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Finance and Performance of Foreign Investment Enterprises in Developing Countries: The Case of Vietnam

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Abstract

This paper studies the growth and performance of foreign investment enterprises in developing countries in the context of global economic integration and domestic reform with a focus on Vietnam as a case study. A model of enterprise performance is constructed to provide empirical findings and evidence-based policy implications on the role of capital, investment, monetary and development policy, entrepreneurship, and legal reform in this important sector's performance.

***Keywords**: Performance of foreign investment enterprises, Capital and investment, Entrepreneurship, Domestic reform and economic integration, Business and trade policy.*

***JEL classification**: E22, E62, F02, F43*

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1. Introduction

Vietnam, a major transition economy in South East Asia and an important member of the Trans-Pacific Partnership, has achieved remarkable economic growth and development since the introduction of its economic reform (Doi Moi) beginning in 1986 (Harvie and Tran, 1997; Phan et al., 2006; Tran 2012). In particular, Vietnam's opening-up policy (the so-called free-market-with-a-socialist orientation reform), new laws on the enterprises in 2001 and 2006, and high economic growth have had a deep beneficial impact on the development, transformation, dynamic structure, entrepreneurship and performance of its industrial sector (Ronnas and Ramamurpthy, 2001; GSO, 2012). In recent years however, the country has faced serious problems. These include high inflation in 2007-08 immediately after its 2007 WTO membership and also in 2012, the rise of China's growth, exports and regional economic power, the impact of the global financial crisis (GFC) that started late in 2008 and was still lingering in 2012 (WB, 2012), and the 2011-2012 Euro sovereign debt crisis and its global contagion. All these developments have adversely affected Vietnam's growth, industrial development, enterprise performance, living standards, legal and institutional infrastructure.

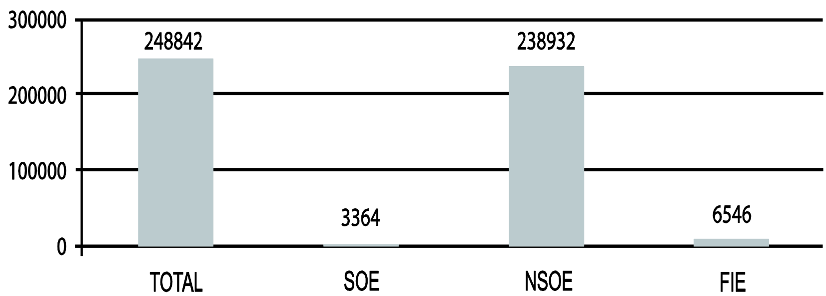
The paper is a rigorous study on the performance of one of Vietnam's important high-growth and high-profit industrial sectors, namely the foreign investment enterprises, during the past 20 years or so, and the role of capital, investment, monetary and development policy, entrepreneurship, legal reform, crises and economic integration on this performance. Its main focus is on constructing a model of enterprise performance (measured in terms of the sector's profit rates) to provide empirical findings to confirm or reject the relevance of this role. Policy implications from the findings for corporate and government decision-makers are then briefly discussed.

The plan of the paper is as follows. In Section 2, historical and survey statistical data are used to describe the main structural and performance characteristics of the foreign investment enterprises in Vietnam and in relation to the features of the other two sectors, namely, state-owned and non-state-owned enterprises. A model of enterprise performance incorporating both industrial production process and economic integration developments is constructed in Section 3 to explore and confirm the causal relationships between the sector's performance and its testable postulated contributing microeconomic, macroeconomic and legal reform drivers. Section 4 reports the empirical findings. Section 5 provides an analysis of the findings and their policy implications. Conclusions are given in Section 6.

2. Vietnam's Foreign Investment Enterprises and their Performance

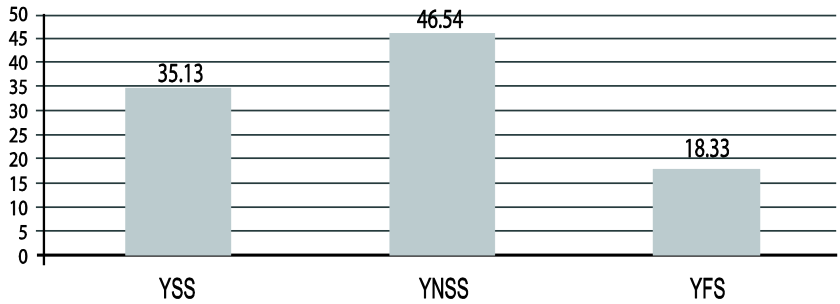
After many decades of devastating colonial and independence wars and their aftermaths, Vietnam has achieved much in recent years with its 1986 renovation reform and earned increasing international acclaim (WB 2012). An important result of this achievement is the transformation and dynamics of the economy as observed through the growth, structural movements, and output shares of its three principal sectors by ownership: state-owned (SOE), non-state-owned (NSOE) (and their three subsectors: collective, private and household), and foreign investment enterprises (FIE), during the period 1995 to 2009 (see Figs 1-5).

Figure 1: Vietnam: Number of Enterprises and their Sectoral Distribution, 2009



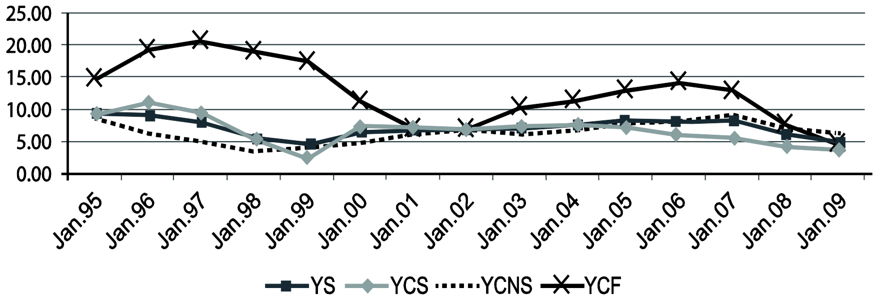
Note: Data in Figs. 1-11 are from GSO (2012) and own calculations.

Figure 2: Vietnam: Sectoral Shares of Enterprises (%), 2009



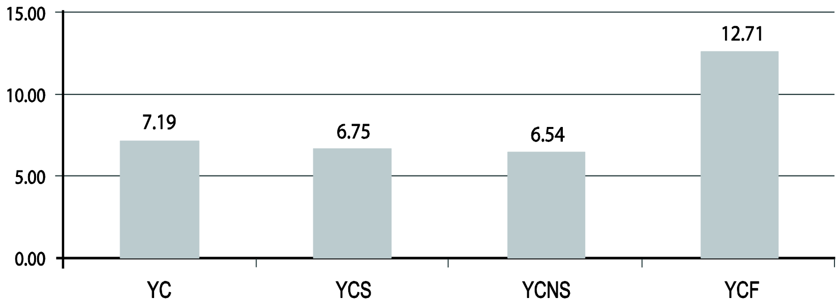
Note: YSS, YNSS and YFS are respectively the shares of the number of state-owned, non-state-owned and foreign investment enterprises in the economy.

Figure 3: Vietnam: Sectoral Output Growth (%), 1995-2009



Note: YC, YCS, YCNS and YCF are respectively national output growth and output growth in the SOE, NSOE and FIE sectors.

Figure 4: Vietnam: Average Sectoral Output Growth (%), 1995-2009



We note from Figs 1 and 2 that, in 2009, while the number of FIEs was small in the economy (2.63 per cent of all enterprises), its output share was interestingly large at 18.33 per cent. From Fig 4, average FIE output growth appeared to be the largest of the three sectors at 12.71 per cent (compared to 6.75 and 6.54 per cent respectively for SOEs and NSOEs). The downside of this growth is that it was more volatile being sensitive to the emergence of regional and global crises such as the Asian financial crisis of 1997 and the GFC in 2008 (Fig 3).

Figure 5: Dynamics and Transformation of Vietnam's Sectoral Enterprises (% of all output), in 1995 and 2009

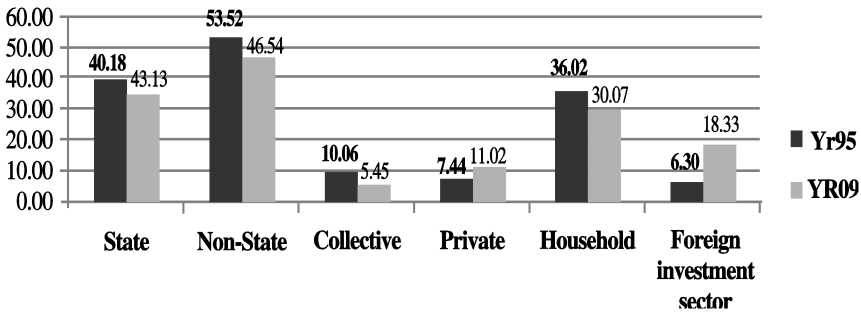
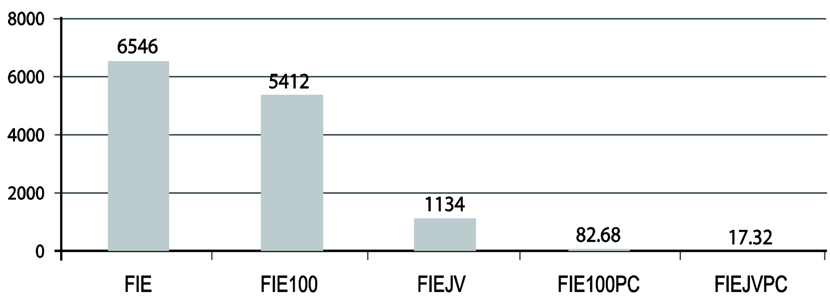


Figure 6: Composition of Foreign Investment Enterprises in Vietnam, 2009



Note: FIE, FIE100, FIEJV, FIE100PC and FIEJVPC are respectively the number of all FIEs, 100%-owned FIEs, joint-venture FIEs, and the percentages of FIE100 and FIEJV.

Figure 7: Shares of Four Industries in the FIE Sector in Vietnam (%), 2009

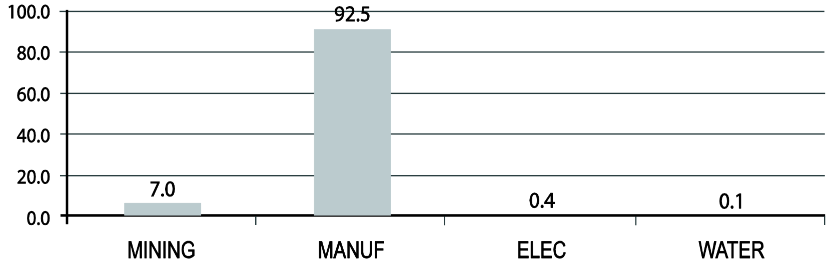
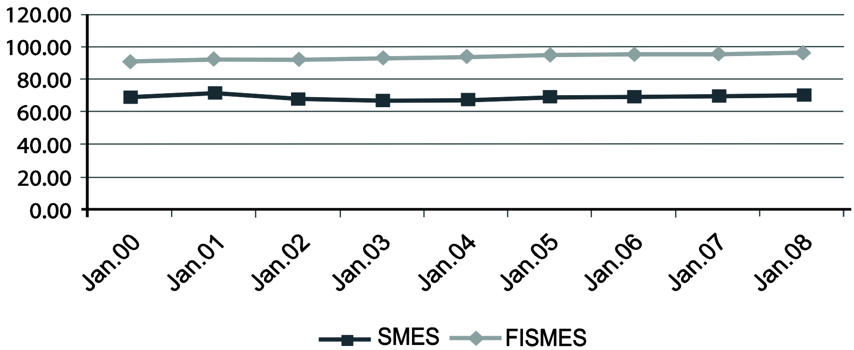


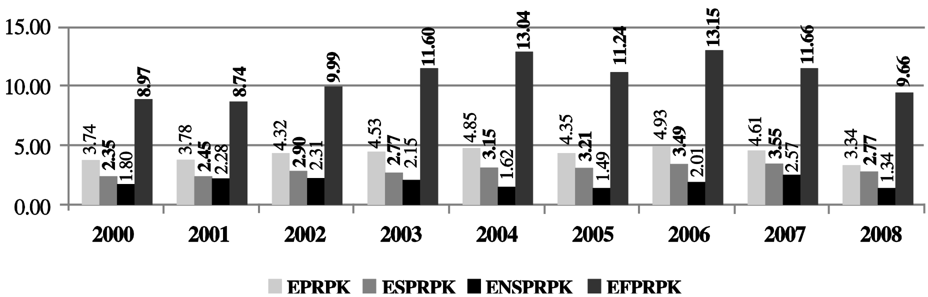
Figure 8: Shares of SMEs in Total and in the FIE Sector in Vietnam, 2000-2008



Note: SMES=SMEs/all enterprises, FISMES=SMEs/all enterprises in the FIE sector.

Data from Fig 5 also shows that, among the three sectors, the FIEs are the only ones that were characterised by a positive growth in terms of their output shares during the period 1995-2009. In Vietnam, the FIEs are predominantly in manufacturing (92.5 per cent) and mining (7 per cent) with the rest in electricity (0.4 per cent) and water (0.1 per cent). The FIEs consist entirely of 100% owned (82.68 per cent) and joint-venture enterprises (17.32 per cent) (Figs 6-7). It is interesting to note that the large majority of enterprises surveyed by the national statistical office (GSO 2012) were small and medium-size enterprises (SMEs) with more than 90 per cent of enterprises in the economy were SMEs and more than 70 per cent of enterprises in the FIE sector were SMEs (Fig 8). The target firms in the paper can therefore be regarded as SMEs, a currently important sector of national and international interest and focus for academic and policy analysis.

Figure 9: Vietnam Enterprise Performance (Profit/Capital) by Sector, 2000- 2008



Note to Figs. 9-10: EPRPK, ESPRPK, ENSPRPK and EFPRPK denote respectively profit rate per capital in the economy, and in the SOE, NSOE and FIE sectors.

Figure 10: Average Profit/Capital Performance by Vietnam Enterprises by Sector, 2000-2008

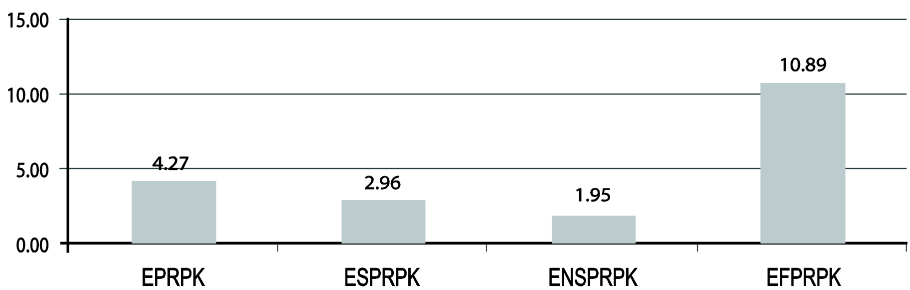
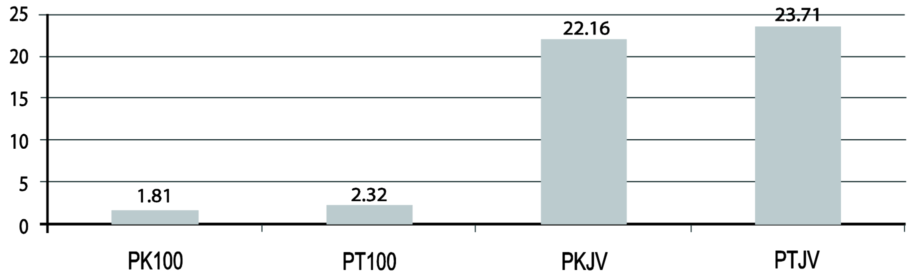


Figure 11: Average Performance per Capital and per Turnover of Vietnam 100%-Owned and Joint-Venture Enterprises, 2000-2008



Note: PK100, PT100, PKJV and PTJV denote respectively the average profit rate per capital and per enterprise turnover for 100%-owned and joint-venture enterprises.

The performance of enterprises can be measured conventionally by output growth or productivity (output per employee) using the production function or alternative growth theory approaches (McMahon et al. 2009), sales (Thang and Trung 2011) or even export growth (Pham 2001). In terms of the theory of international business (Cavusgil et al. 2012), it can also be measured justifiably in terms of the survival rate of enterprises, the growth of enterprise output shares, employment in the firms, capital invested and fixed assets, wage rates paid, and even the financial contribution of enterprise activities to national revenue (GSO 2012). In this paper, we will focus on the performance of enterprises, especially foreign investment enterprises in Vietnam, as measured by two criteria: the profit rate per capital and the profit rate per enterprise turnover. A justification is that the profit rate attained is a good indicator of an enterprise's success and *a fortiori* survival rate and potentially domestic and external expansion. The historical performance of the SOE, NSOE and FIE sectors and the two FIE sub-sectors of 100% owned and joint-venture enterprises in Vietnam during 2000-2008 in this context is given in Figs 9-11. In these figures, we note the prominent sustained dominance of the FIE sector's high profit rate performance over the SOE and NSOE sectors (i.e., 10.89 per cent over 2.96

and 1.95 per cent) and also the higher profit rate per turnover over the rate per capital invested (i.e., 23.71 versus 22.16 per cent for joint-venture FIEs and 2.32 versus 1.81 per cent for 100%-owned FIEs). A study on the causes or drivers of this performance for 100%-owned and joint-venture FIEs is particularly interesting and important for business operation and strategy especially in developing and open economies such as Vietnam.

The literature on the relationship between enterprise performance (e.g., growth, survival, exports and sales) and its potential determinants has been limited to descriptive and survey data analysis (see for example McKinnon 2003; Hansen and Tarp 2004; Rauch and Watson 2004; Baumol 2007; and Vinig and Kluijver 2007) and to conventional production function framework (see Pham 2001; Thang and Trung 2011). A previous macroeconomic study on the performance in terms of the growth of enterprise output shares in Vietnam has been reported (Tran 2011, 2012). However, a rigorous study of the enterprise performance in an open developing economy with economic integration commitments and with existing production technology in general or of the success, survival and expansion of FIEs in Vietnam in particular is conceptually and empirically desirable for enterprise development policy analysis but it is currently lacking.

The paper will focus on a modelling study of the causality of the FIE sector's high performance for corporate and government policy analysis and address the following research questions: *(i) What fundamentally contributed to the high performance of the 100%-owned and especially joint-venture foreign investment enterprises in Vietnam in recent years?; (ii) Are these contributors different for these two sub-sectors?; (iii) Did the 2006 legal reform assist in this performance?; (iv) What are the effects of economic integration and financial crises on the FIE performance in Vietnam?; and (v) What are the best practice strategies for FIE development and survival in Vietnam?*

3. A Model of Enterprise Performance in the Context of Production, Technology, Domestic Reform & Economic Integration

Conceptual Framework: An early detailed study based on a descriptive analysis of the data from two large 1991 and 1997 surveys of Vietnam's enterprises was carried out by the World Bank and reported by Ronnas and Ramamurpthy (2001). A number of quantitative studies especially on the impact of human resource management and training on Vietnam's enterprise performance in terms of output and organisation in a production function framework has also been undertaken (e.g., Thang and Trung 2011). A previous quantitative study on the foreign investment enterprise performance in terms of exports and sales using a non-production function framework has also been carried out by Pham (2001). A more recent comprehensive official report on the three principal sectors' activities, output, industrial structure and dynamic transformation based on the nine annual surveys of Vietnam's enterprises between 2000 and 2008 is given by the General Statistical Office (GSO, 2012). A macroeconomic multi-structural equation model of output growth share performance for Vietnam's enterprises classified by ownership in the context of economic integration has been constructed and reported (Tran 2012).

A number of innovations in modelling enterprise performance will be introduced in the present paper. First, we assume conceptually that the enterprises and their performance in an open economy, developed and developing, with economic integration commitments are constrained by two sets of complementary factors: domestic and international. Second, domestically, the enterprises operate in a generalised meta-production framework where capital, labor, entrepreneurship, and legal enterprise reform are assumed to play an important part in determining their performance. Third, internationally, as the country has economic integration commitments and benefits in the form of liberalised trade in goods (exports and imports) and investment (portfolio and foreign direct investment) (WTO 2012), the enterprises and their performance are assumed to be concurrently affected by these factors. As has been mentioned earlier, enterprise performance is defined by profits per capital invested and profits per enterprise turnover. For pragmatic reasons, only the linear model is specified for the study (see Tran 2012 for other functional forms that can be adopted).

The Model: A simple model of the enterprise profit determination in an environment of metal production function technology and growing regional and global economic integration influence can then be written generally in implicit form as:

$$P=P(L, K, I, T, FDI, D, C06) \qquad (1)$$

where P=PK, profit per capital or P=PT, profit per enterprise turnover, L=average employees per enterprise, K=average capital per enterprise (VND bil), I=average fixed assets & long-term investment per employee, T=openness [(exports+ imports)/GDP], FDI=foreign direct investment/GDP, D=entrepreneurship, C06=2006 legal reform.

In equation (1), enterprise performance or profit is assumed to be determined by the conventional domestic production factors of labor (L) and capital (K), fixed assets and long term investment (I), management skills or entrepreneurship or its proxy indicator (D), the 2006 legal reform in the form of the Law of Enterprises in effect in 2006 for testing purposes. Importantly, this performance is also assumed to be determined by the international factors such as trade or openness (T) and foreign direct investment (FDI) in the context of economic integration theory for open economies with free trade agreement commitments.

In its linear form (a log form is not appropriate as some data on profits in the early 2000s were negative), the model (1) can be written explicitly as:

$$P=a1+a2L+a3K+a4I+a5T+a6FDI+a7D+a8C06+u \qquad (2)$$

where the as are regression parameters and u is the disturbance with regular statistical properties representing omitted determinants.

The Data: The enterprise production and performance data for the model were obtained from Vietnam's General Statistical Office (2012), and trade and FDI data from the Asian Development Bank (2012). While the ADB data are available for the period 1990 to 2010, the GSO data are available only for 2000-2008. A qualitative variable was used for the introduction of the Law of Enterprises in 2006. The continuously rising trend of the two profit rates in the sample can be attributed to enhancing entrepreneurship or business management skills which can also be equated to development progress of the country. This was proxied by a trend variable.

4. Substantive Findings

The empirical findings by the Seemingly Unrelated Regression (SUR) estimation method for the model of enterprise performance (equation 2) applied to two types of profit rates (per capital – PK - and per enterprise turnover - PT) and simultaneously to both 100%-owned (100) and joint venture (JV) FIEs (that is, PK100, PKJV, PT100 and PTJV) in Vietnam are given in Table 1. All variables representing the key conventional production technology process (labor, capital and investment) and the major economic integration activities (trade and FDI – a financial variable was not tested due to unavailable data). A proxy for entrepreneurship or development policy was omitted due to its insignificance and also to the fact that the reported models have very high explanatory power. While the degrees of freedom are small, the serious problem of high RSQ and low DW values in the estimated models was not present. SUR is used instead of the ordinary least squares on the ground that within the FIE sector, there is likely some correlation between the activities of the 100%-owned and joint venture sub-sectors. In addition, the panel regression estimation method was not employed due to the fact that the performance of the two sub-sectors is likely to be structurally characterised by their own determinant factors, and this likely behavioral discrepancy is an objective for testing purposes. As is well-known, the SUR estimates are statistically consistent and efficient in the class of generalized least squares estimators.

Table 1: Foreign Investment Enterprise Performance – SUR Estimation

	Const.	L	K	I	T/GDP	FDI/GDP	C06	RSQ	DW
PK100	2.223	-0.001	0.028	-0.055*	0.035**	0.196	0.148	0.962	2.581
PKJV	-20.025**	0.070*	-0.096**	0.019**	0.361**	-1.254**	5.037	0.988	2.596
PT100	5.374	-0.007	0.047	-0.085*	0.042*	0.277	0.222	0.947	2.537
PTJV	-66.739**	0.345**	-0.377**	0.087**	0.395**	0.366	8.467**	0.724	2.648

Notes: **=Significant at 5%, *=Significant at 10%, RSQ=R squared, DW=Durbin-Watson statistic. See definitions for L, K, I, T/GDP, FDI/GDP and C06 in text

Judged from the results reported in the table, the standard statistical performance of the estimated models for Vietnam's FIEs appears good in terms of the conventional R^2 and a lack of first-order serial correlation.

5. Policy Implications for Foreign Investment Enterprises

The performance of FIEs in the 100%-Owned and Joint Venture Sub-sectors – is interesting that the findings do not support the assumption of identical causal effects on the performance for both 100%-owned and joint venture FIEs in Vietnam. This outcome is expected as the observed performance of the joint venture FIEs completely dominates that of the 100%-owned FIEs (see Fig. 11). One important modelling implication of this is that a combined study of these two sub-sectors would be inappropriate conceptually and in policy implementation. In addition, another implication for serious research in this field is that the use of panel data regression with constant effects from all determinants over all sub-sectors for example for this kind of study would also be inappropriate. A third implication is that while the 100%-owned and joint venture FIEs are two separate legal entities, our findings show that they also have apparently operated under two different production technologies and responded differently to the impact of reform and economic integration. These enterprises require therefore separate study, analysis and strategic policy.

What are fundamental production and integration drivers of FIE performance? For 100%-owned FIEs – the sub-sector is characterised by relatively weak performance or low profit rates. As the findings indicate that openness is the only significant contributor to FIE performance in terms of profits per capital, the importance of economic integration here cannot be underestimated for the survival of this FIE sub-sector. In addition, capital, FDI and the 2006 legal reform appear to have all positive but only weak effects on this performance indicator. Labor and fixed assets and long-term investment surprisingly on the other hand seem to have dampening effects. These reflect apparently the low quality or inappropriate business strategies for these FIEs. The findings are similar in the case of profits per enterprise turnover but the impact of integration is statistically weaker. Both profit equations have however a very high empirical fit. Entrepreneurship as a separate and important factor of profit for this sub-sector is not statistically validated.

Joint-venture FIEs have a much higher success (profit) rate than 100%-owned FIEs and the causality of this seems to be more complex. For this sub-sector of FIEs, the profit per capital is strongly and dominantly supported by factors such as labor, fixed assets and long term investment, openness and especially, the 2006 legal reform. The positive impact of openness on this sub-sector performance is almost ten times that on the 100%-owned FIEs. Unlike the 100%-owned FIEs, the performance of the joint-venture FIEs is surprisingly however not assisted by capital and FDI. In the case of profit per enterprise turnover, while capital is not beneficial, FDI now appears to have a positive but weak impact. Again, the role of labor, fixed assets and long-term investment and legal reform is all important to the sub-sector performance. In fact, the largest contributor to the performance of these FIEs is the 2006 legal reform. Again, entrepreneurship as a separate and important factor of profit performance is not statistically supported.

Is FIE Performance Affected by Economic Integration, Legal Reform and Crises? Economic integration has played a crucial part in Vietnam's economic "miracles" and put the country in the group of high growth economies in the world and contributed to the establishment of FIEs and their high profit achievement especially in the recent years. In addition, the country's Doi Moi openness policy has also led to its industry, investment, structural and especially legal reforms (Hansen and Tarp 2004). The results of this integration and reforms have benefited the FIE performance by both profit per capital and profit per enterprise turnover measures especially for the joint-venture FIEs. A reason is apparently that these enterprises, due to their collaborative nature, are likely to use local knowledge and resources in addition to their overseas expertise and investment to manage their businesses more successfully. Thus, joint-venture FIEs appear the best form of business development and operation in the case of Vietnam. The large and positive impact of Vietnam's 2006 legal reform on the 100%-owned and especially joint-venture FIEs has been noted above. Finally, while the data (Fig 9) indicate a strong damaging effect of crises on Vietnam FIE performance, this effect could not be validated in our estimated models of enterprise activity.

Entrepreneurship in Vietnam's FIEs: If the thesis that innovation and entrepreneurship are the key elements for enterprise success domestically (via increased productivity and efficiency) (see Nguyen et al. 2009; EC 2012) and in international trade (via expanded exports) (see Pham 2001; Nguyen et al. 2007) through enhanced competitiveness and comparative advantages is correct, then our findings cannot provide statistically clear-cut support for this thesis. There are a number of reasons for this. First, when we take into account the dynamics and transformations of the economy in general and the FIE sub-sectors in particular, the results for productivity of labor and capital have been mixed on our definition of success (namely, profit rate per capital and per enterprise turnover). Second, while entrepreneurship can produce high trade and subsequently, as postulated and empirically validated, high profit performance, high trade can also be produced by say Vietnam's trade liberalization obligations and their effective implementation under its various regional and global trade agreements. Our findings appear to support the latter hypothesis. An important policy implication is that, to improve labor and capital productivity in Vietnam's FIEs in the context of the country's early development stages, capital and human resource management training for managers and directors for enterprises in general and for FIEs in particular would be a high priority. This implication is also compatible with the strong focus for funding support to Vietnam's enterprises in general and FIE sub-sector in particular by national and international donors and policy-makers (IFC 2009).

6. Conclusion

In the preceding sections, we have discussed the role of FIEs and their transformations, dynamics and performance in Vietnam in recent years, and constructed a simple model of enterprise performance with micro and macro-economic determination to explore and identify the fundamental factors for these FIEs' success, survival and possible expansion domestically and internationally in the two FIE sub-sectors in focus, namely 100%-owned and joint-venture FIEs. We have found mixed results for the conventional production factors of labor and capital, but strong support for the effects of economic integration and legal reform on these enterprises' performance as measured by the profit rates. We speculate that, due to the development stage of the country, the enterprise performance has benefited from its trade and FDI liberalization and co-operation with its trading partners (Tran 2012) as has also entrepreneurship capacity as a result of this exposure to the global economy. We are also cautious about the risks of damaging contagion of the regional and global financial crises on this performance and call for appropriate policy to avoid them or to mitigate, to some extent, their adverse effects for national, regional and global benefits.

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