# What makes Vietnam a more attractive FDI destination than India

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**Abstract**
*The study examines the crucial drivers that make Vietnam a preferred FDI destination over India following the 'China plus one' strategic initiative by the global MNCs to diversify their supply chains and expand operations beyond China. Findings reveal that Vietnam offers numerous benefits, including closeness to China, competitive manufacturing costs, a favorable investment climate, and excellent manufacturing capabilities. However, challenges like infrastructural development and talent shortages must be addressed. In addition, labor, trade, and financial freedom are the prospective areas where India need to expedite its reforms to provide conducive business environment.*

## Introduction

The International Monetary Fund (IMF) categorizes India, Philippines, China, Malaysia, Vietnam and Thailand as "emerging Asian economies" (EAEs). Despite the gloomy outlook for the global economy, Asia and the Pacific continue to be a vibrant and active area[1].

Foreign direct investment (FDI) is increasingly directed into emerging Asian countries. These economies provide a large market, a growing middle class, potential growth opportunities, and sustained competitiveness. Investors seek cost-effective economies such as China, India, and Vietnam, among others, for investments aimed at improving efficiency. India's huge market and highly educated, English-speaking workforce consistently attract investment in specialized areas, especially technology. (Le et al., 2021). These economies experience rapid shifts from rural to industrial and service-oriented urban areas, accompanied by the emergence of an expanding middle class. This middle class drives the demand for a wide range of goods and services, stimulating economic development and investment. Many EAEs have implemented substantial market liberalization, relaxed barriers, and enacted regulatory changes to stimulate investment, company activities, and economic expansion (Nguyen, 2020; Maroof, et a., 2019).

Due to lower labor costs, multinational companies (MNCs) can establish economically sound manufacturing operations and boost their global competitiveness. It could be executed through vertical FDI or platform FDI. Furthermore, growing consumer demand in these economies enable businesses to establish local operations and meet local demand. Such investments are driven by market seeking motivation and mostly classified as horizontal investments (Nguyen, 2020). Horizontal FDI refers to the duplication of specific elements of the production process in foreign countries to meet local market demands (Helpman et al., 2004). It is often motivated by a want to reduce transportation costs. Vertical foreign direct investment (FDI) is distinct from other forms of investment since it entails the fragmentation of the production process over many sites. The motivation behind it is to exploit disparities in manufacturing prices across various countries (Venables, 1999).

Following the tumultuous business climate in China since the beginning of the US-China trade war, the Covid-19 outbreak, China's zero Covid-19 policy, and the related global supply (GVCs) disruptions, companies have adopted the strategic approach of China+1 to diversify their operations and supply chains in order to reduce risks and improve resilience (Basu & Ray, 2022). The Indian government had high hopes of becoming a strategic plus-one partner; however, most investments have gone to Vietnam rather than India. It is evident that Vietnam is attracting substantially more significant international investments owing to the country's expanding economy and welcoming business environment. The present study thus aims to investigate the factors that makes Vietnam is most preferred destination over India.

1 https://www.imf.org/en/Publications/REO/APAC/Issues/2023/04/11/regional-economic-outlook-for-asia-and-pacific-april-2023

**Overview of 'China plus one' strategy**

Foreign investors are currently contemplating adopting the "China plus one" (China+1) strategy. This approach involves multinational corporations (MNCs) diversifying their supply chains and reducing their reliance on China as their only manufacturing and sourcing hub. The strategy involves establishing supplementary manufacturing or procurement operations overseas in addition to the existing headquarters in China. The aim is to mitigate potential risks arising from rising expenses, disruptions in the global supply chain, trade conflicts, and geopolitical instability. The unpredictable global landscape, changing trade dynamics, multiple ongoing geopolitical events, and increasing challenges of doing business in China give rise to concerns about overdependence on a single market, whether for market access or production location. It has led to the adoption of a China-Plus-One strategy. The choice of a "plus one" location primarily depends on advantageous investment conditions, competitive manufacturing prices, the availability of trained labor, infrastructure development, and proximity to key markets. Investors are turning their attention to growing Asian countries such as Vietnam as part of their strategy. Vietnam offers low manufacturing prices, regional and global market access, and an attractive investment climate. Moreover, Vietnam's youthful and proficient workforce, low salaries, improvements in infrastructure, political stability and good governance foster a favorable economic climate.

**Foreign Direct Investments in Vietnam**

Overall, investing in developing Asian economies such as Vietnam as part of a plan allows firms to diversify their risks, gain access to new markets and cost-effective manufacturing, and profit from favorable investment conditions. In April, reported FDI inflows into Vietnam were just over US$3.4 billion, the most significant monthly gain in 2023[2]. In 2021, Vietnam received $22.4 billion in FDI, a 13.5% increase from the year before. This is the largest influx Vietnam has ever seen in the previous five years. Additionally, Vietnam attracted the greatest amount of foreign investment in 2020 in Southeast Asia. According to the World Bank, the manufacturing sector contributed over 25% of the GDP in 2021. In December 2022, Vietnam's exports reached $700 billion, a rise of $31.5 billion over the previous year. With a total export value of $292 billion, it was the greatest exporter in 2020. The production of electronics, textiles, and footwear has increased in Vietnam. The Vietnamese government is simultaneously concentrating on enhancing manufacturing capabilities and pressuring businesses to advance up the value chain for better-quality finished goods.

**Vietnam's Economic Strength**

The regional advantage of Vietnam's location in Southeast Asia, close to the Asia Pacific region, China, and the ASEAN groups, strengthens its position in the global value supply chain and economic ties with other Asian nations[3]. Vietnam also benefited from low labor costs vis-a-vis other Asian competitors, including India. Low-cost labor is thus a significant driver for attracting investments, including the ones moving out of China [4]. Over the years, various reforms undertaken by the Vietnamese government have improved the investment environment, making it conducive for investors. The government offers numerous incentives, including tax cuts and streamlined relaxed procedures enabling ease of doing business. The government's commitment to attracting foreign investment has resulted in a more business-friendly environment (Mallon, 2004).

Timely and practical investment for infrastructure upgradation, particularly ports, railways, roads, special economic zones, and industrial parks, has started reaping benefits. Besides easing transportation and logistics, advancement in communication has also been a game changer for businesses to thrive and prosper (Bui & Nguyen et al., 2022). Vietnam's entry into the World Economic Organization (WTO) in 2007 signaled its emergence as a dedicated and robust economic partner for the global community. Subsequently, the nation has engaged in many bilateral and regional trade agreements. Overall, Vietnam has entered into

2 *https://www.vietnam-briefing.com/news/vietnam-fdi.html/#:~:text=Vietnam%20Adds%20US%243.4%20Billion%20in%20FDI%20in%20April,-May%204%2C%202023&text=Registered%20capital%20from%20foreign%20direct,2023%20to%20US%248.88%20billion.*

3 *https://www.worldbank.org/en/country/vietnam/overview*

4 *https://www.vietnam-briefing.com/news/why-manufacturing-is-driving-vietnams-growth.html/*

18 bilateral, regional or multilateral trade agreements. The latest accords, namely the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the EU-Vietnam Free Trade Agreement (EVFTA), are seen to enhance Vietnam' attractiveness as a center for manufacturing and exporting5. Vietnam is recognized as an economy with a burgeoning population of over 97 million people. However, in terms of overall size, it is far smaller than India, which has a population of 1.3 billion. Vietnam is also home to young, talented professionals, but India equally competes with it in terms of its vast educated and talented IT professionals. The market size of this magnitude may constrain investors looking to develop massive setups that appeal to a wide range of buyers.

Nonetheless, Vietnam's evolving manufacturing sectors, electronics, Information technology, and renewable sectors are very promising for investors. The rapid growth Vietnam offers early movers (MNEs) has an excellent potential for future growth. Moreover, the improved regulatory environment and political stability also significantly enable a conducive business climate and enhance investors' confidence.

The investigation reveals that as a preferred "China plus one" destination, Vietnam offers proximity to China, competitive manufacturing costs, a favorable investment climate, and better manufacturing capabilities. However, challenges like infrastructural development or talent shortages should be addressed. However, Vietnam has effectively utilized its favorable business climate and growing consumer market to attract the departing multinational enterprises (MNEs) from China and new investments. Since the industry-specific characteristics, distinct business objectives, and firm-specific requirements primarily influence investors' preferences (Grim et al., 2020), investors must analyze country-specific locational advantages since Vietnam and India offer significant specific benefits and future growth prospects.

The study also draws comparison between Vietnam and India based on various components of *Index of Economic Freedom* for the year *2021*(Table 1) and over the period 2014-2021 (Table 2) "published and created by the Heritage Foundation and the Wall Street Journal" and *World Governance Index* (Table 3 & 4) by World Bank. These scores provide a snapshot of the economic freedom and business environment in each country. We choose this time period because the Modi government since then has introduced various FDI liberalization and structural reforms to attract global investments.

*Table 1: Comparison based on the Heritage Index rankings of Vietnam and India:*

| INDEX YEAR 2021 | INDIA | VIETNAM |
|---|---|---|
| OVERALL SCORE | 56.5 | 61.7 |
| PROPERTY RIGHTS | 59.2 | 51.3 |
| JUDICIAL EFFECTIVENESS | 55.9 | 35.9 |
| GOVERNMENT INTEGRITY | 48.1 | 38.0 |
| TAX BURDEN | 78.7 | 80.3 |
| GOVERNMENT SPENDING | 78.5 | 86.0 |
| FISCAL HEALTH | 18.0 | 82.8 |
| BUSINESS FREEDOM | 76.7 | 65.2 |
| LABOR FREEDOM | 41.3 | 62.6 |
| MONETARY FREEDOM | 72.1 | 69.0 |
| TRADE FREEDOM | 69.4 | 79.0 |
| INVESTMENT FREEDOM | 40.0 | 40.0 |
| FINANCIAL FREEDOM | 40.0 | 50.0 |

*Source: Index of Economic Freedom, Heritage Index.*
*Note: Lower to higher score represent worst to best ranking.*

The highlighted parameters in Table 1 reflect the aspects where Vietnam ranks better than India.

5 *https://www.state.gov/reports/2022-investment-climate-statements/vietnam/*

*Table 2: Index of Economic Freedom (2014-2021)*

| *Country* | *India* | *Vietnam* | *India* | *Vietnam* | *India* | *Vietnam* | *India* | *Vietnam* | *India* | *Vietnam* | *India* | *Vietnam* | *India* | *Vietnam* | *India* | *Vietnam* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| *Index Year* | 2021 | 2021 | 2020 | 2020 | 2019 | 2019 | 2018 | 2018 | 2017 | 2017 | 2016 | 2016 | 2015 | 2015 | 2014 | 2014 |
| *Overall Score* | 56.5 | 61.7 | 56.5 | 58.8 | 55.2 | 55.3 | 54.5 | 53.1 | 52.6 | 52.4 | 56.2 | 54 | 54.6 | 51.7 | 55.7 | 50.8 |
| *Property Rights* | 59.2 | 51.3 | 63 | 52.6 | 57.3 | 49.8 | 55.4 | 46.4 | 55.4 | 49.7 | 55 | 15 | 55 | 15 | 50 | 15 |
| *Judicial Effectiveness* | 55.9 | 35.9 | 64.1 | 40.1 | 61.6 | 40.3 | 54.3 | 36.3 | 44.4 | 32 | NA | NA | NA | NA | NA | NA |
| *Government Integrity* | 48.1 | 38 | 47.2 | 33.8 | 47.8 | 34 | 47.2 | 30.4 | 44.3 | 24.6 | 38 | 31 | 36 | 31 | 31.5 | 26.9 |
| *Tax Burden* | 78.7 | 80.3 | 79.4 | 79.5 | 79.4 | 79.7 | 79.4 | 79.7 | 77.2 | 79.6 | 77.1 | 79.3 | 79.4 | 79.1 | 79.4 | 77 |
| *Government Spending* | 78.5 | 86 | 77.9 | 75.9 | 77.3 | 74.1 | 77.7 | 74 | 77.4 | 74.6 | 78.1 | 75.1 | 78.3 | 77.1 | 77.8 | 71.4 |
| *Fiscal Health* | 18 | 82.8 | 13.1 | 58 | 14.7 | 40.7 | 13.2 | 27.3 | 11 | 21.1 | NA | NA | NA | NA | NA | NA |
| *Business Freedom* | 76.7 | 65.2 | 65.6 | 65.6 | 57.1 | 63.5 | 56.4 | 63.2 | 52.8 | 61.2 | 47.6 | 58.3 | 43.3 | 61.5 | 37.7 | 62 |
| *Labour Freedom* | 41.3 | 62.6 | 41.2 | 62.5 | 41.8 | 62.8 | 41.8 | 60.4 | 41.6 | 62.2 | 47.8 | 62.6 | 48.7 | 62.9 | 74 | 68.3 |
| *Monetary Freedom* | 72.1 | 69 | 73 | 68.2 | 72.4 | 68.9 | 75.9 | 75.4 | 75 | 76 | 72.8 | 70.6 | 65.3 | 66.8 | 65.5 | 63.6 |
| *Trade Freedom* | 69.4 | 79 | 73.4 | 79.6 | 72.4 | 79.2 | 72.4 | 78.7 | 72.6 | 83.1 | 71 | 83 | 64.6 | 78.6 | 65.6 | 78.7 |
| *Investment Freedom* | 40 | 40 | 40 | 40 | 40 | 30 | 40 | 25 | 40 | 25 | 35 | 25 | 35 | 15 | 35 | 15 |
| *Financial Freedom* | 40 | 50 | 40 | 50 | 40 | 40 | 40 | 40 | 40 | 40 | 40 | 40 | 40 | 30 | 40 | 30 |

*Source: Index of Economic Freedom https://indexdotnet.azurewebsites.net/index*

*NA- not available*

Table 3 below draws comparison between Vietnam & India based on some key governance indicators from the World Bank's Worldwide Governance Indicators (WGI).

*Table 3: Comparison based on the WGI rankings, World Bank of Vietnam and India (2021)*

| INDICATOR | VIETNAM | INDIA |
|---|---|---|
| **VOICE AND ACCOUNTABILITY** | 13.04 | 51.69 |
| **POLITICAL STABILITY AND ABSENCE OF VIOLENCE/TERRORISM** | 44.81 | 24.53 |
| **GOVERNMENT EFFECTIVENESS** | 62.02 | 62.50 |
| **REGULATORY QUALITY** | 37.98 | 49.52 |
| **RULE OF LAW** | 48.58 | 51.92 |
| **CONTROL OF CORRUPTION** | 47.12 | 46.63 |

Table 4: Comparison based on the WGI rankings (2014-2021)

| Country | VA | VA | PS | PS | GE | GE | RQ | RQ | RL | RL | CC | CC |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **RANK** | India | Vietnam | India | Vietnam | India | Vietnam | India | Vietnam | India | Vietnam | India | Vietnam |
| **2014** | 60.10 | 9.36 | 13.81 | 44.29 | 45.19 | 52.88 | 33.65 | 30.77 | 55.77 | 42.79 | 39.90 | 41.83 |
| **2015** | 60.59 | 10.34 | 17.14 | 50.00 | 57.21 | 56.25 | 38.46 | 35.10 | 55.29 | 43.27 | 44.23 | 41.83 |
| **2016** | 61.58 | 10.34 | 14.76 | 54.76 | 56.73 | 53.85 | 42.31 | 32.69 | 52.88 | 57.21 | 45.19 | 37.50 |
| **2017** | 58.62 | 10.34 | 18.57 | 54.76 | 56.25 | 53.85 | 43.75 | 35.58 | 53.37 | 55.29 | 47.12 | 31.25 |
| **2018** | 57.97 | 8.21 | 14.15 | 49.53 | 64.90 | 53.37 | 45.19 | 37.50 | 54.81 | 52.88 | 49.04 | 37.02 |
| **2019** | 56.04 | 11.59 | 19.81 | 48.11 | 59.62 | 54.33 | 47.60 | 38.94 | 51.92 | 52.40 | 46.15 | 33.17 |
| **2020** | 53.14 | 11.59 | 19.81 | 45.28 | 66.35 | 62.02 | 47.60 | 43.27 | 53.37 | 48.56 | 46.15 | 42.79 |
| **2021** | 51.69 | 13.04 | 24.53 | 44.81 | 62.50 | 62.02 | 49.52 | 37.98 | 51.92 | 48.56 | 46.63 | 47.12 |

*Source: https://info.worldbank.org/governance/wgi/Home/Documents*

*Note: The WGI indicators with higher values corresponds to better outcomes.*

Compared to the Vietnam's economic freedom score of 61.7, it was the 90th freest economy per the 2021 Index of Economic Freedom, however, in 2023 it is ranked 72nd with the economic freedom score 61.8. Vietnam is placed 14th out of 39 Asian countries, and its overall score is higher than the global and regional averages. On the contrary, in 2021 with 56.5 points India was ranked 121st freest economy, whereas with a total score of 59.8 out of 100, India still ranked 121st out of 184 countries (https://www.heritage.org/index). The Vietnamese economy has significantly improved its overall ranking and is becoming increasingly market oriented as it integrates into the global trade and investment system. The Vietnamese reforms includes partial privatization of state-owned firms, trade liberalization, and increased acknowledgement of private property rights. Even so, institutional flaws continue to stymie longer-term economic development.

While regulatory quality and the rule of law ratings in Vietnam is lower than in India (Table 3), several other factors may contribute to the preference for Vietnam over India, including economic growth and stability, strategic location and access to markets, investment incentives and free trade agreements, a competitive labor market, and political stability (Contractor et al., 2020). As a result, while regulatory quality and the rule of law are significant considerations for investors, they are not the only ones. Investors consider various aspects, including market potential, cost competitiveness, business convenience, resource availability, and government policies. Each investor may prioritize different criteria depending on their sector, ambitions, and risk tolerance.

## Conclusion

It is widely recognized that a business environment conducive to investment maximizes the benefits of private investment and guarantees the involvement of GVCs. In order to promote investment attraction and business-driven economic expansion, countries should prioritize the resolution of legal, regulatory, administrative, and institutional barriers that impede the investment process and operational efficacy of businesses. The growth of the private sector relies on a country's capacity to build a legislative and institutional framework that facilitates the investment, formation, and expansion of productive local and foreign companies, both inside the country and beyond.

Financial freedom, labor reforms, and trade liberalization are the primary proposed areas for India's development. In order to promote trade, India is already triangulating its industrial, FDI and trade policy. India implemented the Foreign Trade Policy (FTP) 2023 to increase exports and improve the business climate for exporters. Moreover, the policy emphasizes the "export control" regime. The strategy is designed around four fundamental components—Incentive to Remission, Export Promotion via Collaboration, Ease of Doing Business, and Emerging Areas—and relies on engagement and trust with exporters. The strategy aims to maintain firmly established initiatives while being flexible to accommodate the changing requirements of the current era. At the same time labor reforms are also the integral part of conducive business climate, which though has been given enough attention by the Indian government but still deserves timely adjustments to attract MNEs.

The ongoing realignment of India's industrial strategy, including the execution of production-linked incentive (PLI) measures, is of utmost importance. An allocation of Rs. 1.97 lakh crore has been designated to bolster India's industrial capacity and promote exports in fourteen key sectors, such as automotive, pharmaceutical, and textile industries. India has impressive manufacturing skills, particularly in the medium-tech sector. However, its involvement in global value chains is still restricted. The objective of PLI is to optimize the developmental advantages obtained from the activities of multinational firms and promote the incorporation of economies into global value chains by aligning the strategies of major corporations to attract Foreign Direct Investment. Henceforth, implementing these measures can assist India in establishing a conducive business environment and positioning itself as an attractive investment hub, effectively competing with nations such as Vietnam.

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