

# KOREAN FDI DIVERSIFICATION AND WIN-WIN ECONOMIC COOPERATION BETWEEN KOREA AND MONGOLIA\*

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To utilize FDI (Foreign Direct Investment) for its economic diversification, mining development and infrastructure improvement, at the present day Mongolia pursues a FDI promotion policy that enables foreign investors to make FDI in various sectors and regions of the country through diverse forms and sizes. Such a policy not only represents a diversification opportunity for those who seek to invest in Mongolia, but also provides an opportunity to consider the effectiveness of FDI in more expansive situation. The important point here is the policy includes many incentives for foreign firms to seize the diversified FDI opportunities. These points are particularly decisive for Korean FDI in Mongolia which diversification is strongly recommended. The purpose of this paper is, therefore, to analyze and recommend how Korean FDI can be diversified in Mongolia within the context of the country's recent policy on FDI promotion.

To reach this paper's purpose, the study highlights an actual situation of Korean FDI in Mongolia in terms of its diversification and examines FDI diversification possibilities within the context of the recent FDI policy of Mongolia. The study finds that Korean FDI in Mongolia can be diversified through four ways: diversification of FDI form, region, sector, and implementation size. First, in terms of form, Korean FDI was found to be possibly diversified through merger & acquisition, concession agreement, product sharing agreement, franchising, licensing, financial leasing and strategic alliance. Second, in terms of region, it was found to be possibly diversified in provinces with high competitiveness and FDI projects, and where Free Zones are developed. Third, in terms of sector, opportunities were found for Korean firms to be diversified in export promotion and import substitution sectors. Fourth, in terms of size, FDI of Korean firms was found to be possibly diversified through the country's high demand for heavy industry development and financing of mega-projects. The study also expects that a successful diversification of Korean FDI in Mongolia to be a prerequisite of a win-win economic cooperation between two countries and proposes a strategy with fit between two countries on Korean FDI diversification.

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## 1. Introduction

Currently, the government of Mongolia is pursuing an economic diversification along with mining development and infrastructure improvement.<sup>1</sup> An enormous amount of financing is needed for these developments and FDI is one of the main financing sources.<sup>2</sup> To utilize FDI for these developments, the government of Mongolia is trying to promote FDI and is taking a number of measures that encourages foreign investors' FDI in diverse sectors and regions of the country by diverse forms and sizes. That is, it is devoting special attention to diversification in promoting FDI. The current government's policy towards FDI promotion, therefore, seems to have important implications for Korean FDI in Mongolia where diversification is strongly recommended.<sup>3</sup>

Accordingly, the study aims to analyze and recommend how Korean firms can diversify their FDI in the country within the context of the Mongolian recent policy on FDI promotion.

The study makes contributions in four important ways. First, the study develops a comprehensive framework for Korean FDI diversification in Mongolia. How Korean FDI can be diversified in terms of form, region, sector and implementation size is examined. Second, the study analyzes Korean FDI diversification from the perspectives of both Korea and Mongolia. Such analysis enables the Korean side to diversify its FDI in Mongolia more effectively, and the Mongolian side to use Korean FDI more effectively for its aimed developments. Third, the study makes analysis basing on the most recent policy of Mongolia on FDI promotion. Since 2013, the Mongolia's FDI legal and policy environment has changed drastically. Such change is expected to bring Korean firms more diversification opportunities. Last, the study argues an importance of FDI diversification strategy development. If well developed, the strategy becomes a prerequisite of a successful Korean FDI diversification in Mongolia and further win-win economic cooperation between two countries. The next part will examine the characteristics of Korean FDI in Mongolia in terms of its diversification. This will demonstrate an importance of consideration of Korean FDI diversification within the Mongolian recent FDI policy. Part 3 will review a recent FDI promotion policy of Mongolia and discuss how Korean FDI can be diversified within the context of it. Part 4 will develop a strategy for a successful FDI diversification of Korean firms. Finally, a result of the study will be summarized and conclusion will be made.

<sup>1</sup> Chuluundorj Khashchuluun, "Current Status of Mongolia's Economic and Social Development and Future Trends," Bruce M. Knauft and Richard Taupier (ed), *Mongolians after Socialism: Politics, Economy, Religion* (Ulaanbaatar: Admon Press, 2012), p.43.

<sup>2</sup> Гадаадын шууд хөрөнгө оруулалт Монголд хэрэгтэй юу?, 2013 оны 4-р сар, <http://www.purplebook.mn/pdf/investment.pdf> (searched date: September 29, 2014).

<sup>3</sup> The main researches on Korean FDI in Mongolia (이재영 외, 2010, 2012) examined an actual condition of Korean FDI in Mongolia and viewed FDI diversification very important when Korean firms expand their FDI in the country. However, the researches have not been extended.

## 2. Characteristics of Korean FDI in Mongolia: low diversification

Since 1990, Korean FDI has been steadily made in Mongolia. Between 1990 and 2010, FDI from Korea recorded about US\$ 255.4 million and reached its peak in 2011 by recording about US\$ 54.1 million. But, after 2012 it decreased and amounted to US\$ 23.4 million in 2014.<sup>4</sup>

Korean FDI in Mongolia was made mostly with objectives to expand the market, increase production efficiency, develop natural resources and participate in infrastructure<sup>5</sup>, and demonstrates several characteristics.<sup>6</sup>

First, in mining, manufacturing and service sectors Korean FDI has been made mostly through wholly-owned companies (WOC) and joint ventures (JV). In infrastructure sector, Korean firms usually operated as an executor rather an investor. Second, Korean FDI has been dominated by the geology-mining (26.3 percent) and service sector (67.4 percent). Based on the FDI stock remaining at the end of 2013, investment in manufacturing amounted to 6.3 percent of Korea's total investment in Mongolia. Third, Korean FDI has been concentrated in provinces such as Umnugobi, Uvs, Dornogobi and some other provinces in case of mining sector, and its manufacturing and service sectors' FDI has been mostly made in Ulaanbaatar. Fourth, SME (small and medium-sized enterprises) dominate in Korean FDI in Mongolia. As of 2013, there are over 2,000 firms from Korea in Mongolia and the majority of them are SMEs. There are some larger Korean companies involved in construction, real estate and in telecommunications. The largest groups, such as LG and Samsung have only opened representative offices in the country.

Comparing to Korean firms' investment objectives, however, it can be reviewed through these characteristics that Korean FDI in Mongolia has been made very limitedly in terms of its form diversity, sectoral distribution, regional dispersion and implementation size.

<sup>4</sup> Data until 2013 is from U.S. Department of State, 2014 Investment Climate Statement (Washington D.C: U.S. Department of State, 2014), p.40 and data of 2014 is from 한국 수출입은행, <http://211.171.208.92/odisas.html> (searched date: February 11, 2015).

<sup>5</sup> 강명구·추원서, 「한-몽 간 경제협력 현황과 중장기 비전 및 전략」, 한국 시베리아연구, 제16권 2호(2012), 187-228쪽; 김지연, 「대몽골 광물자원산업 직접투자에 대한 연구: 물류환경을 중심으로」, 물류학회지, 제63호 24권(2014), 269-285쪽.

<sup>6</sup> An argument was made based on the following sources: 코트라, 한국기업의 투자동향(서울: 코트라, 2013), 2-3쪽; 이재영 외, 몽골: 광물자원 개발 현황과 한국의 진출 방안, 전략지역심층연구 11-15 (서울: 대외경제정책연구원, 2011), 158-165쪽; UNCTAD, Mongolia: Investment Policy Review, New York and Geneva: UNCTAD, alternatives if it wished to pursue 2013, p.26; U.S. Department of State, 2014 Investment Climate Statement, Washington D.C: U.S. Department of State, 2014, p.36; B.Khash-Erdene, "Choir - Sainshand Road to be Operational by 2013," UB Post, August 29, 2012; Уул уурхайн яам, "Уул уурхайн салбарт авч хэрэгжүүлсэн 10 том арга хэмжээ," Үнэн сонин, 2014 оны 10-р сарын 11 өдөр.

### 3. Mongolia's FDI policy context and FDI diversification opportunities for Korean firms

Mongolia perceives that economic diversification, mining development and infrastructure improvement would be the only economic development.<sup>7</sup> The government is in particular aware of the significant role of sovereign bond, loan and FDI for these developments. However, with the public criticism and limited impact of bonds and loans in the country's aimed developments, a significance of FDI is increasing. This influences the country to pay more attention upon its FDI promotion. Currently, the country promotes FDI through a range of policy measures and laws designed to stimulate economic diversification, mining and infrastructure development basing on FDI. It should be noted that these laws and policy measures shape a current FDI policy of Mongolia. The key of this policy is to promote FDI in more diverse sectors and regions through more diversified FDI forms and sizes.

More specifically, through the Investment Law, enacted in October 2013, the country allows a variety of FDI forms such as WOC, JV, mergers & acquisition (M&A), concession, product sharing agreements, financial leasing, franchise and other possible forms.<sup>8</sup> The country supports FDI in different sectors and regions with tax and non-tax incentives, as well as the Stability Certificate,<sup>9</sup> and promotes all small, medium and largely-sized FDI projects by the Stability Certificate and the Investment Agreement stipulated in the law<sup>10</sup>. Beside the Investment Law, the country is adopting many policy measures and other laws which stimulate FDI to be made in a more diversified way in terms of form, region, sector and size.<sup>11</sup> Although they do not reflect specific options for Korean firms to choose, in the context of objectives of Korea's FDI in Mongolia and the competitiveness of Korean firms, the recent Mongolia's FDI policy is expected to inevitably lead Korean firms to the paths of diversification.

#### 1. Korean FDI diversification in forms

*Mergers and Acquisition (M&A)*: In June 2014, the parliament of Mongolia endorsed the 'State Privatization Basic Guideline for 2014-2016' and 18 state-owned enterprises (SOE) were decided to be wholly and partially privatized.<sup>12</sup> A garment factory, spring

<sup>7</sup> Several Mongolian official documents show the importance that the government is giving to the diversification of economy, mining development and infrastructure improvement including the Millennium Development Goals-Based Comprehensive National Development Strategy of Mongolia (2007-2021), the Mongolian government's Action Plan for 2008-2012 and 2012-2016 and 2014 State Policy on Minerals Sector.

<sup>8</sup> Investment Law of Mongolia, Article 5.

<sup>9</sup> Investment Law of Mongolia, Article 4-5.19.

<sup>10</sup> Investment Law of Mongolia, Article 5.20.

<sup>11</sup> For further details, see Part 3.1-3.4.

<sup>12</sup> Монгол Улсын Их Хурал, "Төрийн өмчийг 2014-2016 онд хувьчлах, өөрчлөн байгуулах

sanatorium and other SOE in mining, aviation, IT and agriculture sectors were included in the guideline. The privatization is to improve management of SOE and reduce the budget deficit caused by the enterprises' inefficient operations. According to one source, a number of SOE to be privatized would be up to 32. As there are sectors which Korean firms have competitiveness, SOE privatization could create chances for Korean firms to engage in M&A investment. Further, improvements are being made in M&A investment environment of the country. In May 2012, the Mongolia's Stock Exchange introduced the Millennium IT system, in June 2013 the country amended its Securities Market Law and enacted the Investment Fund Law in December 2013. Such recent improvements could strengthen Korean firms' interest in FDI through M&A.

*Concession agreement:* Meanwhile, there have been efforts of Korean firms to make FDI in the country through concession agreements. All except the consortium of GDF SUEZ, Sojitz Corporation, Posco Energy and Newcom Group for a concession right to build the Ulaanbaatar Thermal Power Plant No.5 were unsuccessful. However, since June 2014, investors for 6 projects in energy sector, 20 projects in education sector and 14 projects in road construction have been invited for a public-private partnership (PPP) tender by the Ministry of Economic Development of Mongolia (MEDM). These small and large-sized PPP projects could become challenges for Korean firms to engage in more FDI through concession in the country. Further, the Mongolian government's welcoming of Korean FDI in infrastructure sector is expected to stimulate Korean FDI of this form. As of the latest, during the 'Korea-Mongolia Economic Forum' held on 11-12 August 2014 in Ulaanbaatar, the Mongolian side expressed its interest to cooperate with Korean firms in infrastructure sector and use its technologies for the sector development.

*Product sharing agreement:* In July 2014, the parliament of Mongolia passed the Petroleum Law. The new law was designed to boost FDI in Mongolia's petroleum industry and provide the most competitive production sharing terms in the world.<sup>13</sup> Under the new law, PSA can be approved by the government within 180 days of request by the foreign firms. In addition, contractors can be involved in a cost recovery program, under which 100 percent of exploration, operation, development, and production costs can be recovered. PSC could be an important FDI form option for Korean side, which is pursuing a source diversification of oil import.<sup>14</sup>

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үндсэн чиглэл батлах тухай," 2014 оны 6-р сарын 18 өдөр.

Эдийн засгийн хөгжлийн яам, "Концесс олгох уралдаант болон сонгон шалгаруулалтын урилга: Эрчим хүчний салбар (2014 оны 6 сарын 13 өдөр), боловсролын салбар (2014 оны 6-р сарын 10 өдөр), автозамын салбар (2014 оны 4-р сарын 30 өдөр)", <http://www.med.gov.mn/mn/index.php/gazar-negjuud/inovats-undur-tehnologiin-heltes-m/kostsesiin-heseg-m.html> (searched date: October 12, 2014).

<sup>13</sup> Christine Forster, "Australian Wolf Stalks Mongolian Oil Opportunities," McGraw Hill Financial, July 25, 2014.

<sup>14</sup> Diversification need of oil import source of Korea was argued in detail in 이재은, "이 라크산 원유 수입 31% 뚝 ... 정부 '수입처 다변화' 빛났다," 아시아투데이, 2014년 7월 8일.

*Licensing:* In March 2014, 888 projects of the Mongolian government's 'Export Promotion and Import Substitution Industrialization Program (EPISIP)' were decided to be provided with concessional loans financed by the Chinggis bond.<sup>15</sup> 89 among 888 projects have already got the loans. Loans are informed mostly to be spent on the equipment and machinery purchase and enhancement of production capacity. Better equipment and enhanced production capacity are expected to create opportunities for Korean companies to be licensing investors in a near future. Particularly, licensing of manufacturing processes, technology procedures and product samples of Korean firms in sectors included in the program may be in a great need. The reason is that many Mongolian entrepreneurs have experiences in manufacturing sector of Korea and have familiarity to Korean management, and some of them even prefer Korean technologies.

*Franchising:* Recently, a number of Korean franchises have penetrated the Mongolian market. Most of them are food franchises such as BBQ Chicken, TOMNTOMS and Caffe Bean. However, disposal income per capita in Mongolia is increasing. People are becoming more conscious of where they shop, how they communicate, what they wear, and what they eat.<sup>16</sup> As was stated in some sources "Mongolia, at the moment, is a blue ocean for franchisers and foreign franchises penetrating the market can exploit first mover advantages".<sup>17</sup> Diversification in franchising sectors such as distribution and clothing seems promising in Mongolia.

*Financial leasing:* Due to a development of mining and linked industries and the government's initiatives for SME development (e.g. SME leasing program), a demand for machinery and equipment is increasing. But funding power of local firms lacks. Accordingly, the financial leasing is becoming important and between 2007 and 2010, financial leasing portfolio demonstrated ten-fold increase in the country.<sup>18</sup> As of the latest, in June 2013, a subsidiary company of Japanese Sumitomo Mitsui Banking Corporation, MG Leasing Corporation and TDB Capital, a subsidiary of Trade and Development Bank (TDB) of Mongolia launched a new company under TDB Leasing. The reason is many mining machinery and supplies are imported from Japan and the trusted company to provide with financial leasing services is the most needed today in Mongolia. At present, the Hyundai Glovis Holdings Mongol is making rental, sales and lease of heavy machinery

<sup>15</sup> The government of Mongolia proclaimed 2014 as the Year of Industrialization under "Let's Create in Mongolia" and in the frameworks, it was announced to support projects with purpose to replace import products and increase exports, thereby 888 projects were selected that need to finance from proposed 1,151 ones. Editor, "Some Projects to Replace Import Products and Increase Exports will Be Financed from Government Securities Traded," *InfoMongolia*, June 4, 2014.

<sup>16</sup> U.S. & Foreign Commercial Service and U.S. Department of State, *Doing Business in Mongolia: 2014 Country Commercial Guide for U.S. Companies* (Washington D.C: U.S. Department of Commerce, 2013), pp.8-9.

<sup>17</sup> Micheal Kohn, "Yum Plans to Open 15 KFC Restaurants in Mongolia within 5 Years," *Bloomberg*, May 30, 2013.

<sup>18</sup> D. Jargalsaikhan, "Financial Leasing and its Framework," Paper presented at the conference organized by the International Finance Corporation (IFC) in Ulaanbaatar, 2010, p.16.

such as mining equipment and transport vehicle in Mongolia. Korean firms which export machineries and equipment can challenge financial leasing FDI not only in mining, but also in manufacturing sector. It was informed that Mongolian SMEs benefit from the SME leasing program prefer Korean machinery and equipment. Further, there are a number of local firms in 888 projects which desire to produce products using Korean equipment and technologies.

*Strategic alliance (SA):* As of the end of 2010, there are 37 mining projects which Korean firms take part in Mongolia. 7 of them are at the development stage and others are at the prospecting and exploration stages.<sup>19</sup> The prospecting and exploration projects are mostly of a small scope and at their very initial stages. Korean firms' FDI activities in mining of Mongolia can be vitalized through SA.

As of April 2010, 1,096 mining licenses and 3,659 exploration special licenses have been issued in Mongolia.<sup>20</sup> After the 2014 Minerals Law amendment, 106 exploration and mining licenses are to be issued additionally. Many of Mongolian license holders lack of technical expertise and financial strength. As that much there are opportunities for Korean firms to explore and develop the Mongolian license holders' tenements through SA. Korean firms can contribute funding and technologies and local license holders could provide with in-country knowledge, local operational experience, know-how and contacts and geological databases.

## 2. Korean FDI diversification in regions

*Provinces with high competitiveness:* In May 2014, Mongolia released the '2013 Competitiveness Survey of the Mongolian provinces'. Competitiveness of 21 provinces of Mongolia were assessed through 4 categories (economy, governance and business efficiency and infrastructure) and 180 criteria. As a result of the survey, provinces such as Orkhon, Darkhan Uul, Selenge, Sukhbaatar and Govisumber have been assessed to have high competitiveness besides Umnugobi, Dornogobi and Tuv, the provinces which attracted much FDI.<sup>21</sup> Agriculture, manufacturing and heavy industry are developed in these provinces and the provinces are linked with main transportation networks. The country conducted the survey in the second year. Until 2012, the provinces' competitiveness has not been identified enough and this could have operated as the market failure. There are new possibilities for Korean firms to work jointly with firms from these provinces.

*Provinces with FDI projects:* Comparing to the previous years, FDI projects which can be implemented in different provinces are being developed. Moreover, investment promo-

<sup>19</sup> 이재영 외 (2011), op.cit., 158-165쪽.

<sup>20</sup> Editor, "The Term of Prohibiting Issuing New Special Licenses on Mineral Resources Exploration to Be Extended," *InfoMongolia*, December 25, 2012.

<sup>21</sup> Эдийн засгийн бодлого, өрсөлдөх чадварын судалгааны төв (ЭЗБӨЧСТ), Аймгуудын өрсөлдөх чадварын тайлан 2013 (Улаанбаатар: ЭЗБӨЧСТ, 2014).

tional activities by provinces are being organized. This is quite a new phenomenon. Most recently, in October 2014 an Investment Forum was held in Khovd province to introduce the investment environment and investment projects in 5 provinces of the western part of Mongolia (Bayan-Ulgii, Khovd, Uvs, Govi-Altai, Zavkhan).<sup>22</sup> Investment projects introduced relate to mining, infrastructure, agriculture, manufacturing and construction sectors, which Korean firms are interested in investment. 16 memorandums of understandings (MOU) were signed between local governments and investors from China and Russia.

*Free zones:* In June 2014, a draft of the amended Law on Free Zone of Mongolia was submitted to the parliament of Mongolia. Some main issues of the draft are the development of new manufacturing and trading sectors in the zones (Altanbulag FTZ, Zamiin Uud FEZ, Tsagaannur FTZ), designation of new zones and development of zones' infrastructure by PPP (public private partnership).<sup>23</sup> This, on the one hand, can be an opportunity for Korean firms which have much experience in the zone development, to participate in the zone development. On the other hand, this can be an investment alternative for the Korean market and efficiency-seeking investors. The zones are located on borders of China and Russia and offer a package of tax and non-tax incentives.

### 3. Korean FDI diversification in sectors

*Import substitution industry (Oil refinery sector):* Mongolia imports oil by 100 percent. But, due to oil price fluctuation and foreign exchange burden, a domestic oil production becomes a challenge of the country. Mongolia thus included oil refinery construction in the 'List of Initial High Priority Large Projects to be Announced to Foreign and Domestic Investors by Government' and adopted the State Policy on it to be constructed by PPP. Besides, Mongolia offers incentives for oil refining firms through the new Investment Law and Petroleum Law.

Meanwhile, Korean firms have shown interest in the sector, but there are poor achievements. In May 2008, ENF Mongolia Oil Co., the Korean invested company, signed on MOU with the government of Mongolia on an oil refinery investment project. But, still the investment project has not been implemented. Large corporations such as SK Energy and Hyundai Oil Bank established MOU on oil exporting in 2011-2012 and made oil exports. Korea has competitiveness in the oil refinery sector and the sector is recently facing surplus supply of oil products. A global recession, the US shale gas revolution and expansion of oil refinery technologies in Asian countries are main reasons. Escape from

<sup>22</sup> Хөрөнгө оруулалтын газар, "Баруун бүсэд хөрөнгө оруулагчдын олон улсын чуулга уулзалт 2014," 2014 оны 10-р сарын 30 өдөр. <http://investmongolia.gov.mn/?p=1454> (searched date: January 19, 2015).

<sup>23</sup> "Чөлөөт бүсийн тухай хуулийн төслийг өргөн барив," <http://www.parliament.mn/news/open/categories/30/pages/14565> (searched date: September 29, 2014).

such a crisis is needed.<sup>24</sup> Korean firms' entry into the Mongolia oil refinery sector in this very period could become a timely FDI option.

*Building materials sector:* Beside the government's infrastructure development projects,<sup>25</sup> housing projects<sup>26</sup> are currently underway and the demand for building materials is continuously increasing. Mongolia imports most building materials from China. There are raw materials in Mongolia to manufacture building materials, but capital lacks. The majority of 888 projects are projects which applied for financing for the building materials' production. From this, the needs for FDI and FDI opportunities in the sector can be realized. At present, Mongolia provides foreign investors with incentives during the building materials' factory construction period.

A number of Korean firms invested in the construction sector of the country for the last years.<sup>27</sup> However, FDI by Korean firms in the building materials sector is almost inexistent. There could be synergy effects in market expansion and efficiency increase if Korean firms make a 'building materials+construction' package FDI. However, when see from the 'Forum on FDI and New Technologies in the Mongolian-Korean Construction Sectors' held in Seoul in March 2014, an interest of the Korean side participants (about 150 Korean firms) still prevails in the construction sector.

*Food and consumer products sector:* About 90 percent of products consumed in Mongolia are imported. Although the country's market is small, it can be viewed as to have the market demand for substituting products for these import products. Among 888 projects 757 are import-substitution projects including projects for supplying the domestic food, textile and garment, and consumer products markets beside the building materials. Market research was conducted for most of these projects and the projects are expected to contribute to a decrease in the country's import. There have been left hundreds of similar projects that could not have been included in any financing from the government. It can be interpreted as that much there are FDI opportunities for Korean firms in these products' sectors.

The sectors are those which Korean firms have competitive advantages. Korean firms can possibly make FDI in the sectors with a 'dual business strategy'. This is to supply the domestic market and export to the US, EU and Japanese markets. Mongolia is benefited with tax favors when export the products to 37 developed countries (National Chamber of

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<sup>24</sup> 은기운, "한국 정유산업 위기탈출 해법은," 전자뉴스, 2014년 9월 11일. <http://www.etnews.com/20140911000165> (searched date: December 28, 2014).

<sup>25</sup> 'New railroad' project, 'New airport' project, 'Regional road development' project and 'Regional logistics development' project are currently under construction.

<sup>26</sup> Монгол Улсын Их Хурлын тогтоол, 'Шинэ бүтээн байгуулалт' дунд хугацааны зорилтот хотөлбөр батлах тухай, дугаар 36, 2010 оны 6-р сарын 25 өдөр.

<sup>27</sup> FDI projects by Halla Construction, Ilson Construction, Lotte Construction and Samsung C&T are typical cases.

*Export promotion industry (Light industry sectors):* According to the “Basic Guidelines for the Development of Production and Technology Parks”, 10 production and technology parks (PTP) in the light industry are now to be built in Mongolia.<sup>29</sup> In July 2014, a development of two more PTP (the leather products PTP in Emeelt and building materials PTP in Nalaikh) was decided to be financed by the government budget.<sup>30</sup> The parks are to convert agricultural and other raw materials to intermediate and end products and export abroad.

The parks provide investors with generous tax incentives. Development of PTP could be accepted by Korean manufacturers as a chance to exploit comparative advantages of Mongolia, or to involve the country in their international production chains (e.g. inbound logistics and operation).

#### 4. Korean FDI diversification in size

*Heavy industry development projects:* Mongolia is planning a development of parks for a production of higher value added mining products and increase of mining export items. According to the Mongolian government “the research phase of Sainshand heavy industrial park is to be completed by June 2014, and development contracts are to be signed by the end of 2014. The development of the park is to begin in 2015 and be completed by early 2018.”<sup>31</sup> Except the Sainshand industrial park, there are 6 production and technological parks (PTP) in heavy industries, where Korea has an industrial competitiveness, planned to be developed.<sup>32</sup> These are the Darkhan steel products PTP, Erdenet copper smelting PTP, Baganuur coal-chemical complex, Choir metal processing PTP, Dornod zinc and oil processing PTP and Southern regions’ PTPs (Tavantolgoi, Oyu Tolgoi, Nariin Suhait) and a development of some of them was included in the “2009-2019 Industrialization Program”.

*New railroad construction project:* In October 2014, the parliament of Mongolia approved the “Measures on the State Policy on the Railway Sector” and a debate on the

<sup>28</sup> Монголын үндэсний худалдаа аж үйлдвэрийн танхим, “Экспортын гол баримт бичиг болох гарал үүслийн гэрчилгээ, түүний олон улсын ач холбогдол,” Export, 2013 оны дугаар 1, 3-4 нүүр.

<sup>29</sup> Монгол Улсын Их Хурлын 2003 оны 54 дугаар тогтоолын хавсралт, “Үйлдвэрлэл, технологийн парк байгуулж, хөгжүүлэх үндсэн чиглэл”.

<sup>30</sup> <sup>30</sup> Нийслэлийн засаг даргын тамгийн газар, “Нийслэлийн Засаг Дарга бөгөөд Улаанбаатар хотын захирагчийн 2013-2016 оны үйл ажиллагааны хөтөлбөр”, 2012; Монгол улсын Засгийн газрын тогтоол, “Арьс ширний үйлдвэрлэлийн талаар авах зарим арга хэмжээний тухай”, 2013 он 7-р сарын 6 одор.

<sup>31</sup> Shen Qing, “Mongolia to Build Heavy Industrial Park,” Xinhua, January 29, 2014.

<sup>32</sup> Монгол улсын Засгийн газрын 2011 оны 104 дүгээр тогтоолын 2 дугаар хавсралт, “Хүнд үйлдвэрлэлийн чиглэлээр байгуулах үйлдвэрлэл, технологийн паркийн байршил, үйл ажиллагааны чиглэл”.

railroad gauge of 1,800 km railroad (among 5,600 km railroad) in the southern and eastern parts of Tavan Tolgoi deposit was solved. Now, a railroad construction is to be started. The government is seeking further investment sources for the completion of railway project. Notable major corporations, banking and financial organizations are welcomed to participate in this railroad construction as well as other industrial development projects.<sup>33</sup>

*Mega projects' financing:* As of August 2014, 6 top foreign banks have opened the representative offices in Mongolia<sup>34</sup> and provided domestic firms with financial services up to US\$ 200 million. Many requests for long-term loans are being made to these representative offices for mega projects' implementation in the country. For instance, as of May 2014 about 40 big corporations in Mongolia have requested for loans amounting to US\$ 3 billion from the representative office of the Bank of China (BOK).<sup>35</sup> Further, BOK and Sumitomo Mitsui Banking Corporation announced their interest to provide the country's mega projects in infrastructure and mining with financial services. A high demand for mega projects' financing can be accepted by Korean banking institutions, which pursue an overseas market expansion due to the domestic market saturation and fierce competition, as a market expansion chance (See Table 1 and Appendix 1).

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<sup>33</sup> D. Bilguun, "D. Gankhuyag: Wang Yi's Visit will Strengthen Mongolia-China Relation and Cooperation," *The UB Post*, June 27, 2014.

<sup>34</sup> Those are the European Bank for Reconstruction and Development, ING, Standard Chartered, Bank of Tokyo Mitsubishi UFJ, Sumitomo Mitsui Banking Corporation and Bank of China.

<sup>35</sup> Б.Эгшиглэн, "Хятадын банкны салбар Монголд орж ирэх бололтой," *NNews*, 2014 оны 6-р сарын 16 өдөр.

**Table 1. FDI diversification opportunities for Korean firms in Mongolia**

	Diversification of FDI form	Regional diversification of FDI	Sector diversification of FDI	Implementation size diversification of FDI
Mongolia's recent policy on FDI promotion (A)	To promote FDI, Mongolia allows a variety of FDI forms: WOC, JV, purchase shares, bond/ debentures and other types of securities, M&A, concession, product sharing, marketing and management and other agreements, financial leasing or franchise and other possible forms.	Mongolia is promoting FDI in its different provinces and taking various measures to enable foreign investors to exploit comparative advantages of the country.	Mongolia is taking various measures to promote FDI particularly in its economic diversification sectors.	Mongolia is taking various measures to promote all small, medium and large-sized investors in the country.
Actual condition of Korean FDI in Mongolia (B)	WOC and JV are the most taken forms. Other forms were less taken.	Korean FDI has been concentrated in Ulaanbaatar and some provinces (mostly Uvs, Umnugovi and Dornogobi) with mining resources.	Korean FDI has been made in only a few sectors including mining-geology, wholesale and retail sales, construction and service sectors.	The majority of Korean investors are SMEs. Some larger companies involved in construction and telecommunications. The largest groups are exploring investment opportunities.
FDI opportunities for Korean firms (C=A-B)	There are FDI opportunities through M&A, licensing, franchising, financial leasing, concession agreements and SA.	FDI opportunities exist in other provinces with high competitiveness, provinces with FDI projects and free zones.	FDI opportunities exist in the export-promotion and import-substitution industries: oil refinery, building materials, food and consumer products' sectors.	There are increasing FDI opportunities for Korean large corporations in the country's mega development projects: heavy industry development projects, new railroad construction project and the projects' financing.

*Source: by author.*

### 3. FDI diversification strategies and fit between strategies:

#### Win-win economic cooperation

It is expected that through these diversification options, on the one side, Korean firms better exploit their competitiveness in the country and succeed in more source diversification of resource imports, wider market expansion, less production cost and more infra-

structure development participation. On the other side, Korean FDI diversification is of greater importance in Mongolia.

Economic diversification, mining and infrastructure development of the country can be accelerated. Ultimately, through Korean FDI diversification in the country, there seems to be an economic cooperation encouraging Korea-Mongolia win-win relations. However, it is hard to expect a win-win cooperation to be established automatically with only proposed options. Having the well-defined Korea's FDI strategy in Mongolia and the Mongolia's FDI promotion strategy for Korean firms is important. However, as of today it is hard to see that there exist any FDI strategies between two countries, in the true sense. This could become obvious from recent events between two countries such as the Korea-Mongolia economic forum held in Seoul in June 2014, the Mongolia-Korea Economic Forum held in Ulaanbaatar on 11-12, August 2014 and the visit of the Korean foreign minister Yun Byung-Se in Mongolia on 25-27, August 2014.

To better exploit their competitiveness, expand the market and extensively diversify sources of resource import, it will be needed for the Korean side to develop its FDI strategy in Mongolia. The strategy should fully reflect an interest of the Korean side. Issues about how to exploit its competitiveness in what sectors and regions of the country and through which FDI forms could be dealt in the strategy. Likewise, to use Korean FDI in the country's economic diversification and development of its mining and infrastructure sectors effectively, the Mongolian side should develop the strategy about how to use Korean firms' competitiveness in which sectors and regions through what FDI forms (See Table 2).

**Table 2. FDI diversification strategies and fit between strategies of two countries**

Strategic goals of the Korean side	Issues in the Korea's FDI strategy in Mongolia (interest/concern)	Fit between strategies	Issues in the Mongolia's strategy to promote Korean FDI in the country (interest/concern)	Strategic goals of the Mongolian side
	How to exploit the competitiveness of its firms in which sectors (e.g. export promotion and import substitution sectors) of Mongolia?		How to use the Competitiveness of Korean firms in which sectors (e.g. export promotion and import substitution sectors)?	
	How to exploit the competitiveness of its firms in FDI in which regions (e.g. provinces of high competitiveness, provinces with FDI projects and free zones)?	↔	How to use the competitiveness of Korean firms in which regions (e.g. provinces of high competitiveness, provinces with FDI projects and free zones)?	
Market expansion;				
Source diversification of resources'				Economic diversification;
import;				Development of
Mining development;	Which FDI forms (e.g. M&A, concession agreement, product sharing agreement, franchising, licensing, financial leasing and SA) to take?		Korean FDI (e.g. M&A, concession agreement, product sharing agreement, franchising, licensing, financial leasing and SA) in which sectors?	mining and infrastructure
Infrastructure development participation		↔		
	In which projects its large corporations to make FDI? What favors are needful from the Mongolian government?	↔	How to use Korean large corporations' FDI in which investment projects? What favors it could offer quid pro quo?	

*Source: by author.*

However, when a strategy is developed, a fit of strategies of two sides based on a full consideration of each other's strategies will be crucial if both Korea and Mongolia are to benefit from FDI diversification. That is, the two sides possibly reach their strategic goals if they manage to fit their strategies in a direction to be mutually beneficently implemented. If efforts on the fit between strategies are not made, then there is high probability that a lose-lose situation occurs between two countries. Without a proper fit, the Korean side cannot exploit its competitiveness effectively in the country and the Mongolian side cannot benefit enough from the diversified FDI of Korea. That is, both sides will less benefit from FDI. If the Korean side develops its strategy without much consideration of the Mongolian side interest, then the benefits that the Mongolian side gets from the Korean

FDI will be less. That is, there could be a win-lose situation. On the opposite, if the Mongolian side develops FDI strategy with poor consideration of the Korean side interest, then chances for the Korean side to fulfill its interest in the country could decrease and the Korean side less benefits from its FDI. In other words, a lose-win situation may occur. However, if the Korean and Mongolian sides link the strategies and find an integrated solution to the strategy implementation, then the both sides can maximize their benefits from FDI. That is, there will be a win-win situation to secure the successful achievement of the two sides' strategy goals. Development of the well-defined FDI strategies of Korea and Mongolia and a fit between them are, therefore, the urgent challenges of two countries. The nearest period that two countries can challenge the strategy could be a meeting of the 'Korea-Mongolia Joint Committee', the first cabinet ministerial-level regular consultative group between two countries. The committee has been planned since 2011. During the President Lee Myong-Bak's visit in Mongolia in August 2011, two sides agreed to examine a need of the committee within the context of the 'Comprehensive Partnership'. The committee's role is to make coordination on two countries' cooperation. However, the committee still has not been set up. At the latest, during the visit of the Korean foreign minister Yun Byung-Se in Mongolia in August 2014, the committee was discussed to be set up soon and deal with issues on two countries' economic cooperation including Korean FDI in Mongolia.

#### **4. Conclusion**

This study has analyzed the ways that Korean FDI in Mongolia can be diversified. Korean firms' FDI diversification is highlighted within the context of the recent FDI policy of Mongolia and a special attention is paid to a comprehensive approach to Korean FDI diversification possibilities. As a result of the study, Korean FDI was found to be possibly diversified through four ways: diversification of form, sector, region and size. First, there are opportunities for Korean firms to diversify their FDI through forms such as M&A, concession agreement, product sharing agreement, licensing, financial leasing and SA. Second, opportunities exist for Korean firms to make FDI in provinces with high competitiveness and FDI projects, and where Free Zones are developed. Third, diversification opportunities exist for Korean firms in export promotion and import substitution sectors. Sectors such as oil refinery, construction materials, and consumer and food products were spotted. Fourth, the country's high demand for heavy industry development and financing of mega-projects are good opportunities for Korean firms to be more diversified in their size. Based on the Korean firms' competitiveness, experience, familiarity and the preferred status in Mongolia, the diversification of Korean FDI through the above options seems to be available. It should be noted, however, that some of the upper options could

be hardly be taken in the short term as they are still on the plan stage. Also, it could be somewhat hard to take some of the options in the short term due to the country's investment environment backwardness.

Further, a successful diversification of Korean FDI in Mongolia was expected to be a prerequisite of a win-win economic cooperation between the two countries. Thus, a strategy with fit of two countries on Korean FDI diversification was principally proposed, and 'Korea-Mongolia Joint Committee' soon to be set up seems to be the most proper for strategy development due to its role, scope and discretionary power.

The study has implications for researchers. It enables the studies to further cover an expansion of FDI, and in particular, and the perhaps most importantly, making a suggestion related to a wider scope of the Korea-Mongolia economic cooperation. The wider economic cooperation can be stretched to a better economic development and cooperation in the Northeast Asia. It also has implications for practitioners. If Korean firms are able to ascertain a wider scope of FDI activities, then their investment plan can be better established and effectively implemented. It also has implications for policy. If policy makers are able to ascertain a wider scope of economic cooperation, then the policy for two countries' cooperation can be better developed and implemented.

Although the analytical approach represents an important contribution of this study, the study can be considered preliminary, necessitating considerable additional work. Indeed, it may be argued that further research on the diversification of Korean FDI in the country would be extended to the implementation process of diversification. This study also suggests that there is an acute need to develop more refined FDI diversification analytical frameworks that assess the Mongolian FDI policy and its relevance to Korean firms' competitive advantages. In addition, future studies should conduct more detailed examinations of possible links between Korean outward FDI policy and Mongolian inward FDI policy.

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## Appendix 1. Policy sources of FDI diversification opportunities

FDI diversification opportunities		Policy sources of FDI diversification opportunities
Form	Mergers and acquisition	- State Privatization Basic Guideline for 2014-2016 (Jun 2014)
	Product sharing agreement	- Petroleum Law of Mongolia (Jul 2014)
	Concession agreement	- Concession invitation by the MEDM in energy (Jun 2014), education (Jun 2014) and road construction (Apr 2014)
	Financial leasing	- SME leasing program (since 2010) - Export Promotion and Import Substitution Industrialization Program (EPISIP) (Jan 2014)
	Franchising	- Increase in disposal income - Changes in the consumers' consciousness - First mover advantages
	Licensing	- Better equipment and enhanced production capacity of local firms involved in 888 projects of EPISIP
	Strategic alliance	- 1,096 mining licenses and 3,659 exploration special licenses (as of Apr 2010) - The amended Minerals Law (Jul 2014)
Region	Provinces with high competitiveness	- 2013 Competitiveness Survey of the Mongolian provinces (May 2014)
	Provinces with FDI projects	- FDI projects at the provincial level (since 2014) - FDI promotional activities by provinces (since 2014)
	Free zones	- Draft of the amended Law on Free Zone of Mongolia (Jun 2014)
Sector	Import substitution industry: Oil refinery sector	- List of Initial High Priority Large Projects to be Announced to Foreign and Domestic Investors by Government (2008) - State Policy on PPP (Oct 2009) - Petroleum Law of Mongolia (Jul 2014) - Investment Law of Mongolia (Oct 2014)
	Import substitution industry: Building materials sector	- Housing projects in the New Development Project (2012-2016): Cities project 100,000 apartment units project 1,000 apartment units in each province project - Investment Law of Mongolia (Oct 2014)

	Import substitution industry: Food and consumer products sector	- 757 import substitution projects in EPISIP (May 2014) - Needs for the import-substituting products
	Export promotion industry: Light industry sectors	- Basic Guidelines for the Development of Production and Technology Parks (PTP) in Light Industry (2003) - Some Measures of the Government Related to Leather Manufacturing (Jul 2013) - The Action Plan of the Capital City Governor and Ulaanbaatar Mayor 2013-2016 (2012)
Size	Heavy industry development projects	- Direction on Activity and Location of PTP in Heavy Industry (2011) - 2009-2019 Industrialization Program (Sep 2009)
	New railroad construction project	- Measures on the State Policy on the Railway Sector (Oct 2014)
	Mega projects' financing	- Mega projects in mining and infrastructure of Mongolia

*Source: by author.*