# Foreign Investment Strategies and Sub-national Institutions
# in Emerging Markets: Evidence from Vietnam

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NB: UK English for JMS!

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**Abstract**

Foreign investors entering emerging markets have to take strategic decisions on where and how to set up operations. These decisions have to accommodate institutional conditions that vary not only between countries, but also within the host economy. We offer a theoretical framework to analyse how institutions in an emerging economy influence entry strategy decisions.

On this basis, we analyse the determinants of two key aspects of entry strategy: location and entry mode in Vietnam. We find that sub-national institutional variables have a significant influence on both dimensions. The availability of scarce resources affects the location of FDI and the likelihood of Greenfield entry. Institutional pressures arising from incumbent state-owned firms and the domestic market orientation of the investor lead to a preference for joint venture entry.

## 1. Introduction

Foreign investors have to decide where and how to set up their operations. These strategic decisions have to accommodate institutional conditions that vary not only between countries, but also within the host economy. Investors adapt their strategies to formal and informal institutions prevailing at the host location, especially when entering emerging markets. In this study, we examine these adaptations for FDI in Vietnam.

Scholars have extensively analysed some aspects of entry strategies, especially ownership and control (Anderson and Gatignon 1986, Hill et al. 1990, Agarwal and Ramaswani 1992). However, this literature's shortcomings limit its applicability. First, only a few studies incorporate the institutional context of the host economy (Gomes-Casseres 1990, Meyer 2001), and they limit themselves to national institutions. Second, few international business studies consider the important strategic decision of where to locate an FDI project in a country (but see Shaver and Flyer 2000), albeit this issue receives some attention in the economic geography literature (Coughlin et al. 1991, Head and Ries 1996). Third, most studies focus on FDI

among mature market economies. Scholars have only recently begun to study entry modes in China (Tse et al. 1997, Pan and Chi 1999, Pan and Tse 2000, Luo 2001b).

This paper offers a theoretical framework for how sub-national[1] institutions influence foreign investor strategies, and tests hypotheses arising from this framework in the case of Vietnam. Institutions affect multiple aspects of entry strategy, such as location and mode, giving rise to the central theme of this paper: *Any institutional barrier may induce some investors not to invest in a given location, while others may seek to overcome the barrier by forming a JV.* Our study investigates the impact of sub-national institutions on these two key aspects of foreign entry strategies.

Recent theoretical work has integrated institutional perspectives with the analysis of business strategies (Oliver 1997, Dacin et al. 2002, Peng 2003) and international business (Mudambi and Navarra 2002, Ramamurti 2003) by applying theoretical advances in institutional economics (North 1990) and sociology (Scott 1995/2001). The legal framework and institutions are of pivotal concern to businesses operating in emerging markets, especially when they are still unfamiliar with the local environment. Hoskisson et al. (2000) suggest that the institutional perspective is one of three lines of theorizing that can be expected to yield new insight on business in emerging economies. Scholars working on transition economies have found that institutions influence strategies pursued by both multinational firms (Henisz 2000, Peng 2001b) and local firms (Spicer et al. 2000, Lyles et al. 2004) to a high degree.

Institutions contribute to locational advantages, one of the three parts of the ownership-location-internalisation (OLI) paradigm explaining the pattern of FDI. Still, location has received little attention in recent years, leading Dunning (1998) to call it "the neglected factor" of the OLI framework. International business scholars have extensively studied how institutional variables influence the location of FDI in terms of host country selection (Loree and Guisinger 1995, Globerman and Shapiro 2003, Oxelheim and Ghauri 2004), but they have largely ignored intra-country location and its interaction with other strategic decisions such as mode choice. The specific location of operations is a major concern to multinational firms (Shaver and Flyer 2000, Cantwell and Iammarino 2000) and is of particular relevance in large and decentralized emerging markets where

attitudes, policies and other institutions vary at the provincial or even local level. For instance, in Russia FDI is concentrated not only in the traditional centres of business in St. Petersburg and Moscow, but also in provincial cities known for their reform-oriented local government (Meyer & Pind 1999). In China, institutional differences within the country influence corporate strategies (Schlevogt 2002) and foreign investment inflow (Zhou et al. 2002). In India, states use tax incentives and other policy instruments to compete with each other to attract major foreign investors, such as Ford (Oman 2000).

The institutional peculiarities of different locations within a country affect both the attractiveness of that location to foreign investors and the preferred entry mode. Just as institutions on the national level affect the volume of FDI inflows (Loree and Guisinger 1995, Globerman and Shapiro 2003, Bevan et. al. 2004), sub-national institutions affect FDI inflows at the regional level. For instance, tax rates affect FDI in individual states in the USA (Hines 1996), and special economic zones attract FDI to Chinese cities (Head and Ries 1996).

Institutions are equally important when it comes to selecting an appropriate mode of entry (Henisz 2000, Brouthers 2002). Formal institutions, such as the legal framework, and informal institutions, such as the practices of law enforcement, shape the transaction costs in pertinent markets and, consequently, an investor's preference for internalising markets (Meyer 2001). Moreover, institutions influence the evolution of resources and capabilities. For instance, networking competences are most developed in those countries where transactions are commonly based on personal relationships and networks (Peng and Heath 1996, Kock and Guillén 2001). The institutional environment thus shapes the key parameters determining entry mode decisions. This paper explores the impact of institutions below the national level.

We have chosen Vietnam as empirical setting to study the impact of institutions on FDI. This is a particularly suitable context as Vietnam has gone through a major economic transition process, while weaknesses in the formal and informal institutions remain major obstacles to business (van Arkadie and Mallon 2003, Tenev et al. 2003). Moreover, liberalization has been implemented unevenly, which permits the exploration of implications of institutional variation within a country.

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[1] In the theoretical part of this paper, we use the term 'sub-national' because the relevant units of analysis carry different names in different countries: state, provinces, regions, countries, etc.

This paper makes the following contributions. First, a theoretical framework to analyse how national and sub-national institutions influence entry strategies of foreign investors is developed. Second, we present what to our knowledge is the first empirical study of the impact of sub-national institutions on entry strategies in an emerging economy. Third, we provide results from one of the most representative surveys of foreign investors in Vietnam.[2]

The paper is structured as follows. Section Two offers our theoretical perspective on institutions and foreign investment strategies, which we then use to outline the institutional change affecting FDI in Vietnam. In Section Three, we use the logic of the theoretical framework to develop testable hypotheses. Section Four presents our empirical methodology and our original survey data. Section Five presents the empirical results of two separate tests of location and entry mode decisions. Section Six discusses broader theoretical issues arising from this study, before Section Seven highlights implications for the development of the institutional perspective of strategy.

## 2. Theory: Institutional Change and FDI

Recent international business and strategy research explores the relationship between countries' institutional framework and business strategies (Oliver 1997, Peng 2000a), and has developed an 'institution-based view of strategy' (Peng 2001, 2003). The institutional perspective may not be a theory, that, in itself, would explain corporate strategies. However, it does provide crucial explanations for why transaction costs arise (Meyer 2001), why resources are developed in a certain way (Peng 2001b, 2003), and how organizations evolve (Lewin et al. 1998, Rodrigues and Child 2003). Host economy institutions moderate traditional determinants of entry strategies. Especially in emerging economies, empirical research finds that institutions influence the strategies of both domestic firms (Peng and Heath 1996, Khanna and Palepu 2000, Filatotchev et al. 2001) and foreign direct investors (Henisz 2000, Meyer 2001, Bevan et al. 2004).

The institutional framework of a country consists of both formal and informal dimensions (North 1990) that may vary within countries. Some countries allow regional authorities to set certain laws, as is the

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[2] The only other major survey-based management research in Vietnam that we are aware of is that by Lyles et al.

case in the USA. However, even where sub-national authorities do not have law-setting authority, informal institutions may vary due to variations of normative or cognitive aspects of institutions. Moreover, in emerging economies institutions are continually changing, with change processes at national and local level being interdependent.

In this section we present a theoretical framework that shows how institutions and institutional change influence FDI. We discuss the general principles before moving onto implications for a transition economy such as Vietnam. In the next section, we present testable hypotheses based on our framework.


*** Figure 1 approximately here ***


**2.1. A Theoretical Framework for Institutional Change**

Institutional development and the strategies pursued by firms are interdependent (Lewin et al. 1998, Peng 2001). Firms gravitate towards organizational forms for which they find institutional support. For individual firms, institutions may be exogenous. However, an area's population of firms creates pressures to establish institutions that best meet their needs. Thus, political and social institutions determine the nature of firms, while firms collectively support the institutions that they come to rely on (Hall and Soskice 2001). Figure 1 presents our conceptualisation of the institutional framework faced by foreign investors in decentralized emerging economies. The framework is based on the notion of co-evolution of institutions and organization (Lewin et al. 1998, Lewin and Kim 2004) at both the national and local levels.

Institutions influencing enterprises include, for instance, ownership and corporate governance systems. Formal and informal institutions determine selection mechanisms for top management as well as the pressures to which managers have to respond when defining corporate strategies (Buck et al. 2000, Filatotchev et al. 2001, Mygind 2001). The governance systems influence such aspects as managerial risk taking and the cost of using internal or external markets, and consequently strategies of vertical integration and diversification (Khanna and Palepu 2000). Governance mechanisms are usually defined at the national

(2000), which focuses on relationships between partners in joint ventures.

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level, though informal mechanisms may also allow local institutions to influence local firms or business units. For example, Vietnamese state-owned enterprises (SOEs) fall partly under national ministries and partly under local authorities.

Foreign investors thus face a complex institutional environment that is continuously evolving through interaction with organizations in the host country. Figure 1 is drawn parsimoniously, showing those interactions that we consider particularly relevant, and abstracting from others, such as interaction with the international environment. Prospective foreign investors can observe most aspects of the formal institutions. They can, for instance, study the relevant legal texts. In contrast, informal institutions are much less transparent and, therefore, a source of uncertainty.

Institutions have been included in studies of country level determinants of FDI. The empirical literature shows that investment incentives, lower tax rates and absence of performance requirements (Loree and Guisinger 1995) as well as more general market-oriented institutions attract foreign investment (Globerman and Shapiro 2003, Bevan et al. 2004). Institutions moderate transaction costs in markets in which foreign investors operate (Meyer 2001) and the importance of gaining access to local networks (Peng 2003). Therefore, they may facilitate or inhibit foreign investors' access to complementary resources. Moreover, institutions affect entry mode choice by establishing the range of permitted modes (Makino and Beamish 1998) and by influencing an investor's perceived risk (Brouthers 2002). In these ways, institutions may create barriers to FDI and lower the amount of incoming FDI. At the same time, institutions may induce foreign investors to overcome barriers, especially with respect to access to local resources, by partnering with a local firm.

We focus on variations within one country and suggest that both formal and informal institutions are not homogenous. In terms of formal institutions, provinces or municipalities that have a one-stop agency to work with foreign investors and offer industrial zones with good infrastructure can greatly facilitate relations with investors. Moreover, fiscal incentives such as tax holidays or subsidies can tip the balance between two alternative sites (Oman 2000). Informal local institutions draw on distinct local traditions and cultures, and may show some variation of normative values, as is the case in Vietnam (Ralston et al. 1999). This affects

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the effectiveness of implementation of centrally mandated economic reforms. Moreover, local communities may interact to different extents internationally and with different countries, such that new influences may also vary across regions within large countries.

Although many national governments have adopted favourable attitudes to FDI, implementation of these policies often takes place locally. Foreign investors have to negotiate with local authorities over business licenses, real estate, access to public utilities, and, in some countries, tax incentives and subsidies. Such policy variation is related to administrative decentralization, as local authorities decide how to implement policies set at the central level. This does not necessarily require political autonomy.

Institutions and organizations co-evolve at both the national (Lewin et al. 1998, Lewin and Kim 2004) and local level. For instance, powerful state-owned firms may lobby locally for interpretations of the law that aim at protecting the interests of incumbent firms. Local institutions, such as local bureaucratic practices, influence barriers to entry, and thus the emergence of both domestic private firms and foreign investors. After their establishment, foreign investment firms may enhance local recognition of the benefits of a market economy while promoting norms associated with market economics. In this way, institutions and organizations mutually influence each other.

One might expect that informal local institutions, such as corruption, tend to work against foreign investors. However, foreign investors can also use local informal institutions to their advantage. Recent research points to investors successfully establishing an amicable relationship with the local authorities. Luo (2001a) argues that relations between MNEs and governments should be seen as (potentially) cooperative, and he finds that such relations have a positive impact on subsidiary performance in China. Distinguishing between relationships with central and local governments, he finds that the former impact sales performance only, while relationships with local governments affect both sales and financial performance. Peng (2000b) compares three car manufacturers in China and their relationships with government authorities. He too finds that both local and central governments influence investor performance, and that co-operation with local authorities can help the firm to obtain various approvals from central authorities.

**2.2. Institutional Change during Economic Transition**

A major challenge for foreign investors in emerging economies is the rapid change of institutions. In transition economies, reforms initially concern primarily formal institutions at the central level (World Bank 1996). When the regulatory framework is changed at the centre, this directly affects formal institutions at the sub-national level. However, the impact on informal institutions occurs only with considerable delays (North 1990). Firms may thus react with considerable inertia and gradually move from network-based strategies to market-based ones (Khanna and Palepu 2000, Peng 2003). In fact, Peng and Heath (1996) argue that during periods of institutional change, informal institutions become *more* important as old coordination mechanisms are no longer operational, but new coordination mechanism are not yet fully established. The mechanisms by which these changes of informal institutions influence businesses are not well understood (Hoskisson et al. 2000).

Vietnam is such a transition economy with "a bureaucratic, yet entrepreneurial, business environment" (von Glinow and Clarke 1995). Vietnam began a gradual path of reform in 1986 following the Chinese example of gradualism. However, the communist party still remains firmly in power, and many aspects of the economy are subject to regulation or direct interference by the authorities of the government or ruling party. Even Prime Minister Phan Van Khai acknowledges, *"Our administrative procedures are still cumbersome. You can get approval at the central level, but you still have problems at the local level with issues like land"* (Phan 2003).

State-owned enterprises (SOEs) still contribute more than the domestic private sector to GDP, but their share has been gradually declining from 40.5% in 1997 to 38.3% in 2002 (Nguyen et al. 2004). Government policy aims to restructure SOEs, by "equitisation" (a synonym for privatisation), reduction of subsidies, and restructuring of non-performing loans. Historically, private businesses were subject to substantial discretionary interference by governmental authorities. In 1999, policy changed towards supporting entrepreneurship and the development of private enterprises, but their growth continues to be inhibited by an institutional framework favouring SOEs (Tenev et al. 2003).

The legal framework for FDI has evolved throughout the 1990's. The first FDI law was passed in 1987, followed by major changes in 1990, 1992, 1996 and 2000. Initially only some sectors were open to FDI, but such restrictions and limits on the maximum foreign ownership stake have been gradually removed. Changes in other laws and regulations have been equally important to investors, including establishment of procedures for granting investment licenses, and regulation concerning land lease, recruitment, salaries, and taxation (van Arkadie and Mallon 2003, Nguyen et al. 2004). Consequently, FDI capital inflows peaked at over US$ 2 billion in 1995, and stabilized at around US$ 1.5 billion annually in the late 1990's.

The reforms decentralized some policy responsibilities, which led to varying degrees of change within the country. The foreign investment law of 1996 authorized provinces to grant investment licenses for some FDI projects. For larger FDI projects, provinces are responsible for supporting foreign investors in the preparation of applications at central level. Moreover, many regulatory functions, such as those concerning land lease, import and export licenses, and employment, have been delegated. Provincial authorities vary in how they use their newly gained responsibilities and develop innovative ways of dealing with foreign investors (Nguyen et al. 2004).

Moreover, the ambiguity of many laws and regulations issued at the central level gives local authorities an important role in their interpretation and implementation. Tenev et al. (2003) report that the time that senior management spends dealing with regulations and government authorities - an important indicator of the burden of informality - significantly varies across nine cities in Vietnam. We conducted interviews in Dong Nai province, known to be investor-friendly, and found that investors attribute the attraction of FDI to informal aspects of the institutional framework, among other factors (Meyer and Nguyen 2004).

Discrepancies between official policy and local implementation may appear paradoxical, but they are a natural outcome of the interaction between informal and formal institutions within the public sector. For foreign investors, such variation and decentralization offers both opportunities and risks. On the one hand, an investor-friendly local authority may facilitate administrative processes and create investment incentives. On the other hand, local authorities may not have the administrative capabilities to implement the delegated

tasks, or individuals may seek to use their power to obtain personal benefits, which could increase corruption. Hence, local institutions moderate both the importance of business networks and the ease of access to complementary resources.

Foreign investors clearly interact with complex local institutional settings. In particular, they have to find ways to access resources that they usually acquire through markets, possibly by partnering with local firms. In the next section, we explore how this may affect their entry strategies.

## 3. Hypothesis Development

Theoretical work on institutions suggests important influences on corporate strategies exist, but they are not fully explained. The institutional development affects many aspects of foreign investors' entry strategies. To keep the discussion manageable, we focus on two aspects only: in-country location and entry mode. To apply institutional theory, we combine institutional arguments with mainstream literature on entry strategies. We briefly review the pertinent literature on FDI location and entry modes before presenting our hypotheses.

Institutional theory is still a relative newcomer in international business research, and scholars are exploring how to express theoretical statements and hypotheses. The general principles of this new theory can be expressed in general propositions. However, the testing of these general principles has to find proxies that are suitable in the given specific context. We first provide two general propositions, from which we derive hypothesis that are testable in the specific context of Vietnam.

### 3.1. Institutions and Location Strategy

Institutions constitute a key part of locational advantages, which in turn are one of the three pillars of the OLI paradigm (Dunning 1993). This paradigm states that firms would undertake FDI if they can combine ownership advantages (O) and locational advantages (L), while internalisation incentives (I) favour an internal mode over a contractual mode of entry. However, recent research has focused on the O aspects as drivers of international business and I incentives for explaining organizational modes. Therefore, Dunning (1998) called location the "neglected factor of the OLI paradigm". When studying the location decisions of

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FDI, the international business literature has almost exclusively focused on countries as the unit of analysis, while largely ignoring location <u>within</u> countries.

The economic geography literature analyses intra-country location of FDI empirically. The first theoretical foundation of this literature is the economic agglomeration effect popularised by Krugman (1991). This literature stipulates that firms benefit from locating in the vicinity of other firms in the same industry. Such agglomeration effects affect FDI in several ways: (1) FDI locates where other firms in the same industry exist. (2) New FDI locates near existing FDI firms. (3) New FDI locates near existing FDI firms from the same country of origin. Empirical support exists for all three propositions for both the US and China (Wei et al. 1999, Cheng and Kwan 2000, Head and Ries 1996, He 2003).

The second theoretical foundation is to be found in traditional location advantages, including factor endowments, market attraction, labour costs and physical infrastructure. Efficiency or resource-seeking investors would consider the costs and quality of those local resources that they require for their operations, including natural assets and 'created assets', such as infrastructure and human capital (Narula and Dunning 2000). These factor costs have to be balanced with the cost of bringing goods to market, which depends on moderating variables like the distance to markets and physical infrastructure. These economic variables are frequently found to attract FDI, both in studies of the USA (Coughlin et al. 1991, Head et al. 1995) and of China (Head and Ries 1996, Wei et al. 1999, Cheng and Kwan 2000).

The third theoretical foundation is policy at the sub-national level, with a focus on formal institutions, such as taxation policy in the USA and special economic zones in China. In the USA, several studies find that higher local taxes deter FDI (Coughlin et al., 1991; Hines, 1996). For instance, Head et al. (1999) include several proxies for the individual state's tax policy, a dummy for the existence of a free trade zone, and for the existence of a promotional office in Japan. They find that both tax policy and free trade zones attract FDI, whereas the effect of promotional offices is insignificant.[3]

Studies on China introduce the incidence of special economic zones as a policy variable. Most studies use dummy variables for the existence of a special economic zone (Head and Ries 1996, He 2003) or

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[3] In Vietnam, tax rates are set at national level, such that this issue is not applicable to the context of this study.

for costal provinces (Wei et al. 1999), which are found to attract FDI. Cheng and Kwan (2000) use a count of zones in the cities. Zhou et al. (2002) find effects to vary between different types of zones, which diminish over time. To our knowledge, apart from economic zone dummies or counts, institutional variables have not been analysed in studies of location <u>within</u> an emerging economy.

This discussion suggests that institutions at sub-national level – in addition to national institutions – influence business strategies. Businesses locate where institutions are most conducive to their type of business operation and, in particular, where institutional barriers least inhibit the access to local resources. Hence, we expect an empirically verifiable relationship between local institutions and the number of FDI projects received.

*Proposition 1: The more developed market-supporting institutions in a region are, the more likely foreign investors are to invest in that sub-national region.*

To test this proposition in Vietnam, we develop two testable hypotheses, 1a and 1b, and use provinces as the unit of analysis. Under the decentralized administration in Vietnam, provincial institutions vary in the extent to which they facilitate access to local resources. Where provincial authorities help to overcome resource constraints by increasing supply or by liberalizing markets within their authority, foreign investors would find it easier to establish their operations. Moreover, key measures to facilitate resource access may serve as a signal that the province is committed to providing an investor-friendly informal institutional environment.

The most visible local initiative to foster development of the market economy is the establishment of industrial zones. In Vietnam, industrial zones have been established since 1994 and offer lower profit tax, especially if at least 80% of output is exported. Similar zones in China, with even more distinct economic regulation, have attracted major FDI during the early stages of economic openness, but attracted proportionally less FDI from the mid 1990's onwards (Zhou et al. 2002). Beyond the formal existence of industrial zones, however, provincial authorities can signal their commitment to create an investor-friendly business climate by

providing real estate for industrial zones, which may in turn be offered to foreign investors. Since 1997, the administration of land-use rights has been delegated to provincial authorities. Some authorities help foreign investors obtain land-use rights directly, which leads to a regional variation (van Arkadie and Mallon 2003, Nguyen et al. 2004).

We propose that efficiency of institutions supporting markets for critical resources encourages inward FDI at the sub-national level. We test this hypothesis for provinces in Vietnam, and using real estate in industrial zones as a proxy for scarce resources.

*H1a: The more sub-national institutions facilitate access to scarce local resources, the more FDI the sub-national region receives.*

Our framework (Figure 1) illustrates how the incumbent local industry coevolves with the formal and informal institutional framework. For instance, incumbent local firms may lobby governments to protect their interests and, thus, create administrative barriers to entry. Good relationships with governments and lobbying have been found to be important for business both in mature market economies like the USA (Schuler et al. 2002, Crystal 2003) and in emerging markets like China (Schlevogt 2002).

These informal relations with authorities tend to benefit incumbents over new entrants. More specifically, a strong local lobby of incumbent businesses or interest groups sceptical towards the concept of an open market economy is likely to inhibit inward FDI. Incumbents may influence informal institutions to protect their market share. In transition economies, such lobbies are often related to state-owned firms (SOEs) that can draw upon long-standing personal networks with authorities (Suhomlinova 1999). As incumbents, the SOEs control local resources, including business networks, distribution channels and labour markets. We expect that these SOEs use their power to influence provincial institutions, especially informal ones, to favour their interests over those of foreign investors, which in turn creates a business environment that is perceived as less favourable by foreign investors.

*H1b:  The more state-owned enterprises dominate a sub-national region, the less FDI the region attracts.*


### 3.2. Institutions and Mode Choice

Institutions not only influence foreign investors' preferred location but also the entry mode they may choose at a given location (Gomes-Casseres 1990, Meyer 2001). Entry mode literature has drawn, in particular, on transaction cost economics as its theoretical foundation. However, empirical studies have focused on firm-specific variables that drive transaction costs, rather than context-specific variation, which is of particular concern in emerging economies.

Markets are subject to market failure to different degrees, which affects multinational firms' preference for internalizing these markets (Buckley and Casson 1976, Hennart 1988, 1991, Anderson and Gatignon 1986). Multinational firms often consider JVs as the second-best mode of entry because JVs provide only a limited degree of control over the local operation and reduce the investor's flexibility to change the arrangement. Hence, JVs are only used if specific conditions apply: (1) the project depends on contributions from two or more partners; (2) the markets for the contributions from the parents are subject to market failure, i.e. transaction costs are high; (3) it is not feasible to internalise the whole operation with one partner taking over the other(s) (Buckley and Casson 1976, 1998, Hennart 1988). The first two are conditions for foreign investors to seek collaboration with a local partner rather than establish a Greenfield operation. The third condition distinguishes acquisition from JV entry.

Location factors influence entry modes, in that investors are willing to make larger commitments to countries with higher market potential. This has been shown, for instance, by Agarwal and Ramaswani (1992), who incorporate market size and growth with institutional factors, such as 'government attitude', into a single construct 'market potential'. In this study, we separate this influence. The local institutional framework shapes transaction costs (North 1990), and thus influences entry mode choice (Meyer 2001). It also establishes which options are legally permitted in a given context and has some bearing on the contributions that foreign investors may require from local partners.

In emerging economies, the institutional environment creates particular constraints on entry mode choice. In Vietnam, acquisitions have been permitted only since the late 1990's, and so far have occurred mainly by one foreign investor taking over the business of another foreign investor. Therefore, this analysis has to focus on the trade-offs between the available options: Greenfield and joint venture (JV). One key difference between JV and Greenfield is the origin of the resources employed in the new operation. Hence, entry mode choice is a decision over the origins of the resources that shall be employed in the new venture, as is also the case in acquisition versus Greenfield decisions (Hennart and Park 1993, Meyer and Estrin 2001, Anand and Delios 2002). A Greenfield uses the resources of the investor and combines them with local assets, giving the investor more discretion over the organization of the new venture, but generally permitting only a gradual establishment. A JV provides access to selected resources contributed by the local partner. At the same time, control over the operation has to be shared with the local partner firm.

In the institutional context of many emerging markets, crucial resources include access to local authorities and business networks because competition is often distorted by licensing regimes, industrial regulation and tariff structures that implicitly favour local firms (Khanna and Palepu 2000). In an economy with a primarily network-based exchange, networking capabilities may be a crucial asset for business (Peng and Heath 1996). Since local firms possess such networking capabilities, they become interesting partners for foreign investors (Kock and Guillén 2001).

As argued above, these institutions may also vary within one country. Foreign investors find some regions easier to access than others in terms of business licenses, information on local regulation, and equal treatment when bidding for public procurement contracts. Local institutions may facilitate access to such resources, or – in the case of business networks – make them unnecessary for the conduct of business. Where the local institutional framework is less market-oriented, foreign investors are more prone to use JV partners to access local resources. Hence, we predict that sub-national institutions influence foreign investors' entry modes.

*Proposition 2:   The more developed market-supporting institutions in a region are, the more likely foreign*

*investors are to establish Greenfield operations in that sub-national region.*

To test this proposition in Vietnam, we propose three specific hypotheses, of which the first two match the hypotheses developed for proposition 1. Institutional barriers inhibiting access to local resources may inhibit foreign investment (hypothesis 1a), but they may also induce foreign investors to overcome these barriers through a JV with a local partner. A partnership with a local firm may enable foreign investors to access the resources of the partner, and thus overcome market imperfections. Where local institutions facilitate access to local resources, foreign investors would be less likely to invest in form of JV. Scarce local resources often relate to intangibles, such as marketing and technology-related assets, or to business networks. However, in emerging markets, scarce resources may also relate to tangible resources, such as real estate.

In the Vietnamese context, access to real estate is a key constraint, as illustrated by the above statement by the Prime Minister. Foreign investors may thus avoid investing where real estate is in short supply, but they may also form a JV with a local firm controlling real estate. In consequence, land-use-rights have been a key contribution of local JV partners in Vietnam (Nguyen et al. 2004). Provincial governments providing real estate for the use of foreign investors make it unnecessary to seek JV partners as means to access land-use rights.

We hypothesize that efficiency of institutions in supporting markets for critical resources encourages FDI in the form of Greenfield. As was the case with H1a, we test this hypothesis for provinces in Vietnam using real estate as a proxy for resources subject to institutionally-induced supply constraints.

*H2a:     The more sub-national institutions facilitate access to scarce local resources, the more FDI the sub-*

*national region receives in the form of Greenfield.*

In developing our framework (Figure 1), we argued that incumbent firms influence the investment climate both directly by controlling resources, and indirectly by influencing the evolution of formal and informal institutions at the local level. Incumbent firms are a powerful lobby influencing the local institutional

framework, which thus may favour foreign investors that collaborate with an incumbent firm. This bias of the institutional framework in favour of incumbents may induce foreign entrants not to invest (hypothesis 1b) or to form a JV with an incumbent. A JV also helps foreign entrants to establish legitimacy within the local business environment (Peng 2003).

In transition economies, SOEs are still important players and newcomers may find a partnership an important means to attain legitimacy (Peng and Heath 1996, Hoskisson et al. 2000, Lyles et al. 2004). Moreover, where SOEs dominate the economy, they also control access to crucial local assets and old-style business networks. SOEs in transition economies often pursue network-based growth strategies (Peng and Heath 1996) and may thus see a JV with a foreign partner as an opportunity to strengthen their market position (Fahy et al. 2000, Hitt et al. 2000). Thus, where SOEs are strong, foreign investors may find it more difficult to prosper on their own. They may, therefore, seek partnership with local firms. Institutional analysis thus suggests that strong incumbents would induce foreign investors to seek JV as mode of entry based on three complementary effects: the local firms' control over resources, the newcomer's need to gain legitimacy, and the lobbying power of incumbents.

H2b:    *The more state-owned enterprises dominate a sub-national region, the less FDI is in the form of Greenfield.*

Institutions affect different types of foreign investors in different ways. For this reason, a hypothesis stipulating which investors may be more exposed to institutional pressures to access local resources via a JV is included. Investors pursuing objectives that may conflict with the objectives of local firms are more likely to face pressures for legitimacy, need for local resources, and adverse lobbying. This includes, in particular, investors aiming to dominate local markets. On the other hand, industrial policy may aim to influence the type of FDI (Lall 1996) for such reasons as to increase spillovers from export-oriented ventures. In return for commitment to export, investors attain easier access to local resources, business licenses and, in the Vietnamese context, land-use rights. Consequently, export-oriented investors are less concerned with linking

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into local networks and accessing resources that many market-seeking investors obtain via their local partners. Local firms and politicians would have fewer motives to favour informal institutions that inhibit Greenfield investment. In these cases, we expect export-oriented FDI to be more frequently in the form of Greenfield operations as a result of the institutional set-up.

*H2c:     Local-market-oriented FDI projects are less likely to be in the form of Greenfield.*

## 4.  Data and Methodology of Analysis

### 4.1. Location Choice

We analyse the impact of institutions on entry strategies in two separate empirical tests. To test hypotheses 1a/1b concerning the location aspects of entry strategy, we employ a negative binomial regression model of the determinants of FDI across the 61 provinces of Vietnam. The dependent variables are alternatively the cumulative number of FDI projects registered up to the year 2000, and the number of new FDI projects in 2000. For such count variables, a Poisson or negative binomial regression may be the appropriate empirical method. In the present case, we have on overdispersion in the Poisson regression, which causes an inadequate fit.[4] The interpretation of the results is the same as in the Poisson regression.

The institutional variables hypothesized to influence FDI are operationalized as follows. The accessibility of scarce resources is proxied with real estate made available in industrial zones. Private ownership of land by foreigners was, until recently, not permitted by law, such that access to land has often acted as a constraint to business establishment and expansion, and has frequently been reported as an obstacle to FDI in Vietnam (van Arkadie and Mallon 2003; Nguyen et al. 2004). We measure available real estate by the sum of square meters of industrial zones within a province as reported in a 1999 list of industrial parks (*IP real estate*). The influence of incumbent SOEs is proxied by the share of their output in the total output of

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[4] We conducted a likelihood ratio test of overdispersion, as recommended by Cameron and Trivedi (1998), which was highly significant (LR = 440). Therefore, we had to reject the restrictive assumptions underlying the Poisson model. The authors thank Andrew Delios for his advice on this test.

domestically-owned firms in the province (*state-ownership*). In addition to the institutional variables, we include control variables for provincial market size (*population*) and market growth (*GDP growth*), as well as for human capital development (*education*) and infrastructure (*transport*). These data have been obtained from the Statistical Handbook 2000, with precise definitions given in the appendix. Table 1 presents the descriptive statistics and correlations for variables used in this analysis. Wage level is correlated with other control variables and thus only included in one equation. When using the flow variable of new projects in 2000 as dependent variable, we introduce the stock of FDI in 1999 as additional control variable (*FDI$_{t-1}$*).

*** Table 1 approximately here ***

**4.2. Entry Mode Choice**

The empirical analysis of entry mode is employing data from a survey of FDI in Vietnam conducted in winter 2001/2002 as part of comparative study in four emerging markets (Estrin and Meyer 2004). Data from the survey are complemented with province-level variables that correspond to those used in the first analysis.

The base population of the survey has 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 Ministry of Planning and Investment's database (MPI, the government body in charge of FDI registration), but we excluded contractual co-operations, such as those in the oil and gas industry. This yielded a population of 2454 FDI establishments. We use random sampling to construct a list of 900 firms, of which 731 actually had useable contact information and were individually contacted for an interview.

A great amount of effort was used on getting high returns from all major business centres, and across all groups of foreign investors. The questionnaire was translated to Vietnamese, and back translated to English, as is common 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. Moreover, it was necessary to contact most firms in person through face-to-face meetings or by telephone. This process led to 171 completed questionnaires, which represents 23.4% of the

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firms contacted. Respondents are CEOs (33%), directors or members of the management board (40%) or other senior managers in the affiliate. On average, respondents have been with the affiliate for 4.3 years.

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 within Vietnam, entry mode (categories used by MPI) and registering authority in Vietnam. Table 2 compares the sample and the population for the countries of origin, illustrating the good fit between sample and base population. The table also shows that FDI in Vietnam is largely an intra-Asian phenomenon, with European and American investors being relatively less important.[5]

Of the 171 questionnaires, 2 had to be excluded because the firms did not meet the minimum employment criterion,[6] and 3 were excluded from the analysis for this paper because they were acquisitions. Moreover, 14 observations were lost in the regression analysis due to missing values, such that 152 were used in the regression analysis.


*** Tables 2 and 3 approximately here ***


We analyse the second hypothesis with a Logit regression model using the survey data complemented with province level data. The dependent variable is a binary variable taking the value 1 for Greenfield entry and 0 for a JV entry.

As independent variables we include the same province level variables as in the location analysis. However, due to the high correlation of some variables within this dataset, we can only include subsets at any time. A project-specific variable is included to test hypothesis 2c on firms' likely sensitivity to

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[5] The study design is similar to cross-national studies where construct and measurement equivalence would be a major concern (Mullen 1995, Singh 1995, Styles 1998). In this study, however, equivalence is, in our view, not of substantive concern because the questionnaire items used in this paper do not involve subjective Likert-scale type measures. In fact, the province level variables are taken from archival sources. Moreover, cultural differences within a single country are less likely to lead to substantial variation in the interpretation, function or measurement of concepts. We have tested for respondent bias between expatriates and local executives, and found differences to be insignificant for the variables used in this study.
[6] i.e. the archival information on these firms was incomplete or incorrect.

institutions. *Market orientation* is measured as percentage of sales in the domestic market in the first year of operations, as reported in the survey.

Firm level control variables are two dummy variables measuring whether the investing firm had prior investment experience in Vietnam (*newcomer*) and whether it pursues a focused single business strategy (*parent strategy*). National cultural distance between countries has been analysed in several studies of multinational enterprises (Kogut and Singh 1988, Brouthers & Brouthers 2001, Xu and Shankar 2002). Since we are analysing FDI into a single host country, these <u>national</u> culture effects would affect FDI projects in the sample only through the variation of source countries. We include *psychic distance* as a control variable, proxied by the commonly used Kogut-Singh (1988) index. We also control for the *trend* over time, measured by the year of legal establishment.

Moreover, we control for the *FDI stock* from the source country as a measure of international business experience shared in the business community of the source country. We also include *industry growth* (at 3-level ISIC) and a set of six industry dummies. The correlations for this dataset are reported in Table 3.

## 5. Empirical Analysis

The empirical analysis proceeds in two stages. First, we analyse determinants of location, incorporating variables identified in studies on the national level but analysing them on a sub-national level. Second, in section 5.2, we analyse the choice between JV and Greenfield, incorporating institutional variables in a Logit model of mode choice.

### 5.1. Location Choice

Table 4 shows the results of negative binomial regressions of province level FDI against a vector of province-level variables expected to influence location choice. Equations 1 to 3 estimate the determinants of cumulative FDI, whereas equation 4 estimates the determinants of FDI in the latest year. The results show that the overall explanatory power of the models is high, with large chi-square statistics for relatively parsimonious models. Most variables are highly significant in equations 1 to 3. However, when regressing on

new FDI projects (equation 4), the existing stock of FDI emerges as the most important determinant, which suggests strong agglomeration effects when new FDI locates near existing foreign-owned businesses.

Hypothesis **1a**, which points to the availability of real estate as increasing FDI, receives strong support, as the coefficients on *IP real estate* are positive and highly significant in all equations. We also use other measures of industrial zones, such as the number of zones, reported investment in the zones and a dummy for the existence of zones in the province. They were significant in this equation as well, but the *IP real estate* variable had the highest explanatory power. In equation 3, we add a dummy variable for the incidence of industrial parks. This hardly affects the impact of the real estate variable, while the *IP dummy* variable remains significant. Therefore, the IP real estate variable captures an influence that is, at best, partially captured by earlier studies using only dummy variables (Head and Ries 1996, Wei et al. 1999, Zhou et al. 2002).

In equation 4, we estimate FDI flow while controlling for FDI stock ($FDI_{t-1}$). Naturally this equation is driven by the agglomeration effect proxied by the stock variable to a large degree. However, the only variable remaining significant is *IP real estate*. Hence, our results on this variable are quite robust and improve over earlier studies using dummy variables. We infer that foreign investors are not only interested in the existence of an industrial zone, but in the commitment of provincial authorities to creating an investor friendly environment and, in particular, access to scare resources.

On the other hand, SOEs do *not* significantly inhibit the inflow of FDI at the local level. The coefficient is negative as predicted in hypothesis **1b**, but never significant. Lobbying and the economic bargaining power of SOEs at the provincial level do not have a significant deterrent effect on foreign investors. The incumbents may not perceive foreign entrants as a threat to their market share or they protect their interests in different ways.

The control variables *population, transport* infrastructure, *education* and *GDP growth* are highly significant, in line with studies on China (Wei et al. 1999, Cheng and Kwan 2000, Head and Ries 1996). [7] In contrast, the wage level is not significant (equation 2), such that we excluded this variable elsewhere in view

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[7] In the only earlier study on FDI location in Vietnam, Andréosso-O'Callaghan and Joyce (2000) find that GDP per capita and education attract FDI, while transport infrastructure and a dummy for special economic zones have a negative and not significant effect.

of its multicollinearity with other control variables. The effect of the control variables is diminished if we estimate new FDI, while controlling for FDI stock (equation 4).

Overall, we interpret the regressions results as support for proposition **1**, i.e. foreign investors prefer to locate where provincial institutions support market transactions. However, this effect does not apply to state-ownership of firms in the ways that we had predicted.

*** Tables 4 (Location Choice) and 5 (Mode Choice) approximately here

### 5.2. Empirical analysis: Entry Mode Choice

Table 5 reports the results of the entry mode analysis. Overall, the Logit regression analysis generates statistically significant equations, with high chi-square statistics and high proportions of correctly classified observations. Hypothesis **2a** on the impact of availability of scarce resources receives strong support, as the *IP real estate* in the province is significant at a minimum 10% level in all equations. Hence, investors locating in provinces that offer industrial real estate that foreign investors may acquire are more likely to choose Greenfield investment.

On the other hand, provinces with strong presence of firms under *state-ownership* are more likely to receive JV investment, as predicted in hypothesis **2b**. In the fourth equation, we test whether this significance may be caused by the correlation of state-ownership with provincial *GDP growth*. Replacing the *state-ownership* variable with the *GDP growth* variable, however, leads to a substantial loss in the $O^2$ and Nagelkerke $R^2$ statistics, although the effect of GDP growth is not significant. This effect arises directly from the role of state-owned firms, and not indirectly via GDP growth. Investors in areas where incumbents control access to crucial resources or lobby local governments find it preferable to work with local firms in establishing their FDI operation. Hence, our province-level institutional variables support our proposition that institutions at this level influence entry mode strategies.

Hypothesis **2c** suggested that domestic market-oriented investors face more institutional pressure to engage a local JV partner. This too is confirmed with very high levels of significance of the coefficient on

*market-orientation*. Hence, our project-specific variable confirms our hypothesis that some types of projects are exposed to institutional pressures to establish joint ventures more than others.

Among other province-level variables, *transportation* infrastructure has, maybe unexpectedly, a negative effect, i.e. in areas with higher transport density foreign investors prefer JVs. This might be due to the fact that existing transport infrastructure has been built to serve existing businesses rather than new ones. In these areas, existing firms have better access to infrastructure, which is one reason to cooperate with them. Other province level variables have been included only one at a time because of the high correlation between them. However, none of them is significant, providing evidence that institutional influences dominate over conventional location variables.

The firm and the source country control variables are mostly signed as we would expect, but they are only marginally significant. The investor's home country's *FDI stock* abroad is significant in three equations, suggesting that firms from countries with extensive international business experience prefer Greenfield entry. The time trend is positive, as expected, as liberalization gradually facilitates Greenfield entry. Cultural distance and the parent strategy dummy are not significant, and the same applies to most industry dummies. Maybe surprisingly, foreign investors with prior operations in Vietnam seem more likely to choose JV entry. This may reflect the challenges of partner selection in an environment with few institutional arrangements to provide information on local firms, and support contract negotiations and enforcement. Entrants may first establish a small operation to learn about the local environment before committing to an equity relationship with a local firm.

Overall, these results show support for our three sub-hypotheses, and in consequence for our overall proposition **2** that institutions and institutional change at both provincial and national level affect foreign investor's entry mode choice.


## 6. Discussion and Future Research

This study raises several issues for the advancement of institutional theory as the theoretical framework sets out a broader research agenda than what we have been able to test in the empirical part.

First, we hypothesised that aspects of institutions influence strategies of inward investors. Incumbent state-owned enterprises appear to influence the institutional framework so as to encourage foreign investors to partner with them, yet they do not have a significant deterrent effect on FDI. Weak SOEs may see JVs as a means to enhance their competitiveness. Rather than perceiving FDI as threat to their market position, as Russian SOEs appear to do (Suhomlinova 1999), SOEs in Vietnam may see partnering with FDI as an opportunity to enhance their competitiveness, similar to observations by Fahy et al. (2000) in Hungary. Following the logic of our theoretical framework (Figure 1), we believe that this is due to a direct effect of SOEs' control over scarce resources, and an indirect effect of SOEs influencing local informal institutions. In addition, partnering with a local firm enhances the legitimacy of foreign investors with local constituents.

Moreover, foreign investors are more likely to locate where institutions facilitate access to scarce resources. Provinces with industrial zones attract more FDI. Beyond the establishment of zones, the available real estate in such zones attracts FDI and Greenfield investment in particular. This effect persists even when controlling for past FDI (Table 4, equation 4). Provincial authorities providing land to industrial zones not only create real estate markets, but they also signal commitment to creating a favourable investment climate.

This trilateral interaction between incumbents, institutions and (foreign) entrants extends upon work by Peng (2000), and by Lewin and Kim (2004). We argue that informal institutions play an important role in explaining this interdependence and, in part, explain the significant effects of the IP real estate and SOE variables. Unfortunately, our proxies do not allow a clear separation of the formal and informal aspects of the institutional framework. Future studies may develop better measures of informal institutions at multiple levels of society, which may require survey-based direct measures of informal institutions that are hard to proxy indirectly. However, this also raises important issues for further theoretical work. In particular, in which ways do incumbents influence informal institutions, as suggested by the co-evolution aspect of the model (also see Lewin and Kim 2004), and how do entrants such as foreign investors react to informal institutions favouring incumbents?

Second, the results support our argument that institutions influence the pattern of FDI not only at national but also at local level. Institutional variation within a country may be important for location

decisions. Future research ought to provide a deeper analysis of how economic policy influences sub-national institutions and, thus, FDI in terms of both volume and modes of investment. Foreign investors may be particular concerned about the implications of partially implemented reform policies, and regional policy for institutional development and investment risk. Interviews that we conducted in Vietnam suggest that formal legal changes initiated at the centre vary in their impact across provinces because informal institutions affect the implementation at local level (Meyer and Nguyen 2004, Nguyen and Meyer 2004). This study pointed, for instance, to industrial zones as a phenomenon that has yet to be addressed by business scholars (beyond using control dummies), perhaps by analysing cases of particularly successful zones. Moreover, it would be interesting to ascertain the relative importance of national and sub-national institutions in influencing foreign entry strategies.

Third, institutions establish the range of permissible strategies, including industries open to FDI, investment locations, and entry modes. In Vietnam, the FDI-law did not permit acquisitions for foreign investors, except in special cases such as acquisitions from other foreign owners. Entry mode choice has been only a choice between 100% foreign-owned Greenfield operations and JVs. Future research should determine the permissible range of modes before testing theoretical predictions on variables expected to shift investors' preference between different modes.

Fourth, investors' exposure to local institutions varies with the investment objectives, which in turn affects their need for a local partner, and thus their entry mode. We found that early entrants and local market-oriented businesses, which are more likely to encounter conflicts with local incumbents, are more likely to enter by JV. It would be interesting for future research to deepen this analysis of the interaction effects between project characteristics, local institutions, and investors' entry strategies. Moreover, certain institutional conditions may inhibit some investors, but induce others to overcome institutional barriers by establishing a JV. More broadly, this points to the need for an integrated analysis of entry incorporating multiple dimensions of entry strategies into one empirical analysis, which our data unfortunately did not permit us to conduct. In addition to sub-national location and entry mode, such studies may incorporate timing or marketing in their conceptualisation of entry strategy.

Last but not least, every single country study raises the issue of generalization. Case research (Peng 2000b, Luo 2001a) and interviews that we conducted with expatriate managers in China point to the policies and attitudes of the local government as an important factor influencing FDI decisions. Hence we believe that this issue is highly relevant in China, as well as other countries where both central and local authorities crucially influence institutions of concern to foreign investors, such as India (Oman 2000) and Russia (Meyer and Pind 1999). Hence, we propose to test the propositions presented in this paper in other contexts.

## 7. Conclusion

The institutional perspective is a new line of theorizing in strategic management research (Oliver 1997) that holds particular potential for explaining strategies in emerging economies (Hoskisson et al. 2000, Meyer 2001, Peng 2003). Many theoretical and empirical studies suggest that institutions crucially influence FDI. However, this research has focused primarily on formal rather then informal institutions, and on national rather then sub-national institutions. In this study we have advanced the institutional theory of strategy by shedding more light on *how* institutions affect foreign investors' entry strategy. We propose a theoretical framework highlighting interaction between organizations and institutions at a sub-national level, and their impact on FDI. On this basis, we have presented empirical tests on some aspects of the framework, subject to data constraints.

The institutional perspective suggests that one cannot understand business strategies if one does not understand the context. This basic insights becomes particular pertinent when the context varies from the context that the researcher and/or the reader are used to. We thus reserved some space in our paper for the discussion of the context and refer to qualitative work that illustrates the working of some the institutions affecting business in Vietnam (Tenev et al. 2003, Meyer and Nguyen 2004). Future research on emerging economies may greatly benefit from a more fine-grained understanding of how institutions affect corporate strategies.

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**Tables**

### Table 1: Correlations in the Province Dataset

|  | Mean | SD | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 Cumulative FDI | 51.28 | 150.09 | 1 | | | | | | | | | |
| 2 New FDI | 5.95 | 21.00 | .89 | 1 | | | | | | | | |
| 3 FDI t-1 | 45.33 | 131.77 | .997 | .85 | 1 | | | | | | | |
| 4 Population | 1,255.7 | 793.1 | .63 | .45 | .65 | 1 | | | | | | |
| 5 Transport | 0.23 | 0.19 | .22 | .17 | .23 | .08 | 1 | | | | | |
| 6 Education | 0.24 | 0.48 | .51 | .31 | .53 | .37 | .08 | 1 | | | | |
| 7 State-own | 0.53 | 0.21 | .14 | -.01 | .16 | .12 | .07 | .30 | 1 | | | |
| 8 GDP growth | 75.03 | 93.76 | .03 | .09 | .02 | -.13 | -.17 | -.00 | -.03 | 1 | | |
| 9 Wage level | 505.52 | 92.60 | .66 | .53 | .67 | .52 | .39 | .19 | .15 | -.09 | 1 | |
| 10 IP real estate | 208.34 | 536.70 | .75 | .71 | .74 | .36 | .36 | .30 | .17 | .08 | .59 | 1 |
| 11 IP dummy | 0.25 | 0.43 | .49 | .43 | .49 | .23 | .40 | .34 | .31 | .03 | .42 | .69 |

### Table 2: Survey Population and Sample

| Home country | Population | | Sample | |
|---|---|---|---|---|
| | Obs | Proportion | Obs | Proportion |
| Europe | 314 | 12.8% | 23 | 13.5% |
| North America | 141 | 5.7% | 7 | 4.1% |
| ASEAN | 375 | 15.3% | 25 | 14.6% |
| Hong Kong | 169 | 6.9% | 10 | 5.8% |
| Japan | 310 | 12.6% | 27 | 15.8% |
| Korea | 255 | 10.4% | 26 | 15.2% |
| Taiwan | 626 | 25.5% | 44 | 25.7% |
| Other | 264 | 10.7% | 9 | 5.3% |
| Total | 2454 | 100.0% | 171 | 100.0% |

*Sources:* Population: MPI database, Sample: Enterprise Survey (Estrin and Meyer 2004).
*Note:* Home countries in the MPI database are the immediate home country, whereas the sample data refer to the ultimate home country.

### Table 3: Correlations in the Survey Dataset

|  | Mean | SD | - | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| - Greenfield | 0.57 | 0.50 | 1 | | | | | | | | | | | | |
| 1 State-ownership | 0.63 | 0.22 | -.27 | 1 | | | | | | | | | | | |
| 2 IP real estate | 1602 | 720 | .21 | .04 | 1 | | | | | | | | | | |
| 3 Education | 94.5 | 100.9 | -.11 | .39 | -,22 | 1 | | | | | | | | | |
| 4 GDP Growth | 76.4 | 44.5 | .18 | -.54 | .21 | -.43 | 1 | | | | | | | | |
| 5 Transport | 0.36 | 0.18 | -.04 | -.17 | .29 | -.13 | -.23 | 1 | | | | | | | |
| 6 Population | 3,040.2 | 1,795.9 | .04 | .28 | .41 | .30 | -.67 | .40 | 1 | | | | | | |
| 7 Year | 1995.9 | 2.7 | .33 | -.29 | .07 | -.11 | .27 | -.08 | -.12 | 1 | | | | | |
| 8 Market orientation | 49.8 | 47.1 | -.37 | .09 | -.04 | .15 | .02 | -.07 | -.09 | -.13 | 1 | | | | |
| 9 Psychic distance | 1.72 | 1.27 | -.07 | .10 | -.18 | .14 | -.16 | -.06 | .05 | -.03 | .05 | 1 | | | |
| 10 FDI stock | 221.5 | 298.2 | -.09 | .09 | -.14 | .16 | -.16 | .06 | .04 | -.17 | .23 | .58 | 1 | | |
| 11 Parent Strategy | 0.43 | 0.50 | .27 | -.12 | .09 | -.15 | .21 | -.12 | -.08 | .30 | -.20 | -.09 | -.08 | 1 | |
| 12 Newcomer | 1.18 | 0.39 | -.17 | -.02 | -.14 | -.08 | -.03 | -.02 | -.01 | .00 | .07 | -.08 | -.01 | -.14 | 1 |
| 13 Industry growth | 112.7 | 7.0 | .34 | -.14 | .12 | -.07 | .11 | .01 | .04 | .09 | -.25 | -.02 | .04 | .08 | -.08 |

*Level of significance (two-tailed):* 5% for correlations larger than 0.16; 1% for correlations larger than 0.21; n = 152.

## Table 4: Determinants of FDI Location

*Province-level data; Negative Binomial Regression Model*

| | Cumulative FDI | | Cumulative FDI | | Cumulative FDI | | New FDI | |
|---|---|---|---|---|---|---|---|---|
| Model | 1 | | 2 | | 3 | | 4 | |
| IP real estate | 0.001 | (0.000) **** | 0.001 | (0.000)**** | 0.001 | (0.000)**** | 0.001 | (0.000)* |
| IP dummy | | --- | | --- | 0.848 | (0.359 )** | | --- |
| State-ownership | -0.247 | (0.490) | -0.279 | (0.497) | -0.790 | (0.519) | -0.264 | (0.877) |
| Population | 0.4 | (0.2 )** | 0.3 | (0.2 )* | 0.4 | (0.2)** | -0.0 | (0.3) |
| Transport | 2.680 | (0.737)**** | 2.558 | (0.820)**** | 1.996 | (0.724) *** | 0.90 | (1.182) |
| Education | 0.717 | (0.256)*** | 0.728 | (0.257)**** | 0.669 | (0.244 )*** | 0.300 | (0.456) |
| GDP growth | 0.003 | (0.001)** | 0.003 | (0.001)** | 0.003 | (0.001)** | 0.004 | (0.002)* |
| Wage level | | --- | 0.001 | (0.002 ) | | --- | | --- |
| FDI in t-1 | | --- | | --- | | --- | 0.004 | (0.004)**** |
| Intercept | 1.088 | (0.437)** | 0.874 | (0.786) | 1.372 | (0.428)**** | -0.511 | (0.738) |
| N (provinces) | 61 | | 61 | | 61 | | 61 | |
| $O^2$ (df) | 56.63 (54) | | 70.47 (53) | | 55.93 (53) | | 74.70 (53) | |

*Note:* Standard Errors in parentheses, * = 10%, ** = 5%, *** = 1%, **** = 0.05%.

## Table 5: Entry Mode Choice

*FDI Survey Data; Logistic Regression Model*

| | Greenfield | Greenfield | Greenfield | Greenfield |
|---|---|---|---|---|
| Model | 1 | 2 | 3 | 4 |
| IP real estate | .001 (.000) ** | .001 (.000) * | .001 (.000)*** | .001 (.000) * |
| State-ownership | -3.75 (1.36) *** | -4.50 (1.53) **** | -4.20 (1.48) **** | -- |
| Market orientation | -.022 (0.01) **** | -.023 (0.007) **** | -.022 (.006) **** | -.017 (.006) **** |
| Trend | .230 (.09) ** | .236 (.097) ** | .218 (.095) ** | .269 (.091) **** |
| Transport | -3.33 (1.78) * | -5.45 (2.63) ** | -3.41 (1.83) * | -1.48 (1.52) |
| GDP Growth | -- | -- | -- | .002 (.006) |
| Population | -- | .000 (.000) | -- | -- |
| Education | -- | -- | .002 (.002) | -- |
| Psychic distance | -.313 (.220) | -.351 (.227) | -.305 (.220) | -.328 (.216) |
| FDI stock | .002 (.001) * | .002 (.001) * | .001 (.001) | .001 (.001) * |
| Parent Strategy | .453 (.470) | .414 (481) | .492 (.476) | .415 (.453) |
| Newcomer | -.991 (.593) * | -1.108 (.602) * | -.905 (.604) | -.871 (.562) |
| Industry growth | .088 (.47) * | .084 (.047) * | .082 (.048) * | .092 (.046) ** |
| Six industry dummies | Yes * | Yes* | Yes | Yes |
| Intercept | -459.0 (188.4) ** | -476.4 (194.3) ** | -440.9 (191.0) ** | -548.1 (182.1) **** |
| n (projects) | 152 | 152 | 152 | 152 |
| $O^2$ (df) | 73.0 (16) | 75.0 (17) | 73.9 (17) | 64.0 (16) |
| Nagelkerke $R^2$ | .51 | .52 | .52 | .46 |
| Correctly classified | 81.6% | 81.6% | 82.9% | 81.6% |

*Note:* Standard Errors in parentheses, * = 10%, ** = 5%, *** = 1%, **** = 0.05%.

## Appendix: Variables Measurements and Data Sources

| Variable | Definition | Source |
|---|---|---|
| Cumulative FDI | Number of FDI projects licensed, cumulative up 2000 | Statistical Handbook of Vietnam, 2000 |
| New FDI | Number of FDI projects licensed in year 2000 | |
| Greenfield | Dummy: 1 = Greenfield, 0 = JV; acquisitions omitted from the analysis. | FDI Survey |
| Population | Average population, 1999, in thousands | |
| Transport | Volume of passenger traffic of local transport, (million person km), divided by population. | |
| Education | University teachers per 1000 inhabitants | |
| State-ownership | Ratio of output by state-firms over output of domestic firms | Statistical Handbook of Vietnam, 2000 |
| GDP growth | GDP growth from1995 to 1999 | |
| Wage level | Average income per month of labour in state sector under local govt management in thousands dong | |
| FDI in t-1 | Number of FDI projects licensed, cumulative up 1999 | |
| IP real estate | Square meters of industrial real estate summed over all industrial zones in the province. | List of industrial zones in Vietnam 1999. |
| IP dummy | Dummy: 1 = province has an industrial zone, 0 = no industrial zone | |
| Year | Year of legal establishment | |
| Market orientation | Percentage of sales into Vietnam (rather than exports) | |
| Parent Strategy | Dummy: 1 = focused single business strategy, 0 = related or unrelated diversification | FDI Survey |
| Newcomer | Dummy: 1 = first affiliate in Vietnam, 0 = investor had FDI earlier | |
| Industry dummies | Six industry dummies | |
| Psychic distance | Kogut-Singh index calculated based on Hofstede indices for 5 dimensions | Country of origin: survey, Hofstede indices from Hofstede (2001) |
| FDI stock | Outward FDI stock from source country 2000, bn US$ | World Investment Report |
| Industry growth | Cumulative growth 1990-1999 | Statistical Handbook of Vietnam, 2000 |

*Figure 1: Sub-national organisations and institutions influencing FDI*

NATIONAL ORGANIZATIONS

NATIONAL INSTITUTIONS

*Co-evolution*

SUB-NATIONAL ORGANIZATIONS

FDI firms

Private firms

SOE

SUBNATIONAL INSTITUTIONS

formal

informal

H1b/H2b

H1a/H2a

Investment Climate
*Attractiveness of an investment location, Suitability of alternative organizational forms*

H2c

Potential foreign investor