

Place Image and FDI

**How place image of the EU and the U.S. impacts FDI decision-making by
Korean SMEs in Daegu and Kyungbuk Province**

Hyun-young Lee

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Prof. Dr. Gert-Jan Hospers (University of Twente)
Donnelly (University of Twente)

Dr. Shawn
Dr. Joerg Waldmann (Münster
Universität)

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Place Image and FDI

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Abstract The EU has been developed into the most advanced economic union in the world without any precedent in the history so far, by adopting the common currency, Euro, in the year of 2002. The 27 member states of the EU are subject to the same monetary policy, and their economic policies are set according to EU guidelines, which makes the EU a very attractive Common Market for export as well as FDI (Foreign Direct Investment). Nevertheless, the existence of the appealing economic unity does not seem to be very well-known to Korean SMEs (Small and Medium-sized Enterprises) who are on the contrary familiar with the U.S. market. Indeed, there is a significant gap of FDI flows from Korean SMEs to the U.S. and to the EU. This paper posits that the hesitant demeanour of Korean SMEs towards the EU compared to the U.S. as an FDI destination, has its roots in their asymmetrical place images about the both markets. In order to see whether there are different place images of the two markets and whether the place images can impact FDI decision-making by Korean SMEs, the paper includes an empirical research conducted to a population of 72 individuals who own SMEs in the Daegu Metropolitan City and Kyungbuk Province in Korea.

Chapter 1 Introduction

Around a half century has passed since the inception of the EU in 1958 with the Treaty of Rome. The EU has evolved itself as the most integrated economic union in the history so far with its common currency as well as economic policies and regulations that are based on unified guidelines by the EU. In the meantime, the EU has infiltrated into daily life of citizens in the European continent as a prevalent subject to talk about while the emergence of a brand-new economic union appears to be still unfamiliar to Korean citizens despite the mighty role-play of the EU as a marketplace in the world.

The evolvement of the EU demonstrates the stream of *regionalism* most significantly with its highest economic integration level. Additionally the fact that the number of Free Trade Agreements in the world has been increasing even more since the establishment of World Trade Organization (WTO) also indicates how the *regionalism* is becoming predominant in the global economy¹. In line with the trend, South Korea has also concluded FTAs in 2009 with the EU and the U.S. which belong to major trade partners.

Nevertheless the Korea-EU FTA is expected to come into force before the Korean-US one. To be precise, the FTA between South Korea and the EU has been initialed on the 15th October

¹ Ministry of Foreign Affairs and Trade, Republic of Korea,
<http://www.mofat.go.kr/english/econtrade/fta/issues/index2.jsp>

2009 and is expected to be signed in the first quarter of 2010 which will take effect in the same year, while the ratification of Korea-U.S. FTA meanwhile came to a deadlock. Although the EU forged ahead with the FTA with South Korea faster than the U.S., trade relation between South Korea and the U.S. has been always on a further way than the one with the EU as *table 1* demonstrates.

Table. 1 Comparison of Trade Relation between South Korea, and the EU and the U.S.

	EU	U.S.
Population	499,794,855	307,862,000
GDP(PPP ²)	\$15,247 trillion	\$14,441 trillion
2008 Korean Export to	35,752 million (13.1%)	30,795(11.3%)
1968-2009 Korean FDI to ³	\$16,694,009,000	\$27,981,033,000

Source: the U.N. Department of Economic and Social Affairs, International Monetary Fund, Eurostat, http://keri.koreaexim.go.kr/05_invest/01_statistics/investTotal.jsp

In 2008, South Korea exported more to the EU than to the U.S., which does not show much difference between the two⁴. However there has been a significant difference of Foreign Direct Investment(FDI) inflows from South Korea to the EU, and the U.S. Since the FDI figures from *table 1* encompass all the accumulated years since 1968, it is for sure necessary to consider the economic and political dependence of South Korea on the U.S. after the World War II during the reconstruction of South Korea. Notwithstanding lowered dependence on the U.S. nowadays, there still appears to be certain favoritism in South Korea towards the U.S. compared to the EU, when it comes to FDI as *table 2* more clearly verifies.

Table. 2 FDI inward stocks from South Korea to the EU and the U.S.(billions of euro)

	2005	2006	2007
EU	6.2	7.4	7.9
U.S.	10.1	14.1	36.2

Source: Eurostat, www.koreaexim.go.kr

In spite of the preference of South Korea for the U.S. as an FDI place, the Common Market of the EU is by no means inferior to the U.S. as an FDI place. First, the EU is equipped with a

² Purchasing Power Parities

³ The statistics reflect invest accumulated investment results until September 2009.

⁴ The relative volume of Korean export to the EU must be assessed as a moderate level in comparison to the one to the U.S. when we take each population and GDP into account.

Common Market which allows free circulation of goods even from third countries, once goods has passed through one of the member states. The Common Market provides third countries with a huge market of 27 member states at once since all of them apply the same trade regulations. Secondly, most of the western European countries have bigger purchasing power than the U.S. According to *A Comparison of Purchasing Power Around the Globe, Prices and Earnings 2006*, 16 member states of the EU proved to be more competent than the U.S. in the *Purchasing Power Parities* (PPP). It means that the EU citizens possess more capacities to buy goods and services than the American citizens. Last but not least, apart from the rich western countries, the EU can also provide investors with reasonable prices for lands and labors from the Central and Eastern European Countries (CEEC), which makes a good combination of two sorts of markets, one for production and the other for sale. For instance, one of the biggest Korean automobile manufacturers called KIA established its production line in Slovakia after its membership into the EU, with the objective that cars produced in Slovakia can avoid trade frictions as well as promote quick supply within the EU member states. Indeed, the credentials of the EU market are proved through the similar export volume from South Korea to the EU and the U.S., which means Korean enterprises treat both markets at the same level in terms of export destination. However they tend to retreat back from the EU market when it comes to FDI, which is different from their active attitude towards the U.S. market.

FDI requires different conditions from the ones regarding exports. While an efficient export needs to assess tariffs, costs of transportation, and exchange rates related to the destination country, an FDI demands more detailed and dense information of the host country such as taxes, regulations and policies, institutions, infrastructure, labor conditions and good access to supplier markets which cannot be elicited without a profound market research. Nonetheless FDI determinants, that is, factors which influence the decision of a firm to perform an FDI and then where to do it, have been disputed for a long time in the academic world. We do not know yet FDI determinants of Korean enterprises specifically regarding the EU and the U.S. markets, namely, why more of them go to U.S. rather than to the EU. However, it seems that the U.S. market attracts Korean investors better than the EU market does, under certain criteria which are important to Korean enterprises.

On the other hand, the preference of the U.S. market over the EU market in regard to FDI inflows from South Korea, appears to be far stronger for Korean Small and Medium-sized Enterprises (SMEs) than big Korean enterprises according to *table 3* below.

Table.3 FDI outflows from Korean SMEs and big enterprises to the EU and the U.S.

Unit: one thousand \$, Period: 1968-2009

		Reported number of investment ⁵	Number of new corporations	Reported amount of money	Amount of investment
Big enterprises	EU	1,816	579	18,772,683	14,832,824
	U.S.	2,973	951	24,950,847	21,472,099
SMEs	EU	1,615	719	2,470,620	1,759,856
	U.S.	7,479	3,112	6,744,000	4,473,007

Source: http://keri.koreaexim.go.kr/05_invest/01_statistics/investorSize.jsp

As mentioned before, the difference of FDI figures to the EU and U.S. in total needs to be contemplated from historical and political proximity of South Korea to the U.S. after the World War II, since *table 3* reflects figures since 1968. In addition, we also need to consider when South Korea established diplomatic relations respectively with the 27 EU member states, which affects trade relations. Considering that the EU and the U.S. had different starting points in trade relations, the existence of different figures of FDI between the two is a natural consequence to some extent. Nevertheless the gap of FDI figures between the EU and the U.S. by the big enterprises can be hardly explained as a preference of the U.S. over the EU especially nowadays when the EU has been one of the important target markets to big enterprises in South Korea since the enlargement of the EU in 2004, and moreover with the upcoming FTA between the EU and South Korea. Indeed the big Korean enterprises in industries such as automobile, Information Technology, and electronic home appliances have been spread in the EU common market since around 2000, which proves fair interests of the big Korean enterprises in investing in the EU market, not necessarily favoring the U.S. market over the EU common market. In a word, the different figures between the EU and the U.S. market coming from the big enterprises should not be stretched to interpret as a preference but rather should be tolerated moderately since they are accumulated numbers from the past to the present.

While it is feasible to tolerate the gap of FDI figures by the big enterprises between the U.S. and the EU for the above-mentioned reasons, the difference between the two markets by the SMEs is still very apparent, showing solid favoritism to the U.S. market. According to *table 3*, the number of investments from SMEs to the U.S. is almost quintuple size of the one to the EU, while the big enterprises present only one and a half times gap between the two markets.

⁵ The number includes joint investments and investments whose amount have increased.

It implies that some specific factors of the U.S. market entice Korean SMEs better than the EU market, while the two markets appear to be not really different for the big enterprises. Evidently the big Korean enterprises differ significantly from SMEs in terms of capacities to deal with FDI. Big enterprises are robustly armed with human and financial resources for market research, and moreover in case of negative contingencies they possess area experts who will deal with the problems. In contrast, SMEs lack resources to test an unknown overseas market already from the beginning, and even after going through the first phase of FDI they are likely to venture their businesses with limited sources of information due to lack of financial resources (Park & Kang 2004). To put it concretely, SMEs face in general both internal barriers which are related to capacities and abilities of the firms, and external barriers which the firms face in administrative procedures and different business environments. Firstly, their relative weakness in human and financial resources compared to big enterprises cause difficulties in collecting information of the destination market at the outset. Secondly in external matters again, SMEs do not have enough funds, labors, and time for complicated administrative procedures and for smooth adaptation into different business environments (OECD-APEC 2006). To sum up, Korean SMEs suffer from lack of knowledge about the host country when they want to make inroads to its market.

Considering that deficit of financial and human resources is the biggest problem of Korean SMEs but somehow more FDI flows out to the U.S. market than to the EU market except for the big enterprises that do not show any difference of investing in the two markets, Korean SMEs seem to be more inclined towards the U.S market due to some specific factors.

Interestingly, their main problem, imperfect information on destination markets, implies that they can be easily subject to the image of a market due to the lack of information. Jaffe and Nebenzahl (2006) argue that the image of a country plays a decisive role for a consumer who has not had experiences with a new product. Likewise, little knowledge on markets means that Korean SMEs will be more attracted by familiarity and visibility of the concerned places. In other words, the more well-known a country is, the more the country appeals as a brand (Anholt NBI Special Report 2007). The EU is obviously widely known to the world, however, South Korea which has been deeply associated with the U.S., is far less informed about the EU than the U.S., which reduces the familiarity of the EU in the Korean society. For instance, if a Korean SME targets reduction of production costs, which is *vertical FDI*, they would rather go to familiar Asian countries than unknown Eastern European countries. If they aim at *horizontal FDI* for the sake of sales in the target market, they would prefer to go

to the U.S. which seems to be more well-known country for Koreans than subtle Western European countries.

In conclusion, the fact that there is far less FDI flowing from Korean SMEs to the EU than to the U.S. and Korean SMEs have limited financial as well as human resources to perform market research and to cope with other accompanying problems compared to the big capable Korean enterprises, postulates that Korean SMEs are likely to be inclined to place image which seems to be an important FDI determinant for them. Accordingly, objectives of my research are, first, to uncover the influence of place image on FDI decision-making by Korean SMEs, and secondly as an empirical research to explore the image of the EU Common Market perceived by Korean SMEs in comparison to the U.S. market.

Main research questions;

- (1) How does place image affect FDI decision-making of Korean SMEs?*
- (2) What is the image that Korean SMEs have about the EU market compared to the U.S.?*

I posit in this research that place image is a vital factor for Korean SMEs to select an FDI place. Nonetheless place image is not the only determinant, but there exist various FDI determinants which need to be studied beforehand. Therefore, the second chapter deals with FDI determinants which have been discussed in economics literatures. I will first give a general overview of FDI determinants, to be precise, why a firm decides to become a Multi-National Corporate (MNC), and then how it decides an FDI place, under what conditions. Since my research focuses on FDI location determinants, the second and the third subchapters will give a special attention on how firms and in particular Korean SMEs would choose an FDI place. Peculiarities of Korean SMEs' FDI locational determinants will be naturally integrated with the third chapter, place image. The third chapter will be based on place branding and place marketing literature, while the second chapter relies on economics literature. The third chapter will shed light on how people form an image, an image of a place, and lastly how influential this place image can be on the subject of FDI determinants, especially for Korean SMEs. Based on my hypothesis that place image is a significant FDI determinant for Korean SMEs, the fourth chapter will present an empirical research, namely, what kinds of images Korean SMEs have towards the both markets, which will help validate

my hypothesis.

Chapter 2 Rationale of Firms going to Overseas Market

ING Group is a Dutch corporate, BASF is a German chemical company, and KIA Motors is a automobile manufacturer from South Korea. They all originate from certain countries, but are scattered all over the world, not only through exports but also through affiliates located in foreign countries. This economic activity of investing in foreign markets through subsidiary companies is called *Greenfield investment*, one form of Foreign Direct Investment (FDI). FDI can take place primarily via two methods; one is *Greenfield investment* where a firm establishes a subsidiary in a foreign country, and the other is Merger and Acquisition (M&A) where a firm buys management authority by means of a certain amount of stakes of a firm of a foreign country.

Since the late 1980s, FDI growth started to outweigh trade growth in the world. To be precise, from 1985 to 1995, FDI had grown in its size 3.5 times while trade had increased about two times (Dicken 2003:53). Meanwhile, competition among countries for FDI has increased, which has concurrently caused bandwagon effect in FDI by which firms go overseas market in order for the market not to be dominated by their rivals (Knickerbocker 1973). Hence, FDI became an important indicator of globalizing world economy as well as productivity of a country (Artige and Nicolini 2006: 2; Dicken 2003: 51). Above all, FDI has occupied a very important position in some countries in comparison to others. According to figures from 1999, FDI accounted for around 50% of Gross Domestic Product (GDP) in the Netherlands and in Ireland while the economy of Singapore was entirely occupied by FDI, which was 97% (Dicken 2003: 61).

Highlighting the importance of FDI, many scholars have investigated rationale why firms decide to become multinational corporation (MNC) which performs supply of production or services in more than one country, and moreover among all possible methods why they choose FDI instead of exports or selling license. The determinants of FDI have been researched in depth, but scholars could not reach a consensus on the determinants . In this chapter, I will provide determinants of FDI by reviewing literatures in economics and give a special focus on the determinants which are taken into consideration by firms for selecting business location once they decided to become MNCs.

2.1 Determinants of FDI

There does not exist a generic theoretical framework for determinants of FDI since; first, FDI is inherently complex and multidimensional across industries, regions and countries, secondly, there are no comprehensive international data on FDI for research, and lastly from the nature of FDI it cannot offer comprehensive statistical data (Agarwal 1980). Consequently explanation of determinants has been dominated by partial equilibrium analysis, either at the firm level or at the country level.

A. Partial equilibrium analysis

A1. Firm-specific factors

Prior to analyzing why firms choose the method of FDI to serve foreign markets, we first need to investigate why firms decide to become MNCs. In general, foreign firms have unfavorable conditions compared to local firms of the host country. Less knowledge about the customers, institutions, regulations and socio-cultural customs of the market put foreign firms on a disadvantageous position (Agarwal 1976). Despite the drawbacks, they are willing to go to foreign markets when they possess comparative advantages against the local firms such as cheaper financing, brand name, superior managerial and technological skills, and economies of scale (Kindelberger 1969). With the advantageous position, firms can choose FDI among all the possible means such as exports or licensing for the following reasons. The first possible case is the unique feature of intangible assets of a firm. Contrary to tangible assets which have a physical existence, intangible assets described as technologies or managerial skills cannot be exported, and even in case of licensing it is hard to extract a satisfying outcome for both parties, the licensee and the licensor. The main problem of licensing intangible assets is that the licensee would not pay a satisfying price to the asset since he or she cannot evaluate its value in the process of contract, while the licensor would not want to reveal the authentic asset unless the licensee pays a full price (Blonigen 2005: 384). Secondly, bandwagon effect is expected especially in oligopolistic markets. That is to say, firms follow the actions of the competitors in order to keep the equilibrium of the market (Knickerbocker 1973). Last but not least, FDI happens when a firm internalizes its own market across the borders. Skilled-labor intensive intermediate goods such as marketing and management skills and human capital, cost time and money for transfer, and this hindrance can be removed by establishing affiliates in foreign countries. Those affiliates reduce time delays of transfer of skills, save time for bargaining with unreliable new buyers, relieve the

magnitude of control by governments, and above all allow transfer pricing⁶ within the same firms (Bucky and Casson 1976). Internalization theory elucidates why firms transform themselves into MNCs and perform FDI.

In sum, firm-specific factors clarify inducements especially with the focus why firms decide to become MNCs and establish affiliates in foreign countries. Nevertheless the firm-specific factors have a deficit that there does not exist genuine data for observation (Blonigen 2005: 384).

A2. Macroeconomic factors

While firm-specific factors shed light on the possible motives of firms to become MNCs, macroeconomic factors indicate where and how much money firms will invest for FDI according to the level of determinants. Once a firm determines FDI, it puts effort to choose the most efficient and profitable location and magnitude for FDI (Blonigen 2005: 385).

When a firm decides to provide goods and services in foreign countries, it can attain its goal in general, either by export or FDI. Export can be inferior to FDI since it is vulnerable to volatile exchange rates, trade protection, and costs of transportation. On the other hand, FDI is demanding of taxes and institutions as its placing abroad is subject to those conditions (Barba Navaretti and Venables 2004). In other words, the weaknesses of the both export and FDI become external determinants which influence FDI decision-making. Exchange rates, trade barriers, and transport costs can operate as driving force for FDI. By those disadvantageous elements of export, firms are likely to turn to FDI in order to take avoiding action. What matters further for them is comparatively low tax and reliable institutional framework which are important basic factors for FDI location.

B. General equilibrium analysis

The partial equilibrium analysis with the firm-specific and macroeconomic factors have a big pitfall owing to the exclusion of the relationship between the firm's decision-making and other possible variables except for the variables that they use as hypotheses of their papers. In other words, it only observes the relation between firms' decision and a limited number of variables, leaving out other potential variables. Since those factors explain FDI determinants only partially, there has been effort to establish general framework of FDI determinants.

⁶ Transaction of goods and services within a MNC can be done by the internal-set prices, not passing through the international market. By doing this, it can save taxes (Agrawal, Transfer Pricing).

B1. Horizontal and vertical FDI

The most typical and well-known general equilibrium model divides FDI into two types, that is, horizontal FDI and vertical FDI. Horizontal FDI aims at serving the host country better by duplicating production. The main reason why firms opt for horizontal FDI, is to avoid trade barriers. To the contrary, vertical FDI seeks locations with low cost inputs according to each production line. Vertical FDI fragments each production line dependent on the costs and pick out places where the firm can exploit the cheapest natural or human resources (Markusen 1984). Nevertheless whether trade frictions lead to horizontal FDI, and whether the labor cost contributes to vertical FDI have provoked many debates. For example, vertical inducements were approved by a limited number of industries such as machinery and electronics (Hanson, Mataloni and Slaughter 2003, Feinberg and Keane 2001), which means that other industries were not willing to go abroad even though production costs were cheaper than the home country. The only proved variable without contention is market size which is proportional to the distribution of horizontal FDI.

B2. Gravity approach to FDI

According to *gravity model of trade*, size of GDP and geographical and cultural proximity of two units lead to more trade flows between the two. Although the model was not equipped with a theoretical framework at the outset, there have been scholars who developed theoretical foundations of the model recently. Unfortunately this breakthrough of establishing a theoretical foundation of gravity model in relation to FDI did not happen yet (Blonigen 2005: 392-393). Nevertheless it is likely that an adapted gravity model for FDI determinants will be able to see the link between cultural, economic, and geographical proximity of two units and their bilateral FDI flows.

C. Eclectic FDI theory

Dunning (1977, 1979) developed an *OLI (Ownership, Localization, and Internalization) paradigm* for FDI which integrated firm-specific factors, macroeconomic factors and trade theory. His work was put a value by Agarwal (1980), labeled as the most appropriate general theory of FDI and has been of use up to the present to analyze international activities of firms (John and Narula 2003). The multi-facets of FDI requires elaboration from both factors (Sethi et al 2003) and his paradigm provides a good combination of partial equilibrium analyses. Dunning points out three prerequisites for FDI to take place. First, a firm owns (*Ownership*)

competitive intangible assets which override competitors in the host country. The assets possess the characteristic that can be readily reproduced within a multi-nationalized firm, which makes the firm consider investing in foreign countries. Secondly the host country must have locational advantages(*Localization*) compared to the home country, and FDI must cost less than export. For instance, by helping the firm to jump over trade barriers, to reduce costs of transportation, wage costs, raw materials or investment incentives, FDI can generate better output than export. Obviously if conditions in the home country are preferred, FDI would not happen. Lastly, on the condition that the firm has both *ownership* and *localization*, it will internalize(*Internalization*) the market in order to elude not only the transaction costs but also the risk of transferring intangible assets to an external party.

Conclusions

FDI determinants are still in debates and there has been no successful unified theory (Markusen 2002). FDI determinants have been explained rather by partial equilibrium than general equilibrium since multi-dimensional FDI is almost impossible to fit in one general theoretical framework. Partial equilibrium analysis clarified why a firm decides to be a MNC by firm-specific factors, and then by what kind of macroeconomic factors the firm is influenced for choosing a location for the FDI, which is fundamental for my research. On the other hand, from the general equilibrium analysis, the division of horizontal and vertical FDI will be of use to make an overall distinction between different types of FDI, and the gravity approach will be useful to explain different scopes of FDI according to units. As a final point, lack of consensus and the multiple facets of FDI determinants imply that it is incumbent to apply differential determinants to respective locations with a good combination of theories.

2.2 Criteria to select FDI place

Locating FDI between countries is not necessarily different from allocation of economic activity which is unrelated to FDI (Dunning 1998: 57). When a firm hunts for a business location, it is likely to have the following conditions on the criteria list; labor market, facilities and infrastructure, taxes and regulations, and easy access to customers and suppliers (Kotler et al 1993: 232), all of which were already mentioned in the previous sector for the FDI determinants, to be precise, in the macroeconomic factors as well as in the general equilibrium analysis.

We remember that Dunning (1977, 1979) pointed out locational advantages(*localization*) in

his *OLI paradigm* for FDI to occur, since firms would not dare to go abroad if there are no comparative advantages in the destination place for FDI. It means that FDI is more susceptible to criteria for business allocation than economic activity without any relation to FDI (Dunning 1998: 59). For that reason, we need to give our fullest attention to what criteria firms bear for choosing an FDI place.

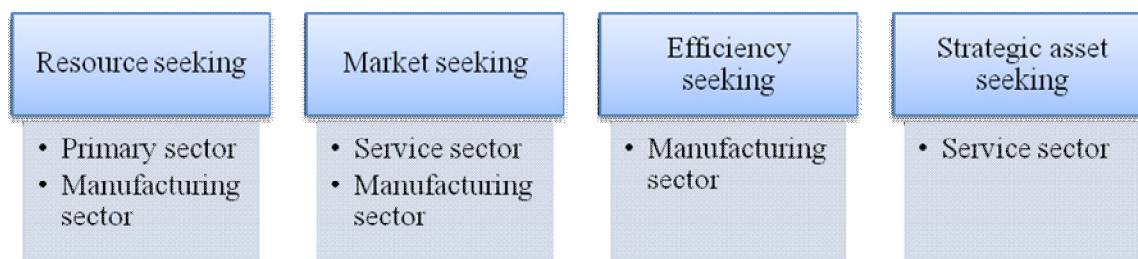
As Markusen developed a general FDI theory by dividing the purpose of FDI into horizontal and vertical FDI in the year of 1984, the mainstream of FDI had been or had been analyzed by two arguments, either looking for a new market or cutting production costs. Changes of FDI pattern occurred, however, with drastically rising service sector since the late 1990s. Service sector became prominent among industry sectors as the top, accounting for around 60% of the world's GNP in 1995 (World Bank 1997). Growing importance of the service sector has notable implications for FDI determinants and for a new FDI pattern. That is to say, first of all, some variables of criteria to select an FDI place have become more critical due to the increasing knowledge-intensive industry, which are skilled labor and good quality of public infrastructure. Both elements are indispensable for service industry to be appropriately deployed (Dunning 1998: 50). Basically the conversion to service sector in the world industries has influenced the scope of importance of the variables which are associated with service industry. Secondly, growing service sector led to advent of a new type of FDI, which is strategic asset-seeking FDI. This strategic asset-seeking FDI does not strive for cheap production or a new market for selling goods, but it intends to update their assets through partnership with foreign firms in the disguise of FDI (Ibid). Some Korean enterprise that want to make inroads into Silicon Valley to catch up with current flows, can be a good example for strategic asset-seeking FDI. In sum, the conversion to service industry has embossed the FDI determinants that are associated with knowledge-intensive industries.

Now bearing the changes in mind that occurred in particular with the focus on the service industry, we turn to determinants of FDI location in detail, that is, what factors are considered to be important for selecting an FDI place. Two determinants were already highlighted in the previous paragraph, which are skilled labor and good public infrastructure. Although they are more emphasized due to the current trend of industry, we should not overlook other possible locational advantages. In brief, determinants of FDI location need to be studied from the general perspective, but with a special focus on factors which are of great magnitude these

days. We should also bear in mind that there does not exist one theoretical framework for FDI determinants, but there are rather many variations of FDI determinants dependent on industry sectors, types of FDI, and FDI locations (Caves 1971, Artige and Nicolini 2006, Sethi et al 2003).

Behrman (1972) constructed a taxonomy with four types of FDI where each has a distinctive object of the FDI; a) *resource-seeking FDI* with the target of either lower labor cost or natural resources, b) by *market-seeking FDI* firms look for a new market to sell their products, c) with *efficiency-seeking FDI*, firms fragment production lines and outsource work overseas by optimizing each location on the global level. d) *strategic asset-seeking FDI* aims to acquire global knowledge on their industries from other foreign competitors, and to make use of local facilities, institutions, and infrastructure in order to enhance their competitive position in the world. Due to the peculiarities that each type of FDI has, they are associated mainly with one industry sector although each type can have other industries as well except for the one listed above. For instance, manufacturing sector is most likely to take place with the efficiency-seeking FDI in order to reduce production costs. However it can go abroad for the sake of cheap natural resources, or it can also serve the host country concurrently while using production lines there.

Fig.1 Taxonomy of FDI associated with taxonomy of industry



Source: Behrman (1972), Schulz (2009 Annual Meeting Paper)

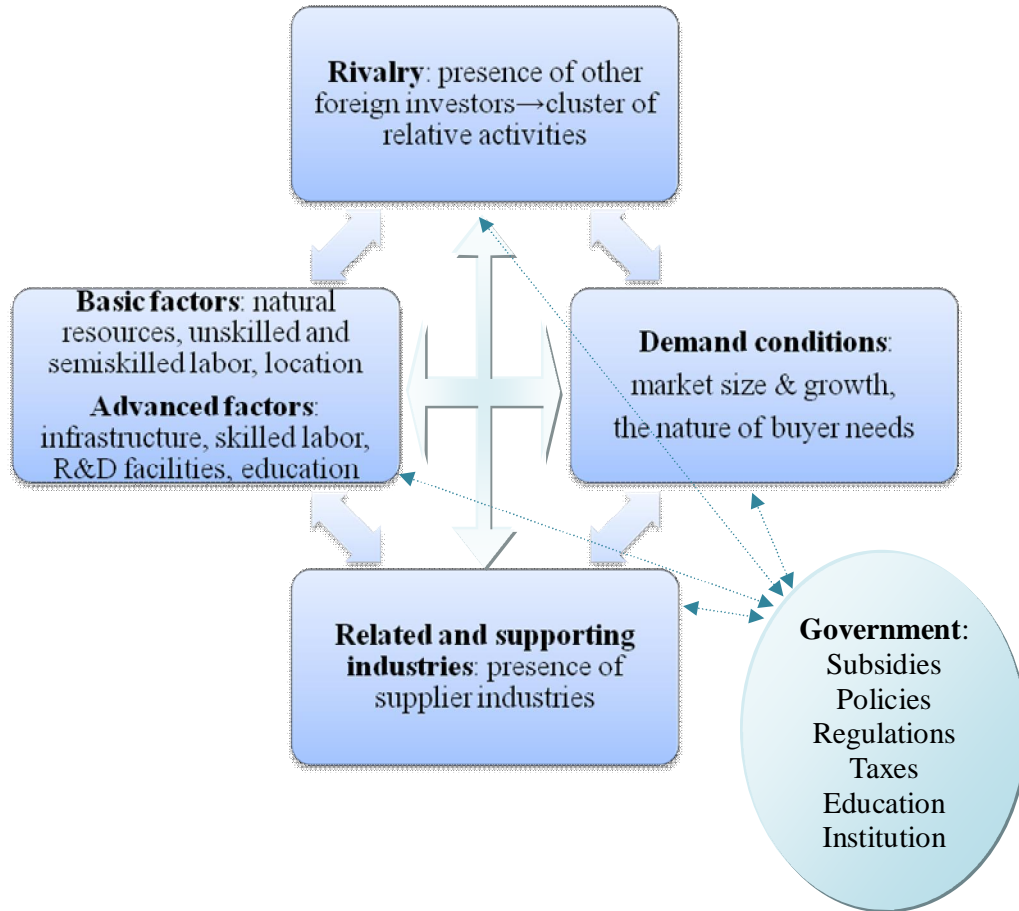
The both industry and FDI taxonomies are very crucial since FDI determinants are significantly influenced by either the taxonomy of FDI or the taxonomy of industry. For instance, in the 1970s, a Korean food company, Daesang Corporation, was having hard time procuring the main raw material called molasses for their seasoning product because its price on the international market had soared. This change of international business environment made the company launch into Indonesian market in the 1980s, in order to secure the reliable procurement and cheap price (*resource-seeking FDI*) as well as to open up a new market

(*market-seeking FDI*). Consequently, we can deduce that presence of natural resources and the market size played a vital role for the company's decision-making. On the other hand, when KIA motors set up a plant in Slovakia (manufacturing sector) in 2007, its main objective was to serve the EU market (*market-seeking FDI*) more efficiently by locating the plant in an EU member state, Slovakia, where still competitive labor costs are available (*efficiency-seeking FDI*). In this case, the concerned factors were low labor costs and the market access. In brief, the taxonomies enable us to predict important FDI determinants contingent upon type of industry or type of FDI, and to draw a comparatively clear line between a variety of possible determinants of FDI location.

The determinants of FDI location which have been discussed among economists, exist in many numbers, but they can be more concisely and more in order classified by adapting Porter's *Diamond Model* (1990) which explains the five determinants strengthening the competitiveness of a nation. Even though he himself conceived inward FDI to be a hazard for a competitive nation (Cho and Moon 2000), there is no doubt that determinants for national advantage by the *Diamond Model* will also attract foreign direct investors who want to benefit from the advantages of the host country in the same way like the domestic industries do. Furthermore the fact that the determinants for a competitive nation described by Porter (1990), corresponds to determinants of FDI location which have been established by a number of scholars, makes it possible to collect the FDI determinants under the *Diamond Model*. One indisputable fact here is that principles of making a competitive business is the same in essence regardless of its doer. That is to say, whether it is a nation or a foreign direct investor who wants to accomplish a competitive economic activity, the principles remain intact.

Porter defines four determinants for a competitive nation, and completes the picture of *Diamond Model* with the final component, government. *Fig.2* is essentially adapted from the Porter's *Diamond Model* (1990), and its contents are verified by other economic literature dealing with FDI determinants.

Fig 2. Location determinants of FDI



Source: adapted from Porter (1990), Kotler et al(1993: 232), Dunning (1977, 1979, 1993, 1998), Srinivasan and Mody (1997), Liu (1998), Hatem (1997), Wheeler and Mody (1992), Artige and Nicolini (2006: 4-5), UNCTAD (1997), Reuber et al (1973)

- Y **Factor conditions:** Factors of production can be largely distinguished between basic factors and advanced factors. Basic factors such as non-skilled labor and natural resources nowadays have little advantage on the global market since the factors can be easily substituted by global sourcing, except for the factor ‘location’ which can have additional effect on proximity to business climate according to the geographical distance. In comparison to the basic factors, the quality and quantity of skilled labor, education and training facilities for the labor, and Research and Development facilities are considered to be inevitable FDI determinants for firms, in order not to lag behind in the global competition. Efficient communication and transportation infrastructure, and capital availability are also necessary means for business to be appropriately deployed.

- Y **Rivalry**⁷: Presence of a number of rival foreign investors in the host country attests establishment of good high-quality infrastructure, human resources, and most likely a cluster of firms in the equivalent area which will reinforce the advanced factors.
- Y **Demand conditions**: Market size⁸ and its growth rate are the most undisputed FDI determinants since they imply great potential of buyer demand in the host country. Nevertheless only the size and growth rate of the host market are of no use unless the demand is readily actualized with easy access to consumers, which is highly associated with the level of cultural proximity as well.
- Y **Related and supporting industries**: For a firm to develop their economic activity, its related supplier industry must be placed at disposal. Needless to say, trouble-free access to supplier markets must be guaranteed.
- Y **Government**: Government is the leading one of all the determinants here as it affects all other determinants by virtue of regulations, policies, education system, and tax policies. Its policies for the capital market, regulations for goods and services, and institutional framework play a dominant role, not only by being as they are but also by impacting other four determinants.

2.3 FDI determinants for Korean SMEs

Globalization presents both opportunities and risks for SMEs in the world. On the one hand, SMEs can form a niche market by utilizing their advantages as local firms, and of course they are given more chances of access to the global market in direct as well as indirect ways nowadays. On the other hand, lack of skilled labor and capital capacities makes the SMEs inferior to big enterprises in the global competition (Lee 2007: 2). While big multinational enterprises are well explained by the *OLI paradigm* which clarifies FDI by means of *Ownership*, *Localization*, and *Internalization*, the theory is hardly applicable to SMEs. Explicitly, competitive firm assets (*Ownership*) and seek for better locations (*Localization*) than the home country for business can suit to SMEs as well, whereas *Internalization* by which firms internalize markets to circumvent transaction costs, time lags, and uncertainty to bargain with new buyers, explains exactly characteristics of immense MNCs fortified with

⁷ In the original *Diamond Model*, firm strategy and structure are added for this part. Although the two elements can be replaced by comparative advantage of firms which explains the activity of firms doing FDI in foreign countries, comparative advantage of firms cannot be a determinant how a firm decides the FDI location.

⁸ Market size in Porter's *Diamond Model* has by and large different implications compared to the context here. On the one hand, size of home market is seen as advantageous due to the effect of economies of scale, but on the other hand, some scholars argue that limited demand in home country drives firms to go abroad.

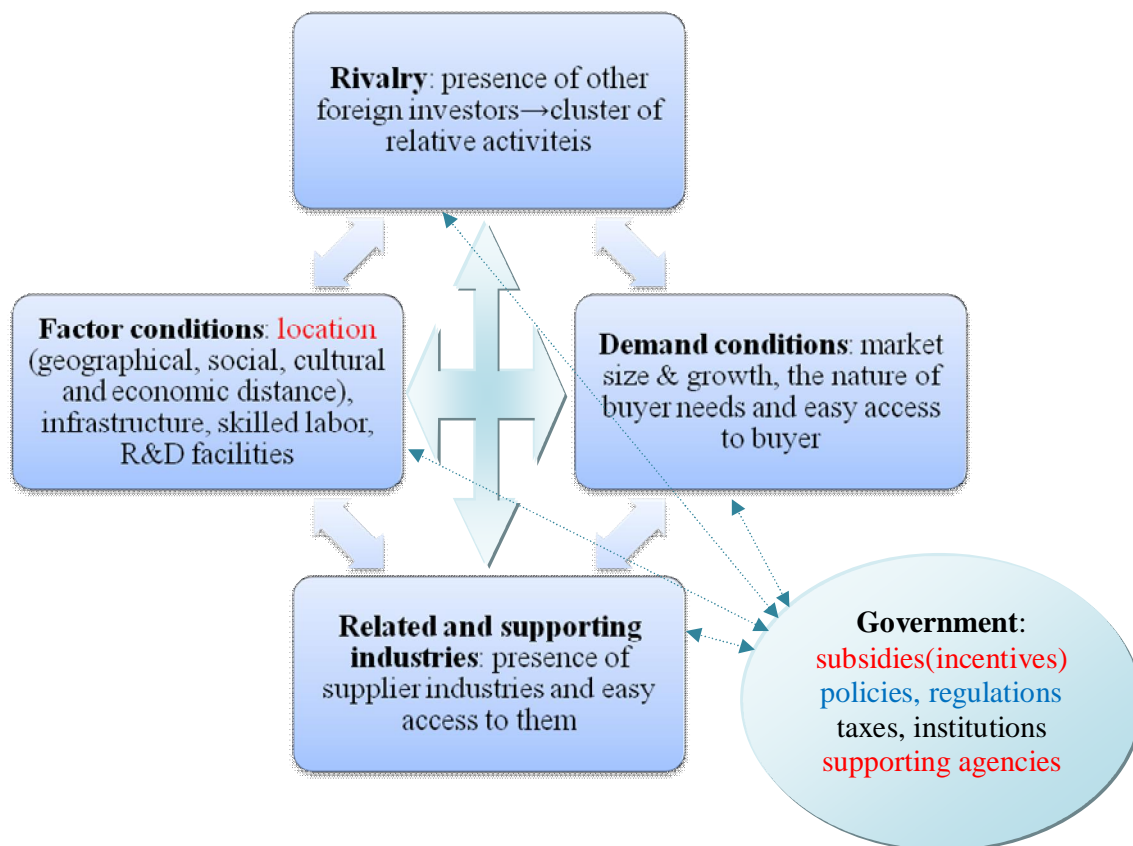
big funds who indeed carry out FDI for the sake of *Internalization*. On the other hand, Korean SMEs' decision-making to become an MNC is to a great extent determined by global orientation and global experiences of entrepreneurs (Kim et al 2008; Cho et al 2007; Park and Khoe 2007). In other words, the scope of global experiences and global traits of the entrepreneur influences decision-making of FDI considerably. However, *Ownership*, that is comparative advantage of firms such as technology, networking activities, information management turned out to be vital FDI determinants for SMEs as well (Ibid).

Not only the first phase why a firm decides to become multinational, but also the second phase how then the multi-nationalized firm selects an FDI place, is different between big enterprises and Korean SMEs. Intrinsically SMEs cannot help being more susceptible to the level of FDI determinants than big enterprises who are able to undergo a number of FDI barriers and correct unforeseen events during their investment period by using their expertise and funds. Hence the absence of some vital abilities of SMEs requires additional research on their peculiar location determinants of FDI.

A survey conducted by Lee (2007) which deals with general barriers of internationalization for SMEs, implies two very potential location determinants of FDI linked to Korean investors, that are incentives and information agencies for foreign investors. There exist slight disparities of determinants between big enterprises and small firms due to their different level of capacities. Moreover since studies on FDI determinants have been strongly associated with large enterprises, the factors which are considered to be crucial for SMEs, are likely to be omitted. The reason why incentives and information agencies are powerful motives to attract Korean SMEs, results from their lack of capital and qualified personnel. Next to them, Korean SMEs find also difficult to overcome different factor endowments. In terms of basic factors, geographical location which causes cultural and social distance and therefore demands different business customs, is seen in particular as one of the barriers in foreign markets (Ibid, OECD-APEC 2006). In other words, the distance of location can impact the scope of psychic distance, which affects the decision-making for an FDI place (Dunning 1993). In general, infrastructure, market size and growth, access to suppliers and customers, and opportunity to reinforce firm's assets such as clusters and R&D facilities, are taken into consideration for decision-making of FDI (Ibid; Park and Khoe 2007), which is in accord with the *fig.2*. In a nutshell, presence of agencies and incentives in the host country, and the level of difference in terms of business environments, are peculiar determinants for Korean

SMEs. Apart from the peculiarities of Korean SMEs, regulations and policies of the host country turned out to be a common denominator that both Korean SMEs and European SMEs⁹ take seriously as an important factor for FDI (Lee 2007: 66-68).

Fig 3. Location determinants of FDI for Korean SMEs



Source: adapted from Lee (2007), OECD-APEC (2006), Porter (1990), Dunning (1993), UNCTAD (1997)

In conclusion, except that Korean SMEs react more sensitively to the *location*-a basic factor which is naturally inherited- than big enterprises do, FDI determinants that Korean SMEs find important are in general same as the general ones from *fig 2*. Nevertheless how the host country's government is at Korean SMEs' disposal, can alter their decision-making of FDI in that country more drastically than it could do to big enterprises. Therefore, the most ideal approach to attract foreign investment from Korean SMEs would be that the government of a host country behaves proactive by means of incentives and information agencies to inform the Korean investors who have difficulties getting access to information from the outset.

⁹ Respondents in the survey (Lee 2007) are France, Germany, and Ireland.

2.4 Conclusion

The second chapter makes a stepping stone to this research, that is, FDI determinants. In order to see the hypothetical relation between place image and FDI, we first examined FDI determinants according to which firms decide to become MNCs and then settle on an FDI place. Among all the theoretical frameworks explaining FDI determinants, the *OLI* paradigm by Dunning encompasses very well from the moment when a firm decides to become multinational, selecting an advantageous place compared to the home country, and to the last purpose to internalize the firm's assets through FDI, even though *Internalization* of the paradigm does not suit Korean SMEs very much. The inclusive *OLI* paradigm can be better understood if we carve up into details and look through partial and general equilibrium analyses. The FDI determinants are then narrowed down to locational criteria for FDI which are presented as two *Diamond Models* illustrating the FDI determinants at one glance. Including peculiarities of service sector which takes up the most part of industry sectors nowadays, the both general *Diamond Model* and *Diamond Model* for Korean SMEs display five important elements for places in order to be selected as FDI destination; (1) *factor conditions* which are natural or made endowments of the market such as quantity and quality of the labor, natural resources, R&D facilities and infrastructure, (2) *rivalry* which especially counts in this time of global economy where firms need to be updated as quick as possible by being embedded in related industries at the global level, (3) *demand conditions* that imply the potential demand of the host market on the basis of the market size, growth and the characteristic of buyers there, which are indisputable important factors in deciding FDI place, (4) *related and supporting industries* that cannot be omitted in order to perform business smoothly in the host market, (5) *government* which is located at the top of the FDI determinants tree, influencing all the other factors with its own rules and institutions. The second *Diamond Model* shares all the principles with the first one but points out distinctive aspects of Korean SMEs, namely, vulnerability of Korean SMEs to cultural distance and the importance of proactive host country's government.

In line with the second chapter, the following chapter will validate the relation between the locational FDI determinants for Korean SMEs and impacts of place image.

Chapter 3 Place Image

Fig 2 in the second chapter lists five vital FDI determinants, in principle adapted by Porter's *Diamond Model*. His model is suitable to arrange commonly approved FDI determinants, allowing a special attention to the most important factor, government. Furthermore the model encompasses multifaceted FDI determinants, from demand conditions which is one of the traditional determinants, to clusters of related activities which has been recently recognized as a determinant due to the trait of service sector which takes up the most proportion among all the industry sectors. Nevertheless the FDI determinants in the *fig 2* look different to a degree when it comes to Korean SMEs. Their shortcoming in capital and qualified personnel leads to two peculiar FDI determinants; one is that they are dependent on the government of the host country regarding incentives, information, and regulation and policies. The other is that they find cultural barriers difficult to overcome and therefore take cultural proximity seriously.

The peculiarities of Korean SMEs in FDI determinants adds one more important feature, that is, place image. First, insufficient information about the host market due to their lack of capacity in combination with time pressure coming from global competition is likely to lead investors to lopsided decision-making, which means that they do not have enough time and material resources to deliberate FDI determinants rationally but have to rely on their image about potential FDI destination to some extent. Deficit in information causes extension of a fact in one area to other areas. Indeed, inexperienced SMEs in global affairs have the propensity to exaggerate market barriers as well as finance problems (Lee 2007). Secondly, the fact that they find cultural barriers difficult to overcome, implies that their psychological distance can infect other practical variables, forming a certain image of a place dependent on the cultural difference. For instance, the investor could assess customers, regulations and policies based on the cultural difference between the home country and the host country, which is also linked to the lack of information. For those reasons, place image cannot be overlooked, but needs to be studied in depth as an imperative determinant of FDI.

Chapter 3 is dedicated to place image in a broad sense. To be exact, we will first define how place image is constructed, in other words, how people form an image of an object and more precisely of a place. Secondly as an outcome of the formation of place image, we will give a definition of place image. Lastly, possible effects of place image on attracting investment will be explained.

The very first area where image had appeared to have influence on purchase selection was product. That is, consumers take the image of a product into account when they are in the decision-making process of purchasing it. In particular, the most discussed theory in product image has been *country of origin effect*, according to which consumers evaluate the quality of goods in relation to its production country (Bilkey & Nes 1982). Jaffe and Nebenzahl (2006) digged further in researching *country image effect* by making a considerable distinction between *consumer perception of the country*-where the brand of goods originates from- and *the country of manufacture*-where goods are made- by reason of growing outsourcing in the world economy. The studies on product images accompanied by its country of origin have transferred to the tourism academics who started to look at the relation between destination image and tourists' decision-making of the destination. That is to say, positive destination image works as a powerful determinant for tourists who want to visit the destination (Echtner and Ritchie 2003). Eventually the role of image has been recognized as one of the important attributes in the field of place marketing by which an entity, ranging from corporate, city, region to country, aims to be an attractive destination for tourism and Foreign Direct Investment (Papadopoulos 1993). Places have acknowledged the importance of image and applied it to its own marketing, which has in the meantime developed further into an independent field as *place branding* in which a wide range of stakeholders belonging to the same place work on the promotion of the place as a brand (Hankinson 2001, Trueman et al 2001).

In both place marketing and place branding, place image is an inevitable attribute. Place image is one of the main components for successful place marketing, next to infrastructure, quality of life, attractions and people (Kotler et al 1993; Kotler and Gertner 2002). In 2004, Gertner and Kotler came up with a more specific method for managing image, so-called strategic image management in which places target a specified audience, trim its image in the direction of the audience's desire and inform the audience. Rainisto (2003) stressed out the importance of cooperative work of all the stakeholders from the outset, and added five components for successful place marketing according to which a common place identity and a place image should be defined. In sum, places which want to attract tourism and investment should keep the vital role of image in mind, need to research how they are perceived by their targeted consumers, and finally apply lessons from the research to their place marketing or place branding.

3.1 Formation of place image

A place is likely to have an image. Kotler, Haider and Rein (1993; 35-36) pick image management as one of the place marketing strategies and classify broadly six possible place images of a place ; places can have a *positive, weak, negative, mixed, contradictory or overly attractive* image. Nevertheless this classification is vague for a real application because a place image is too multidimensional to be described with one adjective and is variable by whom the place is perceived, that is, for what objectives the observer wants to exploit the place. Besides we do not know whether a place image by this classification is rather objective or subjective, real or imaginary, and reliable or unreliable to be included in place marketing and place branding. Therefore, in order to comprehend complexities of a place image, it is incumbent first to know how a place image is constructed. Given that we know how it is formed, we can exercise different applications to understanding of a place image according to places and observers.

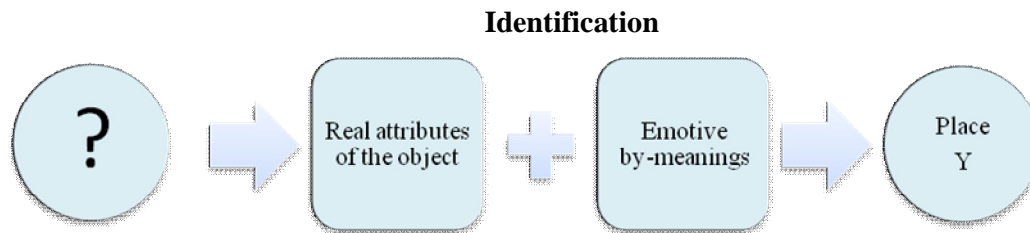
How we perceive an object

Kotler (1997) defined image as “a set of beliefs, ideas and impressions that a person holds regarding an object”. In the context, an image does not include real and objective attributes of the object, but only subjective perceptions of a person. According to *categorization theory*, we perform a learning process regarding an object where either *abstraction* or *generalization* takes place. In *abstraction*, we drop details of the object and filter it with an overall similarity. On contrary, in *generalization*, we focus on certain attributes of the object and envelope the object with those attributes, while excluding other attributes (Jaffe and Nebenzahl 2006). In other words, when observing of an object, we either make it smaller, or bigger than it is in reality in order to fit the new object in the existing categorization of our brain, whose main purpose is to manage abundant information that we receive. Furthermore *cognitive theory* explains that we have a strong tendency to keep consistency in our cognitive system for simplified cognitive structures (Vertzberger 1997: 137; Diez and Pace 2007). It means that people may make either a positive or a negative image out of contradictory or mixed images of a place for the sake of simplification.

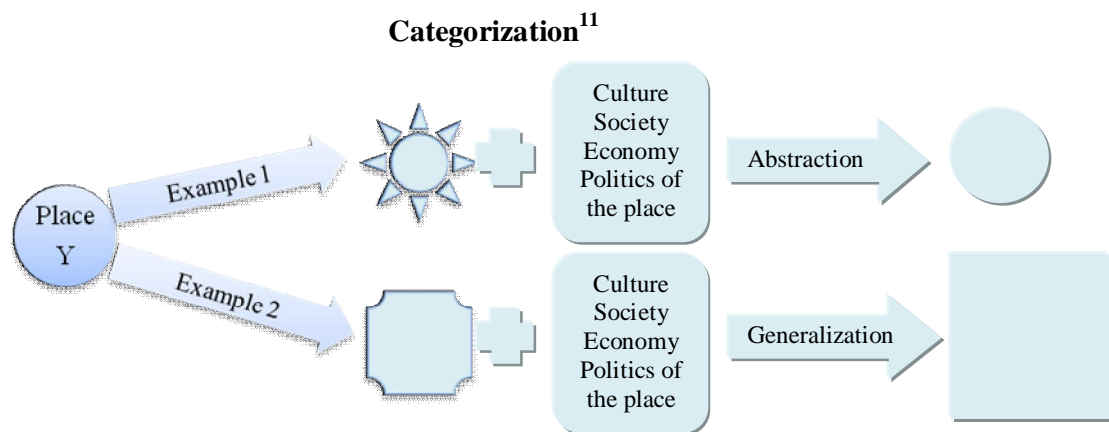
Certainly an image we have regarding a place, takes place in our heads, which means that an *image* is a component of our thoughts and our state of awareness. Nevertheless contents of the thoughts and the awareness are based on the physical and materialistic world. For instance, if we have an image about a place which exists within our psychological realm, the

contents of the image are related to the place which exists in the physical world such as people, infrastructure and culture¹⁰. First there is a place that we want to grasp and perceive. We go through identification process in which we identify it, name it and simultaneously grant special attributes. After this process, the place is reborn with a name “Y” in our consciousness as a cognitive structure which is composed of not only pure knowledge of contents of the place, but also its holistic emotive by-meanings (Graumann 1983). Secondly after the identification process, we add cultural, social and political conditions to grasp the place (Weichhart et al 2006). Place Y may have a strong political turbulence or high cultural prosperity, which will strongly impact the perception by people.

Fig 4. Formation of place image



Source: Graumann (1983)



Source: Jaffe and Nebenzahl (2006), Weichhart et al (2006)

¹⁰ Popper (1972) argued that knowledge has an independent ontological status in his *Three Worlds* theory (Drei-Welten-Theorie). The world is divided into three, namely 1st, 2nd, and 3rd. We exist in our body in a certain location of the world comprised of building and roads, which is the 1st world. We think, feel and are aware of things going on in the world, which is the 2nd world. Then in the 3rd world, we transform our thoughts and ideas into certain objects such as books, music, arts and et cetera, which exist as an object independently from the 2nd world. Therefore culture also has an independent ontological status according to Popper.

¹¹ Example 1 and 2 are only to show two possible outcomes of a categorization, either abstraction or generalization.

In sum, we perform two broad processes when facing an object. The first one is identification process in which the object is identified, named, and put into our cognitive structure with both knowledge-based components and holistic emotive components. It indicates that as soon as an object is settled in our cognitive structure, it cannot circumvent emotive, namely subjective, aspects even in the identification procedure. The second one is called learning process which is here explained by *categorization theory*. In order to cope with overflowing information in our brain, we either process the object by the overall similarity, or emphasize certain attributes and generalize it, with the help of additional information. For instance, if it is to learn a place, we might look at political, cultural, economical and social conditions of the place in order to categorize it. There is however a pitfall regarding the order of the two processes. For instance, categorization can already take place in the identification process, that is to say, we can just utilize existing categories to identify an object. Although it is hard to draw a clear line between the two processes, the clarification how we perceive objects, is a solidifying groundwork for the following finding; we cannot perceive objects only by objective means. From identifying it to learning it in our cognitive structure, subjective elements cannot be avoided, such as the holistic emotive by-meanings in the identification process and processing the object in our heads.

How we form an image of a place with which we have interests

Places can be important destinations for our interests. We may choose a location for various reasons such as business, immigration, and travel. Then we, as potential visitors, go through more specified image formation procedures of potential places which exist as diverse forms of entity such as country, region, or city. Needless to say, the specified formation procedures are dependent and based on the identification and learning processes, and especially how we have been affected by additive elements such as social, cultural, economic and political framework in the learning process.

In the next step when a place becomes one's interest, how the person is informed plays a significant role for his or her formation of image. In other words, the means of information sources can contribute to different outcomes. Whether we get the information via mass media, or through acquaintances, will culminate in totally different image formations. Especially general perspectives of a society towards a place serves as a crucial foundation for image formation.

Place image theory explains by what means potential visitors form place image. Image

formation of a place takes broadly two different steps. One is formation before visiting the place, and the other one is formation after visiting it which might change, lessen or strengthen the previous image. In contrast to the original design of *place image theory* which focuses on the comparison between before- and after-image, academics in the tourism field began to shed more light on before-image nowadays because the before-image works as fundamental criteria for purchase selection, and individuals forming a place image without visiting, may not visit the place after all just due to negative before-image. For that reason, it is necessary to study images of non-visitors in order to find out and correct negative before-image (Selby and Morgan 1996; Echtner and Ritchie 2003). Therefore before-image needs to be studied thoroughly.

According to Gunn (1972, 1988), there are two ways for us to form a place image before visiting it. The first is called *organic image* which we acquire generally in the process of socialization such as mass media, education, and stories of other people. Images shaped through those means have long-resistant effects in general since we are under their constant influence in our society. The thing is, beyond those diverse information channels, it is indeed the society that has a robust impact on those channels. The information of a place which gets to us, is through interpretation of our society, namely by means of socialization. Selby and Morgan (1996) say that *place images are constructed by the amount, source and objectivity of the information*. At this point, it is important to note that societies have the ability to control those features of the information in the society mainly using education and mass media. Hofstede (1983) also acknowledges the impacts of a society which he calls in his paper *importance of nationality*, instead of society. He presents three reasons why nationality matters; a) a society determines a specific type of institutions, laws, an educational system (political), b) its citizens tend to act according to symbolic value of the society (sociological), c) national cultural factors influence our thinking through family, education, and organizations (psychological). For instance, South Korea has been closely associated with the U.S. since the Second World War. The close relationship has affected South Korea in its politics, economy and culture, in a word, in most of the realms, which led South Korea to a fairly Americanized country (Kim and Won 2008). In brief, the strong impacts of a society on its citizens by means of politics, certain values and culture implies that the fairly Americanized aspects of the Korean society will also penetrate Korean people who are then likely to have further inclination to the U.S. than the EU. Therefore the role of *organic image*

which is formed within a certain society, is not to underestimate.

The second way of forming a place image is called *projected or induced image*. *Projected image* is formed by commercial-oriented information such as advertisements, guidebooks and agencies that work on promoting the image of a place. Products and services which are commercial themselves inherently, use this type of information the most, and people get also the most information of products and services from commercial sources. Likewise when people search for additional information of their interested places, they are expected to face *projected image* such as information from a related agency. However when it comes to places, images tend to be formed by various information sources (Echtner and Ritchie 2003), which means only by means of *projected image*, it is difficult to achieve its intended efficiency. Marketers who intend to alter negative *organic image* using the *projected image*, should bear it in mind that a marketing campaign can succeed to change a negative *organic image* only if it reflects real changes in the society (Anholt 2007).

After *organic and projected images*, there is the last step, in a theoretical sense, of image formation called *re-evaluated image*. This image is formed after visiting the place, which can change the previous image. For an image study, it is the most ideal way to research images from both visitors and non-visitors in order to find out differences between the before- and after-image. Image discrepancies between before- and after-visit can occur if the visitor had misinterpreted the information from *organic* and *projected image* and therefore had unrealistic expectations, or if the place did not meet the visitor's expectations which are supposed to be at disposal (Selby and Morgan 1996).

In sum, place image can be formed mainly by two sources. The first one is *organic image* which takes place in the process of socialization such as education, media, culture and literature which are the most powerful component in the formation of place image. The socialization process reflects certain viewpoints of the society and has life-long effects on our formation of place image. Therefore it is important what kind of relationship your society has with the place that you target. Secondly, we shape place image by *projected image* which is created for commercial purposes. Whereas we shape product image primarily via *projected image*, we do not count on commercial-oriented information much when shaping place image. Instead, as mentioned, *organic image* has the dominant influence on the formation of place image. Moreover *projected image* has intrinsic limits in the sense that it can be successful and effective marketing strategies, only if the *projected image* is accompanied by real changes. In other words, commercial information can yield positive images if their

commercial strategies are accompanied by actual reforms. In a nutshell, the facts that place image is constructed by various sources and non-visitors may give up place selection by negative *organic image*, imply that we should put more efforts to find out the *organic image* by non-visitors.

3.2 Place image

We have seen how an image towards an object is constructed, and furthermore how diverse sorts of information contribute to the formation of place image. To get the basic insight into the term, place image, we can ponder it by dividing the term into each individual word. First, *image*, as mentioned above, is built via identification and then categorization processes. During the identification process, the holistic emotive by-meanings are bestowed simultaneously with naming and actual characteristics of the object, and during the categorization process, attributes of the object are *processed*-as it literally means- altered and adjusted. Consequently an image is neither just a pure subjective perception, as Kotler (1997) argued, nor a pure assembly of real attributes. Instead an image is a complex concept which is subjective as well as objective. Psychology names it *imagery* where both holistic impressions and individual attributes are applied at the same time in order to process information in our brain (MacInnis and Price 1987; Dichter 1985). Secondly, the term *place* is in this paper defined as any type of entity which can be demarcated by socio-cultural boundaries as well as political boundaries. Although the definition of place has been recently controversial with the emergence of globalization since globalization rubs out geographical, social and cultural demarcations, *place* in this paper needs to be defined with certain boundaries and identities. It is because this paper looks at places for the purpose of business investment, which makes then places be restricted to certain regions or countries that are respectively equipped with particular economic and social regulations and highly possibly cultural similarities.

Constructing both definitions in an inductive way, we can conclude that *place image* is a merged evaluation of individual attributes and holistic impressions regarding a place which can be characterized by common political, economic, social and cultural framework.

3.3 Impact of place image on attracting FDI to the place

Among all the marketing strategies for a place to attract more investment, its image is considered to be a critical determinant for decision-makers who want to make use of the

place, especially in the era of globalization where too much information flows at the same time. In general, people do not have time to find out real attributes of places, but they rather depend on place image which is an adjusted and amended version of real attributes of the place (Anholt 2007: 1-9), which tells the potential influence of place image on FDI.

A would-be foreign direct investor has a certain image of a place, even before he or she thought of the place as a potential FDI place. This place image is in principle constructed by influences of his or her society, through mass media, education, and people of the society, which is called *organic image*. Since the means of formation of *organic image* have continuous communication to him or her, the *organic image* is likely to have sustainable effect on his or her viewpoint about the place. Images of the place are significantly determined by the society's attitude towards the place which is likely to be a nation in this context. Early education in the family, in the school, and later in various organizations teach us subconsciously our thinking mechanism (Hofstede 1983). In addition to that, he or she can also form *projected image* of the place through some commercial-oriented information sources, once listing the place on the potential FDI locations and looking for further information on it. Nevertheless, the effect of *projected image* on place is meager since a place image is formed by diverse sources, different from product image (Ibid; Echtner and Ritchie 2003). Moreover commercial information can yield positive outcomes for place image only if they are accompanied by real changes of the place and then enough time passes for the changes to be reported to potential investors. After all, sustainable *organic image* regarding a place implies that FDI determinants listed in *fig 2*, can be deterred by place image. Even though the five determinants for being a competitive FDI location which are factor conditions, rivalry, demand conditions, related and supporting industries, and government, carry objective characteristics and therefore need to be examined by objective perspectives, in reality, investors, each of whom belongs to a specific society, cannot be free from their respective place images solidified by their societies.

In other words, place image can be expanded to the objective attributes that investors find important. For example, real attributes of a place such as infrastructure and regulatory environment can convert into a image. The interruption of images into the real attributes of a place occurs by and large under two conditions. The first condition is inevitable to most of the investors, which is *instruction of the society*. Certainly we are living in a globalized world, however, the national boundaries exist and cultural differences exist, in which all the

people on the globe are instructed by each society in different ways. Investors feel insecure especially when they go to another culture zone and cannot help but wear cultural glasses on their eyes when evaluating practical attributes, which they are not supposed to do. Namely the proximity to culture in the host country plays an important role. However the influence of the society does not end in the cultural matter, but goes further to the relation between the home country and the host country, even if the host country belongs to another cultural zone. Investors make themselves easier at home if the host country is associated with their home country in many relations. That is, whether it is the effect of cultural proximity, or relational proximity, instructions by the society are deeply rooted in investors' mind. Investors cannot help interpreting and absorbing information about factual attributes in subjective ways. The scope of subjectiveness is largely determined by the society whose impact is supposed to be amplified if it meets bandwagon effect. The second interruption is lack of time and/or capital. As said before, globalization is producing enormous information on a daily basis. Investors are given a large amount of information on their potential FDI places which need time to evaluate. However, they are under pressure to make a quick decision in order not to lag behind in competition, which after all make them depend on place images. The same goes for lack of capital. Provided that investors do not have enough funds to research their interested markets, they cannot get enough reliable factual attributes of the markets. What is left for them is to interpret limited information, using their imagination. While lack of time allows a general application to investors since the globalization is a trend which affects everybody, lack of capital is conditional on capacities of the firm.

In a nutshell, even though investors seek objective information about the place attributes, a specific image of the place is supposed to intervene in the reception of the information, owing to *instruction of the society*, lack of time and money. As a result, how a place is perceived by potential investors, is of great magnitude when making a decision about a FDI place. Dependent on the place image, the place can either gain chances, or lose the chances of attracting business (Anholt GfK NBI 2008).

3.4 Conclusion

We have images regarding objects as well as places. We are subject to shape an image about a object when we first encounter it and try to identify it, because not only objective components but also subjective feelings are bestowed to the object during its identification procedure.

Besides when the new identified object is coming into our brain by *categorization* which sorts out information according to certain categories, the object cannot circumvent distortion of its components to a degree, since our brain needs to abstract or generalize it in order to manage all the diverse information together. On the back of both identification and categorization explanations which support the argument about our inevitable subjective perspectives, *place image theory* adds more in detail, through what means place image is built. Among various means that construct place image, *organic image* which is formed by *the society instructing* its people via education, mass media, culture and literature, proves to have the strongest effect due to its sustainable interaction with people in the society. Besides the fact that place image is unlikely to change only by means of commercial information consolidates the influential position of *organic image*. Lastly when the great impact of *organic image* meets the soft spot of Korean SMEs, the lack of capital and qualified labor plus the susceptibility to government and cultural distance, the correlation among all the factors reinforces the exposure of Korean SMEs to place image. In sum, the particular circumstances that Korean SMEs face, make it difficult to elude the power of place image when they decide FDI locations.

The following chapter presents an empirical research on comparative image evaluation of the EU and U.S. market perceived by a certain group of Korean SMEs and their sources of building place image.

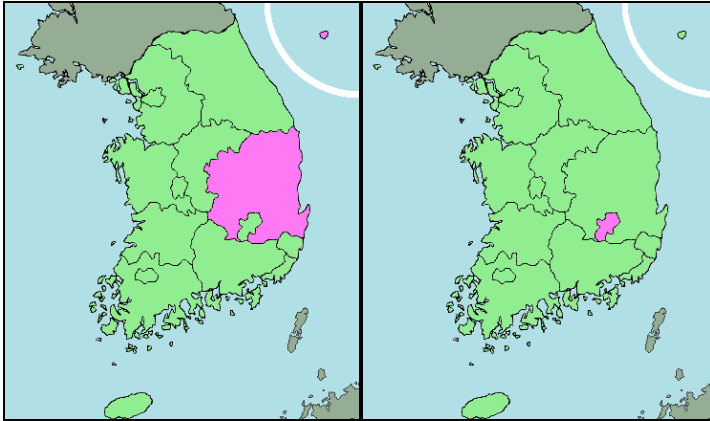
Chapter 4 Empirical Research and its Analysis

4.1 Methodology for the questionnaire

Among the generally accepted FDI determinants which are described in *fig 2*, Korean SMEs illustrate two factors on which they are more dependent compared to big Korean enterprises, which are information availability and psychic distance from the location of the host market. In addition to the two idiosyncratic elements, the fact that place image is constructed by various sources especially with a powerful role of the concerned society, namely, how the society *instructs* its people, reinforces repercussions of place image for Korean SMEs. My hypothesis was that the significantly different FDI outflows from Korean SMEs to the EU and to the U.S. originate from the helpless position of Korean SMEs concerning place image. Above all, Korean SMEs show totally different attitudes towards the two markets in terms of FDI figures, while the big enterprises show only meager difference which can be easily mitigated by the historical background where Korea had been very closely connected to the U.S. since the end of World War II.

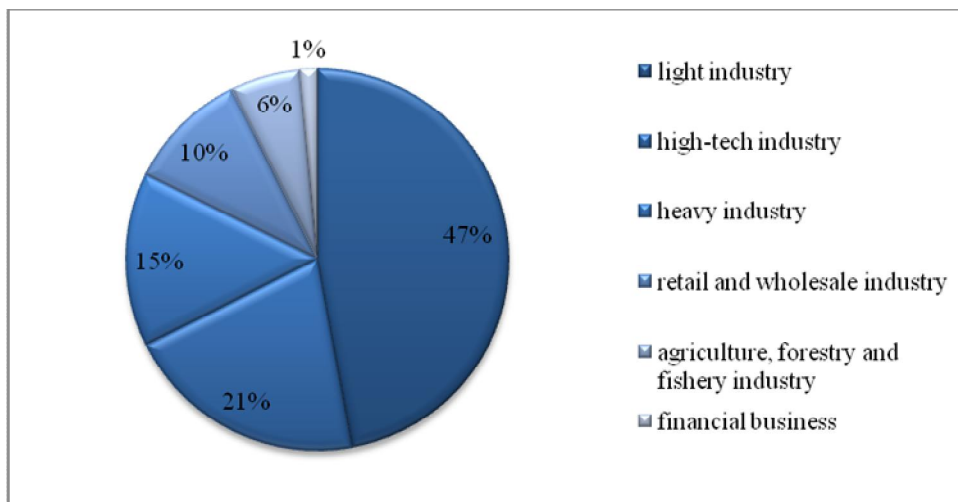
Based on the main postulate of this paper that place image is an important location determinant of FDI for Korean SMEs inferring from the factual data about the different level of FDI outflows from Korean SMEs to the U.S and the EU markets, the fourth chapter will present an empirical research on the image of the EU market perceived by Korean SMEs in comparison to the U.S. market, in order to see difference of the two markets' images by Korean SMEs. The method of research is a questionnaire to a population of 72 individuals who run SMEs in Gyeongsangbuk-do which is a province in eastern South Korea and Daegu Metropolitan City. The questionnaire was conducted in a cross-sectional way.

***Pic.1* Gyeongsangbuk-do and Daegu**



As *graph 1* below demonstrates, almost a half of the population in the survey is associated with light industry, while high tech and heavy chemical industry take the sequent places respectively. Light industry can be generalized with two main characteristics that it is less capital-intensive than heavy industry and has light volume of products. Therefore SMEs can launch it comparatively easily. Examples of light industry are textiles, food, rubber industries that are consumer-orientated¹². Except the fact that most of the respondents are involved in light industry, it is also important to note that almost 85% of the respondents belong to manufacturing sector which is more exposed to internationalization than service sector (KOSBI 2006). The high percentage of manufacturing sector implies in other words that the possibility to get answers from experienced SMEs with internationalization is high, which is beneficial for survey results.

Graph.1 Type of industry



¹² www.britannica.co.kr

The survey¹³ has five phases that are constructed based on the second chapter, the FDI determinants for Korean SMEs, and the third chapter, place image. The first phase is to test familiarity of Korean SMEs towards the EU and the U.S. In order to avoid redundancy by asking every single 27 member states in the EU, only 12 countries whose accumulated FDI numbers of investments from Korea belong to the upper 12 ranking in the whole member states, are selected, using data from *KEXIM Overseas Economic Research Institute*. It is also important not to make the respondents tedious with repetitive questions which can lead to unreliable and insincere answers. In the second phase, I deducted a list of attributes which would interest Korean SMEs based on the *Diamond Model* for Korean SMEs, and the attributes are integrated into the questionnaire in the form of image in comparison to the U.S. market. The respondents will be induced to choose a certain image of each attribute from each market, by means of *Likert Scale* where respondents have to choose one out of seven multiple choices dependent on the degree of their agreement to each question. I expect that respondents will show favoritism towards one market based on the images they have. Unlike most of the factor conditions which will be asked by means of *Likert Scale*, perceptions of prices will be asked in the third phase by giving the respondents free room to fill in their projected prices in order to get a numerical difference of price perception between the EU and the U.S. The fourth phase will ask whether they have trade or FDI experiences with a foreign country and if yes, which source of information they used in order to see the tendency of information sources. Dependent on the sources, whether they use a market research agency or acquaintances, the role of image could be softened or strengthened. Last but not least, the fifth phase poses general questions about their business and above all about their intention to make inroads into foreign countries that are arrayed in a form of multiple choice according to a geographical separation.

The five phases together are expected to bring two important results. First, we can make up comparative images of the EU common market and the U.S. market derived from the first to the third phases. Secondly, out of diverse independent variables, it is feasible to see a correlation between the FDI inflows and them.

4.2 Image of the EU market in comparison to the U.S. market perceived by

¹³ Refer to Appendix.

Korean SMEs

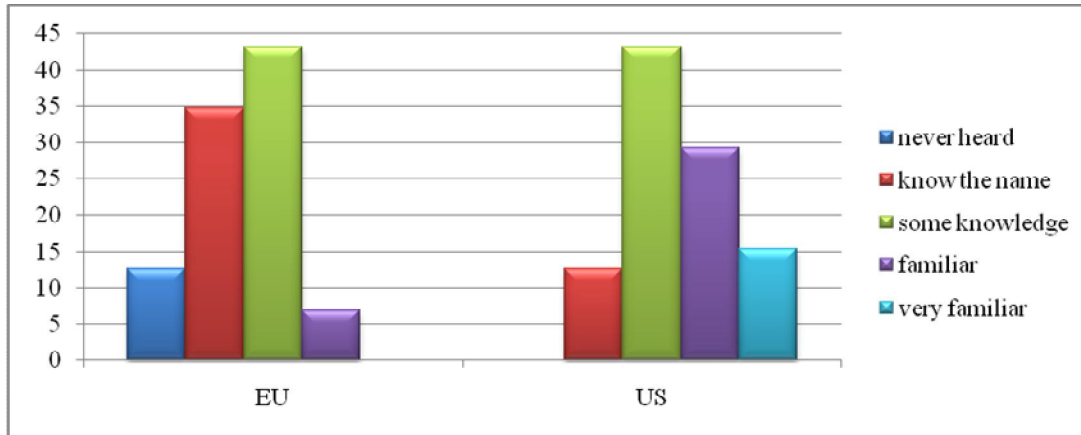
When the impacts of *organic image* on building place image are merged with the peculiar situation of Korean SMEs, it consequently reinforce the susceptibility of Korean SMEs to place image in general. In other words, their scarce financial and human resources not only create vulnerability of cultural distance and dependence on government among the FDI determinants, but also possibility for them to be prone to the influence of place image on other FDI determinants. Therefore I elicited FDI determinants about which SMEs can build place image from the perspective of a potential FDI investor. That is to say, the determinants from the *Diamond Model* meet SMEs' subjective views and are transformed to FDI place image, yielding a complicated place image made of different aspects from basic factors such as familiarity to FDI attracting factors.

Familiarity

One of the basic questions in measuring a place image is to ask respondents whether they know the place, and to what extent. To be known to people serves as the basic and inevitable prerequisite for a place image. It would not be possible to earn a place image after all, if people do not know the place in the first place.

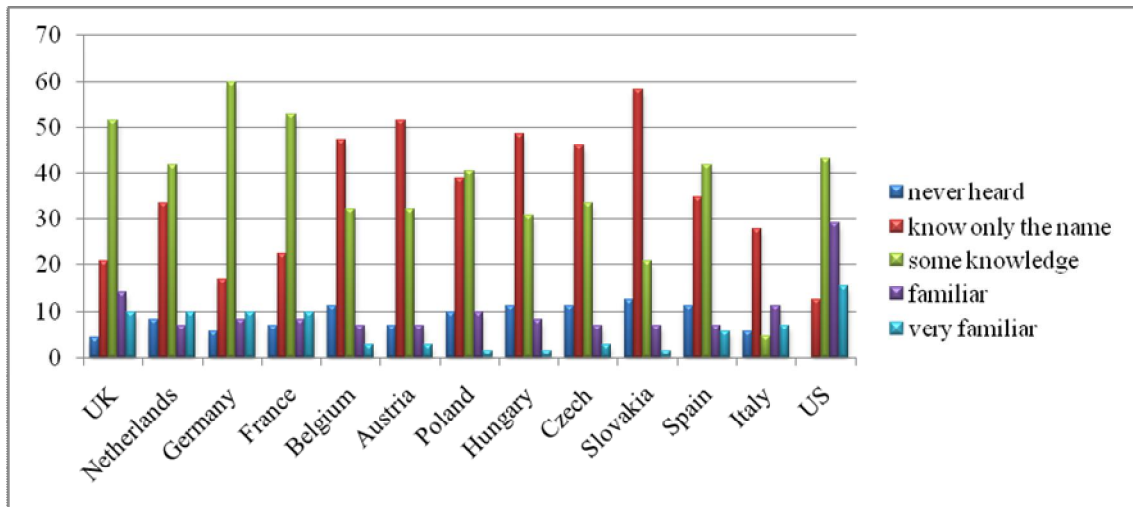
In the *graph 2-1* below, both parties have the same percentage of awareness level in the clause where 43% replied that they have some knowledge both about the places. However in other answers, the EU and the U.S. fork into two different directions. While 34% of respondents only know the name of the EU, 44% feel either familiar or very familiar to the U.S. The relatively low awareness level about the EU market by Korean SMEs is an alarming fact considering the bilateral importance as trade partners.

Graph.2-1 Familiarity level about the EU and the U.S. by Korean SMEs (unit: percentage %)



More exact gap of familiarity level between countries is shown more in depth in the below graph 2-1. As we can see, among the EU member states, UK, Germany and France reach higher awareness level than other member states to which most of the respondents replied that they only know the name of the country. In comparison, most of the people have some knowledge or they are even familiar about the U.S.

2-2 Familiarity level about 12 EU member states and the U.S. by Korean SMEs (unit: %)



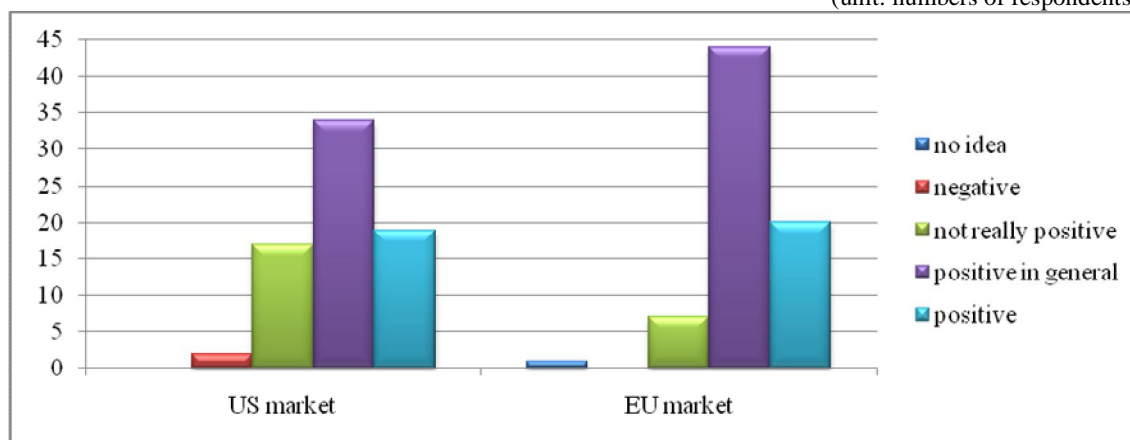
There is one more point which requires explanation though. That is, between 5 and 10% of the respondents replied that they never heard of the nations except for the U.S. Although it could be true with some European countries such as Malta or Cyprus, it sounds very unbelievable that they have not heard of the countries listed above. It is assumed that those who answered with *never heard* may have understood the question about familiarity in the

wrong way by which they relate the question to their business, whether they know the countries in relation to their business realm. Again, although it must have been misunderstanding, the fact that none of them said that they have not heard of the U.S., implies that they are at least informed of the U.S. market while some of them do not have any information about the EU market.

The degree of awareness by people is however not necessarily accordant with a strong place brand. For instance, in *the 2008 NBI global rankings*, it was Germany that was awarded as the best nation brand, even though the U.S. got the most marks in terms of familiarity of the nation. Likewise, superior position of the U.S. in the level of familiarity compared to the EU was not gainable in a question about market outlook in the future.

Graph.3 Future prospects of the U.S. and the EU markets by Korean SMEs

(unit: numbers of respondents)



The winning place of the U.S. was overturned by the EU when the Korean SMEs were asked to put their personal opinion about market outlook. Nine out of ten paint a rosy picture with the EU market while only one in the ten has a negative opinion. In comparison, the U.S. market got more negative answers than the EU market did, namely, one out of four expressed their skeptical view about the U.S. market. Accordingly, the fact that a place is more well-known than the other to a certain group of people does not automatically lead to a better

image. In a word, it is compulsory for a place wanting to get a good place image to be known to target people, but to what extent to be known, that is to say, how deep and how wide the people know about the place, does not necessarily produce good place image automatically.

Place image in relation to FDI determinants

I speculated that the U.S. market is preferred than the EU market by Korean SMEs as a FDI location because the U.S. market possesses a place image which contains more advantageous impression in terms of FDI determinants. The FDI determinants which appeal Korean SMEs were elicited in the second chapter; *rivalry*-existence of competitors, *factor conditions*-location, infrastructure and R&D facilities, labor, *demand conditions*-the size of market and its potential to grow, *related and supporting industries*-easy access to suppliers, and most importantly the *government's* role such as information agency, tax reduction, and flexible regulations and policies. Not all of their images are, however, examined. Instead, based on the conclusion from the second chapter that *factor conditions* such as cultural distance and subsidies and SMEs-assisting agencies in *government* are crucial factors for Korean SMEs, plus *demand conditions* are a convinced FDI determinant, the survey basically concentrates on three major determinants, *factor conditions*, *demand conditions*, and *government* in the *Diamond Model*. They are dissolved in the questionnaire which intends to compare images between the U.S. and the EU market. The first comparison deals with the following questions.

- Y It would not be difficult to overcome the cultural barrier and different business customs in this market.
- Y This market would supply enough skilled labor.
- Y It would not be difficult to find English and Korean speaking labor in this market.
- Y This market would be equipped with developed infrastructure and R&D facilities.
- Y The entry barrier of this market would be low in general.
- Y The consumers of this market would be easy to approach in general.
- Y This market would provide foreign investors with flexible regulations and policies.

The respondents chose one answer in the seven-*Likert Scale* according to their level of agreement to these statements. The result was put in the *Independent-Samples T Test* of *SPSS* in order to compare the average difference between the two groups. Table 4 illustrates the

result about differences.

Table.4 Comparison of place image in regard to FDI determinants between the U.S and the EU market

		US market	EU market	P-value of Levene's test	P-value of t-test
Low cultural barrier	Mean SD	3.85 .988	3.24 .896	.873	.000
Skilled labor	Mean SD	4.01 .909	4.03 1.035	.374	.931
English and Korean speaking labor	Mean SD	4.07 1.068	3.43 1.111	.290	.001
Developed infra and R&D	Mean SD	4.97 .963	4.86 1.026	.421	.498
Low entry barrier	Mean SD	3.73 1.034	3.23 1.144	.226	.008
Easy access to consumers	Mean SD	4.87 .931	4.26 .943	.352	.000
High consumption	Mean SD	4.61 1.011	4.50 1.225	.051	.548
Flexible regulations and policies	Mean SD	4.25 .915	3.61 1.015	.366	.000

First, we need to examine the equality of variances, in this case, the EU and the U.S. market by means of the *p-value* of the *Levene's Test*. In all eight variances, p-values are greater than 0.05, which assumes the equality of all the variances. As a second step, we can confirm from the p-values of *t-test* that two groups do differ in four sections where the p-values are smaller than 0.05.

Overall, the respondents did not show extreme demeanor about both markets, but remain rather neutral, neither showing very positive nor very negative marks. As mentioned, *Likert Scale* used here has seven multiple choices. According to each question described above, number one means strong denial while number seven means strong affirmation. Therefore number four has exactly the middle position, being neutral neither positive nor negative about the question. Now let's look at the *mean* of each section. The *mean* that is the divided number of all accumulated answers by everyone, are distributed between 3.59 and 4.87 out of the 7 which implies that Korean SMEs in general do not consider both markets as effortless targets to penetrate.

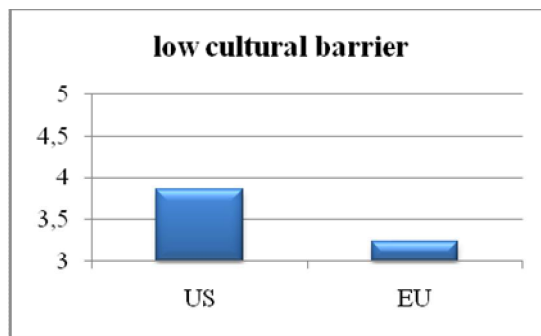
To be exact, the p-values that are lower than 0.05 approve that different place images exist

between the two groups in terms of cultural barrier, Korean and English speaking labor at disposal, entry barriers, easy access to consumers, and regulations and policies of the market.

Comparison of factor conditions

Although the respondents are troubled by a sense of cultural alienation from both markets when seeing the low average grade around three or four, they find the U.S. market comparatively easier to overcome than the EU market in terms of cultural difference.

Graph.4-1 The comparison of Likert Scale

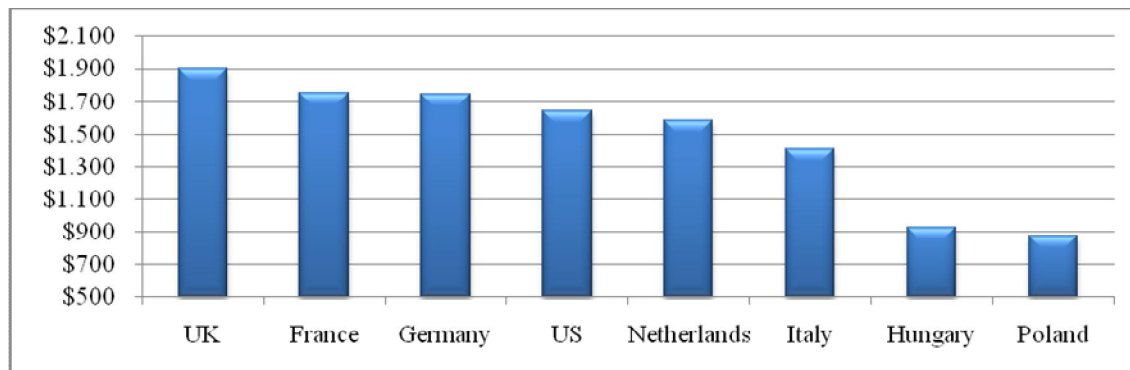


The common and daily news about the U.S. in the mass media and strong influence of the American culture on Korean society, make people feel closer to the U.S. than Europe to which we are hardly exposed in the society. Moreover the fact that Korean SMEs admitted difficulties in tackling cultural barriers in internationalization (Lee 2007; OECD-APEC 2006), implies the potential effect of cultural gap on decision-making of FDI.

In FDI, one of the inevitable elements is credible labor of the host market while trade does not require it. In other words, how qualified and how inexpensive labor the market can supply to investors, has influence on the decision-making of FDI. According to the result of *Independent-Samples T Test* as we can see from the *table 4*, Korean SMEs' perception about the quality of labor does not differ between the two markets. A question about labor costs however was posed in a different way, making the respondents fill in their projected prices in each given country, on the supposition that an employee in Korea is paid a monthly salary of \$1,000. *Graph 5* below illustrates the averages of each country's projected monthly wage. Especially two distinctive outcomes are detected from *graph 4* which shows. First, the UK

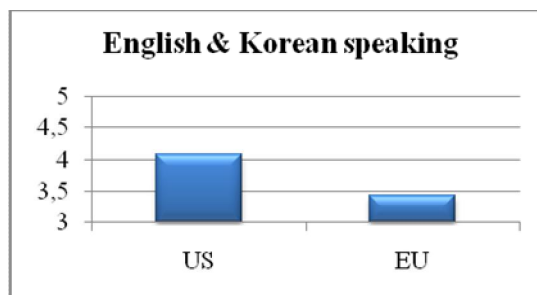
has the most expensive country image regarding costs of labor. Secondly, the two East European countries show that the perception of economical East Europe is prevalent among Korean SMEs. The difference between the averages of other nations is not that noteworthy except that the order of projected image in total equals the result that was drawn from a question which was to answer three economically strong nations in the EU¹⁴.

Graph.5 Comparison of projected labor costs between the EU and the U.S. markets



Apart from the quality and the cost, a Korean SME that wants to operate FDI in a foreign country needs people who speak not only the business language, English, but also Korean in order to communicate with the headquarter in Korea. Needless to say, there is no doubt that the U.S., a nation with native-English speaking folks, wins a better position in this matter than the EU where rather diverse languages are spoken.

Graph. 4-2



The last element to compare in factor conditions was infrastructure and R&D facilities in

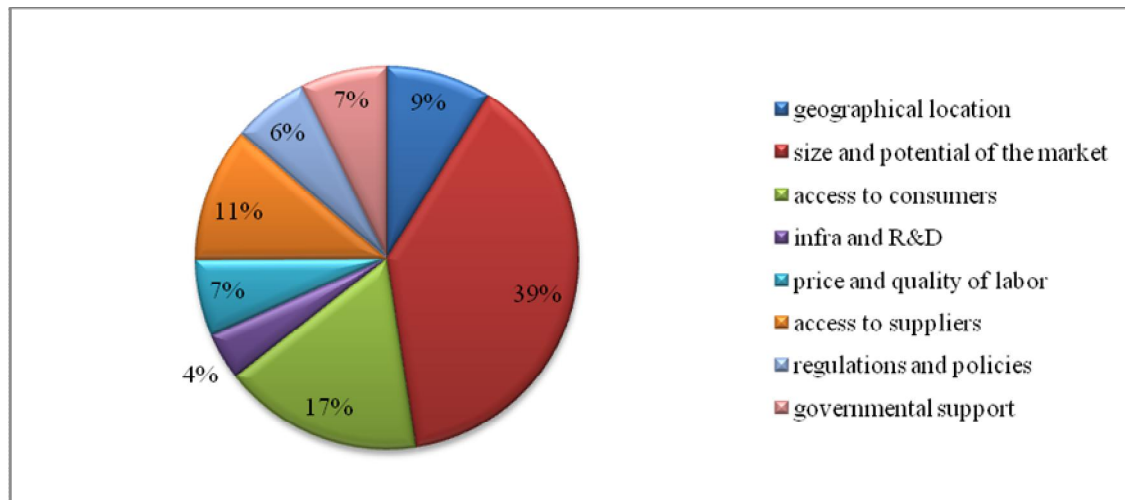
¹⁴ To be precise, the UK, Germany and France were selected the most as a combination of strong countries in the EU. Whereas the same three nations take up around 88% of the entire answer, each given about 30% , only 1.4% of the respondents mention the Netherlands as a strong country, even lower than Italy which was selected by 2.9%. To sum up, it is confirmed that especially the three countries in the EU disseminate image as prosperous countries with robust economy, and consequently expensive nations.

both markets, which however did not show any practical difference. Both markets scored high image in their technological framework. Apart from infrastructure and research institutions, the comparison of factor conditions gives more credits to the U.S. market in terms of better supply of labor speaking Korean and English, and closer cultural sentiment to the U.S.

Comparison of demand conditions

Demand conditions can be basically summarized in two principles, the size and the growth rate of a market. Although other FDI determinants spark off debate, the two conditions are undisputed since the potential buyer's demand in the host market determine certainly the level and location of FDI. A question about significant deciding factors for FDI to the Korean SMEs drew the equal result; size and potential of the market, and access to consumers as *graph 6* below demonstrates. It is however important to note that the respondents were restricted to pick two answers in the multiple choice. Therefore the percent of each attribute does not mean the actual importance.

Graph.6 Most important two FDI determinants thought by Korean SMEs (unit: percent %)

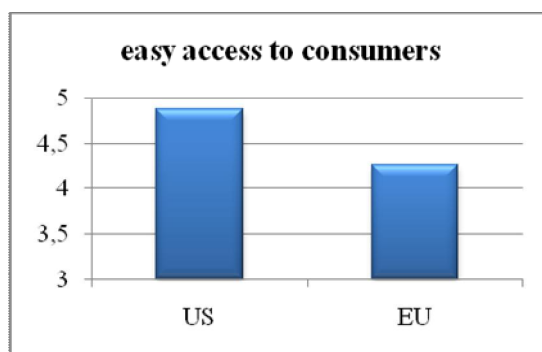


Despite the importance of size and growth rate of the host market as an FDI determinant, a question about them was rephrased as 'the level of consumption' in the market, in order words, how high or low the respondents assume the level of consumption in each market. It is

because, first of all, the size of market is hardly measured by image, but rather understood with factual data, and secondly the main implication of size and growth rate is ultimately to ask how much demand the market has. At any rate, the U.S. market, an average of 4.61 *Likert Scale* and the EU market, 4.50, do not prove any gap between them (*table 4*).

Nevertheless size and growth rate of a market are not a complete set of demand conditions because their successful influence on the final FDI decision-making are very dependent on the level of cultural proximity and easy access to consumers. In other words, solely the size and growth rate cannot affect FDI decision-making, but instead they should be combined with culture and consumers that are easy to manage. From the result about the level cultural barrier where the U.S. gained better image evaluation than the EU, it is deducible that the respondents conceive their consumers in the same direction. Close culture of a place implies also a trouble-free approach to its people. However, taking into consideration that the respondents perceive the EU market with more rosy outlook in the future (*graph 2*) which reflects greater potential of the EU market, aggregate demand conditions are hard to evaluate, namely, which market has better image in total despite of our awareness about the magnitude of the demand conditions as a FDI determinant.

Graph.4-3



Comparison of Government

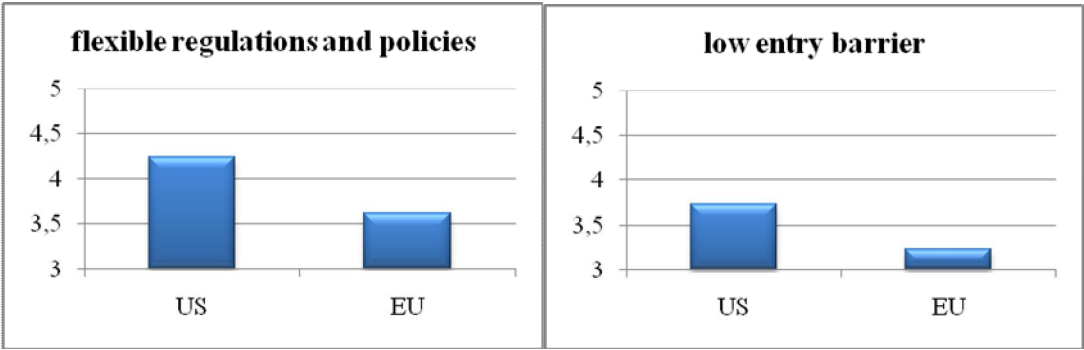
The *Diamond Model* for FDI determinants in *fig 2* whose form is originally adapted by Porter (1990), lays the *government* at the most influential place which is connected to all other attributes. The reason for it is that the government has control of most of the FDI determinants. It is the legislature and the executive of its market that form and implement

policies, regulations, institutions, taxes, and governmental subsidies in the concerned market. In particular, this mighty role of the government comes from the inherent characteristics of FDI which has to be present in a foreign country substantially and therefore is subject to rules and institutions of its market unlike exports, another form of internationalization of a company (Barba Navaretti and Venables 2004).

First, there are policies and regulations that form the basic characteristics of a market. Dependent on them, that is, how open or liberal the market is, the market gives different appealing effects to potential foreign direct investors. In particular, liberal economic policies which lowers entry barriers for new-comers, plus flexible regulations for performing business can attract many investors. Comparing image about regulations and policies as well as entry barrier makes sure of the preference to the U.S. market by the respondents.

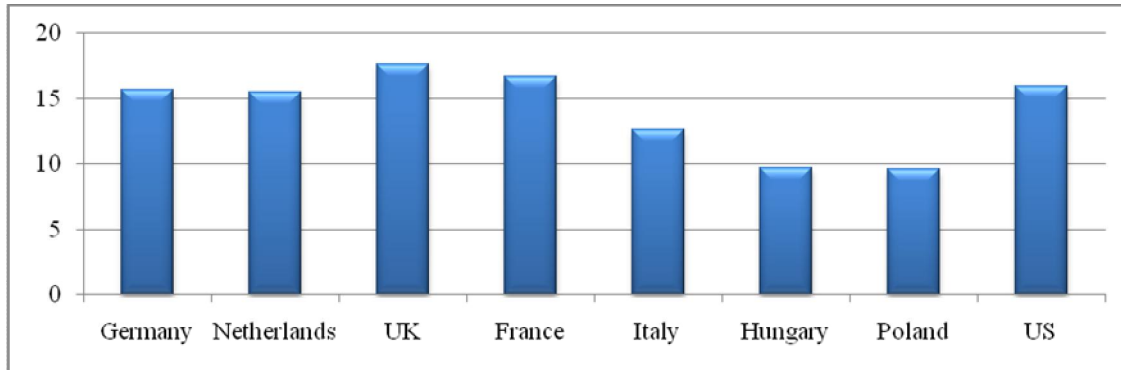
Graph.4-4

Graph.4-5



The secondly compared element was tax which can again control the level of tax can affect the magnitude and the location of FDI. Based on the fact that corporate tax in Korea in 2009 is 11%, the respondents filled in their projected percent of taxes for seven EU member states and the U.S. As the comparison of perception about monthly wage (*graph 4*), the comparison of taxes turned out to be in a very similar order. It implies that the respondents in general proportionally relate the level of wealth with the level of taxes.

Graph.7 Comparison of projected corporate tax (unit: percent%)



Lastly, there remain other two factors of which the government is in charge, subsidies and SME supporting institutions. Unfortunately those attributes are almost impossible to measure since it is not certain whether all the governments are equipped with them or not. In other words, without a certain fact that all of the nations have subsidies and supporting institutions for foreign investors, image about institutions and subsidies unfeasible to assess.

In conclusion, the result of the questionnaire attests three critical points. The first point is that the U.S. wins far higher familiarity level than the EU. As the second point, it is illustrated that the Korean SMEs in general have closer emotional attachment to the U.S. market than to the EU market, as we saw from their average assumption about lower cultural barrier and easier access to consumers in the U.S. than the EU. Although familiarity and cultural closeness do not mean the same, the first and second point are closely related due to their reinforcing effects to one another. As the last point, the U.S. market is perceived to be more liberal in accessing the market, establishing a subsidiary, and performing its business, based on the fact that policies and regulations rate as more flexible and entry barrier as lower than the EU. In brief, the survey proves difference of images between the EU and U.S. market as well as preference to U.S. market in general due to the three critical points mentioned above.

4.3 Possible impacts of place image perceived by Korean SMEs on FDI decision-making

Images of the both markets have been compared, and the preferred image of the U.S. market regarding FDI in general has been confirmed. It is time now to inspect how the result about comparative image can be related to the actual FDI figures. At a glance, good place image and FDI inflows seem to grow proportionally when we see the *table 3*. However, the comparison data between the U.S. and the EU lack samples in order to extract statistical correlation in *SPSS* since there will be only two samples, namely the EU and the U.S. market.

For a reliable result for correlation between place image and FDI flows, we need image evaluation from a number of European countries, not just the place image of the EU market. Another possibility would be to test place image of the both markets and their FDI inflows from Korea repeatedly and to see whether they grow proportionally. However due to the intrinsic characteristics of this survey that it is cross-sectional, the incapacity to test a statistic relation between the place image and the FDI cannot be helped. The only feasible way to conduct a statistical test on the influence of image on FDI from the survey is to examine the relation between familiarity level and FDI inflows from South Korea even though it is partial. To be precise, this test cannot cover inclusive relation between place image and FDI inflows, but it at least shows how familiarity level of a nation is related to its FDI inflows from Korean SMEs. Since the comparison of FDI-related place image between the EU and the U.S. market has only two samples to examine relation to FDI inflows, it is not viable to get a reliable outcome. However since the familiarity level was tested to the 13 nations, we are able to see relation between the familiarity and the FDI inflows by analyzing data of the 13 nations with *bivariate correlation analysis* in SPSS.

Table.5 Correlations between reported number of FDI and familiarity level of 13 nations

	Number of FDI	Familiarity	Number of new corporations
Number of FDI Pearson Correlation	1	.695**	1.000**
Sig. (2-tailed)		.008	.000
N	13	13	13
Familiarity Pearson Correlation	.695*	1	.700**
Sig. (2-tailed)	.008		.008
N	13	13	13
Number of new Corporations Pearson Correlation	1.000**	.700**	1
Sig. (2-tailed)	.000	.008	
N	13	13	13

**Correlation is significant at the 0.01 level (2-tailed).

According to *table 5*, there exists statistical correlation between familiarity and number of FDI as well as number of new corporations and familiarity. Let us first check the second colored row. *Pearson Correlation* show a positive number, which means that familiarity and number of FDI increase proportionally. As significant p-value for correlation is set at 0.01, the significance probability, 0.008 which is smaller than 0.01, proves statistical correlation between the two variables. The same explanation goes for the relation between familiarity and number of new corporations in the respective host market. To sum up, the higher familiarity a market has, the more FDI it attracts from Korean SMEs.

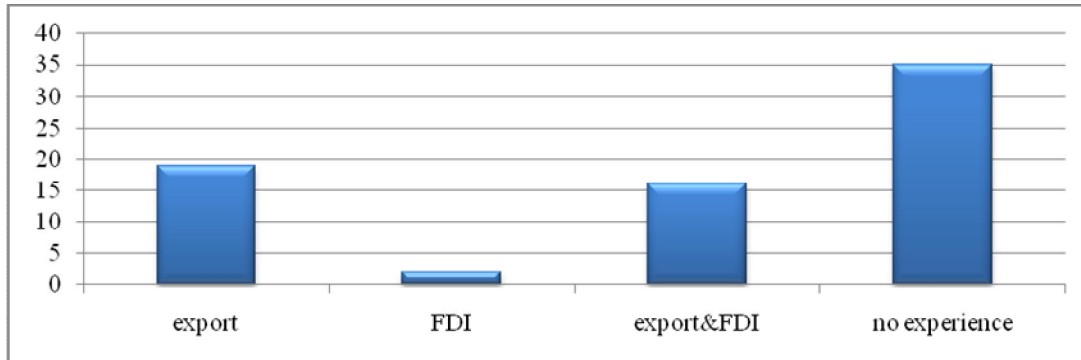
Source for building place image by Korean SMEs

The U.S. market is comprehended as more liberal and more intimate in terms of culture and its consumers, and better and more than the EU market by the respondents of the survey. In line with that, the fivefold difference of FDI inflows between the U.S. and the EU by Korean SMEs seems to show us the linkage between place image and FDI. For the sake of a rational argument, however, we need to elucidate how their place images could in the end impact the final decision-making of FDI by Korean SMEs.

For that reason, we would like to investigate how the researched place images by the respondents have been formed, to be precise, by what kinds of information sources.. It will clarify the possibility of investors' dependence on place image, based on the third chapter where we scrutinized in detail the constructing procedure of a place image and its possible impact on Korean SMEs' FDI decision-making. Specifically, first, we talked especially about *organic image* that we build constantly through the lenses of our society, to be concrete, education, mass media, and people living in the same society. In other words, we are influenced by the *organic image* from the outset through our life, which entails abiding effects on our image building. Secondly, it was said that the strong and persistently effective *instruction of society*, how our society reformulates a certain place by means of mass media and education, is combined with an idiosyncratic shortcoming of Korean SMEs that they lack time and money, whose combination subsequently emits a powerful impact on Korean SMEs' decision-making. The peculiar situation of Korean SMEs that they in general suffer from lack of capital and personnel to manage a large amount of information, or even do not have much information in the first place, but at the same time that they have to catch up with other competitors, drives them into a tight corner, relying on subjective place image. In this regard the inferior position of Korean SMEs in comparison to the big enterprises that do not show big difference of FDI outflows between the two markets, illuminates that their dependence on place image leads to subsequently different FDI outflows to the EU and the U.S.

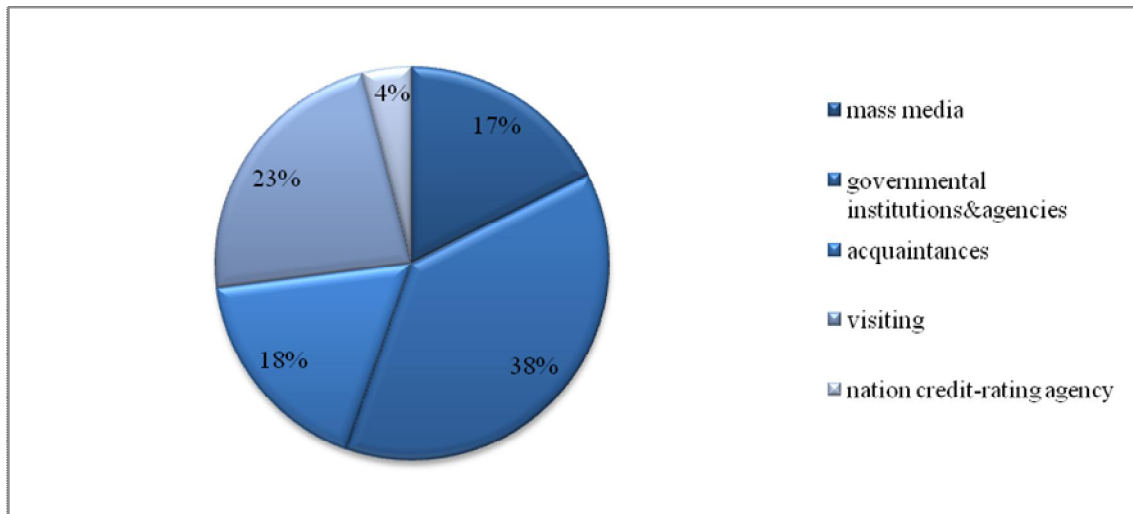
In order to reveal what kinds of information sources Korean SMEs use to research foreign markets, first we asked the respondents about their foreign market experiences.

Graph.8 Experience of foreign market (unit: number of respondents)



About half of the respondents, answered that they have experiences in foreign markets. Secondly we asked the experienced what kinds of information they used at the time of foreign market research where they were instructed to choose everything they used for research. Therefore the pie below indicates the aggregate information sources which include all the information used in their market research, surmounting the number of respondents.

Graph.9 Source of information

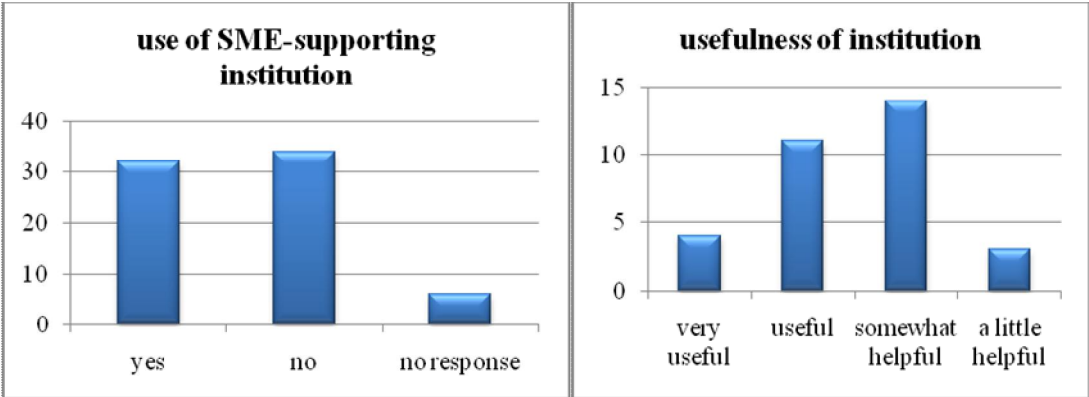


As we can see from *graph 9*, use of governmental institutions and agencies take up 38% of the all information used in the market research, which proves the dependence on the government due to their feeble resources of capitals and labors compared to the big enterprises armed with their own market research agencies. At this point, in order to see whether these institutions and agencies financed by government that are supposed to provide objective information on markets, can impact FDI decision-making of the respondents, two

additional questions were posed. Apart from the issue of foreign market research, we asked the respondents whether they have ever used SMEs-supporting institutions in Korea which are also governmental and how satisfied they are with provided information. Based on the fact that only those who have been to foreign markets can fill in the *graph 9*, a general question about use of governmental institutions was put forward. According to *graph 10-1*, except for the six non-respondents, almost half of the respondents have experiences in using the institutions. Nevertheless the comparatively low rate of use does not come from unwillingness of SMEs, however, the problem lays on the lack of Korean government's marketing about the institutions. According to a survey conducted in 2006 (Lee) to 1,000 SMEs in Korea, they were not aware of the contents and roles of SMEs-supporting institutions supported by the Korean government, and SMEs that had used supporting policies of the institutions for internationalization was only 18%.

Graph.10-1

Graph.10-2 (unit: numbers of respondents)



In evaluating service of the institutions, they fall short of effective standard, but rather being peripheral. Only one third were so to say satisfied with the provided service.

In a nutshell, notwithstanding their reliance on governmental institutions and agencies that assist the SMEs in researching new markets, first of all, participants in the service stand below the half, secondly the appraisal of the service lags behind satisfaction. Therefore we can conclude that the role of governmental institutions and agencies is meager in changing fixed place image by Korean SMEs, and they will not be able to fulfill their duty to help them build objective information and objective place images as long as they do not strive for marketing and better service.

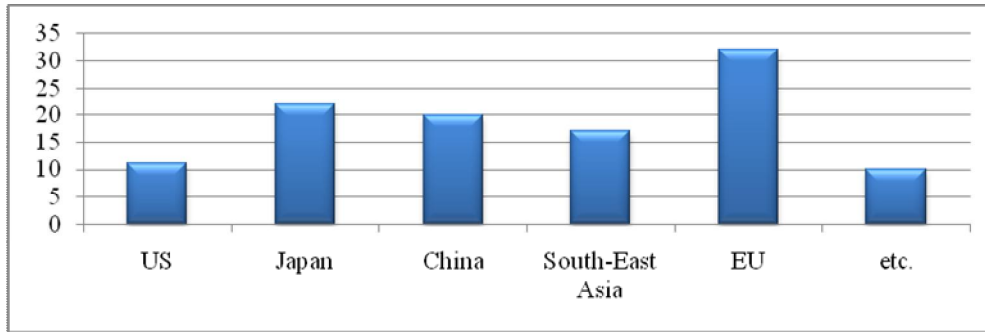
Let us get back to the *graph 9* once more. Now setting aside the attribute, governmental

institutions and agencies due to its weak effect, there are three elements left; mass media 17%, acquaintances 18%, and visiting the concerned place 28%. Whereas mass media and acquaintances are means for building *organic image*, visiting produces *re-evaluated image*, that is after-image. When an investor visits his or her target market in person, there can be either gap between the before- and the after-image, or no difference between the investor's expectation and the reality (Selby and Morgan 1996). However *re-evaluated image* cannot help but function extremely subjectively since after-image varies according to personal experiences in the host country, in comparison to other *organic* or *projected images* to which we are subject in general under the same conditions. For that reason, the re-evaluated image is excluded from the question, how certain types of information for the sake of market research can contribute to image formation. The last two components are mass media and acquaintances which together amount to 35% of the all information sources. The common characteristics of them are, as said before, that they are enclosed with our society, which reflects the possible input of the society's perspective into our perspective. In particular, considering that the users of governmental institutions or agencies do not find their information useful, the effect of those institutions can be only meager. Consequently, except for the visiting option, we can see that how the information sources in the type of *organic image* can be influential in forming the major place image and then forming the final decision for Korean SMEs.

Market outlook

Notwithstanding the lower grades of place image, there is one distinctive fact how the Korean SMEs perceive the EU market, to be precise, the respondents see better prospects in the EU market (*graph 3*). It implies their interest and willingness to take inroads in the EU. Indeed around 75% of the respondents have plans for foreign markets and their tentative target markets appear as followings.

***Graph.11* Tentative foreign markets of the Korean SMEs**



In combination with *graph 3*, we can see that the respondents have sceptical view about the future of the U.S. market and start to show their interest in the EU as a new market. Nevertheless tackling lopsided place image of the EU which has been accumulated in our society for a long time without many relations to the EU so far, will not be easy and need time until the general viewpoint of the society changes or Korean SMEs find a way out for their idiosyncratic problems.

4.4 Conclusion

The fourth chapter provided us with an empirical research that validates the postulation laid on the second and third chapters. Although the selected population for the survey is only a part of Korean SMEs, it was after all a proper choice since they illustrate aptly the typical type of industry of Korean SMEs, light industry, and the manufacturing sector which is the most exposed to internationalization among different industry taxonomy.

Consistent with the previous chapters, the respondents have different familiarity level and place images between the two markets. Especially the level of cultural proximity which is an important FDI determinant for Korean SMEs, proved to be higher in the U.S. market than the EU. In addition, their pattern of information search showed their dependence on *organic image* which consequently leads to uneven image formation about the two markets because of the close relation between Korea and the U.S. in general. In a word, the two distinctive FDI determinants for Korean SMEs, information of the host market and its cultural closeness, are more highly evaluated in the U.S. than in the EU.

Chapter5 Conclusions

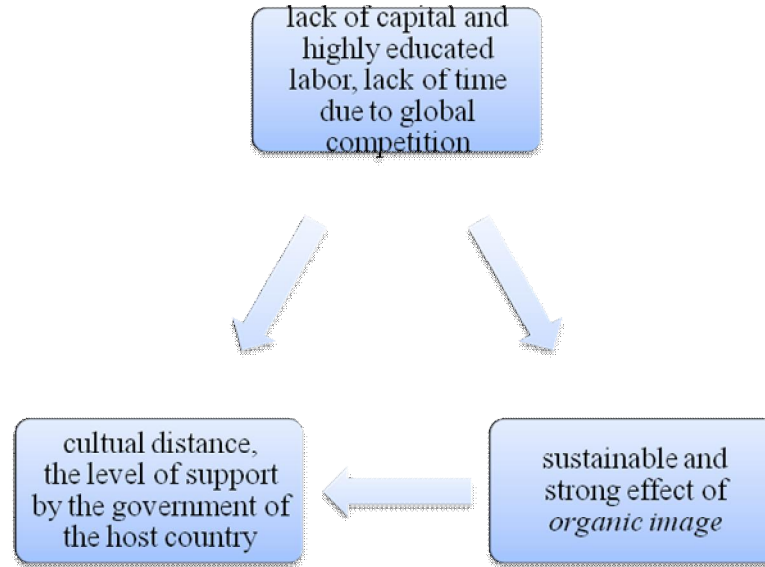
The first question of this research started from why there is difference of numbers between the trade and the FDI to the EU unlike the U.S. When we looked into FDI figures divided into big enterprises and SMEs in Korea, another fact was revealed that the SMEs have been investing very different amount of money to the U.S. and to the EU while big enterprises did not show that much gap between the two markets. It illuminated that the U.S. market fulfills specific factors better than the EU for Korean SMEs to perform FDI. Assuming from the fact that the EU market is not inferior to the U.S. market in terms of economic factors such as market size, market growth or infrastructure, it was hypothesized that investors have subjective criteria over objective economic conditions of the potential host market. Taking the issue of subjective view into consideration, the main hypothesis was set; investors have a certain image for a market, and this image impacts FDI decision-making. Especially Korean SMEs who show a big gap of FDI between the U.S. and the EU are likely to depend on market image as they lack time, capitals and labor to do thorough market research compared to big enterprises not having such a difference of FDI between the two markets.

As the main theoretical framework, the *Diamond Model* consisting of FDI locational determinants for Korean SMEs and *place image theory* especially regarding *organic image*, built the foundation of the empirical research. Specifically in the *Diamond Model*, *location* which in the context means cultural and social distance between the home country and the host country, and information for the host country, proved to act more susceptible to Korean SMEs that are under pressure of capital, labor and speedy global competition. The incapacity of Korean SMEs to conduct a proper market research strengthens also the persistent effect of *organic image -instruction of the society* through education, mass media, and its people- on place image.

In brief, *fig 5* demonstrates the inclusive correlation. First, the inferior position of Korean SMEs leads them to be prone to certain FDI determinants as well as to the impact of place image. Secondly, their vulnerability to place image penetrates into overall FDI determinants and influences other FDI attributes, building a certain market image combined with FDI determinants and place image.

Fig.5 Correlation among the inferior position of Korean SMEs, FDI determinants, and

place image



Based on the theoretical framework that place image plays a vital role in FDI decision-making of Korean SMES, in order to demonstrate different place images of the EU and the U.S. as an FDI destination and the possibility of place image affecting FDI decision-making of the Korean SMEs, a questionnaire was conducted to 72 individuals who run SMEs in Gyeongsangbuk-do and Daegu Metropolitan City. The selected population did not deviate from typical disposition of Korean SMEs in terms of industry sectors and level of internationalization.

The results of the survey turned out to be consistent with the theoretical framework. The respondents, Korean SMEs, showed favoritism to the U.S. market in the sections of culture, labor, consumer, and entry conditions to the market, which tallies with more FDI flows to the U.S. based on the *Diamond Model*. To be concrete, it implies two things. First of all, the U.S. market is seen easier to approach than the EU market in terms of culture and consumers. In relation to the *Diamond Model*, it means that the location of the U.S., or the cultural and social distance between the U.S. and Korea, is conceived closer than with the EU, to which Korean SMEs are especially susceptible. Moreover the fact that the potential demand of the host market-demand conditions- is an indisputable FDI determinant, the level of barrier to the potential customers has also great impact on FDI decision-making. Secondly, the U.S. market is seen as a more flexible market than the EU regarding market regulations and policies. We remember that the government is the most influential one out of the five components in the *Diamond Model* since it is in control of the base construction of the market. How it makes the

investment environment with rules and institutions, influences decision-making of potential foreign investors. In brief, we confirmed that the U.S. market has overall better place image than the EU in terms of cultural proximity and disposition of the government related to the market, which are important FDI determinants particularly for the Korean SMEs.

In addition to the research on EU marketplace image in comparison to the U.S., the tendency of Korean SMEs to search for market information was examined in order to see the relation between their information sources and the scope of being inclined to place image. The biggest information source for market research, governmental institutions and agencies, did not get high reliability score by the respondents and therefore the sequent information sources, namely, mass media and acquaintances proved to be dominant as a type of information for the respondents which are means of forming *organic image*. Mass media and people in a certain society are strongly affected and to large extent instructed by the society which has long-lasting effects. The power of *organic image* cannot help but intensify when it meets Korean SMEs for two reasons. First, place image is formed by diverse sources and does not change abruptly. Second, as we confirmed just before, Korean SMEs have a few disadvantageous features; scarce financial and human resources which lead to high dependence on provided information about the potential host market and to high vulnerability to unfamiliar culture. Consequently they are pushed to the limit to make a decision upon place image to some extent.

In sum, the situation of Korean SMEs on the rack makes it inevitable for them to rely on place image, and the approved different place images of the U.S. and the EU market clearly show that the EU market is placed in unfavorable conditions regarding FDI from Korea.

Nevertheless, the EU market seems to have still a silver lining to become an attractive FDI destination for Korean SMEs as it gained better future prospect and higher interest rate as a potential marketplace. The positive outlook on the EU market along with the actual low FDI flows to the EU implies that Korean SMEs hesitate to come to Europe despite the high interest because of their biased place image to the market. In order to correct the image and activate more FDI from Korea, the EU needs to promote itself proactively to the Korean SMEs who crave for information of potential markets. Korean SMEs are dependent on governmental or public support for market research. Nevertheless according to the survey, they are not very well aware of the existence of those institutions and even in case of

experiences they were not really satisfied with the provided service. Accordingly, unless SME-supporting institutions make effective marketing strategies to raise awareness of the Korean SMEs about them and provide good quality of market information, the invisible image barrier between Korean SMEs and the EU market will be hard to break down.

Although we got expected outcomes, there are still remained tasks from this research. First of all, a statistical test for correlation between place image and FDI flows was not feasible since the survey was conducted only once and has two examples, the EU and the U.S. If more comparisons of place image had been done, the statistical correlation test could have been possible. Secondly, the information sources used by the respondents do not distinguish types of internationalization, whether they used the information for export or FDI. Instead, the answers include market research for all the types of internationalization. However we do not think it is a big defect as a market research regardless of its object has in general the same standards and forms.

As all other researches do, this research about the place image of the EU market will have to be conducted again soon. In order to get changed outcomes in the future and to attract Korean SMEs to the EU market, we will have to illuminate the Korean SMEs by means of long-term investments, and establishment of close relationship with the EU.

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Appendix

I. This part concerns questions about familiarity and favorability of markets. Mark one **Ü** in the segment which corresponds to your opinion.

1. Have you ever heard of the EU Common market where goods, services, people and capital move freely within the market?

• never heard , know only the name **f** some knowledge „ familiar ...very familiar

2. How familiar are you with the following countries?

	Never heard	Know only the name	Some knowledge	familiar	Very familiar
U.S.					
U.K.					
The Netherlands					
Germany					
France					
Belgium					
Austria					
Poland					
Hungary					
Czech					
Slovakia					
Spain					
Italy					

3. How do you evaluate potential of the EU and the U.S. as a marketplace

	positive	Positive in general	Not really positive	negative	No idea
U.S. market					
EU market					

4. Mention three economically strong countries that come first to your mind when you think of Europe.

(, ,)

II. This part is to research image of FDI determinants, provided that you intend to invest in the EU market and the U.S. market. Mark one **Ü** in the section which

corresponds to your opinion.

		not at all	normal	very much so
Differences of culture and business customs in this market will be easy.	U. S.	•	,	<i>f</i> " ... † ‡
	E. U	•	,	<i>f</i> " ... † ‡
There will be enough skilled labor in this market.	U. S.	•	,	<i>f</i> " ... † ‡
	E. U	•	,	<i>f</i> " ... † ‡
There will be enough labor who speak fluent Korean and English.	U. S.	•	,	<i>f</i> " ... † ‡
	E. U	•	,	<i>f</i> " ... † ‡
This market will provide high quality of infra and R&D facilities.	U. S.	•	,	<i>f</i> " ... † ‡
	E. U	•	,	<i>f</i> " ... † ‡
This market will have comparatively low barrier of market entry.	U. S.	•	,	<i>f</i> " ... † ‡
	E. U	•	,	<i>f</i> " ... † ‡
Consumers of this market will be easy to approach.	U. S.	•	,	<i>f</i> " ... † ‡
	E. U	•	,	<i>f</i> " ... † ‡
Consumers of this market will have high consumption rate.	U. S.	•	,	<i>f</i> " ... † ‡
	E. U	•	,	<i>f</i> " ... † ‡
This market will provide flexible policies and regulations for foreign investors.	U. S.	•	,	<i>f</i> " ... † ‡
	E. U	•	,	<i>f</i> " ... † ‡

III. This part is to research the perception of prices in each market. Write in each segment your estimated price.

1. Provided that you pay \$1,000 to an employee a month, how much would you expect to pay for the same quality of labor in the following countries?

Korea	Germany	NL	U.K.	France	Italy	Hungary	Poland	U.S.
\$ 1000	\$	\$	\$	\$	\$	\$	\$	\$

2. In 2009, the corporate tax rate for SMEs in Korea is 11%. How much corporate tax rate do you expect in the following countries?

Korea	Germany	NL	U.K.	France	Italy	Hungary	Poland	U.S.
11%	%	%	%	%	%	%	%	%

IV. This part is to know how you get information on foreign markets. Choose one of the multiple choices which corresponds to your case.

1. Do you have experiences in foreign markets?
 • yes , no **f**not yet but is supposed to be initiated soon „ not yet but currently trying ...never thought of it

2. If you have experiences, how did you get the necessary information?
 Y countries: ()
 Y main source of information (maximum two choices)
 • mass media(internet, TV, newspaper, books & magazines) , governmental institutions and agencies(trade fair, exhibition, events) **f**acquaintances (friends, family, business partner)
 „ visiting the country ...Country Risk Assessment

3. Have you ever used governmental supporting agencies such as chamber of commerce and SME agency?
 • yes , no

4. How did you find the provided information?
 • very useful, useful **f**helpful to some extent „ a little helpful ...not special help

V. This part is to ask particular data of your enterprise.

1. To which industry does your business belong?
 • agriculture & fisheries , light industry **f**heavy chemical industry „ high tech industry ...retailers and wholesalers †tourism ‡transportation business ^ financial business

2. How old is the business?
 • 1~2 years , 3~5 years **f**6~7 years „ 8~10 years ...10~15 years †more than 20 years

3. Do you have experiences either in exports or in FDI?
 • export , FDI **f**export and FDI ...no experience

4. If you have, where was it?(choose all concerned choices)
 • U.S. , Japan **f**China „ Southern Eastern Asia ...West European countries(Germany, France, U.K, NL etc) †East European countries(former Soviet Union; Czech, Slovakia, Poland, Hungary) ‡ETC ()

5. Do you plan to go to foreign markets?
 • yes , no

6. If yes, which areas do you keep in mind?
 • U.S. , Japan **f**China „ Southern Eastern Asia ...West European countries(Germany, France, U.K, NL etc) †East European countries(former Soviet Union; Czech, Slovakia, Poland, Hungary) ‡ETC ()

7. Please choose two choice that you find the most important regarding advancements to foreign markets.
 • Location of the host market , Market size and growth **f**Easy access to consumers
 „ Infrastructure and R&D facilities „ Costs and quality of labor ...Easy access to supplier

markets † Regulations and taxes of the host market ‡ Governmental support of the host market (providing information and reducing taxes)