

**THE GLOBALIZATION STRATEGY OF KOREAN IT OUTSOURCING
COMPANIES VIA FOREIGN DIRECT INVESTMENT**

By

Tae-Kyoung Kim

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

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ABSTRACT

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By

Tae-Kyoung Kim

Global competitive pressure and continuous innovations are forcing many organizations to rethink the manner in which they do business and reengineer themselves. Such reengineering requires, in most all cases, the support of information technology (IT). Therefore, many organizations are creating new business and system integrations to manage their technological assets.

Until now, Korean IT service companies have grown substantially in the domestic market. However, one of the big issues that Korean IT service companies face is the growth-limitation due to the domestic market maturity. Fortunately, IT outsourcing is considered as one of the next growth engines in Korea and other foreign markets.

Hence, I will suggest some ideas for the success in the global IT outsourcing market expansion of Korean IT service companies in the near future while introducing basic concepts of IT services and market trends. Particularly, I will explain foreign direct investment (FDI) as a mean of penetration overseas market through looking into its benefits and costs.

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Dedicated to My Family

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I want to appreciate my colleagues who provided useful data, thoughtful advice and generous support to this thesis. I also want to express my gratitude to my thesis supervisor for his continuous coaching to complete the thesis. Finally, I'd like to express my heartfelt thanks to my family for their persistent encouragement.

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ABBREVIATES

IT	Information Technology
FDI	Foreign Direct Investment
IS	Information System
ITO	IT Outsourcing
BPO	Business Process Outsourcing
ESP	External Service Provider
HR	Human Resource
CRM	Customer Relationship Management
MNC	Multinational Corporation
PC	Personal Computer
ITIL	Information Technology Infrastructure Library
MNE	Multinational Enterprise
OECD	Organization for Economic Cooperation and Development
SMB	Small and Midsize Business
UNCTAD	United Nations Conference on Trade And Development
TNC	Transnational Corporation
KSF	Key Success Factor
ICT	Information and Communications Technology

CHAPTER I

INTRODUCTION

1.1. Research background

We witness the growing importance of computerized information systems. The number of computers is growing rapidly, as are their applications in business, education, government, the military, medicine, and at home. Computerized systems can be found today in even the smallest business. In most cases, it is impossible to run a competitive business without the help of information systems. The major role of information technology is to provide organizations with strategic advantage by facilitating problem solving, increasing productivity and quality, improving customer service, and enabling business process reengineering.

Global competitive pressure and continuous innovations are forcing many organizations to rethink the manner in which they do business and reengineer themselves. Such reengineering requires, in most all cases, the support of information technology. Therefore, many organizations are creating new business and system integrations to manage their technological assets. Managing information resources, new technologies, and communications networks is becoming a critical success factor in the operations of many companies and will be essential for survival in an era of the

global competition.

Until now, Korean IT service companies have grown substantially in the domestic market. However, one of the big issues that Korean IT service companies face is the growth-limitation due to the domestic market maturity. In addition, it is also important for Korean IT service companies to penetrate foreign markets and become successful global players.

Current strong reliance on the internal captive market of Korean IT service companies is a two-edged sword. The upside is a relatively secure customer base to maintain a revenue stream; the downside is the negative image of being a local available services company rather than being a true IT service provider that can compete against multinational corporations on its own.

Recently, IT outsourcing is considered as one of the next growth engine in the field and I think IT outsourcing can be a good means to the end – expanding the global market. I could closely observe the trends and issues of the Korean IT service business. Furthermore, by studying foreign direct investment, I equipped myself with the fundamental concepts, frameworks, and techniques of management and understanding overseas markets.

With the witnessing the fast movements of globalization in many industries and companies, I decided to apply my knowledge about foreign direct investment to the IT

service area. Focusing on the IT outsourcing business, I will introduce the basic concepts of IT service, market trend, and suggest ideas for the successful global market expansion of Korean IT service companies in the near future.

1.2. Objectives of the Study

To suggest ideas that Korean IT service companies can utilize in order to seize the new opportunities and realize them in the global market, this thesis focuses on:

- 1) Understanding the IT outsourcing business and market
- 2) Understanding FDI as a way of entering the overseas market
- 3) Suggestions for global market expansion of Korean IT outsourcing providers.

Hence, this paper attempts to look into the trends of the IT outsourcing business and find ways to penetrate the world market especially through foreign direct investment.

1.3. Major Findings

Based on the analyzed reports and books on this subject, this thesis will show the following major findings.

- 1) IT outsourcing vendors can provide IT services at a lower cost, with higher quality, for the reasons of hardware economies of scale, staffing economies of scale, specialization and tax benefits and so on. However, IT outsourcing can have adverse

effects for the reasons of limited economies of scale, lack of business expertise, contract problems and internal cost reduction opportunities and so on.

2) IT outsourcing in Korea is very much a captive market, with most Chaebol group companies serviced by their respective IT services arms. Because it is internally driven, an ESP's market share typically follows the size of its Chaebol group.

3) Globally, the IT outsourcing market is thriving amidst a state of customer satisfaction. Increased outsourcing by current customers will fuel IT outsourcing market growth. IT outsourcing market is one of the growth engines in IT services market.

4) In the near future, virtual collaborative technologies and a high bandwidth for communications will shrink geographical distances. In that sense, global sourcing will become the norm, with virtual commerce and collaboration driving a robust global economy. Global sourcing becomes the dominant approach for utility and innovative IT services, based around a core set of international standards.

5) The growing attention paid by countries to FDI is reflected in increased attention for the attraction of FDI. Furthermore, governments are granting various incentives and other governmental support to foreign investors in order to promote investment. FDI can be a way of entering foreign markets because companies can enjoy various incentives offered by foreign governments.

CHAPTER II

UNDERSTANDING THE IT OUTSOURCING BUSINESS

2.1. The Advent of IT Outsourcing

Information Systems are playing major roles for companies to bring and sustain competitive advantages. Therefore, it can be a concerned matter to outsourcing a company's information systems to a third party. Nevertheless, some of enterprises started to consider IT outsourcing as a strategic issue in the 1990s.

Since the 1960s, computer technologies have been developed rapidly and information technologies were applied to business operations in the enterprises. Accordingly, executives, consultants and scholars have thought carefully how to manage the information technologies effectively. Actually, people understand the IT as a simple tool to replace or support the existing operations until the 1980s.

However, the business environment was changed substantially due to the fast evolution of technologies and knowledge industries. To correspond with such changes efficiently and have advantage over the competitors, companies regarded the IT as important business strategies. However, the cost of adapting them to the changing circumstances by maintenances information systems will be high. The problem is how to calculate the IT costs.

In the early days of computing, IT costs were much easier to identify. Computers and other hardware were very expensive and were managed by centralized organizational units with their own personnel. Most application software was developed internally rather than purchased. IT was only used for a few well-defined applications, such as payroll, inventory management, and accounts payable/receivable.

In contrast, nowadays computers are cheap and software is increasingly purchased rather than made. The overwhelming majority of the total processing power is located on the collective desktops of the organization rather than in centralized computer centers, and it is managed by individual organizational units rather than a centralized information system (IS) department. A large proportion of the costs are in “hidden,” indirect costs that are often overlooked. These trends make it very difficult just to identify, let alone effectively control, the total costs of IT.

If organizations can effectively define and measure information technology costs and benefits, they are in a better position to effectively manage their IT. On the other hand, they still may not be able to manage it as well as firms that specialize in managing IT. For such organizations, outsourcing may be the most effective strategy for obtaining the economic benefits of IT and controlling its costs. Information technology is now a vital part of almost every organization and plays an important supporting role in most functions. However, IT is not the primary business of many organizations. Their core

competencies – the things they do best and that represent their competitive strengths – are in manufacturing, or retailing, or services, or some other function. IT is complex, expensive, and constantly changing. It is difficult to manage IT, even for organizations with above-average management skills. Because of these considerations, some organizations have decided to use outside vendors rather than internal IS units as their primary source of IT services. Obtaining services from vendors, rather than from within the organization, is known as IT outsourcing.

2.2. The Definition of IT Outsourcing

The idea of outsourcing itself is not new. Organizations have always faced the choice of buying goods and services externally or producing them internally. Outsourcing means a contractual relationship with an outside vendor that is usually characterized by the transfer of assets, such as facilities, staff or hardware. In the IT area, outsourcing can include facilities management (for data centers or networks), application development and maintenance functions, and end-user computing or business process services. Outsourcing can be partial (i.e., modular or selective) or total, and can involve not only operations but also the acquisition of customer assets and personnel.

In a typical situation, the outsourcing firm hires the IS employees of the customer

and buys the computer hardware. This is an important incentive for outsourcing by firms with financial problems. The outsourcer provides IT services under a five to ten year contract that specifies a baseline level of services in with additional charges for higher volumes or services not identified in the baseline.

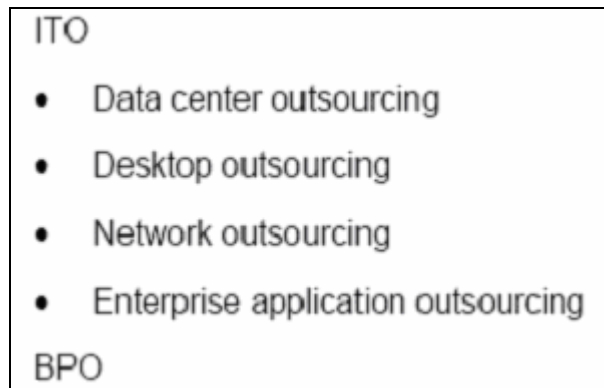
The scope of IT outsourcing in 1970s was quiet narrow such as application package contracts, contract-based programming, and services for handling certain processes but after the 1990s, the scope has been expanded into large scales such as network management, system integrations, development applications, and system management. Nowadays, IT outsourcing include the management of entire system functions in a company. IT outsourcing agreements always include services from the management category, transaction processing or business management segments, and may include services from product support, consulting, and development and integration. As part of an outsourcing agreement, the external service provider (ESP) may acquire the physical assets or the employees of a business client. Services may be provided at the client site or remotely from a vendor-owned site.

Gartner (2005) divides outsourcing in the IT service area into two segments. The first segment is IT outsourcing (ITO) and the second is business process outsourcing (BPO) which means the delegation of one or more IT-intensive business processes to an external provider that, in turn, owns, administrates and manages the selected

processes based on defined and measurable performance metrics. Examples of business processes that are outsourced to an ESP include logistics, procurement, HR, finance and accounting, CRM, or other administrative or customer-facing business functions.

According to Gartner, IT outsourcing is the contractual vehicle through which enterprises use external sources to provide life cycle service and support operations for their IT infrastructure. IT infrastructure outsourcing focuses on companies who provide outsource services in the areas of information technology infrastructure. The typical lines of activities that these providers perform include data center operations; network operations; backup/ recovery services, data storage management services; system administration services; end user support of desktop PCs, laptops, and handheld devices; web site, or application hosting, etc. IT outsourcing is divided into four primary market segments: data center operations, desktop management, network operations, and application management. The outsourcing application software is for selecting outsource-providers in the area of business software development. It includes all activities performed by outsource providers including software development; software maintenance; software reengineering or re-architecting; porting software to a new platform; and more.

In this thesis, IT outsourcing will cover the outsourcing of IT infrastructure.



[Figure 1: Composition of outsourcing in IT service]

2.3. The Benefits and Costs of IT Outsourcing

Pilkington PLC is a major international supplier of glass products, with headquarters at St. Helens in Great Britain. In the early 1990s it downsized its headquarters staff in an effort to reduce costs in a period of declining profitability. Management needed to decide how to handle head office IT services in the context of this downsizing.

Pilkington considered retaining the IT function (IS department) until after the downsizing, or spinning it off as a subsidiary that would sell services to outside organizations as well as to internal business units. However, it decided that most aspects of its IT were essentially commodities, and that a reasonable option would be outsourcing them to a vendor.

The next decision was whether to outsource IT on a piecemeal basis to multiple vendors, or to obtain all services from one vendor. Pilkington decided to use a single source, to minimize management involvement with the outsourcing. This approach

would allow management to focus on strategic issues related to its core competencies. Using a single vendor would also facilitate a transition from a mainframe system to client/server systems. After the extensive analysis for the choice of vendors, Pilkington signed a contract with EDS-Scicon in January 1992. EDS offered support for IS technologies from multiple vendors and had strong technical capabilities, and its worldwide coverage paralleled Pilkington's multinational operations. Another consideration was the favorable working conditions and career opportunities for employees who would transfer to the vendor. Pilkington's key concerns in the arrangement were to minimize risk and to maintain in-house capabilities related to the strategic management of IT. Pilkington negotiated a two-year contract with a renewal option. This flexible arrangement reduced the risk of outsourcing problems that other Pilkington units had experienced. Only six key IS professionals remained on Pilkington's payroll. Two managed the vendor contract, while the other were responsible for strategic policy and technology issues.

In January 1994, EDS successfully replaced the head office mainframe with a local area network. Important financial reports are now available faster than before. The outsourcing contract saved \$ 1.85 million over two years. Pilkington renewed the contract for two more years, and has provided references to other companies considering contract with EDS.

The Pilkington case illustrates an interesting economic issue: the relative benefits of obtaining them via outsourcing versus using internal IT services. To understand Pilkington's situation, I'm going to figure out the benefits and costs of IT outsourcing from the outsourcing buyers point of view like Pilkington.

IT outsourcing advocates describe IT as a commodity, a generic item like electricity or janitorial services. They note the benefits summarized in Table 1. In particular, the advocates claim that outside vendors can provide IT services at 10 to 40 percent lower cost, with higher quality, for the following reasons:

1) Hardware economies of scale: With multiple customers, outsourcers can use more cost-efficient larger computers or get discounts on volume purchases of hardware. They also can operate their computers with less excess capacity because peak loads from different customers will not all occur at the same time.

2) Staffing economies of scale: A larger customer base also makes it possible outsourcers to hire high skilled, specialized technical personnel whose salaries would be hard to justify in smaller IS groups.

3) Specialization: Providing computer services is one of the core competencies of the outsourcing firm, rather than an incidental part of its business.

4) Tax benefits: Organizations can deduct outsourcing fees from current asset in contrast to depreciating computer hardware purchasers over three or more years.

<p>Financial</p> <ul style="list-style-type: none"> • Avoid heavy capital investment, thereby releasing funds for other users. • Improve cash flow and cost accountability. • Realize cost benefits from economies-of-scale, from sharing computer-housing, hardware, software, and personnel. • Release expensive office space.
<p>Technical</p> <ul style="list-style-type: none"> • Be freer to choose software due to a wider range of hardware. • Achieve technological improvements more easily. • Have greater access to technical skills.
<p>Management</p> <ul style="list-style-type: none"> • Concentrate on developing and running core business activities. • Eliminate need to recruit and retain competent IT staff • Delegate IT development (design, production and acquisition) and operational responsibility to support.
<p>Human Resource</p> <ul style="list-style-type: none"> • Draw on specialist skills, available from a pool of expertise, when needed. • Enrich career development and opportunities for staffs.
<p>Quality</p> <ul style="list-style-type: none"> • Clearly define service levels. • Improve performance accountability. • Earn quality accreditation.
<p>Flexibility</p> <ul style="list-style-type: none"> • Respond quickly to business demands. • Handle IT peaks and valleys more effectively.

[Table 1. Potential Outsourcing Benefits]

On the other hand, to evaluate claims about the benefits, Lacity and Hirschhelm (1993) conducted interviews with 14 companies that outsourced or considering outsourcing. They found that outsourcing was not necessarily less expensive, and that it could create problems. They point out the following issues:

1) Limited economies or scale: Although outsourcers can negotiate larger discounts on hardware, the advantage is not large, especially over the five-year life of a

mainframe.

2) Staffing: For the most part, customers are served by their former employees rather than more highly skilled vendor staff. In some cases, the outsourcer shifts the better former employees to other accounts.

3) Lack of business expertise: In addition to losing former employees to other accounts, the remaining staff members tend to become more technically oriented and have less knowledge of the business issues in the customer's industry.

4) Contract problems: Some customers did not adequately specify service levels and had to pay "excess fees" for services not in the contract, or for volumes greater than the averages written into the contract.

5) Internal cost reduction opportunities: Organizations can achieve many of the cost savings of outsourcing by improving their own IT management, for example, through: Economies of scale from consolidating multiple data centers into one location, Increased control over user abuses of IT services through prioritization and formal procedures. The costs of IT outsourcing is summarized in Table 2.

Financial
<ul style="list-style-type: none">• Enormous switching costs due to the termination or cancel of contracts.• Hidden costs due to the communications or coordination between related parties.
Technical
<ul style="list-style-type: none">• Weakening internal IT competitiveness.• Possibility to choose wrong outsourcer and to have out-of-date technologies.
Management
<ul style="list-style-type: none">• Difficulty in verification of the impacts from IT outsourcing.

<ul style="list-style-type: none"> • Security issues on systems and data. • Hard to respond quickly accordance with the changing of environment, and organizational requirement.
Human Resource <ul style="list-style-type: none"> • Demoralized internal staffs due to the threatening of job stabilities.
Quality <ul style="list-style-type: none"> • Difficulty in controlling qualities of system development or management.
Flexibility <ul style="list-style-type: none"> • Losing flexibility due to the over-dependency on outsourcers.

[Table 2. Potential Outsourcing Costs]

However, scientists at the IBM T. J. Watson Research Center investigated the long-term effects on companies that outsourced a major portion of their IT infrastructure between 1998 and 2002. Unlike previous research that relied on the case-study approach, the IBM Research study is the first to apply rigorous statistical analysis to measure the impact of an outsourcing agreement on a company. The study concludes that companies engaged in information technology outsourcing outperformed their peers on a long-term basis in key business metrics, specifically selling, general and administrative (SG&A) expenses, return on assets (ROA) and earnings before interest and taxes (EBIT). Furthermore, the research indicates that the larger the outsourcing contract, the more likely the improvement in bottom-line results. For example, one global telecommunication company outsourced the management of its data centers and other processes in an agreement valued at US\$4 billion. The year before the company outsourced IT, its quarterly SG&A expense was US\$3.1 billion. Three years into the outsourcing agreement, quarterly SG&A expense dropped 13 percent to

US\$2.7 billion. The result is in marked contrast to the sector's 200 percent increase in SG&A expenses during the same period.

According IBM's research, IT outsourcing was clearly a part of an effective management strategy that the companies in the study used to achieve positive results. The study illustrates that IT outsourcing is a proven business tool that other companies should consider to build better bottom-line results and please shareholders.

2.4. Analysis of Domestic IT Outsourcing Market

The Korea IT services market has grown rapidly in the past decade, enjoying strong double-digit growth rates underpinned by a healthy domestic economy. However, the market experienced serious fluctuations since the Asian economic crisis which was exacerbated by the unstable global economy. In addition, Gartner pointed that growth rates will settle down as the market moves toward maturity. Therefore, External Service Providers (ESPs) in Korea will experience increased competition as the market adjusts and consolidates.

Additional characteristic of Korea IT market comes from Chaebol-dominated business environment. Chaebols are large conglomerate groups, usually owned by a family holding company often with intricate cross-holding among member companies. Chaebols, through their numerous subsidiaries, operate in various industries: discrete

and process manufacturing, automobile, insurance, IT, telecommunications, construction, logistics, and chemical. They typically share the services of the parent company's IT group or spin off the IT division as a separate subsidiary to support the overall Chaebol, for example, Samsung SDS.

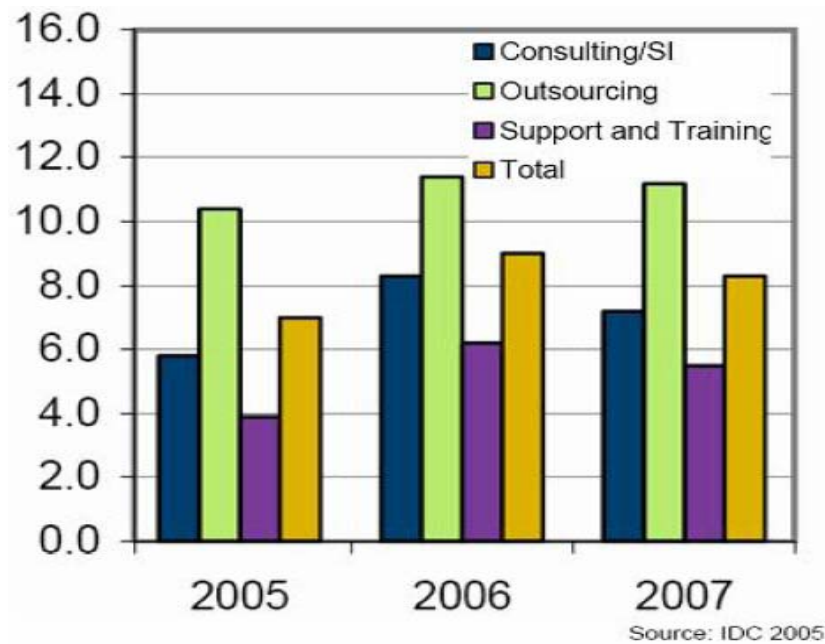
Large Market Presence (Revenue Between 147 Billion Won and 473 Billion Won, or US\$129 Million and US\$413 Million)
IBM
LG-CNS
Samsung
SK C&C
Midsized Market Presence (Revenue Between 37 Billion Won and 90 Billion Won, or US\$33 Million and US\$80 Million)
Hyundai Information Technology
POSDATA
Daewoo
Large Market Presence (Revenue Between 147 Billion Won and 473 Billion Won, or US\$129 Million and US\$413 Million)
Korea Electricpower Data Network
Kolon Data Communication
Shinsegae Information & Communication
Small Market Presence (Revenue Between 10 Billion Won and 28 Billion Won, or US\$10 Million and US\$25 Million)
CJ Systems
Daelim Information & Technology
Dongboo
Liger Systems
SsangYong
Tong Yang Systems
Note: Service providers are listed alphabetically within each segment.

Source: Gartner (August 2005)

[Table 3. Market Share Segmentation of IT outsourcing ESPs in Korea in 2004 by Estimated by IT Management Revenue]

The Korea IT services market is strongly based on systems integration services, which dwarf the other segments, such as product maintenance, consulting and IT management. However, user companies have started accepting more seriously the IT outsourcing concept and are considering the benefit and value that IT outsourcers can

bring. A few IT outsourcing deals signed in Korea in the past five years are acting as stimuli for further market development. Thus, IT outsourcing services will accelerate growth in the IT services market in Korea and the gradual shift to outsourcing is a key driver of future business.



[Figure 2. Domestic IT service market growth outlook in 2006]

In that sense, ESPs with excessive reliance on project-by-project business should start developing a continuing business stream from outsourcing to maintain stability in future years. In addition, local ESPs must start to develop a strategy for the emerging IT utility business, and they have three options: compete, partner in a value chain or stay out of it.

However, IT outsourcing in Korea is very much a captive market, with most Chaebol group companies serviced by their respective IT services arms. As a result, it

is rare to find multinational corporation (MNC) external services providers in the IT outsourcing market, except for a few, such as IBM and Hewlett-Packard. Because it is internally driven, an ESP's market share typically follows the size and volume of its respective Chaebol group. For instance, Samsung SDS has the largest market share because Samsung Group is the No. 1 conglomerate in size and number of subsidiaries.

Accenture, Bearing Point, HP, IBM and Oracle are the multinational ESPs that have a sizable presence in Korea IT services market. However, their market share for consulting, development and integration, and IT management is relatively small compared with other parts of this region, except for IBM. In 2004, a few big contracts were signed, such as Samsung SDS contract win from Mando Winnia, a manufacturing company; LG CNS' KTX deal with KORAIL; and POSDATA's winning deal from Seoul Subway.

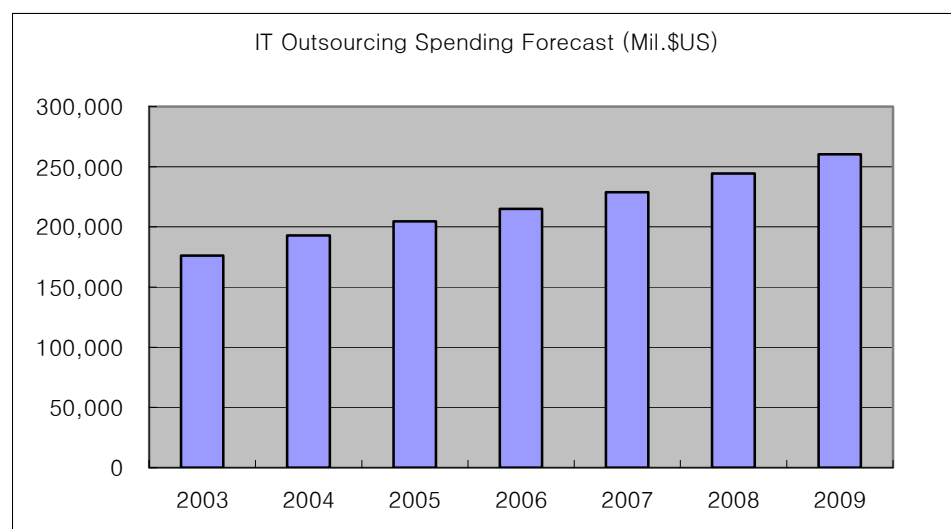
At this moment, IT outsourcing is an emerging market in Korea. While the total IT outsourcing market is gradually growing, the selective outsourcing market is active and growing such as call centers and disaster recovery.

2.5. Forecast of Global IT Outsourcing Market

Recent global market research conducted by Knowledge Systems and Research, Inc. makes it clear that the IT outsourcing market is thriving amidst mass of satisfied

customers. There is high penetration for outsourcing one to two IT functions (data center, applications, desktops, networks) in large companies on a global basis and in the United States – based on Fortune 500. Although the expectations for outsourcing are very high, IT outsourcing providers are met for the majority of customers. High levels of satisfaction with current outsourcing projects have led most companies to plan on outsourcing additional IT functions. Increased outsourcing by current customers will fuel the IT outsourcing market growth.

According to Garter, worldwide IT outsourcing spending will rise from \$193 billion in 2004 to \$260 billion by 2009, while forecasted that IT services market is expected to grow from \$582.5 billion in 2004 to \$759.8 billion in 2009; it is obvious that IT outsourcing market is one of the growth engines in IT services market.



[Figure 3. Forecast of IT outsourcing Spending]

Next, I will explain the drivers and inhibitors of the worldwide IT outsourcing

market.

2.5.1. Drivers of the IT Outsourcing Market

Basically, with improving economic conditions, a shift to a growth-focused business market has ramifications for the outsourcing market. The focus on outsourcing as a viable practice to reduce/control costs does not go away; rather, cost reduction becomes mandatory with focus on strategic growth enablers, access to additional resources, and productivity and quality improvement, as well as simplifying the general perception of the delivery of IT services to the business. Client organizations face ever-changing and demanding challenges to compete in a global economy, often relying on an array of providers (internal and external) to help them achieve objectives of growth, cost, speed and agility. Increasingly, more decision makers are involved in the sourcing decision, indicating greater endorsement and interest in outsourcing throughout the buyer enterprise as a viable business strategy to support business goals.

A continued focus on cost has tended to dominate outsourcing decisions and vendor selection for several years, but Gartner research reveals some subtle shifts from this cost-focused thinking. The research has observed that "improving business processes" is a top user/buyer priority this year, replacing "operating costs/budgets" as the top priority of 2004.

For data center outsourcing, cost is always an issue, but issues around reducing capital expenditure and lack of resources are causing client to look at outsourcing; some clients are looking to outsource their mainframe operations and support, because the operators and technical support personnel are nearing retirement age and the younger people are not interested in customer information control systems and multiple virtual storage; or many clients have several remote data centers that they are supporting and have to pay a premium for support in the off hours and weekends, to reduce their cost and get better quality services.

For desktop outsourcing, in markets where PC penetration of the commercial sector is still on a serious upward ramp, desktop outsourcing is growing at a healthy rate and should continue to do so until market saturation and declining product prices tip the scale in the opposite direction. The most-robust growth rates are in emerging markets.

For help desk outsourcing, lower telecom costs increase possibilities to leverage global resources to support help desk functions in offshore English-speaking countries (for example, technical support in India), thus increasing affordability of broader support requirements.

For network outsourcing, market movement toward all-IP network services and network infrastructure, while not always driven by verifiable business drivers, seems all but inevitable at this point. Network outsourcing is emerging as an exercise to help

companies stabilize and optimize current voice and data infrastructure to understand current costs and architectural weaknesses to plot a more intelligent migration to IP. Layered onto the network IT services discussion is a fast-growing market for the sourcing of business processes related to corporate networks.

For applications outsourcing, cost takeout is the No. 1 driver, as well as demand for greater efficiencies and process effectiveness in internal applications operations; executive-level mandates to offshore applications drive applications project work and, subsequently, outsourcing. A highly competitive marketplace with an array of service provider options accelerates supply-side options, a variety of ways to access global delivery/offshore for labor arbitrage, and access to critical application skill sets.

2.5.2. Inhibitors of the IT Outsourcing Market

Isolated re-insourcing and early termination of highly visible deals (frequently, mega deals) causes market caution, doubt and uncertainty. Because of these fears, the consideration or likelihood of re-insourcing some functions that were previously outsourced, tends to accelerate. Indications of more "bad deals" being signed (the result of extreme cost focus, typically) puts strain on the supply side (vendor profitability) and the demand side (enterprises drive to lowest cost, but then want value). Frequently, these types of arrangements result from lack of proper planning

and expectation-setting prior to engaging in an outsourcing contract.

Escalating competition from new providers (for example, offshore companies, traditional consulting and systems integration firms, and independent software vendors) in IT management and application management are causing: market confusion on ESP options, price competition to accelerate, and revenue erosion for providers (often due to offshore labor bringing reduced overall deal value). With an extended service focus by providers, market skepticism and caution have arisen around the immaturity and incompleteness surrounding IT utility infrastructure services; to this point, vendor investments have been significant, and if the market refuses to adopt, significant setback in the IT management market will result. Furthermore, growth for offshore infrastructure services remains slow because of deep concerns over offshore providers' ability to deliver secure, latency-free, high-quality infrastructure services.

Data center outsourcing inhibitors include issues around the cost of moving hardware to a service provider's site, which inhibits adoption due to the effect on the client's financials – if the market value of the equipment is lower than the book value; cost for communication links to the service provider's site and for offshore service delivery; disaster recovery and business continuity; communication redundancy; and security and data protection.

For desktop outsourcing, the falling average sales prices (of PCs/desktops), increased reliability and the growing perception that client systems are rarely mission-critical have led to an overall downturn in desktop support services in markets that have a high penetration rate of PCs in the commercial sector. Increasingly customers are willing to go with a "no support solution," such as using only authorized warranty support, with neither upgrades nor extensions. Desktop outsourcing will see an impact from this overall trend.

For help desk outsourcing, the negative impact on growth as a result of automation of help desk functions (for example, self-healing, self-help, online support and others) displaces the labor component, thus slowing growth of the help desk market.

For network outsourcing, a cacophony of new market offers to get to IP may ultimately confuse the market. Not only are customers asked to make manufacturer choices for premise-based infrastructure, but also emerging offers from small and large players for hosted IP-private branch exchange (PBX) and IP Centrx-like services will compete for favor and market dollars. Poor execution in the large business segment, as well as affordability for small and midsize businesses, may be the counter-revolution to the premise-based IP revolution.

For applications outsourcing, organizations consider applications knowledge to be core to business. Other inhibitors include concerns about retaining critical staff with

business knowledge, information security and knowledge protection, and reported problems with offshore processes and quality of services.

2.6. The Trends of the IT Outsourcing Business

Based on the research so far, I arranged a few key findings in IT outsourcing business and market. Furthermore, I will introduce four future scenarios about the IT outsourcing.

2.6.1. Key Findings in Trends

1) Profitability and Growth:

Profitability of deals for service providers has always been important, but it has become even more so as the IT services market becomes more visible to investors. Also, several high-profile, unprofitable deals have become visible in recent years, sending a wake-up call that profits are not a given in an industry that was generally able to count on good margins. At the same time, service providers have to post consistent revenue growth.

2) Standardization and the utility movement:

IT outsourcing is moving away from the management of customized, dedicated systems toward delivery using mass-customized, standardized, automated and shared IT systems. The market is selectively investing in the development of utility solutions, and those that invest wisely will be the future leaders. Delivery of these standardized

and shared services has migrated during the past few years from the straightforward, co-location services at Internet data centers to managed-hosting storage utilities, and remote monitoring and management services. More organizations around the world demanded Information Technology Infrastructure Library (ITIL) standardization capabilities and frameworks from service providers. ITIL became a "must have" for providers, rather than the differentiator it was a few years ago.

3) Globalization:

Service providers are showing more interest and investment in offering new offshore infrastructure services, such as remote monitoring, database administration and technical support. At this point, however, more exploration and capability build-out, rather than adoption, is occurring. Providers are more actively pursuing infrastructure globalization plans than clients are. Major providers, such as EDS, CSC and Perot Systems, offered a larger scope of remote management services delivered via offshore resources, including data center monitoring, security monitoring and network monitoring.

4) More Service Options:

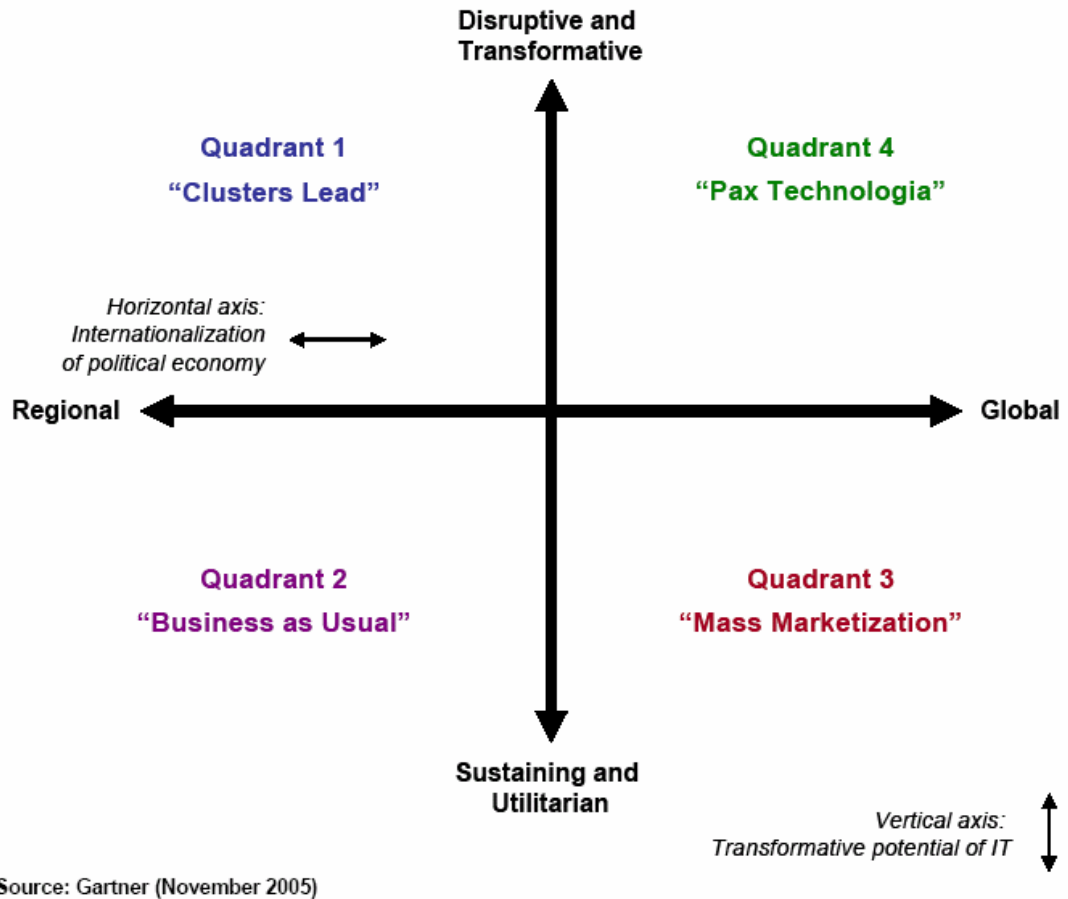
Service providers addressed client demands for more service options. They responded by bundling and unbundling services in the combinations their clients demanded. Selective outsourcing gained popularity among large, global corporations.

At the same time, organizations realized that some outsourced services needed to come back in-house and other services that were retained needed to be outsourced. Organizations with outsourcing experience embraced a multi-sourcing strategy that considers internal and external sources working together, rather than a bidirectional "in vs. out" decision.

2.6.2. Possible Future Scenarios

Gartner developed a few scenarios, each of which defines a business environment that will confront IT management during the next 10 years. From the research, I extract some parts relevant to the IT outsourcing to understand the big pictures of it. Each scenario would demand the transformation of the IT organization.

The research selected two major forces of change: 1) To what extent the global political economy will become more integrated or more regionalized, characterized by highly competitive and differentiated economic clusters and 2) To what extent IT will experience transformative, disruptive innovation over the time horizon, or sustaining utilitarian change. These two spectra create four possible future scenarios depicted in Figure 4.



[Figure 4. Four Future Scenarios of IT management]

In the quadrant 1 case, when local or regional political economies combine with transformative use of technology, the clusters lead quadrant emerges. Inherently local economic clusters are the workhorses of this future, productively applying free-market competition and "open innovation" collaboration to maximize productivity, accelerate growth and act as magnets for expertise and talent. The synchronization of local business practices, politics and economics enables regional clusters to be competitive – first locally, then widening regionally and internationally as they build strength, credibility and reputation. In this quadrant, the regional economy is

continually transformed by a high rate of technological, business, social and educational change.

Therefore, the IT organization will be a more critical component in the management, delivery and support of applications and services that reduce commercial friction within a region. At the same time, the emergence of regional economic clusters introduces new competitors and new options for IT organizations. Commodity functions will increasingly be outsourced to companies in expert clusters. IT professionals must develop behaviors and skills for cooperating with cluster peers, for establishing regional standards and for sharing cluster wide best practices. In-depth understanding of regional markets and economics will enhance IT organizations' success. In addition, the growth of regional economic clusters broadens sourcing options. Aggressive companies, particularly those that have high discipline regarding international marketing and global sourcing, will exploit regional clusters by moving design, research, development, manufacturing and service delivery to areas that exemplify best practice. Service providers and product designers will choose partners or joint-venture entities that suit their future market needs. Protection of and respect for intellectual capital, proprietary processes and copyrights will become a factor in creating successful clusters.

In the quadrant 2 case, the business world has shifted from a national to a global

focus. This process will not stop. Trade continues and the world is growing together. In this scenario, associations between countries will shift from geographical to socioeconomic. Countries will create alliances with countries that are like them or on which they depend. Countries will be increasingly likely to collaborate where they have similar approaches to markets, foreign investment, education, the balance between the individual and society and, increasingly, environmental issues. Business processes are often highly complex and are increasingly likely to involve collaboration and close links between many enterprises – and sometimes also the organs of government. Therefore, managing IT globally will get harder. Also, alliances will reshape around commercial interest such as data privacy, security, intellectual property rights and so on.

Generally speaking, developing economies have weak IT and commercial infrastructures. In many cases, they are so weak that they need to be replaced rather than developed. The combination of skilled labor, low labor cost and low trade barriers makes outside investment in developing economies attractive. Stability and growing local markets mean that investors will – in fact, must – be prepared to invest for the long term. Investors and local managers should learn from experience in the developed world and avoid many of the mistakes made there. The relative lack of legacy systems and attitudes, especially in new plants, should enable them to leap

over their competitors in the developed world. Hence, IT spending in developing economies will have a significantly different profile than that in developed economies.

In this case, the IT department must devote more effort to reconciling incompatibilities. The IT infrastructure management component of IT will extend its role in running the business, assuming more operational responsibility in the daily management of global operations. Moreover, managers in IT service providers who are responsible for international investment should recognize that the advantages of developing economies go beyond low labor cost and a compliant workforce. Investments in analysis and design work, as well as manufacturing and call centers, will be increasingly attractive. Managers should examine outsourcing options in unobvious regions based on key trading relationships and they should closely watch the evolution of international institutions such as the United Nations, the World Trade Organization, the European Union, North Atlantic Treaty Organization (NATO), Organization of the Petroleum Exporting Countries (OPEC) and so on for international investment.

In the quadrant 3 case, mass marketization represents a world in which IT is a commodity that is delivered unfettered on a global basis as a service. In this scenario, it is largely true that IT doesn't matter. Although standardized IT services will play a key role in the creation of a truly global economy, organizations will not look to IT to

gain competitive differentiation. Specifically, business value will be gleaned from people who can see through all the data, interpret it, and make better and faster decisions than the competition. These people will be in great demand. One of the first indicators we may see would be the growth in importance and power of international organizations such as the United Nations, the World Bank and the World Trade Organization, as well as international standards, particularly regarding trade, health, the environment, energy, security, human rights and technology.

In this case, the IT department, as we know it today, shrinks by 70 percent. Those who remain are squarely focused on procurement and vendor management. In many organizations (more than half), the stand-alone IT organization disappears completely. What emerges is a shared-service organization that handles HR, finance, facilities and IT. Virtually all organizations outsource IT, picking from a standard set of commoditized IT services. The use of global standards means that it is simple to switch vendors, so all contracts are short term IT delivers the services required to run a business, but it does not provide any competitive edge. Identical IT services are available to all competitors. In this quadrant, all IT is purchased as a service. All the IT infrastructure and application suites are provided on a pay-as-you-go basis by large global vendors.

The quadrant 4 case is the result of powerful transformative technologies that knit

together a global economy. Economic interdependence and potentially global threats cause greater political collaboration. Virtual collaborative technologies and a high bandwidth for communications shrink geographical distances. Traditional political governmental units would agree to concede some power and operating authority to these multinational worldwide governance organizations. People would begin to increasingly identify with economic and technological demographics, as well as global communities of interest, rather than political and national philosophies.

In that sense, global sourcing will become the norm, with virtual commerce and collaboration driving a robust global economy. Globally consistent professional standards and qualifications will appear. Global sourcing becomes the dominant approach for utility and innovative IT services, based around a core set of international standards. Enterprises must be able to collaborate virtually and globally. They must exploit and adopt international standards. The share of total investment devoted to enterprise IT will increase substantially. The IT industry will be polarized, with a small number of global technology providers and service providers positioned against many small niche or innovative technology companies. The large vendors and ESPs will dominate through economies of scale, leveraging resources in low-cost countries and acquiring the small players as they grow. New standards emerge, supported by global ESPs and vendors (such as standards regarding virtual

collaboration infrastructure, sourcing management and supply chain integration).

In any cases of the scenarios, it is clear that there exists the globalization of IT service. Even in the scenarios expect the leading of regional economies – quadrant 1 or 2, commodity functions will increasingly be outsourced to companies in expert clusters and companies will exploit regional clusters by moving design, research, development, manufacturing and service delivery to areas that exemplify best practice. Hence, Korean IT service companies should prepare the capability and competitiveness with the whole world as their stage.

Chapter III

UNDERSTANDING OF FOREIGN DIRECT INVESTMENT

In this chapter, I will explain the basic concepts for doing international business especially relevant to entering a foreign market. Then, by introducing Foreign Direct Investment (FDI), I'm going to set up the fundamentals for the discussion about the globalization of Korean IT outsourcing companies through FDI.

3.1. Basic Considerations of Entering Foreign Markets

When a firm decides to enter a foreign market, it has to address three basic decisions: which markets to enter, when to enter those markets, and on what scale.

3.1.1. Choosing a Foreign Market to Penetrate

There are more than 180 nation-states in the world, but they do not all hold the same profit potential for a firm contemplating foreign expansion. Ultimately, the choice must be based on an assessment of a nation's long-run profit potential. The attractiveness of a country as a potential market for an international business depends on balancing the benefits, costs, and risks associated with doing business in that country. The long-run economic benefits of doing business in a country depend upon factors such as the size of the market (in terms of demographics), the present wealth (purchasing power) of consumers in that market, and the likely future wealth of

consumers. A firm can rank countries in terms of their attractiveness and long-run profit potential. Preference is then given to entering markets that rank highly.

The value an international business can be created in a foreign market depends on the suitability of its product offering to that market and the nature of indigenous competition. If the international business can offer a product that has not been widely available in that market and that satisfies an unmet need, the value of that product to consumers is likely to be much greater than if the international business simply offers the same type of product that indigenous competitors and other foreign entrant are already offering. Greater value translates into an ability to charge higher prices and/ or to build sales volume more rapidly.

3.1.2. Timing of Entry

Once attractive markets have been identified, it is important to consider the timing of entry. Entry is early when an international business enters a foreign market before other foreign firms and late when it enters after other international businesses have established themselves.

The advantages frequently associated with entering a market early are commonly known as first-mover advantages. One first-mover advantage is the ability to preempt rivals and capture demand by establishing a strong brand name. A second advantage is

the ability to build sales volume in that country and ride down the experience curve ahead of rivals, giving the early entrant a cost advantage over later entrants. This cost advantage may enable the early entrant to cut prices below that of later entrants, thereby driving them out of the market. A third advantage is the ability of early entrants to create switching costs that tie customers into their products or services. Such switching costs make it difficult for later entrants to win business.

However, entering a foreign market before other international businesses also has disadvantages. These are often referred to as first-mover disadvantages. These disadvantages may give rise to pioneering costs. Pioneering costs are costs that an early entrant has to bear that a later entrant can avoid. Pioneering costs arise when the business system in a foreign country is so different from that in a firm's home market that the enterprise has to devote considerable effort, time, and expense to learning the rule of the game. Pioneering costs include the cost of business failure, if the firm, due to its ignorance of the foreign environment, makes major mistakes. A certain liability is associated with being a foreigner, and this liability is greater for foreign firms that enter a national market early. Recent research seems to confirm that the probability of survival increases if an international business enters a national market after several other foreign firms have already done so. The late entrant may benefit by observing and learning from the mistakes made by early entrants.

Pioneering costs also include the costs of promoting and establishing a product offering, including the costs of educating consumers. These costs can be particularly significant when the product being promoted is unfamiliar to local consumers. In contrast, later entrants may be able to ride on an early entrant's investments in learning and customer education by watching how the early entrant proceeded in the market by avoiding costly mistakes made by the early entrant, and by exploring the market potential created by the early entrant's investments in customer education.

3.1.3. Scale of Entry and Strategic Commitments

Another issue that an international business needs to consider when contemplating market entry is the scale of entry.

Entering a market on a large scale involves the commitment of significant resources. Not all firms have the resources necessary to enter on a large scale, and even some large firms prefer to enter foreign markets on a small scale and then build slowly as they become more familiar with the market.

Entering a foreign market on a significant scale will have several effects. On the positive side, it will make it easier for the company to attract customers and distributors. Significant strategic commitments are neither unambiguously good nor bad. Rather, they affect the competitive playing field and unleash a number of

changes, some of which may be desirable and some of which will not be. It is important for a firm to think through the implications of large-scale entry into a market and act accordingly. Of particular relevance is trying to identify how actual and potential competitors might react to large-scale entry into a market. Also, the large-scale entrant is more likely than the small-scale entrant to be able to capture first-mover advantages associated with demand preemption, scale economies, and switching costs.

The value of the commitments that flow from large-scale entry into a foreign market must be balanced against the resulting risks and lack of flexibility associated with significant commitment. Balanced against the value and risks of the commitments associated with large-scale entry are the benefits of a small scale entry. Small-scale entry allows a firm to learn about a foreign market while limiting the firm's exposure to that market. Small-scale entry is a way to gather information about a foreign market before deciding whether to enter on a significant scale and how best to enter. But the lack of commitment associated with small-sale entry may make it more difficult for the small-scale entrant to build market share and to capture first-mover or early-mover advantages.

3.2. Entry Mode for Overseas Expansion

Once a firm decides to enter a foreign market, the question arises as to the best mode of entry. Firms can use six different modes to enter foreign markets: exporting, turnkey projects, licensing, franchising, establishing joint ventures with a host-country firm, or setting up a new wholly owned subsidiary in the host country.

3.2.1. Exporting

Many manufacturing firms begin their global expansions as exporters and later switch to another mode for serving a foreign market. Exporting has two distinct advantages. First, it avoids the often-substantial costs of establishing manufacturing operations in the host country. Second, exporting may help a firm achieve experience curve and location economies. By manufacturing the product in centralized location and exporting it to other national markets, the firm may realize substantial scale economies from its global sales volume.

On the contrary, exporting has some drawbacks. First, exporting from the firm's home base may not be appropriate if there are lower-cost locations for manufacturing the product abroad. A second drawback is that high transport costs can make exporting uneconomical, particularly for bulk products. One way of getting around this is to manufacture bulk products regionally. This strategy enables the firm to realize some economies from large-scale production and at the same time to limit its

transport costs. Another drawback is that tariff barriers can make exporting uneconomical. Similarly, the threat of tariff barriers can make exporting very risky. A fourth drawback arises when a firm delegates its marketing in each country where it does business to a local agent. Foreign agents often carry the products of competing firms and so have divided loyalties. In such cases, the foreign agent may not do as good a job as the firm would if it managed its marketing itself.

3.2.2. Turnkey Projects

Firms that specialize in the design, construction, and start-up of turnkey plants are common in some industries. In a turnkey project, the contractor agrees to handle every detail of the projects for a foreign client, including the training of operating personnel. At completion of the contract, the foreign client is handed the “key” to a plant that is ready for full operation – hence, the term turnkey. This is a means of exporting process technology to other countries. Turnkey projects are most common in the chemical, pharmaceutical, petroleum refining, and metal refining industries, all of which use complex, expensive production technologies.

The know-how required to assemble and run a technologically complex process is a valuable asset. Turnkey projects are a way of earning great economic returns from that asset. The strategy is particularly useful where foreign direct investment is limited by

hosting-government regulations. A turnkey strategy can also be less risky than conventional foreign direct investment. In a country with unstable political and economic environments, a longer-term investment might expose the firm to unacceptable political and/ or economic risks.

Three main drawbacks are associated with a turnkey strategy. First, the firm that enters into a turnkey deal will have no long-term interest in the foreign country. This can be a disadvantage if that country subsequently proves to be a major market for the output of the process that has been exported. Second, the firm that enters into a turnkey project with a foreign enterprise may inadvertently create a competitor. Third, if the firm's process technology is a source of competitive advantage, then selling this technology through a turnkey project is also selling competitive advantage to potential and/ or actual competitors.

3.2.3. Licensing

A licensing agreement is an arrangement whereby a licensor grants the rights to intangible property to another entity (the licensee) for a specified period, and in return, the licensor receives a royalty fee from the licensee. Intangible property includes patents, inventions, formulas, processes, designs, copyrights, and trademarks.

In the typical international licensing deal, the licensee puts up most of the capital

necessary to get the overseas operation going. Thus, a primary advantage of licensing is that the firm does not have to bear the development costs and risks associated with opening a foreign market. In addition, licensing can be attractive when a firm is unwilling to commit substantial financial resources to an unfamiliar or politically volatile foreign market. Licensing is often used when a firm wishes to participate in a foreign market but is prohibited from doing so by barriers to investment. Finally, licensing is used when a firm possesses some intangible property that might have business applications, but it does not want to develop those applications itself.

Licensing has three serious drawbacks. First, it does not give a firm the tight control over manufacturing, marketing, and strategy that is required for realizing experience curve and location economies. Licensing typically involves each licensee setting up its own production operations. This severely limits the firm's ability to realize experience curve and location economies by producing its product in a centralized location. Second, competing in a global market may require a firm to coordinate strategic moves across countries by using profits earned in one country to support competitive attacks in another. A third problem is the risk associated with licensing technological know-how to foreign companies. Technological know-how constitutes the basis of many multinational firms' competitive advantage. Most firms wish to maintain control over how their know-how is used, and a firm can quickly lose

control over its technology by licensing it. However, under a cross-licensing agreement, a firm might license some valuable intangible property to a foreign partner, but in addition to a royalty payment, the firm might also request that the foreign partner license some of its valuable know-how to the firm.

3.2.4. Franchising

Franchising is similar to licensing, although franchising tends to involve longer-term commitments than licensing. Franchising is a specialized form of licensing in which the franchiser not only sells intangible property (normally a trademark) to the franchisee, but also insists that the franchisee agree to abide by strict rules as to how it does business. The franchiser will also often assist the franchisee to run the business on an ongoing basis. As with licensing, the franchiser typically receives a royalty payment, which amounts to some percentage of franchisee's revenues. Whereas licensing is pursued primarily by manufacturing firms, franchising is employed primarily by service firms.

The advantages of franchising as an entry mode are very similar to those of licensing. The firm is relieved of many of the costs and risks of opening a foreign market on its own. Instead, the franchisee typically assumes those costs and risks. This creates a good incentive for the franchisee to build a profitable operation as quickly as possible.

Thus, using a franchising strategy, a service firm can build a global presence quickly and at a relatively low cost and risk. McDonald's is a good example of a firm that has grown by using a franchising strategy. McDonald's has strict rules as to how franchisees should operate a restaurant. These rules extend to control over the menu, cooking methods, staffing policies, and design and location of a restaurant. McDonald's also organizes the supply chain for its franchisees and provides management training and financial assistance.

Nevertheless, franchising may inhibit the firm's ability to take profits out of one country to support competitive attacks in another. A more significant disadvantage of franchising is quality control. Foreign franchisees may not be as concerned about quality as they are supposed to be, and the result of poor quality can extend beyond lost sales in a particular foreign market to a decline in the firm's worldwide reputation. The geographical distance of the firm from its foreign franchisees can make poor quality difficult to detect.

3.2.5. Joint Ventures

A joint venture entails establishing a firm that is jointly owned by two or more otherwise independent firms. Establishing a joint venture with a foreign firm has long been a popular mode for entering a new market.

The most typical joint venture is a 50/50 arrangement in which there are two parties, each of which holds a 50 percent ownership stake and contributes a team of managers to share operating control. Some firms, however, have sought joint ventures in which they have a majority share and thus tighter control.

Joint ventures have a number of advantages. First, a firm benefits from a local partner's knowledge of the host country's competitive conditions, culture, language, political systems, and business systems. A foreign firm provides technological know-how and products and the local partner provides the market expertise and the local knowledge necessary for competing in that country. Second, a firm might gain by sharing these costs and risks with a local partner. Third, in many countries, political considerations make joint ventures the most feasible entry mode. With local partners, investors can face lower risk of being subject to nationalization or other adverse government interference.

Despite these advantages, there are major disadvantages with joint ventures. First, as with licensing, a firm that enters into a joint venture risks giving control of its technology to its partner. However, joint-venture agreements can be constructed to minimize this risk. One option is to hold majority ownership in the venture. This allows the dominant partner to exercise greater control over its technology. A second disadvantage is that a joint venture does not give a firm the tight control over

subsidiaries that it might need to realize experience curve or location economies. Nor does it give a firm the tight control over a foreign subsidiary that it might need for engaging in coordinated global attacks against its rivals. A third disadvantage with joint venture is that the shared ownership arrangement can lead to conflicts and battles for control between the investing firms if their goals and objectives change or if they take different views as to what the strategy should be.

3.2.6. Wholly Owned Subsidiaries

In a wholly owned subsidiary, the firm owns 100 percent of the stock. Establishing a wholly owned subsidiary in a foreign market can be done two ways. The firm can either set up a new operation in that country, often referred to as a green-field investment, or it can acquire an established firm in that host nation.

There are three clear advantages of wholly owned subsidiaries. First, when a firm's competitive advantage is based on technological competence, a wholly owned subsidiary will often be the preferred entry mode because it reduces the risk of losing control over that competence. Second, a wholly owned subsidiary gives a firm tight control over operations in different countries. This is necessary for engaging in global strategic coordination for example, using profits from one country to support competitive attacks in another. Third, it may be required if a firm is trying to realize

location and experience curve economies. When cost pressures are intense, it may pay a firm to configure its value chain in such a way that the value added is maximized.

However, establishing a wholly owned subsidiary is generally the most costly method of serving a foreign market. Firms doing this must bear the full costs and risks of setting up overseas operations. Acquisitions also raise additional problems, including those associated with trying to marry divergent corporate cultures.

3.3. The definition of Foreign Direct Investment

Foreign direct investment occurs when a firm invests directly in facilities to produce and/ or market a product in a foreign country. Once a firm undertakes FDI, it becomes a multinational enterprise (the meaning of multinational being “more than one country”).

From OECD Benchmark Definition of FDI, foreign direct investment reflects the objective of obtaining a lasting interest by a resident entity in one economy (“direct investor”) in an entity resident in an economy other than that of the investor (“direct investment enterprise”). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions

between them and among affiliated enterprises, both incorporated and unincorporated.

OECD recommends that a direct investment enterprise be defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise. Although not recommended by the OECD, some countries may still feel it necessary to treat the 10 per cent cut-off point in a flexible manner to fit the circumstances. In some cases, the ownership of 10 per cent of the ordinary shares or voting power may not lead to the exercise of any significant influence while, on the other hand, a direct investor may own less than 10 per cent but have an effective voice in the management.

According to the U.S. Department of Commerce, FDI occurs whenever a U.S. citizen, organization, or affiliated group takes an interest of 10 percent or more in a foreign business entity.

According to the Foreign Investment Promotion Act (FIPA) of Korea, the term “foreign investment” shall refer to any of the following;

(a) Where a foreigner purchases, under the conditions prescribed by the Presidential Decree, stocks or shares (hereinafter referred to as "stocks") of a Korean corporation (including a Korean corporation in the process of being established) or a company run by a national of the Republic of Korea, for the purpose of establishing a continuous

economic relationship with (including participating in the management of) said Korean corporation or company in accordance with this Act; (b) Where a loan with the maturity of not less than five years is extended to a foreign-capital invested company by its overseas holding company or by a company in a relationship with said holding company of the capital investment prescribed by the Presidential Decree.

In the Presidential Decree, The term “foreign investment” as prescribed in Article 2 (1) 4 (a) of the Act shall mean an investment which amounts (referring to the amount of acquisition in case where it acquires stocks, etc., and to the investment amount per capita in case where two foreigners or more jointly invest) to 50 million won or more and falls under any of the following subparagraphs:

1. A foreigner’s owning not less than 10 percent of the total number of the stocks with voting rights issued by, or of the total equity investment of, a Korean corporation (including Korean corporations in the process of being established; hereinafter the same shall apply) or a company run by a Korean citizen; or

2. A foreigner’s owning stocks or shares of a Korean corporation or a company run by a Korean citizen, and concluding a contract falling under any of the following items with the relevant corporation or company: (a) A contract capable of dispatching or electing officers (referring to directors, representative directors, general partners, auditors or persons corresponding thereto holding a right to participate in an important

decision making for business management; hereinafter the same shall apply); (b) A contract to deliver or purchase the raw materials or products for not less than one year; and (c) A contract for furnishing or introducing the technology or for the joint research and development. As we see above, the definitions of foreign direct investment are slightly different from nations' laws and regulations.

FDI flows consist largely of four categories of capital transactions (commonly referred to as "modes of entry"), namely: "green-field" investment (whereby an enterprise is created essentially from scratch); mergers and acquisitions involving significant cross-border elements; earnings reinvested in foreign-owned companies; and cross-border loans and trade credits between related enterprises. The latter two are not of major concern in a development context, whereas reinvested earnings sometimes make up a significant part of the FDI flows between mature economies. Therefore, FDI takes on two main forms; the first is a green-field investment, which involves the establishment of a wholly new operation in a foreign country. The second involves acquiring or merging with an existing firm in the foreign country.

3.4. The Benefits and Costs of Foreign Direct Investment

To a greater or lesser degree, many governments can be considered pragmatic nationalists when it comes to FDI. Accordingly, their policy is shaped by a

consideration of the costs and benefits of FDI. I will explore the benefits and costs of FDI, first from the perspective of a host country, second from the perspective of the home country, finally from the investor's perspective.

There are three main benefits of inward FDI for a host country: the resource-transfer effect, the employment effect, and the balance-of-payments effect.

Foreign direct investment can make a positive contribution to a host economy by supplying capital, technology, and management resources that would otherwise not be available. If capital, technology, or management skills are scarce in a country, the provision of these skills by a multinational enterprise (MNE) through FDI may boost that country's economic growth rate.

The argument with regard to capital is that many MNEs, by virtue of their large size and financial strength, have access to financial resources not available to host-country firms. These funds may be available from internal company sources, or, because of their reputation, large MNEs may find it easier to borrow money from capital markets than host-country firms would.

Technology can stimulate a country's economic growth and industrialization. It can take two forms, both of which are valuable. It can be incorporated in a production process or it can be incorporated in a product. However, many countries lack the research and development resources and skills required to develop their own

indigenous product and process technology. This is particularly true of the less developed nations. Such countries must rely on advanced industrialized nations for much of the technology required to stimulate economic growth, and FDI can provide it.

The foreign management skills provided through FDI may also produce important benefits for the host country. Beneficial spin-off effects arise when local personnel who are trained to occupy managerial, financial, and technical posts in the subsidiary of a foreign MNE subsequently leave the firm and establish indigenous firms. Similar benefits may arise if the superior management skills of a foreign MNE stimulate local suppliers, distributors, and competitors to improve their own management skills.

Another beneficial effect of FDI is that it brings jobs to a host country that would otherwise not be created there. The effects of FDI on employment are both direct and indirect. Direct effects arise when a foreign MNE employs a number of host-country citizens. Indirect effects arise when jobs are created in local suppliers as a result of the investment and when jobs are created because of increased local spending by employees of the MNE. When FDI takes the form of an acquisition of an established enterprise in the host economy, as opposed to a green-field investment, the immediate effect may be to reduce employment as the multinational tries to improve operating efficiency. However, even in such cases, research suggests that after the initial

restructuring, enterprises acquired by foreign firms tend to grow their employment base at a faster rate than domestic rivals.

The effect of FDI on a country's balance-of-payments accounts is an important policy issue for most host governments. A country's balance-of-payments accounts keep track of both its payments to and its receipts from other countries. Governments normally are concerned when their country is running a deficit on the current account of their balance of payments. The current account tracks the export and import of goods and services. A current account deficit, or trade deficit as it is often called, arises when a country is importing more goods and services than it is exporting. Governments typically prefer to see a current account surplus rather than a deficit. FDI can help a country achieve this goal in two ways. First, if the FDI is a substitute for imports of goods and services, the effect can be to improve current account of the host country's balance of payments. A second potential benefit arises when the MNE uses a foreign subsidiary to export goods and services to other countries.

However, there exist costs of inward FDI on host countries. First, host governments sometimes worry that the subsidiaries of foreign MNEs operating in their country may have greater economic power than indigenous competitors. Because they may be part of a large international organization, the foreign MNE may be able to draw on funds generated elsewhere to subsidize its costs in the host market, which could drive

indigenous companies out of business and allow the firm to monopolize the market. Once the market was monopolized, the foreign MNE could raise prices above those that would prevail in competitive markets, with harmful effects on the economic welfare of the host nation. Moreover, when an industry is infant stage, indigenous firms may never have a chance to develop. While import controls may be motivated by a desire to let local industries develop to a stage where it is capable of competing in world markets, FDI can't be controlled like imports.

Other possible adverse effects of FDI on a host country's balance-of-payments position are twofold. First, against the initial capital inflow that comes with FDI there must be the subsequent outflow of income as the foreign subsidiary repatriates earnings to its parent company. Such outflows show up as a debit on the current account of the balance of payments. The second concern arises when a foreign subsidiary imports a substantial number of its inputs from abroad, which also results in a debit on the current account of the host country's balance of payments.

In fact, many host governments worry that FDI is accompanied by some loss of economic independence. The concern is that key decisions that can affect the host country's economy will be made by a foreign parent that has no real commitment to the host country and over which the host country's government has no real control. A quarter of a century ago this concern was expressed by several European countries,

which feared that FDI by U.S. MNEs was threatening their national sovereignty. However, most economists dismiss such concerns as groundless and irrational. In a world where firms from all advanced nations are increasingly investing in each other's markets, it is not possible for one country to hold another to economic ransom without hurting itself.

There are also costs and benefits to the home or source country. The benefits of FDI to the home country arise from three sources. First, the current account of the home country's balance of payments benefits from the inward flow of foreign earnings. FDI can also boost the current account of the home country's balance of payments if the foreign subsidiary creates demands for home-country exports of capital equipment, intermediate goods, complementary products, and the like. Second, benefits to the home country from outward FDI arise from employment effects. As with the balance of payments, positive employment effects arise when the foreign subsidiary creates demand for home-country exports of capital equipment, intermediate goods, complementary product, and so on. Third, benefits arise when the home-country MNE learns valuable skills from its exposure to foreign markets that can subsequently be transferred back to the home country. This amounts to a reverse resource-transfer effect. Through its exposure to a foreign market, an MNE can learn about superior management techniques and superior product and process technologies. These

resources can then be transferred back to the home country, with a commensurate beneficial effect on the home country's economic growth rate.

At last, I'm going to mention the benefits of investors. With some theories related to FDI, I can explain why firms invest abroad.

The modern theory of foreign direct investment dates back to Hymer (1960). The point of departure for his analysis was the observation that indigenous firms have advantages over foreign enterprises in the domestic market, because of their better knowledge of the local environment. In order to compete with local firms, foreign enterprises must therefore have some advantages that compensate them for the disadvantage of operating in a foreign environment. Furthermore, some market imperfection must also impede the local firms' access to the foreign enterprises' advantages. Thus, the theory of perfect competition is not likely to apply in cases where FDI and multinational corporations are present.

Kindleberger (1969) has presented taxonomy of the monopolistic conditions which induce direct investment, based on departures from perfect competition in goods and factor markets, internal and external economies of scale, and government regulations.

Caves (1971) distinguished between horizontal and vertical FDI and emphasized the importance of product differentiation in the first case. The ability to differentiate products, including advertising, and the concomitant skills developed to serve markets,

are, in his view, the crucial monopolistic advantages behind horizontal FDI. Other advantages, such as technological know-how derived from investment in research and development (R&D), are expected to be strongly correlated with differentiation capabilities, since the bulk of these investments are directed to the development of new products and the improvement of existing ones. Thus, the product differentiation capabilities emphasized by Caves can be seen as both comprising technological intensity and advanced marketing.

Another important step in the development of a theory of the multinational enterprise was taken by the internalization theory, which has an historical antecedent in Coase (1937), and an immediate precedent in the work of McManus (1972). McManus emphasized the role of transaction costs in the development of foreign operations. His analysis recognizes the existence of important interdependencies between activities conducted in different countries and the need to co-ordinate the activities of the interdependent parties. There are three ways in which to co-ordinate economic agents: a) decentralized decision making leading to transactions at arm's length, making use of the price mechanism; b) contractual agreements; and c) the internalization of transactions within a single institution, through the establishment of an international firm.

However, the price mechanism cannot be used without costs. There are transaction

costs that arise from the need to specify the attributes of the good to be exchanged or from the difficulties in quantifying the flows of services or assets being exchanged. When the transacted commodity is information, for example in the form of technological know-how or marketing skills, transaction costs can be expected to be high or maybe even prohibitive. The multinational corporation, then, arises as a response to market failures, as a way to increase allocate efficiency in the presence of high costs of coordinating economic activity between independent economic agents.

McManus' ideas were further developed by Buckley and Casson (1976), who were the first to give an explicit presentation of the so-called internalization theory. The point of departure of this theory is that different business activities are linked by flows of intermediate products, embracing not only ordinary semi-processed materials, but also knowledge and information in the form of technological know-how and skills embodied in goods and human capital. The theory further postulates that external markets are often inefficient, especially with regard to transactions in intermediate products that embody firm specific intangible assets. This is because specification and pricing of these products is particularly difficult. Moreover, external markets in knowledge intensive products are difficult to organize and usually do not cover the multiple eventualities that transactions in information give rise to. Thus, when appropriate external markets do not exist, or when the costs of operating in them are

higher than the benefits, there are incentives for the MNE to develop its own internal organizational structure to achieve internal coordination of activities.

Hence, the internalization theory sees the MNE as the outcome of a process in which firms attempt to secure rents from their intangible assets in the presence of market imperfections. The emphasis is no longer, as in earlier theories, on the possession of firm specific advantages leading to market imperfections; but on the nature of markets, their weaknesses and limitations, and the organization of firms as a response to market imperfections.

A further contribution to the theory of the multinational corporation was made by Dunning (see e.g. Dunning, 1980). Arguing that no single theory could explain the existence of foreign direct investment, he proposed an eclectic approach in order to reconcile the different approaches and hypotheses discussed above. According to him, international production is the outcome of a process in which ownership, internalization and localization advantages work together. The ownership advantages are firm specific in the sense that the firm has control over them. They embrace patents, know-how, labor skills and other forms of superior production technology, control over markets and trade monopolies, scale advantages, managerial capabilities, etc. These factors determine the firm's competitive position in relation to other firms. The internalization advantages arise from the existence of market imperfections, and

have been discussed above. They explain the firm's reluctance to engage in licensing agreements. Location advantages are those associated to the availability of inputs for all firms established in a certain country. They comprise natural resources, location, cultural and political environment, factor prices, transport costs, but also government policies such as trade barriers (quotas, tariffs) and local content requirements. These circumstances explain, for example, why a firm could undertake production abroad instead of producing for export from the home country.

Until now, I look for theories to explain the reason of investor's doing international business. In conclusion, companies invest directly only if they think hold some supremacy over similar companies in countries of interest. However, are companies profitable because they are multinational or multinational because they are profitable? Such a chicken-and-egg question has hounded direct investment theorists. On the one hand, evidence indicates that successful domestic companies both large and small are most likely to commit resources to FDI. On the other hand, ownership of FDI appears to improve a company's performance.

There are also costs of investors' doing business in foreign market. Control is important to foreign companies. They may want to do what is best for their global operations rather than what is best for the operations in a specific country. Companies are also reluctant to transfer vital resources - capital, patents, trademarks, and

management know-how - to another organization. The company receiving these resources can use them to undermine the competitive position of the foreign company transferring them. For example, Samsung Electronics from South Korea leapfrogged to become the world's largest memory-chip maker mostly by acquiring technology from other companies. For this reason, although Intel transfers non-vital resources to partnerships, it has strategically blocked other companies' access to its vital resources by handling them within its wholly owned operations. The control inherent in FDI may lower a company's operating costs and increase its rate of technological transfer because the parent and subsidiary usually share a common corporate culture. Moreover, the company can use its own managers, who understand its objectives and the nature of the sometimes difficult to teach processes that it wishes to transfer.

3.5. History and Trends of Foreign Direct Investment

Much of Japanese automobile companies' investment in the United States during the 1980s and early 1990s was driven by a desire to reduce exports from Japan, thereby alleviating trade tensions between the two nations. Also, much of the recent increase in FDI is being driven by the dramatic political and economic changes that have been occurring in many of the world's developing nations.

The general shift toward democratic political institutions and free market economies

has encouraged FDI. Across much of Asia, Eastern Europe, and Latin America, economic growth, economic deregulation, privatization programs that are open to foreign investors and the removal of many restrictions on FDI have all made these countries more attractive to foreign investors. According to the United Nations, some 94 percent of the 1,035 changes made between 1991 and 2000 worldwide in the laws governing foreign direct investment created a more favorable environment for FDI.

Historically, most FDI has been directed at the developed nations of the world as firms based in advanced countries invested in the others' markets. The United States has often been the favorite target for FDI inflows. This trend continued in the late 1990s, when the United States remained the largest recipient of foreign direct investment. The United States has been an attractive target for FDI because of its large and wealthy domestic markets, its dynamic and stable economy, a favorable political environment, and the openness of the country to FDI.

Although developed nations in general, and the United States in particular, still account for one of the largest shares of FDI inflows, FDI into the world's developing nations has increased. Most recent inflows into developing nations have been targeted at the emerging economies of South, East, and Southeast Asia. Driving much of the increase has been the growing importance of China as a recipient of FDI. Latin America emerged as the next most important region in the developing world for FDI

inflows. Much of investment into Latin America was a response to reforms in the region, including privatization, the liberalization of regulations governing FDI, and the growing importance of regional free trade areas such as Mercado Comun Del Sur (MERCOSUR which means Southern Common Market) and North America Free Trade Agreement (NAFTA).

The high level of FDI outflows from the United States has been driven by a combination of factors including a strong U.S. economy; strong corporate profits and cash flow, which have given firms the capital to invest abroad; and a relatively strong currency, particularly since 1995. The recent growth of foreign direct investment from Spain reflects the fact that companies from that nation have become among the largest investors in Latin America. Although a handful of developed nations still account for the bulk of foreign direct investment outflows, some developing nations are starting to get in on the act, most notably China, which accounted for almost \$20 billion of outward foreign direct investment flows in 1999 and 2000, although the majority of that came from Hong Kong-based enterprises.

According to an OECD report, FDI outflows from the OECD area to the rest of the world picked up from USD 593 billion in 2003 to USD 668 billion in 2004. FDI outflows from the United States reached USD 252 billion in 2004 – up from USD 141 billion in 2003 to hit an all-time record. While this to some extent reflects the

weakness of the dollar it also points to a very strong interest among US companies in acquiring corporate assets abroad.

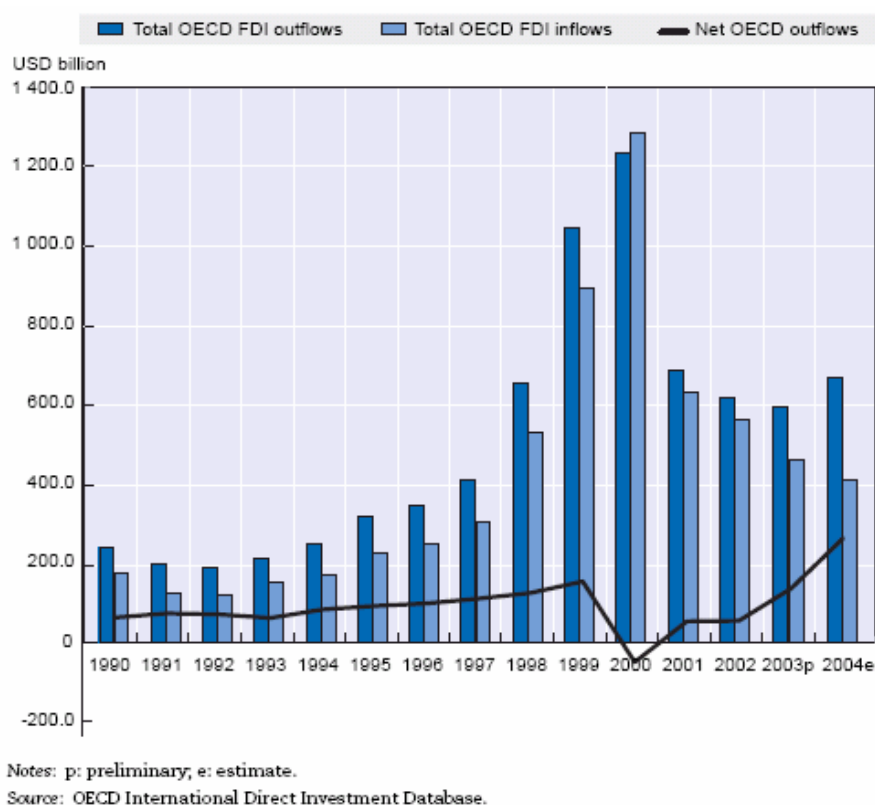
Inward FDI into Germany and France, the two largest economies of the European continent, fell sharply in 2004. In France the inflows almost halved, falling from USD 43 billion to USD 24 billion. In the case of Germany, foreign investors even withdrew about USD 39 billion from the country as opposed to an inflow of USD 27 billion in 2003. Inward FDI include withdrawals from foreign-invested enterprises to their foreign mother companies. The downturn largely reflects a repayment, out of Europe, of inter-company loans and other positions between related enterprises.

Amid declining inflows and increasing outflows, the OECD countries' net direct investment outflows to the rest of the world reached record high levels in 2004. The OECD area was a net contributor of USD 261 billion worth of direct investment – most of which went to developing countries.

While developing countries continue to be important recipients of FDI, several of them are gaining importance as outward investors as well. One case in point is Latin America (e.g. Mexico and Brazil) where large companies appear to be in a process of, first, engaging in regional integration through investment, next developing truly international corporate networks. Chinese enterprises have increasingly undertaken “strategic” investment abroad to gain access to raw materials. However, while these

trends are observationally interesting the sums involved are still small by international comparison.

FDI into a range of countries, including Russia, India and much of South America, has also picked up lately. On top of this, several of the more advanced developing countries are emerging as outward investors, their national companies establishing subsidiaries in neighboring countries and increasingly also on a more global basis.



[Figure 5. FDI flows to and from OECD]

According to OECD Information Technology Outlook, the international expansion of Information and Communications Technology (ICT) firms is driven by the need for market access, growth, economies of scale and access to skills and technology. FDI has increased significantly and investment stocks and international production by

MNEs have grown, although investment flows dropped from 2000. Detailed data on ICT FDI are limited, but show a shift towards globalizing of services in the wake of deregulation and trade liberalization. Telecommunication services are at the forefront of both investment and M&As, despite loss of share value and the cost of third-generation networks.

Cross-border M&As are the most common form of ICT expansion, enabling faster build-up than green-field investment. During the surge in worldwide M&A activity in the 1990s, activity was much higher than average in ICTs owing to very large telecommunications deals and high stock market valuations. Despite precipitous declines, cross-border ICT M&A activity remains higher than in the mid-1990s and growing again in 2003 and the first half of 2004. As the business cycle picks up, surviving firms will seize acquisition opportunities to expand and consolidate.

The report also mention that international sourcing of IT and ICT-enabled business services – or off-shoring – is a recent development and is driven by the dynamics of digital delivery, the need to fill skills shortages, increase efficiency and cut costs, in a context of increased competition and services liberalization. Competition reinforces the trend, as other firms follow the leaders to lower-cost, high quality locations with the available skills. There are no reliable official data on international sourcing, but most exports of computer and information services and other business services

originate in OECD countries, although their share of total exports declined from 79.5% in 1995 to 77.1% in 2002. India as well as Ireland has significantly increased their shares of these exports and some developing countries are rapidly expanding their exports, albeit from very low levels.

CHAPTER IV

SUGGESTIONS FOR THE GLOBAL EXPANSION OF KOREAN IT

OUTSOURCING BUSINESS

4.1. Reasons for Globalization of Korean IT Service companies

Recently, many IT service companies in Korea are strengthening its competitiveness in the IT outsourcing business. They are starting to consider IT outsourcing as one of their strategic business areas because, most of all, IT service companies want more profitable business portfolio and want to expand their market share. Let me explain some reasons the Korean IT service companies should penetrate foreign IT outsourcing markets.

The first reason is the captive domestic market. As I mentioned in Chapter 2, the Korean IT service market is a Chaebol-dominated business environment. IT outsourcing in Korea is also very much a captive market, with most Chaebol group companies serviced by their respective IT services arms. In fact, the domestic market is not large enough to compete with each other excluding the Chaebols' captive clients. Hence, the competition in the non-captive domestic market will be more intense soon. For this reason, Korean companies should start to plan how to penetrate the foreign market.

The second reason is the high expected growth rate of IT outsourcing spending in the worldwide market. According to Gartner Research, core outsourcing (IT management and process management) remains the highest growth area. The sum of these core outsourcing services in 2009 – at \$333.5 billion – is forecast to represent 43 percent of the 2009 market opportunity. Process management services are typically funded outside of IT budgets, and IT management services replace internal IT spending, so growth in these outsourcing segments often occurs, even in the face of restricted growth in IT budgets.

Thirdly, there can be optimistic chances to provide additional services by doing IT outsourcing. Basically, IT outsourcing provider is able to understand not only the IT infrastructure but also other issues related to the IT and business process. Most Korean IT service companies have the competency to solve the comprehensive IT problems because their businesses have been based on the system integrations projects and process consulting projects as well. IT outsourcing providers can evolve their business models as they are strengthening the partnership with the existing clients. Business process outsourcing (BPO) can be a good example. If a company can carry the IT outsourcing business successfully and deeply involve the client's IT strategy, then the client can request the additional services like BPO and extra system integration projects.

The last reason is related to the image of Korea and Korean companies. For Korea to claim itself as an “advanced country,” and more importantly, be recognized as a world-class economy by outsiders, Korea needs to embark on a campaign to instill an efficient and friendly image. These days, Korea is famous for the advanced IT environment for example, high-speed Internet, commercialized CDMA technologies, and so forth. However, Korea needs to be more perceived as it is strong in the software or service oriented business. To be recognized as a business friendly country, Korean companies must show their capability of doing rule-based and process-oriented business in overseas market. In that sense, IT outsourcing suit the purpose, because IT outsourcing business requires strict rule, tight process management, and performance measurement. Increasing the number of success stories of IT outsourcing of Korean IT service companies in the global market means the enhancement of the images not only a Korean company but also Korea itself in the IT service areas.

4.2. Basic Recommendations for Entering the Foreign Market

There can be many ways to invest abroad, however, in order to enhance the potential for success, I will recommend a target industry, a country and entry method for Korea IT companies wishing to invest abroad.

4.2.1. An Industry for Overseas Market Penetration

According to Gartner, Manufacturing IT spending will grow 3.1 percent annually, from \$399 billion in 2004 to \$466 billion in 2009. Particularly, the Middle East and Africa, Eastern Europe, and Latin America have the fastest rates of growth for manufacturing IT spending. However, these regions show the smallest absolute size in spending and are often characterized by economic and political uncertainty. Although manufacturers will claim to have revenue growth, customer satisfaction and retention, and innovation as key drivers of their strategy, cost savings and efficiency will continue to drive or even override strategic imperatives. Therefore, manufacturers will become more vigilant about measuring performance and will use IT to make more quantitatively driven business decisions. Hence, IT vendors should continue to expect modest growth in IT spending in the manufacturing market. Also, IT vendors must hone their applications that help manufacturers boost revenue growth, customer relationship building and innovation, but they should anticipate that cost savings and productivity-enhancing products and services will continue to drive sales, at least over the short term.

Specifically, small and midsize businesses (SMBs) and outsourcers seem to be made for each other. One typically lacks skills and the other specializes in delivering those skills at an affordable price. Robert H. Brown, and James A. Browning in Gartner

claims SMBs are the biggest little outsourcing market in the world. IT departments at SMBs increasingly are turning to IT outsourcing to ensure that critical technology service delivery is achieved and can grow over time, without directly investing in costly skills, hardware and software. However, outsourcing is not yet main stream among SMBs but is rather confined to a small, but growing, number of companies that are outsourcing to save money, access technology that they otherwise couldn't afford and improve service levels.

Although SMBs prefer to maintain control and independence, they need help deploying and managing IT initiatives. With limited skills, SMB project managers struggle to determine the right mix between internal and external IT resources. Waiting to acquire skills until they are forced to – in reaction to customer demand or a shift in the market – can be costly and disruptive, and result in lost customers and revenue. Ironically, however, most SMBs will pursue outsourcing tactically, leading to misallocation of funds and cost inefficiencies.

4.2.2. One Region for Overseas Market Penetration

China has placed the active pursuit of rapid economic at the core of national development strategies. China abandoned its isolationist policy in the year 1979. As a result, China has enjoyed high rates of economic development since liberalizing their

respective policy regimes in the face of modern globalization.

From the IT outsourcing business point of view, the IT services market in China will post a 14.1 percent compound annual growth rate (CAGR) from 2004 through 2009. China's fast economic growth is the key accelerator for the IT service market. Increased demand for IT services is mainly driven by the massive reforms and growth of Chinese companies. The growth results in heavy investments in IT to keep up with worldwide competition, as a result of China entering the World Trade Organization. Foreign investment continues to flood China's market.

The financial and banking and telecommunication sectors lead IT services spending, followed by the manufacturing industry. By service lines, the base is small with the exception of development and integration segments. Strong growth will occur in the professional services segment during the next five years.

Table 4 summarizes infrastructure and network management outsourcing as well as application management and maintenance services. The market is valued at U.S. \$391 million in 2005, a 21.9 percent CAGR. Most of these contracts derived from multinational ESPs providing outsourcing services to their multinational corporation clients in China. The IT outsourcing services will grow in the finance, telecommunications and manufacturing sectors. This demand will be driven by cost reduction pressure, skill shortages and head count control.

Large Market Presence (Revenue Between 289 Million Yuan and 398 Million Yuan)
CSC/CSA
IBM
Midsize Market Presence (Revenue Between 50 Million Yuan and 120 Million Yuan)
Accenture
AT&T
Atos Origin
HP
Indra
Total Siemens
Unisys
Small Market Presence (Revenue Between 17 Million Yuan and 32 Million Yuan)
Alcatel
BearingPoint
CommVerge Solutions
Computer and Technologies Holdings
Ericsson
Getronics
Lenovo
Lucent Technologies
Marconi
Oracle
Note: Service providers are listed alphabetically within each segment.

Source: Gartner (August 2005)

[Table 4. 2004 Market Share Segmentation of IT Outsourcing ESPs in China, by Estimated
IT Management Revenue Range (Yuan)]

From an FDI perspective, China is also one of the most attractive regions. According to World Investment Report 2001, UNCTAD's year-book on global FDI, China's corresponding figures totaled an astonishing \$40.8 billion and \$346.7 billion, or around 18 times higher than India. Foreign investment absorption is a key component of China's basic state policy of opening to the outside world. During its nearly

twenty-five-year-long reform and opening up, China has steadfastly adhered to its opening-up policy, vigorously developed foreign trade and actively absorbed foreign investment, having made world-renowned achievements.

After being the largest FDI recipient among all the developing countries for nine consecutive years since 1993, China ranked the first in the world in terms of FDI inflow in 2002. By the end of April 2003, 436 394 foreign-invested enterprises had been established in China, with actually utilized foreign investment of over US\$460 billion. Investors come from over 180 countries and regions. Over 400 multinational companies out of the world's top 500 have made investment to establish their operations in China. As a result, the number of foreign-invested firms in China constituted 16 percent of all companies in 1998, representing 24.7 percent of China's total industrial output, 17.6 percent of total assets, and 18.8 percent of total revenue. Hence, the presence of foreign-invested firms in China has irrefutably contributed to the strengthening of China's industrial competitiveness.

The high presence of foreign-invested firms in China means the growing demand of IT outsourcing services, because the multinational companies want to manage their IT assets more efficiently. In fact, one of dominant players in China IT outsourcing market, CSC/CSA's customers are almost all multinational companies.

China has outstanding comparative advantages in foreign investment absorption for

enjoying political and social stability, abundant natural resources, high-quality and low-cost human resources and one domestic market with great potential. The long-term devotion of the Chinese government to improving its soft environment for foreign investment and strengthening its comprehensive national competitiveness is a decisive factor contributing to the sustained and rapid growth in its foreign investment absorption. In particular, since China's accession to the WTO, the Chinese government has been faithfully honoring its commitments and attaching greater importance to building the legal framework for foreign investment. Along with an overall adjustment, the existing laws, regulations and rules governing foreign investment have been improved and a legal and regulatory framework for foreign investment is in initial shape, which both fits the current national situation and conforms to the WTO principles of uniformity and transparency. The Chinese government has implemented a series of foreign investment incentives, further expanded the areas open to foreign investment and stepped up the protection of intellectual property. China's WTO membership uplifted its investment environment to be notably and increasingly attractive to overseas investors.

Moreover, the quality of the workforce has improved as a result of the expansion of higher education on the foundation of the basic education system established in the half-century following the establishment of the People's Republic of China in 1949.

Increased investment in specialized vocational education in the past two decades has produced a new generation of skilled workers. Alongside a similar expansion in higher education, there has also been a large contingent of higher-education graduates who have studied at overseas universities and who may therefore often be more familiar with the ethos of MNEs, as well as with the academic disciplines in which foreign managers of MNEs have been trained. There is also now a large number of employees and ex-employees of MNEs whose on-the-job training has enabled them to acquire transferable skills. One expression of the improvement in the quality of MNE employees is that an increasing number and proportion of higher positions in MNEs are being filled by locally-hired Chinese in place of expatriates.

4.2.3. Reasons for FDI

Intense competitive pressures in many industries are leading firms to explore new ways of improving their competitiveness. Some of these ways are by expanding operations in the fast-growing markets of emerging economies to boost sales, and by rationalizing production activities with a view to reaping economies of scale and lowering production costs. Higher prices for many commodities have further stimulated FDI to countries that are rich in natural resources such as oil and minerals. Also, many countries are doing promotions and changing policies to attract more FDI

from transnational corporations (TNCs) for the benefits of host countries mentioned in Chapter 3. Among the various entry modes, other things being equal, the reason I recommend FDI as a way of entering the foreign market to Korean IT service companies is because companies can enjoy the incentives offered by foreign governments.

The growing attention paid by countries to FDI is reflected in an increased attention to attracting of FDI and the establishment of investment promotion agencies (IPAs). Furthermore, governments are granting incentives and other governmental support to foreign investors as the promotional activities.

These incentives take a variety of forms. They include fiscal incentives such as lower taxes for foreign investors, financial incentives such as grants and preferential loans to MNEs, as well as other incentives like market preferences and monopoly rights. Although no reliable statistics of the size of these incentives are available, a detailed study by UNCTAD (1996) suggests that incentive activities have increased considerably since the mid-1980s.

For example, Guangzhou is the home of several state-level economic and technological development zones (ETDZs), including Guangzhou Economic and Technological Development District (GETDD), and Guangzhou Hightech Industrial Development Zone (GHIDZ), which includes Guangzhou Science City (GSC),

Guangzhou Tianhe Science and Technology Park (TSTP), Guangzhou Huanghuagang Information Park (HHGIP), and Nansha Information Technology Park. The zones administer science, technology, and industrial parks that provide a range of incentives for investors including streamlined processes, access to land, VAT and customs duty exemptions, and reduced tax rates. Their targeted sectors include electronics, telecommunications equipment, software, food and beverage products, personal care items, paper and packaging, household goods, and chemical products. Guangzhou's state-level bonded zone affords preferential customs, tariff, and tax treatment.

Nowadays, most countries provide various incentives in the form of tax exemptions subsidies for various activities. To make matters better, these incentives are more favorable to advanced technology providers. Therefore, IT outsourcing companies can have the incentives by taking FDI form as their entry mode.

To give more understanding of the types of incentives, I summarized key incentive types provided for foreign direct investors. Tax reduction or exemption on corporate tax, income tax, acquisition tax, registration tax, property tax and aggregate land tax may be granted to foreign direct investment made in accordance with each country's tax act. Cash grant means reduction or exemption from land rent fee, financial support for construction of public facilities for foreigners. It includes the rent fee reduction or exemption for public or state-owned properties permit of proceeds generated from a

private contract and financial support for construction of infrastructure such as roads. Furthermore, some government can give an exemption of industry-specific business restrictions. Other types of incentives include language services, human resource supports, and consulting or trouble-shooting service to foreign-invested companies like “Ombudsman Office” in Korea.

4.3. Key Success Factors

I collect key success factors (KSFs) of IT outsourcing business from the two opposite viewpoints: the IT outsourcing buyers and the outsourcers. By understanding the KSFs of IT outsourcing buyers, outsourcers can provide higher quality IT outsourcing services and satisfied their clients better. Finally, I will introduce the key to success of IT outsourcing business in India.

4.3.1. KSFs for IT Outsourcing Buyers

Some organizations may decide to outsource because they just do not have the skills to manage the IT functions, or because they need to sell of IT assets to generate funds. For these situations, Lacity and Hirschheim (1993) offer 14 suggestions shown in Table 5 for the successful outsourcing. The research on managing outsourcing relationships has focused either on the legal contract, with tight contractual mechanisms recommended to reduce opportunistic behaviors. The contractual

mechanisms and strategic partnerships complement each other, with the legal contract providing the context in which the relationship exists and defines the interactions between parties.

1. Discard the vendor's standard contract and develop a version more appropriate for the specific situation.
2. Do not sign incomplete contracts.
3. Hire technical and legal experts in outsourcing to assist with negotiations
4. Measure all IT activities during the baseline period that determines the terms of the contract.
5. Develop specific and complete service level agreements and measure.
6. Develop service level reports that make it possible to monitor vendor performance.
7. Specify escalation procedures for failures to meet service levels.
8. Include cash penalties for nonperformance.
9. Specify service level growth rates that reflect the impact of decreasing IT costs on demand.
10. Include provisions for business changes, such as mergers or divestitures that could significantly increase or decrease service requirements.
11. Specifically identify the vendor's account manager for the organization
12. Include a termination clause and be sure that it provides for a transition period.
13. Take special care with clauses that require additional charges for functions that are different ("change of character") from the baseline.
14. Be considerate of the interests of the organization's IS employees who will shift to the outsourcer or move on to some other employment.

SOURCE: Condensed from Lacity, M. C., and R. Hirschheim, "The information Systems Outsourcing Bandwagon," Sloan Management Review, Fall 1993, pp.73-86.

[Table 5. Suggestions for Successful Outsourcing]

In addition, other sources (e.g., Marcolin and McLellan [1998]) offer additional recommendations such as:

- 1) Write short-period contracts. Outsourcing contracts are often written for 5 to 10-year terms. Because IT and the competitive environment change so rapidly, it is very possible that some of the terms will not be in the customer's best interests after five years. If a long-term contract is used, it needs to include adequate mechanisms for

negotiating revisions where necessary.

2) Involve the subcontracting. Vendors may subcontract some of the services to other vendors. The contract should give the customer some control over the circumstances, including choice of vendors, and any subcontract arrangement.

3) Do selective outsourcing. This is a strategy used by many corporations who prefer not to outsource the majority of their IT, but rather outsource certain areas such as connectivity or network security.

As you can see, the IT outsourcing buyers are worry about the risk and the negative impacts of failures and runaways. They want more flexible and less risky contracts. Therefore, outsourcers should be able to show the visibility of their services through effective and accurate communication with the IT outsourcing buyers.

4.3.2. KSFs for IT Outsourcing Providers

I can explain the key success factors for IT outsourcing providers by looking at the evaluation criteria for IT outsourcing service provider selection. The selection of trusted service providers for strategic initiatives that can be brought into strategic planning sessions and treated as an extension of the enterprise is difficult. Basically, the right mix of technical experts and business professionals to help with visioning and project fulfillment is critical.

According to Gartner, the selection of service providers must be guided by evaluation of domain competency on top of solid technical skills. Service providers also should have a strong ability to execute tasks and have low risk and financial stability. Overall, service providers must have an intimate knowledge of a buyer's industry and the market, operational process and systems, project management methodologies and a good track record. They should support the outlined service-level agreements but also deliver insight and innovation to the project, act as a sounding board, provide recommendations and help with business planning. The detailed description of key evaluation criteria follows.

1) Industry Expertise. Domain expertise is fundamental for strategic initiative service providers. Whether providing strategic technology services or business services, the service provider must exhibit a strong understanding of market dynamics, consumer trends, regulations and technologies that exist in the client's market.

2) Innovation. Innovation and industry expertise are tightly linked. Innovation without industry expertise is difficult, but some industry experts will not be innovative. Strategic services providers should have a role in identifying opportunities or risks before asked and have the ability to deliver innovative ideas on how to enhance operations, reduce operation costs, improve IT performance and streamline business processes as part of their normal expectations. Also, they should provide new

technologies and intellectual property that would enhance business processes and payment plans based on project outcomes and business performance (for example, increases in profitability or reduction on claims processing costs) that benefit for both parties.

3) Industry Methodologies, Tools and Models. The use of industry-specific methodologies, tools and models will greatly help identify project options, assess the benefits of the project and fulfill the project. Measurement practices can help assess the overall benefit of outsourcing, measure before/after processing costs and performance, measure technology performance and assess process improvements.

4) Ability to Execute. While a common concept for selecting technology and service providers, there are a few caveats for selecting a strategic service provider. Key points to consider include cultural understanding, especially in customer-facing activities such as policy or claims servicing, language, quality processes, such as the use of Six Sigma methods. In addition, IT outsourcing providers should have the ability to carry the delivery models that include offshore and onshore alternatives. This would include the ability to utilize multiple locations on demand. Also, they must be able to show the suitable size and scope of the organization to support a wide range of IT and business-level projects.

5) Financial Stability. In today's economic climate, clients are looking for low-risk

outsourcers, especially for strategic long-term projects and BPO. Because service providers involved with strategic initiatives will be involved with your internal operations and business vision and will become key stakeholders in strategic planning, their stability is more critical.

6) Deliverables for Customer Satisfaction. Clients are beginning to increase the expectations they set for outsourcers, and this will make higher standards for strategic service partners. Therefore, IT outsourcers must be able to contract stronger and more business-tied service-level agreements, and to show risk mitigation and disaster recovery practices, which include the shifting of work to other locations in the event of a disaster. Also, IT outsourcers should bring the guaranteed process optimization through cost savings and efficiency gains.

KSFs for IT Outsourcing Providers
• Industry Expertise
• Innovation
• Industry Methodologies, Tools and Models
• Ability to Execute
• Financial Stability
• Deliverables for Customer Satisfaction

[Table 6. KSFs for IT Outsourcing Providers]

4.3.3. India's Success in IT business

People says India could become a powerful nation in the IT service business because Indian engineers have accumulated their IT competency by doing outsourcing of

global IT companies' development and managing call centers mainly due to their low wages and English proficiency. However, looking at the reasons closely, the critical success factors are their software quality and establishment of process. From the beginning of IT service business in India, the Indian IT service companies targeted overseas market rather than domestic one, especially the United States. Hence, they had to demonstrate their quality and capability with their outsourcing services of software development. As a result, Indian IT service companies became focusing on the development steps and quality controls.

For example, Satyam Computer Services, one of the largest Indian IT service providers has always been at the forefront in software quality since its inception. Given the importance of quality in enhancing its competencies and delivering business value to customers, its delivery units have been appraised for their process maturity under the various globally accepted quality models and standards. Satyam is one of the founding members of the e-Sourcing Capability Model (eSCM) Consortium in partnership with Carnegie Mellon University. In addition, establishing the on-line quality management system had been the first of such steps to ensure a process-centric approach within the organization. The processes are implemented and the feedback from the implementation used to ensure a continuous improvement framework. Implementation of various quality models like ISO (International

Standardization), CMM (Capability Maturity Model), PCMM (People Capability Maturity Model) and CMMI (Capability Maturity Model Integration) among others have contributed to the process improvement cycle by bringing in the global best practices from the industry.

Satyam has an internal support unit under corporate quality circle known as Total Quality Assurance (TQA) who takes care of all the software quality assurance activities in the projects. Under the guidance of senior quality associates in TQA, Quality Mentors (QM's) are deputed in each project. They work with projects and facilitate the implementation of the quality management system. Other quality initiatives like Six Sigma, Business Continuity & Information Security strengthen Satyam`s commitment to delivery excellence.

Therefore, standardization of the process allows enterprises to increase their overall efficiency and provide qualified services to their customers. The process of complying by standards lays emphasis on quality and service issues.

4.4. Implications for Korean IT service companies

Until now, I described the outlook of the IT outsourcing market and FDI as a way of foreign market expansion. Based on my research so far, I arranged some implications for Korean IT service companies to compete on the global stage.

Because Korean IT service companies have abundant experiences in system integration projects in various industries, their IT services including outsourcing can have high qualities in many ways based on their rich understanding on business process and technologies. Moreover, many domestic IT service companies have already penetrated foreign markets with their core competency such as software, business process management. Some of them have already established their global IT infrastructure to support their global subsidiaries. Hence, the Korean IT service companies in the overseas market create synergy effects by helping each other to provide IT outsourcing services.

However, Korean IT service should enforce more strict service level in terms of quality and endeavor to win the global standards. For example, Information Technology Infrastructure Library (ITIL) developed by United Kingdom's Office of Government Commerce (OGC) is a common language in IT service delivery area. As I mentioned in Chapter 2, more organizations around the world demanded ITIL standardization capabilities and frameworks from service providers. ITIL became a "must have" for providers, rather than the differentiator it was a few years ago. Fortunately, a few Korean IT companies started to win the world-class certificates.

Finally, enhancing the language skills and understanding of cultural differences will become strengths. Particularly, English is and will continue to be the indispensable

official language to do business in the world. Therefore, every company should develop programs to make their employees upgrade their English proficiency and interact with diverse cultures.

4.5. Case Study – AmorePacific outsources IT from IBM Korea

Founded in 1945, AmorePacific has six subsidiaries and four factories, and employs about 2,800 people. The company, which sells a wide range of cosmetics, personal care and health products, is pursuing a strategy designed to increase its brand presence in China, Europe and the United States. While AmorePacific has established itself in China and made some inroads into Europe and North America by selling its products through high-end retail outlets, the company wants to increase its market presence globally.

To grow into a world-class beauty and health company and secure global leadership as a trendsetter, AmorePacific needed to increase its investments in research and development (R&D) and in human resources. At the same time, it had to continually meet competitive challenges in Korea to maintain its market-leading position at home. To help with these efforts, company managers wanted to streamline and reduce the internal resources required to maintain its information technology so it could put more focus on the company's core business activities.

AmorePacific teamed IBM Global Services on a 10-year outsourcing plan in which IBM manages AmorePacific's data center hardware, software applications, network and end-user workstations. IBM Global Services – Worldwide Strategic Outsourcing operates the computing servers in the data center and the data network, staffs a help desk and maintains workstations. IBM Global Services – Integrated Technology Services provides IT services such as data center planning, design and construction, resource management for desktop stations and local area network (LAN) design. The Integrated Technology Services group also provides performance services for networks, Web servers and databases, as well as consulting for systems management and business recovery considerations. IBM Global Services – Application Management Services supports the software applications for AmorePacific departments such as finance, sales, human resources and operations. The application software consists of SAP, several existing applications, IBM Lotus Notes for e-mail and groupware and IBM WebSphere for Web applications. The IBM services are managed by IBM staff, including former AmorePacific staff who transferred to IBM.

With the help of IBM Global Services, the company is reducing IT expenses, modernizing its IT infrastructure and has been able to relieve its internal staff of daily IT management functions, freeing them up to work on strategic IT planning. This solution is helping AmorePacific increase its global competitiveness by enabling it to

concentrate its R&D and human resources investments in overseas expansion efforts.

This case illustrates that foreign IT service providers started to penetrate Koran IT outsourcing market even though the Koran IT outsourcing market is very captive due to its Chaebol-dominated business environment. The foreign players have grown with their advanced process and comprehensive experience.

However, there is still opportunity for the domestic IT service companies. Gartner conducted research which brands were most closely associated with specific categories of IT professional services in the minds of customers. The conclusion is outside of IBM, no one provider overwhelmingly dominated any IT professional services category tested. In fact, "don't know" and "none" were more popular top-of-mind choices than many of the market share leaders. This is good news. The study shows that IT services market remains remarkably fragmented and dynamic. For providers entering the market or established or boutique players that have historically forgone brand building, plenty of mind share is still available.

CHAPTER V

SUMMARY AND CONCLUSIONS

5.1. Summary

Information systems are playing major roles for companies to bring and sustain competitive advantages. Therefore, it can be a concerned matter to outsourcing a company's information systems to a third party. Nevertheless, some of enterprises started to consider IT outsourcing as a strategic issue in the 1990s.

Because Information technology is a vital part of almost every organization and plays an important supporting role in most functions but it is not the primary business of many organizations. Their core competencies – the things they do best and that represent their competitive strengths – are in manufacturing, retailing, services, or some other function. IT is complex, expensive, and constantly changing. It is difficult to manage IT, even for organizations with above-average management skills. Because of these considerations, some organizations have decided to use outside vendors rather than internal IS units as their primary source of IT services. Obtaining services from vendors, rather than from within the organization, is known as IT outsourcing.

IT outsourcing is the contractual vehicle through which enterprises use external sources to provide life cycle service and support operations for their IT infrastructure.

IT infrastructure outsourcing focuses on companies who provide outsource services in the areas of information technology infrastructure. The typical cases of activities that these providers perform include data center operations; network operations; backup/recovery services, data storage management services; system administration services; end user support of desktop PCs, laptops, and handheld devices; web site, or application hosting, etc.

Outsourcing advocates describe IT as a commodity, a generic item like electricity or janitorial services. In particular, the advocates claim that outside vendors can provide IT services at 10 to 40 percent lower cost, with higher quality, for the following reasons: hardware economies of scale, staffing economies of scale, specialization, tax benefits. On the other hand, there are also potential outsourcing costs such as limited economies of scale, lack of business expertise and losing internal cost reduction opportunities. However, one of IBM research indicates that the larger the outsourcing contract, the more likely the improvement in bottom-line results.

The Korea IT services market has grown rapidly in the past decade, enjoying strong double-digit growth rates underpinned by a healthy domestic economy. However, the market experienced serious fluctuations since the Asian economic crisis which was exacerbated by the unstable global economy. Korea IT services market is strongly based on systems integration services, which dwarf the other segments, such as

product maintenance, consulting and IT management. However, user companies have started accepting more seriously the IT outsourcing concept and are considering the benefit and value that IT outsourcers can bring.

However, Korea IT service market is also a Chaebol-dominated business environment. Therefore, IT outsourcing in Korea is very much a captive market, with most Chaebol group companies serviced by their respective IT services arms. In fact, the domestic market is not so large to compete with each other excluding the Chaebols' captive clients. Hence, the competition in the non-captive domestic market will be more intense soon. For this reason, Korean companies should start to plan how to penetrate the foreign market.

According to Gartner Research, the core outsourcing (IT management and process management) remains the highest growth area. The sum of these core outsourcing services in 2009 – at \$333.5 billion – is forecast to represent 43 percent of the 2009 market opportunity. Process management services are typically funded outside of IT budgets, and IT management services replace internal IT spending, so growth in these outsourcing segments often occurs, even in the face of restricted growth in IT budgets.

I recommend foreign direct investment as the way of globalization of Korean IT service companies. Foreign direct investment occurs when a firm invests directly in facilities to produce and/ or market a product in a foreign country.

From OECD Benchmark Definition of FDI, Foreign direct investment reflects the objective of obtaining a lasting interest by a resident entity in one economy (“direct investor”) in an entity resident in an economy other than that of the investor (“direct investment enterprise”). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.

There are three main benefits of inward FDI for a host country: the resource-transfer effect, the employment effect, and the balance-of-payments effect. However, there exist costs of inward FDI on host countries for example, adverse effects of FDI on a host country’s balance-of-payments.

There are also costs and benefits to the home or source country. The benefits of FDI to the home country arise from three sources. First, the current account of the home country’s balance of payments benefits from the inward flow of foreign earnings. Second, benefits to the home country from outward FDI arise from employment effects. Third, benefits arise when the home-country MNE learns valuable skills from its exposure to foreign markets that can subsequently be transferred back to the home country.

Companies invest directly only if they think hold some supremacy over similar companies in countries of interest. The advantage results from a foreign company's ownership of some resource – patents, product differentiation, management skills, access to markets – unavailable at the same price or terms to the local company. However, there are also costs of investors' doing business in foreign market. For example, control is one of the important issues to foreign companies.

Among the various entry modes, other things being equal, the reason I recommend FDI as a way of entering the foreign market to Korean IT service companies is because companies can enjoy the incentives offered by foreign governments. The growing attention paid by countries to FDI is reflected in increased attention for the attraction of FDI and the establishment of investment promotion agencies (IPAs). Furthermore, governments are granting of incentives and other government support to foreign investors for the promotion activities.

These incentives take a variety of forms. They include fiscal incentives such as lower taxes for foreign investors, financial incentives such as grants and preferential loans to MNEs, as well as other incentives like market preferences and monopoly rights. Although no reliable statistics of the size of these incentives are available, a detailed study by UNCTAD (1996) suggests that incentive activities have increased considerably since the mid-1980s.

To success in IT outsourcing business, service providers must have an intimate knowledge of the buyer's industry and the market, operational process and systems, project management methodologies and a good track record. They should support the outlined service-level agreements but also deliver insight and innovation to the project, act as a sounding board, provide recommendations and help with business planning.

To succeed in global IT outsourcing business, Korean IT service should enforce more strict service level in terms of quality and endeavor to win the global standards. For example, Information Technology Infrastructure Library (ITIL) developed by United Kingdom's Office of Government Commerce (OGC) is a common language in IT service delivery area. As I mentioned in Chapter 2, more organizations around the world demanded ITIL standardization capabilities and frameworks from service providers. ITIL became a "must have" for providers, rather than the differentiator it was a few years ago. Fortunately, a few Korean IT companies started to win the world-class certificates. Finally, enhancing the language skills and understanding of cultural differences will become strengths. Particularly, English is and will continue to be the indispensable official language to do business in the world. Therefore, every company should develop programs to make their employees upgrade their English proficiency and interact with diverse cultures.

Actually, even though the Korean IT outsourcing market is very captive due to its

Chaebol-dominated business environment, foreign IT service providers started to penetrate Korean IT outsourcing market. The foreign players have grown with their advanced process and comprehensive experience. Fortunately, one study shows that IT services market remains remarkably fragmented and dynamic. Therefore, for Korean IT outsourcing providers entering the market that have historically forgone brand building, plenty of mind share is still available.

5.2. Recommendations

Finally, the recommendations for doing IT outsourcing business via FDI in the global market are as follows.

1) Thinking globally and acting locally: Multinational service providers struggled to shift resources around the world to connect with local clients while maintaining high service levels. Local service providers that excel at navigating the culture and red tape of their home countries had trouble scaling up to a global perspective.

2) Leveraging scale for buying power: Multinational organizations leveraged their global scale and negotiated service contracts with global service providers, including their different geographic locations under a master agreement. They often modeled the service they expected to buy and deployed globally, overlooking different local practices.

3) Leveraging scale for selling power: Multinational service providers moved to develop Global Delivery Models (GDMs), striving to standardize service, while concurrently heralding the upcoming "utility" generation of products.

4) Creating Strategic Characteristics and Positions: In 2004, small providers were still complaining that they could not compete head-to-head with big providers for multinational clients. In 2005, the small providers adopted distinct strategies – not "scaled down" versions of multinational strategies. They moved away from the standard portfolios offered by multinationals. They leveraged characteristics (such as increased personal attention and relationships) that are beyond the practical reach of multinational service providers. As a result, multinational clients increasingly retained local service providers to cater to specific local needs.

For example, Accenture's target market comprises leading global and national enterprises and public-sector clients across the major geographies Americas, Europe, the Middle East and Africa (EMEA) and Asia/Pacific. By maintaining the strategic characteristics and positions, a company can expand and grow, and continue to be in a position to identify the high-profile opportunities, as well as add to its knowledge-base.

5) Rigorous Service Management: A proven service management methodology drives high quality service delivery, consistent processes and leverage across

competency areas, efficiency gains, and continuous improvements in service. The service management should include the appropriate level of management focus and knowledge transfer process.

6) Flexibility to Change: Governance and contractual change processes should be structured with the flexibility to quickly adapt to changing business requirements.

7) Trusted Partner Relationship: Successful IT organizations can trust their outsourcing partner to do the right thing, live up to unwritten agreements, and be dependable under pressure.

5.3. Limitations of the Study

The core interest of this study is to research on IT outsourcing business and concept of FDI. Due to limited data available, the analysis gives emphasis only on the necessity of Korean IT service companies' penetration by means of foreign direct investment. Detail discussions are not made on the feasibility in terms of regulations or financial evaluations. Further research is needed to assess the feasibility and to explore more specifically the skill set that Korean IT companies can bring to the global stage.

APPENDICES

APPENDIX A

Vertical Market Definitions

Vertical segments for Gartner Dataquest's IT services group are defined as outlined in Table A.1. ISIC is the International Standard Industrial Classification code. SIC is the Standard Industrial Classification code in wide use within the U.S. NAICS is the North American Industry Classification System.

Primary Segment	Secondary Segment	Additional Description	ISIC	U.S. SIC	NAICS
Agriculture, Mining and Construction	Agriculture	Agriculture, forestry and fishing	1-9	1-9	11
	Mining	Mining of coal, petroleum, gas, metal and minerals	10-14	10-14	12
	Construction	Construction and contractors	45	15-17	23
Process Manufacturing	Pharmaceutical and medicine	Pharmaceuticals, medicinal chemicals and botanical products	2423	2833-2835	3254
	Chemical, plastics and rubber	Chemicals, plastics, rubber and minerals	2421, 2422, 2424, 2429, 25	30: 2812-2824, 2836-2899	3251, 3252, 3253, 3255, 3256, 3259, 326, 327
	Petroleum and coal		23	29	324
	Textiles and apparel	Textiles, apparel and leather	17, 18, 19	22, 23, 31	313, 314, 315, 316
	Metal, wood, minerals, paper, printing and publishing	Newspaper, book, periodical publishers, paper and printing, wood, minerals, stone, clay, glass and primary metals	20, 23, 22, 26, 27	24, 25, 27, 32, 33	51111-3, 51119322, 323331, 332
	Consumables	Food, beverages and tobacco	15-16	20-21	311, 312
Discrete Manufacturing	Transportation equipment	Transportation equipment (motor vehicles, aerospace, rail and ship)	34, 37	37	336

Primary Segment	Secondary Segment	Additional Description	ISIC	U.S. SIC	NAICS
	Computer and electronic products	Computers, office, electronic and communications equipment and semiconductors	30, 31, 32	36	334
	Industrial and electrical equipment	Industrial and commercial machinery	29	35	333, 335
	Medical equipment and supplies	Medical, optical, industrial measuring and controlling, scientific equipment and instruments, photographic, watches and clocks	33	38	3391
	Other discrete manufacturing	Fabricated metal, furniture, recycling and miscellaneous manufacturing	28, 36, 37	25, 34, 39	332, 337
Utilities	Electric and gas	Electric, gas and steam	40	4911-4939, 4961	2211
	Water	Water and sewer systems	41	4941-4959	2213*
Wholesale	Wholesale durable and nondurable goods		51	50-51	42
Retail	General retailers	Nonspecialized stores	521	53	452
	Specialty retailers	Specialty stores include building materials, hardware, automotive, fuel, apparel, furniture, miscellaneous and nonstore	50, 523, 524, 525	52, 55, 56, 57, 59	441-444, 446-451, 453, 454
	Grocery	Food, beverage and tobacco stores	522	54	445

	Restaurants and hotels		551, 552	58, 70	72
Transportation	Rail and water		601, 61	40, 44	482, 483
	Motor freight	Truck, transit and sightseeing	602	41, 42	484, 485, 487
	Air transport		62	45	481
	Pipelines	Pipelines except natural gas	603	46	486
	Warehousing, couriers and support services	Transportation support activities, postal, couriers, warehousing	63, 641	47, 4221-4226, 43, 4513, 4215	488, 491, 492, 493
Communications	Wireless		642*	4812	51332

Primary Segment	Secondary Segment	Additional Description	ISIC	U.S. SIC	NAICS
	Wireline		642*	4813, 4822	51331, 51333
	Satellite and other communications		642*	4899	51334, 51339
	Broadcasting and cable	Radio, TV, cable broadcasting and distribution	642*	4832, 4833, 4841	5131, 5132
Financial Services	Banking	Monetary authorities: central banks and credit intermediation	65	60, 61, 67	521-522
	Securities	Security and commodity brokers	67	62	523, 525
	Insurance (other than health)	Insurance carriers and agents	66*	63*, 64	524*
	Health insurance (payer)	Insurance carriers and agents	66*	63*, 64	524*
Healthcare	Healthcare provider	Doctor, nursing, dental and clinical offices, medical and dental laboratories, hospitals, and other health and allied services	851, 852	80	621-623
Services	Software publishers	Supplier in ISIC software consultancy and supply segment	723	7372	5112
	IT services providers	IT services providers, except software publishers	72	7371, 7373-7379, 8742	541*
	Professional, scientific and technical services, except IT	Legal, accounting, design, engineering, management, scientific, advertising and technical services, except IT	73, 741-743	7311, 81, 83, 87, except 8742	541*
	Real estate	Real estate, rental and leasing	70	65	53

Primary Segment	Secondary Segment	Additional Description	ISIC	U.S. SIC	NAICS
	Business and consumer services	Motion picture, video, audio recording, information services and data processing, holding companies, business and building support, employment, travel, security, arts, entertainment, recreation (performances, sports, museums), personal and repair services, religious, civic and membership organizations	90-93, 71, 526, 749, 853	7322-7363, 7381-7389, 75-79, 83-86, 88, 89	624, 512514, 555671, 81
Education	Primary and secondary	Primary and secondary schools	801, 802	8211	6111
	Higher education	Colleges, professional and other	803, 809	8221, 8222-8299	6113, 6116
National and International Government	Defense and intelligence	National defense and intelligence	7522	90*	92*
	Civil	National government, excluding defense	75*	90*	92*
Local and Regional Government	Local and regional government	Local, provincial, state and regional government	75*	90*	92*
Note: *Indicates partial match					

Source: Gartner Dataquest (August 2005)

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