed necessary to remedy the causes of the 1997 financial crisis. These causes, which have been investigated extensively in the literature(Kwon 1998; Cha 2001; Jwa and Yi 2001), were directly linked to government policy and the distinctive structure of Korea's business environment. Hence, the IMF's remedial measures that the Korean government agreed to accept, required some fundamental changes in FDI policy and in the business environment that had created impediments to foreign interests.

Since the onset of the financial crisis, the Korean government has made particular efforts to attract FDI. It has switched its policy emphasis from 'restriction and control' to 'promotion and assistance'. The Korean government's adoption of sweeping measures to actively promote FDI was reflected in the enactment in 1998 of the Foreign Investment Promotion Act that replaced the Foreign Capital Inducement Act(1962).

11) For further details of the Korean business environment before the 1997 financial crisis, see Kwon(2001).

Under the new Act, the government has erased complicated administrative procedures by dismantling or relaxing more than 50 per cent of extant restrictions(KOTRA, 1999) and at the same time provided various types of incentives for FDI. More business sectors including distribution and financial services sectors have been opened to FDI, making the liberalisation rate 99.8 percent in terms of the number of business sectors open for FDI out of a total of 1,121 business sectors according to Korea's Standard Industrial Classification (MOCIE, 2002b).[12] As a result, Korea was brought into in

<Table 4.2> Business Categories with Restrictions on FDI, August 2002

Wholly restricted	Partly restricted
Radio and television broadcasting	· Inshore and coastal fishing · Cereal grain production · Cattle husbandry · Meat wholesaling · Publishing(newspapers, periodicals) · News agency activities · Coastal water transportation · Air Transportation · Telecommunications · Specialized banking · Trust and trust companies · Cable and satellite broadcasting · Electric power generation

Source : MOCIE(2002c), cited in J.D. Kim(2002)

line with general OECD practices in terms of sectoral restrictions by the end of 1998(Bishop, 2001).

12) For chronological developments of the liberalization of the service sector, see J.D. Kim(2002).

The business sectors for which FDI remains restricted - wholly or partly - are presented in Table 4.2. Most of those sectoral restrictions are in the areas of news media, national securities, public utilities(power and communications) and agricultural and food production.

4.2.2 Enhancement of FDI incentives

The new Foreign Investment Promotion Act provides a variety of incentives for FDI. Tax incentives under the Act are primarily aimed at attracting high technology and large-scale manufacturing investment. Thus, FDI that introduces advanced technology and FDI that located in services industries that support domestic industries and in the designated Foreign Investment Zones(FIZs) are exempt from income and corporate income taxes for the first seven years and are entitled to a 50 percent tax reduction for the next three years. Exemptions and reduction on income and corporate taxes on dividends are applied equally. For FDI that meets the above requirements, customs duties, special excise tax and value-added tax on its imported capital goods are also exempted. At the provincial level, foreign investors are exempt from local taxes for the period of eight to 15 years(Lee, B.K 2002 and Kim and Choo 2002).

Another type of incentive is establishment of industrial parks(Free Industrial Zones or FIZs) for FDI, with fully developed industrial infrastructure and financial support for medical, educational and housing facilities in the parks. To qualify to locate in FIZs, FDI should be undertaken in manufacturing industries, high-technology and high-technology services businesses with investment of over US$50 million and employment of 300 local workers. FDI thus qualified is also eligible for the same tax benefits as granted for FDI in advanced high-technology and high-technology services businesses.

The central government supports FDI through local governments. Local governments have substantial autonomy to administer and support FDI activities within their jurisdictions. The central government may lend financial assistance to local governments for the cost of establishing FIZs and procuring rental sites for FDI, and also for defraying education and job training costs incurred by local governments. Also foreign-invested firms located in FIZs are granted up to 100 percent rental-fee reductions for leasing national and local government properties(Kim and Choo 2002 and Lee, B.K. 2002).

4.2.3 Capital Market Liberalisation and M&A

The Korea government has abolished discriminatory laws and regulations against foreign investors in the Korean capital market, including the bond and stock markets. Korea's capital market has been liberalised so that foreigners can buy and sell stocks and bonds on the same basis as domestic investors. Ceilings on foreign equity ownership in the stock market have been eliminated. The compulsory open bidding system, which required a potential acquirer to openly purchase at least 51 per cent of existing shares of the company from public shareholders, was abolished. The maximum limit of shares that can be acquired without permission from the company board was increased from 19 per cent to 33 percent.

The liberalization of the capital market was accompanied by a relaxation of the rules governing foreign exchange. As part of the IMF conditions, Korea has maintained a flexible exchange rate system without state intervention. The Korean foreign exchange system has also been liberalised and deregulatory measures were successfully implemented in 1999 and 2001 whereby both the Korean public and foreigners can purchase foreign exchange without limit and international wire transactions for foreigners' remittance for business purposes are guaranteed(MOFE, 2002: 23). The Korean government announced long-term policy measures to deregulate the foreign exchange market with a target to develop Korea's foreign exchange market to rival the largest financial markets in Asia, such as Japan, Singapore and Hong Kong(MOFE, 2002: 23).

These changes in the capital market and in the rules of foreign exchange transactions liberalised M&A(including hostile M&A). M&A have in effect been promoted in conjunction with the liberalisation of the FDI regime. Before the 1997 financial crisis, M&A of domestic companies either by domestic or foreign investors was practically prohibited. However, since the crisis, takeover laws have been drastically liberalised, including takeovers of commercial banks in Korea by M&A. In essence, these developments have fully liberalised hostile takeovers(Korea Economic Weekly, 8 February 1999: 23). The ownership limit of commercial banks by a single Korean entity remains at 4 percent, but foreign investors can purchase up to 10 percent of a bank's shares (Kwon, 1998). As a result, as shown in Table 2.4 above, about 55 percent of FDI undertaken over the 1998-2000 period was in the form of M&A. The high proportion of M&A may reflect the depreciation of the Korean currency and asset sales at fire sale prices in the wake of the financial crisis as well as new business opportunities resulting from a host of policy changes as discussed above.

4.2.4 Corporate Governance Reforms

The reform of chaebols was a critical part of the IMF policy package and was crucial in improving Korea's business environment. The government's reform measures for chaebols have been focused on the following areas: enhancing the transparency and accountability of corporate management, boosting the rights of minority shareholders as well as institutional investors, and strengthening the capacity and function of boards of directors for listed companies. As a result of corporate reform, management transparency, corporate governance and financial soundness have improved, and a number of institutionalised privileges and the collusive government-chaebol relations that had provided various advantages over foreign firms have been eliminated. Since the abolition of foreign investment ceilings in domestic companies and acceptance of hostile M&A, foreign capital has substantially penetrated the Korean business sector. By the end of 2001, the number of foreign-invested companies(i.e., those with foreign-owned equity exceeding 10 percent) reached 11,515, or a 161 percent increment over the 4,419 companies at the end of 1997(KOTRA, 2002: 19). Foreign investors in Korean companies require increased management transparency, improved corporate governance and enhanced management efficiency. This in turn reduces both government intervention in business operations and the collusion between government and business.

4.2.5 Opening of the Service Sector

The business sectors that were liberalised for inward FDI since 1998 include a number of services: the financial sector, securities markets, commodity exchanges, investment companies and trusts, real estate, golf course operations, grain processing, insurance-related businesses, petrol service stations, power generation and waterworks(DFAT, 1999: 81-82). It is an epochal change to open the real estate market to foreigners, which is highly sensitive politically, whereby they can now purchase and hold real estate. Liberalisation of the financial services sector was also remarkable. In addition to the liberalisation of stock, bond and foreign exchange markets, foreigners are now allowed to establish subsidiaries of banks and securities companies. They are also allowed to provide investment advisory and life insurance, and are partially allowed to operate in banking and investment trust business.

As a result of opening the financial sector, one troubled bank(Korea First Bank) was purchased in September 1999 by Newbridge Capital of the United States, marking a watershed in the Korean financial market. By the end of 2000, foreigners had became the largest shareholders in the five major commercial banks(KOTRA, 2001: 19), and in three commercial banks foreigners participated in management(SERI, 1999a). As a result of opening the securities market, the aggregate market value of foreign-held stocks at the Korean Stock Market amounted to 36.0 percent of the total market value of Korean stocks as of the end of December 2002(KOTRA, 2003: 37). This portion was up from 14.5 percent at the end of 1997(KOTRA, 2001: 19).

For a long time, foreigners were prohibited from entering Korean distribution services. However, in conjunction with the launch of the WTO, Korea's accession to the OECD and the onset of the financial crisis, a remarkable liberalisation of the distribution sector has been undertaken. By relaxing the zoning and land development regulations and by allowing foreigners to purchase land and other real estate for business and non-business purposes, the Korean distribution sector has opened to foreigners. As a result, a number of the huge foreign discount retailers and chains such as WalMart, Costco, Carrefour, Promodes, Tesco, and the Price Club have already begun to set up shops in Korea(Kim and Kim 2001).

A few service sectors remain completely off limits for FDI. Radio and television broadcasting are wholly restricted. Other industries where foreign investment is limited to a minority stake include Korea's telecommunications carrier, some airline activities, cable broadcasting, and power generation and distribution. Foreign investment in newspapers, other media and banking is restricted and examined closely to ensure compliance with the "national interest".[13] In addition, some services are precluded from the list of subsectors where FDI is allowable. For instance, FDI in education up to high-school level is wholly restricted. Some other services have licence and qualifications requirements that make it effectively impossible for foreign service providers to gain market access. Foreign lawyers and medical physicians must have domestic licenses, which can be obtained by passing the national examinations in the respective fields, effectively prohibiting foreigners from obtaining licences.

4.2.6 Labour Sector Reforms

The Korean government intervened extensively in the labour market until the late 1980s. It promoted the rights of management at the expense of labour, suppressing union activities and intervening in labour disputes. At the same time, the government maintained a rigid labour market in the sense that workforce retrenchment was impossible. As the demand for labour expanded alongside expansion of the economy, the rigidity of the labour market was never a serious political or economic issue. Taking advantage of pro-management government policy, management applied authoritarian methods of labour management. When labour disputes arose, management relied on government to resolve these disputes, instead of learning the skills of conciliatory labour management. Political democratization towards the end of the 1980s caused a turning

13) For the service sectors in which FDI is restricted, see Kim and Kim (2001).

point in the Korean labour market, after which militant union activities became rampant, raising labour costs well above productivity. High labour costs together with labour market rigidity reduced Korea's international competitiveness, contributing to the financial crisis.

The 1997 financial crisis was another turning point in the Korean labour market, after which fundamental changes were introduced. One of the IMF's conditions for its rescue-financing package required Korea to ease the structural rigidity of the labour market, so that companies are able to lay off workers in the cases of business emergency, M&A and restructuring. Accordingly, the government managed to reform the labour law in 1998 in order to improve the flexibility of the labour market. The new labour law allows workforce retrenchment, part-time employment, and flexible working hours. For the first time in Korean history, layoffs of workers are now allowed in the event of urgent management needs such as business transfers and M&A caused by extreme financial difficulty. A number of precedents demonstrating the social acceptance of layoffs have been established(MOFE, 1999: 14), creating a new era for human resource management in the sense that lifetime employment is no longer taken for granted. This amendment facilitates the necessary restructuring of the corporate sector and allows firms to function more competitively. At the same time, the position of workers has been enhanced through the introduction of minimum wages and employment insurance. The configuration of the Korean labour market has also changed remarkably since the revision of the labour laws with an increase in the proportion of part-time workers at the expense of full-time workers(SERI, 1999b).

However, progress of the labour market reform has been quite limited, largely because of the stringent procedural restriction imposed on layoffs(Kim and Choo, 2002: 25). For example, to discharge redundant employees, a firm has to obtain advance consent from labour unions and show that its business conditions are near bankruptcy. Then, new employers are obliged to first reemploy dismissed workers when filling future vacancies. Also, there are enormous costs associated with staff retrenchments, such as large severance payments. Because of these rigorous requirements for worker retrenchment, companies tend to increase part-time workers at the expense of full time workers, which decreases the security and employment benefits of workers overall. Therefore, the aforementioned rigorous requirements for labour force retrenchment need to be relaxed to improve labour market flexibility and to expedite economic restructuring, as well as to improve the wellbeing of the labour force in the long run.

4.2.7 Changes in the Business Management System in Korea

Management practices at on-site operations have been changed substantially since the 1997 financial crisis. With the opening of the domestic market to international competition, on-going reform of businesses and banks, and declining collusive government-business relations including chaebol privileges, Korean companies and banks are no longer able to enjoy monopolistic operations within the shielded domestic market. They have to compete against foreign counterparts that are well equipped with capital and technology. The myth that big companies and banks could never fail has already disappeared. For their very survival, Korean companies will need to operate as efficiently as their foreign counterparts. Under these circumstances, Korean companies will not be able to retain the traditional Korean management system, although part of the system ingrained deeply in Korean culture is unlikely to be abandoned easily.

For the sake of survival, Korean companies will need to replace clan management with management by efficient pro- working hours will break the costly and inefficient convention of guaranteeing lifetime employment for workers. The seniority system with its hierarchical structure will be rendered unsustainable in the long term under increasing international competition. As job security in domestic companies declines together with the disappearance of lifetime employment, the loyalty of employees towards companies will abate, undermining the practicability of top-down decision-making and autocratic leadership.

4.2.8 Opening Korea's Closed Society

Foreign firms will find it easier to operate in Korea not only because of the change in the Korean management system toward the western system, but also because of the increasing availability of competent workers who will accept employment with them. As the myth of chaebols' immunity from bankruptcy disappears and job security in domestic companies declines, the preference of Korean workers to work for domestic firms rather than foreign firms will decline. Foreign firms will thus find it easier to recruit competent local staff. Once laying off workers becomes common practice among Korean companies, early retired middle managers will be readily available for foreign companies. The availability of talented female workers will also remain an important recruitment source for foreign companies.

As foreign companies, foreign-owned banks and companies with foreign capital participation play an increasingly important role in the Korean economy, the importance of personal relationships in business operations will diminish, and the existing business networks will undoubtedly change. Under the scrutiny of foreigners, personal relationships may not influence business operations to the extent and in the manner in which they did so powerfully in the past. Many Korean suppliers and financial institutions will volunteer to be incorporated into the industrial network formed by foreign companies for the sake of their own survival.

4.3 Remaining Issues in FDI Policy

Although the FDI regime has been liberalised and the entry procedure has been streamlined to be on par with other OECD countries, there is substantial room to improve particularly seen by foreign investors.[14] Among the long list, important pending issues include the lack of transparency and consistency in regulations, policy making and implementation, intrusive bureaucrats, bureaucratic stonewalling at lower levels of government, and inter-agency turf wars, the lack of transparency in financial reporting on the part of Korean companies, foreign exchange control, and restriction on the legal-service market.

Another set of critical obstacles to FDI are related to the poor quality of domestic business environment, including uncompetitive tax rates, continued rigidities in the labour market, and living conditions of foreign expatriates. The Korean tax laws are ambiguous and Korea's maximum tax rates are higher than those in Singapore and Hong Kong. Korean labour laws discourage firms from dismissing staff, and a company cannot downsize until it is facing a financial crisis. Thus, the manufacturing sector where cheap and pliant labour is needed for low-cost operations will not be able to attract FDI. It should be noted that the obstacles to FDI arising from the unconducive business environment are faced not only by foreign investors but also by domestic firms, and they are partly regulatory matters and partly cultural issues. Thus, it would be more complex to remove them.

14) AMCHAM(2002), EUCCK(2002), Economist Intelligence Unit(2002).

5. A Survey of FDI in Korea

5.1 Background of the Survey

To investigate the motives and concerns of foreign companies and the issues that they have experienced in pursuing their investment and business operations in Korea, a comprehensive survey was conducted from May to July 2002 of foreign companies that had undertaken direct investment and were currently operating businesses in Korea. The survey was premised on recognition that FDI is affected not only by entry regulations but also by on-site managerial restrictions and expatriate living conditions in the country under consideration. A questionnaire was developed and distributed to foreign companies and to foreign expatriates who work for foreign companies located in Korea. In order to supplement the survey and garner additional information, personal interviews were conducted with a number of the responding company representatives and some foreign expatriates.

The questionnaire comprised six sections that questioned respondents on: (i) general characteristics of responding companies, (ii) determinants of their direct investment in Korea, (iii) their perception of Korean chaebols, workers and management system, (iv) managerial issues from on-site business operations in Korea, (v) their perception of changes in the Korean business environment after the 1997 financial crisis, and (vi) living conditions for foreign expatriates. The questionnaire contained 96 specific questions relevant to the present task.

5.2 General Characteristics of Responding Companies

For the survey, foreign companies in Korea were chosen from those listed in 2002 in the Chambers of Commerce in Korea of the United States, Japan, EU and Australia-New Zealand. The survey questionnaire was distributed to about 100 Australian companies by the Internet and about 300 other foreign companies by regular mail. Non-Australian companies were mainly those whose direct investment in Korea was more than $5 million. Altogether 53 companies and 16 individual foreign expatriates responded. The business areas in which the company respondents have undertaken investment in Korea include 12 in the manufacturing sector and 39 in the service sector.[15] This distribution of respondents by industry broadly represents that of the population, as indicated in Table 2.6. For the manufacturing and service sectors, the sample distribution of FDI projects by industry is shown in Table 5.1.

15) Two respondents failed to indicate the industries in which they invested. Foreign expatriates working in Korea did not specify their industries.

<Table 5.1> Sample distribution of FDI projects in Korea by industry

Industry	Number of FDI projects
Petrochemical industry	2
Metal and machinery	2
Electronics and electrical equipment	3
Food processing	3
Transport equipment	2
Total for the manufacturing sector	12
Finance	4
Insurance	1
International trade	1
Wholesale and retail	8
Construction	5
Tourism and hotel	1
Utilities(electric power and gas)	1
Business consulting	3
Other business	15
Total for the service sector	39

In terms of ownership of the projects in which they had investment, 41 companies had 100 percent ownership(fully owned branch, wholly owned subsidiary or independent company), and the remaining seven companies were joint ventures with Korean companies. The chief executive officers were expatriates in 34 companies and Koreans in 16 companies. In terms of the level of employment, 20 companies employed fewer than 50 workers(designated as small companies), and 26 companies employed more than 50 workers. In terms of ownership of the projects in which they had investment, 41 companies had 100 percent ownership(fully owned branch, wholly owned subsidiary or independent company), and the remaining seven companies were joint ventures with Korean companies. The chief executive officers were expatriates in 34 companies and Koreans in 16 companies. In terms of the level of employment, 20 companies employed fewer than 50

workers(designated as small companies), and 26 companies employed more than 50 workers.

<Table 5.2> Ownership Distribution of Sampled FDI Projects

Types of ownership	Number of projects
Fully owned branch	10
Wholly owned subsidiaries	26
Independent companies	5
Joint ventures or strategic alliances	7

5.3 Survey Results

5.3.1 Determinants of FDI in Korea

Companies were asked to rate the importance on a Lickert scale of 1(least important or agreeable) to 5(most important or agreeable) for 11 possible factors that helped determine their choice. The higher the average rating of the factor, the greater its importance. Nine variables concerned the location-specific factors, one variable concerned ownership advantage, and one concerned the oligopolistic behaviour of parent companies in their home countries. The results for these questions appear in Table 5.3.

Serving the Korean market was the predominant motive of these companies to invest in Korea. Of the 11 possible factors listed on the survey questionnaire, 'expected growth of the Korean market' ranked highest with an average score of 4.352 (Table 5.3). Other location-specific variables that were regarded as marginally important were 'advanced related industries', 'easy access to information and technology' and ‘abundant skilled workers’ with mean scores of, respectively, 2.706, 2.385 and 2.294. It is interesting to note that ‘investment incentives by Korea’ was not regarded as an important factor, with a mean score of 1.980. Respondents did not indicate ‘easy access to parts and materials’ as an important investment motive in Korea with a score of 1.843. Nor did they regard Korea as a country with ‘low production costs’ with a score of 1.804. Finally, ‘overcoming tariff and other import barriers’ with a mean score of 1.788 was not a significant factor for investment in Korea. As the Korean economy has been highly liberalised, with trade regulations consistent with the WTO principles, ‘overcoming tariff and other import barriers’ was not regarded highly as an influencing factor for FDI.

<Table 5.3> Determinants of FDI in Korea

Factors	N	Average Ratings	Standard Deviation
Expected growth of the Korean market	54	4.352	0.850
Advanced related industries in Korea	51	2.706	1.270
Easy access to information and technology	52	2.385	1.140
Abundant skilled workers	51	2.294	0.944
Investment incentives offered by Korea	50	1.980	1.169
Easy access to parts and materials	51	1.843	1.138
Low production costs	51	1.804	1.077
To overcome tariffs and other imports barriers	52	1.788	1.177
To make use of patents, technology, brands, know-how or expertise of your company	52	3.096	1.498
To follow competitors‘ entry into Korea	52	1.962	1.188
To gain market access to other Asian markets	52	1.962	1.236

As Hymer(1960) and Dunning(1998) suggest, a firm entering from abroad must have some firm-specific advantages that its local competitors do not have. To investigate the firm-specific advantages of foreign investors entering the Korean market, the questionnaire offered a question, 'to make use of patents, technology, brands, know-how or expertise of your company'. As shown in Table 5.3, foreign firms were reasonably confident about their firm-specific advantages as a factor that had influenced their FDI in Korea, as reflected in the second highest average score of 3.096. From the determinant factors to which foreign firms responded, it may be inferred that, as Dunning's eclectic theory suggests, foreign firms invested in Korea to capitalise on the emerging business opportunities by means of their firm-specific advantages, with 'abundant skilled labour', 'easy access to information and technology', and 'advanced related industries' also influencing their decisions.

It is interesting to note that 'to follow competitors' entry' into Korea was ranked quite low at 1.962. This suggests that Knickerbocker's model of imitative FDI behaviour of following competitors is likely to have little explanatory power for FDI in Korea. It also appears that foreign investors did not consider Korea as a stepping stone to other Asian markets, as shown by a low score of 1.962 for the factor 'to gain market access to other Asian markets'. In other words, foreign firms do not undertake FDI in Korea as a production centre or hub for surrounding countries, which runs counter to the recent Korean campaign to promote Korea as the business hub in Northeast Asia.

5.3.2 Difficulties in Setting up Investment Projects in Korea

The survey also attempted to identify 'the factors that unfavourably affected foreign investment in Korea' during the preparation process for investment in Korea, with nine specific questions. The survey findings suggest that foreign investors found that the process for investment in Korea was in general still onerous, as indicated by the overall average score of 2.952 for the nine questions(Table 5.4).

<Table 5.4>Difficulties in the FDI Preparation Process

Types of difficulties	N	Average rating	Standard deviation
Cultural and communications difficulties	53	3.453	1.186
Complex administrative procedures	50	3.420	0.992
Ineffective corporate governance of Korean firms	52	3.212	1.304
Opaque financial statements of Korean firms	53	2.906	1.377
Difficulties in understanding the Korean market	52	2.904	1.176
Concerns with militant unions	51	2.843	1.488
Inadequate protection of intellectual properties	52	2.827	1.382
Difficulties in M&A	51	2.549	1.390
Difficulties in selecting business partners	51	2.451	1.154
Average	51	2.952	1.272

'Cultural and communication difficulties' were most serious with an average score of 3.453. 'Complex administrative procedures' were still considered difficult(3.420). This may indicate that the Korean government's streamlining of the administrative procedure for FDI might not be working well or that other types of administrative difficulties remain. Two other types of serious difficulties were related to understanding of and dealing with Korean companies. Foreign business people indicated 'ineffective corporate governance of

Korean firms' and their 'opaque financial statements' as difficulties with scores of, respectively, 3.212 and 2.906. This may indicate that, as seen by foreign business people, the restructuring reform of Korean companies was incomplete. 'Difficulties in understanding the Korean market', 'militant unions' and 'inadequate protection of intellectual properties', though moderate, were also pointed out by the survey participants. It appears that undertaking 'M&A' and 'selecting business partners' were not regarded as difficult.

5.3.3 Improvement in Korea's business environments since 1997

It has been argued that the business environment in Korea has improved since 1997. The questionnaire included 17 questions to assess this argument and to identify specific improvements, if any, in the Korean business environment as observed by foreign business people. Each of these questions and its rating are shown in Table 5.5. Foreign business people had a moderately negative view in general of the improvement in the business environment in Korea, as indicated by an overall average rating of 2.725.

With regard to improvements in the area related to political risk and government-business relations, respondents expressed negative opinions on all except 'political stability'. They considered that 'political stability' had improved moderately in South Korea with a mean score of 3.333. However, 'North-South Korean relations' were not seen to have improved, as indicated by an average score of 2.726. Foreign business

<Table 5.5> Improvements in the Korean Business Environment

Types of Improvements	N	Average rating	Standard deviation
Political stability in South Korea	63	3.333	0.916
More transparent and consistent regulations	63	2.841	0.971
Decreases in government regulations and interference	64	2.797	0.995
Improving North-South Korean relations	62	2.726	1.190
Decreasing cronyism and corruption	64	2.594	0.921
Improving intellectual property right protection	62	2.565	1.096
Deregulation of the real estate market	59	2.525	0.971
Declining entry barriers into Korean distribution system	60	2.467	0.929
Optimistic economic prospects	63	3.746	0.950
Koreans becoming better business partners	61	2.820	1.088
Level-field competition with Korean firms	63	2.524	0.965
Decreasing importance of personal relationships in business	62	2.274	0.926
Easier to hire and retain local workers	61	2.672	0.870
Easier to dismiss Korean workers	62	2.435	1.140
Declining union militancy	61	2.410	1.023
Declining Koreans' discrimination against foreign products	62	2.887	1.088
Declining cultural and communication difficulties	63	2.714	1.054
Average	62	2.725	1.005

people did not consider that 'transparency and consistency in government regulations' had improved considerably, with a mean score of 2.841. Nor did they think 'government regulations and interference' and 'cronyism and corruption' had improved considerably with means scores of 2.797 and 2.594 respectively. Respondents also indicated their belief that protection of intellectual property rights had not improved, with a score of 2.565. They also generally held the view that 'regulations on the real estate market' and 'distribution system' had not improved.

Interviews with survey participants revealed their view that there was substantial inconsistency in the policy, regulations and administrative procedures between the central and local governments. Some foreign expatriates voiced their concern at the opacity and variability in interpreting and applying regulations at the local government level. They were also aggrieved by inter-authority turf wars between fire, police, construction, and environmental authorities at both local and regional levels, since these battles delays approval requirements.

In terms of business prospects and business relations with Korean companies, respondents were quite optimistic about the improvement of Korean 'economic prospects', with a mean score of 3.746. However, they had negative views on improvements in their business relations with Korean companies. Views on improvements in Korean companies 'becoming better business partners' or 'engaging in level-field competition' were moderately negative, with mean scores, respectively, of 2.800 and 2.524. It is instructive to note that foreign business people did not consider that the 'importance of personal relationships in daily business operations' had declined, as indicated by a mean score of 2.274. This runs counter to an intuitive perception of many business people in Korea that the Korean management system has of necessity shifted substantially toward the western system that stresses rationality over personal relationships. Respondents' view about the persistent importance of personal relationships in business operations in Korea supports the long-held belief that cultures die hard.

Foreign business expatriates expressed quite strongly negative views on improvements in labour relations. They had a negative, though moderate, view about Korea becoming 'easier to hire and retain local workers', with a mean score of 2.672. They disagreed that 'dismissing Korean workers' was becoming easier, with a mean score of 2.435. Likewise, they strongly disagreed with the statement on 'declining union militancy' with a mean score of 2.410, suggesting strongly that union militancy remains part of the major difficulties in on-site management. Through personal interviews, survey participants expressed strong feelings about the inflexibility of Korean workers, and that militant unions were one of the major difficulties in Korea.

Foreign business people expressed the view that discrimination in Korean society against foreigners and foreign products and difficulties in their cultural and communication improved only marginally. They saw that Koreans' discrimination against foreign products had declined moderately, as indicated by an average score of 2.887. Similarly, 'cultural and communication difficulties' improved marginally, as indicated by a mean score of 2.714. In personal interviews, participants expressed their view that Koreans are still nationalistic and narrow-minded and do not appreciate racial diversity in the world as a matter of fact. They also considered that Koreans did not accept well inter-racial marriages and mixed-race children. A number of participants commented that non-Korean products were not readily available, and that Korea would need more restaurants with foreign and varied menus. Some participants also spoke of conflicts they experienced with Koreans partners and other Koreans, as a result of a lack of understanding of each other's cultures and institutions.

5.3.4 Management of on-site operations in Korea

On the premise that the management of on-site operations for FDI projects in Korea will have important bearing on future FDI in Korea, the survey questionnaire included 19 questions designed to identify difficulties encountered in operating and managing businesses in Korea. The results were consistent with the negative views, mentioned above, on improvements in the Korean business environment. As shown in Table 5.6, most of the difficulties rated quite high scores, with an overall average score of 3.186. This contrasts with the difficulties encountered in the process of undertaking FDI, which respondents ranked relatively lowly. These survey findings may indicate that the Korean government provides various types of support, incentives and assistance in attracting FDI and streamlining the FDI procedure, while it does not perform as well in supporting the on-site operations of FDI projects. It should also be noted that a major portion of the difficulties in on-site management are related to Korean companies or market forces, which are beyond government control in the more liberalized market.

<Table 5.6> Difficulties in On-site Management

Types of Difficulties	N	Average rating	Standard deviation
Lack of transparency and consistency in regulations	61	3.836	1.083
Prevailing cronyism and corruption	63	3.714	1.300
Excessive discretionary power of bureaucrats	61	3.705	1.387
Excessive government regulations	62	3.516	1.238
Complex tax systems	61	2.820	1.041
Poor social overhead capital (infrastructure)	61	2.656	1.124
Importance of personal relationship in business	61	3.836	1.083
Unfair advantages held by Korean firms(chaebols)	63	3.651	1.322
High overhead costs(rent, insurance, utilities)	61	2.967	1.238
High entry barriers to the distribution system	62	2.790	1.332
Conflicts with Korean partners	60	2.567	1.407
Difficulties in getting parts and materials	60	2.183	1.295
Difficulties in recruiting and retaining efficient local workers	61	3.066	1.223
High wage and low labour productivity	63	3.048	1.156
Militant unions	60	2.767	1.407
Cultural and communication differences	62	3.597	1.108
Koreans prejudice against foreign firms and foreign products	62	3.371	1.283
Korean society closed to foreigners	60	3.333	1.100
Poor social amenities for expatriates families	60	3.117	1.329
Average	61	3.186	1.159

In the area of government-business relations, 'lack of transparency and consistency in regulations', 'prevailing cronyism and corruption', 'excessive discretionary power of bureaucrats', and 'excessive government regulations' were all regarded as difficult areas, with mean scores ranging from 3.516 to 3.836. The 'tax system' and 'poor social overhead capital(infrastructure)' were not regarded as seriously difficult areas.[16)]

16) It appears that the views of foreign expatriates on government-business

On their business operations and relations with Korean companies, respondents rated 'importance of personal relationships in business' as the most difficult area and 'unfair advantages held by Korean firms especially chaebols' as the second most difficult area with the average scores of 3.836 and 3.651 respectively. Because respondents perceived that Korean firms still rely heavily on personal relationships in business operations, they considered themselves disadvantaged. As indicated above, this is quite different from the prevailing perception among Korean business people that Korean management is moving toward western management in which personal relationships have much less bearing on business operation. 'High overhead costs(rent, insurance, utilities)' were considered a difficult area, although moderate, by comparison with other difficulties, with a mean score of 2.967. Other types of difficulties in relations with Korean business were not considered as serious, including 'entry into the Korean distribution system', 'conflicts with Korean partners', and 'getting parts and materials', with mean scores ranging from 2.183 to 2.790.

In the area of human resource management, 'recruiting and retaining efficient local workers' was regarded as the most difficult task with a mean score of 3.066. This is consistent with views discussed above, indicating that respondents saw human resources as an area that had not improved in recent years. 'High wage levels and low labour productivity' were

relations in Korea are quite consistent with those expressed by the World Economic Forum(Korea Times, 13 November 2002).

also regarded as an area of concern, with an average score of 3.048. 'Militant unions' were not regarded as part of the major management difficulties with a score of 2.767, even though, as indicated above, respondents claimed that union militancy had not improved. This perception appears to be attributable to the characteristics of respondents, in that the majority of the responding companies were in the service sector where unions are typically less militant.

Foreign business people considered that coping with culture and society was difficult for them and, as indicated above, they felt that circumstances had not improved significantly for them in recent times. 'Cultural and communication differences' was ranked highest with a score of 3.597. They viewed that Koreans had some prejudice against foreign firms and products with a score of 3.371, and that Korean society was closed to foreigners, with a score of 3.333. Finally, many respondents regarded poor social amenities for expatriate families as a serious concern, with a score of 3.117.

5.3.5 Respondents' Views of Korean Firms(Chaebols)

The Korean government and Korean firms have lessons to learn from understanding the perceptions that foreign business people have of Korean firms and workers and the changes under way here. In particular, they can learn from understanding how foreign business people view the restructuring of chaebols. To this end, the questionnaire asked six questions to identify how respondents perceived recent changes in chaebols as their business counterparts. As shown in Table 5.7, foreign business people had negative views on the improvement of chaebols as indicated by an overall average score of 2.501. Related to chaebols reform, foreign respondents did not consider that 'corporate governance' and 'operational transparency' had been improved as indicated by average scores of 2.525 and 2.468 respectively.

<Table 5.7> Respondents' View of Recent Changes in Chaebols

Types of Changes	N	Average rating	Standard deviation
Better corporate governance	59	2.525	0.953
More transparent operation	62	2.468	0.987
Becoming more efficient recently	64	2.844	0.821
Declining dominance in Korean business	64	2.531	1.168
More cooperative as business partners	63	2.603	0.773
Competing on a level-playing field	63	2.032	0.842
Average	63	2.501	0.924

It appears that foreign business people view chaebols as adversarial competitors. They considered chaebols 'becoming more efficient recently' marginally, with a mean score of 2.844. They did not view the chaebols' dominance in Korean business as declining, nor did they view chaebols as becoming more cooperative business partners. In particular, they did not think that chaebols were competing on a level-playing field.

5.3.6 Respondents Views of Korean Workers

The questionnaire included 10 questions related to foreigners' views of Korean workers. Seven questions asked about positive aspects of Korean workers and the remaining three asked about the negative aspects of Korean workers.

Foreign business people agreed strongly with positive aspects with an overall average score of 3.297. They disagreed marginally with negative aspects, with an overall average score of 2.958(Table 5.8).

<Table 5.8> Respondents' View of Korean Workers

Characteristics of Korean workers	N	Average rating	Standard deviation
Willing to work for foreign companies	64	3.656	0.877
Hard working	64	3.594	1.205
Highly loyal to company and supervisors	65	3.477	1.120
Highly collaborative team spirit	65	3.431	1.131
Willing to be trained for new jobs	65	3.185	1.088
Highly skilled and efficient	65	2.923	0.973
Highly reliable and stable	65	2.815	0.983
Average of the above 7 items	65	3.297	1.054
Low English language skill	57	3.281	0.959
Highly unionized and militant	46	2.826	1.161
Changing jobs frequent	64	2.766	1.151
Average of the above 3 items	56	2.958	1.090

The average scores for five of the seven questions that asked about the positive characteristics of Korean workers were higher than 3.0. Of the seven questions, the highest score of 3.656 was given to the statement that Korean workers were 'willing to work for foreign companies'. This may show a significant change in workers' mind-set from their earlier preference to work for domestic companies. Korean workers have a reputation as hard working and highly skilled. These characteristics are reflected in a high score of 3.594 for the response to 'hard working'. However, foreigners marginally disagree with the statement that Korean workers are 'highly skilled and efficient' with a score of 2.923. Foreign business people also agreed with other positive aspects of Korean workers, such as being 'highly loyal to their companies and supervisors', having 'highly collaborative team spirit', and being 'willing to be trained for new jobs'. However, responses on 'high reliability and stability' were rated an average score of 2.815, indicating respondents' marginal disagreement with the characteristics. Overall, however, these survey findings confirm the reputable characteristics of Korean workers.

Foreign respondents disagreed, although marginally, with the negative aspects of Korean workers, with an overall average score of 2.958. Poor English language skills were rated as the most serious issue, with an average score of 3.281. 'Highly unionised and militant' characteristics of Korean workers were not too serious a concern, as indicated by a score of 2.826. This is consistent with the view of foreign expatriates that, as pointed out earlier, while militant unions are a concern, they are not a serious issue for on-site management. The rating of concern about low English language skill higher than concern about union militancy suggests clearly the direction needed in human resource development policy. Finally, foreigners disagreed, although modestly, with the idea that Korean workers 'change jobs frequently', with a mean score of 2.766(Table 5.8).

5.3.7 Respondents' View of Changes in the Korean Management System

It has been argued that the Korean management system has changed considerably toward the western system since the financial crisis in 1997. To develop an understanding of how foreign business people view changes in the Korean management system, the questionnaire included 12 questions that asked their views on changes in various aspects of the management system such as: the objectives of firms, decisionmaking process, organization, leadership, human resource management, overall management efficiency, and overall change.

<Table 5.9> Respondents' View Changes in the Korean Management System

Types of Changes	N	Average rating	Standard deviation
Becoming more profit-oriented management	63	3.349	1.003
Decreasing layers in the hierarchical organizational structure	66	2.591	1.007
Fading of the top-down, authoritarian decision making system	65	2.262	1.065
Fading paternalistic leadership	64	2.594	1.050
Disappearing life time employment practices	64	3.156	1.130
Increases in the lay-off of workers	63	3.032	0.999
Merit-based promotion and compensation	65	2.615	0.963
Willingness to hire foreign workers	64	2.719	1.046
Recruitment by merit rather than by personal connections or university background	65	2.462	1.047
Disappearing seniority system	66	2.394	1.080
Rising overall management efficiency	64	2.734	0.840
Korean management becoming more like yours	61	2.328	0.944
Average	64	2.686	1.015

Respondents had a negative view overall of changes in the Korean management system as indicated by an overall average score of 2.686 for the 12 types of possible changes included in the questionnaire(Table 5.9). Of these 12 possible changes in Korean management, Korean companies developing 'more profit-oriented management' was rated most highly, with an average rating of 3.349. This finding suggests that Korean firms are moving from their traditional business objectives of maximum growth or maximum market shares toward profit maximization as is generally the case for western firms. 'Decreasing layers in the hierarchical organizational structure' was rated at a mean score of 2.591, suggesting that in the view of foreign business people the hierarchical organizational structure of Korean companies is not declining significantly. Consistently, the findings also indicated that the top-down, authoritarian decision-making system was not changing to a considerable extent, as indicated by a low mean score of 2.262. Finally, a mean score of 2.594 for 'fading paternalistic leadership' indicated that from the viewpoint of foreign business people, the paternalistic style of leadership is not really fading in Korean management.

Respondents generally viewed that human resource management in Korea had changed little. The average score on six types of possible changes in human resource management was 2.730. Of those six types of changes, four aspects were rated less than 3.0, while two were rated higher than 3.0. Foreigners generally agreed with the views that 'lifetime employment practices are disappearing' with a score of 3.156, and marginally agreed with the view that 'lay-off of workers is increasing', with a score of 3.032. This indicates respondents' perception that, although lifetime employment practices are disappearing, other conventional human resource management practices are changing little. Respondents appeared to disagree that changes were towards 'merit-based promotion and compensation', 'recruitment by merit' and 'disappearance of seniority system' which were rated, respectively, at 2.615, 2.462 and 2.394. They also disagreed, although marginally, that change is evident in Korean companies' 'willingness to hire foreign workers'.

Finally, respondents indicated they disagreed marginally that changes were towards overall efficiency of Korean management, and that the Korean management system was becoming similar to their own system. The average rating for the former was 2.734 and for the latter was 2.328(Table 5.9). The survey findings suggest that from the perspective of foreign expatriates in Korea the Korean management system remains more or less unchanged, except that it is becoming more profit oriented and that lifetime employment is disappearing.

5.3.8 Respondents' Views of Expatriates' Living Conditions in Korea

Certainly, the issue of living conditions of foreign expatriates and their families in Korea has an important bearing on incoming FDI. Thus, the survey questionnaire included a set of questions, seeking to identify views about some improvements, if any, in the living conditions of foreign expatriates.

As shown in Table 5.10, foreign expatriates had strongly negative opinions on improvements in their living conditions in Korea, as indicated by an overall average rate of 2.192 for the seven possible types of improvements. They viewed that 'social amenities' had improved marginally, as indicated by a mean score of 3.015, while they disagreed marginally with

<Table 5.10> Respondents' View of Expatriates' Living Conditions in Korea

Types of Improvements	N	Average rating	Standard deviation
Improving social amenities(crime, traffic accidents, etc)	68	3.015	1.165
Declining prejudice against foreigners	68	2.765	1.024
Improving overall living costs	65	2.154	0.939
Reasonable rent and real estate price	68	1.956	1.085
Improving environmental pollution	67	1.940	0.936
Declining traffic congestion	68	1.735	0.891
Average	66	2.192	0.991

the statement that Koreans' 'prejudice against foreigners' had weakened, as indicated by a score of 2.765. However, the remaining types of improvement in living conditions, such as 'improving overall living costs', 'reasonable rent and real estate prices', 'improving environmental pollution', and 'declining traffic congestion' were all rated quite low, ranging from 1.735 to 2.154. These results suggest that in the view of foreign expatriates the cost of living in Korea, including rent and education costs, are high, and environmental pollution and traffic congestion are not improving. These findings also suggest that in its bid to attract more FDI, the government should pay more attention to improving the living conditions of foreign expatriates.

6. Summary and Concluding Remarks

In contrast to international trade, which expanded rapidly and played the role of engine for economic development in Korea, inward FDI has remained sluggish and failed to contribute significantly to Korean economic growth. Although it is well established that FDI can enrich a host country's economy in a number of ways, the Korea government restricted and controlled FDI, particularly up to the 1997 financial crisis, largely because of its historical obsession with protecting domestic industries and management control. A number of industrial sectors were closed to FDI by law until the mid-1990s and even in those areas where FDI was permitted, the administrative regulations and processes for FDI were complex and opaque.

The Korean economic structure and socio-culture were not conducive to incoming FDI. The Korean economy was heavily concentrated in a handful of large chaebols that enjoyed various types of institutionalised advantages over foreign firms. The Korean labour market was not flexible and unions were renowned for their militant tactics. Foreigners also encountered various difficulties in on-site management of their businesses, which resulted from the lack of transparency and accountability in the corporate governance of Korean companies, the cronyism prevalent in business-government relations, and poor living conditions for foreign expatriates. Korean society had been xenophobic, and Korean workers, in general, preferred to work for domestic firms rather than for foreign firms. As a result, Korea was regarded as the worst place to invest among Asian nations until 1997. These restrictions of FDI and unhealthy FDI environments were reflected in the flagging level of FDI in Korea.

After the 1997 financial crisis, the Korean government has undertaken a paradigm shift in the FDI policy from "restriction and control" to "promotion and assistance", and undertaken a series of policy measures and all-out efforts to improve business environment and attract FDI. Korea opened more industrial sectors to FDI and streamlined investment procedure. Together with the liberalization of the capital market, Korea has liberalized M&A(including hostile M&A). Business environment has also improved remarkably since 1997. As a result of chaebol reforms, part of the institutionalised privileges bestowed on chaebols and the collusive government-chaebol relations have been eliminated. Corporate governance and management transparency and accountability of Korean firms have improved. Penetration of foreign capital into the Korean business sector has reduced government intervention in business operations. As a result of its reform, the Korean labour market has improved substantially its flexibility. Korean society and culture have also changed. Korean people have changed their perceptions of incoming FDI and come to appreciate the value of FDI in aiding recovery of the crisis-stricken economy and in sustaining economic prosperity. As a result, inward FDI in Korea surged over the three-year period 1998-2000.

Notwithstanding the rapid increases in FDI in the recent past, the magnitude of FDI in Korea is still small as compared to other countries. Furthermore, in 2001, FDI in Korea fell sharply and further declined in 2002. How, then, would the relatively low magnitude of FDI in Korea and a recent sharp decline be explained, despite the liberalization of the FDI regime and the country's all-out efforts to attract FDI? Under these circumstances, what additional measures should the Korean government and Korean people undertake to increase FDI inflows to a level comparable internationally? The objective of this study is to address these vexing questions by investigating the underlying factors for sluggish FDI in Korea from a foreign perspective. To this end, a comprehensive survey was conducted from May to July 2002 of foreign companies that had undertaken FDI and have been operating business in Korea. A questionnaire comprising six sections and 96 questions was distributed to about 400 foreign companies, and 69 of them responded. The questionnaire attempted to investigate the motivations for and difficulties in undertaking FDI in Korea, issues in on-site management, recent improvements in the Korean business environment, and living conditions for foreign expatriates in Korea.

According to the survey results, foreign firms chose to pursue FDI in Korea to capitalise on the emerging business opportunities in Korea by means of their firm-specific advantages, as Dunning's eclectic theory suggests. Foreign firms did not regard Korea as a target country for supply-seeking investment. They considered that Korea did not have competitive production costs and that Korea was not a stepping stone to gain market access to other Asian countries. Foreign investors did not see investment incentives by the Korean government as an important factor for attracting their investment to Korea, and they were not following their competitors' entry into the Korean market.

The survey results indicate that foreign investors encountered various types of difficulties in establishing FDI projects in Korea. They pointed to the continuing complexities of registration, notification, licensing and approval requirements. Other problems included bureaucratic stonewalling, particularly at lower levels of government, and inter-agency turf wars that delay approvals. In the area of business relations with Korean companies, foreign business people pointed out ineffective corporate governance, lack of transparency in the financial statements of Korean firms, inadequate protection of intellectual property, and unrealistic understanding by Korean firms of the fair value of their assets as serious challenges. Survey findings also indicate that cultural and communication difficulties were their most serious problem, followed by difficulties in understanding the Korean market and in dealing with labour relations.

Respondents' views on recent improvements in the Korea business environment were also instructive. Foreign business people generally had a negative view on the improvements except for an enhanced domestic political stability. They saw that government-business relations had not really improved with extensive regulations and corruption still prevalent. Their views on improvements in labour relations were highly negative. Foreign business people felt neither Koreans' discrimination against foreign products nor their experience of cultural and communication difficulties had declined significantly. However, foreign business people were optimistic about Korea's economic prospects.

Consistent with their negative views on improvements in the business environment, foreign business people pointed to various types of difficulties in the management of on-site operations. Much of these difficulties arose from government-business relations, with lack of transparency and consistency in regulations, cronyism and corruption, the excessive discretionary power of bureaucrats and excessive government regulations presenting the most arduous challenges to these foreign firms operating in Korea. The respondents also considered themselves disadvantaged in a system where Korean firms rely heavily on personal relationships for business operations and chaebols still enjoy unfair advantages. However, foreign business people did not see overhead costs, entry barriers to the Korean distribution system, conflicts with Korean partners, and supply of parts and materials as seriously difficult areas.

The areas of human resource management and labour relations were identified as difficult areas, with recruiting and retaining efficient local staff and high wages relative to productivity as particular difficulties. Respondents indicated various types of serious difficulties concerning Korean culture and society, including cultural and communication difficulties, Koreans' prejudice against foreign products, the closed Korean society and poor social amenities for expatriate families.

The survey results also show foreigners' perception of the restructuring of chaebols as business counterparts. They did not consider corporate governance and the operational transparency of chaebols had improved significantly. Chaebols were still seen as adversarial competitors with various types of unfair advantages.

The survey findings confirm the reputable characteristics of Korean workers. Foreign business expatriates had strong opinions on both positive and negative aspects of Korean workers. Korean workers' new willingness to work for foreign companies was considered as one of the most positive changes. Foreign participants also reaffirmed some widely recognised strengths of Korean workers, such as diligence, loyalty toward companies, collaborative team spirit, and willingness to be trained. Survey findings indicate that the weakest aspect of Korean workers was poor English skills, followed by high levels of union activities and militancy.

Except for a few management aspects such as more profit-oriented management, disappearing lifetime employment, and rising lay-off of workers, respondents indicated that the Korean management system remained largely unchanged. They regarded the Korean management system shifting only marginally toward the western management system and the overall management efficiency of Korean firms improving but again only marginally.

The survey findings indicate that foreign expatriates saw minimal improvements in their living conditions in Korea. They viewed that social amenities had improved marginally. However, Koreans' prejudice against foreigners, pollution, traffic congestion and living costs had not improved recently.

In summary, thanks to the liberalization of the Korean FDI regime, the structural reforms of the Korean economy, and the government's serious efforts to attract FDI since1997, FDI in Korea increased remarkably over the three-year period (1998-2000). Much of this could be, however, attributable to the so-called 'fire sales' of Korean companies and their assets to foreigners. And despite this spurt, Korea still attracted FDI less than policy makers have deemed desirable. Indeed, FDI in Korea decreased substantially in 2001 and further declined in 2002.

The surveyed foreign firms pointed out that the main reason for their investment in Korea was to capitalise on the emerging business opportunities. They viewed that Korea lacked other location advantages and presented various types of difficulties for those considering FDI. Survey findings indicate that, although formal entry barriers have been dismantled to the level of OECD countries, the FDI preparation process and the business operational environment have not improved significantly. The challenges in the investment preparation process and on-site management arise not only from excessive, complex and opaque government regulations, excessive bureaucratic power and bureaucratic stonewalling, but also from labour-management relations, unfair advantages held by domestic firms, the lack of transparency in financial reporting and inefficient corporate governance on the part of Korean companies, and cultural and societal differences.

To further attract FDI, therefore, not only should Korea undertake an across-the-board liberalization of the FDI regime, but it should also improve the operational environment for foreign businesses. Although the FDI regime has been liberalised and the entry procedure has been streamlined substantially, the present study demonstrates convincingly that there is substantial room to improve in the area of government regulations, policy making and implementation both at the central and local levels of government. To improve the poor quality of domestic business environment, not only should excessive government regulations and bureaucratic power be removed, but unfair advantages bestowed on domestic firms, continued rigidities in the labour market and living conditions of foreign expatriates should also be improved. Korean society and Koreans need to become more open and amicable to foreigners and foreign business operations in Korea.

The challenges confronting foreign firms that have been examined in this study would be the perceptions of survey respondents. The people of Korea may disagree profoundly with the respondents' claims. Nevertheless, since the respondents have first-hand experience of FDI in Korea and it is these types of investors who the Korean government is trying to attract, the survey findings of this study point to the number of areas that government policy should reconsider in its bid to increase inward FDI in Korea.

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Abstract

In contrast to international trade, which expanded rapidly and played the role of engine for economic development in Korea, inward foreign direct investment(FDI) has remained sluggish and failed to contribute significantly to Korean economic growth. Although it is well established that FDI can enrich a host country's economy in a number of ways, the Korean government restricted and controlled FDI, particularly up to the 1997 financial crisis. As a result, Korea was regarded as the worst place to invest among Asian nations. These restrictions of FDI and unhealthy FDI environments were reflected in the flagging level of FDI in Korea.

After 1997, however, the Korean government has undertaken a paradigm shift in FDI policy from "restriction and control" to "promotion and assistance", and undertaken a series of policy measures and all-out efforts to improve the business environment and attract FDI. As a result, inward FDI in Korea surged over the three-year period 1998-2000. Despite this spurt, the magnitude of FDI in Korea is still small in comparison to other countries, and has been declining sharply since 2001.

How then, would the relatively low magnitude of FDI in Korea and a recent sharp decline be explained? What additional measures should Korea undertake to increase FDI inflows to a level comparable internationally? To address

these vexing questions from a foreign perspective, a comprehensive survey was conducted from May to July 2002 of foreign companies that had undertaken FDI and have been operating in Korea. A questionnaire comprising 96 questions was distributed to about 400 foreign companies, and a total of 69 responses were received.

According to the survey results, foreign firms undertake FDI in Korea to capitalise on the emerging business opportunities in Korea, and do not consider Korea as a stepping stone to gain market access to other Asian countries. Foreign business people generally have a negative view on the improvements in the Korean business environment in the recent past. Consistent with this, foreign business people point to various types of difficulties in establishing and operating FDI projects in Korea. These difficulties arise not only from excessive, complex and opaque government regulations, the excessive discretionary power of bureaucrats and cronyism and corruption, but also from inept labour relations and high wages, unfair advantages held by domestic firms, inefficient corporate governance of Korean companies, cultural and communication difficulties, Koreans' prejudice against foreign products, closed Korean society, and poor social amenities for expatriate families. The respondents also consider themselves disadvantaged in a system where Korean firms rely heavily on personal relationships for business operations. They recognise, however, strengths of Korean workers, such as diligence, loyalty toward companies, collaborative team spirit, and willingness to be trained, but point out poor English skills as the weakest aspect of Korean workers.

The present study demonstrates convincingly that there is substantial room for improvement in the area of government regulations and the business environment. This is despite substantial efforts in the recent past to liberalise the FDI regime and streamline entry procedures. Therefore, to further attract FDI, not only should Korea undertake an across-the-board liberalization of the FDI regime, but it should also improve the operational environment for foreign businesses. To improve the poor quality of the domestic business environment, not only should excessive government regulations and bureaucratic power be removed, but unfair advantages bestowed on domestic firms, continued rigidities in the labour market and living conditions of foreign expatriates should also be improved. Korean society and Koreans should also be more open and amicable to foreigners and foreign business operations in Korea.

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Key words: Foreign direct investment, survey of foreign investors, Korea's FDI environment, causes for sluggish FDI in Korea.