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Determinant of the factors affecting Foreign Direct Investment (FDI) flow to Thanh Hoa province in Vietnam

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Abstract

This paper attempts to identify the main factors that help with the attraction of foreign direct investment capital in Thanh Hoa province in Vietnam. In this study, with forty-one questionnaires have been sent to foreign companies in many region for observation. The survey results show that there are some factors that have been evaluated as much more important such as Availability of resources factors, Infrastructure factors and financial factors; while, others are considered to be relatively less important in the current context of Thanh Hoa province in Vietnam such as social and cultural factors.

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Keywords : Foreign Direct Investment; economic; factors affecting; Thanh Hoa; Vietnam.

1. Introduction

The foreign direct investment concept has become an important role in the economic development of large number of countries in the world. Therefore, it is now widely recognized that FDI can offer important advantages for the recipient economy in addition to capital inflows, FDI can lead to transferring technology and know-how, improve the access to international markets and spur competition (Don Anura Wickramasinghe, 2007). Thanks to the decentralization policy started in the FDI law amendment in 1996, each province had more power and autonomy in dealing with foreign investments such as in granting investment licenses, leasing land, providing

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export and import licenses and recruiting labor. This policy, on the one hand, allows provincial authorities to develop in an innovative ways that attract more foreign investors, and also leads to variations in the implementation of the central laws and regulations among provinces. Foreign investors may experience a lot of red tapes namely, corruption or delays in administrative progress if local authorities possess conservative inherited norms and cognitions. In this context, foreign investors have considered many factors when investing in Vietnam such as modes of entry and location choices for their operations so that they can make use of advantages and minimize disadvantages (Dinh Thi Thanh Binh, 2009)

In order to attract investors to Thanh Hoa and give the most favorable conditions to them, the province has offered many investment priority policies as well as improving administrative procedures. Over the past revised, the province’s investment environment has been significantly improved. With a view to: no restrictions on size, industry, and geographic areas, based on the Investment Law and Enterprise Law, Thanh Hoa is continuing to review and to improve the system of mechanisms and policies towards incentives and making it more convenient for investors. These mechanisms and policies of Thanh Hoa focus on improve and simplify administrative procedures, issue the open and attractive mechanisms and policies, call for investment, create innovative in building essential socio-economic infrastructure, promote the advantages of human resources, improve the quality of human resources in order to meet business’s demands. In addition, resolution No 02/NQ-TU dated 27/6/2011 regarding improvement for investment environment in province in the period of 2011 – 2015 focused on implementing site clearance work in order to meet investors’ requirements, support business development, transparency of information for business, support business development, transparency of information for business. With the above policy, until 2012 in Thanh Hoa province has 41 investment projects involving foreign direct operation with a total registered capital of USD 6,952 million (Le Hoang Ba Huyen, 2013).

Based on provincial competitiveness index, Thanh Hoa is one of the most attractive province and has get some successful results from FDI, but these outcomes are still limited. The number and sizes of investment projects are low. Therefore, the identification of factors affecting the attraction of foreign investment in Thanh Hoa and an analysis of the impact of each factor to attract foreign investment is essential for the government in offering policies to attract investment capital.

2. Theoretical framework and hypothesis development

This study will be conducted based on the theoretical frame work drawn from eclectic paradigm or the “OLI” paradigm develop by “Dunning” as explain under the literature review and studies and according to factors which are influencing to choice of a host market of Gilomre, O’s Donnel, Carson and Cummins (2003). The following factors are mainly affecting to attract FDI to Thanh Hoa province: Political, government and legal factors; Social and cultural factors; Economic and market factors; Financial factors; Availability of resources factors and Infrastructure factors.

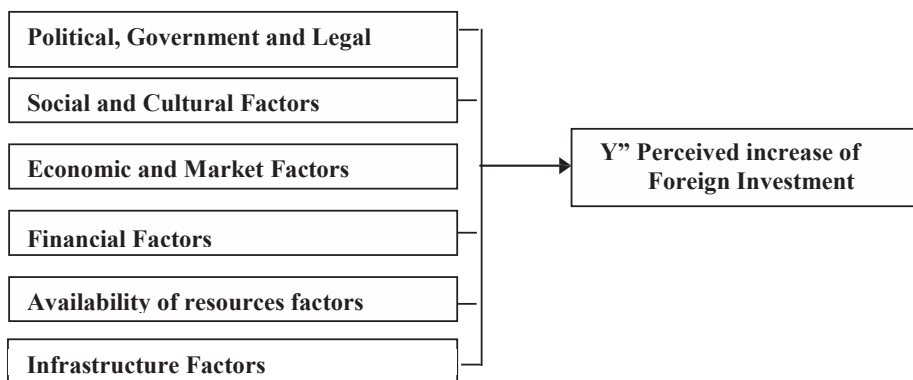


Figure 2.1 Theoretical Framework

Hypothesis 1: Political stability, government and legal factors will positively affect infusion of foreign direct investment capital in to Thanh Hoa province.

Hypothesis 2: Social and cultural factors will positively affect infusion of foreign direct investment capital in to Thanh Hoa province.

Hypothesis 3: Economic and market factors will positively affect infusion of foreign direct investment capital in to Thanh Hoa province.

Hypothesis 4: Financial factors will positively affect infusion of foreign direct investment capital in Thanh Hoa province.

Hypothesis 5: Availability of resource factors will positively affect infusion of foreign direct investment in to Thanh Hoa province.

Hypothesis 6: Infrastructure factors will positively affect infusion of foreign direct investment in to Thanh Hoa province.

3. Data and Methodology

3.1. Sample size and Population determination

3.1.1 Population determination

- Business managers of foreign direct investments and the main shareholders of the businesses: There have been forty one (41) FDI entrepreneurs, which are in companies operation of Thanh Hoa province from 2001 to 2012.

- Government officials: The population of this study is 200 officers who are in Province people's committees, Department of Planing and Investment, Department of Finance, Department of Industry, Tax Authority, Land Authority, Department of Transportation, Department of Agriculture and Rural Development, Investment promotion center of Thanh Hoa province, Branch of State Bank of Thanh Hoa, Union of Cooperatives and Small and Medium Size Enterprises and Vietnam Chamber of Commerce and Industry in Thanh Hoa.

3.1.2 Sample size determination

The sample size determination: the sample size is determined using the Slovin formaltion as follows:

$$n = \frac{N}{1 + Ne^2}$$

Where

- n the sample size of each respondent group
- N total population of the respondent group
- e^2 is probability of error

- Business managers of foreign direct investments and the main shareholders of the businesses: With the population of this study are forty one (41) FDI entrepreneurs ($N = 41$), $e = 5\%$ (at least 95% confidence level), Therefore the sample size for this study is:

$$n = \frac{41}{1 + 41(0.05)^2}$$

$$n = 37$$

Hence the sample size is 37, to collect the required data 37 questionnaires were send to the FDI companies located in Thanh Hoa through the ways of both e - mailing and personally. There is thirtdy seven (37) respondents were received.

- Government officials: With the population of this study is forty one (41) FDI entrepreneurs ($N = 100$), $e = 5\%$ (at least 95% confidence level), Therefore the sample size for this study is:

$$n = \frac{100}{1 + 100(0.05)^2}$$

$$n = 80$$

Hence the sample size is 80, to collect the required data 80 questionnaires were send to the FDI companies located in Thanh Hoa through the ways of both e – mailing, telephone and personally. There are eighty (80) respondents were received.

3.2 Sampling Method

This research was conducted in two phases. The first phase involved secondary collection, deskreview, literatures, research, journals, publications, books, official reports from government officials. The second phase was the primary date collection by conducting a survey using structured questionnaires (either through e-mailing, telephone and direct face to face interview).

The first step, the survey method will be used to collect primary data. There were 2 groups of respondents targeted in the survey using questionnaires. The first respondent group was the business managers of foreign direct investments and the main shareholders of the businesses. The second group of respondent included staff working in agencies and units the government line agencies at provincial, district levels with functions and tasks related to the operation of foreign-invested enterprises in Thanh Hoa province.

The second step, we using SPSS software to analyze the current status of the investment environment and the main factors affecting Foreign Direct Investment in flow to Thanh Hoa province.

The third step, the Pareto chart was used to find out what factors affecting the investment process of firms with foreign direct investment in Thanh Hoa province.

The fourth step, based on the results of the third step, the solutions were proposed to improve these key factors.

4. Empirical Analysis

4.1 Statistics indicating the importance of the factors affecting the attraction of foreign direct investment in Thanh Hoa Province.

(1). Political/governmental/legal factors (F1)

The political/governmental/legal factors are important factors for foreign investors to make investment decisions. The foreign investors only invest their capital when they know that the country has a stable political environment, safety of the movement of capital. The political stability reflects in some aspects such as, the government's commitment in matters of investment capital ownership, policymaking, development orientation. The importance of this factor is reflected in analytical results represented in Table 4.2 below:

Table 4.1 The importance level of political, governmental and legal factors

| Attributes | Rank sum | P Value | Adj. Variance |
|--|----------|-----------|---------------|
| Tax or land incentives | 629 | 0.0403** | 380 |
| Convenient procedures lease/land | 591 | 0.8900 | 330 |
| Political stability | 559 | 0.1806 | 502 |
| The legal requirements for clear and transparent | 604 | 0.4075 | 328 |
| Expropriation risk | 655 | 0.0020*** | 455 |
| Protection of property | 592 | 0.8610 | 399 |
| Protection of intellectual property rights | 555 | 0.0820* | 381 |
| Security and order | 585 | 0.08620* | 408 |

* Statistically significant at the level of 10%

** Statistically significant at the level of 5%

*** Statistically significant at the level of 1%

The table 4.2 presents the respondent's opinions of the importance of various factors under the political/government/legal category. The political/ governmental/ legal factors consist of eight variables as indicated in the table above. Among the eight variables, there are four affecting FDI inflow to Thanh Hoa province significantly, i.e., tax or land incentives factor (with P - Value of 0.0403**), expropriation risk factor (with P - Value of 0.0020***), protection of intellectual property rights factor (with P - Value of 0.0820*) and security and order factor (with P - Value of 0.08620*). All variables mentioned above are rated as high importance, specifically expropriation risk factor was ranked with highest score of 655 (rank sum of 655). Following, tax or land incentives factor is ranked with rank sum of 629. After that, protection of intellectual property rights and security and order factors are arranged subsequently. They have rank sum of 555 and 585 respectively.

On the other hand, convenient procedures lease/land, political stability, the legal requirements for clear and transparent, protection of property factors have positive impacts on decision making of foreign investors in general, however, in particular at Thanh Hoa, it shown that these factors have not statistically affected investment decisions of foreign investors. Specifically, convenient procedures lease/land factor has P - Value of 0.8900, political stability factor has P - Value of 0.1806, the legal requirements for clear and transparent factor has P - Value of 0.4075 and protection of property

factor has P – Value of 0.8610. Actually, these factors above are only taken into account when investors choose different countries. However, when making investment decisions in a country, these factors have no significant impact.

(2). Social and cultural factors (F2)

Social and cultural factors include language, religion, customs and traditions... They have a significant impact on investment choices. In some cases, disagreements about language and culture will bring unpredictable consequences for the business. Consequently, foreign investors will have to consider all the elements of culture and society when deciding investment destination. In Thanh Hoa, these factors are presented in the following table:

Table 4.2 The importance level of social and cultural factors

| Attributes | Rank sum | P Value | Adj. Variance |
|-------------------------------|----------|---------|---------------|
| Attitudes, beliefs and values | 594 | 0.788 | 416 |
| Religion | 582 | 0.730 | 357 |
| Language and communication | 568 | 0.344 | 493 |
| Cultural proximity | 609 | 0.339 | 438 |

* Statistically significant at the level of 10%

** Statistically significant at the level of 5%

*** Statistically significant at the level of 1%

The table 4.3 shows the ranksum, P Value and Adj. Variance for variables under social and culture factors. It shows that investors are not statistically affected by these factors when making their investment decision Thanh Hoa. Specifically, attitudes, beliefs and values factors has P – Value of 0.788, religion factor has P – Value of 0.730, language and communication factor has P – Value of 0.344 and cultural proximity factor has P – Value of 0.339. However, language and communication and cultural proximity factor have a significant statistically impact on attraction of FDI inflow to Thanh Hoa with the rank sum of 568 and 609 respectively. Hence, the social and culture factors is not very important for FDI inflow in Thanh Hoa.

(3). Financial factors (F.3)

Interest rate, inflation rate and exchange rate factors have great impact on attraction of FDI inflows to a country in general and into Thanh Hoa province in particular. Interest and exchange policy have direct influences on profits of FDI enterprises. In Thanh Hoa, investors highly appreciate the role of these factors when they have a decision investing to this local as shown in the following table:

Table 4.3 The importance level of financial factors

| Attributes | Rank sum | P Value | Adj. Variance |
|-------------------------------------|----------|----------|---------------|
| Reasonable and stable interest rate | 596 | 0.72381 | 381 |
| High inflation | 596 | 0.7331 | 566 |
| Fluctuation of exchange rate | 566 | 0.078* | 449 |
| Access to capital | 649 | 0.007*** | 507 |

* Statistically significant at the level of 10%

** Statistically significant at the level of 5%

*** Statistically significant at the level of 1%

As it is shown by the table 4.4, fluctuation of exchange rate factor and access to capital factor is the most important factors in group factors. On the other hand, the reasonable and stable interest rate and high inflation factors are not statistically affected by these factors when making their investment decision Thanh Hoa. In particular, fluctuation of exchange rate factor has rank sum of 566 and access to capital factor has rank sum of 649. It is easy to understand that access to capital factor have been considered as the most important factor in the group of financial factors because of differences between various provinces.

On the other hand, the interest rate, inflation and exchange rate factors are impacted by the center government's policies. Thus, foreign investors rarely interested in these factors.

(4). Economic and marketing factors (F4)

Economic and marketing factors such as: size of domestic market, costs of intermediate goods and service, wealth of Vietnamese consumers, proximity to export markets, pioneer investors and the main competitors factors have positive impacts on attracting FDI. According to Gilmore (2003), factors such as proximity to export markets, the size of domestic market and its growth potentials are regarded as key factors.

Table 4.4 The importance level of economic and marketing factors

| Attributes | Rank sum | P Value | Adj. Variance |
|---|----------|-----------|---------------|
| Size of domestic market | 611 | 0.259 | 380 |
| Costs of intermediate goods and service | 618 | 0.121 | 351 |
| Wealth of Vietnamese consumers | 600 | 0.487 | 274 |
| Proximity to export markets | 647 | 0.0056*** | 445 |
| Other investors in my industry were already | 612 | 0.155 | 273 |
| The main competitors | 609 | 0.286 | 351 |

* Statistically significant at the level of 10%

** Statistically significant at the level of 5%

*** Statistically significant at the level of 1%

Clearly, in the table 4.5 there are some factors evaluated much more important than others such as proximity to export markets factor (with P Value of 0.0056*** and rank sum of 647), costs of intermediate goods and service factor (with P Value of 0.121 and rank sum of 618) and other investors in my industry were already (with P Value of 0.155 and rank sum of 612). Other factors are considered to be relatively less important in the current context of Thanh Hoa province such as, size of domestic market factor (with P Value of 0.259 and rank sum of 611), wealth of Vietnamese consumers factor (with P Value of 0.487 and rank sum of 600) and the main competitors factor (with P Value of 0.286 and rank sum of 609). We can see that foreign investors in Thanh Hoa shows highest interest with regard to proximity to export markets factor (with P Value of 0.0056*** and rank sum of 647). This issue demonstrates that the main purpose of majority foreign investors in Thanh Hoa is producing goods for exporting. Therefore, the proximity to export markets factor have been rated as the most importantly.

(5). Availability of resources factors (F5)

Companies undertaking FDI is influenced by the availability of resources, in particular labor and availability of intermediate goods and services. Nevertheless, the importance of availability of raw materials has recently played less impact as raw materials are sourced on a global basis.

Table 4.5 The importance level of availability of resources factor

| Attributes | Rank sum | P Value | Adj. Variance |
|---|----------|---------|---------------|
| Availability of intermediate goods and services | 586 | 0.88 | 304 |
| Quality of labor force | 622 | 0.1025 | 408 |
| Labor costs | 610 | 0.28 | 408 |

* Statistically significant at the level of 10%

** Statistically significant at the level of 5%

*** Statistically significant at the level of 1%

In the table 4.6, it can be seen that availability of resources factors have not important impacts on making investment decisions of foreign investors in Thanh Hoa. Specifically, availability of intermediate goods and service factor has P value of 0.88 and rank sum of 586, quality of labor force factor has P value of 0.1025 and rank sum of 622 and labor costs factor has P value of 0.28 and rank sum of 610. Quality of labor force factor is considered as the most important factor in the group. In fact, this is a very consistent result because Thanh Hoa province has been ranked as the third largest workforce in Vietnam.

(6). Infrastructure factors (F6)

The “**Infrastructure**” consists of many dimensions ranging from roads, sea and airports, railways, telecommunication systems and institution development such as legal services, accounting etc. The extent of transport facilities and the proximity to major ports factors have a significant positive effect on the destinations of FDI within the country. The issue can be seen clearly in some places with poor infrastructure. However, at some aspects, the infrastructure factor can bring both obstacles and opportunities for foreign direct investment. For the majority of developing countries, it is often cited as one of the major constraints. But foreign investors also point out the potential for attracting a significant amount of FDI projects if host governments encourage more participation of foreign investors in the infrastructure sector.

Table 4.6 The importance level infrastructure factors

| Attributes | Rank sum | P Value | Adj. Variance |
|----------------------------------|----------|----------|---------------|
| Availability of industrial zones | 601 | 0.52 | 354 |
| Infrastructure quality | 622 | 0.09* | 359 |
| Low transport and logistics | 651 | 0.004*** | 474 |

* Statistically significant at the level of 10%

** Statistically significant at the level of 5%

*** Statistically significant at the level of 1%

In the table 4.7, it can also be seen that foreign investors are interested in infrastructure quality factor; Low transport and logistics factor (with P value 0.004*** and rank sum of 651) have been ranked as the most important, while availability of industrial zones factor (with P Value of 0.52 and rank sum of 601) has been rated less important in comparison to two factors above. Hence, considering the overall rank sum and P Value above the importance level is highest.

4.2 Results of the Analysis

Table 4.7 Descriptive Statistics

| Attributes | Rank sum | P Value | Adj. Variance |
|--------------------------------------|----------|---------|---------------|
| Political/governmental/legal factors | 623 | 0.147 | 550 |
| Social and cultural factors | 610 | 0.35 | 537 |
| Financial factors | 617 | 0.23 | 546 |
| Economic and marketing factors | 641 | 0.013** | 439 |
| Availability of resources factors | 617 | 0.201 | 514 |
| Infrastructure factors | 631 | 0.067* | 527 |

* Statistically significant at the level of 10%

** Statistically significant at the level of 5%

*** Statistically significant at the level of 1%

In the table 4.8, we can see that the importance of the group factors affecting investment decisions of foreign investors. In the six groups, the importance of each factor evaluated by foreign investors is very different. Particularly, economic and marketing factors and infrastructure factors have been rated as the most important factors. Moreover, these two groups have very high rank sum (with 641 and 631 respectively).

- Consequently, after two factors above are political/government/legal, financial and availability of resources factors. These groups also affect the investment decisions of FDI enterprises. However, they have significant level lower than two groups above. They have rank sum of 623, 617 and 617 respectively.

- The social and culture factors is ranked as less important for decision making of foreign investors in comparison to others. This factor has P Value of 0.35 and rank sum of 610.

5. Conclusion

In this studies we focus on determine the factors affecting the attraction of foreign direct investment in Thanh Hoa Province. The analytical results show that some factors are very important while other factors are considered less important. We found that there are two aspects of the Thanh Hoa economic environments in which international business partners are particularly interested: the economic and marketing factors and infrastructure factors. Moreover, the provinces with frienly political/government/legal, availability of resources and financial factors can attract more FDI. However, the social and cultural factor seemed not be a significant factor. Most investors put the social and cultural factor in the least important group. In term of every particular group of factors, the importance of the factors is considered differently by foreign investors when they decide to invest in Thanh Hoa. The conclusions for each group are following:

- The group of the factors of political stability and policy mechanisms: It is concluded that these following factors can affect the decisions of foreign investors: tax and used land incentives; investments safety; intellectual property safety and public order. However, some following factors have very little impacts to the decisions of foreign investors: the convenience of renting land procedure, political stability, the clear and explicit legal requirements and assets' protection.

- The Group of socio-cultural environment factors: The result shows that these factors have least impacts to the decision of foreign investors. However, some factors like languages, communication and the close culture have stronger impacts to the investors' decision than some other factors like: religious attitudes, belief and values.

- The Group of financial factors: There are four factors and according to the analytical results, when the changing of exchange rate and ability of mobilization fund factors affect significantly to the decision of foreign investors, other factors like stable and reasonable interest rate, high inflation have less impacts to the decision of investors in Thanh Hoa.

- Group of economy and market factors: In 6 factors in the research, it shows that the distance of the export market is the most important factor. On the other hand, the other factors have very little or no impact to the decision of foreign investors.

- The group of resources factors: the result from previous study shows that the quality of labours and cost of labour are considered more important than the availability of materials, intermediary service in term of making decision for investors.

- The group of infrastructure factors: These are the factors which have strongest impact to the decision of foreign investors. In details, the factors like quality of infrastructure (roads, airports, ports, communication...) and the low cost of transportation and logistics have significant impact to the decision of foreign investors. Otherwise, the availability industry zone's infrastructure is considered less important in comparison to 2 above factors.

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