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Economic Cooperation between Vietnam and Korea through Foreign Direct Investment*

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Ⅰ. Introduction

Since the normalization of relations between Korea and Vietnam in 1992, economic cooperation between the two countries has improved in many fields. There are several ways to enhance economic cooperation between the two countries, yet foreign direct investment (FDI) is the most efficient and intensive mode of economic cooperation. Although Korea is increasing its investments abroad, FDI in Vietnam has been not very significant.

The purpose of this paper is to explain how Korea and Vietnam can achieve economic cooperation through FDI. A comprehensive analysis will be conducted by using related theories such as the diamond model of competitiveness and the imbalance theory of FDI. The diamond model is useful to analyze the investment climate and the imbalance theory to explain

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the reason for FDI in Vietnam. We will first review the current situation of Korea's investment in Vietnam. Then, after a rigorous analysis, we will provide useful implications for further cooperation between the two countries through FDI.

Ⅱ. Korea's Investment in Vietnam

1. Investment of Korean Firms

A survey on Vietnam conducted by the Korea Trade-Investment Promotion Agency (KOTRA 2004) showed a high level of satisfaction from Korean firms in Vietnam. According to the survey, of which 214 responded among the 668 firms inquired, 42.1% were satisfied, 50.5% fair, 6.1% dissatisfied, and only 1.4% very dissatisfied, resulting to 92.6% of the respondents being assessed above fair. Furthermore, 60.6% of the respondents intended to recommend other firms to invest in Vietnam, while only 9.7% of the firms were planning to move their plants to other countries.

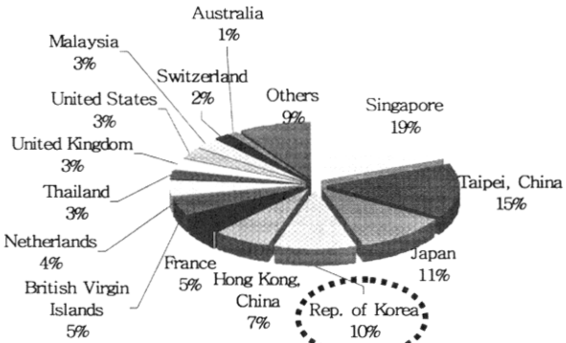
On the other hand, according to the survey by the Korea Federation of Small and Medium Business in 2004, the satisfaction level of Korean firms in China above fair was 79.3%, which is lower than that of the firms in Vietnam. Although this simple comparison may have a risk of neglecting other elements that can affect the reality, the survey results show that there exist great potentials for further FDI in Vietnam.

2. Current Status

Korean TV dramas played an important role in familiarizing the Vietnamese with the Korean culture. The similarity of the two nations' cultures has pulled Vietnam to Korea. This Korean wave in Vietnam is not only limited to the cultural aspects but also heightens the image of Korea and Korean products. For these reasons, many Korean firms are implementing their marketing strategy by using the Korean wave in order to increase their sales in Vietnam. The most successful case of using Korean wave in business is cosmetic products manufactured by LG Household and Health Care. LG ranked number one in the market share of cosmetics thanks to the success of a drama where the model of the cosmetic product was the heroin.

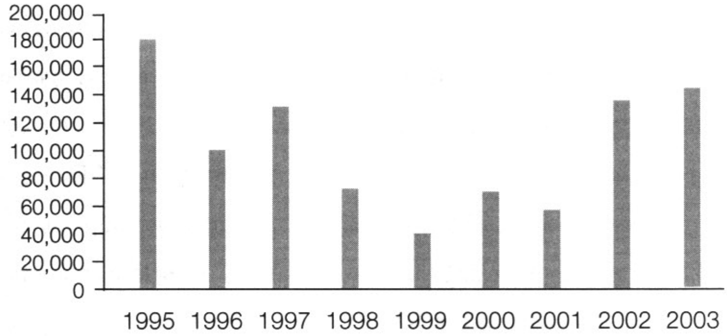
Korea has ranked fourth for investment commitments from 1988 to 2003, accounting for 10% of the total FDI in Vietnam right behind Japan which leads Korea by only 1%. This implies that Korea has continuously played an

〈Figure 1〉 Investment commitments by economy (1988-2003)



Source: Vietnam Economic Times website, http://www.vneconomy.com.vn

〈Figure 2〉 Korea' s Investment in Vietnam (US $)



Source: The Export-Import Bank of Korea website, http://www.koreaexim.go.kr

important role in the Vietnamese economy (see Figure 1). However, Korea's investment drastically decreased during the Asian financial crisis in the late 1990s. It shows clearly in Figure 2 that the investment sharply fell from 1998 to 1999 and then reemerged and grew steadily after the crisis. Although it has been steadily growing since then, the amount of investment has not yet reached the level of the mid 1990s.

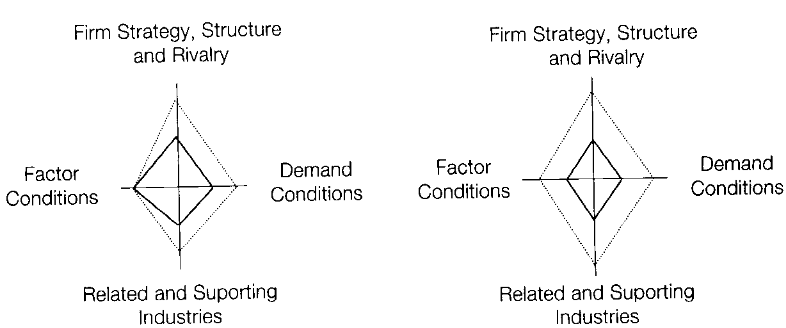
3. Analyzing the FDI Environments

1) The Diamond Model

Porter's (1990) diamond model is a very useful tool in analyzing the business environment of Vietnam. Porter introduced a new paradigm of competitiveness which extends Adam Smith and David Ricardo's concept of prosperity. Porter argues that prosperity is not set by endowment but is created by choices. The diamond model consists of four attributes of a nation: 1) factor conditions, 2) demand conditions, 3) related and supporting industries and 4) firm strategy, structure and rivalry. A nation can enhance its competitiveness through the four determinants of the diamond. The shape and size of the diamond indicate strong or weak sectors of the country assessed. Vietnam's FDI environment will be analyzed by each condition of the diamond.

The diamond model is very useful to analyze a country's competitiveness by the four determinants in the domestic context. However, the original diamond model overlooks multinational activities and so it is not suitable to explain the effect of FDI. Therefore, in order to analyze both domestic and international contexts properly, we need to use the generalized double diamond model (Moon, Rugman, and Verbeke 1995, 1998), which incorporates multinational activities. As shown in Figure 3, Korea's domestic diamond is bigger than that of Singapore's. However, when comparing the international diamonds, Singapore's diamond is much bigger. This implies that Singapore is more competitive in the international context than Korea. The international diamond is mostly represented by the multinational activities, i.e., FDI.

〈Figure 3〉 Generalized double diamond model



2) Comparing Investment Environments of Vietnam and China

In spite of having a higher percentage of satisfaction by Korean investors in Vietnam, the reality is that investments are increasing more in China than in Vietnam. This tendency is not limited only to Korean investors but all others, as seen in Table 1, when comparing FDI volumes of the two countries, China and Vietnam. Contrary to the increase in China's FDI volume per capita, Vietnam has experienced a dramatic drop by approximately 40% from US$ 29 in 1997 to US$ 17 in 2002. So, why are there less Korean investments in Vietnam than before? In order to find out the reasons of the recent decrease in Korean investments, it is necessary to analyze FDI environments of Vietnam in comparison with those of China. The diamond model is used to analyze the investment environments of Vietnam and China.

〈Table 1〉 FDI volume per capita (US$)

	1997	1998	1999	2000	2001	2002
China	36	35	31	30	34	41
Vietnam	29	22	18	17	16	17

Source: Strength, weakness and opportunity of Vietnamese economy, Vietnamese embassy website, http://www.vietnamtrade.co.kr

① Factor Conditions

As one of its strong points, Vietnam has a large pool of cheap but quality workers. Even though the wage level is getting higher, the level is still lower than that of its major competitors, China and other neighboring countries. The inexpensive office rental cost, which is lower than that in China, also gives more attractiveness to invest in Vietnam (see Table 2).

〈Table 2〉 Investment related cost comparison of 7 Southeast Asian cities ($US)

City / Cost	Hanoi	Beijing	Bangkok	Singapore	Jakarta	Manila	Kuala Lumpur
Office Rental (monthly, per m^2)	24	30-60	11.03	40.64	14-20	4.52-7.23	9.92-17.68
Average wage (monthly)	79-119	79-139	184	432-557	133	170	202

Source: Saigon Giai phong website, http://www.sggp.org.vn, 2004. 6. 23.

〈Table 3〉 Attitude and motivation of labor force

Rank	Country	Index
8	Vietnam	75.00
13	China	69.42

Source: IPS National Competitiveness Report 2003-2004. (68 countries).

In addition to the quantitative perspective of the labor force, the attitude of the Vietnamese labor is ranked higher than that of China according to the IPS survey (Cho and Moon 2003), as shown in Table 3. Generally, foreign investors praise Vietnamese staff for being willing and able to learn with high working morale. These characteristics affect foreign investors and induce investment for labor-intensive industries in Vietnam.

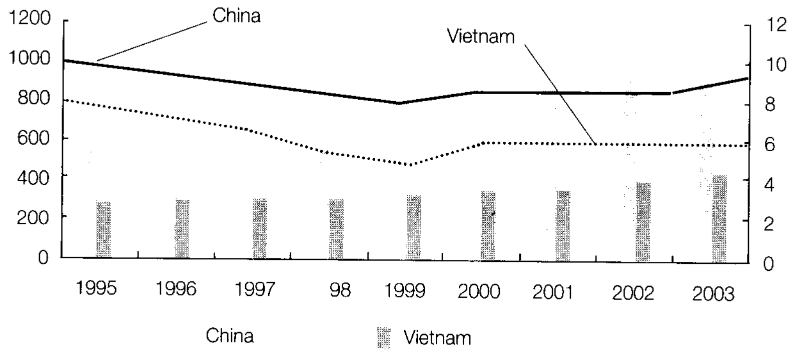
Another important production factor is the natural resource. However, Vietnamese's capability of oil production is relatively lower than that of China, even though Vietnam ranked among the top 10 in the world in oil production. Yet many investors are interested in developing Vietnam's oil production projects (see Table 4) which are very attractive to foreign investors.

〈Table 4〉 Natural resources

	China		Vietnam	
	Rank	Index	Rank	Index
Oil production (bbl/day)	2	3,300,000	8	356,700
Natural gas proved reserves (cum) (million)	20	1,290,000	43	192,600

Source: CIA World Factbook, 2003.

〈Figure 4〉 GDP per capita and GDP growth rate



Source: World Development Indicators 2004, World Bank.

② Demand Conditions

China has better quantitative and qualitative demand conditions than Vietnam. Regarding the quantitative perspective, it is needless to say that China's population ranked first in the world, recording 1.3 billion people in 2003. Vietnam also has a huge population, ranking 14th, although it is not as large as that of China.

As to the economic development stage, Vietnam is still in the less developed stage with GDP per capita of around US$ 400 in 2003. Vietnam

〈Table 5〉 Demand sophistication: The consumers are sensitive to…

	China		Vietnam	
	Index	Rank	Index	Rank
The price of products	71.09	17/68	35.71	50/68
The quality of products	44.76	53/68	43.93	54/68
The design of products	39.08	48/68	43.93	58/68
Quick adoption of new products	46.61	37/68	15.83	58/68

Source: IPS National Competitiveness Report 2003-2004.

has been maintaining quite a high and stable economic growth since the implementation of the Doi Moi renovation policy in 1986. However, it is not as high as that of China (see Figure 4). The rapid growth of the Chinese economy is mainly due to the huge foreign capital flows into China.

Considering the qualitative perspectives of Vietnamese demand conditions, the demand sophistication is lower than that of China as shown in Table 5. The majority of people are poor and relatively indifferent to the quality of products. However, the Vietnamese middle class with a great potential for consumption is growing fast.

③ Related and Supporting Industries

With the enforcement of US-Vietnam trade agreement at the end of 2001, Vietnam enhanced its market attractiveness as many were expecting a roundabout method of inroads into the U.S. through Vietnam. This made Vietnam a magnet to Korea since the U.S. was the biggest market for Korean firms. Vietnam was also attractive to Korean investors as they were considering a step forward to the Southeast Asian market.

〈Table 6〉 Related and Supporting Sectors

	China		Vietnam	
	Rank	Index	Rank	Index
E-readiness (of 64/ of 100)	52	3.96	60	3.35
Transportation (of 68 / of 100)	30	28.15	52	14.11

Source: E-readiness – Economist Intelligence Unit, 2004.

Source: Transportation – IPS National Competitiveness Report 2003-2004.

Note: Transportation includes paved road density, vehicles, railway transport, civil aviation, international maritime transport, ports and international transport.

However, the investment-related infrastructure still remains underdeveloped. Telecommunication costs are too high for corporations to get access to overseas communications, and transportation conditions of both hardware and software are not sufficiently developed. According to the EIU report (The Economist 2004) on whether a country’s business environment is conducive to Internet-based commercial opportunities, the E-readiness of Vietnam ranked 60th out of 64 countries. International business cannot be efficiently achieved without a proper infrastructure of telecommunications. The E-readiness index shows how much Vietnam is in need of IT infrastructure (see Table 6). According to Doanh (2002), the high cost of doing business in Vietnam represents the main disincentive for foreign enterprises to invest in the country.

④ Firm Strategy, Structure, and Rivalry

According to the global mindset analyzed by IPS, Vietnam’s national culture is shown to be more open to foreign influence than China. While China is one of the least open-minded countries, Vietnam has a fairly open global mindset. This will allow a more friendly investment environment to foreigners.

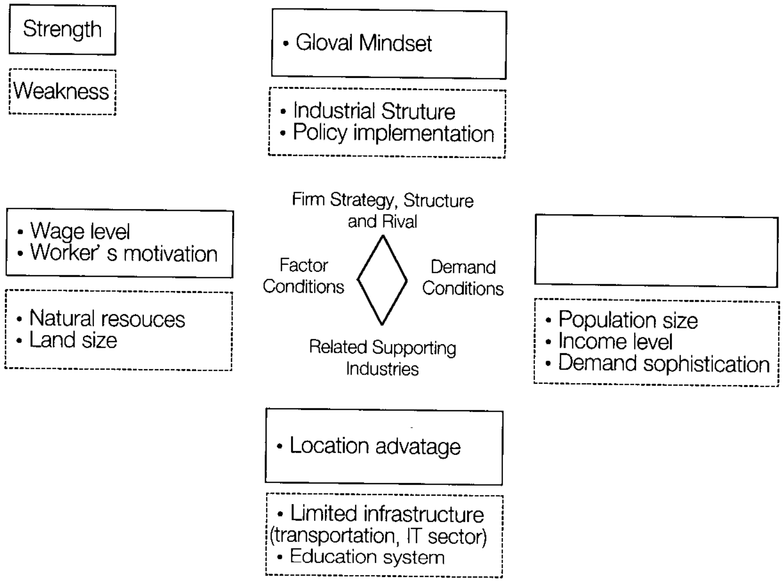
However, there are many complaints about the inefficiency of the Vietnamese government policy implementation and ineffective industrial structure. According to Doanh (2002), red tape, bureaucracy and lack of transparency are the principal problems of the Vietnamese business environment. Law enforcement is not consistent in the country and the interpretation of law and enforcement depend too much on local agencies or on low-ranking local officers (see Table 7).

〈Table 7〉 Firm's strategy, structure and rivalry

	China		Vietnam	
	Index	Rank	Index	Rank
Global Mindset				
National culture is open to foreign influence	36.90	62/68	63.33	32/68
Policy implementation				
The policy on general infrastructure is effective	57.43	32/68	22.77	54/68
The policy on firm's strategy and structure is effective for economic stability and growth	45.47	39/68	34.73	57/68
The government policy does not discriminate foreign professionals from domestic professionals, in terms of immigration status and employment	76.75	26/68	37.87	58/68
Business strategy & structure				
Firm strategy is rational and efficient	33.55	44/68	3.75	62/68
Corporate governance is well organized	33.83	48/68	11.58	67/68
Firm's international competition is important and severe	55.44	30/68	2.36	67/68
Foreign and domestic firms are equally treated	50.79	33/68	33.33	61/68

Source: IPS National Competitiveness Report 2003-2004.

〈Figure 5〉 Comparing investment environments of Vietnam and China



The investment environments of Vietnam and China are well compared in Figure 5. Improving the investment climate is the fundamental challenge for the Vietnamese economy to attract more foreign investment into Vietnam.

Ⅲ. Why Invest in Vietnam?

1. Many Reasons to Invest in Vietnam

By comparing the investment environments of Vietnam and China, Vietnam revealed many problems which repel foreign investors to go elsewhere. Nevertheless, Vietnam still has many advantages that can allure foreign investors to the country. Major reasons for making investment decisions in Vietnam are also analyzed by using Porter's diamond model as follows.

For factor conditions, Vietnam is abundant in various raw materials which Korean firms need. Vietnam's oil resource which amounts to 356,700 bbl/day (CIA World Factbook 2003) does not even reach the 1% of the world's total oil production. However, Vietnam's untapped oil reserves are estimated to be enormous. In addition, Vietnam still has a competitive advantage in terms of cheap, quality labor force with high motivation. The country's labor force reaches about 60% of its total population and is rapidly growing by about 2.5% annually.

Demand conditions are also very attractive to foreign investors. Its current market size, with 80 million people, is big enough. In addition, the growing middle class is very promising. The country's middle class will soon catch up the global standards in some industries such as electronics and other consumer goods, and will attract foreign firms.

Another reason to invest in Vietnam is the development potential for infrastructure. Underdeveloped transportation and communication-related infrastructure give Korean investors having advanced technology and experience an opportunity for improving these sectors. So far, to attract FDI in an environment of limited infrastructure, Vietnam has developed a system of industrial zones. Up till the end of 2002, 76 industrial zones have been built in different areas of the country. When related and supporting industries are located near with one another, easy access to components and information can be attained. Vietnam has advantages which entitle it to be an access base to the third markets. Geographically, it is located in the gate to the Southeast Asia from the East, which can provide opportunities for easy access into the neighboring countries.

For firm strategy, structure, and rivalry, the uprising global mindset in Vietnam helps its business environment to be more global and efficient. The government of Vietnam is making efforts to attract inward FDI by offering various investment incentives. The country is now emerging as one of the fast globalizing countries in the Southeast Asian countries.

2. FDI Motivations

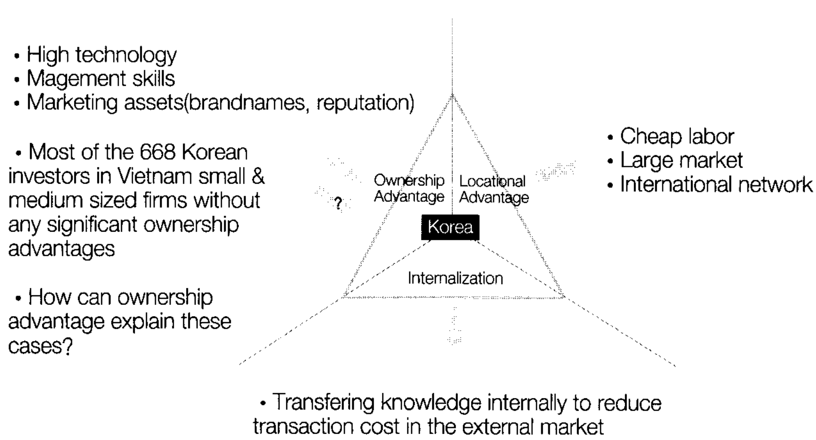
In order to understand why Korean firms make investments in Vietnam, the fundamental motivations for FDI should be carefully understood. Here are two important theories that explain different FDI motivations.

1) Eclectic (OLI) Paradigm

The most popular theory of FDI is Dunning’s OLI or eclectic paradigm (Dunning 1988, 1995, 2000) and is still regarded as the most comprehensive paradigm for explaining FDI among scholars in this field. This theory explains the firm’s behavior or the FDI motivations from an investing firm’s perspective and identifies three variables in order to explain the FDI motivations, i.e., Ownership (O), Location (L) and Internalization (I). According to Dunning (2000), the locational decisions for foreign activities are made by multinational firms based on the purpose of enlarging or exploiting their already existing firm-specific advantages that are called ownership advantages. Meanwhile, Dunning (2000) has argued that the decision of FDI is also affected by the location factors of host country and internalization is the process of internalizing the unique asset that gives the firm the unique advantage and again the ability to combine the surplus advantages with others within the firm to exploit advantages.

Therefore, Korea’s FDI motivation can be explained as follows by using Dunning’s eclectic paradigm (see Figure 6). Korean investors can make use of their high technology, management skills and marketing assets (i.e., brand names and reputation) as their ownership advantages. Cheap labor, large market and international network can be used as locational advantages that Vietnam provides for the Korean investors. Exporting may cause an increase in transaction cost, so the investing firms transfer knowledge internally to reduce transaction costs in the external market. However, most of the 668 Korean investors in Vietnam are small and medium sized firms without any significant ownership advantages. How can ownership advantage approach explain these cases?

〈Figure 6〉 Korea’s FDI motivation by eclectic paradigm



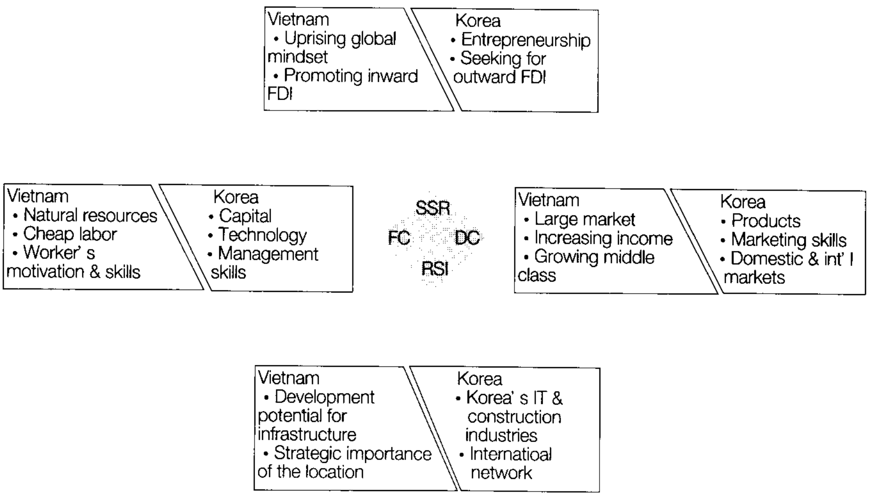
2) Imbalance Theory

In Dunning's eclectic model, the proposition of ownership advantages has its limits. That is, it does not properly consider unconventional FDI. Unconventional FDI are strategic asset-seeking FDI from less developed countries to more developed countries (Moon and Roehl 1993, 2001). Meanwhile, the imbalance theory (Moon and Roehl 2001) modifies and extends the OLI paradigm, explaining the motivation of FDI with either ownership advantages or disadvantages. One important implication of this new approach is that FDI depends not only on the surplus factor (ownership advantage) but also on the deficient factor (ownership disadvantage). This analysis is thus an extension to the traditional approach of ownership advantage. Each firm has different capabilities. Investment is not arranged by the investing firm's unilateral investment motivations but by the complementary motivations of both the investing firm and the host country.

What are the benefits or impacts of FDI for Korea and Vietnam? It is important to provide an integrated analysis of the motivations and impacts of FDI. To determine the fundamental reasons for Korea's investment in Vietnam, it is again important to consider each determinant of the diamond.

For factor conditions, the huge amount of inward FDI that reached Vietnam from Korea during the last decade or so has brought capital as well as management skills and technologies. The technologies of the Korean firms are generally of a higher level than those currently used in Vietnam, especially in industries such as telecommunications, chemical and electronics. The Vietnamese learn and acquire technological capabilities from foreign partners and also modernize management and corporate governance structure. On the other hand, Korean firms make use of the natural resources as well as the motivated and inexpensive labor force of Vietnam.

〈Figure 7〉 Matching recipients & investors by the imbalance theory



The two countries can also benefit from each other in other determinants of the diamond model. Regarding demand conditions, through investment in Vietnam, Korean firms gain both the Vietnamese domestic market and its international market. Korea can provide Vietnam with various products of high quality. In terms of related and supporting industries, being located in the middle of Indochina and having effective US-Vietnam bilateral trade agreement, Vietnam has a strategic importance of the location and offers development potential for infrastructure to Korean investors. Therefore, the Korea's IT and construction industries have particular significance in Vietnam. The country's uprising global mindset and government's inward

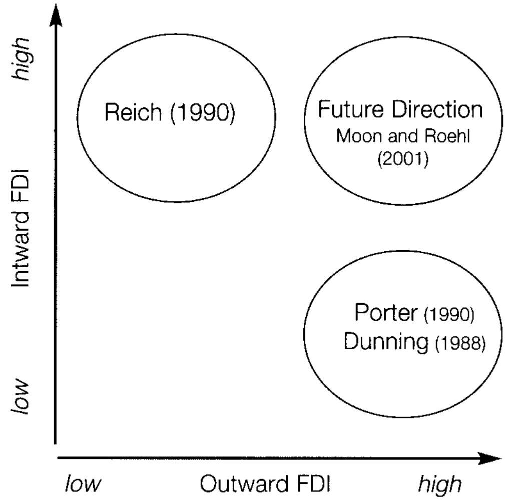
FDI promotion policies help its industrial structure to be more competitive and efficient. Korean firms utilize their entrepreneurship in order to maximize the productivity of outward FDI. Figure 7 shows mutual benefits from both recipients and investors as FDI fixes the unbalanced conditions of each side.

Ⅳ. Policy Directions

Robert Reich (1990), Harvard professor, presented an interesting perspective of national competitiveness in his paper called "Who is Us?". According to Reich, any firms that utilize the national workforce at home are "us" rather than the firms headquartered in the home country and utilize the workforce of other nations. Therefore, he preferred inward FDI to outward FDI for national competitiveness. Michael Porter (1990), another Harvard professor, presented an opposite perspective. As the best indicators of national competitiveness, he chose exports and outward FDI. Also, Dunning (1988) was for outward FDI, arguing that FDI depends on the surplus factor i.e., ownership advantage.

Neither Reich nor Porter is comprehensive in explaining the ideal type of FDI policy. The policy that is open to both inward and outward FDI directions should be adopted and only this policy direction can produce mutual benefits as shown in Figure 8. This is the future direction of Vietnam and Korea in order for the two countries to achieve economic cooperation through FDI as explained above by the imbalance theory.

〈Figure 8〉 Policy directions



Korea has played a significant role in the development of the Vietnamese economy through FDI on a long-term basis. Although the volume of investment sharply dropped during the Asian financial crisis, Korea is increasing its investment in the country. In order to further increase the cooperation between the two countries through FDI, policy makers and business managers should look at all of the four determinants of the diamond model. They often look at only a part, for example, natural resource development or cheap labor. In reality, there are many other opportunities for further businesses between the two countries as suggested in this paper.

V. Conclusion

This paper has compared the investment environments of Vietnam and China. Considering the four conditions of the diamond model, Vietnam has proved to be a very promising country for Korea to invest. Vietnam is unveiling itself to the world and has shown its latent yet potent possibility for development. This paper has also examined why Korean investors are making investments in Vietnam and how mutual benefits between Korea and Vietnam can be created through FDI. Analytical models such as the diamond model and the imbalance theory are useful for rigorous analysis for these purposes.

This study can be further developed. A more in-depth study of each diamond determinant can be done to enhance economic cooperation between Vietnam and Korea through FDI. Furthermore, the analytical framework of this paper can be easily applied to other units of analysis including industries and firms. This paper has provided some useful conceptual models. Therefore, more quantitative, statistical analyses can be conducted to verify the theoretical frameworks of this study.

Key words : Foreign Direct Investment, OLI paradigm, Imbalance theory, Diamond Model, Generalized Double Diamond Model.

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국문초록

해외직접투자를 통한 한국과 베트남의 경제협력

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본 연구의 목적은 해외직접투자를 통한 한국과 베트남의 경제협력 방안을 찾고자 하는 것이다. 이를 위한 분석의 틀로서 Porter의 다이아몬드 모델을 발전시킨 새로운 모델과 Dunning의 OLI paradigm을 발전시킨 모델을 사용하였다. 본 논문에서 소개된 더블 다이아몬드 모델은 베트남의 투자환경을 분석하는데 유용하고 베트남 투자의 타당성을 평가하기에 용이하다. 또한 Dunning의 모델을 발전시킨 imbalance theory는 한국의 해외투자 동기와 효과를 설명하기에 적합하다. 연구 결과, 베트남의 투자환경은 중국 못지않게 우수한 것으로 나타났고 한국은 베트남 투자를 통해 상호 이익을 얻을 수 있다는 결론을 도출 할 수 있었다. 본 연구는 실무적이어서 국가 정책 결정자 및 기업의 전략 수립자들에게도 중요한 시사점을 제공할 수 있을 것이다.

주제어: 해외직접투자, OLI 패러다임, Imbalance theory, 다이아몬드 모델, 더블 다이아몬드 모델.