9. Foreign Direct Investment in Vietnam

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ECONOMIC OVERVIEW

Macroeconomics

Vietnam, in 1986, embarked on a path of reform, known as "doi moi", a comprehensive change by restructuring the economy from a planned economy to a market economy. Since then, the Vietnamese economy had shown a remarkable performance as one of the fastest growing economies in the world. GDP per capita increased from US$ 100 in 1990 to US$ 416 in 2001; real GDP based on the constant prices of 1994 increased from VND 109.2 trillion in 1986 to VND 292.4 trillion in 2001. Despite a global economic recession in 2001, real GDP growth in 2001 was 6.8. Annual inflation fell from 67.5 per cent in 1990 to 0.9 per cent in 2001 and the fiscal deficit fell from 6.7 per cent of GDP in 1990 to 5.0 per cent of GDP in 2001 (CIEM 2002).

Vietnamese businesses include three distinct categories: state enterprises (SOEs), domestic private enterprises (PEs) and foreign-investment enterprises (FIEs). Agriculture and industry still had an important role in the economy, and in recent years, the services industry had emerged as an important sector. SOEs have been growing slowly, yet their relative contribution to gross industrial added value had been declining in recent years, from 52.6 per cent in 1994 to 41.3 per cent in 2001, due to the rapid growth of PEs and FIEs. PEs, which include small-scale industry such as handicrafts and household businesses, accounted for approximately 21.5 per cent of Vietnam's industrial gross added value in 1994 and 21.8 per cent in 2001. The fastest growth had been in FIEs, whose contribution to Vietnam's industrial gross output increased from 25.9 per cent in 1994 to 36.9 per cent in 2001.

International Trade

Before "doi moi" in 1986, Vietnam's international trade was restricted to commodities exchange programmes with other, former Socialist countries. High tariffs and numerous non-tariff barriers governed the trade. During the economic reform, international trade had become an increasingly important part of the Vietnamese economy. In order to promote trade, Vietnam had implemented trade liberalisation, including tariff reductions and other measures designed to relax import and export restrictions. In addition, Decision 46 of the Prime Minister, which became effective in May 2001, provides a roadmap for future trade liberalisation. This Decision leads to a reduction of non-tariff barriers and more transparent and predictable import and export regulations.

Further trade liberalisation will result from bilateral and multilateral commitments. Currently, Vietnam had signed bilateral trade agreements with more than 60 countries, including a treaty with the USA that came into force in December 2001. Vietnam is also formally committed to implement reform to integrate into The ASEAN Free Trade Area (AFTA), with detailed plans for reducing tariff rates and removing other non-tariff barriers. Vietnam expects to fulfil all the obligations necessary to substantially comply with AFTA by 2006, and to completely comply with AFTA by 2010. Presently, Vietnam is engaged in talks on accession to the WTO, with the objective of entering the WTO at the earliest possible date. Moreover, the quantitative restrictions on steel and edible oil were removed by the end of 2002 to fulfil Vietnam's commitments to the IMF.

As a result of liberalisation, international trade had been expanding rapidly since 1990. Exports grew at an average annual rate of 24.7 per cent for the period from 1990 to 2001, while imports grew by 92.2 per cent over the same period. Total exports reached US$ 15,027 million in 2001 and total imports US$ 16.200 million in the same year. Vietnam exports crude oil, textiles, footwear, seafood, and agricultural commodities such as rice, coffee, vegetables, rubber etc., while it imports oil and gasoline, travel vehicles, fertilizers and other chemicals for agriculture, steel, plastic in primary form, and various kinds of consumer goods. Export earnings from the 10 largest export commodities account for 72 per cent, with crude oil alone accounting for 20 per cent of export earnings.

The FIE sector emerges as an important exporter. Its share in total exports increased from 27 per cent in 1995 to 45.2 per cent in 2001. This trend in accordance with a boom in export-led FDI projects, including Taiwanese projects in Binh Duong and Dong Nai provinces.

The majority of increased imports were inputs for production, such as raw material and machines and equipment, whilst the proportion of consumer goods declined dramatically from 15.2 per cent of imports in 1995 to only 5 per cent in 2001. Amongst the imported goods, materials accounted for a large share (65.7 per cent in 2001), reflecting the fact that some export

industries in Vietnam were processing imported material such as textile, footwear, and electronics, and took advantage of cheap labour and availability of land. The FIE sector was also a significant importer, accounting for 30.8 per cent of total imports, however as this was much less than its share of exports, this sector was a net exporter.

Human Resources

In 2001, Vietnam had a workforce of 39.5 million people over the age of 15, of which women accounted for 49.4 per cent. The workforce was distributed unevenly with 23.3 per cent in urban areas and 76.7 per cent in rural areas. Correspondingly, only 14.4 per cent were employed in the industry-construction sector and 60.5 per cent in agriculture.

The general education level of the workforce was quite high with illiteracy of only 3.8 per cent. However, this was distributed unevenly between regions. The labour force was highest educated in the Red River Delta which includes Hanoi, and in the South East Region which includes Ho Chi Minh City, while the levels of education were lowest in remote regions.

Whilst the general education level of the workforce was considered to be relatively high, its professional qualifications were not. The majority of the workforce did not have professional qualification (83 per cent) and for those who had, for many it was in the form of an informal “professional” qualification (without certification). It was reported that many employers had to spend a great deal of effort and passion re-training their workforce at all levels. One US software company estimated that it took about 4-6 months to train a distinguished graduate to work effectively. A motorcycle part-maker reported that it had taken more than six months to reduce the deficiency rate of a new worker from 50 per cent to 2 or 3 per cent.

In response to that situation, many efforts were made in recent years to improve the professional qualifications of the workforce at both national and local level. Some provinces were willing to cover the whole or part of training costs incurred by FDI companies as a means to attract foreign investment into their province, with a shift in the structure of the education system giving more attention paid to professional training. These policy measures were hoped to upgrade the professional qualifications in the workforce to the levels expected by foreign investors.

From State to Market

The establishment of a modern enterprise system was an important objective of Vietnam's overall reform programme. Traditionally, SOEs played a leading role in Vietnam's economy. Vietnam had approximately 5,700 SOEs, employing 1.7 million people in various industries. SOEs contributed 40.5 per cent to GDP in 1997 and 38.6 per cent in 2001. However, most SOEs

suffered from inefficiency, outdated technology, non-competitive products, poor management and an inability to respond to market demands. The Government estimated that about 40 per cent of SOEs were profitable on a stand-alone basis, 40 per cent break even and 20 per cent consistently incurred losses. In order to realise the goals of the “doi moi" policy, an SOEs restructuring programme had been initiated with assistance from the World Bank, ADB and other foreign donors. The principal objective of the SOE reform included:

- Restructuring SOEs, primarily though equitisation, a multi-step approach in restructuring SOEs. For political reasons, the term equitisation is preferred over privatisation;
- Reducing the dependence of the overall economy on SOEs and the dependence of SOEs on Government's support; and
- Restructuring the non-performing loans of SOEs.

Equitisation converts SOEs into joint-stock companies. This involves the issue of new shares by an SOE, or the sale, by the government, of an equity stake in an SOE to outside or inside investors. As a result of the restructuring efforts, the total number of SOEs decreased from about 12,300 in 1990 to 5,700 in 2001. However, the remaining SOEs grew sharply in terms of both capitalisation and gross revenues. In the 1997/2001 period, 886 SOEs were equitised, mostly in the trading, services and manufacturing sectors. They were believed to have now become more profitable.

The Government made commitments to multilateral lenders regarding the pace of SOE reform, concurrently with a transparent and competitive legal environment for SOE operations. Direct subsidies are only provided to SOEs in public services, particularly in the agricultural sector. However, indirect subsidies are still available for SOEs in the form of preferential loans, energy cost subsidies, and subsidies for interest payments.

The legal environment for SMEs had been improved to some extent and this was expected to continue. Private businesses were historically not allowed and were subject to significant discretionary restrictions in their operations. Under the Enterprise Law of 1999, numerous discretionary licensing requirements imposed by administrative agencies had been replaced by more common licenses that could eventually be replaced by a system of legal supervision. The government thus significantly shifted its policy towards the private sector by supporting the establishment and operation of private enterprises. To implement this policy, Vietnam intends to reform and liberalise the non-state economic sector, principally by:

- Enhancing the legal environment for small and medium-sized enterprises (SMEs);
- Increasing access to capital for SMEs;
- Establishing an institution to promote SMEs; and
- Continuing trade promotion and export development efforts.

Consequently, about 34,000 new enterprises with registered capital equivalent to US$ 2.1 billions have been registered under the Enterprise Law of 1999, a huge number compared to the numbers in the past.

Fiscal and Financial System

Fiscal policy underwent an important reform that aimed at delegating more autonomy to local governments. This autonomy included responsibility to collect revenue and self-finance for local expenditures. This meant local authorities had more responsibility to balance their own budgets. Amendments of the Budget Law had been prepared to improve the budget and the public debt management system, as well as to increase transparency in enforcing the fiscal policy.

The tax system in Vietnam had also undergone a significant reform. The period from 1986 to 1995 was characterised by remarkable efforts to make taxes a significant source of budget revenue. The following period was characterised by refinements of the tax system with the introduction of VAT, company income tax, and individual income tax. Further tax reforms are expected to include a gradual reduction of tax rates, more uniform tax ranges and improvements in the tax collection mechanism.

The banking sector includes the State Bank of Vietnam, six state-owned commercial banks (SOCB), various joint-stock commercial banks, foreign bank branches, and foreign-invested joint-venture banks. The goal of the banking sector reform was to strengthen the financial position of, and public trust in, the banking system, and bring it closer to international standards. Banking sector reform included:

- Reforming the regulatory framework for banking with increased transparency;
- Promoting risk-based commercial lending;
- Recapitalising and restructuring SOCBs and joint-stock banks;
- Improving the balance sheets of banks by restructuring non-performing loans;
- Separating policy and commercial lending
- Improving accounting standards;
- Liberalising interest rates and foreign exchange transactions; and
- Modernising banking technology.

The government also planned to reform the organisation of the State Bank, including the reorganisation of State Bank departments to suit their functional activities.

INSTITUTIONS GOVERNING FDI

The first Law on Foreign Investment in Vietnam was passed by the National Assembly of Vietnam on 29 December 1987. This law was amended several times before being replaced by a new Law on Foreign Investment in Vietnam in 1996. Recently, that was amended on 9 June 2000. The law provides general regulation for setting up a foreign invested company in Vietnam, as well as for its operation. More detailed regulations and FDI incentives are specified in various kinds of documents, at both central and local government level.

In the 1987 law, a private organisation alone was not allowed to enter a joint venture with a foreign partner. It had to have joint capital with a state-owned organisation to be acceptable, but since 1992, private organisations are entitled to set up a joint venture with a foreign partner.

Regulation of Investment Mode

Vietnamese FDI law considers three modes of FDI: (i) business cooperation contract (BCC); (ii) joint -venture; and (iii) 100 per cent foreign-owned. In the late 1980s and early 1990s, high transaction and establishment costs made 100 per cent foreign-owned option prohibitively expensive in many sectors, leaving JVs as the only realistic choice for many investors.

From 2000, enterprises with foreign-owned capital, and parties to BCCs, have been allowed to change the mode of investment, and to split, merge and consolidate enterprises. Recently, there have been several cases of a joint venture being converted to a 100 per cent foreign-owned enterprise, although the bureaucratic procedures are complex. In these cases, foreign investors in a JV acquired the share of its local partner to make their own firm.

Procedures for granting Investment Licenses

Before 1996, pre-licensing evaluation procedures applied to all foreign investment projects. During the evaluation process, the Ministry of Planning and Investment (MPI) could request any "necessary" documents apart from those stipulated by law. The time it took to acquire an investment was supposed to be three months from the date of receiving a completed application dossier. However, in reality this usually took much longer, possibly even years.

Since 1996, procedures for granting investment licenses have been gradually streamlined, and authority to issue investment licenses for projects, up to specified sizes, had been delegated to local governments.

Before 1996, many issues, including many day-to-day operation issues in the joint venture, had to be decided on the principle of unanimity by the Board. Since 2000, the scope of issues needing to be approved on the

principle of unanimity had been reduced significantly. Now, only key issues of (1) appointment, dismissal of the General Manager (GM), or the first deputy GM and (2) amendments of, and additions to, the Charter of the joint venture require the unanimous decision of the board of directors.

Land Lease

Access to real estate is a major concern for foreign investors as they cannot buy land as they might in other countries. Since the amended FDI Law of 2000, the Vietnamese side bears the responsibility for site clearance, including the necessary compensation payments. More precisely, nowadays, in those joint ventures where the Vietnamese party contributes capital in the form of the value of the land-use right, the Vietnamese party shall be responsible for site clearance, compensation and completion of procedures to obtain the land-use right. In cases where the state leases out land, these responsibilities fall to the provincial Peoples Committee wherever the investment project is located. Previously, the foreign investor might have had to do all this to obtain land.

Special Economic Zones

Vietnam had created different types of industrial zones that offer special investment conditions for foreign investors. Export Processing Zones (EPZ), Industrial Zones (IZ), Hi-Tech Zones. The first regulation on EPZs was issued by the Government in 1991. An EPZ specialises in the production of goods for export and in the provision of services for the production of export goods and export activities. It had specific geographic boundaries and is open for both foreign and domestic investors. Enterprises operating within EPZs enjoy a profit tax rate at 10 per cent, 15 per cent in respect of production and service enterprises.

IZs have been established since 1994. An IZ is a concentrated zone specialising in the production of industrial goods and services for industrial goods production. Enterprises operating within IZs enjoyed profit tax rates of 18 per cent in respect of production, 12 per cent if exporting at least 80 per cent of its products, and 22 per cent in respect of service enterprises. From 1997, these rates are 15, 10 and 20 per cent respectively. There may be EPZs and export processing enterprises in an IZ and these enterprises shall enjoy tax rates applied to EPZs.

A Hi-tech zone is a zone where hi-technology industrial enterprises and units providing hi-technology development services, including scientific technological research and development, training, and other related services, are concentrated. There may be an EPZ in a hi-tech zone. The profit tax rate applied to enterprises operating in the hi-tech zone is 10 per cent after an eight-year tax holiday from the first year in which the company is profitable.

Regulation of Recruitment and Salary

In the late 1980s and early 1990s, all foreign-invested enterprises had to recruit their workforce through labour supplying centres. In the late 1990s, although the procedures for recruiting employees had been simplified, the stipulation for recruiting employees through labour supplying centres still created disadvantages for foreign-invested enterprises. From 2003, foreign-invested enterprises have been entitled to recruit their employees directly.

Taxation

From 1987, the enterprises with foreign invested capital and foreign partners, operating under business co-operation contracts, were liable to pay a corporate income tax ranging from 15 to 25 per cent of earned profits. From 1996, these enterprises have been subject to corporate income tax at 25 per cent on the profit earned. If the investment was located in those priority areas, this rate was 20 per cent. If the investment satisfied certain investment promotion criteria, the rate was only 15 per cent, and if the investment was strongly encouraged, the rate was 10 per cent. These enterprises were exempted from corporate income tax for a maximum period of two years, commencing from the first profit-making year, and were entitled to a 50 per cent reduction of corporate income tax for a maximum period of two successive years. Since 1996, in cases where investment is strongly encouraged, exemption from corporate income tax had been allowed for a maximum period of eight years.

When transferring profits abroad, a foreign investor had to pay an amount of tax equal to 3, 5 or 7 per cent of profits transferred. This imposition was lower than the rates of 5, 7 and 10 per cent payable under the 1996 law, and lower again than the rates of from 5 to 10 per cent under the law of 1987. Vietnamese citizens permanently residing overseas who invested in Vietnam were entitled to a holding tax rate of 3 per cent of the profits transferred abroad, marginally lower than the 5 per cent imposed on other foreign investors.

Banking

Under the 1987 FDI Law, an enterprise with foreign invested capital could open Vietnamese and foreign currency bank accounts at the Bank for Foreign Trade of Vietnam, or at a branch of a foreign bank established in Vietnam. This would need approval from the State Bank of Vietnam (SBV).

In the 1992 Law, these enterprises were able to open bank accounts at any banks operating in Vietnam, and could open loan capital accounts at overseas banks with approval from the SBV. From the year 2000, in special cases approved by the SBV, an enterprise with foreign owned capital was permitted to open an overseas account, and mortgage assets attached to the land and use

the value of the land-use rights as security for borrowing loans from credit institutions permitted to operate in Vietnam.

Informal institutions

As the formal above-mentioned institutions governing FDI have been established quite recently, it is no surprise that informal institutions have significant effects on the FDI in Vietnam. Some of most notable informal institutions are the followings:

First, there was a strong departmentalisation and a high degree of centralisation, which is the legacy of several decades of the command centrally planning economy. As a result, although the official FDI policies and regulations had been considerably liberalised and decentralised, it was still costly and time-consuming, especially for small investors, to do business in Vietnam. Therefore, in provinces where such top provincial leaders actively worked to implement streamlined FDI regulations and promotion, for example in Dong Nai, FDI inflow was higher.

Second, there was a preference at all levels of the Government for Western European and North American investment, with the belief that it brought along more advanced technology and management. However, most FDI continued to come from Asian countries where businesses maintained personal and professional networks with Vietnam.

Third, the attitude toward merger and acquisition by many government officials and some businesses was still negative. For them, it was the result of some "unfair" competition. At least, it was not in the interest of weak, failing businesses, a legacy of the many years of egalitarian society. It was partly because of this that many foreign investors chose a greenfield investment.

TRENDS OF FDI

Joint Venture versus Greenfield

In Vietnam, there were effectively only two main modes of entry, greenfield and joint venture. Acquisitions of partial stakes in existing firms had been permitted since 1994, yet due to the lack of supporting institutions, they remained rare and almost always between foreign investors. Thus, the statistics did not record them as new FDI projects. Local sources moreover often referred to certain forms of non-equity cooperation as foreign investment, but this was not FDI as defined by, for example the OECD, and thus not a subject of this study.

JV was the dominant mode of investment in the early 1990s, while greenfield was the preferable choice later on. This pattern had been reversed over time. In 1991, more than 80 per cent of FDI projects were JVs; while in

2000, more than 80 per cent of newly established FDI projects were greenfield. However, the average size of the new greenfield projects was small.

Investors

In terms of the number of FDI projects, Asian investors were dominant in Vietnam with more than 3 out of 4 projects. Taiwanese investors were leading (25.5 per cent), followed by Japanese (12.6 per cent) and Koreans (10.4 per cent). ASEAN investors also accounted for a large proportion (15.3 per cent), and other parts of Asia including Australia & New Zealand (3.8 per cent). Europeans were important investors and accounted for 12.8 per cent, while North American investors made up a moderate proportion of 5.7 per cent.

Since 1998, Taiwanese investors have become most active. In 2000, they accounted for more than 40 per cent of new FDI projects, double their proportion during the period from 1991 to 1997. The proportion of Japanese investors was much higher in the 1995 to 1997 period, compared to other periods. The proportion of Hong Kong investors was high in the early 1990s, but fell to a moderate level in later years. The share of Korean investors had been more stable level over time.

In terms of mode of entry, greenfield was very popular among Taiwanese investors. This popularity was also observed among Japanese and North American investors but at a lower level. In the case of Taiwanese investors, many came to Vietnam when greenfield was more feasible and located in the Ho Chi Minh City area where favourable conditions were provided by the local authorities.

A large proportion of investors invested in basic consumer, intermediate and machinery. However this was more obvious with Taiwanese and Korean investors. The proportion of European, North American and other Asian investors that invested in business services (including IT) was higher than with the other investors. The proportion of projects in trade & tourism was highest for Hong Kong investors.

Location

Over time, Ho Chi Minh City and environs are still leading in attracting FDI projects into their provinces. With respect to the number of new FDI projects, the trend of FDI locating in these provinces, had, in fact, determined the FDI trend for the whole country. The number of new projects coming to Hanoi is more stable over time. Ho Chi Minh City (HCMC) and environs became the most favourable destination for Taiwanese investors, while Hanoi attracted more European investors. Japanese and Korean investors did not seem to have any particular favourite location.

While manufacturing accounted for most of the FDI projects in HCMC and HCMC areas, the proportion of project in trade & tourism and business services was exceptionally high for Hanoi. The primary and trade & tourism sectors also accounted for a relatively large entry of FDI projects in other provinces, including many remote provinces.

FDI SURVEY IN VIETNAM

To further investigate the pattern and contribution of FDI in Vietnam, we conducted our own survey. The base population had been defined as FDI establishments that were set up during the period from 1991 to 2000, with at least 10 employees and registered capital of at least US$ 100,000. We used the database of Ministry of Planning and Investment, but excluded contractual co-operations, such as those in the oil & gas industry. This yielded a population of 2,454 FDI establishments. We used random sampling to construct a list of 900 firms, of which 731 actually had useable contact information, and were contacted for an interview.

Table 9.1: Sector and size of FDI firms, Vietnam (No. of firms)

Local sectors	Employment in FDI firms					
	10-50	51-100	101-250	251-1000	>1000	Total
Primary	0	3	2	0	0	5
Basic consumer goods	4	5	11	20	6	46
Intermediate goods	15	11	8	11	1	46
Machinery & equipment	4	2	3	4	0	13
Infrastructure & construction	5	4	2	2	0	13
Trade, tourism & recreation	1	2	1	1	0	5
Financial & business Services	6	5	2	1	0	14
Total	35	32	29	39	7	142

We expended considerable efforts to get a large return rate from major business centres, and across groups of foreign investors. The questionnaire was translated into Vietnamese, and back into English, as is common practice in management research. Moreover, we prepared a Chinese translation using a

similar procedure to target firms with Chinese origins, as they are known to be reluctant to complete questionnaires in English or Vietnamese. It was in most cases necessary to contact firms in person, by meeting face-to-face or by telephone. This process led to 171 completed questionnaires, 23.4 per cent of the firms contacted. Comparing the base population and the sample, we could confirm that the sample is representative by all major criteria, including country of origin, industry, location, mode and registering authority in Vietnam.

Introduction of the Firms in the Sample

The survey confirms that FDI in Vietnam is strongly concentrated on the manufacturing sector, and this is reflected in our survey dataset. Most investors are in the light industries, which for this analysis are divided into basic consumer goods and intermediate products (Table 9.1). Few investors are in service industries, as Vietnam opened up manufacturing sectors earlier, and for many services the local demand is low due to the comparatively low level of income. There are only a handful of firms in financial or IT related services, which are all included in financial & business services. Two pharmaceutical firms are included among intermediate products along with other chemical industry firms as most sales are to government authorities or other businesses. Hence, there is little FDI in typical high tech sectors in Vietnam at this stage.[50]

Table 9.1 reports the variation of the size of the local firms across sectors. The largest firms are mostly in consumer goods industries, i.e. 6 out of 7 firms with over 1000 employees. In contrast, service FDI is often small. FDI in infrastructure is relatively small reflecting the fact that many investors in this sector employ local subcontractors for their operations. The majority of FDI firms in Vietnam had capital stock of less than US$ 20 million.

Distribution among sectors did not fluctuate much over the decade, albeit the relative importance of FDI in intermediate goods and in business services increased slightly. Recent projects have much smaller registered capital than in earlier years. In terms of total registered capital, 1996 was a peak, and it dropped dramatically thereafter.

The survey data confirm that FDI was strongly concentrated on the two main business centres in the North and in the South, Ho Chi Minh City and Hanoi, and provinces in their immediate vicinity. This unequal distribution, and the different development between the North and the South was of considerable concern to policy makers and business peoples in Vietnam. The destinations within Vietnam were relatively stable despite the volatility of overall in inflows. Over time, there had been a trend towards the provinces neighbouring the cities of Hanoi and HCMC. However provinces further away from the traditional business centres continued to receive little FDI.

Introduction of the Investors

In Vietnam, Asian investors dominated, accounting for more than 3 out of 4 FDI projects. They took advantage of lower psychic distance, which facilitates marketing and operations, as well as lower transportation costs and, compared to the USA, less complex political relationships between countries. The home countries varied little across sectors, except that North American FDI is concentrated on business services with information technology and insurance companies, possibly a long-term effect of the trade-embargo lifted in 1994 – yet the absolute numbers are too small for more detailed inferences (Table 9.2).

Table 9.2 Sector by home country region, Vietnam (No. of firms)

Sector	North America	Europe	Asia	Other	Total
Primary	0	1	4	0	5
Basic consumer goods	0	9	43	1	53
Intermediate goods	1	8	41	0	50
Machinery & equipment	1	1	14	0	16
Infrastructure & construction	1	4	8	1	14
Trade, tourism & recreation	0	0	3	1	4
Financial & business services	5	3	15	1	24
Total	8	26	128	4	166

Within Asia, Taiwan, Japan, Korea, and Hong Kong were the main investors. In the sample, Taiwan alone accounted for 25 per cent of projects, with 16, 15 and 7 per cent for Japan, Korea and Hong Kong respectively (Figure 9.1).

The development of FDI over time indicated that there had been a peak in 1995, and a subsequent decline even before the Asian crisis of 1997. The data show a slight increase in the year 2000, which corresponds to a similar modest increase shown in official records. The first peak was particularly noticeable for Japanese firms and for ASEAN firms. A wave of Japanese FDI in 1995/1996, was followed by a sharp decline thereafter, with a small recovery in 2000. Hong Kong firms had been more active before 1995, while Taiwanese investors had been growing gradually in numbers. European investment had been more stable over time with a slight anti-cyclical tendency, that is Europeans participated less in the 1995 boom.

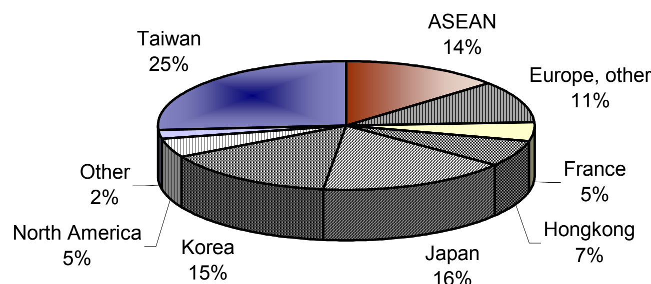

Figure 9.1 Distribution by home country

Foreign investors in Vietnam were overwhelmingly small and medium size firms, with few very large firms (Table 9.3). The median employment of the parent firm was about 2,000 employees. Across sectors we find that FDI in business services (sector 7) came from, on average, slightly larger firms, while light-manufacturing FDI (sectors 2 & 3) included many small parent firms. Taiwanese parent firms were often very small, whereas some European and North American parent firms employed more than 100,000 persons worldwide (Table 9.3).

Table 9.3 Parent worldwide employment by sector (No. of firms)

	Parent size (worldwide employment)				
	<1,000	1,001-10,000	10,001-100,000	>100,000	Total
Primary	1	-	-	1	2
Basic consumer goods	17	13	6	1	37
Intermediate goods	16	12	8	-	36
Machinery & equipment	3	5	5	2	15
Infrastructure & construction	1	2	2	2	7
Trade, tourism & recreation	-	1	-	-	1
Financial & business Services	2	7	7	-	16
Total	40	40	28	6	114

Correspondingly, many investors had a very high proportion of their global business in Vietnam. As a corollary of having many small parent firms, the local affiliate was often relatively important for the parent. The relative size of the Vietnamese operations showed a bimodal distribution with more than a fifth of the investors reporting more than 20 per cent of their turnover in Vietnam. This contrasted with the pattern observed in Egypt and South Africa, but resembled the pattern found in India (though there were fewer individuals as investors). Hence, many FDI projects in Vietnam resembled entrepreneurial firms, or small and medium size firms, rather than the large multinational firms of the FDI literature.

This included firms, notably with Taiwan or Hong Kong origins, that appeared specifically set up to operate in Vietnam, and FDI owned by individuals rather than parent firms. More than half of the Taiwanese investors had more than 20 per cent of their turnover through the Vietnamese affiliates, which included about 8 firms owned by individuals rather than firms. On the other hand, Japanese and Korean firms were most likely to have only a relatively small operation in Vietnam.

Local policy makers were concerned about the small size of investment. Following continuous efforts to improve investment environment in Vietnam, the country had expected investments of large multinational firms. In fact, a recent study considered FDI environment in Vietnam quite competitive relative to other countries in the region. This had however so far not led to increased FDI capital inflows, in contrary to predictions by some policy advisory organisations.

R&D intensity of the parent firms was generally low, but higher for light manufacturing compared to service industries. For advertising intensity a similar but weaker pattern could be observed. Low advertisement expenditure in manufacturing industry reflected that many investors were sub-contractors for larger companies and their investment in Vietnam served their production network in the region.

Most investors in Vietnam had other operations in emerging Asian economies, which may have included their country of origin. However, there were very few investors that had experience on other continents. Some French, Japanese and Australian investors engaged in their first ever FDI in an emerging market in Vietnam. International experience was especially low among manufacturers of basic consumer goods.

The pattern of global experience and diversification of the parent firms showed that late entrants were all small focused firms with little international business experience. On the other hand, large multinational firms, which we could call global players, seemed to have lost interest in new FDI in Vietnam. This also strengthens the argument that new investors often were entrepreneurial firms and businesses relocating production because of rising costs in their home country.

In concluding the review of investors, there were very few ‘global players’ among the foreign investors in Vietnam. Many of the investors were not only small but had little international experience outside Asia. The median investor had other overseas affiliates in only two other countries, which was far lower than the values for the other countries in this study. There was little variation of investors across sectors of industry, with small differences between light-manufacturing and service industries. However, we noticed some features with substantial variation across countries of origin:

- Taiwanese investors were small but plentiful, often with high export orientation. Their location tended to follow earlier Taiwanese FDI, notably to HCMC and surrounding provinces.
- Japanese and Korean investors included both big multinationals and small firms. They also attracted their traditional parts and components makers to invest in Vietnam.

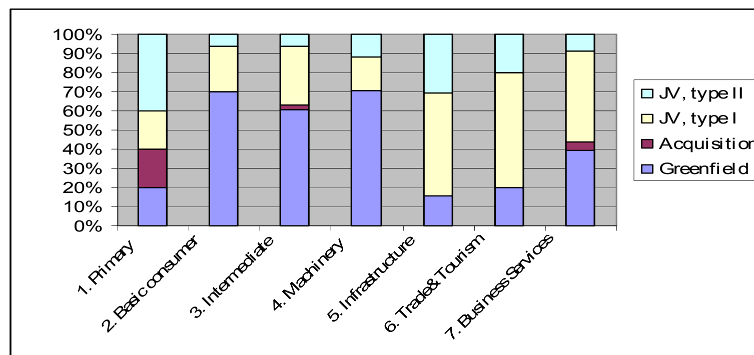

Figure 9.2 Entry modes by industry, Vietnam

- ASEAN and Hong Kong businesses appeared to be neighbours expanding into Vietnam, yet the numbers may include FDI, particularly from Singapore, Hong Kong and Malaysia, that was undertaken by regional headquarters of MNC from Europe or America. To the extent this was evident from the data, we have reclassified the observations to the ultimate headquarter as requested in the questionnaire.
- The French lead among European investors. They mainly invested in light industry.
- North Americans can best be described as ‘non-investors’ with only eight firms, of which five were in business services.

Entry Mode Choice

In Vietnam, there were effectively only two main modes of entry, greenfield and joint venture. Our results corresponded to other studies and official statistics that distinguished only between JV and wholly owned firms. In the early 1990's JV's accounted for more than 9 out of 10 business licenses, yet the relative number of greenfield had been steadily increasing. In 1998 for the first time more licenses were issued to greenfield ventures than to JVs.

This trend is related to the liberalisation of FDI regulation in Vietnam. As mentioned earlier, 100 per cent foreign ownership was permitted, only on a case-by-case approval basis, which created transaction costs that were prohibitively high in some sectors in the early 1990s. These costs have been reduced over time and thus the share of greenfield projects had increased.

In Vietnam, we distinguish two types of joint ventures. The type I is what is commonly called a JV, a new firm established with contributions by both partners. The JV type II is a venture where the local firm contributes it existing assets to the JV. The local firms continues as a legal entity, yet primarily as a shell company owning the shares in the joint venture. The three cases studies of this research illustrated the different uses of joint venture (Chapter 10). Carlsberg established in 1993 a brewery joint venture that in most ways resembled a normal joint venture where both firms contributed assets, and the JV was run and controlled jointly. Yet both firms developed their other business activities independently. Honda established a joint venture to manufacture motorcycles with a local partner that mainly contributed land use rights, but was not actively involved in the running of the JV. These two ventures would be classified as JV type I. On the other hand, ABB formed a JV with a local firm, which transferred all existing assets and liabilities to the JV. ABB was in control of most operating management issues, but local stakeholders could, by way of the local JV partner firm, influence strategic issues. In all three cases the local partner was a state-owned firm.

Across sectors, it appeared that JVs were more common in service sectors and greenfield in manufacturing sectors (Figure 9.4). Across provinces, greenfield had been particular common in the provinces neighbouring HCMC, while JV had been more common in the more remote 'other' provinces.

Resources for Success

We asked respondents, which resources would be most crucial for their competitiveness. The priority of resources showed considerable variation across sectors, but no clear pattern emerged (Figure 9.3). In the basic consumer goods industry, brands were relatively unimportant, which may have been due a large number of textile and clothing firms that were mainly

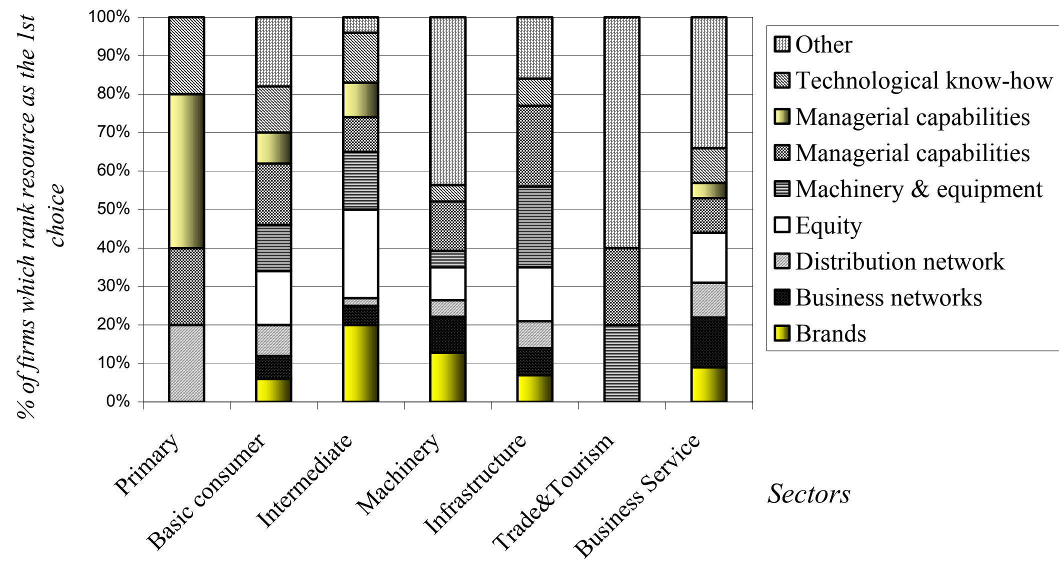

Figure 9.3 Key resources for successful performance, Vietnam

Table 9.4 Percentage of Vietnamese firms that selected the resource as being of primary importance (by source of resource)

Resources for success:	Brand	Business network	Distribution network	Equity	Machinery & equipment	Managerial cap.	Marketing cap.	Technological know-how
Source of resource								
Local parent firm	13	15	23	11	4	11	13	11
Foreign parent firm	78	53	46	76	78	67	44	72
Local source	2	21	23	4	9	14	20	11
Foreign source	7	11	0	9	7	6	14	6
Other	0	0	11	0	0	0	9	0

subcontractors of an international retailer. As a result, production capacity was more important than brands for these investors. In the intermediate goods industries, equity and distribution networks were most important, in the machinery industry, machinery was important, while marketing and technology was considered less important. In businesses services, managerial capabilities were most important.

In acquisitions, managerial capabilities were named as important by more than half of the respondents, followed by machinery. Joint ventures type I reported more items from the lists that were not in the top 8 contributions. Joint ventures of type II were in this respect more like greenfield projects as managerial capabilities and machinery were most important.

Smaller firms were more frequently reporting brands, marketing and technology among their top resources, while larger firms named managerial capabilities and machinery, and to a lesser extend business networks.

In Table 9.4, we report who contributed the resources considered most important. The foreign parent firm was the most important source for all resources. Local parent firms were relatively important with respect to distribution networks, while other local sources matter for business networks, distribution, and marketing.

Institutional and Market Environment

The institutional and market environment for FDI had undergone substantial change in the second half of 1990s. Most notable was the change in the licensing regime, which had been decentralised, and administrative procedures have been simplified. A lot of restrictions on the operation of FDI, e.g. on foreign exchange control etc, were also deregulated. At the same time, as the domestic private sectors developed, it had become easier for FDI to source intermediate products and supplies within Vietnam. These changes were reflected in the respondent's assessment of the business environment, which overall pointed to improvements facilitating the operation of business.

Across industries, most respondents give the most favourable assessment to availability of business licenses (Table 9.5). This criterion along with access to real estate also saw the largest margin of improvement. The worst assessment had in most industries been given to the general legal framework and the predictability of the legal framework. The variation across industry may reflect the industry's exposure to different types of regulation or bureaucracy. For example, infrastructure and construction was most negative about environmental regulation, and had a considerably weaker assessment of local government, compared to their view of the central governments.

Across entry modes, the assessment of the institutional framework showed little variation. Acquirers provided more favourable assessments, but there were very few of them. JV type II firms seem to get along best with local governments.

Table 9:5 Evaluation of institutional environment, Vietnam (by industrial sector)

(on scale from 1 to 5, 1= not conducive at all)(by industrial sector of the respondent)

	Primary		Basic consumer goods		Intermediate		Machinery & equipment		Infrastructure & construction		Trade & tourism		Business services	
Institutional environment	Initial	2001	Initial	2001	Initial	Initial	2001	Initial	2001	2001	Initial	2001	Initial	2001
Business license	2.60	4.00	3.31	3.75	3.54	3.00	3.50	2.79	3.57	3.93	2.81	3.53	3.00	3.75
Real estate acquisition	2.00	3.20	3.02	3.27	3.32	2.75	3.67	2.37	3.00	3.61	2.69	3.07	2.64	3.36
Visa & work permit	3.20	3.40	3.36	3.73	3.42	3.25	3.50	3.04	3.65	3.71	2.62	3.12	2.79	3.82
Environmental regulation	3.20	3.25	3.32	3.52	3.34	3.00	3.50	3.08	3.57	3.47	3.31	3.44	3.29	3.08
General legal framework	2.60	2.80	2.98	3.31	3.04	2.75	2.75	2.71	3.35	3.38	2.56	2.87	2.64	2.92
Predictability of rules	2.40	2.40	2.96	3.33	2.86	2.50	2.75	3.04	3.35	3.04	2.50	2.87	2.64	3.17
Central government	3.00	3.20	3.17	3.51	3.34	3.50	4.00	3.04	3.57	3.68	2.94	3.31	3.43	4.00
Provincial government	2.80	3.00	3.22	3.50	3.43	3.25	3.75	2.96	3.48	3.71	3.00	3.33	3.33	3.64
Local government	2.80	3.00	3.19	3.48	3.24	3.25	3.67	2.75	3.27	3.48	2.87	3.20	3.14	3.45

Table 9.6 Evaluation of institutional environment, Vietnam (by province)

	HCMC		HCMC region		Hanoi		Hanoi region		Other provinces	
Institutional environment	Initial	2001	Initial	2001	Initial	2001	Initial	2001	Initial	2001
Business license	3.03	3.66	3.70	4.07	2.95	3.68	3.20	3.89	2.93	3.29
Real estate acquisition	2.77	3.30	3.29	3.53	2.63	3.26	2.80	2.89	2.92	3.23
Visa & work permit	3.15	3.72	3.51	3.78	2.89	3.33	3.00	3.50	3.13	3.20
Environmental regulation	3.22	3.41	3.38	3.52	3.74	3.89	2.90	3.10	3.14	3.29
General legal framework	2.65	3.19	3.35	3.63	2.63	2.95	2.44	2.78	3.07	3.20
Predictability of rules	2.69	3.18	3.00	3.19	2.89	3.16	2.22	2.56	3.00	3.29
Central government	3.13	3.60	3.43	3.70	3.32	3.58	2.89	3.33	3.29	3.43
Provincial government	3.21	3.61	3.42	3.69	3.21	3.47	2.44	2.89	3.27	3.40
Local government	3.01	3.35	3.48	3.68	3.05	3.32	2.33	2.89	3.08	3.31
No. of Observations	73		47		19		10		15	

On scale from 1 to 5, 1= not conducive at all

Within Vietnam, businesses in the vicinity of HCMC gave the best ratings of the business environment by most criteria, followed by HCMC itself (Table 9.6). Only on environmental regulation Hanoi got the best rating. On the other hand, the weakest rating was reserved for Hanoi region and the ’other’ provinces. Comparing the ratings given to central and local governments, investors in HCMC region gave almost the same score, while investors in Hanoi region rated the local government considerably less conducive.

Thus, the business environment in Vietnam showed encouraging trends in the assessment of foreign investors, as both the resource endowment and the institutional environment have improved. The assessment varies however within Vietnam, and to a lesser extent across industries, yet not between investors who came by different entry modes.

Firm Performance

ASEAN and European firms were more likely to report above average financial performance, while Taiwanese and Japanese firms were more likely to under-perform (Table 9.7). Within Vietnam, investors in HCMC were more likely to report above average performance, while investors in Hanoi and in ‘other’ provinces perform below average. Hence, it appeared that new investors preferred those areas where existing investors reported good results. However, the performance data requires more detailed analysis to provide policy advice.

Impact on the Host Economy

Export Contribution

Producers of basic consumer goods were most likely to export to global markets, and to deliver products to other affiliates of the parent firms. Vietnam thus attracted many investors in traditional light industries with labour intensive production that took advantage of comparatively low production costs. Domestic market orientation was much higher in business services than in the manufacturing sectors. Trade and tourism firms, for which we have data for only 4 firms, appear most oriented towards regional markets.

The domestic focus was much higher among joint ventures than among greenfield projects, which supported the contention that local joint venture partners were crucial to provide access to local markets. The import-substitution policy had apparently encouraged joint ventures that were oriented towards local market.

Table 9.7 Performance across source countries and host regions, Vietnam (No. of firms)

Source	Low	Middle	High
ASEAN	7	7	7
Europe	7	7	9
Hong Kong	3	4	3
Japan	9	12	2
Korea	3	16	4
North America	2	2	2
Taiwan	16	17	3
Other	1	1	2

Province	Low	Medium	High
HCMC	19	31	17
HCMC region	13	19	6
Hanoi	8	8	3
Hanoi region	2	5	2
Other	6	3	4

Market orientation varied across home countries, with most investors serving in the initial year either only the local market, or only export market. About half of the investors from Japan and Taiwan were exporting all their output, compared to an average of 36 per cent. The labour cost differences combined with moderate geographic distance made the establishment of production sites in Vietnam attractive for investors from these two economies. On the other hand, 40 per cent of investors were selling only in the local market. This included all American investors and the majority of French and ASEAN investors. Domestic market oriented investors were distributed across all provinces, while export oriented investors were concentrated in HCMC.

Initially there seems to have been a clear either-or distinction between exporters and firms selling in the local market. This distinction blurred after 1995; as more recent entrants served both domestic and export markets.

Spillovers to the Local Industry

We expected that foreign investment might create positive spillovers that supported the development of the local industry in the same sector. If this was true, then it should have been reflected in positive changes in the assessment of the local industry at the time of entry and at the time of the survey. Comparing the assessment of local industry at the time of entry and at the time of the survey, we noted an improvement in the local industry, which was fairly consistent across sectors, and for different aspects of the local

industry.

Outliers and large margins of change emerged only for industries with few observations: In the trade and tourism industry, the local industry was improving by a large margin, followed by machinery and equipment while in the construction industry change was small. This contrasted with a widely held view in Vietnam that construction was one of fastest developing industries since opening to FDI. In the primary sector, the local industry was by some criteria even declining. Marketing capabilities increased by a relatively large margin, but as an outlier they appeared to be declining in the infrastructure and construction sector.

Joint ventures were generally more favourable about the local environment, and they reported a larger improvement of their assessment. This indicated a positive spillover favouring institutional development, but it may also have been due to the fact that joint ventures had on average been in existence for a longer time.

Human Capital Accumulation

The main contribution of foreign investment was often seen in the transfer of knowledge from the parent firm to local affiliates. We thus asked respondents about the foreign investors training expenditures. We found that these expenditures were on average higher in business services, while they were lowest in the machinery industries. However, there was no clear relationship between employment in the local firm and training expenditures. The relationship between training expenditures and financial performance appears U-shaped as training expenditures were higher in both the above and below average performing firms.

The training expenditures appeared weakly related to the R&D intensity of the parent (Table 9.6). The highest training expenditures (over 15 per cent) were incurred by parent firms with R&D expenditures of more than 4 per cent of sales. On the other hand, of firms with less than 4 per cent R&D expenditures, more than half spent less than 0.5 per cent on training. Hence there appears to be some support for the notion that attracting R&D intensive firms generated more knowledge transfers. In the current policy debate in Vietnam, this result provides support for policy to provide favourable treatment to FDI with R&D intensive operations.

CONCLUSIONS

Following gradual liberalisation over 15 years, FDI had surged in Vietnam, and foreign investment firms made a major contribution to the domestic economy in terms of for instance output and exports. Our survey provides new insights in the nature of this foreign investment and its potential contribution.

Table 9.8: Training relative to R &D expenditure, Vietnam (No. of firms)

	R&D expenditures							
Local training	0-0.5%	0.5-1%	1-2%	2-4%	4-8%	8-15%	Over 15%	Total
0-0.5%	18	7	5	6	4	3	5	48
0.5-1%	6	2	2	3	3	2	1	19
1-2%	1	2	2	1	1	3	0	10
2-4%	1	0	0	0	1	0	1	3
4-8%	0	0	1	1	0	0	0	2
8-15%	0	0	0	0	1	1	2	4
Total	26	11	10	11	10	9	9	86

Notes: R&D expenditures = worldwide R&D expenditures as percentage of sales; local training = training expenditures as percentage of subsidiary sales.

Foreign investors in Vietnam, especially more recent entrants, were often small focused firms with little international business experience. In contrast, most large multinational firms, which one could call global players, had little interest in FDI in Vietnam. Our data illustrates several features that vary substantially across countries of origin. For instance FDI from NICs appears to show different characteristics such as labour intensity, export-orientation, and regional clustering. Rising costs in some of the neighbouring countries appear to be an opportunity for Vietnam to attract FDI. Thus, country-of-origin influences on FDI were an area requiring further investigation, while sector variation seems to have little explanatory power.

Entry modes available to foreign investors in Vietnam are more constrained than in other emerging economies, such that there are no partial acquisitions and very few full acquisitions in our sample. In part, foreign investors have used joint ventures to effectively acquire control of an existing operation, which we classify as JV type II. Over the decade of the 1990s, there has been a clear trend from JV to greenfield entry, and to a very limited extend acquisitions. The entry modes also vary across countries of origin, and across locations within Vietnam. Hence, an analysis of entry mode in Vietnam has to pay careful attention to the institutional context prevailing at the time of entry.

Foreign investors in Vietnam report managerial capabilities and machinery as their most important resources, ahead of both technology and networking assets. This applies in particular to large and wholly owned affiliates. Managerial capabilities appear important across all industry sectors, while machinery and equipment is naturally more important in the manufacturing and infrastructure sectors. This pattern suggests a traditional pattern of competition, as few references are made to intangible assets such

as technology and marketing assets. This ought to be investigated further in relation to the changing patterns of globally integrated operations of MNE.