DETERMINANTS OF FOREIGN DIRECT INVESTMENT IN VIETNAM 1988-2009

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DECLARATION

I certify that this work has not been accepted in substance for any degree, and is not concurrently being submitted for any degree other than that of PhD being studied at the University of Greenwich. I also declare that this work is the result of my own investigations except where otherwise identified by references and that I have not plagiarised the work of others.

London, 26 October 2011

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ABSTRACT

This thesis analyses the determinants of Foreign Direct Investment in Vietnam from 1988-2009. It examines the nature, motivation and impact of FDI upon the Vietnam economy and its contribution to the subsequent leap forward in economic growth. The focus is on developing Dunning's eclectic theory through case study analysis of Honda-Vietnam Motorbike Company and ANZ-Vietnam Bank. The prominent theories on FDI generally used in the thesis focus on Vernon's Product Life Cycle (PLC) model, the Market Imperfection Theory (MIT), the Transaction Cost (TC) or internalisation approach and Dunning's Eclectic Theory. Dunning is the clearest methodology for understanding the Vietnamese case as its method is to take account of a countries particular FDI characteristics and their impact on economic growth. The addition of an emphasis on the impact of culture upon the development of FDI in Vietnam provides this thesis with evidence of its originality and legitimacy to the claim of filling a gap in the literature on FDI in developing countries and the advancement of economic theory.

The main focus in the case studies is demonstrating how foreign invested enterprises altered production, management, service and marketing processes to adapt their traditional, organisational and locational advantages to suit the local environment, and give them both foreign and domestic comparative advantages, ensuring the maximum possible capital return on their investments.

CONTENTS

TABLES

CHAPTER 1: INTRODUCTION

Vietnam's Foreign Direct Investment (FDI) did not flourish until the decision in 1986 (*Doi Moi*) to move from a planned economy to a market economy. In the following three decades the development of FDI has been 'spectacular' (Nguyen Ngoc Anh and Nguyen Thang, 2007) with the poverty rate falling from 58.1 per cent in 1993 to 12 per cent in 2009 and GDP increasing from USD100 in 1990 to USD1010 in 2009. With an average growth rate from 1990 to 2010 of 7 per cent and total gross domestic product rising from USD15 billion in 1990 to USD91.8 billion in 2009 (World Bank, 2009) , the growth of FDI has reflected the movement of Vietnam into the global economy, and demonstrated that it is now a country to invest in. FDI has grown from USD213 million in 1991 to over USD10 billion in 2009 (Vietnam General Statistics Office 2010).

PriceWaterhouseCoopers (2009) declared Vietnam the 'most attractive emerging market in manufacturing in the world' in 2007 (PriceWaterHouseCoopers, 2007) and among the top ten countries for FDI in 2009 (UNCTAD, 2009). Vietnam's accession to the World Trade Organisation in 2007 has accelerated its economic growth and provided an ideal opportunity for yet further 'spectacular' growth in FDI. It has led to further reductions in the restrictions on foreign investment and operation and is forecast to become one of the most attractive investment countries in Asia (PriceWaterhouseCoopers, 2009).

This thesis explores the determinants of Foreign Direct Investment in Vietnam from 1986-2009. It examines the nature, motivation and impact of FDI upon the Vietnam economy and its contribution to the subsequent leap forward in economic growth.

The thesis begins with an analysis of the different theoretical approaches to understanding FDI and its affect upon a developing country's economy and ends with two in-depth case studies (Honda and ANZ Bank), which illustrate that political, legal and cultural factors were significant determinants of the success of their investment into Vietnam.

Analysis of the existing literature on Vietnam FDI has shown that studies have mainly focused on either legal or political change as the main determinants of FDI, and subsequently demonstrated a gap in the literature based on an absence of a study that combined the unique impact of the Vietnam culture on the FDI growth and on the cultural implications to the political, economic and legal determinants. New research through elite interviewing and survey of investors, businessmen, politicians and legal experts in Vietnam is combined with analysis of the existing data and literature.

FDI development in Vietnam has taken the country from a position of minimal impact of foreign investment upon the economy to an impressive and constantly improving record that is a credit to the pro-active policies of the Vietnamese government. As Jovančević and Šević (2006) note, ‘All in all, a government’s pro-active behaviour is usually rewarded with an increase in FDI inflows into the country’ (p.11). This thesis research examines how the political, legal and economic reforms of the Vietnamese government over a two decade period has helped strengthen economic development and contributed towards its growing strength as a South East Asian ‘tiger economy’(Dapice, 2003; Iswaran, 2007; Dollar, 1999). This development has followed a further point of Jovancevic and Sevic in that ‘the promotion of a country as an FDI destination is linked with both hardwork and luck. The analysis of its competitive position (competitive positioning), after careful painstaking research may provide the many sought after answers’ (2006, p.9).

Šević and Jovančević noted, besides a need for an ‘effective legal system and effective judiciary’ an environment conducive to FDI development should entail a country having stability and consistency in government policy (p.57). They go on to then highlight a possible problem for successful development of FDI where the ‘clumsy reactions of government’, alongside ‘unnecessary corrective actions’ and a ‘tough stance’ *against* FDI can lead to various negative impacts on the efforts to attract foreign investment. In the case of Vietnam, the government has constantly striven to be a positive force for change in the economic environment felt necessary to attract significant amounts of effective investment from around the globe (Pham Duy Nghia, 2006; Seow and Ching, 2008).

This thesis shows how Vietnam’s FDI record and the determinants of its success have developed to a point where the country is moving through the stages of economic development and can become a major centre of trade and industry in South East Asia. The thesis follows the analysis of the theories of investment with an assessment of the impacts of that financial input into the developing economy of Vietnam and examines the overall relationship between investment and economic growth.

The chapter on FDI analyses the benefits to the host country, including:

- An improved Balance of Payment for inward flow of foreign earnings;
- A manufacturing base with low costs of production;
- An assured domestic market;
- Creation of a demand for export, where we also then have an export demand that can create jobs;

- Increased knowledge from operating in a foreign environment;
- Benefits to the consumer through lower prices;
- Savings in labour and resources for higher value added activities.

The factors determining where the world's largest multinational corporations (MNCs) invest are complex, reflecting the rising importance of intangible assets (UNCTAD, 2005). A report of UNTAD (2005) points out that although there must be a basic regime in place in countries that welcomes FDI, the existence of a pro-investment regime is now a given. The majority of countries have introduced measures to liberalise their FDI frameworks and have in this way opened the door for MNCs to an increasing degree. Factors beyond the existence of a pro-FDI regime, especially economic factors such as the existence of created assets, have become significant.

There exists definite links between economic growth and foreign investment and whether FDI is a determinant for growth of the economy, especially in the host developing countries. Chakrabarti (2001), Asiedu (2002) and Zhao (2003) recognised that there was a correlation between improvements in economic growth and the attraction and success of foreign investment and that actually, success in FDI did match increases in growth. Moore (1993), Lucas (1993), and Cernat and Vranceanu (2002) looked at FDI flows as a consequence of improved economic growth and that this included the spillovers in such areas as acquiring advanced technology, which transferred from foreign invested ventures to domestic enterprises. However, overspill is still a contested idea in Vietnam, but this thesis will still argue that FDI has had a significant impact upon Vietnam, especially in contributing towards its successful transition and that the future of domestic and foreign enterprises is still very much inter-dependent and necessary for future development economic growth and the case studies here support the idea that foreign and domestic enterprises will eventually become more inter-linked (Le Quoc Hoi and Pomfret, 2008).

The neoclassical theory of economic growth has sought to provide an explanation on the consequences as well as the causes of the presence of FDI in developing countries. On the other hand, in the endogenous growth theories, the effect of FDI on economic growth is explained through knowledge externalities and the existence of human capital in host developing countries.

Neoclassical growth and endogenous growth theories support the role of FDI in promoting economic growth in host countries. According to these theories, FDI is viewed as a way to transfer knowledge, promote learning by doing, and bring in technology spillovers and human capital augmentation. Consequently, FDI stimulates economic growth in host countries. The Eclectic Theory of FDI, on the other hand, provides a tool to explain the influence of economic growth on FDI in host countries. Empirical studies have found two way linkages between FDI and economic growth in both developed and developing countries (Dunning, 1988; 2001).

Very little empirical analysis of the issue has been carried out for Vietnam compared to other developing countries, especially in applying a simultaneous system of two equations to test the two way linkages between FDI and economic growth in Vietnam. However, studies of Greece (Stoian and Filippaius, 2008), Thailand (Minde, 2000; Siripoisalpipat, 2000), Jordan (Said and McDonald, 2002) and Sweden (Johanson and Weidersheim, 1974) were helpful in applying FDI theory to Vietnam.

The Legal Framework for FDI in Vietnam chapter examines how the reform of the legal system has been driven by a need to make the country more attractive and suitable for foreign investment. Development of Vietnam Foreign Investment Law (FIL) can be divided into five periods:

- 1988-1990: - The Vietnamese National Assembly approves the FIL. FIL was basic with many constraints and limitations to foreign firms to invest in Vietnam. Many articles did not comply with domestic situation, international rules and customs. The Law allowed foreign investors to establish a joint venture with state-owned or cooperative organisations but not in the private sector in Vietnam (Pham Duy Nghia, 1998; Chan and O'Donnell, 1988; Javasuruja, 1993; Bo Chinh Tri, 1988).
- 1991-1995: The Law was revised twice, in the years 1990 and 1992 (SRV 1990, 1992). Revisions allowed private sector business cooperation with foreign organisations and individuals; expanded forms of joint venture companies from 'two-party' into 'three-party'; gave preferential tax rates for FDI in areas with given priority (e.g., FDI enterprises producing necessary goods for import substitution): corporate income tax of 10 percent within 15 years of commencement of operation. FDI enterprises were allowed to rent land for operation while Vietnamese local government was responsible for compensation and site clearance for foreign-invested projects. The Government would guarantee foreign currency balance to FDI projects in infrastructure facilities and import substitution (Pham Duy Nghia, 2000; 2001; 2002; Hayward and Lay, 1997; Luu Van Dat, 1997).
- 1996 -FDI enterprises were allowed to choose forms of investment, rate of capital contribution, investment location and Vietnamese partner; enterprises with export proportion of more than 80 per cent were given priority in granting license; FDI

enterprise in export-oriented and hi-tech industries were encouraged. Amendments and supplements to the FIL in 1996 reflected improvements in the legal framework for FDI in Vietnam. International assessments deemed that 'Vietnamese authorities suddenly had second thoughts about the desirability of opening the economy and introduced various bureaucratic hurdles that blatantly discriminated against foreign interests' (John 2006, p.87). Despite positive changes in the Law, bureaucratic graft and extortion topped the list of foreign-investor complaints in Vietnam.

- 2000 – 2005: The Government proposed numerous FDI legal reforms. The FIL was amended for the fourth time, in June 2000 (SRV 2000b), attached by series of decrees, decisions, and circulars, among of which was the Decree No.24/2000/ND-CP dated 31 July 2000 of the Government, providing detailed regulations on implementation of the FIL (SRV 2000a).
- 2005-2008: In July 2006, a new investment regime comprising a Unified Enterprise Law (UEL) for the management of both domestic and foreign enterprises, and a Common Investment Law (CIL), regarding both foreign and domestic investment activities, came into effect, granting a more level playing field than that found under the previous investment regime (Pham Duy Nghia, 2003; 2004; 2006; Seow and Ching, 2008).

The chapter on *Doi Moi*, which was a slogan promulgated by Vietnam's Communist Party in 1986 meaning 'renovation', focuses on how the political changes of policy in Vietnam by the Communist Party helped establish better conditions for foreign investment, and it explores the rationale for *Doi Moi*. Vietnam's economy at that time was centrally planned and the system of government subsidies was considered ineffective and not fully utilizing economic potential. There was a gradual decrease of the support of economics and policy assistance from the socialist bloc. Modern science and technology developments created a new platform for a new economics (Do Le Chau, 1995; Chu Van Lam, 1987; Dang Duc Dam, 1997; Le Dang Doanh, 2002).

By 1976, after two decades of war with the US, Vietnam was one of the least developed countries in the world. Being a country under the strong Soviet connection and deeply influenced by Communist ideology, Vietnam had few opportunities to gain access to the world economy. Limited resources and there inefficient utilisation, undeveloped trade and investment increased Vietnam's problems. A US Trade Embargo isolated Vietnam from the global market and by the middle of 1980s, the Soviet Union and Eastern European system started facing terminal difficulties and economic failure (Dang Duc Dam, 1997; Do Phu Tran Tinh, 2006; Fforde, 1996).

Vietnam's centrally planned and heavily subsided demand-led economy resulted in backward infrastructure, and an inadequate production system. Despite the demands for capital and technology, Vietnam found it hard to access FDI to support the attraction of these vital needs. The weak legislation system was considered to be a high barrier for international economic integration, including FDI attraction. Successful economic and political reform in Russia and Eastern Europe, along with the renovation and achievements of China was a rejection of strict Communist economic planning and policies. The obvious benefits of a movement towards free market systems made a great impact on Vietnamese policy makers, leading to pressures to find a new way for the economy. Dramatic changes in the Vietnamese economy were initiated (Fforde, 1996; Do Le Chau, 1995).

These developments actually attracted specific new investors into Vietnam. Case studies on ANZ and Honda provide an evidence of the economic development of Vietnam and how these foreign investors (Western-ANZ-Australia/Asian-Honda-Japan) chose different ways to assimilate to the Vietnamese culture, whilst also tackling the problems of an under-developed economic legal system and the product of long years of economic decline that resulted in poor levels of skills in human resources and poorly developed international trading and finance systems.

Vietnam is a unique case study as this was an economy originally supported by its French colonialists for nearly 150 years and then in the South of Vietnam by the Americans for nearly a further two decades. Rich in natural resources, with an industrious and intelligent work force, it was extremely unfortunate that a destructive and long-term war of independence first brought the country to the point of economic collapse and then to more than a decade of isolationism and failure made worse by political and economic dogma that ensured it was cut off from the industrialised world and regularly suffer periods of starvation and extreme poverty (Dang Xuan Ky, 2002).

The successful institution of a new policy of open door free market economics has now reversed the decline and Vietnam demonstrates one of the fastest rates of growth in the world today. The success has been built up in less than three decades and this study will show how a country has managed to build its new vibrant economy through the attraction of FDI and do it in an amazingly short time, and from an extremely low baseline. Whilst the thesis does concentrate on the economic factors that have created this success, the influence of culture upon the process cannot be ignored. Political and economic reform has demonstrated dramatic changes in style and content, and yet the culture has remained conservatively constant, whilst actually contributing to the successful development of the investment environment. In the next section we look at why that is the case (Nguyen Ngoc Anh and Nguyen Thang, 2007; Athukorala and Tran Quang Tien, 2009).

1.1 FDI development and the Vietnamese culture

In the 1960s accepted thinking was that Western institutional forms, values and behavioral codes were 'essential elements' in bringing about economic development, while Asian culture and values were a 'hindrance' to development (Gong and Jang, 1998. p.2). Max Weber's works were actively used to promote the idea that Confucianism and Asian cultures were a barrier to capitalism and its successful development in the East (Weber 1968, p.248).

The subsequent economic growth of Japan, Hong Kong, Singapore, Taiwan and Korea proved this not to be the case. What is notable in the research here is that the success of these countries has predicated on their economies being focused on export-oriented policies, rather than import substitution strategies, and it is clear that the Vietnam Government's *Doi Moi* policy was clearly focused on replicating its regional neighbor's successes (Gong and Jang, 1998). Gong and Jang (1998) note that a question still unanswered by economists is why both the authoritarian state model, where the State 'actively participated in public and private spheres of the economy and has in fact been the leading actor in the economic growth' (Hamilton and Biggart, 1988, p.77) and the neo-Confucian theory cannot be offered as ideal explanations for why Asian development has progressed so well in some countries and not in others.

However, the Confucian ethics of 'self-confidence, social cohesion, subordination of the individual, education for action, bureaucratic tradition and moralizing certitude' are all elements that have helped Vietnam see a long period of record high rates in economic growth since the introduction of *Doi Moi*. At the same time the 'authoritarian' model has had a steady and positive impact upon Vietnam, with the Government managing to overseer almost every aspect of the social, political and economic transition of the country from a Command economy to a market economy (Gong and Jang, 1998, p.82).

Thus, although both the neo-Confucian and the revisionist authoritarian theories are often criticised for their inadequacies in fully explaining the reasons for Vietnam's dramatic levels of economic growth, there is strong evidence that both the culture and the dominance of an authoritarian state control system have contributed towards the sustained growth of the Vietnam economy and the increased levels of FDI in particular. However, this thesis will also point out that both the neo-Confucian/Marxist-Leninist based culture, and the centralised authoritarian management of the Vietnamese transition to a free market economy does present a few negative influences on the rate and depth of ‘renovation’. However, the analysis in the following chapters will show that the stark economic data shows that the balance between the negative and positive impacts of these factors are firmly in favor of accepting an overall constructive contribution to progress from the culture of Vietnam (Benito *et. al.*, 1992; Barkema and Vermeulen, 1997; Casson and Nicholas, 1989). However, as the thesis progresses, the analysis of the transition process as experienced by Honda and ANZ will demonstrate that future development may depend on what degree there remains room for both the culture and politics of Vietnam to continue to adapt and even substantially change in order to fully integrate into the global economic system (Gong and Jang, 1998)

The integration of Vietnam into the global economy through its transition to a market economy model began with the introduction of the policy of *Doi Moi*, but the actual mechanisms of change required involved the movement of the legal and economic structures from a hybrid of Confucianism and Soviet style traditions that meant the culture of business and society needed to adapt towards a new global business model. This change was especially the case in the legal reforms required to support the new policy and this thesis clearly points to the need for understanding how cultural transition was as vital a factor to successful growth as the political and economic adjustments. The extent of the transformation needed was radical and the theme for the transition was clearly identified by the main policy being identified simply as *Doi Moi*, which literally translates as ‘changing into something new’, but is more commonly referred to as ‘renovation’. *Doi Moi* involved a commitment to dismantling cooperatives and shifting production away from a ‘household economy’ to the ‘private sector’, whilst also restructuring the state-owned sector to be more competitive (Salemink, 2003).

Essential to this policy was Vietnam seeking a new globalised economic position that allowed it to firstly trade with its regional neighbors and later work within all international markets. However, the isolationism and strict Soviet style administration of the late 1970s and early 1980s meant that a major shift was needed in the political, economic and social ‘habits’ and social norms of the nation. The law of Vietnam was the central mechanism for actually ordering the new style economic model and bringing in something ‘new’. The next section looks at how that legal model of the isolationist years was itself a hybrid of socialism and Confucianism which has left the Vietnam system with a residue of habits and norms that cannot easily be eliminated and is likely to continue to constrain, or at least alter the mode of the determinants of FDI growth in Vietnam for many years to come (Dapice, 2003; Iswaran, 2007; Dollar, 1999, Bui Hai Thiem, 2009).

1.2 Confucianism, Socialism and the Vietnam legal framework

The cultural context within which FDI operates in Vietnam is shaped by its historical legacy, which now involves a hybrid mixture of Confucianism inherited from over a 1,000 years of colonial occupation by China and Socialism as a result of the recent Communist governance of Vietnam. This can be seen in the way the Vietnamese legal framework has developed and impacts significantly not only upon the FDI sector, but also generally on the way business is conducted. In this section we look at how Confucianism and socialism are two influential factors on how business and the economy operate.

Its further significance is that it is the Confucianism and socialist cultural frameworks of the Vietnam society (socially, economically and governmentally) shape the environment within which FDI is established and operate. This thesis argues that FDI needs to be understood within the particular cultural context of the host country and that this is vital to the development of how theories on FDI such as Dunning (1980, 2000 and 2001) can progress in order to improve levels of knowledge on how FDI ventures can operate successfully in a developing economy.

Whilst the new economic and political rules of Vietnam required a transition from 'socialist legality' the actual structures of Vietnam still retained a dominance of 'social norms' that involved a combination of Daoism, Buddhism and Confucianism, and while 'socialism' maybe swept away at some point in the near future, it is unlikely that the culture of Vietnam is going to transform to the same degree. Thus, FDI success in the past and in the future is reliant on reaching a compromise between the culture of Vietnam and the economic model of the West. To understand clearly how the determinants of FDI are shaped by the cultural framework of Vietnam the thesis addresses how culture actually impacts on the legal system (Pham Duy Nghia, 2002; 2003; 2006).

In the first place the 'collectivism' of the Soviet 'blueprint' of the period immediately following independence and unification was not merely a political ideology, but also a Confucian principle entirely at odds with the individualism of Western capitalism. In Confucian societies 'A human being is born to be member not only of the family, but a village and in a broader sense, a member of a country. He or she lives only in a natural connection with other members of the society, as an integrated part of one organised body… where the collective interest of society is supreme over individual interests' (Pham Duy Nghia, 2008, p.80). In Vietnam '*khon chet, dai chet, biet thi song'*- 'if you are too clever, you will perish, if you are too stupid you will also perish; but if you know how to live, you will survive'. This overtly anti-individualist and un-ambitious mindset of the culture would not immediately appear compatible with the demands of a capitalist system and not conform to the needs of the required determinants for FDI growth in Vietnam (Pham Duy Nghia, 2008). It did actually provide numerous difficulties in the process of reform, as while the law and political policy changed, the system itself was still run along the old Confucian and Marxist-Leninist values (it is clear to see that the collectivism and communitarianism of communism was in some ways compatible with Confucianism).

In this context the reform of the economic system and the operation of the determinants of FDI growth were affected by the culture, and this is clear to see in the 'operation' of the new economic laws, as set against the principles and requirements of the laws, such as the new laws on foreign investment. Previous laws were a reflection of the Marxist Leninist style that attempted to replace Confucianism and bring about a 'dictatorship of the proletariat' (Pham Duy Nghia, 2008, p.82). The liberalisation of the economy was carried out enthusiastically, but importantly, the system of settling disputes, for example, remained exactly as before. As Pham Duy Nghia notes, 'the power and discretion of the state authorities to intervene in the activities of contracting parties remained unconstrained. Business contracts, for example, may be declared void, often arbitrarily, based on outdated and conflicting regulations (Pham Duy Nghia, 2008, p.85).

This methodology of opaque and nepotistic behaviour on the behalf of the 'authorities' presiding over economic matters was as much a result of the Confucian culture as it was reflective of the 'Soviet' authoritarianism. The complaints against corruption in business and politics in Vietnam have to be set against a Confucian culture which is by its nature 'lacking in clear, systematic and transparent rules'. What is sometimes seen as corrupt by Western businessmen, can just as easily be seen as merely the Vietnam '*way*', such as with the general practice of giving 'gifts' at business meetings and at the beginning or end of negotiations (Pham Duy Nghia, 2008).

Importance here is to explain further the impact of 'socialist legality' as a concept that still today dominates the business setting. Traditional structures, economic practices, etc were replaced after Independence by the 'rule' of the People's Committee's and People's Council's with a centralisation of decision-making and a budget resource allocation that was decided through political ideology and community dominated ethics. Rather than the interests of the economic 'individual/organisation' it was 'The People's' interest that were placed paramount. However, the law remained a hybrid compromise between tradition, culture and communism, if not in the letter of the law, then often in its practice. Thus, it can be seen that while the law has directly sought to promote further the positive reform of the determinants of foreign investment, the practice has sometimes countered this and brought barriers into bringing about the complete 'openness' of the economy. To hope that this can be solved by the introduction of 'Western' style law would appear optimistic, as the Vietnamese culture is still likely to dominant economic practices. In fact, Pham Duy Nghia points out that replacement of the Confucius/Marxist-Leninist ‘style’ is a mistake and that there should really be a ‘convergence’ of Confucian values with the Western doctrine and this to bring about a ‘harmonization’ of legal standards (Pham Duy Nghia, 2003; 2006; 2008).

This thesis examines the determinants of FDI in Vietnam and the economic and political factors involved in their development, with the view that they cannot be isolated from the cultural influences and are significantly affected by the Vietnamese ‘way’ of working and living. Nevertheless, the evidence presented in this thesis shows that despite any negative impacts of the Vietnamese culture, the determinants of FDI have been increasingly positive and in some ways, the culture has actually contributed to that record of success. The conclusion of this chapter examines how FDI has developed in Vietnam and provides analysis that appears to confirm that there is actually a ‘harmonisation’ of the culture, politics and economics to the Western doctrines of business that clearly dominate the global economic economy.

1.3 Theoretical Framework

This thesis will examine the development of FDI in Vietnam through the perspective of two enterprises- Honda motorbike company and ANZ Bank. Honda first established its operations in Vietnam more than forty five years ago and since then have invested over USD500 million on three motorcycle producing plants with over two million bikes sold each year (Thang, 2012). ANZ Bank established operations in Vietnam in 1993 and now have eight branches throughout the country. The two case studies provide primary research for supporting the description of determinants of FDI in Vietnam. While focusing on Dunning’s Eclectic theory the thesis also combines this with an examination of the impact of national culture and assimilation to that culture by the two foreign enterprises. The development of Dunning’s eclectic paradigm comes through the attention to the alignment of the competitive advantages of Honda and ANZ Bank with their own development of relational assets such as trust, cultural affinity and ethno-cultural understanding. With Vietnam, as with China, the need for an understanding of the impact of Confucian beliefs upon business behaviour has proven to be essential in any analysis of successful business activity in Asia.

Dunning’s eclectic theory has developed a classical OLI (ownership/location/internalisation) paradigm that is driven by asset exploitation. At the outset, foreign investors face two major challenges in a ‘liability of foreignness’ through ‘foreign exchange risks and unfamiliarity with business conditions of the foreign market’ (Filippov and Saebi, 2008, p.11). For Dunning the motivations for seeking to invest in a country like Vietnam are: a need for access to new supplies of natural resources (resource-seeking); a new market (market-seeking/horizontal FDI); seeking to transfer overseas parts of the value chain in order to rationalise production (efficiency-seeking/vertical FDI); and seeking to create new assets (asset-seeking). (Fillippov and Saebi, 2008)

With Dunning's eclectic theory and the attention to OLI advantages, the case studies on Honda and ANZ Bank can be first assessed through the traditional framework of ownership, location and internalisation. However, the outcome lacks a thorough understanding of how and why both Honda and ANZ have become so successful in Vietnam, and the eclectic theory thus needs a more sophisticated understanding of the impact on business in Vietnam of Confucian values and norms. Nevertheless, Dunning provides a satisfactory framework to analyse the basic determinants of FDI, and in the case studies the data and information supplied provides a means to assess the competitive advantages of the two companies and their contribution to the success of the enterprises. Primary research focused on interviews provided a means to take the analysis further and see to what extent a willingness to understand and adapt to the local culture and environment also provided extra elements of advantage.

For Ownership advantages, Dunning's theory points towards the offset of the costs of operating abroad through higher revenues and/or lower costs. In the case of both Honda and ANZ the costs incurred through initial lack of knowledge of local conditions and the increased costs of operating abroad were balanced by having monopolistic advantages, access to advanced technology and economies of scale not enjoyed by domestic competitors.

In using Dunning as the basic framework for the thesis, there is at the outset a traditional focus on the configuration of three sets of forces:

1. Competitive advantages of a foreign firm in a new location due to privileged ownership of income generating assets and the coordination of these assets across national boundaries.
2. 'The extent to which firms perceive it to be in their best interest to internalise the markets for the generation and/or use of these assets and by doing so add value to them'(Dunning 2001, p.176)
3. The degree of commitment made to locating value-adding assets and activities to a location outside of their own national boundaries (Dunning, 2001, p.176).

Dunning's search for the variables determining successful foreign operations and the depth of value adding activity is based on a generic model which has been criticised for not providing a full explanation of the 'kinds of international production' but is defended by Dunning in that he seeks to identify a methodology that encompasses a generic set of variables (Dunning, 2001, p.177). However Dunning (2001) points briefly to his growing interest in the development of relational assets and the growth of the need to explore more their impact. This thesis provides a focus on the Honda motorcycle company and ANZ Bank strategies for not only coming to understand and use traditional location advantages, but also the importance of extending those advantages to include the development of relational assets, while also providing a reciprocal balance between the domestic environment and the foreign investor. However, Dunning (2001) does provide only a narrow definition of relational assets with it confined to 'beneficial relations' between persons within a firm' and persons 'in other institutions' (Dunning, 2001, p.188). In the study here of the determinants of FDI in Vietnam there is an expansion of the concept of relational assets which involves an examination of the quest of the investor to develop an understanding and reciprocal relationship with the national culture in Vietnam, while designing a business model that works with, and helps develop, a mutually beneficial mode of operation that respects the norms and values of the ethno-cultural environment. In Chapter Three: Methodology, the thesis presents a clearer linkage of Dunning's eclectic paradigm to an understanding and empathy to the effects of Confucian dynamism. It is essential that the primary target of the thesis is to show how the FDI determinants in Vietnam are uniquely affected by the cultural environment and that the traditional asset exploitation of foreign investors is optimised through a development of reciprocal relationships that form the very basis of the norms and values of Asian societies who are culturally bound by the principles and behaviorial expectations of Confucian based traditions and cultures. This may appear an idiosyncrasy when one assumes that the advent of Communism and decades of its ideological rule would, of itself, displaced the religious adherence to Confucianism. However, the persistence within the culture of Vietnam of the values and norms of Confucianism while ruled under Communism demonstrates the culturally bound permanence of these beliefs and foreign investors should never underestimate their need to understand and accommodate these traditions and practices.

The basis of Dunning's eclectic paradigm is the transaction cost theory. Transaction cost theory examines the absolute costs of a purchase, including all possible costs in time, effort and money to make a purchase and this is added to the actual cost of the product or service to assess the overall costs involved.

The term transaction costs is commonly associated with the work of Ronald Coase (1960) and was expanded on by Oliver E Williamson(1981) in "The Economics of Organization: The Transaction Cost Approach”.

In establishing the determinants of transaction costs, Williamson identifies them as arising from “frequency, specificity, uncertainty, limited rationality, and opportunistic behavior” (1960, p.3). Broadly speaking the transaction costs can be seen as all costs outside of those incurred internally by a company in completing a ‘transaction’. The general theory includes a concept of bounded rationality which relates to the idea that structures, such as institutions, time limits, lack of information, etc. impact upon the freedom of any agency to reach a rational outcome and decisions are far more complicated than merely the ability of an agency to reach a decision based upon their own ‘rationality’. That rationality is ‘bounded’, framed and to some degree determined by outside structures that either impede or facilitate particular courses of action.

In foreign direct investment there are generally three modes of entry into a foreign market: licensing, export or foreign direct investment. With Dunning’s eclectic paradigm firms are believed to calculate the relative advantages of each of these entry modes on the general basis of the transaction costs, and extend this analysis to the three further factors of ownership, location and internalisation advantages. Each advantage factor leads to the decision of how to enter a foreign market and the type of entry. For example, location advantage might be the presence of cheap raw materials in the targeted country, while ownership advantage might be the specific production technique of the investor firm and an internalization advantage would involve the core competencies of the investor firm and its wish to retain those competencies internally rather than share them through licensing or joint ventures (Dunning, 1981).

There are various levels of costs involved in operating in a foreign country, such as a lack of knowledge and understanding of the foreign culture; the costs involved in an entirely different market and the obvious extra costs of communicating and operating at a long distance from a firm’s home base. These will all incur some form of ‘cost’ to the firm, which then needs countermanding by some other advantage which leads to a net benefit. For example, the brand, image and technological advantages of the firm are its individual ownership advantages which cancel out the ‘foreign’ costs of operation and leave a net benefit to the prospective foreign investor. The foreign investor is comparing its advantages and core competencies against those of its market competitors and believes that they provide either a higher marginal return or a lower marginal cost that can be enjoyed by their main competitors, thus providing rational reasons and better profits by expanding into a foreign country.

With location advantages a large part of the advantages are in the hands of the host country, where their political and economic policies can create the environment that is beneficial to the foreign investor, alongside the more general advantages of, for instance, cheap and educated labour, a large domestic market and easy access to raw materials. The factors involved in the location are divided into economic, political and social advantages that provide specific benefits. In the case of Vietnam the economic advantages include a very large domestic market, that in the case of both Honda and ANZ provided them with a substantial opportunity for selling their products and services, while the political advantages included a government that was increasingly promoting opportunities for foreign investors and actively introducing policies such as tax breaks and special subsidies to encourage foreign direct investment. Social advantages included a growing willingness to see ‘foreigners’ as welcome and important ‘guests’ who deserved ‘special’ treatment.

As Dunning’s (1981) earlier works noted, it is not necessary that a foreign company operate as well or as profitable as its main native country company works, in order for it to find relative advantages in expanding to a foreign country. It can still be assessed as having sufficient advantages if it can operate at an advantage over the local domestic companies. For example, ANZ could see the benefits of operating in Vietnam as stemming from an ability to work at a higher margin or/and lower cost than the competing domestic Vietnamese banks.

Dunning declares that the major influences on his work were Peter Buckley and Mark Casson (1976) in the *Future of the Multinational Enterprise* and J.C McManus (1972) in *Multinational Firm and the Nation State* (Dunning, 2001). The purpose of Dunning’s work was to explain the extent and pattern of international production. International production is seen as the activities of the Multi National Enterprise and its use of foreign direct investment to provide them with improvements in their production benefits. Important here is the value added activity produced by an MNE by expanding its operation and interests in foreign countries and diverting capital from its domestic basis into another country, using its core competencies and advantages to create increased value. The theory then is a means to provide explanations as to why a firm has acquired value added activity through foreign direct investment.

Various variables can have endogenous and exogenous impacts upon FDI and are identified by Dunning as: Endogenous- strategic responses, technological or organisational innovations, changes in compositions of senior management, increases in labour productivity, mergers and acquisitions; Exogenous- population, raw materials prices, exchanges rates, national government policies (Dunning, 2001, p.179).

Important utility of OLI theory is its ability to help explain the Investment Development Path and the changing international position of a country as a possible investment destination in relative comparison to other developing countries. In this thesis the chapters on law and on *Doi Moi* provide an historical tracking of the changes the Vietnam government made to encourage the growth of foreign direct investment. These chapters indicate the positive trajectory of the Vietnam government in creating the right environment for FDI growth and help identify the factors that are important in creating the right structural environment to encourage investment. Dunning (2001) indicated the crucial role government plays in attracting foreign direct investment and this thesis has focused in a large part on how the Vietnam has structured its development path. The primary overriding framework for this was the introduction of *Doi Moi*, which initiated the vital movement away from ideologically bound control of the economy in a centrally planned market, towards a free market. This transformation cannot be under-estimated in its importance as a starting point for the beginning of a significant step forward in the development of Vietnam. The *Doi Moi* policy provided the strongest indication of a willingness of the Vietnam government to move the country into a new era of competitive advantages over its competitors for foreign investment.

In line with Dunning's recommendations the OLI paradigm is utilised in the case studies to also show how these separate advantages are inter-related and have an impact on each other. The case studies of ANZ and Honda both examine how the Ownership advantages of these two MNEs were adjusted to enhance and benefit from for instance the increasing locational advantages provided by penetration into the Vietnam market. Dunning expresses a need to understand that there are continually related impacts of the three OLI advantages, and Dunning illustrated this with the example of asset ownership and transaction ownership advantages where asset ownership involved the resources an MNE possessed in competition with other enterprises, while in transaction advantages 'mirror the capacity of multinational enterprises hierarchies, vis-à-vis external markets, to recoup the transactional benefits (or lessen the transactional costs) of the common ownership of separate but inter-related activities located in foreign countries' (Dunning, 1988, p.13). OLI advantages are also to be seen as continually changing over time and the comparison between one period and another presents different levels of advantages in a particular MNE, while the merit of any country as a possible destination for investment by a company is also not static and is relative to the growth or decline in attractiveness of other FDI locations. Dunning also warns that 'as knowledge becomes more idiosyncratic, tacit and noncodifiable, the market has proved an increasingly inappropriate modality for the organisation of cross-border transactions' (Dunning and Archer, 1987, p.26). In examining the OLI factors in Vietnam for ANZ Bank and Honda the advantages are also divided into firm-specific, industry-specific and country-specific categories. For example, in line with Dunning's recommendations we can see that Honda enjoyed both structural and strategic related firm specific advantages that meant it could compete successful with other motorcycle firms both in Vietnam and in other foreign countries. For Honda, the industry specific advantages related to the market structure, which on the point of penetration into Vietnam was at the beginning of a dramatic growth period. The country-specific advantages included a work force that was extremely low cost, but educated to a reasonable level and a succession of governments that focused on providing an increasingly attractive financial environment for FDI.

Due to low wages and resource costs alongside political and economic reforms that are continually improving the investment climate in Vietnam, foreign companies did, and still do, consider Vietnam a destination for foreign investment as their competitive advantages 'secure sufficient in order to cover the risks and costs that overseas operations entail (Fillipov and Saebi, 2008, p.8). However, one cannot be too positive about the improvements that have been made in the Vietnam economy as there are numerous negative signs that still provide problems to investors. Child and Rodrigues (2005, p.288) described a number of problems that can be identified in developing economies. These include:

- 'regional protectionism limiting opportunities available otherwise in a large domestic market to exploit economies of scale;
- Restricted access to capital preventing investment in plants of optimal scale;
- Underdeveloped international property rights (IPR) regime limiting access to sophisticated technologies;
- Lack of skilled human resources;
- Weak local infrastructure entailing rising transport costs.

In the case of Vietnam there are a number of issues, such as the still much undeveloped human resource training system, which has led to an increasing lack of human resource quality and the lag in the developments of the transport systems. However, in general there are policies to at least try an improve the present situation.

1.4 Conclusion

The last two decades of FDI development in Vietnam have established the foundations for future success in attracting foreign investment, and this thesis highlights the positive and negative impacts that were inevitable when the process was begun by a paradigm of 'learning by doing'. However, it has now established a proven model for future development and the onset of the financial crisis now means that countries around the world must compete for FDI in a highly competitive environment. Nguyen Mai (2009), chairman of the Vietnam State Commission for Cooperation and Investment and chief advisor on the State Panel for WTO entry believes that the experience of the past has enabled Vietnam to place itself as a highly attractive location for future investment at a time when many of the world's developed economies are re-trenching and offering fewer opportunities for good returns on investment. Vietnam is also an oil exporting country and the rich returns that were accrued from the high price period of 2008 earned many billions of dollars in profit (Vietnam Tonight, 2008).

Mai believes that the memory of this period of 'rich pickings' will remain in many investors minds and that both domestic and foreign investors will identify Vietnam as a future place to invest heavily. But Vietnam has also learned from its mistakes of the past two decades and can now make changes to the environment that will improve the FDI prospects. As Mai notes, the public are more discerning of the benefits of FDI and less willing to accept a policy of accepting any and all prospective FDI projects. The Government is also more careful and now asking whether or not an FDI project will be profitable, instead of just accepting the money.

As one Ministry of Planning and Investment's official, Nguyen Thu Quang said, 'in the last ten years we tended to license an FDI project purely on the basis of whether the money was there or not. Now we tend to be more sophisticated and not just accept the money without first calculating whether it is likely to be a successful and profitable venture in the future, or beneficial to the public good' (Interview: Nguyen Thu Quang, Ministry of Planning and Investment, 6 May 2009),

This thesis is in itself an assessment of the success and failures of FDI in Vietnam over the recent years, and provides the academic analysis upon which the future FDI environment can be reformed. Vietnam is a late entry into the process of industrialisation and foreign investment now needs to be directed towards the areas and fields most likely to benefit from it and ensure that the future of the economy is based on policies that bring sustainable and environmentally friendly growth.

This thesis will show that ANZ and Honda are examples of those investments that have become successful, yet they went through a process of learning by doing that was sometimes costly and demonstrated some of the failings of investors and the Vietnamese Government. As Mai warns, it is necessary to now be more careful of investment and ensure, for instance, that the foreign investor and the foreign invested projects are fully researched before being licensed. The process of reform also needs to enhance aspects such as 'tax holidays' and the reform should also provide new incentives. For example, 'The objective should be that when after a period of time an FDI project fails to be implemented, there should be a better process of administration, where licenses are revoked in order to put the land being withheld back into circulation' (Pham Quang Ngoc, 2009,17). There is a need for 'strong and consistent reform' and for the Vietnamese managers to be able to 'track economic swings and have an ability to forecast trends…when reasonable forecasts can be made, appropriate new development plans can be made by central planners' (Pham Quang Ngoc, 2009, p.17). If anyone knew beforehand, the after effects of the US financial crisis, which includes the global economic recession- many mistakes, could be avoided. The aim of this thesis is to provide that analysis of how, when and why FDI development took place in Vietnam and to fully understand the present environment.

The purpose of this thesis is to fill the gap in the literature and knowledge of FDI development in Vietnam and to use that analysis to help in shaping future policies. Theories used, such as Dunning's eclectic theory, allow a focus on important aspects such as the location advantages, which also then includes the impact of not only political and economic reform, but also allows the impact of the Vietnam culture to be assessed alongside the empirical data. By concentrating to some degree on the subjective analysis of the process and success of investing in Vietnam the thesis allows the empirical data to be better understood in the context of Vietnam.

The Vietnam case study is a unique opportunity in the academic analysis of economic theory and practice, in that the country suffered decades of violent conflict that was followed by almost complete isolation from the world. Foreign investment was only provided by the Soviets and Chinese as an ideological obligation and a strategic political and military option that did not fully take into account the economic implications. As one senior former Communist Party cadre said 'the money was merely to keep us as friends and prop up the system, which, although we could enjoy political and military friendship, really left us economically more isolated and unable to develop. We became captive prisoners of the ideology and the payment we made was in poverty and starvation. We needed to reform and *Doi Moi* was a conversion as much of the ideology as it was the economy. We could now as a Party remains true to Communism (*sic*), but in a free market model. It was a compromise between our beliefs and the reality of the economic structures of the world.' (Interview: details remain anonymous at the request of the interviewee, 3 May 2009). He explained that the process of reform now does need to be analysed and for us to learn from our experiences. The thesis will point out the mistakes as well as the successes and in the process allow upcoming government decision-makers to plan better for the future.

Thus, this thesis examines first the political policy changes and how these were enacted through the development of the legal system. But both were brought about in a unique political and cultural environment that altered both the style and consequences of foreign investment into Vietnam. For this reason the thesis merges economic theory with socio-economic and cultural factors in order to take forward the discipline of economics and its theoretical base, with a view to both understanding and explaining how economic strategies in Vietnam have led to its successful development and venture that there is a link between successful foreign direct investment and economic growth. The FDI environment in Vietnam was both a cause and a consequence of its movement towards being an export oriented economy, and this thesis will show that the theories of economics needs to take a position where the links between FDI export orientation and economic growth are compatible factors that when linked result in successful development, which now leaves Vietnam on the verge of a movement from a less developed country to a developing country and hopefully soon a fully industrialised developed economy.

In examining the link between political and economic factors to cultural and social influences, the research found that the links was not only proved successful when the factors were compatible, but that successful development cannot be brought about by isolating these factors from each other. Following the evidence presented through the case studies of ANZ and Honda, the conclusion of the thesis will discuss further the necessary links between these analytical tools. The national economic data has proved also to have a sometimes negative impact upon the research. This has been due to the organisational and structural problems in empirical data collection in Vietnam. Official sources of data are often untrustworthy and this leaves the researcher with the problem of actually finding reliable data. By concentrating on a narrow study of the experience of two foreign invested firms, the thesis allows the available national data to be assessed alongside that of the companies and for that to be re-enforced by the subjective recollections and analysis of the people involved in the historical development of their companies successful penetration of the Vietnam market.

However, elements of the central control of both the economy and the politics of Vietnam are likely to remain in place for many years to come and the thesis thus suffers from a certain lack of trustworthy data and analysis and where many may have said more of what they think they should say, than what is actually the case. For example, corruption is still a problem in a few areas of the economy, yet its depth and impact is still very hard to assess and thus a major influence on the process of deciding whether to invest, and/or the costs and reasons for successful or failed investment is difficult to fully analyse. Nevertheless, the empirical data and evidence examined through this thesis does provide a clear indication that Vietnam has managed to become an extremely attractive and rewarding foreign investment location, which is also both a reason for, and a consequence of, joining the WTO as an internationally recognised member of the global economic system. This thesis thus, presents an analysis that fulfils Professor Mai's call for a full examination of why foreign investment in Vietnam has been successful and how future reform can be directed to improve the environment for attracting more of the world's foreign investment capital and the 'spillover' effect of that in improving human resource skills, the levels of advanced technology and the productivity and efficiency of the Vietnamese economy.

1.5 Organisation of the Thesis

Chapter 1: Introduction

Chapter 1 provides a broad over view of FDI and its determinants in Vietnam. While justifying the decision to use Dunning's eclectic theory as the basic methodology, the thesis then introduces a second force (the impact of culture on FDI) for in depth analysis, and tenders that the development of relational assets through cultural assimimlation, provided an added value to the investor in Vietnam. The development of FDI in Vietnam is linked with its economic growth and two case studies, Honda and ANZ bank are presented as good examples of where foreign investors have altered products, services and management styles to accommodate the cultural peculiarities of Vietnam. The basic hypothesis is that traditional FDI determinants are sufficient to develop a generic model of understanding of FDI investment, but a more sophisticated approach that considers the impact of Confucian dynamism is needed to adequately explain why some foreign investors have been so successful in Vietnam.

Chapter 2: Literature Review

In Chapter 2 the literature on the patterns and determinants of FDI is analysed. Although a variety of theories on FDI are considered, it is Dunning's work that is given the greatest focus and attention. The FDI determinants are examined and assessed for relevance in the Vietnam investment market and linkages between economic growth and FDI are made. Extensive literature is reviewed in regard to the movement of Vietnam from a centrally planned system to a transition economy, whilst still remaining ideological communist and the impact of FDI in this dramatic reform of the economy is analysed.

Chapter 3: Methodology

The Methodology chapter moves towards explaining why Dunning's eclectic paradigm is selected as the main approach of the thesis and introduces and in-depth analysis of why Confucian dynamism and relational asset development are two central concepts that bneed to be added to the Dunning paradigm in order for one to get a fuller understanding of the determinants of FDI in Vietnam. The methodological framework is explained and the validation of using Honda and ANZ Bank as ideal case studies for acquiring primary research on the subject is given.

Chapter 4: Doi Moi and Vietnam's FDI Policies

Chapter Four establishes the background for introduction of the *Doi Moi* policy in Vietnam in the late 1980s when market reforms dramatically improved Vietnam's business climate. The developments in FDI government policy and legal systems and the international and national contexts to FDI policy in Vietnam are examined, and this provides the framework for policy improvements and changes, the development of laws on foreign investment in Vietnam, elements of the Enterprise Law and other government policy initiatives that facilitate FDI in Vietnam such as land and technology (Nguyen Nhu Binh and Haughton, 2002; Chu Van Lam, 1987). There is an overview of FDI implementation in Vietnam, general FDI facts and figures, inflows of FDI into the country, the common forms of FDI that foreign investors take, and the FDI structural composition. Finally, the impacts of FDI on Vietnam's economic growth, particularly on the country's export and employment are examined.

Chapter 5: The Legal Framework for FDI in Vietnam

Chapter 5 examines the vital changes made in the legal framework in order to facilitate the grwoth of foreign direct investment in Vietnam since the introduction of *Doi Moi*. Comparisons are made between the changes in FDI law in Vietnam and a number of other countries. The most notable reforms such as the Investment Law are analysed and a critical approach is made to the continued shortcomings of the present system. This mainly focuses on the need for an acceleration speed of law reform and greater emphasis placed on developing the capacities in the system to support rapid and efficient change.

Chapter 6: ANZ Bank

The case study on ANZ Bank provides the first opportunity to fully present the outcomes of the primary research. The chapter examines the establishment and development of ANZ Banks and demonstrates how the core competitive advantages of ANZ were added to by a conscious strategy of assimilating its products and services to fit the Vietnam culture. The ANZ Bank was a particularly relevant example of cultural assimilation as the culture of the Vietnamese people was originally quite adverse to the idea of even opening personal bank accounts. By coming to understand the cultural resistances to traditional banking services and carefully shaping its strategies to slowly alter the general mindset of Vietnamese towards banking, ANZ grew rapidly to 8 branches throughout the country and actually contributed to the changes in the culture of the people. These changes were further made possible by direct cooperation between the government and the banks, such as the legal reform that directed all government civil servants payments of salary to be made only through bank accounts. One of the primary objectives of this thesis is to show that economic development cannot be isolated from its surrounding cultural climate and that penetration of Vietnam requires investors to combine its global financial strategies to cultural sensitivity to the Vietnam 'way' of living and how that alters 'how to do business' in Vietnam.

Chapter 7: Honda

The case study of Honda in Vietnam in chapter concentrates on an examination of the cultural specific variables evident in understanding Dunning's eclectic paradigm and the impact of internalisation theory. As early as 1997, Dunning and Bansal realised that it was 'an opportune time for more in-depth research' on 'cultural specific variables' in FDI ventures (p.12). The chapter here forms a study of the application of the eclectic paradigm to Honda-Vietnam by examining how its entry mode and subsequent management system of operation provides clear indication that a culturally specific strategy for FDI is the optimum method of ensuring the maximum capital return on any foreign investment.

Chapter 8: Summary and Conclusion

Chapter 8 provides a final analysis that points to clear evidence from the two case studies of Honda and ANZ of a need for including and understanding of local culture and developing strategies for growth of relational assets are essential in successfully investing in Vietnam. While the traditional determinants of FDI are assessed and shown to point to clear reasons why Vietnam has become a focus of many foreign investors attention, the benefits of also addressing the cultural dimensions in the business environment are also proven to be vital to optimising any foreign investment in Vietnam. In the case of Honda this has involved the investment of more than USD500 over a 45 year period and the building of three prodcution plants, whilst also radically transforming the culture of Vietnamese through the improved mobility that Honda's motorbikes help develop. Both Honda and ANZ accepted from the outset that their investment required a culturally bound approach to its products, services and management systems. That willingness to adapt and change based on ethno-cultural pressures allowed both companies to develop as long term and successful investors in the Vietnamese economy.

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

High economic growth and swift reduction in the levels of poverty has followed the introduction of the *Doi Moi* process in Vietnam. The positive inflows of foreign capital and resources into the country have been as a result of pro-active government policies towards FDI. Foreign investment contributes significantly towards gross investment, aggregate export expansion and Gross Domestic Product (GDP) while aiding the expansion of the MNE sector.It is the government's promotion and support of FDI that has led to a healthy and vibrate attraction of foreign investment and maintained its positive affect upon the economy. The recent accession to the WTO requires the government to further expand is positive FDI policies, including the privatisation of SOEs, the reform of legislation on FDI, the general rules on business ownership, property rights and the way that government insitutions deal with foreign enterprises entering the Vietnam market (Nguyen Ngoc Anh and Nguyen Thang, 2007; Bui Hai Thiem, 2009; Nguyen Nhu Binh and Haughton, 2002; Dapice, 2003).

This chapter will examine the literature on the patterns and determinants of FDI in both developed and developing countries. Although the literature on FDI in Vietnam is developing (Baban, 2002; Do Phu Tran Tinh, 2006) there is still significant room for a full review of its impact on the Vietnam economy and this thesis will carry forward the growing interest in how FDI has developed in Vietnam. Many of the previous studies have concentrated on using macro data to analyse patterns of FDI in Vietnam and more recent material has focused on technological spillovers in the productivity of Vietnam's manufacturing industries (Le Thanh Thuy 2005; Nguyen Thi Tue Anh *et.al.* 2006; Le Quoc Hoi, 2006). Less work has examined how FDI affects economic growth patterns, especially in the context of *Doi Moi,* and on how the inputs of FDI has helped re-structure the economy in a period of rapid transition from a centrally planned economy to a market oriented. This study will provide a new level of analysis that examines the direct and indirect effects of FDI in the background of Doi Moi.

The economic development of Vietnam has seen FDI play a a significant role and witnessed growth to a point where FDI contributed14 per cent to GDP in 2003 (General Statistics Office, 2004). By 2009 the contribution had risen to 18.33 per cent and Foreign Invested Enterprises provided 10.52 per cent of the State budget (VietnamNet, 2010). In 2010, Foreign Invested Enterprises continued too disburse US$3.1 billions to the State budget, which was 26 per cent increase against 2009 (Ngoc Linh, 2011). FDI has provided jobs, increased trade and encouraged the import of advanced technology, with the subsequent improvement in management skills and learning. Economic re-structuring, domestic enterprise reform, diversification and the introduction of high quality, low price goods and services have provided customers with new choices, through the introduction of Foreign Invested Enterprises and the liberalisation of trade and investment.

As discussed in Chapter One, the thesis is focused on Dunning's (2001) eclectic paradigm model and uses the theory to assess the OLI- Ownership specific, Location and Internalisation advantages, whilst also developing the model of analysis by addressing the more specific location advantages through the need for an understanding and use of ethno-cultural strategies.

In looking at the work of Dunning (1988; 1993; 2001) and at location specific advantages, Dunning promotes analysis of country's different structures; addressing such factors as the different income levels, the market variables such as size and composition and the influence of different governments upon the political climate and financial frameworks, Dunning points to these factors in the context of how they affect for example, production costs. The Dunning model identifies the variance in location advantages caused by local languages and cultures, alongside the pyschic distance between the foreign investor and the environment of their domestic location (Dunning, 2001). This links into the transaction cost theory and the economic rationale of entry mode selection determined by least-cost factors (Anderson and Gatignon, 1986). However, Tse et.al (1997) indicates again the need for further concentration on not only firm-specific variables, but also their impact on, and reaction to, locational differences. Dunning's (1993) OLI model gives the lead in addressing locational variables, and this thesis takes that awareness deeper into the analysis by focusing to some extent on culture as a major variable. Dunning (1988) indicates that firm-specific and market-specific factors influence a foreign investors ability to control returns, risks and resources. Whilst the eclectic theory and OLI model provides core access to understanding the optimal use of assets, and the development of new assets, it is the reciprocal impact of local conditions and the factors influencing that environment that needs further attention. It is clear that foreign market entry modes need to be based upon calculation and positive balancing of risks against returns. In the case of Honda, a 45 year investment of over USD500 million has proved financially sound and the Honda (Japan) decision to develop a bespoke model of Honda (Vietnam) has enabled it to accommodate cultural change and relational asset development. An equally clear strategy of accommodating the local culture is seen with ANZ Bank. With Dunning (1988), the assessment of transaction costs is relative to the locational advantages. The assets of the companies into spearate categories with the first being the asset advantages the foreign investor brings to the new market, such as higher levels of technology, stable financial capital and superior management skills, whilst the second is the more intangible advantages of effective communication between the investor and 'others' in the local environment. The later is seen as a transaction specific asset (Heledd, 2006).

With the case studies of Honda and ANZ Bank we can clearly see the development of intangible advantages borne from strong efforts to become a positive communal partner, bringing reciprocal benefits and developing mutual understanding. The thesis now considers the basic structures and processes of FDI and considers the theories, while demonstrating also why the prefered methodology here is based on Dunning's eclectic paradigm.

2.2 <u>The basic concepts of FDI</u>

Foreign investment (international investment or capital export) is the capital investment by foreign enterprises that is used in production and aims to gain capital expansion and provide numerous socio-economic benefits. FDI is the movement of capital over borders (IMF Balance of Payments Compilation Guide, 2009)

Under the definition and classification of international accounts presented by the International Monetary Fund (IMF) Balance of Payments Manual (BPM5) (IMF, 1993) foreign investment is classified into the following types:

- (i) direct investment;
- (ii) portfolio investment;
- (iii) other investment.

What is essential is that the foreign investor gains a certain degree of control over their investment in the host country (IMF, 1993). In Krugman and Obstfeld (1997) the international capital flows of FDI involves the creation of new enterprises or the introduction of subsidiaries of existing ones, where the financial obligations of the subsidiary are combined with being part of the organisational structure of the parent company.

'*Direct investment is the category of international investment that reflects the objective of a resident entity in one economy obtaining a lasting interest in an enterprise resident in another economy*' (BPM5, 1993, p.86). A resident entity is defined as foreign investors including individuals, private or public enterprises, governments and other organisations which have direct investment enterprises.

A direct investment enterprise or a foreign-invested enterprise (FIE) can be an incorporated or unincorporated firm in which a foreign investor owns a part or whole of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise. The IMF (1993) gives two options for distinguishing domestic enterprises and FIEs.

1. 10 per cent of ordinary shares.
2. Voting power (the influence of the direct investor on management of the FIE).

The recognition of the influence of the foreign investor can be expressed in a number of ways including representative roles on the Board of Directors, a direct role in formulating business policy, the transactions involving inter-company transfer of materials including the provision of management personnel, technology and long term capital (OECD, 2008).

The forms of direct investor classified as FDI include

(1) equity capital,

(2) the reinvestment of earnings and

(3) the provision of long- and short-term intra-company loans, i.e. between the parent and subsidiaries (Duce, 2005; Dinh Van An and Nguyen Thi Tue Anh, 2008).

The production of goods and services in the host country are the result of foreign direct investment providing the capital or other resources to make their provision possible.This should be contrasted with foreign portfolio, which provides an interest only in share speculation and has no influence over the production of goods or services (Goldstein and Razin, 2005).

The definition of FDI does not require that the investor be domiciled in one country of investment, and can include the participation of the domestic company in the multinational network of the investing company. The source of funding for FDI can be transferred from a parent company to a new subsidiary or affiliate, or can be capital from the foreign country or host country lenders under the parent company (Goldstein and Razin, 2005, p1-3). There is not a need for the investor to be sourcing the capital from both the same country as the source of origin.

The IMF and the OECD's Benchmark Definition of Foreign Direct Investment (OECD, 2008) categorise FDI as international investment being transferred from one country to another to achieve a lasting interest in the host country. . A lasting interest is seen as the establishment of a long-term relationship of the investor in the new enterprise and the maintenance of a significant level of control over the business by the investor (IMF, 1993).

The direct investor can include ‘individuals; incorporated or unincorporated, private or public enterprises; associated groups of individuals or enterprises; governments or government agencies; or estates, trusts, or other organisations that own direct investment enterprises in economies other than those in which the direct investors reside’. However, that investment should account for at least 10 per cent or more of the enterprises and include significant levels over control of the business of that enterprise (IMF, 1993). The ownership of 10 per cent of ordinary shares or voting power is the criterion for determining the existence of a direct investment relationship (IMF, 1993; OECD, 2008).

Direct investment capital is:

(i) capital provided by a direct investor to a direct investment enterprise or
(ii) capital received from a direct investment enterprise by a direct investor.

However, this excludes funds gain by the investor through merely the negotiation work of the investor of for instance loans, but concerns itself particular with capital or resources directly provided by the foreign investor (IMF, 1993; Dinh Van An and Nguyen Thi Tue Anh, 2008; Duce, 2005).

The United Nations Conference on Trade and Development (UNCTAD), in its World Investment Reports defines the relationships of FDI as those formed between the parent enterprise and its foreign affiliate and must involve the parent company acquiring significant control over the new company, which includes both actual ownership of greater than or equal to 10 per cent and effective access to voting rights. In the incorporated form the growth of FDI depends on the MNE having effective control over such areas as the management of the business of the company. Any ownership shares falling below this definition is merely defined as foreign investment portfolio ownership and is not categorised as FDI (UNCTAD, 2008).

Thus, merely the presence of transactions between the direct investor and the host country do not rate the definition as FDI, for the investment must involve capital transactions that lead to significant business control (IMF, 1993). This control on the other hand, has to demonstrate that the investor is making a commitment to long term involvement in the business in the host country, and that itself should be demonstrated by the foreign investor display the patience and capacity to work through the initial barriers and problems associated with developing a business in a foreign country.The path from an interest in investing in a foreign country to actually becoming operational involves a number of often difficult steps that can only be successfully negotiated through a strong commitment on the part of the investor and a realistic understanding of the problems involved, such as being in line with the different legislative responsibilities found in a foreign country and the different cultures of business, the challenges of a new market for goods or services and the weaknesses that may be found, such as in the under-development of human resources (Dapice, 2003; Iswaran, 2007; Dollar, 1999).

The definition of FDI in Vietnam is in line with this understanding (Pham Duy Nghia, 2002; 2003; 2006) and according to the 2005 Investment Law, FDI means the transfer of lawful capital in cash or other assets of a foreign investor into Vietnam in order to carry out the investment activity, whereby the investor participates in the management of the investment activity.

2.3 The classifications of the Foreign Direct Investment

Foreign direct investment may be classified as inward or outward. While inward investment is foreign capital investment into local resources, outward investment is referred to as direct investment abroad. Foreign Direct Investment may be further classified by the entry modes of investment, the enterprise format and the motivations behind the foreign interest (Dinh Van An and Nguyen Thi Tue Anh, 2008; Gates and Truong, 1994).

2.3.1 Classification of FDI through Entry modes

There are two different ways of FDI entry modes including, green-field investment or the acquisition or merger with an existing enterprise in the host country. FDI in green field investment requires the building up of new capacities in the host country's production or the improvement of the company's existing production facilities. This capacity development brings numerous advantages to the host country, including the development of human resources, the creation of jobs and improvements in levels of research and development. Obviously, there are the negative aspects of repatriation of profits, the subsequent impact upon capital accumulation in the host country and the contraction of the market for host country's domestic companies (Roots, 1994; Tse, *et.al* 1997).

The acquiring of proprietary assets underpins FDI accumulation, and although M&A is often restricted in host countries, the development of green field FDI is a principal form of entry into developing countries (UNCTAD, 2000). The 82 per cent increase in world FDI inflows from USD150 billion in 1990 to a record USD1.1 trillion in the year 2000 was chiefly fuelled by the prominent role that cross border M&A has played in expanding the global FDI flows (UNCTAD, 2002; Mueller, 2001; Eicher and Kang, 2004).

Horizontal M&As with the merger being between competitors in the same industry and, vertical M&A as enterprises either bringing producers and distributors into a partnership in forward mergers, or backward with the mergingof producers and suppliers or in same value change mergers, or conglomerate mergers between enterprises in different industry sectors are all forms of FDI penetration (UNCTAD, 2001).

2.3.2 The Different Types of FDI enterprises

There are different types of investment classifications which are used in national laws regulating FDI in Vietnam (e.g. the Law on Investment of Vietnam, 2005). The different forms of FDI enterprises include:

Cooperation under BCC (Business co-operation contract): An investment form signed between two or more foreign and local parties that are cooperating in business and sharing the profits or products without creating a new legal identity.

Joint venture enterprise: A Joint Venture is an enterprise involving a joint venture contract signed by two or more parties established in a single host country.

Wholly foreign owned enterprise (or 100 per cent foreign owned enterprises): Where the foreign company is the sole investor providing 100 per cent of the enterprises capital needs and owners 100 per cent of its enterprise in the host country.

Alternative forms of public-private partnership are:

- Build – Operate – Transfer (BOT) Contract: Which is an investment between a competent State body and an investor formed with the intention of constructing and operating commercially an infrastructure facility for a fixed period and upon reaching the end of that period the investor freely agrees to transfer that facility to the host country with no charges or fees payable.
- Build – Transfer- Operate (BTO) Contract: In contrast to the BOT, the BTO involves an agreement between a competent State body and an investor, where on completion of an infrastructure facility the State will grant the investor the right to commercially operate the facilitate for a fixed period of time with a view to recovering the invested capital and eventually make a profit.

- Build – Transfer (BT) Contract: With the BT the investor and the competent State body agree to complete the construction of the facility with an understanding that on completion the investor will transfer that structure to the State, but be allowed to attempt recovery of the invested capital and make a profit, through the building of another facility or be compensated by the State body (Pham Duy Nghia, 2000; 2003; 2006)

2.3.3 Dunning's classification of FDI

FDI can fall into one of the four categories (Dunning, 1988; 2000):

- **Market-seeking FDI**: This is where the investor wishes to take advantage of economies of scale in production or where the foreign investor is faced with barriers to exporting from the home country. The access to economies of scale are achieved through opening up of local or adjacent markets, but these markets should involve large scale populations and the ability to support the increased levels of demand with a reasonable period of time. Eicher and Kang's (2004) make this point clear when they compared the opportunities in small or large countries.
- **Resource-seeking FDI:** Resource seeking FDIs are undertaken with the intention of taking advantage of the availability of natural resources or mineral commodities which are scarce in the investors' home country. There is rarely a need in this FDI enterprise for high capital expenditure or high adding activities involved in operating a plant or its equipment. The MNEs avoid investment in internalisation of raw material markets and their resource seeking activities often mean low-added value activity and low capital expenditure.
- **Efficiency seeking FDI:** These FDI ventures are focusing on gaining economies of scale or lower production costs. The efficiency seeking investments take advantage of cross-border specialisation situations and the uneven distribution of immobile created assets. Particular characteristics of the efficiency seeking investment are the domination by firms with integrated global networks that are highly dependent on cost minimization through its global access. Their cost competitiveness is achieved by their control over the value chain and the location of production in places that provide the lowest levels of overall costs.

- **Asset seeking FDI**: Asset seeking FDI enterprises seek to acquire new assets or develop a local partnership that enables the investor to meet domestic needs through improved distribution channels. The enterprises are usually associated with middle-income and industrialised countries. Nunnenkamp (2003) considers these entry modes and recognises that South East Asia is a prime destination now for new investors, although they are still competing for FDI with developed countries (Dunning and Bansal, 1997; Bui Hai Thiem, 2009; Richard and Young, 2007).

2.4 Theories of FDI

In this part of the thesis we examine the different theories on foreign direct investment.

2.4.1 FDI and the Market Imperfection Theory

A significant contribution made to the literature on FDI was made by Steven Hymer (1960) and Charles Kindleburger (1969) when they developed the market imperfection theory that considered where enterprises developed coherent strategies for companies to expand their businesses through capitalising on their clear advantages over the local firms. Such overseas operations require more care, time and effort but local advantages enable the enterprises to maximise the financial returns. Kindleberger (1969) proposed that it was market imperfections in the host country that provide the opportunities for FDI. Rather than searching for perfect competition sites, the investor takes advantage of product differentiation, economies of scale, advanced skills in marketing, high technology access, better management skills, positive government policies and their improved access to capital to take advantage of the host countries imperfections in the market. Although the investor inherits the problems of operating in a new environment, these are counterbalanced by their advantages in competing.

2.4.2 FDI in the Context of the Internalisation Theory

McManus (1972) and Buckley and Casson (1976) considered the FDI development in the context of the internalisation theory, especially in transactions arising in the presence of market imperfections or failures. The MNEs foster efficiency strategies and through the internalisation of markets across national boundaries they achieve greater business success. Buckley and Casson (1976) identified that the creation of internal markets allowed them to assign intellectual property rights to these enterprises and take advantage of the markets imperfections (see also: Rugman, 1982; Parry, 1985).

The basis of the internalisation theory is transaction cost economics (Williamson, 1975; 1985), where there is the existence of factors that incentivise opportunistic behaviour between trade partners and the higher transaction costs incurred protect the enterprise against opportunism. In such cases the internalisation companies tend to seek high levels of control through common ownership and control of the markets activities. Rather than export or licensing strategies the enterprises carry out internalisation of international activities.

Through this theory we can develop further the understanding of location advantages and assess them through a concentration on efficiency factors. The latest impact of this theory is the concentration on the decision-making process and its taking into account such issues as the *industry-specific factors* which are concerned with the nature of the product and market, the structure of the market, etc and *region-specific factors* that are concerned with the impact of geographical distances, cultural differences, etc. There are *nation-specific factors* such as politics and fiscal influence and *firm-specific factors*, such as the expertise in management and the organisational structures and processes. In Vietnam these factors are influential and their importance increased by the restrictions on the movements of funds and the inefficiency of the financial markets but countered by the low labour and resource costs (Dunning, 1988; 2000; 2001). Pham Huong Mai (2003) has concentrated much of his work on examining how internalisation has impacted significantly on Vietnam's FDI record.

2.4.3 FDI and the Eclectic Theory

The eclectic theory (Dunning, 1980; 1988; 2000; 2001) has become a popular analytical framework for understanding FDI success by combining the understanding of determinants of FDI with other theories such as organisational theory, location theory and market imperfections approaches. The basis of the eclectic theory is the **OLI** conditions: **O**wnership specific advantages ('why' the firm operates in a foreign country?), **L**ocation advantages ('where the firm produces in a particular host country?), and **I**nternational advantages' ('how' they are to compete in the domestic market of the host country?). The conglomeration of effects of these inter-related pathways are seen as defining the patterns and extent of FDI success. The theory helps analyse why, where and how FDI enterprises operate in host countries (Dunning, 1988).

With **O**wnership-specific advantages, the higher net **O** advantages of other nationalities, the more incentive they have to exploit investment opportunities abroad and thus engage in FDI (Dunning, 1988). The form of intangible assets or the common governance advantages provide the overall positive advantages of the FDI enterprise and factors such as unlicensed secret technology, management knowledge advantages, and access to foreign markets enable the FDI to enjoy profitable benefits over their competitors (Zhao and Decker, 2007; Nguyen Thi Van Anh, 1995).

The MNE use their advantages in internalisation incentives to maximise their ownership specific advantages across borders, while maintaining the advantages within their own organisation.The preference is for internalising their advantages rather than take the risks of licensing them. The **I** factor is a result of the market imperfections and mainly concerned with the interrelation between ownership and internalisation advantages. Internalisation enables the enterprise to acquire further ownership advantages such as the increase of their assets (Dunning, 2001; 1988; Dunning and Bansal, 1997).

A main condition for the advancement of MNEs is the location specific advantages. The MNE combine their ownership specific advantages with the positive factors of the host country in areas such as larger markets, population growth, etc, combined with infrastructure advantages, political stability and positive factors such as stable interest rates, beneficial tax tariffs and the balance of trade (Rugman, 1982). Thus, the macro-levels of the economy help determine the location, size and type of FDI.

This, thus, points to the eclectic theory as having a number of positive aspects for studying FDI development in Vietnam, where the transition provides additional factors from the host country's characteristics. The eclectic theory encourages a focus on analysing the impact of a host country's particular characteristics and the affect these have on FDI development. The theory points out that 'countries with low labour costs and/or natural resources tend to have an above average inward investment because of their locational attractions, while rich industrialised countries have an above average outward direct investment, because their factor endowments favor mobile ownership advantages' (Dunning, 1981, p.50).

Le Viet Anh (2004) reviews FDI and sees the locational advantages as the chie focus of his study of Vietnam, with economic size, the lower labour costs, the fiscal incentives and the markets openness. The swift and impressive rise in FDI in Vietnam can thus be best studied through a combination of the Market Imperfection Theory and the Eclectic Theory with a close attention also to how culture impacts on FDI outcomes.

2.5 <u>The Complex Factors influencing FDI</u>

The increases in capital flows, advanced technology, human resources skills and market know-how are some of the major benefits accrued from the development of FDI and are the reasons why nearly all countries are actively seeking to attract FDI. In the next paragraphs the thesis examines the theories of international investment in the context of trying to attract foreign investment.

Table 2.1 : Host Country determinants of FDI

Host country determinants

I. Policy framework for FDI

- Economic, political and social stability
- Rules regarding entry and operations
- Standards of treatment of foreign affiliates
- Policies on functioning and structure of markets (especially competition and M&A policies)
- International trade and FDI agreements
- Privatization policy
- Trade policy (tariffs and NTBs) and coherence of FDI and trade policies
- Tax policy

II. Economic determinants

III. Business facilitation

- Investment promotion
- Investment incentives
- Hassle costs or red tape (corruption, administrative efficiency, etc.)
- Social amenities (quality of life, bilingual schools, etc.)
- Goog infrastructure and support services (banking, legal accountancy service,etc.)
- Social capital, attitude to work

Type of FDI by motives of TNCs	**Principal economic determinants in host countries**
A. Market – seeking	• Market size and per capita income • Market growth • Access to regional and global market • Country specific consumer preferences • Structure of markets
B. Resource – seeking	• Availability of raw materials and natural resources (e.g. for tourism) • Cost of raw materials • Physical infrastructure (ports, roads, railways, power, telecom) • Availability & cost of skilled labour
C. Efficiency-seeking	• Low-cost unskilled labour or skilled labour • Cost of resources and labour adjusted for productivity • Other input costs, e.g. transport and communication costs to and from and within host economy • Regional integration agreements (inter-country division of labour)
D. Strategic asset - seeking	• Note: this type of FDI takes place through cross-border M&As for a variety of strategic reasons • Availability of firm-specific assets: technology, innovatory, marketing, brand names, etc. • Buying market power or new markets, spreading risks, lowering transaction costs.

Source: UNCTAD, 1998.

There are a number of complex factors sought by Transnational Corporations, especially in the importance of intangible assets. These factors encourage the TNCs to invest in foreign countries. A major factor, pointed out in a UNCTAD report of 2005 was the need for the host country to the FDI to have policies of a pro-active nature towards FDI and for the government to welcome its impact on their economies. Within the last two decades the majority of countries have opened their doors to FDI and pursued pro-active policies in its development.Thus, the investors are offered a number of alternatives in their search for a suitable target for their capital and the existence of governments' simply encouraging investment is not enough of an attraction. The FDI investor is searching for instance, for the existence of created assets (Minde, 2000; Siripousalpipat, 2000; Dunning and Wymbs, 2001).

2.5.1 Laws and Government Policies Affecting FDI

Direct government policies supporting FDI are the 'inner ring' of government activities, such as the regulations governing how investors operate, the environment they are expected to invest in and the protection of their investment following the initial entry and on-going operation. The policies supporting this inner ring include market supervision and competition controls (Pham Duy Nghia, 2002; 2004; 2006; Seow and Ching, 2008).

The core FDI policies are intended as mechanisms to either reduce or to increase FDI, and focus on the specific contributions targeted from the investment and its sectoral composition and geographic origin. Despite these central policies to attract FDI into a host country and take advantage of the economic determinants, their impact depends on the presence of intelligent market supervision and a competitive market structure. Alongside the need for entry encouragement policies, the correct policies to sustain that investment, including the standards of treatment of the investment and its protection, there is also a need for liberal investment promotion policies and other measures to attract and facilitate the development of FDI (Seow and Ching, 2008; Dapice, 2003; Iswaran, 2007).

As the global FDI market becomes more selective and competitive there is a need for strong and direct influence on both inner and outer ring policies, with a realisation that although the core policies are vital, the supporting environment of additional facors can be equally as important to the success of the development of FDI (UNCTAD 1998).

Macro-economic policies such as sound monetary control and the strategies for supporting secure price stability, clearly impact on the costs involved in capital investment, and are now seen as just as important as the traditional core policies promoting a host country's development of FDI. The pro investment fiscal policies, such as exchange rate policies for the transfer of profits are essential elements in developing the locational advantages of a host country. The host country's trade and privatisation policies are also major influences, alongside international agreements, such as bi-lateral investment treaties (BITs). Corporate organisational issues become vital factors as the global market for competing for FDI grows and develops. It should be recognised that FDI is part of the globalisation of the world economy and that FDI development is essential for the growth of any economy (Javasuruja, 1993; Luu Van Dat, 1997; Pham Duy Nghia, 2000; 2001).

The simplicity of decision-making over the targeting of locations for FDI has become both far more sophisticated and intense and a multitude of factors are taken in to consideration when FDI investors are searching for a suitable host country. For example, as technology and rapid advancements are made in the advantages accrued from technological innovation, the policies of host country toward technological development become vital factors in the FDI decision-making process and the government policy approach takes on wider and more influential affects upon a host country's successful attraction of FDI investors. Such issues as telecommunications privatisation or tax credits for technology research, or provision of programmes to facilitate technological partnerships between domestic and foreign firms either attract or deter the capital investment from foreigners needed for the survival of many developing economies (Le Quoc Hoi and Pomfret, 2008). The aim by host country's is to develop a good FDI climate and this provides governments with strong challenges to introduce and support sound investment policies in an era of competition for FDI among countries.

The emergence of new areas of policy seen as impacting upon FDI development, such as in the production of created assets through such elements as the development of human capital or the establishment of new innovations in technology are seen as essential parts of building the right framework for FDI. In this respect it becomes important for governments to understand why and how TNCs make the decisions they do in locating and sustaining their FDI strategies. The national policy framework determines to a large extent the capacity of a host country to develop its record in successful management of its FDI performance (Bui Hai Thiem, 2009; Athukorala and Tran Quang Tien, 2009; Nguyen Ngoc Son, 2008)

Host country governments are only able to compete in the increasingly more competitive FDI market by being pro-active in promoting FDI and this means they must display the right 'attitude' towards the foreign investor, as for instance, in their active demonstration of anti-corruption policies, the reduction of red tape involved in business and the provision of services that aid foreign investors operate in the host country. These policies need to be more liberal based and they are to be expected by the investor, meaning that governments are obligated to ensure their existence if they want to attract a significant share of the global FDI market. Le Viet Anh (2004) identifies how the Vietnam Government has focused on maintaining an environment of political and economic stability alongside numerous changes in the legal framework. However, Le Viet Anh has also recognised that although their remains positive competitive signs in the costs of labour, in contrast, the poor quality and lack of training of that labour are likely to be one of the most important outer ring challenges to its future success in attracting FDI.

Culture, history and numerous current events have a significant impact on how countries develop and nurture their trade and investment outcomes.Vital to this is how open a country is to trade and investment, with many taking a global view rather than a more nationalistic view where the country sees FDI penetration as a threat, as in for example, the competition the FDI ventures provide to their previously protected domestic industries. How receptive a country is to FDI is reflected in the amount of barriers and restrictions they provide to foreign capital investors. The more open and attractive the legal framework is the more likely a country is to attract FDI and provide new opportunities in exports, imports and investment (Pham Duy Nghia, 2002; 2003; 2006).

In the case of Vietnam there is the classic and daunting problem of it attracting FDI while also in the process of transition from a command economy to a market economy. This gigantic task involving wholesale reforms in the legal system is likely to make FDI attraction a delicate balance between change and stability. The process of change, while maintaining stability is taking place in a situation where a high cost and wasteful system of communism is being transformed by the competitiveness and challenges of the market system, requiring increases in productivity and efficiency at the same time as coping with a culture of inefficiency and low productivity, aggravated by a lack of market competitiveness. . These factors were focused on by Itoga (1992) for the countries of ‘Indochina’ and later developed by Le Dang Doanh (2002). The legal framework is challenged by a need to move towards new levels of transparency and requires a fostering of certainty and efficiency in investment. A point reviewed by Pham Duy Nghia (2000; 2001; 2003; 2004) in his focus upon the direct impact on commercial companies.

Equally important is the challenge of political risk where governments’ political changes are likely to have a significant impact upon the business environment. Political decision-making has a direct impact upon such factors as the exporters market, the manufacturers’ production facilities and the transference of profits to home countries. However, in Vietnam the political situation is complicated and contradictory. On the one hand, while the communist system and its strict maintenance by the Party creates a certain level of positive stability in the political system, its slow and resistant change in many areas, such as the maintenance of support for ‘protected’ industries such as insurance and banking, provides numerous negative aspects for prospective investors. This is aggravated by the dated and often confusing laws remaining from a still operating communist system intent on controlling all aspects of society. For instance, an investment in something as simple as a café or bar is beset by problems in license application, fire licenses, licenses for painting and decorating, etc, made even more difficult by the almost instutionalised levels of corruption where investors feel forced to make pay-offs, rather than face what is a series of difficult, expensive and bureaucratic systems of multiple licensing needs (Desai, 1997).

2.5.2 The Economic Determinants of FDI

3.1.2.1. FDI and the Importance of Natural Resources

A vital and historically important determinant of FDI is the availability of natural resources in the host country (WIR, 1998). In the 19th Century, much of the FDI by European, American and Japanese firms need to secure cheap and reliable access to minerals and other primary products essential to the growth of their industries in their home countries. By World War II, 60 per cent of the world FDI stock was in natural resources (Cherunilam, 2007). However, over the last few decades the importance of natural resources as a major determinant of FDI has declined. This has been a result of the increasing focus away from the primary sector and towards the production and distribution of raw or processed products by often large state-owned enterprises with the required capital and skills, although the presence of rich sources of natural resources still does remain an attraction to foreign investors (Cherunilam, 2007; Solatanov, 2006; Green and McNaughton, 1995).

Although the relative, but not absolute importance of natural resources has occurred, they still remain a primary attraction for many firms. They are a major factor, for example, in FDI flows to much of Africa, to Australia, to Azerbaijan, Kazakhstan and the Russian Federation. However, regardless of their availability, it still requires the presence of a welcoming system to foreign investors where the access to permits, licences, etc is quick, easy and low cost processes (Lipsey, 2001; Salarakos, 2006).

3.1.2.2. Market Size and Market Growth as Influences on FDI

Market size and market growth remain key economic determinants of FDI with many TNCs motivated by a need to access new markets and to increasing their share in existing markets in order for them to remain competitive. The FDI investor will consider the size of the market, especially in relation to the population as measured by total and per capita income (Rasciute and Pentecost, 2008).

There is a need to define the prospects offered by that domestic market and to calculate the levels of domestic demand, with the development speed, the scale of the market, the consumption index and the competitive merchandising opportunities factors taken into consideration. A vital factor in the decision-making processes of foreign investors is the levels of access to the customer base offered by the domestic market (Vallejo, 2006; Rasciute and Pentecost, 2008).

The size and levels of growth of the domestic markets, alongside their geographic proximity and likely access to other key potential markets form an essential part of decision-making of major foreign investors, Natural resources and the national market size are traditional economic determinants and play an essential role in attracting FDI. The economic determinants related to large markets, trade barriers and non-tradable services still account for a large share of worldwide FDI flows (Phu My Yen, 1997; Le Dang Doanh, 2002; Nunnenkamp, 2003).

3.1.2.3. The Impact of the Labour Market on FDI

Low labour costs and the quality of the human resources are still an indispensable factor in the attraction of FDI, coupled with the need for a system that allows easy recruitment of that labour and the opportunity to improve the technical skills of the labour force (Bui Anh Tuan, 1991). TNCs are attracted by countries that concentrate on development their human resources. This has become a high priority issue in Vietnam where the skills levels and productivity of the labour force need a lot of improvement. Nevertheless, the Government is trying to overcome these problems. For example, a MOLISA policy document (Paper No.18- MOLISA- 'Labour and Social Issues Emerging from Vietnam WTO Entry) notes how FDI Law has consistently developed to encourage a favourable labour market climate for investors.

3.1.2.4. Created Assets and the Success of FDI

Alongside the importance of traditional determinants of FDI and the locational advantages available, the investor is constantly searching for other competitiveness enhancing factors (Le Dang Doanh, 2002; Nguyen Thi Van Anh, 1995; Brouthers, *et.al*, 1996; Zhao and Decker, 2007). The existence of created assets is now seen as a major determinant of FDI and for the attraction of foreign investment in flows, as the TNCs seek a number of created assets as other means of providing incentives for investment besides the traditional determinants such as natural resources or large domestic markets. UNCTAD (2007) shows, for example, that Costa Rica created the conditions and human capital that were needed to attract a USD500 million investment project from the Intel Corporation in 1997 (UNCTAD, 2007).

3.1.2.5. FDI and the Costs of Infrastructure and Transactions

The fundamental basis for investment decision is whether the investment environment facilitates foreign invested enterprises' activities. The investment environment can be highly rated if it provides for the infrastructure that supports economic activities such as harbours, roads, communications, electricity, and water systems. The more under-developed economy a country is the less performing the infrastructure is and subsequently there is a 'knock on' affect to the success of attracting FDI. The absence of a good infrastructure and the subsequent increases in costs either deter the initial investment or negatively affect future profits.

2.5.3 Government Facilitation of Investment

The liberalisation of core national FDI policies is increasingly complemented by proactive measures by host-country governments, aimed at facilitating FDI and the business that foreign investors undertake in a host country. With more and more countries adopting open FDI policies and actively seeking FDI to supplement their domestic resources and capabilities, such measures have become increasingly routine, pervasive and sophisticated (Pham Duy Nghia, 2000; Dapice, 2003).

These include measures relates to FDI promotion, the provision of incentives to foreign investors, the reduction of the 'hassle costs' of doing business in a host country, and the provision of amenities that contribute to the quality of life of expatriate personnel in host countries.

3.1.2.6. Investment Promotion Strategies

One important category of business facilitating measures relates to FDI promotion, which includes a range of programmes and actions, typically undertaken by investment promotion agencies (IPAs) established (or transformed from earlier screening and monitoring agencies) for the purpose. The key functions of FDI promotion at present include image-building, investment generation and targeting, investment facilitation, after-care servicing, and policy advocacy with respect to FDI (Lim, 2001; Thomas, 2009).

Historically, the need for promotional action and measures arose when countries changed their attitudes and policies towards the role of FDI in their economies from negative stance to positive promotion, but investors responded more weakly than desired. As that experience and others have made clear, when making investment decisions, TNCs do not have perfect – or sometimes even adequate – information about all host countries or locations; moreover, they dislike risk and prefer known locations and may even be biased and subjective. At the same time, when designing policies, governments need an understanding of what TNCs need or more generally, is investor-friendly. Investment promotion activities can address both these shortcomings. Over time, promotional activity has become more important and expanded its scope. The scope of investment promotion policy has grown from a first generation approach of simply liberalising FDI policies to a second-generation one including marketing of countries as locations and setting up IPAs and most recently, to a third-generation one targeting foreign investors, marketing sub-national regions and matching location advantages with foreign investors' needs (Thomas, 2009). In an increasinigly competitive market for foreign investment, governments' can no longer wait for the investor to come to them, but instead must go out and actively promote their country as an investment opportunity.

3.1.2.7. Incentives for Attracting FDI

Incentives are measurable economic advantages afforded to specific enterprises or categories of enterprises by (or at the direction of) governments (national, regional or local) in order to encourage them to behave in a certain manner (UNCTAD 1998, p.102). Governments use incentives to attract FDI to their respective countries, regions or localities (locational incentives), or to steer it into favoured industries or activities or to make foreign affiliates undertake functions such as training, local sourcing or R&D that it regards as desirable (behavioural incentives).

The main types of investment incentives used by governments are financial incentives (e.g. outright grants and loans at concessional interest rates); fiscal incentives (e.g. tax holidays and reduced tax rates); and other incentives such as subsidised infrastructure or services, market preferences, and regulatory concessions, including exemptions from labour or environmental laws. The effectiveness of financial incentives in attracting FDI is analysed by Easson (2004), who sees the impact on cost effectiveness of FDI ventures as vital to their success.

The main rationale for providing incentives to attract FDI to a location (or an industry or activity therein) is the need to correct the failure of markets to capture the wider benefits arising from externalities in production that may arise from economies of scale, diffusion of knowledge, or upgrading of skills. To the extent that such externalities exist in a host economy, they justify offering incentives to the point that the private returns equal social returns, although the latter may be difficult to calculate.

It is generally agreed that incentives are rarely the main determinant of investment location decisions by TNCs. But where all else is equal, they can tilt the balance in favour of a particular location. However, although incentives may assist in attracting FDI flows to a location and may in principle be justified on the grounds mentioned above, they can involve significant costs for host governments and ensuring that the costs do not exceed the benefits involved is not easy. Location incentives can be economically inefficient if they divert investment from other locations that would have been selected on economic grounds (Le Viet Anh, 2004).

More importantly, if the offer of incentives by one country leads to a bidding war for FDI, host countries lose to the TNC (or its home country, if it can tax away the concessions). If incentives are used to address market failures, the best policy may often be to correct the failure rather than to compensate for it. For these and other reasons, there is a widespread view that countries should try to attract FDI not so much by offering incentives as by building genuine economic advantages and a favourable investment climate. Blomstrom and Kokko (2003) believe financial investment incentives are actually not an efficient way of attracting FDI, or of improving the general state of the host economy, as local firms rarely do experience any significant ‘spillover’ of the funding.

2.6 The Impact of FDI on a Host Country

Since the end of the Second World War, one significant phenomenon in the world economy is the rapid growth of foreign direct investment (FDI) in the wake of the rapid expansion of TNCs. Although FDI growth slowed or even dropped occasionally, it has been maintaining an overall trend of growth. With the growth of FDI, there have been many significant changes in the world economy and politics, such as the growth and liberalisation of international trade, the formation of regional trading groups, the rapid expansion of many industrialised countries, etc. Thus, FDI has been playing an increasingly important role in international business and globalization over the years (Aldana-Benetez and Posadas, 1994; Greer and Singh, 2000)

FDI plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organisational technologies and management skills, and as such can provide a strong impetus to economic development (Alburquerque, 2000).

The overwhelming majority of foreign direct investment is made in the form of fixtures, machinery, equipment and buildings (in other words ‘real assets’). This investment is achieved or accomplished mostly via mergers & acquisitions. In the case of traditional manufacturing, this has been the primary mechanism for investment and has been very efficient. Within the past decade there has been a dramatic increase in the number of technology startups and this, together with the rise in prominence of Internet usage, which has fostered increasing changes in foreign investment patterns. Many of these high tech startups are very small companies that have grown out of research & development projects often affiliated with major universities and with some government sponsorship. Unlike traditional manufacturers, many of these companies do not require huge manufacturing plants and immense warehouses to store inventory. Another factor to consider is the number of companies whose primary product is an intellectual property right such as a software program or a software-based technology or process. Companies such as these can be housed almost anywhere and therefore making a capital investment in them does not require huge outlays for fixtures, machinery and plants (Dunning and Bansal, 1997; Dapice, 2003, Richard and Yang, 2007; Le Quoc Hoi and Pomfret, 2008).

The most profound effect has been seen in developing countries, where yearly foreign direct investment flows have increased from an average of less than USD10 billion in the 1970s to a yearly average of less than USD20 billion in the 1980s, to explode in the 1990s from USD26.7billion in 1990 to USD179 billion in 1998 and USD208 billion in 1999 and now comprise a large portion of global FDI. Driven by mergers and acquisitions and internationalization of production in a range of industries, FDI into developed countries rose to USD636 billion, from USD481 billion in 1998 (data by UNCTAD, as cited in Graham and Spaulding, 2005).

Proponents of foreign investment point out that the exchange of investment flows benefits both the home country from which the investment originates and the host country, the destination of the investment. Opponents of FDI note that multinational conglomerates are able to wield great power over smaller and weaker economies and can drive out much local competition. The truth lies somewhere in the middle (Singh, 2001; 2003).

2.6.1 Benefits to the Host Country of Foreign Investment

FDI is now an essential part of the modern global economy. In less developed countries, FDI has become an important source of capital, technology, know-how and other valuable resources that otherwise would be unavailable. To the transition economies, whose internal sources of finance dried up due to economic recessions and collapse of government budgets, FDI too becomes a fundamental factor in their modernisation. FDI may greatly assist economic development by spurring domestic competition and thereby resulting eventually in higher productivity, lower prices and more efficient resource allocation. Thus, FDI is a valuable contribution to economic and social development (UNCTAD, 1999).

Aside from increasing outputs and incomes, potential benefits to host countries from FDI flows include the following:

- *Creating jobs*, the most common benefit associated with FDI is increased and protected employment. Together with new employment, additional income and spending power for local residents will come.
- *Generating revenue*, FDI will widen the local tax base and contribute to Government's revenue. Even if foreign investors are exempted wholly from corporate income tax, the Government can generate revenue from personal income tax and other indirect taxes.
- *Foreign firms bring superior technology*. The extent of benefits to host countries depends on whether the technology spills over to domestic and other foreign-invested firms.
- *Foreign investment increases competition in the host country*. The entry of a new firm in a non-tradable sector increases industry output and may thereby reduce domestic price, leading to a net improvement in welfare.
- *Foreign investment gives advantages in terms of export market access arising either form foreign firms' economies of scale in marketing or from their ability to gain market access abroad*. Besides their contributions through joint ventures, foreign firms can serve as catalysts for other domestic exporters. In an empirical analysis, the probability that a domestic plant will export was found to be positively correlated with proximity to multi-national firms. One implication is that government may encourage potential exporters to locate near each other by (i) creating special economic zones or export processing zones, or promoting clusters, or by (ii) conferring special benefits, such as duty-free imports or inputs, subsidised infrastructure, or tax holidays, to help reduce costs for domestic forms in breaking into foreign markets.

- *Foreign investment can aid in bridging a host country's foreign exchange gap*. Two gaps may exist in the economy: insufficient savings to support capital accumulation to achieve a given growth target, and insufficient foreign exchange to purchase imports. Often investment requires imported inputs. If domestic savings are insufficient, or face barriers in being converted to foreign exchange to acquire imports, they may be insufficient to guarantee growth. Capital inflows help ensure that foreign exchange will be available to purchase imports for investment (Brooks, 2003).

2.6.2 FDI Home Country Benefits

FDI is considered a major instrument through which the home country could maintain or increase its relative position in world markets. In other words, FDI is recognised as an effective way to securing key raw materials, maintaining market position, and as a tool of diplomacy (Desai, 1997; Taylor and Thrift, 1982). Hence, potential benefits to home countries from FDI flows include the following:

- *Improve Balance of Payment for inward flow of foreign earnings*. Same as host countries, home countries need a healthy balance of payment as well, while the multiple effects of outward direct investment also involve some individual effects which result respectively in benefits.
- *Assure of manufacturing base with low costs of production*. It is the case that enterprises' investment aimed at making use of low cost labour and cheap raw material, thus, reducing costs of production to increase their competitiveness. This form is very effective with industries that are labour intensive. Countries having an abundant labour force with low costs became countries to be invested in. In the future, investment in foreign countries shall spread out to other countries.

- *Assure domestic market*. This is the case of selling products at the producing country; it meant that investment aimed at domestic demand. Countries with high population and forecasted to be developed in respect of market scale became that to be invested in (Krugman and Helpman, 1989; Feenstra, 2004).

2.6.3 The Linkages Between Economic Growth and FDI

Economic growth relies on investment and the subsequent capital inflows and the additional investments from TNCs affect the volume and characteristics of the overall inputs of FDI. The outcome is that there are direct linkages between economic growth and the impact of FDI, although there are still questions from some economists on whether we can make a direct causal link between FDI and economic growth of a host country (Nguyen Phi Lan, 2006).

In the neoclassical theory of economic growth the linkage is made between the saving-investment gap, the foreign exchange gap and the fiscal gap, where economic growth is seen as occurring in ‘stages’ that reflect the influence of the presence of FDI (Rostow, 1956; 1971). FDI inflows provide both capital and the benefits of transfers of new technologies in transitional economies (Nguyen Phi Lan, 2006). In Solow’s neoclassical growth model (1956) Solow focused on how the growth outputs caused increases in the quality and number of the labour, chiefly through a direct influence on population growth, the development of education, the inputs of foreign capital and the technological advantages brought to the host country (Nguyen Phi Lan, 2006) Endogenous growth theories explain that FDI development needs ‘known externalities’ and the availability of high levels of ‘human capital’.

Balasubramanyam *et. al.* (1996) showed that growth is driven through the presence of FDI while Blomstrom and Kokko (1998) concentrated on the benefits multi-national corporations (MNCs) have in their possessions of modern technologies which enable them to be highly competitive against both other MNCs and local companies. Such competition forces the local firms to imitate the foreign competition in order to remain competitive and profitable.

In the endogenous growth theory, the economic growth of the host developing country is directly linked to the influence of FDI through the subsequent inputs gained in the development of managerial capacities and the growth of a research and development culture. The MNCs bring with them a host of human resource developments including the training of local workers to meet international standards and the eventual attainment of higher skill levels in technology and management. Developing countries often suffer from a low level of skills and incentives for research and development, but FDI inevitably brings pressure on the host country to develop these areas and create longer term growth plans that provide greater stability to the host country’s economy (Blomstrom and Kokko, 1998; Balasubramanyam *et. al.* 1996). In the Eclectic Theory of FDI a different causal linkage is made between economic growth and FDI, where the location advantages are emphasised and seen as a major determinant of FDI. Chakrabarti (2001), Asiedu (2002) and Zhao (2003) point out that it is the advantages of the host country that actualy attracts the FDI and we have a situation where economic growth attracts FDI as the main determinant, rather than seeing economic growth as the consequence of FDI (Moore, 1993; Lucas, 1993; Cernat and Vranceanu, 2002).

In the case of Blomstrom, Lipsey and Zejan (1992), a single equation estimation method using data from 1960-1985 for 78 developing countries found that a case could be made for seeing FDI as a positive influence upon economic growth and these findings were re-enforced by Borensztein *et. al.* (1998), where the influence of 'technological diffusions' of FDI in 69 developing countries over two periods, 1970-1979 and 1980-1989 clearly showed a direct link between FDI and economic growth. In addition, there was evidence of clear linkages between foreign and domestic investment. However, Bengoa and Sancher-Robles (2003) emphasised that this causality rested on the host country having 'adequate human capital, economic stability, and liberalised markets' (Nguyen Phi Lan, 2006). Wang and Wong (2004), in a study of 84 countries also pointed to the dominance of human capital as a determinant of FDI, and indicated that the development of the manufacturing sector through FDI was a vital influence on economic growth when there existed sufficient levels of human capital (Nguyen Phi Lan, 2006). However, the impact on non-manufacturing sectors of FDI was not seen as significant. For Alfaro *et al* (2002), the linkage between economic growth and FDI was also determined by the levels of development of the host countries financial markets, a view also supported by Hermes and Lensink (2003) whose study of 67 developing countries from 1970-1995 and Aghion *et. al*. (2006) study of 118 countries from 1960 to 2000, confirmed Alfaro's hypothesis that financial markets significantly influenced both the economic growth and the development of FDI.

Jackson and Markowski (1995) and Balasubramanyam *et. al.* (1996) demonstrated that it was economic growth that influenced strongly the record of developing countries attraction of FDI, while Basu *et. al.* (2003), in a study of 23 countries from 1978 to 1996 demonstrated a direct link between GDP and FDI. Despite this, Ekanayake *et. al.* (2003) used a vector autoregressive (VAR) model and error correction techniques to illustrate how the linkages between output growth, the development of the export sector and the growth of FDI were clearly linked to the growth of economies in both developed and developing countries. Nevertheless, it was easier to find direct causal links between the development of a host countries export sector and economic growth, than it was to prove a connection between economic growth and FDI. Tsai (1994) in a study of 62 countries from 1975 to 1978 and 51 countries from 1983 to 1986 believed there was a direct connection between the growth of the economy and FDI. These studies showed that economic growth was directly linked to having an impact on FDI, but the relationship was also chiefly determined by the levels and quality of human capital (Nguyen Phi Lan, 2006). Saha (2005) focused on a simultaneous system of equations to prove the linkage between economic growth and FDI in 20 countries from Latin America and the Caribbean and found that the influence of both upon each other was positive and significant.

In both the neoclassical growth theories and the endogenous growth theories there have been numerous valid studies to show the positive causal linkages between FDI and economic growth. The savings-investment, foreign exchange and fiscal gaps are solved in neoclassical growth theories by the inflows of FDI, whereas in the endogenous growth theories there is the idea that FDI affects economic growth positively by its ability to bring in new and advanced economic activities, such as in technological developments, which then positively influence economic growth (Nguyen Phi Lan, 2006). The inputs of human resource development, technological innovations and educational advantages are seen as direct linkages to the growth of the host country's economy (Deme and Graddy, 2006; Parente, 2001).

In the Eclectic Theory of FDI the influence of economic growth on developed and developing countries FDI is clearly demonstrated. But, in the case of Vietnam, the studies of FDI and economic growth are yet to be fully developed and much research needs to be carried out. This thesis will overcome some of the gaps in knowledge of the development of FDI and economic growth in Vietnam, and show that Vietnam is an ideal location in which to study the relationship between FDI and economic growth (Dunning, 1988).

2.7 Development of FDI Ventures in Transition Economies

2.7.1 The Movement from Centrally-planned Economy to a Transition Economy

An essential aspect of the study of Vietnam and its FDI is the fact that, like the transformation of the Soviet-bloc countries, Vietnam is moving from a centrally planned economy to a market oriented. Although one must never forget that the system in Vietnam still rests firmly on a basis of communist ideology and that while the movement to a market oriented economy is taking place, the political movement towards a democratic system is still staunchly resisted, and without that basis of democracy the liberalisation of the economy is likely to always be only relative to the lack of progress in the political system. The reform of the Soviet-bloc and Vietnam economies have both been on a long term basis and involved the movement of state owned enterprises to private ownership, which has entailed the withdrawal of sizable amounts of state subsidies and the promotion of the competitive spirit in business (Estrin, 2002). Whole industries were re-structured and resources were re-allocated according to the competitive principles where formerly, industries had relied on the support of the state for both capital and labour. Essential here was reform of the ownership model and the new imperative of focusing on productivity, which required massive changes in the skills and practices of management and the down-sizing of labour forces to create a market friendly model that based its strategies on productivity, efficiency and profitability. The additional challenges were to adopt new technologies and focus in the present and future on the level of customer demands for products and services (Blanchard, 1997).

However, it is hard to see the continued success of Vietnam strategies unless the political situation also moves towards increasing reform. In a centrally-planned economy, government bodies allocate resources and the centrally controlled decision-making is based on quantity-based planning. In the centrally planned economy the firms are either state owned or are collectives. The incidence of private ownership is rare and weak and has little affect on the gross output structure. All enterprises are chiefly focused on factor or product markets driven by mechanisms subverted by the negative and inefficient decision-making processes of the centrally planned economy. Sales and pricing are determined by the government and the consumers have little influence, aggravated by the poor connection between the consumer and supply markets. However, the collapse of the Soviet Union and the clear connection between that and the poor economic strategies of the centrally planned economy meant that only through privatisation and movement away from State control of industry could economies escape stagnation and possible collapse.

The market mechanism, privatisation and production efficiency are the three main platforms of transition for formerly centrally planned economies (Lin, 2006). Nevertheless, such dramatic reforms are always likely to meet strong resistance, especially from the SOEs as it is clear they are likely to become the victims of reform with bankruptcy threatening any of those who cannot access the necessary capital or unable to provide the necessary skills, technologies and know-how to underpin the process of reform.

Any reform on this scale is likely to meet resistance. Especially as its initial impact is likely to be a rise in unemployment and a loss of outputs and there is likely to be a general downturn in the economy. In the case of Vietnam, they also experienced a downturn in the economy with the introduction of *Doi Moi*, but eventually experienced a movement to a more highly skilled and competitive economy.

2.7.2 MNE and the Process of Privatisation

The privatisation of the state owned sector is vital in the reform of a country from a centrally planned economy to a market oriented economy (Estrin, 2002). The government should no longer be solely concerned with employment rates and the importance of political relationships with business and instead focus on productivity, efficiency and profitability as the guiding rules of economic reform (Maw 2002; Guo and Yao 2005).

The transition to a market economy requires the government to allow the market to be driven by the supply-demand relationship and for that to be the basis of returning the economy to the private sector and ending the dominance of the system by SOEs (Nguyen Phi Lan, 2006). However, the government still needs to help by taking on the burdens of debt incurred in the reform of the SOEs and maintaining social and political stability. The centrally controlled period saw firms depend for their survival on the political favouritism of the government and now need to be subject only to the forces of demand, productivity and competition. However, we should note that the continued existence of communism as the single party governance of Vietnam means that the return to productivity, competition and profitability as the guiding foundations of the economy and business can never be totally completed, and the influence of political favouritism and Party relationships is likely to remain a major factor in the success of many businesses in Vietnam (Hoi Dong Bo Truong, 1989).

Corruption, poor management and inefficiency remain in many businesses that are SOEs or former SOEs, and who survive through continued relationships of favouritism with the government. For example, major electricity distributors rely on a fixed price they pay to producers, which is set by the government. Their management of distribution is poor and the control of supply sees waste, numerous power cuts, areas still not developed and a general low performance. Meanwhile, producers are finding that they must pay a fixed price that is actually more than it costs them to produce electricity, and many diversify into other industries in order to gain some profit and deterred from making the investment to improve and expand their capacities for the production of electricity (Hoi Dong Bo Truong, 1989).

The diversification of ownership in the transition process re-structures the economy and introduces competition as the guiding logic of business success, which is essential for any long term growth of the economy. However, that introduction of open markets and competition requires all agencies within the economy to reform, and this includes existing SOEs who must contribute to the improvement of efficiency in all aspects. This includes eventually being able to compete in the international market and at this point the important of FDI becomes a crucial factor in the continued success of reform (Dapice, 2003; Seow and Ching, 2008; Iswaran, 2007).

The choice for governments becomes whether they remain protective of certain firms, both SOEs and particular private entities, a decision which leaves the barriers to foreign firms in place, Or, they can open up fully and welcome the competition of the foreign firms and the challenges it presents to the SOEs and domestic private firms. This expands in influence as foreign firms actually purchase domestic entities (Maw, 2002). They bring modern technology, advanced levels of skills in management and experience of working in a truly competitive environment. However, the reform of Vietnam still remains in a situation where many barriers remain to foreign firms and numerous private agencies that were former SOEs alongside existing SOEs remain in privileged positions, distorting the efforts to transfer the economy over to the market oriented style and eliminating the inefficiencies and corruption of the centrally planned economy (Estrin *et.al* 1997). In Vietnam, where even after over twenty years of reform, the government stills retains numerous constraints and restrictions on foreign entry into many sectors of the economy, such as in insurance, banking and private security.

In studies by Konings (1997), it was shown that de novo private firms performance outstripped that of SOEs in the transition process, while Li (1999) showed that reform did improved their own performance. The emergence of non-state owned enterprises fuels the process of transition and this is compounded by the introduction of MNCs and their affiliates. Li (1999) demonstrates that the transition process, in for example China and movement toward the market oriented model actually causes reform and improvement in many of the state owned enterprises. That shows that transition and economic reform to a market oriented economy has positive impacts on the performance of many state owned enterprises and that the evidence of this can be found in the development of reform in China. However, this is not seen as a totally voluntary and many state owned enterprises are forced by the pressures of competition to reform and eventually compelled to become privately owned.

2.7.3 <u>The Impact of FDI on Transition Economies</u>

The evidence for understanding and analysing the process of reform in developing countries is impressive, but in the last few decades, following the end of the Cold War the literature on FDI in transition economies has grown extensively. Comparative studies have centred on the transition economies in Europe, for instance Konings (1997; 2001) and Angelucci *et. al.* (2002) use data from three countries whereas Damijan *et. al.* (2003) compare the FDI effect in the top ten transition economies. In Kinoshita (2000), Djiankov and Hoekman (2000) they use country specific studies, exploring the firm-level data for manufacturing in the Czech Republic. The transition in China has resulted in a number of empirical studies. For instance, Xiaodong Wu (2001b), Haishun Sun (2001), Liu and Wang (2003) and Lai *et. al.* (2006) covered the impact of FDI on the performance of exports, total factor productivity and on economic growth.

Further studies have focused on FDI spillovers in transition economies such as with Damijan *et. al.* (2003) where static and dynamic panel data techniques were studied in ten countries to further investigate the impact of backward and horizontal spillovers. The studies of the Czech Republic, Poland, Romania and Slovakia revealed horizontal spillovers, while the Czech

Republic, Poland and Slovenia demonstrated backward spillovers. Both Kinoshita (2000) and Djiankov and Hoekman (2000) investigate the Czech data in two consecutive periods, 1992-1996 and 1995-1998. Very little differences were found between the two periods. In a study by Kinoshita (2000) no productivity spillovers were found as a result of the entrance of MNE FDI or from their affiliates and Djankov and Hoekman (2000) come up with a negative FDI effect on local firm productivity. What was discovered was that technology spillovers are often more evident in liberalised transition economies that allow the presence of foreign involvement in the process of privatisation (Konings 2001; Damijan *et. al.* 2003).

Smarzynska 2002b and Damijan *et. al.*, (2003), focused on vertical spillovers and found that in the measurement of horizontal and vertical spillovers could be lessened due to the effects of export and import activities in FIEs. Using input coefficients at a two digit level, the calculation of the influence of spillovers varying over industry classification were found to often be inaccurate and suspect (Le Quoc Hoi and Pomfret, 2008).

Kinoshita (2000) and Damijan *et. al.* (2003) studied the European transition economies mechanisms for research and development and technology spillovers brought through FDI operations and found some degree of spillover. Kinoshita (2000) concentrated on manufacturing firms in the Czech Republic and found that the research and development coefficient was very positive and extensive, with a significant impact on production and productivity. The interaction between research and development and technology spillovers recorded results that showed the absorptive capacity was more important that the record as a renovation tool. Damijan *et. al.* (2003) however, did not discover either an innovative or absorptive capacity for research and development in the period of transition economics for any of the ten Eastern European Countries they studied. In fact, in the case of Hungary, Latvia and Estonia they found that research and development record was actually a barrier to the promotion of FDI spillovers.

The reasons for this may be that the OLS estimates were used in the studies were used in the Damijan *et. al.*study through the two-step Heckman procedure while Kinoshita used panel data techniques. However, there may also be a correlation between expenditure on research and development and foreign investment, where FIEs are more likely to invest heavily in research and development than local firms (Kinoshita, 2000).

There is significant evidence that FDI contributes to the improvement of corporate governance in private firms in transition economies. The inputs of capital to joint ventures with SOEs means the new companies are less reliant on financial support form either the banks or the government and that this inevitably leads to greater restraint in the board room on the management of budgets. Konings (2001) studied the effects of FDI on horizontal spillovers and on the impact these had on different ownership types, comparing the results with OLS and the dynamic estimation method developed by Arellano and Bond (1991). The dynamic estimate shows privatised firms do not perform better than SOEs, which is surprising as the levels of activity were more active and productive in the local private sector than in the state-owned sector. Konings (2001), in studies of Bulgaria, Romania and Poland the indirect effect was that negative coefficients for spillovers in Bulgaria and Romania were found. Thus, in less open economies, or in the first stage of transition, spillovers are negative due to domination of the competition effect that forces less efficient firms to exit. Also, in the long term spillovers might occur when the absorptive capacity of the local firms has developed.

Firm level data was used by Angelucci *et. al.* (2002) to investigate the impact of both international and domestic competition and on how the development of a competitive environment affected productivity performance. By focusing on the augmented production function they were able to assess the value added impacts of foreign capital against that of local capital and investigated how additional factors such as employment and import penetration affected the outcomes. Three different econometric methods were used, but confusing results were found. However, it did find that there were positive effects from the introduction of both local and foreign ownership in Poland and Bulgaria, while the impact on Romania was less clear. The inclusion of the interaction between private share and the Herfindahl index, demonstrated that the effects of private local ownership were diminished and that privatisation process needs to be encouraged through the introduction of greater levels of competition.

What is clear is that the introduction of the privatisation model with differentiated private owners involved in the privatisation of state owned firms increased incentives to focus on exports. Foreign shareholders have high expectations that efficiency will be the guiding policy of any enterprise and will lead to greater levels of export, whereas domestic investors, especially those involved in the management structure are focused more on protecting their position and raising their stake in the enterprise, rather than improving the firms performance, which often leads to restrictions on the firms capacity for exports. However, there is further pressure here on restriction of exports from SOES, for the danger is that the government is focused on macro economic objects such as employment and inflation, rather than export led growth strategies, and that influence will be reflected in the strategies of the SOE.

Buck *et. al.* (2000) studied Russia, Belarus and Ukraine through firm level data and aimed at analysing what the export propensity determinants were for local firms, and concentrated to some degree on the levels of managerial stakes in the firms, finding that the more ownership stakes the managers possessed, the lower the levels of incentives to export.

Mickiewicz *et. al.* (2000) and Radosevic *et. al.* (2003) concentrated on the effects of FDI on employment in Eastern European transition economies. Mickiewicz *et. al.* (2000) analysed the extent to which FDI created new jobs in Hungary, the Czech Republic, Slovak Republic and Estonia. They found that generally there was an increase in unemployment in total manufacturing, as well as some significant drops in employment in specific industries. However, this was counter-balanced by the employment creation activities of FIEs. Significant here also was the record in Hungary where it was shown that FIEs had contributed highly to the improvement of employment figures. Overall, Mickiewicz *et. al.* (2000) believed that the contribution of FDI was supplementary to the existing system rather than an employment substitute agency in transition economies.

2.8 Empirical studies Examining the Impact of FDI in Vietnam

The initial opening up of the Vietnam's economy to the global system rested on:

- International trading liberalisation
- Removal of many export taxes
- Removal of many non-tariff barriers
- The reduction in tariff levels and bands- with the maximum tariff reduced to 120 per cent from 200 per cent and the number of bands reduced to 15
- The creation of new economic opportunities through international agreements such as the ASEAN Free Trade Area (AFTA)
- The promotion of import and export duty rebates and the establishment of export processing zones (Jenkins, 2006, 120)

The introduction of *Doi Moi* provided a significant boost to the process and speed of economic reform, which inevitably meant moving forward on a continuous process of elimination of barriers to FDI. This should be understood against a background where in Vietnam, by 1986 the economy was on the point of total collapse and only widespread, dramatic and deep levels of policy reform could bring about any form of recovery. By the 1980s the choice was to open up to the global market and actively welcomes foreign investment and support, or see the total economic collapse of the economy and possibly return to the years of famine and economic disaster seen at such times as in 1945-1946. *Doi Moi* marked the turning point in Vietnam's economy and the reforms have been dramatic with an average growth of 8 per cent in gross domestic product from 1990 to 1997 and 6.5 per cent from 1998 to 2003. Foreign trade and FDI improved to nearly USD 18 billion by 2007 and agricultural production doubled from 1990 to 2005, while exports reached USD49 billion per year by 2007. The per capita income rose from USD220 in 1994 to USD832 by 2007 and industrial production went from 27 per cent of GDP in 1985 to 41 per cent in 2007. Many industries reached impressive rates of growth, such as in the production of oil which went from 40,000 tons in 1986 to 7.6 million tons in 1990 and 12.5 million tons in 1998 (Tran Thi Ben, 1999). The inflation rate dropped from an alarming 774 per cent in 1986 to a more normal 7.5 per cent by 2006, while the poverty rate was reduced from 58.1 per cent in 1993 to 22 per cent in 2005. By 2007 there were 7067 FDI projects with a capital of USD63.5billion (Nguyen Ngoc Anh and Nguyen Thang, 2007).

Nguyen Ngoc Anh and Nguyen Thang (2007) gave the following reasons for the dramatic success as:

- Strategic location
- Stable economic and political environment
- Large natural mineral resources
- A young and well-educated workforce
- The ability to be an export platform for US and EU markets
- Liberal investment environment and a commitment by the Government to economic reform.

The rapid economic growth of Vietnam began with the introduction of the *Doi Moi* policy and the FDI reforms begun in 1987. Even the Asian economic crisis of 1997/1998 failed to seriously impact on Vietnam's recovery, although FDI flows were significantly cut and at one point were only one fifth of the figures for 1996. But prospects of entry to the WTO brought about renewed confidence and Vietnam is witnessing long term and significant growth again in its FDI record.

The expansion of FDI has seen the records in agriculture and the service sectors begin to reach record heights as they too join the manufacturing sector for competitive signs of success in attracting foreign investment. Nguyen Ngoc Anh and Nguyen Thang (2007) identified that in the early years of opening up the market, the industrial zones and real estate sectors showed low levels of interest from foreign investors, but these are potentially very rich areas for development. However, the real estate market still remains one of the most protected areas of government policy, with extremely restrictive laws on ownership and a bureaucratic nightmare to be negotiated for even the simplest land purchase. This is also aggravated by the early focus of investors on only targeting HCMC and Hanoi, leaving vast areas of the country untouched, yet containing a rich potential for investment, such as Hai Phong and Da Nang (Fforde, 1997;

Dollar, 1999).

The Government has been pro-active in attracting foreign investment by offering tax incentives, making a number of regulatory changes such as simplification of the licensing systems and in promoting the transfers of high technology. However, there is a long way to go before the system becomes fully open to foreign investment and the overly burdensome administration of business still remains in many areas, aggravated by some levels of corruption in the existing government systems. Nguyen Ngoc Anh and Nguyen Thang (2007) use Dunning's eclectic theory to examine the levels of success and focus on the OLI (ownership, location and internalisation) framework.

Nguyen Ngoc Anh and Nguyen Thang (2007) point to the importance of exports and the impact of FDI on them, quoting Nguyen Thanh Xuan and Xing (2008), who believe that USD2.5 of FDI will generate USD1 of export. They also venture that FDI spillovers will occur as the domestic firms are forced to imitate and innovate in the light of the increased efficiency and innovation of the FDI forms. However, care should be taken in looking at Vietnam's success as some concerning data shows alarming threats to the future, as with, for instance the fact the each FDI in Thailand generates 3,370 jobs per project, and 2,699 in Malaysia, while Vietnam records a pitiful 86 per project. Vu Bang Tam (2008) declared that foreign investment does have positive and high levels of impact upon the growth of economy's but this should also be recognised as mainly occurring in the manufacturing sectors. They also are concerned about the corruption, especially at the middle ranking government officials' level, and there is no doubt that despite some figures showing a decline in the corruption, the general feeling is in business, corruption still makes a significant impact on the system.

Singer (1950) proposed that FDI will actually 'crowd out' the investment of domestic investors as the international investor has far higher levels of access to the capital markets and thus enjoys significantly higher levels of opportunities to acquire cheaper credit terms and can use that capital advantage to drive out the domestic investor, a factor made even more serious by the international investor have advantages of being able to invest in larger projects and enjoy advantages in comparative costs and market conditions.

Findlay (1978) examined the possibility of negative impacts from the attraction of foreign investment, venturing that the dependency on foreign capital was likely to outweigh the benefits of high technologies. Vu Bang Tam (2008, p.7) in looking at whether the benefits of FDI and its determinants have helped Vietnam's economic growth, examined the economic equations that 'take the logs and time derivatives of the explanatory variables' and finds that 'it yields an equation in growth rates for all variables with a Solow residue measuring total factor productivity (TFP) growth'. For Vu Bang Tam the point to make is that the varied impact of both positive and negative returns for FDI affects on economic growth depends often on whether the host country is an export promoting country like Vietnam or an import substituting economies as is found in many countries in Africa where FDI has shown no real positive impact on growth.

Vu Bang Tam (2007) demonstrates his hypothesis through the accurate calculations and assessment of FDI, and examines its impact on economic growth, but ventures that his final analysis is compromised by a lack of reliable data where accurate reporting continues to be a major problem. Vu Bang Tam concludes that FDI does have a significant and positive effect on economic growth in Vietnam, but that foreign investment growth should be applied though an interaction with labour.

The success of Vietnam in attracting foreign investment has only occurred through wholesale changes in legal and governmental policies and that taking place in an era of globalisation, where FDI inevitably has lead to significant economic growth (Nguyen Thi Tue Anh, *et. al*, 2006). The link for the mutual benefits between FDI and economic growth are:

- FDI inflows help to increase the surplus of capital accounts, improve the balance of payments and the macroeconomic stability of the country.
- The poor countries usually have low rates of capital accumulation and thus, FDI is regarded as a vital supplementary source of capital to support domestic investment, in order to achieve economic growth.
- FDI provides the poor countries with better access to modern technology, easier technology transfer, promotion of knowledge diffusion, while also improving managerial and labour skills (Nguyen Thi Tue Anh *et. al.,* 2006).

The Vietnam Government has had to accept that economic growth and the attraction of foreign investment are two essentially interlinked factors and the increasing levels of competition in global trade means that the government has no choice but to introduce and sustain political, economic and ideological reform (Nguyen Thi Tue Anh *et. al,* 2006, p.180). The mobilisation of capital, technology, organisational and managerial skills depends in the modern economy on being able to attract sustainable FDI inputs and the Communist Party has had to undertake radical reforms in policies that separate the economic sector to some degree from the political ideology of communism and submerge the Vietnam market for FDI into the global network of competitive economics.

However, the reforms cannot be seen as sufficient as there are numerous weakness that remain, such as in the problems in acquiring land use rights, the difficulties in foreign exchange and the barriers to international trade such as profit transference restrictions (Nguyen Thi Tue Anh *et.al*, 2006, p.23). These problems are increased by the poor record on law enforcement in business transactions and the foreign investor feeling that many corrupt practices are not diligently investigated and eliminated by the authorities.

A further area of concern is in the disbursement of FDI wherein 2008, although there was USD31.6 billion of FDI registered, only USD5 billion was actually disbursed. In 2000-2005 disbursement fluctuated between 50 to 80 per cent of newly registered capital, falling to less than 40 per cent in 2006 and 38 per cent in 2007 (Yao, 2008). Such low levels of disbursement and at a declining rate, leads one to question just how effective is foreign investment as 'poor infrastructure, shortage of electricity and skilled personnel' are cited as primary obstacles to the efficient use of FDI (Yao, 2008, p.1).

Pham Thi Huyen (2006) considers these problems as he finds that, 'the successful sourcing of FDI it is necessary to find their specific needs, desires and goals' and a need to improve 'place marketing' potential of Vietnam and develop strategies that are interlinked and focused on improving the attraction of Vietnam as an investment destination (2009, p.23). This includes

- Changes in the form, formality and awareness of government institutions
- Financial incentives
- Organisational changes.

The government in Vietnam has attempted to improve the investment environment through commitment to change in business, government and society, but their remains significant problems pointed out by Pham Thi Huyen in the apparent inability to sufficiently convert registered capital into actual investment (Pham Thi Huyen, 2006 p.32). With Pham Thi Huyen claiming that failure to convert promised capital into actual projects is costing the Vietnamese government more than USD 5 billion a year, the problem is obviously of a serious nature.

Pham Thi Huyen (2006) concentrates on the capital, Hanoi, and found that the inefficient and overly bureaucratic administrative mechanism and the poor regulatory systems and policies convert into high costs for any investment and lead to excessive levels of un-coordination of projects and investment. However, to counter-balance this there is the hard-working labour force, immense potential in the market of 88 million people and a high degree of stability in the political system, but again, one could point to the levels of corruption, the lack of transparency and hidden costs in all projects. Hidden costs that if not seen as corrupt by government officials who demand payment to ensure smoothly running processes of licensing, regulation, etc are obviously seen by many foreign investors as coming close to being unnecessary and verging on illegal barriers to good business. There are very few foreign invested firms that are enjoying smoothly operated and profitable investments that would not point to certain payments that they see as suspect and not required in their home countries.

Since *Doi Moi* was initiated the reform of the economy has accelerated and the record of foreign investment is impressive, with new reforms continuing the process, opening up fresh opportunities for improvement and establishing even better conditions for successful foreign investment in the Vietnamese economy. The improvements include opening up new sectors for investment by foreigners, and policies that include moving responsibility equally for investment start-up costs to the Vietnamese side as well as the foreigner, such as in the switch in cost burdens for land clearance projects in the development of building projects. These were formerly always transferred to the foreign investor but are more likely now to be met by the Vietnamese side (Schaumburg-Müller, 2002). This was demonstrating new levels of concern for the foreign investor being displayed by the Vietnam government. The result is increasing opportunities for the foreigner to capitalise on their investment, with increasing new rights in acquiring land and mortgages, a relaxation of restrictions on currency transfers and capital transactions and the new rights to alter or re-arrange investment to take account of changing circumstances.

The Vietnam government has contributed further to this improvement in the investment environment by improving the training and investment in human resources and reductions in the cost and time taken for administration of the investment. These infra-structural reforms have seen a continual development of systems and human resources, thus reducing the costs to the investor of delays, red tape and inefficiency (Jenkins, 2006). As Red8 Executive, Andrew Goddard explained ‘When we originally decided to penetrate the Vietnam market the initial stages were a nightmare with a turnstile bureaucracy and meant visits to a multitude of offices, filling in a library of forms and never really knowing if you were in the right office or not. Now the new ‘one door’ policy is designed to re-organise the bureaucracy of license applications, business permissions, etc. Now the different functions are being merged and often the process can be completed through one visit to one office and dealing with one more simple process. This helps limit costs of investment and maximise profits.’ (Interview: Andrew Goddard, CEO of Red8 Consulting Services, 15 June 2009).

The development of FDI has seen the government opening up new sectors and encouraged a new focus on investment areas such as on a movement away from, for instance, the over-concentration on the oil and gas sector and a transfer to the manufacturing sector. The new direction of investment has also seen a shift from the emphasis on domestic oriented markets for the manufacturing sector to a new focus on export oriented markets. Nevertheless, some negative aspects remain as Jenkins (2006, p.139) notes, 'the impact on employment has not been very substantial, but the indirect effects have also been minimal and possibly even negative'.

Nguyen Thi Tue Anh *et.al* (2006) is one author who has identified the levels of success in spillover from FDI improvement, with an analysis of 66 foreign invested enterprises compared to the performance of 33 domestic firms. He found that foreign investment actually provides 'investment funds and increases in capital stock, but also improves the investment efficiency of the whole economy' (2006, p.50). With the foreign invested firms possessing numerous advantages over the domestic firms, there was evidence that a foreign project had on average over 18 times larger stock capital and enjoyed far higher levels of use of advanced technology. Despite the FDI enterprises being far less labour intensive, the human resources they had were more efficient and productive than the labour in domestic companies (Jenkins, 2006, p.52). However, the evidence for transfer over of this human resource advantages was very low and it appears that very few FDI trained and highly skilled workers 'spillover' into domestic ventures. In fact, the skilled worker are far more likely to move from one FDI project to another and in some economic sectors such as in textiles and electronics the spillover to domestic firms from FDI ones was found to be virtually zero (Nguyen Thi Tue Anh *et. al.,*2006, p.53). Domestic firms cannot, or they are unwilling, to compete with foreign firms in paying high salaries and other benefits or provide meaningful free training. In addition, the foreign firms often have more modern machinery, better working conditions and more highly skilled managers. Unless drastic action is taken on the part of domestic firms to improve salaries and working conditions against the standards being set by foreign investment ventures, the gap between the skills and quality of human resources is likely to reach critical levels and provide a significant problem for the future of the economy.

The lack of micro and macro data on FDI means that there is a shortage of studies on the economic effects of FDI in Vietnam. The two important studies were undertaken by the General Statistics Office (GSO) (Nguyen Thi Phuong Hoa 2003; Nguyen Thi Tue Anh *et. al.* 2006). The studies use the new endogenous growth theory but are methodologically different with Nguyen Thi Phuong Hoa using provincial level data for 1995-1999 to analyse the impact of foreign investment on GP growth, while Nguyen Thi Tue Anh uses a time series analysis in which the dependent variable is the logarithm of quarterly real GDP per capita.

Nguyen Thi Tue Anh *et. al. (*2006) examined the impact of FDI through proxy variables for human capital. These were: the proportion of working people who finished primary school, the proportion that finished secondary school, and the rate of literacy for the total population. He found that in all specifications, FDI is not clearly showing a positive impact on growth despite its interaction with human capital where FDI shows a clear sign of providing positive affects upon the growth and quality of human capital. FDI was shown to have a complementary effect on domestic investment and foreign investment was clearly also more efficiently used than domestic investment as the coefficients of FDI is greater than that of gross investment. However, Nguyen Thi Tue Anh *et. al.* (2006) used a growth model and did not sufficiently consider the fundamental impact of FDI upon the labour force, the trade policy regime and a wider series of investment forms. A growth model used by Nguyen Thi Phuong Hoa (2003) overcame some of the difficulties of analysis by including more exogenous variables such as public investment, the growth rate of the workforce and population, inflation, education and the levels of skilled workers. The outcome was a clearer picture of positive effects on economic growth by foreign investment and a more distinct interaction between FDI and the improvement of human capital.

The interaction between foreign investment and trade has been extensively analysed by Nguyen Nhu Binh and Haughton (2002), Pham Hoang Mai (2001), Phan Minh Ngoc and Ramstetter (2004), and MPI and USAID (2005). The causal link between international trade and FDI has been of concern for over a decade, especially in the light of the impact of such agreements as the US-Vietnam bilateral trade agreement (BTA) and its affects on FDI, trade performance and economic growth. There are a further two studies on the relationship between foreign investment and export performance and in the first, by Pham Hoang Mai (2001), MPI data is used to identify the determinants of FIE export probability in both the primary and manufacturing sectors. Pham Hoang Mai (2001) is limited in her conclusions as not all FIE data was available at the time and several variables, such as capital intensity, the size of firms, the orientation of export were omitted. The different effects of FDI were considered and based on the experience of Vietnam, using a simple linear regression method, but the interpretation of the data still leaves many questions unanswered.

Phan Minh Ngoc and Ramstetter (2004) looked at the development of the relationship between export propensity and foreign ownership, carrying out a focused study by the comparison of FIE export behaviour divided by groups of two digit Vietnamese Standard of Industrial Classification (VSIC) sectors while also conducting a comparison between enterprises chiefly owned by foreign investors against those owned on the large part by domestic investors. A Tobit estimate, using data from 2000/1 and 2001/2 years and relying on signs and significance of effects on the industrial sector and weighted non-weighted models, showed that export propensity was far higher in firms mainly financed through foreign capital compared to enterprises that were only partially owned by foreigners. However, a problem was a fundamental limitation created by the use of unbalanced data samples for the regression and they do not seem to have been controlled or tested for the lack of variables concerned directly with FDI determinants, such as the policies on trade and industry. Despite this there are still a lack of studies on the market access affects of FDI or on the different behaviour towards international trade of FIEs and domestic firms, including on the export performance of domestic enterprises.

Kokko *et. al.* (2003) studied the FDI determinants rather than focus on the role of foreign investment between 1988 and 2000, using the data to demonstrate how many unsuccessful FDI projects there were. Kokko *et. al.* (2003) was interested in investment failure and used a Probit model focusing on the probability of failure of an investment brought about by difficulties in firm size, the project location, the type of project, the source of investment, local poverty levels and the effective rate of protection. Through the transaction cost approach the study showed how the characterisitcs of difference ventures impacted upon them and therefore led to project failure. However, the study lacks a number of determinants, especially in looking at the host country policies towards the investment and the external circumstances, thus making an accurate analysis of why projects fail suspect.

Three studies have examined the indirect effects of FDI and (Le Thanh Thuy 2005; Nguyen Thi Tue Anh *et. al.* 2006; Le Quoc Hoi 2006) scrutinised the productivity spillovers, with a focus on labour productivity using the endogenous growth method. Le Thanh Thuy (2005) used a log linear labour productivity model and estimated the equation conditioning by three different aspects: capital intensity spillovers, spillovers with technology gap and spillovers within the domestic private sector. Nguyen Thi Tue Anh *et. al.* and Le Quoc Hoi take a different approach and examined how spillovers can be assessed through diverse approaches which not only consider spillover differentiation through the domestic firms capacity for absorptiveness, but also consider the impact spillovers have on the particular industries, on the types of ownership and the geographical locations. However, there still may remain problems with the definitions for technology gaps at the industry level when the impact of foreign sector productivity is weighted in a wider industry sector (Le Thanh Thuy, 2005).

Le Thanh Thuy (2005) investigated the primary and manufacturing sectors in 29 different countries and focused on a seven year period from 1995 to 2002. However, she sub-divided the seven year period into two separate periods of 1995 to 1999 and 2000 to 2002, running both periods through separate regressions of the data composition, although one might see more problems with the use of aggregated data with mis-specification of the model used. What was clear was that there were high levels of variation between two VSIC industries, and yet the empirical model may also have been faulty due to the poor quality of the data sources utilised. Nguyen Thi Tue Anh *et. al.* (2006) and Le Quoc Hoi (2006) on the other hand relied on the data from the GSO and acquired more accurate material for a firm level research made during the 2000-2004 period. The GSO, itself, carried out many reforms over the last decade and its is more probable that the data in Nguyen Thi Tue Anh and Le Quoc Hoi's study is far more reliable than that used by Le Thanh Thuy.They were also more specific in the data required, using a common theoretical model where the productivity of labour was controlled by more relative factors such as the capital intensity, the size of the different firms studied, the economies of scale acquired and characterisitics more specific to the industry. Nguyen Thi Tue Anh *et. al.* (2006) and Le Quoc Hoi (2006) also consider the degree to which geographical flows of foreign investment affect spillovers in different ways and are also concerned with the variables of labour productivity and how foreign investment may affect this as an exogenous variable. Nevertheless, both Nguyen Thi Tue Anh *et. al.* (2006) and Le Quoc Hoi (2006) used simple OLS techniques which may have overestimated the results and did not identify any long term variations in FDI spillovers.

Both Le Thanh Thuy (2005) and Nguyen Thi Tue Anh *et. al.* (2006) demonstrated that there were a number of positive effects resulting from the inputs of FDI, while Le Quoc Hoi (2006) concentrated more on the negative impacts of horizontal spillovers. Le Thanh Thuy (2005) did reveal a marked difference in the positive impacts of spillovers in capital intensive industries compared to the impacts found in labour intensive industries. Equally concerning was that wide technology gaps produced negative impacts upon the success of FDI spillovers, but these were found only in the second period of study. Despite this Le Thanh Thuy (2005) discovered that in the period following 2000, when more reforms were taking effect and the economy was more firmly on the road to liberalisation, the private sector was playing a far more positive roll in improving the impacts of FDI spillovers, and that this demonstrated the highly effective influence of improvement of the economy that privatisation was playing, re-enforcing the belief that movement towards greater openness of the market and promotion of the private sector were the right policies for bringer growth to the Vietnam economy. What the studies also showed was that despite the continued support of government preferences and subsidies to the remaining SOEs, these enterprises were still performing at far lower rates of efficiency and productivity than the MNEs, further demonstrating that the old centrally controlled methods were far less effective than industries operating under the pressures of productivity and profit and subject to the demands of the markets, rather than the levels of support of the government. All of the studies showed that the centrally planned economy was the source of problems in the economy and that despite the varied levels of success of foreign invested enterprises, their overall record was always more positive and effective, while also promising a better future record, than the prospects of the domestic enterprises still operating separate from the competition of the foreign invested enterprises and to some extent still be supported by the government. We can safely assume that the difficulties many domestic firms suffer are more likely to be a result from the still existing levels of government support and that regardless of the difficulties found in foreign invested enterprises, the domestic firms performance is likely to only improve adequately when they copy the foreign firms and let competitiveness and market oriented influences be the main influences on their business decision-making. All studies showed that FDI has impacted upon the performance of the Vietnam economy, and those impacts, on the whole have been immensely beneficial.

From the above studies we can show that Le Quoc Hoi (2006) showed a negative effect for horizontal spillovers and only small positive impacts from vertical spillovers. This may have been due to the focus on only panel data at firm levels, the over use of an OLS method and the lack of differences in defining spillover variables. Le Thanh Thuy (2005) used the two-digit data method and her spillover variables may not have been totally accurate, while Nguyen Thi Tue Anh *et. al.* (2006) and Le Quoc Hoi (2006) calculated horizontal spillovers at the 4-digit VSIC level, but there use of a Vietnam Input-Output table which combines vertical linkages and imported goods data could have produced a large number of errors in measurement. However, despite the methodological problems in collection of data and in its analysis, the studies, as previously said, all show some support for seeing foreign investment as not only beneficial to the Vietnam economy, but probably also essential.

2.9 <u>Conclusion</u>

The Second Chapter of this thesis has examined the existing literature on foreign investment generally and in specifically in Vietnam. Although the general influences on FDI have also been examined the chapter also illustrated how this was qualitatively different when looking at an economy moving from the centrally planned model to the market oriented model. The transitions in the former Soviet bloc countries and in China were helpful in providing historical cases to compare Vietnam with, and similar to China, it is worth noting that although the economic system is in transition, the movement towards a liberalised political model is not evident, and this will obviously have an impact on the future path that FDI takes in Vietnam.

The chapter also supported the basic proposition of the thesis, that there exist gaps in the literature, with many Vietnam studies for instance relying on unreliable data and producing suspect findings. Something this thesis has been able to overcome by accessing more reliable sources of data. Numerous determinants were examined and the finidings were that many of the analyse are impaired by a lack of attention to certain conditions in the country such as the firms capacities and sizes, the low levels of advanced technology, the quality and training of labour and the general; economic conditions supporting investment. In the next chapter we examine the methodology of the thesis.

In looking at the methodology approach of the thesis there is a focus on Dunning's eclectic theory and the utility of examining location, ownership and internalisation advantages. The variables involved allow the determinants of FDI in Vietnam to be examined against a criteria that balances risks against returns, and focusing on the generic impact of transaction costs. However, the case studies of Honda and ANZ bank also provided the opportunity to assess the more qualitiative and subjective influences of developing relational assets that provided maximum impact of the investment of the two MNEs. To understand clearer the need for synergy between the OLI advantages and the immersion into a Confucian culture that provided the dynamism for its development, the next chapter examines how the methodology marries these theories into an analytical framework for guaging the levels of reciprocity. Honda and ANZ Bank not only assessed the need for complicity with local conditions but also developed strategies and systems for optimising their own impact upon the culture and environment. The changing of management systems for instance in Honda, developed mutually beneficial modes of operation that allowed the parent company to reach financial and growth targets, while also learning to change and alter products and services to suit the immediate the customer market.

Generally the focus on Honda and ANZ concerns itself more with locational advantages and the development of these to even reach a point where Honda has not only reached an accomodation with the local culture, but has actually become a part of the culture; with its product, motorbikes, dramatically changing the culture of Vietnam life and these specific products seen as 'Vietnamese' rather than "Japanese'. As one interviewee declared 'Honda is Vietnam and its products like 'the Wave' and the 'Dream' are seen as specifically Vietnamese'.

CHAPTER 3: METHODOLOGY

The definitions of FDI are varied and this thesis relies on an accumulation of classifications accrued from such sources as the IMF, the United Nations, UNCTAD and authors such as Gillis *et al* (1992), Hogendorn (1992), Thirwall (1994) and Myer and Qu (1995). The prominent theories on FDI generally used in the thesis focus on Vernon's Product Life Cycle (PLC) model, the Market Imperfection Theory (MIT), the Transaction Cost (TC) or internalization approach and Dunning's Eclectic Theory. Dunning is the clearest methodology for understanding the Vietnamese case, as its method takes into account a countries particular FDI characteristics and their impact on economic growth. The addition of an emphasis on the impact of culture upon the development of FDI in Vietnam provides this thesis with evidence of its originality and legitimacy to the claim of filling a gap in the literature on FDI and developing countries (Dunning and Bansal, 1997; Dunning, 1980; 1988; 2000; 2001; Dunning and Wymbs, 2001).

In Vernon's Product Life Cycle a three phase model explains the evolution of a product in international trade, including how the export product is produced out of the inward investment. In the early or development phase there is little initial demand and concentration is on skilled production methods, producing a small output for the host country. In the growth phase, the demand for the product in home and international markets is expanded. Production techniques become standardised and tend to move towards a large scale production model with long term commitments to the host economy. Once the process moves towards the 'mature' phase and demand in the innovating market is fully met, then production and technology are further standardised and overseas investment is likely to reach its peak (Vernon, 1974).

In the Market Imperfection Theory (Steven Hymer, 1960), later developed by Charles Kindleberger (1969), the analysis of FDI achieves ground-breaking proportions, with a fully coherent approach to understanding its impact on an economy. In Hymer (1979), for a firm to expand its operations abroad, it is essential that they possess advantages over the local firms. These advantages could be the firms' market position, patents, access to expert markets and to credit sources and the technological advantages.

With the Transaction cost theory the explanation of FDI is carried out through the analysis of the response to market imperfections. Multinational Corporations (MNCs) minimise their transaction costs caused by market imperfections by internalizing their economic activities. Through FDI, structural market imperfections such as tariffs or subsidies, import restrictions, income taxes, foreign exchange controls and other regulatory restrictions can be internalised by the MNC. Market imperfections can impose transaction costs on the transfer of intangible assets, such as technology. To overcome these problems, the MNCs invest in overseas markets instead of selling or licensing their technology or patents (Rugman, 1986; Caves, 1982).

3.1 **Methodological Framework**

Dunning's Eclectic Theory (ET) is a synthesis of the existing literature on the determinants of FDI, and combines many elements of the PLC, MIT and TC models and gives close attention to location aspects (Country Specific Advantages - CSA). Vietnam offers political, economic and socio-cultural advantages for foreign investors. Vietnam culture has often been used as an explanation for the faults and barriers to successful development of FDI in Vietnam, especially as an explanation for over bureaucratic administration, problems with labour productivity and general work practices. A foreign executive said: 'whenever you are criticising the work force, or the official process, the first excuse is almost always – it is the culture' (Interview: Thomas Leonard, Managing Director of Red8 Insurance Services, 15 September 2009). Despite this, the executives of Honda and ANZ identified the general advantages of employing the Vietnamese as a work force that was quick to learn, intelligent and through their cultural tendency towards the family, the society, the country rather than towards themselves as individuals (Ministry of Industry, 2007). Mr Pham Van Nang, Deputy Director, Automobile Division of Honda Vietnam Co. Ltd noted, 'workers leave when the job is done- rather than when the time clock says the shift is ended'.(Interview: Pham Van Nang, Honda Vietnam Company, 30 January 2009).

The hypothesis of the eclectic theory is that the firm can take advantage of the OLI factors. OLI is the Ownership, Location and International advantages and a country progresses through five phases of investment development focused on outcomes concerning the three OLI factors (Brouthers, *et.al*, 1996; Zhao and Decker, 2007; Vernon, 1974).

Stage 1: The local specific advantages of a country are deemed to be insufficient to attract a foreign firm. This excludes the possession of natural resources, but concerns the presence of low per capita income, a poor economic environment, often aggravated by poor political policy-making, an inadequate infrastructure and the lack of a skilled and mobile labour force. It is assumed that these conditions will mean that foreign investment will be very low and the economy unattractive to future outside investors. (Dunning and Narula, 1996)

Stage 2: At this stage there is an increase in direct investment, although outward investment remains low. The country involved must display some degree of locative advantages, such as a good infrastructure and skilled or low cost human resources. A large domestic market is an attractive feature and the high population of Vietnam (now over 88 million in 2009) has always been a good incentive for foreign investors. By the end of stage 2 there is evidence of an increase in outward investment, but at quite low levels and the country is still dominated by a demand for increased inward investment.

Stage 3: The third stage is one marked by increases in both inward and outward investment and the attractiveness of the domestic market is enhanced by the increase in wages and income per capita. With improvements in the domestic innovatory capacity the prospect for increasing foreign investment is enhanced. Foreign investment is often concentrated on efficiency seeking operations.

Stage 4: Outward direct investment equals or exceeds the inward investment and the growth rate of outward flows is still rising faster than that of the inward ones. The domestic firms can compete effectively with foreign firms and penetrate foreign markets.

Stage 5: The net outward investment first falls and then later fluctuates around the zero level. Both inward and outward direct investment is likely to increase. This is the position at which industrialised countries are believed to operate. There is increased propensity for cross border transactions to be conducted within MNCs and as the countries converge in the structure of their location-bound assets their international direct investment positions are likely to become evenly balanced (Dunning and Narula, 1996).

With an economy in transition, the study of Vietnam shows that with low labour costs and rich natural resources the economy has above average inward investment because of location advantages, while industrialised countries have an above average outward direct investment, because their factor endowments favour mobile ownership advantages (Dunning, 1981). MNEs doing business in Vietnam have their own ownership-specific advantages such as better infrastructure and technology, better knowledge and skill levels, better business practices and management skills, and so. MNEs invest to take advantage of the opening market, supported by low labour costs and rich natural resources (Richard and Yang, 2007).

In using Dunning's model to examine determinants of foreign direct investment in Vietnam, the thesis adopts also an analysis of Confucian dynamism to better understand and expand on locational advantages and their impact as a determinant. Hofstede (1980, 2001) examined extensively the need for successful economic activity to result from an understanding of the contrasting impacts of Confucian dynamism and Western-style individualism. Finding cross cultural balance includes mitigating the possiuble differences in needs, values and aspirations.

Although Dunning's theory is an apt tool for accepting a cultural impact upon OLI, the application of this in Asian cultures requires a need to first understand Confucian dynamism, which is basically the major under-pinning identifier of the cultures and even survived decades of ideological ‘re-training’ brought in through one-Party rule and communism. As Kejun Xu (2006, p.1) strongly argues ‘a full understanding of ethical differences of multiple cultures is indispensable for enterprises to survive and ultimately thrive in a foreign market’. In this thesis it is proposed that Confucian thought and the understanding of its influence upon the environment in Vietnam is crucial to showing through Dunning’s approach, the importance of culture learning as a FDI determinant. Kejun Xu (2006) clearly supports the idea that ‘a good understanding of the target market, especially its culture, ethics, and the way people communicate is essential in achieving business success’. Again it is Kejun Xu who points out that even Chairman Mao Zedong’s ‘Cultural Revolution’ could not eliminate the age old traditions of Confucianism and in Vietnam, the Communist system and ideology has equally failed to eradicate the influence of Confucianism upon its own society and it’s the Confucius social and moral values that still remain the cornerstone of the social and business communities behaviour. The business effect of Confucian dynamism in Vietnam is that it proviudes the framework of values that structure the conduct of economic activity. Essential elements are: ‘reverence’ and is most easily understood as a total aversion to causing a person or entity to ‘lose face’; ‘relationship’ as an essential means of communication and the need to build close and developing contacts on the basis of mutual benefits, respect and patience; ‘localisation’ where the ‘foreigner’ makes constant efforts to merge with the local companies/people/organisations; and finally – provide positive benefits and support for the communities the foreign investor locate in (Kejun Xu, 2006).

Thus, it again demonstrates that culture and business are ‘inextricably linked’ and that Dunning’s model can develop a greater focus on examining the influence more closely of culture on the understanding of ownership, location and internalisation advantages and subsequently, better understand the determinants of FDI (Kejun Xu, 2006, p.14)

The linkage between understanding the impact of culture upon FDI and the use of Dunning’s locational theories is concentrated on by Erdener and Shapiro (2005). In a study of Chinese Family Enterprises (CFE) the cultural and economic factors are examined through the Dunning paradigm. By aligning Dunning’s ecletic paradigm of multinational enterprises (MNEs) with the conceptual dimensions of Chinese family businesses, the analytical framework can focus on the influence of Confucian values and morals upon business relationships. The tendency for Vietnam businesses to mirror the Chinese family business style in many respects is reflective of a common adherence to Confucian thought, especially in the importance given to building mutually beneficial relationships and alliances.

Erdener and Shapiro (2005) focus on the relational assets and identify these as trust, culture, networks, contacts and reciprocity, and examine these through their ethno-cultural origins. Just as they promote further research, so does this thesis examine the growth of relational asset building of MNEs in Vietnam. The eclectic paradigm does not presently clearly incorporate relational (ethno-cultural) aspects essential to achieve a more full analysis of the determinants of FDI in Vietnam. The thesis moves on in the later chapters to examine the existing business environment in Vietnam whilst also seeing how Honda and ANZ Bank created an ability to change that environment to owns own benefit through its core competitive advantages.

There have been a number of attempts to advance Dunning's eclectic theory, as with Markusens (1991) Multinational Enterprise Theory, where there is the development of the theory that instead of markets being purely served by exports or products and services from local companies, the multinational possess knowledge based firm specific (FSAs) assets. These are firm based assets such as human capital skills of their employees or brand reputation, and because these assets are easily 'exportable' firms decide to carry out foreign investment strategies. In addition the assets are able to be transferred at lost costs to bases in foreign countries and this further encourages them to carry out FDI strategies. In the Multinational Enterprise Theory, the companies have three motives for investment:

1. Market oriented direct investment
2. Raw material based investment
3. Cost reducing investment

Market oriented direct investment is obviously applicable to Vietnam where the market of over 88 million people, with growing evidence of rising expendable income is a justifiable reason for investment, alongside the rapidly growing economy. The raw materials oriented investment is of course linked to colonial patterns of exploitation and now is still mire likely to involve the extraction of raw materials from former colonized, less developed countries into the developed world. However, rather than crude exploitation, the pattern of this form of investment is now more likely to involve new institutional arrangements, such as partnerships between developed country's companies and less developed country's domestic companies. With cost reducing investment is a popular reason for FDI in Vietnam, where the availability of low labour costs is a prime attraction (Markusen, 1991).

In looking at the theories that are used to explain why firms involve themselves in FDI we can identify the main factors as proportion hypothesis, the technology ladder hypothesis and the FDI dynamics or industrial cluster hypothesis (Sosukpaibul, 2007). The factor proportion hypothesis concerns itself with capital and labour factors and their relationship to production and trade according the Hechsher-Ohlin theory, while the technology ladder hypothesis concerns itself with the production pattern and whether a country can acquire the improved necessary skills and technology to move towards the production of more complicated goods. The FDI dynamics or industrial cluster hypothesis concerns its with the theory that industrialisation stems from whether there is an accumulation of a critical mass of FDI.

While Dunning has provided us with a focused theory to examine foreign direction investment the mainstream view adapts this to focus on 'classical economic theory and emphasizes the connection between FDI and economic growth, capital accumulation, promoting free-market and laissez-faire economics, free trade policies, open markets and individual decision-making' (Pham, 2004). The focus is on primary production inputs, and concerns a movement from 'countries with low marginal productivity' and abundant capital to 'countries with high marginal productivity', but a scarcity of capital (Pham, 2004, p.7). Through FDI the developing country is able to overcome the problems of the savings-investment gap, foreign exchange gap, technological gap and the fiscal gap. It should be remembered that mainstream theories on FDI provide that 'FDI driven high economic growth, changing economic structures and industrialisation also provide backward and forward effects that alleviate poverty and income inequality in developing countries (Pham, 2004, p.10).

However, in returning to Dunning we have an eclectic paradigm that helps explain why two MNEs, Honda and ANZ Bank chose not only to carry out FDI ventures, but chose to situate these in Vietnam. In updates by Dunning (2000) of his theory there is a concentration on the advantages demonstrating that 'relative to those of other firms' the investing firm has ownership advantages which encourages it to carry out FDI ventures. As Dunning notes, the means to penetration of the foreign market that take many forms with 'buying and selling goods and services in the open markets, through a variety of inter-firm non-equity agreements, to the integration of intermediate product markets, and the outright purchase of a foreign corporation' (Dunning, 2000, p.164). However, even in Dunning updates his focus for locational advantages still chiefly focuses on the impact of political and economic factors and remains short on attention to the impact of social and cultural factors. Dunning does not under-estimate the importance of locational factors and even goes as far as to call it the 'key determinant of the foreign production of companies' and linked this to 'context-specific theories of the geographical distribution of FDI'. (Dunning, 2000, p.174). Dunning does ask researchers to consider the importance of inter-country cultural differences, but the term is generic and little research is done on defining and assessing the impact of these cultural differences (Dunning, 2000, p.176).

Thus, with examining theories of FDI we can see that Dunning's Eclectic Paradigm and its focus on ownership, internalisation and location advantages provides a means to analyse the determinants of FDI in Vietnam. The present studies of the theories also identify locational advantages as a key factor, yet, there remains more work to be done in actually defining the cultural and social factors that help structure the success of a foreign venture. This thesis attempts to better define the impact of these factors by applying the concepts to the case studies of Honda and ANZ Bank in Vietnam, and in the process expand on Dunning's eclectic paradigm and its focus on OLI advantages.

3.2 <u>Research methods</u>

Western FDI is a topical issue in Vietnam in terms of the impact on theory and practice. Vietnam's FDI policy making and its changes is indicative of what kind of theory the government is adopting towards foreign investment and its impact on FDI practice. This study covers the theoretical and practical analysis of Vietnam's FDI. The research methods applied to this study include a review of published materials, mail survey, face-to-face interviews, and case studies of ANZ and Honda. A review of published materials helped build up a general picture of the Western FDI theory and practice, including the theoretical explanation and practice, and also embracing FDI policies and changes of the Vietnamese government.

To analyse FDI practice in Vietnam an investigation and field study had to be carried out. The result of this research provides researchers and practitioners with first-hand data and evidence. It also enables the author to supplement quantitative analysis and supports answers to the research questions raised by the author.

The research methods selected and applied were: mail survey, face-to-face interviews, and case studies.

- Mail survey is an efficient and economical way to support observations and provides good coverage (Emory, 1985); but, unlike interviews, it is difficult to probe for additional information or clarification of an answer (Zikmund, 1997).
- Face-to-face interviews enable the interviewer to obtain valuable first hand data and trace the answer to questions (Hussey and Hussey, 1997). The disadvantages of the

interview are that: (a) It is more expensive than mail surveys (Zikmund, 1997) and (b) Face-to-face interviews are more difficult to conduct than mail surveys, as willingness to participate in a face-to-face interview is influenced by cultures (Zikmund, 1997). Also, the different business and political culture of Vietnam sometimes made interview answers a little difficult to understand

- The case studies selected by the author reflect many of the representative problems existing between different companies and different regions.

Reviewing published materials helped the author to draw an overall picture of Vietnam's FDI in terms of its theory and practice, while field work enabled the author to gain updated first-hand data and to explore some questions other researchers have yet to consider. This is because differences in culture, languages and political beliefs between Western countries and Vietnam means that it is difficult for Western researchers to fully understand the impact on business of the culture and political system.

In contrast, because the author is a Vietnamese national, it was easier to gain access and answers to interviews in one-party Communist regime and a partly closed society with all traditional elements of that meaning 'outsider', 'foreigner', are still treated with some suspicious and 'information' is often kept 'secret'. This is often for no particular 'political' reason, but more a consequence of a 'Soviet' style bureaucratic 'mindset'.

The specific characteristics of the research methods used in carrying out the research are explained below.

3.2.1 Desk Research

Published materials included academic articles, research reports, statistical figures, documentation materials, company leaflets, newspaper articles, etc. The research included both English and Vietnamese language resources. Often, the viewpoints from Vietnamese publications are in line with the country's socialist principles and this ideological slant can cause many issues in FDI to be viewed from a biased perspective. This also led to problems in the availability and reliability of the materials sourced as a consequence of various media controls and censorship.

In general publications in Vietnamese resources were generally supportive of the Government's position. Articles written by government officials or official researchers tended to focus on always giving a positive viewpoint on political and economic issues in Vietnam and constantly avoid any constructive criticism, however warranted that criticism is. Thus, authors may feel they are not allowed to go as far as challenging the government position, and primarily support the government policy and follow official rationale.

One could also fear that the government's ideological approach might lead it to release false data and information in order to protect its image and power. As most figures relating to local and national economy were published by government bodies, rather than by independent organisations, it is possible that many of them can be called into question. For example, some local governments tend to give inflated FDI figures to Hanoi, especially when they had difficulty in attracting the planned target number of FDI, thus avoiding censorship or criticism.

In order to resolve the problems of censorship, availability and reliability of Vietnam published materials, the author sought numerous alternatives which included: (1) review of overseas related publications; (2) use of the author's contacts in Vietnam and obtaining many unpublished documents as 'internal' references.

While Vietnamese published materials usually adopted a positive approach towards reporting FDI matters in order to protect the government policy and position, overseas publications about Vietnam's FDI tended to identify and analyse the various problems.

The author has a number of useful contacts in Vietnam's local and central government bodies, research institutions, and foreign investing companies after having worked there for many years. This enabled the author to gain valuable publications and resources, while also able to verify or question some of the published forms of information and data. These included internal FDI news and reports, FDI problems and analysis of them, the debates about Vietnam's government FDI policy and position, and actual and verifiable FDI figures.

The availability and reliability of Vietnamese publications has been improving in recent years, following the country's opening of its doors through *Doi Moi* to the outside world.

For instance, statistical data published by the State Statistics Office and various Ministries is regarded as increasingly trustful and reliable by western researchers and international bodies, and widely used by them as sources of information.

3.2.2 Mail survey

Research data through questionnaire is primary data, and therefore primary data collection methods are required to be employed. In the case of the study (business research), surveying and interviewing are more appropriate and popular methods employed in business research (Zikmund, 1997).

Surveying was carried out by designing a questionnaire and sending it by mail. Research questions included were relatively general and basic and were designed to have adequate coverage of the topic.

- ❖ **Main features**
- **Advantages:** As mentioned earlier, surveys are more efficient than observation and more economical than interview. The on-going study needs to be completed in a limited time. Mail-survey makes information possible to be gathered by a few well-chosen questions which would take much more time and effort to gather by observation. In addition, using the mail as a medium of communication, it can expand geographic coverage at a typically lower cost than interview.
- **Disadvantages:** There are two major weaknesses of mail survey. One is the difficulty of securing the quality of information; the other is the poor percentage of mail return (Emory, 1985).
- ❖ **Survey design**

Some measures were taken in order to improve the quality of information and mail-survey returns

The mail questionnaire was designed and revised several times in order to make it as simple, clear, and easy to answer as possible, as it is generally believed that respondents are unlikely to co-operate with a long and / or complex mail questionnaire. In the questionnaire, the respondents needed to tick an appropriate answer(s). If they wished, they had the opportunity to add some comments to offer more detailed information.

Some incentive was provided to the respondents in order to raise the mail return percentage: (1) Postage-paid self-addressed envelopes were enclosed with the original questionnaire; (2) A special way to send and collect the questionnaire. Because the study was carried out by the author based in the UK, while the survey was conducted in Vietnam, it would have been extremely expensive sending and returning the questionnaire internationally, as international postage is very expensive. Also, it is difficult for people in Vietnam to return post to a Western country. Thus, the sending and receiving the questionnaire was done in Vietnam and by doing so the cost of the postage was largely reduced as Vietnam’s local postage is very cheap, and the author reviewed the results of the questionnaire in Vietnam when visiting. However, there may have been some reticence on the part of respondents to truly answer all the questions.

Special access to respondents was undertaken since it is extremely important to seek assistance and get things done in Vietnam by having special relationships with business people and governmental contacts. Therefore, most questionnaires were sent to contacts which the author had previous relationships with

The questionnaires mainly related to the background information about the case studies. Difficult questions relating to Vietnam's political policy issues were avoided, since political trouble could have been caused to the respondents if they answered the questions as such. Therefore, all the questions were carefully-planned, but relevant to the research questions.

3.2.3 Interviewing

Following the questionnaire survey, a face-to-face interview was carried out. The author obtained more detailed information from each interviewee. Interviewing was considered as the second stage of data collection, following up the results of the mail survey, in order to deepen the research. More detailed and specific questions were discussed at interview. However, one problem was that many interviewed for the case studies specifically asked to keep their identity anonymous. This may reflect the fear found in many former communist and existing communist societies of 'officaldom' and the tendency for many of the people to remain silent, even when subject being studied is quite apolitical.

Two methods were employed in the interview. One was semi-structured (questions asked referred to the essential information about the company), the other was unstructured (open-ended discussions with the companies interviewed about FDI related policies). In general, each interview took an hour. In the first half an hour, for the semi-structured interview, the questions asked were based on the questionnaire, in the second half hour, the author tried to let the interviewees give information and their own viewpoints and comments on Vietnam FDI and their own company's management of the ventures in Vietnam. The evidence and examples given by company managers and directors strongly supported some points the author made in the work.

From the interviews, various printed materials were also provided by the interviewees, including annual reports of Honda's and ANZ FDI performance, government reports and articles and research papers written by interviewees and Vietnamese business analysts.

Following in-depth analysis of the surveys, interviews and published resources, it was clear that Dunning's eclectic theory; especially with its focus on adjusting the knowledge gained on FDI to assess the cultural impact upon outcomes was the correct theory to use in examining the context within which investment determinants operated. A number of other theoretical approaches were also helpful in strengthening the analysis.

3.2.4 Case Study

The selection of two case studies in this thesis was based on the need for "a flexible research approach that are suited to a range of different types of research questions (Ghauri, 2004, p,127). As Ghauri recommends, the need for case studies to underpin the development of a 'how' and 'why' of a hypothesis while validating the basic premise of the theory is essential. In the theiss a major premise is that the culture has a significant impact on the optimum success or not of a foreign investment. The focus on in-depth interviews allows the researcher to balance the theory to be tested against the reality and a multitude of meetings with Vietnamese government officials and leading business entrepreneurs, alongside senior and middle management personnel of both Honda and ANZ Bank produced results that can be interpreted as primary evidence of cultures impact upon foreign investments (Ghauri, 2004, p.111). As Ghauri (2004) notes, case studies are a qualitative means to study a research phenomenon that allow us to take a longitudinal approach, help formulate the right contextuality, provide depth that not only tests theory but is also a theory builder and is holistic in that the research can be approached from a number of angles.

In selecting Honda motorcycle company and ANZ Bank the criteria for justifying their inclusion included the liklihood and initial evidence of national culture based upon a Confucian dynamism having a significant impact upon the success or failure of a foreign investment in the Vietnamese environment. Additional personal advantages were often practical benefits to the quality of the research as the ability of the interviewer to speak the same language help facilitate the benefits of the interviews, whilst also helping the interviewee to understand the nuances of language that are often lost in translation. In addition, the presence of a network of former relationships made access to essential decision-makers and relevant government officials easier and the understanding of the national culture from the native perspective, borner from birth, education and work in the home country prior to the start of the thesis helped this author to comprehend better the outcomes of the research.

As the research progressed, the Honda and ANZ Bank case studies provided the deductive means to further deepen the basic hypothesis. However, a constant difficulty was the tendency in Vietnam of interviewees to 'fear' open voicing of opinions or criticisms. With some government officials, for example, the main concern was whether comment fell inside or outside of the often vague censorship constraints and regulations, and an even greater fear of the possible consequences. This phenomena also extended to interviews with Honda and ANZ personnel. Although it can be surmised that these concerns were often more a consequence of national culture, than of any internal restrictions on openness to criticism or freedom of speech operated by Honda and ANZ management. It is worth remarking at this point that the author of this thesis feels the reluctance of interviewees to speak openly and the fear of voicing strong criticism are further examples of how culture strongly affects the mode of business a foreign company adopts in Vietnam. For example, in Vietnam it is believed to be insulting and disrespectful to openly criticise a person and this often translates into a reluctance to offer any critical comment in interviews on all levels of work, from the levels of productivity of workers to the financial performance of the company. It is worth noting here that the advent and embedding into society of the communist ideology has only strengthened this aversion to openness. Politically, open criticism is avoided and in communism all aspects of life can become seen as 'political' from the performance of government and the usefulness or not of its regulations or to criticism of the levels of skills of Vietnamese business managers. All can be seen as either 'non-patriotic' or 'dangerous' negative comments in a political context, while the confucian culture tends towards seeing such 'negative' comments as destructive influences on the status quo, rather than as constructive means to overcome difficulties in for instance, management systems.

The solution for this thesis was to guarantee certain interviewees most concerned with 'retribution' or 'censorship' total anonymity, while generally allowing all interviewees various means to 'censor' their own comments before inclusion into the thesis. This need for a quite extensive principal of anonymity in personal interviews opens the research to a degree of questioning of its validity, but was necessary in order to guarantee access to some of the most important findings of the research.

The factual data produced from the case studies, through such elements as access to company reports, also helped validate national data and statistics claiming significant foreign investment and sustaining that investment over long periods.

Overall, the two case studies demonstrated a common systemic pattern of foreign investors and companies finding that practical and conscious efforts to assimilate to the national culture, even to a point of altering the products (example is Honda development of versions of the Wave and Dream bikes made suitable for Vietnam) and service (ANZ style of customer/staff interaction).

As Pauwels and Matthyssens (2004, p.127) demonstrate, case studies provides a 'context-bound intersubjective reality'. In this thesis the case studies show a conscious effort to maximise the returns on foreign investment by assimilating the Honda and ANZ Bank products, services and management systems to the Vietnam culture. The case studies provided subjective validity to the cause/effect relationship that the thesis claims for the linkage between FDI success and cultural assimilation. That causality found with ‘local emphais, causal complexity, temporality, retrospection and contextualisation’ (Pauwels and Matthyssens, 2004, p.128) provided clear evidence of direct links between the business strategies of Honda and ANZ Bank and there efforts to re-design their operations according to the local conditions.

In order to produce effective research from personal interviews in the case studies Pauwels and Matthyssens (2004) four reading styles (varidical reading; experiential reading; symptomatic reading and consequential reading) were taken into consideration in the construction of the questions and in the data, such as company statistics, requested from the interviewees at the meetings. Parameters were defined and analytical questions formulated.

As identified by Napier et.al (2004), the research met specific problems with the location of case studies in Vietnam. Research as a specific skill and valued element in justifying or formulating an hypothesis is challenged by an over concentration of the Vietnamese on its ‘solution-oriented basis’. Little effort is given in Vietnam to ‘theory-building or its testing’. An example of this was evident in the case studies interviews where interviewees were generally concerned about tape-recording or taking notes of conversations. Many felt uncomfortable in an interview situation, believing that recording of the interview was unnecessary and questions that were hypothetical or required analytical reasoning or justification were superfluous, with more than one interviewee replying ‘it is because it is’.

3.3 Conclusion

The methodology of this thesis began with the basic hypothesis that although Dunning’s OLI model provided a framework for analysing the general determinants of FDI in Vietnam and validating the claim that foreign investment and impressive economic growth over the last two decades were linked and mutually benefical to each other, the full understanding of why particular foreign investments were significantly improved by adoption of a management style and strategy of cultural assimilation needed more focus in the study on location advantages and relational asset development. The study of each example (Honda and ANZ Bank), provided qualitative evidence of linkages between a consciously planned strategy for creating images of the two companies as having deep respect for the culture and participants in the local communities as socially conscious business entities. This development could clearly be seen as an awareness of the improtance of confucian dynamism on the social and business environment and an acceptance that the companies opportunities for maximum returns on their investments relied more on their acceptance of the cultural restraints, rather than a determination to transfer its own cultural beliefs and values to the new environment.

With both Honda and ANZ, traditional determinants, such as the ability to access cheap educated labour and the presence of government initiatives that directly supported foreign investment were examined and found to show a high level of advantages for the two companies. However, the ability of the companies to maximise the benefits of these determinants required a more subjective approach that delved into the way that culturally bound behaviour and systems provided either facilitators or constraints to the investors opportunities for success. Ownership and internalisation factors assessed, but the location advantages were examined more closely and analysed for the degree to which there were reciprocal elements present. For example, Honda provided standard company training courses for its employees in order to transfer the regular patterns of management Honda (Japan) style, but also understood that regulation of the management of employees required a human resource strategy that avoided any open criticism of workers performance, as this directly offended the Confucian aversion to criticism that made a person 'lose face'. The , the Company's workers discipline systems were adapted to fit the local environment and impacted upon workers productivity and efficiency through a culturally sensitive method.

The template for the research was founded first on an examination of the general environment, examining first the most significant change in the political and economic structure of Vietnam- the movement from a centrally planned economy to a market economy. This dramatic shift in government policy was brought about by the introduction of '*Doi Moi'* which was based on the renovation and reform of the whole Vietnamese economy. However, the economic transformation was not matched by a equally dramatic conversion from the basic political ideology of communism. Whilst open markets, the introduction of competition and principles of capitalism were introduced, the basic tenets of communist ideology were retained and continued to shape how the economic sector operated in an ideology based upon a Marxist confrontation to capitalism. There is a identified a need here for future researchers to study this transformation in Vietnam politics and ideology and bring greater understanding to the knowledge of how two confrontational forces, communist political ideology and liberal free market principles can operate in synthesis with each other. The lack of present knowledge in academia on how these two forces in Vietnam are either compatible or confrontational was a difficulty in this thesis. For example, In the operation of any foreign or domestic firm the tax authorities require taxes, such as Foreign Corporate tax, to be paid before even the start of production or even any sign of income. Businesses generally, even if exempt from taxes are required to actually pay the tax then claim it back at a future date. It is difficult to discern whether this is a result of a communist based mistrust of the ‘businessman’ (the bourgeoisie) and manifests as a pay first and retrieve later policy, or is a result of a confucian culture of ‘righteousness’ (social ethics) and sees it as a principle of ‘trust’ and in contrast to ‘benefit’ (personal material interests) (Zhu and Yao, 2008).

For over half a century, the Vietnamese system has been shaped and directed through communist ideology and Ho Chi Minh social values and morals. However, more than a 1000 years of Confucianism remains a major influence upon the culture. Now this mix of cultural influences are being transformed again by liberalism and an opening up to the global economy and Vietnam culture is in a mode of cultural transformation, especially evident in a new young rising entrepreneurial middle class, many who are already breaking from ‘family traditions’ and also largely free of ‘old’ communist based ‘reeducation’.

However, the case studies and research showed that Confucian dynamism remains a major influence on the Vietnamese business sectors and that its own particular form in Vietnam culture remains a major structuring force on how business is conducted in Vietnam. The methodology was successful in enabling the thesis to focus on Dunning’s paradigm in determining the advantages that a foreign investor utilised for gaining and sustaining successful investment opportunities, while the application of an understanding of Confucian dynamics and their cultural influence on business practices enabled the thesis to maintain the basic tenets of the hypothesis (that an understanding and concern to cultural, relational asset development and locational advantages are essential to optimising foreign direct investment returns).

The thesis now moves into studying the impact of *Doi Moi* and then into the development of the legal framework for foreign direct investment before applying it to the two case studies of Honda and ANZ Bank.

CHAPTER 4: DOI MOI AND VIETNAM'S FDI POLICIES

4.1 Introduction

At the end of the Vietnam War in 1975, Vietnam had little economic co-operation with countries outside the Soviet bloc. In the 1980s, however, the country opened its doors to the world and embarked on reforms that would create investment opportunities for potential foreign investors. In 1986, Vietnam launched the *Doi Moi*, or renovation policy, a governmental initiative aimed at developing a market-oriented economy (Dang Xuan Ky, 2000; Dang Phong, 1995).

In 1986, it was concluded by a group of more radical party leaders (led by the General Secretary of the Communist Party Nguyen Van Linh) that reforms which consisted of six major economic policy changes (*Doi Moi*) could help Vietnam grow out of its economic crisis. The *Doi Moi* policy package focused on the decentralisation of state economic management providing autonomy to state owned enterprises, the development of the private sector as an engine of economic growth, more flexibility in the management of external economic relations, exchange rates and interest rates, agricultural policies allowing for long term and use rights, and freer national and international trade flows (Murray, 1997; Dang Xuan Ky, 2000).

Gradually, Vietnam managed to attract significant inflows of FDI. The impact of investment has been significant and foreign investors have been a major force in the economic transformation during its integration into the world economy. While FDI inflows have been notable so far, Vietnam has considerable potential to attract significantly more foreign investment, which could further boost the economy and reduce poverty. The Government has pursued a strong agenda of reforms in recent years, which made accession to the World Trade Organisation (WTO) possible, sealing the integration of Vietnam into the world economy.

Chapter Four sets out the background for *Doi Moi* policy in Vietnam in the late 1980s when market reforms dramatically improved Vietnam's business climate. The chapter discusses the developments in FDI government policy and legal systems and the international and national contexts to FDI policy in Vietnam, which serve as the background for policy improvements and changes, the development of laws on foreign investment in Vietnam, elements of the Enterprise Law and other government policy initiatives that facilitate FDI in Vietnam such as land and technology (Nguyen Nhu Binh and Haughton, 2002; Chu Van Lam, 1987). There is an overview of FDI implementation in Vietnam, general FDI facts and figures, inflows of FDI into the country, the common forms of FDI that foreign investors take, and the FDI structural composition. Finally, the impacts of FDI on Vietnam's economic growth, particularly on the country's export and employment are examined.

4.2 Vietnam's *Doi Moi* Policy

4.2.1 Background context

Economic stagnation marked the period after reunification from 1975 to 1985. In 1986, the Sixth Party Congress approved a broad economic reform package called '*Doi Moi*' (renovation) that introduced market reforms and dramatically improved Vietnam's business climate. Vietnam became one of the fastest-growing economies in the world, averaging around 8 per cent annual gross domestic product (GDP) growth from 1990 to 1997 and 6.5 per cent from 1998-2003. From 2004 to 2007, GDP grew over 8 per cent annually. Foreign trade and foreign direct investment have improved significantly. Average annual foreign investment commitment has risen sharply since foreign investment was authorised in 1988, and in 2007 Vietnam licensed USD17.86 billion in foreign direct investment (Nguyen Nhu Binh and Haughton, 2002; Athukorala and Tran Quang Tien, 2009).

The *Doi Moi* policy package came out of changes in the way of thinking of the country's leadership in the late 1970s and 1980s (Dang Phong, 2008). This incremental process started on small scales at municipal levels – fence-breaking experiments – and proceeded to national scale by the late 1980s with macro policy anti-inflation measures, trade liberalisation and extensive international economic integration (Vo Dai Luoc, 2007).

International and national forces both played important roles in this process. Internationally, the collapse of the former Soviet Union and socialist countries in Central and Eastern Europe, and the end of the Cold War placed Vietnam in a totally new situation. In economic terms, aids from the former Soviet Union and China declined precipitously, having totaled an estimated USD 1.5 billion by the end of the 1980s; trade between Vietnam and this block of countries also declined extensively (Arkadie, 1993). At the end of the Cold War Vietnam did not have either the economic assistance or the political support it needed for its economic development.

Because of the US Trade embargo Vietnam could not access to production resources from America, US allies in the West, or international financial institutions. Economic and political reform in the Soviet Union and Eastern Europe, along with initial renovation and achievements of China made an impact on Vietnamese policy makers, leading to strong pressures for developing a new way for the economy (Fforde, 1996).

Vietnam was confronted with high inflation and wide-spread poverty. In 1986 the failure of the price-wage-money reform package caused the retail price index to be nearly six hundred times of that of 1985 (Dang Phong, 2008). Production in all sectors stagnated. Generally, the centrally planned, heavily subsidised and demand economy resulted in a poorly developed infrastructure, and stagnation of the economy. International trade partners were limited to the former Soviet bloc and Central and Eastern Europe. Domestic trade was ineffectively prohibited.

The weak legal system was another issue for Vietnam before the *Doi Moi* policy package. No fundamental laws governing trade and investment were enacted in Vietnam before 1990. One of the greatest hindrances that law makers faced in the process of promulgation of legislation was the failure to develop laws in line with international standards and best practices (Pham Duy Nghia, 2000; 2002; 2003; 2006).

The importance of legal reform is highlighted by Greic and Babic (2003, p.1) as one of Dunning's concerns in promoting the right environment for OLI advantages to take effect and vital for promoting the 'attractiveness of individual transitional countries for potential investment'. As Greic and Babic (2003, p) note, the two indicators for the establishment of the correct legal environment for FDI are 'legal extensiveness' and 'legal effectiveness'.

4.2.2 ***Doi Moi* policy process since 1986**

The renovation policy started with the 6th Congress of the Communist Party (Chu Van Lam, 1987; Communist Party of Vietnam, 1987). Its fundamental viewpoints were: developing a multi-sectoral economy, shifting the economy from the bureaucratic planned centralised and State-subsidised mechanism to the socialist-oriented market economy under State management; opening the diversified and multilateral economy as well as enhancing foreign economic efficiency on the basis of expanding economic co-operation to the countries in the region and all over the world; democratising all fields of the socio-economic life, implementing administration reforms and building a state governed by law (Fforde, 1997; Ha Thiet Tung, 1989).

The main driving force behind the first five-year plan (1986-1990) was to renovate the administration mechanism. Many resolutions and decisions were issued by the government and ruling party in an attempt to improve economic management, monetary and agricultural policies (Hoang Ngoc Nguyen, 1991). During these early years of this five- year plan, however, the fact that the old mechanism did not yet disappear and the new one did not prominently emerge made reform ineffective. GDP increased by 3.9 per cent on average in five years only (General Statistics Office, 2000).

In 1988, Vietnam put forward the 'Khoan' regulation fixing of farm output quotas for each household, assigning land to farmers and considering each household as one economic unit. As a result, instead of having to import 450,000 tons of food as it did in 1988, Vietnam became one of the main rice exporting countries (nearly one million tons) in 1989 and third biggest exporter of rice in 1990 with 1.5 million tons. Other key industries such as electricity, laminated steel, cement and crude oil attained fairly good growth. An average import- export value increased by 28 per cent, which gradually reducing trade deficit (Do Phu Tran Tinh, 2006; Danh Son, 1993; Le Dang Doanh, 2002; Bui Hai Thiem, 2009). The ratio of export to import in 1986-1990 period was 1 to 1.8 in comparison with 1 to 4 in 1976-1980 periods. Another great success was that inflation had been controlled and driven back from 774.7 per cent in 1986 to 223.1 per cent in 1987, 34.7 per cent in 1989 and 67.4 per cent in 1990 (Tran Vo Hung Son and Chau Van Thanh, 1998).

The successes of renovation in the 1986-1990 periods were production recovery, a growing economy and a rolling back of inflation. The more important aspect was the fundamental shift to a new management mechanism. These successes make more sense as the reform process had been implemented before East- European countries and the former Soviet Union got into total recession. However, it took Vietnam five more 5 years in order to eliminate the social-economic crisis (Dang Duc Dam, 1997; Chu Van Lam, 1987; Nguyen Ngoc Tuan, 1995; Le Dang Doanh, 2002).

In June, 1991 the Sixth Congress of the Communist Party of Vietnam initiated the 'Stabilizing and developing the socio-economic situation to the year 2000' strategy, putting forth the orientation and tasks for the 1991-1995 five-year plan (Dang Quoc Tien, 1996). The major obstacle then was the long-lasting economic embargo together with economic blockade imposed by the United States. The growing crisis in the Soviet Union meant trade turnover in the 'rouble' areas sharply decreased in 1991 accounting for only 15.1 per cent of that in 1990 (Fforde, 1997; Dang Phong, 2008).

There were several outstanding achievements during the 1991-1995 periods:

There were fundamental changes in the economic management mechanism. There were dramatic changes in many sectors, namely: state-run, state capital, private capital, co-operative, individual. The non state-run sector accounted for 60 per cent GDP. The state run sector, however, was still given special attention to help it play the decisive role in the economy.

World leading economic growth rate attained. In 1991-1995 period, GDP on average increased by 8.2 per cent, reaching 9.5 per cent in 1996. The agricultural field, especially food production firmly developed, adding to the yield, one million tons every year. Industrial production, adapted step by step to the new mechanism, increased on average 13.5 per cent per year (the highest level ever expected before). Domestic production began accumulating, ensuring more than 90 per cent of annual accumulation and consumption funds.

Economic branches structure moved round to raising the proportions of service and industry areas, steadily reducing that of fishing, forestry, and agriculture. Economic areas structures also began to shift towards establishing essential areas, central industrial zones, and export processing zones as well as areas specialising in growing industrial plants and producing food.

Due to production development, convenient commodities circulation and anti-inflation experiences from several years before, prices were gradually stabilised. Prices for goods and services increased by 67.5 per cent in 1991, by 5.2 per cent in 1993, and only by 4.5 per cent in 1996 (Danh Son, 1993; Dang Xuan Ky, 2000; Nguyen Cuc, 2000).

By the end of 1996, Vietnam had official economic-commercial relations with more than 120 countries, foreign trade turnover rapidly increased by more than 20 per cent a year. Vietnam was granted non-refund aids and loans for social-economic development investment by many countries and international organisations. The total ODA loans received by Vietnam from 1994 to 1997 were USD8.53 billion. There were 1,868 licensed investment projects with total capital of USD 26,976 million from 1988 to 1996 (Nguyen Thi Tue Anh, *et. al.* 2006; Dollar and Litvack, 1998).

Since 2001, GDP growth recovered on a year-on-year basis, reaching 6.9 per cent, 7 per cent, 7.3 per cent and 7.7 per cent for 2001, 2002, 2003 and 2004 respectively. The figure for 2007 was 8.4 per cent. Vietnam has now succeeded in gradually replacing the centrally-planned economy, bureaucracy and a subsidy mechanism by a socialist-oriented market economy with growing dynamism. The GDP growth rate of 7 to 8 per cent has been sustained, along with stronger industrialisation and expanded integration with the world and regional economy. Vietnam has enjoyed a sharp rise in trade volume, especially exports, and an increase of foreign investment and income. The proportion of trade volumes in the industry and construction sectors rose from 38.13 per cent in 2001 to 41.03 per cent in 2005; the service from 36.63 per cent up to 38.08 per cent; and the agriculture, forestry and fishery from 23.24 per cent (Bui Hai Thiem, 2009).

The economy is on the road to a multi-sector model operating according to a market mechanism and state regulations. In the 2000-2004 periods, 73,000 private enterprises were registered, up by 3.75 times against the period 1991-1999. By 2004, the total number of private enterprises operating under the Enterprise Law amounted to 150,000 with the total capital of VND 182 billion. From 1991 to 2003, the private sector's share in GDP was up from 3.1 per cent to 4.1 per cent; other non-state sectors increased from 4.4 per cent to 4.5 per cent; and foreign-invested sector from 6.4 per cent to 14 per cent; and the household sector were down from 35.9 per cent to 31.2 per cent. By 2008 there were 1,171 FDI projects with a registered capital of over USD 64,000 million (General Statistics Office, 2008).

Table 4.1: FDI projects licensed in period between 1988 and 2010

	Number of Project	**Total Registered Capital (USD Million)**	**Implementation Capital (USD Million)**
Total	**13,812**	**214,315.6**	**77,945.5**
1988	37	341.7	n/a
1989	67	525.5	n/a
1990	107	735.0	n/a
1991	152	1,291.5	328.8
1992	196	2,208.5	574.9
1993	274	3,037.4	1,017.5
1994	372	4,188.4	2,040.6
1995	415	6,937.2	2,556.0
1996	372	10,164.1	2,714.0
1997	349	5,590.7	3,115.0
1998	285	5,099.9	2,367.4
1999	327	2,565.4	2,334.9
2000	391	2,838.9	2,413.5
2001	555	3,142.8	2,450.5
2002	808	2,998.8	2,591.0
2003	791	3,191.2	2,650.0
2004	811	4,547.6	2,852.5
2005	970	6,839.8	3,308.8
2006	987	12,004.0	4,100.1
2007	1,544	21,347.8	8,030.0

2008	1,557	71,726.0	11,500.0
2009	1,208	23,107.3	10,000.0
2010	1,237	19,886.1	11,000.0

Source: General Statistics Office, 2010.

With a view to raising the productivity of the state-owned sector, policies were formulated with concrete measures to adjust and reorganise SOEs. The proportion of SOEs in GDP decreased from 40.1 per cent in 1991 to 38.3 per cent in 2003. In 2002 and 2003, 1,655 SOEs were listed for re-organisation and reform. The figure for 2004 and 2005 were 882 and 413 respectively (General Statistics Office, 2008).

Economic prosperity is spreading throughout the economy. The Human Development Index of Vietnam increased from 0.583 in 1994 with a rank of 120/174 to 0.725 in 2009 with a rank of 116/182. The average life expectancy was raised from around 50 in the 1960s to 73 in 2009 (Klugman, 2009). The poor household ratio dropped from 70 per cent in 1980 to below 7 per cent in 2005 (Bui Hai Thiem, 2009). By 2008 GDP purchasing power parity stood at USD242.3 billion with GDP growth a 6.2 per cent (General Statistics Office, 2008)

4.2.3 *Doi Moi* policy and Vietnam's international integration

In the early 1980s, Vietnam began the first steps in the international economic integration. With policies aiming at multinational diplomatic and economic relation diversification and finding a way to overcome the problems of the US blockade and embargo, Vietnam gradually established diplomatic and economic relations with many bilateral and multinational partners (Phan Minh Ngoc and Ramstetter, 2004; Irvin, 1995).

Vietnam joined ASEAN in July 1995. In addition to the founding members of 1967 (Indonesia, Malaysia, the Philippines, Singapore and Thailand), ASEAN includes Brunei Darussalam (1984), Vietnam (1995), the Lao People's Democratic Republic (1997), Myanmar (1997) and Cambodia (1999). The overarching purposes of ASEAN are to accelerate economic growth, social progress and cultural development, and to promote regional peace and stability (Nguyen Nhu Binh and Haughton, 2002).

The ASEAN Free Trade Area (AFTA) is only one component of a wider project of establishment of an ASEAN Economic Community, which aims to create a single market and production base with free flow of goods, services and investment. Although it seeks the complete elimination of tariff and non-tariff barriers among member countries, that goal has not been achieved yet. The five founding members and Brunei Darussalam have reduced their intra-ASEAN tariffs on goods on the Inclusion List to less than 5 per cent, with more than 60 per cent of these goods subject to zero tariffs (Tran Quang Lam and Nguyen Khac Than, 1999; Sandhu *et.al* 2003).

The other members were given more time to reduce tariffs on goods on the Inclusion List to a 0–5 per cent range. Viet Nam was given until 2006 to do so. The elimination and reduction of intra-ASEAN tariffs are also constrained by the Highly Sensitive List and General Exception List, to which commitments to liberalisation do not apply (Sandhu, *et.al* 2003).

APEC started in 1989 and its objective was 'free and open trade and investment in the Asia–Pacific by 2010 for developed economies and 2020 for developing economies', set out in the APEC leaders' declaration of Bogor (1994). APEC operates as a cooperative multilateral economic and trade forum, and it seeks to advance its objectives of free trade and investment without requiring its members to agree to legally binding obligations. The policy agenda is advanced through annual leaders' meetings, in addition to ministerial meetings and the work of special committees and working groups. The 14th leaders' meeting was held in Hanoi in November 2006 (Nguyen Hoang, 2007).

Vietnam became a member of the WTO in January 2007. It is a signatory to the General Agreement on Trade and Services (GATS), WTO's Trade-Related Aspects of Intellectual Property Rights (TRIPS) and Trade-Related Investment Measures (TRIMS) agreements. Vietnam did not sign up to WTO's optional Agreement on Government Procurement.

In bilateral relations, Vietnam has set up cooperative relation for trade and investment with such major partners as the USA, Japan, China, etc (Nguyen Ngoc Son, 2008, p.1-20). One major achievement in Vietnam's international integration is the Bilateral Trade Agreement (BTA) between Vietnam and the US. The BTA to which the United States is a party differs slightly from those of other countries in that they seek not only to create protection for enterprises, but also seek to create free access for investments in the economy of the other contracting party. By entering into a BTA with Vietnam, the United States hoped to promote far-reaching changes in the Vietnamese economy. Specifically, as a result of this BTA, the Vietnamese government has agreed to protect intellectual property rights, to positively accept foreign investment, and, as far as is possible for a communist dictatorship, to introduce new economic and commercial transparency (Bui Hai Thiem, 2009).

The central purpose of the BTA between Vietnam and the United States is to increase trade between the two countries through the attraction of access to their markets. The BTA intends lowering both tariff and non-tariff barriers in the Vietnamese economy. Tariffs on exports are reduced from 40 per cent to 3 per cent and the target is reducing all barriers to the market for US investment. Some analysts hypothesise that this reduction could double the already USD600 million of exports to the United States (Athukorala and Tran Quang Tien, 2009; Bui Hai Thiem, 2009; Nguyen Ngoc Son, 2008). The result of this BTA should yield an influx of investment into the Vietnamese economy and cause a spill-over effect through the accompanying increase in employment, housing purchases, and the purchasing of other durable and non-durable goods. With little doubt, this BTA is a key element in creating a more secure and attractive market for FDI (Nguyen Ngoc Anh and Nguyen Thang, 2007; UNCTAD, 2008).

4.3 FDI mainstream policy

The adoption of market-oriented institutions and open door policy has opened Vietnam to the world economy which has brought in a lot of structural transformations. Together with exports, FDI has been considered as a substantial factor contributing to the recent speediness of Vietnamese economy's development. The Law on Foreign Investment (1987) institutionalised the policies to attract FDI. The Law on Foreign Investment has been amended numerous times with the aim of creating an economy conducive to attracting more FDI to Vietnam. Vietnam is increasing the rights of foreign investors and narrowing the policy gap between foreign and domestic investor (Le The Gioi, 2004).

This section of the chapter discusses the international and national contexts to FDI policy in Vietnam which serve as the background for policy improvements and changes. It then focuses on the development of laws on foreign investment in Vietnam. It proceeds to discussing elements of the Enterprise Law. It then goes on to introduce other government policy initiatives that facilitate FDI in Vietnam such as land and technology.

4.3.1 International and national contexts to FDI policy

Internationally, the internationalisation of the world economy helps attract FDI to Vietnam. The process lessens the investment barriers among countries and helps develop a swift and convenient investment framework. Internationalisation forces countries to modify the policies to be more open and liberal, which improves the operation of the FDI trade. Vietnam's entry into APEC, AFTA, WTO and numerous bilateral commercial agreements indicates the government's commitment to development of investment policies (Bui Hai Thiem, 2009; Dapice, 2003).

By 2005, Vietnam had signed bilateral trade agreements with over 160 countries and territories. Notable international agreements and forums include: i) Framework Agreement on the ASEAN Investment Area (AIA); ii) Asia Pacific Economic Cooperation forum (APEC) with the action plan to liberalise investment in the region; iii) Asia – European Summit, which includes the implementation of Investment Promotion Action Plan IPAP (William, 2005). In 2008, the official entry of Vietnam into the WTO marked an international acceptance of the success of the country in merging with the global economy and becoming a free market economy in line with universal standards of economics. Vietnam has become an official member of the World Trade Organisation (WTO) since November, 7th, 2007 and this marked a milestone in the development process of Vietnam (Iswaran, 2007).

Vietnam is gradually recognised as one of the most attractive locations for FDI (Athukorala and Tran Quang Tien, 2009; Bui Hai Thiem, 2009; Dinh Van An and Nguyen Thi Tue Anh, 2008; Do Phu Tran Tinh, 2006).

Table 4.2: Large investors in Vietnam by 2008

	Number of projects	**Registered capital *(Mill. USD)***
Total	**10,981**	**163,607.2**
India	31	190.5
Austria	13	25.4
Belize	6	44.1
Belgium	34	85.0
Bulgaria	5	17.2
Canada	100	4,892.4
F.R Germany	132	746.3
China, PR	711	2,188.3
Czech Rep.of	18	61.9
Hong Kong SAR (China)	671	7,416.7
Taiwan	2,135	20,951.9
Denmark	69	280.6
Netherlands	115	3,018.8
Korea Rep. of	2,153	16,666.3
United States	493	5,029.0
Indonesia	28	307.0
Italy	43	176.7
Israel	8	11.6
Fed. Russian	105	1,935.4
Malaysia	340	18,005.6
Mauritius	31	224.4
Japan	1,102	17,362.2
New Zealand	26	93.3
Australia	236	1,811.2
France	296	3,216.2

The Philippines	50	395.6
Cayman Islands	33	4,352.2
British Virgin Islands	438	13,824.1
Thailand	256	6,121.6
Turkey	7	41.4
Sweden	22	415.6
Switzerland	71	1,693.1
United Kingdom	134	2,711.1
Samoa	62	1,549.1
Singapore	733	17,071.0

Source: General Statistics Office, 2008.

The degree of acceptance of Vietnam as a 'good' destination for FDI is clearly seen as 'old' enemies like France, Japan, China and the USA show increasing levels of interest in Vietnam. The policy of Vietnam has been under-pinned by a quest to become 'the friend of everyone and the enemy of no one' (Dinh Van An and Nguyen Thi Tue Anh, 2008; Le Dang Doanh, 2002). Thus, when the diplomatic relationship between Japan and China became strained in the late 1990s and 2000s, Japanese investors switched Sino- investment into ASEAN countries which included Vietnam (Bui Hai Thiem, 2009; Lee, 2004; Nguyen Ngoc Son, 2008, Onho, 2003).

The stability of countries after the Asian financial fostered the implementation of FDI projects in Vietnam. Vietnam was stable politically and economically and this was seen as a positive sign of its attractiveness as an investment destination (Doan Phuong Lan, 2001).

Nationally, the attempt of Vietnam Government and Party to create a fair and comfortable environment for FDI attraction underpins government policy initiatives in FDI policy framework. The Resolution adopted by the Ninth Party Congress has confirmed the attempt to continue renovating, improve industrialisation, modernisation and positive investment policies in a developing economy.

Vietnam has maintained a stable political economy, which is a very important condition for attracting FDI, and makes investors feel safe for long term investment, and this is supported by the present Vietnamese legal system (Pham Duy Nghia, 2003; 2004; 2006; Tran Quang Tien, 2009).

Vietnam continues to develop their foreign relations with a focus on attracting investors (Bui Hai Thiem, 2009; Tran Quang Tien, 2009). New policies for encouraging investment are actually working and attracting foreign interest into the economy. The US and Vietnam bilateral agreement made a significant impact with FDI enterprises in Vietnam able to expand production in order to export into the US market (Tran Quang Tien, 2009).

Regulatory barriers to FDI attraction still remain and although there have been numerous legislative reforms; foreign investors still find restrictions in some industries. For example, the domestic division import services sector still requires the approval of the Prime Minister for any acceptance of foreign investment, while in some sensitive industries such as communications or advertising, investors can choose only BCC (Business Co-operation Contracts), not wholly foreign-owned capital enterprises (Seow and Ching, 2008; Tran Quang Tien, 2009).

Infrastructural problems in commerce still remain, such as the government administration and licensing systems, and thus, still make it difficult to implement FDI projects and bureaucratic costs are still high (Tran Quang Tien, 2009). Mr Chiu, a representative of Hong Kong Enterprises Association, announced that the main concern when investing in Vietnam was the high operating costs. Operating costs here includes land rent, personal income tax, production cost and other activities such as electricity, telecommunication and airline (Tran Quang Tien, 2009).

4.3.2 Laws on foreign investment

During the period before *Doi Moi* 1986 the State of Vietnam published some several legal regulations on FDI (for example-Decree 115-CP on April, 18th, 1977 consisting of 27 articles). However, the regulations were unpopular with investors (Pham Duy Nghia, 2002; 2003; Tran Quang Tien, 2009; Do Phu Tran Tinh, 2006). In 1984, the Politburo issued Resolution 19 based on the economic relationship between Vietnam and other countries and declared that to encourage corporation with the non-communist countries the regulations on investment needed to be drastically reformed. Since then, Vietnam's FDI legislation has been issued and revised a number of times (Tran Quang Tien, 2009; Pham Duy Nghia, 2002; 2004; 2006; Le Dang Doanh, 2002; Nguyen Nhu Binh and Haughton, 2002). From the first Law on FDI in 1987, amendments to FDI legislation has been seeking to minimise much of the red tape that burdens enterprises, such as governmental restrictions and procedures that are more burdensome in Vietnam than in other foreign investment areas (Tran Quang Tien, 2009).

4.3.3 Law on FDI 1987

The Law on FDI 1987 had 42 articles, 6 chapters, which contributed to Vietnam's regional and global integration in the legal sector on FDI (Pham Duy Nghia, 2002; Tran Quang Tien, 2009). A legal framework on Foreign Investment in Vietnam was established and protected the position of Vietnam enterprises in business. According to the Law, foreign investors were obliged to 'ensure respect for Vietnam's independence and rights, the unity and the whole territory of

Vietnam, and the host's laws'. The Law on FDI 1987 restricted foreign investors to cooperation only with SOEs. The Law was amended and supplemented in 1990 and 1992 (Pham Duy Nghia, 2003; 2004; 2006). The amended Law on FDI in 1990 now permitted private enterprises to partner with foreign investors. The amendment in 1992, opened investment up to all economic sectors and allowed co-operation with foreign enterprises. The Law on FDI still retained some limits on contents and legislation skills', so on November, 12th, 1996; the National Assembly passed a 'New Law on FDI' in Vietnam (Pham Duy Nghia, 2006; Tran Quang Tien, 2009; Nguyen Ngoc Anh and Nguyen Thang, 2007).

4.3.4 Law on FDI in Vietnam in 1996

The amended Law on FDI in Vietnam concentrated on simplifying administrative procedures. The new Law provided supplementary modes of entry: the BTO, BT and legislated investing mode in Industrial Zones. The focus of the law was on FDI control, financial activities, license granting and complaints (Tran Quang Tien, 2009; Nguyen Nhu Binh and Haughton, 2002; Nguyen Thu Thuy, 1999).

About FDI control:

The Law on FDI 1996 centralised state management of foreign investment in Vietnam and sited license regulation in the Ministry of Planning and Investing (MPI); with some degree of decentralisation of the process to provinces and cities under the central government. MPI was made the lead Ministry in charge of foreign investment.

Financial activities and investment licensing

The licensing procedure was made quicker and more convenient (maximum time for assessing licensing is 60 days upon receipt of documents). Ministries, and equivalent agencies, offices under the central government, local people's committee were made responsible for undertaking procedures for implementing investing projects within 30 days upon the receipt of legal documents (Pham Duy Nghia, 2002; Tran Quang Tien, 2009; Nguyen Nhu Phat, 1997).

Complaints:

The rights to complain, sue for difficulties and obstruction from staff of government agency involved in investment were increased. Foreign invested enterprises could also appeal to either the central or local government offices (Pham Duy Nghia, 2002).

The Law on FDI 1996 aimed at calling for more FDI and established higher quality systems that improved processes and helped transform the economic-structure of investment which was seen as improving export and technology and enhancing productivity (Tran Quang Tien, 2009).

4.3.5 Law on FDI in Vietnam in 2000 (revised)

During 1997-2000, Asia experienced a financial crisis, which decreased FDI in Vietnam. With FDI rates recovering in June 2000, the Law on FDI was once again revised with higher attractiveness and correspondence to the circumstances (Pham Duy Nghia, 2002; 2004). The new Law supplemented 2 provisions and revised 20 provisions of the old Law (1996), which consisted of 3 groups:

- **Group 1**: regulations reduce the difficulties and risk in foreign invested businesses including opening foreign bank accounts, the rights to land use and compensation and clearance of the ground.
- **Group 2**: Regulations on extending self-control in business administration in foreign invested enterprises. Eradicate the unnecessary interference of the Government in the operations of domestic and foreign enterprises.
- **Group 3**: Regulations on correcting the import tax exemption, tax on profit transfer abroad and loss transfer (Tran Quang Tien, 2009).

4.3.6 Law on investment (2005)

The Law on Investment 2005 comprised 10 chapters and 89 articles, stipulating investing mode and open investment related to trade (Tran Quang Tien, 2009; Pham Duy Nghia, 2006; Athukorala and Tran Quang Tien, 2009). The law gave parity between domestic and foreign investors and ensured that foreign entities could operate with the same advantages and disadvantages as domestic enterprises (Tran Quang Tien, 2009, p.70). Table 4.3 shows FDI policies in each revised Law on Foreign Investment in Vietnam.

Table 4.3: Summary of changes in FDI legislations

Policy areas	Revised Law in 1992	Revised Law in 1996	Revised Law in 200
Registration procedures	+ FDI license shall be granted within 45 days + After being licensed, FDI enterprises still have to register their business	+ FDI enterprises are allowed to choose forms of investment, rate of capital contribution, investment location and Vietnamese partner + Enterprises with export proportion of more than 80 per cent are given priority in granting license	+ Publishing the list of FDI enterprises which are permitted to make business registration, without FDI license. +Removing registration related fees
Decentralising registration/licensing process Areas	+ Encouraging joint venture with domestic enterprises; restriction of enterprises with 100 per cent foreign-owned capital	+ Encouraging FDI enterprise with export-oriented and hi-tech industries	+ Publishing the list of projects calling for foreign investment in the period 2001-2005+ Expanding areas for foreign investment, allow FDI in housing construction; + Diversifying the investment form; +Allowing foreigner to buy stock of domestic enterprises
Land	+ Vietnam is responsible for compensation,	+ Local People's Committee shall help	+ May use the construction

	site clearance for foreign-invested projects + FDI projects may rent land for operation, but are not permitted to re-renting land	foreign enterprise to clear the site when the project is approved; The enterprises shall make payment for site clearance to the People's Committee + The FDI enterprises may rent out the land in industrial zones, export processing zones to other firms	attached to land and value of land use right as collateral for borrowing loan
Capital requirement	+ Legal capital must not be smaller than 30 per cent of total investment capital		
Policies on Exchange rate, foreign currency	+ the Government shall guarantee foreign currency balance to FDI projects in infrastructure facilities and import substitution + FDI enterprises in other areas shall have to arrange foreign exchange balance themselves; the State shall not be responsible for foreign exchange balance in such projects.	+ Self guarantee of foreign currency balance + Apply the restriction of international remittance (80 per cent) due to regional crisis, and then gradually release this rate. + The enterprises may purchase foreign currency from commercial banks with the permission from the State Bank	+ May purchase foreign currency from commercial banks to meet transaction demand, in accordance with the law; + Not requiring approval on capital transfer; Reducing the fee on profit remittance abroad. + Reducing the rate of international remittance from 80 per cent to 50 per cent, 30 per cent and 0 per cent
Policies on import, export	+ Foreign firms must ensure export proportion as declared in investment license;	+ Entirely removing the regulation that the export plan of enterprise must approved by	+ Reducing number of areas with require for export proportion of

	+ The products of FDI enterprises must not be sold in Vietnam via dealers + FDI enterprises must not act as dealers for imports – exports	authorities; + Improving import-export procedures with regard to certification of origins	80 per cent; + FDI enterprises may act as dealers for imports – export services
Tax policies	+ Preferential tax for FDI in areas with given priority: corporate income tax of 10 per cent within 15 years of commencement of operation; + The regulation on the income tax on whole foreign enterprise does not allow the deduction of profit in later years to compensate for the loss in previous years; + The FDI enterprises must exclude some cost items from production costs; + Import duties are calculated based on the low import price applied for calculating tax;	+ Exemption of import duties on machinery, equipment, specialised means of transports, raw materials, etc. for production and business of FDI enterprises; +Exemption of import duties for projects in prioritised industries, regions within 5 years of commencement of operation; + FDI enterprise those have export can get tax exemption while import raw materials for their production; + The firms supplying inputs to export enterprises are exempted from import tax on raw materials, intermediate goods with corresponding proportions;	+ Removing regulation that the FDI enterprise has to allocate their certain profit proportion to reserve fund; + Further reform the tax system; gradually reduce the tax gap between domestic and foreign investment

4.3.7 The Enterprise Law

The Enterprise Law was passed on January 1, 2000. The Enterprise Law allows businesses to register without waiting for government approval. During the four months following the Enterprise Law's enactment, registrations for private firms more than doubled compared to the same period in 1999. This increase in registration stemmed from the reduced cost of registering a new business from ten to thirty million Vietnamese Dong (VND) (approximately between USD 900 to USD 2,000 at official exchange rate in 1999) to only VND 100,000 (Tran Quang Tien, 2009). The registration process was shortened from six months to one week.

Thus, the Enterprise Law was a major step in streamlining the investment process, but most foreign investors still thought the law was inadequate (Pham Duy Nghia, 2006; Tran Quang Tien, 2009). For example, while eighty-four licenses restrictions were removed, 300 such barriers still remained. Thus, most foreign enterprises still believed that bureaucracy and over-regulation was a barrier that limited the returns on investment and made new projects difficult to implement (Tran Quang Tien, 2009; Nguyen Ngoc Anh and Nguyen Thang, 2009).

4.4 Vietnam Government policies facilitating FDI

The following sections examine the policies that the Vietnam Government have introduced to support FDI. Although the record of policy development has always been to facilitate FDI in Vietnam, the actual performance in properly structuring the governmental and legal framework has been a little slow at times and not always effective. However, it can be seen that this is a result of a lack of fully understanding the needs of the FDI sector and a poor level of administrative and governmental capacities.

In the course of the authors research and analysis of FDI in Vietnam it was soon clear that the levels of ability in the Vietnam civil service are generally very low, with low pay and a failure to attract the very best personnel meaning that even the most effective policy for supporting FDI is often not administrated very well. Although the Government is moving more to supporting a research capability in Universities and think tanks, the poor financial support and the lack of experience and knowledge in economic research and analysis still leads to problems in ormulating effective advise to governmental decision-makers.

This inevitably means that FDI support by the Government is often poorly informed and sometimes out of date. An example of this is the accession of Vietnam to the WTO, where the legal and governmental regulatory system is still failing to overcome problems in actually adapting to the obligations of the WTO regulations and commitments.

This is further complicated by a dilemma for the Government in that it wants to quickly abide by its WTO commitments, but it also wants to protect to protect small and medium enterprises from stronger foreign competition. In a review of the last three years of Vietnam regulations the general view of the Vietnam Government is that they are committed and supportive of foreign investment but ‘in spite of these efforts, however, the reforms are not comprehensive enough to avoid inconsistency and legal uncertainty in the course of implementation, interpretation and application of the commitments’ (Turksen and Nguyen Mai Phuong, 2010).

The problems include an overlapping and conflicting regulatory system which is causing a significant level of ‘chaos’ in the regulation of foreign direct investment. A lack of transparency and explicit instructions for market access, made worse by a concentration on an unnecessary amount of official form filling and long delays in an otherwise quick process. There is a transposition timing mismatch between the actual implementation of international commitments and the changing of the domestic law to enforce those obligations. The present government reforms supported by various international development funds are aimed at improving the administrative and technological capacities of the government, but the reality is that they will still take time and the above problems will continue at present to impact negatively upon the foreign direct investment sector (Turksen and Nguyen Mai Phuong, 2010).

4.4.1 <u>**Land lease**</u>

For foreign investors with long-term projects the major concern is the regulations on ‘possession’ of land. The term used here is ‘possession’ rather than ‘ownership’ as all land in Vietnam is the ‘peoples’ heritage and ‘owned’ in their name by the Government. The only way a foreigner can than have legal title of the land is through leasehold which is restricted up to a maximum of 70 years. This was and still remains a serious limit on foreign investment and a major negative determinant. Investors, especially American investors fear that the Government ownership of the land is a constant future threat of foreclosure by them on the grounds of political reasoning, rather than any economic reasons. However, the new regulations did try to close the gap between the lower price domestic investors paid for leaseholds and the price which foreigners paid which was usually 20 per cent more (Tran Quang Tien, 2009; Pham Duy Nghia, 2006; Bui Hai Thiem, 2009)

In 1993, the Land Law was amended, eradicating the subsidy on households, and paving the way for establishing and developing the real estate market, thus mobilising a huge national asset (Tran Quang Tien, 2009). Under the FDI Law of 2000, a positive move was to switch the responsibility for site clearance onto the Vietnamese, including payment of compensation. The capital contribution of Vietnam mainly comes from the value of land using rights and real estate (which was estimated to be 3 billion USD in 2003). Today, 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' (Tran Quang Tien, 2009 p.34). 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 had sole responsibility. Decree 24/2000/ND-CP regulated that foreign investors were not allowed to sub-let the land. Foreign investors had the mortgage rights on land and assets on land if payments are made for all the hiring period or 5 years in advance (Tran Quang Tien, 2009).

As Land Law reform continues the real estate market is developing as one of the prime targets for foreign investors, yet restrictions still make foreign investors wary of investing into something they still do not have complete ownership of.

4.4.2 Technology

According to the Ministry of Industry, nearly 10 per cent of all Vietnam's enterprises use advanced technology. Another 38 per cent use mid-level technology. Its use among the remainder is poor. The rate of technological renewal is just 10 per cent and of this, the figure among foreign-owned businesses is higher than with domestic enterprises (Nguyen Quan, 2009).

Over the past few years, the Government has issued policies encouraging businesses and individuals to invest in researching and developing science and technology. The portfolio in these policies includes: science and technology services, business investment, business administration, intellectual property protection, transfer of technology, training engineering staff, and enhancement of business administration. The most outstanding feature in this sector is the continuous encouragement of the Government to renovate technology in the business, especially in foreign invested enterprises. The priorities in the land lease fee, credit, import duties give the proof of the special treatment of the Government to hi-tech projects. The Civil Code of Vietnam and other related documents have regulated industrial property rights of goods and scientific and technological services such as: creation, useful solutions, industrial design, brand, original name of goods, business secrets (Tran Quang Tien, 2009). With a view to improve intellectual property rights, Vietnam has joined the WIPO (World Intellectual Property Organisation) and also signed international agreements throughout the 1990s and 2000s like: the Paris Convention on Intellectual Property, Patent Cooperation Treaty – PCT (signed May, 2006), the Berne Convention (signed 2004), The ASEAN Frame Agreement on Intellectual Property (1995) and the Madrid Protocol on Trademarks (2006).

Vietnam also pays attention to technology transfer. The regulations related to technology mentioned in Law on FDI in Vietnam 1987, Technology Transfer Ordinance 1988 and regulations about technology transfer in the Civil Law 1995 focused on performing the following aims: i) encourage organisations and foreign businesses invest and transfer new and advanced technology in order to enhance competitive competence in global market; ii) support domestic organisations in receiving and controlling technology. However, one concern is that even recent studies fail to see a significant spillover of technology from foreign enterprises to domestic firms (Le Quoc Hoi and Pomfret, 2008)

4.4.3 Special Economic Zones

Vietnam created different types of industrial zones that offered special investment conditions for enterprises.

(1) Export Processing Zones (EPZ).
(2) Industrial Zones (IZ).
(3) 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 was open for both foreign and domestic investors. Enterprises operating within EPZs enjoyed a profit tax rate of 10 per cent and 15 per cent in respect of production and service enterprises.

IZs have been established since 1994. An IZ is a concentrated zone specializing 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 were 15, 10 and 20 per cent respectively (Nguyen Ngoc Anh and Nguyen Thang, 2007; Nguyen Ngoc Son, 2008; Bui Hai Thiem, 2009).

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 starting from the first year in which the company is profitable (Le Quoc Hoi and Pomfret, 2008).

4.4.4 The Labour Regulatory Framework

In the late 1980s and early 1990s, all foreign-invested enterprises had to recruit their workforce through labour supplying centers. In the late 1990s, although the procedures for recruiting employees had been simplified, the stipulation for recruiting employees through labour supplying centers still created disadvantages for foreign-invested enterprises. From 2003, foreign invested enterprises have been entitled to recruit their employees directly (Tran Quang Tien, 2009; Pham Xuan Kien, 2008).

The development and adjustment of the labour regulatory framework of Vietnam started as far back as the early 1990s. The 1995 Labour Code of Vietnam and the 2002 Revised Labour Code received technical contributions from International Labour Organisation experts (Pham Xuan Kien, 2008). Vietnam's labour law is now focused on a market-based labour relations regulatory framework which is in line with WTO principles. The relationship between successful foreign investment and good labour relations is a very important factor (Baban, 2002, Friedman *et.al*, 1998; Keith and Will, 2001; Pham Xuan Kien, 2008). Although labour is not an item in the WTO agenda, it is a factor of evaluation to determine whether a country has a market or non-market economy.

In May 1992, a minimum wage was instituted for workers in foreign-invested enterprises. Under the new Labour Code, all employers of 10 or more workers are required to pay the minimum wage, though for domestic enterprises a lower rate applies. The minimum wage rates are periodically revised by the Ministry of Labour-Invalids and Social Affairs (MOLISA). As of mid-1995, the domestic minimum was Dong 120 000 (approximately USD10.90) per month. At this level, the minimum wage does not appear to pose a serious disincentive to hiring new workers (at least in the major urban centers) since, in 1994, the average wage for an unskilled worker was about USD34 per month, almost three times the minimum (Planning Department, SPC, 1995). The minimum wage for workers in foreign-invested enterprises is several times higher: on 1 July 1996, it was raised from USD35 to USD45 per month in Hanoi and Ho Chi Minh City and from USD30 to USD40 per month in medium-size cities. At that rate, it is much closer to the average wage in foreign-owned enterprises. For example, one large foreign enterprise based in Ho Chi Minh City reports paying an average wage of USD50 per month to its 1,000 unskilled workers, or only one-fourth more than the new minimum (Pham Xuan Kien, 2008).

Since 2009, the minimum wage levels were divided into 4 regions, based on economic growth, price index, poor household ratio. While region 1 comprises Hanoi and Ho Chi Minh city, region 2 include provinces in focal economic zones and those with large number of FIEs such as Binh Duong, Baria-Vung Tau and Dongnai. The minimum monthly wage in the domestic sector was set at USD 89 (region 1), USD 80 (region 2), USD74 (region 3) and USD 66.3 (region 4). In FDI sectors, this number was USD 122, USD 108, USD 94.5, USD 91 respectively. With the division of 4 regions, the minimum wages was expected to be closer to the actual wage as well as living standards in each region.

To attract highly trained personnel, the government provided an enhanced wage schedule, and SOEs were forced to increase wage scales. In 1993, the government modified the public sector pay scale: whereas previously the ratio of the salaries of the highest paid workers to those of the lowest paid workers had been 3.5:1, it was raised to 13:1 (ILO, 1994). The changing labour market conditions are reflected in average wages for skilled and unskilled workers across enterprise type. A survey of some 200 enterprises, public and private, in Hanoi and Ho Chi Minh City found the following: in 1991, the average wage paid to skilled workers was about 50 per cent higher than that paid to unskilled workers; in 1994, the skilled wage was 70 per cent higher than the unskilled wage (Planning Department, SPC, 1995; Pham Xuan Kien, 2008).

4.4.5 Tax policy for FDI enterprises

The general policy of facilitating FDI activities with the aim to attracting FDI into Vietnam, through the tax policies is one of the most important factors in attracting FDI. In Vietnam corporate income tax and the remittance tax that are applicable to FDI enterprises have been adjusted favorably for FDI enterprises (Pursuant to the Vietnam Law on Corporate Income Tax Regulation 09-2003-QH11).

Generally, the corporate income taxes remained unchanged at 25 per cent during the whole period from 1987 to 2009 for FDI enterprises. 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 (Pham Duy Nghia, 2006). From 1996, these enterprises were subject to corporate income tax at 25 per cent on the profit earned. If the investment was located in priority areas, this rate was 20 per cent. If the investment satisfied certain investment promotion criteria, the rate was 15 per cent, and if the investment was strongly encouraged, the rate was 10 per cent. FDI 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 (Pursuant to the Law on Corporate Income Tax 09-2003-QH11).

In 2007, new investment projects, including FDI projects and FDI enterprises were given tax incentives to promote business entry. Greenfield projects could be exempted from corporate income taxes from two to four years, and could get preferential treatment of reduced tax rates, 10, 15, or 20 per cent from two to nine years, subject to the fields and areas of investment. The total duration of preferential income tax rates cannot be over 15 years (Pursuant to the Vietnam Law on Corporate Income Tax 09-2003-QH11).

Since 1999 there have been attempts to develop the tax regime on income in Vietnam and costs such as contingencies and unemployment benefits are taken into account. In the area of concessions the limit set, for example, on the brand name advertisement cost was increased from 5 per cent of total cost to 5 to 7 per cent and to 10 per cent in 2007 (Yui, 2009).

The Enterprise Law and the Investment Law 2006 concentrated on eliminating any distinction between foreign direct invested enterprises and local enterprises. The latest legislation, the 2009 Corporate Income Tax also reflects the government policy of FDI attraction. Discussion is underway within the Government as to whether limits pre-fixed on certain costs such as advertisement and promotion costs can be removed (Yui, 2009; Ministry of Finance of Vietnam, 2009).

In a similar track, the tax on remittances of investment-earned profits abroad was constantly changed. When transferring profits abroad, a foreign investor had to pay an amount of tax equal to 3, 5 or 7 per cent of the profits that were to be transferred and 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. This tax was totally eliminated in 2004 (Pham Duy Nghia, 2001; 2002; 2003; 2004; 2006; Yui, 2009; Tran, 2008). A second major transformation was the ending of ‘splitting sectors’ where different rates were applied to different economic sectors (Pham Xuan Kien, 2008, p.6).

4.5 FDI - from policy to implementation

An overview of FDI implementation in Vietnam, i.e. general FDI figures, inflows of FDI into the country, the common forms of FDI that foreign investors take, and the FDI structural composition, is presented in this chapter (Athukorala and Tran Quang Tien, 2009; Nguyen Ngoc Anh and Nguyen Thang, 2007; Dinh Van An and Nguyen Thi Tue Anh, 2008).

Since 1987, Vietnam has attracted increasingly impressive levels of FDI. The FDI has been a major factor in Vietnam's economic transition, business liberalisation and macro-economic growth story in Vietnam over the last two decades (Tran Quang Tien, 2009). The presence of FDI was seen as an imported 'private sector' for a country whose own private sector was almost non-existent at the beginning of the 1990s. In the late 1990s, although foreign-invested companies employed less than 1 per cent of the total workforce in Vietnam, they cumulatively accounted for around 27 per cent of the country's (non-oil) exports, 35 per cent of the country's total industrial output; they constituted almost 13 per cent of Vietnam's GDP, and contributed around 25 per cent of total tax revenues (Tran Quang Tien, 2009; Bui Hai Thiem, 2009; Nguyen Ngoc Anh and Nguyen Thang, 2007). In the period from 2001-2005, the FDI sector contributed to almost 15.5 per cent GDP, 35 per cent of the country (non-oil) export turnover (if crude oil export included, the ratio came up to 56 per cent). The sector accounted for 100 per cent output of oil exploitation, car production, office equipment production, etc. The FDI sector provided 60 per cent steel output, 28 per cent cement output and 76 per cent output of the medical equipment industry (MPI, 2008).

Despite the importance and growth of FDI inflows in Vietnam the record since the Asian financial crisis of 1997-98 has been mixed, with new inflow pledges sometimes below government targets (Tran Quang Tien, 2009). It was felt that despite reforms of the legal system and incentives to attract investment, the actual levels of FDI were below what could be expected. Even at present, Government concern is that the levels of FDI potential are higher than the actual achievement levels (Tran Quang Tien, 2009, p.14). Thus, Vietnam needs to re-visit their FDI policies and correct some of the negative approaches towards foreign investment, for example, by introducing 'freehold' purchase of real estate. At the same time, studies such as this thesis can point to lessons learned in the successful growth of investment from Honda and ANZ. The case studies here provide an analysis that can help re-invigorate the government policies on FDI in Vietnam.

4.5.1 FDI flows

FDI data in Vietnam shows significant differences between the data sets published by Vietnamese government agencies and those by international organisations. For example, the Table below compares FDI inflows from three different sources: the MPI, UNCTAD and the General Statistics Office of Vietnam. The MPI is a legal administrative body for managing FDI and Official Development Aid (ODA). MPI defines 'FDI as total investment in foreign invested firms'. (FIEs) and calculates shares of capital from both domestic and foreign partners (Tran Quang Tien, 2009, p.12). Changes in the FIE capital stock as a result of earnings invested is also regarded as a change in FDI. International organisations define FDI into Greenfield investment measured by the actual capital inflows from multinational enterprises (MNEs) or cross-border M&A activity (Tran Quang Tien, 2009). Further differences are due to the capacities of the Vietnam statistical agencies which suffer to some degree from a lack of qualified staff to properly analyse data. Capable individuals are far more likely to be attracted by the significantly higher salaries and better conditions of the private sector.

The Table below demonstrates the type of discrepancies in data reported by the two government agencies, and demonstrates how prevalent the mistakes were in the early years of reform. The figures are further distorted by the exclusion of FDI originating from Vietnamese people who are citizens of overseas countries (*Viet kieu),* which is usually classed as domestic investment as most *Viet kieu* channel their investment through resident relatives.

Table 4.4: Registered and implemented FDI flows to Vietnam by sources of data (USDmil.)

Year	FDI flows, MPI source			Actual FDI flows, UNCTAD source (mil.USD)	FDI flows, General Statistics Office source		
	Number of licensed projects	Registered capital (mil. USD)	Implemented capital (mil.USD)		Number of licensed projects	Registered capital (mil.USD)	Implemented capital (mil.USD)
1988	38	322	N/A	8	38	322	N/A
1989	68	526	N/A	4	68	526	N/A
1990	108	735	N/A	180	108	735	N/A
1991	151	1,284	428	375	151	1292	329
1992	197	2,077	575	474	197	2,209	575
1993	274	2,829	1,118	926	274	3,347	1,018
1994	367	4,262	2,241	1,945	367	4,535	2,041
1995	408	7,925	2,792	1,780	408	7,699	2,556
1996	365	9,429	2,923	1,803	387	9,735	2,714
1997	348	5,822	3,218	2,587	358	6,055	3,115
1998	275	4,781	2,375	1,700	285	4,877	2,367
1999	311	2,197	2,537	1,484	311	2,264	2,335
2000	379	2,494	2,420	1,289	389	2,696	2,414
2001	550	3,236	2,430	1,300	550	3,230	2,451
2002	802	2,805	2,591	1,200	802	2,963	2,591
2003	772	3,128	2,650	1,450	791	3,146	2,650
2004	723	4,222	2,860	1,610	811	4,222	2,852
2005	922	6,339	3,300	2,020	970	6,839	3,308
2006	800	10,200	N/A	N/A	987	12,004	4,100
2007	N/A	21,300	8,030	N/A	1544	21,347	8,030
2008	1,557	71,726	11,500	N/A	1,171	64,011	11,600
2009	2,090	22,616	10,000	7,600	1,208	23,107	10,000
2010	1,238	18,590	11,000	8,173	1,237	19,886	11,000

Source: Combined sources from General Statistics Office website, MPI database and UNCTAD.

Significant levels of FDI inflows began in the last half of the 1990s which reached a peak in 1996 with registered and implemented capital at USD8.2 and USD2.9 billion, respectively (FDI data on the MPI website 2006). FDI inflow then slowed as a result of the Asian financial crisis until 2000. FDI inflow recovered in 2001, although only slowly as foreign investors took a cautious approach (Tran Quang Tien, 2009; Dinh Van An and Nguyen Thi Tue Anh and Nguyen Thi Tue Anh, 2008). Thus, we can see that the recovery period for FDI began post-2000 and has gradually built up since then, with the latest figures showing impressive improvements. The UNCTAD data including only new FDI projects shows the recession episode ended in 2002 (Tran Quang Tien, 2009).

Vietnam's early hesitation on reform meant they suffered a comparative disadvantage and only the advent of a far more committed policy to *Doi Moi,* brought about improvements. The long-lasting effect of the Asian crisis in Vietnam compared with the other nations was also a factor and contributed towards the slow change in policy to overcome negative externalities (Tran Quang Tien, 2009; Nguyen Ngoc Anh and Nguyen Thang, 2007; Dinh Van An and Nguyen Thi Tue Anh, 2008). After the crisis, many ASEAN countries introduced additional incentives and more aggressive investment promotion programmes (JICA 2003), whereas the fundamental policy changes in Vietnam have occurred only from about 2000. Joint ventures and fully-owned FIEs have been the two most popular foreign investments. Apart from these entry modes, other nations have received more capital from encouraging M&A and any other forms of investment, so that the total capital going to these countries is more volatile than that going to Vietnam (McGrath, 1995; Nguyen Ngoc Son, 2008; Vu Bang Tam, 2008).

In the 1986-1994, there were low levels of domestic investment, while foreign direct investment showed improvement and reached 30.4 per cent in 1994. But from 1995 to 2005 the levels of foreign investment fell relative to domestic investment, reaching only 18 per cent (Tran Quang Tien, 2009). Domestic private investment also declined in the period 1985-1994. The reasons for the declines were structural as the economic system was previously dominated by 'collectives' (which formed a component of non-state investment) and they played an imperative role in the economy, especially in rural areas. The policy of *Doi Moi* involved direct reform of the 'collective' system and the movement towards a market-oriented economy, which forced closure of most agricultural collectives or their transformation into corporate entities (Ha Thiet Tung, 1989; Chu Van Lam, 1987; Dang Duc Dam, 1993; Le Dang Doanh, 2002; Bui Hai Thiem, 2009; Tran Quang Tien, 2009).

Table 4.5: Total Investment for Development: Composition and Growth, 1985-2008

Year	Composition (per cent)			Growth index (1994=100), at 1994 price			
	FDI	Domestic private	State-owned	FDI	Domestic private	State-owned	Total
1985	0.0	28.5	71.5	0.0	25.3	52.0	27.8
1986	0.0	40.2	59.8	0.0	34.0	41.2	26.4
1987	0.0	47.2	52.8	0.0	38.0	34.8	25.3
1988	2.5	44.2	53.3	2.4	40.4	39.9	28.6
1989	13.6	40.9	45.5	14.4	42.1	38.4	32.3
1990	13.1	46.7	40.2	17.5	61.0	42.9	40.8
1991	14.3	47.7	38.0	22.8	73.8	48.0	48.4
1992	21.0	43.9	35.1	51.1	103.8	67.9	74.0
1993	25.2	30.8	44.0	83.7	99.4	116.0	101.0
1994	30.4	31.3	38.3	100.0	100.0	100.0	100.0
1995	30.4	27.6	42.0	119.0	105.0	130.7	119.1
1996	26.0	24.9	49.1	117.0	109.0	175.4	136.9
1997	28.0	22.6	49.4	150.1	117.8	210.6	163.2
1998	20.7	23.7	55.5	114.4	127.0	242.8	167.5
1999	17.3	24.0	58.7	104.6	141.2	281.7	183.9
2000	18.0	22.9	59.1	125.4	154.9	327.3	212.0
2001	17.6	22.6	59.8	138.1	172.0	372.3	238.4
2002	17.5	26.2	56.4	156.6	228.0	401.4	272.7
2003	16.3	29.7	54.0	165.4	291.7	434.4	308.0
2004	15.5	30.9	53.6	175.1	338.8	481.2	343.6
2005	15.7	32.1	52.2	201.2	400.0	532.8	390.5
2006	16.2	38.1	45.7	122.0	116.0	109.9	113.7
2007	24.3	38.5	37.2	193.4	126.9	104.2	127.0
2008	31.4	40.0	28.6	134.6	113.0	83.6	106.4
2009	25.6	33.9	40.5	91.4	103.9	134.6	111.4
2010	25.8	36.1	38.1	107.0	115.9	103.9	107.8

Source: C.E.I.C Asia Database, 2009

State-owned or public investment still dominated during this period and showed the highest growth index (532.8), followed by the domestic private (400.0) and foreign-owned sectors

(201.2) (Tran Quang Tien, 2009). The dominant public investment was for state-owned enterprises (SOEs) and reflected their leading role in the economy. The data shows that the public sector still retained government led advantages over the private sector. Table 4.6 FDI flows for the type of investment projects and the share of Vietnamese partners in total investment. A number of projects expanded their capital base through additional funds from parent companies or profits from previous investments in Vietnam (Tran Quang Tien, 2009). The expansion investment inflows in 2004 and 2005 indicated a fresh confidence in the investment climate in Vietnam and offered hope for attracting new FDI (Tran Quang Tien, 2009; Dinh Van An and Nguyen Thi Tue Anh, 2008; Pham Xuan Kien, 2008).

After the Asian financial crisis, the expired investment ratio and FDI inflows increased during the post financial crisis period (1998-2003). A major proportion of the expired investment was from approved projects not yet started. Kokko *et. al.* (2003) investigated the determinants of the likelihood of failed projects and found that most failed FDI projects were approved in the early 1990s in the form of joint ventures and located in remote areas. The high expired/FDI inflow ratio was a result of the slow and complicated procedures in project licensing and assessments. With the exception of 2005, domestic partners contributed a small proportion of total investment, approximately 10 per cent. 'All domestic-partner contributions were in joint ventures. As a result, the share of domestic partners in total implemented capital decreased over time because the share of joint ventures in total investment declined relative to fully-owned FIEs' (Tran Quang Tien, 2009, p.31).

Table 4.6: FDI inflows decomposed by situation of operation

Indicatos\year	FDI projects	New registered projects	Capital increased projects	Registered capital inflows (mill. USD)	New projects (mill. USD)	Expansion (mill. USD)	Implemented capital inflows (mill. USD)
1988-1990		214	1	1,582	1,582	0.3	
1991		151	9	1,284	1,275	9	428
1992		197	13	2,077	2,027	50	575
1993		274	60	2,829	2,589	240	1,118
1994		367	84	4,262	3,746	516	2,241
1995		408	151	7,925	6,607	1,318	2,792
1996		365	162	9,429	8,64	788	2,923
1997		348	164	5,822	4,649	1,173	3,218
1998		275	162	4,781	3,897	884	2,375
1999		311	163	2,197	1,568	629	2,537
2000		379	174	2,494	2,018	476	2,420
2001		550	241	3,236	2,604	632	2,430
2002		802	366	2,805	1,669	1,136	2,591
2003		772	416	3,128	1,993	1,135	2,650
2004		723	497	4,222	2,222	2,000	2,860
2005		922	607	6,339	4,268	2,070	3,300
2006		797	439	9,622	7,500	2,122	4,100
2007		1,406	361	20,250	17,600	2,650	4,600
2008		1,557	397	71,726	66,500	5,226	11,500
2009		839	215	21,482	16,345	5,226	10,000

Source: MPI, 2009.

4.5.2 Common FDI forms in Vietnam

The stock value of FDI decomposed by form of investment showed fully-owned FIEs dominating with 74.7 per cent of total projects and 51.0 per cent of total registered capital (Tran Quang Tien, 2009, p.22). Joint ventures stand second in terms of amount of registered capital but are first on implemented capital. However, it must also be remembered that many FDI ventures gained further benefits from transfer of technology, management skills and know-how, while Vietnamese counterparts 'contribute legal knowledge, trademarks, and infrastructure in terms of mostly land and space' (Tran Quang Tien, 2009; Dinh Van An and Nguyen Thi Tue Anh, 2008; Nguyen Ngoc Son, 2008). Research shows that joint ventures are generally larger than fully-owned FIEs in capital stock as the JV normally involved partnerships between the FDIs and large SOEs (Tran Quang Tien, 2009; Bui Hai Thiem, 2009). Other entry modes, like BCC and BOT, are concentrated in some highly protected industries. New forms of investment include shareholding companies and capital holding companies, which were now legal options due to a policy change allowing the purchase of equity shares from domestic enterprises by foreign investors.

Table 4.7: FDI by forms of investment (stock value, million USD), December 2005

FDI forms	Project numbers	Registered capital	Realised capital	Per cent of projects	per cent of Registered capital	Realised/ Registered (per cent)
Fully- owned FIEs	4,504	26,041	9,884	74.7	51.0	38.0
Joint-ventures	1,327	19,181	11,146	22.0	37.6	58.1
BCC	184	4,171	6,053	3.1	8.2	145.1
BOT	6	1,370	727	0.1	2.7	53.1
Shareholding company	8	199	170	0.1	0.4	85.4
Capital holding company	1	56	6	0.0	0.1	10.8
Total	6,030	51,018	27,986	100	100	54.9

Source: MPI, 2008.

In 1988-1990, cooperation with SOEs (joint ventures) were the most popular entry mode for foreign investors and benefited from privileged access to government and advantages in accessing credit, land ownership and other administrative procedures (Tran Quang Tien, 2009; Pham Duy Nghia, 2006).

In 1991-1995, forms of investment became more equal with a significant increase in fully-owned FIEs. Joint ventures still dominated but foreign investors could also now enter into many formerly 'protected industries' (Tran Quang Tien, 2009). However, joint ventures are declining in their relative position in regard to share of total registered capital and share in number of projects.

In 2001-2005 there was a diversification of forms of investment as more FDI was entering through either shareholding companies or capital holding companies), while the number of fully-owned FIEs numbers exceeded joint ventures and other entry modes for the first time (Pham Duy Nghia, 2006; Tran Quang Tien, 2009; Nguyen Ngoc Anh and Nguyen Thang, 2007). Tran Quang Tien (2009, p.12) believes that 'policy reform had significantly improved the investment climate and foreign investors were now allowed to set up any form of investment in most industries and services. They followed the trend in preferring to form fully-owned enterprises, probably in order to avoid benefit conflict and make business decisions easily'.

4.5.3 Source country composition

In the period from 1988 to 2009 there has been 12,275 FDI projects with a registered capital of USD194,429 million and Implementation capital of USD66,945 million. Investment came from 75 different countries and territories. The top ten sources of FDI comprised seven Asian and three European nations.

Table 4.8: Top ten source countries of FDI as at December 2005 (stock value)

Countries/ territories	Project numbers	Registered Capital (million USD)	Implemented capital (million USD)	Realised/ registered	per cent of total registered	per cent of total Projects
Taiwan	1,422	7,769	2,831	36.4	15.2	23.6
Singapore	403	7,611	3,621	47.6	14.9	6.7
Japan	600	6,290	4,669	74.2	12.3	10.0
Korea	1,064	5,338	2,591	48.5	10.5	17.6
Hong Kong	360	3,728	1,986	53.3	7.3	6.0
British Virgin Islands	251	2,693	1,240	46.1	5.3	4.2
France	164	2,171	1,188	54.7	4.3	2.7
Netherlands	62	1,996	1,924	96.4	3.9	1.0
Malaysia	184	1,571	840	53.5	3.1	3.1
Thailand	130	1,456	804	55.2	2.9	2.2
Subtotal	4,640	40,622	21,694	53.4	79.6	76.9
Total	6,030	51,018	27,986	54.9	100.0	100.0

Source: MPI, 2008.

Ten nations contributed about 80 per cent of total registered capital and 77 per cent of total projects. Taiwan surpassed Singapore as the leading country in FDI flows to Vietnam. Japan was the largest contributor in terms of implemented capital, followed by Singapore. In terms of investment performance measured by the ratio between implemented and registered capital (in Vietnam a number of promised (registered) FDI investments registered capital fail to actually become fully realised implemented projects for a variety of reasons, such as not gaining a license, foreign investors withdrawing pledges of FDI, etc), the Netherlands stood first followed by Japan. The performance indicator of these two countries was much higher than for any other countries. Although Taiwan was the largest investor in Vietnam, its performance level was the lowest amongst the 10 leading investors.

Table 4.9: Registered FDI by source country (million USD)

Country group	1996-2000		2001-2005		1988-2005	
	Total investment	per cent	Total investment	per cent	Total investment	per cent
OECD Countries	5,391.4	26.4	5,155.6	35.0	16,443.8	32.2
UK	1,255.1	6.1	77.8	0.5	1,248.3	2.4
France	1,197.6	5.9	455.5	3.1	2,171.2	4.3
Australia	144.3	0.7	294.8	2.0	664.8	1.3
Switzerland	111.6	0.5	28.3	0.2	686.4	1.3
Belgium	30.6	0.1	5.4	0.0	74.7	0.1
Germany	188.2	0.9	46.6	0.3	344.4	0.7
Italy	39.1	0.2	26.7	0.2	54.9	0.1
Netherlands	123.5	0.6	787.8	5.3	1,996.0	3.9
United State	581.2	2.8	721.9	4.9	1,455.1	2.9
Japan	1,550.3	7.6	1,555.4	10.5	6,289.7	12.3
Canada	64.6	0.3	231.0	1.6	276.1	0.5
Other	105.3	0.5	924.4	6.3	1,182.0	2.3
Transition/Centrally planned economies	1,426.4	7.0	96.1	0.7	571.2	1.1
Russian	1,391.2	6.8	81.7	0.6	277.9	0.5
Ukraine	4.0	0.0	4.9	0.0	24.0	0.0
Other	31.2	0.2	9.5	0.1	269.3	0.5
Developing Asia	11,606.6	56.8	7,572.5	51.4	28,755.1	56.4
China	97.4	0.5	488.2	3.3	739.2	1.4
Thailand	586.3	2.9	247.6	1.7	1,456.1	2.9
Philippines	39.1	0.2	12.2	0.1	234.5	0.5
Malaysia	446.1	2.2	537.9	3.6	1,571.1	3.1
Taiwan	1,744.8	8.5	2,358.1	16.0	7,769.0	15.2
Singapore	4,324.7	21.2	739.1	5.0	7,610.7	14.9
South Korea	1,790.3	8.8	1,986.7	13.5	5,337.9	10.5
Hong Kong	1,776.1	8.7	1,129.7	7.7	3,727.9	7.3
Indonesia	198.3	1.0	15.4	0.1	130.1	0.3
Other	603.5	3.0	57.6	0.4	178.7	0.4
Tax-haven Islands	1,118.1	5.5	1,066.2	7.2	3,895.9	7.6
British Virgin Islands	742.4	3.6	901.9	6.1	2,692.7	5.3
Bermuda	142.0	0.7	-	0.0	260.3	0.5
Channel Islands	141.9	0.7	0.5	0.0	84.9	0.2
Other	91.8	0.4	163.8	1.1	857.9	1.7
Other countries	887.2	4.3	855.8	5.8	1,352.0	2.7
Total	20,429.7	100.0	14,746.2	100.0	51,017.9	100.0

Source: C.E.I.C Asian database (for sub periods) and MPI website for the whole period 1988-2005. The data of MPI covers only effective projects.

4.5.4 Sectoral composition

Table 3.11 provides data on accumulative FDI during 1988-2005 disaggregated by the main economic sectors. As of December 2005, half of the registered capital and over 60 per cent of total FDI projects were allocated in manufacturing industry. Within this sector, most foreign capital was invested in heavy industry (26.5 per cent), followed by light industry (16.6 per cent). The FDI composition of food processing and seafood) was negligible. Construction investment accounted for about 23 per cent of total investment and 7.5 per cent of total projects. Most of this investment was in building new residential apartments and offices. The service sector attracted about 17 per cent of total registered investment as well as FDI projects, with the concentration of FDI in transportation and telecommunication services (5.7 per cent) the same as in hotel and tourist services (5.6 per cent). In terms of FDI disbursement, the primary sector had the best performance with a realised/registered FDI ratio of 134.4 per cent (Tran Quang Tien, 2009).

The most striking feature in contemporary FDI inflows is that it has increased significantly in manufacturing relative to other sectors. In the early 1990s, FDI flowed mostly into mining, quarrying and services (Tran Quang Tien, 2009). The service sector was stable except immediately following the Asian crisis.

Table 4.10: Sectoral compositions of FDI stock in 1988-2005

Sector	Number of Projects	Registered capital (million USD)	Implemented capital (million USD)	per cent of projects	Per cent of Registered capital	Realised/ Registered capital
Primary production	702	5,357	7,202	11.6	10.5	134.4
Crude oil	27	1,891	5,542	0.4	3.7	293.0
Agriculture and forestry	675	3,466	1,661	11.2	6.8	47.9
Manufacturing	3,824	25,447	11,736	63.4	49.9	46.1
Light industry	1,693	8,471	3,143	28.1	16.6	37.1
Heavy industry	1,754	13,528	6,543	29.1	26.5	48.4
Foodstuff	263	3,139	1,895	4.4	6.2	60.4
Seafood	114	309	155	1.9	0.6	50.3
Construction	453	11,526	4,684	7.5	22.6	40.6
New resident Park	316	4,011	2,326	5.2	7.9	58.0
New cities	4	2,552	51	0.1	5.0	2.0
Office-building	112	3,937	1,780	1.9	7.7	45.2
EPZ&IZ, infrastructure construction	21	1,026	527	0.3	2.0	51.3
Service	1,051	8,688	4,364	17.4	17.0	50.2
Transportation & telecommunication	166	2,924	741	2.8	5.7	25.3
Hotel, Tourism	164	2,864	2,342	2.7	5.6	81.8
Finance-Banking	60	788	643	1.0	1.5	81.6
Cultural-Health-Education	205	908	284	3.4	1.8	31.3
Others	456	1,203	354	7.6	2.4	29.5
Total	6,030	51,018	27,986	100.0	100.0	54.9

Source: FDI database on website of MPI, 2008.
Notes: Data are for effective projects only.

Table 4.11: Sectoral composition of implemented FDI flows to Vietnam (percentage of total)

Sector\year	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Agriculture	9.8	5.2	6.0	3.0	5.6	5.0	8.4	5.2	9.1	9.1	7.6	3.2	10.4	17.3	3.2
Agriculture-Forestry	4.6	3.6	5.4	2.7	5.0	4.5	7.8	5.0	8.6	8.0	7.3	2.0	7.8	16.8	2.8
Fishing	5.2	1.6	0.7	0.3	0.6	0.4	0.7	0.3	0.5	1.1	0.3	1.1	2.6	0.5	0.4
Industry	66.5	49.4	66.3	66.9	55.9	62.2	65.3	63.5	61.1	68.3	79.1	76.0	62.6	60.6	60.3
Mining and Quarrying	53.2	32.3	23.1	32.0	20.6	13.2	8.3	13.9	12.3	11.9	33.8	2.2	1.1	0.6	0.5
Manufacturing	13.3	17.2	40.7	31.9	34.6	47.7	55.2	48.0	47.5	54.4	44.8	73.8	61.6	60.0	59.7
Electricity, Gas and Water Supply	0.0	0.0	2.5	3.0	0.7	1.3	1.8	1.6	1.3	2.0	0.5	0.0	0.0	0.0	0.0
Construction	0.0	0.9	0.8	1.0	2.5	4.8	4.4	2.1	2.8	0.9	0.6	5.7	15.1	7.8	9.3
Service	23.7	44.5	26.9	29.1	36.1	28.1	21.9	29.1	27.0	21.7	12.7	15.1	11.9	14.4	27.2
Wholesale and Retail trade/service	0.2	0.0	0.0	0.0	0.1	0.0	0.0	0.4	1.0	0.9	0.5	1.4	2.0	1.3	2.5
Hotels and Restaurants	6.7	11.6	11.0	12.6	11.1	9.9	7.3	10.2	6.0	7.7	2.0	10.4	7.0	10.2	1.0
Transport, Storage and Communication	8.8	7.9	3.5	3.8	9.5	4.1	3.5	3.3	5.0	1.2	2.8	1.3	0.9	1.6	17.7
Financial Intermediation	2.3	19.7	5.0	2.3	3.8	2.8	0.2	1.0	1.2	0.6	1.0	0.0	0.0	0.0	0.0
Renting business activity and Consulting	5.5	4.2	4.7	6.8	10.5	9.5	9.8	13.3	12.9	9.4	4.3	0.0	0.0	0.0	0.0
Cultural-Health and Education	0.3	1.1	2.7	3.6	1.0	1.8	1.1	0.9	0.9	1.9	2.0	2.0	2.0	1.3	6.0
TOTAL (million USD)	427	558	1,117	2,238	2,794	2,901	3,156	2,440	2,240	2,301	2,018	1,333	1,513	2,054	3,811

Source: General Statistics Office, 2005.

4.5.5 Provincial distribution of FDI

Despite government policies to increase regional diversity the distribution of FDI still remained in certain provinces and regions. As of December 2005, about two-thirds of FDI projects associated with over 60 per cent of total registered FDI were invested in the South East area of Vietnam (Tran Quang Tien, 2009). The Red River delta and the South East area accounted for about 90 per cent of total FDI. Thus, the situating of FDI still relies on conventional factors like geographical conditions (transportation costs), population density (market size), labour supply and the competition level (Tran Quang Tien, 2009; Dinh Van An and Nguyen Thi Tue Anh, 2008; Athukorala and Tran Quang Tien, 2009).

The implemented FDI flows divided into four periods in Table 3.14 and help explain more clearly the geographical allocation of foreign capital. In the first period (1988-1990), only five of six regions received FDI and there was an extremely high concentration in the South East area (72.4 per cent of total). In the following two periods (1991-1995 and 1996-2000), FDI seemed more evenly distributed in all six regions with significant increases for the Red River Delta and the Central Coast. The period 2001-2005 was associated with a small increase in FDI for the North Mountainous area, while the South East remained dominant (Tran Quang Tien, 2009). Thus, although FDI was originally concentrated in the main urban areas it can now be seen that an 'overspill' is occurring and the benefits of FDI are reaching a far wider area.

4.5.6 FDI in special economic zones

World Bank (1992, p7) defined Export Processing Zone (EPZ) as 'a fenced-in area of 10 to 300 hectares, that specialised in manufacturing for export. It offers firms free trade conditions and liberal regulatory environments'. The primary purposes of establishing EPZs are mainly provision of foreign exchange earning by promoting non-traditional exports, easing unemployment situation of the host country, attracting more FDI as well as technological transfer (Madani, 1999). The main difference between 'Export Processing Zones (EPZ) and Industrial Zones (IZ) is that the former specialises in the production of exported goods and the provision of services for the production of exports and export activities' (Tran Quang Tien, 2009, p.15). EPZs have the benefit exceptional regulations and incentives from the government. However, many of these advantages will have to disappear as the full entry into WTO and subsequent restrictions on tariff and non-tariff barriers curb the use of special rules and incentives for EPZs (Ministry of Industry, 2007; Brunt, 2003; VNEP, 2009). The government's emphasis has shifted from EPZs to IZs in order to redress inequality in regional development. This has also narrowed the differences between EPZs and IZs in terms of investment incentives.

The first EPZ was established in 1991; 12 IZs/EPZs were set up before legal regulation for development of IZs/EPZs was adopted in 1996. Under this regulation, 100 IZs/EPZs were planned to be set up by 2010. In the 1996-2000 periods, there were actually 44 new IZs/EPZs established. As of 2003, 149 IZs/EPZs were approved by the government and 96 are operating, although only five are EPZs (Tran Quang Tien, 2009). Geographically, nearly half of the total number of IZs is located in the South East of Vietnam. IZs/EPZs are difficult to set up in the Highlands and Northern Mountain areas.

Despite of the fact that more than 80 per cent of total exporting merchandise come from EPZs (Tyler and Negrete, 2009), EPZ represents no substitute for good economic policies. An overall government's policies conducive for growth and development is still regarded as essential. Heike Baumuller (2009) also pointed out that not all EPZs would necessarily be effective mean in attracting FDI as eight out of ten EPZs performed poorly due to either their remote locations or shortage of labour, or due to implementation difficulties.

4.5.7 FDI and employment

The role of FIEs in creating new jobs has been discussed in some previous studies. For example, Nguyen Tuan Dung (1999) and Le Dang Doanh (2002) found the number of new jobs produced by FIEs was lower than expectations when compared with the important share of FDI in total investment. From 2000 onward, foreign investment shifted from IS production to export-oriented production. Foreign share of total employment increased by only 0.5 per cent over the period 1993-2000 and one per cent during 2000-2005. By 2005, the foreign-owned sector accounted for the smallest share of working population (about 1,030,000 people or 2.3 per cent). This number of workers employed by FIEs in 2010 was 1.72 million people (General Statistics Office, 2005; 2010). Foreign Invested Enterprises (FIEs) are mostly concentrated in manufacturing and it has resulted in notable gains in jobs created. The role of FIEs in creating new jobs has been discussed in Nguyen Tuan Dung (1999) and Le Dang Doanh (2002), who claimed the number of new jobs produced by FIEs was lower than expectations when compared with the important share of FDI in total investment (Tran Quang Tien, 2009). The total foreign share of employment increased by only 0.5 per cent over the period 1993-2000 and then only one per cent during the period 2000-2005.

Table 4.12: General situation of FDI in Vietnam from 1988 to 2000

No.	Categories	Period 1988-1990			Period 1991-1995					Period 1996-2000				
		1988	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**
1.	**Total registered capital projects**	**37**	**67**	**107**	**152**	**196**	**274**	**372**	**415**	**372**	**349**	**285**	**327**	**391**
	Capital- increased projects			1	9	13	60	84	151	162	164	162	163	174
2.	**Total registered capital (*Mil. USD*)**	**342**	**526**	**735**	**1,284**	**2,077**	**2,829**	**4,262**	**7,925**	**9,635**	**5,955**	**4,873**	**2,282**	**2,762**
	Registered capital inflows	342	529	735	1,275	2,027	2,589	3,746	6,607	8,842	4,782	3,929	1,609	2,166
	Expanded capital			0.3	9	50	240	16	1,318	793	1,173	944	673	596
3.	**Implemented capital inflows *(Mil. USD)***				**428**	**575**	**1,118**	**2,241**	**2,792**	**2,938**	**3,277**	**2,372**	**2,528**	**2,398**
	Capital inflows from foreign partners				375	492	931	1,946	2,343	2,549	2,911	2,209	2,244	2,166
	Capital inflows from Vietnamese partners				53	83	187	295	449	389	366	163	284	232
4.	**Contribution of FDI sector to GDP (per cent)**					**2.00**	**3.60**	**6.10**	**6.30**	**7.39**	**9.07**	**9.80**	**11.75**	**13.28**
	National GDP growth rate								9.83	8.80	7.41	5.08	2.30	5.32
	GPD growth rate of FDI sector								14.98	19.42	20.75	19.10	17.60	11.44
	Growth rate of national industrial sector									14.20	13.80	12.10	11.60	17.50
	Growth rate of FDI in industrial sector									21.70	23.20	23.30	21.00	21.80
	Proportion of FDI in industrial sector									26.50	29.00	33.20	38.10	41.30
5.	**Contribution to State Budget *(Mil. USD)***							**128**	**195**	**263**	**315**	**317**	**271**	**324**
6.	**Labour force in FDI sector (thousand)**								**210**	**220**	**250**	**270**	**296**	**407**

Source: MPI, 2010

Table 4.13: General situation of FDI in Vietnam from 2001 to 2010

No.	Categories	Period 2001-2005					Period 2006-2010				
		2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
1.	**Total registered capital projects**	**555**	**808**	**791**	**811**	**970**	**987**	**1,544**	**1,171**	**1,208**	**969**
	Capital- increased projects	241	366	416	497	640	570	420	311	355	269
2.	**Total registered capital (*Mil. USD*)**	**3,265**	**2,993**	**3,172**	**4,534**	**6,840**	**12,004**	**21,348**	**71,726**	**23,107**	**18,595**
	Registered capital inflows	2,633	1,857	2,037	2,482	4,705	9,096	18,718	66,500	17,236	17,229
	Expanded capital	632	1,136	1,135	2,052	2,135	2,906	2,629	5,226	5,871	1,366
3.	**Implemented capital inflows *(Mil. USD)***	**2,394**	**2,978**	**2,791**	**2,860**	**3,300**	**4,100**	**8,034**	**11,500**	**10,000**	**11,000**
	Capital inflows from foreign partners	2,040	2,634	2,623	2,565	2,825	3,500	6,700	9,000	7,300	8,000
	Capital inflows from Vietnamese partners	185	250	100	143	475	600	1,334	2,500	2,700	3,000
4.	**Contribution of FDI sector to GDP (per cent)**	**13.76**	**13.76**	**14.47**	**15.13**	**15.99**	**16.98**	**17.96**	**18.43**	**18.33**	**n/a**
	National GDP growth rate	6.10	6.54	7.26	7.79	8.48	8.29	8.68	6.18	5.32	6.25
	GPD growth rate of FDI sector	7.21	7.16	10.52	11.51	13.22	14.33	13.04	8.10	4.81	n/a
	Growth rate of national industrial sector	14.60	14.80	16.80	16.60	17.10	16.80	16.70	13.90	7.60	13.80
	Growth rate of FDI in industrial sector	12.60	15.20	18.00	17.40	21.20	19.90	19.70	17.50	9.20	17.40
	Proportion of FDI in industrial sector	41.60	41.60	43.10	43.70	43.70	44.20	44.60	44.40	n/a	n/a
5.	**Contribution to State Budget *(Mil. USD)***	**373**	**459**	**628**	**916**	**1,297**	**1,472**	**1,576**	**1,982**	**2,470**	**2,050**
6.	**Labour force in FDI sector (thousand)**	**489**	**691**	**860**	**950**	**1,030**	**1,129**	**1,265**	**1,467**	**1,850**	**1,900**

Source: MPI, 2010

4.5.8 FDI in 2008

Vietnam saw a dramatic increase in foreign direct investment to Vietnam from 2006 to 2008 (confirmed figures for 2009 are still only provisional estimates). The Foreign Investment Agency under the Ministry of Planning and Investment, reported that 1,059 FDI projects with a total registered capital of USD59 billion were licensed in 2007, and in 2008 there was over USD65 billion of investment. This was six times the 2006 figure.

The implemented foreign direct investment capital has also grown sharply compared to previous years, at USD11.5 billion, up 1.5 times compared to 2007. A substantial increase was seen of foreign investors from Canada, the US, India, and the Middle East (General Statistics Office - Vietnam) and although Vietnam faced a number of problems in 2008 which was compounded in 2009 by the global financial crisis, ‘foreign investors… still believed in the medium and long-term investment outlook in Vietnam’ (Ha Anh, 2009).

A major contribution to this success was the attraction of large-scale industrial FDI projects such as the Nghi Son oil refinery project in Thanh Hoa, the steel project in Ha Tinh province, and other projects to build new urban centres, international university township or international airports (Ha Anh, 2009).

The success indicated that Vietnam’s policies towards foreign investors and the overall development of Vietnam had worked, and that its ‘concentration on the maintenance of political stability and security, the improvement of investment environment, and particularly the perfection of economic regulations and the door opening of the economy according to WTO commitments’ were a ‘recipe’ for future success (Ha Anh, 2009; Athukorala and Tran Quang Tien, 2009; Pham Xuan Kien, 2008).

Of the total 9,700 valid projects with a total registered capital of over USD145 billion, over 4,000 foreign invested enterprises are operational, contributing over 40.7 per cent of the country's total industrial production value (the figure is over 35 per cent if oil and gas production excluded). The foreign invested sector also contributes 55 per cent of the country's total export turnover (the figure is 38.4 per cent if crude oil export excluded). Currently, over 1.45 million workers are working for foreign-invested enterprises.

However, there are still weaknesses in the domestic economy, especially in infrastructure structure and the limited access high quality human resources. There is also a need to re-exert ‘national’ control over FDI as the tendency for localities to ‘promote investment and grant investment licenses to some projects based on their local benefits without taking full account of the general benefits of the country and the whole economy' is causing problems and limiting the benefits to individual areas rather than the country as a whole (Ha Anh, 2009).

The ratio of investment in manufacturing, hi-tech and export industries is still low while foreign investors are also beginning to over-concentrate on real estate. A major problem is that the infrastructure of Vietnam is still weak and projects such as roads and electric power plants still find severe difficulties in attracting suitable and substantial investors. Ha Anh (2009) found that post-licensed investment procedures, especially procedures for land clearance, were still in need of substantial improvements and in some localities the poor performance of authorities was actually hindering the progress of existing projects.

The problems are thus direct influences on Vietnam business confidence and the World'vest Base Inc (WVB) index of business confidence declared in 2009 that business enterprises in the fourth quarter of 2008 indicated a reduction to 93 points compared to 100 points in the third quarter (WVB, 2010).

With this in mind it is vital that confidence be re-built and that in the face of the financial crisis Vietnam learn from its mistakes. However, it is equally important that Vietnam learn from its successes and in the two case studies of this thesis it will be shown that FDI investments can become extremely successful in Vietnam, with the provision that in order to do so they must develop their ability to combine their capital, technological and asset advantages in order to acquire cultural affinity and develop and adapt to the business environment of Vietnam. This should be broken down into bespoke programmes for particular economic sectors and geographical regions in order attract investment in a more effective manner (Ha Anh, 2009).

Vietnam culture is not only deeply influential in the way business is conducted, but it varies across regions, particularly between the main regions of North, Middle and South of Vietnam. For example, there are significant linguistic differences, the 'style' of conducting business is different and the approach to how foreigners are treated varies according to region and the influence of politics and business practices in that region. For example, an often voiced comment is that Hanoi (the North) is focused on politics first and business second, while in Ho Chi Minh City (the South) it is business first and politics second. Although there is little actual evidence to support this perception, it is still an influence upon some foreigners' geographical choice of investment in Vietnam. Andrew Goddard noted 'I first went to Hanoi but re-located to HCMC. The North seems too political and every business decision appears to always be required first to go through a political sensitivity test before acceptance. Here [HCMC] is more like the West and just gets on with making a profit.' (Interview: Andrew Goddard, CEO of Red8 Consulting Services, 15 June 2009).

Although there are some significant cultural differences and perceptions in Vietnam, particularly between the North and the South, it still merges into a generic national identity that has a particular impact upon business and economic decision-making and operation. It is this cultural impact upon FDI that forms one of the basic platforms for this thesis, arguing that FDI success is culturally determined. The two case studies show how adaptation by ANZ and Honda to the Vietnamese 'context' was significant and that both operations, whilst importing many of their 'international' practices and systems, also created nationally based strategies that were sensitive to the Vietnam culture. It is this ability to open up to the cultural and change business strategy to suit the local area that has helped both NZ and Honda become successful FDI operations in Vietnam.

Table 4.14: Foreign direct investment projects licensed in 2008 by kind of economic activity

	Number of projects	Registered capital *(Mill. USD)*(*)
Total	**1171**	**64011.0**
Agriculture and forestry	17	203.2
Fishery	6	20.3
Mining and quarrying	7	6840.8
Manufacturing	455	28902.4
Electricity, gas and water supply	1	3.7
Construction	142	492.1
Wholesale and retail trade; Repair of motor vehicles, motor cycles and personal and household goods	29	54.8
Hotels and restaurants	17	1350.2
Transport; storage and communications	23	1882.1
Financial intermediation	1	62.6
Real estate, renting business activities	447	23702.8
Education and training	12	86.7
Health and social work	7	402.9
Recreational, cultural and sporting activities	4	5.8
Community, social and personal service activities	3	0.6

Source: General Statistic Office, 2009.

(*) Including supplementary capital of licensed projects in previous years.

Table 4.15: Foreign direct investment by provinces in 2008

	Number of Projects	Registered Capital *(Mil. USD)*
Total	**1,171**	**64,011.0**
By localities		
Red River Delta	***382***	***5,336.3***
Ha Noi	218	3,150.9
Vinh Phuc	18	154.3
Bac Ninh	31	984.4
Quang Ninh	11	180.6
Hai Duong	40	366.7
Hai Phong	31	310.9
Hung Yen	24	94.0
Ha Nam	2	30.0
Nam Dinh	3	22.2
Ninh Binh	4	39.3
Northern Midlands and mountainous areas	***25***	***216.9***
Cao Bang	1	4.1
Tuyen Quang	1	19.8
Lao Cai	3	11.2
Yen Bai	1	3.2
Lang Son	2	31.2
Bac Giang	11	65.8
Son La	n/a	n/a
Hoa Binh	6	13.4
North Central area and Central Coastal area	***51***	***32,957.0***
Thanh Hoa	5	6,211.3
Ha Tinh	1	7,879.1
Thua Thien-Hue	12	1,096.0
Da Nang	17	602.3
Quang Ngai	1	2,406.0
Binh Dinh	1	0.1
Phu Yen	1	4,345.9
Khanh Hoa	2	126.9
Ninh Thuan	2	9,800.3
Binh Thuan	9	435.1
Central Highlands	***19***	***105.5***
Kon Tum	1	67.0
Lam Dong	18	83.5
South East	***611***	***21,515.8***
Binh Phuoc	1	1.0

Tay Ninh	16	112.6
Binh Duong	127	1,026.1
Dong Nai	45	1,928.6
Ba Ria-Vung Tau	4	9,376.0
TP. Ho Chi Minh	418	9,071.6
Mekong River Delta	***80***	***3,818.6***
Long An	65	929.2
Tien Giang	2	14.0
Ben Tre	2	7.5
Tra Vinh	2	17.0
An Giang	1	2.0
Kien Giang	2	2,304.0
Can Tho	4	540.1
Soc Trang	1	4.7
Ca Mau	1	0.1
Oil and Gas Projects (East Sea)	3	16.0

Source: General Statistics Office, 2008.

Table 4.16: Export performance FDI sector in Vietnam

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Export (inc. oil) (mil.USD)	6810.3	6798.3	7871.8	10161.2	14487.0	18553.7	23061.3	27774.6	34529.2
Annual growth rate		*-0.2*	*15.8*	*29.1*	*42.6*	*28.1*	*24.3*	*20.4*	*24.3*
	22.2						*23.0*		
Import (mil.USD)	4352.0	4984.6	6703.6	8815.0	11086.6	13640.1	16489.4	21712.4	27898.6
Annual growth rate		*14.5*	*34.5*	*31.5*	*25.8*	*23.0*	*20.9*	*31.7*	*28.5*
	25.7						*26.9*		
Net Export	2458.3	1813.7	1168.2	1346.2	3400.4	4913.6	6571.9	6062.2	6630.6
Per cent in total export	47.0	45.2	47.1	50.4	54.7	57.2	57.9	57.2	55.1

Source: General Statistics Office, 2008.

4.6 Conclusion

Each transition economy has its own way to undertake economic reform towards a market-oriented economy from a history of central-planning and the world has witnessed significant changes in Russia, Eastern Europe and China since late 1980s. Vietnam followed its own direction with the *Doi Moi* policy and contributes a unique study to the knowledge pool on the transition of an economy from a controlled economy to a free market.

Viet Nam embarked on the *Doi Moi* (reform) policy in 1986. Since then, the country has seen dramatic changes, first and foremost in the economic thinking. The centrally-planned economy was replaced by the socialist-oriented market economy; national industrialisation and modernisation were initiated together with the policy of multilateralisation and diversification of external economic relations, openness and international integration. The *Doi Moi* process helped Vietnam rapidly escape hunger and poverty and lay the initial foundation for an industrialised economy, as well as maintaining a high growth rate and a relatively equal society.

The 1987 Foreign Investment Law was the first legal document that helped form the legal framework for the Vietnamese market economy. This was followed by the promulgation of a number of laws essential for the formation of the market economy, including Land Law, Tax Law, Bankruptcy Law, Environment Law, and Labour Code etc. Along with the law-making process, market economy institutions with economic management measures and establish an array of financial institutions, banks and basic markets for money, labour, goods and land, etc have also been established. The administrative reform was promoted so as to improve economic competitiveness and to help create a more favorable business environment and mobilise all resources for economic growth. Tremendous economic reforms taking place over nearly two decades of *Doi Moi* have yielded encouraging results. Vietnam has created an ever more competitive and dynamic economic environment.

During 20 years of *Doi Moi*, Vietnam has changed in every aspect of socio-economic life. The GDP growth rate of 7 to 8 per cent has been sustained, along with stronger industrialisation and expanded integration with the world and regional economy. Vietnam has enjoyed a sharp rise in trade volume, especially exports, and an increase of foreign investment and income. The multi-sector economy has been encouraged to develop, thus mobilising effectively all social resources for economic growth. With a view to raising the productivity of the state-owned sector, policies were formulated with concrete measures to adjust and reorganise SOEs. Vietnam has succeeded in translating economic achievements into social progress. Economic growth is combined with the improvement of life quality and development of health care and education.

The implementation of *Doi Moi* policy effectively helps to increase Vietnam's image under the eyes of international community. The judicious policy of the government has made Vietnam an appealing destination for FDI. Over the past years, Vietnam has drawn increasing inflows of FDI. However, Vietnam has yet to entirely take advantages to attract more FDI inflow as well as to optimise its benefits. The evidence for such claim is the up and down movements of FDI inflows to Vietnam, the small proportion of implemented FDI relative to registered FDI, the concentration of FDI in some industries and regions etc. Most FDI projects are small in scale, with moderate technology which originates mainly from Asia. This situation, together with increasing competition pressures from China and other regional countries in attracting FDI inflows, are posing considerable challenges to Vietnam.

CHAPTER 5: LEGAL FRAMEWORK FOR FDI IN VIETNAM

5.1 Introduction

Through '*Doi Moi*' policy reform Vietnam has gradually been transformed from a centrally planned economy into a market economy and opened its doors to foreign investment. FDI has been considered to be an essential factor for the economic development in Vietnam. Simultaneously, the legal system in Vietnam has rapidly developed, with a new laws and regulations on foreign investment, especially in terms of foreign exchange rules, licensing procedures and tax incentives. However, frequently-made amendments and supplements to existing laws, together with inconsistent interpretation and application of these laws, still create difficulties for foreign investors.

This chapter will discuss important changes in the legal framework for FDI in Vietnam and the reasons for these amendments and supplements.

Foreign investment in Vietnam has been regulated by the Foreign Investment Law (FIL) in Vietnam which was first adopted in December 1987 and revised several times to become more favourable to foreign investors.

5.1.1 Foreign Investment Law: Period 1988-1990

When the Vietnamese National Assembly first approved the FIL in Vietnam in December 1987, the Law defined the following issues:

- Foreign organisations and individuals were allowed to invest in Vietnam in sectors of its national economy, aimed at large national programs. Encouraged investment projects were given priority at different levels.
- Foreigners could invest in Vietnam through three forms: business co-operation contracts; joint venture companies; and wholly foreign owned companies.
- Foreign investors were allowed to transfer capital and profit out of Vietnam; their paid income tax would be returned if profits were re-invested into projects with over-3-year duration. Vietnamese government committed not to nationalise their properties.
- Foreign enterprises were exempted from import duties imposed on machinery, equipment, and materials for production and business. (NAV, 1987)

This was the legal foundation for FDI activities, which now attracted FDI inflows from the whole world rather than only from socialist countries. Vietnam attracted 213 FDI projects with the total investment capital of about USD1.8 billion in the period 1988-1990 (General Statistics Office, 2004).

However, the first Law on foreign investment faced many shortcomings, which became barriers to FDI activities. For example, many articles did not match the domestic situation to international rules and customs. Also, the Law only allowed foreign investors to establish a joint venture with state-owned or cooperative organisations but not the private sector (Pham Duy Nghia, 2003, 2006; Luu Van Dat, 1997; Seow and Ching, 2008).

Vietnam's legal framework was inadequate as it lacked specific regulations and laws directly concerning FDI activities such as laws on wages, taxation, intellectual property and technology transfer. The State Committee of Cooperation and Investment was the government agency responsible for investment management and this newly-established committee had little experience in supervision and monitoring of FDI activities. Therefore, this was called the period of 'learning by doing' in management of FDI activities in Vietnam (Hayward and Lay, 1997; Pham Duy Nghia, 2006).

5.1.2 Period 1991-1995

Between 1991 and 1995, the Law was revised twice (NAV, 1990, 1992a). The amended versions allowed the private sector to:

- Undertake business cooperation with foreign organisations and individuals directly
- Expanded forms of joint venture companies from 'two-party' into 'three-party'
- Provided preferential tax rates for FDI in areas with given priority (e.g., FDI enterprises producing necessary goods for import substitution)
- Corporate income tax of 10 per cent within 15 years of commencement of operation.
- FDI enterprises were allowed to rent land for operation while Vietnamese local government was responsible for compensation, site clearance for foreign-invested projects.
- The Government would guarantee foreign currency balance to FDI projects in infrastructure facilities and import substitution (Pham Duy Nghia, 1998).

However:

- Enterprises with wholly foreign-owned capital were still be restricted
- The registration procedure was still time-consuming when FDI enterprises had to register their business even after being granted FDI license (which took 45 days).

- FDI enterprises were not allowed to act as dealers for imports – exports
- Import duties were calculated based on minimum import price applied for calculating tax
- Except for FDI projects in infrastructure facilities and import substitution, FDI enterprises in other areas would have to arrange foreign exchange balance themselves (Pham Duy Nghia, 1998; 2001).

In Vietnam's economic reforms of the early 1990s, the government made extensive efforts to attract outside investment through improvements in the Law on foreign investment. Thanks to that, major foreign firms set up shop in Vietnam to market their products and services. Gainfully employed Vietnamese benefited from increased purchasing power, and the quality of life in Vietnam's largest cities visibly increased (Luu Van Dat, 1997; Pham Duy Nghia, 2003; 2004; 2006).

5.1.3 Period 1996-1999

FIL was modified comprehensively in November 1996 (NAV, 1996b), and FDI enterprises were now allowed to choose the form of investment, rate of capital contribution, investment location and Vietnamese partner; enterprises with export proportion of more than 80 per cent were given priority in granting license; FDI enterprises in export-oriented and hi-tech industries were encouraged (Pham Duy Nghia, 1998).

The local People's Committee still helped foreign enterprises to clear the site when the projects were approved while the enterprises would make payment for site clearance to the People's Committee. In addition, FDI enterprises could rent out land in industrial zones and exporting processing zones to third parties. The regulation that the export plan of enterprise must be approved by authorities was entirely removed. FDI enterprises in prioritised industries and regions were exempted from import duties within five years of commencement of operation; the firms supplying inputs to export enterprises were exempted from import tax on raw materials, intermediate goods with corresponding proportions (Pham Duy Nghia, 1997; 2001; Seow and Ching, 2008).

Under the 1996 FIL, foreign investors were entitled to select one of six following vehicles or forms for their investment in Vietnam:

- Business Co-operation Contract (BCC);
- Joint Venture Company (JVC);
- Wholly Foreign Owned Company (FOC);
- Build – Operate – Transfer (BOT);

- Build – Transfer – Operate (BTO);
- Build – Transfer (BT).

The JVC has shown to be the most common vehicle in Vietnam so far, but in practice foreigners have most preferred FOC thanks to the decision-making independence and flexibility. BCC has been often chosen for projects in the oil and gas exploration and exploitation, erection and exploitation of telecommunication network, and advertisement. BOT, BTO and BT have been often selected for infrastructural construction and development. Policies on industrial zones, export processing zones were supplemented to the revised Law in 1996 (Pham Duy Nghia, 2001; 2003; 2006).

With policies on exchange rate and foreign currency, FDI enterprises had to guarantee foreign currency balances and restrictions remained on international remittances. The import-export procedures with regard to certification of origins were improved (Gillespie, 2006; 2007; Balme and Sidel, 2007).

The Ministry of Planning and Investment (MPI) was the official state agency responsible for management of foreign investment activities in Vietnam. Local Departments of Planning and Investment were responsible for helping local People's Committees to manage FDI activities in each province (Gillespie, 2006; 2007)

.Amendments and supplements to the FIL in 1996 improved the legal framework for FDI in Vietnam. However, according to international assessment, it seemed that 'Vietnamese authorities suddenly had second thoughts about the desirability of opening the economy and introduced various bureaucratic hurdles that blatantly discriminated against foreign interests' (John, 2006, p.8). Despite positive changes in the Law bureaucratic graft and extortion topped the list of foreign-investor complaints in Vietnam, with excessive red tape stifling business operations and contract negotiations and the Government inefficiently creating new *ad hoc* business laws (Moore, 2004). For example, in 1997, the import of various consumer goods such as shampoo, soap, toothpaste, televisions and radios was outlawed. This was the government's attempt to encourage the domestic industry and increase its labour force, but foreign investors saw it as command economy politics (Moore, 2004).

Many foreign investors subsequently exited before the onset of the 1997-98 Asian financial crises. When the crisis hit, Vietnam suffered indirectly because the country's biggest investors, such as Thailand, Japan and Taiwan - had less to invest as they propped up their own economies from the effects of currency devaluations and capital flight. The country's key FDI problems were caused by the lack of a coherent government FDI policy (Scown, 1997).

In 1998-1999, the Vietnamese Government introduced temporary solutions to improve the investment environment and the decline in FDI. New exemptions and reduction of taxes, land rents, goods prices and service fees were used to encourage investment. The most significant FDI policy step forward was to allow foreign joint-venture partners to buy out local partners, which marked a major policy turnaround from 1996, when the government allowed but discouraged wholly foreign-owned enterprises. However, these solutions were not enough to meet foreign investors' requirement of more progressive investment laws and regulations. On the contrary, Vietnam's strict controls on the holding of foreign currency (due to the regional crisis) made it difficult for investors to retain US dollars in order to pay salaries, loans and repatriate profits. Also, it was the difficult-to-interpret and ever-changing investment legal system that became the obstacle for FDI attraction in Vietnam in this period (Moore, 2004; Gillespie, 2006; Pham Duy Nghia, 1998; 2003; 2004).

Consequently, the 1996 policy of FDI supplying Vietnam with 40 per cent of its investment needs by 2000 was not achieved. The resulting fallout hurt the Vietnamese economy and contributed to its unnecessary sluggish growth and poorly utilised resources and workforce (Nguyen Mai, 1997; Nicholson, 2003).

5.1.4 Period 2000-2005

The Government proposed numerous FDI legal reforms. The FIL was amended for the fourth time, in June 2000 (NAV, 2000b), attaching a series of decrees, decisions, and circulars, among of which was the Decree No.24/2000/ND-CP dated 31 July 2000 of the Government, providing detailed regulations on implementation of the FIL (NAV, 2000a; Pham Duy Nghia, 2006; Gillespie, 2007).

The 2000 FIL continued to guarantee the authorised capital and assets of foreign investors, and allowed foreign investors to invest in most sectors of the economy, except for those relating to the national security, defense and public interests, and others of similar nature. It especially encouraged foreign investment in many new fields, such as in production and processing with at least 80 per cent export; cultivating and breeding in agricultural, forestry and aquatic sectors; application of new technology for production of telecommunication and information products; projects of high-tech level; projects in development research; production of waste treatment facilities/equipment; production of input materials for anti-biotic products (Balme and Sidel, 2007; Gillespie, 2007).

The licensing process was substantially simplified and streamlined. Under the 2000 FIL, investment projects were divided into two categories, one of which required only registration for licensing and the other required appraisal for licensing. Previously, MPI served as the only 'one-stop' shop for licensing applications. Now, not only MPI but also provincial People's Committees and industrial zone (IZ) authorities were delegated and authorised to evaluate and issue investment licenses. Investment licensing bodies were not allowed to refuse to grant investment licenses to projects qualified for registration for investment licenses. They had 15 days from the date of receiving valid applications to grant licenses to investors. The maximum time limit for evaluation and issuance of an investment license was significantly shortened (AIBP, 2006). The official fee for a FDI license was abolished (Gillespie, 2006; 2007; Pham Duy Nghia, 2006; Balme and Sidel, 2007).

In addition to basic forms of investment (BCC, JVC, FOC, BOT, BTO and BT), as a move to further liberalise investment and trade environment, the law allowed foreign companies engaging in trade to establish branches in the country and operate certain international and domestic trading activities. Representative offices were another option for companies with existing commercial ties with Vietnam. Investors were entitled to convert the form of investment, divide or separate, consolidate or merger, or equitise their companies in accordance with the law. Foreigners were allowed to buy stocks of domestic equitised state-owned enterprises (Nguyen Tan Dung, 2005; Le Viet Anh, 2004).

The leasing of land and the evaluation of planning and architecture (of projects involving construction) were considered and approved during the course of project evaluation and the investment licensing process. After the technical design had been approved by the competent authority, the investor was entitled to commence construction work without any construction permit which was previously required before the commencement of construction. FDI enterprises also might use the construction attached to land and value of land use right as collateral for borrowing loan (Pham Duy Nghia, 2003; 2004; 2006; Gillespie, 2006; 2007; Balme and Sidel, 2007)

Approval on capital transfer was no longer required and the fee on profit remittance abroad was reduced. Regulation that the FDI enterprise had to allocate their certain profit proportion to reserve fund was removed. Moreover, the tax system was further reformed to reduce the tax gap between domestic and foreign investment. Companies with foreign capital were autonomous in their operation. They could recruit local labour directly from the market, and sign and terminate labour contracts directly with employees in accordance with the Labour Law (Nicholson, 2003; McCargo, 2004). They could also directly handle the importation of equipment, machinery, materials and other supplies for the construction and operation of their project, as well as the export and/or distribution of their products in Vietnam (i.e., FDI enterprises might act as dealers for import-export services).

Nevertheless, the 2000 FIL did not see fruition until the 9th Party Congress in 2001 because many local administrative bodies hindered FDI via corruption and bureaucratic obstacles. It is the 9th Party Congress in spring 2001 that laid the groundwork for a new investment law that was published five years later. The resulting 9th Party Congress resolution came out, including improvements and transparency in the FIL; opened medical, travel and tourism sectors to foreign investment; declaration of the intention to change to a ‘common tax system’; and granting foreign businesses the ability to hire local staff on their own accord and not via local hiring agencies (Communist Party of Vietnam, 2001). Perhaps the most significant change at that time was a lower foreign-currency surrender rate of 40 per cent, down from 50 per cent (Moore, 2004; Pham Duy Nghia, 2006).

Since then, several past hindrances to FDI, such as myriad permits required by investment authorities, had by this point been removed (AIPB, 2004). Especially, numerous industrial zones around the country made it easy to set up a factory with a small degree of red tape and bureaucratic interference. In 2003, the Foreign Investment Agency belonging to the MPI was established, making management of foreign investment activities more concentrated, less overlapping and cumbersome. After that, the Prime Minister enacted the Instruction No.13/2005/CT-TTg dated 8 April 2005, which offered several solutions to boost foreign investment, made it easier to carry out licensed projects and attract more FDI sources (NAV, 2005g). The decentralisation in licensing investment projects was shown by Government’s approval of the Decree 92/2005/ND-CP, which provided detailed instructions on the implementation of the Hanoi Ordinance, etc (NAV, 2005e; Pham Duy Nghia, 2006; Gillespie, 2007).

These changes, beginning a five-year FDI-reform movement, were a positive step in gaining investor confidence. Based on Vietnam’s commitment to the American Bilateral Trade Agreement (BTA), a continually touted desire to join the WTO, and also the Association of Southeast Asian Nations' Free Trade Area, Moody's upgraded Vietnam's creditworthiness from ‘stable’ to ‘positive’ in 2002. Vietnam’s slow but tangible FDI legal reforms probably contributed (Moore, 2004). The value of proposed FDI projects and disbursements both climbed gradually in spite of the global economic downturn (Gillespie, 2007).

In short, the government reformed FDI policy for the better by smaller steps. However, there remained gripes about FDI policy, such as a high top income tax of 30 per cent, high import tariffs for various product components that cost more than the final product, or forced purchase of locally produced parts for some products. For example, in September 2003, Vietnam instated a 25 per cent import tax on automotive parts kits for foreign manufactures with assembly plants in the country. The Government wanted to force FDI firms to purchase domestically made parts, partly due to the belief that it would decrease the number of cars on Vietnam's increasingly traffic choked roadways. Regardless, some auto makers declared to raise domestic prices per unit and to scale back investment until more optimal conditions evolved. Additionally, according to Ha Thu (2006), Vietnamese legal system still contained dozens of shortcomings which were hindering the development of economic sectors, not only FDI enterprises. Undeniably, the impacts of the FIL, the Law on Enterprises (LE), the Law on Domestic Investment Promotion (LDIP) and other rules that provided incompatible provisions on different economic sectors should be reconsidered.

The divergence in establishment procedures and incentives was also in place, all of which reflected the fact that the business-related legal framework and law enforcement tended to be protectionism oriented, inconsistent, lacking in strategies for priorities, and discriminatory. It was commonly agreed that regardless of its source, domestic or overseas, because of its growth-fuelling nature, investment indisputably needed to be encouraged. And creating a common legal framework promised to provide all investors with increased flexibility on an equal footing. Finally, there was also a need to set up a more transparent, stable and predictable legal framework for FDI (Pham Duy Nghia, 2007; Gillespie, 2006; 2007).

5.1.5 Period after 2005

Twenty years after the beginning of '*Doi Moi*', 2006 became an important year in Vietnam's development and integration in the world economy. Important developments could be seen from the establishment of a new investment legal framework. Under the former investment regime, foreign and domestic investors were subject to different regulations: foreign investors were governed by the FIL and domestic investors by the LE and the LDIP. In July 2006, a new investment regime comprising a unified Enterprise Law (UEL) for the management of both domestic and foreign enterprises, and a common Investment Law (CIL), regarding both foreign and domestic investment activities, has come into effect, granting a more level playing field than that found under the previous investment regime (NAV, 2005). This section will discuss some new features of the CIL and the UEL (for sources and further reading see: Le Van Triet, *et.al*, 1991; Le Xuan Dinh, 1999; Luu Van Dat, 1997; Nguyen Thi Anh, 1997; Pham Duy Nghia, 1998; 2000; 2001; 2002; 2003; 2004; 2006, Gillespie, 2006; 2007; Nicholson, 2003).

(1) One of the more encouraging clauses in the CIL, and a promising indication of the development of law in Vietnam, is an article stating: ‘Investors shall be permitted to invest in all sectors and in all industries and trades which are not prohibited by law; and shall have the right to autonomy and to make decisions on investment activities in accordance with the law of Vietnam’ (NAV, 2005j). This principle is a departure from the general principle, followed in the previous investment laws, allowing investments only in areas specified by law. However, investment projects must fall within the plans approved and provided by the Government. When a project does not fall into a stipulated master plan, the State administrative body for investment shall be responsible to act as coordinator with the State bodies responsible for master planning for the purpose of responding to investors (NAV, 2005j). This means that although the new Investment Law allows investments not prohibited by law, some of them are still subject to further regulation and State authority's decision (Pham Duy Nghia, 2006).

(2) A new parallel system of registration and licensing for enterprises is also introduced in the CIL. Investors must follow different licensing and registration steps depending on the size and the sector of investment.

Level 1 (Business Registration): Small domestic enterprises with invested capital below VND15 billion (USD 940,000), not falling in conditional sectors are only subject to business registration. However, they are subject to investment registration in the event they fall into a conditional sector, or if domestic investors want incentives for investment recorded in their license.

Level 2 (Investment Registration): Foreign projects with invested capital under VND300 billion (USD19 million) not falling in conditional sectors require investment registration, where the investor must submit an application for investment registration to the Licensing Authority, along with a ‘report on the financial capacity of the investor’ and the proposed constitutive documents for the enterprise (Decree No.108/2006/ND-CP dated 22 September 2006). The investment certificate also serves as business registration of a corporate entity. Domestic invested projects between VND15-300 billion (USD19 million) are also subject to this registration. Local investors may set up their corporate entity separately and then file for registration of any project without receiving an investment certificate. Enterprises can register additional investment projects subsequently without the need to create a separate entity.

<u>Level 3 (Investment Evaluation)</u>: Any project with invested capital over VND300 billion (USD19 million) or projects in conditional sectors must undergo an investment evaluation by the Licensing Authority and other relevant authorities. For the evaluation of investment projects greater than VND300 billion, along with the application documents, the applicant must also submit an 'econo-technical explanation' of the investment project. When assessing the certificate application, the Licensing Authority will liaise with other Ministries and authorities in evaluating the proposed investment project. For investment projects in conditional sectors, the investor must also demonstrate compliance with requirements specific to that conditional sector (Gillespies, 2007; Athukorala and Tran Quang Tien, 2009).

(3) The licensing of certain investment projects in 'sensitive sectors' must be approved by the Prime Minister. These investment projects include those relating to air and seaports, mining, broadcasting, casinos, cigarette manufacturing, and foreign investment projects with an investment capital over VND1.500 billion (around USD94 million) in the industries of electricity generation; mineral processing; road and railway construction; alcohol production and trading; other sectors such as post, delivery, telecommunications networks and publishing.

(4) Article 66 of the CIL grants government guarantees: 'Based on the principles stipulated in this Law, the Government shall decide on important projects and provision of guarantees for loans, supply of raw materials, sale of products, payment and guarantee for performance of other contractual obligations to projects.' (NAV, 2005j). This gives investors a good basis to rely on guarantees for important projects in Vietnam even though the phrases 'Based on the principles stipulated in this Law' and 'important projects' are unclear.

(5) Disputes between foreign invested enterprises (considered local entities) and state administrative bodies may be resolved not only through Vietnamese arbitration or a Vietnamese court, but by an international arbitration body in some cases. International arbitration must be written into a contract, or stipulated in an applicable trade treaty with Vietnam. This should give foreign investors greater confidence when doing business with Vietnamese partners, especially the government.

(6) The UEL provides four main forms of business including a limited liability company (LLC), a joint stock company (JSC), an incorporated partnership, and a private enterprise (i.e., sole proprietorships). Foreign investors having chosen to set up a business in the form of a JVC will find that either a LLC or JSC would be the most appropriate structures. Moreover, it should be noted that previously, foreign investors were limited by the business models that were available to them, which in essence consisted of either

JVCs with state enterprises or BCCs that were heavily and at times arbitrarily regulated by the government. Now, foreign firms can diversify into other business models, most notably wholly foreign-owned businesses.

(7) Neither the CIL nor the UEL set restrictions on the percentage of a company a foreigner may own. There are some exceptions to this general rule under regulations dealing with conditional sectors or WTO commitments. Foreigners can purchase shares in domestic companies, subject to the restrictions on conditional sectors mentioned above. In addition, there is currently a general 49 per cent cap on foreign equity ownership of companies listed on the Vietnamese stock market. Discussions within the legal community predict that changes in the near future will positively affect potential foreign shareholders. It is speculated that rather than have a list of sectors where foreigners may purchase shares of an enterprise, the government will list sectors which are either prohibited or restricted for foreigners (VILAF, 2007).

(8) On managing issues, the FIL requires a quorum and a unanimous vote of the board of management in order to decide certain issues pertaining to JVC, which means neither party to a JVC can exercise absolute control over the board of management because a management board quorum requires a representative from each party be present at the meeting. Even where a quorum is present, a super-majority or consensus requirement applies to many decisions of the board. In practice, these strict requirements have caused problems to many JVCs as the minority shareholder is able to deadlocks board meetings. Constraints like these will be lifted from the CIL and the UEL, which is a positive sign. The UEL also creates management structures with built in mechanisms allowing future meetings with reduced or no quorums preventing manipulation of quorum in shareholder's meeting, and board meetings of a limited liability company.

(9) LLC and a JSC both have distinct advantages and disadvantages that investors should be aware of before choosing an appropriate structure.

(10) The distinct advantage of a JSC is that a foreign partner may always sell shares to raise capital. The foreign partner may allocate for himself enough shares to achieve quorum in a first meeting to enable them to control any voting.

(11) The JSC structure may be preferable for a minority foreign partner interested in testing the market before fully establishing themselves in an unknown market. A JSC offers an easier method for a minority partner to increase his activity within the company by purchasing other shares, and potentially a majority share and also gives an easier exit to a partner wishing to sell his shares.

(12) The LLC structure is likely to be the optimum structure for a fully foreign owned enterprise. The single owner has complete control of the company and is not subject to

rules governing business relationships with partners, quorums, and majority voting. The LLC structure may also be preferable for foreign investors entering into joint ventures with Vietnamese parties. In an LLC, the foreign investor may choose his partners, rather than in a JSC where the public has the rights to purchase shares. The foreign partner may also enter an agreement within an LLC that, in the event the local partner wants to sell his share in the company, the foreign partner has pre-emptive rights of purchase.

(13) A good indication that Vietnam is developing rules for a market economy are articles prohibiting the Government from: forcing purchase, use of domestic goods and services; forcing export of a certain percentage of goods and services; limiting imports based on the quantity of goods exported; requiring a certain ratio of local content in manufacturing; requiring certain levels of domestic research and development; and forcing supply and location of goods and services or a head office in a certain location. Ensuring that foreign investors are protected from these unnecessary externalities will help keep business operations simple, efficient, and productive. Foreign entrepreneurs are more likely to invest in Vietnam if their operations can be based on market demands rather than Government dictations. This is an encouraging legal point and a critical market principle.

(14) One of the hotly debated issues during the drafting process of the CIL was how to include and record investment incentives. The CIL grants that investors, established and new, will be entitled to incentives, including tax incentives. These incentives will be recorded in the investment certificate which records investment incentives, for all foreign projects as well as those domestic projects of VND300 billion or more or in conditional sectors. It is optional for other domestic projects to obtain an investment certificate. Foreign investors generally appreciate their incentives recorded on their investment licenses since many have experienced challenges when dealing with the tax office regarding entitled incentives.

These new Laws are part of Vietnam's efforts to follow international investment practices as it looks to further integrate into the global market. Although this effort indicates Vietnam's seriousness regarding FDI attraction, the Laws have faults that alarm foreign investors.

The UEL, which regulates all matters of corporate governance for both domestic and foreign enterprises, could significantly improve the corporate governance framework within Vietnamese enterprises. The CIL, on the other hand, no longer regulates corporate governance but regulates access and entrance to the market through licensing and registration requirements. While the UEL promises to grant a more level playing field than the earlier regime, the CIL holds onto some old restrictions with many ambiguous and vague clauses (Pham Duy Nghia, 2004; 2006).

The main provisions regarding licensing have not been changed dramatically for foreign investors and still resemble the old FIL in many ways. Perhaps one of the greatest problems of the CIL is the multi-tier, multi-step system of registration and licensing for enterprises. Investors must fulfill different procedures depending on the size and the sector of investment. Especially, projects over 300 billion VND or in conditional sectors must undergo an investment evaluation, but the evaluation criteria are rather vague focusing on a series of investment conditions and goals a project must fulfill (VILAF, 2007). Definitions of what the goals and conditions are, and clarifications of several other unclear provisions will be updated in future implementing regulations. As of now, the CIL does not provide much guidance on the criteria an investor must meet to pass evaluation. This type of market uncertainty, in relation to government licensing and registration, is not helpful. Also, conditional sectors of investment are rather broad and vague, and will require both further implementing legislation as well as lessons from practice to fully understand (Pham Duy Nghia, 2003; 2006; Athukorala and Tran Quang Tien, 2009; Bui Hai Thiem, 2009).

Another worrisome creation of the CIL is the Investment Inspectorate. Some observers fear the creation of an Investment Inspectorate will cause more harm than good. One fear is that the Investment Inspectorate will be able to inspect different projects at their own discretion without justifying their investigation to another independent body. In other words, an investment project need not be suspected of wrongdoing to be inspected. The process of arbitrary inspection without cause may become a regular tool of corruption and extortion, as inspection activities will probably be intrusive, annoying, and slow down production. This powerful body with high potential for corruption may add to already existing problems of doing business in Vietnam (Pham Duy Nghia, 2006; Seow and Ching, 2008).

Vietnamese authorities still have work to do when drafting implementing decrees: filling in holes, clarifying ambiguities, and creating a more transparent investment system. But, the open dialogue and willingness of the government to engage problems indicates a strong possibility that future developments will continue positively.

5.2 Other laws and regulations involved in FDI

5.2.1 Investment Agreements

Prior to joining the WTO, Vietnam entered into bilateral investment treaties with a number of partners, including the US, Japan, Singapore and the European Union. The provisions in these bilateral treaties have largely been superseded by Vietnam's commitments upon acceding to the WTO (Nguyen Quan, 2003; Nguyen Lory 2004, Kurtz, 2004).

Vietnam joined the WTO as its 150th member on 11 January 2007, concluding a 12 year negotiation process. Joining the WTO is seen as a significant step for Vietnam as it marks the country's entrance to the global club of trading nations (Bui Hai Thiem, 2009; Athukorala and Tran Quang Tien, 2009).

Two fundamental principles embodied in the WTO treaties are MFN (most-favored nation) and National Treatment (WTO, 2008). MFN requires each WTO member country to give other investors from other member countries treatment no less favourable than that accorded to any third country. MFN does not prevent countries from granting extra privileges to certain countries under separate agreements (e.g. ASEAN), as long as such agreements have substantial sectoral coverage and provide for the absence or elimination of trade discrimination between the parties to such an agreement. National Treatment requires each country give to nationals and companies of the other treatment no less favourable than that which is given to its own nationals and companies (Athukorala and Tran Quang Tien, 2009).

Under the WTO rules, Vietnam must extend national treatment to the projects of investors from WTO member countries. This means that Vietnamese and foreign invested projects should be treated equally. In fact, this principle has been reflected in the CIL and the Government is reviewing a range of legislation to ensure that national treatment extends to all business regulations.

5.2.2 Trading and distribution rights

The Vietnamese Commercial Law (2005) has been significantly amended, establishing a new legal framework for foreign participation in the import and distribution sector. While previously foreign investors could only conduct commercial activities from representative offices and branches, the new Commercial Law allows foreign invested enterprises to independently conduct commercial activities (NAV, 2005c). In accordance with market access commitments contained in international treaties to which Vietnam is a signatory, the Decree No. 23/2007/ND-CP dated 12 February 2007 of the Government provides the legal basis for foreign-invested companies (FICs) to engage in trading and distribution activities (NAV, 2007a).

The first cornerstone trade treaty with Vietnam is the BTA (UTR, 2001), by which, as of 10 December 2004, an American company with up to a 49 per cent share in a JVC with a Vietnamese counterpart has the right to engage in trading activities. Import trading and distribution rights will still, however, be subject to Government approval regarding existing manufacturers. With effect from 10 December 2007, an American company may own up to 51 per cent of a JVC; and from 10 December 2008, it may wholly own an enterprise in Vietnam.

Vietnam also gives MFN status to investors from Japan and the EU and they may also enjoy the same entitlement given to American investors. However, before enjoying BTA trading and distribution rights, an existing manufacturer must first amend its license through application subject to government approval. Thus, American enterprises would not automatically enjoy trading rights and distribution rights under BTA without going through further legal mechanisms of approval (Kurtz, 2004; Seow and Ching, 2008 p.1-30).

By far the most important treaty in this area is Vietnam’s protocol of accession to the WTO. As part of its WTO accession package, Vietnam has committed to granting trading rights (the right to import and export goods) for all goods to foreign individuals and organisations from WTO member states no later than 1 January 2007. Trading rights do not apply to various products reserved for ‘State-trading’ enterprises (for example tobacco products, crude oil and petroleum products) and products for which rights are being phased in, for example import rights for pharmaceuticals will be phased in on 1 January 2009 and rights to export rice will be not be granted until 1 January 2011. Moreover, despite the WTO accession package, an importer is not permitted to directly distribute the imported goods in Vietnam without a distribution license, but Vietnam has committed to steadily increasing foreign participation in distribution services (Athukorala and Tran Quang Tien, 2009; Taussig, 2009; Bui Hai Thiem, 2009).

It is still necessary to conduct some legal and regulatory reforms to enable Vietnam fully meet its commitments with regards to liberalising trading rights and distribution. However, trading and distribution rights of FICs have undeniably been broadened in consistency with Vietnam’s market access schedule in its international undertakings, which could help increase the efficiency and profitability of investment as forecasted by IMF (2007).

5.2.3 Banking and Finance

- **Foreign Exchange**

While the Government is responsible for the macro-economic foreign exchange policies, the State Bank of Vietnam (SBV) is responsible for regulating and implementing those policies and for overseeing currency transactions to ensure that they comply with the relevant guidelines. A significant step in State management on foreign exchange is the birth of the Foreign Exchange Ordinance (NAV, 2005f), which was passed by the Standing Committee of the National Assembly on 13 December 2005 with an expectation that this new legislation would regulate the high level foreign exchange market in Vietnam and satisfy the conditions for the country's integration into the WTO (Nguyen Nhu Binh and Haughton, 2002; Vu Bang Tam, 2008,).

- **Bank Accounts**

Accounts in Vietnam: All FICs and foreign parties to BCCs must open a Capital Account with a bank located in Vietnam. The main purpose of the Capital Account is to monitor the flow of capital in foreign currency into and out of Vietnam. Therefore, certain transfers of capital (e.g. transfer of capital/equity, profits or off-shore loans) must be effected through this Capital Account. In addition to the Capital Account, FICs and foreign parties to BCCs can open other foreign currency and VND accounts at other banks in Vietnam.

Accounts outside Vietnam: The opening and operation of off-shore accounts are under the strict control of, and must be approved by, the SBV. Normally, the SBV approves off-shore accounts for the purposes of disbursement and repayment of an off-shore loan provided that the loan principal must not be less than US$ 5million. Recent regulations have allowed FICs to open off-shore accounts in certain special circumstances. In practice, SBV has approved several off-shore accounts opened by BOT companies in Vietnam for security purposes as required under financing agreements or for the remittance of equity (Taussig, 2009,).

- **Liberalisation of current transactions**

With the introduction of the Foreign Exchange Ordinance and the issuance of Decree No.160 (NAV, 2006b), the payments and money transfers in relation to current transactions in Vietnam are said to be liberalised. This represents Vietnam's commitment to the liberalisation of current transactions in accordance with such conditions set out in Article VIII of the IMF Rules (VILAF, 2007). In particular, a foreign investor is now allowed to remit overseas his profits or invested capital without presenting the remitting bank a tax certificate from the tax office as evidence that it has fulfilled all tax obligations in Vietnam.

- **Foreign Currency Payments**

Foreign currency payments within Vietnam, except for certain limited circumstances, are strictly prohibited under the Foreign Exchange Ordinance and are subject to the strict control of the SBV. Except certain permissible circumstances provided by the Circular 01 of the SBV dated 16 April 1999 or otherwise permitted by the Prime Minister, residents and non-residents are prohibited from making payments, granting loans and advertising of goods and services in a foreign currency (NAV, 1999). A breach of the above requirements may make the whole contract, to which the payment relates, invalid (Taussig, 2009).

- **Exchange Rate**

In term of rates of exchange, each day the SBV announces, in the mass media, an average exchange rate in the Foreign Currency Interbank Market of VND against USD. This official exchange rate shall be used to calculate import/export duties; to consider bidding for national projects at the time of bidding openings; and to calculate the value of capital contributions made to a JVC or a BCC at the time of the capital contribution. Commercial banks (including foreign bank branches) shall determine and announce their buying/selling rates of VND against US$ within the range permitted by SBV (Taussig, 2009,)

- **Taxation**

Taxes that may affect foreign invested projects and foreigners working in Vietnam include Corporate Income Tax; Capital Transfer Tax; Value Added Tax; Special Consumption Tax; Import - Export Duties; so on. The backbone of the tax system is all the tax laws, for instance, the Law on Corporate Income Tax (2003), the Law on Value-Added Tax (1997), the Law on Special Sales Tax (1998), the Law on Import/Export Duty (2005), etc. There are also hundreds of decrees, circulars and other regulations being issued by the Government, various ministries and agencies, from time to time, with a view to guiding for the implementation of those laws (Seow and Ching, 2008).

- **Corporate Income Tax**

Before the CIL comes into effects, Corporate Income Tax (CIT) is levied on the taxable income of FICs and foreign parties to BCCs licensed to operate in Vietnam. The calculation of taxable income for CIT is revenues generated in their production and business less reasonable expenses in the relevant fiscal year. The reasonable expenses for the stated deduction purpose are strictly regulated by the tax authority and must be supported by valid invoices, vouchers and relevant documents. Limitations are applied to certain deductible expenses (Athukorala, 2006; Magennis, 2006).

With effect from 1 January 2004, the new Law on CIT (NAV, 2003b) introduces a standard CIT rate of 28 per cent (instead of 25 per cent previously applicable to FICs and foreign parties to BCCs) for both local enterprises operating under the UEL and FICs, including foreign parties to BCCs. Other than the standard rate, preferential rates of 10, 15 and 20 per cent apply to a number of investment projects which satisfy certain conditions such as investment in certain fields of business and/or encouraged geographical locations.

In addition to preferential CIT rates, FICs and foreign parties to BCCs may enjoy CIT exemption from 2 to 4 years after the first profit-making year and reduction of 50 per cent CIT from 2 to 9 years subsequently. However, the refund of CIT with respect to reinvested profits is no longer entitled by FICs and foreign parties to BCCs. (Athukorala and Tran Quang Tien, 2009; Nguyen Ngoc Anh and Nguyen Thang, 2007)

During the operation, any losses incurred by FICs or foreign parties to BCCs in any tax year may be carried over to the following years. However, losses cannot be carried over for more than 5 years. Carrying - back of losses are not permitted. The registration of losses carried-forward is strictly monitored by the tax authority. In principle, the tax authority will not accept losses carried-forward if they are not registered on time.

From 1 January 2004, profits derived from foreign investments in Vietnam have not been subject to profit remittance tax when remitted out of Vietnam. (The rate of this tax before was, depending on the prescribed capital scale and other criteria, 3.5 or 7 per cent).

- **Capital Transfer Tax**

Capital transfer tax is in nature a form of CIT imposed on profits earned by foreign investors from the transfer of their interest in the legal capital of an FIC or in the capital of a BCC. The taxable profit is determined as the sales price less (i) the initial value of contributed capital and (ii) any transfer expenses. With regard to subsequent transfers, the initial value of the contributed capital shall be the price of the preceding transfer plus the amount of any additional contributed capital. The tax rate applied to capital transfer is 28 per cent of the taxable profit. Upon obtaining the amendment to the investment license, the transferor is required to register the transfer of capital and file tax returns with the tax authority. (VILAF, 2007)

- **Value Added Tax**

Value Added Tax (VAT) applies to supplies of goods and services for use in production, business or consumption in Vietnam (NAV, 1997). VAT is calculated on the sale/purchase price of the relevant goods or service before the addition of VAT. The applicable VAT rates are 0, 5 and 10 per cent, of which the normal rate of 10 per cent is applicable to most goods and services; 5 per cent for a number of encouraged goods and services; and 0 per cent for exported ones. VAT payments to the tax authority are the difference between output VAT and input VAT. Foreign invested projects shall be exempt from VAT in respect to the certain imported items.

- **Special Consumption Tax**

Special consumption tax (SCT) is applied to the production or import of certain goods and the provision of certain services, which are either luxury or discouraged for consumption. In addition to being subject to SCT with the rates ranging from 15 to 100 per cent, the above goods and services also are subject to VAT at 10 per cent. If they are imported, import duty at various rates will apply in addition. (NAV, 1998)

- **Import and Export Duties**

According to NAV (2005i), export duties are charged on a few items, primarily agricultural products (e.g. rice, forest products and fish) and natural minerals. Rates vary between 0 and 50 per cent of the FOB price of exported goods.

Import duty rates are now classified into three categories as follows: (1) *preferential rates* vary between 0 and 150 per cent of the CIF price of imported goods. Preferential rates are applied to goods imported from one of some 60 countries which have MFN status with Vietnam; (2) *ordinary rates* apply to goods imported from other countries. These are up to 50 per cent above the preferential rates applicable to MFN countries; and (3) *special preferential rates* apply to goods imported from countries which have a special preferential agreement with Vietnam, e.g. the ASEAN member countries under the CEPT and EU member countries under the Textile-Garment Treaty between Vietnam and EU. The dutiable value of imported goods is based on the invoice price (with penalties for fraudulent declarations), which is not available or 10 per cent lower than the minimum price, which is set by the Ministry of Finance (MOF) under Circular 113 dated 15 December 2005 (NAV, 2005a).

FICs and parties to BCCs shall be exempted from import duty imposed on some goods, provided that: (a) they are implementing a project in an encouraged field of business or in a geographical location set out in Decree No. 108 (NAV, 2006a); (b) such goods are imported to form the fixed assets of the enterprise; and (c) they are imported to expand the project's scale and to replace or remove the technology.

With regard to materials and raw materials imported for producing exported goods, the payment of the import duty can be postponed for a certain period of time. If the enterprise fails to export its products within such a period, the import duty will be imposed. However, the import duty will be refunded when the products are eventually exported. This exemption may have to be abolished as part of Vietnam’s commitments to abolish export subsidies when joining the WTO.

In fact, in Vietnam’s legal framework, import-export policies mainly reflected by the Law on import and export duties are considered one of important factors to raise the attractiveness of investment environment. However, despite many times of amendment and supplement, after years of implementation, the Law on import-export taxes has exposed several shortcomings that need revising in order to create clearer and more effective legal framework for not only attracting FDI, promoting export, improving Vietnamese goods' competitiveness in local and international markets but also harmonizing Vietnam's regulations with international standards (Nguyen Ke Tuan, 1996, Pham Chi Dung, 1992; Nguyen Ngoc Anh and Nguyen Thang, 2007; Magennis, 2006).

- **Withholding Tax and Foreign contractor tax**

According to Circular 05 dated 11 January 2005 by the MOF, the amount of interests and fees payable under offshore loans is subject to withholding tax at a rate of 10 per cent. Loans obtained by a branch in Vietnam from its offshore parent companies also are subject to withholding tax (NAV, 2005b).

Foreign contractor tax (FCT) applies to foreign organisations and individuals that have business incomes sourced in Vietnam, even though they do not have a physical presence in Vietnam. Services which are performed wholly overseas but provided to a project in Vietnam will also be subject to FCT. Under Circular 05, foreign contractors will have one of following options: (i) paying taxes by way of withholding by the relevant employer; (ii) registering with the Vietnamese accounting system for the direct payment of taxes; and (iii) with respect to foreign contractors having a 'permanent establishment' in Vietnam, paying taxes under the 'hybrid' method, which combines elements of both other methods.

- **Personal Income Tax**

Tax payers include (1) Resident foreigners who stay in Vietnam for 183 days or more within a consecutive 12 month period are subject to Personal Income Tax (PIT) at progressive rates on worldwide-sourced regular income (regardless from where the income is paid) and Vietnam-sourced irregular income; (2) Non-resident foreigners who stay in Vietnam for less than 183 days in a consecutive 12 month period are subject to PIT on regular and irregular income sourced in Vietnam during their residence in Vietnam; and (3) Vietnamese citizens working in or outside Vietnam are subject to tax on worldwide-sourced regular income and irregular income. (VILAF, 2007)

For resident foreigners and Vietnamese citizens working overseas, PIT rates change from 0 per cent (imposed on persons with monthly income below 8 million VND), to 10 per cent (from 8 to 20 million VND); 20 per cent (from 20 to 50 million VND); 30 per cent (50 to 80 million

VND); 40 per cent (over 80 million VND). Non-resident foreigners are subject to a tax rate of 25 per cent of incomes sourced in Vietnam during the relevant period of time.

- **Technology Transfer**

Following the Decree 11 detailing regulations on technology transfer dated 2 February 2005, technology transfer in Vietnam is currently regulated by the newly enacted Law on Technology Transfer on 1 July 2007 (NAV, 2005d; 2006d).

Under the Law on Technology Transfer, ‘technology’ is defined as ‘solutions, processes and know-how, which may or may not be associated with tools and means, to turn resources into products.’ This definition may prove difficult to implement in practice.

The Law on Technology Transfer prohibits transfer of technologies which: (i) fail to satisfy the requirements stipulated by the laws on occupational safety, labour hygiene, protection of human health, and protection of natural resources and the environment; (ii) create products causing harm to socio-economic development and having an adverse impact on national defense and security or social order and safety; (iii) are not permitted to be transferred pursuant to a provision in an international treaty of which the Socialist Republic of Vietnam is a member; or (iv) are on the list of State secrets, unless a provision of law provides otherwise (Pham Duy Nghia, 2004).

5.2.4 Land Law

On the 6th November 2003, the National Assembly of Vietnam passed the Land Law, which commenced effect on 1 July 2004 (NAV, 2003a). The Government issued Decree 181 dated 29 October 2004 (NAV, 2004b) for providing guidance on the Land Law, as amended by Decree 17 dated 27 January 2006 (NAV, 2006c). These laws and guidance stipulate some main issues such as land use rights, real estate market and land price (Ton Gia Huyen and Tran Thi Minh Ha, 2009).

Under the Law, private ownership of land is not permitted in Vietnam and the State/Government holds all ownership powers. The Land Use Right Certificate, unlike a deed, is not a certificate of ownership of the land, but a certificate of ownership of Land Use Right (LUR). While the Land Law allows domestic companies to purchase the LUR from others, foreign investors are not allowed to do so. Foreign investors in Vietnam however could obtain the LUR by way of (i) capital contribution in the form of the LUR value by the local partner to a JVC; or (ii) land lease directly from certain permitted leasers', including the State (Ton Gia Huyen and Tran Thi Minh Ha, 2009).

The new Land Law finally recognises the existence a real estate market and regulates what types of land that can be traded in the market. It specifically prohibits land users from putting land allocated/leased to them by the State to carry out investment projects into the market. It also recognises that the State must play a role in the development of this market and empowers the State body in charge of land to regulate the registration of real estate transactions; establishment of real estate investment funds; establishment of related-service providers and to take measures to avoid speculation and protect participant in the market (Ton Gia Huyen and Tran Thi Minh Ha, 2009).

Land Price is determined in three ways: (i) by the relevant People's Committee; (ii) via auction; or (iii) by land users upon transfer/lease, sublease of LURs or contribution of LURs as capital. The State determines land price based on actual value of land in normal circumstances, if there is a large discrepancy in their calculations compared to the market price the State must adjust the price (Ton Gia Huyen and Tran Thi Minh Ha, 2009).

While private ownership of land is not permitted, Vietnamese law expressly recognises mortgages over LURs in favour of credit institutions in Vietnam, including foreign bank branches in Vietnam. Unfortunately, foreign investors may be disappointed to find that the right to mortgage LURs to offshore lenders is not provided for and they must still lease land from the State (Ton Gia Huyen and Tran Thi Minh Ha, 2009, p. 1-4).

In general, compared to the previous 1993 Land Law, the current Law does contain some significant changes in respect of land administration formalities, recognition of the reality that land is a valuable commodity and the existence of a real estate market and pricing of land. However, during application of the Land Law, many shortcomings have come to light. Due to constraints remain in land clearance and compensation, as well as administrative formalities, the real estate market has not become transparent, making it difficult for foreign investors (Mai Thanh Hai, 2009). Moreover, as the law is not currently clear on a number of aspects, further implementing legislation need be issued (Ton Gia Huyen and Tran Thi Minh Ha, 2009).

5.2.5 Employment

Following the promulgation of the Labour Code in June 1994 (as amended), a series of implementing regulations have been issued to govern particular areas of labour law, including labour contracts, employment procedures, working hours and salary (NAV, 1994a, Nicholson, 2003; McCargo, 2004). The Labour Code is often said to be complex, and some foreign firms have found it difficult to comply with its requirements. (For further reading see ‘Vietnamese Labour Code 23-VLC, 1994 as Amended 2002, Ministry of Labour, Invalids and Social Affairs - MOLISA)

- **Recruitment**

Under the Labour Code, FIEs are allowed to recruit Vietnamese employees directly or through a recruitment center. Before recruiting, FIEs are required to make a public announcement on either local or central mass media and post at their head office their recruitment requirements such as job description, qualifications, number of labourers to be recruited, contract term, salary and working conditions.

Where highly technical, managerial or other qualifications are required for which Vietnamese personnel are not available, a FIE may recruit expatriates. However, there must be a training program to allow Vietnamese employees to eventually replace such expatriates. Vietnamese law recently imposed a cap on the total number of expatriate employees, which cannot now exceed 3 per cent of the total workforce, but a FIE may employ more expatriates if it obtains approval from the Chairman of the provincial People's Committee (VLC-MOLISA, 2002).

- **Labour Contracts**

A labour contract must, with the exception of contracts with a term of less than 3 months, be in writing and signed directly between an employee and the legal representative of the employer. The contract must be made in the standard form issued by the MOLISA. The contents of a labour contract must be in compliance with the laws of Vietnam and the collective labour agreement of the relevant company if there is one (VLC-MOLISA, 2002).

- **Termination of Employment**

The Labour Code only allows unilateral termination of a labour contract in limited circumstances, irrespective of any mutual agreement or other circumstances. An employee who signs a non-fixed term labour contract is entitled to unilaterally terminate the contract whenever he/she wishes so, provided that a 45 day prior notice is duly given to the employer. However, during the term of a labour contract, unilateral termination by an employer is permitted only in the certain circumstances (VLC-MOLISA, 2002).

Dismissal is permitted only when the employee has committed one (or more) of the following acts: theft; embezzlement; disclosure of technological and business secrets; repeating a breach while a disciplinary sanction remains in place for an earlier breach; or absence for 5 working days or more in a month or 20 working days in a year without justifiable reasons… However, companies should exercise caution when dismissing employees. The laws and practice of Vietnam differ from those in certain other countries. The concept of employee conflict of interests or employee loyalty is not well developed.

A company may retrench its employees where there is an organisational restructuring or technological change resulting in the redundancy of an employee who has worked for the company for 12 months or more. The retrenchment must strictly follow procedural requirements, otherwise it would be deemed unlawful (VLC- MOLISA, 2002).

- **Wages, Overtime Payments, and Statutory Minimums**

The Government decides and publishes a minimum wage which varies, depending on geographical regions and types of work. In particular, FICs must not pay salaries to their employees lower than the statutory minimum wage levels applicable to untrained labourers. With respect to employees who have obtained vocational training (including vocational training conducted by the relevant FIC itself), FICs are required to pay a salary at least 7 per cent above the statutory minimum wage.

An employee working for at least 12 months is entitled to annual leave of 12 days in addition to public holidays. Especially certain hazardous and toxic jobs are entitled to either 14 or 16 days annual leave as determined by the Government. An employee is entitled to paid leave for the following personal reasons: marriage (3 days' leave); marriage of son or daughter (1 day's leave); and death of parents, spouse's parents, spouse, son or daughter (3 days' leave). Female employees are entitled to maternity leave of at least 4 months, with an allowance equal to 100 per cent of the salary to be paid by the Social Insurance Fund.

In terms of other issues involved in work permits, collective labour agreement, working rules, trade unions, employment funds (funds for social insurance, health insurance, retrenchment allowances) and labour disputes, FICs must comply with the common Law Code articles in Vietnam (VLC-MOLISA, 2002).

- **Employment Funds**

Contribution to the State Social Insurance Fund is a statutory obligation of both the employer and employee in all contractual employment relationships longer than three months. The Social Insurance Fund provides benefits such as pensions, salaries during sick days, salaries and treatment for labour-related accidents and occupational illnesses, maternity benefits, and death benefits. Employer pays 15 per cent of the monthly salary pool to the Social Insurance Fund. Employee pays 5 per cent of his/her monthly salary to the Social Insurance Fund.

The Health Insurance Fund covers 100 per cent of medical expenses, except for cases where high value treatments are involved. In such cases, the Health Insurance Fund covers 100 per cent of medical expenses incurred by working employees provided that they are less than VND 7 million and 60 per cent of such expenses if above VND 7 million (but not more than VND 20 million in any event). An employer is obliged to pay 2 per cent of the monthly salary pool to the Health Insurance Fund. Each employee must also contribute by paying 1 per cent of his or her monthly salary to the Health Insurance Fund (Nguyen Nhu Binh and Haughton, 2002; Athukorala, 2006; Pham Duy Nghia, 2004; 2006).

5.2.6 Dispute Resolution

Although Vietnam is in the process of building a more internationally acceptable dispute resolution framework, such framework remains at an early stage. As such, in common with other developing countries, formal dispute resolution and enforcement will continue to be a concern for investors in the short term for the following reasons:

the laws and regulations of Vietnam are still relatively unclear and undeveloped in many important areas, not only in relation to substantive matters such as the rights and obligations of parties to a contract but also in relation to procedural matters such as enforcement of rights;

- there is no systematic publication of judgments or judicial decisions;
- the Vietnamese courts and arbitration centres have only recently been legislated for and are still underdeveloped in many respects;
- the independence of the judiciary is not guaranteed;
- judges and arbitrators generally have little experience in dealing with or settling complicated disputes;
- while the incorporation of foreign laws to govern contracts is permitted in certain circumstances under the laws of Vietnam, there is currently little practical possibility of such laws being applied in Vietnam;

- choice of foreign courts is of limited value as foreign court judgments are generally not enforceable in Vietnam; and
- despite the enforceability of certain court judgments and arbitral awards, the actual enforcement process is uncertain, expensive and time-consuming (VLC-MOLISA, 2002; Pham Duy Nghia, 2006; Gillespie, 2007).

5.2.7 <u>Competition Law</u>

The promulgation of the new Competition Law shows Vietnam's efforts in improving the legal environment in general and the economic legal framework in particular. This Law ensures international competition principles and brings about legal corridor relevant to foreign trade practices, process of free trade and investment. This can be considered as Vietnam's commitment to observe common rules of international community and create open, attractive environment for FDI (Pham Duy Nghia, 2002; 2003; 2006).

The new Competition Law (Law) governs two types of anti-competitive activities: activities in restraint of competition and unfair competition. While foreign companies familiar with Western antitrust laws and trade regulations will find that the Vietnamese Competition Law draws on common aspects of these laws, the Law is the first legislation of its type in Vietnam and has some significant differences with Western law. (NAV, 2004a; Gillespie, 2007)

- **<u>Economic Concentration</u>**

When a merger, consolidation, acquisition (with some exceptions), joint venture, or other type of 'economic concentration' results in a market share of between 30 to 50 per cent, the Competition Commission must be notified, unless the concentration results in a small or medium enterprise. An economic concentration resulting in a market share of 50 per cent or above is prohibited, unless the concentration results in a small or medium sized enterprise or an exemption is granted. Exemptions are available when one of the parties is at risk of being dissolved or insolvent or where economic concentration enhances export, socio-economic development or technical progress. So far, enhancement of export, technical progress, and socio-economic development interpretation remains at the discretion of the Competition Commission and the Ministry of Trade (MOT).

5.2.8 <u>Bankruptcy Law</u>

One of the many new laws reflecting developments in Vietnamese business law is the Law on Bankruptcy, which came into effect 15 October 2004 (NAV, 2004c). In the 10-year lifespan of the old law only 63 out 150 bankruptcy cases were accepted and administered by the court system. The new Bankruptcy Law was designed in part to be a more user-friendly law.

The Bankruptcy Law applies to all enterprises, including FICs and state-owned enterprises (SOEs). Exceptions exist for enterprises linked to national defense and security, and sectors of finance, banking and insurance, and other sectors directly supplying essential public utility products and services. Although no list setting out the industries falling under this exception currently exists under the Bankruptcy Law, it is envisaged that such a list is forthcoming (Pham Duy Nghia, 2006; Gillespie, 2006; 2007).

The Vietnamese legal definition of the ‘state of Bankruptcy’ describes: businesses ‘which are incapable of repaying their due debts at creditors' request, shall be regarded as falling into the state of bankruptcy.’This definition is clearer than the one it replaced, which referred to undefined terms such as ‘financial difficulties’ and ‘failure of all necessary financial measures.’ In the past it has been very difficult for creditors to prove that the relevant company had faced financial difficulties and had completed all necessary financial measures and those issues make the bankruptcy proceedings a very cumbersome and time-consuming process for creditors of a bankrupt company (Pham Duy Nghia, 2004; 2006, Gillespie, 2006; 2007).

To begin bankruptcy proceedings an application must be submitted and the court must agree to commence proceedings. After the court issues a commencement decision, an enterprise may continue conducting business but will be monitored and inspected by the court and an Asset Administration and Liquidation Team (AALT).

One of the criticisms of the old law was that the bankruptcy process focused more on punishing debtors than recovering debts. The AALT shifts the focus towards recovery. The AALT is established when the judge commences bankruptcy proceedings. The team is comprised of an executor of the judgment-executing agency (a member of the executive branch) who acts as leader of the team; an officer of the court; a representative of the creditor; a representative of the enterprise subject to bankruptcy procedures; and representatives of labour when appropriate (Pham Duy Nghia, 2004; 2006).

Business may continue as usual, however it is subject to supervision and inspection of the court and AALT. One significant change from the old law allows the court appoint a business administrator at creditors' request if the manager of the business lacks the ability to operate, or continues jeopardizing the business's assets.

5.3 Reasons for changes in the legal framework for FDI in Vietnam

The changes in the legal framework for FDI sector come from various reasons. Along with the performance of FDI sector, those changes for the last 19 years were also derived from three other factors, namely: (1) Changes in awareness and viewpoint of the Communist Party and the Government toward foreign economic sector; (2) Competition pressures from other countries in the region, and in the world, with respect to FDI attraction; and (3) Vietnam's international commitments regarding foreign investment. The section below will discuss these factors, and indicate some challenges to the Government of Vietnam in improving FDI policies and regulations in the forthcoming years (Pham Duy Nghia, 2006, p.1-20).

5.3.1 Changes in Vietnam's awareness and view point on FDI

According to the Article 25 of Vietnam's Constitution in 1992, 'the State encourages foreign organisations and individuals to invest funds and technologies in Vietnam in conformity with Vietnamese law and international law and usage; it guarantees the right to lawful ownership of funds, property and other interests by foreign organisations and individuals. Enterprises with foreign investments shall not be nationalised. The State creates favourable conditions for Vietnamese residing abroad to invest in the country' (NAV, 1992b). This reflected Vietnam's awareness of the role of FDI sector in the early period (Gillespie, 2006; 2007).

Since then, there has been a number of changes so far in the views of the Communist Party and the Government on foreign economic in general and FDI in particular. This resulted from the actual situation of the economy, as well as the changes in regional and world economic settings. In fact, FDI enterprises were not considered as an independent entity before 2000. However, the 9th Party Congress in 2001 marked an important change when FDI sector was officially recognised as one of the six sectors in the economy (Gillespie, 2006; 2007; Balme and Sidel, 2007). The landmarks of significant changes in awareness and views of the Party and the Government of Vietnam, with respect to the role of FDI in the economy, are as follows:

The 7th and 8th Party Congress, in 1991 and 1996 respectively, have recognised the cooperation and joint venture between State enterprise and foreign partner, and affirmed that FDI sector 'has a vital role in the mobilization of capital, technology, organisational and managerial skills.' (Communist Party of Vietnam, 1996) though they were yet to separate the FDI into an 'economic sector' in Vietnam's multi-sector economy. From that viewpoint, the policies regarding FDI mainly focused on encouraging joint ventures between foreign investors and Vietnam's SOEs, with operations, in a number of economic industries, except for areas of particular importance to the national economy, security and defense (Pham Duy Nghia, 2003; 2004; 2006; Gillespie, 2006; 2007; Nguyen Dung, 2005).

The year 2001 marked the first time the sector with foreign capital was recognised as an economic sector. Its contribution was emphasised as ‘export orientation, construction of socio-economic infrastructure facilities, as well as transfer of advance technology and creation of additional employment, etc.’ (Communist Party of Vietnam, 2001). Because of that great contribution, at the 9th Central Party Congress, the Communist Party of Vietnam had put forward the task of ‘generating fundamental changes in attracting foreign direct investment’. Accordingly, FDI policy in the forthcoming years will focus on raising the quality of FDI inflows to Vietnam, by further attraction of FDI from multinationals involving with important industries and sectors of the economy, particularly industries that use hi-tech or source technology. The positive changes in awareness and viewpoint of the Party and the State become an essential foundation for the Government's amendment and improvement of legal documents and policy framework with respect to FDI attraction and operations of FDI enterprises in recent years (Magennis, 2006; Nguyen Nhu Binh and Haughton, 2002; Athukorala, 2006;).

Seemingly, the changed perceptions among Vietnam's top leadership about the future role foreign capital have fostered Vietnamese officials to display an unprecedented openness to foreign capital and commitment to liberal economics in recent years, which has been reflected in Communist Party of Vietnam (2006).

5.3.2 Comparing current legal framework for FDI in Vietnam and some countries

As presented in previous sections, Vietnam's legal framework for FDI has now been more relaxing, and more favorable to foreign investors than ever. Table 4.1 is the comparison of some recent key policies regarding preferential treatment to foreign investors in some regional and transitional economies.

From the table, some remarks may be drawn accordingly, as follows:

Firstly, in principle, Vietnam's priorities given to foreign investors are relatively competitive compared to some countries in investment form, licensing procedures. Nevertheless, in comparison with some transitional economies and regional countries like Poland, Hungary, the Czech Republic, Thailand, Philippines, Indonesia, such preferential treatment is still weak

Table 5.1: Comparing key FDI policies in Vietnam and some regional and transitional countries in 2006

Country name	Restriction on the form of enterprises and areas	Regulation on the granting license	Access to Land	Exchange rate and foreign exchange
Vietnam	The enterprises are permitted to choose investment form; wholly foreign enterprise are allowed, except for some important and sensitive industries; The FDI enterprises may be converted to joint stock companies, and free to choose investment partners	Investment in some industries only need to register with authority while others still have to obtain the investment license; Issuing license for small and medium projects is decentralised to the local government, and management board of industrial zones	Land ownership is not permitted; allowing renting land in industrial zones or business premise; transfer and mortgage of land use right is permitted	Controlling current account; imposing fees/tax on the transfer of money abroad; permission is required for money transfer abroad.
China	Wholly foreign enterprises must ask for license, and can operating only in export - oriented industries; some industries require minimum proportion of domestic investment; FDI enterprises may convert investment form, and are free to choose investment partners	Investment license required; licensing for small and medium projects is decentralised to the local government	Ownership on land and house is permitted; some difficulties for investors in terms of site, land; transfer and mortgage of land use rights are permitted	No limit on transfer of foreign currency; current account is still under control; permission is required in transfer money abroad
Philippines	Wholly foreign enterprise is permitted operating in many industries; restriction on maximum	License is required only if the project want to enjoy preferential policy (within 3 weeks); otherwise	Enterprises with more than 40 per cent foreign owned capital are not permitted to	Flexible foreign exchange management; no restrictions on loans in foreign currencies

Country name	Restriction on the form of enterprises and areas	Regulation on the granting license	Access to Land	Exchange rate and foreign exchange
	capital contribution of FDI in some industries; investors are free to choose investment partners	the investment procedures are similar to domestic investors (only require registration)	own land; they have to lease from real estate agent. Other enterprise may lease land for 50 years; transfer and mortgage of land use rights are permitted	and transfer of foreign currencies abroad; No requirement on mandatory foreign exchange reserves in the enterprises account
Thailand	No restriction of FDI, and enterprises are permitted to choose investment form, except for some restricted industries	License only required if the project want to enjoy preferential investment policy. The investors only have to register with the Ministry of Commerce and Department of Tax	Enterprises may lease land for 50 years, with automatic extension when expire; the land leasing contract may be used to mortgage.	Flexible foreign exchange, no restriction on loans, transfer or reserve of foreign currencies
South Korea	Very strict initially, but now changed. Basically no restriction on FDI except for some 'sensitive industries'. Investors may own up to 33 per cent of SOE capital; free to choose investment partners	Complicated procedures, has been improved much after the regional crisis	Enterprises may lease land for 50 years; land mortgage is allowed; however, domestic firms still have better access to land	Flexible foreign exchange, no restriction on loans, transfer or reserve of foreign currencies
Indonesia	Prohibition of wholly foreign enterprises in some sensitive	Complicated procedures; prevalent corruption in investment licensing;	Leasing land in industrial zones is permitted, but not	No significant restrictions in foreign exchange policy

Country name	Restriction on the form of enterprises and areas	Regulation on the granting license	Access to Land	Exchange rate and foreign exchange
	industries. For the rest, foreign investors are free to choose investment form	Approval of president is required if the project capital is greater than $100 million; a number of licenses required even after being granted investment license	easy in reality; land lease for 30 years is most popular. Transfer, mortgage of land use rights are permitted.	
Malaysia	Enterprises with 100per cent foreign owned capital only permitted in export-oriented sectors, while restricted in others	License is required for all FDI projects (granted within 6-8 weeks, may be longer for some projects)	FDI enterprises may choose to lease or buy land in 99 years; mortgage, transfer of land is permitted	Tax levied on transfer of money abroad after financial crisis
Hungary	No restriction on the form of investment and the type of FDI enterprises	No license required, except for a few areas	Land purchase and land ownership permitted	Flexible foreign exchange regime, converted currency
Poland	No restriction on the form of investment and the type of FDI enterprises	No license required, except for a few areas	Land purchase and land ownership permitted; however it requires the permission	Flexible foreign exchange regime, convertible currency
Czech Republic	No restriction on the form of investment and the type of FDI enterprises	No license required, except for a few areas	Land purchase and land ownership permitted	Flexible foreign exchange regime, convertible currency

Source: Le Xuan Ba (2006).

Secondly, relative to other countries in the region as well as transition economies, foreign investors still encounter certain difficulties in Vietnam, particularly those related to land, site clearance to carry out the project after they receive the license (except when they are located in industrial zones, export processing zones). In many instances, as a result of these problems, it may take longer to prepare and construct necessary facilities, delaying the commencement of projects and the investors may miss the business opportunities.

Thirdly, underdevelopment of banking sector, unconverted currency, monetary policy as well as regulations on foreign exchange management are currently unfavorable to the investors, and less competitive than countries in the region and transition economies.

Fourthly, compared with the situation in a decade ago, the conditions regarding Vietnam's investment environment have become more favorable to foreign investors in Vietnam. Nonetheless, the legal system and policies related to FDI still lack consistency, transparency, predictability, and have been rather changeable, which could still cause unreasonable barriers and difficulties to investors. Specifically, restricting areas of operations, expanding the list of business with required conditions, imposing export proportion on FDI enterprises, raising the land price and compensation of site clearance are the sources to increasing instability in Vietnam's FDI policy. This also proves the weak competitiveness relative to other countries (Le Xuan Ba, 2006).

In the situation where the competition to attract investment between countries is getting more and more fierce, Vietnam could and must learn from other country's experience and examine how it improved its investment environment. Especially, Vietnam will have to compete more with China, what is referred to as 'an overwhelming challenge' not just for Vietnam but for the rest of Southeast Asia as well. This will likely entail accelerating reform and developing niche sectors where FDI can both generate profits and benefit the country's labour force, foreign-currency coffers and technology intake. Similarly, government FDI policy will have to continue to change to attract FDI in an ever-increasing competitive global market. But Vietnam's Government has realised this and seems to be making a real effort to meet investor demands (Vu Bang Tam, 2008, p.1165-1170).

5.4 Vietnam's international commitment on foreign investment

Together with the establishment and gradual improvement of the legal system on foreign investment, Vietnam has also signed some international bilateral and multilateral agreements on foreign investment. This is indispensable in Vietnam's international economic integration and in overall policy on investment encouragement and protection. And, as Vietnam increasingly integrates with the global economy, the country cannot go against the commitments it has made nor international practices, which partly urges Vietnam's Government to improve the legal framework for FDI (Athukorala and Tran Quang Tien, 2009; McCargo, 2004; Bui Hai Thiem, 2009).

Up to now, Vietnam has had bilateral agreements on investment encouragement and protection with 45 countries and territories so far. Those agreements have wider scope of adjustment than that of current regulation as stipulated in Vietnam's Law on Foreign Investment. For example, these agreements specify the terms regarding various forms of investment: direct, indirect, contract rights, tangible and intangible assets, property rights, and other rights as stipulated in the laws. Notably, with the signing of the Vietnam-US Bilateral Trade Agreement, a separate chapter of which is devoted to the development of investment relations, Vietnam has committed to comply with the highest-ever investment treatment standard. Nonetheless, Vietnam has only committed to the MFN treatment as well as committed to encourage and protect investment in accordance with common standard and practices (Bui Hai Thiem, 2009; Iswaran, 2007; Athukorala and Tran Quang Tien, 2009).

Vietnam has also participated, since 1995, in some multilateral agreements and forums such as: (i) Framework Agreement on the ASEAN Investment Area (AIA); (ii) Asia Pacific Economic Cooperation forum (APEC) with the action plan to liberalise investment in the region; (iii) Asia - European Summit, which includes the implementation of Investment Promotion Action Plan (IP AP). In particular, Vietnam has been admitted to the World Trade Organisation (WTO) on 7 November 2006 after eleven years of negotiation. The commitment with regard to the Trade-Related Investment Measures (TRIMS) has become an indispensable requirement in that negotiation process. It is said that the process of implementation and enforcement of the WTO commitments has shaped a more predictable and integrated legal framework on doing business in Vietnam. This process also helps improve the level playfield for foreign invested companies doing business in Vietnam (Nguyen Nhu Binh and Haughton, 2002; Vu Bang Tam, 2008; Kurtz, 2004).

Vietnam's international commitments on foreign investment, though varied in forms and levels, are all aimed at liberalising foreign investment activities through opening economic domains, not discriminating foreign investors, establishing a mechanism of investment promotion and protection and dispute settlement within a given duration in accordance with international practices. It is easy to see that Vietnam has been taking initiative in building and perfecting the country's legal system in order to step by step make it conform to international customs and practices. A great example is substantial improvement in Vietnam's Foreign Investment Law through amendments and supplements over the last 21 years. Vietnam's legal provisions, therefore, are becoming more perfect, conforming to the trend of international economic integration, contributing to creating an investment environment favorable, transparent and equal for enterprises of all economic sectors. It could be argued that foreign direct investment over 20 year operations in Vietnam has become an integral part of the Vietnamese economy from not only business perspective and but also legal perspective (Nguyen Nhu Binh and Haughton, 2002; Nguyen Ngoc Anh and Nguyen Thang, 2007; Athukorala, 2006; Kurtz, 2004).

5.5 Conclusion

It seems that Vietnam's leaders have implemented reform at a low pace, but the quest for further international integration and fierce competition in FDI attraction has changed that. In the past, this was much to do with reluctance to relinquish power and also a lack of understanding about the needs of foreign investors. Although the leaders were well-intentioned, the middle and lower ranks of the bureaucracy were experienced in delay mechanisms.

However, the execution of commitments on international economic integration in general, and investment integration in particular, is clearly not only the international community's requirement for Vietnam but also an urgent requirement for the Vietnamese Government to improve the country's investment environment in order to raise its competitiveness and attract foreign investment.

Moreover, the fierce competition in FDI attraction between developing countries, especially between regional and transitional economies, makes Vietnam's Government realise that if the country wants to continue attracting FDI over a long period of time Vietnam cannot rely on just traditional factors such as low labour cost, plentiful natural resources and large domestic market. There must be in place stable, consistent, appropriate and generous policies involved in FDI, and business costs could be lowered by reforming and defining the administrative management system, along with the lists of projects calling for FDI (Athukorala and Tran Quang Tien, 2009; Magennis, 2006; Nguyen Ngoc Anh and Nguyen Thang, 2007).

There have been several noteworthy reforms, many offering foreign investors greater legal protection than ever before. Changes to the legal framework, specifically the Unified Enterprise Law (UEL) and the Common Investment Law (CIL), have promised to level the competitive playing field for foreign and domestic businesses. Major changes in FDI policy over time in accordance with each revision show that, in general, Vietnam tends to increase rights of foreign investors, to make investment environment more favorable, and narrow the policy gap between foreign and domestic investor. These changes have been highly appreciated by international observers and brought about a new wave of FDI into Vietnam in recent years (Magennis, 2006; Vu Bang Tam, 2008).

As a matter of course, there are still a lot of developments that Vietnam needs to do in this changing global environment. Vietnam needs further clarify powers and duties in investment approval and licensing, as well as improve certain state authorities' performance in investment approval and licensing or in dealing with investment-related problems. In addition, investment promotion activities need to be more effective while the Enterprise Law and the unified Investment Law must be taken seriously. However, the whole country are optimistic that progress on these measures will increase foreign investor satisfaction, making them find Vietnam to be an attractive investment environment, worthy of ranking fourth worldwide, after the US, China, and Thailand.

CHAPTER 6: THE ANZ CASE STUDY

6.1 Introduction

This chapter examines how the establishment and development of ANZ banks in Vietnam demonstrates the successful penetration of Foreign Direct Investment (FDI) ventures into the economy. However, for optimum success in the political and economic climate of Vietnam, ANZ also shows how foreign ventures need to change their style of management and business, taking into account the culture of the people and the business world in order to ensure their own operations run smoothly and effectively. Dunning's theory has brought the cultural factor into the analysis of FDI, and a case study of ANZ in Vietnam shows how the actual culturalisation of a foreign enterprises operation occurs. The need to aclimatise to the local context not only alters the management style and branding of a foreign enterprise, but can also define the actual operation of the company. In the case of ANZ we see that the legal framework limits the scale and type of services ANZ can provide in Vietnam, but the culture also shapes how the company operates. An example in the early years of ANZ operations was a realisation that generally the Vietnamese people did not trust banks and were suspicious of placing their wealth in the hands of what appeared an 'official' institution. To the Vietnamese 'official' meant government and politics, or more generally 'the system' and the culture has a high level distrust of officialdom and the system when it comes to their personal income.

In order to understand the effect of FDI on the Vietnam banking sector in particular, the growth of ANZ bank business is an ideal case study, with the Australian bank combining its financial power with a style of strategic management that entailed changing how it operated in the rest of the world in order to assimilate successfully to the Vietnam environment. One of the primary objectives of this thesis is to show that economic development cannot be isolated from its surrounding cultural climate and that penetration of Vietnam requires investors to combine its global financial strategies to cultural sensitivity to the Vietnam 'way' of living and how that alters 'how to do business' in Vietnam. In 'Capital theory' (Mundell, 1960) one could merely analyse the level of attraction of a foreign economy purely on the basis of its comparative difference between the rates of return on capital with neighbouring countries. Through the eclectic theory, Dunning (1973) develops Hymer's (1960) work and shows that FDI requires not just a capital analysis but shows how FDI involves 'the transmission of factor inputs other than money capital, viz. entrepreneurship, technology, and management expertise, and is likely to be affected by the relative profitability of the use of these resources in different countries as that of money capital' (p.299). In modern business a primary role is given to the concept of 'risk' and management and entrepreneurship require not only an understanding of the opportunities and threats in the financial environment, but also assimilation, understanding and methods for tackling the challenges of the different political, social and cultural environments. These elements in Vietnam play a particularly important role in business success, as all foreign investors need to adapt operations significantly in order to optimise their capital rewards for investment into the country. This chapter will show how ANZ altered their business strategy in Vietnam and how analysis that is sensitive to political, cultural and social influences in a developing country is equally important as understanding the economic influences that make Vietnam appear to investors as having significant comparative advantages over other potential target countries for their investment (Magennis, 2006,).

Dunning (1973, p.313) states that: 'there are two primary determinants of the amount of international production. The first is the extent of the market in each country and the second is the competitiveness of foreign affiliate's vis-à-vis indigenous and non-resident firms'. As The Hymer-Kindleberger hypothesis proposes, the foreign firms have disadvantages in regard to domestic competitors (e.g., knowledge of the market, communication). FDI ventures need to counter-balance theses disadvantages and add them to their own advantages (such as the international transfer of proprietary and intangible assets - technology, business techniques, and skilled personnel, Hymer, 1960). The strategies of building up competitive advantages in the same areas of ability as the domestic firms' means that foreign ventures need to assimilate to the political and cultural environments and then learn how to turn the initial disadvantages into competitive assets of their own projects. ANZ and Honda demonstrate how an FDI venture can embed itself into an entirely different political and social culture to its base country and generate capital accumulating strategies that use the advantages of both domestic and foreign firms to the best effect. In this chapter we see how ANZ changed and adapted to Vietnam in such a way that it introduced new competitive policies to the Vietnam banking sector, whilst also changing its own mode of operation to become as equally acceptable to the domestic customers as its domestic rivals. In the later chapter on Honda we can see that they went even further than assimilation and can now been seen as not only able to be part of the economic and social culture of Vietnam, but have also now helped shaped and direct the present culture of Vietnam (Biallas and Nguyen Hanh Nam, 2006; Doan Anh Toan, 2005; Hansen and Diaz, 2008).

These strategies of change are part of the 'internationalisation' of the FDI firm and is the 'the consequence of a process of incremental adjustments to changing conditions of the firm and its environment' (Johanson and Vahlne, 1977: p.35). Dunning recognised that eclectic theory required taking into account far more factors than for instance capital theory and considers the methodology more a 'paradigm' than simply a 'theory (Dunning 1977, p.277). Rather than a focus alone on economics, the FDI success needs to be assessed on its ability to also assimilate to the political system, the culture, the language and the levels of education and industrial development (Johanson and Vahlne, 1977, p.33)

Dunning and Bansal (1997), has addressed the lack of cultural analysis in economic theory, and applied it directly to his own eclectic paradigm. As Dunning noted, 'There is a realignment of Superpowers along different ideological, political and sociological vectors…compelling scholars to give more attention to the role of culture in determining the ownership and locational patterns of business activity' especially in the rising Asian economies (Dunning and Bansal, 1997, p.2). Political science addressed this lack of cultural analysis with Huntington's 'Clash of Civilizations' thesis. The hypothesis of this study of Vietnam is that rather than an economists purely scientific review of company's penetrating Vietnam with FDI on the basis of a culture-free strategy, the opposite is true, and successful operation of FDI enterprises is now dependent not only on choosing the right OLA factors, but subject to culture which is 'an informal institution that constrains behaviour and structures political, economic and social interactions' (Dunning and Bansal, 1997, p.3). Thus, this thesis moves onto the next level of analysis where the theoretical merging of Dunning's eclectic paradigm and his development of it to take account of cultural influences is applied to two actual case studies (ANZ and Honda).

Subsequently, the focus of the internalization and the eclectic paradigms methodology is on 'relevance of culture in influencing the location of economic activity' and, on 'the modality by which the competitive advantages of ANZ are explored' (Dunning and Bansal, 1997, p.6).

6.2 ANZ and Vietnam

6.2.1 Establishment

The Australia and New Zealand Banking Group (ANZ) was the first overseas bank entering Vietnam and is one of the leading foreign banks in Vietnam. ANZ is one of the top four banks and top ten listed companies in Australia. At 30 September 2008, its total assets reached AUD471 billion (USD301 billion). ANZ has operations in 26 key markets in the Asia Pacific region. Mr Phillip Patterson, Head of Corp, Vietnam-ANZ said: ' the Vietnam market was an obvious choice for ANZ once the economy began to grow and the demands for all sectors included the development of an efficient, high quality banking sector'. However, all senior management interviewees did recognise that Vietnam was a very different challenge and that the history of the country had left a 'market' of customers who might not easily be inculcated into the 'Western' acceptance and appreciation of 'banking services' (Hansen and Diaz, 2008; Doan Anh Toan, 2005; Le Mai Lan and Tran Nhu An, 2003).

ANZ was the first foreign bank to commence branches in Vietnam since the start of *Doi Moi* (1986). It officially opened in 1993 under the license 07/NH-GP granted on 15 June 1992 by the State Bank of Vietnam (SBV). ANZ fulfilled its banking activities in a single branch in Hanoi with a chartered capital of 20 million US dollar while its representative office in Ho Chi Minh City acted as an intermediation agent for the branch in Hanoi. In March 1996, that office was upgraded to be the second branch which could implement banking activities. However, growth of business was slow and it was 10 years operation before it expanded its network by launching another representative office in Can Tho province. The long gap demonstrating that the internalisation process was not something that developed quickly and 'learning' how to do business in Vietnam was a process of trial and error where mistakes directly affected their ability to expand (Nguyen Dinh Trung, 1996; Pham Chi Dung, 1992; Pham Duy Nghia, 2006).

6.2.2 Services

Although banking products are similarly offered by all types of ownership banks ANZ aims at attracting customers by creating differentiation in service. Its retail banking has been recognised as the best, not only in Vietnam, but also in Asia by Asian Bankers (2004).

ANZ offers a variety of products, including transactional banking, loan products, cash management, finance lease, trade finance, treasury business, small business and other services.

- *Transactional banking:* comprise current and savings accounts, call deposit accounts, remittance service, etc.
- *Cash management*: involves ANZ link (ANZ electronic banking service), fixed deposit account, etc. Clients enjoy higher interest rate with fixed deposit account than savings accounts and the convenience of electronic banking.
- *Loan products:* include short term and medium term loans, syndicated loans and structured export finance. The two last products are just for corporate customers, especially large firms because these products are often used in case firms want to mobilise a large amount of loan capital.
- *Finance lease:* In order to promote this service, ANZ established its subsidiary (by holding 90 per cent stake) in the leasing sector named ANZ/V-TRAC Leasing Company in 1999. In early 2009, this subsidiary has allowed it to raise its chartered capital from 84 billion VND to 103 billion VND by the SBV.
- ANZ V-TRAC purchases the goods of client's choice in exchange for a series of rental payments over a period of 1 to 5 years.

- *Trade finance:* Import-export finance activities including import letters of credit, import trade finance, export collections, finance of export transactions, and bid and performance bonds. The trade finance will provide customers the safest method of payment for their international trade.
- *Treasury:* This relates to derivatives including spot foreign exchange, forward exchange contracts, and foreign exchange swaps. Firms can decrease its risk relating to the exchange rate by using one of the best services in this field which are offered by ANZ.
- *Small business:* focuses on a daily service for small firms including access flexi smart accounts, consumer accounts and the progress saver.
- *Other services:* ATM night and day service, merchant card service, etc. which allows customers access the banking service at any time they want.

ANZ's products are diversified and aim at satisfying customers' demands and maximise the convenience and comforts for their clients. However, the services are altered to take account of the Vietnam culture and the constraints provided by the ideologically bound political system. For example, the actual operation of the Bank is chiefly restricted to domestic business with only limited international transactions compared to its operation in Australia or New Zealand. This is because Vietnam still remains isolated to some degree from the international financial market with strict controls on currency exchange, international payments, etc. For customers, the chief cultural problem is the historic and social aversion to 'trusting' national financial institutions and generally preferring to 'hide' their assets. As one manager said 'many Vietnamese would rather hide their money under the bed than trust a bank' (Interview: details remain anonymous at the request of the interviewee, 5 October 2007).

6.2.3 Clients

- **Institutional clients**

ANZ Vietnam offers the business banking services to 280 small businesses and corporations (ANZ Banking Group Ltd., 2008). They are using all types of services including derivatives (Petro Vietnam Transportation – PVT), loan products (An Giang Fishery Import Export – AGF), etc. In comparison with local banks, this number is very limited but it shows that ANZ has been successful in attracting corporate clients.

- **Individual clients**

In order to understand the classes as well as which kind of services that ANZ individual clients are using and their opinion about ANZ, 30 individual clients are interviewed.

Half of interviewed clients use the current account service because they often go abroad for business. In particular, they are students, government officers, tour guides. Others (26 percent) are accountants and managers of firms which are using ANZ services. They said that they decided to use ANZ current accounts following their firms' advice (Authors Customer survey, 2007).

However, besides ANZ, all of them are also using services from local commercial banks (BIDV, Vietcombank, and Agribank) because at that time withdrawing from these banks and their annual fee for account maintenance was free while ANZ charged a fee. Having too few ATMs, as well as the shortage of available branches of the bank, are further problems. The problems are limited as all local banks are charging ATM withdrawal fees as well as collecting an annual account fee.

Interviewees pointed out advantages and disadvantages of ANZ and all agreed that ANZ is the best bank in Vietnam in term of services. Their opinion again confirms that ANZ aims to create differentiation in service as the primary mechanism for capturing a large market share in Vietnam.

6.2.4 Staff

In line with the development of ANZ in Vietnam, its employees increased sharply from 28 to 350 (ANZ Vietnam, 2008). They are educated in national professional universities or overseas. Senior positions require finance skills including credit analysis, and ANZ always recruit those who have past experience and a high level of education. Their strict requirements is one of the reasons leading to the success of ANZ in Vietnam, as it reduces the risks in the operation of its activities, especially in loan products and investment banking.

Interviews with the ANZ staffs pointed to a general satisfaction with their employment in the bank and they all stated that they have been really satisfied with the working environment in ANZ. One bank employee said: 'I love working in ANZ. They reward my loyalty and hard work by being loyal and supportive to me, while all my colleagues are very kind and enthusiastic' (Interview: Staffs, ANZ, 12 May 2009).

Interviewees generally confirm that they have no intention to seek work with another employer. They often expressed a lifelong commitment to ANZ and its development in Vietnam. This is borne out when looking at the profiles of ANZ leaders' in Vietnam including Ms Dam Bich Thuy (Country Head and General Manager, ANZ Vietnam), Quynh Vu (Chief Manager, ANZ

Hanoi and General Manager, ANZ V-Trac Leasing). They have all already devoted nearly two decades of loyal work to ANZ.

6.2.5 <u>Business awards, prizes and honours</u>

Business awards and prizes presented by host country agencies can be seen as a general indication of the growing acceptance into the country of an FDI. All competitive awards that involve both domestic and foreign candidates demonstrate that the winner has in some way impressed the judges to an extent that they stand out from the competition, and ANZ presentations in Vietnam demonstrate that they have made significant grounds in gaining acceptance from both the business community and the public. ANZ is renowned in Vietnam for its differentiation in service quality and this is recognised by its receipt of a number of awards and prizes for business excellence. In particular, the Asian Banker complimented ANZ as the Best Retail Bank in Vietnam for 2007 and 2004. The Asian Banker is a renowned research and intelligence company in the financial services industry. The award recognised the excellence of ANZ in dealing directly with customers. Moreover, local magazines and newspapers also appreciated ANZ as the Best Service Bank for 2007, the Saigon Tiep Thi magazine award 2007, the Best Customer Oriented Bank award five times to ANZ in 2002 to 2007 and with the Golden Dragon Award granted by the Vietnam Economic Times and the Ministry of Planning and Investment, awarded for ANZ's contribution to the development of FDI in Vietnam. The awards demonstrate that ANZ 'brand' image is firmly established in the Vietnam banking sector. The continual accolades won either from the general public or the government; indicate how well ANZ has also merged into the culture (Hansen and Diaz, 2008; Businessweek, 2005; Le Mai Lan and Tran Nhu An, 2003).

6.2.6 <u>ANZ's perspectives</u>

Australian Foreign Minister Stephen Smith on his 2008 tour to Vietnam said 'ANZ's proposed growth strategy in Vietnam represents a welcome expansion of the bilateral investment relationship and also sends a clear signal to investors that Vietnam is open for business' (Gluyas, 2008). In addition, ANZ International places Vietnam as its priority in Asia, according to Mr Michael Smith, General Manager of ANZ Group (ANZ-media release, 2007).

Recently, ANZ International chose Vietnam, Malaysia, Indonesia, and Cambodia for the investment tour of its Australian analysts, with them focusing on the success of the current investment environment in Vietnam. Vietnam has attracted more FDI and in increasing fields. In 2008 when the world economy was in turmoil, the FDI still reached USD64 billion, double that of 2007. Foreign investors recognise that Vietnam is one of the best places for strong investment (Hansen and Diaz, 2008).

But even at the highest level of the bank they are aware of the constraints of the culture as demonstrated by an ANZ manager, who said ‘the Vietnam situation was one where it was a cash culture. People did not fully trust ‘authorities’ or official declaration of their actual incomes. They preferred to ‘hide’ their money and banks would at first appear to go totally against this culture’ (Interview: details remain anonymous at the request of the interview, 4 August 2007). But ANZ believed that the modernisation and growth of Vietnam would progressively lead to a change in these attitudes. ANZ had to develop a mutual trust between them and the customer. A feeling that their money was still a ‘private’ matter and that their privacy was not threatened by having a bank account or conducting business through banks. Thus, we see that the domestic culture of the customers in Vietnam was actually a barrier to the prospective success of FDI investment. Unlike their operations outside of Vietnam, ANZ needed to focus some attention on actually ‘selling’ the idea of banking and its benefits to a population who viewed banking itself as undesirable. Internationalisation of the FDI required a degree of promoting banking as a secure and private service to customers which demonstrates a degree of ‘internationalisation’ of the customer market. The culture of Vietnam was naturally averse to banking itself and understanding that, whilst also trying to change it was necessary for ANZ to penetrate successfully the market place (Le Mai Lan and Tran Nhu An, 2003; Doan Anh Toan, 2005; Hansen and Diaz, 2008).

In the future, ANZ Vietnam face many challenges from fiercer competition with local commercial banks (BIDV, Vietcombank, etc), especially in terms of fees and number of branches and other foreign banks in terms of services (HSBC, Standard Chartered Bank, etc.). Although controls are still largely in place, their gradual reduction is an inevitable consequence of signing agreements such as the WTO, and ANZ has positioned itself in the market quite effectively as it has addressed challenges with a view to assimilating to both the economic and cultural demands whilst also finding effective ways to bring about change that educates the Vietnam customer and makes banking in Vietnam more acceptable.

6.3 The strategies of ANZ in the development of Vietnam FDI framework

The more open to the world economy, the more change Vietnam’s legal framework requires. In FDI for the banking sector, the legal framework has developed significantly. Reacting to these changes, ANZ has also adjusted its strategies to promote its business in Vietnam.

6.3.1 Foreign banks coming to Vietnam

Before *Doi Moi*, The Vietnam banking sector had relied on its economic relationship with the Communism bloc. With the changes in the Party viewpoint shown in the National Party Congress 6th (1986), other countries outside the Capitalism bloc were welcomed (Nguyen Dinh Trung, 1996; Pham Chi Dung, 1992).

A realisation of the need for a change in strategy was seen with the establishment of the first FIL in 1987, which welcomed foreign investment by allowing the establishment of 100 percent foreign firms in specific sectors.

The banking sector was opened up to the world, but this came some years later. In particular, foreign banks could operate their business in Vietnam by creating joint-venture banks, according to the Decree 38-LCT/HDNN8 on May 23, 1990 by the Government Council. Through this regulation, the first joint-venture commercial bank, 'IndoVina Bank' was established, demonstrating the governments realisation that opening up to the global economy would inevitably limit the protection the authorities could give to the domestic banking sector (Nguyen Dinh Trung, 1996; Pham Chi Dung, 1992).

The 7th National Party Congress (1991) welcomed foreign banks to operate in Vietnam and declared they were needed in order to establish the right foreign exchange structures to create an advantage for foreign currency trading via banks and in line with the market rate. The Party also required the Government to promote reform in the banking system and develop policies to establish a modern insurance organisation, and establish joint-stock companies in order to build a stock market function (Polevoy, 1998; Nguyen Ke Tuan, 1996; Hansen and Diaz, 2008).

Two years afterwards, Vietnam officially welcomed foreign banks and financial companies by allowing them to set up representative offices or create joint-venture banks in Vietnam by issuing the Decision 188/QD-NH8 on October 2, 1993 by the SBV, and officially sanctioning the establishment of operations for foreign banks and financial firms in Vietnam (Nguyen Dinh Trung, 1996). More foreign banks decided to invest in Vietnam in this period, with ANZ Bank Limited as one of the first banks registered to operate in Vietnam.

6.3.2 Strategic Alliance with a domestic joint-stock commercial banks

Porter's (1990, p.30) 'determinants of national advantage include the country specific conditions governing how companies are created, organised and managed, related supplier networks, factor conditions, and the presence of sophisticated and discerning customers'. Essential in this section is understanding the success of ANZ to merge with the business 'culture' of Vietnam which is described by Mr Tran Thang, head of the Hong IT Group as 'dependent first and foremost on relationships. All successful businessmen know that it is best to be 'friends' first and partners second, but development can only come then by creating high level alliances that provide major benefits' (Interview: Tran Thang, Hong IT Group, 1 May 2008). Vietnam would be placed in the category of a country which would be identified by Dunning as having a 'high degree of social interrelatedness and cohesion' and somewhere that places 'great store on interpersonal relationships', and 'will invest in their human resources and supplier networks' (Dunning and Bansal, 1997, p7). Thus, the strategic alliances ANZ agreed in Vietnam were vital to helping it assimilate to the business culture (Business Week, 2005).

According to Decision 228/QD-NH5 - December 12, 1993 - Governor of the SBV, all domestic credit organisations, included banks, could call for foreign capital contribution up to 30 per cent. However, this regulation was not brought into effect because at that time the words 'shares' and 'holding stakes' were unfamiliar in Vietnam. Understanding of what these terms really meant only came with the establishment of the stock market and the first real steps to modernizing the Vietnam financial system. However, the Government regulations left FDI enterprises with little option to actually initiate business ventures in the financial sector through partnerships and alliances with domestic hosts (Nguyen Dinh Trung, 1996).

A major advance was in attracting foreign banks to purchase a 'holding stake' in joint-stock commercial banks and the complementary decision to require the issue of annual financial reports. Joint-stock commercial banks were now required to openly state their financial position and thus allow investors access to the knowledge to fully understand the financial status of joint-stock banks before deciding to invest in them (decision 1407/2004/QD-NHNN by the SBV on 1 November 2004).

The new regulations strengthened foreign banks confidence in the Vietnam banking system by providing more transparency in their operation. As a result, in 2005, foreign banks (ANZ and HSBC) decided to hold 10 per cent stakes in Sacombank and Techcombank respectively, valued at USD27 and 17.3 million (Pham Duy Nghia, 2006; Hansen and Diaz, 2008).

ANZ Vietnam is still the strategic shareholder of Sacombank with 10 per cent shares ownership. As strategic shareholders, ANZ and Sacombank can cooperate with each other in banking activities, thus allowing ANZ to expand its market share.

However, ANZ seems still to have a number of difficulties in comparison to its main fellow foreign competitors (HSBC and Standard Chartered Bank) as these banks have already raised their holdings to 20 and 15 percent respectively in their strategic joint-stock banks after the Government released the Decree 69/2007/ND-CP which stipulates strategic foreign partners can hold 15 to 20 percent (in special cases) of a joint-stock bank' shares.

6.3.3 Holding stakes in public companies

According to the decision 238/2005/QD-TTg on 29 September 2005, every public company can currently attract 49 per cent of its capital contribution from foreign investors while that rate before was just 30 per cent (decision 36/2003/QD-TTg on 11 March 2003 by the Prime Minister). It is obvious that the Vietnam Government has tried to treat foreign investors more equally in comparison with domestic investors. However, it will take time for the equality process to embed itself because the Vietnam Government wants to ensure that the domestic economy will integrate with the world, but still have a domestic advantage or safeguard against stronger foreign competitors (Nguyen Ke Tuan, 1996; Le Minh Toan and Walker, 2006).

It is a difficult situation for the Vietnamese government as the globalization of the banking system means that domestic companies must develop stronger, more efficient and competitive operations, but their human resource and technological abilities are still very weak in comparison to foreign competitors. Many of the banks do not have the liquidity or technical skills to compete on the international market, and yet, Vietnam's commitment to agreements such as the WTO entry, allows little opportunity to provide the protectionism that Vietnam banks still need. However, the aim was to promote development of Vietnam banks by allowing the foreign banks enter the market through strategic alliances that were believed to offer not only new capital sources, but also be a route to transfer of the human resource knowledge and technological skills of international banks, that the Vietnam banks so desperately needed if they were to become competitive in the 'open door' environment (Bui Xuan Hai and Walker, 2005; Bui Xuan Hai, 2006).

The new regulations allowed the speedy development of a Vietnamese stock market, and foreign traders could now become actively involved in Vietnam shares trading. ANZ strongly participated in the stock market by acquiring shares of Saigon Securities joint-stock company (SSI). ANZ aims to expand its expertise in banking and finance sectors via its strategic relationships with large companies in this field.

6.3.4 Foreign bank establishment approvals

As with its commitments under the WTO agreement, Vietnam has allowed the establishment of wholly-foreign banks in Vietnam since March 2006 (Decree 22/2006/ND-CP on 28 February

2006). In order to establish a subsidiary bank, foreign banks must have at least USD10 billion in total assets in the year prior to registering for a license. In addition, their branches in Vietnam must meet a certain financial criteria including having enjoyed profits in three consecutive years, a bad loan rate of less than 3 per cent and having no legal disputes with the Vietnamese Government (Hansen and Diaz, 2008; Le Mai Lan and Tran Nhu An, 2003).

Up to now, there are currently three foreign banks granted that license, including HSBC, Standard Chartered Bank and ANZ.

6.3.5 <u>ATM installation</u>

ANZ, with its advantage of having access to the latest ATM technology in Australia was allowed to launch the first ATM in Vietnam in 2000. However, as regulated by the law, all foreign banks or branches of foreign banks cannot install ATMs outside its branch office, except in cases where the SBV approves. Even in the commitment of joining WTO, Vietnam still requires this condition in the roadmap for banking liberalisation.

As a result, ANZ, as well as branches of other foreign banks will face disadvantages in competing with local banks in attracting individual clients to use banking, including ATM services.

6.3.6 <u>Derivatives instruments</u>

Derivatives have been well known and widely used in developed countries for decades. However, it was not until 2003 that derivatives-interest rate swaps were promulgated in Vietnam by SBV, according to Decision no 1133/2003/QD-NHNN. However, that decision was only applicable for firms with overseas loans under the decree 90/1998/ND-CP on 7 November 1998 and banks who offered this service were required to have a chartered capital of at least 200 billion VND. Other derivatives relating to foreign exchange rates, including cross currency swaps, forward start swaps, options and futures were regulated in Decision 62/2006/QD-NHNN on 29 December 2006 by the SBV. They offered these to all type of firms and by local and foreign banks with a chartered capital of equal or more than 1 trillion VND. ANZ has positioned itself as the leading bank in providing this service in Vietnam.

6.3.7 <u>Community involvements</u>

The Communist Party in Vietnam aims at improving people’s living standards, especially those who live in rural and mountainous areas, and banks are thus instructed to address both economic and community needs.

ANZ, an FDI bank, not only contributes in the economic aspects of development, but also in the social aspect by building schools for rural children or helping rural women improve their livelihoods. This strategy not only helps poor people but also promotes ANZ Vietnam position as a 'Vietnamese's Bank' which is 'of the Vietnamese, for the Vietnamese and by the Vietnamese' (Biallas and Nguyen Hanh Nam, 2006; Hansen and Diaz, 2008).

6.4 The development of ANZ Vietnam

For each strategy, ANZ has implemented a series of activities to promote its business in Vietnam. In addition, ANZ also has expanded its business by launching new products following the changes in Vietnam's social and economic condition. The following part will take a deeper analysis of ANZ development in Vietnam over time and through its different strategies (Hansen and Diaz, 2008; Businessweek, 2005; Le Mai Lan and Tran Nhu An, 2003).

6.4.1 Expanding activities

In 2008, ANZ opened two trading counters in Noi Bai Airport to bring convenience for those entering or leaving Vietnam. This is an appropriate move as the clients who uses banking services at the airport often are middle class or higher, and hence they enjoy the convenience and satisfaction gained from using ANZ services. As Ms Vu Thuy Quynh, General Manager of ANZ-Vietnam said, 'we need as a bank to continually expand our availability to the customer and expand our operations, both in our types of services and in our accessibility to as many people and areas as possible, and this is a major strategic necessity' (Interview: Vu Thuy Quynh, ANZ, 3 July 2008)

Thus, ANZ short-term strategy is to open more branches (from 10 to 12) in many of the large cities (according to Mr Alex Thursby, operating director of ANZ in Asia Pacific area). In the longer term, the ANZ Vietnam intends to establish more than 50 branches and attracts 1400 institutional clients (compared to 280 in 2008) with a major focus on Hanoi and Ho Chi Minh City, and facilities developed in Da Nang, Hai Phong, Mekong Delta and Vung Tau (Dam Bich Thuy, 2008)

In addition, the prospective establishment of its wholly-owned subsidiary under license 268/GP-NHNN granted on 9 October by the State Bank Governor will help ANZ take an even greater market share in Vietnam and become more popular with local Vietnamese. Thus, confirming the statement by Australian Prime Minister Kevin Rudd that 'Vietnam has been given a high priority for growth of all the countries in ANZ's Asia strategy' (Adelaide Now, 2008 p.7).

The expansion is understandable after ANZ's successful operation in Vietnam over 15 years of operations and further recognised by the granting of a license to establish a subsidiary, with the blessing of the SBV.

Although normally, it is impossible to access the financial reports of ANZ's performance in Vietnam (as well as those of other foreign banks' branches as there is no statutory requirement for them to publish their reports), it is clear that ANZ have met all the necessary requirements of the SBV, including a record of profit in three recent consecutive years.

Other foreign banks are reluctant to follow the lead of ANZ and establish a subsidiary. This reluctance was explained by the Vice Chairman of Commezbank of Germany, Mr Peter Born who declared that few banks are planning on establishing their own subsidiaries in Vietnam (ANZ, Hong Kong Shanghai Banking Corporation (HSBC) and Standard Chartered are the exceptions) because of the large capital investments required and the costs in other resources, in a contemporary atmosphere of severe competition and a belief that the most profitable advantages are found in concentrating on retail banking. Ms Vu Thuy Quynh explains: 'the strategy of further involvement and commitment to business in Vietnam means that the establishment of a subsidiary is a natural consequence of our development' (Interview: Vu Thuy Quynh, ANZ, 3 July 2008).

As a result, ANZ business performance may increase through its subsidiary strategy as the only likely competitors are the local banks and HSBC and the Standard Chartered Bank. The lack of a strong foreign competition element in this area of business could provide ANZ with a significant market advantage (Biallas and Nguyen Hanh Nam, 2006; Businessweek, 2005).

6.4.2 Investing activities

ANZ has invested in firms operating in banking and financial sector, or essential commodity producing, etc. Not only is ANZ the investor, but it is also an essential improvement in the framework of investors new to the country, providing a service and access that foreign customers are familiar with and giving them a sense of security. General Manager ANZ – Vietnam, Mr Phil Crouch explains that 'ANZ is bringing a quality and familiarity of operation that helps foreign investors feel safer when conducting new business in Vietnam. We are part of the Vietnam banking system but hope to set ourselves as a level above those of the domestic banks, whilst also working within the banking and finance system in general in order to raise the standards and reputation of the sector as a whole' (Interview: Phil Crouch, ANZ, 15 April 2009). This strategy is captured in the new slogan for ANZ in Vietnam- - 'Foreign standard with a local approach' (Dam Huy, 2008, p.10). Thus, ANZ continually emphasises that it is building upon its local image and continually striving to be accepted as not as a ‘foreign’ bank, but a ‘local’ bank whose investment is foreign and therefore more reliable and secure (Businessweek, 2005, Doan Anh Toan, 2005; Biallas and Nguyen Hanh Nam, 2006).

- **Saigon Thuong Tin Bank (Sacombank – STB)**

In 2005, ANZ became the strategic shareholder of Sacombank, the second largest joint stock bank in Vietnam, by buying 10 percent of its shares valued at 27 million US dollar and has had a seat on Sacombank Board of Directors. Sacombank is also the largest commercial publicly listed bank in Vietnam in terms of chartered capital and branch networks. Sacombank has raised its chartered capital from 1,125 billion VND (or 71 million US dollar) at the same time as ANZ investing more than 5,100 billion VND (or 310 million US dollar) in Sacombank. Table 1 shows ANZ investment progress in Sacombank. It can be seen that ANZ has been willing to pay much higher than the market price because its objective has not been to gain an immediate profit from the investment, but instead take an advantage of a strategic alliance to gain a strong market position.

That is the reason why in June 2006, ANZ signed a Memorandum of Understanding for development of a credit card joint venture with Sacombank. This arrangement will position the joint venture to enter the first developing credit card market in Vietnam. This strategic relationship brings benefits for both of them. STB receives supports from ANZ Vietnam in terms of technology, consultancy, etc while ANZ Vietnam can expand its banking activities via the cooperation with STB. In 2007 ANZ Bank Ltd. ANZ Vietnam and Sacombank continued to corporate in overseas remittance payments, in which AZN Bank Ltd. clients can withdraw their remittance at all branches of ANZ in Vietnam and Sacombank (Vietbao, 2007a). ANZ Vietnam, Sacombank and Phuong Nam Bank coordinated with each other to link their ATMs in 2003 (Vietnam Net, 2003).

However, the proportion of shares that ANZ kept has still been left at 10 percent while according to the Decree 69/2007/ND-CP, strategic foreign credit institutions can own 20 per cent of shares (out of 30 per cent foreign ownership) of a joint-stock commercial bank, if the Prime Minister allows this, as in the case of HSBC and Techcombank. An explanation for ANZ reluctance to increase its share is the actual present structure of foreign share ownership in Sacombank. ANZ is the third largest foreign institution investing in Sacombank, coming after Dragon Financial Holdings (DC) and International Finance Corporation (IFC) which currently account for more than more than 15 percent of Sacombank shares. In addition, foreign ownership in Sacombank has already reached 30 percent- the maximum proportion promulgated by the current decree. Therefore, ANZ are in some ways constrained by the present foreign shareholding structures of Sacombank and limited in the opportunity to alter its share proportion in Sacombank by the strong possibility that any change would also need a change in Vietnam law.

It should be noted here that the still developing legal system and economic policies of Vietnam are thus still leaving certain disadvantages to efficient promotion of Vietnam as an FDI destination. Restrictions are still in place that deter overseas banks from venturing further into Vietnam and constrain their ability to expand operations. However, WTO entry is definitely going to alter the present conditions and will lead to numerous new policies that will further open the door to new foreign and already established international banks.

However, in this particular case, at the moment, the only alternative is to actually acquire existing foreign owned shares and the opportunity did arise for this on 17 December 2008 when the IFC announced the decision to reduce by half its shares in STB despite it having helped Sacombank become one of the best joint-stock banks in Vietnam. On 17 and 18 December 2008, 5.285 million STB shares were transferred by negotiations among foreign shareholders. However, the actual purchasers of these shares are still a commercial secret and there is merely speculation on whether ANZ was one of the main purchasers. Nevertheless, interviews with ANZ did point to a strong desire in the company to raise its proportion of shares in Sacombank, and such a purchase would be in line with the general commitment ANZ has already made to continually promote development of its strategic relationship with Sacombank. However, a formal statement is claimed to have been made by ANZ that the new strategy is actually aimed at a future withdrawal of ANZ capital from Sacombank. An interview with Sacombank chairman did reveal that they have not received any formal request from ANZ for withdrawal from Sacombank, but he did indicate a high concern that withdrawal was an option being considered by ANZ. The following table shows details of ANZ investment on STB:

Table 6.1: ANZ Investments on Saigon Thuong Tin Bank

Date	Chartered Capital in		ANZ holding			ANZ Investment in		Note
	bil. VND	US. mil. $	Added	Total	per cent	bil. VND	US. mil. $*	
8-Aug-05	1,125	71.0	11,250,000	11,250,000	10.00	427.63	27	
28-Sep-05	1,250	78.8	1,250,000	12,500,000	10.00			Dividend of 10 per cent by shares
31-Mar-06	1,899	119.4	6,250,000	18,750,000	9.87	62.5	3.93	Buy at face value
Q4 - 06	2,089	130.2	1,875,000	20,625,000	9.87			Dividend of 10 per cent by shares
23-Aug-07	4,449	275.2	2,475,000	23,100,000	9.84	37.125	2.30	Dividend of 12 per cent by shares
			20,684,970	43,784,970		310.27	19.2	15,000 VND per share
Dec 07	4,449	275.2	703,122	44,488,092	10.00	40.08	2.5	Market price
Aug 08	5,116	310	6,670,167	51,158,258	10.00			Dividend of 15 per cent by share
							54.93	Total
							47.8	Profit (market price)

* calculated by using exchange rate quoted by the SBV.

Source: Combined sources from ATPVietnam, Sacombank and State Bank of Vietnam (SBV) website from 2005 to 2008.

- **Saigon Securities Incorporation (SSI)**

In middle of 2007, ANZ was willing to pay 170,000 VND per SSI share in SSI private placement for its strategic shareholders while the market price at that time was only around 110,000 VND (or equivalent to more than USD6). Totally, ANZ paid approximately 88USD million to own a 10 percent stake. Currently, ANZ has invested approximately USD117 million on SSI to possess 17.66 percent of SSI stake (see Table 2). There are a number of reasons for ANZ motivations for overvaluing SSI.

First, as stated by Bob Edgar, ANZ General Manager, the investment on SSI is an ANZ strategy to expand its role in Vietnam banking (ANZ Media Release, 2007). Under the coordination with SSI, ANZ expects to gain more clients in the finance sector. According to Mr Gilles Plante, the joint managing Director of ANZ's markets business, the strong strategic relationship with the SSI Board of Directors provides a means to greater access to this market for ANZ (Saigon Security Incorporation, 2007).

Second, ANZ believes that it will receive high dividends from investment in SSI as they have already shown an amazing profit of USD15 million in 2006 and estimated figures of USD50 million in 2007. Its average Return on Equity (ROE) and Return on Assets (ROA) in these two years were very high at 20 and 10 respectively (Saigon Security Incorporation, 2007). These figures were understandable when Vietnam stock market was booming at that time and while SSI was the largest securities firm in Vietnam. It has successfully positioned itself as one of the leading providers of securities services in Vietnam, holding the largest market share in brokerage (StoxPlus, 2011)

However, in line with the downtrend of VN and the current world financial crisis, it seems that ANZ might not increase its ownership in SSI if looking at present profit aspects. SSI is currently facing a huge drop in profit to just 280 billion VND (Saigon Security Incorporation, 2008) due to the strong decrease in the whole Vietnam stock market and a strong fall in securities transactions. But that figure is still a positive sign when returns are compared to almost all other securities firms, which have shown major losses and even appear on the verge of bankruptcy (Bao Viet Securities BVS, etc.).

In comparison with the early years of investment by ANZ into SSI, the SSI share price has slipped by a significantly worrying 70 percent, mirroring the same fall generally in the VN Index. Therefore, SSI shareholders are all unconfident and distrustful of any possibility of high dividend in the immediate future.

However, an alternative argument is that ANZ might take advantage of such a low price to increase its share ownership in SSI. Actually, ANZ showed that it intends to promote its strategic alliance with SSI by registering to buy 1.3 millions SSI shares from November 2008 to January 2009 and raise its stakes from 18.35 per cent to 19.35 per cent. It is said that this move is reasonable as SSI has taken a large market share in consulting for listed firms such as Ben Tre Fishery Import-Export JSC (ABT), An Giang Fishery Import-Export JSC (AGF), Petroleum Technical Services Corporation (PVS), Vinashin Petroleum Investment and Transport JSC (VSP), etc. and we saw that some of them (AGF, etc.) have moved towards using ANZ services in such areas as accessing corporate loans, etc. Although this does not mean that firms consulted by SSI will always consider utilizing ANZ services, there is grounds to believe that the strategic alliance between ANZ and SSI is helping ANZ expand its services in the Vietnam market.

Table 6.2: ANZ Investments on Saigon Securities Incorporation

Date	Chartered Capital in		ANZ holding			ANZ Investment in		Note
	bil. VND	US. mil. $	Added	Total	per cent	bil. VND	US. mil. $	
To Aug-07	800	50	8,000,000	8,000,000	10%	1,422	88	Private placement
				1,111,200				Convertible bonds
2007				555,600		55.56	3.43	Convertible bonds – Private placement
Dec-07	1,200	74	4,000,000	12,000,000	10%			Bonus shares
Dec-07	1,366	83	1,666,800	13,666,800	10%			Convertible bonds to shares
Apr - May 08	1,366	83	1,900,000	15,566,800	11.39%	87.50	5.47	Market Price
Jul-08	1,366	83	3,416,700	18,983,500	13.89%	93.89	5.71	Market Price
3 Jul 08						(31.13)	(1.90)	Dividend of 20 per cent by cash
Jun – Aug 08	1,366	83	5,147,160	24,130,660	17.66%	220.37	13.38	Market Price
Aug – Oct 08	1,366	83	947,350	25,078,010	18.35%	55.4	3.36	Market Price
Nov - Jan 09	1,366	83	1,366,667					Registering to buy
							117.4	Total
							(102.1)	Profit (market price)

* calculated by using exchange rate quoted by the SBV.

Source: Combined sources from ATPVietnam, SSI and SBV website from 2007 to 2008.

- **Diversification**

ANZ is also one of three strategic shareholders of Traphaco Joint Stock Company, operating in the pharmaceutical sector and recently listed on Ho Chi Minh stock exchange center under the code TRA. ANZ owns 250,000 TRA shares (or 3.13 percent).

The company has a vision of developing into a large firm trading in products and services relating to health care, as well as in studying and developing 'natural-origin' products in 2010. In addition, it is forecast to continue to return 30 – 35 per cent annual growth over the next few years.

In regard to pharmaceuticals, this sector still has significant growth potential, and is an area where Vietnam is still dependent on imported drugs and medical equipment, with present costs of this to the economy already valued at more than half of billion USD per year (General Statistics Office, 2008). In addition, this sector's profitability has been quite attractive (see Table 6.3).

Table 6.3: Average profitability in pharmaceutical sector

Indicator	2006	2007	2008
ROE	14.9	15.2	16.0
ROA	9.9	11.7	12.5

Source: Combined sources from financial reports of Hau Giang Pharmaceutical JSC (DHG), Imexpharm Pharmaceutical JSC (IMP) and Traphaco JSC (TRA) from 2006 to 2008.

In conclusion, ANZ has invested in key sectors including finance and pharmacy. The ANZ portfolio has been quite selective and potentials in both profit and non-finance aspects are high as Vietnam, while still a developing country, has returned impressive growth in its finance sector and the pharmaceutical industry. This progress has been constantly maintained through Vietnam government support for development and ANZ has strategically placed itself to take advantage of both the market opportunities and the benefits of strong strategic partnership with domestic actors.

6.4.3 Banking activities

With the strengths and experiences of being one of the four leading banks in Australia, ANZ has played an important role in developing the Vietnam banking, especially with the adoption of new technology, as well as the introduction of well-known banking products from around the world. In the following part, typical services will be mentioned in order to emphasise how ANZ has developed, especially in comparison with other banks.

- **Standard services**

First ATM

Not only being the first English-speaking bank in Vietnam, ANZ launched the first ATM in Vietnam in 2000. This was very much as a result of advantages in technology ANZ possessed in comparison to the Vietnam state-owned and other join stock banks. The first ATM launch helped ANZ attract lots of clients who often worked overseas, especially in Australia. Afterwards, ANZ continued satisfying local clients by integrating with Sacombank and Phuong Nam bank in ATM services in 2003. That move is considered as the very first efficient step in integration of a payment card system in Vietnam banking. Up to now, ANZ has more than 60 ATMs throughout Vietnam. However, ANZ seems to be losing its market dominance as HSBC has recently installed its 108th ATM. In the long-term strategy, ANZ will open more ATMs in Vietnam in order to satisfy clients' demand (Xuan Ha, 2008).

- **Debit visa card**

In October 2006, ANZ introduced its first debit visa card. However, two years before that, 7 local banks already offered this services including Asian Commercial Bank, Vietcombank, etc. It is said that ANZ launched the service later than other big local banks because in comparison with these banks, ANZ has had limited number of individual clients. As a result, ANZ can be seen as providing this service to give client satisfaction, rather than in pursuit of a new profit source.

- **E-Biz**

Although E-Biz is very well-known in western countries, it is unfamiliar in Vietnam. Just in late January 2007, ANZ introduced the new service, called 'E-Biz' which allows the clients not only keep track of their transaction online but also bank online including transferring, paying, etc. At that time, none of local banks can offer this service due to their limitation on technology. Only HSBC, a very large bank in the world, also can introduce this service in Vietnam. Even now, clients can only enjoy this service in two local banks including Tien Phong Bank, a member of FPT group, and Techcombank. Others banks such as BIDV, Vietcombank, etc. only allow clients to keep track of their transactions online. Other services relating to E-biz have not been introduced because Banks appear to not enough strength to ensure their systems safety.

- **Services for students**

Besides other banking activities, ANZ understands that overseas students are an important source of potential customers. As a result, ANZ has coordinated with the Royal Melbourne Institute of Technology University (RMIT) Vietnam to offer loans for students since September 2007 (Hanoimoionline, 2007). Before that, in March 2006, ANZ Vietnam started providing free ISIC card (International Student Identify Card) and an international ANZ card to overseas students.

The education market in Vietnam offered great opportunities for foreign education institutions and this was a market that ANZ Vietnam could not neglect to capture. By end of 2008, there were approximately 75,000 Vietnamese students studying overseas in total and just in the year 2008 alone, there were 25,000 Vietnamese granted student visas to study abroad. Canadian Foreign Affairs and International Trade (2009) estimated that this number would grow by about 25 per cent per year over the coming years as continuous economic development of the country and personal income levels rise. The demand for overseas education will rise because affluent Vietnamese parents look for quality education for their children. When more foreign invested enterprises come to the country, the demand for skilled professionals conforming to Western working standards will also increase. And as 60 per cent of 88 million Vietnameses are young population under 30 year old and most of them are eager to acquire knowledge and skills that lead to high-paying jobs.

Table 6.4: Number of Student visas issued for select countries (2005-2008)

Country	Year			
	2005	2006	2007	2008
US	2,655	4,093	7,303	9,600
Australia	1,712	2,512	3,779	5,650
United Kingdom	1,312	1,396	1,735	1,930
Canada	332	214	263	589

Source: Foreign Affairs and International Trade Canada, 2009.

The table above shows that many Vietnamese students chose Australia for their higher education, especially in 2008. The reasons for this are the more reasonable living costs and tuition fees in Australia, while its education quality is still considered to be of a high standard.

As a result, ANZ has significant potential as the primary choice of Vietnam students studying overseas and requiring various services in transactional banking, loan products, etc.

- **<u>Home Loans</u>**

In this area, ANZ has been much slower to develop than local banks. Only in September 2007, could individuals access this service from ANZ. ANZ Vietnam launched its mortgage products on 3rd September 2007 and offered Vietnamese customers convenient access to Home Loan Services. ANZ mortgage is considered the most competitive package set against the normal Home Loan service with it offering in 2007 a 1-1.4 per cent interest rate per month, over 15-20 years term and providing up to 70 per cent of the house value, with the whole process made even more attractive by it requiring only a simple procedure to acquire the loan (ANZ, 2007a).

One reason for the initial slowness in developing this product was a belief that the Vietnamese preferred to choose loans from local banks as they believed that foreign banks usually offered higher interest rates than local banks.

Understanding this issue, ANZ aimed at offering an ‘impressive and competitive’ interest rate, with a simplified application procedure for loans and the service also aligned to the bank giving free consultancy on making the loan part of a wider financial plan. In fact, by introducing this product, ANZ has shown its intention to directly compete with local banks in a major financial area.

- **<u>Services for corporate clients</u>**
- ➢ ***<u>Derivatives</u>***

ANZ has been one of leading banks in offering derivatives. In 2007 ANZ has perfected its interest rate swap in VND which allows clients to enjoy interest rate constant in comparison with the Vietnam Inter Bank Offered Rate (VNIBOR). As we have known, interest rate swap in VND has been quite new in Vietnam banking and only few banks can offer this service. Cross currency swap is also another rates derivative offered by ANZ.

The most noticeable client of ANZ in this service is Petro Vietnam Transportation (PVT). They signed an interest rate swap deal with duration of 5.5 years on the 5^{th} June 2008. PVT is one of the top firms operating in petrol transportation to overseas in Vietnam.

- ***Bond underwriting***

ANZ is the first foreign bank in Vietnam to implement underwriting of Corporate Bonds in Vietnam dong. In July 2006, ANZ was the book runner for the first ever local currency corporate bond issued for the Electricity of Vietnam (EVN) 900 billion VND (60 million US dollar equivalent) with a 5 years Bond. In October 2008, ANZ has coordinated with BIDV to underwrite 1 trillion billion VND corporate bonds for Vincom JSC (VIC) to local and overseas firms. Vinashin (the Vietnam leading ship-building company) was also one of large ANZ clients in this field. Both of these clients are blue-chips on the Vietnam stock exchange market. Moreover, ANZ acted as the underwriters for the Government bond issue.

It can be seen that ANZ has underwritten for large corporations, and not just small firms. And these firms have often involved in major foreign operations. In particular, both EVN and VIC are often working with oversea firms and their bond issues are aimed at attracting foreign firms. This shows that ANZ has not only tried to advance its domestic role in the Vietnam market, but also ventured into links between the Vietnam and overseas financial markets.

- ***Strategic loans***

In Sep 2007, ANZ was the leading 'arranger' for long term financial services, including arranging export finance services to China and trade financing, valued at USD120 million with 13 years tenure for Thai Nguyen Iron and Steel Corporation to promote its production capacity. With regard to steel production, it is obvious that this sector has played an important role in the development of Vietnam and there is a huge demand for infrastructure construction projects that require significant inputs from the financial sector. Thai Nguyen Corporation is a well-known State-owned firm involved in many of the largest operations and the demand for financial services is thus significant and long-term. The capture of Thai Nguyen as a client is a major success for the continued growth of ANZ business in Vietnam (ANZ, 2007b).

Also in 2007, ANZ was one of the arrangers to the Ministry of Finance to finance the Dung Quat oil refinery requiring USD300 million of investment. Moreover, a series of Hydropower Plants for EVN, including at Vuong in Quang Nam, Dong Nai 3 and Dong Nai 4, An Khe Ka Nak and Srepok 3 plants brought a need of loans reaching a total of USD161 million.

In late December 2007, ANZ, along with BNP Paribas, Natixis and Petrol Vietnam Finance Corporation (PVF) signed credit contracts with Petro Vietnam valued at USD 270 million over eight years in order to construct the Nhon Trach 1 thermal power project in Dong Nai province. This project is one of the Government's strategies aimed at stabilizing the national electricity supply.

It can be seen that ANZ has focused on large loans for trusted entities which are often related to the Government. Throughout these loans, we also see that Vietnamese government has confirmed its confidence in ANZ service and recognised its expertise and financial capacity. The ability of a foreign bank to successfully operate in Vietnam and build up strategic relationships with Vietnamese clients and the Government cannot be lightly considered. Vietnam is a country where the business, governmental and societal culture is often a source of misunderstanding and confusion between foreign and domestic partners. Thus, the ANZ progress in successfully negotiating a trusted and profitable position in the market cannot be under-estimated.

- **Import-Export Support**

ANZ, as the No.1 provider of trade finance in Australia, has committed to support importers and exporters, especially exporters by offering short loans in foreign currency with term of less than 180 days. Thanks to this service, business clients' working capital is ensured to meet their production schedules, especially through periods when there is a slow payment by clients.

In 2008, the workshop 'Strengthening seafood material import for processing and exporting' given by the Vietnam Association of Sea Food Export, ANZ introduced a new financial package; the 'inventory support for buyers', and aimed at solving particular difficulties in working capital problems for seafood exporters (Interview: Ms Dam Thuy, ANZ, 10 June 2009).

That package includes two parts: 1) inventory support for buyers to help in importing and 2) pre-export trade support to help processing and exporting trades. Fishery firms will use its imported seafood materials to support mortgage loaning to pay for the imports. This product is very helpful for these firms because it is suitable to the typical characteristics of fishery companies, which include needing large working capital bases on a short term arrangement that allows the processing of imported material into finished products for export. An advantage of the new product is that the loaning procedure is quite simple, especially in mortgaging terms. This again indicates a strong strategic ANZ strategy of avoiding providing new products that fail due to complicated application procedures and shows that simplicity is often the key to providing satisfaction and achieving customer loyalty in the Vietnamese market.

ANZ has provided this service to a series of fishery firms, including two listed companies, Ben Tre Import-Export Fishery joint-stock company (FBT) and An Giang Import-Export Fishery joint-stock company (AGF). These firms are the leading firms in the sector and listed in the Ho Chi Minh Stock Exchange Center.

It is predicted that the package will be very popular in the fishery sector especially since ANZ declared itself during the workshop as a major supporter for Vietnamese seafood exporters.

- **Financial Advisor**

ANZ has provided financial advisor services for a series of large projects. ANZ has provided significant financial packages these projects through bond issuance, bank loans and calls for more partners. And in Thu Duc Water Treatment project, ANZ directly participated as a 'co-arranger'.

It is recognised that large clients often look to ANZ to use this service, and it is not merely reliant on the small to medium sized clients. A major reason for this is that the existing availability of sophisticated financial advisory services in Vietnam is very low and the problem with acquiring a service that has the necessary technical and knowledge based ability to manage very large projects is very limited. In this aspect, ANZ has often co-operated with other banks including BIDV and Sacombank, to provide the necessary inputs and shown that the weaknesses in the Vietnam financial sector have actually provided ANZ opportunities to advance its own market share and overall reputation for quality services.

- **Perspectives**

In banking markets for institutions, ANZ' s goal is to become the core bank (top 3) and intends targeting major clients, such as leading agri-bank's and 'natural resources' bank. In the retailing banking market, ANZ is trying to expand to be in the top 4 by NPAT and achieve 10-20per cent share of targeted segments.

To achieve its targets, ANZ's strategies are focused on developing the retail sector, using partnerships to compliment ANZ's offers. Its track record in retail banking demonstrates strong institutional capabilities in delivering retail banking services.

In retailing bank market, ANZ‘s strategy is to widen the attraction to customers bank and emphasis its understanding of the culture, while also winning points for its service convenience and standards, thus ensuring the banks position as a market leader. ANZ heavily invests in training programs to create the ideal human resource advantages. It aims to increase the quality of the services with the slogans like ‘ANZ has great staff’, ‘Open when and where you want’ or ‘we come to you’. The Bank is striving to achieve a competitive advantage through quality of human resources and efficient, friendly and available services. ANZ is complimenting its existing advantages by introducing increasingly more competitive and convenient ways to bank, such as ATMs, internet, call centre and mobile phone offerings.

Obviously ANZ has great potential to develop, especially in individual banking services, and its existing disadvantages, such as the high fee in ATM withdrawal (in x-times depending on account package) will be lessened when the SBV allows accounting fees to be applied for all ATM transactions.

6.5 ANZ contribution to the development of Vietnam

ANZ in Vietnam has become an important and respected contributor to the economic development of the country, especially in the reform of the banking system and its impact upon both economic and social aspects of Vietnamese society. However, the social aspect should be examined in detail as it is vital factor in the development of the profitability of ANZ in Vietnam (Hansen and Diaz, 2008).

6.5.1 Community development

ANZ Vietnam has contributed significantly towards community development in Vietnam and takes its social responsibility very seriously. It, along with Youth Newspaper co-sponsored the building of a primary school in Ca Mau with the fund of 200 millions Dong in 2005 (Vietbao, 2005). It also supported the ‘Rural Development for a Future without Poverty’ project to provide women in Tuyen Quang province additional micro-credit, and training in small business establishment (ANZ, 2007c). ANZ Bank Ltd. (International) also contributed to the International Women’s Development Agency (IWDA) charity with USD 100,000 to build a school. Its staff also mobilised to donate USD 160,000 to provide credit loans and support for women in Tay Bac area in the program ‘ANZ- overcome threats for the community’. The Vietnamese culture is one that sees the business community as having a social responsibility to provide a percentage of its profits as charitable donations. The connection between the reputation of a business and its standing in the society as a whole is strongly dependent on the company demonstrating openly its commitment to local communities and its willingness to help development generally. Firms that focus merely on gaining market shares and are run ‘purely for profit’ soon lose the loyalty and custom of their clients. ANZ has shown its awareness of a responsibility to the community and demonstrated that it is willing to share the rewards of its business with some of the less fortunate in Vietnam society. This directly enhances its position in Vietnam, especially with its development of fruitful relations with the government and the business community.

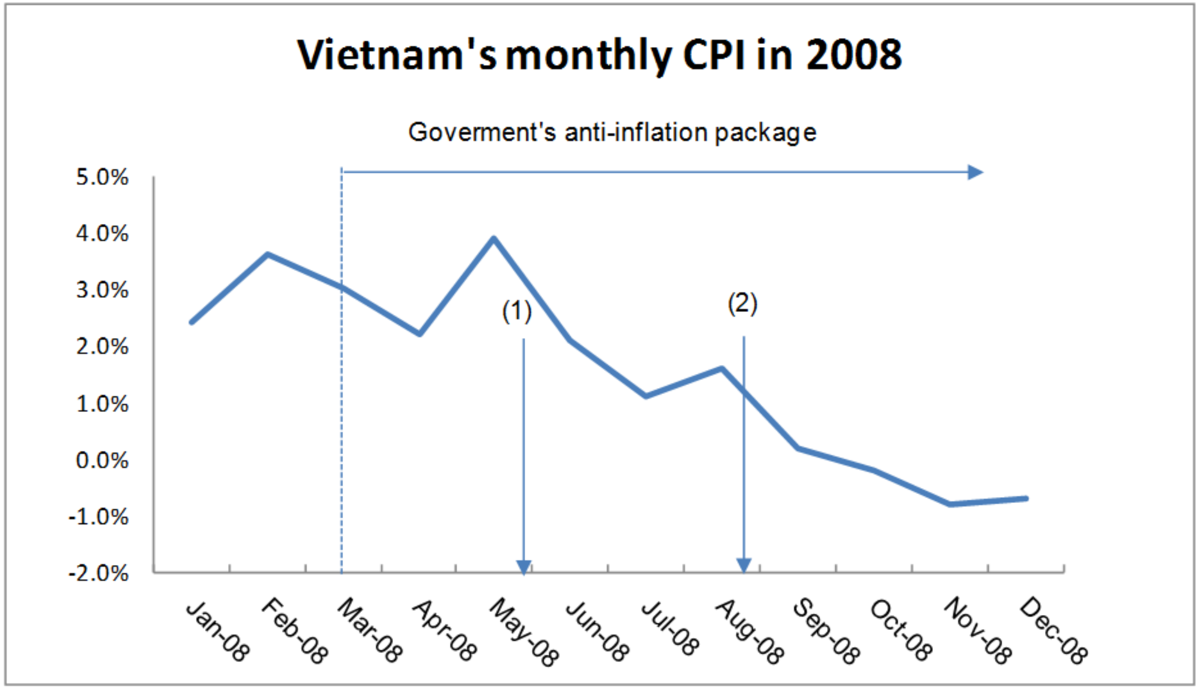
6.5.2 Comments on laws

Having expertise in finance and banking, ANZ has often contributed valuable advice to aid reform of the Law, including Personal Income Law and Securities Law. It suggested that foreigners who work in Vietnam less than 30 days should not be applied tax because they are often expert and during their short-term visit to Vietnam, they might find opportunities to invest. As a result, taxing them will not only discourage them to come to Vietnam but also lessen opportunities to attract FDI. As regards to Securities Law, ANZ recommended that the rate tax of 25percent is too high and cannot stimulate the stock market (Vietbao, 2007b). That statement is correct because the draft as well as the official law has played an important role in pulling VN Index down since early September 2009 (Le Minh Toan and Walker, 2009).

6.5.3 Economic Research of Vietnam’s economy

ANZ International and Morgan Stanley both still consider Vietnam economy as stable and one of the world’s better developing macro economy’s’. ANZ experts think that the recent inflation control package of the Vietnam Government has followed the right track (Le Huong, 2008). ANZ Vietnam has made significant contributions to the development of the control package, including providing astute recommendations and helping to ensure that the correct data was used to compile the strategy. The following figures show the movement of Vietnam’s inflation and the prediction of ANZ on inflation trend.

Figure 6.1: Vietnam's CPI in 2008



Source: General Statistics Office (2008)

(1): Alex Thursby, ANZ General Manager in Asia- Pacific, stated that 'I do not think Vietnam is in crisis' and inflation might be in controlled.

(2): ANZ, along with Morgan Stanley considered the Government's anti-inflation package as 'the right way' forward.

The bank's economics and market research team has been actively watching the market and producing reports evaluating and forecasting about Vietnam's economy on a regular basis. ANZ's forecasting reports are usually close to the reality, even when the economy was considered to be in crisis (very high inflation in May – time (1)). Morgan Stanley believed that Vietnam was in financial crisis. The drop in CPI proved how correct the statement of ANZ, not Morgan Stanley was.

In general, ANZ Vietnam has devoted significant efforts in helping the development of Vietnam in both economic and social aspects. Its viewpoint has helped investors understand more about Vietnam economy, and hence they have made more appropriate investment decisions.

6.6 Recommendation and Conclusion

The case study has shown that the law is very important in attracting FDI as it creates opportunities for foreign investors to gain their achievements. However, in order to become a successful FDI firm in Vietnam, the firm also needs to have appropriate strategies as well as activities to create differentiation in order to gain sustainable development. Thus, specific recommendations will be made for ANZ, based on its strengths and weaknesses.

6.6.1 Viewpoint of the Government and the Party as well as politic stability

It cannot be denied that the point of view of the Government plays an important role in attracting FDI. Before *Doi Moi*, FDI in Vietnam was at a dangerously low level. Since *Doi Moi* began, FDI increased gradually and focused in other sectors which could advantage of cheap labour and/ or natural resource costs.

An example of practical policies issued by the Vietnam Government to support the development of a 'banking culture' was Direction No.20/2007/CT-TTg on the system for salary payment of civil servants and later developed further with Decree 21/2010/ND-CP of March 8th, on the Management of civil servants payrolls. Although also designed as strategies for promoting and securing anti-corruption policies in the government administration system, the new regulations provided a direct boost to the growth of a banking culture with many government employees now forced to open and sustain bank accounts in order to receive their pay and benefits from their employer. Further supportive regulations for FDI included Decision No.12,2011/QD-TTg on Favourable Policies for Supporting Industries which included the Vietnam Ministry of industry and Trade allowing foreign enterprises to advertise free of charge on the government website; prioritising supporting industries for receiving funds; the allocation of land and low rental rates for new ventures and direct assistance from the government in job recruitment and training; export/import duty incentives

Like other countries in the Asian area, FDI into the banking sector came later than in many other sectors. For instances, ANZ Bank Ltd. decided to invest in Vietnam in 1993, seven years later than the start of *Doi Moi*. Meanwhile, it already had a presence in Mainland China in 1986, eight years later than China's renovation. It seems that foreigners only invested in this sector when they recognised absolutely positive signals being given by the Government. Their thinking is reasonable because this sector requires a large amount of capital risk and Governmental cooperation is vital to limiting the risk. That early suspicion of the Governmental commitment to reform explains ANZ initial reluctance to enter the Vietnam market and is reflected also in its present avoidance of investing Myanmar which is still considered relatively unstable in term of politics (Hansen and Diaz, 2008; Doan Anh Toan, 2005; Mai; 2003; Biallas and Nguyen Hanh Nam, 2006).

Obviously, the Vietnamese Government and the Party have been consistently active in promoting the openness of the Vietnam economy to foreign partners and as a result, FDI firms have become more comfortable in deciding to operate in Vietnam (such as ANZ, HSBC, etc.). The Vietnam Government still retains a number of negative aspects that concern the FDI investor, such as the need for more reform of the bureaucratic system and further development of business law, but they have demonstrated a willingness to cooperate and encourage the necessary reforms, which has convinced FDI investors to increasingly focus on entering the Vietnam market (Hansen and Diaz, 2008)

6.6.2 Potential markets

Vietnam has significant potential as a market for banking activities. According to ANZ (2008), only 10 percent of Vietnamese and 35 per cent of urban residents presently have bank accounts. And the urban middle class have demonstrated a fresh willingness to actually use credit services. In addition, Vietnam has had stable growth rates. This demonstrates that demand for banking services is likely to only increase and that the profit potential of the Vietnam market is one of the most positive in the global banking market.

This is especially so with the requirement from the Government in August 2007 that all state agencies and firms must pay staff salaries via bank account, thus ending the culture of cash payments and forcing many people to become bank customers. This measure was evaluated as an advance in technology application as well as a new restriction on corruption. In the future, all firms in the private sector will also be required to implement this measure. Therefore, almost overnight, the potential size of the market for banking services will grow to new heights, with a present population of over 88 million people promising both domestic banks and foreign banks exciting opportunities to capture invaluable new market shares.

ANZ bank has been implementing the right strategy in marketing and banking, as they have created a brand-name of a ‘for the customers’ bank. More Vietnamese, especially the medium and high classes in urban areas are looking for confidential and quality services from foreign banks like ANZ. For example, they feel confidence is assured when their individual banking needs can be discussed in a private room, and not over the counter, as is the general practice with existing local banks. ANZ has implemented mobile-banking to save time for customers. Customers also record high levels of satisfaction with the ANZ services, especially in even simple terms, such as always being presented with cordial and smiling attitude towards them by Bank staff, including from the levels of tellers to managers. These are differential competitive advantages provided by ANZ when compared to the services of many of the local banks, where customer service and the quality of human resources are relatively low. The faults of the local banks are only compounded by the low levels of service quality also being joined by the introductions of new charges that include the collection of an annual banking account fee and withdrawal fees for transactional banking (introduced in 2008). ANZ’s advantages are likely to increase further when the fees are eventually abolished and the major competitive advantages between local and foreign banks will rest solely on the quality of customer service.

6.6.3 <u>Labour</u>

Average salary for an employee with bachelor or master degree (even overseas) in banking and finance sector (both State-owned, joint-stock and foreign firms/banks) was USD450 per month (Navigos Group, 2008), just equal to the figure of a banking customer service officer in Indonesia, according to Indonesia Salary Guideline 2007. These figures show that labour in Vietnam is quite cheap in comparison with other countries. And that will be a factor to attract more FDI into the financial sector.

In addition, foreign banks have advantages in attracting experienced and highly educated employees from domestic banks, even the SBV, due to their attractive salaries and their better working environments. For instance, ANZ is proud to be creating a positive environment for its staff. It listens and values its employees, and hence promotes good working effectiveness. That is reflected in the comments of some of its current staff with ‘Our working environment is very professional’. ‘We enjoy what we can devote to our bank’’ ‘Our working life is secure at ANZ’ and ‘Working at the Bank is fun’ (Interview: Staffs, ANZ, 12 May 2009). In contrast, the staff of competitors are sources of concern for their working environments and subsequently become targets for ANZ to attract to employment in their own bank.

6.6.4 Transparent information/ Investors protection

Transparency still is an issue, as evaluated by Transparency International (2006). There has been no official data on banking market shares. Bank financial reports are limited. Only joint-stock commercial bank must disclose their financial report as regulated by decision 1407/2004/QD-NHNN on 1 November 2004. The lack of information will cause concerns for investors and hence lessen the attractiveness and well as effectiveness of FDI.

Investors’ protection covers requirements for immediate disclosure of announcements and financial reports of public firms. To evaluate this index, World Bank also considers the liability of the board of directors for damages or even the availability of documents which can be used during a trial, etc. The following figure shows how World Bank evaluates the level of Vietnam’s investors’ protection in comparison with countries in the areas. The scale is from 0 to 10.

Table 6.5: Protecting Investors

Protecting Investor Data	**2007**	**2008**	**2009**				
	VN	VN	VN	Malay	Thai	Indo	Laos
Rank		168	170	4	11	53	180
Investor Protection Index	1.7	2.7	2.7	8.7	7.7	5.7	1.7

Source: World Bank, 2008

Based on this index, it can be seen that Vietnam needs to improve its regulation on the disclosure requirements and transparency. In comparison with Indonesia and Thailand which have economic conditions just a little higher than Vietnam, Vietnam is evaluated much lower in protection. Regulatory protection should not only be adopted for joint-stock banks but also for all types of banks in order to help investors and taxpayers have a full understanding about the banking system. Currently branches of foreign banks and state-owned have not published their financial reports. Therefore, it is very difficult to understand the effectiveness of these banks (Hansen and Diaz, 2008; Biallas and Nguyen Hanh Nam, 2006).

ANZ also faces this problem. It is very difficult to acquire accurate ANZ’ financial data in Vietnam as illustrated by the comment of an ANZ executive who said in reply to requests for data 'our policy on financial information release is confidential, except to that for export to SBV'. Looking at other foreign banks including HSBC and Standard Chartered Bank, the same policy has been applied.

As a result, ANZ, as well as other banks and FDI firms in financial sector, should disclose more financial information in order to help investors and their clients understand more about the effectiveness of that bank, and therefore they might feel more confident in its services. What is worrying is that instead of foreign firms becoming the vanguard in positive changes of the levels of transparency, the banks such as ANZ have virtually adopted all the same negative practices as the domestic banks and seem to find more advantages in being more opaque rather than open. Much of the reform in Vietnam has been aided by foreign concerns setting a new example and their lack of constructive reform in this area of business is a mistake that can only compound the present difficulties.

6.6.5 Access to Credit

According to World Bank (2008), 'Getting credit index' is determined by evaluating legal right, credit information, public registry coverage and private bureau coverage.

Table 6.6: Getting Credit

Getting Credit	2008	2009					
	VN	VN	Malay	Thai	Indo	Philip	Laos
Rank	51	43	1	68	109	123	145

Source: World Bank, 2008

This index reflects the effectiveness of banking system. Although the Government is currently adopting strict monetary policy, great efforts have been made in granting credit and protecting both lenders and borrowers. Valuation for a credit grant is stricter to prevent bad loans while more information is released by credit institutions.

However, Vietnam still needs to improve more in this field in order to follow Malaysia which is also an ASEAN member but always evaluated as being 'very good' in this area. More information should be offered by credit bodies and the law also should be more clarified to protect partners.

6.6.6 Legal documents and regulations

The following figure shows that for specific years, FDI in banking and finance sector rose. Looking at the laws and regulations in this period, there is a link between them.

Table 6.7: FDI in Banking and Finance from 2000 to 2007 (using 1994 price)

(In billions Dong)	2000	2001	2002	2003	2004	2005	2006	2007
Banking and Finance	489	388	160	865	487	535	619	698
per cent/ Total FDI	0.72	0.50	0.18	0.91	0.46	0.46	0.49	0.51
Total FDI	68,089	77,426	86,677	95,471	105,082	115,196	126,601	135,860

Source: SBV, 2007.

2003 witnessed record FDI in this field. In the same year, State Bank Law was amended on 17 June. In addition, Law on Corporate Tax, Law on Value Added Tax, and Law on Accounting were also adjusted in order to concretise these aspects. These amendments might have positive effect on FDI as foreign investors realised that Vietnamese Government had tried to create a more convenient investment environment.

In 2005, the banking and finance sector made significant advances with the raising from 30 to 49 percent of foreign ownership in public firms. This is an effective lever in attracting FDI in banking and financial sectors. Afterwards, the booming of the Vietnamese stock market, as well as the participation into the World Trade Organisation (2006) played an important role in exposing the Vietnam market to the world. The acceptance of a 100 per cent foreign bank in 2007 is a major step to fulfilling Vietnam's commitments when joining the WTO. As a result, ANZ and other current foreign banks will face more competition from future players.

One of regulations which will restrict the development of foreign banks in Vietnam is ATM installation. ANZ and other foreign banks face many difficulties in competing with local banks in attracting individuals as the Vietnamese still often pay by cash, not by credit as with many developed countries. Therefore, ATMs play a very important role in satisfying individuals' demand. This issue is very difficult to solve, except if SBV treats foreign banks the same as local banks (Pham Duy Nghia, 2006; Gillespie, 2006, 2007; Balme and Sidel, 2007)

6.7 Conclusion

This chapter has examined how ANZ has established a successful FDI venture in Vietnam and considered the extent to which its ability to find affinity with the culture has contributed to that success. For Dunning and Bansal, this should be complemented by a study of the Australian and New Zealand cultures 'and the propensity of a nation to engage in FDI…and does the culture affect the locational and modal choices? In other words, does culture affect the competitiveness of firms and their perception of transaction costs and market failure' (1997, p.4). However, the focus here is on Vietnam and the thesis does not extend to studying the ANZ home cultures.

Vietnam and the banking sector in particular, need to improve its management quality to exploit FDI effectively. However, it cannot be denied that Vietnam has gained many achievements as foreign investors are increasingly willing to disburse in Vietnam. In the banking sector, ANZ can be a seen as a typical example of how the sector can develop. ANZ has ambitions to 'expand the services we provide in the country' as stated by Ms Dam Thuy, its country manager. That intention might meet customers' demands as almost of them think ANZ is the best at services, however it has limitations on ATMs and branch numbers (Interview: ANZ's clients, 12 May 2009).

The analysis of ANZ shows that there has been a fulfillment of many of Dunning and Bansal criteria for assessing a successful FDI enterprise. They instruct the scholar to focus on the 'MNEs impact on host country cultures'. ANZ have helped create demand where none existed and raised the standards of demand by providing a variety of new banking products and services, while also demonstrating to the home banks new levels of efficiency and standards (Dunning and Bansal, 1997, p.5). ANZ have worked with their Vietnam business customers to help and advice them on how to 'inject a spirit of entrepreneurship and competition' among their business community. The surveys of the workforce show that the Vietnamese employees constantly display a development of their ability to work through teamwork and provide higher levels of customer service. They have helped 'change the relationships between themselves and their suppliers' and improved 'quality standards of production which' has resulted in a 'spill over' effect that has seen the 'quality of other related products' improve (Dunning and Bansal, 1997, p.5)

The banking sector has been a relatively new area of investment where changes and opportunities are still in their infancy. Nevertheless, the ANZ study demonstrates how they experienced a process of learning by doing, and rather than arriving with a complete system in place within which to establish their operations, they have been actively involved in the ongoing process of change. Their operations, advice, and sometimes resistance has been instrumental in actually changing the determinants of FDI in Vietnam, and in the process gradually developed the structures of investment to meet more and more needs of the foreign investor. However, the key word is ‘change’ as it is evident in this thesis that the last two decades have required extensive and thorough changes of the political policies, legal frameworks and economic conditions in Vietnam in order to attract and retain foreign direct investment. As Nguyen Mai explained the future prospects for continuing to attract and retain foreign investment means that the process of change must continue and probably needs to accelerate. *Doi Moi* was the initial change that made the attraction of international funds on a satisfactory scale possible, but it was just the beginning of a long and difficult process in which even more revolutionary change in policy may be required (Nguyen Mai, 2011).

ANZ has managed to ‘penetrate’ the Vietnamese market and use its foreign investment, technology and know-how to become a major competitor. The success may also have come at some cost, as one could believe that it has in some ways ‘gone native’ assuming many of the traits of domestic banking operations, such as a far more opaque financial disclosure process than it demonstrates in its own home operations. This may have helped it assimilate to the Vietnam environment, but could also carry with it some of the weaknesses of the domestic banks and when Vietnam fully opens to foreign competition, may put it at a disadvantage to new foreign bank entrants into the market. Nevertheless, present evidence is that ANZ is a successful example of FDI operation in Vietnam, a claim that can be made for the next case study- Honda.

CHAPTER 7: HONDA COMPANY IN VIETNAM CASE STUDY

7.1 Introduction

The case study of Honda in Vietnam is an examination of the cultural specific variables evident in understanding Dunning's eclectic paradigm and the impact of internalisation theory. As early as 1997, Dunning and Bansal realised that it was 'an opportune time for more in-depth research' on 'cultural specific variables' in FDI ventures (p.12). The chapter here forms a study of the application of the eclectic paradigm to Honda-Vietnam by examining how its entry mode and subsequent management system of operation provides clear indication that a culturally specific strategy for FDI is the optimum method of ensuring the maximum capital return on any foreign investment.

Dunning (2008, p.274-276) examines the impact of informal institutions upon MNEs activity and identifies these as cultural packages consisting of a home countries 'norms, values, conventions, practices and artefacts derived from the national culture'. Here we should note that the study accepts the consequent impact on the home culture of the foreign venture and the case study here of Honda demonstrates that although the Honda (Vietnam) venture demonstrated clear conscious strategies for assimilation to the Vietnam culture, the reverse impact went beyond even an effect on just the business partners, but extended into actually contributing to dramatic changes in the Vietnam national culture. The motorbike is now seen as much a reflection of the culture as eatig rice or taking a 'siesta' at midday. Dunning largely focused on the impact of a national culture upon foreign investment activity, yet, clearly the study of the reciprocal impact of a foreign culture upon a home countries culture is as relevant.

The criterion given by Dunning and Bansal (1997, p.12) for assessment of the degree to which a FDI strategy is culturally specific has the following main dimensions:

(1) 'The motives' for the 'activity'- in the case of Honda-Vietnam it was dominated by a market seeking strategy that could take advantage of the 88 million population of Vietnam while benefiting from the export into Vietnam of Japanese efficiency and strategic assets.

(2) 'The specific characteristics of both the investing and the invested' entities- For Honda-Vietnam, the massive potential demand for modern transport methods and a new sense of need for public mobility meant the market was primed for Honda, while the Vietnamese reputation for adaptability meant Honda could hope to easily transfer their

productivity and management advantages into Vietnam in a style that would work for the Vietnamese.

(3) 'The kind of activity engaged in'- which in the case of Honda-Vietnam involved the transfer of technology and capital, while concentrating on the specific advantages of the growing domestic market for motorbikes.

(4) 'Strategy and characteristics of the firms including their corporate culture' – Honda brought a Japanese corporate culture of discipline and efficiency, but did not slavishly adhere to it in Vietnam. Instead, they incrementally harmonised the Japanese discipline to the Vietnamese 'casualness' and used their Asian cultural empathy and understanding of cultures, values and approaches to provide dual benefits to Vietnamese and Japanese stakeholders.

Honda-Vietnam has successfully established a high returning capital investment into Vietnam that shows the relevance of cultural understanding in the eclectic paradigm. Presently, the policy towards FDI attraction by the Vietnamese Communist Party has provided a strong engine for economic growth. The Honda Company has launched its 'just-in-time' campaign and focused on its 'physical assets' into the Vietnamese economy, with a view to expanding their hold over the Vietnamese market. They are seeking to pursue fresh market and resource opportunities, and after 12 years operating in the Vietnamese market, Honda has proved they have a successful business strategy that includes diversification into the motorbike market and delivering its own set of corporate values based on a philosophy of management called the 'power of the dream' (Nguyen Nhu Binh and Haughton, 2002).

The acquisition of a 'local responsiveness' is the main focus of Honda's penetration strategy into Vietnam and has helped Honda become the motorbike market leader. In the context of proactive integration of Vietnam into the world economy, Honda has kept their philosophy in step with the development of Vietnam and sees that as a critical factor in its success. From point of view of a marketing strategy (and ignoring the influence of 'luck'), the Honda Vietnam Company has acquired significant core competencies that new entrants to the market cannot easily attain. Furthermore, these core competencies are designed to be adaptive to the fast changes of the environment and are developed in the framework of a 'practical and real' approach to how to operate in Vietnam. The Vietnam motorbike market has demonstrated a close affinity to the philosophy of Honda and the development of both the market and Honda has been rapid and profitable (Nguyen Nhu Binh and Haughton, 2002; Lee, 2004; Nguyen Duc Tiep, 2007).

Honda Group is a multinational corporation in the list of '500' corporations. Honda's record is one of tremendous success and based on an aesthetic 'love of life' and a reflection of a basic connection between a philosophy of 'hard work', responsibility to 'mankind' and the commitment to promoting a 'better future'. Mr Satoshi Toshida, managing director Honda Asia Oceania noted: 'Asian culture is based on a community spirit and obligation. Our cultural affinity to the Vietnamese was a reason for our confidence in making our investment into Vietnam a success' (Interview: Satoshi Toshida, Honda Vietnam Company, 17 April 2008).

Mr Hiroaki Funami, General Director Honda explained how this social responsibility policy fitted not only with the culture of Vietnam, but also aligned perfectly with the political ideology of the Vietnamese Government: 'the Vietnamese are a sensitive and proud people who see the pursuit of the capitalist profit as one that can be easily accepted if it is accompanied by the demonstration of a sense of a duty to the community. We felt the philosophy of Honda fitted well with the culture of Vietnam' (Interview: Hiroaki Funami, Honda Vietnam Company, 19 April, 2008).

The story of Honda has attracted significant interest from business analysts and its venture into Vietnam as the Honda Group and Honda Vietnam Company is documented in a number of publications, including the now the famous book 'My Life Record' (2007) written by Honda Soichiro, which has been translated into English and later into Vietnamese by the Liberalisation Saigon Newspaper Publisher and Saigon Cultural Publisher. It is a typical work dealing with the story of the founder of Honda, the Company's history of development and promotes the idea of a 'Honda philosophy'.

Research done by Kohei Mishima (2005) 'The Supplier System of the Motorcycle Industry in Vietnam, Thailand and Indonesia: Localization, Procurement and Cost Reduction Process', provides comprehensive analysis of Honda, including a focus on the Honda 'supplier system' of the motorbike industry and examines clearly how a Vietnam specific system was established. It also made comparisons between other supplier systems, with a focus on three countries- Vietnam, Thailand and Indonesia. Its analysis includes 3 interactive dimensions of the motorbike industry including the localization, procurement and cost reduction processes. The three supplier systems of the different countries can be supplementary and substituted for each other in the regional production chain of motorbike industry. The recommendations and suggestions proposed by the research are a pointer to how the governments of all three countries should develop a favorable environment and realise the effective supporting activities for motorbike manufacturers to attract and utilise effectively FDI.

Pham Truong Hoang (2004) examined the products and organisation of the Vietnamese motorcycle market. The research concentrated on the evolution of the production organisation of any entities as the foundation of the business ties in the modern era. The research has also made clear the architecture of supplier systems of Honda Company especially the dynamic evolution of business architecture in response to agglomeration and modularization. However, these researchers mainly approached the business of Honda from technical aspects or the business architecture. The business of Honda has been constructed though a very comprehensive system of activities and functions that are not only focused on the business architecture (Pham Truong Hoang, 2004; Nguyen Duc Tiep, 2007)

7.2 <u>The first step of Honda in Vietnam</u>

Honda motorbikes first appeared in Vietnam in 1967, in the Southern part of Vietnam under the former - Republic of Vietnam administration. Initially shipments of Honda motorcycles arrived in Vietnam were a part of massive US's Aid programs for the South Vietnamese Government. At that time, people in the South Vietnam were impressed by the economy and reliability of Honda motorbikes. After the reunification of North and South Vietnam in 1975, Honda motorbike took the chance to expand its brand into the Northern part and then all over the Vietnamese territory. Even during the time of the command controlled and closed economy of Vietnam, the brand of Honda has had significant influence over the growing brand choices of Vietnamese customers, and facilitated that through the importation of re-conditioned Models 78, 81, 84, etc motorbikes. This was in competition with the other models of motorbikes imported from the former socialist countries such as the Simpson, made in East Germany, or the Minsk, made in former Soviet Union (Mishima, 2005, Nguyen Duc Tiep, 2007; Ministry of Industry, 2007).

By continuously undertaking the innovation of policy of FDI since 1986 with the controlling guidelines noted in the Preamble of the Law of Investment of Vietnam 'to protect and encourage foreign investors on the basic of mutual treatment and law pursuance', Vietnam has been considered as the prime destination for foreign investors.

The estimation of Vietnamese policy makers (MPI, 2004), of the investment needed to meet the demands generated by movement towards industrialisation and modernisation is in the region of 200-250 billion USD of investment. Simultaneously, Vietnam also needs modern technology, management expertise and job creation to effectively exploit the resources and to modernise the economy towards a basically industrialised country by the year 2020. Therefore, FDI source, especially that of Transnational Corporations, is the most important resource to serve these development objectives of Vietnam. The Vietnamese government commits not to nationalise all kinds of assets that belong to the lawful ownership of foreign investors. In addition to that, the Rate of Effective Protection (REP) of Vietnamese economy as a whole at this time is about 1.300 per cent (Athukorala, 2002) and as a result, while the higher REP of Vietnamese economy exists, there is an opportunity to attract larger amounts of FDI inflows.

7.2.1 Entry Mode of Honda

Among the modes of entry into the foreign markets, Honda Group, headquartered in Japan, chose the joint venture model as the main approach to the Vietnamese market (Lee, 2004; Nam2007; Nagatani, 1995). This allowed them to gain valuable knowledge on the Vietnamese local market and to exploit the cooperation from the local partner in terms of solving the very complicated procedures of Vietnam, especially as for such issues as acquiring land use and dealing with the complexity of administrative formalities during its operation. As Mr Pham Van Nang, Deputy Director- Honda-Vietnam, explained: ‘The mistake that many prospective investors making in entering the Vietnam economy is that they underestimate the value and maybe even necessity of having a Vietnamese partner. The system here is a mixture of the open and the hidden, where outsiders often become confused in how to actually get things done. A Vietnamese partner helps foreigners quickly acclimatise to the uniqueness of the Vietnam economy’ (Interview: Pham Van Nang, Honda Vietnam Company, 30 January 2009).

Kindleberger (1969) and Hymer (1976) present the monopolistic advantage theory as an example of why firms undertake international expansion and argue that a ‘foreign firm has a knowledge disadvantage of the new market compared to its local competitors’ (Friberg and Loven, 2007, p.4). Here Honda had capital, knowledge and resource advantages that gave them an advantage of local competitors. Dunning’s (1977; 1988) eclectic theory uses the monopolistic advantage theory and ‘stipulates that the choice of entry mode is influenced by three types of determinant factors: ownership advantages, location advantages of a market, and internalization advantages of integrating transactions within the firm’. Thus, the basic premise is that the FDI venture can only be successful if it has ‘advantages sufficient to compensate for costs of setting up and operating a foreign subsidiary’ (Friberg and Loven, 2007, p.5). However, Honda chose an entry mode that attempted to combine both the comparative advantages of its own firm and the domestic advantages of a domestic partner, and evidence to date is that this strategy was, and is still, successful.

Barkema and Vermeulen (1997) examined the impact of culture on FDI and show that local partnership through joint ventures helps overcome many of the negative domestic influences on successful operation of an FDI venture. Using Hofstede's and Bond's (1988) 'five dimensions' including the 'Confucian dynamism' aspect, we see that Honda- Vietnam's success was contributed to in so degree by the cultural affinity built up between Honda and its local partners. However, this also depended on the willingness of Honda and the local partner to negotiate through the differences between the Japanese and Vietnamese cultures. The key here for Honda-Japan was its selection of a suitable local partner for its mode of entry. It also depended on its willingness to surrender Headquarters hegemony to a bartered negotiation between the made Honda base and its local Vietnamese partners.

Japanese FDI ventures are usually managed in a process where they empower domestic decision-making, whereas, for example, US FDI ventures tend to remain subject to central control from the source country (Kriger and Solomon, 1992; Schneider and DeMeyer, 1991; Dunning and Bansal, 1997). This case study of Honda supports much of these findings, especially as a building on the conclusions of Kriger and Solomon (1992). There hypothesis of Japanese domestic empowerment in FDI ventures and the application of an incremental process of building up local independence in decision-making of the subsidiary were borne out from the analysis of Honda-Vietnam's management strategy (Nguyen Duc Tiep, 2007; Pham Truong Hoang, 2004; Do Duc Dinh, 1994; Poapongsakorn, 1995).

7.2.2 Investment Conditions

The investment conditions were favourable due to the external situation, where the impacts of the revaluation of Japanese Yen against the US Dollar and other hard currencies under the arrangements of Plaza Cord of G6 since 1986 became a strong motivation for Honda to make investment and even reinvestment abroad, including in Vietnam. By revaluating the exchange rate of Japanese yen against US dollar from 340 JPY/USD to 140 JPY/USD in 1990s, the value of Japanese assets abroad increased around 2.5 times (Kim, 2004).

In March of 1996, Honda acquired the Investment License (Reference Number 1521/GP dated March 22, 1996) from the Vietnamese state agency responsible for foreign investment (MPI) and was thus able to produce and assemble all types of motorbike under the Honda trademark, and distribute into the Vietnamese market. They started actual operations in December 1997. The Honda Vietnam Company had also acquired the right to distribute the components of motorbike and other maintenance and repair services for motorbikes in Vietnam. However, according to the Investment Licence, since the first year of operation, Honda was restricted to using 'made in Vietnam' components and accessories for at least 10 per cent of the total value of the motorbike and such a portion of local content requirement would be yearly increased to at least 64 per cent in the 6th year of operation. Honda established its main plant in Vinh Phuc province, 40 km North-West of the capital city, Hanoi. Although quite near to Hanoi the land fees were relatively low priced, but the area itself was a quite prosperous location and provided easy access to the main city. Mr Asoko Suzuki, Deputy Director- Honda –Vietnam: 'We were placed close enough to Hanoi for us to be seen as central to the countries plan of developing the economy. Whilst much of the South is seen as the centre of business, Hanoi is the political capital and the policy of *Doi Moi* needed to be seen as both a political and economic change that would transform the Vietnamese economy. By positioning ourselves in Hanoi we identified Honda as a key to the future success of the new policies' (Interview: Asoko Suzuki, Honda Vietnam Company, 5 December 2008).

7.2.3 Entry Mode, Partnership and Honda

Dunning and Bansal (1997) identify that 'certain business customs and attitudes, e.g. towards bribery and corruption, negotiating procedures, the sanctity of contracts, trust and loyalty… are almost entirely culture specific (p.8). In Vietnam, a 'relationships' culture in the general pattern of the process of conducting daily business means optimum success is borne from a combination of formal and informal processes. Honda showed their awareness of Vietnamese business culture by their willing to conduct business with and through a local partner. For example, there more disciplined Japanese management style was adapted to suit the more hybrid management process of formal and informal rules and practices, and this was undertaken through a willingness to listen to the advice of the local partner (Nguyen Duc Tiep, 2007).

An alternative approach to contrast this is the many attempts by US FDI ventures to penetrate the market in a mode of entry based on an almost culturally specific distrust by Americans of the Vietnamese and subsequently a constant tendency to prefer 100 per cent foreign owned enterprise for US investment, which then tend to be dominated by all senior personnel being either American or American source Viet Kieu (Wheeler and Mody, 1992; Nguyen Ngoc Son, 2008).

The Honda Vietnam Company is a joint venture between the Honda Group (Honda Motor Co., Ltd which contributes 42 per cent of the legal capital and Asian Honda Motor Co., Ltd which contributes 28 per cent) and Vietnam Engine and Agricultural Machinery Corporation, a Vietnamese machinery company that contributes 30 per cent of the legal capital, although this is actually achieved through its possession of the land use rights and the value stemming from that. The registered total capital of Honda Vietnam Company is USD 104,003,000 in which the legal capital is USD 31,200,000. The duration of Honda Vietnam joint venture is 40 years (Mishima, 2005; Nguyen Duc Tiep, 2007; Pham Truong Hoang, 2004).

Honda had established its initial business model in Vietnam by opting for an operation that was closely linked with Vietnamese domestic partners and demonstrated a commitment to not only pursuing its own interests, but also supporting and strengthening domestic partners. Honda management was aware that Vietnam had a few peculiar differences, based on such issues as the culture and traditional business practices that needed to be addressed through an understanding and cooperation with local business entities. Rather than investing into Vietnam as a separate entity, with Honda focusing on operating as an independent foreign investor, Honda was demonstrating a willingness and enthusiasm for actually working with domestic partners and sharing the benefits of a growing and increasingly profitable motor vehicle market (Pham Truong Hoang, 2004). Mr Hiroaki Funami, Honda General Director explained: ‘although now taking an outward view of the future of the economy, the attraction of foreign investors and companies was a risk, as many Communist conservatives feared that domestic companies would not be able to compete and would quickly go out of business. Honda wanted from the start to demonstrate that they were here to help, not only to profit from its penetration of the Vietnam market’ (Interview: Hiroaki Funami, Honda Vietnam Company, 19 April, 2008)

7.2.4 <u>Vietnam Motorcycle Market</u>

The booming Vietnam economy, which was matched by the rising incomes of a vast section of Vietnamese residents and the new ability to purchase luxury items with excess income, meant the demand for motorbikes consistently increased over the last few years. The Transportation Police Bureau-Vietnam declared the number of registered motorbikes in the whole country increased by about 12 per cent annually in the period of 1995-1999. By the end of 1999, in the 77-million population there were approximately 20 million bicycles and 5.6 million motorbikes. In the year 2000, total number of motorbikes sold by all motorbike assemblers over the country reached 1.4 million sets. Annual sales of bicycles in recent years is estimated as of from 700.000 to 1 million units (Le Anh Tuan, 2001; Ministry of Industry, 2007).

Vietnamese customers wanted a flexible and easy to use form of transport that was also easily maintained through the access to components. Whilst the high income levels preferred to regularly buy a new bike, the vast majority of the population would make a single purchase which they then focused on repairing themselves or at any local motorbike repair shop (Nguyen Duc Tiep, 2007; Mishima, 2005). To sustain the market for Honda bikes and to establish a dominant competitive advantage, the new Honda project needed to ensure that it not only provided the complete bike, but also provided a constant and readily accessible supply of components for repairing and maintaining all models.

The influx of other brands to compete with Honda meant that this competitive advantage was even more important over time, as many other competing models were made less attractive purchases as the time lag for importing the components and the actual difficulties in obtaining them meant the buyers were reluctant to switch from the reliability of the Honda models (Ministry of Industry, 2007). Mr Do Viet Dung, Deputy Manager, Honda Vietnam said 'The Vietnamese like to get the maximum benefit from their purchases and most anyway, in the early years of our operation were not in a position to make regular purchases of our bikes. Unlike Western economies the access to loans and debt was extremely limited, and for most, impossible. A Honda was often a cash purchase that involved families combining incomes and saving over long periods. To expect them to make regular purchases was not sensible. So Honda gave as much planning to how to support the repair and maintenance aspects of their business in Vietnam as they did to the purchase of the bike itself' (Interview: Do Viet Dung, Honda Vietnam Company, 7 December 2008).

Each family of Vietnam has an average number of 2-3 motorbikes (General Statistics Office, Vietnam). In comparison with other motorbike producers such as VMEP (Taiwan motorbike producer), Suzuki and Yamaha, Honda has some distinct advantages in terms of low prices, more reliability and the quality and the availability of spare parts for repair and maintenance became a central strategy of Honda in Vietnam. Motorbikes were now replacing the bicycle as the mass mode of transport in Vietnam (Ministry of Industry, 2007). This was an ideal opportunity for Honda to expand its market share in the ensuing motorbike market boom (Mishima, 2005).

However, the bike was not to become simply a mode of transport as the Vietnamese quickly adopted it as a symbol of the development of the economy and the indication of someone's status as a 'new modern' individual. Its status became a focus in the arts and culture of Vietnam. Honda has managed to gain a unique level of creditability as the motorbike dominant brand of choice in Vietnam (Ministry of Industry, 2007).

7.3 Marketing of the Honda motorbike in Vietnam

For many years the bicycle was treated as the one of the most valuable assets for families of the working class in Vietnam and its role as an essential item in the budget of all families was widely accepted. With improvement of standards of living of the Vietnamese people, the demand for a more modern mode of transportation increased, but it needed to be suitable to the Vietnamese transportation conditions, with its narrow streets, often very crowded pavements and roads, numerous small ‘on the street’ traders, low incomes and a weak management system for transportation (Mishima, 2005). Within a few years, Honda has been accepted in Vietnamese society as the typical indicator of the rise of mass production, mass consumption and modernity. The Vietnam economy was previously stagnated into a continuance of its agriculturally based existence, with poor access to manufactured goods and a transportation system more suited to a lifestyle of the past (Nguyen Nhu Binh and Haughton, 2002). The movement into a modern and open society based upon rising incomes and consumer demand meant that the industrialisation and modernisation of Vietnam went hand in hand with a change in the culture. Central to that cultural change has been a transformation of the role and acceptability of the motorbike as an essential item in every family’s’ budget. The motorbike has also become the indicator of a person’s status and in an increasingly wealthy society the motorbike is seen as a ‘must have’ product (Kim, 2004).

As a ‘black market’ form of public transport, the motorbike offers a readily available source of income, from the ‘regular’ motorbike taxi service waiting for passengers on every street corner, to the worker transiting to and from work who can also be often found soliciting for casual ‘fares’ from the passersby. As a commercial transport system, the motorbike plays an important role in communications and transport of goods, from the transit of mail to even the carrying of large construction materials. For the farmer it is an essential form of transport to and from the market, with bikes often seen laden down with the carcasses of two or three pigs to the dangerously overloaded multiple cages of chickens (Mishima, 2005; Nguyen Duc Tiep, 2007; Pham Truong Hoang, 2004). The motorbike market is a vast opportunity for FDI and Honda arrived at the perfect time to establish market dominance and coupled their FDI potential with a business acumen that focused on working in partnership with the Vietnamese. The increasing demand means that the number of motorbikes on circulation in 2008 14.3 times greater than 1990 (General Statistics Office, 2008).

7.4 Honda Production Strategy

Honda has changed its normal business architecture in Vietnam by converting the integral-based style to a modular-based one to quickly meet the demand for mass consumption of motorbikes by Vietnamese residents (Mishima, 2005).

Table 7.1: Business Architectures

	Modular manufacturing	Integral manufacturing
Parts interface	Parts are common and can be used for any model	Each product has unique parts, specifically designed
Merits	Quick results and flexibility	Endless pursuit of quality
Demerits	No differentiation, excess entry, low profit, lack of R&D	It takes much energy and time to achieve results
Institutional requirement	Openness, quick decision making, flexible outsourcing	Long-term relations, building internal skills and knowledge

Source: Fujimoto (2005).

By making comparisons between a modular-based style and an integral-based one mentioned in the Table 1, it is possible to say that the modular-based style is the best way for producers to improve their global production network and to flexibly respond to the fast changes in the local market demand for motorbikes, especially in terms of the need for availability of spare parts, their durability, a low price of inputs, particularly with those bikes manufactured in Vietnam and a need for convenience in collecting the spare parts from different suppliers in different countries. This system of production and business was also supported by the integration of the Vietnam operation with the Honda spare parts produced in neighbouring China. The Honda Vietnam Company developed its own guidelines through the proverb 'act locally, think globally' and when Honda Group mainly operated in Japan it established the 'think globally, act locally' strategy as a cornerstone of its internationalization and globalization (Mishima, 2005; Nguyen Duc Tiep, 2007).

7.5 Motorbike prohibition and adaptability of Honda to the Vietnamese business environment

Since 2003, in order to solve the increasingly heavy traffic jams in some major cities in Vietnam, like Hanoi and Ho Chi Minh City, the Vietnam National Assembly passed a decision that stipulated one Vietnamese citizen in the big cities above has only the exclusive right to own just one motorbike (Pham Duy Nghia, 2004; 2006). The decision was based on the argument that via the limitation of the number of motorbikes owned by each citizen, the quantity of motorbikes circulated on the streets would be reduced, therefore, eliminating traffic jams. With the sudden implementation of the decision, ordered by National Assembly, the demand for motorbikes generally and for Honda motorbikes in particular dramatically decreased. In additions, some of Chinese motorbike manufacturers jumped into Vietnamese market, such as Lifan and Loncin. They were intent on seizing a larger portion of the Vietnamese motorbike market, with cheaper models and a concerted marketing campaign. In order to adapt to the disadvantageous changes in policy, Honda shifted the market focus from selling its products in the big cities to expansion of sales in the rural areas. However, the new decision on motorbike ownership has met with almost universal rejection by the citizens; with many feeling it was a direct violation of the property rights of the citizen as regulated in the Vietnamese Constitution.

Although the Honda Vietnam Company has taken a practical approach to how it reacts to the decision, by taking this as an opportunity to expand its market in the remote rural areas, the decision does point to an important part of governmental control of the structural conditions needed to promote safe FDI environments. Virtually overnight, the Government dramatically altered the conditions in which Honda FDI would operate and managed to negatively change the prospects for profitable business (Nguyen Duc Tiep, 2007; Mishima, 2005; Pham Truong Hoang, 2004).

The logic behind this decision is worth closer attention as the impact on FDI development in this and many other industries can be very severely affected. Whilst the Government wanted to encourage the expansion of the motorbike industry and the profitability of FDI in this area, the unforeseen consequences was almost daily traffic chaos in many of the major cities. Rising numbers of fatal casualties in traffic accidents, and increasing complaints from the business community at the regular logjams being created in transport logistics meant the Government felt compelled to find a way to control the expansion of the industry and bring some much needed order to the road systems. The control of the motor vehicle industry was already very much in hand with the imposition of tax rates as high as 100 per cent on imported cars, but motorbike sales were outstripping the ability of local authorities to control the increasing number of riders on the city roads (Nguyen Duc Tiep, 2007).

Left with a choice between supporting FDI growth or what appeared the increase in chaos on the road, the Government chose public safety and order instead of economic development. However, a universal feeling of rejection by citizens of the new rules showed that the purchase and possession of motorbikes was probably beyond the ability of the Government to easily control. It also indicated that a Government decision, although logically taken could have very adverse impacts upon the FDI environment, and may even have discouraged prospective investors in other economic areas to decline opportunities for FDI investment in Vietnam, their decision fuelled by the reality of seeing a government decree adversely affecting overnight the conditions within which that investment would operate (Ministry of Industry, 2007). Koji Onishi, General Director, Honda Vietnam explained 'the decision to limit bike ownership could be seen as a logical and simple answer to the growing problem of traffic in the main urban centres, but it demonstrated the lack of knowledge in the power centres to see the interlinking relationship of political and social decisions on the profitability of the economy. The Assembly had not properly assessed the unforeseen consequences of a decision that had many foreign investors asking if the rhetoric of reform was actually matched by the policies of the Party. The decision met severe criticism and opposition from both the people and the foreign investor (Interview: Koji Onishi, Honda Vietnam Company, 16 November 2008).

The decision on limiting the ownership of motorbikes demonstrated the relative lack of business knowledge of the Assembly and their inability to foresee that this seemingly practical decision could have far wider implications for the economy. As John Clark, Director, Janus Consultancy Hanoi noted, 'at the time we were required by many interested investors from the US and UK to explain why this decision was made. Their immediate appraisal was that it indicated proof of their main fear, that central single party government control meant that in an instant the government could negate all possibility of profitability for an investment. Some investors even decided that Vietnam was not for them, fearing that an investment might suddenly be nationalised, or land allocated overnight taken back by the government, or money transfers stopped' (Interview: John Clark, Janus Consultancy Hanoi, 12 June 2007).

However, popular opposition and to some extent the Vietnam culture came to the rescue. As Mr Pham Van Dung, Deputy Director, Honda Vietnam recalled: 'Yes, Vietnam is a Communist country with single Party central control, but even that is sometimes not enough to control the Vietnamese people. If they generally dislike and do not see the sense of a ruling or new law then they will smile, agree and appear compliant, but then do exactly what they want, and they are experts at 'going around' a rule' (Interview: Pham Van Dung, Honda Vietnam, 25 November 2008).

7.6 State Policy and Honda Vietnam

The policy towards the attraction of foreign direct investment into Vietnam has changed in order to match the achievements of other countries in the region like China and Thailand (Pham Duy Nghia, 2006; Nguyen Ngoc Son, 2008). The two basic pillars of the policy on foreign direct investment in Vietnam are to protect and to encourage the foreign investors. For the first pillar, all of the assets of foreign investors have been strictly protected in Vietnamese territory (Ministry of Industry, 2007; Le Viet Anh, 2004; Dapice, 2003).

The Vietnamese government is committed to never nationalise the assets of the foreign investors and behave towards both domestic and foreign investors on an equal basis (NAV, 2005j). The foreign investors have the right to transfer their lawful capital and assets abroad after completion of all financial rights for the Vietnamese government. Since issuing the Law on Foreign Investment in 1988 to 2008, such a Law has been supplemented and amended several times in 1990, 1992, 1996, 2000 and 2005 (Pham Duy Nghia, 2002; 2003; 2004; 2006). The main direction of these amendments is to create the attractive environment for foreign investors and to enhance the competitiveness of investment environment in Vietnam with the other regional countries. For that to happen there was a need for positive changes in the legal environment, plus the pursuit of entrance into WTO membership of Vietnam on January 11, 2007 (Athukorala and Tran Quang Tien, 2009). The outcome has been that the stock of FDI in Vietnam has increased rapidly and stood at nearly 100 billion USD at the end of 2008 (Magennis, 2006; Nguyen Ngoc Anh and Nguyen Thang, 2007; Athukorala and Tran Quang Tien, 2009).

In contrast to foreign investors from other countries and territories, all Japanese investors in general felt safe investing in Vietnam and the Honda Vietnam Company in particular has enjoyed the rights of asset protection laid down in the Treaty for Vietnam- Japan Investment Protection, Promotion and Freedom, officially approved by both governments in 2003. Besides this, the Vietnam-Japan Co-operation Initiative has also provided Honda the opportunities to expand their market due to a commitment for long term development of both sides. The regulations on protection of intellectual property of foreign investors have been addressed seriously and every effort made to execute it successfully (Nguyen Ngoc Son, 2008; Lee, 2004).

For the second pillar, the foreign investors have been allowed to take many incentives from investment policies for their investment in Vietnam in terms of land clearance, tax refunds and exemptions. The Law on Foreign Investment in Vietnam stipulated the highest level of corporate income tax at 25 per cent and then to increase this to 28 per cent in the following years, in order to harmonise with the tax levied on the domestic enterprises of 30 per cent (Pham Duy Nghia, 2006). However, from 2007, the tax was again decreased to the 25 per cent level (‘Tax reform’ Vietnam News, Dec. 2007). The withholding tax levied on foreign invested enterprises for their profit transfer out of Vietnam to home countries has been reduced from the 7 per cent level to zero. According to the Investment License granted by MPI, the Honda Vietnam Company must pay the corporate income tax at the level of 15 per cent of total profits in 5 years from the date of investment licensing and of 25 per cent in the following years. When transferring the profit abroad, Honda Vietnam Company must pay the withholding tax of 5 per cent of transferred profit. For the amendment of the legal regulation, Honda pays zero for withholding tax (Nguyen Ngoc Son, 2008; Nguyen Ngoc Anh and Nguyen Thang, 2007; Kokko *et.al*, 2003; Chang, 2007).

The foreign investors have been also treated as the same to that of domestic investors in accordance with WTO principles. The corporate income tax stipulated for all investors in Vietnam stood at 28 per cent and then decreased to 25 per cent from 2007. Additionally, Honda can take some advantages from a friendly relationship between Vietnamese and Japanese governments, especially as Japan is the main donor of ODA for Vietnam. In fact, the majority of ODA of Japan provided to Vietnam flows in the improvement of infrastructure for smooth circulation of the transportation and means it thus directly impacts on the future prosperity of Honda motorbikes. The amount of ODA provided by Japanese government flowed into Vietnam gets the new record of more than USD 2 billion by the year 2009 (Vietnamese National Assembly, 2009). The strategic economic partnership built by high-ranking officers of Vietnam and Japan is a politically favorable environment for long- term investment of Honda in Vietnam (Ohno, 2003).

The institutional environment for Honda Vietnam Company has also been surrounded by comprehensive interactions of several supranational Japanese agencies such as JICA, JBIC and other intelligent economic units of the motorbike manufacturers. These agencies become the ‘antennas’ to provide Honda ‘just-in-time’ and all-around sources of information in the motorbike market, thus enabling Honda to remain ahead of the competition. Therefore, Honda can understand and respond promptly to the fast changes of demand for Honda motorbikes to Vietnamese customers. For example, JICA has established a permanent branch in Vietnam that attracts many young and talented researchers of Vietnam and Japan and has led to significant cooperative bi-lateral research outcomes. The focus of the research has paid much attention to the macroeconomic issues and the policy options for the motorbike industry and for the manufacturing industry in general in Vietnam (Nguyen Duc Tiep, 2007; Pham Truong Hoang, 2004).

This methodology has also been supported by the regular organising of scientific seminars in the VDF, JICA and has helped achieve targets for growth in both FDI and the motorbike industry in particular. On the one hand, JICA has fully mobilised all research capacity of both Vietnamese and Japanese researchers, especially the young and elite researchers of Vietnam, to settle the critical issues in Vietnamese policies; JICA also helps understand in detail the important information and the relationships between state bodies and business world in Vietnam, not only for policy building but also for future decision making of Japanese- related enterprises. All companies of Japan, including Honda, have ideal opportunities to take advantage of utilization of all sources of information from JICA and other Japanese investors in Vietnam to offer the best solutions for each specific investment case (Onho, 2003; Nguyen Duc Tiep, 2007; Lee, 2004).

The representative branch of the mass media of Japan in Vietnam - Kyodo Broadcasting Company always maintains close attention to changes of policies of the Vietnamese government that may have a major influence on the operations of Honda-Vietnam. Negative changes in the policies that impact on Japanese investors are immediately transmitted to the investors. Equally important is the transmitting back to the Vietnam Government and public the adverse reactions of the foreign investor to changes in policies and the ability to exert some degree of foreign business and governmental pressure on the Vietnamese is an important mechanism for regulating change and avoiding negative options (Onho, 2003; Lee, 2004).

An example of this is the case involving the decision by the Vietnamese government to levy a restricted import quota on CKD components for assembling motorbikes. The actual consequences of the decision would have been the need for the motorbike companies to lay off hundreds of Vietnamese employees. A general public and investor protest against this decision meant that the Vietnamese government was forced to withdraw its original quota restrictions. This reaction deserves closer attention as is indicates the presence of a wholly new force of influence on Vietnamese government decision-making. For many years following the Vietnam (American) War the Government enjoyed an uncontested dominance over decision-making. Its central control and absolute authority meant all decisions were often adopted without question or protest. But the open door policy means that while the economy can develop, its progress is also dependent on the Government system allowing it to be sensitive to adverse or contrary reaction to its own authority. In the case of the quota decision, that sensitivity had to extend to foreign actors, whose interest in Vietnam was focused on investment returns and were demanding a reversal of a decision, that in former years would have been adopted and applied nationally without question. However, the reversal also demonstrated the degree to which the Government was willing to pay attention to both public and international reaction and the willingness on their part to reverse decisions that were not in their interests of all parties involved. Its success in adopting a more friendly and cooperative attitude to the needs of FDI investors demonstrated the leap forward in openness that *Doi Moi* has achieved (Chang, 2007).

In parallel, Honda has worked together with other motorbike manufacturers in Vietnam such as Suzuki and VMEP to send recommendations to the Vietnamese government about the policy adjustment and the prevention of barriers to the development of the motorbike industry in Vietnam. This demonstrating how the FDI investors themselves can work together to actually affect the Governmental decision-making process in the first instance, and avoid later mistakes (Nguyen Duc Tiep, 2007). As Mr Asako Suzuki, 2nd Deputy General, Honda Vietnam said, the decision on *Doi Moi* could not just simply be a law change that attracted investment. The policy change required a change also in the 'style' of the Party and its governance of Vietnam. Honda actively encouraged this by trying to provide pressure politically in a sensitive but informed manner. By co-operating with the government and helping to explain the full consequences of any decision or ruling, or by indicating the level of adverse reaction to a decision already made, Honda could safeguard its investment without becoming oppositional to the Party and Government' (Interview: Asako Suzuki, Honda Vietnam, 10 November 2008).

In order to develop the domestic motorbike industry, the Vietnamese government has implemented a 'localisation policy' that focuses on developing a domestic spare parts operation that will allow Vietnam to move away from a reliance on foreign imports The types of the spare parts of motorbike have been categorised into 3 main groups and the standards of quality have been adopted from similar countries like Thailand, Malaysia and etc. Spare parts are classified as Semi-Knocked Down (SKD), Completely Knocked Down (CKD) and Incomplete Knocked Down (IKD) and in connection with this classification the rules on the 'local content' requirement have been coordinated with the regulations on import duty levies. The types of components such as SKD, CKD and IKD are commonly used in Vietnam, and the aim has been to introduce a modular architecture in motorbike assembly in Vietnam. The greater the proportion of the local content used, the lower the import duties levied on the spare parts of motorbike. In other words, the local content requirement has been one of the most important criteria to enjoy preferential treatment from the government (Nguyen Duc Tiep, 2007).

This policy, although obviously favouring the development of a domestic motorbike assembly industry and not the interests of the foreign investor, has been the very foundation of the success for the Vietnamese motorbike industry and opened numerous opportunities to develop the supporting industries, as well as creating many more jobs for Vietnamese employees. Furthermore, many endowed resources of Vietnam like plentiful labour force and a variety of natural resources have been effectively exploited to serve the course of industrialisation and modernisation. By doing this way, Vietnamese policy makers expected to establish a cluster of motorbike manufacturers in Vietnam and eventually to widen its potential as not only serving the domestic market, but developing a strong export business in motorbike sales. Unfortunately, the localization strategy of Vietnamese government has not been totally successful and after nearly 12 years of encouragement to create the domestic motorbike production premises problems still remain. Consequently, in light of the need to avoid protectionist elements in FDI policies, the compulsory regulations upon local content requirement set by Vietnamese Government on foreign invested motorbike manufacturers have been eliminated under the strict commitments of Vietnam in TRIMs of WTO since January 11, 2007 (Nguyen Duc Tiep, 2007; Kokko *et. al.*, 2003; Onho, 2003).

To respond to the localization policy, Honda organised a network of production of spare parts into 6 plant branches in Vietnam. These 6 plant branches have utilised the domestic materials to produce the simple parts like steel baskets, plastic covers, rubber parts, etc. By nature, the local content requirement made in Vietnam has been mainly provided by Japanese producers other than Vietnamese producers. Some of the components of Honda that are produced in Vietnam have a cheap price and serve the localization of Honda to attain the preferential treatment from the Vietnamese Government. The solution to effectively responding to pressure of localization is the application of a modular manufacturing architecture as mentioned above. Other foreign motorbike companies also have done the same way as Honda. As result, in only in 4 years from the date of establishment the percentage of localization of Honda motorbike achieved stands at 45 per cent and meanwhile Suzuki is 36 per cent, VMEP 50 per cent and GMN 31 per cent (Ministry of Industry, 2003).

7.6.1 Substitutes and sliding maturity

The Honda motorbike is facing increasing competition from several firms. The strongest competition for Honda is from Suzuki, Yamaha, Spring, VMEP, Daelim, Sunfat, Loncin, Lifan. By skillful techniques of product differentiation, competitive price setting, sharp advertising campaigns and imitation of the trademark of Honda, competitors are challenging Honda as the motorbike of first choice. There is also a growing import of motorbikes from new manufacturers in Thailand, Japan and China. In the face of multiple choices of motorbike in the market, the density of demand for Honda motorbike seems to be weakening (Nguyen Duc Tiep, 2007).

A further change in the market is due to the changing society of Vietnam. Whilst generally shifting from an agricultural economy towards an industrial one, the number of people in the high income bracket is increasing and the demand for motorbikes from this sector is switching to cars. Here we can see that the development of FDI, its ‘spillover’ in the economy and the general assistance to economic growth that it has given, is interlinked with the changing financial status of the Vietnam population. Whilst supply has been expanded and improved through FDI, the demands and thus the profitability of investment have been continually improving in the domestic market. This has given FDI investors a double benefit, in that investment has seen now able to access both profitable domestic and foreign markets (Nguyen Ngoc Son, 2008).

Mr Satoshi Toshida, Senior Managing Director and Chief Operating Officer, Asian-Oceania Region declared in his speech on the occasion of the 10th Anniversary of Honda Vietnam in 2006: 'Honda are committed to a long-term partnership with the people and nation of Vietnam' (Toshida, 2006).

A remarkable growth in people replacing their bikes with cars is dramatically altering the shape and value of the transport market. Despite the high cost of living and unusually dense traffic jams, high import duties on cars and a poorly regulated road system, and an only newly developing transport infrastructure that at rush hours in the narrow streets makes large vehicle movement almost impossible, and leads to heavy violation of traffic rules, the vehicle of first choice is becoming the car, rather than the motorbike (Nguyen Duc Tiep, 2007).

Honda has 'just-in-time' supplied the Civic car model as its own alternative to the motorbike, hoping in the process to retain Honda customers, even when they have chosen to no longer own a motorbike.

As a consequence of the growing traffic problems the demand for better public transport is promoted by the government and demanded by many of the citizens. The city and inter-city network of public transportation modes such as that of the bus service and taxi has been improved in term of providing a very low cost, convenience and time saving for the passengers that compete directly with motorbikes. In additions, the traffic regulations on environmental pollution control, as mentioned above, have been slowly coming into effect and intend eliminating many of the environmental problems of exhaust fumes. The regulations themselves are designed to generally force a decline in motorbike demand and encourage a greater movement towards using public transport All of these factors lead to the sliding maturity of Honda motorbike in the near future in Vietnam. The technology of motorbike manufacturing, in fact, has been out of date for some time in developed countries and the motorbike (especially the motorbikes of high capacity) have become prime sources of environmental concern. However, the profits in motorbike sales still continue to be impressive, even with the decline in individual sales prices. However, the concerns for this movement are mitigated by the feeling that Vietnam's motorbike production industry is ready and able in profit and quality terms to further enter the export market (Nguyen Duc Tiep, 2007; Ohno, 2003; Ministry of Industry, 2007). For example, Mr Trinh Quang Dung, 1st Deputy General Director, Honda-Vietnam notes 'the production quality and efficiency makes the development of a Honda export operation a profitable outcome of our investment into Vietnam. With growing neighbouring markets such as Laos and Cambodia, the potential for still further expansion of our venture into Vietnam may not be too adversely affected by the shrinking of the domestic market here' (Interview: Trinh Quang Dung, 19 August, 2008)

7.7 Distribution network and Vietnamese selling style

To accelerate the selling of Honda products in the highly competitive market of motorbikes in Vietnam, the aim has been for Honda to use its long term accumulated experience of business in Vietnam as a foundation for development. It has adopted its globalization strategy to the demands of the Vietnamese market. Honda Vietnam Company has based its corporate identity on the guideline of being 'the most convenient service for customers' and it has also taken this as the guiding tenet of its distribution network. Firstly, Honda has created a huge network of distribution in almost every populated area of Vietnam. At present, there are over 300 selling agents of Honda in Vietnam and these points of selling are connected with many stores that sell a variety of other types of motorbikes.

The distribution system has been designed into different levels. Honda Motorbikes after production will be delivered to the network of dealers with the unified price in the nationwide level. These dealers have been operating under the management of selling direct from Honda and they have the exclusive selling power in terms of distribution, discount rate pricing to intermediate and final buyers. Besides, they also have offered the best maintenance and repair services to the customers at the lowest price. The discount rate applied to each dealer is very flexible and set at the level of 10 per cent of the selling price of unit. The price level used for buyers, however, has been stipulated in certain bands by Honda headquarters in Vietnam. The buyers can bargain with the salesman in the selling point to have the appropriate price.

The Vietnamese buyers are accustomed to the bargaining style and to greater extent they are more interested in purchasing after a series of bargaining rounds with the seller. However, the negative aspect of the distribution network is that it is widely dispersed and only lightly controlled, making it possible for sellers to substitute 'official' components for lower quality 'fakes' and create a situation where Honda quality is compromised by defective fakes, leaving Honda with the negative impact on its reputation and the customer with a false idea on the quality of Honda products (Ministry of Industry, 2007; Nguyen Duc Tiep, 2007; Lee, 2004).

Most Vietnamese motorbike consumers pay attention to not only buying the right motorbike but also to the availability of spare parts to repair the broken motorbikes. Vietnam with the complicated terrain and tropical climate is generally not suitable to continued use of motorbikes and all realise that readily available spare parts are an absolute necessity. Secondly, Honda Company has introduced an installment payment scheme for selling its bikes to low - income consumers. Such a way of distribution has also helped Honda to also solve its inventory stock problems and reduce the costs of inventory fees (Nguyen Duc Tiep, 2007).

Thirdly, Honda has systematically organised a major national advertisement campaign with the title ‘I Love Vietnam’ on the one of the main official Vietnamese Television channels and in support of the movement ‘week and month for nationwide safety transportation’ promoted by the Vietnamese government. The campaign has achieved a good involvement of many Vietnamese people, and that fact can be considered as the direct success of local responsiveness to Honda being in the Vietnamese market.

Fourthly, Honda has a number of assistance funds for charity activities and philanthropic movements for the poor.

Fifthly, in the favor of the compulsory regulation on wearing helmet when riding motorbikes in Vietnam set by Vietnamese government, Honda promptly launched the program of helmet ‘gifts’ for Honda motorbike buyers. Additionally, Honda has offered ‘the package of administrative services’ (including help in gaining the motorbike certificate and making tax payments for motorbike ‘consumption’ which amounts to a fee of about USD15 per unit). Moreover, Honda also granted scholarships to many students of universities in Vietnam, such as the Hanoi University of Technology, and funded campaigns such as the ‘Voluntary Summer’ work project undertaken by the Students’ Union of the Vietnam National Economics University (Nguyen Duc Tiep, 2007).

In parallel, Honda has organised a global journey for the famous robot, Asima, the most well-known invention of Honda. By using socially-based programmes, Honda Vietnam Company took up their advertisement activities in the most appropriate way to respond to the restrictive regulations on advertisement fees, which allows companies to spend only 8 per cent of total revenue on advertising and is set by the Vietnamese government. Clearly, in the competitive market, the effort to advertise the image of business plays a very important role for maintaining and expanding the influence of the business.

In the economic and financial situation of the year 2008, Honda differed from other motorbike manufacturers facing the drop in volume sales, as well as some of them standing on the edge of bankruptcy. Honda Vietnam Company has gained the loyalty and respect of Vietnamese customers and a good reputation for its own locally produced Honda brand. Despite a down turn in the financial markets and stiff competition in the transport market in Vietnam, Honda remains the brand of choice for most Vietnamese bike owners.

The important factors to note here are that Honda did not merely enter the Vietnam market with a set strategy. Their style was one that involved a high level of cooperation with the Vietnamese partners, a willingness to listen and act on their advice and a sensitivity to how things should 'be done differently' in Vietnam. This is an essential determinant of the success of FDI in Vietnam in that the investor needs to be adaptable and cooperative, with a strong incentive to alter strategy and policies to suit the domestic environment. Honda has found it profitable to be flexible and also willing to venture into a multitude of areas as active partners, such as cooperating with the local community, contributing towards education and training and supporting the cultural and social life of Vietnam, rather than trying to resist or change it (Lee, 2004).

According to Koji Onishi, General Director of Honda Vietnam, 'the country's biggest motorbike manufacturer Motorbike makers have been battered by a weak economy, rising petrol prices and the ailing Vietnamese dong to US dollar rate, which depleted the market for motorbikes. Most of motorbike retailers reported their worst sales ever, with sales volume reduced by 50 per cent compared to the same period last year. Retailers in Hanoi have experienced a 70 per cent sales drop in the last several weeks. This time last year, Honda sold an average of at least 300 units per month, which is now down to 100 units, even after considerable discount for some models (Koji Onishi, Honda Vietnam Company, 16 November 2008).

According to vice chairman of Vietnam Motorbike and Bicycles Association Le Anh Tuan, the number of motorbike manufacturers in Vietnam has reduced to 10 from over 30 two years ago. While most of the motorbike makers have not reported their overall sales in 2008, Honda Vietnam reported it has sold 1.25 million motorbikes this year, an increase of 9 per cent over 2007, accounting for some 75 per cent of the market share (Interview: Le Anh Tuan, Vietnam Motorbike and Bicycles Association, 3 August 2008)

7.7.1 Intellectual property protection

The protection of intellectual property is vital to sustaining the loyalty of FDI investors (Wu, 2001a). The legal enforcement on protection of intellectual property right in Vietnam has not been serious enough to eliminate all of the violation actions against the intellectual property. The situation of violation of the intellectual property right becomes a critical issue for both policy makers and for business world in Vietnam (Vietnam Department of Intellectual Property).

For Honda Vietnam Company, up to the year 2008, about 80 trademarks and 64 industrial designs of Honda Vietnam Company have been protected in Vietnam. (Department of Industrial Properties, 2008) However, for the complicated and hidden actions of the violation against the industrial property right in Vietnam, especially the violators who produce off- brand components, Honda has required the authorised agencies to protect Honda, not only for the entire industrial design of motorbike but also for each specific important component of each motorbike. Many *ad hoc* inter-ministerial delegations of inspectors in charge of industrial property have been established to carry out the monitoring and evaluation activities investigating the violations by individuals and other entities against Honda trademarks. Additionally, several agencies related to industrial intellectual property rights in Vietnam, such as the Economic Police Force, trade ombudsman and the courts have been mobilised to help protect the intellectual property rights of Honda industrial designs in Vietnam (Vietnam Intellectual Property Department).

For protection of trademark, Honda has registered a number of trademarks with the Department of Industrial Properties of Vietnam; not only the trademarks of motorbike but also the trademarks for HEADs of Honda are registered. However, in the Vietnam business environment, registering the objectives of industrial properties is still the necessary condition for protecting them and enforcing the regulations on them is sufficient (Nguyen Duc Tiep, 2007; Pham Truong Hoang, 2004).

Some administrative solutions like administrative sanctions against the violations have been applied to the entities copying Honda industrial designs. To a greater extent, Honda has also utilised the Forum of the Vietnam- Japan Cooperation Initiative to deliver its opinions to high-ranking officers on the violations of its industrial designs by other businesses and individuals in Vietnam, with the hope to galvanise the authorised agencies to protect Honda from these illegal actions. Such an issue, on the one hand, does have a positive impact for the value of Honda in Vietnamese market, because day by day, Honda remains firmly in the public eye. Nevertheless it also delivers a negative message in that the public are aware of the high rates of profitability of Honda motorbikes and their components, and the ability of copyright violators to make them far cheaper. Despite this, the legal framework controlling property rights protection in Vietnam has not been enough sufficiently improved to guarantee against further violations and the ability of criminal elements to produce and sell copies of Honda motorbikes and parts remains a serious threat to the company's profitability in Vietnam (Ministry of Industry, 2007, p.20-30). As Mr Satoshi Toshida said, 'the question of property rights and the protection of brands is a vital concern in Vietnam, not only for Honda but also for all existing and potential investors unless companies feel safe bring their technology, production techniques, software, etc into Vietnam then they will choose alternative markets where they do feel protected. Fortunately the Party and the Government appear aware of this and are making concerted efforts to deal with the problem. But the main problem here is that it is not enough to have the rules and sanctions against violations, the investor must feel confident that the enforcement procedures are as equally efficient and stringent' (Interview: Satoshi Toshida, Honda Vietnam Company, 17 April 2008).

7.7.2 Financial issues

Honda Vietnam Company continuously improves its financial performance in different aspects. The annual revenue of Honda Vietnam Company increased rapidly from the year 1997 to the year 2008 (See Table 7.2). In 1997, the revenue of Honda Vietnam Company stood at 4.5 million USD but in 2008, the revenue of Honda gained 1,398 million USD. The revenue of Honda Vietnam Company in 2008 is greater than that in 1997 by about 300 times. It is a new record in the motorbike market in Vietnam (Honda Vietnam Company (2008).

Table 7.2: The annual revenue of Honda Vietnam Company in the period 1997-2008

Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008*
Revenue	4.5	158	169	277	250	304	358	455	568	734	1,151	1,398

Unit: Mil. USD

Source: Honda Vietnam Company, 2008 (2008* preliminary)

According to the tax payments including domestic tax and import duty, Honda Vietnam Company has paid tax amounting to 14 million USD and the accumulated tax payments from 1996 to 2008 reached to about 57 million USD. Honda Vietnam Company has been one of the enterprises that have made the largest tax contributions to the Vietnamese state budget. In Vinh Phuc province of Vietnam, Honda Vietnam Company became the top enterprise in term of tax payments to the Provincial budget. This was officially recognised when Honda were presented with the 'Award of Gold Star of the Vietnamese Land' organised annually by the Association of Vietnamese Enterprises (Honda Financial Report, 2008).

In terms of the change and adjustment of the capital investment to respond to the market boom in motorbikes, Honda Vietnam Company has needed to annually increase the capital investment needed to take full advantage of the opportunities presented by the rapid market expansion for motorbikes. In 1996, Honda began to contribute more capital to the 'total invested capital' of the joint venture. In 2002, Honda increased its capital to become the largest motorbike investor in Vietnam and in line with that fact the scope of influence of Honda over Vietnamese market also increased. Honda chiefly financed its capital injections by making contributions from its retained profits after tax (Nguyen Duc Tiep, 2006; 2007).

Honda also has also enjoyed the significantly preferential treatments granted by Vietnamese government in term of tax reduction and refunds. This is an important financial source for Honda, and the preferential treatment has acted as a form of subsidization of the Honda operation through government incentives. However, the financially preferential treatments must be minimised now under the international commitments made by Vietnam in the WTO framework. The Government has long used the preferential treatment it could award to foreign companies through tax reductions, limited land fees, etc, as a means to attract and retain FDI. Under the conditions of WTO membership, many of these preferential incentives may need to be eliminated, and alternative forms of attraction of FDI be looked at. For the future of companies in Vietnam, like Honda, the changing economic environment brought about by WTO membership may mean that they are encouraged to re-evaluate the benefits of placing production in Vietnam, and could even lead to establishment of production activities in neighboring countries that are not constrained by commitments made under WTO membership (Onho, 2003; Lee, 2004; Athukorala and Tran Quang Tien, 2009).

7.8 Honda Management

Honda lowered their governance costs by transference of their organisational culture that socialised and acculturated the Honda-Vietnam employees to the international standards and modes of management of Honda-Japan (Dunning and Bansal, 1997, p.8). The goal here was to limit the internal costs of administration and management through efficiency improvements by transference of Honda-Japan systems, structure and knowledge, yet, adapt these to the host country and gradually empower Vietnam employees to take independent control of the processes of production and management, but remain true to the operating principles and general style of the Honda Company, creating an international organisational management framework with a localised style.

In examining Honda-Vietnam staff management strategies and their contribution to the success of Honda we can return to Hofstede and Bond's (1988) five dimensions and see a vital change in how Honda operated in comparison to local competitors and its own domestic style in Japan. Japanese companies are renowned for how disciplined and structured their workforces are. In Vietnam, although the superficial impression of the workforce is one of strict discipline and a 'Confucian' based demand for loyalty and obedience to the employer, a deeper analysis shows that rather than rigid rules and hierarchy, the Vietnamese workers are actually more flexible and ad-hoc, which creates room for 'improvisation and negotiation' (Barkema and Vermeulen (1997). Vietnam's identity as a 'communist' country adds to the impression that alongside the Confucian based values of obedience, all Vietnam workers will react positively to an expectation they will work to a high standard purely as a result of their 'duty' to the employer. However, Honda-Japan worked with the local partner to establish various levels of incentives and rewards for workers improved efforts. As one employee noted 'At Honda I get an award for reaching targets and a bonus for exceeding them. The harder I work the more opportunities I get for promotion. In jobs before I never got recognition. That is the way with Vietnam employers'.

To exploit the advantages of the low labour cost and plentiful supply of Vietnamese workers, Honda has recruited large numbers of Vietnam employees and trained them to operate an entire assembly line for motorbikes (Nguyen Duc Tiep, 2007). According to 'The Annual Report of Honda', the total number of employees in Honda Vietnam Company is 5,057 in the year 2008.

To keep the qualified personnel to work for Honda Vietnam Company, the performance- pay system has been applied to. The high profitability of Vietnamese Honda Company is the most critical factor for Honda to keep and to develop the key personnel in the strongly competitive market of labour in Vietnam by increasing their wage step by step. The average monthly salary of employees in Honda Vietnam Company is about USD200 and that of the managers is USD 3000 plus.

To have the high capacity in human resources, Honda has provided the training service for employees and managers in the form of short- training courses or by the way of a process of 'learning by doing'. Many Honda experts from their Headquarters have been sent to Vietnam to train the assembly skills of Vietnamese employees. In fact, Vietnamese employees are often endowed with good technical skills and are able to quickly learn the necessary assembly skills and this is also aided by the relatively simple production methods used by Honda. Vietnamese workers were able to become skilled substitutes for the Japanese experts, and become strategically valuable assets for successful performance of the Honda motorbike assembly line in Vietnamese market. Although quickly achieving the same levels of expertise as their Japanese counterparts, the Vietnamese worker still commanded only a fraction of the Japanese workers wage, ensuring that the Honda Company could still produce to the same high quality, but at a far lower cost ratio. The compensation within Honda Company has been structured in accordance with the grade level of the job (Nguyen Duc Tiep, 2007).

To maintain the sound position of a major market share and to increase the high rate of profitability of Honda Vietnam Company, the incomes of both managers and employees have been kept stable, although always also focused on a steady rise that encouraged employee loyalty, but helped maintain a profitable operation. The working conditions are built on a theme of 'trust' and aimed at encouraging long-term commitment to the Honda by all managers and workers within Honda. All of the labour regulations are in accordance with Vietnamese Labour Code and Honda has an impressive record of strictly following national legislation on employee protection. The Trade Union has been established to protect the rights of employees in Honda and all employees have signed full labour contracts with the employers and the employers are diligent in paying the necessary social insurance. The Honda Vietnam Company has team work spirit and good labour principles. So far, there have not been any major strikes and any long layoffs have not occurred in Honda plants (Nguyen Duc Tiep, 2007).

The issue of pay and working conditions in Vietnam needs careful analysis as it is a vital aspect of maintaining the profitability of FDI ventures. Foreign investors establishing ventures in Vietnam should understand that the pay and working conditions of some Vietnamese employees is a highly controversial issue, and that although there is strict legislation on how workers should be treated, its actual effective regulation can often be questioned. Non-payment of wages, the failure to provide adequate social welfare schemes, dangerous or unhealthy working conditions, lack of training and promotion through nepotism or familial connections rather than on merit are all issues that often make Vietnam employees lack of commitment to companies a serious concern. This is further aggravated by the Vietnamese fascination with the credibility of 'rumours' than the actual fact and many Vietnamese workers loyalty and efforts are negatively affected by stories of employer bad practices. With the almost generic lack of official enforcement of worker regulations, unofficial strikes and worker apathy in the workplace can become a serious concern that eventually affects the running costs of a business venture. On the other hand, a company such as Honda, that rests its reputation on providing extremely good levels of pay and working conditions can find it soon possessing a vital competitive advantage.

The attraction is not confined just to its own workers and the skilled personnel from its competitors can soon find themselves valuable employees of Honda (Ministry of Industry, 2007; Nguyen Duc Tiep, 2007; Lee, 2004).

Honda also has a good record on following regulations on environmental protection. All of the waste products of Honda Vietnam Company are generated from the industrial production and assembly lines and Honda has ensured that they have been carefully filtered before entering the environment. The communes surrounding Honda Vietnam Company particularly and customers generally are pleased with the presence of Honda Vietnam Company and by its high standards of care, not only for the workers, but for the local community and the environment in general. Honda has concentrated not only on building its reputation as the provider of high quality motorbikes cat a competitive price, but also on winning accolades as a good employer, a trusted and benevolent member of the local community and a benefit to the Vietnam society as a whole. It is Honda's reputation and focus on social responsibility that has helped win the loyalty and trust of its customers. Honda has aimed at positively positioning itself into the Vietnam culture and society, and been rewarded by achieving a brand loyalty not matched by any of its competitors (Ministry of Industry, 2007).

7.8.1 Honda Vietnam's Corporate Culture

The management apparatus of Honda Vietnam Company has been organised according to the regulations of Vietnamese legal framework. The Board of Management is the highest level of power in the management system of Honda. The most important working principle of the Board of Management is consensus. The lower level of management is the Executive Section, which is responsible for tactic and daily running activities. The different departments under the CEO are the product and technology, purchasing, marketing, human resource, financial and accounting sections. The lowest level is the production and assembly lines with not so many direct workers. In a working shift (8 hours of assembly line construction), nearly 600 motorbikes are assembled per day. Full automation is utilised on the assembly lines, and this increases productivity and efficiency. The internal information network of Honda has been organised in a professional manner that ensures constant two-way communication. The overall system of operating in Vietnam is effective at moving some distance from the traditional hierarchical Japanese management style, and establishing a corporate culture suited to the Vietnamese style of working. The system of values of Honda is very comprehensive and can be expressed in different dimensions. They convey the sense of development of loyalty, trust building and respect for rules and regulations. These values create the Honda cultural identity and the core competencies to strongly develop under the threat of strong competition and the accelerated globalization of Vietnam (Nguyen Duc Tiep, 2007; Mishima, 2005; Pham Truong Hoang, 2004).

A number of FDI joint ventures in Vietnam have suffered from a record of conflict between personnel, but the conciliatory and consensual style of the Board of Management of Honda Vietnam Company has helped reduce conflict to the minimum. Honda's style has been strictly regulated to abide by the very letter of Vietnamese Law on Investment and helped further its reputation as a perfect FDI investor in Vietnam. This may be explained to some extent by the many corporate cultural similarities between Japan and Vietnam, with both rooted firmly in the Eastern culture and still affected to some extent by a Confucius type philosophy (Nguyen Duc Tiep, 2007).

7.9 Recommendations and Conclusion

Honda Vietnam Company has undertaken a successful local responsiveness strategy in Vietnam in several dimensions. The main philosophy of Honda Vietnam Company in Vietnam is to serve the customers to the best possible degree and that has proved the right choice in Vietnam. To respond to each problem that arises in the changeable business environment in the transitional period of becoming WTO member, Honda tries to look for the most appropriate way to solve issues in a calm and conciliatory atmosphere.

The Vietnamese people have become familiar and loyal to the Honda brand and this has led to a highly profitable and durable venture for Japanese FDI in Vietnam. Honda Motorbike Company in Vietnam has become an essential part of the life for the majority of Vietnamese people, and provided them with the perfect complement to the fast moving lifestyle of a modern industrializing economy. The demand for a quick and easy form of transport that is of high quality and at an affordable price has allowed Honda to situate itself at the very pinnacle of the market and create a unique position in the market that competitors will find extremely difficult to challenge (Ministry of Industry, 2007).

The Vietnamese market is one of the most rewarding places for Vietnamese Honda Company to invest capital, technology and management expertise. There remain further opportunities to expand its market share and to improve its competitiveness (Ministry of Industry, 2007). The philosophy of Honda Vietnam Company is 'converting the dream into the power of going ahead'. This is a special kind of invisible asset that differentiates Honda from other motorbike companies.

In building scenarios for growth of Honda Vietnam Company in Vietnam in the financial crisis and attempting to go further in Vietnamese market, Honda has three options for its annual growth rate of revenue in the next period: low, medium and high with the rate of 5, 15 and 25 per cent respectively. From the optimistic point of view, Honda can achieve the high annual growth rate of 25 per cent of revenue for next five years because the potential for the motorbike market is still huge in Vietnam, although there is the highly competitive density from other modes of transportation and competitors.

The Vietnamese policy toward FDI attraction has offered many preferential treatments for foreign investors entering the market and these have become strong motivations for foreign investors, including Honda Company, to move huge amounts of assets into Vietnam. Under the pressures of WTO commitments, this policy has some contradictions to international rules and customs, and the former incentives to invest now need to be re-designed. Some barriers to foreign investment in Vietnam such as the regulations on local content requirements of motorbike assembly and others in line with TRIMs have had to be removed. This is a new favorable condition for Honda Vietnam Company and has opened up new opportunities for the further long-term operation of Honda in Vietnam. Clearly, both Vietnamese policy and Honda Vietnam Company have found mutually beneficial rewards to cooperation.

In the more competitive market of motorbikes in Vietnam, and under the strong pressures of international commitments of WTO and the pressure of the global financial crisis , and to continue to be successful over the long term, Honda should take into consideration the following issues:

* The need for diversification of the range of products to meet the diversified demands of the motorbike in Vietnam, whilst also taking advantage of the low labour cost and policy preferences of bilateral trade and investment of both countries.

- Applying the appropriate strategy to reduce the price of motorbike to make longer the product life cycle of the motorbike.
- Developing new products, especially in the luxury class, as the growing demand for cars and the increase in prosperity means more people now looking not only for high quality, but also for comfort and opulence regardless of price. The main mass of the people wanted easily affordable and effective forms of personal transport. But the new developing Vietnam has a growing middle and higher income class that look for the expensive and extravagant symbols of wealth that indicate their new standing in the economic hierarchy, and Honda need to

address this demand by also providing the luxury bike options found in many of the showrooms of Western competitors.

- Taking effective advantage of the strategic co-operation relationships at the governmental level between Vietnam and Japan and to continue to build these as a framework for Honda Vietnam Company in terms of protection of its market share and its reputation in Vietnam.
- Developing the flexible strategy of local responsiveness to react to the fast changes of the business environment of Vietnam in several aspects such as the quality, price and after- sale services. The sophisticated terrain and weak infrastructure of Vietnam require good quality motorbikes. The low income of majority of Vietnamese residents sets the demand for motorbikes assembled in Vietnam at as low a price as possible. The bad and unsystematic after-sales services for a long time offered by small and medium sized enterprises of Vietnam, cannot fully meet the high demand for improvements of the service. Honda has a lot of advantages and has used these to accumulate a large amount of experience on providing a good after-sales service and the Vietnamese motorbike user is beginning to pay as much attention to this as they always did to price and quality.
- They need to keep close attention to the evolution of change in the business strategies of their competitors in the motorbike market, and to promptly launch the appropriate strategies to meet changes in the market in the context of deeper international integration. Therefore, a better economic intelligence unit responsible for monitoring the market for Honda motorbikes should be established, and used to gather and analyse all necessary information needed to support a strategy of expansion of Honda in Vietnam. Additionally, there is a need to focus on production activities in order to produce comprehensive solutions for Honda in terms of the designs, technical qualifications, price and the environmental protections.
- Honda needs to be willing to carefully learn from both the successes and failures of other motorbike producers in Vietnam in order to prepare the way for the next phases of development in the Vietnamese market. The most important lesson in Vietnamese market for all businessmen who want to be successful in the market is to build the sound base of customers and Honda is not an exception. Perhaps, the simple philosophy 'think globally, act locally' should continue to be the basic guideline for Honda in Vietnam. Honda has not only showed a deep understanding of Vietnam and demonstrated its affection and social responsibility towards the culture and people, it has also created a highly profitable FDI venture that has been supported through the growing mutual affection of the Vietnamese towards Honda.

However, we cannot examine Honda and its impact on FDI without also considering the general interaction between the whole motorcycle industry, the government and FDI.

In 2007 the Government issued a report on the motorcycle industry that clearly stated the ideological approach of the Party to economic development. The report Nam *et.al*, (2007), declared that:

In an increasingly integrated market with a large presence of foreign producers, such as the motorcycle market in Vietnam, the basic role of the government should be to *support the healthy growth of the industry* by understanding and responding to its needs instead of dictating it. Private business enterprises are the primary decision-makers and executors of industrial dynamism, but the government also has an important role of providing supportive visions, rules and measures to ensure that the industrial playground is predictable, fair, and in line with the general interest of the nation (Ministry of Industry, 2007).

A central aspect of the hypothesis of this thesis is that the Government has following an increasingly free market policy towards FDI, despite the country being politically identified as communist. The above Ministry of Industry statement shows that Vietnam is making government policy a direct positive determinant of FDI, rather than an ideologically based barrier. The subsequent policymaking decisions are focused on supporting the general economic principles of industry being the decision-maker and government facilitating the right environment for profitable business. For example, the following are the government action plans for the future of the motorcycle industry:

- **Target 1**: A new mechanism should be set up in Vietnam to coordinate demand and supply of foreign expert dispatch services.
- **Target 2**: Establish a mechanism to receive retired Japanese managers and engineers with high skills in manufacturing to level up Vietnamese factories (this may coincide with the mechanism mentioned in Target 2-1 above).

One measure is strategic FDI marketing in order to strengthen supporting industries. Draw up and effectively implement a strategy to absorb narrowly targeted foreign enterprises to strengthen Vietnam's supporting industry base. The strategy should include improvements in procedure, focused vision and targets, better FDI marketing and production-related infrastructure and services.

Thus, there is a clear indication through examination of the case of Honda and the motorcycle industry in Vietnam that a major positive determinant is the overall transformation of how the Government manages economic policy in contemporary Vietnam. The chapter also shows that the FDI investor should seek maximum capital return on their investment by taking into account and adjusting their strategic management strategy to take in account the impact of culture in Vietnam upon foreign enterprises. Dunning and Bansal, 1997), encouraged economic theorists to move beyond the constraints of the disciplines focus on traditional economic theory and draw in the lessons of political science with its move towards critical realism, and international relations theories move towards constructivism, by developing economic theories that included finding the relationship of the theory to its cultural environment. In this case study, the impressive success of Honda in Vietnam is partly to it developing cultural affinity to the Vietnamese.

CHAPTER 8: SUMMARY AND CONCLUSION

This thesis has examined the determinants of FDI in Vietnam over the period of 1986 to 2009, and provided a political, economic and socio-cultural analysis of the growth of the economy and the impact of foreign direct investment upon it. However, although the concentration is on the period immediately following *Doi Moi* and covering the next two decades, the thesis has also briefly considered what the determinants impact will be on the future economic growth and its dependency on attracting greater sums of foreign investment. The majority of existing studies on FDI in Vietnam have involved a focus only on the political and economic factors involved in development of FDI and this thesis has presented this as a weakness in the methodologies of the studies. This thesis contends that the cultural environment and unique social network, built upon a foundation of Confucianism, Buddhism and Soviet style 'socialisation' has either significantly constrained or facilitated aspects of the impact of political and economic policies underpinning the national strategy for development and inclusion into the global economy.

In order to provide a full analysis, the thesis has relied on Dunning's eclectic theory, especially with its concern to the local advantages and combined this with support to the collection of quantitative data sources by the use of qualitative research accrued from extensive elite interviewing of a number of politicians, business leaders, workers, government officials and economic analysts from both Vietnam and around the world.

In the first chapters the introduction of a policy change that shifted Vietnam from a centrally planned economy to a free market model was analysed. This analysis was then directed into explaining how political policies were changed through legal and administrative reform and how development, the growth of the economy and reform of the economic infrastructure was vitally assisted by the attraction and utilisation of FDI.

To provide research that supported the basic hypothesis of the thesis, including the linkage of determinants of FDI with economic growth, extensive research was carried out on two particular case studies. In the chapter on ANZ Bank it was demonstrated how a Western style business model was strategically re-positioned within the Vietnamese economy. This included evidence that the ANZ venture involved a reform of its own Western business model in order to create a synergy with the Vietnamese culture, in order to facilitate a penetration of the Vietnam financial markets and gain market share by becoming domesticated to the Vietnamese style of living and earning. Whilst the inadequacies of the law, and the constraints of the political system and its sometimes relatively slow reform did limit the size, style and variety of financial products and services ANZ could provide, the ability to adapt to the local culture did directly impact upon its continued growth and success in the Vietnam market. In the case of Honda, the Vietnam business model was also a hybrid of its Japanese parent company and the Vietnamese operation. This manufactured model of operation was developed to not only take account of the political and economic constraints of Vietnam, but to also accommodate the cultural style of Vietnam. For Honda, the similarities between the Japanese and Vietnamese cultures, allowed the company to quickly position itself as the dominant market leader in the Vietnam motorbike trade. So effective were Honda in their penetration and acclimatisation to the Vietnam system, they actually have become as much a participant and sometimes leader in the nature and development of the culture, as they were once a foreign 'invader' (i.e. the occupying force in World War II).

The Honda Company generated aspects of cultural change that altered the style of life and contributed to the social and economic status of their customers, with Honda also finding its image and brand reflected in art, music and lifestyle. The Asian mindset of Vietnam was one that the Japanese easily understood and catered for, as their own culture was already deeply embedded in the Asian traditions and values. The mixture of Confucianism, Asiatic based religions and ethnic similarities meant the Japanese were less uncomfortable than Westerners in adjusting to the culture of Vietnam.

Equally clear is that the ANZ Bank was equally successful at adapting and actually developed a competitive advantage based on their willingness to work with the cultural constraints of Vietnam. The significance of the case studies was that both Asian and Western culturally based investors could effectively adapt their business and national cultural styles to the Vietnamese 'way'. And thus optimise the full potential of their foreign investment. As Ms Vu Thuy Quynh, General Manager of ANZ explained, 'the culture of Vietnam has a significant impact on business in Vietnam. Not being aware of its influence and failing to adjust corporate strategies to take account of it is a recipe for failure. This is not only the case when dealing with customers, but also when conducting negotiations, formulating partnerships and business in general' (Interview: Vu Thuy Quynh, ANZ, 3 July 2008).

In addition to the interviews, this thesis has relied on published data sources. However, a fault in the analysis is immediately clear as Vietnam has, and to some extent still suffers from a lack of reliable data reporting. In past history the political and economic systems of Vietnam have demonstrated a certain degree of fragmentation and obscuration when it comes to the provinces reporting to the Central Government. This is chiefly due to a form of natural decentralization, where the provinces enjoy a certain level of independence from the diktat of the Central Government by failing to accurately report statistics in a regulated and timely fashion. This was explained by one former Communist Party official as ‘a culture of resistance where a chaotic and inaccurate reporting of statistics is a way for Provincial officials to undermine Central control and make monitoring them extremely difficult’ (Interview: details remain anonymous at the request of the interviewee, 20 October 2008). Obviously, this is also a worry for the economy in general as a lack of reliable data makes informed and accurate economic planning and strategy difficult, if not sometimes impossible to carry out.

However, as this thesis progresses through the years of reform, it has become clear that this problem of availability of reliable data, although still prevalent in places, has become less of a concern. For example, data from the General Statistics Office of the Vietnam Government Office (General Statistics Office –Viet Nam) is now more widely accepted for its accuracy by such international organisations as the World Bank and the IMF. Nevertheless, all data for the last three decades, especially during the controlled economy period should be treated with some level of caution.

Two issues present themselves as consequences of this thesis. In the first place the thesis has analysed the period from 1986/7 to 2009, but it is clear that a full understanding for decision-makers of the future requires an equally concise analysis of the present conditions. The period from 1986/7 to 2009 can stand alone as the initial foundation period of FDI development in Vietnam. The period following this is equally important and in order to fulfill Nguyen Mai’s (Chairman of the State Commission on WTO entry) request for a full analysis that can precede the efficient reform of the FDI environment, future research needs to concentrate on the latest period of development.

Secondly, the thesis has also been overtaken by global events as a critical juncture in FDI development has occurred with the onset of the global financial crisis in November 2008. The impact of the crisis is still not fully understood, but even now it is clear it will have a deep and possibly long-term impact on the future success of FDI in the Asian World. One consequence is that a popular concept in Europe now is the social market economy, which appears to be a middle medium between the Communists centrally controlled command economy and the capitalist free market system. The concept of a social market economy discards some of the strict tenets of the free market, such as an almost religious allegiance to the self-regulating mechanism of pure capitalism which sees government interference with the free market principle as its chief threat to working effectively. However, the economic theory of the social market economy requires further academic research in the light of the impact of the global financial crisis, before it can properly be used as a structural background in which the determinants of FDI can be examined.

However, Vietnam's FDI growth has proven to be rapid and impressive, whilst the link between FDI development and the general growth of the economy has been demonstrated in this thesis. The analysis of the Vietnam economy can be divided into three main periods. 1) 1975-1985, when immediately following the war and re-unification of North and South Vietnam, the economy was run on a centrally planned strategy that replicated the Soviet Union's model. 2) 1986/7-2003, which marked the building of the foundations of a free market model that relied on development of FDI. 3) 2003 to the present.

Bui Tat Thang (2000) notes how the first period was shaped by 'a heavy legacy of war damage, and an extremely impoverished economy, but also institutional structures that were to have a profound influence on economic policy' (p. 21). Bui Tat Thang criticises the economic policies of the early years as ones intent on a concentration on prioritizing heavy industry and founding the 'revolution of the relations of production' (Bui Tat Thang 2000, 21). By 1975, The North had already established a centrally planned economy and it now desired an extension of this to all of Vietnam. Economic development was immediately curtailed as the Government focused on centralization and nationalization. GNP became half the rate of population growth and national income grew at only one-fifth. A recession in the latter half of the 1970s and a domination of the economy by the agricultural sector pushed the Vietnamese economy to the point of near total economic collapse. Even with vast sums of foreign aid from allied Communist states, such as the Soviet Union and China, the majority of the population still suffered severe famines and shortages of all essential goods. By the 1980s national debt equaled annual national income. Gross foreign trade turnover was only USD1.7 billion per year, and entirely focused on the Communist bloc. Overspending of the state budget was 45 per cent of revenues in the last half of the decade of post war recovery.

As explained in the thesis chapter on *Doi Moi*, it was the shift to an 'open door' policy of renovation that clearly saved Vietnam from total economic disaster. It is important to note that this collapse of the economy has allowed this study to examine a country where FDI was of virtually no importance and then track its successful growth from a virtual scenario of nil influence to being one of the major contributors to its successful inclusion into the global economic system.

While Vietnam's closest Communist partner (the Soviet Union) was also transforming its own economic model from a centrally planned economy to a free market, the Vietnam case was very different to that of the Soviet's. The emphasis in Vietnam was on 'social and political stability that went hand in hand with macro-economical stabilization and control of state resources' (Bui Tat Thang, 2000, p. 23). *Doi Moi* aimed to address the relevant issues with:

(1) Fundamental elimination of state-subsidised mechanisms
(2) Diversification of publically owned assets
(3) Encouragement and stimulation of development of private organisations
(4) Maximisation of the use of potential resources for development of production and commodity exchange
(5) Enactment of policies for the integration of Vietnam into the world and regional economies
(6) Speeding up of foreign trade activities
(7) Encouragement of foreign direct investment
(8) Combining administrative reform with the renovation of economic policies
(9) Strengthening of state management and macro-regulation
(10) Combining economic growth with general social development to stabilise politics and maintain social targets.

The point to note here is that *Doi Moi* was not merely a change in political strategy and economic policies, but also linked directly to the social and cultural aspects of the Vietnam society. FDI was a central aspect of the policy reform and whilst it also denoted a movement from isolation to integration into the global economic and political structures, it also involved a degree of accommodation of the culture of Vietnam to the outside world. However, the case studies in this thesis, ANZ and Honda, show that whilst the political, economic and cultural systems of Vietnam's 'renovation' have reformed, the successful foreign investment enterprises have involved foreign investors also acclimatizing and merging their different value systems and practices to fit with the less changeable aspects of Vietnam. The thesis thus shows that economic theory concerning global patterns of growth and development of investment needs an analysis and methodology that includes the assessment of the impact of culture, as well as an analysis of the political and economic factors involved in determinants of foreign direct investment. Understanding how a domestic environment adapts in order to facilitate the successful development of foreign direct investment, entails some degree of holistic analysis of the domestic structures and influences, and the degree of change to which they are susceptible. Avoiding FDI failures also involves a certain level of adaptability of local conditions and a partnership of change between the domestic environment and the foreign investor.

However, the revolutionary change was initially with the Vietnamese in the early years of reform. In the first five years from 1986, following the introduction of *Doi Moi* policies by the Vietnamese Government, the administration delivered a 'series of market-oriented shock treatments to the economy with:

(1) Liberalisation of the prices of consumer goods
(2) Elimination of state subsidies for goods
(3) Formulating and implementing the policy of positive effective interest rates
(4) Floating the exchange rate
(5) Selling the state-owned enterprises (Nguyen Ngoc Anh and Nguyen Thang, 2007; Athukorala and Tran Quang Tien, 2009, Nguyen Nhu Binh and Haughton, 2002)

An initial level of slow growth was eventually ended in the next period of development in 1992 to 1996, and showed increases in GDP across most sectors, while inflation was also brought under control. Infrastructure, media and communications sectors development underpinned the recovery, and even the Asian financial crisis failed to end the pace of reform, as within a few years of stagnation there was a return to the record rates of growth (Bui Tat Thang, 2000, 26).

Nevertheless, despite the obvious successes of FDI in Vietnam, serious faults still threaten the future development. The pace of reform needs speeding up in the capital, monetary and labour markets, whilst the lack of sufficiently trained and qualified human resources is still a serious concern.

The central challenge for Vietnam is the need to solve the problem of a lack of quality human resources in some key industries, such as Information Technologies and petroleum. However, as pointed out in this thesis, the lack of a 'spillover' of human resource talent into domestic enterprises from FDI projects is also a serious concern. For example, the transfer of human resource talent from FDI projects in the electronics industry to the domestic sector is virtually zero. For the effective and widespread benefits of FDI to be replicated in the domestic economy there needs to be a strengthening nationally of the pool of quality human resources. As Nguyen Thi Xuan Thuy and Mori warns there is a need for a supply of domestic labour that can carry out middle management roles and equally available pool of high-skilled technicians (Nguyen Thi Xuan Thuy and Mori, 2008). With this in mind the Vietnamese Government has focused its attention on developing programmes of vocational training at all levels, and advance the quality and content of education, especially at the University level.

In the Socio-Economic Development Plan for 2001-2005 the target for the ratio of the workforce possessing professional qualifications was 30 per cent, rising to 40 per cent by 2010 in the Socio-Economic Plan for 2006-2010. In addition, the Ministry of Labour, Invalids and Social Affairs (MOLISA) have also introduced a ‘Master Plan’ for development of vocational training in professional schools, colleges and universities. MOLISA aims to achieve an annual increase of 11-12 per cent of industrial trainees (Nguyen Thi Xuan Thuy and Mori, 2008).

However, even though the training of skilled workers is recognised as an essential need for future economic growth, the actual quality of the training remains a crucial concern for both domestic and foreign businesses in Vietnam. The programs of training, although more readily available suffer from outdated training equipment, a shortage of skilled instructors and an unclear division of responsibility between the Ministry of Education and Training and the Ministry of Labour, Invalids and Social Affairs, and a general public and business community attitude that questions the utility and quality of training.

A further problem is the cultural as well as business attitude to training of workers. A majority of the business community have traditionally seen the benefits of training as firstly a direct advantage to the worker, and secondly to the business in the form of future greater efficiency and productivity gains. Thus, business leaders see the payment for training as the responsibility of the worker alone, and most CEOs refuse to actually fund training. As one CEO of a major business group in Vietnam said ‘we do not pay for training. The employee pays for the training. It is their responsibility. Why would we pay for the training only for them to leave afterwards and work maybe for a competitor? Also, if we pay the workers training fees they will not value the training and not put their full efforts into attending the courses and learning from them. ‘When they pay it makes sure they are dedicated to succeeding in the training’ (Interview: details remain anonymous at request of the interviewees, 15 September 2009).

Further discussions with business leaders revealed that the attitude to training is also influenced by the Vietnamese ‘way’ and attitudes guided by Confucian thinking. The worker is believed to have a ‘duty’ to the ‘boss’ and provide as high quality work as possible. Thus training is part of the responsibility of the worker and he benefits in the long run as better work performance may lead to improved pay and/or position. Generally, the leaders in business saw the long term benefits of training as an unnecessary burden on the short term profit margins, with often no guarantee that the benefits will in the long term accrue to the business. This attitude was also encouraged by the high rates of attrition in workforces. The basis of nearly all relationships between workers and bosses with concern to promotion and higher salaries was often seen as depending on ‘relationships’ based on friendship and/or family connections, rather than on merit. On the one hand this meant that workers relied on advancement through the relationship and did not see the need for training. Workers also saw that the levels of salaries in the same offices/workplaces varied greatly, even for workers doing exactly the same job, and the levels depended almost entirely on the ‘relationship’ with the ‘boss’ and not on merit and the actual quality, efficiency and productivity of the worker, thus, even providing a logic for not undertaking training. Workers who did pay for training often did so in order to improve their opportunities by raising the profile of their CVs in order to find jobs in competitors businesses or to actually start up their own business.

Extensive interviews were carried out privately with a number of employees in different sectors, but virtually all requested their identities to be kept secret, thus demonstrating how sensitive this issue is in the workplace. To some degree the problem was a self fulfilling prophesy as the workers believed they should pay for training in order to find work elsewhere, while the ‘bosses’ would not pay for training as they believed the workers would only leave once trained. Aggravating the problem was the Confucian philosophy behind the concept of ‘duty’ to the employer, which was used by the employers as reasoning for justifying the costs of training lying with the employee. This also maybe a contributing reason to the lack of ‘spillover’ from FDI projects to domestic firms of quality human resources. FDI led enterprises are more likely to accept the long-term benefits of training and thus ready to make the financial investment in training, as the foreign management come from national systems that have already accepted the logic of the ‘investment’ in improving productivity and efficiency through training and education of human resources.

Culture of earning promotion or pay increases through nepotism and relationships, rather than on merit is a serious challenge to the future of FDI. It is clearly becoming a negative determinant of FDI, but could also be difficult to overcome as the cultural logic constantly countermands the business logic, and whilst it can be a simple process to change the business system, it may be far more difficult, expensive and time consuming to change the cultural philosophy (Dunning and Bansal, 1997; Barkema and Vermeulen, 1997).

A further problem is that the future of training of human resources can only be ensured through greater financial resource inputs and knowledge investment by business leaders and private enterprises. At the moment the private sector directly competes with the training and education sector and is not only often refusing to make the long-term financial investments into the sector, but are contributing towards a brain drain scenario, where private enterprise is overcoming its skill shortage problems by using high salaries and additional benefits to attract the trainers, lecturers, experts and professionals away from the training sector and into the private sector (Nguyen Thi Xuan Thuy and Mori, 2008).

A recommendation stemming from the research in this thesis is that further research needs to be carried out on the human resource problems and issues in Vietnam. The gap in the literature that this thesis fills is focused on the success of particular FDI enterprises, but it also presents evidence of an additional gap in the literature that concerns the training, quality and efficiency of human resources. Research on Honda and ANZ showed that these two FDI supported ventures were ensuring their success by conducting extensive and on-going human resource training programmes. The subsequent benefits in their quality of work and level of service to the customer significantly contributed to their gain in market share through a competitive advantage. One of their core competitive advantages is their quality of human resources and the advantage is magnified by the lack of similar programmes in their domestic competitors. Thus, for the enterprises focused on in this thesis, the human resource issues can be seen as positive determinants of FDI growth, but for the Vietnam economy as a whole the long-term implications may seriously limit future economic growth for the nation.

The problem of human resources is also an indication of the stage of development that Vietnam is in with concern to the overall pathway from a less developed, to developing, to a developed economy. The road to becoming a fully developed and industrialised economy through economic growth and attraction of FDI has been identified as a series of four stages (VDF Report, 2008)

The first stage is based on the input of foreign investors in design, technology, production and marketing, where key materials and resources are imported and the host country's focus is on providing cheap labour. The main benefits to the host country, besides increased employment for many of its poor, are limited and the economic value is mostly in favour of the foreign investor.

In the second stage of development, the benefits of increased production are seen as the growth in the demand for domestic resources. Domestic industries are now able to also begin to compete on a quality level and the demand for domestic labour is now increasingly enhanced by the demand for local parts, resources, etc. The economy is boosted by demand for physical and human inputs, but the management and control of the industries involved still largely remains with the foreign investor.

The third phase requires a universal change in the capabilities of the domestic economy, with human resources now able to take on the challenges of development, including be able to carry out unassisted the responsibilities of management, the development of technology and the efficient operation of manufacturing, logistical and marketing needs. This new found level of independence directly contributes towards increased domestic value.

In the final stage the country is not only a producer, but also becomes an innovator. The principles of production are high quality products/services at a low cost, and this is now universally applied across all sectors.

The stages of development can been thus clarified as

(1) Agglomeration: simple manufacturing under foreign guidance
(2) Technology Absorption: Having supporting industries, but still under foreign guidance
(3) Creativity: with technology and management mastered, and can produce high quality goods.
(4) Full Capability in Innovation: innovation and product design capabilities at a global leader level (Ministry of Industry, 2007).

As the VDF Report (2008) notes, several particular aspects of Vietnam directly affect the development of FDI. These include that the ‘current industrial dynamism is financed chiefly through private investment and consumption and private demand is mostly financed through Viet Kieu remittances, ODA, FDI, tourism and security investments. The main advantages of Vietnam are its good location and good workers, who if properly managed and technically trained – demonstrate high levels of skill and a universal dedication to diligent work’ (p.6).

However, only though increased reform of policies and institutions can Vietnam continue to achieve high records of growth. The strengths required to promote further growth are:

(1) Good workers
(2) Political stability
(3) Rapidly improving FDI climate
(4) A good location
(5) A large population.

These are essential needs for attracting and retaining FDI while the weaknesses that threaten the economic growth and development of FDI are:

(1) Unstable policy and law

(2) A poor infrastructure

(3) Irregular business practices

(4) Corruption

(5) Lack of supporting industries

(6) Shortage of skilled engineers and middle level managers

(7) The possible negative impact of integration.

Vietnam can be seen to clearly score highly on the needs for development, but unfortunately suffers as equally high levels in the seven areas of weaknesses.

From the research of this thesis it is clear that Vietnam as an economy lies chiefly in the first phase of development with aspects of the second phase also prevalent in some geographical regions and particular sectors. However, in the case of FDI enterprises it is clear that Honda and ANZ have successfully negotiated their business progress through the first three phases and are actually on the brink of moving into the final phase of development. The aim of the Vietnam Government is that such an example of development 'spills over' to the entire economy.

Nevertheless, with analysis of the evidence of research it is clear that the Vietnam economy still suffers from a certain level of still slow reform of the legal administration. Despite the obvious evidence of major changes to attract and retain high levels of FDI, problems persist in the legal administration. For example, Pham Thi Thuy Dung of PriceWaterHouseCoopers heavily criticises the legal system, where despite reform, the investors seeking to advance education projects still require an applicant to apply for a general license and twelve different sub-licenses at local and Provincial level. Besides the legal obligations the structure of the government management of FDI needs reform to ensure new levels of transparency and clarity in investment policies and procedures. Pham Thuy Dung recommends that carrying the whole process onto the Net would speed up the integration of Vietnam into the world economy (Interview: Pham Thuy Dung, PriceWaterHouseCoopers, 7 April 2009)

Despite the problems that still persist in the Vietnam economy, the attraction of high quality FDI investment still continues. After the successful attraction of Berjaya Malaysia Land, Berham to build an 880 hectare university township in Vietnam at a cost of USD3.5 billion, Pham Huu Thang chairman of the Vietnam Foreign Investment Agency said 'the FDI increase in the context of Vietnam's supposed economic difficulties proves foreign investors great confidence in the business environment' (VietnamNet, 2008).

The impressive growth of FDI from the virtually non-existent levels of 1987 contributed to the economy in general and directly influenced the rate of growth. It has also revolutionised the structures of the economy; taking Vietnam to a point where the UN Conference on Trade and Development (UNCTAD) of 2008 declared that Vietnam has undergone an impressive process of transformation from an isolated, poor and collectivised agriculturally based economy into a booming nation with a dynamic and diversified private sector co-existing with a large public sector, fully integrated into the world economy (UNCTAD, 2008).

Data from the Vietnam General Statistics Office (working closely with the Ministry of Planning and Investment) demonstrates the basic tenets and analysis of this research, underpinning the international opinions, such as from UNCTAD, applauding the policies and outcomes of the last two decades of economic reform. The original problems with collection of reliable data experienced in the first period of this thesis research is an issue that is being tackled by the Vietnam General Statistics Office and the latest data summaries are an attempt to demonstrate its improvements in effectively provided the vital statistics needed for planning future economic policy reforms. The data also clearly re-enforces many of the major findings of this research.

For example, the latest data on the period of 1988-2005 shows that FDI has steadily transformed the Vietnam economy with improvements in FDI licensing and implementation. In 1996-2000 there were 1,724 new FDI projects with a further 825 existing FDI ventures increasing their capital investment (General Statistics Office, Vietnam; MPI Report, 2008).

The constant contributions to the speed of industrial growth and the steady improvement in the levels of labour creation in FDI projects shows how the international investment has impacted on the Vietnam economy. However, the distribution of FDI across sectors demonstrates a continuing over-concentration of investment into certain areas and a need for two areas (health and education) to attract significantly more foreign investment. The Vietnamese government is attempting to facilitate this increase in investment to health and education through a ‘creeping’ strategy of privatisation. Private and independent hospitals and schools are being actively promoted and new legislation is attempting to improve the overall environment for attracting foreign investment to these vital areas of social development. Health and education can provide lucrative opportunities for future FDI projects and the improvement of these sectors will inevitably contribute further to the overall quality of the FDI environment in Vietnam, for example, in helping to further advance the levels and quality of human resources (Athukorala and Tran Quang Tien, 2009, Nguyen Nhu Binh and Haughton, 2002, Nguyen Duc Tiep, 2007).

The origins of investment are now taken to a global level as the countries now taking an interest in investing in Vietnam are extremely diverse and ‘partners’ are now spread across Asia, Europe and America. Nevertheless, there is significant untapped potential for further investment from many countries in Europe and the Arab World. At the moment the Middle East has only recently focused on Vietnam as a potential investment target. The oil rich investors from countries like Saudi Arabia and Iran are notable for their absence from any major FDI project, although the UAE is an exception to this trend and may act as a vanguard of future Arab investment into Vietnam (General Statistics Office, Vietnam).

Despite the international diversity of the investment, a similar diversity in domestic location of investment is still not apparent. A select and limited number of provinces still dominate the FDI environment and many areas of Vietnam enjoy only minimal benefits from the FDI inflows. The concentration into specific areas risks many parts of Vietnam being ‘passed by’ in the quest for economic development, thus demonstrating that the Vietnam government needs to improve is regional policies and offer international investors further reasons to spread their financial support across the whole of Vietnam.

The contribution of FDI to the economy has come in the form of major investments into the energy, telecommunications, and transport and finance sectors. Vast opportunities still offer themselves in areas such as insurance, where the almost total concentration has been on Life insurance, some forms of business and trade insurance and motor vehicle policies. The non-life insurance market is almost non-existent outside of the vehicle sector (Interview: Andrew Goddard, CEO of Red8 Consulting Services, 15 June 2009) and the potential for investments in trade support policies such as Import/Export Credit insurance schemes is ready for a number of new FDI investments.

From the research carried out in this thesis the determinants of FDI in Vietnam have shown a relatively speedy and impressive support for further development. The latest data issued demonstrates that the record on FDI and its impact on the general economic growth of the country has helped move the Vietnam economy from stagnation and starvation to a period of stability and growth with significant potential for further attraction of FDI.

The contribution of FDI to the economy has come in the form of wealth creation, the generation of employment and economic diversification and the building of a stable and growing export sector. Economic experts point to the creation of ‘effective and flexible solutions’ to ease the affects of the global economic ‘slowdown’ and forward thinking planning that now has a full portfolio of medium and long-term strategies.

The Vietnam Government realises that pro-FDI policies of the future must deal with the continued reform of legal and administrative systems, including on the ownership of land, the reform of the tax and customs procedures and even more focus on ensuring equity in the treatment between domestic and foreign investors.

Thus, this thesis presents two case studies of successful FDI projects that illustrate how the determinants of FDI have affected the investment. It is clear that these problems, such as the lack of quality human resources, the piecemeal benefits of spillover from FDI to domestic enterprises, and difficulties with the legal and administrative systems still provide major challenges. But overall, the policy to shift from a centrally controlled command economy and attain economic growth through transition to a free market economy has been successful; and this *Doi Moi* policy focused on attraction and retention of FDI as its core methodology. Future growth depends on understanding, reforming and improving the determinants of FDI growth in Vietnam.

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