IMPACTS OF CHARACTERISTICS OF FDI FIRMS ON THE RELATIONSHIP BETWEEN FDI FIRMS AND VIETNAMESE DOMESTIC SUPPLIERS

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ABSTRACT

The paper investigates the impact of characteristics of FDI firms on building a relationship with domestic suppliers in Vietnam, especially, differences between Japanese FDI firms and other FDI firms in Vietnam. Using General Statistics Office's (GSO) survey on FDI manufacturing sector in three years, from 2015 to 2017, the authors found that: (1) Domestic suppliers are less likely to be selected by FDI firms if they are wholly-foreign firms or export-oriented firms; (2) Domestic suppliers are inclined to be chosen by other foreign investors rather than Japanese FDI firms; (3) However, on the other hand, when being selected by Japanese FDI enterprises as their suppliers, Japanese FDI enterprises tend to establish long-term relationships compared to other foreign investors.

Keywords: FDI firms, Domestic suppliers, Relationship, Characteristics, Japanese and Vietnam.

JEL: F20, L23

INTRODUCTION

Attracting foreign investment is one of the major goals of developing countries since capital shortage remains one of the main obstacles in the path of economic prosperity. It can be deduced from the experience of many countries that foreign investment, while necessary, is not substantial for sustainable growth and development. The effectiveness of these investments in the economy or their impact on the investment host country depends crucially on not only the business ability of domestic firms and government policies of recipient countries but also the characteristics of FDI firms.

In Vietnam, the FDI sector is making a clearer imprint on the impact on total investment, contributing to GDP, exports, and budget revenue. According to the Vietnamese General Statistics Office (GSO), the proportion of foreign-invested sector's contribution to GDP increased from only 2% of GDP in 1992 to 16.98% in 2006 and by 2019, it reached 19.8%. In international trade, the foreign-invested sector has gradually become a major factor in promoting exports and continuous trade surplus; especially, since 2003, it has begun to surpass the domestic sector, contributing up to 66.87% to the total export turnover of the country in 2013 and 69.6% in 2019. This situation shows the role of foreign-invested sector in Vietnam's economic growth.

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However, it also indicates the economy is dependent on the FDI sector. This reality seems to go against the expectation of benefits from foreign direct investment, which creates doubts about the sustainable impact of foreign direct investment on the economy.

As previous studies have shown, building the linkages between FDI firms and domestic firms is crucial, even seen as the key to create sustainable impact from developed manufacturing economies to developing economies like Vietnam. As international economic integration becomes more and more intensive, division of labor becomes increasingly higher along with the development of the global value chains, these linkages, especially backward linkages, has become more and more important. The close link to FDI firms helps Vietnam stay on the path of globalization and join global supply chains. Nevertheless, there are still limitations in studies into how FDI firms pose impacts on building linkages with local suppliers. Moreover, Japan is one of the major investors in Vietnam and has always been possessing sustainable business practices. Therefore, the purpose of this paper is to find out some characteristics of FDI enterprises, especially Japanese FDI firms, which have influences on the relationship with domestic suppliers. The findings of the research will help Vietnamese companies make the choice of appropriate partners for the development and implementation of their business strategies as well as the government to take initiative in formulating policies enabling businesses to attract and efficiently utilize foreign investment capital.

The paper includes five sections. Next section describes main determinants of relationship between FDI firms and domestic suppliers via literature reviews. Section 3 introduces an empirical model. And Results and Discussions are presented in section 4. The last section is Conclusions.

Determinants of Relationship between FDI Firms and Domestic Supplier: A Literature Review

There are several aspects of FDI firms that have been mentioned in previous studies to examine the possibility of creating new relationships with domestic suppliers.

Forms of foreign direct investment are the first factor affecting the linkages. There are many businesses investing in Southeast Asia with an aim of exporting to other markets, namely EU, North America and Japan. If a company follows a sales strategy targeting the domestic market, multiple linkages with local firms will be created (Pangestu et al., 1992; Supapol, 1995; Belderbos et al, 2000). The rationale is that, in addition to low technical product requirements when targeting the domestic market, companies have to import cheap raw materials and components to meet the domestic demand. Amendolagine et al (2013) also suggested that investing firms with the purpose of seeking market share in host countries will have stronger connections with local firms. However, this does not appear to be the fact for NIEs (Belderbos et al., 2000).

When it comes to the ownership, M&A affiliates have stronger linkages with local firms than start-ups (Scott-Kennel and Enderwick, 2001). Obviously, in case of making investments and building from the scratch, companies will take up lots of time to establish relationships; whilst those affiliates under the form of M&A could take advantage of and further enhance such

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connections. The research of Belderbos et al. (2001) on Japanese offshore investment enterprises also shows that mergers and acquisitions have a more consolidated relationship with local firms than startups since they already have old associations formed by the merged entities.

A recent study by Sanchez-Martin et al (2015) on factors influencing the backward linkages in developing countries indicates that export-oriented foreign investment of 100-percent foreign owned entities that are reliant on foreign advanced technology is less likely to develop linkages with domestic firms.

Operation time and experience in the host country is another key factor that exerts impacts on the linkage. Firms that have long been established are inclined to consume more domestic products and services. Meanwhile, businesses that experience a long period of operating and developing in another country will have more advantages in hiring local workers, acquiring information relating to domestic suppliers and making efficient use of domestic supply in order to reduce costs (Amendolagine et al, 2013; Kiyota et al, 2008).

Additionally, the scale of the industry and the infrastructure are positively related to the linkages of Japanese affiliates (Belderbos, Capannelli, and Fukao, 2000). Larger-scaled affiliates are less likely to purchase locally compared to smaller companies. This is due to the fact that such companies are well-equipped with in-house production capacity and available global supply systems as well as experienced in operational control. This is not to mention that local suppliers do not have enough production scale and capacity to provide Japanese affiliates with a large volume of goods (UNCTAD, 2001; Chen et al., 2004).

Empirical Model

This paper uses probit model to estimate the effect of the FDI enterprises' characteristics on establishing relationships with domestic suppliers. The estimation equation is as follows:

$$Y_{it} = \beta_1 X_{it} + \beta_2 D_{it} + \varepsilon_{it} \qquad (1)$$

Y_{it} reflects the relationship between FDI firms with domestic suppliers through: (1) the buying rate of raw materials from domestic enterprises, *vninput_rank*, this variable takes the value of: (i) 0 if not buying the raw materials from domestic suppliers, (ii) 1 if the percentage of purchasing raw materials is less than 50%, (iii) 2 if the percentage of buying materials is greater than 50%, and (iv) and 3 if the percentage is 100%; (2) concluding a 36-month contract between a FDI enterprise and a supplier, *long_link*, this variable takes the value of 1 if a 36-month contract is signed and of 0 if there is no 36-month contract. The purpose of this variable is to consider factors affecting the ability of FDI firms to build long-term relationship with domestic suppliers.

X_i is a set of variables reflecting the characteristics of FDI enterprises that can affect the ability to link with domestic suppliers. Due to the limited data, the study considers two main features, including:

1. Foreign ownership of FDI enterprises, *fdi_100*, and this variable takes the value of 1 if the enterprises ownership is 100% foreign capital and receives value 0 if the ownership is a joint venture.

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2. The investment orientation of the enterprise is towards the domestic market or is export oriented, *domes_target*, this variable takes the value of : (i) 0 if the FDI firm is 100% export oriented, (ii) 1 if domestic market share less than its exportation share (the ratio of selling products to the domestic market is less than 50%), (iii) 2 if the firms focuses mainly on the domestic market (the ration of selling products for the domestic market from 50%), (iv) and 3 if the firm is completely focused on the domestic market (the ratio of selling products to the domestic market is 100%).

Di is a dummy variable to compare the differences in characteristics between Japanese FDI firms and other FDI firms in building relationships *Di* is the dummy variable to compare the differences in characteristics between Japanese FDI firms and other FDI firms in building relationships with domestic suppliers.The paper uses survey data implemented GSO for FDI manufacturing firms from 2015 to 2017.

RESULTS AND DISCUSSIONS

Descriptive Statistics

The sample includes 4457 FDI enterprises operating in the field of manufacturing industry, of which 674 enterprises are from Japan. Descriptive statistics are shown in Table 1.

Table 1
DESCRIPTIVE STATISTICS

Variable	Obs	Mean	Std. Dev.	Min	Max
vninput_rank	4452	1.6031	1.1018	0	3
long_link	4457	0.0918	0.2887	0	1
fdi_100	4457	0.9082	0.2887	0	1
domes_target	4450	1.3231	1.0858	0	3
JP	4457	0.1512	0.3583	0	1

Descriptive statistics show that the number of Japanese enterprises accounts for 15% of the sample. Most of the FDI enterprises are 100% foreign owned, accounting for nearly 91%. When investing in Vietnam, FDI firms tend to export rather than selling their products to domestic market. The rate of FDI enterprises in Vietnam selecting domestic supplierst is low. The proportion of enterprises signing long-term contracts with domestic suppliers was only 9.1%.

Estimation Results

The regression results to examine the effect of the characteristics of FDI firms on the purchasing of raw materials from domestic firms are shown in Table 2.

The regression results show that the effect of characteristics of FDI firms considered on the degree of cooperation with domestic suppliers is statistically significant at 1% significant level. Research results have similarities with theory and previous studies. The results show that 100% foreign owned FDI firms are more likely to import input materials than purchasing from

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domestic firms. Export-oriented enterprises investing in Vietnam also acted similarly, tending to buy less inputs from domestic firms than firms targeting the domestic market.

Table 2
FDI FIRMS CHARARATERISTICS AND RELATIONSHIP WITH DOMESTIC SUPPLIER

Vninput-Rank	Coef.	P-value	Coef.	P-value
fdi_100	-0.297	0.000	-0.303	0.000
	[0.059]		[0.059]	
domes_target	0.239	0.000	0.234	0.000
	[0.016]		[0.016]	
JP			-0.187	0.000
			[0.045]	
No Observation	4450		4450	

And it is also not surprised when the results show that Japanese investors tend to be less selective of domestic suppliers. Japanese investors often have very high standards for suppliers such as quality, delivery time, size, etc., it is difficult for domestic firms to meet those requirements and thus Japanese investors tend to import raw materials rather than purchasing from domestic manufacturers. According to Jetro (2019), the buying rate of inputs from Vietnamese enterprises by Japanese FDI enterprises has increased from 22.4% in 2010 to 36.3% in 2019, but it is still low compared to other countries like China (69.5%), Thailand (60.8%), India (55.5%), Indonesia (40.8%)

When considering the possibility of building long-term relationships with domestic suppliers, the regression results are shown in Table 3.

Table 3
FDI FIRMS CHARARATERISTICS AND LONG TERM RELATIONSHIP WITH DOMESTIC SUPPLIER

long_link	Coef.	P-value	Coef.	P-value
fdi_100	0.002	0.986	0.023	0.804
	[0.091]		[0.092]	
domes_target	0.048	0.048	0.063	0.011
	[0.024]		[0.025]	
JP			0.346	0.000
			[0.067]	
cons	-1.396	0.000	-1.498	0.000
	[0.098]		[0.102]	
No Observation	4450		4450	

The estimation results show that, with a significance level of 5%, the level of foreign ownership of FDI enterprises does not affect the ability to sign long-term contracts with domestic

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suppliers. Meanwhile, FDI enterprises investing in Vietnam with the aim of directing their products to the domestic market tend to establish long-term relationships with domestic suppliers.

Particularly for foreign invested enterprises from Japan when selecting the input factors, although they tend to be less selective of domestic suppliers, they still tend to build long-term relationships with domestic suppliers than investors from other countries.

CONCLUSION AND RECOMMENDATION

The benefits derived from foreign investments depend on the density, depth and nature of the linkages between offshore investors and domestic enterprises. Hence, host countries often focus on attracting investments from foreign enterprises having ability to create a large spillover effect and relationship with the local economies; from which attempt to remove obstacles that limit the interaction of foreign companies with local suppliers and customers. A host of previous studies also shows that when FDI enterprises take domestic suppliers as their partners, it will create a profound spillover effect.

This study utilizes the Profit models and survey data of the Vietnamese GSO for FDI enterprises specializing in the processing and manufacturing sector during the period from 2015 to 2017 in order to examine how characteristics of FDI firms influence their relationships with suppliers. The paper reviews two typical features of FDI entities, namely ownership and investment objective. The result shows that 100-percent foreign owned enterprises are less favored of purchasing raw materials from domestic suppliers, but this will not affect the establishment of long-term relationships with domestic suppliers. Regarding the investment objectives, export-oriented FDI companies have a tendency not to opt for local suppliers and are also reluctant to enter into long-term contracts with them.

When considering the differences in building relationships with domestic suppliers between Japanese FDI firms and other FDI entities, the study found out that local suppliers are not on the top priority of Japanese FDI firms; however, once they are chosen, domestic suppliers are able to win long-term contracts with the Japanese than investors from other countries.

Last, the research also gives some implications for FDI attraction policies in order to have apparent spillover effects on the economy. To specify, the government should make choices of investors that are oriented towards the domestic market rather than export-oriented entities. Besides, there should be programs to increase the domestic enterprises' capacity so that they could become the key suppliers for Japanese firms; thereby, fostering long-term and sustainable linkages for the business growth.

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