Going Multinational: The Korean Experience of Direct Investment
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CHAPTER ONE

Emerging Multinationals: The Main Issues

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A TALE OF TWO COMPANIES

In early 1996, Daewoo Electronics joined forces with the Lagardère Group to bid for Thomson SA, which the French government was in the process of privatizing. Daewoo was interested in the consumer electronics subsidiary, Thomson Multimedia (TMM), while Lagardère was to get control of the defense business. TMM was the second largest consumer electronics company in Europe after Philips and the fourth largest in the world. It had a broad array of middle- to upper-range of production, including TVs, video, audio and digital equipment, along with brands well known in both Europe and the United-States, including RCA, an icon in American electronics. The company was heavily indebted, but was developing products in future high-growth markets. In October 1996, TMM launched the digital video disc (DVD), the first truly multimedia product.

Daewoo had already invested in the unemployment-stricken Lorraine region and Chairman Kim Woo-Choong had been praised by French Prime Minister Alain Juppé for his investments and efforts to promote economic and cultural cooperation between France and Korea.[1] In October 1996, the French government expressed its preference for the Lagardère-Daewoo solution for privatizing Thomson. It expected that «Daewoo Electronics, having real expertise in controlling production costs of mass market products, will endow TMM with the competitive gains required for its recovery and its future development».[2] The attitude of the government suggests that it was considering Daewoo as it would have considered a Japanese company bringing production technology and new management practices to France. The Committee in charge of overseeing privatizations in France nevertheless rejected the government's choice. The Committee had formal objections about the bid, but also considered that Daewoo Electronics would get control of TMM's first-rate portfolio of technologies without sufficient guarantees as to its future development.

With hindsight, the French Committee on privatization may have taken a wise decision. In 1999, TMM successfully floated its shares on the Paris Stock Exchange[3] after a remarkable recovery partly based on its strong patent portfolio and its innovative multimedia products. TMM's management is confident that the group's new media and services unit has great potential. Since 1998, the group has bolstered its technological and commercial credibility by entering into agreements with big names in the computer and telecommunications arena, as a result of which Alcatel, DirecTV, Microsoft and NEC have become leading shareholders of Thomson. On the contrary, the Daewoo group, which had paradoxically been piling on more debt after the 1997 Asian crisis, has struggled on the verge of bankruptcy. In 1998, Daewoo Electronics postponed a number of investment projects in France. In 1999, while Daewoo was negotiating the restructuring of its electronic business, the firm had to dispel rumors of closure of its three Lorraine factories which assemble microwave ovens (350 employees), TV sets (350) and cathode-ray tubes (600).

This reversal in the two companies' fortunes both illustrates the breathtaking ascent of the large Korean groups in the 1990s and raises questions as to the sustainability of their strategies.[4] It also hightlights the fundamental role of technological assets in today's global competition. This book addresses these issues by exploring the economic dynamics underlying the international strategies of Korean firms. It shows that the bold strategies of the 1980s and 1990s have been rooted in the Korean economic development path. Consequently, the lessons to be learned from the late 1990s crisis imply questioning not only risky behavior by some firms but also some of the convictions underlying the «Korean model» of development.

GLOBALIZATION AND DEVELOPMENT

In the 1990s, there was broad agreement between the Korean government and large groups on the issue of globalization. During the first half of the 1990s, Korean firms rushed to internationalize, while the government liberalized the domestic economy so as to comply with the rules of OECD, to which it was admitted on 25 October 1996. Both evolutions were considered as indicators of the country's remarkable economic success, while globalization and liberalization were actually considered by Korean managers and policy-makers as means to further and deepen economic development in the wake of structural problems. Fundamentally, both the government and firms hoped that globalization would represent an opportunity to ease Korea's technological bottleneck and build international brands. At the beginning of the 90s, large Korean groups embarked on very ambitious strategies to shed their status of latecomer competitors and join the club of «first-class companies» which, among other objectives, meant upgrading their technological capability.[5] The quest for globalization was at the core of these corporate strategies (Ungson et al. 1997). The government also considered that Korea should adjust its policies in order to reap more benefits from globalization. In 1994, for example, the government reacted to Korea's low ranking in a number of competitiveness indicators[6] by launching the ambitious segyehwa scheme. This «globalization policy»[7] aimed at lifting Korea to international standards in a number of areas, including education and the development of industries of the future.

At the beginning of the 1990s, both public and private Korean leaders seemed eager to participate more fully to the globalization process which was picking up steam. At the time, from an economic point of view, globalization primarily meant increasing exports and booming outward direct investment (ODI). The large Korean groups were pursuing and extending their strategies by becoming multinationals. After the 1997 Asian crisis, the Korean perspective on globalization has changed, in particular with more of a role being given to inward foreign direct investment. This shift is one of the major themes explored in this book.

THE SURGE IN KOREAN OUTWARD DIRECT INVESTMENT

Since the 1980s, foreign direct investment has been much more dynamic than international trade. This constitutes one of the major features of globalization, which may be described as a phase of both broader and deeper internationalization.[8] During the 1990s, an international wave of cross-border mergers and acquisitions accelerated the deepening of economic integration among countries even further.[9] As an emerging economy, Korea has participated fully in the globalization process. During the 1970s and 1980s, its exports grew much more rapidly than world trade and by the early 1990s, Korea had become the eleventh largest trading nation in the world (Sakong, 1993). From the late 1980s through the late 1990s, Korean outward direct investment exhibited a similarly dynamic pattern.

During the 1980s, Japan had attracted considerable attention as its ODI flows grew exceptionally rapidly. During the 1990s, outflows from Korea and Taiwan have in turn experienced a breathtaking rise. Figure 1 shows that Korean ODI recorded an initial surge at the end of the 1980s, and then again in the mid-90s.

Asia and North America began to attract a higher share of Korean investment at the end of the 1980s, while flows to Europe really increased in the course of the 1990s. Impressive growth rates were easily reached as Korean ODI started from a very low base in the late 1980s. The relative importance of Korean ODI has nevertheless increased, from 0.46 per cent of the world total during the period 1987-92 to 1.23 per cent in 1996.[10]

ODI has also increased rapidly in relation to the size of the Korean economy. Nevertheless, as can be seen from table 1, ODI still represents a smaller share of GDP than in advanced economies. Table 1 also shows that Taiwan is catching up with the advanced economies more quickly than Korea. Roger van Hoesel (1999) has attributed this lagging ODI pattern to Korea's late industrialized economy status. From this perspective, the issue is to a large extent that of catching up by latecomer Korean firms; they should gradually build up sufficiently strong competitive advantages in order to internationalize on a larger scale.

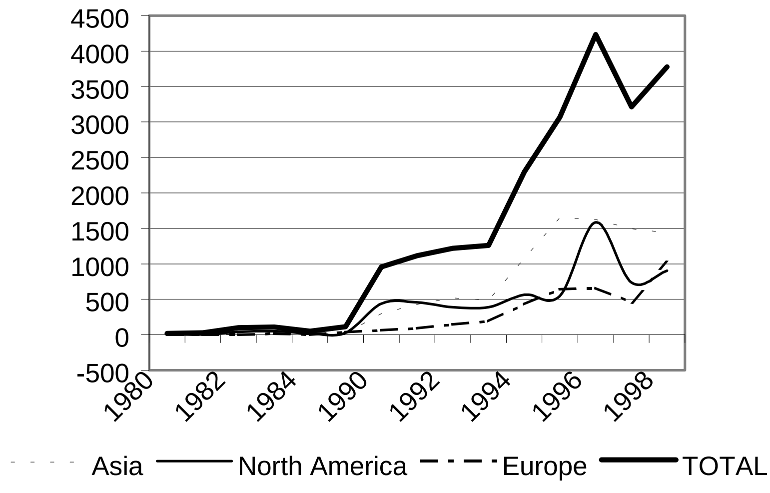

Figure 1.1 ODI by Korean firms, $ million

Table 1.1 The importance of outward direct investment for the Korean economy

	ODI stock/GDP, %			
	1980	*1990*	*1995*	*1998*
Korea	0.2	0.9	2.1	6.6
Taïwan	0.2	8.0	9.6	14.5
Japan	1.9	6.9	4.6	9.7
USA	8.1	7.9	9.9	12.1
UK	14.9	23.5	28.1	39.8
France	3.8	8.7	12.0	18.6

Sources: (Hoesel, 1999) and calculations for 1995 and 1998 from UN and OECD data

The issue of the competitive advantage of Korean firms is indeed crucial to understanding their specific pattern of internationalization and assessing its future evolution.

FROM «THIRD WORLD» TO «EMERGING» MULTINATIONALS

In the 1990s, Korean multinationals exhibit quite a different profile from the «Third World multinationals» clustered in traditional manufacturing and low-cost neighboring countries in the 1970s and 1980s (Caves, 1996; UN, 1998).

This «first wave» (Hoesel, 1999) of latecomer multinationals was actually quite diverse. Some investments were resource-seeking (natural resources and low-cost labor), while others were market-seeking in developing countries which had adopted import substitution policies and had been raising trade protection barriers accordingly. During the 1980s, Korean firms invested in South-East Asia on a large scale to make up for increasing domestic production costs. However, the «second wave» of ODI by firms from emerging countries which has been gaining momentum since the late 1980s, exhibits quite different characteristics.

During the 1990s, Korean firms have continued to invest in Asian developing countries (figure 1). However, 46 per cent of their ODI flows have been directed to North America and Europe.[11] A substantial share of these investments are concentrated in capital-intensive and R&D-intensive sectors. These investment flows by latecomer firms from an emerging country into high-tech sectors in leading countries do not dovetail with the received theory of multinational companies, which tends to emphasize the role of competitive advantages as determinants of foreign production.

Several empirical contributions have already explored the issue of the specific determinants of foreign location by latecomer firms. They have built on insights from the theory of the multinational company and from empirical studies of the Japanese case. Consequently, they have focused on the role of trade barriers and firms' specific assets. Since Korean firms typically do not possess strong competitive advantages vis-à-vis their competitors in developed countries, the usual indicators of ownership advantages have fared poorly as explanatory variables of Korean ODI. Neither marketing expenditures nor R&D outlays seem to significantly influence Korean ODI in developed countries (Jeon, 1992; Perrin, 1999).

The recent empirical work of Roger van Hoesel (1999) has nevertheless shown that Korean electronics firms which invest in advanced economies have accumulated more human capital than those which do not.[12] On the contrary, human capital is not a determinant of the decision to invest in developing countries. The accumulation of human capital certainly constitutes a major element of catching-up strategies. Korean firms which invest in developed countries also strive to improve quality, e.g. by obtaining ISO 9000 or ISO 9001 certification. These different elements suggest that the main ownership advantage of these Korean firms may be their mastery of production techniques and their ability to deliver goods which meet the standards of the leading markets, rather than their innovative capability or brand name.

Taken together, the results of the available empirical studies would then lead to the conclusion that Korean firms have invested in developed countries mostly to jump over anti-dumping barriers to export. Large Korean firms which have invested in the United States and Europe to preserve their export markets may have done so without possessing the adequate assets and skills on which to build strong competitive advantages over local firms. When viewed from this perspective, their strategy would be to try to reinforce their competitive advantage on the low end of the market in which they have proved the most competitive so far.

Some of the Korean ventures in the United States do not correspond to the barrier-jumping rationale since they are in high-tech sectors where local firms have world class competitive advantages. On the contrary, a number of examples suggest that large Korean groups have resorted to investment abroad as part of their strategy of technological upgrading (Kim, 1997; Ungson et al, 1997, Hoesel, 1999). The profile of Korean multinationals thus seems quite complex.

THE MAIN ISSUES

The broad aim of this book is to explore the pattern and determinants of Korean foreign direct investment. The main focus is on ODI, but data and analysis are provided on both inward and outward flows in developed and developing countries in order to arrive at a better understanding of the dynamics at work.

The book provides new insights by deliberately linking two main issues which emerge from the literature on foreign direct investment but which are often tackled separately: first, that of the relevance of the theories of international production for analyzing the specific profile and organization of the emerging Korean multinationals, and second, that of the underlying dynamics which have led to the remarkable emergence of Korean multinationals and to Korea's specific overall FDI trajectory. In order to address both issues, the book uses complementary approaches; the appendix to this chapter provides a synthetic presentation of the content and methodology of the different chapters.

Do Korean multinationals fit the theory?

Serge Perrin and Frédérique Sachwald (chapters 3 to 5) address the first issue by discussing the literature and by empirically testing hypotheses. The major contribution here is the attempt to design empirical tests to fit the specific features of the Korean economy.

The Korean case supports well-established determinants of foreign production on a number of points. Results from tests on both cross-sectoral samples and the electronics sector support protectionism as a major determinant of Korean ODI. Korean firms tend to set up foreign production units in sectors where they possess a clear competitive advantage and when protectionist measures threaten their access to European or American markets. Serge Perrin also discusses the influence of oligopolistic rivalry on the choice of international production and examines the role of the chaebol as the major actors of Korean ODI in advanced economies (chapters 3 and 5). As suggested above, the type of ownership advantages which Korean firms might enjoy is a major empirical issue. It seems that the chaebol structure constitutes a more important determinant of Korean ODI than traditional indicators of marketing and technological assets.

Through case study analysis of the internationalization of four Korean and Taiwanese firms, Roger van Hoesel (1999) has identified technology sourcing as one of the motivations for growing ODI flows from emerging countries, and calls in his conclusion for a more thorough examination of this issue. Chapter 4 constitutes such an exploration of the hypothesis of strategic asset-seeking. Luis Miotti and Frédérique Sachwald relate the upgrading of Korean firms' technological base to the evolution of the channels of technology transfer on which they have relied. From the late 1980s onwards, the latter have included foreign R&D outposts, international technological alliances and the acquisition of high-tech firms, primarily in the United States. The empirical test is designed to clearly distinguish technology sourcing from competitive advantage as motivations for setting up foreign ventures. It uses an original indicator to proxy the ownership advantage of Korean firms and assesses the relationship between the firm's motivation and the choice of entry mode. Chapter 4 thus provides a general discussion and a test of the appropriate entry modes to source technology through foreign investment.

These different results suggest that Korean ODI in North America and Europe is diverse, as it is motivated either by market-seeking or by strategic asset-seeking. In a number of cases, the same firm may operate both types of ventures. Moreover, it seems that barrier-jumping is becoming relatively less important as a motivation, while technology sourcing has become more frequent during the late 1990s. Finally, there are clearly sectoral differences. All these observations suggest that the interactions between firms' international strategies and the dynamics of the Korean economy should be examined.

The institutional context

A dynamic analysis of Korean ODI flows calls for specific approaches as it requires both an understanding of the context and a historical perspective. Accordingly, the analysis of the Korean trajectory of internationalization is explored from various perspectives; the different chapters discuss the influence of the following features of the Korean economy: macroeconomic and policy issues; the influence of the chaebol on industrial development, the structure of domestic competition and international strategies; technological upgrading and the evolution of the modes of technology transfer. Sectoral characteristics are examined at length for the electronics and automobile industries. Finally, a case study of the acquisition of the German firm Rollei by Samsung Aerospace provides an in-depth discussion of the latter's internationalization strategy.

In chapter 2, Françoise Nicolas analyzes the interactions between the specific features of the Korean development path and the evolution of inward and outward direct investment flows. She provides a detailed account of the national features which have shaped Korea's foreign investment path[13] since the 1960s. Previous contributions have identified the role of a number of such idiosyncratic features as size of local market and availability of natural resources (Narula, 1996). In the case of Korea, Roger van Hoesel (1999) has emphasized the influence of the government in relation to the national development strategy as the major idiosyncratic factor. Françoise Nicolas provides a detailed account of the role of government policies, which shows that regulations on inward and outward investment have evolved in relation with the national development strategy. This monitoring of investment flows by and large explains the specific profile of the Korean investment path, which was characterized by very low inward investment until the late 1990s and a surge of outward flows in the 1990s (figure 1). The government has lost part of its oversight capacity as a result of its liberalization policy in the 1980s and 1990s. In the 1990s, as ODI was liberalized, Korean firms have embarked on ambitious international strategies and have borrowed from foreign local financial institutions. The government therefore introduced a number of prudential measures in order to try to control the impact of ODI liberalization on the domestic economy.

In chapter 6, Marc Lautier studies the international trajectory of the Korean automobile industry. His major contribution is to show how the internationalization of the Korean carmakers is deeply rooted in their overall development strategy. He examines the role of inward direct investment as one of the channels for technology transfer. More generally, international cooperation has been a major component of the catching-up strategy in the automobile sector, but Korean carmakers have sought to phase out the dependency which has resulted from the early technological agreements.

The main driving force of the internationalization strategy of Korean carmakers has been the quest for scale. Marc Lautier argues that this quest goes a long way towards explaining both the export strategy and the foreign production strategy of Korean carmakers. Accordingly, the detailed study of the automobile industry provides a sectoral illustration of one of the book's major themes, i.e the close interactions between the international trajectory of firms and the underlying overall national development path.

The case study of the acquisition of Rollei, the German camera specialist, by Samsung Aerospace (SAS) provides a more detailed look at several issues, including technology transfer and diversification onto sophisticated international markets. Kong-Rae Lee explains that this acquisition was part of a diversification strategy, aimed both at upgrading the technological capability of SAS in optical technology and at securing better access to sophisticated markets through a renowned brand and an established distribution network. This diversification benefited from the favorable institutional context, where chaebol affiliation provides patient capital. Kong-Rae Lee also shows that success has been partly based on the existence of an OEM[14] relationship before the acquisition in 1995. OEM contracts have been extensively used by latecomer firms from emerging Asian countries as channels of technology, design and production know-how transfer (Hobday, 1995, 2000). Consequently, OEM contracts have fostered close relationships between the two companies and enabled SAS to assess Rollei's skills.

The general conclusion first considers the implications of our findings for the theoretical analysis of international production and international knowledge flows. It then draws on the different contributions to assess the specific nature of the internationalization patterns of Korean companies. The latter is not only due to the fact that they are latecomers, but is also rooted in the idiosyncratic institutional context which has produced a specific Korean development path.

In this perspective, both the discussion of chapter 8 and the general conclusion argue that part of Korea's ODI boom was actually the flip side of its restrictions on inward investment. Moreover, as a result of Korea's very development, national, ownership should not be considered as essential for further economic up grading as in the past. These conclusions go a long way towards explaining Korea's liberalization of inward investment after the 1997 crisis. The conclusion thus predicts that Korea's internationalization pattern will become more balanced, with relatively more inward foreign investment.

Appendix Overview of the book

Chapter number and main theme	*Main issues*	*Perspective/Methodology*
Chapter 1		
General introduction	Specific profile of Korean multinationals; Korean FDI and ODI	Theory of the multinational, idiosyncratic institutional context
Chapter 2		
Macroeconomic and development context	Impact of policies in relation to FDI and ODI on the foreign investment path	Macroeconomic dynamics Relevance of the «Investment Development Path»
Chapter 3		
Korean manufacturing direct investment in the US and Europe	Main determinants and discussion of the role of the *chaebol*	Cross-sectoral test of the role of protectionism and rivalry
Chapter 4		
ODI as a technology sourcing strategy	Co-evolution of the technological capability of Korean firms and of their modes of technology transfer	Cross-sectoral test of the technology sourcing motivation
Chapter 5		
Internationalization of the Korean electronic firms	Influence of protectionism and of the domestic market structure	Test of propensity to invest on a sample of Korean electronic firms
Chapter 6		
Internationalization of the Korean carmakers	Influence of catching-up and export strategies on ODI. Extent of international production	Historical perspective and field study to assess the extent of foreign operations
Chapter 7		
Acquisition of Rollei by SAS	Role of this foreign acquisition in SAS' diversification strategy	Detailed case study
Chapter 8		
Discussion	Comments by discussants on the main issues of the book	Discussants take various perspectives, depending on their focus and the specific chapters to which they refer
Chapter 9		
General conclusion	The "Korean model" of development and globalization; national ownership and economic development; ODI and FDI as substitutes	Theory of the multinational, national production and innovation systems

NOTES

1. In May 1996, Chairman Kim received France's highest award bestowed upon a civilian, namely Commander in the Order of the Legion of Honor.
2. Quoted in (Withell, 1997).
3. The initial public offering (IPO) was oversubscribed 6 times by retail investors and 35 times by institutions. On the first day of trading, the share price soared 35% above the IPO price which had been set at the top of the reference range (*Financial Times*, 4 Nov. 1999).
4. Even though Daewoo has followed a rather specific international strategy by steering an uncharted course in Eastern Europe and other risky markets (see chapter 6 in particular).
5. In the 1990s, Chairman Lee Kun-Hee wanted to turn Samsung into a «first-class company» by 2000 (Ungson et al.1997). Other large Korean companies had similar objectives.
6. More precisely to the 1994 International Management Development (IMD, Switzerland) report on competitiveness (Kim, 1997).
7. *Segyehwa* means globalization in Korean, but the word has been used to describe a generally favorable and pro-active attitude towards globalization.
8. For a discussion and comparison with previous waves of internationalization, see (Sachwald, 1994; Dicken, 1998).
9. Direct investment channels some of the funds necessary for M&A, but does not include funds raised locally.
10. The Korean share was back to 0.73% in 1998 after the 1997 Asian crisis.
11. Over 1990-98 (calculation on the data from the Ministry of Finance and Economy).
12. He conducts a Tobit test where human capital is measured by the firm's average annual earnings per employee.
13. The chapter uses the notion of «Investment Development Path» which refers to Net Outward Investment flows (outward minus inward flows).
14. Original Equipment Manufacture. SAS has been manufacturing a number of camera models for Rollei.

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