THE JOURNAL OF THE KOREAN ECONOMY, Vol. 5, No. 1 (Spring 2004), 69-96

Causes for Sluggish Foreign Direct Investment in Korea: A Foreign Perspective

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In spite of the liberalisation of the FDI regime since the 1997 financial crisis, the magnitude of FDI in Korea is smaller than a level comparable internationally, and has declined significantly in the recent past. To address the issue of flagging FDI in Korea, a comprehensive survey was undertaken of foreign companies in Korea. The survey results show that foreign firms undertake investment in Korea mainly to capitalise on the emerging business opportunities and that there is substantial room for improvement in the areas of government regulations and the business environment. To further attract FDI, therefore, not only should Korea undertake an across-the-board liberalization of the FDI regime, but it should also make concerted efforts to improve the operational environment for foreign businesses.

JEL classification: F21

Keywords: foreign direct investment in Korea, survey of foreign firms

1. INTRODUCTION

Until the 1997 financial crisis, South Korea (Korea hereafter) was regarded as the worst place to invest among Asian countries (Booz.Allan & Hamilton, 1997, p. 28; Far Eastern Economic Review, 1998). To protect domestic industries Korea restricted incoming foreign direct investment (FDI) with a heavy burden of laws and regulations. A number of sectors were closed to FDI by law until the early 1990s and even in those areas

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where FDI was permitted, the administrative regulations and procedures for FDI were complex and lacked transparency. The Korean economic structure, society and culture were not conducive either to incoming FDI. The labour market lacked flexibility, thereby raising labour costs to one of the highest among the Asian newly industrialised countries (NICs). The real estate sector was closed to foreigners and overhead costs were among the highest in Asia (Cha, 2001; Jwa and Yi, 2001; Kwon, 2001).

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 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, compared to the proportions of 10.0 percent and 18.9 percent for the world and East Asia respectively (UNCTAD, 2002).

Since 1997, however, Korea has liberalised the FDI regime up to the level of other OECD countries and switched its policy emphasis on FDI from 'restriction and control' to 'promotion and assistance'. Korean society and the business community as well as the government have sought to improve the Korean business environment. As of 2002, 99.8 percent of all business sectors were open to foreign investment – a level on par with that of other OECD economies (Sohn, Yang, and Kim, 2002). The labour market was reformed to improve its flexibility, and the real estate sector was opened to foreigners. 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. As a result, FDI in Korea increased substantially over the three-year period (1998-2000).

Notwithstanding this rapid increase in FDI, the magnitude of FDI in Korea is still small by international comparison. Furthermore, as shown shortly, FDI in Korea fell sharply for the three consecutive years from 2001 to 2003.

The Korean government has undertaken a series of policy measures in an all-out effort to attract FDI. How, then, can this relatively low magnitude of FDI in Korea and recent sharp declines be 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. In particular, it attempts to identify and explain the factors underlying sluggish FDI in Korea from the perspective of foreign investors in Korea.

Although a number of studies are available in the literature on FDI in Korea (Kim and Choo, 2002; Kim and Kim, 2003; Kim 2003; Sohn, Yang, and Kim, 2002), most of these were undertaken by Korean scholars in Korea from a domestic perspective. There is no in-depth study of the issue from a foreign perspective. Yet, the views of foreign business people who have investment and business experiences in Korea are critically important because it is these people that Korea must convince if it seeks to attract FDI. It is thus appropriate to investigate the latest developments of FDI in Korea from the perspectives of foreign investors and business expatriates.

2. METHODOLOGY

Any viable strategy, either by governments or by private firms, to attract or undertake FDI must be based on relevant and 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 was undertaken from May to July 2002 of foreign companies that had undertaken FDI and were operating businesses in Korea. In developing the questionnaire for the survey, it was attempted to include a large number of factors for FDI identified in literature on FDI (Dunning, 1998 and 2000; Kojima, 1978; Knickerbocker, 1973; Pearce and Robinson, 1994). These factors include not only numerous spheres of Korea’s international business environment but also on-site managerial restrictions and the living conditions of foreign expatriates in Korea. It appears that earlier studies have paid little attention to on-site management as a determining factor for FDI. In addition, recent changes in the Korean business environment, particularly since 1997 are taken into account, acknowledging their influences on FDI in Korea.

A questionnaire was thus developed, which was comprised of eight sections and 78 specific questions related to various aspects of the FDI environment in Korea. Respondents were questioned on: (i) general characteristics of responding companies, (ii) determinants of their direct investment in Korea, (iii) difficulties in the FDI preparation process, (iv) improvements in the Korean business environment, (v) difficulties in on-site management, (vi) recent changes in Korean chaebols, (vii) the characteristics of Korean workers, and (viii) changes in the living conditions of foreign expatriates. The questionnaire was then distributed to about 400 foreign companies in Korea and 69 of them responded.[1)] 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, Canada, Japan, EU, and Australia-New Zealand.

The present research is an 'exploratory' study with a focus on addressing the research question of what perceptions foreign business people have of Korea as an investment target country.[2)] No attempt has been made to test any hypothesis or to draw causality relationships. Nor has any attempt been made to identify differences in response among different industries because of a small number of responses. However, it should be pointed out that, as mentioned above, the survey is quite comprehensive and includes a large number of factors for FDI and the FDI environment in Korea.

No attempt has been made to conduct validity and reliability tests of the

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[1)] It was learned that the response rate of sample surveys of foreign companies in Korea was dismally low as they were all inundated with such surveys. It was also learned that the response rates were markedly different by national backgrounds of the foreign companies in Korea. Hence, random selection of companies was abandoned. Therefore, companies were chosen based on the increased likelihood that they would respond following suggestions from the officials at the Korean Ministry of Commerce, Industry and Energy and at foreign Chambers of Commerce.

[2)] For the concept of exploratory studies, see Neuman (2000, p. 21).

data (responses) because the response to each question is a one-time and one-form measurement. However, various measures have been undertaken to enhance validity and reliability. First, each of the questions in the questionnaire is based on theoretical concepts in the literature of FDI.[3)] Second, a draft questionnaire was commented on by a number of colleagues, and a pilot survey was conducted with a draft questionnaire that was completed by a number of foreign business people in Korea on a person-to-person basis. Through these processes, the format of the questionnaire was finalised.[4)] Third, as mentioned above, a large number of questions (78 questions in eight sections), representing all spheres of FDI and Korea's international business environment, was contained in the questionnaire to enhance the validity of the data (Neuman 2000: 168). Finally, 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 business expatriates.

In order to highlight the seriousness of the issues under consideration, Section 3 examines recent trends and major characteristics of FDI in Korea in light of global trends in FDI. Since government policy is critically important for FDI in Korea, an overview of the FDI regime and its changes after the 1997 crisis is provided in Section 4. Then, the findings of the survey are discussed in Section 5. Finally, Section 6 contains conclusions of the study and recommends strategies for attracting FDI in Korea.

3. RECENT DEVELOPMENTS IN FDI IN KOREA

Inflows of FDI in Korea have increased remarkably since the 1997 crisis in response to the liberalisation of the FDI regime and improvement in the business environment. As shown in Table 1, FDI in Korea leaped from $2.8 billion in 1997 to $5.4 billion in 1998, and further to $9.3 billion in both 1999 and 2000. However, the magnitude of FDI in Korea is still small

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[3)] This is a way of enhancing validity of the questions in the questionnaire (Frankfort-Nachmias and Nachmias 1996, p. 168; Neuman, 2000, p. 167).

[4)] These are tactics to enhance validity of the data (Yin, 1984).

Table 1 FDI Inflows in Korea and Other East Asian Countries

(units: $bill, %)

	1990-95 (avg.)	1996	1997	1998	1999	2000	2001	2002
FDI in Korea ($bill)	1.0	2.3	2.8	5.4	9.3	9.3	3.5	2.0
World	225.3	396.1	478.1	686.0	1079.1	1393.0	823.8	651.2
E. Asia*	44.6	87.8	96.3	90.1	105.3	138.7	97.6	88.6
FDI/GI**, Korea (%)	0.8	1.2	1.7	5.7	8.3	7.1	3.1	1.5
FDI/GI, World	4.1	5.9	7.4	10.9	16.5	20.8	12.8	12.2
FDI/GI, E. Asia	6.7	9.1	10.0	11.0	12.2	14.8	10.3	7.3

Notes: * E. Asia includes South, East and Southeast Asia.
** GI denotes gross fixed capital formation.
Source: UNCTAD (2003).

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 20.8 percent and 14.8 percent respectively (Table 1). In the same year, the ratio of FDI stock to GDP was 8.0 percent in Korea, while 19.6 percent and 37.0 percent, respectively, for the world and East Asia (Table 2). Furthermore, as shown in Table 1, FDI in Korea fell sharply for two consecutive years from 2001 to 2002. During this two-year period, the FDI ratio to gross fixed formation also declined, and was remarkably lower than those for the world and East Asia. Similarly, the ratio of FDI stock to GDP was also markedly lower than the corresponding ratios for the world and East Asia (Tables 1 and 2).

FDI in Korea played only a minor role in increasing the levels of value added and employment. In 1999, the level of value added by foreign affiliates as a percentage of GDP was 3.1 percent in Korea compared to 18.4 percent on average of 33 developing countries. In the same year, employment by 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, p. 275).

Table 2 Inward FDI Stocks as a Percentage of Gross Domestic Product

(unit: %)

	1980	1985	1990	1995	2000	2001	2002
Korea	2.1	2.3	2.1	1.9	8.0	9.5	9.2
World	6.7	8.4	9.3	10.3	19.6	21.2	22.3
East Asia	27.9	24.9	20.9	21.1	37.0	37.2	37.9

Source: UNCTAD (2003).

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 for the 1988–1990 and 1998–2000 periods respectively, ranking it 93rd and 87th among 140 countries over these periods (UNCTAD, 2002, p. 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 19th and 18th, respectively, among 140 countries in the periods 1988–1990 and 1998–2000.[5)] By comparing the 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 government policy, a tradition of low reliance on

[5)] 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, p. 24).

FDI, political and social factors, and weak international competitiveness (UNCTAD, 2002, p. 32).

The trend of FDI inflows in Korea from a domestic data source is consistent with the trend that is shown in Table 1 which is in turn based on the UNCTAD sources. As shown in Table 3, FDI in Korea rose from $3.2 billion in 1996 to $7.0 billion in 1997, continued to increase to $15.5 billion in 1999, and then slightly declined to $15.2 billion in 2000. It then declined significantly in the three consecutive years (2001-03) to $6.5 in 2003. It should be noted that FDI data in Table 3 are from the Ministry of Commerce, Industry and Energy (MOCIE) of Korea – not from UNCTAD, and that FDI values in Table 3 are on an approval (or notification) basis in contrast to a realisation basis of UNCTAD's FDI data in Tables 1 and 2.

In terms of industries, more than 60 percent of FDI in Korea was traditionally undertaken in the manufacturing sector (Table 3). However, since the 1997 crisis the share of FDI in the manufacturing sector has declined, while increasing in the service sector. Over the three-year period (2001-2003), in particular, the service sector accounted on average for 70 percent of FDI, while the FDI share of the manufacturing sector declined to 27 percent. It should be noted that decreases in FDI in the manufacturing sector over the 2001-2003 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 in the recent past. Primary industries – agriculture, fisheries and mining – have continued to attract an insignificant amount of FDI, except in 2003 when its share of FDI increased to 9.9 percent.

As examined above, inward FDI has increased substantially and become an increasingly important component of the Korean economy in recent years. This has been attributed to the changes in the FDI regime and a series of policy measures to attract FDI. Nonetheless, Korea has clearly failed to attract FDI to its full potential or to a level comparable internationally. It is

Table 3 FDI by Industry on Approval Basis

($mill and %)

	1962-1995	1996	1997	1998	1999	2000	2001	2002	2003
Primary industries	42	18	55	179	54	3	9	18	639
	(0.3)	(0.6)	(0.9)	(2.0)	(0.3)	(-)	(-)	(0.2)	(9.9)
Manufac-turing	8686	1930	2348	5735	7129	6649	3090	2432	1697
	(60.0)	(60.3)	(33.7)	(64.8)	(45.9)	(43.7)	(27.4)	(26.7)	(26.2)
Services	5744	1254	4568	2938	8359	8565	8192	6651	4131
	(39.7)	(39.1)	(65.6)	(33.2)	(53.8)	(56.3)	(72.5)	(73.0)	(63.9)
Total	14472	3203	6971	8853	15542	15217	11292	9101	6467
	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)	(100.0)

Note: On approval basis
Source: MOCIE (2004)

thus necessary to understand how and to what extent the FDI regime has changed in Korea.

4. THE KOREAN FDI REGIME

4.1. FDI Policy before the 1997 Financial Crisis

Unlike trade, for which international rules exist 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 restricted and discouraged inward FDI over a long period of time until the mid-1980s. From the mid-1980s, however, Korea began to liberalise the FDI regime under rising pressure from trade partners, thereby opening more business categories to FDI and relaxing restrictive regulations. 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 1990–97, Korea further liberalised its FDI regime with the launch of the WTO and its admission to the OECD in 1996. The approval system of relevant government organisations 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 in high technology areas. 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, 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.

The Korean economic structure, society and business culture were not conducive to incoming FDI either. The Korean economy was heavily concentrated in a handful of large chaebols that enjoyed various types of institutionalised advantages over foreign firms (Kwon, 2001). Compounding these problems, Korean society had been xenophobic, and failed to appreciate the economic benefits of FDI. Korean business culture has not been congruous with foreign investors, and Koreans in general preferred to work for domestic firms rather than foreign firms. The Korean labour market was not flexible and unions were renowned for their militant tactics. Restrictive zoning laws raised real estate prices extraordinarily high and foreigners were prohibited from purchasing real estate. As a result, Korea was regarded as the worst place to invest among Asian countries until 1997 (*Far Eastern Economic Review*, 1998).

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 interests that sought to enter the Korean market. The consequences of Korea’s restrictive policy toward FDI and the business environment have been huge. The sudden crippling of the economy born out of the 1997 financial crisis was an inescapable watershed, signalling unmistakably that both the structure and the principles that had supported Korea could not be sustained. As a consequence, Korea had to make a shift in policy principles not only regarding FDI but also other areas. The business environment and management also had to undertake fundamental changes.

4.2. Liberalisation of the FDI Regime after 1997

Since the onset of the 1997 financial crisis, Korea has switched its policy emphasis on FDI from 'restriction and control' to 'promotion and assistance' and has undertaken a series of policy measures and all-out efforts to improve the business environment to attract FDI. With the enactment of the new Foreign Investment Promotion Act in 1998, replacing the Foreign Capital Inducement Act enacted in 1966, Korea has liberalised the FDI regime to the general extent of OECD practices (Bishop 2001). The new Act has opened more business sectors (including the service sector) to FDI, making the liberalisation rate 99.8 percent in terms of the number of business sectors opened to FDI as mentioned earlier, and has erased complicated administrative procedures by dismantling or relaxing more than 50 percent of extant restrictions (KOTRA, 1999). The new Act has eliminated discriminatory laws and regulations against foreign investors in the Korean real estate market and permitted M&A (including hostile M&A) by liberalising the capital market. The new Act has also provided a variety of tax incentives for FDI.

The 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 the 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. Reform of the Korean labour market has substantially improved its flexibility. Management practices have substantially changed toward the western style. Korean society and culture have also changed. In particular, many Koreans have changed their perceptions of incoming FDI and have come to appreciate the value of FDI in aiding recovery of the crisis-stricken economy and in sustaining economic prosperity. Their discrimination against foreign companies and products has also declined considerably. Korean workers' preference of domestic firms to foreign firms has declined, leading foreign firms to find it easier to recruit and retain competent local staff. [6)]

How, then, would the relatively low magnitude of FDI in Korea and a recent sharp decline in FDI be explained? This study attempts to address this vexing question through investigating the motivations and issues faced by foreign investors in undertaking FDI and operating businesses in Korea.

5. SURVEY OF FOREIGN DIRECT INVESTORS IN KOREA

5.1. General Characteristics of Responding Companies

As mentioned earlier, to investigate the causes for sluggish FDI in Korea from a foreign perspective, a comprehensive survey was conducted in 2002 of foreign companies that had undertaken FDI and have been operating businesses in Korea. The survey questionnaire was distributed to about 400 foreign companies in Korea and 69 of them (53 companies and 16 individual foreign expatriates) responded.[7)]

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.[8)] This distribution of respondents by industry broadly

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[6)] For further details of the change in the Korea FDI regime soon after the 1997 crisis, see Kwon (2001) Kim and Choo (2002), and Kim (2003).

[7)] Individuals are those respondents who did not provide company details and therefore could not be identified in a particular sector.

[8)] Two respondents failed to indicate the industries in which they had invested. The sums of the companies for their specific aspects are not equal to a total of 53 companies because some of the respondents did not respond to the relevant questions.

represents that of the population, as indicated in Table 3. 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.

5.2. Survey Results

5.2.1. Determinants of FDI in Korea

From the literature on FDI (Dunning, 1998 and 2000; Kojima, 1978; Knickerbocker, 1973), 11 possible factors that would help foreigners determine their FDI choice in Korea were selected. 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 4. 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 4). Foreign business people had a negative view, though moderate, on the importance of the other location-specific variables, with mean scores ranging from 1.788 to 2.706. These included 'advanced related industries', 'easy access to information and technology' 'abundant skilled workers', 'investment incentives provided by Korea', 'easy access to parts and materials', 'low production costs', and 'overcoming tariff and other import barriers'. It is interesting to note that investment incentives by the Korean government was not regarded as an important factor. As the Korean economy has been highly liberalised, with Trade regulations Consistent with the WTO principles, it was expected that overcoming tariff and other import barriers would not be regarded as an

Table 4 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 import 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

influencing factor for FDI in Korea.

As Dunning (1998) suggests, 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 4, 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.

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 (Knickerbocker, 1973). 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’. This runs counter to the recent Korean campaign to promote Korea as the business hub of Northeast Asia.

5.2.2. 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 process of undertaking FDI with nine specific questions. The survey findings suggest that foreign investors found that the procedure 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). ‘Cultural and communication difficulties’ were most serious with an average score of 3.453. ‘Complex administrative procedures’ were still considered difficult (3.420), indicating the need for improvement in the Korean government’s streamlining of the administrative procedures for FDI. Another type of serious difficulty was related to understanding and dealing with Korean companies. Foreign business people indicated ‘ineffective corporate governance of Korean firms’ as difficult. Although rated 2.906, ‘opaque financial statements’ of Korean companies also appeared to be an area of concern. These findings may indicate that, as seen by foreign business people, the reform of Korean companies has not been completed. Other types of difficulties were not regarded as serious, with their mean scores ranging from 2.451 to 2.904. They included ‘difficulties in understanding the Korean market’, ‘militant unions’, ‘inadequate protection of intellectual properties’, ‘M&A’, and ‘selecting business partners’.

5.2.3. Improvement in the Korean Business Environment since 1997

There is no doubt that the business environment in Korea has an important bearing on FDI decisions in Korea, and it has been argued that Korea’s business environment has improved since 1997 (Kim and Choo 2002; Kim

Table 5 Difficulties in the FDI Procedure

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

2003; Kim and Kim 2003). To assess this argument and to identify specific improvements, if any, in the Korean business environment as observed by foreign business people, the questionnaire included 17 questions. Each of these questions and its rating are shown in Table 6. 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 areas 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, they did not consider that significant improvements had occurred in other areas such as 'North–South Korean relations', 'transparency and consistency in government regulations', 'government regulations and interference', 'cronyism and corruption', 'protection of intellectual property rights', 'regulation of the real estate market', and 'distribution system' with mean scores ranging from 2.467 to 2.841.

Table 6 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

Interviews with survey participants revealed their view that there was substantial inconsistency in the policies, 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 delay 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 playing-field competition' were moderately negative. 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 a 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 negative, though moderate, views about Korea becoming 'easier to hire and retain local workers' and 'easier to dismiss Korean workers'. Likewise, they strongly disagreed with the statement on 'declining union militancy' with a mean score of 2.410. 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 negative views, though moderate, regarding both declining discrimination in Korean society against foreigners and foreign products, and abating cultural and communication difficulties, as indicated by mean scores of 2.887and 2.714 respectively. In personal interviews, participants expressed views that Koreans are still nationalistic and narrow-minded and do not appreciate racial diversity in the world as a matter of fact. Some participants also spoke of conflicts they experienced with Korean partners and other Koreans as a result of a lack of understanding of each other's cultures and institutions.

5.2.4. Management of on-site operations 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 7, most of the on-site operational difficulties raised in the questionnaire 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 (Table 5). These survey findings may indicate that, while the Korean government provides various types of support, incentives and assistance to attract FDI and streamline FDI procedures, it does not perform as well in supporting the on-site operations of FDI projects. It should be noted here 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.

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.

Regarding 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 Korean firms as still relying heavily on personal relationships in business operations, they considered themselves disadvantaged. This is quite different from the prevailing perception among Korean business people that Korean management is moving towards western management in which personal relationships have much less bearing on business operation. Other on-site managerial issues such as 'high overhead costs (rent, insurance, utilities)'

Table 7 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 localworkers	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

'entry into the Korean distribution system', 'conflicts with Korean partners', and 'getting parts and materials', were not considered as serious with mean scores ranging from 2.183 to 2.967.

In the area of human resource management, 'recruiting and retaining efficient local workers' and 'high wage levels and low labour productivity' were regarded as areas of concern. This is consistent with views discussed above, indicating that respondents saw human resources as an area that had not improved in recent years. ‘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 problematic.

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’, ‘Koreans prejudice against foreign firms and products’, and ‘Korean society closed to foreigners’ were all regarded as serious concerns with mean scores ranging from 3.333 to 3.597. Finally, many respondents regarded poor social amenities for expatriates’ families as a serious concern, with a score of 3.117.

5.2.5. Respondents′ Views of Korean Firms (Chaebols)

How foreign business people perceive chaebols as business partners would have a significant bearing on their investment decision. Hence, the questionnaire asked six questions to identify how foreign respondents perceived recent changes in chaebols as their business counterparts. As shown in Table 8, foreign business people had negative views on the improvement of chaebols as indicated by an overall average score of 2.501. Related to chaebol 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. They did not consider chaebols as ‘becoming more efficient recently’, with a mean score of 2.844.

It appears that foreign business people view chaebols as adversarial competitors. They did not view the chaebols’ dominance in Korean business as declining, nor did they view chaebols as becoming more

Table 8 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

cooperative business partners. In particular, they did not think that chaebols were competing on a level-playing field.

5.2.6. Respondents' Views of Korean Workers

The questionnaire included 10 questions related to foreigners' views of Korean workers. Seven questions enquired about positive aspects of Korean workers and the remaining three asked about the negative aspects of Korean workers. Foreign business people agreed strongly with the positive attributes of Korean workers with an overall average score of 3.297. They disagreed marginally with negative aspects, with an overall average score of 2.958 (Table 9).

The mean scores for five of the seven questions regarding 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 the mind-set of Korean workers, as their earlier preference was to work for domestic companies. Korean workers have areputation as hard working and highly skilled. These characteristics are reflected in a high score of 3.594 for the response to 'hard working'. Foreign business people also agreed with other positive aspects of Korean

Table 9 Characteristics 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 frequently	64	2.766	1.151
Average of the above 3 items	56	2.958	1.090

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, foreigners did not consider Korean workers as being 'highly skilled and efficient', nor possessing 'high reliability and stability' with mean scores of 2.923 and 2.815 respectively. Overall, however, these survey findings appear to confirm the reputable nature of Korean workers.

Of the negative aspects of Korean workers, poor English language skills was 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 skills being 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'.

5.2.7. Respondents' Views of Expatriates' Living Conditions in Korea

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 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.

Table 10 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 prices	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

They viewed that 'social amenities' had improved marginally, as indicated by a mean score of 3.015. However, the remaining types of improvement in living conditions, such as Koreans' 'declining prejudice against foreigners', '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 2.765. These negative views on improvements in the living conditions of foreign expatriates are consistent with their concerns about poor social amenities of expatriates' families, as shown in Table 7. These findings suggest that in its bid to attract more FDI, the government should pay more attention to improving the living conditions of foreign expatriates.

6. CONCLUSIONS

The Korean government restricted and controlled FDI up to the 1997 financial crisis, largely because of its historical obsession with protecting domestic industries and management control. The Korean economic structure, society and business culture were not conducive to incoming FDI either. As a result, Korea was regarded as the worst place to invest among Asian nations until 1997. Restrictions on FDI and unhealthy FDI environments were reflected in flagging levels of FDI at this time.

Since the 1997 financial crisis, the Korean government has undertaken a paradigm shift in its FDI policy from “restriction and control” to “promotion and assistance”, and has undertaken a series of policy measures and all-out efforts to improve the business environment and attract FDI. As a result, FDI in Korea increased remarkably between 1998 and 2000. Despite this spurt, Korea still attracted FDI that was less than a level comparable internationally. In addition, FDI in Korea decreased substantially over three consecutive years from 2001 to 2003. In order to investigate the causes for sluggish FDI in Korea, a comprehensive survey was conducted of foreign companies that had undertaken FDI and have been operating business 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. Foreign firms did not regard Korea as a target country for supply-seeking investment. They did not consider Korea as having competitive production costs, nor being a stepping stone to gain market access to other Asian countries. Additionally, foreign investors did not see investment incentives by the Korean government as an important factor for attracting their investment to Korea.

The survey results indicate that foreign investors encountered various types of difficulties in establishing FDI projects in Korea. Although formal entry barriers such as the approval process and FDI-restricted industrial sectors 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 unique Korean business cultures, unfair advantages held by domestic firms, and cultural and societal differences.

Some studies have attributed recent decreases in FDI to some external factors such as economic stagnation in the world particularly in the United States and Japan, the September 11, 2001 terror attack, and China's accession to the WTO (Kim, 2002, 2003). However, the present study shows that 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. Although the FDI regime has been liberalised and the entry procedure has been streamlined substantially, the present study clearly indicates that there is substantial room to improve in the areas of government regulations, policy making and implementation, both at the central and local levels of government. 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 the living conditions of foreign expatriates should also be improved. Furthermore, 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 are 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 that the Korean government is trying to attract, the survey findings of this study point to a number of areas that government policy should reconsider in its bid to increase inward FDI in Korea.

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