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Foreign small- and medium-sized enterprises and regional institutions

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ABSTRACT

This study centers upon Vietnam's Law on Investment 2014—a place-based policy that offers investment incentives for foreign firms located in disadvantaged areas. Using the difference-in-differences method for 46,211 firm-year observations 2006–2021, we find that the policy increased the revenue growth of foreign SMEs located in such areas by 17 % more than that of comparable firms located outside. The positive impact is strengthened in regions with stronger governance institutions, namely more efficient business-support services and lower policy bias. Moreover, the impact of the place-based policy combined with business support (policy bias) is stronger in southern (northern) regions embedded in pro-capitalist (pro-socialist) values.

1. Introduction

The roles of host countries' national institutions in facilitating multinational enterprises (MNEs) have been widely examined in the international business literature. Some authors have focused solely on the impacts of formal institutions, such as regulative distance (Hernández & Nieto, 2015) and market-based institutional reform (Dau et al., 2020; Mukherjee et al., 2023). Although informal institutions have been less examined (Boddewyn & Peng, 2021), it has been found that religion (Barnard & Mamabolo, 2022) and norms and values (Yao et al., 2022) that persist over time can govern MNEs through managerial behaviors. Overall, the extant international business literature suggests that national institutions in host countries significantly influence the performance of MNEs.

Prior research has however paid little attention to the relationship between *sub-national* institutional forces and foreign *small- and medium-sized enterprises* (SMEs) (Hutzschenreuter et al., 2020). While large MNEs typically choose more developed areas with well-established supply chains (Asmussen et al., 2020; Yang & Meyer, 2020; Yao et al., 2023) and can negotiate ad hoc special treatments with host countries' central governments (Shukla, 2023), foreign SMEs are relatively more resource-constrained and have less negotiating power (Lee & Brown, 2016; McCann, 2010; Nguyen & Canh, 2021). Moreover, due to their smallness, foreign SMEs typically restrict their scope of business to specific local regions within the host country (Urata & Kawai, 2000). They may therefore need to follow the "rules of the game" that prevail in their sub-national regions if they are to operate their businesses effectively; this makes them highly responsive to local institutional settings (Li & Sun, 2017). However, the extent to which host-country regional institutional forces influence and shape foreign SMEs' performance remains unclear, highlighting the need for more detailed investigations into the roles of sub-national institutions in these contexts.

We aim to fill this gap in the international business research by examining the interplay of regional institutions on foreign SMEs' growth in the context of Vietnam—a developing country with unique institutional settings. Our study centers upon the influence of formal institutions on foreign investments. Specifically, we examine Vietnam's Law on Investment (LOI) which was enacted in 2014 to, inter alia, attract foreign firms to Vietnam's economically disadvantaged areas by offering them special investment incentives in return. For foreign firms operating in Vietnam, the 2014-LOI is an exogenous factor. This institutional change may exert significant impacts on foreign firms, especially the smaller ones, since it creates an uneven playing field in which location advantages (i.e., developed economic zones) may be traded off for tax alleviation and other special treatments.

We evaluate the effects of this place-based policy in conjunction with the governance quality (i.e., business support and policy bias) and informal institutional forces (i.e., the pro-socialist and pro-capitalist values) of a region. Business support incorporates the business-partner matchmaking services offered by local governments (Nguyen et al., 2018); policy bias occurs when a region's state-owned enterprises (SOEs) are allocated favorable credit, land, or government-related contracts over private and foreign businesses (Dinh Thanh et al., 2020). Pro-socialist values are evident in the relationship-based business

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practices popular in the north of Vietnam; pro-capitalist values favor arm's-length business practices, widely followed in the south of Vietnam (Kim, 2007; Nguyen, 2021; Nguyen et al., 2018; Shibai, 2015).

To examine the interplay between regional institutions on foreign SMEs' growth, we investigate 46,211 firm-year observations of foreign SMEs in the manufacturing sector in Vietnam over the period 2006–2021. Using a difference-in-differences model, we find that thanks to the place-based investment incentives offered by the government, foreign SMEs located in disadvantaged areas yield higher revenue growth than their counterparts in non-disadvantaged areas (e.g., areas with better-developed infrastructure and better-functioning financial markets). This positive impact is strengthened in regions with more efficient business-support services and a lower level of policy bias toward SOEs. Moreover, the overall impact of the 2014-LOI with business support (policy bias) is stronger in southern (northern) regions embedded in pro-capitalist (pro-socialist) values.

This paper contributes to the intersection of research on geographical economics and international business. *First*, it introduces a new theoretical lens to examine how place-based policies (i.e., regional investment incentives) affect the performance of foreign SMEs. Prior research has predominantly focused on national policies and their impact on large multinational enterprises (Carney et al., 2019; Deephouse et al., 2016), leaving foreign SMEs—smaller, resource-constrained, and regionally embedded—under-investigated. This study challenges existing paradigms by shifting the focus from centralized institutional influences to sub-national dynamics (see Hutzschenreuter et al. (2020) for a research agenda), emphasizing how regional policies can act as critical levers to offset locational disadvantages for foreign SMEs. This contribution enriches the international business literature by integrating place-based policy analysis with institutional theory (Beugelsdijk, 2022; Tang & Beer, 2022), opening avenues for future research on the interaction between localized incentives and foreign SMEs' behavior and performance in developing economies.

Second, this paper provides a fresh perspective on the role of evolving formal institutions, particularly investment laws, in fostering foreign SME development within developing economies. Unlike traditional approaches that emphasize macroeconomic determinants such as market size, infrastructure, or supply chains (see Nielsen et al. (2017) for a review), this paper shifts the discourse to the design and evolution of legal frameworks, specifically the 2014-LOI. It highlights the dynamic role such laws play in not only attracting foreign SMEs but also enabling them to thrive in emerging economies undergoing institutional transformation. By highlighting the need to align legal incentives with a country's developmental trajectory, this research enhances understandings of how tailored legal instruments can foster sustainable foreign investments and support the growth of foreign SMEs.

Third, this paper reconceptualizes regional institutional heterogeneity in international business research and challenges the conventional view that national policies operate uniformly across regions (Hutzschenreuter et al., 2020; Li & Sun, 2017). It does so by unveiling the profound influence of regional heterogeneity in both formal and informal institutions. As such, it provides a conceptual framework to analyze how variations in governance quality (e.g., business support, policy bias) and entrenched cultural values (e.g., pro-socialist vs pro-capitalist norms) moderate the effects of national investment policies. These sub-national institutional forces are essential for foreign SMEs, which lack the resources and negotiation power of MNEs and therefore rely on local governance and regional norms. These factors shape SMEs' operations and competitiveness, making regional institutions key to their success. This novel viewpoint highlights the impact of formal institutions, such as place-based investment policies, in shaping foreign sector performance (Beugelsdijk, 2022). Also, by emphasizing the necessity for integrating national and sub-national analyses, the study fosters a more holistic understanding of institutional influences on foreign SMEs' behavior and performance.

2. Institutional theory and institutional forces in Vietnam

Institutions have emerged as a prominent determinant of how economies function, perform, and develop. Institutions may be formal (e.g., regulations and laws) or informal (e.g., cultures, norms, beliefs, values) (Acemoglu & Johnson, 2005; DiMaggio & Powell, 1991). In this study, we adopt the new institutional economics perspective of Williamson (2000) for three reasons. *First*, the perspective enables us to understand the sensitivity of foreign firms to host-country formal institutions manifested as first-order economizing (i.e., the formal "rules of the game" which economic agents must follow for survival and growth (Webb et al., 2020)). *Second*, it fits into our contextual understanding that in a developing economy where formal institutions may be underdeveloped, a set of regional governance institutions executed at the local level can reset the "play of the game" (Nguyen et al., 2018), thereby crafting second-order choices. *Third*, the new institutional economics places formal institutions and local governance in a system that is interconnected with informal institutions (Webb et al., 2020). This relates to our primary interest: how foreign entrants respond to values that are deeply rooted in the local economy. We detail below these institutional forces in the context of Vietnam.

Since the DoiMoi economic reform of 1986, Vietnam has continuously improved its legal framework (Le & Tomasi, 2023), including laws on foreign investments. On 26 November 2014, the new Law on Investment (LOI) was enacted. It extensively affects all foreign firms, including foreign SMEs, and their investment activities in all parts of Vietnam. The law is an instrument of geospatial oversight, putting much emphasis on attracting foreign firms to disadvantaged low-skilled areas where the economic conditions are less well-developed than elsewhere in the country. In particular, foreign firms locating their operations in such areas are eligible for special investment incentives by way of taxes and levies. The policy was designed to leverage the resources of foreign firms in disadvantaged areas to reduce Vietnam's spatial economic imbalance. This regional dimension of foreign investment law creates a tradeoff for foreign firms to choose between disadvantaged areas where they can enjoy special treatment from the government and non-disadvantaged areas that typically have larger markets, skilled labor, and more developed industries but do not offer special tax treatments. As this formal institutional force has not been examined systematically in geographical economics, we offer a critical evaluation of the 2014-LOI by examining the growth performance of foreign SMEs located in such disadvantaged areas versus those outside them.

The next layer down of Williamson (2000)'s institutional framework is institutions of governance. These are concerned with how local governments interpret national laws and regulations (Nguyen & Canh, 2020). In this study, we pay particular attention to two governance settings: business support and policy bias. Business support refers to provincial services for the private sector such as trade promotion, business-partner matchmaking (e.g., trade fairs and business clusters), and provision of regulatory information (Nguyen et al., 2018). Policy bias measures the levels of bias toward SOEs at the expense of the private sector, such as where SOEs receive preferential access to credit or state contracts (Dinh Thanh et al., 2020). These two governance forces can critically determine foreign SMEs' access to resources and potential capabilities. Specifically, business-support services help them establish stronger connections with local firms and expand their networks with local partners, which later translate into capabilities and growth (Zhao et al., 2021); low levels of policy bias ensure that foreign SMEs have an even playing field for accessing the local resources that often motivate internationalization in developing countries (Dziemianowicz et al., 2019).

In the Williamson (2000) framework, informal institutions (e.g., values and norms) are the most sticky and resistant to change. Research in the Vietnamese context typically studies pro-socialist and pro-capitalist values (Kim, 2007; Nguyen et al., 2018; Shibai, 2015). Their rise to prominence was seen as a historical trajectory—after the country's division in 1945, with the north (south) above (below) the 17th parallel. While the north of Vietnam followed socialism, the south was remained under the Americans' control and was thus embedded in capitalism until 1975, when the two regions (which at the time were two countries) were unified. Although Vietnam now has a single formal institutional framework, the distinct values within each region persist (Dell et al., 2018) and exert substantial impacts on local firms' behaviors and performance. Accordingly, firms in northern regions are more subject to pro-socialist values: collectivism, relationship-based business practices, and belief in a centralized economic system (Nguyen, 2021), while those in southern regions are more exposed to pro-capitalist values: individualism, arm's-length business practices, and belief in a liberalized economic system (Shibai, 2015). These informal institutional values have been shown to influence local private businesses (Nguyen et al., 2018) and SOEs (Tenev et al., 2003), but their potential impacts on foreign SMEs are yet to be examined.

Overall, drawing on the extant literature, we propose that regional formal, informal, and governance institutional forces significantly influence the growth of a foreign SME to a far greater extent than if the firm were large. But why should this be the case? In the next section we elaborate on why these regional institutions are highly relevant to foreign SMEs.

3. The relevance of regional institutions in the context of foreign SMEs

Foreign SMEs, unlike resource-abundant MNEs, encounter distinct constraints and opportunities when navigating host-country institutional environments. Their limited resources and deep regional embeddedness mean that place-based policies (e.g., the 2014-LOI) and regional institutions (e.g., governance quality and informal norms) play a crucial role in their success.

Place-based policies, such as Vietnam's 2014-LOI, offer specific investment incentives for foreign firms in disadvantaged areas, including tax reductions and subsidies. For foreign SMEs, these incentives provide crucial financial relief that compensates for their smaller operational scale and limited financial resources (Chen & Martin, 2001). Unlike MNEs, which have the capacity to negotiate tailored deals with central governments (Grosse, 1996; Nebus & Rufin, 2010), foreign SMEs rely heavily on place-based policies to offset their liabilities of smallness (Erramilli & D'Souza, 1993). Moreover, MNEs often prioritize locating their operations in developed regions with robust supply chains and solid economic conditions (Li et al., 2018), making them less likely to be influenced by place-based incentives. In contrast, foreign SMEs are more sensitive to cost-saving opportunities (Erramilli & D'Souza, 1993; Westhead et al., 2001) and are incentivized to trade location advantages for financial benefits. This dynamic underscores the criticality of place-based policies in leveling the playing field for foreign SMEs, enabling them to compete effectively despite their inherent resource limitations.

Meanwhile, the governance quality of local governments plays an essential role in shaping the performance of foreign SMEs. Efficient local governance—marked by robust business-support services and minimal policy bias—directly impacts foreign SMEs' ability to access resources and expand networks (Daude & Stein, 2007). For example, matchmaking activities, regulatory information, and trade promotion facilitated by local authorities can significantly reduce transaction costs (Malesky et al., 2015) for foreign SMEs, which often lack the network embeddedness of local firms and the independent capabilities of MNEs (Stoian et al., 2017). Conversely, regions with high policy bias toward SOEs may limit foreign SMEs' access to essential resources (e.g., land, credit, government contracts) and further exacerbate their disadvantages. While MNEs can leverage their political influence and financial clout to bypass these constraints, foreign SMEs rely heavily on local governance quality to thrive (Nguyen et al., 2018; Westhead et al., 2001). Therefore, regional governance quality is a critical determinant of whether place-based policies like the 2014-LOI can fulfill their intended role of fostering foreign SME growth.

Finally, regional informal institutions, such as cultural norms and values, further amplify the importance of sub-national contexts for foreign SMEs. In Vietnam, the dichotomy between pro-socialist values in the north and pro-capitalist values in the south shapes the business environment in distinct ways (Dell et al., 2018; Nguyen, 2021). While the global scale and institutional autonomy of MNEs (Nebus & Rufin, 2010) may insulate them against localized institutional pressures, the local embeddedness of foreign SMEs causes them to be deeply affected by cultural differences (Vanninen et al., 2022). Therefore, foreign SMEs must strategically adapt to variations in informal institutions, highlighting the need for a nuanced understanding of regional dynamics. Unfortunately, existing literature seldom delves into the influence of sub-national regional contexts on the performance of foreign SMEs. In the Vietnamese context, previous studies have predominantly concentrated on MNE investments, as outlined below.

4. Foreign firms in Vietnam

It was not until DoiMoi that the Vietnamese government officially welcomed foreign business entrants in the hope of improving the country's economic conditions. Since studies have found the impacts of foreign investment on the overall economy to be positive (Nguyen et al., 2022), negative (Nguyen et al., 2019), and minor (Nguyen & Diez, 2019), that hope is yet to be fully realized. The reasons for this are twofold. *First,* national regulations, which affect foreign investments, result in firm- or area-specific improvements. Using a difference-in-differences method, Pham (2020) and Luu et al. (2022) demonstrate differences in firm performance and foreign direct investment (FDI) inflows between affected and non-affected firms and areas in the aftermath of tax-cut or re-centralization programs, respectively. *Second,* there are place-based institutional variations in local governance across Vietnamese provinces (Hoang & Goujon, 2014; Jaax, 2020). These reasons can well explain the location-choice strategy of foreign firms investing in Vietnam. As these firms mainly focus on upstream value-chain activities (i.e., they produce/process labor-intensive products) for exporting rather than on downstream processes (i.e., local-market consumption), they thoroughly scan local institutions to understand the conditions that affect resource availability and the constraints of the production markets so that the locations selected are best suited to their growth objectives.

Noticeably, most research on foreign entrants in the Vietnamese local institutional context has focused on large MNEs (Hoang & Goujon, 2014; Luu et al., 2022). Little is however known about whether and how Vietnamese local institutional variations influence foreign SMEs, which account for a majority of the foreign firms in Vietnam (Nguyen et al., 2022). Foreign SMEs in Vietnam are typically family-owned, operate in low-tech processing industries (Hsu et al., 2020), and often face substantial resource constraints due to their size liability (Nguyen & Canh, 2021). We hypothesize the relationship between local institutional variations and foreign SMEs in the next section.

5. Hypotheses

5.1. The impact of the 2014-LOI on foreign SMEs' growth

The 2014-LOI offers foreign SMEs that locate in certain geographical areas special investment incentives by way of taxes and levies. A place-based eligibility condition for the incentives is that the foreign firms must locate their operations in less-developed areas—where local market sizes are generally smaller and access to high-skilled labor is deemed harder. However, the foreign SMEs in these areas may still achieve growth for the following reasons.

First, investment incentives—tax and levy reductions and exemptions—directly contribute to the firm's cash holdings or internally generated funds (Edwards et al., 2016). The cash savings obtained from the special treatments can be reinvested in essential growth-oriented activities, including innovation, workforce training, and marketing, thus increasing firm revenue growth (Guariglia et al., 2011). To obtain the same amount of cash savings, foreign SMEs in non-eligible areas would have to call for equity investments or increase their borrowings. These options come with costs that inevitably dampen firm pricing competitive advantages or otherwise impact firm growth opportunities (Dhaliwal et al., 2006; Edwards et al., 2016).

Second, disadvantaged locations serve as a thin disguise for two economic assets: lower-cost labor and weaker market competition. These can help foreign SMEs to pursue their competitive advantages for growth. Labor-wise, the location choices of foreign firms largely center on a "least-cost location" search, which is contingent upon the firm's specific activities (Kim & Aguilera, 2016). As foreign manufacturing SMEs in Vietnam mainly operate in labor-intensive and low-tech processing industries, they may find that the skilled workforce of highly developed places does not offer a good fit (Huu Cung, 2021). Conversely, less-developed areas present "a double-edged sword," offering low-cost labor as a key production input. In these disadvantaged regions, foreign SMEs can hire workers at significantly lower costs than in developed urban areas (Wiggins & Proctor, 2001), enhancing their operational efficiency.

Regarding competition, foreign SMEs in disadvantaged areas face lower market competition because large MNEs are rarely strongly present in such areas (Brodzicki & Uminski, 2018) and the local firms have relatively weak capabilities and skills (Tri, 2020).[1] Conversely, foreign SMEs in well-developed locations may struggle to force down input prices or to make revenue-generating investments in marketing or other functional activities (Yang & Meyer, 2020). The reason is that well-developed regions offer superior infrastructure and larger local markets, which often attract MNEs with greater resources (Li et al., 2018). For SMEs, these advantages translate into higher costs for labor and land, which exacerbate the difficulties of competing against more established firms. The absence of targeted incentives like those offered under the 2014-LOI diminishes the financial flexibility of SMEs in these regions, potentially constraining their growth opportunities. Therefore, we propose:

Hypothesis H1: The 2014-LOI improves the revenue growth of foreign SMEs in disadvantaged areas more than that of foreign SMEs in non-disadvantaged areas.

5.2. Local government support

The impact of the 2014-LOI on foreign SMEs' revenue growth in disadvantaged areas is magnified when the area has high-quality local governance. This synergy arises from the interplay between the financial and operational advantages provided by the 2014-LOI and the enabling environment created by effective local business support and reduced policy bias toward SOEs. These factors foster an ecosystem where foreign SMEs can overcome institutional voids, integrate into local markets, and achieve stronger growth.

The joint effect of the 2014-LOI and regional business support quality

The tax incentives and special treatments under the 2014-LOI significantly alleviate cost pressures for foreign SMEs in disadvantaged areas. These savings can be reinvested in growth-oriented activities, such as expanding operations, adopting new technologies, or entering new markets. However, the benefits of these incentives are fully realized only when they are complemented by proactive local business support.

High-quality business support, such as trade promotion, supplier matchmaking, and efficient administrative processes, addresses operational bottlenecks that foreign SMEs typically encounter (Malesky et al., 2015). As foreign small businesses, they are more likely to struggle with complex regulatory procedures than domestic firms; when local government offers support that facilitates firms' understandings of regulatory information, their decision making can be more efficient and timely (Malesky et al., 2015; Liu et al., 2020). Moreover, when local governments in disadvantaged areas organize frequent industrial trade fairs, exhibitions, and conferences, foreign SMEs gain not only information but also logistical and legal assistance, helping them optimize their resource allocations and expand their networks (Nguyen et al., 2018; Evers & Knight, 2008). The combination of these support systems with the financial relief gained from tax incentives allows foreign SMEs to focus on strategic goals rather than operational hurdles, leading to enhanced growth performance.

Furthermore, the presence of robust business support enhances the utility of 2014-LOI incentives by reducing transaction costs and fostering trust (Nguyen et al., 2018). For example, SMEs often lack the networks and bargaining power of larger MNEs. Local governments that actively facilitate connections with local businesses help bridge this gap, enabling foreign SMEs to capitalize on the cost advantages provided by the 2014-LOI. Specifically, they can utilize the cash exempted from taxes and levies to form strategic alliances, establish long-term relationships with local suppliers, and achieve further competitive advantages for their growth imperative (Westhead et al., 2001). Thus, we form the following hypothesis:

Hypothesis H2a: *The impact of the 2014-LOI on the revenue growth of foreign SMEs in disadvantaged areas is strengthened in regions having better local business support.*

The joint effect of the 2014-LOI and regional low policy bias

Policy bias toward SOEs poses a significant barrier to foreign SMEs because it restricts access to vital resources like land, credit, and government contracts. The effectiveness of the 2014-LOI depends on the extent to which local governments implement policies that are fair to all business sectors. In regions with low policy bias, the joint effect of 2014-LOI incentives and equitable governance creates a level playing field, empowering foreign SMEs to grow effectively.

For example, equitable land allocation policies in disadvantaged areas ensure that foreign SMEs have access to industrial plots at competitive rates. This enables them to invest their 2014-LOI tax savings in infrastructure or production capacity, driving revenue growth. Moreover, transparent procurement processes further enhance this dynamic by allowing SMEs to bid for local contracts without fear of favoritism toward SOEs (Drabek & Payne, 2002). For instance, Du et al. (2015) show that a non-biased institutional environment paves the way for SMEs in China to overcome discrimination in accessing bank loans. Similarly, Sojli and Tham (2017) confirm the role of inclusive policies in negating foreign firms' liabilities of foreignness to gain government contracts.

In contrast, in regions with high policy bias, the benefits of the 2014-LOI are undermined as foreign SMEs face discriminatory practices that negate the advantages of tax incentives. The absence of fair governance erodes trust and discourages long-term investment (Hakhverdian & Mayne, 2012), limiting the incentive for foreign SMEs to grow and thrive. Lower policy bias not only facilitates the effective utilization of 2014-LOI incentives but also fosters confidence among foreign SMEs, encouraging them to reinvest in local economies to achieve sustainable growth. Formally, we propose:

Hypothesis H2b: *The impact of the 2014-LOI on the revenue growth of foreign SMEs in disadvantaged areas is strengthened in regions having lower policy bias toward SOEs.*

5.3. Informal institutions: pro-socialist versus pro-capitalist regions

The informal institutions of pro-socialist and pro-capitalist values can alter the collective impact of the 2014-LOI and local governance on foreign SMEs' growth performance.

[1] Large MNEs with their negotiating powers and political connections preferred to locate in large cities where skills and technological capabilities are clustered within certain regions (Brodzicki and Uminski, 2018).

Pro-capitalist values, which are dominant in the south of Vietnam, emphasize individualism, entrepreneurial freedom, and market-driven business practices (Dell et al., 2018; Nguyen, 2021). Historically shaped by influences from capitalist economies during the Vietnam War era, regions like Ho Chi Minh City—the country's largest economic hub (Nguyen & Diez, 2017)—have fostered a culture in which competition, innovation, and private enterprise are prioritized (Ho et al., 2022; Truong & Schuler, 2021). These values align with the principles of efficient business support to enhance access to resources and streamlined processes. Indeed, local governments in these regions typically adopt business-friendly approaches, facilitating partnerships, matchmaking services, and resource allocation without excessive bureaucracy (Malesky et al., 2015; Nguyen et al., 2018).

The alignment between pro-capitalist norms and business support mechanisms creates a synergistic environment for foreign SMEs. These norms reduce reliance on the relational networks that are often necessary in pro-socialist regions (Truong & Schuler, 2021), allowing foreign SMEs to operate efficiently through formalized channels. This setup not only lowers transaction costs but also promotes transparency, enhancing the effectiveness of business support initiatives (Nguyen et al., 2018). For instance, foreign SMEs benefit from matchmaking services and networking events that connect foreign firms with local suppliers and distributors (Chen et al., 2004). These streamlined governance practices align with pro-capitalist values that foster competitiveness and market-driven efficiency, enabling foreign SMEs to establish operations more quickly and reduce costs.

In contrast, foreign SMEs in disadvantaged areas in the north, where the business culture is relationship-based (Shibai, 2015) and resources are disclosed within small collectivist groups (Nguyen, 2022), may gain little benefit from business-support activities such as arm's-length matchmaking activities (e.g., trade fairs organized by local governments). This is because trust and resource access in the north are primarily built through personal connections and long-term relationships rather than via formal, transactional interactions facilitated by external organizations (Nguyen et al., 2018).

Moreover, the entrepreneurial mindset in pro-capitalist regions aligns with the need for rapid scalability and market adaptation—traits that are particularly relevant to foreign SMEs seeking growth (Erramilli & D'Souza, 1993; Oviatt & McDougall, 2005). Better arrangements for business support, in combination with investment incentives from disadvantaged locations, help these foreign SMEs gain substantial competitive advantages (Malesky et al., 2015; Nguyen et al., 2018). As such, regions embedded in pro-capitalist norms amplify the positive impact of business support on foreign SME revenue growth by fostering a competitive ecosystem that values efficiency and innovation (Nguyen, 2021). In short:

Hypothesis H3a: *The impact of business support on the revenue growth of foreign SMEs in disadvantaged areas after the 2014-LOI is more pronounced in pro-capitalist regions than in pro-socialist regions.*

Meanwhile, pro-socialist values, predominant in the north of Vietnam, emphasize collectivism, relational networks, and state-led development (Dell et al., 2018). Rooted in Vietnam's historical governance by a centralized state, these values manifest in a preference for collective action and a deep reliance on social and political connections and relationship-based practices to navigate institutional landscapes (Ho et al., 2022) or secure critical resources and approvals (Truong & Schuler, 2021). A majority of SOEs headquarter in northern Vietnam to be close to the capital Hanoi and its strong political connections (SarDesai, 2018). That high concentration of SOEs and connected politicians drives significant economic favors (e.g., credit, land access, and natural resources) toward SOEs, leaving the private sector, including foreign SMEs, also-rans (Ha and Frömmel, 2021). Low policy bias in these northern regions is crucial for foreign SMEs, as pro-socialist norms often privilege SOEs over private and foreign businesses (Du et al., 2015), limiting their access to land, credit, and government contracts (Rahman et al., 2017). In pro-socialist regions, reducing this bias mitigates these challenges, allowing foreign SMEs to integrate into the local economy more effectively. For example, recent land allocation reforms in northern provinces have provided foreign SMEs in disadvantaged areas with equitable opportunities to lease land for manufacturing, allowing them to expand their operations (Moise, 2017; Nguyen, 2021).

Meanwhile, foreign SMEs in southern Vietnam, where arm's-length business practices and capitalist values may substitute for a low level of policy bias, can respond differently. These firms conduct transactions and gain access to resources by following market-based principles (Nguyen, 2021), making them less reliant on government intervention or preferential policies. They compete based on efficiency, innovation, and market dynamics rather than by leveraging political or relational advantages. Additionally, the prevalence of competitive, open-market mechanisms in the region allows them to independently access financing, partnerships, and supply chains, reducing their dependence on policy-driven advantages. Since their success is primarily shaped by economic conditions rather than by institutional favoritism, an improvement in policy bias may offer them little additional benefit.

In short, unlike MNEs, which can bypass regional institutional constraints through direct negotiations with central governments, foreign SMEs depend heavily on equitable governance at the regional level. In pro-socialist regions, where informal relational norms dominate, the absence of policy bias becomes a key enabler of business performance. This ensures that SMEs can access necessary resources without being sidelined by institutional preferences for SOEs. Thus, we propose:

Hypothesis H3b: *The impact of low policy bias on the revenue growth of foreign SMEs in disadvantaged areas after the 2014-LOI is more pronounced in pro-socialist regions than in pro-capitalist regions.*

6. Data

We test our proposed hypotheses on a sample of foreign manufacturing SMEs in Vietnam during the period 2006–2021. We construct our firm-level dataset from the Vietnam Enterprise Surveys (VES) conducted by the Vietnam General Statistics Office (GSO). We match that dataset with provincial data from the Provincial Competitiveness Index (PCI) and the GSO provincial annual reports.

The Vietnam Enterprise Surveys (VES) offer by far the most representative data on Vietnamese firms. The surveys extensively cover firms nationwide in both the manufacturing and services sectors and across all forms of ownership: foreign, private, and state. The rigor of the VES data makes it widely used in prior research (Nguyen, 2021; Tran, 2019); as such, it is ideal for our analysis. The Provincial Competitiveness Index (PCI) dataset jointly created by the Vietnam Chamber of Commerce (VCCI) and the US Agency for International Development (USAID) provides reliable information on dimensions of local governance, such as support for local businesses and policy bias. Constructed from representative-sample surveys of both domestic and foreign firms across provinces in Vietnam, each governance dimension is given a score out of 10, with higher scores indicating better governance quality. The VES was first made available in 2000 and the PCI in 2006, and both datasets are updated annually. We also include some provincial information from the GSO provincial annual reports. Combining these datasets affords longitudinal data from 2006 to 2021, which captures the time periods before and after the 2014-LOI.

Our sample contains majority foreign-owned firms (i.e., wholly owned firms and joint ventures between foreign investors and Vietnamese local partners with >50 % of foreign ownership). This practice of focusing on majority foreign-owned firms follows Carney et al. (2019) to pre-empt diffusion between ownership and control of the firms, and is also driven by the context of this study on foreign SMEs rather than MNEs more generally.[2] Our criterion for SMEs is the one set by the Vietnam Enterprise Law (Nguyen et al., 2018): firms with 10–299 employees. Our final sample contains 7915 unique foreign SMEs for an unbalanced panel of 46,211 firm-year observations.

7. Empirical settings

7.1. Difference-in-differences estimation

The difference-in-differences method requires us to construct a treatment group and control group from our set of firms. To evaluate the efficiency of the 2014-LOI, we assign firms to one of two groups according to their geographical location. The treatment group includes foreign SMEs operating in disadvantaged areas as designated by the 2014-LOI and thus eligible for investment incentives after enactment of the policy. The control group includes foreign SMEs operating in non-disadvantaged areas who are therefore ineligible for investment incentives. See Fig. 1 for a geographic map of Vietnam showing the locations of the disadvantaged and non-disadvantaged areas.

7.1.1. The impact of the 2014-LOI

To gauge the impact of the 2014-LOI on the revenue growth of foreign SMEs located in disadvantaged areas, we employ the fixed-effect difference-in-differences (DiD) specification in a reduced form as follows:

$$Revenue\ growth_{it} = \alpha + \beta Post_t \times Eligible_i + \gamma X_{it,jhpt} + d_i + d_{pt} + \varepsilon_{it} \quad (1)$$

where $Revenue\ growth_{it}$ denotes the annual percentage change in revenues of a foreign SME i in survey year t relative to year $t-1$. $Eligible_i$ equals 1 if the foreign SME i operates in disadvantaged areas and becomes eligible for investment incentives after the enactment of the 2014-LOI (the treated group), and 0 for those outside these areas (the control group). $Post_t$ is an indicator for the years after 2014 (when the LOI was passed). $X_{it,jhpt}$ is a vector of time-varying firm-, industry- and place-specific covariates.

7.1.1.1. Firm-specific covariates. Our firm-specific variables include firm size, age, exporting, cashflow, and inventory holdings. Larger firms have more human and physical capital resources for firm growth (Carney et al., 2019; Li & Sun, 2017). Younger firms likely invest in risker innovation and exhibit more flexibility (Belso-Martinez et al., 2024; Coad et al., 2016; Trąpczyński & Banalieva, 2016) with resultant increases in their revenue growth. Exporting may not enhance the performance of young foreign firms due to the sunk costs of foreign entry, which can hinder them from maintaining their exporting commitments (Gumpert et al., 2020); however, as foreign entry is the typically dominant mode of serving distant markets, export-oriented foreign firms that internationalize aggressively can grow over time through the learning-by-exporting process and by accumulating international experience (Sun & Hong, 2011). We therefore add an interaction between exporting and firm age to our models. Cashflow indicates the firm's ability to generate internal finance from profits and reflects investment expenditures that imply firm-growth opportunities and prospects (Dougal et al., 2015; Guariglia, 2008). Studying Chinese firms, Guariglia et al. (2011) emphasize that the impact of cash flow on growth is higher for foreign firms than for local SOEs or collectively-owned firms because foreign firms are more likely to be financially constrained in local credit markets. A high level of inventory holdings in raw materials or intermediate goods can help manufacturing firms avoid production disruptions but may also reduce their available short-term financing for profitable investments (Abdallah et al., 2015; Carpenter et al., 1994; Ding et al., 2013).

7.1.1.2. Industry- and place-specific covariates. We construct industry- and place-specific covariates to capture the pass-through of universal cross-sectional shocks into firms operating within certain industries or geographical proximities. The pass-through may occur through different channels—such as disrupted supply chains, reduced consumer demand, and price fluctuations—that mask industrial and regional variations (Ciravegna et al., 2023). The Covid-19 pandemic is an exemplar example of increased difficulty in the production and sourcing of basic materials and healthcare through supply chain disruption and accelerated demand for digital products from the technology sector (Hassan et al., 2023). The localized lockdowns during the pandemic indirectly affect businesses through regional resilience and the local business environment. More broadly, Martin et al. (2016) and Stojčić and Orlić (2020) emphasize that regions with greater industrial specialization have slower recovery from external shocks because the local economic structure (employment and technology) adjusts more slowly than in industry-diversified regions.

Accordingly, *first*, we construct an industry-level (at two-digit) variable of industry size for industry (j) as the natural logarithm of the total number of firms in an industry. Larger industry size indicates stronger industry competition, which can lower the efficiency and growth of firms.

Second, we construct three place-based covariates to control for the structure of overall economic activity in the local economy. Local labor supply, as the percentage of employed workers aged over 15 years old in the population of the province (p), largely reflects local labor market dynamics, to which foreign firms in Vietnam are sensitive (Nguyen, 2021). But it may not be the quantity but the quality of the local labor force, for which we introduce the local wage covariate. Local wage, measured as the ratio between the average wage of a district (h) and the national average wage (Stojčić & Orlić, 2020; Stojčić & Vojinić, 2023), is an indicator of human capital quality and the labor costs of the local economy, and has mixed results on firm growth. Human capital investments (the easy acquisition of high-skilled workers from the local labor force) are conducive to firm growth through increased production and innovation capabilities; however, high labor costs can place a financial burden on resource-constrained foreign SMEs, which may have to forgo other investment opportunities for firm growth. The presence of SOEs in a district (i.e., local SOE presence), measured as the employment share of manufacturing SOEs in a district, signals the geographical concentration of SOEs. A strong presence of SOEs in a district is likely to inhibit the growth of co-locating foreign SMEs due to intensified market competition and the crowding out of resources (Meyer & Nguyen, 2005; Liu et al., 2024).

Finally, we control geographic-industry measures to capture the

[2] We acknowledge that our focus on majority foreign-owned firms is driven by the context of this study, which looks at foreign SMEs rather than MNEs more generally. Majority foreign-owned firms have fewer political connections and make lower legitimacy gains from their host environments (Contractor et al., 2014), thus providing a better context for understanding the impact of the host environment's formal and informal institutions. Minority foreign-owned firms (with <50% foreign ownership) often favor larger firm sizes (MNEs) for high visibility and legitimacy gains (Ertuna and Yamak, 2011), which does not seem to fit our context of foreign SMEs. As robustness checks, we provide evidence of estimations using the more common foreign-ownership thresholds of 10% (Mistura and Roulet, 2019) and 25% (Sun and Hong, 2011; Li, 2004) and also with full 100% foreign ownership. These results, which are reported in Online Appendix A, are largely consistent with the baseline estimates using 50% as the threshold. We thank the reviewer for this suggestion.

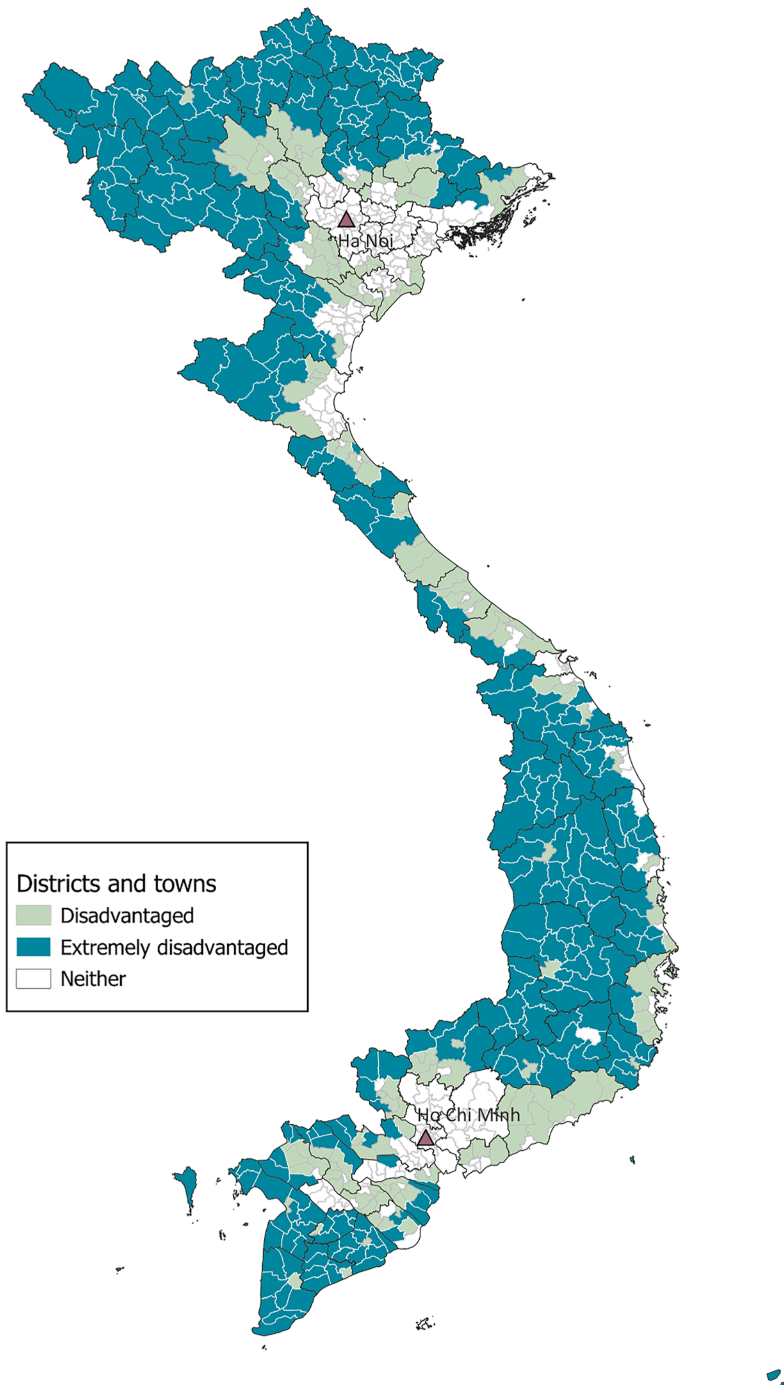

Fig. 1. Disadvantaged and non-disadvantaged areas by the 2014 Law on Investment.
Source: Authors' own elaboration based on the 2014 Law on Investment. Note: "Disadvantaged areas" refer to districts and towns that are either disadvantaged or extremely disadvantaged as regulated by the 2014 Law on Investment. Disadvantaged areas account for 63 % of total districts and towns in Vietnam. These areas are colored in light green and deep green in Fig. 1, whereas non-disadvantaged areas are colored in white. For a full list of disadvantaged areas, see Appendix II of the Vietnamese Government Decree No.118/2015/ND-CP, dated November 12, 2015.

spatial distribution of high-tech industries, which can enrich knowledge connections across locations.[3] We measure local private domestic firm (POE) presence as the share of private domestic firms in a (2-digit) industry in a district over the total (national) number of firms in that industry. High local POE presence can promote market-oriented corporate cultures and reduce institutional distance, which can allow foreign firms to grow; yet in the context of a transition economy, POEs may cling to old communist norms, so high local POE presence may not be conducive to the performance of foreign firms (Liao, 2015). Indicators related to the presence of local high-tech firms capture the size and performance of technology-intensive manufacturing in the district. High-tech industries are largely driven by differentiation-diversification

[3] Following Czarnitzki and Thorwarth (2012) and Padula et al. (2015), we classify high-tech industries (chemicals; pharmaceuticals; computers and electronic products; machines and equipment; and transportation vehicles) and low-tech industries (food, beverages, and tobacco; textiles; wood and furniture; paper; rubber and plastic; and metal sectors).

strategies; they can thus generate sophisticated knowledge and diverse resources, which can be transferred to other firms within the geographical proximity and subsequently embedded in the local economy. Foreign SMEs located in localities with a strong presence of high-tech industries are better positioned to absorb such knowledge and resources into their innovation activities, with implications for their growth opportunities (Stojčić & Orlić, 2020).

We measure local presence at the district level (i.e., the administrative level below provinces) from our Vietnamese firm-level data for two reasons. *First*, the advantaged and disadvantaged areas, as detailed in the 2014-LOI, are classified by district; controlling characteristics at the district level therefore enhances our setup of the treatment/control assignment. *Second*, recent papers on industrial clustering measures have shifted interest from the provincial level (Liao, 2015) to disaggregated geographical levels, such as county level (Guo et al., 2020, 2022) or township level (Barbieri et al., 2020) because provincial-level measures can mask economic variations at the granular level, such as failures to capture the dynamics of firms.

Our reduced-form model in Eq. (1) includes a set of firm-level fixed effects (d_i) and province-by-year fixed effects (d_{pt}) to capture time-variant unobservables at the provincial level, and idiosyncratic error terms (ε_{it}) with standard errors clustered at the firm level.

In the setup of Eq. (1), the coefficient β associated with an interaction term $Post_t \times Eligible_i$ denotes the difference-in-differences effect of interest. The coefficient captures the post-pre differences in the revenue growth of foreign SMEs located within and outside the disadvantaged areas. The coefficient β is therefore the average treatment effect of the 2014-LOI on firm revenue growth. Following the extant literature and to enhance the rigor of the DiD estimation (Agrawal et al., 2020; Amuedo-Dorantes et al., 2022), our reduced-form model replaces the inclusion of the two dummies $Eligible_i$ and $Post_t$ with d_i and d_{pt}, respectively. Specifically, firm fixed effects (d_i) control for time-invariant unobserved heterogeneity of each foreign SME, thereby explaining heterogenous characteristics shared within each group of $Eligible_i$. Similarly, a set of dummies d_{pt}, which controls for province-level time-varying shocks for each year, subsumes aggregate time periods before and after the law's enactment $(Post_t)$ in an added context of provincial dynamism.

7.1.2. The heterogeneous impact by local governance quality

Moving forward, to test hypothesis 2—the moderating effects of policy bias and local business support—we use triple-differences models to estimate how the impact of the 2014-LOI on foreign SMEs' revenue growth varies across provinces with different levels of policy bias toward SOEs and the extent of support they offer local businesses. Specifically, we propose the following reduced-form triple-differences model:

$$Revenue\ growth_{it} = \alpha + \beta_0 Post_t \times Eligible_i \times PCItop_{pt} \tag{2}$$

$$+\beta_1 Post_t \times Eligible_i + \beta_2 Eligible_i \times PCItop_{pt} + \beta_3 PCItop_{pt}$$

$$+\ \gamma X_{it,jhpt} + d_i + d_{pt} + \varepsilon_{it}$$

where the indicator variable *PCItop* is a vector of *BusinessSupport* and *PolicyBias*; it is assigned to provinces with high local governance forces (i.e., their PCI score falls into the top quartile in the yearly sample distribution).[4] Expanding the previous reduced-form regression—Eq. (1)—with the same set of covariates, this model continuously subsumes $Eligible_i$ and $Post_t$ in two sets of fixed effects: d_i and d_{pt}. The rigor of province-by-year fixed effects (d_{pt}) continues to absorb a two-way interaction $Post_t \times PCI_{pt}$ to indicate that each province is individually responsive to a wide range of nationwide policies, one of which is the 2014-LOI.

The triple interaction term $Post_t \times Eligible_i \times PCItop_{pt}$ enables us to explore the difference in the revenue growth of foreign SMEs located in disadvantaged areas versus those outside $(Post_t \times Eligible_i)$ and then resolves the difference between high and low local governance quality $\left(PCItop_{pt}\right)$. As such, the triple-differences model helps retain sample size and degrees of freedom, which is better than running separate regressions for subsamples of high and low *PCI*.

7.2. Parallel trend and summary statistics

In our difference-in-differences models, the key parallel trend assumption (under which the pre-treatment characteristics of the treated firms in eligible areas and control firms are identical) should hold to guarantee the validity of treatment-control-group classification. Violation of the assumption can raise concerns over selection bias, in that differences in firm characteristics among these firm-groups can contribute to differences in their revenue growth. To rule out such concerns, we perform balancing tests over the mean property of each covariate for foreign SMEs located in eligible areas for investment incentives (the treated group) versus those from outside these areas (the control group) for the years prior to the enactment of the 2014-LOI. Following Abadie (2005), Abadie and Imbens (2016), and Arnold and Javorcik (2009), we use propensity score matching; we regress the treatment variable *Eligible* on a full set of covariates, and impose an additional nearest-neighbor-matching procedure. The results in Table 1 show that almost none of the differences in means are statistically significant after matching. The statistics indicate that all firm-, industry- and place-specific characteristics of the treated and control groups are balanced, and that our parallel trend assumption holds.

The summary statistics reported in Table 2 show that our estimation sample of foreign SMEs in Vietnam averaged annual revenue growth of 22 %. Those in the north region yielded annual growth that was over twice as high as that of their south-based counterparts. Only 9.9 % of all sample observations are located in areas deemed disadvantaged by the formal institution of the 2014-LOI, and eligible for investment incentives. Of these, 6.3 % are treated (i.e., eligible after the policy was enacted). The share of observations in eligible areas, and treated observations in the north versus south regions, seems proportional to the region size. Regarding local governance quality, roughly a third of south-based firms locate their operations in provinces that have less policy bias toward SOEs or stronger local business support, while a slightly lower proportion of foreign-owned SMEs in the north do so. Most firm and local characteristics, except for firm age and local high-tech presence, are fairly similar across regions.

8. Empirical results

8.1. Main results

Table 3 presents the overall impact of 2014-LOI in column 1, its treatment heterogeneity by business support and policy bias in the two following columns, and by pro-socialist and pro-capitalist regions in the remaining columns.

We first start with the impact of 2014-LOI (column 1). The interaction terms *Post* × *Eligible* are positive and statistically significant. This finding indicates that the policy increased the revenue growth of foreign SMEs located in eligible geographical areas by 17 % more than that of those located outside. This is quite a sizeable effect since the increase amounts to 77 % (=0.170/0.220) of the sample average for the firms studied. The finding supports Hypothesis 1 and confirms that the 2014-LOI has a significant impact on the development of foreign SMEs in disadvantaged areas.

We next examine hypotheses H2a and H2b, which propose moderating effects of provincial-level business support and policy bias on the

[4] The PCI values of interest are standardised on a 10-point scale, with higher scores indicating lower policy bias toward SOEs or better local business support. For measurement details, see the Appendix F.

Table 1
Balancing tests over means of covariates between treated and control firms: Before and after propensity score matching.

	Mean (in disadvantaged areas = treated)	Mean (outside disadvantaged areas = control)	p-value (*t*-test: treated = control)
Before matching			
Firm size	10.491	10.477	0.412
Firm age	1.951	1.956	0.705
Export	0.730	0.791	0.000
Export*Firm age	1.436	1.588	0.000
Cashflow	0.074	0.083	0.169
Inventory	0.180	0.189	0.000
Industry size	8.110	8.053	0.000
Local labor supply	57.294	55.218	0.000
Local wage	1.698	1.875	0.000
Local SOE presence	0.167	0.146	0.000
Local POE presence (by industry)	0.004	0.007	0.000
Local high-tech firm presence (No. firms)	0.127	0.166	0.000
Local high-tech firm presence (Revenue)	0.710	0.867	0.000
After matching			
Firm size	10.511	10.490	0.408
Firm age	2.086	2.075	0.403
Export	0.752	0.744	0.372
Export*Firm age	1.566	1.539	0.221
Cashflow	0.075	0.068	0.462
Inventory	0.188	0.189	0.803
Industry size	8.151	8.146	0.799
Local labor supply	57.282	57.225	0.441
Local wage	1.710	1.701	0.602
Local SOE presence	0.174	0.180	0.366
Local POE presence (by industry)	0.004	0.004	0.453
Local high-tech firm presence (No. firms)	0.127	0.126	0.676
Local high-tech firm presence (Revenue)	0.715	0.709	0.579

Note: The table reports the difference in means and *t*-test statistics of covariates among eligible foreign SMEs located in disadvantaged areas for investment incentives (the treated group) versus those from outside these areas (the control group). “Before matching” shows rather different balancing tests from “after matching,” where the propensity score matching is used on a range of covariates. Source: Authors’ calculation.

relationship between the 2014-LOI and foreign SMEs’ growth rate. Results are presented in columns 2 and 3 of Table 3. The triple interaction term *Post* × *Eligible* × *BusinessSupport* is the triple-difference estimate for the firms operating in disadvantaged yet strong local-business-support areas relative to the difference-in-differences estimate *Post* ×*Eligible* for firms in disadvantaged, weak business-support areas. A positive and significant coefficient associated with the triple interaction term in column 2 highlights that the impact of the policy was about five times larger (=0.445/0.086) for firms in areas where local authorities offer better support for local businesses. Similarly, eligible foreign SMEs located in provinces that are less biased toward SOEs yield revenue growth two and a half times larger (=0.180/0.073) than their counterparts who also receive treatment incentives but operate in policy-biased locations. These findings thus support hypotheses H2a and H2b, suggesting that local governance quality in terms of business support activities and low policy bias toward SOEs helps enhance the positive effect of the 2014-LOI on foreign SMEs’ growth performance.

Next, we add an additional contextual understanding of how local informal institutions interact with local governance quality to generate treatment heterogeneity. To this aim, we decompose the overall associated impact across regions with pro-socialist versus pro-capitalist values. Columns 4 and 5 present the results for the sub-sample of firms in the north of Vietnam where pro-socialist values are dominant. Meanwhile, columns 6 and 7 present the results for the sub-sample of firms in the south of the country, where pro-capitalist values prevail. The coefficients associated with the interaction term *Post* × *Eligible* × *BusinessSupport* are not statistically significant in the north (column 4) but are positive and statistically significant in the south (column 6). This finding indicates that business support strengthens the impact of the 2014-LOI on foreign SMEs’ revenue growth only in the south of Vietnam, where competition is more severe and foreign SMEs need more support. As such, hypothesis H3a is supported. Meanwhile, coefficients associated with the interaction term of *Post* × *Eligible* × *PolicyBias* are positive and statistically significant in the north (column 5) but statistically insignificant for south-based firms (column 7). This finding reveals that foreign SMEs in the north of Vietnam benefit more from the 2014-LOI when local policy biases toward SOEs are governed at a reasonably low level. Therefore, hypothesis H3b is supported.

8.2. Additional tests

We conduct a set of additional tests to examine the robustness of the findings. Specifically, we (1) use alternative thresholds of foreign ownership to define foreign firms; (2) investigate spatial spillovers from neighboring, advantaged areas to the disadvantaged areas; (3) examine dimensions of the country of origins; (4) explore the dynamic of the 2014-LOI; and (5) decompose local governance settings. The results of these tests remain consistent with our main findings and are presented in the Online Appendix.

9. Discussion

9.1. Theoretical contributions

This study advances three key theoretical insights, contributing to the intersection of international business, geographical economics, and institutional theory. These contributions offer novel perspectives on the interplay between place-based policies, regional institutional forces, and the growth performance of foreign SMEs in a developing country with an evolving LOI.

First, this paper introduces a framework that is conducive to the performance of foreign SMEs via place-based policies. By shifting the scope from nationwide policies to place-based policies, we expand the traditional institutional framework within which such policies act as formal institutions and interact with local governance systems and informal institutions. Vietnam’s 2014-LOI is an exemplary place-based policy that provides investment incentives for foreign firms located in economically disadvantaged areas. While prior research focuses on how national policies shape the operations of resource-rich MNEs (Carney et al., 2019; Grosse, 1996; Rizopoulos & Sergakis, 2010), this study emphasizes the unique challenges and opportunities for foreign SMEs, which lack the financial and political leverage of MNEs. We robustly show that foreign SMEs located in these disadvantaged areas perform better than those located outside, demonstrating that the place-based policy can serve as a strategic tool for enhancing the competitiveness of foreign SMEs in underdeveloped regions. This reveals the tradeoffs faced by foreign SMEs as they choose between the locational advantages of the developed regions or the investment incentives available for locating in disadvantaged regions. Our approach thus shifts the narrative from MNE-dominant frameworks to the nuanced dynamics of smaller foreign firms operating at the regional level in developing host countries (Hutzschenreuter et al., 2020; Li & Sun, 2017). Expanding institutional theory to account for regional variations (Nguyen et al., 2018), this paper contributes to the literature on place-based policies and SME internationalization (Beugelsdijk, 2022; Tang & Beer, 2022) by offering a systematic investigation of how such policies reshape the

Table 2
Variable definition and summary statistics.

Variable	Definition	Total Mean	Std. Dev	North Mean	Std. Dev	South Mean	Std. Dev
Revenue growth	Change in logs of revenues (normalized by inflation) between two consecutive years	0.220	1.066	0.366	1.321	0.155	0.921
Institution variables							
Post	=1 for years after 2014 when the 2014-LOI was enacted, 0 otherwise	0.595	0.491	0.689	0.463	0.553	0.497
Eligible	=1 if foreign SMEs are located in disadvantaged areas and eligible for investment incentives, 0 for those outside these areas	0.099	0.298	0.056	0.230	0.118	0.323
Post x Eligible	=1 if foreign SMEs are located in disadvantaged areas and eligible for investment incentives for years after 2014, 0 otherwise	0.063	0.242	0.041	0.197	0.073	0.260
BusinessSupport	=1 for provinces with more local business support (i.e., their PCI score on business support falls above top quartile in the yearly sample distribution), 0 otherwise	0.286	0.452	0.202	0.401	0.324	0.468
PolicyBias	=1 for provinces with less policy bias toward SOEs (i.e., their PCI score on policy bias falls above top quartile in the yearly sample distribution), 0 otherwise	0.319	0.466	0.261	0.439	0.346	0.476
Covariates							
Firm-specific							
Firm size	Logs of total assets normalized by inflation (report here the value of total assets in mil.VND)	70,447	78,301	70,507	79,277	70,420	77,859
Firm age	Logs of operating years since establishment (report here the number of years)	9.809	5.889	7.973	5.015	10.636	6.064
Export	=1 if a firm exports, 0 otherwise	0.812	0.390	0.801	0.399	0.817	0.386
Cashflow	The sum of after-tax earnings and depreciation divided by last year's total assets	0.082	0.399	0.092	0.436	0.078	0.381
Inventory	Ratio of inventory to total assets	0.197	0.167	0.182	0.167	0.203	0.167
Industry- and place-specific							
Industry size	Logs of the number of firms by (2-digit) industry (report here the number of firms)	4850	4617	4802	4946	4872	4461
Local labor supply	Percentage of employed workers aged over 15 years old in the population by province (%)	55.412	3.588	54.954	4.059	55.618	3.334
Local wage	Ratio of average wage in a district to national average wage	1.867	0.816	1.698	0.752	1.943	0.832
Local SOE presence	Employment share of SOEs in a district	0.146	0.314	0.192	0.340	0.125	0.299
Local POE presence (by industry)	Share of private domestic firms in a (2-digit) industry in a district over the total (national) number of firms in that industry	0.007	0.011	0.004	0.007	0.008	0.012
Local high-tech firm presence (No. firms)	Share of high-tech manufacturing firms in the total of manufacturing firms in a district	0.160	0.076	0.205	0.101	0.140	0.049
Local high-tech firm presence (Revenue)	=1 if the ratio of average revenues of high-tech firms in a district to their national average is higher than 1, and 0 otherwise	0.852	0.355	0.869	0.337	0.845	0.362
N		46,211		14,351		31,860	

Note: Summary statistics are based on the total sample of 46,211 firm-year observations over the 2006–2021 period with 14,351 and 31,860 observations of the north- and south-region subsamples, respectively. North (South) regions are those above (below) the 17th parallel. Values are normalized to 2010 prices using gross domestic product deflators from World Bank.

economic geography of foreign investment, providing insights into the interplay between location-specific incentives and firm strategies in developing economies.

The *second* contribution lies in the examination of formal institutions as dynamic drivers of foreign SME growth within developing economies. Previous studies often treat formal institutions as static determinants of firm performance, focusing on market size, infrastructure, and supply chains as primary enablers (Nielsen et al., 2017; Paul & Feliciano-Cestero, 2021). This study expands the discourse by highlighting how evolving investment laws, such as Vietnam's 2014-LOI, serve as catalytic instruments for attracting and retaining foreign SMEs in economically disadvantaged areas. This insight bridges the institutional and international business literature by demonstrating that legal frameworks can do more than establish a regulatory baseline (Sornarajah, 2021); they can actively shape firm behavior, location decisions, and performance, particularly for resource-constrained foreign SMEs. By linking the 2014-LOI's incentives to the foreign small business sector, the study emphasizes the alignment between national policy evolution and the performance of foreign SMEs. This theoretical advancement adds to understandings of the institutional underpinnings of foreign SME competitiveness in developing economies (Hsu et al., 2020). Additionally, the study's findings extend institutional theory by illustrating how regulatory evolution interacts with sub-national economic conditions to produce differentiated outcomes for foreign SMEs. This contribution is significant because it reframes formal institutions as dynamic and contextually adaptive (Deephouse et al., 2016; Elsner, 2012), encouraging future research to explore how regulatory evolution can promote spatial economic balance in developing economies.

The *third* contribution is to demonstrate the role that regional diversity plays in further developing the institutional framework created by place-based policies, and how this impacts on foreign SMEs. Generally, this paper fills a gap in the broad international business literature, which assumes uniform impacts of national policies across a country (Oetzel & Doh, 2009; Carney et al., 2019) and neglects regional variations in governance and cultural contexts (Hutzschenreuter et al., 2020; Li & Sun, 2017). Specifically, our study provides a nuanced analysis of how the application of governance settings (business support and policy bias) and informal institutions (pro-socialist vs. pro-capitalist values) at the regional level can moderate and magnify the impact of the place-based policy 2014-LOI on foreign SMEs' performance. The governance-culture alignment can promote a more synergistic environment for foreign SMEs to navigate local resources and manage their relationships with local stakeholders. This is especially important because foreign SMEs, in contrast to MNEs, often target a fairly small spectrum of local stakeholders (Shou et al., 2024). For instance, the alignment between pro-capitalist norms and business support mechanisms promotes entrepreneurial and partnership-oriented practices in areas that lack the relational networks supported by a pro-socialist environment. Local informal institutions and local governance are essential for foreign SMEs, which can enhance their local embeddedness by playing the "rules of the games".

This layered framework echoes institutional theory by emphasizing the interplay between formal and informal institutions at the regional level (Nguyen, 2021; Nguyen et al., 2018), offering a comprehensive understanding of how foreign SMEs navigate complex institutional

Table 3
The heterogenous impact of the 2014-LOI on revenue growth.

	(1) All firms **H1**	(2) **H2a**	(3) **H2b**	(4) North **H3a**	(5) **H3b**	(6) South **H3a**	(7) **H3b**
Post x Eligible	**0.170****	0.086	0.073	0.248	0.033	0.064	0.102
	(0.075)	(0.082)	(0.098)	(0.200)	(0.203)	(0.089)	(0.110)
Post x Eligible x BusinessSupport		**0.445****		**0.405**		**0.438****	
		(0.181)		(0.419)		(0.200)	
Eligible x BusinessSupport		-0.263*		-0.405		-0.246	
		(0.154)		(0.377)		(0.169)	
BusinessSupport		-2.845		4.401**		-2.828	
		(2.072)		(2.012)		(2.077)	
Post x Eligible x PolicyBias			**0.180***		**0.626****		**0.079**
			(0.108)		(0.259)		(0.121)
Eligible x PolicyBias			-0.041		-0.290		-0.011
			(0.082)		(0.222)		(0.089)
PolicyBias			-0.020		-0.039		-0.015
			(0.024)		(0.061)		(0.025)
Covariates							
Firm size	0.199***	0.200***	0.199***	0.164***	0.165***	0.218***	0.218***
	(0.026)	(0.025)	(0.026)	(0.044)	(0.044)	(0.031)	(0.031)
Firm age	-2.192***	-2.191***	-2.191***	-3.155***	-3.153***	-1.776***	-1.776***
	(0.056)	(0.056)	(0.056)	(0.122)	(0.121)	(0.060)	(0.060)
Export	-0.191**	-0.191**	-0.190**	-0.222	-0.222	-0.133	-0.133
	(0.077)	(0.077)	(0.077)	(0.143)	(0.143)	(0.088)	(0.088)
Export × Firm age	0.095***	0.094***	0.094***	0.111*	0.112*	0.070*	0.070*
	(0.032)	(0.032)	(0.032)	(0.067)	(0.067)	(0.036)	(0.036)
Cashflow	0.361***	0.361***	0.362***	0.398***	0.398***	0.332***	0.333***
	(0.043)	(0.043)	(0.043)	(0.072)	(0.072)	(0.052)	(0.052)
Inventory	0.044	0.044	0.044	0.049	0.046	0.047	0.047
	(0.055)	(0.055)	(0.055)	(0.129)	(0.129)	(0.059)	(0.059)
Industry size	0.009	0.009	0.009	0.360***	0.359***	-0.098*	-0.098*
	(0.053)	(0.053)	(0.053)	(0.120)	(0.121)	(0.052)	(0.052)
Local labor supply	-0.395*	-0.001	-0.395*	-1.152***	-1.146***	0.043	-0.347
	(0.217)	(0.092)	(0.217)	(0.416)	(0.413)	(0.095)	(0.215)
Local wage	0.053**	0.054**	0.052**	-0.101	-0.099	0.052**	0.051**
	(0.024)	(0.024)	(0.024)	(0.066)	(0.066)	(0.024)	(0.024)
Local SOE presence	-0.065	-0.067	-0.066	-0.619*	-0.620*	0.256	0.261
	(0.181)	(0.181)	(0.180)	(0.358)	(0.358)	(0.198)	(0.198)
Local POE presence (by industry)	-1.139	-1.234	-1.286	-3.919	-3.912	-1.037	-0.998
	(1.202)	(1.204)	(1.203)	(2.967)	(2.967)	(1.288)	(1.286)
Local high-tech firm presence (No. firms)	0.176	0.173	0.183	-0.256	-0.220	0.165	0.177
	(0.309)	(0.309)	(0.309)	(0.523)	(0.522)	(0.353)	(0.353)
Local high-tech firm presence (Revenue)	0.100***	0.099***	0.101***	0.157*	0.155*	0.070*	0.072*
	(0.038)	(0.038)	(0.038)	(0.081)	(0.080)	(0.041)	(0.041)
Constant	23.691**	4.642	23.706**	59.037***	59.517***	2.185	21.152*
	(11.267)	(3.882)	(11.267)	(20.241)	(20.461)	(3.924)	(11.445)
Firm fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Province-year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No.obs	46,211	46,211	46,211	14,351	14,351	31,860	31,860
R2-within	0.231	0.231	0.231	0.299	0.299	0.191	0.191
R2-between	0.117	0.104	0.117	0.037	0.059	0.074	0.085
R2-overall	0.077	0.071	0.077	0.021	0.038	0.044	0.059

Note: The table reports the impact of the 2014-LOI on revenue growth and how the associated impact varies by different institutional factors. Estimations in columns 1 to 3 are performed on the entire estimation sample of foreign SMEs in manufacturing sector in Vietnam. Column 1 reports the reduced-form difference-in-differences estimation as in Eq. (1). Columns 2 and 3 display estimates of the reduced-form triple-difference models as in Eq. (2) for two local governance areas: policy bias toward SOEs and local business support. Columns 4 to 7 decompose the local-governance impacts by north (pro-socialist) versus south (pro-capitalist) regions. *$\rho<0.10$, ** $\rho<0.05$, *** $\rho<0.01$. Standard errors in parentheses are clustered at the firm level. Source: Authors' calculations.

landscapes. By advocating for an integrated national and sub-national analysis, this paper provides a framework for future studies to investigate the intricate relationships between policy design, regional governance, and cultural values. The insights are particularly relevant for understanding the challenges foreign SMEs face in developing economies, where institutional diversity is pronounced (Bardhan & Mookherjee, 2006).

9.2. Managerial and policy implications

For policymakers interested in attracting foreign investments, the national implementation of formal institutions appears, on the face of it, to provide a uniform incentive structure. However, a place-based condition changes the “rules of the game” (Dziemianowicz et al., 2019). The 2014-LOI policy shows positive outcomes that go one step further toward a more even distribution of foreign capital and the redressing of spatial economic imbalance. This finding suggests that policymakers should further refine place-based incentives to maximize the policy’s impact on spatial economic balance and foreign investment attraction.

Another policy implication is that local policy instruments that pursue a “race to the top” approach in local governance quality and embrace local business cultures can add application and efficiency to the national planning of policies aimed at attracting foreign investment. Although formal institutions are hard to alter, the instruments available to local authorities have the power to magnify the overall institutional context. Such local interventions can unleash foreign SMEs’ growth potential by offering business-support activities, particularly those connected with regulatory procedures and information (Liu et al., 2020; Malesky et al., 2015; Nguyen, 2021; Tung, 2014), or by holding back from directing local resources toward SOEs (Du et al., 2015; Sojli & Tham, 2017). Using a single-country example, our findings relate to other economies with similar regional institutional contexts in which local governments have great autonomy in directing local resources.

For foreign entrants, the foreign investment policies of host countries’ governments are likely to offer some initial answers to pertinent questions about potential location choices. The economic appeal of the place-based policy in the 2014-LOI can direct foreign SMEs’ location choices toward disadvantaged areas, where these firms can commit to undertaking and financing new investments. The tradeoff between the well-developed markets in non-disadvantaged areas and the investment incentives contingent upon operating within disadvantaged areas seems relevant for foreign SMEs. Indeed, they can accrue additional cash savings from the tax and levy incentives, which boosts growth, while also enjoying low-cost labor and avoiding fierce competition from local firms or larger MNEs (Edwards et al., 2016; Kim & Aguilera, 2016; Yang & Meyer, 2020).

The heterogeneity of informal institutions and local governance quality is also an important factor for foreign SMEs to consider. Our findings indicate that these institutions are relevant to the location-choice decision-making process and to firm growth. We show that firms that are attracted to disadvantaged areas in pro-socialist regions (i.e., the north of Vietnam) should choose areas with a relatively low degree of policy bias. This governance setting allows them access to local resources that may otherwise be targeted toward SOEs, exclusive economic elites, or small politically connected groups (Dell et al., 2018; Nguyen, 2021). Our additional test on foreign involvement emphasizes that a combination of high policy bias and pro-socialist values can decrease the growth of wholly foreign SMEs more than their joint-venture counterparts where the local partners understand local institutions. Meanwhile, foreign SMEs in disadvantaged, pro-capitalist regions (i.e., the south) should opt for areas with high business support since arm’s-length business practices are the norm for local businesses in the south.

9.2.1. Limitations and future research

This study has some limitations to be addressed in future research. *First*, while our analysis highlights the influence of regional institutions on the revenue growth of foreign SMEs, it does not account for the cultural and institutional distance between the host and home countries. These types of distance may significantly affect how firms leverage investment incentives (Xu & Shenkar, 2002). For example, SMEs from countries sharing similar informal institutions, such as pro-socialist or pro-capitalist values, may find it easier to navigate local systems and achieve superior performance (Dau et al., 2022). Future research could integrate measures of institutional or cultural distance to explore the moderating effects of home-country factors, contributing to a deeper understanding of cross-border SME dynamics.

Second, our study is confined to revenue growth as the primary performance indicator. The long-term contributions of foreign SMEs to local socioeconomic development—such as employment generation, knowledge transfer, and supply chain integration—remain unexplored. Future research could examine how place-based incentives influence these broader outcomes, thereby providing a more comprehensive evaluation of the policy’s effectiveness. Such work could also inform strategies to enhance the developmental impacts of foreign investments.

Third, while we consider local governance and cultural values as moderators, our data does not capture how SMEs dynamically adapt their strategies in response to evolving institutional environments. Longitudinal case studies or mixed-methods approaches could provide richer insights into the strategic adaptations of foreign SMEs operating in diverse institutional settings, offering nuanced contributions to institutional and international business theory.

Fourth, we focus on economic growth and have not considered the social and environmental performance of foreign SMEs. Future research could explore these aspects of foreign SMEs operating in Vietnam, particularly in disadvantaged areas. This includes examining how these firms contribute to sustainable practices, community development, and resource utilization. Insights into whether and how foreign SMEs balance economic growth with environmental conservation and social responsibility could provide valuable guidance for policymakers and entrepreneurs in fostering more inclusive and sustainable development.

10. Conclusion

This study investigates the impact of Vietnam’s 2014-LOI on the performance of foreign SMEs in disadvantaged areas, with a focus on the role of regional institutional factors. Our findings demonstrate that the 2014-LOI, which introduced tax incentives and special treatments for foreign firms operating in less-developed regions, significantly enhanced revenue growth for foreign SMEs in these disadvantaged areas compared with those in more developed regions. This effect is amplified by the presence of strong local governance, such as business support services and reduced policy bias, and is shaped by regional informal institutions, particularly the cultural divide between pro-socialist and pro-capitalist norms. These insights contribute to the growing body of literature on the intersection of place-based policies, institutional theory, and foreign SME performance, especially in developing economies. By emphasizing the role of sub-national institutions, this study extends the understanding of how tailored regional policies can drive economic growth and reduce spatial disparities.

CRediT authorship contribution statement

Chau M. Chu: Writing – review & editing, Writing – original draft, Investigation, Formal analysis, Conceptualization. **Bach Nguyen:** Writing – review & editing, Writing – original draft, Conceptualization.

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Supplementary materials

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