WORLD ECONOMY UPDATE

April 5, 2013 | Vol. 3 No. 14

The Russian ODI and FDI promotion strategy of Korea

ISSN 1976-0515

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Recent Trends of Russian ODI: Patterns and Motivations

Russian overseas direct investment (ODI) has been increasing rapidly in recent years, thanks to the continuous high oil prices phenomenon in the world and political stability in the nation since the early 2000s. Naturally, Russian ODI began to exhibit an upward trend since the early 2000s and rose more steeply from the mid-2000s. The 2008 global financial crisis could not stop the Russian ODI. Rather, it continued with large amount and is expected to keep the trend in the future.

The total volume of Russian ODI in stock recorded $362.1 billion at year-end 2011, ranking 15th place in the world. The volume grew more than 18 times of that in 2000. From 2007 to 2011, Russia invested more than $1 billion on the average to 12 countries and $100 million to $1 billion on the average to other 17 countries annually.

Russian ODI Patterns

When it comes to regional distribution of Russian ODI, we should keep in mind that there is a strong trans-shipping or round-tripping feature. Ostensibly, Russia's major investment destinations are Cyprus, British Virgin Island, Luxemburg, Bermuda, and the Bahamas. So far two-thirds of Russian ODI are concentrated in so-called "tax haven" territories. However, as one can guess, they are far from the endpoint of the investment. Usually, the money goes back to Russia or third countries.

In fact, real Russian ODI pattern shows "neighbor effect." This means that Russian investors are usually interested in and actually investing in countries or regions that are culturally, ethnically, and historically close to them. Indeed, more than 10% of Russian ODI is concentrated in CIS countries, including Belarus, Ukraine, Moldova, Armenia, Uzbekistan, Tajikistan, Kyrgyzstan, and Montenegro that share close culture with Russia. Among these, Ukraine is the most popular investment destination for Russians. This is because the nation is well perceived by Russian investors in terms of geography, culture, and production network potential.

Russian ODI in each industry shows certain patterns as well. At present, Russian oil-gas industries are the most active overseas direct investors followed by metal conglomerates. Also, Russian companies in these fields have overseas investment strategies or behaviors that the traditional multinationals in developed countries usually use. They began expanding in the global market in the early 1990s when Russian ODI was first embarked. They are now globally competitive and equipped with transnational production network, which combines commodity production, processing, and complete product making in all different countries.

Meanwhile, Russian manufacturers are improving their production via technology transfer, which is obtained through M&A abroad. With enhanced competitiveness through R&D, they try to develop new products. Such ODI activities are expected to contribute to modernization of Russia. Russia's service sector is lagging behind, compared to that of other countries. Thus, "catch-up" strategy is a better way to develop the industry in general. Nevertheless, Russian service companies have unique competitiveness in the post-Soviet region, thanks to the knowledge on business culture of transition economies, business relations inherited from the Soviet era and no language barrier, etc. Against this back drop, they started expanding in neighboring countries and made a success in competing with western multinationals.

Russian ODI Motivations and strategies

In order to better analyze motivations and strategies of Russian ODI, we surveyed Russian companies that have conducted or are considering ODI. The questionnaire was distributed in May–August to 150 Russian businesses. However, the response rate stood merely at 15% (22 answers). This is mainly due to Russian companies' behavior of not willing to open their information. However, the rate is not too disappointing because it is close to that of similar surveys by IMEMO RAS.

The respondents vary from oil-gas industries to high-tech companies. Based on the result, ODI motivations can be divided into two: conventional and nonconventional. Then conventional motivation can be subcategorized into obtaining natural resources, market expansion, and lower labor cost. Nonconventional motivation consist of enhancing foreign partnership, access to new technology, optimization of financing, and asset insurance among others (see Table 1).

Table 1. Motivations of Russian ODI

	Traditional			Nontraditional				
	Natural resources	Market expansion	Lower labor cost	Enhancing foreign partnership	Access to new technology	Optimization of financing	Asset Insurance (including negotiation leverage)	Others
CIS	9	4	4	4	2	1	2	2
EU	4	5	2	10	12	3	2	0
China	3	4	4	4	2	1	1	0
Korea	0	2	0	2	5	2	3	0
North America	2	1	0	2	2	2	1	0
Others	5	2	1	2	0	1	1	0
Total	23	18	11	25	23	10	10	2

Note: Others include Turkey, Australia, Canada, Africa, and South America.

According to respondents, traditional ODI motivation is mostly applied to investments in the CIS region while nontraditional motivation is largely employed investments in the EU and North America. In addition, Russian ODI destinations are often decided by investors' personal links or Russia's traditional relations

ODI strategy of Russian companies can be summarized as follows. First, although Russian businesses are generally using conventional strategies, such as securing natural resources and market expansion, specifics or priorities can vary along with their specialized fields and interested regions. Russian major investors usually do not have evident regional priority. However "second group (medium sized)" investors seem to possess regional preference. Recently, the second group's investment is concentrated in the CIS region to a large extent and the EU with less frequency. However, geographical proximity and culture play bigger role when it come to acquiring foreign assets. Second, not all foreign assets of Russian companies are integrated into transnational production-sales chains. Mostly, Russian oil-gas and metal industries have vertically integrated chains. This is to lessen external shocks because their main products — commodities — are vulnerable to economic conditions. They can also effectively control all stages of production from resource development to end goods. Third, M&A is preferred to green field investment by Russian businesses. In 2011, 10% of the total Russian M&A took place abroad. This is often done by conglomerates than small- and medium-sized companies. Fourth, it is hard to say that Russian companies are not receiving any government support, although there has not been direct support from the Russian government so far. For example, the Russian government provided massive financial support to Russian businesses in the wake of the 2008 global financial crisis. Currently, the Ministry of Foreign Affairs is making efforts to support them.

FDI in Korea and Evaluation of its Policy

FDI in Korea soared in the late 1990s after the 1997 East Asian financial crisis and constantly recorded \$10–12 billion in the mid-2000s. Then, the volume exceeded \$13 billion in the last two years (see Table 2).

Table 2. Recent FDI Trends in Korea

(Unit: 100 million USD)

Year	'92 to '94 Ave.	'95 to '97 Ave	'98 to '00 Ave	'01 to '03 Ave	'04 to '06 Ave	'07	'08	'09	'10	'11
FDI volume	11	40	132	89	119	105	117	115	131	137

Source: Ministry of Knowledge Economy, FDI Statistics.

Investor structure displays that more than 90% of FDI in Korea has been from developed countries. Whereas FDI from advanced economies has been around $10–11 billion annually since 2004, FDI from developing countries was a mere $500 million. The number of investment cases from developing countries is bigger than that from developed nations. This can be interpreted that the investment amount from developing economies tends to be small and done by individual investors.

Table 3. FDI Trends of Major Investor- Countries in Korea and Russia's Share

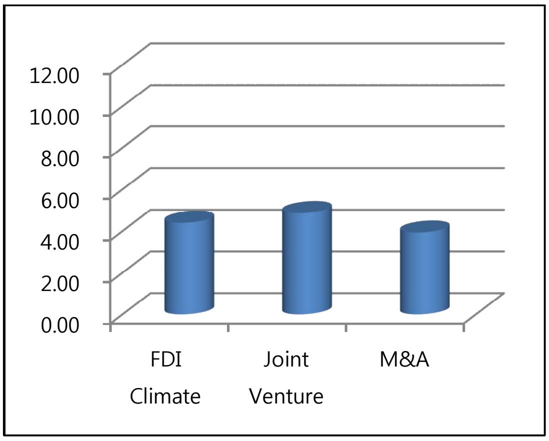
(Unit: Thousand USD, %)

Year	2005	2006	2007	2008	2009	2010	2011
Japan	1,880,795	2,111,046	990,290	1,423,941	1,934,253	2,083,233	2,289,081
U.S.	2,689,764	1,710,925	2,329,120	1,328,190	1,486,417	1,974,404	2,372,028
Netherlands	1,140,928	791,717	1,965,056	1,228,067	1,897,667	1,184,887	1,011,004
UK	2,316,458	706,556	363,853	1,232,792	1,952,895	648,956	920,115
China	68,414	37,887	384,131	335,481	159,607	414,177	650,768
Germany	704,812	483,907	438,902	685,418	569,813	268,260	1,471,446
France	85,179	1,173,434	439,300	537,889	109,551	159,919	236,282
Russia	2,506	2,424	2,526	16,001	1,426	5,054	8,764
(share, %)	0.022	0.022	0.024	0.137	0.012	0.039	0.064

Source: Ministry of Knowledge Economy, FDI Statistics

Meanwhile, Russia's direct investment toward South Korea is rather trivial, compared to its total volume worldwide. Russia's direct investment in Korea, which began with five cases worth of $200,000 in 1991, recorded 520 total cases with some $54.6 million in stock in 2011. This is a mere 3% of the total amount of Korea's direct investment toward Russia. This is a puny 0.03% of the total FDI volume in Korea, which stood at more than $187 billion at the end of 2011. In 2005–2011, Russia's average ODI in Korea recorded only about $5.5 million (see Table 2). Russia's ODI in Korea is small not only in terms of total investment volume, but also in the aspect of average amount of each case, which is about $105,000. This implies that Korea is not yet an attractive investment destination with the Russians.

Figure 1. Investment Attractiveness of Korea

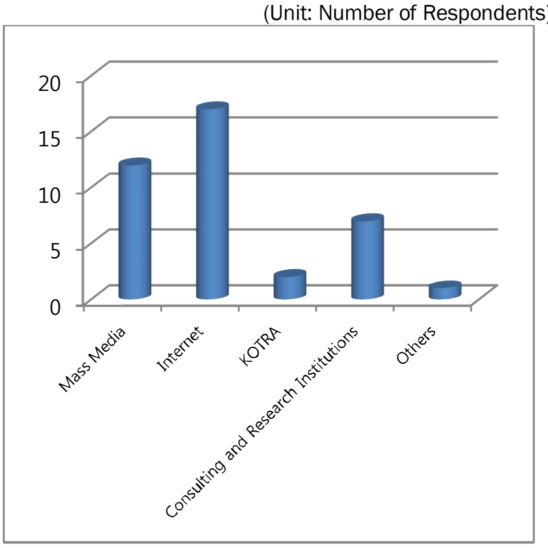


Note: "1" denotes very bad, "10" indicates very good.

In our survey, we also asked Russian respondents how they evaluate Korea's investment attractiveness in terms of general FDI climate, establishing joint ventures and M&A. [Figure 1] is the result of the survey. According to the result, FDI climate in Korea was rated 4 out of 10, which reflects the fact that Russian businessmen think that Korea's business environment is worse than the average. In addition, establishing joint ventures and M&A in Korea received 5 points and 4 points, respectively, out of 10 points. This also shows that Russian companies are not that interested in investing in Korea.

Figure 2. Motivations of Russian ODI

(Unit: Number of Respondents)



Besides, most of the Russian respondents did not have investment plans in Korea. However, it can be interpreted that Russian businesses are not well aware of the Korean market, not that Korea's FDI environment is virtually unfavorable. This is supported by [Figure 4] that most of Russian respondent companies rely on the Internet or mass media as sources on Korea and are not fully employing professional or in-depth information. Among respondent companies, 16 are obtaining necessary information about Korea through the Internet and 10 are getting the information from other mass media sources; six of them are receiving the information through publications by consultation or research institutions.

We analyzed two representative cases of Russia's direct investment in Korea in our study. First is the investment case of Tagaz Korea. It was to be a knockdown business model, using well-developed automobile industry cluster that compartments are produced in Korea and they are imported to and assembled in Russia. However, Russian investors were not in technologically leading position, which usually should come along with FDI in order to succeed. Rather, they tried to obtain technology by leaking information. Thus, it ended up as failure. Second is a success case that Seoul city launched Russian Science Seoul. The institute deals with various fields of research, including high-tech medical videos, aerospace, physics of nanoelectronics, physics electronic technology, solar cell, advanced clinical research, mechatronics, power electronics, machine control, electronic medical device, etc.

The reasons for low performance of Russia's direct investment in Korea can be analyzed with three aspects: market-seeking, efficiency-seeking, and asset-seeking. While many Russian companies are globally competitive in the resource sector, only a few Russian businesses are competitive enough in other sectors. From the market-seeking point of view, it is hard for Russian corporate to choose Korea as a production foothold to enter the Korean or East Asian market due to disadvantageous cost effectiveness. In order for efficiency-seeking FDI to succeed, a company should secure competitive advantage of both product and relevant technology. Thus, from efficiency-seeking point of view, Tagaz Korea should have had its own technology and know-how of auto engine and compartment designs as well as manufacturing. However, they were not in such leading position. Therefore, it was easy to guess that their investment in Korea, employing Korea's efficiency in the automobile industry, would not succeed. Meanwhile, although Russian companies are increasingly conducting strategic asset-seeking foreign direct investment in large, such hardly takes place in Korea. One reason can be a lack of business experience in and cultural unfamiliarity with East Asia.

Policy Implications

Investment Promising Sectors

We tried to select attractive sectors for Russian investors and measures to increase Russia's investment in Korea. According to our study, Russia's defense industry holds promising investment potentials. It contains comparatively high technological competitiveness among Russian businesses, and with its abundant capital resources, foreign direct investment is likely to result in success. Agreements at the government level should precede any technical and investment cooperation with Russia's defense industry, as it requires approvals from Russia's technology-related government agencies.

Second, investment promotion through market-oriented joint ventures. Korea's investment promotion agencies, such as *Invest Korea*, should sort out particular sectors with prominent market share effects in Russia, in order to develop a business model that will accelerate mutual investment between the Korean and Russian industries. Such business model could be implemented in prospective investment counseling programs for businesses of both countries, and the launch of such programs needs to be actively considered.

Third, investment promotion targeted at Russia's energy sector is promising. Korea needs to participate in Russia's resource development projects to establish cooperative ties between the energy sectors. This may open the way for further joint investment cooperation between the businesses of both countries in a third-party energy resource development. Moreover, energy efficiency technology of Russia's leading energy enterprises can provide opportunities to launch joint investment projects in Korea.

Fourth, investment promotion targeted at the research development and education sector. In the case of the medical sector, Korea may implement Russia's science technology skills to commercialize it into medical devices. Such strategy fits in the broader objective of establishing a Korea–Russia joint enterprise for global markets in the territories of Korea. In case of the information and communication sector, leading enterprises of both countries could consider reaching an agreement for strategic technology partnership and joint investment cooperation. In the case of the education sector, methods to derive investment promotion through increased cooperation in the higher education and science technology should be actively considered.

For Further Investment Cooperation

As such, in order to expand Russia's foreign direct investment in each of these sectors, the

Republic of Korea should place more effort in the following areas.

First, mutual cooperation with Russia's government agencies needs to be expanded. Building cooperation channels to promote Russia's foreign direct investment in Korea necessitates omnidirectional contact with the Ministry of Economic Development, the Agency for Export Credit and Investment Insurance, and the Chamber of Commerce and Industry of the Russian Federation. In such processes, it would be favorable for the Korean government and related agencies to replace the current individual channels of contact with the so-called "control towers" that would allow more comprehensive and systematic control for continuous and consistent policy for investment promotion to Russia.

Second, the present investment promotion system should be modified with increased interests concerning all of Russia's regions. It would be necessary to strongly reinforce investment promotion affairs conducted at the KOTRA. Concurrently, it would be important to develop "Korea–Russia investment cooperation MOU" signed in 2011 between *Invest Korea* and Moscow Investment Agency to provide expanded investment opportunities and information exchange.

Third, Korea's economic success should be promoted to Russian businesses. It would be rational to promote Korea's images as a developed country through diverse exhibitions, while modifying incorrect stereotypes via published works of comparative country analysis. In particular, it would be vital to effectively employ the Internet and mass media outlets, while providing the information with rich contents in Russian language through the embassy, consulates, business related institutions, and conferences.

Fourth, Russian businesses need more active provision of information on investment in Korea. Korea should expand channels of interaction among business people of both countries and reinforce cooperation with the Chamber of Commerce and Industries of the Russian Federation and Moscow Entrepreneurs' Association. In addition, it is necessary to further activate the annual Korea–Russian Business Forum hosted by the Korea Chamber of Commerce and Industries and the annual Korea–Russia Business Dialogue hosted by the Korea International Trade Association, while setting Korea's investment promotion issues as the main agenda.

Fifth, cases of successful Russian investment in Korea need to be created. A single case of Russia's large-scale project successfully executed in Korea would motivate the Russian Federation to spread the information concerning Korea's investment environment.

Sixth, joint investment to a third-party should be more aggressively sought. For instance, merging Korea's technical skills and Russia's capital for a joint entry to Russia's neighboring CIS region and other allies since the Soviet era would be an opportunity to fully implement Russia's resources while reducing potential risks.

Lastly, Korea and Russia need to establish a joint investment fund to promote further investment. It could be a utilization of the already established "global new growth engine fund" between Korea and Russia or a creation of a similar joint investment fund. KIEP