

# Foreign Direct Investment From Korea

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## I. Introduction

Analytical framework for foreign direct investment (FDI) is changing. The seminal Hymer-Kindleberger hypothesis [7, 10] contended that FDI be analyzed on firm specific monopolistic advantages in contrast to the country specific analyses prevalent in trade theory and international capital movement theory. The hypothesis became the cardinal analytical framework for FDI in ensuing years. Starting in the mid 1970's, however, there has been a growing movement to view FDI flows as a country specific rather than firm specific phenomenon. On theoretical ground, Dunning [5] claimed that the seemingly firm specific monopolistic advantages are bred in respective home country environments and thus multinational companies (MNC) from the same home country tend to have similar monopolistic advantages. On empirical grounds, the once insurmountable dominance of the U.S. in the FDI flow is fading and it is being replaced partly by the rise of Japanese and Third Country MNCs. Concurrently, studies with country specific titles such as Japanese MNCs or Third Country MNCs have begun to attract scholarly interest.

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This paper basically follows the current analytical framework in that it analyzes the characteristics of Korean FDIs. It is hoped, however, that this paper contribute to discovering whether the observed characteristics are permanent features of Third Country MNCs thus warranting a country specific approach in FDI theory development, or are just transitional phenomena in the process of converging into general characteristics of FDI irrespective of country origin.

To facilitate international comparisons, this paper will analyze Korean FDIs in Dunning's eclectic approach with minor alterations. Conventionally, the eclectic approach begins with identification of monopolistic advantages. Internalization and locational incentives are then weighed to choose the best alternative among FDI, licensing and exporting to exploit the monopolistic advantages. This paper, however, will present locational incentives for Korean FDIs ahead of identification of Korean monopolistic advantages and the discussion of internalization incentives will be deferred to the last section.

This reversal of presentation order was warranted because the characteristics of Korean FDIs differ greatly from those of developed countries. In developed countries, international horizontal investments by manufacturing firms dominate, and discussion of monopolistic advantages relates to the viability of these firms in alien environments. The dominant shares of Korean FDI data, however, are either for non-manufacturing industry FDIs or vertical investments by manufacturing firms. Thus to make international comparisons, one needs to evaluate Korean FDI data according to firm specific motivations for FDI to compile a FDI data base comparable with that of a developed country. Discussion of Korean specific monopolistic advantages, if there are any, will only be meaningful for the companies that have a foreign production base.

## **II. Characteristics of Korean FDI Data**

Foreign Exchange regulations stipulate that every Korean Foreign Investment obtain a license from the Bank of Korea. Thus BOK data is the most compre-

**Table 1. Korean Foreign Investment.**

(as of June 30, 1984, in thousand \$)	
Equity investment	\$ 233,393
Intercompany lending	158,162
Real estate investment	20,107
Exports on a deferred payment basis	2,087,384
Total	\$ 2,499,046

source; Bank of Korea

hensive and reliable data source for Korean FDI. In reading the data, however, the following precautions are needed.

First, Korean FDI data are presented in conjunction with Korean foreign investment data which, according to the legal definition, include intercompany lending, real estate investment and export on a deferred payment basis in addition to the conventional equity investment.

Second, theoretically, equity investment can include outward portfolio investment. Legally, however, Koreans are prohibited from making outward portfolio investments as of now. Thus the full \$ 233,393,000 of equity investment can be considered as pure FDI amount. Unfortunately, however, intercompany lending data are separated from pure FDI data only in the aggregate as in Table 1 but intermixed when yearly or industry data are presented as in Table 2. Thus the industry classification of Korea FDIs includes intercompany lending.

Third, as shown in Table 2, the share of FDIs in the manufacturing industry in terms of the number of FDIs or in terms of the invested amount is marginal. Sales subsidiaries of trading companies dominate the number of Korean FDIs and the amount invested by the mining industry overshadows that of manufacturing industry. Since FDI theories developed in advanced countries, including the eclectic approach, focus mainly on the behavior of the manufacturing industry, the relevant figure for Korean FDIs is the \$ 78,748,000 for the manufacturing industry.

**Table 2. Korean FDI's by year and by industry** (as of June 30, 1984 in thousand \$)

year	industry	Mining	Forestry	Fishery	Manu- facturing	Constr- uction	Storage	Trading	Others	Real Estate	Balance <sup>(1)</sup>
71 <sup>(2)</sup>	number	—	2	1	1	3	—	3	6	3	19
	amount	—	7,115	84	140	1,600	—	665	3,163	3,547	13,364
72	number	—	2	1	5	2	—	2	2	1	13
	amount	—	1,468	539	62	1,566	—	345	391	744	4,767
73	number	—	2	2	3	2	—	2	—	—	10
	amount	—	735	342	24	994	—	670	33	1,109	3,717
74	number	—	—	—	6	1	1	9	2	—	17
	amount	—	3,058	—	6,723	616	2	1,637	6,080	33	18,045
75	number	—	—	3	1	3	—	12	—	—	11
	amount	—	3,976	237	7,039	1,346	—	750	542	281	9,701
76	number	—	—	6	2	1	1	31	3	2	30
	amount	—	26	105	1,562	172	206	4,076	1,825	248	6,943
77	number	—	2	4	—	—	3	14	—	—	46
	amount	—	2,414	5,027	—	—	698	8,156	1,500	—	12,331
78	number	2	11	5	4	9	2	59	2	2	74
	amount	386	4,448	1,363	8,203	11,067	330	7,889	2,574	7,158	38,761
79	number	1	—	8	6	4	4	22	5	2	49
	amount	1,034	3,262	2,616	4,117	2,679	945	2,826	1,971	3,321	18,820
80	number	—	—	2	8	7	3	22	2	—	18
	amount	1,791	—	149	5,319	7,839	365	4,714	136	752	15,456
81	number	2	1	4	7	5	2	22	—	2	34
	amount	10,039	11,053	187	4,202	3,442	237	6,670	15	4,532	31,697
82	number	4	1	1	3	8	3	19	11	—	31
	amount	89,757	9,499	31	5,454	9,701	211	8,103	6,616	—	115,962
83	number	1	2	6	14	9	4	22	2	—	49
	amount	48,550	18,206	150	26,479	2,641	804	13,248	3,085	—	96,819
84	number	—	—	—	7	1	1	9	6	—	18
	amount	6,432	2,649	73	9,394	197	184	2,098	2,034	—	25,279
Total number		10	12	44	63	58	24	278	41	12	419
amount		157,989	67,910	10,903	78,748	43,560	3,614	61,847	27,968	12,725	411,662

1) Total investment minus divestment

2) cumulative balance up to

Source: Bank of Korea

### III. Locational Incentives

Given that a firm has distinctive monopolistic advantages, the eclectic approach tries to discern locational and internalization incentives that prompted the firm to choose the form of direct investment. Locational incentives often cited are transportation cost, production input cost, marketing cost, and tariff and non tariff barriers. These incentives basically influence the choice between exporting and FDI.

Some of the locational incentives are quantifiable. For example, one can compare tariffs, transportation costs, and labor costs to come up with the least costly production site. However, factors like the improvement in after service, the influence of the country origin, local image and improved marketing intelligence are hard to quantify. Thus instead of attempting to isolate quantifiable locational incentives, this paper relies on a motivational study of Korean FDI.

Accepting the risk of arbitrariness, Korean FDIs are categorized into the following 6 different motivational factors for FDI as set out in Table 3.

The list of names, foundation date, investment amounts and Korean ownership shares of the 62 manufacturing FDIs as of June 1984 is presented in Table 4. This paper analyzed only the 47 firms for which sufficient information was accessible either by personal interviews or by secondary data to determine the firms' motivations for foreign direct investment. As a reference, the 47 firms studied in this paper are marked by a corresponding motivation category

**Table 3. Motivations for Korean FDI**

1) Local market development	19 cases
2) Local market protection	3 cases
3) Saving labor cost (Quota circumvention)	8 cases
4) Securing natural resources	6 cases
5) Supporting plant export	7 cases
6) R & D outlet	4 cases

**Table 4 Korean FIDs by Manufacturing Industry as of June 30, 1984**

Name of Subsidiary	Motivation for FDI*	Foundation date	Investment amount (in thousand \$)	Invested country	Korean share (%)
P.T. Miwon Indonesia	2	73. 7. 30	1,696	Indonesia	80
Ssang Yong Cement (Singapore)LTD.	1	73.12. 31	3,310	Singapore	30
P.T. Hanil Jaya Metal Works	1	74. 2. 8	1,278	Indonesia	80
Saudi Industrial Kesins LTD.	5	74. 9. 28	541	Saudi	9. 25
The Pilot Pen Co., (Thailand)LTD.	1	74.11. 19	1,048	Thailand	99. 76
Samhwa Printing Japan Co., LTD	N.A.	75.12. 16	25	Japan	50
Munhwa development Co., LTD.	N.A.	77. 1. 6	35	Japan	50
Winstone SamSung Industries LTD.	4	77. 2. 6	1,348	New Zealand	5. 1
Nazpoush Mfg. PVT Co., LTD	N.A.	78. 2. 15	263	Iran	35
Yuhwa Honduras LTD.	3	78. 4. 19	450	Honduras	100
Thai-DaeDong Ind. Co., LTD.	1	78. 4. 29	551	Thailand	49
Int'l Tire Mig. & Distributing Co., LTD	5	78. 7. 20	7,000	Sudan	50
Thai Yeong Electronics Co., LTD.	4	78.10. 17	100	Thailand	50
Korea-Lanka Garments LTD.	3	78.11. 23	118	Srilanka	50
Prime White Cement Corp.	5	78.11. 23	1,000	Philippines	24. 29
Lotus Export Specialists Inc.	3	78.11. 13	1,007	Philippines	100
Ali Bin Abdullah Al-Attiyah Lim Co.	1	79. 2. 24	255	Quatar	49
Mahjak Int'l Electric Co., LTD.	2	79.11. 15	396	Thailand	20
The Saudi Steel Pipe Co., LTD.	5	80. 3. 7	2,130	Saudi	30
P.T.Rimba Sunkyong	5	80. 3. 8	235	Indonesia	49
Philippine Chain Mfg. Co., LTD.	3	80. 3. 21	63	Philippines	12. 9
Albilad Concrete Co., TD.	1	80. 5. 1	1,520	Saudi	49
Youngones (Bangladesh) LTD.	3	80. 7. 4	92	Bangladesh	49
P.T. Kalimautan Wood Industrial	4	80. 7. 7	1,500	Indonesia	—
Korea Ceylon Footwear Mfg.Co., LTD.	3	80.10. 10	600	SriLanka	30. 6
Shin Yang Koralux Industrial Co.,LTD.	1	80.10. 30	44	ThaiLand	49
San Seng National Plastic PTE., LTD.	1	81. 1. 20	949	Singapore	55
Dongkuk-Techco Rubber Ind.SDN. BHD.	1	81. 2. 25	800	Malaysia	65
Primier Metal Ind. (Nigeria) LTD.	5	81. 4. 16	306	Nigeria	12
Gold Star of America Inc.	2	81. 4. 23	500	U.S.A. Alabama	100
P.T.Kodeco Batulicin Plywood	4	81. 6. 5	5,000	Indonesia	49
Goulburn Wool Processors PTY. LTD.	4	81. 7. 29	563	Australia	49
Pepak-Hanjoong Simen SDN. BHO.	5	81. 8. 11	25,656	Malaysia	60
Kosama SDN. BHD.	1	82. 2. 24	231	Malaysia	49
Samsung Electronica Portuguesa S.A.R.L.	3	82. 7. 5	275	Portugal	55
Americana Big Boy, Inc.	N.A.	82. 7. 5	300	U.S.A. Utah	100
Onosiem Heeco Engineering Co.,LTD.	N.A.	82. 7. 6	450	Nigeria	30

King Stone U.S.A. Co., LTD.	1	82, 8.27	200	U.S.A., L.A.	100
Hyundai Furniture	1	82, 8.27	1,000	U.S.A., L.A.	100
TaeHeung Bangladesh LTD.	N.A.	82, 12.17	54	Bangladesh	49
Hyundai Electronics America	6	83, 3.12	5,000	U.S.A.	100
Chosun (Malaysia) SDN. BHD.	1	83, 3.28	112	Malaysia	100
Batook Haitai Chewing Gum Mfg.Ind. LTD.	1	83, 4.13	349	Saudi	30
Decision Support Systems Inc.	6	83, 4.16	500	U.S.A.	83
Jung Woo Development PTY. LTD.	1	83, 5.23	222	Australia	51
LVR & Dong In Stone PVT.LTD.	1	83, 5.27	120	Indo	40
Venus Industrie Inc.	1	83, 5.28	200	Senegal	50
Tokai Seiki Co.(Thailand)LTD.	1	83, 5.31	435	Thailand	40
Fook Ngiap Samill SDN.BHD.	4	83, 6.17	219	Malaysia	30
Tokyo Saebeol Co., LTD.	6	83, 6.25	114	Japan	90
Tristar Semi-Conductor Inc.	6	83, 7. 4	6,000	U.S.A.Calif.	100
Brentwood Clothes Inc.	3	83, 7.12	196	Dominicar Rep.	49
Kip & Kale San (Kenya), LTD.	N.A.	83, 7.19	90	Kenya	49
Tom Co., LTD.	N.A.	83, 10.13	80	Bangladesh	49
National Plastic Co., (IBN Hayyan)	N.A.	83, 11.17	20,693	Saudi	15
Samsung Int'l Inc.	N.A.	83, 12.17	2,000	U.S.A. N.J.	100
Format Corporation	N.A.	83, 12.31	498	U.S.A. L.A.	98.6
Korea-Colombia Ind. Co., LTD.	N.A.	84, 1.23	2,500	Colambia	100
Cmos Circuit Inc.	N.A.	84, 5. 9	120	U.S.A., III.	40
Nothern Marianas Corp.	N.A.	84, 5.18	350	NORTH Mariana	100
Frigifico La Esmerulda S.A.	N.A.	84, 5.31	98	Argentine	49
Kereen Botswana (PTY) LTD.	N.A.	84, 9.16	100	Botswana	50

- |   |                                    |
|---|------------------------------------|
| * (1) Local market development              | (5) Supporting plant export        |
| (2) Local market protection                 | (6) R & D outlet                   |
| (3) Saving labor cost (Quota circumvention) | N.A. indicates cases not analyzed. |
| (4) Securing natural resources              |                                    |

number.

The distinction between local market development and local market protection was based on the previous record of export and the presence of sudden changes in commercial policies of the host country. When a firm passively opted for FDI to protect its export market in response to a sudden change in tariffs or non tariff barriers, this was categorized as a local market protection oriented FDI. FDIs motivated to develop new market opprtunities in the host countries are categorized as local market development.

When one notes that Korea has been promoting exports for the last two decades, it is really hard to believe that offensive FDI's outnumber the defensive FDI's in Korean FDI's. Considering the existing export network of Korea which spans the globe, and the growing protectionist movements in the world, natural expectation would have been the reverse. However, when one analyzes the countries receiving the FDI and the size of the local market development FDI's, the answers to this strange phenomenon are not hard to follow.

First, Korean FDI's thus far are mainly directed to developing countries which suffer from foreign exchange shortages. (See Table 5) Therefore, sometimes it is easier to set up a FDI than to export. This was especially true with South-east Asian countries where the earlier Korean FDI's were concentrated. Second, earlier Korean FDI's were led by small and medium sized firms. Thus their internationalization strategies were not systematic in that they did not follow the text book order of export first and FDI next. Rather FDI decisions were made on ad hoc basis by top managers of family owned firms based on their special knowledge of the host country or on a special relationship with host country personnel. In fact this ad hoc and unsystematic nature of the significant portion of Korean FDI's explains the overall absence of monopolistic advantages and the resulting disappointing experience in terms of subsidiary profitability.

Pecking order theory and macroeconomic theory provide a theoretical ground for Korean companies to make FDI's in host countries where labor costs are

**Table 5. Korean FDI's by host country characteristics**

Host country character Motivations for FDI	Developed country	Developing country	Sub Total
Local market development	4	15	19
Local market protection	1	2	3
Securing natural resources	2	4	6
Saving labor cost (Quota circumvention)	1	7	8
Supporting plant export	0	7	7
R & D outlet	4	0	4
	12	35	47



cheaper than in Korea. In fact, Korean firms have set up production bases in Honduras, Sri Lanka, Philippines, Bangladesh, Portugal and Dominican Republic. But care must be taken in the interpretation of these FDIs. Labor costs rose rapidly in the latter half of the 1970's in Korea, but the rising trend was tempered significantly in the 1980's when the inflation rate was restrained to single digit figures. Thus even though it is possible that Korea will lose her comparative cost advantage in labor intensive industries in the future, price competitiveness is not an immediate concern in her export drive. Furthermore, savings in hourly wages in developing countries are often dwarfed by the low productivity and the inability to show Korea as the country of origin. Therefore, at this point in time in 1985, it is safe to conclude that there are no Korean FDIs which are motivated solely by labor cost savings. The real concern of Korean exporting companies is the import quotas of developed countries which are applied to Asian Newly Industrializing Countries. Therefore, one shoe manufacturing company made a FDI in the Philippines partly to save labor costs but mainly to circumvent import quotas of the U.S. The same is true for textile companies which have production bases in such central American countries as Honduras and Dominican Republic and in such Southeast Asian countries as Bangladesh and Sri Lanka. An electronics company made FDI in Portugal to penetrate the European Common Market.

International vertical integration to secure raw materials is more prevalent among Korean mining companies. In the manufacturing industry, however, there are 6 cases of vertical FDIs. Natural resources they sought after include: thermo-mechanical pulp for a paper manufacturing company, timber for plywood manufacturing companies, and wool fiber for a textile firm.

Foreign direct investments to set up R & D outlets in a developed country are relatively a new phenomenon and concentrated entirely in the electronics industry and confined to the United States. In fact not only Korea but also developed countries like Japan and some European countries find that Silicon Valley in America is a good place to set up an R&D outlet. Therefore, R&D oriented

FDIs irrespective of their home countries are motivated by a set of incentives entirely different from conventional marketing or production oriented FDIs.

A very distinctive breed of Korean FDIs, unfound in the experiences of developed countries and other developing countries, is the plant export supporting FDIs by Korean firms. Plant export refers to a turn key operation where a Korean firm is originally responsible only for building the manufacturing plant. However, due partly to a foreign exchange shortage of the host country and also partly to the deficiencies of managerial experience of the plant, host countries sometimes insist that the Korean firm make an equity investment in the venture. A management contract is a definite alternative to the equity investment but the bargaining strength is with the host country. This is so because Korean firms are more concerned with the plant export contract itself since very often its value is 10 to 20 times larger than the requested equity investment.

So far, this paper has analyzed motivations for foreign direct investments either to develop or to protect foreign markets, and motivations for vertical integration to secure production inputs and for horizontal investment to save production costs often cited in FDI literature. FDIs to set up R&D outlets in the U.S., even though a relatively recent phenomenon, are also growing in number. Only the plant export supporting FDIs seem to be a truly Korean phenomenon.

It should be noted, however, that when FDI literature discusses monopolistic advantage, the focus is confined to horizontal investment. One can argue that the monopolistic advantage for a vertical investment is the existence of captive consumption by the investing company. However, this argument is very seldom cited. Following this convention, this paper will confine the study of the sources and types of monopolistic advantages of Korean FDIs to horizontal investments. Thus Korean FDIs motivated to develop or protect local markets and to save labor costs will be the focus in the discussion of Korean monopolistic advantages.

#### IV. Monopolistic Advantages

Even though criticisms have mounted that the monopolistic advantage theory provides only the necessary condition for FDI and thus leaves the sufficient condition to location theory and internalization theory, there is no doubt that the monopolistic advantage theory remains as the fundamental basis for FDI theory. The logic underlying the development of the theory calls for an assumption that a firm has built-in disadvantages in running a manufacturing concern in a foreign country compared to its local counterpart. To compensate for this cost of "foreignness", the firm must have monopolistically held advantages to which local companies have no access. The seminal Kindleberger paper in 1969 cited four sources of these monopolistic advantages, namely, (1) imperfection in the goods market, (2) imperfection in the factor market, (3) economy of scale, and (4) government protection. Since then, many scholars have refined the sources and the resulting types of monopolistic advantages. Often cited types of monopolistic advantages are (1) production technologies protected by patents, (2) marketing technologies supported by internationally well known brand names, (3) management technologies including the scanning ability for business opportunities in the local market, and (4) preferential access to production inputs including financial resources.

The monopolistic advantage theory has been found very convenient and persuasive in explaining why big firms from developed countries with heavy investments in R&D and advertising dominate FDI activities around the world. Unfortunately, however, the theory needed a significant modification for it to remain a relevant theory in explaining how small firms from developing countries with marginal, if any, investments in R&D and advertising engage in FDI.

There are a growing number of studies on Third country multinationals and the main focus of these studies has been on the identification of third country specific monopolistic advantages. It differs a bit among scholars, but generally

cited third country specific monopolistic advantages are (1) possession of an appropriate technology: small scale, multi-purpose and labor intensive, (2) ability to use locally available production inputs, (3) low management and technical cost, (4) more personal selling, (5) host or home country preferential treatment, (6) ethnic connections, (7) indirect benefits from conglomerate parent firm, etc.

Monopolistic advantages of Korean FDIs differ depending on their motivations for foreign direct investment. Monopolistic advantages of local market development FDIs include (1) scanning ability of business opportunities and willingness to take risk, (2) personal devotion to the project by the top manager and/or by Koreans dispatched to the subsidiary, (It is not uncommon that married male employees leave their families behind in Korea. It is also not uncommon that Korean employees voluntarily bear the hardships of learning the local language to promote better relationship with local employees), (3) more personal selling, (4) ability to use locally available production inputs, and (5) low management and technical cost. Korean FDIs in this category do not seem to have a distinctive adapted technology. And since there are very few Korean residents in Southeast Asian countries, they do not enjoy an ethnic connection. It is often claimed that developing countries give preference to Third Country FDIs to promote south to south economic cooperation. Very often this claim turns out to be only lip service and in reality developing countries tend to prefer developed country FDI in hopes of importing advanced technology whether the technology is appropriate or not to the resource endowment of the country. Korean FDIs are not getting preferential treatment from the Korean government either. The Korean Export-Import Bank provides cheap financing but only for natural resource developing FDIs.

Defensive Korean FDIs really lack distinctive monopolistic advantages. These are the companies that used to produce in Korea but have been compelled to set up a local production base due to sudden changes in the commercial policies of the host country. When they exported from Korea, the companies competed not on its global monopolistic advantage but mainly on the locational advantage

by using the low cost but high quality labor force in Korea. Their immediate response to the loss of export market propelled them to set up local production bases but whether the production base will be competitive and profitable is a totally different question. The New York Times once cited that a Korean electronic firm in the U.S. has been successful in instilling a family like atmosphere into the organizational behavior of local employees. The question remains, however, whether such an ethnic flavor will be a sufficient monopolistic advantage in the bottom line. One distinctive advantage of these FDIs is preferential access to cheap sources of intermediary products from the parent firm. But if the parent firm uses transfer pricing just to record profits in the subsidiary, the profitability of the subsidiary will not be a good indication of the subsidiary's competitive strength.

Among the three categories of Korean FDIs, the companies that invested to save labor cost and to circumvent import quotas of developed countries seem to enjoy the most extensive list of monopolistic advantages. These firms have been producing in Korea and tend to possess adapted technologies that are appropriate to developing countries that host the FDIs. These firms also have been marketing to the developed countries and they have a marketing edge over local firms. Compared to developed country MNCs, these firms have low management and technical costs, and the personal devotion of top managers and other Korean employees in the subsidiaries are very deep. However, these firms very rarely use local input but tend to import intermediary goods from Korea. This negates one often cited source of a Third Country FDI monopolistic advantage, namely the ability to use locally available production inputs, but at the same time the removal of uncertainty surrounding the quality of intermediary goods can be a source of monopolistic advantage.

## **V. Internalization Incentives**

The definition of internalization incentives varies among scholars, even though

it is generally agreed that motivation for internalization stems from market imperfection, market absence and market failure.

The broadest definition of market imperfection covers, (1) deviations from perfect competition in industrial structure, (2) international elements that make the law of one price for physical goods difficult, and (3) factors that influence appropriability from public goods. Since the first kind of market imperfection breeds monopolistic advantages and the second imperfection determines the choice between export and FDI and the third influences the choice between licensing and FDI, proponents of internalization theory claim that the internalization theory is the general theory of FDI. In the eclectic approach, however, the internalization incentives are more narrowly defined and thus cover only the third kind of market imperfection that influences the choice between licensing and FDI. As stated earlier, this paper follows the eclectic approach and thus adopts the narrow definition of internalization incentives.

Incentives for internalization are extensively studied by Magee [14] and Casson [3]. Magee claimed that when there is asymmetry in information between the supplier of knowledge and the potential user, the supplier can improve appropriability by setting up its own subsidiary abroad and transfer the knowledge internally. Casson stated that when the market for knowledge is imperfect, internalization can save costs relating to the negotiation and supervision of licensing contracts.

One must note, however, that the above discussion of the internalization incentives presupposes that knowledge can be detached and sold independently. This presumption is acceptable in the study of developed country FDIs where the types of monopolistic advantages are patented production and marketing technologies. However, in the cases of Third Country MNCs and for that matter in the cases of Korean FDIs, their monopolistic advantages are imbedded in plant technicians and top managers. Therefore, it is rare that these advantages can be sold separately. The difficulties of selling technologies independently is eloquently demonstrated in the fact that Korea has so far contracted only 8

cases of licensing exports. For the so called adapted technologies to be exported separately, they must be documented in detail so that a licensee can duplicate them with marginal supervision by a licensor.

This fundamental documentation process is delayed by the following factors. First, as stated earlier, the adapted technologies are imbedded in plant managers and thus it is hard to detach. Second, even for the theoretically detachable technological know-how, Third Country firms, including Korean, have not really tried to document them. One needs to note at this juncture that Korean firms are not yet in the habit of documenting job descriptions. Living in such a dynamic economy as Korea, day to day adaptive capacity has been valued more highly than blind following of written job descriptions. This environment has also influenced the behavior of the plant managers. Instead of trying to document accumulated knowledge, plant managers are occupied with day problem solving in the plant. Third, once the adapted technologies are documented, it is almost impossible to protect them because patent law very seldom covers production know-how. Therefore to avoid leakage of industrial secrets and to maximize appropriability, the adapted technologies are not documented.

Without a well documented, well protected and detachable technology, Korean firms do not have a choice between licensing and foreign direct investment. Thus, a discussion of market imperfection, market absence and market failures that induce firms to prefer licensing to FDI is not immediately relevant to Korean FDIs.

## **VI. Precautions in Interpretations.**

So far the characteristics of Korean FDIs were analyzed in the generally acceptable eclectic approach. There were a few Korean specific characteristics such as the predominance of offensive FDIs and the presence of plant export supporting FDIs, but in general the characteristics of Korean FDIs did not differ significantly from those of Third Country MNCs; small in size with marginal

investment in R&D and advertising.

Where does this observation lead us? Does it mean that Third Country MNCs will always be small in size and rely on adapted technology? Or is what we observe just a static cut from the continuum, converging to the characteristics of more developed country MNCs?

At this juncture, we need to recall the lessons from the extensive studies of Japanese MNCs. In the mid 1970's, it was claimed by many Japanese scholars that Japanese MNCs were distinctively different from MNCs of American and European countries. Japanese MNCs were claimed to be trade-oriented while conventional MNCs were antitrade-oriented. This argument gave birth to macro-economic theory in FDI literature. However, as we enter the 1980s' this dogmatic argument lost its favor as the share of Japanese MNCs invested in developed countries grew. The share of Japanese MNCs that moved to developing countries due to the industrial adjustment in Japan became growingly smaller. Japanese MNCs are now armed with internationally competitive production and management technologies and began to compete American firms on the latter's homeground. Thus, it is now a general agreement that the characteristics of Japanese MNCs in the 1970', which were once claimed to be a country specific feature of Japanese MNCs, were nothing but temporary phenomena in a transition process. One can make a similar argument that even in American experience the early U.S. FDIs had different characteristics from the current U.S. FDIs.

Therefore, it is the contention of this paper that the characteristics that we observe from current Korean MNCs, and for that matter Third Country MNCs, are temporary phenomena and thus do not provide a theoretical basis to claim a permanently distinctive characteristics of Third Country MNCs. This contention is especially valid because FDI activities are still in the infant stage in Third Countries. The sample sizes are simply too small to allow generalization and the more recent FDIs tend to have characteristics distinctively different from those of older ones, even in the same country. Emphasis of Third Coun-



try specific characteristics at a given point in time has been popular due partly to the exotic nature of the cited characteristics. But Third Country MNCs must be approached in dynamic context because it is not clear on an a priori basis that the current particular nature of the Third Country MNCs will remain permanently.

As a reference, there were only 13 cases of Korean FDIs as of December 31, 1978 as shown in Table 6. Out of the 13, only one vertical investment to secure natural resources went to a developed country. If one concluded from this observation that Korean FDIs go almost exclusively to developing countries, it would have left no room to explain the growing share of Korean FDIs in developed countries in the ensuing years.

The other extreme of particularism is the convergence hypothesis. This hypothesis contends that in the end the Third Country MNCs will have identical types of monopolistic advantages as those of current developed Country MNCs. Thus currently observed characteristics of Third Country MNCs are believed to be temporary phenomena.

This convergence hypothesis, however, also has its share of weaknesses. Japan has caught up with the U.S. and European countries to become one of the most technologically advanced countries. Thus, convergence theory fits very well with Japanese case. The fate of Third Countries, however, is at best uncertain. What if the third countries remain permanently as technologically undeveloped countries? Then localization theory in the selection of specific technologies by

**Table 6. Koreans FDIs in 1978**

Motivations	Host country characteristics	
	develoed country	developing country
Local market development	0	4
Loal market protection	0	1
Saving labor cost	0	3
Securing natural resources	1	1
Plant export supporting	0	0
	1	12

a firm and the argument of adapted technologies said to characterize Third Country MNCs would then have a much longer life expectancy as an explanation of Third Country FDI phenomenon.

## VII. Conclusion

Following the current trend of FDI studies that emphasize the national characteristics of the home country, this paper has evaluated the characteristics of the Korean FDIs. It was indicated that great care is warranted in reading Korean FDI data because the aggregate data contain non-FDI items such as exports on deferred payment and such nonmanufacturing industry data as FDIs by mining, fishery, construction and trading companies. It was also pointed out that even among manufacturing industry FDIs, the types of monopolistic advantages differ depending on the motivations for foreign direct investment.

In general, however, the locational incentives, monopolistic advantages and the internalization incentives relating to the birth of Korean FDIs do not seem distinctively different from those cited in the literature on the Third Country MNCs. It is the contention of this paper, however, that static analysis of the characteristics of Third Country MNCs runs a great risk. Since FDI activities from Third Countries are still in the infant stage, regeneralization from a small sample is a risky venture. In fact, even in the same Third country, the characteristics of FDIs are changing very rapidly. Therefore a dynamic analysis of the changing patterns of Third Country MNCs characteristics must be accumulated before one can argue conclusively whether there are truly Third Country specific characteristics or whether what we observe as the present characteristics of Third Country MNCs are just temporary phenomena in the process of converging into the characteristics of developed country MNCs.

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