

Internationalization of Firms: An Analysis of South Korean FDI in India

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International flows of capital in the form of FDI are being recognized as a means of promoting economic development. Outward FDI from emerging economies enhances the competitiveness of their companies by providing access to strategic assets, technology, skills, natural resources and markets in improving their efficiency. The present paper focuses on motivating factors of outward FDI from a fast growing emerging economy - South Korea - to another emerging economy - India, over the period 2000-01 to 2012-13. FDI flows between such emerging economies challenge the well established theory which operates on the premise that the pattern of international flow of investment is from developed to developing countries. Though both South Korea and India have fairly liberal FDI policy regimes, yet the flow of FDI from Korea to India is a small percentage of its total FDI inflows. South Korean firms have penetrated those sectors in India where other countries were investing relatively less. The prime motivation for investing in India is the large size of market and low wages in the host country. But it seems that only a liberal policy regime might sometimes not be enough to attract FDI, as qualitative aspects, too, play their roles. However, there is still scope for furthering business cooperation between these two countries.

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I. Introduction

The 21st century has witnessed significant new trends in the pattern and nature of international investment in the world economy. This change has been in the form of rapidly increasing participation of emerging economies (developing and transition) in the world economy in terms of the surge of new competitive companies that operate worldwide - be it in the form of greenfield investments, or acquisition of competitive firms. Although outward foreign direct investment (OFDI) from these countries is not new and can be traced back to its modest beginnings in 1970s, it is the magnitude that this development has achieved and the motivating factors behind it, which invokes academic interest.

International flows of capital in the form of FDI are being recognized as a means of promoting economic development. OFDI from emerging economies enhances the competitiveness of their companies by providing access to strategic assets, technology, skills, natural resources, markets and in improving their efficiency. It is also a means of promoting international cooperation, especially South-South (Kwak 2007).

OFDI from emerging economies also provides a rich research agenda in the sense that this phenomenon poses a challenge to the traditional FDI theories which operate on the premise that the flow of FDI is from the developed countries to the developing countries. This phenomenon is also not fully comparable with investment by developing countries' MNEs (Multinational Enterprises) in developed countries, because this neglects the fact that an emerging country's firms undertake international activities not only in developed countries, but also in other emerging/developing countries. It is a process of internationalization, termed as the genesis of MNCs from emerging countries (Amal and Teodorescu 2011), which represents one of the major characteristics of the new phase of globalization.

The present paper focuses on OFDI from a fast growing emerging economy - South Korea - to India, another emerging economy, but not as economically developed. South Korea is too developed economically to be classified as developing but remains sufficiently underdeveloped to be considered at par with the traditional advanced countries (Kim and Rhee 2009). It is one of the main providers of FDI in Asia. Between 1968 and 2006, Korean OFDI in Asian countries was US\$ 32 billion, *i.e.* 46 per cent of its total OFDI (Kwak 2007). Most of Korea's OFDI in Asia has been in China. However, India has started attracting Korean

FDI, it being US\$ 20.67 million in 2000-01, which increased to US\$ 214.65 million in 2012-13 (up to February 2013) *i.e.* more than a 10-fold increase. Further, of the nearly 70 countries providing FDI inflows in India, South Korea ranks 13th, with a 0.64 per cent share of total FDI inflows in India (DIPP's FDI data base). Yet, there is a dearth of empirical research focussing only on FDI inflows in India from South Korea. This paper attempts to fill this gap by analyzing nature, motivation factors and policy framework for understanding the OFDI from developing countries in general and South Korean investments in India particular during the period 2000-2012.

The rest of the paper is organized as follows: Section II discusses the theory and available empirical evidence of internationalization of firms from emerging economies. Section III dwells on the details of OFDI policy of South Korea, as well as India's FDI policy changes. The trend, pattern and motivation of Korean FDI in India have been taken up in Section IV. Finally, major conclusions and policy implications that emerge have been presented in Section V.

II. Internationalization of Firms from Emerging Economies: Theory and Empirical Evidence

Internationalization of firms from emerging economies through OFDI is receiving increasing attention from policy makers and academia alike. This is because the established pattern of international operation of firms has been a flow of investment from developed to developing countries. The well established wisdom which explains this phenomenon has been challenged not only by the process of FDI from emerging economies to developed economies, but also by FDI from emerging economies to other emerging economies.

The theoretical perspectives on the international operation of firms evolved with focus on how firms place their assets abroad. While Hymer (1960) opined that a firm should have competitive advantage so as to exploit market imperfections to expand business, Vernon (1966) focussed on seeking foreign markets as an opportunity for minimizing marginal costs and enhancing a product's profitability by reproducing abroad the same methods applied in the home market. It was Dunning (1980) who integrated in a single model the various theoretical perspectives of international expansion of firms. Dunning's Eclectic Paradigm, or the OLI theory, focuses on the unique competitive advantage in the form of

ownership (O), location (L) and internalization (I) which allows a firm to acquire monopolistic or oligopolistic power in the market and expand business internationally through investments, mergers and acquisitions. A complementary model to Dunning's Eclectic Paradigm - the Investment Development Path (IDP) - provides a framework to understand the relationship between FDI and the level of development of a given country (Dunning and Narula 1996). The IDP model identifies five different stages/development levels of countries where these progress from being only a FDI destination to perform FDI (Appendix 1). This approach identifies three motives to FDI - efficiency seeking, market seeking, and strategic asset seeking.

The internationalization of firms from developing/emerging countries does not possess the unique competitive advantage as inherited by the firms of developed countries, so these firms internationalize to acquire competitive advantage (Nayyar 2008). Theoretical developments providing an explanation based on the experiences of advanced countries are thus inadequate to explain the spirit of internationalization of firms from emerging economies. Hence, Mathews (2006) in his work developed a plausible explanation that firms of emerging economies invest overseas to secure strategic resources for enhancing learning capabilities of the firm. Dawar and Frost (1999) pointed towards the use by emerging multinational firms of defensive and assertive options leveraging on some of the unique assets or resources. Khanna and Palepu (2006) argued that emerging multinational firms of developing countries possess distinct advantage to deal with institutional voids which can be exploited to counter foreign multinational firms in the local economies and can also be extended to international markets. It has also been argued that the emerging economy multinationals use existing ownership advantage to pursue the acquisition of complementary resources and capabilities that is required to developed potential competitive advantage for survival in the more competitive environments (Aulakh 2007).

Empirical evidence based on country/region studies on the drivers and motivations of OFDI from emerging economies categorise these into two waves: The first wave is said to occur during the 1960s and 1970s, when efficiency and market seeking factors (*i.e.* push factors) drove firms to invest in other developing (and often neighbouring) countries. These firms were primarily from Asia (China, South Korea, India, *etc.*). In the second wave beginning 1980s, a combination of push and pull factors (mainly the pull factor of strategic asset seeking) drove firms from developing countries to invest more in developed countries or in

developing countries outside their region. Again, South Korea and China were identified as the main players in this wave (Dunning *et al.* 1996).

While examining the trend, pattern, and determinants of OFDI from China and India, covering a period of 1990-2010, Gill and Singh (2012) found that internationalization of firms from China and India has been driven by push factors that enable firms to acquire resources, markets and technologies. The trend of both India and China was observed to be towards developed economies. However, more Asian economies find place in China's OFDI than in India's OFDI. Kim and Rhee (2009) tested the determinants of South Korean OFDI using macroeconomic factors of host countries. They found that while market seeking was a key motivation for South Korea's OFDI, the motive to acquire strategic assets was also important, irrespective of the fact whether the investment was to be in developed or developing countries. For developing countries in particular, Korea's OFDI was motivated by potential market attractiveness including low wage levels and strategic assets. They also examined the validity of traditional theories of FDI in explaining the investment behaviour of South Korean firms at stage 3 or 4 of the IDP and found that the behaviour does not completely comply with the traditional theories of FDI.

Moon (2007) examined the drivers and motivations of Korean OFDI and their impact on firms' competitiveness using an extended version of Porter's diamond model (Appendix 2) by including factor conditions, demand conditions and strategy, structure and rivalry and related and support sectors. According to him, Korean OFDI has been mainly due to a saturated market at home, cost disadvantages, competition, and a search for cheap labour. Kwak (2007), in an intensive study of investment strategies and corporate motivations for Korean OFDI, listed rising domestic wages, interest rates, exchange rates, limited domestic market and regulation as the domestic push factors, while the need of natural resources, export markets, technology and improved efficiency were identified as the global pull factors. The characteristics of Korea's outward FDI particularly in Asia as examined by Yoon (2007) identified low labour cost combined with low transport cost as the reasons behind Korea's OFDI concentration in Asia.

Thus there are multiple factors that drive internationalization of firms from emerging economies. These range from market access for exports, access to technology, cost disadvantages, and a search for cheap labour. In the particular case of South Korea, recent empirical studies point mainly towards market seeking and search for cheap labour as the

prime motives, especially in case of its FDI in other developing/emerging economies. Korean OFDI is concentrated in China but needs to contemplate diversifying to other countries (Moon 2007; Kwak 2007; Yoon 2007). The present paper is an attempt to study and analyze Korean FDI in another giant sized emerging economy *i.e.* India, which is and should increasingly catch South Korea's interest (with its liberalized FDI norms, low wages *etc.*) so far as FDI is concerned. Such a study based only on these two emerging economies would be distinct from the previous, aforementioned studies that have largely concentrated on Korean OFDI in Asia/other emerging economies in totality.

III. Public Policy towards FDI: South Korea and India

There is no doubt about the fact that of the factors driving investment flow to/from a country, policy regime is of utmost significance, apart from macro fundamentals. It is the public policy which mainly determines the promotion (or restraint) of foreign investment flows in/from a country. Hence, in this section, keeping in line with the theme of this paper, the outward FDI policy framework of Korea will be reviewed. Along with this, the FDI policy in India will also be discussed to examine whether India is sufficiently geared up to attract FDI inflows in the current environment of intense competition among developing countries to attract FDIs. These observations will also reveal the extent of attractiveness of Indian investment environment specifically for South Korean OFDI motivations.

A. South Korea's OFDI Policy

The evolution of South Korea's OFDI policy can be traced back to 1968, when the Korean Government introduced articles on foreign investment law. As can be seen from Appendix 3, four stages of Korea's OFDI policy have been identified (Moon 2007). Though the laws governing OFDI were restrictive in the beginning (stages 1 and 2) the Government actively encouraged OFDI since 1980 (stage 3), when its international debt position eased, by relaxing many of the restrictive conditions. These relaxations continued through mid 80s to the first decade of the next century also (stage 4).

South Korea recognized the indispensability of OFDI towards the end of 1960s, with the passing of the Act of Foreign Exchange Management in December 1968. However, permission to make foreign investments

was only for sectors which could contribute to export promotion. To meet the demands of growing exports, raw materials and overseas construction projects, the South Korean government established the Guiding Principles of FDI and Post Investment Management under the authority of Bank of Korea. Then in 1978, rules for the Approval of Foreign Investments were framed which required prior approval permission to invest abroad (Pattnaik and Kwon 2006).

The second oil crisis and its aftermath saw the Korean government simplifying foreign investment regulations, and the prior approval of the business investment plan was done away with. In the later half of the 1980s, with a surplus balance of payments, and rise of input prices in the domestic market, combined with the external revaluation of Won, foreign investment was actively encouraged by the South Korean government. The period 1986-90 saw more processes and pre-requisites for foreign investment relaxed. From early 1991, the Korean government began transforming its role as a regulator of foreign investment. A series of laws were passed to support OFDI by Korean firms. The Law of Foreign Exchange Management was revised in 1991 as a result of which autonomy in foreign investment became a standard norm. To facilitate foreign investors, the Korea Development Bank and the Industrial Bank of Korea were also authorized to provide foreign investment permission. Lower limits of outward investment requiring prior government approval were also raised to US\$ 50 million. Affiliates of Chaebols (big business groups) directed foreign investment towards Asia (mainly China) during this period.

In 1997, South Korea became a member of OECD. Following this, the government transferred considerable authority on issues of foreign investment policy to the non-governmental sector, and the domain of foreign investment activities moved to the private sector (Pattnaik and Kwon 2006). Permission procedures were further simplified. The economic crisis of 1997 led to decline in foreign investment, hence post-crisis, the foreign investment system witnessed aggressive deregulation. The Korean government did away with the General Guidelines for Foreign Investment and Guidelines for the Purchase of Foreign Real Estate. Since 1999, the support ratio for foreign investment to develop mines and mineral industry was raised to 90 per cent of total investment. After the economic crisis, especially from 2001 although more authority and discretion on FDI policy issues were transferred to the private sector, public policy moved towards monitoring the activities of overseas subsidiaries of Korean firms.

Some changes were brought about in recent years to promote Korean OFDI. Korea Investment Corporation (KIC) was established in 2005, mainly to manage foreign exchange reserves. Post-2005, the Korean Ministry of Finance and Economy launched an aggressive promotion plan for OFDI. Under this, it raised the investment limit from US\$ 1 million to US\$ 10 million for individual overseas investors. Financial support from the Export-Import (EXIM) Bank of Korea was also increased by raising the limit of loan up to 90 per cent in case of investment for transfer of technology. The Government extended support for the establishment of financial organization subsidiaries in host countries of Korean FDI, such as China and Vietnam. To reduce risks of overseas investment, new insurance policies for investor Korean firms were also announced. Support through co-financing with Multilateral Development Banks, and a one-stop service centre for foreign investment to supply user friendly information, is some of the other state sponsored and promoted measures to encourage OFDI (Moon 2007). It is pertinent to note that the Korean government supports and promotes its outward FDI through four measures: (i) financial support (extended by EXIM Bank of Korea), (ii) taxation (avoidance of double taxation vide Double Taxation Avoidance Agreement, under which Korean enterprises can subtract the corporate tax paid abroad from their domestic corporate tax liabilities), (iii) overseas investment services (provided by the Korea Export Insurance Corporation) which include export credit insurance against non-payment risks by buyers, covers war and civil disturbances *etc.* and the threat of contract risks inherent in new investment overseas; (iv) institutional services such as administration and information (provided mainly by The International Management Institute which provides consultation services to Korean small and medium enterprises investing abroad (Kim and Rhee 2009).

It is evident that the Korean government has played an active role in internationalization of firms by liberalizing the regulatory environment supporting OFDI and providing institutional support and other incentives. "The role of the Korean government has transformed from that of a rule setter to a regulator to that of a facilitator of foreign investment" over a period of time (Pattnaik and Kwon 2006, p. 19).

B. India's FDI Policy

At the time of attaining independence in 1947, India had FDI stocks largely owed to her colonial master *i.e.* United Kingdom. Post-independence,

when India embarked on a strategy of industrialization with active governmental intervention, it had important bearings on its FDI position also. The government's attitude towards foreign investments evolved in four distinct phases: (i) the period from 1947 to late 1960s was that of a gradual liberalization of attitude, (ii) 1960s to 1970s was a period of selective stance, (iii) certain liberalization of policy marked 1980s, and (iv) a liberalized policy regime beginning 1991 with respect to both inward and outward FDI (Kumar 1995a). However, we will follow a more convenient division of the pre-liberalization period (before 1991), and the post-liberalization period (post 1991).

Keeping the objective of 'self-reliance' in the period proceeding independence, the Indian government's policy was that of encouraging FDI through foreign collaboration in high technology areas to build national capability, but to discourage it in low technology areas to protect domestic industries. In 1968, a Foreign Investment Board (FIB) was established to deal with cases involving foreign investment/collaboration with up to 40 per cent foreign equity. The Foreign Exchange Regulation Act (FERA) of 1973, allowing foreign equity holding in a joint venture only up to 40 per cent, acted as a regulator. Exceptions were made for companies in high technology sectors, tea plantations or for production for exports. The period 1968 to 1979-80 saw policies designed to protect local expertise, and can be said to see the completion of India's transition to stage two of IDP (Kumar 1995a).

The outcome of the policies in favour of highly protected local market was a negative impact on India's export competitiveness, as it had led to technological obsolescence and high cost. Hence, some exemptions were given to foreign companies in the form of allowing equity holdings over 40 per cent, if these were operating in high technology areas. The government established special economic zones (SEZs) and provided liberal incentives for promoting FDI in these zones. Partial liberalization in trade and investment policy were introduced in the 1980s. The Industrial Policies of 1980 and 1982 and Technology Policy of 1983 adopted a liberal attitude towards foreign investment by relaxing industrial licensing approval rules, exemption from foreign equity restrictions under FERA to 100 per cent export oriented units, tariff reduction, and shifting of large number of items from import licensing to Open General Licensing (OGL). A 'fast channel' was set up in 1988 for expediting clearance of FDI proposals from major investing countries. The 1980s saw Japan becoming a major source of FDI in India, along with US, UK and Germany.

In 1991, to overcome the crisis of adverse balance of payments, coupled with political uncertainty, India embarked upon an economic liberalization and reforms program vide the announcement of a New Industrial Policy (NIP) in July 1991. The policy aimed at gradual removal of restrictions on investment projects and increased access to foreign technology and funding. A Foreign Investment Promotion Board (FIPB) was set up to provide a single window clearance to facilitate investment in India by international companies. A number of measures to liberalize foreign investment were taken which included: (i) introduction of dual route of approval of FDI *i.e.* Reserve Bank of India's (RBI's) automatic route and the Government's approval route Secretariat for Industrial Assistance (SIA)/FIPB); (ii) automatic permission for technology agreements in high priority industries, and removal of restriction of FDI in low technology areas, along with liberalization of technology imports; (iii) permission to Non-Resident Indians (NRIs) and Overseas Corporate Bodies (OCBs) to invest up to 100 per cent in high priority sectors (iv) raising foreign equity participation limits to 51 per cent for existing companies and liberalization of the use of foreign brands name; (v) signing the convention of Multilateral Investment Guarantee Agency (MIGA) for protection of foreign investments. In addition to these measures, the FERA Act of 1973 was replaced by the FEMA (Foreign Exchange Management Act) in 1991, which was much less stringent (RBI 2013).

The RBI deals with the investment proposals under the automatic route and matters related to FEMA, while the Government handles investment through approval route and issues relating to FDI policy, through three institutions - FIPB, SIA and FIIA (Foreign Investment Implementation Authority). Under the automatic route, without taking prior approval, the investors are only required to notify the RBI (in its concerned regional office) within 30 days of issuance of shares to foreign investors. Under the approval route, it is the FIPB which considers proposals and gives its recommendations. FDI in India is banned in atomic energy, lottery business, chit funds and nidhis, gambling and casinos, real estate business, construction of farm houses and sectors not open to private investment (*e.g.* rail transport). Latest sector specific limits of foreign investment in India are given in Appendix 4.

India, thus, has a fairly liberal policy regime so far as FDI is concerned.

TABLE 1
GLOBAL TRENDS OF OUTWARD FOREIGN DIRECT INVESTMENT: 1990-2012
(Stock in US\$ million)

Year	World	Developing Economies	Share of Developing Economies in World	S. Korea	Share of S. Korea in Developing Economies
1990	2091496	144664	6.92	2301	1.59
1991	2344609	158934	6.78	3328	2.09
1992	2384763	184730	7.75	4425	2.39
1993	273189	222454	8.02	5441	2.45
1994	3110850	276643	8.89	9720	3.51
1995	3791296	330343	8.71	13280	4.02
1996	4307598	385233	8.94	17266	4.48
1997	4988219	558687	11.20	19550	3.50
1998	5940651	574708	9.67	19090	3.32
1999	7217762	725617	10.05	19190	2.64
2000	8025834	905229	11.28	21500	2.38
2001	7804039	968489	12.41	19970	2.06
2002	7891989	978044	12.39	20730	2.12
2003	10053730	1079141	10.73	24990	2.32
2004	11845887	1245651	10.52	32170	2.58
2005	12575883	1447274	11.51	38680	2.67
2006	15766400	1931532	12.25	49190	2.55
2007	19343062	2648119	13.69	74780	2.82
2008	16511202	2613175	15.83	97910	3.75
2009	19518956	2980331	15.27	120440	4.04
2010	21130046	3484157	16.49	143160	4.11
2011	21441873	3928686	18.32	171530	4.37
2012	23592739	4459356	18.90	196410	4.40

Source: Derived from UNCTAD: unctadstat.unctad.org/tableviewer/download.aspx?x (accessed on 20 July 2013).

IV. South Korean FDI in India: Trends, Pattern and Determinants

The growing internationalization of firms from developing countries can be judged from the outflows of FDI from these countries. According to World Investment Report 2013, developing economies generated almost one-third of global FDI outflows, continuing a steady upward trend. On the other hand, FDI outflows from developed countries dropped to a level close to the trough of 2009.

Table 1 gives the global trends of OFDI over a 23 year period, from 1990 to 2012. While the stock of world OFDI increased from US\$

TABLE 2
FDI INFLOWS AND OUTFLOWS FROM KOREA AND INDIA
(US \$ million)

Year	S. Korea		India		Outward-Inward Ratio	
	Inward	Outward	Inward	Outward	S. Korea	India
1990	788.50	1051.60	236.69	6	1.33	0.03
1991	1179.80	1488.60	75.00	-11	1.26	-0.15
1992	728.30	1161.50	252.00	24	1.59	0.10
1993	588.10	1340.00	532.00	0.35	2.28	0.00
1994	809.00	2461.10	974.00	82	3.04	0.08
1995	1775.80	3552.00	2151.00	119	2.00	0.06
1996	2325.40	4670.10	2525.00	240	2.01	0.10
1997	2844.20	4449.40	3619.00	113	1.56	0.03
1998	5412.30	4230.20	2633.00	47	0.78	0.02
1999	9333.40	3795.60	2168.00	80	0.41	0.14
2000	9283.40	4481.50	3587.99	514.45	0.48	0.14
2001	3527.70	2195.70	5477.64	1397.44	0.62	0.26
2002	2392.30	3024.20	5629.67	1678.04	1.26	0.30
2003	3525.50	4135.30	4321.08	1875.78	1.17	0.43
2004	9246.20	5650.80	5777.81	2175.37	0.61	0.38
2005	6308.50	6366.30	7621.77	2985.49	1.01	0.39
2006	9046.80	12514.10	20327.76	14284.99	1.38	0.70
2007	8960.50	21607.10	25349.89	17233.76	2.41	0.68
2008	11195.30	20289.40	47138.73	21147.36	1.81	0.45
2009	8960.70	17392.40	35657.25	16031.30	1.94	0.45
2010	10110.10	28357.20	21125.45	15932.52	2.80	0.75
2011	10246.50	28998.60	36190.40	12456.13	2.83	0.34

Source: Derived from UNCTAD (2013).

Note: Outward-Inward Ratio figures are up to two decimal points only.

2091496 million to US\$ 23592739 million over this period, registering an 11-fold increase, developing economies registered a whopping 31 fold increase over the same period. The share of developing economies in world OFDI stock increased from 6.92% in 1990 to nearly 19% in 2012. The table also reveals South Korea's share in OFDI. Its OFDI stock increased from US\$ 2301 million to US\$ 196410 million over the same period, meaning an 85-fold increase. Korea's share in developing economies OFDI stock increased from 1.59 per cent in 1990 to 4.4 per cent in 2012, while its share in world OFDI stock also registered an increase from 0.11 per cent to 0.83 per cent over the same period.

Table 2 gives the inflows and outflows of FDI from Korea and India, as well as the outward to inward ratio from 1990 to 2011. This will

TABLE 3
INFLOWS OF FDI FROM S. KOREA IN INDIA

(US \$ in million)

Financial Year (April-March)	FDI equity inflows from S. Korea	FDI equity inflows from all countries	Percentage (of column 2 to column 3)
(1)	(2)	(3)	(4)
2000-01	20.67	2463.0	0.84
2001-02	1.00	4065.00	0.02
2002-03	39.17	2705.00	1.45
2003-04	23.90	2188.00	1.09
2004-05	34.56	3219.00	1.07
2005-06	60.18	5540.00	0.09
2006-07	70.89	12492.00	0.57
2007-08	99.52	24575.00	0.40
2008-09	114.64	31396.00	0.36
2009-10	166.88	25834.00	0.65
2010-11	131.35	21383.00	0.61
2011-12	244.79	35121.00	0.70
2012-13 (up to February)	214.65	19103.00	1.12
Total	1222.21	190084.00	0.64

Source: Adapted from Data Base of Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry.

indicate the importance of FDI for both these economies. It is observed from the table that Korea's outward FDI during the mentioned period was higher than its inward FDI inflows, except for a four year period from 1998 to 2001. During this period, Korea's increasing trend of OFDI fell dramatically as a result of the financial crisis in 1997-98. The post-crisis restructuring measures included closing down of foreign subsidiaries and delaying (or even cancellation) of investment plans abroad which explains the fall in its OFDI. Korean OFDI began to recover 2002 onwards, with its outward-inward ratio depicting outflows much more than inflows. On the other hand, India's inflows have been higher than its outflows throughout the period.

Table 3 gives details of inflows of FDI from Korea in India from April 2000 till February 2012. FDI equity inflows from Korea increased from US\$ 20.67 million in the year 2000-01 to US\$ 214.65 in 2012-13., i.e. a 10-fold increase. A comparison of Korean FDI inflow in India with total FDI inflows in India from all countries reveals that Korea's share was

TABLE 4
TOP FIVE SECTORS ATTRACTING FDI EQUITY INFLOWS IN INDIA
FROM S. KOREA (APRIL 2000 TO FEBRUARY 2013)

Sr. No.	Sector	FDI equity inflow from S. Korea in this sector in India (US\$ million)	Percentage of total FDI equity inflows from S. Korea*	FDI equity inflows in this sector in India from all countries** (US\$ million)	S. Korea's share in FDI equity inflows in India in this sector
1.	Metallurgical Industries	316.99	25.94	7426.21	4.27
2.	Prime Mover (other than electrical generators)	125.24	10.25	768.99	16.29
3.	Machine Tools	99.44	8.14	622.77	15.97
4.	Automobile Industry	79.75	6.52	7652.59	1.04
5.	Electronics	72.21	5.91	1197.62	6.03
	Total of above five sectors	693.63	56.76	17668.18	3.93

Source: Calculated from Data Base of Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry.

Note: (i) *Total FDI equity inflow in India from S. Korea is US \$ 1222.21 million in the period 2000-2013, as given in Table 3.

(ii)** Figures are from April 2000 to January 2013.

0.84 per cent in 2000-01, which increased to 1.12 per cent in 2012-13. In between this period, Korea's share registered considerable fluctuations.

Destination-wise analysis shows that, though North America was Korea's favourite destination for OFDI in early 1990s, thereafter Asia became its preferred destination. Till end 2012, South Korean OFDI in China was US\$ 39.67 billion, in Hong Kong US\$ 14.18 billion, US\$ 8.38 billion in Vietnam, and US\$ 3.81 billion in Japan (Business Line 2013). It is amply clear that India figures quite low on the list of preferred destinations for Korean OFDI, with a rank of 16 worldwide (and rank of 13 in case of inflows in India from all countries).

Tables 4 and 5 give the sector-wise position of FDI flows in India from Korea as well as from other countries. Table 4 gives the top five sectors in India which have been attracting Korean FDI inflows from

TABLE 5
 TOP 10 SECTORS IN INDIA ATTRACTING FDI EQUITY INFLOWS FROM ALL
 COUNTRIES (APRIL 2000 TO JANUARY 2013)
 (US\$ million)

Sr. No.	Sector	Equity Inflows (US\$ million)	% of total FDI inflows in India
1.	Services Sector	37062.75	19.51
2.	Construction Development	21953.51	11.56
3.	Telecommunications	12645.05	6.66
4.	Computer Software and Hardware	11640.37	6.13
5.	Drugs and Pharmaceuticals	10202.44	5.37
6.	Chemicals (other than fertilizers)	8856.89	4.66
7.	Power	7824.56	4.12
8.	Automobile industry	7652.59	4.03
9.	Metallurgical Industries	7426.21	3.91
10.	Hotel and Tourism	6561.78	3.45

Source: Adapted from FDI Database of Department of Industrial Policy and Promotion.

April 2000 to February 2013. These sectors are - metallurgical industries, prime mover, machine tools, automobile industry, and electronics. While metallurgical industries in India attracted nearly 26 per cent of Korean FDI in India during a twelve year period, the other sectors did not attract as much FDI. Overall, around 57 per cent of Korea's FDI inflow in India from 2000-2013 (February) was absorbed by these five sectors. These figures confirm that for Korean FDI in India also, Korea's competitiveness lies not in the service industry, but in manufacturing, just as is the case of Korean OFDI in the other countries of the world. The picture becomes clearer if we also take into account the figures given in Table 5. The list of top 10 sectors in India attracting FDI equity inflow from all countries shows that here metallurgical industries occupied the ninth place, while automobile industry occupied the 8th place. The other top sectors listed in Table 4 do not find a place in Table 5. This means that Korean firms have penetrated in those sectors where other countries were investing relatively less in India, so that these had competitive advantage in these sectors. Low wage rates in India (lower than those in China), and gaining access to India's large domestic market could also be the motivation for Korean manufacturing companies in India.

To capture the phenomenon empirically, an attempt has been made in this study to test the determinants of Korea's OFDI in India, taking

up some macroeconomic factors of host countries (as in Kim and Rhee 2009). The logic behind taking up these factors is that these affect all MNEs uniformly.

Data on the flow of Korean FDI to India has been taken up for the period 2000-01 to 2011-12, *i.e.* a twelve year period. The dependent variable is thus, the Korean OFDI in India (Y) at the end of time period denoted by ' t '. The specifications and expected behaviour of the key macro-economic determinants of FDI has been explained as follows:

Exchange Rate (X_1): This variable represents India's yearly average exchange rate in US\$. This variable is expected to be negatively associated with OFDI. A weaker host country currency attracts FDI as depreciation makes the assets of host country less expensive relative to assets in the home country.

Inflation Rate (X_2): This refers to India's (host country) yearly average inflation rate. This is also assumed to be negatively associated with OFDI. Lower inflation rate attracts higher FDI inflows.

The variables X_1 and X_2 are assumed to be negatively associated with OFDI, because high inflation rates and steady exchange rates are damaging for backward supply linkages with the home country. The firms repatriate part of the profits and also engage in imports and exports transactions. Therefore, exchange rate of currency and rate of inflation in host country has profound impact on these transactions.

GDP per capita (X_3): This represents India's gross domestic product per capita in US\$.

Wages (X_4): Average annual industrial wages in India (in US\$). It is assumed that foreign investors make efficiency-seeking investments in low wage countries to reduce costs. Developing countries like India offer lower wages and factor costs. In this context we can hypothesise that Korea's FDI in India is negatively associated with wages in India, *i.e.* lower the wages, higher the expected inflow of Korean FDI in India.

GDP (X_5): This is India's gross domestic product in US\$ million.

Patents (X_6): These refer to the number of annually applied for patents in the host country. The rate of patenting in the host country (India) is hypothesized as being positively associated with Korean FDI flows in India. Patent data serves as a proxy for intangible strategic assets of a country. Firms invest in countries possessing high levels of human and intellectual capital.

Population (X_7): This represents the host country's year end population in millions.

The variables X_3 , X_5 and X_7 are assumed to be positively related with

FDI inflows. Firms have a tendency to undertake FDI in large-sized markets so as to compensate the cost of investment. Market potential is usually judged from the size and growth of GDP (X_5) or the size of population (X_7). GDP per capita (X_3) is a relative indicator of market size.

Thus, the model that would indicate the determinants of Korea's FDI inflows in India would be:

$$Y_t = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \beta_7 (X_7) + \mu_t$$

When all the variables put together to estimate the regression equation, the independent variables turned out to be collinear. Therefore, we have relied on using a step-wise linear regression equation to avoid this problem. The diagnostic tests clearly bring out the fact that model used in the analysis is suitable and the parameters are meaningful and significant. The results are summarized in Table 6 as follows:

TABLE 6
RESULTS OF STEP-WISE REGRESSION

	Step 1	Step 2	Step 3
Constant	-54.0052	86.8706	107.1751
X_1	-	-	-
X_2	-	-	-7.35245** (-3.100)
X_3	-	-	-
X_4	-	-0.19906** (-3.039)	-0.19310* (-4.120)
X_5	0.0014886* (9.254)	0.0027969* (6.26)	0.0029703* (9.162)
X_6	-	-	-
X_7	-	-	-
Adjusted R^2	0.885	0.937	0.968
Model test: F	85.64*	82.70*	111.10*
Akaike Info. Crt	9.36	8.82	8.19
Mellows Cp	24.16	13.95	8.52

Source: Author's Estimates

Note: (i) Figures in parentheses are t-values.

(ii) * implies significant at 1 per cent level.

** implies significant at 5 per cent level.

From the results obtained, it is evident that GDP (X_3), wages (X_4) and inflation rate in the host country (X_2) are the most important determinants of Korean FDI inflows in India. These have the expected signs, *i.e.* relation with FDI inflows. While wages and inflation have the expected negative sign, FDI inflow is positively related with GDP. The empirical results show that Korean OFDI favours large markets and low wages. High inflation rates are a deterrent for FDI inflows. The preference for large markets in the host country is indicated by the GDP, which is positively associated with FDI inflows and is significant in our results. This finding is in some consonance with what Kim and Rhee (2009) observed in their model (for only developing countries).

However, it is surprising that India's high population did not turn out to be a determinant of South Korean FDI flow in India. This may probably be due to the fact that the entire large population of India does not have purchasing power, with poverty levels being high. Purchasing power is limited to the rich and the dominant middle class in India. Hence, population as a representative of purchasing power is not significant. India's large domestic market (indicated by GDP), thus, seems to be the biggest motivation for FDI inflows from Korea.

V. Conclusions and Policy Implications

The present paper is a modest attempt to study various aspects of Korea's FDI inflows in India. Along with the theoretical framework, the policy developments regarding FDI for both Korea and India have also been outlined. The study has used a slightly different approach in that it examines the influence of a single host country's (India's) macro economic factor on FDI inflows from another single country (Korea). The fact that both these countries are emerging (though at different levels/stages of development) is also a distinct feature of this study.

It emerges from the study that though Korea's FDI inflow in India is growing, its extent and pace does not present a very satisfactory picture. FDI inflows from Korea in India as a percentage of FDI inflows in India from all countries are quite low, although it is slowly increasing, especially since 2011.

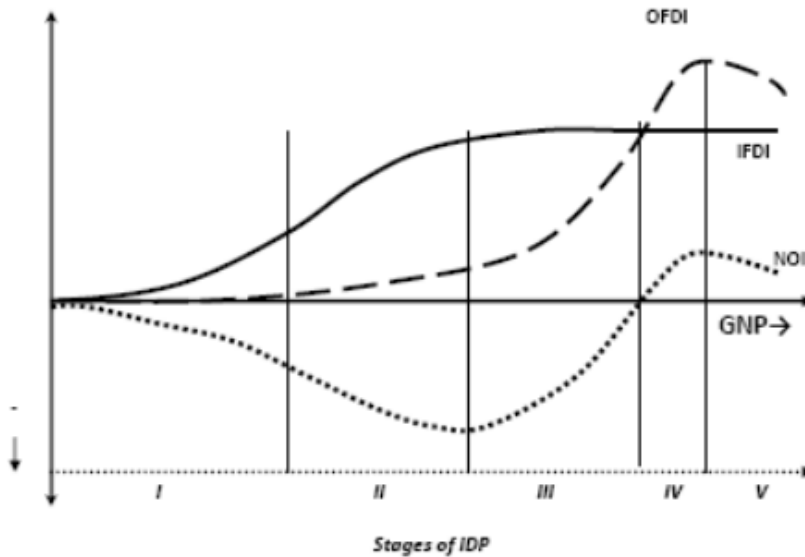
However, it is encouraging that Korea's OFDI policy is increasingly improving the regulatory environment to support outward investment. Also, the fact is that Asian countries are favoured by Korea for FDI outflows. Strong institutional support and promotion measures provide

ample opportunities to Korean investors investing abroad. On the other side, India's FDI policy offers a fairly liberal regime and is catching up with the liberalized policy stance of many other emerging economies of the world. Repatriation of dividends, norms for owning equity *etc.* are some of the FDI-encouraging policy stances. This liberal policy is supported by favourable macroeconomic fundamentals like low wages, a large market size with increasing appetite and purchasing power of its dominant middle class, and its comparative advantage in IT software, auto components *etc.* These can serve as a perfect complement to Korea's capabilities in electronic hardware, automobiles, machines and metal-lurgy. Thus, there are ideal opportunities for both countries to engage in further business cooperation. India is already a highly preferred investment destination (World Investment Report 2013) especially among Asian countries, and Korea can help in boosting this image further, reaping gains for its own economy in return.

There are, no doubt, a few hiccups that are believed to hamper FDI inflows in India. These may be labelled as "qualitative parameters" (RBI 2013) - time to lease private land, access to information, judicial assistance *etc.* - which are relatively conservative in India. Such parameters lead to procedural delays and act as a disincentive for foreign investors. Further, in many cases, sectoral caps are low due to apprehensions regarding losses on the domestic front (*e.g.* FDI in multi brand retail, insurance). But it is important to note that India is a democratic country committed to 'growth with equity and social justice'. Hence it is imperative to take hard decisions at times. Nevertheless, mutual cooperation and understanding can resolve many of the aforementioned problems to the economic benefit of both the countries.

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Appendix 1. Graphical representation of the IDP



Source: Narula and Dunning, 2010, reproduced in Narula and Guimon (2010).

Note: Only for illustrative purpose. Not drawn in scale.

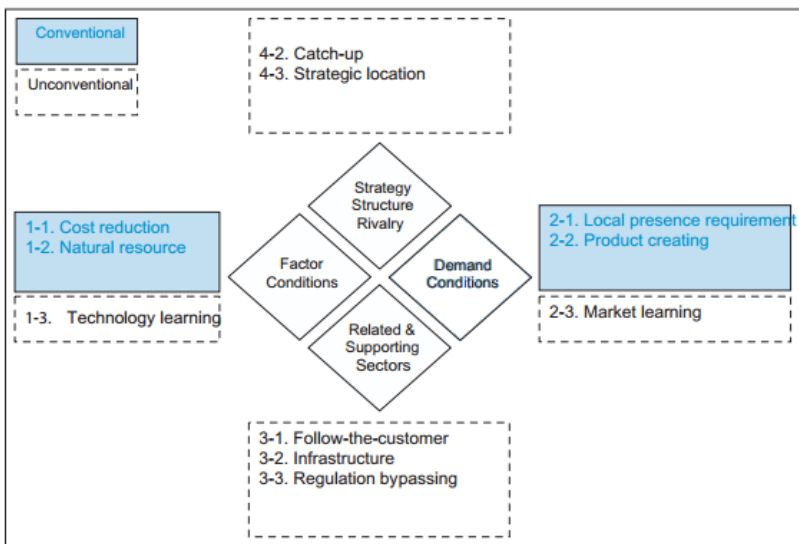
Stages of IDP:

The first stage of the IDP reflects the situation in most of the least developed countries, where both inward and outward FDI are very small. The country lacks O or L advantages, often due to the combination of a limited domestic market, lack of infrastructure, low-skilled labour force and inappropriate institutions and government policies. In stage 2 inward FDI (IFDI) grows significantly thanks to the development of some L-specific advantages that raise the country's attractiveness to MNEs. However, outward FDI (OFDI) remains very limited because the O-advantages of domestic firms are still weak, giving rise to an increasingly negative net outward investment (NOI) position. At stage 3, OFDI increases as domestic firms become more competitive in comparison to foreign firms. In this stage OFDI may surpass IFDI flows, but the IFDI stock remains higher (and hence the NOI position remains negative). In stage 4, the NOI position turns positive after continued growth in OFDI underscoring the development of O advantages. Finally, in the most developed countries (stage 5) the expected outcome is an unstable equi-

librium around zero, although often this unstable equilibrium is not achieved at zero but rather around a substantially positive or negative position. It is worth emphasising two points. First, that these stages are indicative. Second, progress within stages and between stages is by no means 'automatic'. Countries may move backwards as well as forward.

Source: Narula and Guimon (2010).

Appendix 2. Extended Diamond Model



Source: Adapted from Moon, Rugman and Verbeke (1998) and Moon and Roehl (2001), reproduced in Moon (2007)

Appendix 3. Korean OFDI Policy Developments

Korean OFDI policies in general can be classified into 4 specific stages:

Stage 1: Introduction (1968-1974)

In 1968, the Republic of Korea's Government introduced four articles on foreign investment law under the foreign exchange regulation. Article 131 refers to the approval of foreign investment. It states the establishment of overseas subsidiary as an exception. To acquire foreign stock,

real estate or bond, approval of the Ministry of Finance is required. The investor must submit required documents, including contract paper, permission by the host Government, business plan, acknowledgement, and other required documents.

Stage 2: Growth (1975-1979)

Due to an increase in OFDI activities, the Republic of Korea's Government revised the laws on OFDI in 1975 and 1978. In 1975, the Ministry of Finance enacted foreign investment approval and post management guide and in 1978 the Bank of Korea established the by-laws on foreign investment approval operations. The approval requirement was needed. Investing companies had to get prior approval of their business plans by the president of the Bank of Korea before concluding a joint contract or acquiring the warrant by the host Government. The attempt of the Government to control capital flight from the country pushed the introduction of controls.

Stage 3: Encouragement (1980-1985)

During this period, the Government liberalized the law relating to OFDI. Revisions were made in 1981, 1982 and 1983. Many restrictive conditions for OFDI were relaxed. In July 1981, the requirement of three years business experience, host country condition were relaxed and streamlined, and pre-approval process on OFDI plan was abolished. In July 1982, the rate of investment was relaxed and in December 1983, restriction on the credit limit of profit reservation was also relaxed.

Stage 4: Openness (1986-2004)

Since 1986, the Korean economy has recorded trade surpluses and thus OFDI was more actively encouraged. Increasing wage costs and deterioration of labour-management relations also drove firms to go abroad. The Korean Government has relaxed most of the OFDI-related regulations including the investment ceiling for venture capitalists. In 2003, a new enforcement ordinance in foreign trade law was established, which included support for OFDI by Korean firms by solving obstacles faced by Korean firms operating abroad.

Source: Moon (2007)

Appendix 4. Sector Specific Limits of Foreign Investment in India

Sector	FDI Cap/ Equity	Entry Route	Other Conditions
A. Agriculture			
1. Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisciculture, Aquaculture, Cultivation of vegetables & mushrooms and services related to agro and allied sectors.	100%	Automatic	
2. Tea sector, including plantation	100%	49% Automatic FIPB Rest through	
(FDI is not allowed in any other agricultural sector /activity)			
B. Industry			
1. Mining covering exploration and mining of diamonds & precious stones; gold, silver and minerals.	100%	Automatic	
2. Coal and lignite mining for captive consumption by power projects, and iron & steel, cement production.	100%	Automatic	
3. Mining and mineral separation of titanium bearing minerals	100%	FIPB	
C. Manufacturing			
1. Alcohol- Distillation & Brewing	100%	Automatic	
2. Coffee & Rubber processing & Warehousing.	100%	Automatic	
3. Defence production	26%	FIPB	
4. Hazardous chemicals and isocyanates	100%	Automatic	
5. Industrial explosives- Manufacture	100%	Automatic	
6. Drugs and Pharmaceuticals	100%	Automatic	

Sector	FDI Cap/ Equity	Entry Route	Other Conditions
7. Power including generation (except Atomic energy); transmission, distribution and power trading.	100%	Automatic	
(FDI is not permitted for generation, transmission & distribution of electricity produced in atomic power plant/atomic energy since private investment in this activity is prohibited and reserved for public sector.)			
D. Services			
1. Civil aviation (Greenfield projects and Existing projects)	100%	Automatic	
2. Asset Reconstruction companies	49%	FIPB	
3. Banking (private) sector	74% (FDI+FII). FII not to exceed 49%	Automatic	
4. NBFCs: underwriting, portfolio management services, investment advisory services, financial consultancy, stock broking, asset management, venture capital, custodian, factoring, leasing and finance, housing finance, forex broking, etc.	100%	Automatic	s.t. minimum capitalization norms
5. Broadcasting			
a. FM Radio	20%	FIPB	
b. Cable network;c. Direct to home; d. Hardware facilities such as up-linking, HUB.	49% (FDI+FII)		
e. Up-linking a news and current affairs TV Channel	100%		
6. Insurance	26%	Automatic	Clearance from IRDA
7. Petroleum and Natural gas:	49% (PSUs) 100% (Pvt. Companies)	FIPB (for PSUs) Automatic (Pvt.)	
a. Refining			

Sector	FDI Cap/ Equity	Entry Route	Other Conditions
8. Print Media			
a. Publishing of newspaper and periodicals dealing with news and current affairs	26%	FIPB	st. guidelines by Ministry of Information and Broadcasting
b. Publishing of scientific magazines/speciality journals/periodicals	100%	FIPB	
9. Telecommunications	100%	Automatic up to 49% and FIPB beyond	
E. Single Brand Retail	100%	49% Automatic, Rest through FIPB	

Source: Abridged and updated version RBI (2013): Department of Economic and Policy Research, Division of International Trade and Finance.

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