

## The effect of political factors on FDI attraction in Vietnam

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**CHRONICLE**

**ABSTRACT**

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Attracting foreign direct investment (FDI) to contribute to Vietnam's limited development resources is an objective and indispensable activity. In fact, the investment attraction activities have gained many important achievements in stimulating economic development, curbing inflation and creating jobs. Nevertheless, in many prior studies, there were less discussion on the important role of political factors in the relationship with FDI attraction in Vietnam. Therefore, this study aims to explore that relationship through three variables such as the transparency, the similarity in political characters, and business policies. The findings show the significant effects of those studied factors on the FDI attraction within Vietnam context.

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### 1. Introduction

The COVID-19 pandemic has affected comprehensively and extensively to all countries in the world, and it is now continuing to develop in a very complicated manner. The global economy is in a serious recession. Vietnam's economy has great openness, extensive international integration has been affected by many impacts, seriously affecting all socio-economic fields, disrupting the supply chain and trading flows. Nevertheless, by well-managed of the pandemic, Vietnam has currently risen as potential emerging market in Asian market context (Kumar and Gray, 2013; Shim, 2006; Nguyen et al., 2020), by that fact, it triggered parallelly either desires of growing business of Vietnamese entrepreneurs individually or the need of expanding international market of multi-national corporations (MNCs). Although Vietnam's business environment has improved positively, the business community still believes that the enterprise has to bear the burden of formal costs derived from the enforcement of legal regulations, laws and policies of the state. In recent times, Viet Nam has joined international organizations, especially the ASEAN Economic Community (ACE), and most lately, has signed the Trans-Pacific Partnership agreement (TPP), the levels of competition among businesses have been getting tougher (Lewis & Moise, 2018). Nguyen et al. (2019) investigated the capacity of tax authorities and its impact on transfer pricing activities of FDI enterprises in Vietnam. In the field of market entry, in general, the steps in the market entry process are strictly implemented, in accordance with the regulations. However, the ineffective implementation at some steps of the market entry process has made the ranking of this index still not as expected. In recent years, the legal framework in the field of market entry has been amended, supplemented synchronously, clearly, and simplified administrative procedures have helped the implementation process achieve many effective results. It also helps to reduce the time for implementing the process of market entry in Vietnam in recent years. If these procedures are strictly followed, ensuring that they are implemented in the same time as the current regulations, the market entry index will certainly have significant improvements (Chaisse and Górski, 2018; Usinyn and Gáspár-Szilágyi, 2018; Nguyen & Do, 2020).

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## 2. Literature Review

Most of the largest FDI-attracting economies in the world, such as the US, EU, Singapore, Hong Kong and Australia, have fairly complete institutional systems following international standards, thus creating a fair business environment, transparency and protection of foreign investors (Jadhav, 2012, Jasmine et al., 2003)). Justice in the American legal system is something that very few countries possessed (Campisi & Caprioni, 2017). This is considered a strong point of the US compared to many other countries. All companies are treated equally in the United States and must follow the same laws, rules and procedures for conducting business. In addition, with Ongoing reform efforts to create favorable conditions and improve the investment environment, Singapore is recently considered as country with smooth and fast administrative system and effective cooperation between relevant agencies to help businesses operate and grow easily.

The EU's investment policy is also inclined to provide investors with legal stability and certainty, along with a favorable environment for doing business and complying with international rules. The EU has removed all trade barriers that act to hinder free trade. Moreover, the European Union has adopted a popular currency, which acts as a major complement to increased trade in the European Union (Schneider and Frey, 1985).

### 2.1. Transparency (abbreviation as TRANS)

Transparency is always widely mentioned in international practice as a leading criterion for evaluating the discipline and management effectiveness of any organization. Fung (2014) explains that corporate transparency describes the extent to which a company's behaviors can be observed by outsiders. Transparency is one of the basic steps for corporate governance. Schnackenberg and Tomlinson (2016) emphasize transparency as a result of the enforcement of laws, internal regulations, specific regulations and business policies related to corporate decision making, and expand operations for employees, stakeholders, shareholders and the public. Thus, from a legal perspective, transparency is understood as the framework of the laws and internal management regulations of the company, which are compulsory to comply with the public disclosure, timely and accurate information. Information related to financial and business activities. Otherwise, A fundamental reason that needs to be mentioned is that the decline in the amount of FDI comes from the internal weaknesses of a country such as unstable macroeconomics, besides issues such as high interest rates and debt. bad, the investment environment loses its appeal (Biglaiser & Staat, 2010, Schneider & Frey, 1985)

Vietnam is in the process of strong administrative and institutional reform, hence, foreign investment activities become more active, the demand for Vietnamese enterprises to list or attract capital in foreign markets is increasing day by day. In particular, the financial market in general and the stock market in particular are experiencing strong developments, attracting more and more foreign investors and organizations to seek business opportunities. From international practices to the operational practice of administrative agencies in Vietnam, it can be seen that the strict enforcement of the principle of transparency plays an important role in facilitating foreign investment and the level of transparency depends on the capacity and performance of supervisory agencies. Therefore, the hypothesis is formed up as below:

H<sub>1</sub>: Transparency has an impact on attracting FDI.

### 2.2. geopolitical, cultural and linguistic (abbreviation as GCL)

The proximity of geopolitical, cultural and linguistic relations also explains the flow of FDI between countries (Azam, 2009). This can be explained by the special historical, political, cultural and linguistic relationship between these economies. In term of international trade, this is an activity where an enterprise will export goods and services to consumers in another country or import foreign goods and services into its country. A country's goods and services are products of that culture (Bütthe and Milner, 2008). Therefore, from a cultural perspective, international trade is the transfer of products and services produced from one culture for use by people from another culture. For any business that introduces a product to a foreign market, the first factor to consider is whether the product fits the needs, tastes, or in other words, is appropriate for culture of indigenous customers or not, rather than trying to change the culture to suit the products they produce. Granted, each company has strong and key products in the business. and have been successful in a certain market, but cultural differences in new markets often require the product to correct a few details (Azam, 2009; Biglaiser and Staat, 2010, Schneider and Frey, 1985; Tran, 2020).

With comparative advantage in culture, politics, geography, FDI enterprises will benefit from minimizing the cost of moving production and still maintain a close relationship with the existing production facility. The similarity in political institutions also contributes to help FDI enterprises possessing a favorable commencing in exploration, development, and strict compliance with laws in the host country. As a result, the hypothesis is proposed as follow

H<sub>2</sub>: Geopolitical, cultural, and linguistic factors have impacts on attracting FDI.

### 2.3. Business Policies (abbreviation as BP)

Business policies have a significant impact on enterprises. These policies can increase the level of supply of entrepreneurs or restrict the development of new ventures. Respectively, the policies may be hard or soft. Hard policies usually provide assistance in the form of finance (loans and grants), otherwise, soft policies include counseling activities to entrepreneurs facilitating financial assistance, enhancing technology and access to technology and improving access to physical infrastructure.

By that fact, many researches point out that many factors influence investment behavior such as investment intent; stability of investment environment; the development of the financial system; interest rate policy; public investment policy; the development of supporting industries or projects in the same industry where there are links; ability to acquire and apply and develop technology; support capacity and investment support policy of the country that attracts investment (Bucci, 2002; Knowles and Owen, 1995; Romer and Lucas, 1988; Shefer and Frenkel, 2005). As a result, the hypothesis is proposed as follow

H<sub>3</sub>: Business policy factor has an impact on attracting FDI.

### 3. Research Methodology

The study consists of two main steps: qualitative research and quantitative research.

Qualitative research is conducted by in-depth interview method. With this method, the target is a group of representative firms receiving FDI funding in HCM City. This research aims to explore and adjust the scale of political factors that affect the FDI's attraction. Quantitative research includes Preliminary quantitative study, conducted a survey from 100 to 150 representatives of FDI firms mentioned above to check their trustful, unidirectional and convergent validity. The official quantitative research, intensive survey was carried out by creating a questionnaire. Based on the study of sample size to make the selection of the appropriate number of samples. According to Bollen (1989), sample size was proportional to variables of 5:1; however, Hair et al. (2009) said that the minimum sample size was from 100 to 150. Data collection and analysis: The data collection was officially based on representatives of firms facilitating from the FDI receiving sector as mentioned above. After getting the data, we started the Exploratory Factor Analysis (EFA). Scale of trustful was judged by Cronbach's Alpha, the unsuitable variables would be removed. The next step was to affirm the scale by analyzing confirmatory factor (Confirmatory Factor Analysis – CFA), the model trustful was judged by composite reliability, convergent validity and discriminant validity. Finally, analyzed theoretical model by structural equation modeling – SEM.

### 4. Findings

Through Table 1, the load of the observed variables ranged greater than 0.6. Cronbach's alpha ranges from 0.726 to 0.768. The results below showed that the scales achieved convergence validity and reliability.

**Table 1**  
Reliability and Validity results

Variables	Items	Mean	SD	Loadings		Cronbach's Alpha
				EFA	CFA	
TRANS	TRANS2	4.11	0.683	0.650	0.72	0.759
	TRANS3	4.03	0.690	0.748	0.71	
	TRANS4	4.01	0.682	0.620	0.72	
GCL	GCL1	3.81	0.779	0.685	0.71	0.768
	GCL2	3.85	0.767	0.700	0.77	
	GCL4	3.73	0.794	0.742	0.69	
BP	BP2	4.11	0.668	0.664	0.65	0.726
	BP2	4.13	0.660	0.752	0.76	
	BP5	3.99	0.635	0.611	0.65	
FDI	FDI1	3.85	0.782	0.509	0.61	0.750
	FDI2	4.00	0.725	0.622	0.80	
	FDI4	3.99	0.715	0.895	0.744	

CFA calculating is partially set the basis for SEM, apparently, it provides the establishment of convergent and discriminant indices in order to serve the evaluation of validity construction as well as reliability of instruments. Referred to the likelihood of two measures, the combination of indices such as composite reliability, average variance extracted (Anderson & Gerbing, 1988), maximum shared variance, and maximum BP-construct correlation (Hair et al. 2009); are employed to serve the convergent and discriminant validity via factor loadings. Thus, Table 2 indicated the proper reliability and validity of all instruments as well as the CFA model in Fig. 1 by applying the regulation as  $CR > 0.7$ ,  $AVE > 0.5$ ,  $MSV < AVE$ , and  $\sqrt{AVE} >$

Max correlation.

**Table 2**

Convergent and Discriminant findings

	CR	AVE	MSV	MaxR(H)
TRANS	0.728	0.500	0.428	0.738
SLV	0.759	0.512	0.479	0.759
AG	0.761	0.518	0.479	0.780
FDI	0.768	0.525	0.434	0.773

**Table 3**

Model fit indices

Indices	Criteria	Model
$\chi^2/df$	< 3	2.228
GFI	> 0.8	0.976
CFI	> 0.9	0.980
TLI	> 0.9	0.973
RMSEA	$\leq 0.08$	0.041

Statistical indicators such as  $\chi^2 / df = 2.228 < 3$ ,  $GFI = 0.976$ ,  $TLI = 0.973$ ,  $CFI = 0.980$  are greater than 0.9,  $RMSEA = 0.041 < 0.05$  all proved that the model is considered appropriate.

**Table 4**

SEM results

Relationship		Estimates	P-value
FDI	←-	TRANS	0.188
FDI	←-	SLV	0.579
FDI	←-	AG	0.433

Table 4 illustrates the result of the suggested hypotheses for the suggested research model. As can be seen the table, H1, H2, H3 are significantly supported. Respectively, the highest effect is SLV, at 0.579, and following by AG and TRANS at 0.433 and 0.188.

## 5. Conclusion and Recommendation

FDI does not only stop at adding development capital and creating jobs for workers but also contributes to bring new technologies and development for human resources. Accordingly, FDI has been recognized as one of the sources of capital contributing positively to the economic growth of Vietnam. All the stated agencies need to consider and continue building and perfecting the legal system, correcting asynchronous content, adding new regulations to create a gradually completed legal system with international practices. The Government needs to monitor and supervise the implementation of laws on investment and regularly monitoring businesses to promptly detect and handle arising problems. In addition, the government should prioritize welfare facilities to serve social needs such as hospitals, schools, houses, especially, in industrial parks and export processing zones for workers and investors' peace of mind to work. Proposing the government to direct the review to create favorable conditions for the licensing of foreign workers who are experts; tax breaks for bus, truck and motorbike manufacturing, with more specific guidance on severance allowances, job losses, unemployment benefits, and central regulatory issues such as taxes, customs, environmental impact assessments.

Regarding policies, mechanisms, it is necessary to have a policy to prioritize FDI projects in key areas of the Southeast region, especially Ho Chi Minh City, to motivate and link provinces located in the southern key economic region, in order to exploit the strengths and inherent potential of these localities

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