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Korea's Overseas Direct Investment: Evaluation of Performances and Future Challenges

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<Executive Summary>

The 1997 financial crisis in Korea has had a substantial impact on the economy and the society as a whole. Korea’s overseas direct investment is no exception. Korea’s direct investment abroad, which surged in general from the late 1980s to 1996, has fallen dramatically after the financial crisis. Accordingly, a large number of companies have cancelled or delayed their overseas direct investment plans in the face of a wide range of problems, including liquidity. The financial crisis has prompted the need to reassess Korea’s past overall economic development strategy; evaluating the accomplishments achieved through the overseas direct investment by Korean multinationals is now more important than ever.

Since the financial crisis which erupted at the end of 1997, the debates over the effects of overseas direct investment have focused on the soundness of overseas investment rather than its effects on the domestic industry or trade. This paper analyzes the performance of overseas subsidiaries holding outstanding invested amounts of more than $10 million based on the financial statements of overseas subsidiaries in 1997 and 1998, before and after the financial crisis. This study shows the poor business performance of Korea’s direct investments abroad. Korean subsidiaries exhibit extreme instability due to capital depletion caused by continuous losses and high debt ratios in 1997 and 1998. Added to this are net losses resulting in profit indexes indicating low earning rates.

Such problems in foreign subsidiaries are identified as aggravation of profitability, instability and high dependency on the parent company. This inferiority results from the deteriorated management practice of entering overseas markets for quantitative expansion without sufficient evaluation of business profitability. However, limiting advance into foreign markets on the basis of low business performance is not only unrealistic but also undesirable. Rather, the role of redirecting direct investment abroad toward more profit-based decision making procedures must be left up to the market participants such as creditors and shareholders. In order for market participants to perform their role, openness and easy access to management details must be guaranteed.

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I. Introduction

The 1997 financial crisis in Korea has had a substantial impact on the economy and the society as a whole. Korea's overseas direct investment is no exception. Korea's direct investment abroad, which surged in general from the late 1980s up to 1996, has fallen dramatically after the financial crisis. Accordingly, a large number of companies have cancelled or delayed their overseas direct investment plans in the face of a wide range of problems, including liquidity. However, despite the recent decrease, overseas direct investment had increased at unprecedented levels in the mid-1990s, with the outstanding invested amount rising from $2.3 billion in 1990 to $22.4 billion in 1999.

A notable example of the aggressive expansion of overseas direct investment by Korea prior to the financial crisis was the global management strategies of the Daewoo group. In 1998, Daewoo was included in the world's 100 largest transnational corporations (excluding financial institutions) for the first time as a company from a developing country[1]. However, the aggressive overseas investment strategy pursued by Daewoo over the last ten years has proven to be problematic. The company currently stands on the verge of liquidation due to inappropriate investments financed by excessive borrowings both at home and abroad.

Daewoo's case reveals the flipside of Korea's overseas direct investment. While direct investment abroad had been a useful tool in stimulating growth and enhancing the competitiveness of businesses and the national economy, it has lead to the insolvency of business groups, threatening the well-being of the national economy as a whole.

The financial crisis has prompted the need to reassess Korea's past overall economic development strategy; evaluating the accomplishments achieved through the overseas direct investment by Korean multinationals is now more important than ever. In particular, a review of Korea's overseas direct investment is necessary in that massive corporate restructuring is currently underway both domestically and abroad. This paper reviews the recent trends in Korean overseas direct investment and its accomplishments. Furthermore, several desirable strategies and policy implications for Korea's future overseas investment are proposed.

[1] TNCs refers to businesses involved in international production. Together with Daewoo, "Petroles de Venezuela" was included in the top 100 multinational companies for the first time in 1997. UNCTAD, *World Investment Report*, 1999.

II. Recent Trends in Korea's Overseas Direct Investment

At the end of the 1980s, Korea's overseas direct investment increased rapidly as it had been achieving surpluses in the balance of payments due to three low cost factors: oil prices, exchange rates and interest rates. Korea's overseas direct investment continued to rise in the 1990s and in 1996, one year before the financial crisis, investment peaked, recording $4.25 billion. However, with the eruption of the financial crisis in 1997, the level of investment began to decline drastically. A clear downward trend in the number and total amount of investments throughout 1997–1999 was evident and, in particular, investments decreased to $2.55 billion in 1999. Coming into 2000, the level of investment still remains at a similar level as the previous year. It is only natural that Korean companies facing a liquidity crisis and strong pressure to restructure are reducing the scale of overseas direct investment.

Table 1 shows the annual trends in Korea's overseas direct investment. Based on the outstanding invested amount as of the end of 1999, direct investment reached $22.4 billion. The content of the direct investment abroad in 1998 and 1999, when Korea was greatly affected by the financial crisis, reveals some interesting points. Comparing the level of foreign direct investment immediately following the financial crisis to the pre-crisis level, the number of investment projects in 1998 is only half of that in 1996 (Figure 1). However, the amount of individual investment did not show large changes, remaining at $3.9 billion. On the other hand, despite the small change in the number of investment projects prior to the financial crisis, the amount of investment sharply decreased to $2.5 billion in 1999, when the financial crisis had settled down to some extent.

The slight fall in the absolute amount of investment can be explained by the increase in the substantial amount of additional investment by parent companies in their foreign subsidiaries. As a result of the fall in Korea's national credit rating, overseas subsidiaries were unable to roll over their short-term borrowings or acquire new funds in the local financial markets. Consequently, the parent companies were forced to increase investments in the form of capital increase.

Meanwhile, the total amount of individual investments in 1999 fell drastically to $2.55 billion. This was the result of a decrease in new investments and a reduction in additional investment from parent companies to foreign subsidiaries, which were made right after the financial crisis.

Trends in Korea's overseas direct investment in the first half of 2000 show a similar level of investment compared to 1999. However, the number of investment projects has sharply increased. Table 2 shows that while the average number of investment projects by quarter in 1999 was 257, figures in the first two quarters of 2000 have drastically increased to 383 and 487. This is due to the fact that the rise in small-scale investments by small and medium sized companies was larger than the fall in investment by large companies.

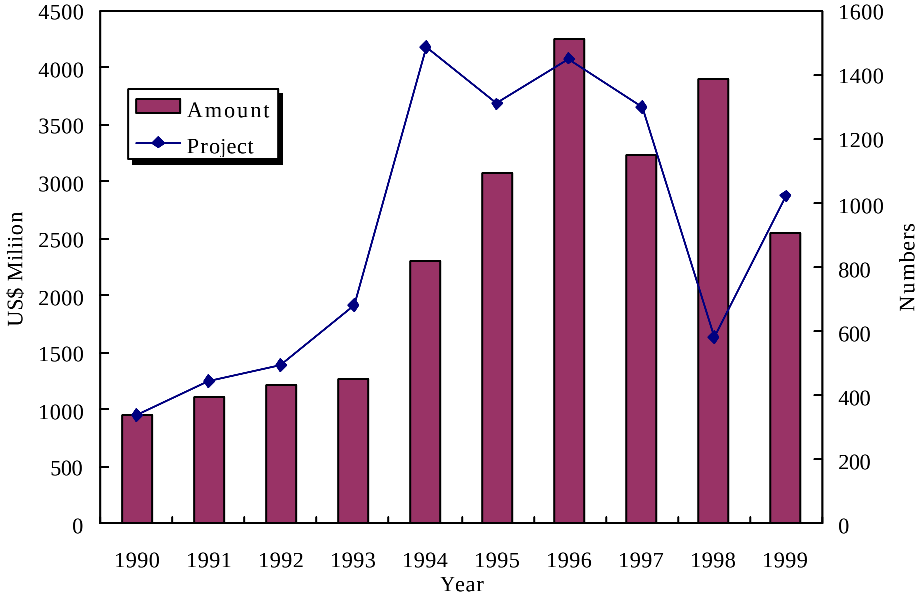
<Table 1> Korea's Overseas Direct Investment by Year

(Unit: US$ million)

Year	Overseas Direct Investment					
	Total Accepted		Total Invested		Outstanding Invested Amount	
	Cases	Amount	Cases	Amount	Cases	Amount
1968-80	400	250.7	352	145.2	279	127.0
1981	64	108.5	49	28.2	315	148.9
1982	54	121.4	49	100.8	347	246.5
1983	67	83.0	56	108.9	391	349.1
1984	49	67.4	46	50.2	424	397.3
1985	43	219.1	38	112.8	433	461.0
1986	73	363.8	50	182.7	464	619.3
1987	109	367.4	91	409.7	523	939.4
1988	249	474.8	171	215.9	662	1,095.6
1989	368	943.7	269	569.6	908	1,488.0
1990	515	1,610.9	341	958.9	1,227	2,300.7
1991	527	1,524.2	445	1,115.4	1,648	3,327.7
1992	632	1,348.8	497	1,219.4	2,108	4,425.9
1993	1,051	1,876.5	682	1,261.8	2,725	5,442.3
1994	1,948	3,581.9	1,485	2,299.6	4,141	7,472.2
1995	1,569	4,950.5	1,309	3,071.8	5,355	10,232.9
1996	1,809	6,290.4	1,452	4,248.5	6,727	13,828.0
1997	1,600	5,829.4	1,299	3,229.6	7,935	16,821.7
1998	702	5,132.7	583	3,895.1	8,455	20,288.2
1999	1,220	4,538.6	1,023	2,549.1	9,414	22,437.0
Total	13,049	39,576.4	10,287	25,770.4	9,414	22,437.0

Source: Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook,* 2000.

<Figure 1> Korea’ s Overseas Direct Investment by Year
(total invested)



<Table 2> Korea’ s Quarterly Overseas Direct Investment

(Unit: US$ million)

	1999					2000	
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Average	1st Quarter	2nd Quarter
Cases	165	221	276	464	257	383	487
Amount	549.5	422.5	641.9	1,196.6	637.3	669.0	700.1

Source: http://www.koreaexim.go.kr/osis/osismain.html (as of the end of June 2000).

As shown in Table 3, the manufacturing industry accounts for 51.5 percent of the total amount of investment, recording $11.5 billion in terms of outstanding invested amount as of the end of 1999. In addition, the trade industry accounts for 24.4 percent, marking $54.8 billion. Figure 2 indicates a continuous decrease in the ratio of investments directed to the manufacturing sector from 58.9 percent at the end of 1995 to 51.5 percent at the end of 1998. On the other hand, the investment flow into the trade sector shows a steady increase from 19.4 percent at the end of 1995 to 24.4 percent at the end of 1999. This is consistent with the recent global trend of overseas direct investments showing a faster increase of investment in the service sector compared to the manufacturing sector.

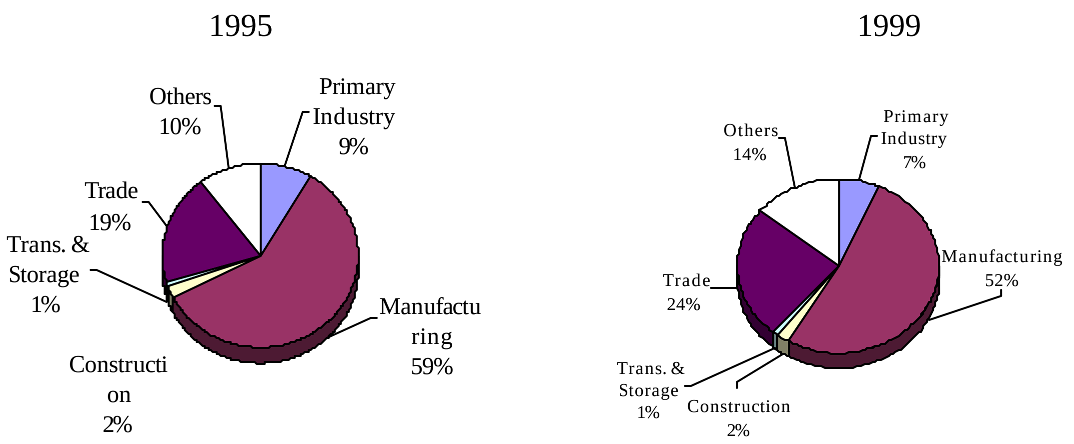
<Table 3> Korea’ s Overseas Direct Investment by Industry
(outstanding invested amount as of the end of respective year)

(Unit: US$ million, %)

	1995		1996		1997		1998		1999	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Primary Industry	869.6	8.5	1,081.9	7.8	1,291.0	7.7	1,378.6	6.8	1,498.8	6.7
Mining	701.7	6.9	906.8	6.6	1,105.5	6.6	1,181.5	5.8	1,295.6	5.8
Forestry	78.1	0.8	84.9	0.6	94.3	0.6	98.7	4.9	101.7	0.5
Fishery	89.8	0.9	90.2	0.7	91.3	0.5	98.4	0.5	101.6	0.5
Manufacturing	6,026.0	58.9	7,757.1	56.1	9,026.4	56.7	10,552.3	52.0	11,556.5	51.5
Construction	215.3	2.1	300.0	2.2	367.7	2.2	448.8	2.2	500.9	2.2
Trans. & Storage	76.7	0.7	90.9	0.7	165.3	1.0	178.4	0.9	243.1	1.1
Trade	1,982.9	19.4	2,819.9	20.3	3,251.8	19.3	4,807.7	23.7	5,477.9	24.4
Others	1,062.3	10.4	1,778.3	12.9	2,719.6	16.2	2,922.4	14.4	3,159.7	14.1
Total	10,232.9	100.0	13,828.0	100.0	16,821.7	100.0	20,288.2	100.0	22,437.0	100.0

Source: Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook*, 2000.

<Figure 2> Korea’ s Overseas Direct Investment by Industry
(outstanding invested amount as of the end of each year)



As shown in Table 4, the sectoral distribution of overseas direct investment in the manufacturing industry indicates that fabricated metals accounts for 45.3 percent of total investments, recording $5.2 billion. Leather and footwear, basic metals, and petroleum and chemicals account for 11 percent, 8.6 percent, and 8 percent, respectively. Based on the outstanding invested amounts at the end of 1995 and 1998, the ratio of investment in leather and footwear decreased while, on the other hand, that of fabricated metals showed a relative increase.

<Table 4> Korea's Overseas Direct Investment in the Manufacturing Industry (outstanding invested amount as of the end of respective year)

(Unit: US$ million, %)

	1995		1996		1997		1998		1999	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Food & Beverages	234.2	3.9	351.5	4.5	381.1	4.2	416.4	0.2	470.0	4.1
Textiles & Clothing	733.9	12.1	954.9	12.3	1081.2	12.0	1159.8	11.0	1266.7	11.0
Leather & Footwear	272.5	4.5	323.2	4.2	346.5	3.8	356.6	3.4	376.7	3.3
Wood & Furniture	150.7	2.5	161.0	2.1	171.6	1.9	183.7	1.7	187.1	1.6
Paper & Printing	69.0	1.6	127.6	1.6	168.9	1.9	177.5	1.7	180.4	1.6
Petroleum & Chemicals	530.4	8.8	664.9	8.6	744.3	8.2	884.5	8.4	919.4	8.0
Non-Metallic Minerals	359.6	6.0	392.4	5.1	387.2	4.3	343.8	3.3	361.7	3.1
Basic Metals	551.5	9.2	709.4	9.2	951.6	10.5	968.2	9.1	997.8	8.6
Machinery	237.8	3.9	297.3	43.0	333.0	3.7	455.9	4.3	477.7	4.1
Fabricated Metals	2,427.6	40.3	3,163.0	40.8	3,763.2	41.7	4,755.7	45.0	5,233.3	45.3
Others	431.7	7.2	611.8	7.9	697.7	7.7	850.3	8.1	1,085.5	9.4
Total	6,026.0	100.0	7,757.1	100.0	9,026.4	100.0	10,552.3	100.0	11,556.5	100.0

Source: Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook*, 2000.

The geographical distribution of Korea's overseas direct investment (Table 5, Figure 3) shows that the Asian region makes up the largest share, with 44.5 percent of total investment. North America (28.4 %) and Europe (17.3%) follow. Based on the outstanding invested amounts at the end of 1995 and 1998, the investment ratios between regions do not vary substantially.

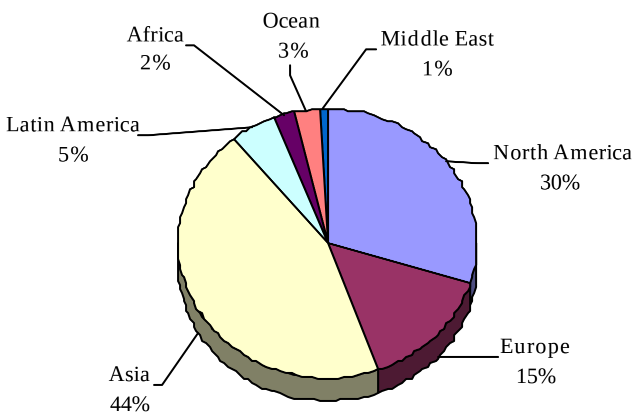
<Table 5> Geographical Distribution of Korea' s Overseas Direct Investment
(outstanding invested amount as of the end of respective year)

(Unit: US$ million, %)

	1995		1996		1997		1998		1999	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
North America	3,145.9	30.7	4,338.1	31.4	5,020.3	29.8	5,736.2	28.3	6,674.4	29.7
U. S.A.	2,701.3	26.4	4,068.9	29.4	4,741.2	28.1	5,423.4	26.7	6,343.3	28.3
Europe	1,399.9	13.7	1,893.1	13.7	2,224.6	13.2	3,165.8	15.6	3,327.3	14.8
Asia	4,714.4	46.1	6,290.8	45.5	7,749.9	46.1	9,149.0	45.1	9,983.9	44.5
Japan	228.2	2.2	299.8	2.2	361.7	2.2	383.5	1.9	418.7	1.9
China	1,898.9	18.6	2,698.6	19.5	3,311.8	19.7	3,931.7	19.4	4,135.5	18.4
Latin America	265.9	3.3	566.1	4.1	811.3	4.8	1,008.8	5.0	1,168.3	5.2
Africa	265.9	2.6	274.1	2.0	361.8	2.2	443.5	2.2	460.7	2.0
Oceania	270.5	2.4	339.0	2.5	458.9	2.7	585.8	2.9	620.4	2.8
Middle East	102.7	1.0	126.8	0.9	194.9	1.2	201.1	1.0	202.0	0.9
Total	10,232.8	100.0	13,828.0	100.0	16,821.7	100.0	22,288.2	100.0	22,437.0	100.0

Source: Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook*, 2000 .

<Figure 3> Geographical Distribution of Korea' s Overseas Direct Investment



Note: Outstanding invested amount as of the end of the year 1999.

Table 6 shows Korea' s overseas direct investment as a percentage of equity ownership. 57.4 percent of the total investments in 1999 was used for 100 percent equity ownership overseas, while 25.4 percent was invested for equity ownership of between 50 percent and 100 percent. These figures indicate that most of Korea' s direct investments in abroad were directed to majority shareholding.

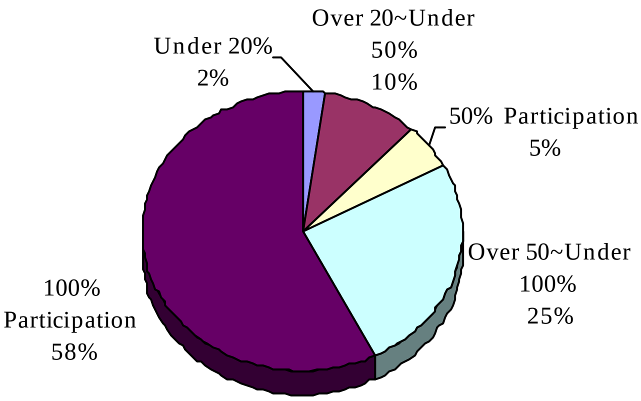
<Table 6> Equity Participation Ratio
(outstanding invested amount as of the end of respective year)

(Unit: US$ million, %)

Equity Participation Ratio	1995		1996		1997		1998		1999	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Under 20%	214.3	2.1	446.5	3.2	520.0	3.1	508.6	2.5	514.6	2.3
Over 20- Under 50%	1,072.6	10.5	1,182.7	8.6	1,657.8	9.9	1,962.6	9.7	2,166.6	9.6
50%	678.0	6.6	783.0	5.7	933.2	5.5	1,157.2	5.7	1,178.2	5.3
Over 50- Under 100%	2,567.3	25.1	3,353.4	24.2	4,351.7	25.9	5,039.9	24.8	5,690.5	25.4
100%	5,700.7	55.7	8,062.3	58.3	9,359.1	55.6	11,619.9	57.3	12,887.1	57.4
Total	10,232.9	100.0	13,828.0	100.0	16,821.7	100.0	20,288.2	100.0	22,437.0	100.0

Source: Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook*, 2000.

<Figure 4> Equity Participation Ratio
(outstanding invested amount as of the end of the year 1999)



III. Evaluation of Korea's Overseas Direct Investment

1. General Review

With the steep increase in Korea's direct investment abroad after the late 1980s, there have been numerous debates over the impact of overseas direct investment on the domestic economy and the amount of imports and exports. The impact of overseas direct investment on the amount of imports and exports was questioned, while another main concern was the possibility of direct investment abroad reducing domestic investment, driving local industries abroad.

Despite slight differences in analysis, the results of earlier studies show that overseas direct investment has a minimal relationship with the amount of trade (Kim Seung-jin 1998; Kim Young-chan, Kim Jeong-gyu 1997). No distinctive evidence points to overseas direct investment as the cause of the deterioration of domestic investment or the ousting of local firms. On the contrary, some view direct investment abroad as a potential long-term strategy for the rationalization of industrial structure, with consideration for enhancing the competitiveness of businesses. In this context, some argue that the channeling of direct investment abroad is a way to strengthen the linkages and complementary relationship between overseas and local sectors.

2. Performance and Financial Soundness of Korea's Overseas Direct Investment

Since the eruption of financial crisis at the end of 1997, the debate over the effects of overseas direct investment have refocused on the soundness of overseas investment rather than its effects on domestic industry or trade. The shift in the debate was in part due to the recognition that overseas investment had been carried out through excessive foreign borrowings. In the following, we examine the results of Korea's overseas direct investment by analyzing recent financial statements of individual foreign subsidiaries.

1) Combined Financial Statements of Korea's Foreign Subsidiaries

KIEP analysis[2] of the total of the 1997 financial statements of 219 foreign subsidiaries with investments of over $10 million revealed negative net worth (Table 7). At the end of 1997, capital depletion ($2.375 billion) reached 34 percent of the capital of all subsidiaries in the study ($7 billion). With a debt-equity ratio of 653.9 percent and all returns on investment ratios showing minus signs, the financial stability of foreign subsidiaries was proven to be extremely weak[3].

The 1998 financial statement analysis[4] of 290 foreign subsidiaries with a current outstanding invested amount over $10 million also revealed poor business performance

[2] Unpublished. Carried out upon the request of the Ministry of Finance and Economy.
[3] Korean foreign subsidiaries showed a high debt ratio and low profit rate in the analysis of the financial statements of 1994 and 1995, as well. Wang Yunjong, Kang Insoo, Kwon Yul (1998).
[4] Export-Import Bank of Korea, *1998 Financial Statement Analysis of Foreign Subsidiaries of Korean Companies*, 2000.

(Table 8). Figures showed foreign subsidiaries were experiencing deepened capital depletion at 45.3 percent, compared to 34 percent in 1997. Considering that most of the investments in 1998 were capital increases by parent companies as subsidiaries faced difficulties in local financing, the real rate of capital depletion is expected to have reached much higher than the 45.3 percent indicated in the analysis. Among the 290 foreign subsidiaries, only 90 were free of capital depletion, and though there were differences in level, the rest of the 200 businesses showed capital depletion.

<Table 7> Combined Financial Statement of 219 Subsidiaries of Korean Companies (1997)

(1) Balance Sheet

(As of Dec. 31, 1997, US$ million)

Credit			Debit		
Current Assets		21,317	Liabilities		30,268
Inventories	3,069		Current Liabilities	22,450	
Other Current Assets	18,248		Non-Current Liabilities	7,818	
Non-current Assets		13,580	Capital		4,629
			Capital stock	7,004	
			Others (incl. Net Income or Losses)	△2,375	
Total Assets		34,897	Liabilities and Capital		34,897

(2) Income Statement and Financial Ratios

(Unit: US$ million, %)

Item		Amount/Ratio
Income Statement	Sales	41,102
	Ordinary Income	△1,461
	Net Income	△1,619
Financial Ratios	Net Income - Sales Ratio	△3.9%
	Return on Investments (ROI)	△4.6%
	Return on Equity (ROE)	△23.1%
	Equity Ratio	13.3%
	Debt-Equity Ratio	653.9%
	Current Liabilities Ratio	485.0%
	Capital Depletion Ratio	34.0%

Note: The above financial statements and analyses are the total of financial statements of 219 major subsidiaries with investments of over $10 million (data as of December 31, 1997).

<Table 8> Combined Financial Statements of 290 Subsidiaries of Korean Companies (1998)

(1) Balance Sheet

(As of Dec. 31, 1998, US$ million)

Credit		Debit	
Assets	38,305.3	Liabilities	31,928.3
		Capital	6,377.0
		Capital stock	11,657.2
		Others (incl. Net Income or Losses)	△5,280.3
Total Assets	38,305.3	Liabilities and Capital	38,305.3

(2) Income Statement and Financial Ratios

(Unit: US$ million, %)

Contents		Amount Ratio
Income Statement	Sales	45,070.0
	Net Income	△1,212.7
Financial Ratios	Net Income to Sales Ratio	△2.7%
	Return on Investments (ROI)	△3.2%
	Return on Equity (ROE)	△10.4%
	Equity Ratio	16.6%
	Debt-Equity Ratio	500.7%
	Capital Depletion Ratio	45.3%

Note: The financial statements and analyses were produced on the basis of the financial data of 290 foreign subsidiaries with an outstanding invested amount of over $10 million. The tables are the total of the financial statements of the businesses. The figures represent an aggregate of the percentage claims on each account or item by share ownership of subsidiaries by their parent companies (data as of December 31, 1998).

<Table 9> Capital Depletion in Foreign Subsidiaries (as of the end of 1998)

(Unit: US$ million, %)

Foreign Subsidiaries	Capital(Outstanding Investment)		Capital Depletion		Maintained Equity Capital	
	Amount	Ratio	Amount	Ratio	Equity Capital	Ratio
39 companies*	4,169.4	35.8	4,259.7	80.7	-90.0	-0.2
Remaining 251 companies	7,487.8	64.2	1,020.5	19.3	6,467.3	86.4
Total	11,657.2	100.0	5,280.2	100.0	6,377.0	54.7

* Refers to foreign subsidiaries with capital depletion over $30 million.

Source: Export-Import Bank of Korea, *Overseas Direct Investment Statistics Yearbook,* 2000.

A closer look at the status of capital depletion in 1998 indicates 39 foreign subsidiaries of the 290 companies in the survey were experiencing capital depletion reaching over $30 million. The total capital depletion of the 39 subsidiaries amounted to $4.26 billion exceeding their total investment amount of $4.17 billion. The mentioned subsidiaries showed an average investment amount of $100 million and accounted for 80.7 percent of total capital depletion by the 290 companies included in the survey. The results of the analyses indicate that the insolvency of Korea's oversea's direct investment is due to large-scale overseas investments by Korean conglomerates.

2) Borrowing Structure of Korean Foreign Subsidiaries

Table 10 summarizes the borrowing structures of 111 foreign subsidiaries, reporting the details of their funding that reached over $10 million at the end of 1997. Table 11 shows the borrowing structure of 290 foreign subsidiaries with an outstanding invested amount of over $10 million. In 1997, around 81 percent ($11 billion) of total borrowings ($13.4 billion) were funded through parent guarantees; the figure falls to 73.3 percent in 1998. Foreign borrowing on parent company guarantees and domestic bank guarantees are viewed as the Korean Risk[5] in overseas direct investment, reaching 76.6 percent of total borrowings by foreign subsidiaries in 1998.

[5] The uncertainty in the guaranteed borrowings which Korean companies and financial institutions must submit if foreign subsidiaries are shut down.

<Table 10> Borrowing Structure of Korean Subsidiaries Abroad
(as of the end of 1997)

(Unit: US$ million, %)

Type of Financing	Short Term Borrowings		Long Term Borrowings		Total Borrowings	
	Amount	Number	Amount	Number	Amount	Number
(1) Parent Guarantees	7,966 (90.3)	88 (66.2)	2,990 (65.5)	57 (57)	10,956 (81.8)	145 (66.2)
(2) Direct Local Borrowings by Subsidiaries	396 (4.5)	21 (15.8)	688 (15.0)	16 (16)	1,084 (8.1)	37 (15.9)
(3) Guarantees of Local Partners	3 (0.1)	1 (0.7)	187 (4.1)	4 (4)	190 (1.4)	5 (2.2)
(4) Others	452 (5.1)	23 (17.3)	707 (15.5)	23 (23)	1,159 (8.7)	46 (19.7)
Total	8,817 (100)	133 (100)	4,572 (100)	100 (100)	13,389 (100)	233 (100)

<Table 11> Borrowing Structure of Korean Subsidiaries Abroad (as of the end of 1998)

(Unit: US$ million, %)

Type of Financing	Subsidiaries of Top 5 Conglomerates		Subsidiaries of Top 6 to 30 Conglomerates		Others		Total	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
(1) Parent Guarantees (incl. Related Company guarantees)	13,392.6	78.0	822.9	71.3	2,162.2	53.6	16,377.6	73.3
(2) Domestic Financial Institution Guarantees	216.7	1.3	144.7	12.5	381.7	9.5	743.0	3.3
(3) Foreign Financial Institution Guarantees	57.2	0.3	0.0	0.0	331.4	8.2	388.7	1.7
(4) Foreign Subsidiary's Collateral	1,093.6	6.4	39.8	3.4	303.8	7.5	1,437.3	6.4
(5) Direct Local Borrowings of Subsidiaries	1,760.7	10.3	146.8	12.7	856.3	21.2	2,763.7	12.4
(6) Guarantees of Local Partners	646.3	3.8	0.0	0.0	0.0	0.0	646.3	2.9
Total	17,167.1 76.8%	100	1,154.2 5.2%	100	4,035.3 18.0%	100	22,356.6 100%	100

Data: Export-Import Bank of Korea, *1998 Financial Statement Analysis of Foreign Subsidiaries of Korean Companies*, 2000.

In general, excessive borrowings increase the riskiness of overseas investments, particularly when a foreign subsidiary fails to meet the expected rate of return. Not only does the subsidiary become vulnerable, but the domestic parent companies or member companies who are the debt guarantors may also experience corporate distress. The recent case of the Daewoo group is a good example where overseas investment based on excessive borrowing has been deemed one of constituting causes of its demise.

3) Other Performances of Overseas Direct Investment

(1) Returns on Investment

Table 12 shows the investment profits of Korean parent companies from overseas direct investment in 1998. While the total outstanding invested amount in 1998 of the 290 companies included in the survey is $11.66 billion, the dividends reach only $44 million, showing investment profits at 0.05 percent with profits including royalties and interest at 1.58 percent.

<Table 12> Returns on Overseas Direct Investment (1998)

(Unit: US$ 1000, %)

	Number of Foreign Subsidiaries	Capital Stock (Outstanding Invested Amount)	Return on Investment				Rate of Return on Investment	
			Dividends	Interest	Royalties	Total	Dividend Yield Ratio	Total Yield Ratio
Top 5 Conglomerates	191	8,567,687	38,338	10,051	58,342	106,731	0.45	1.26
Top 6 to 30 Conglomerates	29	870,286	215	456	7,800	8,471	0.02	0.97
Others	71	2,219,209	5,198	19,145	41,402	69,208	0.02	3.12
Total	290	11,657,182	43,751	8,471	69,208	184,410	0.04	1.58

Source: Export-Import Bank of Korea, *1998 Financial Statement Analysis of Foreign Subsidiaries of Korean Companies*, 2000.

(2) Export-Inducing Effects

The inferior performance of foreign subsidiaries was the focus of the above analysis. Despite the losses, the importance of these subsidiaries cannot be overlooked, as they are the windows of export for Korean parent companies. Tables 13, 14 and 15 show the analyses of the transactions between foreign subsidiaries and the parent company by region, company and industry. The survey shows exports in 1998 through foreign subsidiaries were at $19.5 billion while imports were at $290 million, indicating a trade surplus of $16 billion. The above results confirm the role of foreign subsidiaries as the main export passage for Korean companies, while proving the dependency of the management of foreign subsidiaries on the parent company. The ratio of the purchase from parent company to foreign subsidiary sales reached 38.6 percent, showing high dependency on the domestic parent company.

Seen by region, foreign subsidiaries in North America showed more distinct features as the window of export compared to those located in Europe or Asia. However, the subsidiaries in Oceania exhibited a higher ratio of imports than exports by the parent company. This seems to be due to investments by Korean companies in the Oceania region for the purpose of natural resource acquisition.

Meanwhile, foreign subsidiaries of domestic conglomerates showed stronger export-inducing effects compared to other companies. Comparison by industry showed that the manufacturing sector is more effective in inducing exports than the trade sector, as trading companies not only purchase products from their domestic parent companies but also pursue active international offshore trade. On the other hand, manufacturing companies have connected production systems with the domestic parent company, raising the ratio of product parts that are brought in from Korea.

<Table 13> Transactions between Overseas Subsidiaries and the Parent Company (by region, 1998)

(Unit: US$ million, %)

	Number of Foreign Subsidiaries	Outstanding Investments	Sales	Transactions between Overseas Subsidiaries And the Parent Company			
				Forwarded to Parent Company		Forwarded to Overseas Subsidiaries	
				Amount	Ratio to Sales of Overseas Subsidiaries	Amount	Ratio to Sales of Overseas Subsidiaries
Asia	144	3,991.9	17,198.9	1,942.5	11.3	7,050.9	41.0
North America	55	3,937.9	17,222.9	618.6	3.6	8,944.9	51.9
Europe	59	2,713.3	14,449.6	216.8	1.5	2,955.4	20.5
Latin America	17	621.3	1,054.8	9.7	0.9	338.4	32.1
Oceania	8	232.6	284.9	109.3	38.4	47.8	16.8
Africa	7	160.2	221.0	0.0	0.0	142.4	64.4
Total	290	11,657.2	50,432.2*	2,896.8	5.7	19,479.7	38.6

Source: Export-Import Bank of Korea, *1998 Financial Statement Analysis of Foreign Subsidiaries of Korean Companies,* 2000.
* Sales of overseas subsidiaries are not adjusted by the equity ratio of the domestic parent company.

<Table 14> Transactions between Overseas Subsidiaries and the Parent Company (by company)

(Unit: US$ million US$, %)

	Number of Foreign Subsidiaries	Outstanding Investments	Sales	Transactions between Overseas Subsidiaries And the Parent Company			
				Forwarded to Parent Company		Forwarded to Overseas Subsidiaries	
				Amount	Ratio to Sales of Overseas Subsidiaries	Amount	Ratio to Sales of Overseas Subsidiaries
Top 5 Conglomerates	191	8,567.7	45,585.2	2,271.3	5.0	18,780.4	41.2
Top 6 to 30 Conglomerates	29	870.3	2,334.2	99.5	4.3	400.0	17.1
Others	70	2,219.2	2,504.8	526.0	21.0	299.5	12.0
Total	290	11,657.2	50,424.2	2,896.8	5.7	19,479.7	38.6

Source: The Export-Import Bank of Korea, *1998 Financial Statement Analysis of Foreign Subsidiaries of Korean Companies*, 2000.

<Table 15> Transactions between Overseas Subsidiaries and the Parent Company (by industry)

(Unit: US$ million, %)

	Number of Foreign Subsidiaries	Outstanding Investments	Sales	Transactions between Overseas Subsidiaries And the Parent Company			
				Forwarded to Parent Company		Forwarded to Overseas Subsidiaries	
				Amount	Ratio to Sales of Overseas Subsidiaries	Amount	Ratio to Sales of Overseas Subsidiaries
Manufacturing Industry	134	5,293.0	13,312.3	1,046.4	7.9	6,158.9	46.3
Mining	14	466.4	422.5	166.5	39.4	7.4	1.8
Trade	88	4,303.5	35,073.7	1,683.9	4.8	13,315.4	40.0
Others	54	1,594.3	1,615.7	0.0	0.0	0.0	0.0
Total	290	11,657.2	50,424.2	2,896.8	5.7	19,479.7	38.6

Source:Export-Import Bank of Korea, *1998 Financial Statement Analysis of Foreign Subsidiaries of Korean Companies*, 2000.

IV. Future Challenges for Korea's Overseas Direct Investment

Despite the many unfavorable situations in the global investment environment such as the Asian financial crisis, global direct investment showed a remarkable increase in 1998. Global overseas direct investment flows in 1998 reached an all-time high of $649 billion, a $174 billion increase from the previous year (UNCTAD 1999). Such increases are due to the growth in cross-border M&As. In 1998, M&As expanded by $202 billion from 1997, reaching $544 billion. Such increases, driven mostly by the growth of M&As among multinational companies from the U.S., EU and Japan, provide evidence of strategic efforts to enhance competitiveness as a way to survive under intensified global competition.

In light of increasing global direct investment, there is of no doubt that Korea should stimulate overseas investments as a strategy for corporate and national growth. World economic integration is deepening, bringing with it a more severely competitive global environment. It is hard to imagine that domestic companies can maintain competitiveness and market share without the utilization of overseas direct investment under the current business environment. It is also true that direct investment abroad entails various problems. However, as the countereffects are mainly due to the immaturity of Korea's overseas direct investment, it does not justify undermining the importance of direct investments abroad. Efforts, therefore, should be focused on directing overseas direct investments in a way that enhances the soundness of the national economy and the competitiveness of Korean multinationals.

Two tasks lie ahead in developing Korea's direct investment abroad. First, problems that have surfaced to date regarding the flow of overseas direct investments must be resolved with efficiency. Second, such investments that lead to the rationalization of industrial structure, promote export growth and enhance long-term competitiveness need to be facilitated together with supportive government policies to induce productive overseas direct investment.

1. Streamlined Restructuring

Existing direct investment abroad needs to be restructured to improve profitability and financial soundness. To date, Korea's overseas direct investments have primarily focused on expanding through heavy dependence on local borrowings, resulting in high debt ratios and low profitability. The restructuring of overseas subsidiaries during the past two years have largely leaned in this direction[6].

Improving profitability is the most important prerequisite in providing viability to overseas subsidiaries so that they are able to survive independently. On the other hand, enhancing financial soundness should be oriented towards decreasing local borrowings on debt guarantees from the parent company, frequently adopted by foreign subsidiaries

[6] With regard to restructuring cases, refer to the KIEP series, *Restructuring and Problems of Foreign Subsidiaries of Korea after the Foreign Currency Crisis(Thailand, Indonesia, China, UK, US),* KIEP Working Papers 98-7 through 98-11. Park Young-ho (1998), Kwon Kyung-duk (1998), Kim Wan-jung

as a way of financing. Although the method has made local borrowing easy, it directly put the parent company and domestic affiliates at risk of being affected by the distress of foreign subsidiaries, and thus must be reduced to the lowest level possible.

It is important to remember that the restructuring of overseas direct investments is not to be a means to merely improve profitability indices. Low profitability may result invariably from various factors, including export price controls by the parent company, rather than poor performance of foreign subsidiaries themselves. Foreign subsidiaries are hard-earned front bases for securing export markets and advanced technology. Therefore, the premature withdrawal of overseas direct investment may cause more harm than good by depriving the company of the chance to prepare itself for an improved business environment in the future. Therefore, reform should be conducted carefully, following a comprehensive evaluation of investment performance and prospects for potential market growth. Unless foreign subsidiaries are experiencing chronic deficits or are unable to survive, they need to be directed towards improving profitability through all possible means as opposed to closure.

2. Promoting New Sound Investments

Overseas direct investment, managed successfully, may contribute to the improvement of the welfare of the national economy and the competitiveness of Korean businesses in the world market. Key merits include rationalization of the industrial structure, export growth and access to overseas markets and advanced technology. There are, of course, risks of transferring of domestic industries and labor cuts, as well as export substitution. In addition, there is also the risk of prompting domestic insolvency due to poor performance by foreign subsidiaries.

In this respect, the promotion of new overseas direct investment should be directed towards preventing the risks mentioned above, while at the same time strengthening the positive aspects. Most importantly, a specialized structure between domestic and foreign businesses needs to be established to prevent deindustrialization due to overseas direct investment. In this context, local manufacturing lines should be developed towards the production of high value-added products and related components, while foreign subsidiaries look toward exports of materials and components.

When linked with domestic corporate restructuring, this specialization induced by overseas direct investment can yield still more positive results. Furthermore, production

(1998), Kim Jong-geun (1998), Shin Dong-hwa (1998). See also Park Jae-sung (1999).

facilities, subject to restructuring due to low comparative advantage at home, should be transferred to third countries where they can maintain competitiveness for a substantial period of time. Currently, Korean paper producers (Hansol, Daehan, Hankuk) are moving their production facilities to China and Southeast Asia through joint ventures or other forms, while improving domestic production lines with cutting-edge technologies.[7] China and Southeast Asian countries are good candidates for Korea's overseas direct investment in connection with the corporate restructuring efforts. In particular, Southeastern Asia provides a particularly attractive investment opportunity due to the fall in factor prices after the Asian financial crisis.

In the fields where the company is competitive, active foreign investment is a way of pioneering new markets and maintaining acquired markets. The company may lose a perfect opportunity to expand into a foreign market if they only concentrate on domestic structural reform. Once a market is lost, even more capital and resource investment is needed to recover it. Accordingly, aggressive investment is needed in foreign markets with potential. Samsung Electrics invested $15 million to construct a manufacturing plant for mobile communication parts in the Philippines and Samsung SDI has also proceeded to increase investment in their semiconductor plant in Texas. The transfer from investments for the replacement of facilities to new investments can be seen as a positive change in overseas direct investment.

From a long-term strategic perspective on Korean businesses, overseas direct investments that entail the transfer of advanced technologies to domestic firms should be stimulated. As Asia is still dealing with the aftermath of the financial crisis, overseas direct investment for the purpose of technology acquisition may not be easy to commit to as there are no visible results in the short run. However, technology acquisition is one of the most important determinants for overseas direct investment and Korea should focus its overseas investment on this area. In particular, new investments should be made to secure foreign R&D bases in order to make use of the advanced technologies offered in the developed countries such as the United States.

Despite the strong need for new investment, a careful approach is required different from that of the past in its detailed implementation. The decisions for new overseas direct investment must be made based on detailed profitability forecasts and the sound financial structure of the company.

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[7] Korea Economic Daily (April 1, 1999). After the financial crisis and subsequent factor price falls, Southeast Asian countries have been offering a particularly favorable investment environment for securing secondary export bases for Korean products.

Ⅴ. Summary and Policy Implications

1. Summary of Main Problems in Korea's Overseas Direct Investment

This study presents the low business performance of Korea's overseas direct investment. The foreign subsidiaries of Korean companies exhibit extreme instability due to capital depletion caused by continuous losses and high debt ratios. Meanwhile, payment guarantees by the parent company or affiliates account for 73.3 percent of total borrowings by foreign subsidiaries, excluding financing through capital increase.[8] This indicates the heavy reliance of foreign subsidiaries on the parent company for fund raising. The sum of debt guaranteed by affiliates and parent company and debt guaranteed by local financial institutions, referred to as the Korean Risk, accounts for 76.6 percent of the total debt. This indicates the high potential for the insolvency of overseas subsidiaries to become a direct burden on the domestic economy. In addition, sales and purchases from the domestic parent company make up a large portion of foreign subsidiary trade volume. Taking into consideration the financing structure described above, it is difficult to say that the foreign subsidiaries of Korea are under independent management.

Problems such as profitability aggravation, instability and high dependency on the parent company plague foreign subsidiaries. This inferiority results from the deteriorated management practice of entering overseas markets for quantitative expansion without sufficient evaluation of business profitability. There may be several reasons for the deterioration of past management practices, which focused more on quantitative growth rather than profitability. Nonetheless, the absence of measures to control dogmatic decision making by owners at the corporate management level and the lack of transparency in the management of Korean companies in general are pointed to as the main culprits.

Limiting entry into foreign markets on the basis of low business performance is not only unrealistic but also undesirable. Rather, the role of redirecting direct investment abroad toward more profit-based decision making procedures must be left up to the

[8] According to Feldstein (1994), 20 percent of the investment capital (debt and equity financing) of U.S. foreign subsidiaries are delivered by the parent company, with 18 percent funded by retained earnings of the foreign subsidiaries themselves. The remaining 62 percent is normally funded through local borrowings but local capital borrowing on parent company guarantees is very rare. See also Wang Yunjong, Kang Insoo, Kwon Yul (1998).

market participants such as creditors and shareholders. In order for market participants to perform their role, openness and easy access to management details must be guaranteed.

2. Policy Implications for Overseas Direct Investment

The preparation of accurate data is the first step to achieving sound overseas direct investment. The information must then be delivered to the market participants such as investors and creditors at the right time to assist them in reaching a rational decision. In this sense, the following two suggestions on overseas direct investment policy can be made (Lee Seong-bong & Min Sang-ki, 2000).

First, as most of the fund raising for overseas direct investment is pursued through borrowing and parent company guarantees, domestic creditor financial institutions must execute primary monitoring on the soundness of the investment. However, these institutions are not gathering or analyzing sufficient data on the company's overseas direct investments. Domestic creditor financial institutions must consider the anticipated effects of the overseas direct investment in their credit management of the investing company.

The greatest hazards in overseas direct investment are excessive debts and low profitability. As the domestic parent company or affiliate generally guarantees the foreign investment related debts, insolvency of foreign investment can jeopardize the stability of the domestic company which in turn leads to the instability of the creditor financial institution. Despite the importance of payment guarantee in foreign investment, current financial supervisory regulations do not cover risk management of payment guarantees on overseas direct investment of the borrowing company. In addition, the risk in the borrowing company credit is not taken into account in the evaluation of bank asset soundness. The responsibility of monitoring potential risk in foreign investment guarantee falls on the creditor financial institution. Such a system should be promptly institutionalized.

Second, information on business management and the results of overseas direct investment are not being delivered at the right time in the right form to the investors through market mechanisms such as the stock market. This makes it impossible for the investors to evaluate the status and future profitability of their target company in consideration of the effects of the investments abroad. Providing adequate and timely information to investors is necessary to allow the performance and status of foreign subsidiaries to be taken into account in the evaluation of the domestic parent company.

The preparation and public announcement of consolidated financial statements were not mandatory in the past; therefore consolidated financial statements including the status of foreign subsidiaries were seldom produced. As a result, sensitive information regarding the management of foreign subsidiaries was not relayed to the investors. The preparation and public announcement of consolidated financial statements and combined financial statements of the conglomerates have brought about improvements allowing the management of the foreign subsidiary to be fully reflected in the management results of the parent company. However, there still remains room for improvement in the consolidated financial statement and combined financial statement including supplementation of the public announcement of information on foreign investment-related debt guarantees.

The consolidated financial statements and combined financial statements of conglomerates can provide useful information related to overseas direct investment. However, these financial statements are announced some months after the close of the business year, thereby making it impossible for the business performance of overseas direct investment (size of debt, contents of payment guarantee and any changes, profitability) to be used by the related personnel. Therefore, timely information must be promptly announced even if the content is insufficient.

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<국문요약>

1980 년대 후반부터 1996 년까지 전반적으로 큰 증가세를 보여왔던 해외직접투자가 1997 년 발생한 외환위기의 영향으로 위축되고 있다. 해외직접투자를 계획했던 많은 기업들이 유동성 위기 등 여러 가지 이유로 해외사업을 포기하거나 미루고 있기 때문이다. 외환위기를 경험하면서 과거의 경제개발전략 전반에 대한 재평가가 이루어지고 있듯이, 해외투자에 대한 공과에 대해서도 그 관심이 쏠리고 있다. 특히 최근 기업구조조정이 국내뿐만 아니라 해외부문에 대해서도 광범위하게 이루어지고 있다는 점에서 우리나라 해외투자의 평가와 향후 발전방향에 대한 검토가 필요하다.

외환위기가 발생하면서 해외직접투자에 대한 관심은 수출 및 산업공동화에 대한 것보다는 대외자산의 부실정도와 그에 따른 가능한 국내 영향에 대한 것으로 옮겨졌다. 본 연구에서는 1000 만 달러 이상 투자잔액이 있는 해외현지법인의 경영성과를 외환위기 전후인 1997 년과 1998 년 현지법인의 재무제표를 토대로 분석하였다. 그 결과 우리나라 해외직접투자의 경영성과는 매우 부진한 것으로 나타났다. 1997 년말과 1998 년말 모두 우리나라의 해외 현지법인들은 누적손실로 인한 자본잠식과 높은 부채비율 등으로 안정성이 매우 취약한 상태이며, 당기순손실을 기록함에 따라 각종 수익성지표들도 열악한 상태이다.

이러한 해외 현지법인들의 수익성 악화, 안정성 저하 및 높은 모기업 의존도는 모기업의 손실을 해외 현지법인으로 이전시켜온 관행, 외환위기의 여파 및 진출한 지 오래되지 않았기 때문에 발생하는 초기 정착비용과 현지 영업환경에 대한 부적응 등의 요인도 있을 것이나, 보다 근본적으로는 철저한 사업성검토가 결여된 상황에서 양적 성장을 위해 무리하게 해외로 진출해 온 경영행태가 그 원인이라고 할 수 있다.

해외 현지법인의 경영성과가 저조하다고 해서 기업의 해외진출을 제도적으로 제약하는 것이 현실적으로 어려울 뿐만 아니라 바람직하지도 않은 상황에서, 기업의 해외진출이 수익성 등에 근거하여 이루어질 수 있도록 보다 바람직한 방향으로 유도하는 역할은 주주나 채권자 등 시장참여자에게 맡기는 것이 현실적이면서도 바람직한 대안이 될 것이며, 시장참여자들이 이러한 역할을 제대로 수행하기 위해서는 경영현황에 대한 투명한 공시 및 용이한 접근이 보장되어야 할 것으로 사료된다.

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