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A new theoretical framework to assess Multinational Corporations' motivation for Foreign Direct Investment: A case study on Vietnamese service industries☆

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ABSTRACT

Purpose: This paper develops a new theoretical framework, based on eclectic paradigm and institution theory, to evaluate Multinational Corporations' (MNCs') incentives for Foreign Direct Investment (FDI). The new framework is applied as a case study in the service sector across Vietnam.
Design/methodology/approach: This study applies the Structural Equation Modelling (SEM) approach to investigate the motivational factors of MNCs by using primary data on MNCs working in service industries in Vietnam. This paper introduces five motivational factors, and conducts a Confirmatory Factor Analysis (CFA) to study the construct validity of the research measures and to cluster the variables into common factors that can be used to present relationships among sets of interrelated variables.
Findings: The SEM results reveal that the key determinants of MNCs' incentives to invest in service industries are market-seeking government policies and culture, all of which have significantly contributed to FDI.
Originality/value: This study offers new knowledge and insights into the factors that motivate FDI by MNCs in general and in service industries in Vietnam. The findings are plausible and in line with the recent economic reforms launched in Vietnam, along with the increased FDI inflows into the country in the last twenty-five years.

1. Introduction

Academic literature has extensively discussed the key determinants of Foreign Direct Investment (FDI) at both theoretical and empirical levels. Countries try to improve FDI-related parameters to attract more investment for economic development. For example, Vietnam, where FDI is considered to be a vital source for economic growth and development, has followed a policy of encouraging FDI since the endorsement of its first Law on Foreign Investment in 1987 (Le, 2002). The key objectives of Vietnam's FDI policy are to attract capital, advance technology, and enhance skills in order to effectively improve the country's prospects, boost savings, and improve people's lives (Uhy, 2008). Due to the implementation of this program, the country has been receiving a large amount of

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foreign investment, especially in service industries. However, studies examining this phenomenon are few and focus only on economic factors. Very few empirical studies explore the motivations of Multinational Corporations (MNCs) or worldwide enterprises investing in the service sector. Most current studies have concentrated on the link between FDI inflows and economic development by using secondary data at the state level (Dinh, 2009) or district level (Meyer and Nguyen, 2005). To address this knowledge gap, this study offers and investigates new insights into the factors that motivate FDI by MNCs in general and in Vietnamese service industries in particular, using primary data to answer the following research questions:

– Based on the former studies, what are the key factors motivating MNCs to invest in Vietnam? What is the impact level of each factor?

The Doi Moi (economic renovation) in 1986 altered Vietnam economy from a central planned economy to a sort of mixed economy through building and strengthen international relations and recognizing the existence of different sectors such as private sector, foreign investment, and state owned sector (Vu-Thanh, 2014; Delaunay and Torrisi, 2012; Vuong, 2014).

The Vietnamese government significantly and successfully improved policies to boost the country's economy (Anwar and Nguyen, 2010). The most important policy changes that directly or indirectly impacted FDI inflows and private sector activities in Vietnam include introduction of Foreign Investment Law in 1987; introduction of Corporate Law and Enterprise Law in 1990; recognition of the private sector by Vietnam's Amended Constitution in 1992; introduction of the Law of Enterprise in 1995; being a member of Association of Southeast Asian Nations in 1995; United State and Vietnam Bilateral Trade Agreement in 2001, Law of enterprise 2005, and being a member of World trade Organization in 2007 (Vuong, 2014; Anwar and Nguyen, 2010; Vu-Thanh, 2014).

Changes in polices are translated into dramatic increase of FDI inflows. The fist FDI inflow took place after a year of the enforcement of the Foreign Investment Law in 1987. Since then, FDI has significantly grown to become one of the main drivers of the Vietnamese economy (Vu-Thanh, 2014). According to Büthe and Milner (2008) and Delaunay and Torrisi (2012), opening international trade through agreements contributes to the FDI growth.

Vietnam is potentially attractive for many businesses not only because of its policies favouring international investment, but also due to some other factors, such as large markets, new markets and cheap labour costs. Vietnam currently is ranked among the fastest growing economies in the world, having forged ahead at an average growth rate of 7.3% between 1990 and 2010 (IMF 2011). According to the World Factbook, the population of Vietnam in 2016 was over 95 million people (The World FactBook: Vietnam, 2017). Thus, Vietnam has become a large market not only for manufacturing products, but also for the service industries. Vietnam, as a developing country with the goal of upgrading its economy is now an attractive place for other business sectors as well, such as construction and machinery supply. In the context of labour, factor-cost advantages arising from low labour costs make Vietnam an attractive destination for foreign companies compared with neighbouring countries, especially in the service industries. Moreover, with the rapid growth of FDI in developing countries, the findings have important implications for similar developing economies and the global economy. Therefore, these findings provide support for researchers and policymakers in Vietnam and other economies in the region needing to understand the key incentives of FDI in the service sector and to make informed decisions. This paper continues as follows: the next section describes the research background, followed by research questions and hypotheses development, data collection and methodology, empirical results and discussion, and finally, conclusions and policy implications.

2. Research background

The motivations of MNCs to invest abroad, especially in developing countries such as Vietnam, have resulted in conflicting opinions among economists. Many believe that economic variables, such as market-seeking, asset-seeking, efficiency-seeking and resource-seeking, as well as government policies, are important factors that affect inward FDI (Cheng and Kwan, 2000; Huilin Lin and Ryh-Song, 2004; Kang and Lee, 2007; Ali et al., 2010; Sethi et al., 2003; Mirza and Giroud, 2004; Meyer and Nguyen, 2005). However, the studies of Blonigen and Piger (2011), Du et al. (2008), Du et al. (2012), Gast and Herrmann (2008), Lei and Chen (2011), Strange et al. (2009), and Yi (2006) show that in addition to traditional economic variables and government policies, culture and business networks are key drivers of FDI growth.

In terms of the theoretical aspect, Dunning (1981), an early scholar in this field, developed what is known as the theoretical eclectic paradigm, which offers the following three distinct advantages why MNCs invest abroad: ownership, location and internalisation. Ownership advantages refer to MNCs' production processes, used to ensure their competitive advantages over local firms (e.g., patents, technical knowledge, management skills and reputation). Location advantages refer to the MNCs' motivations to produce abroad, such as access to protected markets, favourable tax treatments, lower production and transportation costs, and favourable competitive conditions. International advantages occur where the home market does not exist or MNCs can receive more benefits to use their ownership and location advantages to enter foreign markets (investment), rather than selling their rights to local firms (licensing/exporting) (Dunning and Archer, 1987). Thus, when these advantageous conditions (i.e., ownership, location, internalisation) exist, foreign investors decide to make investments in the particular locations. The eclectic paradigm is extended by Dunning (1988) to "embrace intermediate products and to allow for the possibility that some endowments are mobile across national boundaries". This means the more geographically and unevenly distributed endowments are, the more likely international production is to occur (Dunning, 1988).

Some factor endowments (illustrated in Appendix A) generate comparative advantages that can be better exploited abroad. That is, firms can build their competitive advantages upon the home country's specific location-advantages, but they can better exploit these advantages abroad. According to the eclectic paradigm (Dunning, 1993, 1998), the most important motivations of FDI are asset-