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Quynh Nga Nguyen Thi
Foreign Trade University, tranquoctrung.cs2@ftu.edu.vn

Quoc Trung Tran
Foreign Trade University

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Are Foreign Investors Afraid Of State Ownership?

Quynh Nga Nguyen Thi and Quoc Trung Tran[*]

Foreign Trade University, Ho Chi Minh City Campus, Ho Chi Minh City, Vietnam

State ownership may help firms have better access to credit and lower financing costs but it also results in "double agency" problem. This paper investigates whether foreign investors are afraid of investing in firms with state ownership. Our research sample includes 4,079 firm-years from 567 firms listed in Vietnamese stock markets during the period 2008-2017. We employ probit and tobit models to examine how state ownership determines foreign investors' likelihood to invest and investment magnitude respectively. Furthermore, we continue to examine how an increase in state ownership changes foreign ownership. We find that firms with higher state ownership have lower foreign ownership. Besides, an increase in state ownership reduces foreign ownership. These findings imply that foreign investors tend to avoid investing in firms with high state ownership due to their concern for "double agency" problem.

Keywords: Foreign ownership; Foreign investors; State ownership; Vietnam.

Introduction

Emerging markets have become more attractive to investors from developed countries since they have better growth prospects, more financial deregulation (Karolyi, Ng, & Prasad, 2015). Foreign investors are expected to have some advantages over local investors such as better investment experience, modern technology and highly professional expertise. In addition, they are able to compare firm performance in different countries and have better investment decisions (Batten & Vo, 2015). However, investors may face information disadvantages over local investors because of geographical, cultural, and political differences (Coval & Moskowitz, 1999; Portes & Rey, 2005). Therefore, they tend to mitigate these disadvantages in their investment decisions (Batten & Vo, 2015;

Lin & Shiu, 2003). This research investigates how foreign investors' investment behavior is affected by state ownership in Vietnamese stock market.

Prior studies show that state ownership may bring both benefits and problems to firms. On the one hand, firms with higher state ownership have more opportunities to obtain bank credit (Chang, Liu, Spiegel, & Zhang, 2018; Cong, Gao, Ponticelli, & Yang, 2018; Song, Storesletten, & Zilibotti, 2011) and incur lower costs of debt (Shailer & Wang, 2015). On the other hand, state ownership also makes firms face "double agency" problem. The government is a principal in the relationship with firm managers but becomes an agent in the relationship with the public. The government or politicians tend to pressure firm mangers to exploit firm resources in order to serve political and social

* Corresponding author's email: tranquoctrung.cs2@ftu.edu.vn

objectives. Therefore, firms with higher state ownership experience more complicated and weaker corporate governance. Several prior studies document that state ownership negatively affects corporate governance (Chen, El Ghoul, Guedhami, & Wang, 2017; S. Chen, Sun, Tang, & Wu, 2011) and firm performance (Boubakri & Cosset, 1998; Boubakri, Cosset, & Guedhami, 2005).

Based on benefits and problems of state ownership, we develop two opposite hypotheses. First, we argue that foreign investors can eliminate the agency problem of state ownership with their advantages including better investment experience, modern technology and highly professional expertise (Aggarwal, Erel, Ferreira, & Matos, 2011; Baba, 2009; Cao, Du, & Hansen, 2017; Chen, El Ghoul, Guedhami, & Wang, 2017; Jeon, Lee, & Moffett, 2011; S. Kang, Sul, & Kim, 2010) and they prefer benefits of state ownership. Accordingly, state ownership is positively related to foreign ownership. Second, we posit that foreign investors are afraid of weak corporate governance in firms with state ownership (Brennan & Cao, 1997; Dvořák, 2005; Hau, 2001; Portes & Rey, 2005; Seasholes, 2000). Consequently, state ownership is negatively related to foreign ownership. We utilize probit and tobit models to investigate how state ownership determines foreign investors' likelihood to invest and investment magnitude respectively. Furthermore, we continue to examine how the change in state ownership affects the change in foreign ownership.

In Vietnam, foreign ownership is capped at 49% in most industries. Therefore, we only select non-financial firms of 49% foreign ownership cap and obtain a final sample of 4,079 observations from 567 non-financial firms during the period 2008-2017. Our estimation results show that state ownership negatively affects foreign ownership and the change in state ownership is negatively related to the change in foreign ownership. This paper contributes to the knowledge on foreign investors' investment behavior by showing that foreign investors are afraid of state ownership. The rest of our paper is structured as follows: The first section presents the extant literature on advantages and disadvantages of state ownership and develops research hypotheses on the effect of state ownership on foreign ownership. Then, we design research models in the second section. The third section presents data collection and descriptive statistics. The fourth section reports regression results. Finally, we present main conclusions and policy implications.

Literature Review

Advantages of state ownership

Prior studies show that state ownership provides firms more credit with lower costs (Brandt & Li, 2003). In an emerging market, state-owned banks often dominate its financial system and other banks are controlled strictly by government agencies. As a result, banks' lending decisions are based on political goals rather than economic efficiency. Private commercial banks may also support government-related firms with favorable loans to develop a relationship with politicians (Butler, Fauver, & Mortal, 2009). Chang, Liu, Spiegel, and Zhang (2018); Song, Storesletten, and Zilibotti (2011) find that state-owned firms archive a superior access to bank loans even they are less productive than private firms in China. Moreover, Shailer and Wang (2015) examine the effect of government ownership on external financing costs. They find that firms under government control incur lower costs and firms with financial distress tend to benefit most from state ownership. Borisova and Megginson (2011) document that decreases in government ownership lead to increases in credit spread in European countries. Furthermore, Borisova, Fotak, Holland, and Megginson (2015); Megginson and Netter (2001); Qi, Roth, and Wald (2010) show state ownership helps firms have better access to credit and reduce costs of credit.

When state ownership is considered as a signal of the government's favorable treatment, it may increase firm value. Motivated by the emerging state capitalism, Boubakri, El Ghoul, Guedhami, and Megginson (2018) examine how state ownership affects firm value in East Asia. They document that firms with state

ownership are valued higher and the effect of state ownership on firm value is affected by local government quality. These findings suggest that government ownership is valuable. Ang and Ding (2006) also show that government-related firms have higher market values and stronger corporate governance. Furthermore, Beuselinck, Cao, Deloof, and Xia (2017) find that high state ownership firms tend to experience small decreases in market value.

Corporate governance problem of state ownership

The extant literature shows that firms with state ownership face ineffective corporate governance due to a "double agency" problem (Chen, El Ghoul, Guedhami, & Wang, 2017). According to agency theory, there is a conflict of interest between a principal and an agent since they have different utility functions. The principal tends to sacrifice the agent's benefits in order to increase their own interest (Jensen & Meckling, 1976). A fully private firm only faces a single agency problem between shareholders and managers. However, a state-owned enterprise faces two separate agency relationships. Government is a principal in the relationship with managers but it becomes an agent in the relationship with the public (Rodríguez, Espejo, & Cabrera, 2007). Consequently, their managers are not only exposed to market pressures (e.g. competition, products and managerial labor markets) but also social and political objectives from the government (Bennedsen, 2000; Shleifer, 1998; Vickers & Yarrow, 1991). Bushman, Piotroski, and Smith (2004); Chaney, Faccio, and Parsley (2011); Guedhami and Pittman (2006) document that state ownership decreases corporate financial transparency and reporting quality. Borisova, Brockman, Salas, and Zagorchev (2012) investigate the relationship between state ownership and corporate governance across European countries and show that state ownership reduces governance quality. Ben-Nasr and Boubakri (2012) find that state ownership increases costs of debt. Furthermore, Chen, El Ghoul, Guedhami, and Wang (2017); S. Chen, Sun, Tang, and Wu (2011) document

that state ownership decreases investment efficiency in newly privatized firms.

In addition, many prior studies document the negative relationship between state ownership and firm performance. Boubakri and Cosset (1998) investigate how corporate financial performance and operating performance change when firms are privatized. They find that a decrease in state ownership leads to better firm performance. Gupta (2005) examines how partial privatization affects firm performance in India and documents that low state ownership firms experience high profitability, investment and productivity. Boubakri, Cosset, and Guedhami (2005); D'Souza, Megginson, and Nash (2005) also find that state ownership dampens firm performance.

Foreign investors and state ownership

Since state ownership contains both advantages and disadvantages, foreign investors' behavior relies on marginal benefits and marginal costs of state ownership. First, according to Andriosopoulos and Yang (2015); Batten and Vo (2015); Lien, Tseng, and Wu (2013), foreign investors have some advantages since they have better resources for fundamental research and long-run investment such as investment experience, modern technology and professional expertise. Moreover, they are able to compare firm performance across countries to make better decisions. Therefore, foreign investors monitor managers' behavior effectively and improve corporate governance. Aggarwal, Erel, Ferreira, and Matos (2011) show that institutional investors from foreign countries may help firms improve corporate governance. Many prior studies document the positive impact of foreign investors on corporate governance through dividend decisions (Baba, 2009; Cao, Du, & Hansen, 2017; Jeon, Lee, & Moffett, 2011; S. Kang, Sul, & Kim, 2010) and investment decisions (Chen, El Ghoul, Guedhami, & Wang, 2017). When foreign investors are able to improve corporate governance and increase market value of state-owned firms, they tend to purchase shares of firms with higher state ownership. Consequently, we hypothesize that

higher state ownership leads to higher foreign ownership and an increase in state ownership results in an increase in foreign ownership.

H1: State ownership increases foreign ownership.

H2: An increase in state ownership leads to an increase in foreign ownership.

However, international investors have informational disadvantages over local investors (Portes & Rey, 2005). Prior studies document consistent evidence of these disadvantages in different countries such as Taiwan (Seasholes, 2000), Indonesia (Dvořák, 2005) and Korea (Choe, Kho, & Stulz, 2005). Therefore, they try mitigate their disadvantages in their investment decisions by focusing on firms with larger size, lower leverage (Batten & Vo, 2015; J.-K. Kang & Stulz, 1997), low book-to-market value (Lin & Shiu, 2003) and high dividend payout (Cao, Du, & Hansen, 2017). Based on this mechanism, foreign investors have high incentives to avoid firms with state ownership due to their severe agency problem. We hypothesize that state ownership negatively affects foreign ownership and an increase in state ownership leads to a decrease in foreign ownership.

H3: State ownership decreases foreign ownership.

H4: An increase in state ownership leads to a decrease in foreign ownership.

Research models

We argue that foreign investors' investment behavior includes two decisions: (1) selection of a share to purchase and (2) volume of shares to purchase. Therefore, we investigate the effects of state ownership on both the probability and the magnitude of foreign investment with probit and tobit regression models respectively[1].

$$
\begin{aligned}
\text{For\_inv} = \alpha &+ \beta^* \text{ State ownership} + \gamma^*\text{Control} \\
&+ \phi^*\text{Policy\_dum} \\
&+ \eta^*\text{Industry dummies} \\
&+ \theta^*\text{Year dummies} + \varepsilon \qquad (1)
\end{aligned}
$$

$$
\begin{aligned}
\text{For\_own} = \alpha &+ \beta^*\text{State ownership} + \gamma^*\text{Control} \\
&+ \phi^*\text{Policy\_dum} \backslash \\
&+ \eta^*\text{Industry dummies} \\
&+ \theta^*\text{Year dummies} + \varepsilon \qquad (2)
\end{aligned}
$$

Where For_inv is the likelihood to invest in firms with state ownership. It is a binary variable assigned 1 for positive foreign ownership and 0 otherwise. For_own is foreign ownership measured by the proportion of shares held by foreign investors. State ownership is measured by the proportion of shares held by government agencies (Sta_own) or state-owned enterprise dummy (Sta_soe). State-owned enterprise dummy is assigned 1 for observations with more than 50% shares held by government agencies. Control is a vector of lagged firm characteristics including profitability, cash holdings, net working capital, asset tangibility, market to book ratio, sales growth and dividend yield[2]. Firm profitability (PRO) is measured by return on assets. Firms with better performance attract foreign investors due to lower information asymmetry and agency costs (J.-K. Kang & Stulz, 1997). Cash holdings (CAS) is total cash and short-term investment scaled by total assets. Net working capital (NWC) is measured by current assets minus current liabilities and cash holdings scaled by total assets. Firms with more cash holdings can seize investment opportunities early and thus they may attract foreign investors (Ozkan & Ozkan, 2004) Net working capital may also have a positive impact on foreign ownership since it is an alternative of cash holdings (Lian, Sepehri, & Foley, 2011). Financial leverage (LEV) is long-term debt scaled by total assets. Asset tangibility (TAN) is computed by net fixed assets scaled by total assets. Firm size (SIZ) is the natural logarithm

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[1] Research data is left-censored; therefore, we use tobit regression instead of pooled OLS that may be affected by the selection bias. We also use pooled OLS as a robustness check and find consistent results.

[2] Since prior research shows that foreign investors make decisions based on firm characteristics, we use the lagged variables to avoid the endogeneity (Batten & Vo, 2015; Dahlquist & Robertsson, 2001; J.-K. Kang & Stulz, 1997; Lin & Shiu, 2003).

Thi and Tran: Are Foreign Investors Afraid Of State Ownership?

Q. N. N. Thi and Q. T. Tran / Indonesian Capital Market Review 13 (2021) 1-11

Table 1. Data Description

Panel A. Annual number of observations

Year	N	Percent	Year	N	Percent
2008	163	4.00	2013	467	11.45
2009	231	5.66	2014	479	11.74
2010	300	7.35	2015	494	12.11
2011	408	10.00	2016	533	13.07
2012	451	11.06	2017	553	13.56

Panel B. Industry Distribution

Industry	N	Percent	Industry	N	Percent
Technology	158	3.87	Health Care	143	3.51
Industrials	1,852	45.4	Consumer Goods	672	16.47
Oil & Gas	43	1.05	Basic Materials	581	14.24
Consumer Services	387	9.49	Utilities	243	5.96

Panel C. Descriptive statistics

Variables	Mean	Median	SD	Min	Max
For_own	0.092	0.034	0.130	0.000	0.490
For_inv	0.759	1.000	0.427	0.000	1.000
Sta_own	0.261	0.238	0.240	0.000	0.49
Sta_soe	0.281	0.000	0.449	0.000	1.000
ΔFor_own	0.010	0.000	0.050	-0.122	0.280
ΔSta_own	0.008	0.000	0.104	-0.347	0.510
PRO	0.129	0.126	0.123	-0.357	0.479
CAS	0.104	0.064	0.110	0.001	0.524
NWC	0.109	0.090	0.192	-0.315	0.644
LEV	0.092	0.029	0.134	0.000	0.589
TAN	0.209	0.149	0.192	0.001	0.831
SIZ	26.787	26.785	1.485	23.080	30.430
MTB	0.591	0.395	0.605	0.046	3.515
SAG	0.164	0.103	0.424	-0.652	2.399
DIY	0.063	0.050	0.063	0.000	0.278

of net sales. Firms with larger size, lower leverage and higher tangibility have lower costs of external funds (Myers & Majluf, 1984); therefore, they are more attractive to foreign investors (Batten & Vo, 2015; J.-K. Kang & Stulz, 1997). Market to book value (MTB) is measured by market capitalization to total assets. Sales growth (SAG) is measured by the annual growth of net sales. Dividend yield (DIY) is measured by cash dividend to stock price ratio. Market to book value, sales growth and dividend are reliable signals of firm performance, hence they may affect foreign investors' behavior (Cao, Du, & Hansen, 2017; Lin & Shiu, 2003). Policy_dum is a dummy variable to examine if there are differences in foreign ownership after Vietnamese government increases the cap of foreign ownership. It is assigned 0 for observations before 2015 and 1 otherwise. Expected signs of financial variables are as follows: PRO (+), CAS (+), NWC (+), LEV (-), TAN (+), SIZ (+), MTB (+), SAG (+), DIY (+). Besides, we also use dummies to control industry and year effects. For brevity, we fail to present their coefficients in our regression results.

Moreover, we develop another model to analyze the effect of an increase in state ownership on the change in foreign ownership.

$$\Delta For\_own = \alpha + \beta * \Delta Sta\_own + *Control$$
$$+ \phi * Policy\_dum$$
$$+ \eta * Industry\ dummies$$
$$+ \theta * Year\ dummies + \varepsilon \qquad (3)$$

Where ΔFor_own is the change in foreign ownership. ΔSta_own is the change in state ownership. The negative (positive) relationship between the two variables implies foreign investors focus more on advantages (problems) of state ownership. We employ three regression approaches namely fixed effects, random effects and pooled OLS to estimate Equation (3).

5

Table 2. Baseline Regression Results

Variables	State ownership is proxied by Sta_own			State ownership is proxied by Sta_soe		
	Probit	Tobit	Pooled OLS	Probit	Tobit	Pooled OLS
Intercept	-6.919***	-1.059***	-0.757***	-6.799***	-1.070***	-0.770***
	(-6.92)	(-8.70)	(-7.65)	(-6.75)	(-8.51)	(-7.55)
State ownership	-0.435**	-0.127***	-0.108***	-0.087	-0.053***	-0.047***
	(-2.17)	(-5.63)	(-5.94)	(-0.85)	(-5.04)	(-5.74)
PRO	1.470***	0.104***	0.047	1.411***	0.096***	0.040
	(4.86)	(2.84)	(1.59)	(4.65)	(2.61)	(1.36)
CAS	2.293***	0.223***	0.148***	2.191***	0.209***	0.136***
	(5.16)	(4.83)	(3.85)	(4.94)	(4.58)	(3.58)
NWC	1.390***	0.144***	0.093***	1.364***	0.141***	0.089***
	(5.41)	(4.80)	(3.88)	(5.31)	(4.69)	(3.74)
LEV	-0.539*	-0.016	0.002	-0.565*	-0.019	-0.001
	(-1.75)	(-0.34)	(0.05)	(-1.84)	(-0.40)	(-0.02)
TAN	0.581**	0.074**	0.052*	0.530**	0.070*	0.048*
	(2.33)	(2.10)	(1.85)	(2.11)	(1.91)	(1.68)
SIZ	0.259***	0.040***	0.031***	0.252***	0.040***	0.031***
	(7.27)	(9.02)	(8.26)	(7.00)	(8.73)	(8.00)
MTB	0.021	0.052***	0.055***	0.024	0.050***	0.054***
	(0.21)	(4.91)	(5.90)	(0.24)	(4.82)	(5.92)
SAG	-0.130**	-0.016***	-0.013***	-0.111*	-0.013**	-0.010**
	(-2.28)	(-2.79)	(-2.92)	(-1.93)	(-2.31)	(-2.39)
DIY	0.044	-0.086	-0.092**	-0.112	-0.124**	-0.122***
	(0.09)	(-1.64)	(-2.26)	(-0.22)	(-2.39)	(-3.01)
Policy_dum	-0.007	-0.016***	0.044***	0.001	-0.014**	0.047***
	(-0.09)	(-2.69)	(3.12)	(0.01)	(-2.34)	(3.35)
F statistics		13.11***	11.72***		12.83***	11.39***
Wald χ²	215.50***			209.42***		
Left-censored		981			981	
N	4,079	4,079	4,079	4,079	4,079	4,079

Notes: The likelihood to purchase (For_inv) and the percentage of foreign ownership (For_own) are the dependent variables in probit and tobit regression models respectively. For_own is the dependent variable in pooled OLS regression. t-statistics are in parentheses. * is significant at 1%. ** is significant at 5%. *** is significant at 1%.

Research data

In Vietnam, foreign ownership is limited to 49% in most industries. Therefore, we only select non-financial firms of 49% foreign ownership cap. Both financial variables and ownership information are collected from Stoxplus database. After eliminating firm-years without complete information, we have the final sample including 4,079 observations for subsequent analysis. To control the effect of outliers, we winsorize all research variables at 1%.

Table 1 describes our research data. We find that the number of observations rises significantly over the period 2008-2017. Table B illustrates that industrial firms account for the largest proportion of observations in our sample with 45.4%. Oil and Gas industry is the smallest industry with only 1.05%. Panel C shows descriptive statistics of research variables. On average, foreign ownership is relatively low at only 9.2%. The maximum foreign ownership is 49%. Before September 2015, the cap for foreign ownership in non-financial firms was 49%. From September 2015, the cap is eliminated in some industries but few firms have over 49% of shares held by foreign investors. Firms with foreign ownership accounts for 75.9% of observations in the research sample. Moreover, the average state ownership is 26.1% on average and its maximum value is 79.6%. These findings indicate that state agencies still hold high proportion of shares despite the government privatization policy. Observations with over 50% of state ownership also constitute 28.1% of the sample.

Research results

Table 2 show results of probit and tobit regression models clustered by firms to inves-

Thi and Tran: Are Foreign Investors Afraid Of State Ownership?

Q. N. N. Thi and Q. T. Tran / Indonesian Capital Market Review 13 (2021) 1-11

Table 3. Additional Analysis

Variables	Fixed effects	Random effects	Pooled OLS
Intercept	0.087	-0.026*	0.075***
	(1.50)	(-1.82)	(4.66)
ΔSta_own	-0.041***	-0.041***	-0.041***
	(-3.41)	(-3.53)	(-3.53)
PRO	0.038***	0.036***	0.036***
	(2.98)	(4.23)	(4.23)
CAS	0.011	0.019**	0.019**
	(0.82)	(2.40)	(2.40)
NWC	0.005	0.007	0.007
	(0.61)	(1.54)	(1.54)
LEV	0.011	0.012	0.012
	(0.82)	(1.62)	(1.62)
TAN	-0.005	-0.002	-0.002
	(-0.46)	(-0.30)	(-0.30)
SIZ	-0.003	0.001*	0.001*
	(-1.51)	(1.66)	(1.66)
MTB	0.007*	0.004*	0.004*
	(1.67)	(1.94)	(1.94)
SAG	0.002	0.003	0.003
	(0.83)	(1.38)	(1.38)
DIY	0.007	-0.013	-0.013
	(0.46)	(-1.02)	(-1.02)
Policy_dum	-0.009***	-0.008***	-0.095***
	(-3.29)	(-3.10)	(-9.50)
F statistics	10.33***		13.11***
Wald χ^2		340.91***	
N	4,079	4,079	4,079

Notes: The dependent variable is the change in foreign ownership (ΔFor_own). t-statistics are in parentheses. * is significant at 1%. ** is significant at 5%. *** is significant at 1%.

tigate the effect of state ownership on foreign ownership. Pooled OLS regression results are also presented as robustness checks. State ownership is negatively related to both the likelihood and the magnitude of foreign investment. These findings imply that foreign investors are afraid of state ownership. Firms with state ownership face "double agency" problem. Politicians tend to follow social and political objectives rather than economic efficiency. This is a good opportunity for managers to increase their expropriation of shareholders and destroy firm value (Boubakri, Cosset, & Guedhami, 2005; D'Souza, Megginson, & Nash, 2005; DeWenter & Malatesta, 2001; Megginson, Nash, & Van Randenborgh, 1994). Therefore, firms with higher state ownership are less attractive to foreign investors.

Moreover, in line with Batten and Vo (2015); J.-K. Kang and Stulz (1997), we find that firms with higher profitability, cash holdings and net working capital tend to have higher foreign ownership. Firms with larger size and higher market value attract higher foreign ownership since they experience less information asymmetry. The effect of the change in government policy on foreign ownership is mixed.

Table 3 presents regression results to investigate how an increase in state ownership affects the change in foreign ownership. In consistent with our research findings in Table 2, we find an increase in state ownership leads to a decrease in foreign ownership. These results indicate that foreign investors do not prefer state ownership due to severe agency problem. Besides, firm profitability positively affects the change in foreign ownership.

Remarkably, Table 3 shows that foreign ownership decreases after the government increases foreign ownership cap in some industries. This is contrary to our expectation but consistent with the development of Vietnamese stock market. The new policy came into force at the end of 2015; however, there were many economic shocks in the world after that. Chinese stock market crashed in 4th January

7

2016, the UK decided to leave EU (Brexit) in June 2016 and the US election was at the end of 2016. These shocks made foreign investors withdraw their investment significantly from Vietnamese stock market in 2016 and foreign investment only slightly recover in 2017.

Conclusions

The extant literature shows that state ownership may lead to both benefits and problems. Therefore, we propose two opposite hypotheses on the relationship between state ownership and foreign ownership. First, we argue that foreign investors are able to control the agency problem and they prefer benefits associated with state ownership. Therefore, firms with higher state ownership are more attractive to foreign investors. Second, we posit that weak corporate governance associated with state ownership is an obstacle and foreign investors are less likely to prefer state ownership. Using a sample of 4,079 firm-years in Vietnamese stock market over the period from 2008 to 2017, we find that

state ownership is negatively related to both the likelihood and the magnitude of foreign investment. In addition, an increase in state ownership results in a decrease in foreign ownership.

Implications

Our research findings imply that foreign investors are afraid of state ownership due to severe agency problem. Consequently, Vietnamese government should promote and enhance the privatization process to reduce state ownership and attract international investors. Besides, the government should have regulations to improve corporate governance in firms with state ownership. Moreover, high state ownership firms should have effective corporate governance mechanisms if they want to cooperate with foreign investors.

Due to data unavailability, we only conduct this research in Vietnam. Future research may investigate the role of state ownership in foreign investors' investment behavior across countries to address this topic fully.

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Thi and Tran: Are Foreign Investors Afraid Of State Ownership?

Q. N. N. Thi and Q. T. Tran / Indonesian Capital Market Review 13 (2021) 1-11

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