DETERMINANTS OF KOREAN DIRECT INVESTMENT IN VIETNAM: IMPLICATIONS FOR POLICY

By

Vuong, Hieu Thi Minh

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
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ABSTRACT

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This study addresses the main determinants, including pull and push factors, leading to the investment decision of Korean firms into Southeast Asian countries generally and Vietnam particularly. The author aims to describe the typical features of Korean investment in Vietnam and explain the reasons prompting Korean investors to engage in investment activities. Qualitative and quantitative techniques are applied in collecting the data. With analyzing methods including logical reasoning, comparative method and bivaritate analysis, the author finds that among the push factors prompting Korean to invest in Southeast Asia, low labor cost proves the key determinant. As for a particular case of Vietnam, pull factors include a competitive legal framework, low labor cost, an emerging market and cultural proximity to Korea. However, in a fierce competition context, the determinants implicit hinders for Vietnam in inducing and nurturing Korean direct investment. The country is facing with a series of challenges namely language barrier and information unavailability; bureau and red tape; inadequate infrastructure quality; and lack of supporting industries, which need tackling seriously in the coming time.

Dedicated to Le Tuan Anh

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The idea of the thesis theme first came across my mind in a lecture given by Prof. Antony Michell about investment attractiveness, in which he briefly explained the reasons why Korean firms invest abroad, especially in Southeast Asia. During the time at KDI School, I also had a chance to discuss further with Prof. JungHo Yoo about the economic context of Korea as well as the economic cooperation between Vietnam and Korea. I would like to thank them for bringing me fundamentals to carry out the study.

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I also would like to express my deep attitude to the KDI School of Public Policy and Management for providing me the excellent opportunity to study at the first raking business school of Korea and among the top ten schools in Asia. The Master Program of Public Policy, for which this thesis is a partial fulfillment, has truly laid a foundation for my academic life as well as my current career at the Ministry of Planning and Investment.

Finally, I would like to thank my family members, who have always been beside, supported and encouraged me.

Thank you.

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LIST OF ABBREVIATIONS

ANOVA	Analysis of Variance
AFTA	ASEAN Free Trade Area
ASEAN	Association of South East Asian countries
FDI	Foreign Direct Investment
KOTRA	Korean Trade Investment Promotion Agency
LDCs	Least Developed Countries
MNEs	Multi-national Enterprises
MPI	Ministry of Planning and Investment of Vietnam
NICs	Newly Industrialized Countries (Hong Kong, Korea, Singapore and Taiwan)
OECD	Organization for Economic Cooperation and Development
SMEs	Small and Medium Enterprises
UNCTAD	United Nations Conference on Trade and Development
USBTA	Vietnam – United States Bilateral Trade Agreement
WTO	World Trade Organization

Chapter 1

Introduction

This chapter describes the background leading to the thesis's object of study and provides an overview of the major parts of the thesis. The object, determinants of Korean investment in Vietnam, is placed within the interactive relationship of Vietnam and Korea, as well as the influences of global context.

1.1. Background

1.1.1. New trend of FDI

The 1990s experienced a new trend of FDI, the South-South investment flow. UNCTAD (1997) presented that FDI among developing countries was growing faster than either between developed countries or among developed and developing countries. The share of inbound investment stock of South, East and South East originating from newly industrialized countries rose from 25% (in 1980) to nearly 40% (in 1995) of total FDI stock (UNCTAD, 1997). This trend towards South – South investment is due to the fact that more-advanced developing countries (NICs, Malaysia, and Hong Kong SAR in 1990s; Chile, Mexico and South Africa in 2000s) and lower-developing countries in the same region shared similarity, including structural, cyclical and policy factors. The flow has also been motivated by a combination of push and pull factors. Among push factors, increasing competition and limited growth opportunities in home countries seem to be the major reasons prompting southern firms to invest abroad. As for pull factors, advantages of low labor cost and market access opportunities have been coupled with the increase in inward investment flow. Less mentioned, however, taking an increasingly important part in the South-South trend are the geographic proximity and ethnic and cultural ties.

Since the cost of acquiring reliable information about foreign markets and transaction costs can be high for relatively small companies from the South, they tend to invest in neighboring countries, where they have established a certain familiarity through trade, or ethnic and cultural ties. The FDI flow between Korea and Vietnam can be one of the cases.

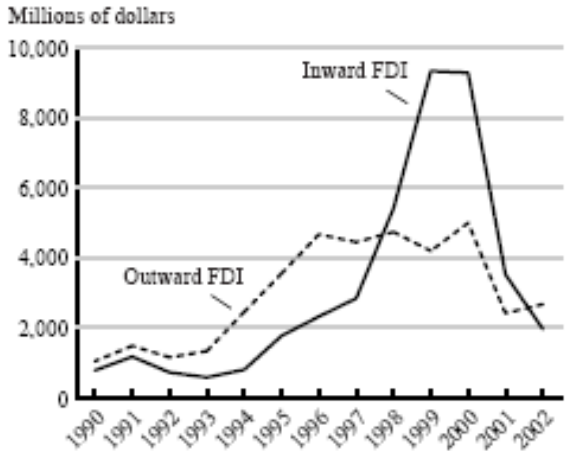
1.1.2. Korean outward direct investment

Originated from an underdeveloped agrarian country, Korean attitudes towards foreign investment (including both inward and outward) followed a specific path in evolution. In the earliest time of its opening economy, investment appeared in the form of inward flow. From 1960s to 1970s, Korea, on one hand, pursued an export-promotion strategy, on the other hand promoted import substitution in specific sectors and was keen to nurture national economic groups (chaebols). Korean government elaborated a bureaucratic mechanism to steer foreign investment into targeted sectors in line with the 5-year-plans and to facilitate technology transfer as for developing domestic enterprises. Inward investment was closely monitored; economic context remained backward, as a result, outward investment was hardly been paid attention to. In the period of 1970s to 1990s, despite great efforts of Korean government to encourage FDI, the deep-rooted influence of developmental state, which resulted in administrative guidance aiming at steering investment in desired industries and promoting exports, created costs, delays and opportunities for corruption.

Not until the sweep-over of financial crisis 1997, did Korean investment policies see an improvement. The liberalization of investment regime under President Kim Dae-jung's structural reform strategy was considered one way to increase Korea's technological capability. Aiming to overcome the currency crisis and

stimulating industrial upgrades, a combination of further liberalization such as the enforcement of Foreign Investment Promotion Act (IPA), the fully liberalization of foreign land ownership and the establishment of KOTRA and Office of Investment Ombudsman, have positioned Korea among the liberalized states in OECD during 1998-2000[1].

Along with the FDI's thriving, Korean economy has seen remarkable achievements, which leads to the dramatic increase of Korean outward investment. However, since 2000, as the inward investment has plummeted due to the boom of cross-border M&A, the outward investment reduced for 2 years and started to recover in 2002 (See Figure 1.1). The main purposes of Korean outward investment have been to accelerate the evolution of industrial structure (to less developed countries) and access to foreign technologies (to the United States and EU). In 1990s, outward investment helped the labor-intensive industry, which was losing its competitiveness, to relocate in less developed countries, and overcome protectionist barriers in recipient countries such as the United States and EU.



Source: Statistics database, Bank of Korea, 2003

Figure 1.1: Korean inward and outward investment from 1990 to 2002

[1] Globus and Stephen (2003).

1.1.3. Overview of FDI in Vietnam

As a developing country, Vietnam considers FDI as an important part in its economy. Since 1987, when the first Law on Foreign Direct Investment came into force, the country has witnessed a dramatic increase in inbound investment (See Figure 1.2), reaching a peak of nearly 9.5 billion US dollars in 1996. The investment capital plummeted as a result of the 1997 financial crisis, rebound from 2000 and has kept increasing up to now.

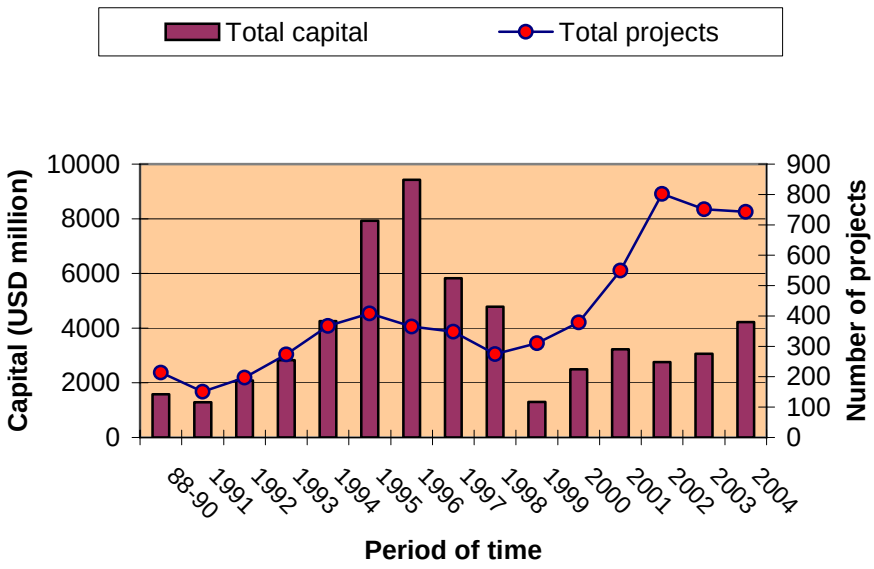


Figure 1.2: FDI in Vietnam by capital and number of projects from 1988 to 2004

Source: MPI, Vietnam.

South East Asian Volume (2004) also indicated that in 2003, FDI into Vietnam accounted for 15.2% of the country's total fixed capital formation and 50.6% of GDP stock compared to the average level of 9.7% and 34.6% in South, East and Southeast Asia respectively. According to the MPI's Final Report for the 2001-2005 Investment Enforcement Campaign, the total export turnovers brought by FDI sector (except for crude oil exportation) was approximately 11 billion US dollars, increasing

by 26% compared to the previous year, making up 35% of the nation's export turnover. FDI sector contributed 1.29 billion US dollars or 12% of the total State budget in 2005, experiencing an increase of 39.5% of last year's.

To date, Vietnam has been the investment destination of over 100 out of the 500 global MNEs. With more than 200 projects worth 10.5 billion US dollars, the MNEs are taking a share of 20% of the total inward investment capital in Vietnam. The majority of these firms have invested in the large-sized projects with an average of 45 million US dollars. In addition, investment flow from SMEs is increasingly intensified, especially the project of around 3 million US dollars (MPI Annual Report, 2005).

Korean direct investment has contributed significantly to this FDI booming. According to the Annual Report by MPI, by December 2005, Korea ranked 4th in investment in Vietnam with 1,028 projects and registered capital of 5.3 billion US dollars, taking an account of 17.65% of the total number of projects and 10.46% of the total capital invested in Vietnam, following Taiwan, Singapore and Japan. However, from the view of Korean investors, Vietnam has made a modest proportion of 2.66% and 2.82% of the total outward projects and capital respectively.

Though it is undeniable that Korean FDI is greatly contributing to Vietnam's economy, there exist few studies thoroughly investigating either the characteristics of Korean FDI in Vietnam or the motivations and determinants to locate Korean investment in the country (See Chapter 2 - Literature Review). Korea is firmly proved a potential market for Vietnam, however, its typical characteristics are not adequately considered; that, in turn, leads to the fragile background for policymakers to formulate investment policies to attract targeted markets. Therefore, an in-depth understanding of determinants prompting Korean to invest in Vietnam will contribute to elaborate

appropriate policy framework and strategies to attract and nurture this source of investment.

1.2. Research questions

Acknowledging the above-mentioned fact, this thesis attempted to suggest measures for Vietnamese policy-makers to increase the volume of Korean direct investment. In particular,

1. What are the main features of Korean direct investment in Vietnam?

2. What are the key determinants to locate Korean direct investment in Vietnam?

3. How do these key determinants relate to the volume of Korean direct investment?

4. What measures should Vietnam take to increase the volume of Korean direct investment?

1.3. Research goals

Based on the questions set above, the thesis targeted the following goals:

1. To describe the features of South-South investment flow from the more-advanced developing countries to the less-advanced developing countries in Asia, stipulated by Hafiz Mira (2000), through the case of Korea and Vietnam.

2. To identify the motivations and key determinants affecting the location of Korean direct investment in Vietnam based on the findings of Dunning (1977) and Porter (1990).

3. To test the finding of World Bank (1989), and the economic analysis by Yeon (1992) which indicated that Korean direct investment that went to lower

developing countries appeared to be driven mainly by cheap labor and other comparative advantages including local sale potential, incentives offered by host governments, and host country's GSP or preferential status with major trading partners.

4. To find the relations between the key determinants and the volume of Korean direct investment in Vietnam

5. To suggest measures to induce and nurture Korean direct investment in Vietnam and set the foundation for policy-makers to formulate investment policies

6. To provide the background for further studies on determinants of Korean investment as well as the features of FDI in Vietnam.

1.4. Significance of the questions

The study is of importance for the following reasons:

1. The number of researches on determinants of South-South investment is still limited (see Chapter 2). In addition, there have not been many researches studying the characteristics of Korean investment in Southeast Asia.

2. There have been few researches about determinants of Korean direct investment in Vietnam based on the two widely accepted theories on location determinants of FDI.

Therefore, the author believes that the thesis will contribute to the knowledge of characteristics of Korean investment in developing countries generally and the determinants of Korean investment in Vietnam particularly. Moreover, the thesis findings are expected to be of meaningful results, which should be of value to investment policy-makers.

1.5. Overview of the methodology

1.5.1. Units of Analysis and Data Collection

The author focused on four units of analysis namely (1) *The main characteristics of Korean direct investment in Vietnam, (2) Key determinants to locate Korean direct investment in Vietnam; (3) Relation between these factors to the volume of Korean direct investment; and (4) Measures for Vietnam to increase the volume of Korean direct investment.*

In answering the first question, documents were be archived from (but not limited to) the following sources: Ministry of Planning and Investment of Vietnam (1987-2005), General Statistics Office of Vietnam (1987-2005), Korean Export and Import Bank (2005), Ministry of Construction, Industry and Energy of Korea (2005), National Statistics Organization of Korea (2005), Statistics by UNCTAD (from 1991 to 2005).

For the second question, determinants were identified based on the perspectives of foreign investors and host country. To find the push factors by Korean MNEs and Korea itself as home country, the author relies on the survey's results by KOTRA Vietnam in 2004 and 2005 and statistics of Korean economy from National Statistics Organization of Korea (from 1987 to 2005). The pull factors by the recipient country were then analyzed based on reports, researches, investment journals, etc. from MPI, the Central Institute of Economic Management of Vietnam (CIEM), and relevant agencies; and interviews of experts in the field of FDI.

For the third question, the author tested the relation between these factors to the volume of Korean investment. Indicators of the factors were from secondary data documented by various official FDI related organizations.

The final unit, implications for policy, was withdrawn based on the findings of the analyses above.

1.5.2. Data Analysis

Data treatment and analysis were carried out based on two methods: logical reasoning and statistical analysis. *Logical reasoning* was done through analyzing the empirical data in different sources. The author combined the logical reasoning and statistical techniques by Statistical Package for the Social Sciences (SPSS) to identify the relationships between different variables. Bivariate regression analysis was used to identify the most important determinants of Korean investment in Southeast Asian countries. The author then applied logical reasoning to find the relation between the determinants and Korean direct investment in Vietnam.

1.6. Delimitation of the Thesis

The thesis covered the push factors affecting investment decisions of Korean firms in Southeast Asia and the pull factors to their direct investment in Vietnam. As the portfolio investment was beyond the scope of study, Korean investment was referred to Korean direct investment. On analyzing the research issues, the author compared Vietnam with other countries in the region. The thesis was implemented mainly based on the logical reasoning method. Statistical method was also used, still, at the limited level. As for the period, Korean investment to Vietnam was studied from 1988, a year after the first Law on FDI of Vietnam came into effect, up to now.

Chapter 2

Literature Review

The chapter reviews the literature related to the determinants of Korean direct investment in Vietnam, as a means of providing an intellectual background for the present study. The author summarizes conceptual and empirical work accomplished in the four areas, namely: (1) Motives for FDI; (2) Determinants of FDI; (3) Korean direct investment; and (4) Korean investment in Vietnam.

2.1. Major concepts and reviewed Literature

2.1.1. Motivations for FDI

Foreign direct investment (FDI) is a part of a firm's strategy to grow and expand on a global scale. There exists an abundance of theories on motives for FDI based on different points of view: market/industrial organization theory, theory of growth of the firm, finance/investment theory, international trade theory, location theory, transaction cost theory, and dynamic theory (Ensign, 1995), however, within the scope of this thesis, the author chooses firm's production process as a ground to investigate reasons prompting firms to undertake FDI.

To this extent, borrowing and extending from an earlier taxonomy used by Behrman (1972), Dunning (1992) found that firms are motivated to engage in foreign production primarily by what they perceive to be in the interest of their stakeholders, who must be recompensed for their contribution to the production process by an amount at least equal to the opportunity cost and the capability they provide. Dunning pointed out the 4 types of foreign production firms might take as well as their distinguishable driving forces to engage in FDI.

First, *resource-seeker* is the basic type of foreign investors. They seek for either physical resources, cheap and well-motivated unskilled labor or technology capability, management, marketing expertise and organizational skills. They are driven to engage in FDI by the motives of cost minimization and security of supplying resources, labor-intensive intermediate or final products for export, and of value-added process.

Second, *market-seeker* is the investor seeking to sustain or protect existing markets or to exploit and promote new markets. This type of investor is greatly influenced by host government's incentives. There are 4 main reasons for firms to engage in market-seeking investment, including: (i) The fact that the main suppliers or customers have set up their overseas production facilities, (ii) Frequently products need to be adapted to local tastes or needs, and to indigenous resources and capability, (iii) Production and transaction costs to locate production overseas are less than supplying it from a distance, and (iv) The increasing importance of physical presence of MNEs in the leading markets served by their competitors.

The third type of investor is *efficiency-seeker*, who intends to take the advantage of different factor endowments, and similarity in cultures, institutional arrangements, economic systems, policies and market structures by concentrating production in a limited number of locations to supply multiple markets. The investor of this kind is becoming less attracted by factor endowment and increasingly interested in the availability of supporting industries, characteristics of local competition, consumer demand and macro and micro policies. The host country can be attractive to this type of investor when its cross-border markets are well developed and open.

The forth type is *strategic asset-seeker*, who seeks to acquire the assets of foreign corporations to promote their long-term strategic objectives, especially that for sustaining or advancing their international competitiveness. Both efficiency-seeker and strategic asset seekers are accounting for increasing share of global FDI, particularly within the major markets of the world, and concentrated in the technology and capital-intensive manufacturing and information services sectors.

2.1.2. Determinants of FDI

One of the salient characteristics of foreign investment is its location. This locational aspect of FDI is evident in almost all studies of the behaviors of international firms, their investment decisions and economic impacts. Location is no longer limited to the traditional sense of place or physical space, but increasingly measured based on the cultural proximity between business environments.

One of the foremost and fundamental theories about the determinants of FDI is that by Dunning (1977). In his Eclectic Paradigm, Dunning specified conditions required if a MNE is to engage in FDI. According to Dunning, a firm is not likely to invest directly in a foreign country if any one of the *firm-specific advantage (O: ownership)*, *internalization (I)* or *country-specific advantage (L: location)* is not intact.

Firm-specific advantage is the essential factor to distinguish different firms in the competitive market. Largely in the form of intangible asset, the advantage includes a unique technology, large company size, and the contribution of key managers. This advantage gives foreign firms the ability to compete with local firms. Moreover, foreign firms incline to keep its advantages privately known.

Internalization illustrates the MNEs' unique ability to insulate its *specific advantage* from competitors through trademarks and patents, its vertically/ and

horizontally integration and transfer pricing. It is more beneficial for firms to internalize their *specific advantage* through subsidiaries than to sell or lease them to foreign firms. It is the reason why FDI is more favored than other forms of external activity.

Country specific advantage includes (1) Market factors (market size and potential, market share and promotion of trade between parent company and subsidiaries); (2) Trade barriers; (3) Cost factors and (5) Investment climate. It is widely proved that the more open the host economy, the more attractive the investment environment.

In summary, with the eclectic approach, Dunning provided a consolidation of literature and specified a set of conditions for firms to engage in FDI. Furthermore, Dunning predicted that if a firm has its own specific advantage, it is able to internalize the advantage, and can take advantage of specific host country attributes. By that, FDI occurs.

From a difference point of view, Reuber (1973) investigated the MNE's relationship with its host country and the firm's potential of regional economic development. Reuber saw a MNE's decision to invest directly belonging to either one of the three control-based motivations: *(i) export-oriented, (ii) market development-induced or (iii) government-initiated.*

In the case of LDCs as the recipient, mainly inexpensive labor and/or abundant resources induce overseas MNEs. *Export-oriented firms* aims to protect their competitive position through more cost-effective vertical integration. Looking forward to a longer term of relationship with the host country, *market development-induced investors* are mainly attracted by host-specific considerations, especially the

new technology application, whereas the *government-initiated investors* are enticed into the host nation by government subsidies and incentives.

Reuber also found that in the efforts to improve the national level of well-being, LDCs' government tends to pursue a generous policy toward foreign investment while maintain some control over the domestic enterprises.

Many of the FDI theories and empirical researches afterwards have emphasized the relationship between foreign firms and the recipient country. These studies revealed that "pull" factors always associated with direct investment and the host country's subsequent benefits and losses. In addition, "push" criteria concentrated on the "negative" business environment of the home country and the conditions that force domestic firms to look elsewhere for investment opportunities.

In the field of relationship between the host country and the foreign firm, it is undeniable that Porter (1990) has contributed the solid grounds for further researches through exclusively relying on home country conditions in accessing outward trade and investment levels. Though Porter was most concerned with how countries gained and sustained their competitive advantages in sophisticated industries, his "diamond theory" placed a specific cornerstone for FDI theories.

Porter considered outward direct investment to be generally a positive contributor to the home country's level of competitiveness (and conversely inward FDI as largely detrimental). He argues that firms which have nourished in the global market are those that have successfully extended their home-based advantage abroad. He agreed that the benefits accruing from a firm's proper selection of host location is important to international success but that home based advantages are usually significant. Interdependent 'diamond' parameters can be as follows:

- *Factor conditions* include the nation's position in factor of production, skilled labor and infrastructure, which are necessary to compete.

- *Demand conditions* are the nature of the home demand for the industry's product or service.

- *Related and supporting industries*: the presence or absence of supply industries or related industries that internationally competitive.

- *Firm strategy, structure and rivalry*: the conditions in the nation governing how companies are created, organized and managed, and the nature of domestic rivalry

Besides, Porter pointed out the two variables that inevitably affect the diamond, chance and the role of the government. Chances include the events beyond firms' control (such as wars, technological breakthrough or major shifts in foreign market demand). The main impact by the government is the political climate. It was argued that specific government policies greatly affect the firms' investment behaviors.

Porter's findings were further developed in a study by Birkinshaw (n.d.). He described and interpreted some of the recent changes observed in the strategy and organization of large MNEs. According to Birkinshaw, there is a *de facto* increase in the geographical dispersal of value-adding activities of MNEs. A strong *'push' component* is driven by the efforts of MNEs to build their presence in major overseas markets, to counter the threats of competitors, to get access to leading-edge ideas or low-cost factors of production. There is also a strong *'pull' component* that is driven by the efforts of host country's government to bring in additionally inward investment and by the initiative of subsidiary managers attempting to develop their own operation.

The convergence of 'push' and 'pull' factor is the prerequisite to induce and nurture inward investment.

In an attempt to explain the bargaining relationship between MNEs and governments, the two most notable are Lecraw and Morrison (1991) and Rugman and Verbeke (1998). According to the authors, the relative bargaining positions of two parties are based on the opportunity costs perceived by the MNEs of their O (ownership) advantage and the L (location) advantage offered by the host country; and that of host countries of their L advantage and the O advantage offered by the foreign investors.

Combining the model of Dunning (1993) and Lecraw and Morrison (1991), the interactive relation between MNE and host country is illustrated in Figure 2.1. The development path of a developing country is strongly dependent on specific resources, institutions, economic structures, political ideologies, and social and culture fabric of countries. However, as Dunning and Narula (2004) indicated, developing countries represent the difference in economic development, rather than a homogeneous group, which in turn results in different motives underlying FDI. The globalization with new technologies, economic liberalization and appearance of new players in the international scene has brought in dramatic changes from both foreign firms' and the host countries' perspectives. As for firms, the O advantage of MNEs is becoming more mobile and tends to shift towards efficiency and asset seeking FDI. Internationalization of markets has been reduced as the result of networking and strategic alliances. New technologies in communication have saved the cost of coordinating cross-border activities. Locational opportunities have widened for market and efficiency seeking FDI, concurrently, enhanced the bargaining power of MNEs.

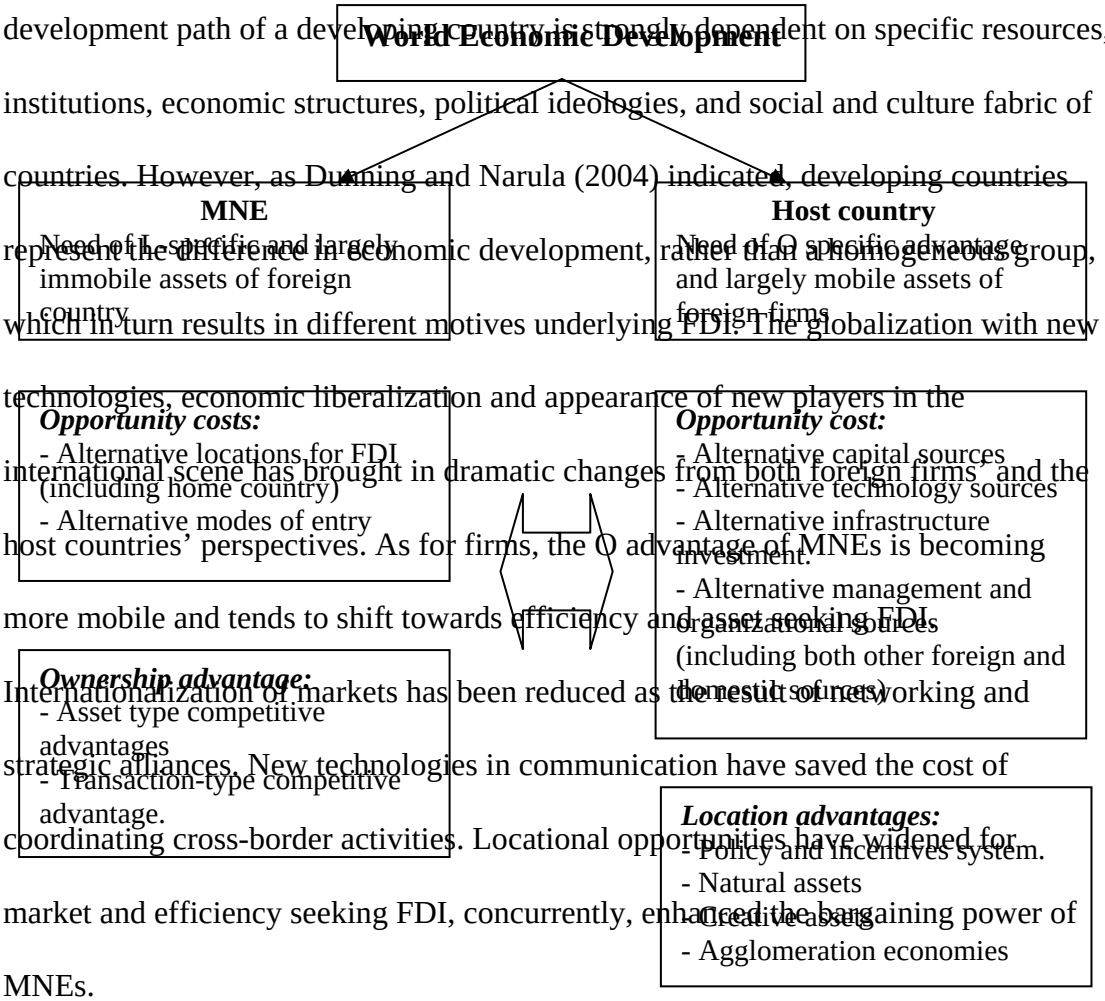


Figure 2.1: Characteristics of MNEs and host country

Source: “Industrial development, globalization and multinational enterprises: new realities for developing countries”, *Oxford development studies,* vol.28, no.2, 2000.

Globalization has affected the location advantages of countries differently based on the economic divergence and disparity in upgrading created assets. Dunning and Narula categorized countries into 3 broad groups (corresponding to 5 stages of economic development) and analyzed the utilization of location advantage in attracting FDI. The first consists of wealthy industrialized countries in stage 4 and 5 of economic development, which have adapted most efficiently to changes. The countries of this type possess the comparative advantage in skill-intensive and created assets and the availability of economic clusters. Also, they have been the home

countries of major MNEs. The second includes the more advanced developing countries (Asian NICs) in advantage stage 2 and stage 3 which have invested in location advantage of created asset type. FDI poured into this group are mainly for the purpose of market-seeking, strategic asset-seeking and efficiency-seeking; and almost from the first group. Determinants to attract FDI into the countries of this group have proved to be well-developed infrastructure, intermediate quality created asset and improving 'cluster-related' opportunities for investors. However, these countries are relatively disadvantageous in natural assets. The last category is made up of poorer developing countries, which far lagged behind with the first group. Having not fully developed created asset location advantage, the countries of this type mainly attracted either resource-seeking or market-seeking investors, as their determinant is limited in the abundant natural resources. Rudimentary infrastructure, limited domestic industry, under-developed supporting sectors and few economic clusters are the main reasons of their less attractiveness in FDI location.

The relation between host countries and foreign firms according to different stages of development is illustrated in the Table 2.1.

Table 2.1: Relationship underlying the investment development path

	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5
Level of FDI	- Limited L advantage - Little or no inward FDI - Few domestic firms with O advantage - No outward FDI	- Generic L advantage - Growing inward FDI - Growth of domestic industry in support sectors - Little outward FDI	- Created asset type - L advantage is developed. - Rising inward FDI - Strong domestic industry - Rising outward FDI	- Strong L advantage in created assets - Strong created asset O advantage of domestic firms - Outward FDI levels exceed inward FDI	- As for stage 4 but fluctuating - Net zero or positive level of inward and outward FDI
Motives for FDI	- Resource-seeking investment - L advantage limited to natural resource endowments	- Resource-seeking FDI - Growing L advantages, particularly unskilled labor and infrastructure - Attract labor intensive manufacturing - Growing presence of market-seeking FDI	Market-seeking FDI and increasing efficiency-seeking FDI in manufacturing, as L advantages become increasingly created asset-based	Efficiency-seeking FDI, market-seeking FDI and asset-augmenting FDI	

Source: "Industrial development, globalization and multinational enterprises: new realities for developing countries", *Oxford development studies*, vol.28, no.2, 2000.

2.1.3. Korean direct investment

The miraculous development of NICs, including Korea, has resulted in a new trend of FDI. Mirza (n.d.), in an attempt to explain how the East Asian developing-country multinationals were engendered by globalization, has figured out the characteristics, scale and scope of East Asian outward investment.

The world economic crisis in 1970s resulted in a new concept called "corporate survival strategies" of Western industrialized countries whose manifestation led to the rise of East Asia. Mirza analyzed the FDI by East Asian

multinationals in terms of both globalization process and the ensuing political-economic consequences. *First*, many East Asian firms, including Korean chaebols, invested abroad as the result of the "spillover process". The geographical and culture ethnic proximity as well as cheap labor are important reasons for this process. *Second*, the regional economic ties are strengthened by a variety of corporate strategies. The FDI in East Asian countries was often driven by government's incentives, which later spill over into nearby countries. *Third*, regional momentum was intensified by the specific regionalization strategies of MNEs, which aimed at economies of scale and regional division of labor. *Finally*, government policies (such as customs union, free trade areas, regional institution and incentives) played a key role to encourage FDI from East Asian countries.

Among the four types of East Asian multinationals[2] involved in FDI activities, Korean firms are either large chaebols (industrial groups) or SMEs. According to Mirza, a number of Korean enterprises concentrate in comparatively advanced industries (electronics, automobiles, chemicals) because of their global perspective with regard to sales. As for location, approximately 44% of Korean FDI located in China and ASEAN countries, 31% in North America and 15% in Europe. While Korean firms in industrialized countries were large, wholly owned subsidiaries, their counterparts in developing countries were in small scale and join-venture form.

Mirza also described the difference in Korean firms' motives for investing abroad: market in industrialized countries, growing opportunities in Asia Pacific markets, rising cost of production in the home market, need for resources, and ethnic Koreans. *Large firms are responding to global competition with regional policies*

[2] 4 types of East Asian developing-countries multinationals include: (1) Large industrial groups, (2) Multi-sector, diversified conglomerates, (3) Small and Medium-sized Enterprises and (4) China's developing-countries multinationals (primarily in state-determined activities).

whereas SMEs plays a significant role in investing in ASEAN to take the advantage of cheap labor.

Sharing the same view of Mirza, Yeon (1992) investigated the characteristics of FDI from developing countries. His findings revealed some distinct conclusions about Korean investment from the perspective of NICs. Korean investment could be categorized into two groups: FDI by industrializing country to industrialized countries (US, EU) and FDI by industrializing country into lower-developing country (ASEAN). Yeon found that on one hand, FDI from Korea to developed countries seemed to be motivated by the desire to overcome non-tariff trade barriers. Korean direct investment that went to LDCs, on the other hand, appeared to be driven mainly by cheap labor and other comparative cost advantages that can often be experienced in developing nations.

From a different perspective, the "Intra-industry foreign direct investment and Intra-industry trade in Korea" (2002) examined the relationship between FDI and trade in Korea. Though there was a rapid increase in both inward and outward investment, the paper found a weak relationship between intra-investment and intra-trade within Korean economy. In illustrating the recent development and industry patterns of Korean inflow and outflow investment, the paper briefly mentioned the typical features of Korean outward investment.

Though having started from the mid 1980s when the macroeconomic environment deteriorated, the massive outflows of Korean FDI accelerated since 1993 as the result of the appreciation of Korean Won, the rapid increase in the real wage and the liberalized policies toward foreign investment. Since the mid 1990s, capital and technology intensive industries such as electrical and electronics industry, transport equipment industry, petroleum industry and machinery industry have been

the major capital exporting industries. The author worked out three possible interpretations: (1) Korean MNEs are vertically integrated, so the production requiring simple assembly process was located in cheap-labor-cost countries as China, India and Vietnam; (2) Korean MNEs adopted a global business strategy thus assimilating MNEs in industrialized countries; (3) Capital and technology-intensive industries might have conducted FDI to support FDI previously conducted in the labor-intensive industry of host countries.

Investigating the Korean investment in EU, Gray and Hong (1998, November 4) found the unique characteristics of Korean investment in developed countries, especially the motivations and location patterns. By focusing on three major Korean electronics companies (Samsung, LG and Daewoo), the research managed to find out factors motivates them to manufacturing in the EU and the significant factors to consider when they select specific locations within EU.

The authors illustrated a reverse of the traditional FDI flow from developed countries to developing or less developed countries even though Korean MNEs were relatively small and inexperienced which mainly because they has a short history of manufacturing overseas. Gray and Hong gave out seven hypotheses, of which four relevant to FDI motivations to EU and the left related to the location patterns within EU. Through surveys and case-by-case analysis, the paper drew some significant conclusions:

As for FDI motivations, Korean firms could not distinguish themselves with the host country's firms with their specific advantage such as manufacturing technology and management know-how. Market proximity was not the answer as Korean products were not highly differentiated. The moves of domestic rivals were

proved to be stimulating factors. The main reason for Korean firms to invest in EU was circumvent imminent export barriers.

As for location patterns within EU, market size was obviously the most important consideration for Korean MNEs to select host countries. Korean firms was attracted by under-developed regions with strong incentives and low labor-cost (as they were mainly small and medium sized), rather than developed areas with high demand and living standards. Agglomerate advantage had little effect on the behaviors of Korean firms. Korean electronics companies preferred industrially concentrated areas but did not show any tendency to locate close to other Korean companies. It could be concluded that *Korean firms were concerned to find a location with labor surplus and strong incentives in a country with large domestic market. By doing that, they can achieve two different goals at the same time: sufficient demand and low cost manufacturing*.

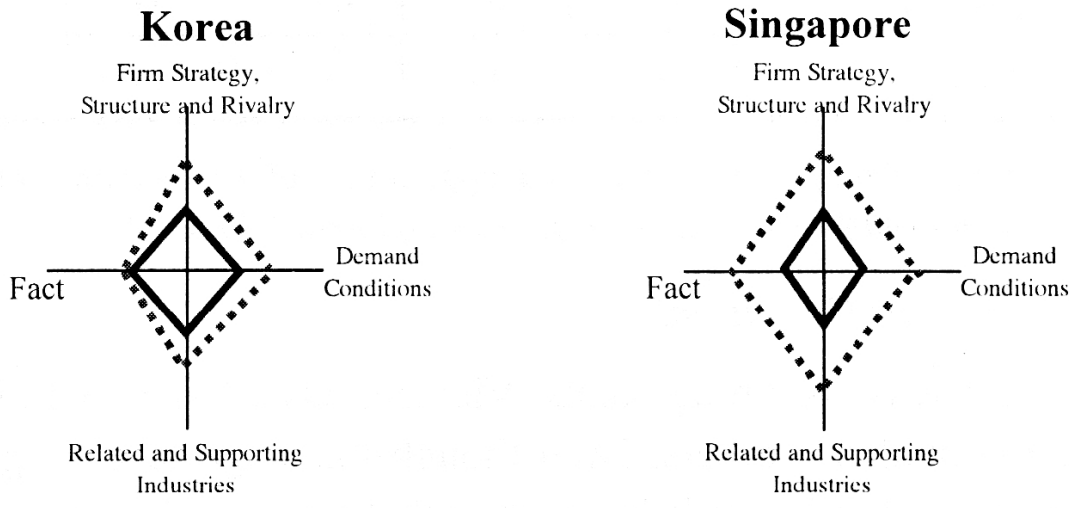
2.1.4. Korean direct investment in Vietnam

In Vietnam, MPI is the governmental body in charge of formulating policies, administer the issues, and carrying out the scientific research related to FDI in Vietnam. Annually, MPI has its own publications on FDI, including the Korean direct investment in Vietnam. Although FDI from Korea has significantly contributed to the total FDI amount in Vietnam, there have been few studies investigating this prominent source of investment so far. MPI has limited itself to reports and specialist articles in studying and analyzing Korean investment generally and their investment behavior in Vietnam particularly.

In an attempt to study the economic cooperation through FDI between Korea and Vietnam, Moon (2005) is among the rare researchers applying the FDI related

theories such as Diamond model of competitiveness and Imbalance theory to analyze the investment climate of Vietnam as well as explaining the reasons for FDI in the country.

According to Moon, Porter (1990)'s diamond model is the most appropriate theory to analyze the FDI environment of Vietnam. However, the diamond model overlooked multinational activities (represented by FDI), thus was not comprehensive to explain the effects of FDI. In a new model, the generalized double diamond, Moon incorporated multinationals' activities in the outer diamond (See Figure 2.2), which meant that not only the domestic diamond but also the international diamond affected the country's competitiveness. Based on the new theory, Moon compared the investment environment of Vietnam and China.

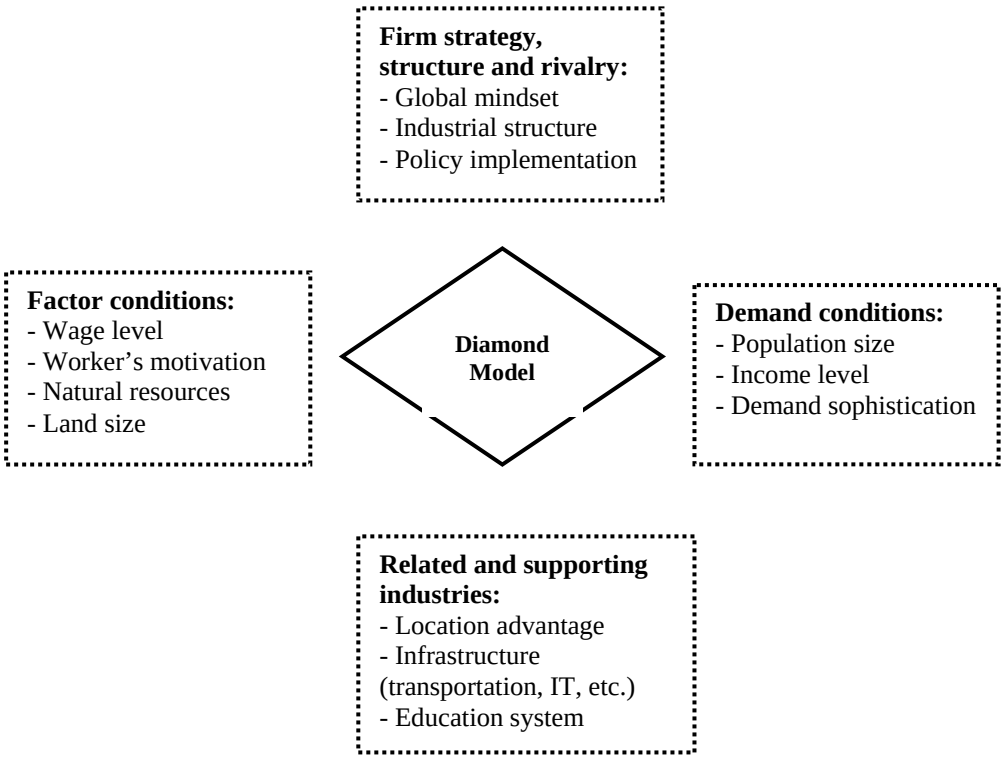


Source: "Economic cooperation between Vietnam and Korea through foreign direct investment" by Moon, H.C, 2005, *Economic Cooperation between Vietnam and the Republic of Korea in the East Asian integration*, p.403. Copyright by Vietnam Academic of Social Science.

Figure 2.2: Generalized Double Diamond

In factor conditions, Vietnam is less advantageous than China (except in oil and gas industry) because of the rising production cost. However, the attitude and motivation of labor force was ranked higher than those of China. In demand conditions, China showed better in terms of both quantitative and qualitative demand

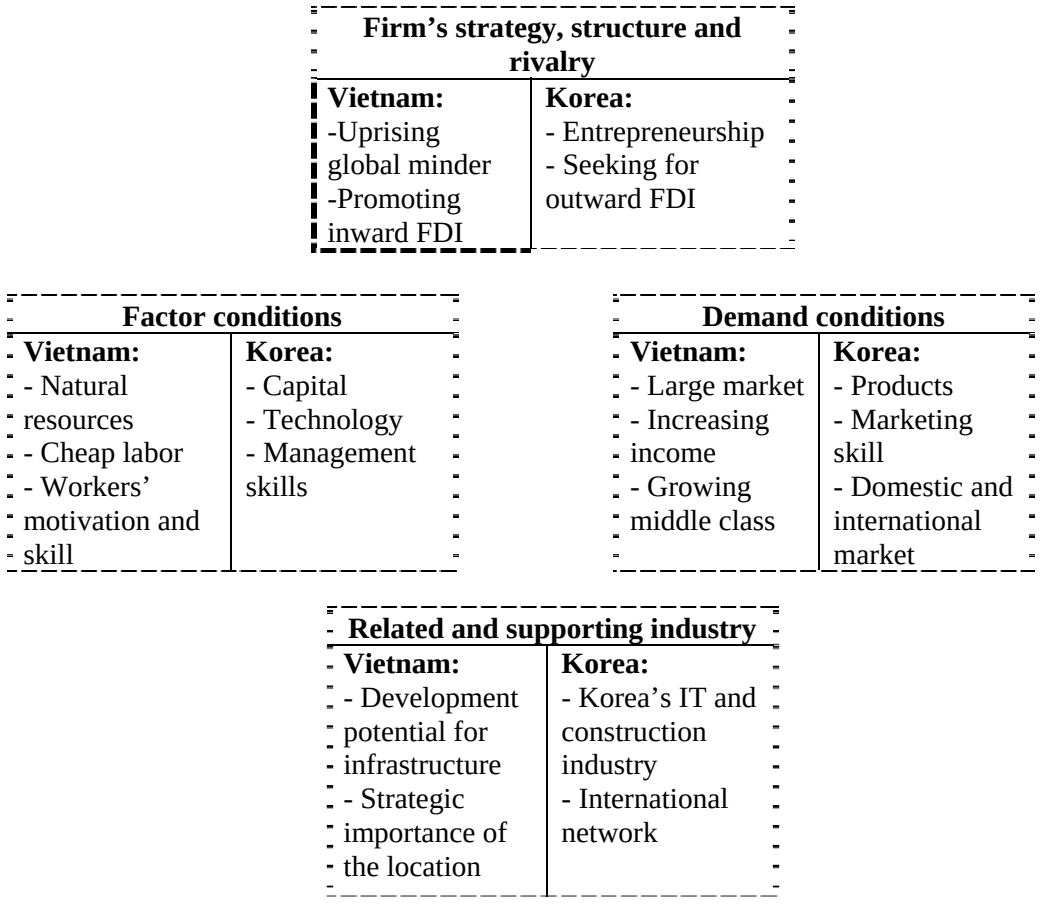
conditions. In related and supporting industries, the bilateral trade agreement between US and Vietnam was increasing the country's attractiveness to Korean investors though the infrastructure for investment remained underdeveloped. Inefficient education system was still a weakness in attracting high value added investment. As for firm strategy, structure and rivalry, Vietnam has a more open global mindset than China, however, transparency of legal documents and efficiency of administrative procedure were still troublesome in Vietnam business environment (See Figure 2.3)



Source: "Economic cooperation between Vietnam and Korea through foreign direct investment" by Moon, H.C, 2005, *Economic Cooperation between Vietnam and the Republic of Korea in the East Asian integration*, p.410. Copyright by Vietnam Academic of Social Science.

Figure 2.3: Investment environment based on Diamond Model

As for FDI motivation, Moon applied the Dunning's eclectic paradigm to explain the motivations of Korean FDI in Vietnam. However, according to Moon, the eclectic paradigm is not sufficient as the majority of Korean investors were small and medium enterprises without any significant ownership advantages.



Source: "Economic cooperation between Vietnam and Korea through foreign direct investment" by Moon, H.C, 2005, *Economic Cooperation between Vietnam and the Republic of Korea in the East Asian integration*, p.415. Copyright by Vietnam Academic of Social Science.

Figure 2.4: Matching recipients and investors by the Imbalance Theory

With that reason, Moon and Roehl (1993, 2000) modified and extended the OLI paradigm, explaining the motivation of FDI with either ownership advantages or disadvantages; by that, FDI depends not only on surplus factors but also the deficient factors. As countries have different capabilities, investment seemed to be arranged by the motivations of both the home and the host countries. Moon examined each determinants of the diamond to find the fundamental reasons for Korean FDI in Vietnam and concluded that the two countries can also benefit from each other in all the dimensions of the diamond model. Moon's finding was summarized in Figure 2.4.

2.2. Distinctive characteristics

According to the Literature Review, it is apparent that this study is different to all the above researches. Nevertheless, all the reviewed literature had their merits. They will be the background and fundamental theories for the author to analyze the research issue.

Among the four types of investors, whether Korean investors in Vietnam are belonging to one type or the combination of several types will be analyzed based on the features of each investor type stipulated by Dunning (1992).

In reviewing of the literature related to FDI determinants, it is obvious that the FDI determinants were generated from both the investors' perspectives and the host country's point of view, which resulted in the "push" and "pull" factors accelerating outward investment. However, one of the determinants received less attention could be the home's countries context. Parts of this aspect will be examined further in this thesis.

There remained two kinds of Korean investors based on their size of capital, leading to their different behaviors in investing. While large industrial groups (chaebols) tend to invest in highly-developed countries like EU and US, small and medium enterprises incline to investing in the less-developed countries, especially in the ASEAN. Yet, the appearance of chaebols in ASEAN has it own meaning. That could be clarified in the thesis.

The most related research was that of Moon (2005). However, the two studies can be distinguished in the following aspects:

1. China is far more a country for Vietnam to be compared with. The country is a unique investment destination with special characteristics. The increasing

disparity between the central mainland and the coastal regions in China are fostering Chinese government to amend its investment policy. Therefore, as a China's bordering country, Vietnam is more in the advantageous position than in the disadvantageous context. This study will attempt to differentiate Vietnam's characteristics with other countries of similar socio-economic conditions in the Southeast Asia such as Indonesia and Philippines, which are scrambling for Korean investment.

2. Moon defined the motivations of Korean investors based on the domestic factors of Vietnam. Differently, this study stems from Korean firms' perspectives to analyze the characteristics of Korean investors and apply the findings of Dunning (1992) to classify them in groups (the so-called 'push' factors) to define their motivations for investing in Vietnam.

3. Though both are based on the Porter's theory, Moon directly applied the double diamond theory to analyze the Vietnam FDI environment; whereas this study locates Vietnam in Korean investors' choice range with main attractive features (the so-called 'pull factors').

4. The study is to combine both the qualitative and quantitative method. While quantitative method is applied to find the relationship between determinants and Korean investment in five selected Southeast Asian countries, qualitative method and logical reasoning will be the main methods to prove the positive the relation between the determinants and Korean direct investment in Vietnam particularly.

Chapter 3

Methodology

This chapter explains the methods used in carrying out the study. In this thesis, Vietnam is chosen to be a case study to suggest measures for policy makers to induce and nurture Korean investment. The thesis is, therefore, an applied research with descriptive and explanatory characteristics. In collecting data, both qualitative and quantitative data techniques were utilized. The thesis is based on the data provided by Vietnamese and Korean governmental bodies and agencies, the publications of international organizations, as well as ideas of economic experts and professionals. During the process of conducting the thesis, there were, however, some difficulties in approaching prestigious experts in Vietnam and Korea, and in coping with time constraint. In data processing, relevant data are classified into categories according to criteria, then reported and displayed in different form according to identified purposes. Different analyzing methods, including both the logical reasoning and bivariate regression analysis, were applied for each question. The methodology in details is described in details as follows:

3.1. General perspectives and type

With the purpose of describing the typical features of Korean investment in Vietnam and explaining the reasons prompting Korean investors to engage in investment activities, typical features of both descriptive and explanatory methods are combined in the research, which is aimed at drawing a picture of Korean investment with its own characteristics in the general setting of foreign direct investment in Vietnam. Based on these characteristics, the findings of World Bank (1989), and

Yeon (1992) were then examined, particularly for the case of Vietnam, in an effort to explain why Korean investors have chosen the country as their investment destination.

The thesis does not limit itself to academic aspects, but focuses more on its possible application. In the given practical context of Vietnam, the research targets to solve the problems of Vietnam investment policies and strategies towards Korean investors. Based on the defined determinants and its level of influence to the volume of Korean investment, suggestions are made to assist the investment policy-makers to formulate appropriate strategies.

In collecting data for the thesis, the method for case-study research is applied in examining features of Korean investment in Vietnam over a time series from 1992 to 2005. Five countries in Southeast Asia are compared, focusing on the chosen factors whose indicators are found from various data sources. This case study method helps to connect the micro level (factors influencing the firms' decisions) to the macro level (factors belonging to both Korea's and Vietnam's economy to push and pull investors). The author applied both *qualitative data technique*, collecting data in the form of words and pictures, and *quantitative data technique*, collecting data in the form of number, in addressing specific parts of the thesis.

As for quantitative techniques, analysis and existing statistics were used as follows:

Content analysis was used for examining information (content) in written symbolic materials (for instance the investment licenses of Korean firms issued by Vietnam authorities in this case). The author first identified parts of materials to analyze and create a system to archive the necessary parts. Then, information in the content was measured as numbers and presented in the form of table or figure. This

method was applied when the author described the main features of Korean investment in Vietnam.

Using existing statistics, the author located a source of previously collected information related to Korean investment in recipient countries, including Vietnam, mainly from the related governmental bodies and organizations' reports or previously conducted surveys. The author then combined or reorganized the collected information in a different way to address the research issues. Furthermore, previous analyses are also used in the way that the author reexamines all the stored surveys and other data, using the Statistical Package for the Social Sciences (SPSS).

As for qualitative data techniques, historical comparative research was used. While conducting the research, the author contacted targeted groups, including economic experts and relevant authorities related to and responsible for investment in Vietnam. Informal interviews were conducted in investment meetings and conferences. A large combination of evidence, including existing statistics, documents, observations and interviews is used in this study.

3.2. Research context and participants

3.2.1. Availability of data

The thesis was carried out in Vietnam based on the above data collecting techniques. One of the favorable conditions was the availability of data related to Korean investment archived by the MPI of Vietnam and other government bodies in the period of 1987 - 2005. All these data were officially published.

For data related to the general trend of investment, the author used publications of international organization such as United Nation Conference on Trade and Development (UNCTAD), World Bank (WB), International Monetary Fund

(IMF), World Association of Investment Promotion Agencies (WAIPA), Asian Development Bank (ADB) in the form of printout documents and electronic reports available in the Internet.

In collecting the data related to Korean MNEs' perspectives, the author referred to documents published by Korean national bodies such as Korean Export and Import Bank, Ministry of Construction, Industry and Energy of Korea, National Statistics Organization of Korea and other national organizations such as Korean Development Institute (KDI) and Korean Economic Institute (KEI). The author also contacted Korean Trade Investment Promotion Agency (KOTRA) in Vietnam to get relevant information, especially the KOTRA surveys done in 2004 and 2005. The surveys studied Korean firms in Vietnam, approaching them through post mails, fax, emails, and interviews based on a pre-design questionnaire on six main criteria: (i) Enterprise information, (ii) Investment location, (iii) Employment recruitment and management, (iv) Business activities and profit, (v) Export and Import Information and (vi) Vietnam investment environment and satisfaction. Out of over 600 questionnaires, there were 224 feedbacks in 2004 and 118 feedbacks in 2005.

For data to run the statistical tests, seven determinants were chosen, including (1) Real GDP growth rate, (2) Output openness (proportion of export earning over real GDP), (3) Growth competitive scores, (4) Labor cost, (5) Cost and time delay in business, (6) Office rent and (7) Transportation fee. Based on the determinants, data of 5 countries in 2002 were collected and calculated from various sources, including: Vietnam National Statistics Publishing House (for 1 and 2), World Economic Forum (for 3), Center for International Private Enterprise- US Chamber of Commerce (for 5), and JETRO (2003) (for 4,6,7).

3.2.2. Collaboration of agencies and professionals

The author found little difficulty in contacting relevant agencies to collect necessary data. However, some professionals were difficult to approach. Alternatively, the author took advantage of meetings and international conferences to interview economic experts of different nationalities as well as the authorities of Vietnam. They were asked to evaluate the investment environment in Vietnam, opportunities and threats to investors generally and Korean investors particularly and the changes in policies that can affect investors in the coming time. Korean satisfied investors were also interviewed for sharing their experience in investing in Vietnam, as well as their opinions and comments. Also, the author paid much attention to the Korean potential investors in their fieldtrips to Vietnam seeking for investment opportunities.

3.2.3. Time framework

The idea of the thesis theme appeared while the author studied in the KDI School of Public Policy and Management during February – December 2005. After initial ideas emerged, the data collection process began since October 2005. With the assistance of the supervisor, Prof. Seong Ho Cho through discussion and consultation, the outline was established in February, and constantly supplemented since then. Accordingly, the writing process began in March. Because of time constraint, there may be some shortcomings in the thesis.

3.3. Data analysis methods

The data are analyzed by several strategies. First, a mass of collected data are grouped into the categories related to Korean investment. In details, data of Korean enterprises invested in Vietnam were extracted from investment licenses issued by MPI, were classified in the following criteria: (i) Date of establishment, (ii) Registered capital, (iii) Implemented capital, (iv) Business sector (v) Location of

investment and (vi) Form of investment. Other criteria were supplemented based on the KOTRA surveys' reports.

Second, the reduced data were reported in the forms of percentage of enterprises belonging to each sub-category, mean and median for investment capital to describe the general characteristics of Korean investment. Displaying methods involved narrative text, tables, and figures.

Third, analyzing methods were applied according to each question. For the first question, the author applied logical reasoning method to analyze the archived documents. Comparative method was also used to find the similarity and difference between Southeast Asian countries in proving the south-south investment trend as well as the typical features found in Vietnam. For the second question, based on the results of the first question, logical reasoning continued to be used to define the types of investor that Korean firms are classified into. Combining with the KOTRA surveys, the author then identified main determinants of Korean investors in Vietnam. Answering the third question, the author combined logical and statistical reasoning methods, mainly the bivariate analysis to find the correlations between the seven selected determinants, as the dependent variables and the volume of Korean investment in five Southeast Asian countries in 2002, as the independent variables, to find the main determinant(s). Contingent tables and scatter-grams produced by SPSS were utilized to illustrate the relationship between factors. Logical reasoning was then applied to present the relationship between pull factors and the volume of Korean investment in Vietnam. For the last question, suggestions for Vietnam investment policies were withdrawn from the outcomes above.

In conclusion, it should be emphasized that the author combined both qualitative methods and quantitative methods in addressing the research questions.

Accordingly, the data were from various sources, and analyzed by different techniques. The results of these methods were represented in Chapter 4 and 5.

Chapter 4

Korean investment in Vietnam

A new wave of investment in Vietnam was firstly shaped in 1993, contemporaneously with the flourishing time of Korean investment in the country. Apart from the stagnancy in 1998 due to the Asian financial crisis, Korean investors have been firmly placing themselves in the leading position of inward investment with an upward trend of both projects and capital invested.

4.1. Chronological trend

Vietnam welcomed the first project of Korea in 1988, right after the 1987 Law on Foreign Investment of Vietnam came into effect. However, the period of 1987-1992 saw a moderate increase in the number of projects as well as the total amount of capital. According to the statistics by MPI, Vietnam, out of 23 projects worth 176 million US dollars, 11 projects were dissolved, making up a total loss of 30 million US dollars to the country. The official establishment of diplomatic relation in 1992 was amongst the positive factors influencing the upward trend of Korean investment, resulting in a big jump in the number of project as well as the amount of capital in 1993 (see Figure 4.1).

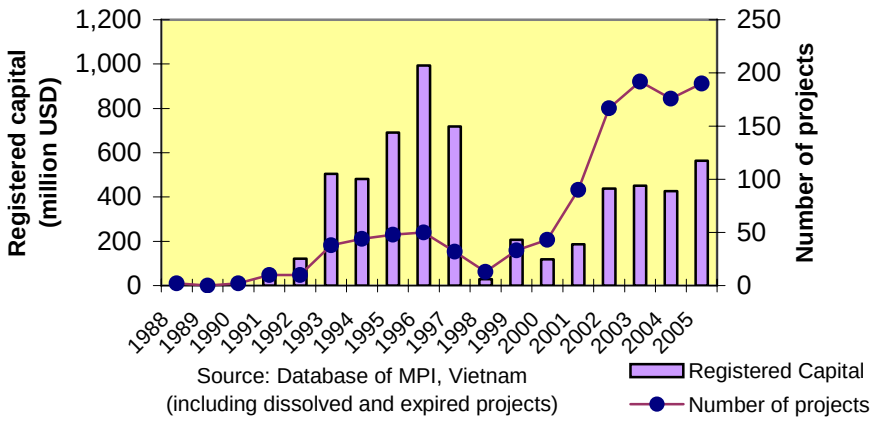


Figure 4.1: Korean direct investment in Vietnam by capital and projects

In 1993, Korea was ranked the second biggest foreign investor by projects and the third biggest by registered capital in Vietnam with 38 projects worth over 400 million US dollars (taking into account the dissolved projects, the number was 504 million US dollars), following Taiwan and Hong Kong with 48 and 31 projects, and capital of 420 million US dollars and 412 million US dollars respectively.

The period of 1993-1996 witnessed a rapid increase in foreign investment in Vietnam generally and Korean investment particularly. In line with the rocketing of Korean outflow investment, the country's investment in Vietnam reached the peak of 994 million US dollars with 50 projects.

Generally, Korean direct investment in Vietnam saw an upward trend since 1992, in which 1993-1996 was the flourishing period. However, the pace of investment increase began to slow down from 1997 to 2000, resulting from the 1997 financial crisis. Due to the collapse of Asian financial markets and the depression of Korean economies, a series of Korean overseas firms sunk into stagnancy, including those in Vietnam. The year 1998 marked the gloomiest days of Korean investment in Vietnam with the total projects slummed to 13 projects (the lowest since 1993) and total capital plummeted to 28.2 million US dollars, just 2.83% of the amount registered in 1996.

In 2000, in line with the recovery of the domestic economy, Korean investment in Vietnam began a new thriving period. The year 2003 saw a highest number of projects attracted (192 projects); however, the total capital invested was modestly 451 million US dollars. The fact that projects increased dramatically in number but the total capital registered could not follow this pace implied a powerful penetration of Korean small and medium enterprises into Vietnam.

By the end of 2005, Korea had 1,027 projects in validity with the total capital of 5.3 billion US dollars, ranked the fourth biggest investor in Vietnam, following Taiwan, Singapore and Japan. In 2005 alone, Korea was the third among 43 countries and territories in Vietnam with 190 projects and registered capital of 551.6 million US dollars.

4.2. Forms of investment

Table 4.1: Korean direct investment by forms (by 2005)

Form of investment	Number of projects	Registered Investment	Implemented Investment
100% foreign firm	855	3,159,156,688	979,878,972
Joint venture firm	151	1,952,690,695	1,127,216,441
Business cooperation contract (BCC)	21	166,538,694	244,348,826
Total	**1,027**	**5,278,386,077**	**2,351,444,239**

Source: MPI, Vietnam.

In its investment legal framework, Vietnam allows 3 forms of foreign direct investment, namely 100% foreign firm (in which a foreign investor holds 100% of the firm's legal capital), joint venture (in which both foreign investors and Vietnamese counterparts enjoy rights and bear responsibilities based on their investment proportions) and business cooperation contract (BCC: in which the 2 parties sign a contract to run business in some sensitive industries without forming a legal entity under the Law on Enterprises). Korean investors tend to prefer the form of 100% foreign firms. With 855 projects and 3.2 billion US dollars, this form of investment took 83% and 59.8% of Korean projects and capital. Joint venture firms made up 14.7% of the projects and 16.9% of the capital while the BCC form occupied the modest proportion of 2% and 3.1% respectively.

4.3. Investment by sectors

While investment from other Asian countries such as Taiwan and Singapore clusters in services sector (mainly hospitalities and tourism), Korean direct investment concentrated mainly on industrial sectors (particularly in light and heavy industries) with the total of 839 projects and registered capital up to 3.2 billion US dollars, taking an account of 83.3% and 59.8% of the projects and capital respectively. Service industry ranked the second with 12% of the total projects and 25.5% of the capital followed by agriculture sector, which makes up 6.4% of the projects and 2.1% of the capital (See Table 4.2 in details).

As can be seen in Figure 4.2, by the end of 2005, light industry topped the list of industries attracting Korean investment with 40% of the total capital invested, followed by heavy industry with 27% and building offices and houses for lease with 9%.

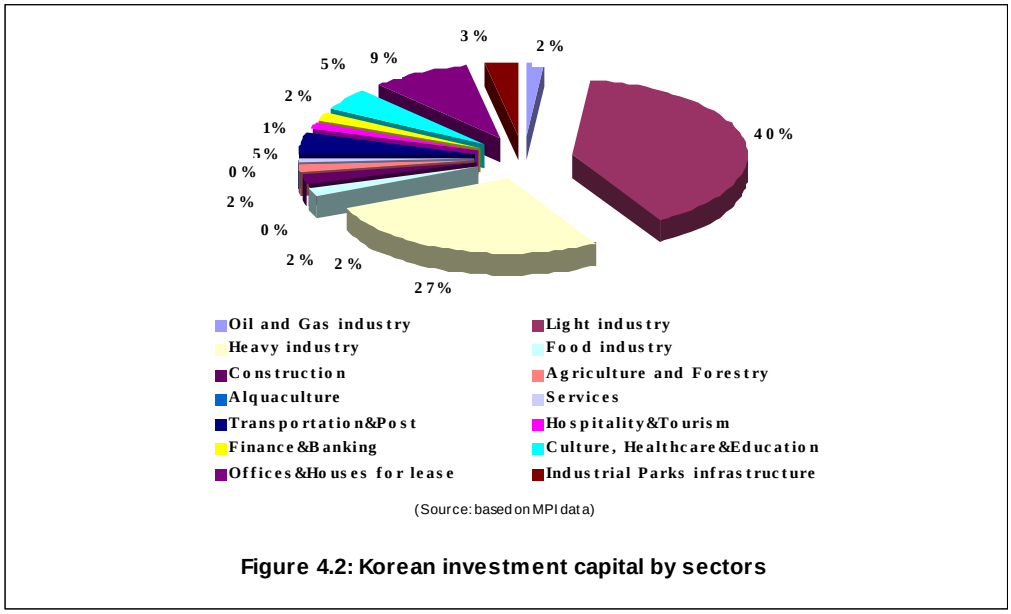


Figure 4.2: Korean investment capital by sectors

In the early phase of outward investment, Korean investors were highly interested in light industry, particularly in textile, garment, and foot-wear; and processing industry using forestry and fishery products due to the advantage of labor-

intensity to reduce its production cost. For instance, in the period of 1888-1992, 40% of Korean projects invested into light industry, while just 15% of the projects in heavy industry. Those rates changed dramatically in the thriving time of Korean investment in 1996. The rate of projects in light industry reduced relatively, in turns, leading to the increase in proportion of heavy industry, transportation and post services as well as construction and offices and houses for lease. A trough of 11% of the projects invested in light industry while heavy industry saw a rise to 25%. Transportation and post services witnessed an increase to 6.5%. Number of projects invested in building offices and houses for lease rose significantly from below 1% to 9.7% of the total projects. That illustrated a fact that Korean investment has been increasingly inclined to high tech industries, such as electronics, automobile industry, mechanical manufacturing, and service sector.

4.4. Investment by regions

Apart from an oil and gas project situated in the continental terrace of Vietnam, Korean investors have been located in 41over 64 cities and provinces along the host country. In the years 1988-1996, the majority of Korean projects were located in Southern part of Vietnam, which had a vast area of land in stock, better infrastructure and accessibility to qualified labor force than other parts. Another reason could be the fact that Southern Vietnam was more familiar to middle-aged Koreans who have experienced the American war in Vietnam. Out of 140 projects invested in 16 cities and provinces of Vietnam during this period, 61% located in Ho Chi Minh City, 23% in Dong Nai province and 18% in Binh Duong province (mostly in industrial parks).

In competing for investment after the financial crisis, a number of cities and provinces in Vietnam have granted foreign investors more favorable conditions and inducement policies. This movement has brought about positive effects to relocate

Korean investment in the post 1997 period. Ho Chi Minh City, Binh Duong and Dong Nai remained the top of investment list with 31.8%, 19.7% and 12.6% out of 886 projects respectively; however, other cities in northern part of Vietnam are trying to keep pace with. Hanoi topped the list of northern cities and provinces with 7.1% of the projects, accompanied by Phu Tho province with 3.5% and Vinh Phuc province with 2.7%.

To date, Korean projects represents a tendency towards locating in more-developed cities and provinces. Taking the 4 cities and provinces (including Hanoi, Ho Chi Minh, Binh Duong and Dong Nai) alone, the number of projects has been up to 751 with USD 3.9 billion registered, making up more than 73% of projects and 73% total capital (for detailed statistics, see Table A.1).

4.5. Investment by capital size

The size of Korean projects differed by investment period as well as by investment sector. Generally, the average of Korean projects was approximately 5.143 million US dollars; however, the difference between the largest project and the smallest project was rather large (19 million US dollars, computed by SPSS). Compared to the average capital of FDI projects in Vietnam, Korean capital per project was much smaller[3].

First, the difference was illustrated in Figure 4.1. The period 1988-1997 saw a great amount of investment capital whereas a modest number of projects. In this period, the average registered capital of a project was USD 18.218 million, as 5 times as the number of the whole period 1988-2005. After the financial crisis, a new trend

[3] For the whole period (1988-2005), the average capital size of FDI projects in Vietnam was approximately 8.3 million US dollars. Notably, after peaking at 23 billion US dollars per project in 1996, the average capital size has been steadily reduced to below 5 million US dollars, for instance, 2.5 million US dollars in 2003 and 3.1 million US dollars in 2004.

of Korean investment started up. The number of projects invested in Vietnam has increased significantly, yet the total capital registered fluctuated and experienced a slowdown in its growth. That resulted in the average capital of Korean projects in this period plummeted to USD 2.713 billion.

Second, it is notable that the period of 1988-1997 was the time for Korean giant business groups (chaebols) investing abroad. Vietnam was among a range of destinations with low production cost and preferable geo-economic position. In Vietnam particularly, out of 10 biggest Korean projects in the whole period, which were all invested by chaebols, 8 projects belonged to the period of 1988-1997 (see Table A.2). These projects alone have accounted for 32% of the total Korean capital invested in Vietnam.

Third, investment from Korean individuals as well as Korean SMEs is taking an important part in forming a new trend of investment in Vietnam. SMEs preferred light industries to take advantage of low labor and production cost in developing countries as well as utilize their manufacturing techniques and chains imported from Korea. The majority of Korean enterprises in light industries are producing textile and garment, materials for textile industry to supply domestic market, re-import to their home country and export to third markets.

4.6. Business operation

a. Profit:

KOTRA surveys revealed a medium rate of efficiency of Korean businesses in Vietnam. However, the percentage of firms gaining profit represented a steadily increase (from 55.6% in 2004 to 62.8% in 2005) with a number of firms finishing their site building and start operating. At average, business profit in 2005 was 5.68

million US dollars much higher than that of 2003 (3.63 million US dollars). The gap between business startup and profit gaining time has slightly declined to 2.87 years from 2.92 years in 2004.

b. Trading partners and export turnovers:

According to the 2004 survey, the total export turnover of Korean investors running business in Vietnam was approximately from 2 billion to 2.33 billion US dollars, making up 10% of the country's total export earnings. Profit gained from Korean business in Vietnam took 5.7% of the enterprises' turnover nationwide. Korean market was the major supply source of production materials with the imported value of 970 million US dollars annually, whereas the export turnover to this market limited at 230 billion US dollars.

Korean firms in Vietnam played an important role in enhancing the economic relation between the two countries and between Korean with the third countries. 37% of the import turnovers from Korean were originated from the business of Korean-invested enterprises with their counterparts in the home country. That resulted in the relatively low proportion of Korean firms launching their products in the host market (18.2% in 2004).

However, the gap between turnover of export to the third countries and re-import to Korea might unveil a fact that Korean firms are diversifying their markets. In 2004, the United States was considered the main export market of 36% respondents, followed by ASEAN (26.5%), EU (14.7%), Korea (12.7%) and Japan (5.5%). These proportions changed dramatically in 2005. The United States still topped the list, yet its proportion has declined to 25%; Korean market became the second priority with 17.6%, followed by ASEAN (17.2%), EU (16.2%), Japan (7.3%) and China (1.9%).

c. Competitive features:

Referring to the competitive features of Vietnam, 85.1% of the investors in 2004 survey appreciated the skillful and low-cost labor force while 11.3% favored the domestic market potentials. This assessment has changed in the 2005 survey. Together with the reduction in firms attracted by low labor cost, there was a relatively increase in proportion of investors induced by productivity, tax incentives and business facilitation measures from Vietnam authorities. For instance, 76.6% of the respondents were induced by low-labor cost, whereas 7.3% were prompted by high productivity, 4.9% were influenced by tax incentives and the 2.4% left appreciated the business facilitation measures from local authorities.

d. Satisfactory level:

As for satisfaction to invest in Vietnam, the country proves to become an auspicious destination for Korean investment with an increasingly proportion of business profit. In 2004 survey, 4.2% of respondents are highly satisfactory to their business in Vietnam, 37.9 % satisfactory and 50.5% show their neutral attitude, whereas 6.1% of firms surveyed presented the dissatisfaction and 1.4% showed highly dissatisfactory attitude, making up a 92.6% of investors showing positive attitudes towards the investment environment in Vietnam. This rate improved in 2005 with positive attitude increased to 95.2%, correspondingly, the dissatisfaction and high dissatisfaction lessened to 4.8%.

4.7. Summary

To conclude, the characteristics of Korean investment in Vietnam have changed over periods of time, depending on the economic context of the host country. However, the country represented an upward trend of both amount of capital as well as the number of project. The majority of Korean investment has fallen into the form of 100% foreign firm, including both the affiliates of Korean business groups as well as the individual's capital. The average capital size of Korean projects has been relatively small, especially in the latter half of 1990s. Korean investment has clustered in the industrial sector, however, tends to diversify into service and high tech industries. Light and heavy industry are the most attractive sectors to Korean investment. Korean investors preferred to locate their capital in big cities and well-developed areas, where they could also enjoy both investment incentives and accessibility to favorable manufacturing conditions.

From the characteristics illustrated above, Korean firms belong to the first three types of foreign investors stipulated by Dunning (1992). With their clustering into labor-intensive industries such as textile, footwear industry, Korean investors who seek for resources have been driven by domestic resources supply, especially the low labor cost. Korean market seekers paid much attention to the third markets rather than the host country market, which illustrated by a low proportion of their sale in the recipient market. Within the host country, Korean investment gathered in more advanced cities and provinces (mostly in industrial parks within these provinces) to seek efficiency. These efficiency-seekers were mainly influenced by investment inducement policies offered for locating in industrial parks as well as the well-developed public utilities. The fourth type of investor, the strategic assets seeker,

could not obviously be seen even though there kindled some evidences that Korean investment is increasing in technology, information and service sectors.

These findings well match with the model of Dunning and Narula (2004) (see Chapter 2 – Literature Review). In the second stage of economic development, Vietnam has its location advantage (mainly low labor cost and preferable infrastructure conditions) with the growth of inward FDI and startup of outward investment[4]. In this stage, the majority of foreign investors are resource seekers in manufacturing industries. Market seeking FDI shows an upward trend. However, in Vietnam, the efficiency seeking investors are also prevalent. The determinants leading to Korean investors' choice, including both the push and pull factors, are further examined in Chapter 5.

[4] According to MPI Annual Report to Vietnam National Assembly, at the end of 2005, the country has 151 outward projects with the registered capital of USD 617.8 million. In 2005 alone, 34 projects were licensed to invest abroad with capital of USD 365.5 million, in which Xemakhan Power Plant in Laos Republic topped the list with USD 273 million registered.

Chapter 5

Determinants of Korean direct investment in Vietnam

5.1. Determinants

Push factors to locate Korean direct investment in Southeast Asia

Push factors prompting Korea to invest in Southeast Asian countries are supposed to be: (1) Korean policies shifting to lower developing countries to seek efficiency by all means; (2) Production cost and (3) Market development.

The first hypothesis is derived from Porter (1990) theory, which considered outward investment a positive contributor to home country's competitiveness. For that reason, Korean government is supposed to encourage outward investment as a mean to lift up the country's competitiveness. In addition, deep-rooted changes in firms' strategies to access to the leading-edge are also the driving forces for Korean enterprises to seek investment opportunities abroad.

The second and third hypotheses are based on the arguments of Birkinshaw (n.d). Beside changes in strategies, Korean enterprises are pressed by increasingly production cost as well as the narrowing of distribution market. What they are seeking for is not simply markets for manufacture but more emphasis on their presence in targeted overseas markets to enhance firms' competitiveness.

Pull factors to drive Korean direct investment to Vietnam

Compared to other Southeast Asian countries, Vietnam is supposed to be more advantageous in the four factors: (1) A more competitive legal framework; (2) Relatively lower labor cost; (3) An emerging market and (4) Cultural proximity to Korea.

The four hypotheses are based on the characteristics of Korean direct investment in lower developed countries stated by Mirza (n.d) and Yeon (1992). They are also supported by the relation of MNEs and host country stipulated by Dunning and Narula (2004).

5.2. Relations between determinants and the volume of Korean direct investment

5.2.1. Push factors to locate Korean direct investment in Southeast Asia

5.2.1.1. Push factors

5.2.1.1.1. Shifting to lower developed countries to seek efficiency

According to Ahn et al. (n.d), Korean outward investment flow started in 1968, yet the size of investment was relatively small due to various constraints to foreign reserves and firms' inability to conduct investment abroad. The importance of outward investment was first paid attention to in 1980 when Korean government passed a new economic policy, shifting from economic growth to development in sustainability and equality.

In an effort to foster the export-oriented strategies, the government adopted a series of liberalization policies in mid-1980s, including those enhanced the outward investment flow[5]. Thanks to these liberalization policies, Korean outward FDI steadily grew, notably during the years 1993-1996, coincided with the booming time of Korean investment in Vietnam.

The success of export-oriented strategy was one of the key factors leading to the economic miracle of Korea. According to Pham (2005), export turnover

[5] For instance, FDI projects up to 2 million US dollars has not required the government approvals since 1989; the government started to offer tax incentives including a reserve for loss incurred by FDI and Export and Import Bank of Korea provided subsidized loans for outbound FDI, financing up to 80% of the investment adopted in mid 1980s

contributed 33% to the economic growth, while the end-user consumption took an account of 31%. The United States and Japan used to be the two biggest overseas partners in this period[6]; however, since 1991 when the United States excluded Korea from GSP recipient countries, the country's competitiveness in the United States market was reduced to 19.3%. This movement also led to the shift in Korean diplomatic policy, more focusing on diversifying trading partners to eliminate risk in economic development and promoting the intra-investment and trade with Asian countries. Particularly, Korea considered ASEAN as a prominent market. Being a part of the globalization strategy, the country implemented a "South-oriented" policy, which was a red carpet to foster Korean outbound investment flow.

Moreover, the fact that Korea successively maintained a high rate of trade surplus due to the success of export-oriented strategy[7] and the inflation of Korean Won[8] had negative effects to the economy and lessened the efficiency of export-oriented strategy. For that, Korean government encouraged its firms to shift their business outward. ASEAN, including Vietnam, was the destination that could satisfy the demands of Korean investors.

The changes also happened in firms' structure and strategies. Prior to the financial crisis, Korean chaebols dominated the economy; the role of small and medium enterprises was rather limited and feeble. With their large capital size in parent companies, chaebols' affiliates located overseas also maintained a large size of capital registered and prioritized economics of scale rather than risk diversion. However, the financial crisis ushered changes in the industrial landscape of Korea, which affected the changes of outward FDI.

[6] The United States and Japan made up 30.2% and 25.5% of Korean export turnover in 1975; 35.5% and 15.5% in 1985 respectively (Pham, 2005)
[7] The average of 7 billion US dollars in the years 1987-1989 (Korea Annual 1996)
[8] Korean Won increased from 861 Won: 1 US dollar to 679 Won: 1 US dollar ((Korea Annual 1996)

Firstly, thanks to a refresh after the financial crisis, a mass of global MNEs came into Korea, which created a seriously competitive climate to chaebols, especially in the industrial supply chain. In efforts to restructure and downsize, Korean leading conglomerates pursued a new strategy, fostering outsourcing and offshore in other countries, including both the more advanced and the less-developed ones. That led to the recovering in Korean outward investment after the crisis.

Secondly, the activities of Korean firms have been further upgraded. The corporate value chain has been shifted from production to a higher value added activities such as marketing and R&D. Not only pronounced within the leading conglomerates, the trend has also swept to small and medium enterprises in large. A number of them have increased investment in IT and R&D activities and engaging new markets through the form of FDI. That results in the fact that an increasing number of firms in IT field are investing abroad to gain the efficiency.

Thirdly, by improving its performance in domestic market, vanguard firms in semi-conductor and automobiles are leaping forward in the global markets, setting up manufacturing sites with their technologies and financial supports in less costly countries. The more-advanced countries tend to be places for high-tech and R&D activities whereas the less-developed countries remain the producing sites, yet, at a higher technology.

5.2.1.1.2. Production cost

Korea developed based on the empty stock of natural resources. According to Morita (1987), there was nothing abundant in Korea in the old days but water resources and a quarter of area, which was considered cultivatable. In its industrial process, the country depended heavily on other countries in supplying oil and gasoline,

iron ore, bronze and other natural resources pivotal to the industrialization[9]. Developing labor-intensive industries for export was considered the driving force in economic development at that time. Thanks to the outward capital and technologies, the abundant labor force and a resolute economic development path in the early day of economic takeoff, Korea has placed itself as leading country in Asia.

However, together with economic growth, the low production cost has no longer been the advantage of Korea, especially to labor-intensive industries. High production costs are prompting its small and medium enterprises in manufacturing industries, in which labor wages takes a large proportion of the production cost, to invest abroad. As for investment-related cost within Asian, Korea is becoming less advantageous than other lower-developed countries[10]. That resulted in the relocation of labor-intensive industries from the country to the less-costly places, especially in ASEAN.

5.2.1.1.3. Narrowing market

Korean exports were concentrated in a limited category of goods, notably semiconductors, automobiles, machinery, chemicals, computers, and cellular phones. Before the financial crisis, over 50% of Korea's export went to other Asian countries, of which 15% in ASEAN. After the crisis, Korean firms engaged in a more global strategies aiming at diversifying their export markets rather than focusing on ASEAN countries. In 2003, China, the United States and Japan were Korean major trading partners, accounting for 44.5% of Korean export and 46.5% of the country's import.

[9] Song (1999)
[10] JETRO (2003) has pointed out the average wage of unskilled workers in Korea is as twelve times as that in Vietnam, 8.9 times in Indonesia and 3.45 times in Malaysia, 6.44 times in Philippines and 5.93 times in Thailand.

However, in seeking market for its manufacturing outputs, ASEAN remains a better choice. The region still plays an important role in diversification strategies of Korea because ASEAN is more liberalized than ever with a high development growth. For instance, via affiliates and investment agreement with Vietnam, Korean can easily access to the potential market and further extend to China (as neighboring country) and the United States market (through USBTA).

Moreover, the fostering of irregular free-two side agreement, ASEAN+3 (China, Japan and Korea) is opening new opportunities for both Korea and ASEAN. The agreement aims to promote economic cooperation, especially finance and monetary, while maintaining collaboration on agriculture, food industry, oil and energy and technological research. Awaken by China-ASEAN Free trade area consisting of 1.7 billion consumers, with a GDP of 2,000 billion US dollars and international trading turnover of about 1,300 billion US dollars[11], Korean is accelerating its FTA with ASEAN. Coming into effect, the agreement will expand markets for each side, through which they can make full use of their own advantages and allocate resources more properly. Further more, advantages of each partner can be fully exploited upon the removal of trade barriers.

5.2.1.2. Correlations between determinants and the volume of Korean investment in 5 Southeast Asian countries

5.2.1.2.1. Preliminary findings

In an effort to find the correlation between the above mentioned determinants and the volume of Korean investment in 5 Southeast Asian countries, including

[11] Ngo (2005)

Vietnam, Indonesia, Malaysia, the Philippines and Thailand, the author selects 7 (seven) determinants to carry out statistical test.

For market seeking purpose, four possible determinants should be suggested, including (1) Real GDP growth rate, (2) Output openness (represented by the proportion of export earning over real GDP), (3) Growth competitive scores (ranked by the World Economic Forum of World Bank). For resource seeker, the major factor influencing location of Korean investment in ASEAN was proved to be (4) labor cost. For efficiency seeking, determinants include: (5) Cost and time delay in business, (6) Office rent, and (7) Transportation fee. Therefore, the statistical analysis is applied to seven determinants in the five cases of ASEAN countries. The null hypothesis (H_0) and the alternative hypothesis (H_1) are given by:

(H_0): No correlation between Korean investment and the determinant.

(H_1): Reject H_0, i.e. there are/is correlation(s) between Korean investment and the determinant.

The decision rule is set as follows:

Accept Ho, if the significant level > 0.05

Reject Ho, otherwise

In identifying whether there exits any correlations between the volume of FDI and these determinants, bivariate correlation analysis shows that the correlation between the dependent variable (Korean investment capital) and the independent ones (7 determinants) could hardly be seen or even not reflect in accuracy the relation between determinants and capital, except for the labor cost.

Table 5.1: Correlation table

		Investment capital	Real GDP growth rate	Output open-ness	Growth compe-titive score	Labor cost	Busine ss cost	Office rent	Transpor tation fees
Investment capital	Pearson Correlation	1	.514	-.619	-.710	-.928(*)	-.316	.647	.304
	Sig. (2-tailed)		.375	.266	.179	.023	.604	.238	.619
	N	5	5	5	5	5	5	5	5
Real GDP growth rate	Pearson Correlation	.514	1	-.128	-.382	-.599	-.266	.521	.905(*)
	Sig. (2-tailed)	.375		.838	.526	.286	.665	.368	.035
	N	5	5	5	5	5	5	5	5
Output openness	Pearson Correlation	-.619	-.128	1	.781	.773	.877	.198	.066
	Sig. (2-tailed)	.266	.838		.119	.126	.051	.749	.916
	N	5	5	5	5	5	5	5	5
Growth competitive score	Pearson Correlation	-.710	-.382	.781	1	.888(*)	.627	-.141	.004
	Sig. (2-tailed)	.179	.526	.119		.044	.257	.821	.995
	N	5	5	5	5	5	5	5	5
Labor cost	Pearson Correlation	-.928(*)	-.599	.773	.888(*)	1	.588	-.412	-.321
	Sig. (2-tailed)	.023	.286	.126	.044		.297	.491	.598
	N	5	5	5	5	5	5	5	5
Business cost	Pearson Correlation	-.316	-.266	.877	.627	.588	1	.455	-.148
	Sig. (2-tailed)	.604	.665	.051	.257	.297		.441	.813
	N	5	5	5	5	5	5	5	5
Office rent	Pearson Correlation	.647	.521	.198	-.141	-.412	.455	1	.438
	Sig. (2-tailed)	.238	.368	.749	.821	.491	.441		.460
	N	5	5	5	5	5	5	5	5
Transportation fees	Pearson Correlation	.304	.905(*)	.066	.004	-.321	-.148	.438	1
	Sig. (2-tailed)	.619	.035	.916	.995	.598	.813	.460	
	N	5	5	5	5	5	5	5	5

* Correlation is significant at the 0.05 level (2-tailed).

With the .05 Level of significant, the hypothesis that there exists a correlation between labor cost and Korean investment capital is testable. As seen in the table, probability to calculate Pearson coefficient is -0.928; therefore, there is enough evidence to reject the null hypothesis.

5.2.1.2.2. Correlation analysis between Korean direct investment and labor cost

a. A strong association between the two variables

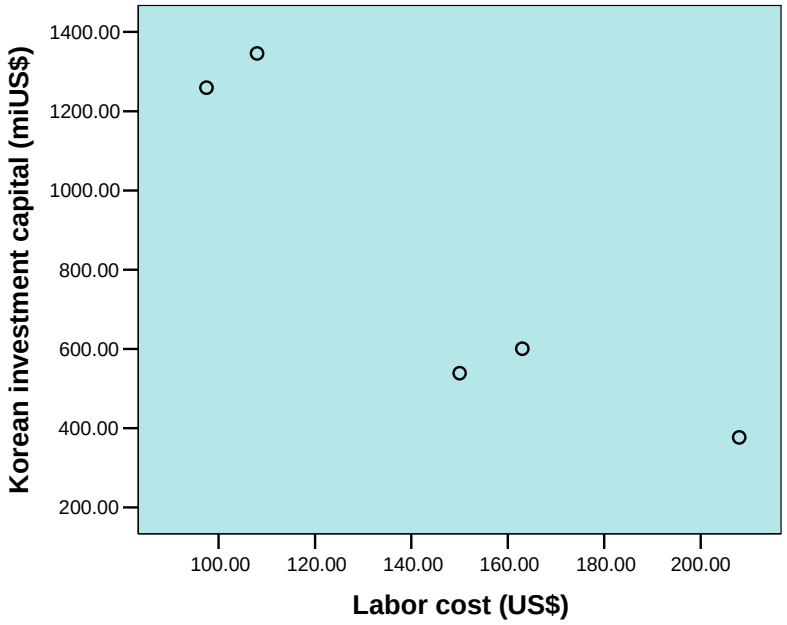


Figure 5.1: Association between Labor cost and Korean investment capital of 5 Southeast Asian countries

Table 5.2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.928(a)	.860	.814	192.14554

a Predictors: (Constant), Labor cost (US$)

Table 5.3: ANOVA (b)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	681955.956	1	681955.956	18.471	.023(a)
	Residual	110759.722	3	36919.907		
	Total	792715.678	4			

a Predictors: (Constant), Labor cost (US$)
b Dependent Variable: Investment capital (mi US$)

Table 5.4: Coefficients (a)

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2170.605	324.835		6.682	.007
	Labor cost (US$)	-9.266	2.156	-.928	-4.298	.023

a Dependent Variable: Investment capital (mi US$)

The diagram represents graphically a negative relationship between the variables. The countries with lower labor cost tend to attract more Korean investment. The null hypothesis that there exists no correlation between labor cost and Korean investment capital is tested in a two-tailed test. As computed by SPSS, H_0 is rejected at the .05 level of significance, which means the negative correlation between the two variables is significant.

b. Regression analysis

In order to estimate Korean investment capital on the basis of labor cost in host countries, the author manages to find a regression equation based on least square principle.

$$\mathbf{Y_i' = B_o + B_1 * X_i}$$

Where:
X_i: any value of the independent variable X_i (labor cost)
Y_i': predicted value of the Y_i (Korean investment capital for a selected X_i)
B_o: Y intercept
B_1: slope of the regression line, the average change in Y' for each change of one unit of X

The table represented the least square regression line:

$$\mathbf{Y_i' = 2170.605 - 9.266 * X_i}$$

The equation means for each dollar reduced in labor cost, the countries could expect to increase amount of Korean investment by 9.226 million US dollars. However, in measuring the inaccuracy of the estimate, the standard error is rather large (192.145554), representing that the data are widely scatter around the regression line; therefore, the estimation meanings withdrawn based on the regression line is limited. That may be partly due to the small number of observations.

c. Determination

The coefficient of determination (R square) illustrates that 86% of the variation in the volume of Korean investment is accounted for by the variation in the labor cost, representing the high conformity between the regression model and its data set. Moreover, ANOVA analysis unveils that with the F statistic rather large compared to the critical value (10.1 referred to the Table of Critical value of F distribution at 5% significant level), or in other words, the significance level (2.3%) is much smaller than the level of significance. Therefore, the null hypothesis is firmly rejected and our regression model well fits with the population.

d. Interval estimations

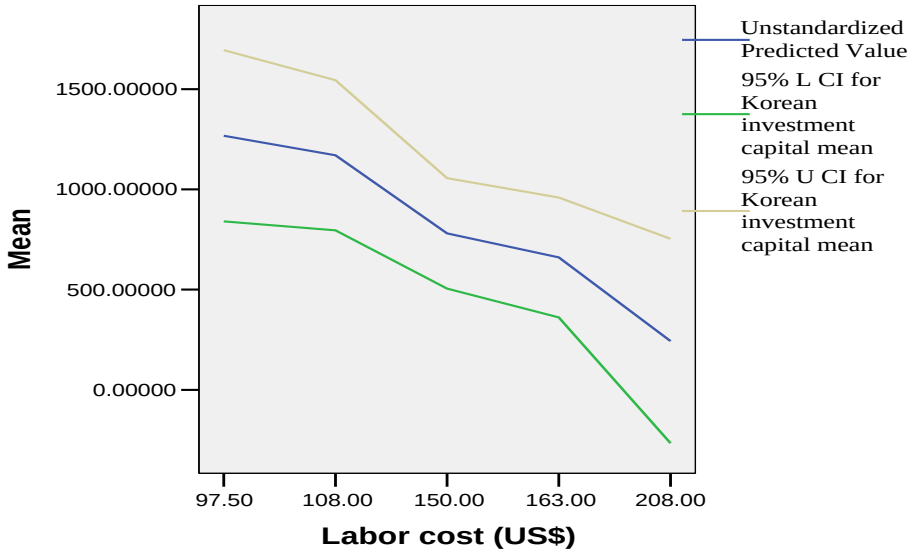


Figure 5.2: Estimation the correlation between Labor cost and Korean investment capital of 5 Southeast Asian countries

In the analysis, the sample size is rather small; therefore, a correction factor is needed to account for the size of the sample. *Confident interval* for the mean of Korean investment capital (Y) for a given cost of labor (X) is represented by the distance between the green line and the yellow line at 95% level of confidence. For instance, should a country fixes labor cost at 108 US dollars, it would expect to attract a volume of Korean investment from 800 million US dollars to 1.6 billion US dollars.

The medium labor cost is expected to be 150 US dollars. The farther the labor cost is from the medium level, the lower the confidence we have in estimating the volume of Korean investment. Another applicable method of estimation originates from *prediction interval*, which reports the range of value of Korean investment capital (Y) for a particular value of labor cost (X), illustrated by Unstandardized predicted value line.

The findings confirm a heavy influence of the low labor cost on the volume of Korean direct investment within the five Southeast Asian countries. That could well match the results of Yeon (1992) indicating that Korean investment into lower developed countries was driven mainly by labor cost advantage.

5.2.2. Pull factors to induce Korean direct investment to Vietnam

5.2.2.1. Competitive legal framework

a. The Law on Foreign Direct Investment

Vietnam has passed a long way in improving its FDI policies. The first Law on foreign investment was ratified in 1987 as soon as the country began its economic reforms The Law was regarded as one of the earliest and most liberalized legal framework for FDI in the region[12] So far, the 1987 Law on Foreign Investment has been revised 4 times with notable changes each time (See Appendix 1). Vietnam has made great efforts in enhancing the rights of foreign investors, formulating an increasingly favorable investment environment, gradually filled the gap between foreign investors and their domestic counterparts. These changes were implemented in the sensitive policy areas that affected immediately to the right of investors.

[12] UNCTAD (1998) p 56.

To date, the number of activities in which FDI is barred or restricted has been considerably reduced, especially in the manufacturing sectors and the required export proportion. The country gradually moved to open its traditionally closed industries, which created more opportunities for foreign investors. However, Vietnam is still maintaining ownership requirements and control restrictions to certain strategic industries (such as oil and gas, post and telecommunications, cultural and publishing activities, insurance and finance, national defense and securities) or to projects with invested capital of at least forty (40) million US dollars in certain fields (such as electricity, mining, metallurgy, cement, mechanical engineering manufacture, chemicals, hotels, apartments for lease and tourism-entertainment areas), that have gradually been embargoed on the way to WTO.

b. Investment incentives

Investment incentives have also seen enormous improvements. In 1992, FDI firms investing in priority areas would enjoy the corporate income tax of 10% within 15 years, however, firms were not allowed to grant the deduction of profit in later years to compensate for the loss in previous years; moreover, their import duties were imposed based on the special import price applied for calculating tax only, much lower than the market price. The most striking features in 1996 were the import duty exemptions. FDI would be exempted from import duties on machinery equipments, means of transports, raw materials for production and business, especially for export processing zones. Tax holidays were applied within 5 years from the commencement of projects and applied in whole life of export processing firms. The effort of policy makers to eliminate tax gap between foreign and domestic enterprises have been pushed forward from the year 2000. Thanks to deep improvements, in 2004, firm duties related to taxation have been equalized between domestic and foreign legal

entities, marking a step to ensure national treatment principle of WTO. Comparing the current FDI legal framework between Vietnam and other Southeast Asian countries, the country is rather competitive in providing inducement measures to attract FDI.

Table 5.5: FDI inducement measures in selected Southeast Asian countries (by 2005)

	Indonesia	Malaysia	Philippines	Thailand	Vietnam
Restriction on forms of FDI firms	Prohibition of 100% foreign firms in some sensitive industries	100% foreign firms are restricted in all sectors, except for export-oriented sectors	None. Yet, restriction on maximum FDI capital in certain industries	Hardly no restriction, except for some restricted industries	100% firms are not allowed s in some important and sensitive industries. FDI firms shall transform to joint stock companies.
Access to land	FDI firms may lease land in industrial zones but not easily (most popular within 30 years) Transferring and mortgaging the right of land use is permitted.	FDI firms may choose to buy land or lease land in 99 years; may mortgage and transfer land. Land ownership and purchase are permitted.	FDI firms with over 40% capital owned by foreigners shall lease land from real estate agent instead of owning land. Others may lease land for 50 years, transfer and mortgage the right of land use.	FDI firms may lease land for 50 years, which is automatically extended when expired. Land leasing contract may be used to mortgage.	Prohibit land ownership. FDI firms may lease land in industrial zones. Transferring and mortgage the right of land use is permitted.
Exchange rate/ Profit with-holding tax	None 15% for residents; 10-20% for non-residents (50% reduction in referential sectors/areas)	Dividend withholding tax is levied after the financial crisis.	Flexible foreign exchange management 10-25% on profit remitted abroad	Flexible foreign exchange management. 10% on profit remitted abroad; domestic inter-company dividends are	Controlling current account. 3, 5 or 7% on profit remitted abroad Foreign currency transfer abroad shall

	Indonesia	Malaysia	Philippines	Thailand	Vietnam
				partly or wholly exempted.	be permitted.
			TAX INCENTIVES		
Sectors qualified	Exports, hard-crop plantations, mining, businesses in remote areas	Manufacturing, agriculture, tourism, other activities receiving "pioneer" status	Exporters	Exporters, various industries	Exporters, agriculture, processors, high-tech industries, labor-intensive industries, certain remote locations
Tax holidays	3 - 8 years for newly-established firms in 22 specific sectors	5 years on 70-100% of statutory income; 10 years for companies of national importance	3-8 years	3-8 years	Up to 8 years
Reduce corporate tax rate	Progressive rate: 10, 15, 30% Reduction: none	Standard rate: 28% Reduced rate: 3% for offshore firms in Labuan 10% for foreign fund management companies	None	50% reduction of standard rate for 5 years for firms in investment promotion areas	Standard rate: 28% for both domestic and foreign firms. Preferential rate: 20, 15 and 10% accompanied with specific tax holidays.
Investment allowances and credit	A maximum 30% reduction of taxable income for investment priority sectors	Investment allowances of 60-100% of qualifying capital expenditure	Tax credits for purchasing breeding stocks and genetic material; and incremental export revenue	Allowance of 25% for investment in infrastructure	Profits re-invested in other projects shall be refunded totally or partially.
Import duties and VAT exemption	For inputs in certain sectors, especially exporters	Exemption and reduction for inputs in certain sectors,	Exemption and reduction for inputs in certain sectors, especially	Exemption and reduction for inputs in certain sectors, especially	Exemption for import duties for exporters Exemption

	Indonesia	Malaysia	Philippines	Thailand	Vietnam
		especially exporters	exporters	exporters	within 5 years and reduction of duties for imported fixed asset of FDI projects
Industrial parks (IPs) and export processing zones (EPZs)	None	None	5% tax on corporate income upon the lapse of tax holidays	None	Various inducement policies for service firms in IPs; service and production firms in EPZs; IPs and EPZs infrastructure developers; and export processing firms and high-tech firms

Source: self-compilation based on Le (2006) and Fletcher (2002)

It could be noted that for Korean investors who are seeking for resources and efficiency, investment incentives take an important part in prompting them to invest. A high rate of Korean investors satisfying with their business in Vietnam represents a fact that Vietnam could be among prominent investment destinations considering the legal framework alone. However, they expressed their expectations toward the more deep-rooted improvement in legal framework, especially the distribution and domestic trading system. Investment inducement was also appreciated within the respondents[13].

Investment incentives are acting as a push factors in inducing foreign investment in Vietnam generally and Korean investors particularly. The fact that Vietnam authorities have launched a series of competitive investment inducements

[13] KOTRA (2005): 90.1% of the respondents expected the improvement of investment environment, of whom 38.5% emphasized the domestic distribution channels and 28.1% believed in the revision of investment inducement policies.

has taken positive influences on the location of Korean projects. Korean investment mainly located in Hanoi, Ho Chi Minh city, Binh Duong and Dong Nai (especially in IPs and EPZs within these areas) where the local authorities are offering generous investment incentives (land clearance and low land-leasing fee, utilities availabilities, tax exemption and reduction, etc.) and where the infrastructure conditions and labor expertise are satisfactory to investors.

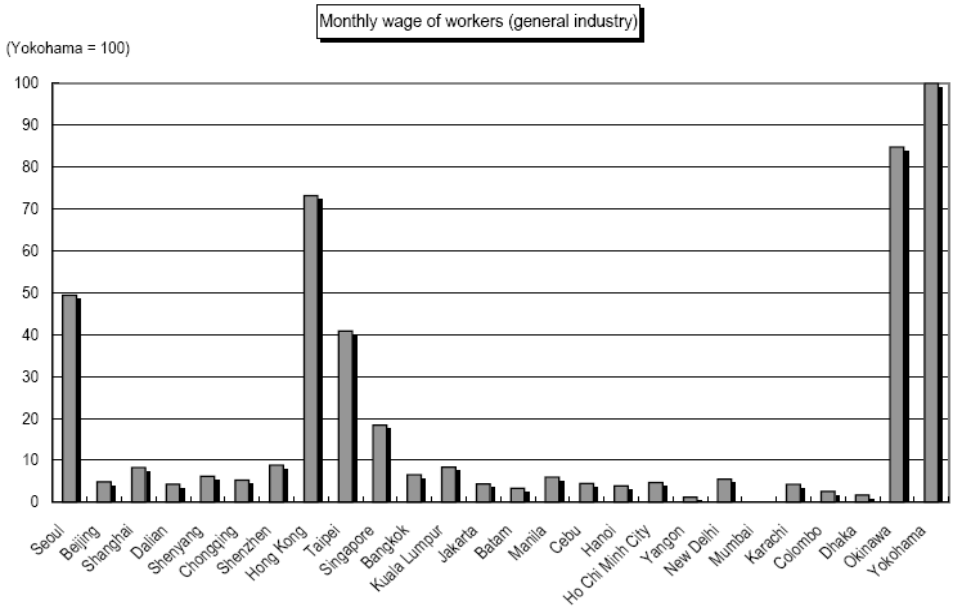
5.2.2.2. Low labor cost

The majority of Korean projects have clustered in light industry and heavy industry. Light industries, particularly food processing, textile and garment, leather and shoes have been the most attractive sectors to invest. That represents a fact that Korean investors are taking the advantage of low labor cost to cut down their production cost and increase business efficiency. KOTRA (2005) revealed an average of 595 employees per firm, representing a relatively high proportion of labor force in firm's business. Specifically, shoe-making enterprises topped the list of labor-intensive firms with the average of 9,040 workers. Among respondents, 48.6% are hiring below 100 employees; 10.3% have the labor force of more than 1000 workers. Notably, the proportion of 76.6% respondents ranked low-labor cost as the most competitive feature to invest in Vietnam prove that the cost of labor still remains the main strength of Vietnam.

Based on the Vietnam Household Living Standard survey in 2004, the average wage in Vietnam is about 824,000 Vietnamese dong per month (roughly 55 US dollars). Comparing to neighboring countries, it is significant that labor force is much cheaper in Vietnam than almost countries in the region[14]. A recent report of MPI also unveiled that the average wage of unskilled workers in the sector is around 75 to 80

[14] See Table A.4, Appendix A.

US dollar per month; the average salary of an engineer is about 220 to 250 US dollars, that of an administrative officer is close to 500 US dollar[15]. There was also a disparity between the wages in FDI companies and domestic enterprises operating in the same sectors, which employees in FDI sectors receive higher paid than their domestic counterparts. In comparing the labor cost in 26 cities and 16 major countries in Asian, JETRO (2003) revealed that labor cost in Vietnam (Hanoi and Ho Chi Minh City) was slightly higher than China (Beijing), still much lower than Indonesia (Jakarta), Malaysia (Kuala Lumpur), Philippines (Manila), Singapore, and as twelve time lower than the average wage in Korea (see Figure 5.3)[16].



Source: JETRO (2003)

Figure 5.3: Monthly wages of workers (general industry)

There are also considerable differences in remuneration levels within Vietnam. Data from the Household Living Standard survey in 2004 shown that the average monthly wage in Ho Chi Minh city was close to 1.5 million dong per month (about 100 US dollars), exceeding the average of 1.2 million dong (80 US dollars) in Hanoi.

[15] Vietnam Development Report 2006
[16] For detail figures, see Table A.4

At the other end, monthly wages in Hau Giang, Tra Vinh, Soc Trang (Mekong River Delta) and Ha Nam (Red River Delta) were below half a million dong (below 35 US dollars). It is interesting to note that although being heavily driven by labor cost, Korean investor preferred to locate their business in provinces with higher labor cost (Hanoi, Ho Chi Minh City, Dong Nai and Binh Duong) but better infrastructure. As a result, labor cost is proved a key determinant to induce Korean investors to Vietnam, yet, might not be the key factor influencing their decision to locate investment site within the country.

5.2.2.3. An emerging market

International integration in the global playground has been the focal of the economic reform in Vietnam. There have been the remarkable milestones of Vietnam government efforts. In 1991, a duty rebate scheme was introduced, enabling export-oriented firms not to pay trade tax in their imported inputs. In 1993, all enterprises with a business license were authorized to engage in foreign trade of products specified in the license. In 1995, Vietnam became the member of AFTA, under which it committed to reducing tariff on imports from AFTA members, on all but a few sensitive products to less than 5% by the year 2006. In addition, products with certificate of origin in ASEAN enjoyed the tax rebate when being exported within the region. In 2001, the USBTA was signed after long and protracted negotiations, which was considered the most comprehensive of all bilateral trading agreements signed between the United States and a developing country[17]. In 2004, a requirement for exporters to surrender foreign exchange to the State Bank of Vietnam was abolished export duties and import quotas have been gradually dismantled (by now the former only apply to crude oil and scrap metal, the latter to sugar and refined petroleum

[17] Vietnam development report (2006)

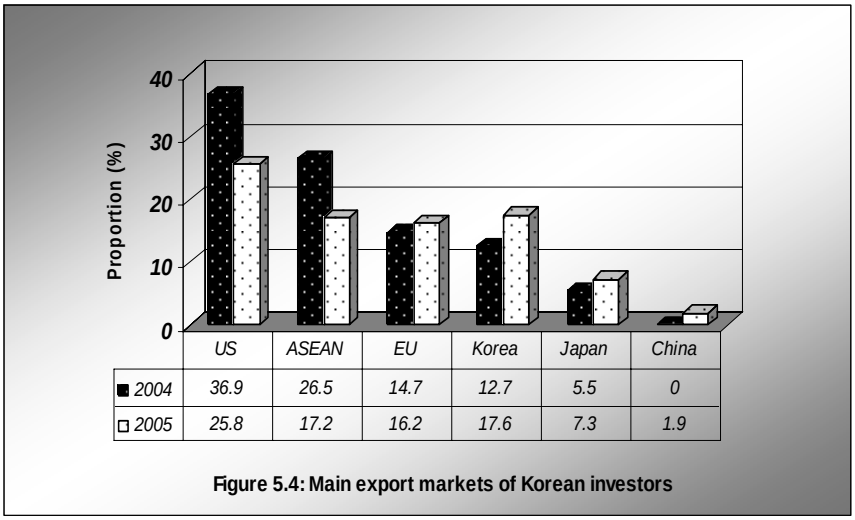
products. Vietnam is pushing forward her integration efforts and expected to join WTO in 2006. The result has been a remarkable open economy with the sum of export and import by now surpass the total GDP (more than 130% of GDP). Export has grown at 18% each year since 2000.

From participation in AFTA to the implementation of the USBTA, the country has made its market more competitive to investors. However, regardless of the virtues of this process, WTO accession will entail essential changes both at the border and behind the border. On one hand, it will lead to a demand to further reduce trade barriers and increase efficiency. That places a challenge to Vietnam's government as its protection rates is still at high level comparing to neighboring countries. On the other hand, accession to WTO will result in institutional changes to a more level playing field between domestic and foreign enterprises. All the changes will enhance the investment environment, widen the output market and boost the productivities in the medium to long term.

These fundamental improvements are the positive factors to attract Korean investment. As revealed by KOTRA (2004, 2005), apart from labor cost advantage, market-seeking (including both the domestic market and the third markets) is also the motivation prompting Korean firms to invest in Vietnam. 31.1% of the respondents run business in Vietnam to export to the third countries, 28.1% to penetrate into the domestic market, and 27.8% for production cost saving. That can be explained as follows:

Foremost, the United States and ASEAN remained their important part in business activities of Korean firms. That explained the reason why Korean investors paid more attention to the intra-regional trading within ASEAN and the trading relationship between Vietnam and the United States. To some extent, Vietnam has

been a production base for Korean firms who seek for a broader market like ASEAN, the United States or recently China.



	US	ASEAN	EU	Korea	Japan	China
2004	36.9	26.5	14.7	12.7	5.5	0
2005	25.8	17.2	16.2	17.6	7.3	1.9

Figure 5.4: Main export markets of Korean investors

As for the third market, international agreements take an important part in investors' decision. 65.3% of the respondents in KOTRA (2005) expressed their interest in Vietnam's accession to WTO. 61.5% of Korean investors believed in a more competitive business environment after Vietnam becomes a full member of WTO.

The economic relationship between the two countries has received special attention among respondents. 84.5% of Korean investors regularly updated information about the road map of ASEAN+3 free trade agreement. 58% of them hoped that upon the fulfillment of ASEAN – Korea agreement, the competitiveness of Korean firms would be further enhanced.

Moreover, Vietnam has becoming a manufacturing factory for Korean investors, of which products were either re-imported to Korea, exported to the third countries or consumed in domestic market. However, domestic suppliers are not the main source of input. In KOTRA (2005), a limited proportion of 28.9% of firms use

domestic inputs, whereas 34.5% have their suppliers in Korean and 16.9% in China. To some extent, the bypassing of domestic suppliers is not totally surprising. Increasingly, companies that operate in international market tend to have a production network transcending national borders. The geography of Vietnam can support this trend. For instance, a Hanoi-based enterprise is 1,400 kilometers away from Ho Chi Minh City, but only 1,000 kilometers away from Bangkok and 800 kilometers away from Guangzhou, China.

Finally, Vietnam is among suitable places for investment in Asia. especially for investors seeking a non-China destination to reduce risks. In the past, China was always the first choice for foreign investors as they eyed the vast market of 1.3 billion people. In addition, China can offer good sources of material as the country has developed supporting industries. However, concerns over the investment environment in China have been raised among Asian investors since 2003 when SARS broke out. The troubles occurring later in China, like the worker and electricity shortages in 2005, and the demonstrations in many localities in China. All have dampened the enthusiasm of foreign investors in China and created more opportunities for other Asian countries, including Vietnam.

5.2.2.4. Cultural proximity:

Both situated in South East cultural cradle, Vietnam and Korea shared the long history of culture and the unique characteristics of “han” spirit (in Korean old sayings). Confucianism was once the prevalent logical idea in the two societies, which greatly influenced in forming the people’s characteristics such as loyalty, studiousness, economy and patriotism.

Despite of the difference in period of time, the two countries experienced devastating wars and originated from the colonial regime. Prior to the economic miracle, Korean passed the hardest time being an underdeveloped agrarian country with low cultivating skill and extremely hard weather. In similarity, Vietnam has just already come over the underdeveloped situation of an agricultural country with low national savings and hardly competitiveness in the global market. Before taking off its economy, Korean used to develop labor-intensive industries based on the abundance of labor force. At present, Vietnam is following Korean model in its development path. For that, the similarities in cultural and social background are amongst the positive factors influencing investment decision apart from low labor costs and market-access opportunities. Since the cost of reliable information about foreign market becomes higher as the size of firms gradually reduces, Korean firms tend to invest in neighboring countries with geographic proximity, where they can establish a certain familiarity through trade and cultural ties.

In conclusion, the findings confirm a heavy influence of the low labor cost on the volume of Korean direct investment within the five Southeast Asian countries. Low labor cost remains the most importance factors influencing investment decision of Korean investors in these countries. With the lowest cost, Vietnam is rather competitive in inducing Korean investors, however, that might not be the whole story of the country.

Chapter 6

Discussion

6.1. Key determinants – Positive factors

Korean investment inflow to the ASEAN and Vietnam was the outcome of both ‘push’ and ‘pull’ factors. As for push factors, Korean government attitudes toward outward investment and corporate strategies have played important roles. After the period of rocketing economic growth, Korean government is now pursuing a policy of sustainable economic development, more inclined to increase its global competitiveness through FDI. Being paved the way for overseas business activities, conglomerate Korean firms who seek for a reduction of production cost targeted Southeast Asian region. Concurrently, a new wave of small and medium-sized enterprises is sweeping over the region, creating lot of opportunities for recipient countries. Korean enterprises seek for either resources, efficiency or market to overcome the rising cost and narrowing market in home country. Cultural ties and geographical proximity become increasingly important when Korean investors decided to locate their projects within the region. Among the determinants, low labor cost was proved to be the key factors to locate Korean investment outflow in Southeast Asian countries.

From the host country’s perspective, Vietnam is pursuing a mass of measures to induce investment which positively contribute to increasing the volume of Korean investment. A competitive legal framework with highly appreciated Law on Foreign Investment and effective investment incentives are performing their effects to attract Korean to Vietnam and allocate their investment within the country. However, the main competitive feature of the country was low labor cost compared to other

neighboring countries, especially attractive to resource and efficiency seekers. Apart from labor cost advantage, market potential, mainly the third market, was inducive to Korean market-seeking investors. Cultural proximity was also a positive contributor to the high volume of Korean investment in the country.

It can be withdrawn from the study that Vietnam remains in the threshold of the third phase of investment development, representing in the utmost importance of FDI legal framework, availability of production resources, especially labor force, and the emerging market; nevertheless, the findings implicit instable elements.

Firstly, in a fierce competitive context, FDI policy framework remains a necessary determinant but not sufficient one, moreover, becomes relatively less importance with the liberalization and globalization as countries are increasingly loosing its tights over investment requirements. What matters investor most might not be how much liberal the FDI framework per se but how coherence between the FDI policies and other macroeconomic and microeconomic policies. Secondly, immobile determinants, i.e. the availability of production resources, which used to be the most important FDI determinant for countries lacking of the capital, skills, know-how and infrastructure (as the Southeast Asian countries) has not seen its importance declined but the decline of the primary sector in the world output. This results from a fact that technology and innovation have become the critical to competitiveness. The openness to trade, FDI and technologies worldwide as well as the deregulation and privatization have increased firms access to immobile factors, pushing the outward investment flow for locational assets' portfolio to complement their competitiveness rather than seeking for immobile factors. Thirdly, the increasing similarity in FDI framework between countries in the region has lifted up the importance of business facilitation.

Investment promotion, after-investment services and reduction of hassle costs have proliferated as a mean of competing for FDI.

6.2. Hindering factors

In KOTRA (2004), Korean investors expressed their great concerns about the lack of information (41% of the respondents), difficulty in language (26%), less supports of local authorities (19.6%). In details, main concerns focused on the lack of information about new legal documents, incomprehensive information database for foreigners, the disparity between newly-established legal documents and the invalid ones, and lack of their guidelines documents. For textile companies, import quota to the United States topped the list of concerns. All investors presented negative attitudes towards bureaucratic behaviors of authorities and their red tape.

In KOTRA (2005), Korean firms faced with a series of difficulties in operation process, namely less transparent legal guidelines (20.9% of respondents), material supply (20.6%) and inadequate infrastructure conditions (19.9%). The hardest obstacles to investors were considered the lack of information and language barrier which accounts for 36.6% and 22.1% of the respondents respectively.

Korean investing and running business in Vietnam were also hindered by the red tape of local authorities (making up 28.2%), incomprehensive guideline legal documents (20.8%), cultural barriers (17.3%), labor management (11.8%), increasing production cost (9.8%, including high electricity fee).

Based on the two surveys, main obstacles to Korean investors to do business in Vietnam could be concentrated into four groups: language barrier and information availability; bureau and red tape; infrastructure quality and production cost; and lack of supporting industries.

6.3. Implications for policy to enhance Korean direct investment

It is critical for domestic policies in Vietnam to solve the deep-rooted impediments in an effort to create a favorable business climate for investors.

6.3.1. Upgrade language skills and information availability

Language barrier is among the top concern of Korean investors. This is due to the fact that language skills were paid less attention to in Vietnam, especially among unskilled workers. Moreover, this is another problem in Vietnam: skilled labor is in demand, and managers who are available tend to be unfamiliar with new technologies. This lack of technical expertise and language skills tends to hamper new investment in Vietnam.

Though inexpensive labor cost has been proved to remain the key competitive determinant of Korean direct investment, it is wise to place the reliability of labor supply and the level of its skill to top priorities, rather than its cost. To offer investors more by way of the quality and quantity of labor force to prevail in competition, Vietnam authorities has considered vocational training and education as one of the key national policies, representing in an increasingly high proportion of national budget to spend on education[18]. Further more, the country has granted top priorities to education projects invested by both foreigner and domestic legal entities. However, in order to meet requirements of investors, a combination effort of Vietnam government and Korean enterprises should be further enhanced. The government should need to consider a basic level of English and computer skills as the compulsory education for at least high school education level. Moreover, it is suggested that enterprises

[18] The proportion of expenditure for education in GDP was 6.1%, 7.6% and 8.3% in 2003, 2004 and 2005 respectively (Ministry of Education and Training of Vietnam, 2005).

themselves should perform actively to provide training courses for employees, especially those working in high-tech industries.

Korean firms are also concerning about the unavailability of information for investors. In spite of the rapid development of information technologies in Vietnam, information related to the country's investment environment and promotion campaigns provided via websites were rather limited. Korean investors had to rely on Vietnam's governmental bodies, KOTRA, Korea's governmental agencies or other happy investors for investment information. KOTRA(2004) uncovered that 32% of the respondents getting access to necessary information for their decision to invest in Vietnam via other happy investors or Korean partners, 25% were assisted by the host country's governmental bodies, 22.3% through KOTRA, 7.6% and 3.4% via Korean embassy in Vietnam and the home country's governmental bodies respectively.

In short term, investment promotion through these channels should be further fostered through the close collaboration between FIA, domestic enterprises and the overseas investors. In addition, with the rapid development of information technology and the widespread of Internet, it is of serious need that FIA improves its website providing necessary information related to investment opportunities and procedures as well as the investment environment in Vietnam. In addition, as satisfied investors could be the best advertisement, after-investment should be paid more attention to in order to attract more reinvested earnings and to consolidate the reliability of domestic investment environment.

Further more, cooperation between the two governments should be enhanced by pushing up the implementation of the Bilateral Agreement on Investment Promotion signed on December 2005. Aiming at establishing an agency in Vietnam to facilitate Korean investors and vice versa, when fully in operation, the agreement is

expected to strengthen the investment cooperation between the two countries, especially in labor force training and exchange, investment promotion sharing, investor facilitation as well as investment events coordination.

Finally, Vietnam also lacks of a special permanent unit in charge of investment promotion campaigns in Korean market. During the years 1990-2000, a mass of international and Korean organizations and the two countries' governmental bodies have collaborated in launching promotion campaigns, yet these programs were not regularly implemented. Thus, it is a necessity to have a representative agency bridging Korean investors and the host country though a transparent and available information network as well as professional and effective promotion campaigns.

6.3.2. Eradicate bureau and red tape

Receiving much concern from Korean investors, bureau and red tape are a heavy-weighted negative factor to the country's investment environment. In 2005, the corruption Perception Index of Transparency International gave a rating of 2.6 to Vietnam, on a scale of 1 to 10 where 10 corresponds to the highest integrity standard. Most other countries in the region got higher grades, including Malaysia (5), Korea (5.0), Thailand (3.8), Laos Republic (3.3) and China (3.2). Only the Philippines (2.5) and Indonesia (2.2) appeared to be more corrupt.

According to the Investment Climate Survey (ICS) in 2005[19], the bribes and gifts in dealing with government agencies are becoming more popular. For instance, the average bribe payment is estimated at 3.6 million Vietnamese dong (roughly 230 US dollars) for customs, 3.4 million VND (226 US dollars) for tax administration, 1.9 million VND (126 US dollars) for the police and market controllers, 1.4 million VND

[19] The ICS 2005 for Vietnam conducted by the International Development Centre of Japan and Concetti has one of the biggest samples, comprising 1,150 firms located in 25 provinces across 5 of the 8 regions of the country (Vietnam Development Report, 2006)

(93 US dollars) in the case of environmental agencies and 1.2 million VND (80 US dollars) for business registration and licensing. In another diagnostic study on corruption by the Central Committee of International Affair of the Party, the average additional cost per business transaction ranges from 0.1 to 2.1 million VND (from 10 to 140 US dollars). However, the overall amount of bribes paid by enterprises in Vietnam is not high when compared to other developing countries, certainly not as high as expected given Vietnamese's development level (see Table 6.1).

Table 6.1 : Corruption in the East Asia region

Unit: % of respondents

	Whether corruption constraint to business.		
	No	Minor	Severe/ Major
Cambodia	4.7	39.4	55.9
China	24.1	48.5	27.3
Indonesia	29.3	29.2	41.5
Malaysia	53.8	31.7	14.5
Philippines	40.6	24.3	35.2
Thailand	49.7	32.1	18.3
Vietnam	52.3	17.8	14.2

Source: ICS database of the World Bank, Vietnam Development Report (2005)

To reduce hassle costs, it is necessary to put forward the improvement of administrative efficiency and elimination of corruption and red tape. In the last 5 years, administrative procedures in Vietnam have seen considerable improvements with an increasing decentralization of investment licensing process and business ombudsman to local People Committee and IP Management Board. One-stop shop mechanism is contributing greatly in strengthening the confidence of investors. In an effort to streamline administration procedure in taxation, investors are facilitated in tax declaration and payment. Taxation services have thrived to consult enterprises. Taxation bureaus have also pushed up technology application to increase the transparency and save time for taxpayers. In the years to come, it is suggested that the authorities should closely cooperate to avoid overlapping procedures between

different administrators, strengthening the relationship between authorities and investors through periodical meetings, facilitate investors in both registration and operation process, timely address the investors' concern in running their business.

6.3.3. Improve infrastructure quality

Vietnam has attained enormous progress in infrastructure recently to catch up with its neighbors in terms of availability and cost of services. Still, enterprises in Vietnam, including Korean investors, complained about insufficient transport infrastructure, and excessively expensive electricity and telephone services.

Generally, Vietnam has sustained an impressive growth in access to infrastructure services since the early 1990s. All urban areas in Vietnam are electrified by now. In rural areas, electrification expanded from 51% of all household in 1996 to 88% in 2004. The length of road network increased from 96,100 kilometers in 1990 to 224,500 kilometers in 2004. For national level roads, the increase was from 15,100 kilometers to 17,300 kilometers. By 2002, 45% of the road networks were evaluated in good condition, compared to 37% in 1997. The number of fixed and mobile lines per 100 people rose to 9.2 in 2005 from 1.1 in 2002. It is on target to reach a total of 10 million lines in 2006-2007, achieving one of the fastest growth rates of tele-density on record. In an effort to abolish the dual price system between domestic and foreign enterprises, the government has dramatically reduced its communication charges, achieving the same level of neighboring countries[20]. Paradoxically, the increasing availability of infrastructure is among reasons leading to a relative rise in price aligned to those in the regions, elevating the price of inputs, which in its turn pushes up the production cost.

[20] For example, the international call charge has been reduced by about 70% in the late three years, from 6.93 US dollars in 2002 to 2.70 US dollars in 2003 and 1.95 US dollars in 2004,

In the long term, the government should aim to improve the infrastructure facilities rather than manage to reduce production cost, for the fact that inadequate infrastructure conditions may be more costly to manufacturing. Such facilities include high-quality telecommunication links and reliable transportation system for enterprises to develop a “just-in-time” production system. At present, investment capital for infrastructure mainly comes from the state budget and ODA. FDI in infrastructure takes a minor part with 18 projects totally and worth 3.7 billion VND, whereas that from domestic enterprises can hardly be seen. As state budget and ODA are not sufficient, the government should pave the way for domestic and foreign enterprises to invest in manufacturing facilities with a transparent framework for infrastructure projects.

6.3.4. Develop supporting industries

Revealed by KOTRA (2005), material supply for manufacturing process received a great concern among investors. 20.6 % of the respondents were facing difficulty in finding the material supply. The proportion of investors using domestic supply was relatively small compared to those imported input from the third countries. A modesty of 28.9% of investors was using domestic materials, while 34.6% imported input from home country and 16.9% imported from China.

It is such a paradox that the majority of Korean investment was in manufacturing industries, yet, the domestic supply was far under-developed to satisfy investors’ needs. Lack of supporting industries may in one end increase the production cost of investors; in the other end discourage the domestic manufacturing and contain the unstable development of foreign investment.

Not only Korean but also other foreign investors are suffering from the underdevelopment of domestic supporting industries. The majority of materials for textiles, leather and shoes, electronics have been imported, which leads to the heavy dependence on material supply abroad. The added value of domestic supporting industries reached the minimum of 10%, far lower than neighboring countries. For instance, a quarter of enterprises in electronics industry are supplying materials, yet the majority is foreign firms who products will be shipped abroad. Besides, the domestic proportion stands at 20%, mainly in packages and plastic components.

It is high time Vietnam should consider the importance of supporting industries seriously. That can be done firstly by defining the scope of supporting industries development, followed by a master plan to develop the industries, concentrating on selective spearhead ones. A legal system should be formulated to create a playing field for supporting industries to operate, including taxation treatment, incentives, and business facilitation measures without disparity between domestic and foreign firms. Moreover, development of supporting industries not only assists foreign investors but also spread their spillover effects over domestic industries. Foreseeing signals of asset-seeking investors in knowledge-intensive industries, strengthening supporting industries also contributes to a foundation for agglomeration economies where related activities and specialized support services can be provided within the recipient country.

In summary, defining the determinants of Korean investment in Vietnam and their impacts to the investment volume implicit some issues for the host country's policy-makers to address. Only by enhancing the positive factors and step-by-step reducing the negative factors could policymakers induce and nurture the Korean investment inflow in a fear competitive context.

6.4. Limitations of the study and suggestions for further researches

The thesis is considered one amongst the first studies in the country attempting to investigate the characteristics of Korean investment in Vietnam within the regional context. Its scope of research covers the push factors leading to investment decision of Korean firms in Southeast Asia and the pull factors to their investment in Vietnam. As investment determinants is a broad field of study, the thesis limits itself in investigating the study theme based on the literature of Dunning (1977) and Porter (1990). For that reason, other perspectives should be considered for further studies.

The thesis is implemented basically on descriptive and logical reasoning methods. Statistical methods are also applied to test the results, showing some clear quantitative correlations, however, the scope is only limited to some available secondary indicators from various sources. It is suggested that the impacts of determinants, especially the pull factors should be further developed through economic models.

The author expects that this study will stimulate new questions and new themes for further researches which on the whole create a solid background for policy-makers in Vietnam to formulate investment policy. To facilitate studies afterwards, the author would be willing to provide data and information related to the study and happy to receive feedbacks from whom the thesis may concern.

APPENDICES

Appendix A

Table A.1: Korean direct investment in Vietnam by location (1988-2005)

No.	Location	Project	Registered Capital (US dollars)	Implemented Capital (US dollars)
1	Dong Nai	135	1,297,896,415	392,981,673
2	Ha Noi	80	1,053,618,627	413,985,523
3	Ho Chi Minh City	342	1,049,477,142	477,733,942
4	Binh Duong	193	452,171,150	143,450,766
5	Hai Phong	26	273,513,704	273,801,157
6	Phu Tho	34	252,322,987	148,328,974
7	Khanh Hoa	14	185,184,680	162,231,058
8	Vinh Phuc	24	120,685,513	36,510,513
9	Offshore oil exploitation	1	84,000,000	178,348,719
10	Hung Yen	20	57,512,942	21,153,796
11	Long An	14	54,940,214	20,922,000
12	Quang Ninh	8	52,200,000	1,500,000
13	Nam Dinh	4	51,316,272	350,000
14	Tay Ninh	25	40,826,425	9,745,979
15	Da Nang	8	37,306,960	8,436,255
16	Hai Duong	11	35,816,400	8,018,773
17	Ba Ria - Vung Tau	15	33,200,000	10,090,908
18	Hoa Binh	1	20,000,000	1,000,000
19	Binh Thuan	10	16,360,000	1,100,000
20	Lam Dong	5	14,043,135	6,067,460
21	Bac Ninh	5	13,772,000	6,500,000
22	Bac Giang	6	11,435,820	6,838,000
23	Phu Yen	6	9,735,000	1,085,000
24	Ha Tay	6	8,877,783	7,126,000
25	Binh Phuoc	3	8,735,000	0
26	Thai Binh	5	8,413,000	500,000
27	Binh Dinh	2	5,350,000	1,950,000
28	Tien Giang	3	3,911,936	1,303,000
29	Quang Ngai	2	3,460,000	400,000
30	Son La	2	3,000,000	900,000
31	Thua Thien Hue	1	2,950,000	885,000
32	Ninh Binh	2	2,664,972	0
33	Thai Nguyen	1	2,310,000	320,000
34	Quang Nam	1	2,200,000	1,000,000
35	Nghe An	1	2,000,000	2,000,000
36	Can Tho	2	1,850,000	718,113
37	Kien Giang	2	1,668,000	600,000
38	Dong Thap	3	1,600,000	440,000
39	Vinh Long	1	1,200,000	2,941,630
40	Ben Tre	1	500,000	0
41	Thanh Hoa	2	360,000	180,000
Total		**1,027**	**5,278,386,077**	**2,351,444,239**

Source: Database of MPI, Vietnam

Table A.2: Top 10 biggest Korean projects by capital size

Year	Project	Investors	Forms of investment	Registered capital (USD)	Legal capital (USD)	Implement -ed capital (USD)	Business sector	Location
1993	Orion-Hanel Co., Ltd.	ORION Electrics Co., Ltd.	Joint venture firm	297,347,000	66,372,200	193,980,800	Manufacturing electrics components	Hanoi
1996	Kumho Saigon Co., Ltd.	Kumho Construction & Engineering,Inc.	100% foreign firm	223,000,576	62,858,789	37,200,576	Building offices, houses and press centers	Ho Chi Minh city
2005	Kwang Myung Vietnam Polyclinic	Management Global Leader Corp.	100% foreign firm	198,448,835	60,136,106	0	High-quality healthcare services	Hanoi
1995	Samsung Vina Synthetics Company	Samsung Corp. and Cheil Synthetics	100% foreign firm	192,692,000	57,807,600	0	Manufacturing fibers, polyester fibers and fabric	Dong Nai
1996	Hyundai-Vinashin Shipbuilding Co., Ltd.	Huyndai Corp.	Joint venture firm	167,284,680	28,617,000	159,415,000	Ship building and maintenance	Khanh Hoa
1996	Daewoo-Hanel industrial park building Co., Ltd.	Daewoo Engineering & Construction Corp.	Joint venture firm	152,000,000	45,903,125	24,251,250	Sai Dong industrial park building and managing	Hanoi
1997	Kolon Vietnam Industrial Co., Ltd.	Kolon Industries,Inc.	100% foreign firm	147,860,000	44,358,000	0	Fibre manufacturing	Dong Nai
1999	Hanoi Daewoo public transportation Co., Ltd.	Daewoo Corp.	Joint venture firm	134,286,000	40,286,000	0	Bus services; offices, houses and press center building	Hanoi
1995	International commercial centre Co., Ltd.	Posco Engineering and Construction Corp.	Joint venture firm	91,941,635	23,353,977	92,000,500	Offices building for lease	Ho Chi Minh city
1992	Oil and gas exploring and exploiting contract	Korea National Oil Corp.	Business cooperation contract	84,000,000	84,000,000	178,348,719	Exploring and exploiting oil and gas in 11-2 plot	Vietnam continental terrance
Total capital				**1,688,860,726**	**513,692,797**	**685,196,845**		

Source: Database of MPI

Table A.3: Key changes in FDI policies in Revised Law on FDI of Vietnam

Policy areas	Law on Investment (revised in 1992)	Law on Investment (revised in 1996)	Law on Investment (revised in 2000)
Registration procedure	- Deadline for granting license: within 45 days. - FDI firms are required to register their business after being licensed.		- Issue List of projects permitted to register business without FDI license. - Leave off all kinds of registration fees.
Business forms and areas	- Encouraging joint venture firms - Restrict 100% foreign capital firms	- Foreign investors are free to choose form of investment, proportion of capital invested, location and domestic partners. - Encouraging export processing firms (especially export over 80% of the production) and high-tech firms.	- Issue List of projects calling for investment in the years 2001-2005. - Extend business areas, including housing construction. - Diversify investment forms; portfolio investment is accessible to foreigners
Land	- Vietnam local authorities are responsible for site clearance. - Foreigners shall rent land for operation, yet shall not transfer the right of land use.	- Local authorities shall undertake site clearance upon the approval of the project in the expense of investors. - Investors shall transfer the right of land use within industrial zones and export processing zones.	- Investors shall mortgage the construction attached to land and the right of land use for financial loans.
Foreign exchange	- Government shall guarantee foreign exchange balance to FDI projects invested in infrastructure development and import-substitution; Investors shall be responsible for foreign exchange balance in other business fields.	- Self guarantee of foreign exchange balance - Restrict international remittance (up to 80%) due to regional crisis. - Firms can purchase foreign currency upon the State Bank's permission.	- Firms can purchase foreign currency from commercial banks in accordance with the legal framework. - Investors are allowed to transfer capital; Fee on profit remittance abroad is reduced. - International remittance rate shall be reduced gradually from 80% to 0%.
Importation/ Exportation	- Investors shall abide by export commitment in the investment license. - FDI firms' products are not allowed to sell domestically. - FDI firms shall not be agents for export-import activities.	- Abolish export plan requirement. - Streamline import and export procedures related to certification of origins.	- Narrowing the list of business sectors, in which export proportion rate of 80% is required. - FDI firms shall be agents for export and import services; yet in accordance with Prime Minister's regulations.

Source: Extracted and revised from Le (2006) pp.144-147

Table A.4: Investment related cost in major cities in Asia in 2002

Unit: US dollars

Cost		Korea (Seoul)	Vietnam (Hanoi)	Indonesia (Jakarta)	Malaysia (Kuala Lumpur)	Philippines (Manila)	Thailand (Bangkok)
1.Wage (monthly)	Workers	966-1,520	79-116	108	208	150	163
	Engineer	1,110-1,400	184-345	205	710	237	296
	Mid-level manager	1,663-2,326	484-573	540	1.518	506	671
	Legal minimum wage	425.09	40.81	65.62	---	4.44/day	3.8
2. Land prices, office rents, etc. (monthly)	Industrial estate rents (per sq.m)	0.02	0.21	3.84-4.10	---	4.5-5	4.6
	Office rent (per sq.m)	38.07	21	14-20	15.58-17	7.49	10.13
	Housing rent for foreigners	1,723	1,660	1,800-2,800	763	1.124-1.311	1,496 - 1,726
3. Telephone expense	Telephone installation fee	49.69	84.75	49.94	Ind.: 48.68 Corp.:160 .53	Ind.: 37.43 Corp.:65.54	85.16
	Telephone charge (A: basic fee; B: charge/min.)	A:4.31; B:0.01	A:1.76 B:0.003-0.008	A:5.12 B:0.01	Ind.: A:5.79,B: 0.01 Corp.: A:11.84, B:0.01	Ind.: A:12.17, B:nil Corp.: A:24.34, B:nil	A: 2.3; B: 0.07-0.41
	International call charge	2.09	A:6.93 B:5.59	3.76	1.42	1.2	2.07
	Internet connection fee (tel.line: A: initial contract fee, B:monthly basic charge, C:connection fee/hour)	A:nil, B:8.28, C:nil	A:nil B:1.96 C:0.16-0.7	A:5.55 B:2.22 C:0.33	A:13.16 B:1.32 C:0.47	A,B: nil C:0.28-0.56	A:nil B: 13.79 C: nil
4. Public utilities (A: monthly basic charge; B: charge per unit)	Electric rate for business use (unit: Kwh)	A:3.35 B:0.04	A:0 B:0.05-0.07	A:2.72 B:0.04	A:4.55 B:0.05	A:4.12 B:0.03-0.04	A:5.10 B:0.04
	Electric rate for general use (unit:Kwh)	A:0.31 B:0.03	A:0 B:0.08-0.1	A:3.80 B:0.07	A:nil B:0.06	A:0.33 B:0.03-0.06	A:0.94 B:0.04-0.07
	Water rate for business use (unit:cu.m)	A:0.89-509.3 B:0.66-1.04	A:0 B:0.23	A:1.75-653.47 B:0.58	A:nil B:0.47	A:4.17 B:0.17-0.2	A:nil B:0.22-0.36
	Water rate for general use (unit: cu.m)	A:0.89 B:0.27-0.65	A:0 B:0.13	A:1.75 B:0.28-0.39	A:nil B:0.15	A:2.91 B:0.12-0.14	A:nil B:0.22-0.33
	Gas rate for business use (unit: cu.m)	A:nil B:0.28	0.5-0.59/kg	A:nil B:0.12	A:39.47 B:0.17	A:3.75 B:2.06	4.67/mil BTU

		Korea (Seoul)	Vietnam (Hanoi)	Indonesia (Jakarta)	Malaysia (Kuala Lumpur)	Philippines (Manila)	Thailand (Bangkok)
	Gas rate for general use (unit: cu.m)	A:0.7 B:0.38	0.65-0.72/kg	A:nil B:0.11	A:2.63 B:0.21	0.52/kg	0.34/kg
5. Transport-ation	Container transport (40 foot container to (A) Yokohama port, (B) Los Angeles port	A:600 B:2,200	A:1,470 B:3,420	A:820 B:3,570	A:884 B:3,054	A:700 B:2,400	A:1,304 B:2,704
6. Automobile	Passenger car purchase price (1500 cc sedan)	9,896	25,500	16,881	14,102	15,581	18,251
	Large Passenger car purchase price (over 2500 cc sedan)	119,186	46,000	95,660	110,148	29,206	18,457
	Regular gas price (1 liter)	1.07	0.35	0.19	0.35	0.35	0.36
7. Personal income tax rate	(highest tax rate) %	36	50	35	28	32	37

Source: JETRO (2003)
---: not available

Appendix B

Table B.1: Raw data for correlation analysis (2002)

Country	Korean Capital	GDP growth rate	Outward Openness	Growth Competitive Score	Labor	Business cost	Office rent	Transport-ation Fee
Vietnam	1,259.24	7.10	56.79	3.37	97.50	661.00	21.00	1,470.00
Indonesia	1,345.66	4.40	32.97	3.53	108.00	609.00	17.00	820.00
Malaysia	376.75	4.10	98.03	4.90	208.00	1,471.00	16.29	884.00
Philippines	538.98	4.30	45.17	3.47	150.00	381.00	7.49	700.00
Thailand	600.66	5.30	54.43	4.50	163.00	400.00	10.13	1,304.00

Source:
(1) http://www.nso.go.kr/newnso/main.html and http://www.koreaexim.go.kr/en/fdi/m02/s04_01.jsp
(2) http://www.adb.org/statistics
(3) Calculated by data of General Statistics Office of Vietnam
(4) http://www.weforum.org/pdf/Global_Competitiveness_Reports
(5) Average unskilled labor wage by JETRO (2003)
(6) JETRO (2003)
(7) JETRO (2003)

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