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______________Ly Le_______________ ______________ __7/1/2013___________

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The Politics of Business Group Diversification in Vietnam

By

Ly Le

Master of Arts

Political Science

Richard Doner

Advisor Signature

Jennifer Gandhi

Committee Member Signature

Thomas Remington

Committee Member Signature

Accepted:

Lisa A. Tedesco, Ph.D.

Dean of the James T. Laney School of Graduate Studies

Date

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Ly Le

Bachelor of Arts Degree in Economics and Business

Advisor: Richard Doner, PhD in Political Science

A thesis submitted to the Faculty of the

James T. Laney School of Graduate Studies of Emory University

in partial fulfillment of the requirements for the degree of

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Abstract

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One of the most salient features of the Vietnamese economy is the state-owned business groups that unsuccessfully expand into unrelated business activities but are allowed to dominate the economy at the expense of the private sector. I argue that the persistent dominance of business groups in Vietnam stems from two main factors: political fragmentation and natural resource abundance. These two factors independently lead to the persistence of diversification strategies that underscore economies of scale rather than economies of scope. Moreover, natural resources also act as an intervening factor between political factions and unrelated diversification. In other words, natural resource abundance fuels fragmentation in the government which in turn prompts firms to expand into non-core markets. The study goes on to illustrate the theory by examining the Vietnam Electricity Corporation (EVN), one of the thirteen general corporations in Vietnam in 2011.

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I. Introduction

After three decades of spectacular growth rates averaging 7 percent per annum, the economy in Vietnam has experienced tremendous trials and tribulations in the post-2008 period when the world is grappling with the global financial crisis. At first glance, the deteriorating economic figures seem to move in line with those of the global market. However, it is this period of turbulence that has disclosed the fundamental political and economic weaknesses of the country. One of the most salient features of the system is the state-owned business groups that unsuccessfully expand into unrelated business activities but are allowed to dominate the economy at the expense of the private sector. The two groups, Vinalines and Vinashin, which owe 43,000 billion VND ($2.15 billion) and 80,000 billion VND ($4 billion) respectively due to inefficient diversification into non-core areas, exemplify the plethora of floundering state-owned business groups in the country. Studies, however, show that firms that operate in related areas have, on average, higher profitability than those that expand into unrelated business activities (Amit and Livnat 1988, Farjoun 1994). The puzzle at issue is: Why do state-owned business groups in Vietnam diversify into unrelated industries despite the benefits they can yield from expanding into related markets?

Vietnam is chosen for two reasons. First, Vietnam is one of the very few communist countries that exist to this day. Despite the fact that the country still clings onto a communist political system, it has implemented market-oriented reforms. The economy in Vietnam can be described as a hybrid of capitalism and communism. An understanding of the resilience of business groups in Vietnam will shed light on the origin and characteristics of business groups in other post-communist economies. Second, Vietnam is in a strategic location that borders both East Asia and Southeast Asia. It is, therefore, important to examine a salient feature of the country – business groups – in order for Vietnam to emanate the East Asian development path and avoid the weaknesses that have plagued Southeast Asian countries (Harvard Vietnam Program 2008). A better understanding of the business groups in Vietnam will also offer valuable lessons for other Southeast Asian nations.

Explaining the puzzle is crucial for two main reasons. First, an insight into diversified business groups will shed light on the origins and impacts of this resilient and crucial type of institutions in emerging markets. It will also contribute to the discussion on institutional emergence and evolution in comparative political economy. Second, it is imperative for Vietnam to avoid the middle income trap in which other developing countries such as Thailand have found themselves. A middle income trap is "a situation in which a country that is successful in lifting its economy from the status of being a least developed or low-income country to a middle-income one but remains at that level without much prospect of becoming an advanced, rich country" (Jitsuchon 2012, 14). Vietnam has successfully diversified its exports and boosted its economic growth on the basis of natural resources and low-cost labor. The challenge facing the country is to sustain and strengthen that growth amidst fierce competition from both more technologically advanced countries, such as India and China, and lower-wage countries, such as Laos and Cambodia. It is imperative for Vietnam to move from labor-intensive to high-tech products in order to avoid the middle income trap.

I argue that the persistent dominance of business groups in Vietnam stems from two main factors: political fragmentation and natural resource abundance. These two factors independently lead to the persistence of diversification strategies that underscore economies of scale rather than economies of scope. Moreover, natural resources also act as an intervening factor between political factions and unrelated diversification. In other words, natural resource abundance fuels fragmentation in the government which in turn prompts firms to expand into non-core markets. The study goes on to illustrate the theory by examining the Vietnam Electricity Corporation (EVN), one of the thirteen general corporations in Vietnam in 2011. Section II justifies the importance of the research question. Section III explains different diversification strategies and their emergence. Second IV addresses the theory. Section V lays out the research design. Section VI discusses the typology of business groups. Section VII presents the empirical evidence in Vietnam. Section VIII concludes.

II. The Significance of the Puzzle

Institutions have constituted a prominent topic of comparative political economy in the last couple of decades. Institutions are conceptualized as "the rules of the games or a set of human devised constraints that shape actors' behavior" (North 1990, 3). The importance of institutions has emerged after scholars and policy-makers realized the detrimental impact market failures have on the economy. The major theoretical differences with regard to the role of institutions underscore their functions to reduce transaction costs and alleviate the incomplete information problem.

Although scholars and policymakers have acknowledged the importance of institutions in generating economic development, there are two major theoretical differences with regard to the role of institutions in reducing transaction costs and solving the incomplete information problems. First, institutions can reduce transaction costs which are the costs incurred in economic exchange (North 1990). The Coase theorem in modern economics posits that absent transaction costs, private actors can bargain to arrive at efficient outcomes regardless of the initial allocation of private properties (Coase 1937). Transaction costs, in reality, exist in various forms such as information, monitoring, and enforcement of contracts. Institutions thus are warranted to reduce these costs. In the Western world, various forms of complex institutions have been established to serve this purpose: trademarks, patents, intellectual property rights, etc. In developing countries, however, weak institutions may not be effective at reducing transaction costs (Khanna and Palepu 1999). Informal institutions such as familial connection and ethnic ties may be alternative solutions.

Second, institutions can solve the incomplete information problems (Williamson 1995, Stigliz 1985). The function of tackling the incomplete information problem is part of the transaction cost perspective, but it focuses on *ex ante* mechanisms to sustain contracts rather than *ex post* transaction costs. An example of institutions that can serve this purpose is coordinated market economies (CMEs). CMEs requires firms to provide employees with specific skills, high quality health care, and generous unemployment benefits to assure that firms are willing to invest in employees and employees have long-term interests vested in firms (Hall and Soskice 2001).

The business group is a prevalent institution in developing countries such as Vietnam and those in Latin America (Chang and Choi 1988, Abegaz 2005) and some developed economies like Italy and Sweden (Khanna and Yafeh 2005). However, business groups have played a much more important role in emerging markets than in advanced economies (Smith and Trebilcock 2001). In emerging markets, the lack of strong institutional arrangements that enable a fully-functioning market has given rise to the emergence of business groups (Khanna and Yafeh 2005, Hoskisson 2005, Chang and Hong 2000, Chang and Hong 2002, Kim et al. 2004, Yiu et al. 2005, Kock and Guillen 2001). A business group is defined as a "collection of firms bound together in some formal and/or informal ways" (Granovetter 1995, 95). Business groups can take on various forms, ranging from vertically-controlled groups where groups are held together by equity ties to horizontally-linked groups where affiliation stems from cross shareholdings (Khanna and Yafeh 2005, 1). Besides formal connection such as equity ties, firms can be held in the same group through informal ties such as family and social ties, and trade relations (Khanna and Yafeh 2005, 1). The variants of business groups include Korea's chaebols, Japan's prewar zaibatsu and postwar keiretsu, Italy's industrial-district groups, China's qiye jituan, Taiwan's guanxi qiye, and Latin America's grupos economics (Abegaz 2005, 4).

Business groups are established to internalize market failures so that businesses can gain easier access to resources such as capital, labor, raw materials and technology in emerging markets (Guillen

2000). In places where the market is not fully functional, business groups institutionalize "an alternative allocation mechanism so that production can take place" (Guillen 2000, 363). In 2000, business groups accounted for 60% of China's industrial output; in Korea, the 30 largest business groups took up 40% of the country's economic activity (Hoskisson 2005, 945). As of 1996, Samsung, Hyundai, LG, and Daewoo had 80 member companies operating in a number of sectors such as semiconductors, consumer electronics, construction, shipbuilding, and financial services (Chang and Hong 2000). In this study, I focus on business groups in developing countries to highlight their importance in markets with weak institutional arrangements.

An understanding of these groups is imperative to formulate and implement effective policies on training in Vietnam. A crucial determinant of development, especially for countries moving up the global value-chain, widely acknowledged in the literature is human capital or the level of skills possessed by workers in a country (Hanushek and Woessmann 2008, Chinhui et al. 2005, Romer 1986). In developing countries abundant in young labor, skill formation is particularly crucial to take advantage of "demographic window," a period over which the working age population reaches its peak relative to the dependent population, in order to induce high growth rate. Vietnam is one such country. As of July 1, 2011, the country had 51.4 million people aged 15 years and older in the labor force, representing 58.5% of total population, among which 50.35 million were employed and 1.05 million unemployed (GSO 2011,7). In fact, however, 84.4% of the labor force or 43.4 million workers have never received training to acquire technical expertise (GSO 2011, 4).

Training is particularly crucial for Vietnam's labor force since even the higher education system does not equip students with the skills needed on the job market. According to a survey that includes 500 businesses in Ho Chi Minh City in December 2010, 94 % of graduates need to be retrained to meet the needs of each company; 92% of the training was about professional expertise, 61% basic soft skills, and 53% management and leadership skills (Thank Nien 2011). Vietnam needs to adopt effective human capital development strategies in order to make use of a "golden labor force" during "demographic window" (GSO 2011, 17). Failure to improve qualifications and skills for the abundant young labor force will not only hinder Vietnam from achieving sustainable high productivity and fast growth, but also undermine the country's ability to develop human capital in the long run to become a high-tech and developed nation. I argue the business strategy of state-owned business groups in Vietnam has a strong impact on the country's human capital development policies.

Literature Review

1. The Significance of Diversification Strategies for Growth

Firms can diversify into related markets to take advantage of economies of scope or unrelated business activities to avail themselves of economies of scale (Amit and Livnat 1988, 99), which have direct implications for economic growth. The variation in diversification can be explained through two main economic incentives (economies of scope and risk hedging) and policies that directly or indirectly promote diversification (Schneider 2009b, 183).

1.1. Related diversification

Studies show that firms that diversify into related areas have, on average, higher profitability than those that expand into unrelated business activities (Amit and Livnat 1988, Farjoun 1994). Groups that focus on economies of scope can "transfer existing organizational models, market strategies, and experienced personnel to new activities in ways that tend to flatten learning curves and reduce costs" (Schneider 2009b, 183). The general efficiency theory of diversification posits that when a firm, seen as a pool of resources, underutilizes a certain input such like capital and labor which cannot be used profitably in its current business activities, it can allocate this input to other industries in order to make profits and benefit from economies of scope (Penrose 1959). Due to market imperfections (high transaction costs and incomplete information), firms choose to diversify internally by expanding its operation into new areas instead of transferring resources to another firm. In terms of human capital, the underutilized resource comes in the forms of "unused abilities, learning and accumulated experience, and new pressure" rather than "idle employees" (Farjoun 1994, 188).

A large extent of the firm's diversification tends to occur within industries with similar needs of human skills. Corporate specialization and subsequent diversification into related areas are prevalent in the United States and Western Europe (Chandler 1990). Using a sample of 12,781 diversified firms operating in all sections of the US market, Farjoun (1994) finds that firms that expand operation within groups of industries that are related to one another in terms of skills and specialization crucial to each industry. By so doing, firms can make more efficient use of their resources by "sharing and transferring them across similar products" (Farjoun 1994, 185). The Korean *chaebols s*hare and transfer intangible resources such as technical know-how and human skills among their affiliates. Since these inputs do not depreciate with increased use, they induce economies of scope and prompt these firms to further diversify (Khanna and Yafeh 2005, 11). The *chaebols*' ability to transfer and share expertise, management skills, and inputs with their affiliates was integral to their rapid economic growth (Kim et al. 2004, 25). Ferris et al. (2003, 251), however, find that the *chaebols* suffer an overall loss since they: (1) favor profit stability over profit maximization, (2) over-invest in less successful sectors, and (3) subsidize loss-making member firms. They conclude that the cost of being affiliated with the *chaebols* outweighs its benefits, and that chaebol-affiliated firms are not as efficient as their non-*chaebol* counterparts (Ferris et al. 2003, 251).

1.2. Unrelated diversification

On the contrary, the pattern of business groups diversifying into unrelated activities is manifest in emerging markets in post-WWII such as the developing economies in Southern Europe, Latin America, and Asia (Khanna and Palepu 1997). Groups whose goal is risk management branch out into unrelated markets such as steel and cattle that have different market cycles to cope with market volatility, especially in such areas as raw materials and industrial commodities (metals) (Schneider 2009b, 184).

While economies of scope can lead to high-value products and advanced technology, risk-hedging diversification has the undesired consequence of deterring firms from investing in R&D in a certain business operation and lead to an overall low level of technology and skills among workers.

Scholars have found that business groups that diversify their operations into more specialized assets outperform those that are more widely diversified into unrelated economic activities (Scott 1993). Using data on business groups in 12 countries,[1] Khanna and Yafeh (2005) find that group affiliation helps member firms to share risks by stabilizing income flows and reallocating funding among affiliates in Japan, Korea, and Thailand, but not in other markets in the sample. The difference between business groups in developed and developing countries may stem from the fact that business groups in the emerging markets diversify to establish new businesses across multiple industries swiftly at a low cost, whereas business groups in advanced economies branch out in new areas for financial diversification (Guillen 2000, 363). By analyzing data on 889 Indian firms (171 focused and 675 diversified firms) over the 1998-2000 period, Singh et al. (2007) find that diversified firms perform substantially less successfully than specialized firms. They also find a negative relationship between the level of diversification and firms' performance. These findings do not imply that profitability is the criterion used to evaluate the developmental impact of diversification. Rather, they show that, on average, firms that use expertise and technology from their core products for new areas tend to be more viable and effective than those that operate in multiple unrelated markets. The focus on economies of scope diversification thus can explain why business groups in such countries as Korea and Japan were successful in serving as a pillar and a driving force for the two countries' strong long-term economic growth.

2. Evolution of diversified business groups

[1] Argentina, Brazil, Chile, India, Indonesia, Israel, Korea, Mexico, the Phillipines, Taiwan, Thailand, and Turkey

Previous studies have proposed two main theories that explain the emergence and persistence of business groups: (1) government-driven policies and (2) economic and political volatility. This section examines these two theories.

2.1. Government-driven policies

Political factors such as policies that push or encourage firms to branch out into new areas can induce business groups to diversify (Schneider 2009b, 180). Groups vary in their responses to market reforms and globalization. Privatization reforms encourage groups to grow and diversify (Schneider 2009b, 192). However, liberalization with tariff reduction and increased entry of multinational corporations (MNCs) prompt MNCs to acquire subsidiaries and discourage domestic groups from branching out into high-tech sectors; the de-diversification effect of this trend, nevertheless, is limited. Groups also vary in their international expansion, pursuing either market-seeking (acquiring competitors in foreign markets to increase market share) or efficiency-seeking (focusing on exporting lower-cost and higher-quality products) (Schneider 2009b, 193).

Business groups generally have close ties with their governments in many countries and thus are seen as "parasites" (Khanna and Yafeh 2005, 29). In many countries, business groups are the product of government policies. Prior to WWII, the Japanese government's privatization program gave rise to *zaibatsu* groups in the early 1880's (Khanna and Yafeh 2005, 29). These groups diversified their business to get government-awarded contracts under preferential conditions and were closely tied to the Japanese government. The two major Japanese *zaibatsu*, Mitsui and Mitsubishi, dominated two major parties in the Japanese parliament in the 1910's. The Korean business groups, the *chaebols*, also had a symbiotic relationship with President Park. The *chaebols* gained preferential access to resources controlled by the Korean government such as credit and foreign currency. The Korean *chaebols*, like the Japanese *zaibatsu* in the late nineteenth century, emerged under the aegis of the government; however, the *chaebols* gained more autonomy and opted for business strategies that allowed them to take advantage of their resources and competitive advantages (Chang 2003). In Latin America, *grupos* also facilitate coordination and communication for governments (Schneider 2008a, 387). When policymakers formulate policies and need information or cooperation from businesses, they can formally or informally convene the management of business groups in a more expeditious fashion.

2.2. Economic and political volatility

The diversification of business activities can also stems from economic and political volatility. Due to the lack of fully functional markets (Abegaz 2005, Montgomery 1994, Nguyen Phong 2010), business groups constitute a formal inter-firm network that encompasses finance companies, distributors, and manufacturers (Nguyen 2010, Schneider 2009a). By diversifying their business operations, *grupos* in Latin America seek to preclude major risks associated with a particular economic activity. This behavior differs from that of business groups such as Korea's *cheobol*, Japan's postwar *keiretsu,* and China's *qiye jituan* whose goal is to achieve economies of scope where groups use expertise and resources in one sector to increase returns to diversifying into other sectors by reducing costs of joint production (Panzar and Willig 1981, Schneider 2009a).

Political volatility can also prompt firms to expand into unrelated sectors to hedge against risks. In parliamentary systems in Latin America, parties are fragmented; under majoritarian presidentialism, the median voter suffers de facto exclusion from policymaking (Schneider 2009a, 566). These fragmented political structures provide little incentives and make it difficult for firms to press for effective training programs. The high level of political volatility in Latin America discourages domestic firms from investing in skill training to develop technological advancement since skill formation has a long gestation period fraught with risks and unpredictable outcomes. Instead, these unstable political conditions induce firms to diversity into unrelated market and be less willing to hire long-term workers for fear of unexpected downsizing.

These theories, however, cannot explain two crucial questions: (1) why do some governments adopt policies that promote economies of scale, and some do not? And (2) through what mechanism does political fragmentation prevent some governments from reversing firms' strategy of unrelated diversification? In this paper, I address these two questions by proposing a theory that focuses on two important factors that lead to and reinforce diversified business groups: natural resources and political fractionalization. I argue that the availability of natural resources causes politicians and firms to rely on resource rents and expand operation into low-tech markets. Political fragmentation increases the number of effective veto players that block policies that promote upgrading. Natural resources also incentivize political coalitions to remain divided to vie for resource rent. The high degree of political fractionalization, nevertheless, prevents coalitions from reaching a consensus on upgrading the economy, which further induces politicians and firms to rely on natural resources and seek economies of scale diversification. The section below further lays out the theory.

III. Theory

I argue that the economies of scale diversification by business groups in Vietnam stems from two main factors: political fragmentation and natural resource abundance. These two factors independently lead to business strategies that underscore economies of scale rather than economies of scope. Moreover, natural resources also act as an intervening factor between political factions and unrelated diversification. In other words, natural resource abundance fuels fragmentation in the government which in turn prompts firms to expand into non-core markets.

First, a high level of political fragmentation can preclude the political cohesion needed to push forward industrial policies that target key sectors. These coalitions act as veto players whose consent is needed to change the status quo (Tsebelis 1995, 35). Veto players are conceptualized as political actors with different ideological preferences and a high level in internal cohesion. A political system that has many veto points is thus more factionalized and faces more policy rigidity. Despite being a single-party regime, Vietnam is characterized by four main coalitions in the government: conservatives, modernizers, rent-seekers, and supporters of China (Vuving 2010, 368). The goal of the conservatives and SOE-dependent actors is to impede further restructuring of state-owned enterprises (SOEs) that forces them to specialize and upgrade their products. A focus on productivity will put those who benefit from the status quo at risk since their gains will be contingent on their productivity, in which they are currently lacking. It will also put SOEs at a disadvantage compared to private companies and lead the former to lose control of the market. Modernizers, on the other hand, support liberalization and promote the interest of the whole nation. Proponents of China push for policy that benefits the foreign nation rather than the Vietnamese public. Rent-seekers look to maximize gains through government-granted privileges at the expense of the national interests. The friction among these groups renders difficult the reforms of state-owned business groups that pursue economies of scale diversification.

Second, the availability of natural resources reinforces the role of the *rentier* or petro-state in promoting its comparative advantage of agricultural and resource sectors. This focus on low-value added products, however, deters the petro-state from investing in innovation and boosting technological advancements. A petro-state has a dominant control of resource rents and accounts for a lion's share of economic activity (Schneider 2008b, 18; Karl 1999, 34). Due to natural resource abundance, the Vietnamese government, like those in the emerging markets in Latin America and Southeast Asia, focuses on their competitive advantages in commodity production, such as agro-industry (i.e. pulp and paper), minerals and metals (i.e. steel and copper), and more industrial commodities (i.e. textiles and electronic components) where "design and marketing are located in developed countries and production is subcontracted out to firms in developing countries in global production networks" (Schneider 2008b, 14). The petro-state thus encourages state-owned business groups to follow the business strategy of diversifying into agricultural and resource markets. Schneider (2008b), however, does not specify the mechanisms through which *rentier* states can induce economies of scale diversification. I argue that natural resource endowments can hinder state-owned business groups from upgrading by diverting their effort from promoting technology and innovation to exploiting natural resources for rent.

Third, natural resources engender political fractionalization which causes firms to pursue unrelated diversification. Natural resources deepen the rifts among the four coalitions in the Vietnamese government by incentivizing them to remain divided and compete for resource rent. The high level of fractionalization in the Vietnamese government, in turn, precludes them from adopting industrial policies that encourage state-owned business to expand their operation into related industries to take advantage of technology and expertise. These state-owned business groups, therefore, pursue economies of scale diversification into low-value added resource markets and become further reliant on natural resources. What ensue are a government and an economy that rely heavily on unrelated diversification in agricultural and resource sectors.

IV. Research design

This study addresses the question: Why do state-owned business groups in Vietnam diversify into unrelated industries despite the benefits they can yield from expanding into related markets? In this section, I present a research design that tests the theory that political fractionalization and natural resources induce and reinforce economies of scale diversification. This theory is tested through the use of qualitative analysis. I generate following hypotheses:

H1: An increase in natural resource rents causes business groups to diversify into more unrelated markets.

H2: An increase in the level of political fragmentation is associated with a higher degree of economies of scale diversification.

H3: An increase in resource rent leads to a higher level of political fractionalization.

The causes of effects approach is chosen to elucidate firms' decision to invest in training since it has the most leverage to draw causal inferences (George and Bennett 2005). I start with the outcome of interest – high level of firms' diversification into unrelated markets in Vietnam – and explain the relationships between the causes and the effect (Bennett and Elman 2006). This approach differs from effects of causes in quantitative research which examines the magnitude of influence a cause has on an outcome. Although quantitative methods are regarded as an effective way to generate broad inferences, they are less effective at evaluating the relationship between the causes and outcomes (Seawright 2010).

I employ Mill's method of difference (MMD) where I carry out a controlled comparison of similar cases which only differ in the dependent variable to show that the different levels of resource dependence can explain the disparity in the outcomes (George and Bennett 2005). This approach is germane to the purpose of this study in that due to the similarities of the subjects, MMD can hold constant the various variables that are irrelevant to the question at issue. The shortcoming of this method is that it is applicable to only a few cases that resemble in all aspects but one, and that it is not feasible to hold all explanatory factors constant. Inferences based on this approach, therefore, can be spurious and invalid. In this section, however, I will use the MMD method to test the theory of interest.

I focus on the temporal variation in diversification. In other words, I will examine the business strategy of a business group over two episodes. The business group under examination is the Vietnam Electricity Corporation (EVN) over 1994-1998 and 2004-2008 (Pham Son 2012). 1994 is chosen since it was the year when EVN was established. 2004 is of interest since it was four years before the global financial crisis hit the international market and the 2004-2008 period marked the peak of diversification in Vietnam. The operation of the group is observed for four years after these milestones to allow for the time needed to implement policy. A look at EVN over a period of time will allow me to hold constant the external factors (i.e. the political system, connections with politicians) and internal factors (i.e. the group's core business, the leadership, and firms' policies). If the theory is correct, these episodes should reflect the leadership's concern with a decline in commodity export prices and the need to restructure their operation and shift to human capital development.

In focusing on one business group, I have to consider the tradeoff between external validity, statements that are generalizable across cases, and internal validity, inferences that identify the causal process in a particular case (Slater & Ziblatt 2008). Controlled comparisons have been criticized by quantitatively oriented comparativists and qualitative methodologists for its inability to generate generalizable inferences (Slater & Ziblatt 2008). However, I argue that the controlled comparison used in this study can produce externally valid arguments since it meets three conditions specified by Slater and Ziblatt (2008). First, the case study can assess the validity of alternative mechanisms though which business groups diversify into unrelated markets. Second, the argument is represented in terms of general causal variables, namely natural resource dependence and political fragmentation, and mechanisms – the impediment of effective industrial policies. Third, since Vietnam shares a number of similarities with other transition and Southeast Asian economies, the range of variation in the case study can be comparable to that in other countries.

V. Typology of business groups

Table 1: Typology of business groups

	Resource-rich	Resource-poor
Fragmented politics	Unrelated diversification (Vietnam, Thailand, Indonesia, Latin America)	
Unified politics		Related diversification (China, South Korea, Singapore)

In this section, I construct an explanatory typology of business groups. Typologies are used to determine which type a case belongs (Elman 2005). Business groups in a certain country are coded as falling into one cell or another. I use this classificatory system to compare business groups in different countries based on their respective scores on two attributes: natural resources and political fragmentation. These constituent attributes are taken from the two main variables of my theory. The dimensions of the property space (rows and columns) show the values of the theory's independent variables. Each cell in the space corresponds with the predicted values of the theory's dependent variables – economies of scope and economies of scale diversification.

I illustrate this typology with two examples: Thailand and China. I go on to carry out a more extensive case study of Vietnam. Vietnam, Thailand, and China are theory testing case studies which evaluates the validity and scope conditions of the theory at issue (George and Bennett 2004, 75). These are the most likely cases where the independent variables proposed in the theory take on values that predict a certain outcome. These most likely cases will put the theory into question if their outcomes are not in line with the theory's predictions. As demonstrated below, these cases support the theory.

1. Fragmented politics and resource abundance: Thailand

Thailand is characterized by fragmented politics, resource abundance, and economies of scale diversification. The country's growth has been driven primarily by "cheap labor, and low innovation, with technological acquisition mainly through technology importation" (Jitsuchon 2012, 16). The main reason for Thailand's dependence on low-tech and low-cost labor, according to Jitsuchon, can be accounted for by the lack of the government's incentive to invest in R&D and boost innovation. Thailand has diversified into a wide range of agricultural and industrial products such as rubber and pickup truck assembly; however, the Thai economy has yet to move up the value the global value chain by developing midstream and upstream production such as dyeing and printing in textile, and indigenous auto parts (Doner 2009).

Business groups in Thailand are highly diversified in terms of the sectors in which they operate and the number of firms affiliated with the groups (Polsiri and Wiwattanakantang 2004, 9). A prime example is the Siam Cement group, which is the largest business group in Thailand and is affiliated with the Crown Property Bureau, which partakes in various industries such as manufacturing, banking, finance and insurance, hotels, and real estate. Like the chaebols, Thai business groups are made up of legally independent companies that belong to a common group and are under the control of family members of the group owners (Polsiri and Wiwattanakantang 2004, 14). Like business groups in other emerging markets, business groups in Thailand are largely family owned (Polsiri and Wiwattanakantang 2004, 14; Suehiro and Wailerdsak 2004, 81; Bertrand et al. 2008, 466). Scholars, however, have found a negative relationship between some form of family ownership (excess control by sons of the founder) and firm performance in Thailand (Bertrand et al. 2008).

I argue that this outcome stems mainly from two factors: a divided government and an abundance of natural resources. First, the Thai government can be described as fragmented, which has made it difficult to pass economic policies that promote innovation and technological advancement. During the three years after the end of World War II, Thailand installed a parliamentary system with nine administrations succeeding each other (SarDeSai 1997, 257). Such a high level of government turnovers resulted from the realignment of five thousand elites vying for office spoils. From 1973 to 1992, Thailand was a democracy dominated by the military. The government was held together by different coalitions, and was led by Prem Tinsulanond from 1980-1988 and Chatichai Choonhavan from 1989 to the coup of 1991. No single party won the majority of votes in the elections over this period. In the 1992 election, the five prodemocracy parties won in a close race with 185 out of 360 seats. The Democrat Party, thus, held the prime minister post. Their victory, however, depended on the weak support of the small prodemocracy parties and faced strong opposition from the pro-military parties that had 144 House seats held by the National Development Party. In the 2001 election, the Democrat

Party lost to the new Thai Rak Thai (Thai Love Thai Party) led by Thakin Shinwatra (DeSai 1997, 270). The frequent shifts in coalitions in the Thai government impeded them from adopting economic policies that focus on long-term innovation and training, thereby rendering business groups more reluctant to adopt economies of scope diversification.

Second, the Southeast Asian newly industrializing country of Thailand differs substantially from the East Asian economies (NIEs) of Hong Kong, the Republic of Korea, Singapore, Taiwan, and Japan, especially in terms of the natural resource abundance of the former and the lack thereof of the latter (K.S and Rock 1998, 1). The resource-rich NICs have diversified their economic activities primarily on the basis of new crops and resource exploitation, which has attenuated their incentive to pursue industrialization based on higher-value added products. Abundant land endowment in Thailand has a detrimental effect on agricultural and technological upgrading, indicating that Thailand has failed to effectively mobilize resource rent for modern development (Douangngeune et al. 2005, 3). An increase in output can come from intensified exploitation of natural resources such as cultivating new land using traditional technology rather than developing technological advancements through education and research. The development and industrial capacity of Thailand has relied heavily on agro-processing. The NIEs, on the other hand, have successfully pursued export-oriented strategies aimed at promoting high-value added sectors such as chemicals, automobiles, and electronics (Frieden et al. 2010).

Third, I argue that abundant resources incentivize Thai coalitions to remain divided and compete for resource rent. The high level of political fragmentation, in turn, precludes coalitions from reaching a policy that can upgrade the economy. The failure of government coalitions to develop high-value added sectors further deepens politicians and firms' reliance on natural resources, leading the latter to diversify into low-value added agricultural and resource markets. In Thailand, coalition governments consist of ministers with individual jurisdictions. The establishment of a new ministry "increases the overall value of the 'political cake', and therefore, readjustments would have to be made in the portfolio allocations among coalition partners" (Bowornwathana 1996, 24). This creation eases the tension due to the lack of promotion prospects in the old ministry where the key positions had already been filled (Kaosaard 1998).

A new ministry also enables the agencies and member bureaucrats to get budget allocations and more leverage to pursue their agendas. Ministers are primarily parliamentarians from different provinces who tend to pursue local rather than national interests. These local politicians have a large stake in their local natural resources; obtaining political power at the national level gives them leverage to change the rules of the game and become the rule keepers. Each ministry develops their own agendas in compliance with the National Plan, which guides budgetary purposes. However, national plans fail to provide effective guidance for policies and projects involving government spending. Each minister is granted tremendous discretion through ministerial regulations and notifications – the means for policy implementation. Thailand has no industrial policies that promote high-value added sectors. Instead, the country's economy is driven primarily by "the nation's trade tax regimes (tariffs and export taxes mainly on agricultural products) and various sectoral policies such as local content requirements" (Kaosaard 1998, 6).

2. Unified politics and resource scarcity: China

Unlike Thailand, China has a unified political system, resource scarcity, and economies of scope diversification. Business groups in China were modeled after the Korean chaebols and have played a pivotal role in promoting economic growth in this emerging market (Kim et al. 2004, 46). China's state-owned enterprises (SOEs) constitute some of the world's largest companies (Szamosszegi and Kyle 2011). After the implementation of economic reforms in 1978, the market in China was plagued by market imperfections due to the rigid control of the Communist Party and the inefficiency of state-owned enterprises (SOEs). These weak economic institutional arrangements gave rise to the importance of business groups in functioning as internal markets to provide capital and technological expertise to member firms. In 2000, business groups in China accounted for 60 percent of the nation's industrial output (Yiu et al. 2005, 183).

There is wide variation in the role and performance of SOEs in China over after the start of economic reforms in 1978. By mid 1990s, the reform of SOEs had led to some major economic and political problems, such as corruption of firm managers and state officials (rent-seeking), short-term visions of the managers, and firms incurring huge debts to the banks under the aegis of the government (Wang 2001). SOEs are seen as "a major concern in the country's overall economic reform and one of the potential stumbling blocks to China's sustained economic growth and social stability" (Ralston et al. 2006 , 3). The big picture, however, is that these business groups as the driving force of the national and local economies in China (Keister 1998, 405). They are used by the Chinese government to transition the country from a central planning to a market-oriented economy without being plunged into the crisis Russia fell into due to its drastic privatization process in 1992 (Yiu et al. 2005, 188). Desay, a business group in China, was established in 1983 and has 25 affiliates employing roughly 11,000 employees and operating in areas such as electronics, telephone equipment, audio and visual products, and real estate (Yiu et al. 2005, 188). I argue that this business strategy can be accounted for by China's unified politics and resource scarcity.

First, the political clout in China lies in the hands of a small group of leaders. In 1978, the unconstitutional selection of the General Secretary attenuated the power of the Central Committee and reinforced the position of Deng Xiao Ping. Deng Xiao Ping pushed for the consolidation of the three most important posts in China's politics – President, Head of the Military Commission, and General Secretary – under Jiang Zemin, which led to the notion of a "fused troika" (Makesky et al. 2010, 10). The Tiananmen Square incident in 1989 generated a concentration of power into a small group of leaders in the Poliburo (Malesky et al. 2010, 10). A comparison with Vietnam, a country with a similar political system as China, illustrates the unification of Chinese politics. While the decision-making authority lies with the 160-member Central Committee in Vietnam, it is concentrated in the 25-member Politburo in China. This concentration of power makes it easier for the government to formulate and implement industrial policies that target key sectors in the economy. Although there is factional infighting in the Chinese government, the repercussions of the Tiananmen protests helped consolidate the unified politics in China (Makesky et al. 2010, 10), whereas Vietnam did not experience such a political influential incident.

The State-owned Assets Supervision and Administration Commission (SASAC), which is responsible for monitoring SOEs in China, has specified a number of sectors that play a key role in China's economic and national security and indicated that these strategic sectors will be under the government's control. China's five-year plan promotes the key industries that are "cutting-edge, emerging industries" (Szamosszegi and Kyle 2011, 5). China's goal is to promote their position in key industries such as automobiles, pharmaceuticals, electronics, and petrochemicals (Szamosszegi and Kyle 2011, 65). The Chinese government has used SOEs to push for indigenous innovation in China to reduce the country's reliance on foreign technologies, expedite structural change in the economy, and to procure raw materials from overseas. With the support of the government, Chinese SOEs have also acquired foreign technologies through joint ventures and licensing agreements with foreign firms. SOEs in China, therefore, are encouraged to diversify into high-tech sectors in accordance with the nation's industrial plans and objectives. The top SOEs accounted for roughly three quarters of China's automotive production in 2010. Using data on 233 SOEs in China, Ralson et al. (2006) find that the SOEs have become "viable, world-competitive economic entities" (31).

Second, China's scarce resources puts pressure on the government to encourage business groups to diversify into related areas where they can develop innovation and acquire advanced technologies. In 2009, area land in China accounted for 11.79% of land area in China, 11.78% in Japan, and 16.43% in Korea (WDI 2012). Land endowments were much higher in Vietnam, Indonesia, and

Thailand with 20.25%, 13.03%, and 29.95% respectively. In 2010, the total natural resources rents as a percentage of GDP was 4.01% in China, 0.03% in Japan, 0.05% in Korea (WDI 2012). The figures were 10.36% in Vietnam, 5.95% in Indonesia, and 2.68 % in Thailand. In 1979, Hua Guofeng, one of China's leaders with the most power after Mao's death second only to Deng Xiaoping made it a special undertaking to "develop oilfields to take advantage of the high price of crude oil following the oil shock of 1973, [but] despite high hopes and strenuous exploration efforts, no major new oil fields were discovered" (Vogel 2011, 426). From 1977 to 1978, Deng Xiao Ping, leader of China at the time, set a national goal to promote science and technology since only basic research can help China "achieve scientific breakthroughs that would drive the other three modernizations in industry, agriculture, and national defense" (Vogel 2011, 201). It was, therefore, imperative for China to focus on science and technology to drive economic growth since tremendous efforts to exploit natural resources had not paid off. Deng Xiao Ping thus used state-owned business groups as a tool to boost China's research and innovation in light of resource scarcity.

VI. Empirical evidence: Implications for Vietnam

Despite the large body of literature on business groups, little attention has been paid to their emergence and persistence in emerging economies (Guillen 2000). In this paper, I fill in this gap by discussing the origin and resilience of diversified business groups in Vietnam. Given their dominance in the market in terms of access to political authorities and resources, an adequate understanding of business groups will shed light on the way in which Vietnam can move towards higher-value added products and achieve sustainable economic growth.

1. Diversified business groups in Vietnam

As of October 2, 2012, there are 11 state-owned business groups in Vietnam:

1. Vietnam National Coal-Mineral Industries Holding Corporation Limited (Vinacomin)
2. Vietnam Posts and Telecommunications Group (VNPT)

3. Vietnam National Oil and Gas Group (PetroVietnam)
4. Vietnam Electricity Corporation (EVN)
5. Vinashin Business Group (Vinashin)
6. Vietnam National Textile and Garment Group (Vinatex)
7. Vietnam Rubber Group (VRG)
8. Vietnam Finance – Insurance Group (Bao Viet)
9. Viettel Mobile Telecommunications Group (Viettel)
10. Vietnam National Chemical Group (Vinachem)
11. Vietnam National Petroleum Group (Petrolimex)

Vietnam's economic reform started with Doi Moi in 1986. At the beginning of this process, Vietnam had around 12,300 state-owned enterprises (SOEs), many of which were unprofitable and inefficient (Pham and Carlin 2008). The privatization program, officially called 'Equitization Program' (co phan hoa) commenced in 1992 when the number of SEOs in Vietnam had declined by 47 percent to around 6,500 enterprises (Vu 2006). On July 3, 1994, the Prime Minister issued Decision No. 90 and Decision No. 91 to establish general corporations (Pham Son 2012). The formation of General Corporations (GCs) — collections of smaller SOEs — was institutionalized in the 1995 and 2001 Vietnamese Law on Enterprises. As of 2005, Vietnam had 18 GCs operating –"5 in public utilities and business services, 4 in mining and agriculture, and 9 in manufacturing" (Abegaz 2005, 16).

In 2005, some general corporations were organized into business groups. Vietnam National Coal-Mineral Industries Holding Corporation Limited (Vinacomin) was the first business group to be established on December 26, 2005. From 2005 to 2011, thirteen business groups have come into existence. In 2011, there were 13 business groups and 96 general corporations operating in the form of parent and subsidiary companies. State-owned enterprises dominate the key sectors, including oil and gas (PetroVN), electricity (EVN), shipbuilding (Vinashin), petroleum (Petrolimex) (Nhat Binh 2012a).

There are also 96 state-owned corporations with thousands of subsidiaries. On October 2, 2012, Prime Minister Nguyen Tan Dung approved the decision to dismantle two pilot business groups: Vietnam Industrial Construction Corporation (VNIC) and Housing and Urban Development Corporation (HUD Holdings). With the new decision of the Prime Minister, there are now 11 business groups. In the next few years, only five to six business groups will be allowed to operate, and thus seven or eight business groups will be returned to their ministries.

Vietnam's group formation was inspired by *qiye jituan* in China and *chaebols* in South Korea (Abegaz 2005, 16). State-owned business groups in Vietnam are groups of companies that are linked together in terms of economic gains, technology, markets, and other business activities (Pham 2010). These business groups are established through the reshuffling and transformation of state-owned corporations based on the decisions of the government. In theory, business groups are one of the macroeconomic tools of the government. They operate in the strategic industries where the private sector and other economic actors find it hard to undertake due to their limited financial resources or management experience. State-owned business groups in Vietnam account for 30% of GDP, 51% of capital, and approximately 40% of the workforce among state-owned enterprises.

These business groups have three main characteristics (Pham 2012). First, in terms of management, the fact that Ministries have directly controlled business groups is contrary to the law which stipulates that business groups and general corporations have to have multiple parties managing and being held accountable for certain aspects of the operation (Pham 2012). Prime Minister Nguyen Tan Dung, the Ministry of Finance, and the Ministry of Industry and Trade can be said to form a coalition that profiteer from resource rent and dominate the oil and gas sector (Thuong Son 2011). Second, in terms of operation, business groups have not been efficient (Pham 2012). Therefore, they need to limit their participation in non-core markets. A recent study shows that a state-owned enterprise has to invest $13 in capital to generate $1 of extra production (ICOR index), whereas it costs a privately-owned company only $0.5 to get the same outcome.

Third, in terms of rights, the boards of directors appointed by the Prime Minister with great leverage have created tremendous barriers for state management agencies. The board of directors has direct control over capital and investment decisions. State management agencies, on the other hand, have authority in paper but have no control over business groups. This shortcoming has given rise to detrimental consequences such as corruption, red tape, and monopoly. Whether the board of directors follows the orders of the Prime Minister to diversify or have independent motives to line their own pockets is beyond the scope of this study. However, this issue poses a principal-agent problem in the Vietnamese government where the board of directors (the agent), hired to undertake a task assigned by the principal, is insulated from risks (moral hazard) and has conflictual interests with the principal (Grossman and Hart 1983). The issue underlying this problem is the principal's difficulty in monitoring the actions of the agent.

The government is the owner of state-owned business groups and has authority over the ownership and capital of the corporations. The Prime Minister has the power to appoint board members of business groups according to the current law, and the charter and operation of each group. However, the lax legal framework has created opportunities for business to diversify into unrelated markets, which reached a peak over the 2005-2008 period. With a view to becoming the "*chaebols*" of Vietnam, many state-owned business groups and general corporations have expanded their operation into multiple sectors, especially stock markets, real estate, and banking. Examples include Vinashin Business Group (Vinashin), Vietnam Electricity Corporation (EVN), Vietnam Rubber Group (VRG), and Vietnam National Oil and Gas Group (PetroVietnam).

However, they had incurred billions of dollars in bad debts due to the 2008 financial crisis. As of September 2011, their total debts reached $10.94 million, which accounted for 8.76% of the debts in the banking sector and 52.66% of the total debts of state-owned businesses. Vietnam National Oil and Gas Group (PetroVietnam) tops the list with $3.61 million, followed by Vietnam Electricity Corporation (EVN) with $3.14 million, Vietnam National Coal-Mineral Industries Holding Corporation Limited (Vinacomin) with $1 million, and Vinashin Business Group (Vinashin) with $0.9 million. According to Dr. Carl Thayer, an expert in Vietnam, Mr. Dung allows his business groups to diversify into their non-core areas. These business groups have borrowed a colossal amount of money and overspent. Corruption has spread through this network of borrowing and spending (BBC 2012).

Most businesses in Vietnam operate without long-term development strategies such as research and market and projections in the next three to five years. These firms do not learn from other markets, have inefficient financial strategies, and have limited access to capital; most of them follow market trends rather than leading them (CAND 2012). Mr. Dang Huy Dong, Deputy Minister of Planning and Investment, stated: “Most of the state-owned economic groups are geared towards expanding their investment into unrelated operations and do not focus on specialization, which leads to a low level of investment efficiency. A number of these groups have limited financial capacity and lack capital for the core business; however, they still diversity outside of their core industry” (Vu and Dang 2012). The managers of businesses in Vietnam maintain that this diversification strategy will support their main economic activities to hedge against risks. According to Ms. Cao Ngoc Dung, Chairman of the Board of PNJ, a jewelry company, argues that operating in more than one market will yield profits faster and more efficiently. PNJ is expanding to become a conglomerate by establishing joint-stock companies which PNK holds shares in such areas as fashion, real estate, seafood, and consumer goods. Ms. Dung asserts that although revenue from gas and seafood account for a small proportion of the total sales, these two sectors constitute a long-term and stable development strategy for the company (Thoi Kinh Te 2011).

2. EVN

The Vietnam Electricity Corporation was established under Decision No. 562/QD-TTg on 10/10/1994 on the basis of reorganizing the units of the Department of Energy (EVN 2011). On 06/22/2006, the Prime Minister issued Decision No. 147/QD-TTg to approve the pilot scheme that formed the Vietnam Electricity Group and Decision 148/2006/QD-TTg to establish the parent company – the Vietnam Electricity Group. On 06/25/2010, the Prime Minister issued Decision No. 975/QD-TTg to transform the parent company – the Vietnam Electricity Group – into a limited liability one member company under state ownership (EVN 2011). EVN is structured as a holding company with a number of wholly owned subsidiaries due to reckless diversification (ABD 2009, 2). EVN owns the key electricity plants, has majority shareholding stakes in partially privatized power plants, and is the sole investor or in partnership with other public and private sectors in new power plants.

The Vietnam Electricity Group (EVN) is one of the eleven business groups that still remain in 2012. EVN has run into colossal debts, especially after 2008. However, due to their strategic importance to the economy and national security, it is not likely that EVN will be dismantled or privatized (Pham Thanh 2012). According to a 2007 UNDP report, EVN was the third largest enterprise after Agribank and VNPT (UNDP 2007, 11). The core business activity of EVN is produce, transmit, distribute, and trade electricity; import and export electricity; invest into and manage power projects; manage, operate, repair, maintain, overhaul, renovate, and upgrade electrical equipment and electrical work (EVN 2011). EVN has five general corporations distributing electricity to customers: Northern Electricity Corporation (EVN NPC), Southern Electricity Corporation (EVN SPC), Central Electricity Corporation (EVN CPC), Hanoi Electricity Corporation (EVN Hanoi), and Ho Chi Minh City Electricity Corporation (EVN HCMC).

Table 2: The History of EVN

Date	Decision	Activity
10/10/1994	Decision 562/QĐ-TTg	The Vietnam Electricity Corporation was established.
22/6/2006	Decision 147/QĐ-TTg	The Vietnam Electricity Group was established.

25/6/2010	Decision 975/QĐ-TTg	The Vietnam Electricity Group was transformed into a one-member limited liability company under state ownership.
06/6/2011	Decision 857/QĐ-TTg	The charter of organization and operation of the Vietnam Electricity Group was finalized to establish the following issues: • Full name: Vietnam Electricity Group • International transaction name: Vietnam Electricity • Abbreviated name: EVN • Type of business: one-member limited liability company

Source: EVN (2011)

In this section, I examine the business strategies of EVN over two periods: 1994-1998 and 2004-2008. I choose 1994 and 2008 since they mark two crucial milestones for EVN. In 1994, the Vietnam Electricity Corporation was established. In 2008, the global financial crisis hit the international market, including the Vietnamese economy, and has had tremendous impacts on the business strategies and performance of EVN. A four year lag is included to allow for policies and business strategies to take effect. I argue that the Vietnamese Electricity Corporation focused primarily on its core area of power production and dissemination over the 1994-1998. This strategy changed into massive diversification into unrelated areas from 2008 to 2012. The difference in business strategies between the two time periods, as shown in Table 3, can be attributed to the lower levels of resource rents and political fragmentation in Vietnam over 1994-1998 compared to those over 2004-2008.

Table 3: The Shift in the Outcomes (Diversification) and the Two Explanatory Variables (Natural Resources and Political Fragmentation)

Period	Unrelated Diversification	Natural Resources (% of Total GDP)	Political Fragmentation

1994-1998	Low	7.20 %	Reformers were the majority.
2004-2008	High	15.16%	3 main coalitions: 1) Prime Minister Nguyen Tan Dung 2) President Truong Tan Sang 3) General Secretary Nguyen Phu Trong

2.1. 1994-1998

2.1.1. Diversification

After its establishment on October 10, 1994, the Vietnam Electricity Corporation (VEC) focused primarily on their core activity of producing and disseminating electricity. Diversification into unrelated areas was restricted. From 1990 to 1994, the units currently under the VEC operated in a central planning system. For example, the Electricity Department of Hanoi Power Company I operating in North Vietnam was heavily subsidized (HEC 2012). All the formulation and implementation of development plans were commanded from the top. Outcome indicators and economic efficiency in production fluctuated dramatically. The whole power system was stagnant with no transparent accountability. In 1995, after 20 years of construction and development, the Corporation had successfully implemented the Power Development Master Plan Phase (1981-1985), Phase II (1986-1990), Phase III (1991-1995), increasing the national power capacity to 4,550 MW (more than 3 times higher than that in 1975) and the power output to 14.6 billion kWh (nearly 5 times more than that in 1975) (Pham Thanh 2012). Diversification into unrelated sectors, therefore, was minimal, if not non-existent.

2.1.2. Natural resource

Table 4: Total natural resource rents (% of GDP) 1994-2008

Indicator Name	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total natural resources rents (%	8.44	7.49	7.56	7.02	5.49	7.46	11.64	9.61	9.28	9.91	13.90	16.80	16.17	13.93	14.99

of GDP)															

Source: World Development Indicators (2012)

Vietnam's oil reserves were not exploited until the late 1980s after the country began its economic reform in 1986 (Nguyen 2011). Without the capacity to take advantage of the resource abundance in the country, EVN had yet to adopt an economies of scale diversification strategy. From 1994 to 1998, the share of total natural resource rents as a percentage of GDP declined from 8.44 percent to 5.49 percent (WDI 2012). These figures were approximately half of the figures over the 2004-2008 period when diversification reached its peak. After the discovery and exploitation of oil from the fractured base of the White Tiger field in the Cu Long Bsin, Vietnam's oil reserves first appeared in the statistical account in 1990 (Nguyen 2011). After the discovery of the Lan Tay gas field in the Nam Con Son has basin, Vietnam was first included in the world's statistics in 1992. Research on the oil and gas reserves in the Asia-Pacific region shows that while China, India, Indonesia, Malaysia's oil reserves have declined compared to those in 1992, Vietnam's oil and gas reserves have increased substantially. The rise in oil and gas production can be attributed to the success in oil and gas exploration in Vietnam thanks to a series of oil and gas contracts in new areas and exploration extended throughout the continental shelf to deep water of 200 meters. The increasing yet still limited oil and gas exploitation over the 1994-1998 period left EVC with little opportunity to diversify since most of the exploitation was undertaken by PetroVietnam.

2.1.3. Politics

From 1994-1998, the reformers in Vietnam won a majority of votes. During this period, the Vietnamese government was characterized by a unified leadership. Prior to 1989, Vietnam was a communist country isolated from the rest of the world where the Politburo with its General Secretary had the most clout in decision-making (Malesky et al. 2010, 10). However, from 1986 to 1989, four of the most important members on the Politburo passed away. These incidents happened when the

Vietnamese Communist Party was coming up against popular criticism for dismal economic growth and the prolonged conflict in Cambodia. The lack of consensus among the new leaders as to what direction the country should take led to increasing pressure for checks and balances within the party. The Central Committee (CCOM) gained greater power vis-à-vis the Politburo.

The two prominent reformers, Nguyen Van Linh (1991-1997) and Vo Van Kiet (1991-1997), employed the gerrymandering strategy to expand their support base in the CCOM and managed to push for deeper liberalization of the economy despite opposition by supports of the state sector led by the General Secretary Do Muoi. A third group led by Le Duc Anh, commander of forces in Cambodia championed the role of the military in politics (Malesky 2010, 11). The three groups eventually gained institutionalized power which constitutes Vietnam's "difused troika" of General Secretary, Prime Minister, and President. The key decision-makers in Vietnam shifted from the Politburo prior to 1989 to the CCOM, which consists of more divergent preferences, especially among provincial leaders. All decisions made by the Politburo, thus, need to gain approval of the CCOM in order to be passed and implemented. The COMM consists of "members of the Party apparatus, government officials, state owned enterprises, provincial leaders, military, mass organizations (such as the Women's Union and Peasant Union), business associations, ethnic organizations, and research and educational institutions" (Makesly 2009, 15). The CCOM thus represents a much broader constituency than does the Politburo.

In 1996, the reformers in Vietnam had successfully used gerrymandering to avoid the partial reform trap by creating new provinces (Malesky 2009, 132). This tactic enabled reformers to win a majority of votes in the Central Committee against the conservatives led by General Secretary Do Muoi (1991-1997), and thus to pass a number of economic reforms that directly conflicted with the state-owned enterprises. Over Kiet's tenure (1991-1997), the creation of new provinces helped increase the representation of provincial officials in the Central Committee by 50% (to 61 delegates). I argue that the level of political fragmentation in Vietnam was much lower over the 1994-1998 compared to that prior to 1996. The success of the reformers further exposed state-owned enterprises, in this case the Vietnam Electricity Corporation, to market forces and international competition due to reformers' support of deeper economic liberalization. EVN thus had to focus on efficiency instead of relying heavily on the state for its finances in the central planning system.

2.2. 2004-2008

2.2.1. Diversification

Nguyen (2012) argues that the electricity sector in Vietnam has become more competitive (1). He finds that EVN productivity has increased consistently in terms of the number of its employees per MWh produced, and that the business group has remained efficient and financially viable. However, these data are based on EVN annual reports. In fact, EVN has incurred huge losses due to its reckless diversification into areas where it has little or no expertise instead of expanding into different methods of generating power.

Over the 2004-2008 period, EVN's production of power proved to be inefficient. According to the Vietnam Energy Association, the production and trading system of electricity companies still face numerous deficiencies, which drive up the cost of electricity (Pham Huyen 2012). At Pha Lai thermal power plant of EVN, four units with a capacity of 1040MW have operated for 28 years and consumed coal 1.5 times more than the new units. The total payroll workforce is 1,400 people, which stands at too high a level compared to the workforce needed for power production. The Ca Mau gas power plants I and II of PVN are very passive in receiving gas. The amount of gas based on the pipeline design is not sufficient for two power plants to operate at their full capacity simultaneously. The pipeline was designed to provide enough gas for only one power plant with a 750 MW capacity and the Ca Mau protein plant. Therefore, when there is not sufficient gas, it will be allocated to the protein plant. When there is a problem with the gas pipeline, the Ca Mau power plants I and II will have to run on fuel oil, which will further drive up the cost of electricity.

Vietnam has faced a serious power shortage since 2006 (Tran 2012). From January 1 to May 31, 2007, Vietnam needed more than 28 billion KWh of electricity, of which EVN met only 27 billion KWh. In 2007, EVN stated that the rotating power cuts would start in early May. However, the power cut began at the beginning of March. In the 27 provinces and cities in North Vietnam, except Hanoi, the power shortage was 9-12 percent (222-326 million) a month in the dry season compared to the national level of 3.2 percent. These power cuts not only interrupted people's everyday activities but also caused businesses to incur big losses worth millions of dollars. Shim Wonhwan, General Director of Samsung Electronics Vietnam in Yen Phong industrial zone, called for help in his letter to Deputy Prime Minister Hoang Trung Hai due to the stagnation electricity cuts caused to production and qualify of products. These power cuts also led to big losses worth billions of dollars among steel mills in Vietnam. EVN has also faced a backlash from the public due to their rapid increases in electricity prices. However, the corporation still got approval from the Ministry of Industry and Trade to do ahead with the plan (Hoang Lan 2011).

On the surface, the deteriorating power shortage in Vietnam since 2006 seems to stem from the rising demand of the citizens and the inability of the business group to meet such demand. Economies of scope diversification, according to Dapice (Year: N/A), is advisable for EVN since it is dangerous to be over-reliant on a single method of power production. Overreliance on gas only can lead to a major disruption or even shutdown of the electricity system in case of an earthquake. Similarly, if hydro power was the sole source of supplies, a drought could lead to major supply issues.

However, the crux of the problem lies in EVN's diversification into markets in which the group has little or no expertise. EVN is among the top three groups with the highest amount of capital invested outside of their core operation, preceded by the Vietnam Oil and Gas Group and the Rubber Group (Viet 2012, Pham Son 2012). According to Mr. Tran Du Lich, the Deputy Head of the Ho Chi Minh National Assembly delegation, the main reason for EVN's losses and debts lies in the groups' massive investment in non-core markets and their neglect of their main area of operation – production of electricity (To 2011).

The group's expansion into these unrelated areas not only diverted investment from the core area of producing and disseminating electricity to the non-core markets where EVN incurred tremendous losses due to its lack of experience and business vision. This business strategy has caused EVN to neglect investment in R&D to enhance its productivity in electricity production. Instead, the group has sought profits from other seemingly more profitable yet volatile areas without much success. As of December 31, 2010, the long-term financial investments of the parent company EVN totaled nearly $2.5 billion of which approximately 90 percent was in the subsidiaries (Song Ha 2011). The rest was in joint ventures and other long-term investments. However, the total profit stood at about $27 million; the rate of return on investment was merely over 1 percent. Audit results by ABD show that EVN had invested over $105 million in sensitive non-core areas such as real estate, insurance, banking which accounted for 3.27 of the equity. Besides, EVN also invested inefficiently in the telecom sector, causing huge losses. The group invested 100 percent capital into EVN Telecom with an investment of up to $122.1 million, but the sales and provision of services declined by 42 percent in 2010 compared to those in 2009. In addition, EVN also partnered with Ha Thanh Securities Company, Sai Gon Real Estate Electricity Corporation, etc. In 2006, EVN also signed an agreement with Hanoi Telecom with an investment worth hundreds of millions of dollars.

EVN's performance has worsened drastically over the 2008-2010 period. If EVN's profit reached $4.69 million in 2008, it decreased to $0.41 million in 2009 and turned into losses of more than $52.5 million in 2010 (Song Ha 2011). The State Audit Report shows that the group's total liabilities as of 2010 are $10 billion, which accounted for nearly 80 percent of its total capital. As of June 30, 2010, the amount of loans EVN owed the Vietnam Oil and Gas Corporation and the Vietnam Coal and Mineral Group from purchasing their power stood at 8,860 and $60 million respectively. The group lost over

$420 million in 2010; the rate of return on equity was -14.8 %, and the rate of return on total assets was – 2.78 % (Song Ha 2011). As of June 2011, EVN had lost $1.55 billion (Viet 2012).

Table 5: EVN's performance from 2008 to 2010

Year	Figures
2008	$4.69 million in profits
2009	$0.41 million in profits
2010	- $52.5 million in losses
2010	28 accounting units, 12 subsidiaries in which the group held 100% charter capital in power generators, power distribution, power transmission, mass communication, and public information, 26 companies where EVN held over 50 % of the capital or the right to control, and 15 other companies (EVN CPC 2011)
As of December 31, 2010	The long-term financial investments of the parent company EVN totaled nearly $2.5 billion of which approximately 90 percent was in the subsidiaries (Song Ha 2011) Total profit stood at about $27 million; the rate of return on investment was merely over 1 percent. The group lost over $420 million; the rate of return on equity was -14.8 %, and the rate of return on total assets was – 2.78 % (Song Ha 2011).
As of June 2011	EVN had lost $1.55 billion (Viet 2012).

According to a state audit, of the total long-term financial investment, the amount of investment outside the electricity sector (telecommunication, securities, banking, insurance, real estate, and others) is $179.5 million, which accounted for 7.22% of capital and 4.82% of the total equity. This indicates that EVN has not mobilized and focused resources on their core production. The EVN case shows that when deciding whether to diversify into new areas, state-owned business groups need to assure the operation of their core businesses (InfoTV 2008).

2.2.2. Natural resources

Vietnam is a nation rich in natural resources. In terms of the fuel-power resources, oil and gas reserves can be found in all sediment surface throughout the country and are estimated to have 4-5 billion tons of oil while coal reserves are estimated at 220 billion tons (VNR 2010). Vietnam's oil reserves are among the most abundant in the world and constitute a major export for the country (Pham et al. 2011). Vietnam is also home to most types of minerals, most of which have tremendous industrial-scale exploitation capacity. Iron ore reserves can be found mostly in the Northern mountainous and Central region and hold about 1.8 billion tons of ore. Bauxite is located primarily in the Central Highlands and is estimated at 6.6. billion tons. Other metal minerals include chromites, manganese, cooper, tin, lead, zinc, and gold (VNR 2010).

Vietnam has become a major oil supplier to the regional and domestic markets over the past two decades (EIA 2012). The country has stepped up its exploration activities, attracted an increasing amount of foreign investment and cooperation in oil and gas exploitation, and reformed the energy sector. As a result, the country's oil and gas production has increased dramatically. The Oil & Gas Journal (OGJ) ranks Vietnam third in proven oil reserves for the Asia-Pacific region. As of January 2012, Vietnam had 4.4 billion barrels of proven oil reserves, an increase from 0.6 billion barrels of oil in 2011. Table 6 shows the importance of natural resources to Vietnam's economy. Oil rents accounted for an increasing portion of GDP, increasing from 3.23 percent in 1998 to a record high of 12.40 percent in 2005. The same pattern applies to total natural resource rents as a percentage of GDP, which increased from 5.55 in 1997 to 17.06 in 2005.

Table 6: Natural resources in Vietnam 1994-2008

Indicator Name	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total natural resources rents (% of GDP)	8.44	7.49	7.56	7.02	5.49	7.46	11.64	9.61	9.28	9.91	13.90	16.80	16.17	13.93	14.99
Adjusted savings: natural resources depletion (% of	5.61	5.02	5.22	4.77	3.44	4.94	8.05	6.90	6.13	6.34	10.69	12.25	11.67	11.01	13.39

GNI)															
Arable land (% of land area)	16.79	16.60	17.06	17.41	17.71	18.43	19.93	21.37	21.25	21.22	20.86	20.51	20.47	20.35	20.26

Source: World Development Indicators (2012)

The increase in resource rents has led different coalitions to form and collude to profiteer from the nation's natural resources, which takes place in many places and on different scales. This monopolistic and opportunistic behavior of state-owned business groups is a form of corruption in business, management, and administration. These groups have monopolistic power over the resource sector (Nhan Khang 2012). At the 2012 National Assembly, Ms. Le Thi Nga, Vice Chairman of the Judiciary Committee, pointed out the relationship between political fragmentation and natural resources. Every time the petroleum industry adjusted their prices, there is always a sign of price imposition from the highest authorities, which violates competition law.

According to Dr. Ngo Tri Long, former Deputy Director of the Research Institute of Market Prices, fuel prices follow Decree 84 of the government. The petroleum market remains monopolistic with three state-owned corporations accounting for 90% of market shares. There are currently 12 gasoline enterprises, but the total market share of Petrolimex, PV Oil, and Saigon Petro is 90%. Petrolimex alone accounts for about 60% (Minh Minh 2012). The Decree allows these corporations to decide on the prices. When world prices increase, these corporations immediately follow suit. However, when world prices fall, even drastically, these businesses are reluctant to lower their prices. These businesses only lower their prices when faced with strong public pressure, but they only do so by bits and pieces.

During the first ten months of 2012, the price of gas has increased six times; in August, it increased three times (Minh Minh 2012). Critics have pointed out that the Ministry of Finance and the Ministry of Industry and Trade usually approved changes in gas prices at the request of Petrolimex. The political moves of these ministries in turn get approval from Prime Minister Nguyen Tan Dung. Ms. Nga states: "There are sufficient grounds for the Competition Bureau to conduct an investigation into the abuse of market domination. However, the governing body of Petrolimex and the Competition Bureau are both under the Ministry of Industry and Trade, no investigation has been conducted. This means that the state is always under the influence of petroleum businesses to increase fuel prices at the expense of the public (Minh Minh 2012). Prime Minister Nguyen Tan Dung, the Ministry of Finance, and the Ministry of Industry and Trade can be said to form a coalition that profiteer from resource rent in competition with the coalitions led by President Truong Tan Sang and General Secretary Nguyen Phu Trong. The increases in fuel prices in March 2011 were approved by the Ministry of Finance in concert with the Ministry of Trade and Industry. Many people in Hanoi understand the close connection between these two ministries and the Petroleum Corporation (Petrolimex). These close ties have developed and overcome the world's downward trend of oil prices. Despite the fact that Petrolimex lost 10,700 billion VND in 2008, the oil interest groups, under the aegis of the Ministry of Trade and Industry, have become a challenge to the overall social welfare which has been shrinking in Vietnam (Thuong Son 2011).

Vietnam's resource abundance and EVN's monopolistic power in the electricity sector, however, has allowed the business group to acquire power at lower than market prices and thus discouraged them from investing in more efficient methods of power production and dissemination. EVN is a monopolistic player in the power sector. According to Deputy Minister of Industry and Trade Hoang Quoc Vuong, many power companies had run into colossal losses since they had no choice but to sell electricity to EVN at below market prices (Vietnam News 2012). Coal and gas corporations have incurred tremendous losses in the competitive electricity market. The price of electricity sold to EVN is much lower than the official price (Pham Huyen 2012). The price of coal sold to EVN is only 70% of that in 2011. The Energy Association acknowledges that the coal industry is suffering double losses by selling coal and electricity to EVN at lower prices than market price. The gas power plants of PVN have found themselves in the same predicament. An important reason for these losses is the mechanism of mobilizing resources in the competitive electricity market. In the bidding system, the electricity trading company of EVN will only choose the providers with the best offer. Due to its low costs, hydroelectric power will prevail; coal, gas, and oil power will be at a disadvantage. EVN has reaped the most benefits. Most hydroelectric power sources belong to EVN. According to Mr. Dao Van Hung, Chairman of the Board of the Vietnam Electricity Group, EVN got an approval from the Prime Minister to invest in three main areas: power, telecommunication, oil and gas (InfoTV 2008). The availability of oil, gas, and alternative sources of power production has enabled EVN to delay improving their methods of producing electricity while allocating their resources to expanding into unrelated markets.

2.2.3. Political Fragmentation

From 2004-2008, the “diffused troika” or political fractionalization in Vietnam became more pronounced compared to the 1994-1998 period. The three main coalitions that caused friction within the Vietnamese government were led by Prime Minister Nguyen Tan Dung, President Truong Tan Sang, and Party General Secretary Nguyen Phu Trong. Increased political fragmentation impeded the restructuring of businesses. These coalitions used resource rent to support certain business groups. After Vietnam implemented economic reform in 1986 and started pursuing a high economic growth rate, the state has become more powerful than the Party. The high growth rate Prime Minister Nguyen Tan Dung promotes has led to economic activities that are difficult to monitor. These deficiencies in the economic system have become even more prominent, especially in finance and banking, since Vietnam is now faced with the economic crisis. The downsides of high growth rates have caused concerns about political instability among Mr. Dung’s opponents.[2]

On August 23rd, 2012, President Truong Tan Sang asserts that Vietnam’s economic challenges are pressuring the country’s political system and impoverishing the people: “The state budget has been tightened. Public debts have skyrocketed. Various businesses have gone bankrupt. Unsold goods have

[2] http://www.bbc.co.uk/vietnamese/vietnam/2012/08/120824_viet_arrests_malaise.shtml

built up. Inflation is eating up the income of the majority of workers…Those are tremendous pressures for the Party, the State, and the whole society.” Unlike other high-profile senior officials who put the blame on external factors such as the global recession or the financial crisis in Europe, President Truong Tan Sang pointed to the internal conflict among the different interest groups and coalitions in the Vietnamese government. [3] After failing to overthrow Mr. Dung in the reshuffling phase of the Communist Party that takes place every five years in 2011, Mr. Truong Tan Sang, Mr. Dung’s opponent, held the Presidential position which has mainly ceremonial importance. Since then, Mr. Sang has tried to call for more economic reforms and crackdowns on corruption.[4] The rift among the three coalitions has made it difficult for them to reach a consensus on how to effectively restructure state-owned business groups.

Prime Minister Nguyen Tan Dung has created business groups to equip the economy with the iron fists which have led the country into a deep crisis. Like the *chaebols*, the Prime Minister’s business groups are given favorable access to credit with the guarantee of the government (Nhat Binh 2012b). If the credit growth in the 1990s was only 20%, in 2010 it increased to 136%. However, unlike the *chaebols*, Vietnam’s business groups were not formed through capital accumulation and thus cannot compete in the international market. They not only cannot replace imports with exports but also have led to a trade deficit by importing too much material. Moreover, the decision to allow SOEs to diversify as part of the tasks of socio-economic development over 2006-2010 together with the poor management of the Prime Minister has created an opportunity for these businesses to take advantage of the abundant supply of credit to diversify into unrelated markets and destabilize the domestic economy with loss-making companies that account for 70% of the 200 trillion VND at state-owned banks.

[3] http://www.bbc.co.uk/vietnamese/vietnam/2012/08/120822_president_sang_directiven.shtml
[4] http://www.bbc.co.uk/vietnamese/vietnam/2012/08/120824_viet_arrests_malaise.shtml

From 2005 to 2007, the government had no regulations limiting diversification into unrelated areas (Pham Huyen 2011). The peak of diversification among the state-owned business groups and corporations was the 2007-2008 period. This was also a period of strong economic growth and the heyday of securities and banking. EVN, like other state-owned business groups could not stay on the sideline of these areas (Vu and Dang 2012). Many critics state that the government needs to tighten the regulation that allows state-owned groups to invest more than 30% of their charter capital into unrelated markets since EVN has incurred huge losses by investing 2.8% of their charter capital in economies of scale diversification (Pham Huyen 2011).

According to Mr. Dao Van Hung, Chairman of the Board of the Vietnam Electricity Group, EVN got an approval from the Prime Minister to invest in three main areas: power, telecommunication, oil and gas (InfoTV 2008). Despite the huge losses due to its inefficiency in operating non-core business, EVN does not face substantial pressure from the government to restructure its production and improve its productivity in order to make up for such losses. Instead, the Ministry of Industry and Trade stated that EVN's losses will be amortized into the price of electricity. However, as Mr. Tran Du Lich points out, EVN has the resources to diversify their operation but not to reduce power inefficiency and invest in power grid (To 2011). Every year EVN seeks approval to increase electricity prices due to the lack of capital for power production (Pham Huyen 2011). With the backing of the Prime Minister, EVN has expanded inefficiently into various unrelated markets while maintaining their dominance in the power sector. With their monopolistic power, EVN has acquired power at lower than market prices from coal and gas companies such as PVN with the support from Prime Minister Nguyen Tan Dung. Under the aegis of Mr. Dung, EVN has also been able to secure great amounts of loans. EVN has been working with several financial institutions to arrange 22.500 billion VND in capital for urgent projects: 2,500 billion VND from the Vietnam Development Bank (VDB), 421 billion VND from VDB's subsidiaries, 6,200 from VietinBank - Vietnam Joint Stock Commercial Bank for Industry and Trade (VietinBank), 4,200 billion VND from the Vietnam Foreign Trade Bank (Vietcombank), 2,657 billion VND from the Vietnam Bank for Agriculture and Rural Development (Agribank) (VnExpress 2012). EVN also plans to obtain from the World Bank a US$378.9 million loan, a US$330 million loan to improve the distribution network, and a US$200 million loan to reform of the power sector (VNN 2012).

The three coalitions in the Vietnamese government have been vying for a larger share of the profitable resource sector pie, most of which is under the control of Prime Minister Nguyen Tan Dung. Mr. Dung and his coalition's control of the resource sector has caused his opponents, Mr. Truong Tan Sang and Party General Secretary Nguyen Phu Trong, to push for reforms of state-owned oil companies which have benefited greatly from preferential access to capital and credit. Mr. Dung's symbiotic relationship with the resource sector, however, has led him to allow and encourage oil and gas companies to diversify into non-core areas, which has caused the Vietnam National Oil and Gas Group (PetroVietnam) to top the list of SOEs incurring bad debts with 72,300 billion VND. The Prime Minister has also encouraged funding to be channeled from PetroVietnam to EVN to make up for the latter's losses. With the backing of Mr. Dung and the availability of funding from PetroVietnam, EVN has not focused their efforts on their core function. Instead, they have inefficiently diversified into various non-core markets. In 2012, EVN owes PVN 14,000 billion VND mainly to buy electricity from Petro Vietnam Power Corporation, a subsidiary of PVN (Pham Huyen 2012). Political fragmentation in the Vietnamese government and the country's natural resource abundance, therefore, complement each other to induce and reinforce business groups' economies of scale diversification strategy.

3. Alternative explanations

One might argue that EVN' expansion into unrelated diversification is part of the group's maturation. In other words, EVN has reached a point in its development where the group has saturated its capacity to make profits from its core product – electricity – and needs to diversify to maintain its cash flow. The lifecycle of a business has four distinct phases: start-up, growth, maturity, and decline

(Feinberg 2006). The start-up of a business begins with a business plan. Some of the primary features of the start-up phase include “obtaining customers and delivering the product or service contracted for” (4). At the second phase, growth, the business increases its revenues and expands its customer base. At the maturity phase, the business reaches a point where revenues are no longer treble/double digit growth. When revenue goes down to a single digit, it is advisable for the company to adapt to the more challenging business environment. Decline marks the point where the business needs to diversify its customer base to “maximize cash flow that can be used to fund new product or service offerings” (12). Proponents of the maturity view insist that EVN moves from start-up to maturity, it needs to adjust its resources, skills, and tools in order to meet the different business and customer requirements and to maximize its opportunities. Therefore, diversification into non-core sector is warranted to maintain the profitable operation of the groups.

However, this critique does not hold water. As discussed above, EVN’s main function – the production and distribution of electricity – has largely been neglected and left under-tapped since the group has not focused its resources on reducing the egregious inefficiency of its operation. Instead, EVN has diverted its capital to the new markets where the rate of return on its investment is roughly 1 %. Indubitably, EVN has incurred tremendous losses by first moving away from its core product and second expanding into new areas where it has no expertise or experience. This reckless strategy has left EVN wallowing in debts. It shows that not only has EVN not reached maturity in electricity production, but the group also has not had the necessary financial and technical capacity to diversity into non-core products. Underlying this dangerous move of EVN is the role of natural resources and political fragmentation in inducing economies of scale diversification.

Another critique of the theory proposed in this study is that EVN’s diversification strategy might be a response to the high level of economic and political volatility between 2004 and 2008. However, the peak of diversification among the state-owned business groups and corporations was the 2007-2008 period. This was a period of strong economic growth and the heyday of securities and banking. In fact, when the global financial crisis hit Vietnam in 2008, the economy was faced with a high level of volatility, forcing business groups to scale down their scope of expansion. In October 2011, Prime Minister Nguyen Tan Dung issued a mandate which requires the Ministry of Finance and the Ministry of Industry and Trade to assess EVN's investment in securities, banking, insurance, and telecommunication. Mr. Dung also asked EVN to ascertain the responsibility of individuals and groups regarding its violations in conducting business (Song Ha 2011). At the regular meeting of the government in September 2011, Mr. Dung also instructed state-owned businesses and corporations to stop investing outside of their primary industries in order to improve their efficiency in the core operation. In his closing speech to Plenum XI, General Secretary Nguyen Phu Trong, Mr. Dung's opponent, emphasized: "We need to put an end to the expansion into unrelated markets of state-owned business by 2015" (Vu and Dang 2012). Under mounting pressure from the public and the opposition, Mr. Dung had to heed the criticisms and ordered the restructuring of state-owned business groups.

4. Implications for other business groups

The case study of EVN supports the internal validity of the theory by identifying the causal process in a particular case. In this section, I discuss the generalizability of the findings across cases to establish the external validity. I argue that the controlled comparison used in this study can generate generalizable inferences for tthre reasons. First, the case study evaluates the alternative mechanisms, namely business maturity and economic/political validity through which business groups expand into non-core areas. I have shown in this study that the aforementioned alternative mechanisms are not applicable to the EVN case and, as I will demonstrate below, to other state-owned business groups.

Second, the theory has two general causal variables – natural resources and political fragmentation – and a general mechanism – resource rents fuel political fractionalization which in turn induces unrelated diversification. This mechanism also applies to other business groups in Vietnam.

According to the Ministry of Industry and Trade, from the time of its establishment in 1977 to March 31, 2008, the Vietnam Oil and Gas Group had invested $105.25 million in the financial sector, $9.51 million in the insurance market, $59.87 million in the banking industry, $5.73 million in securities, and $16.03 million in real estate (InfoTV 2008). Oil and gas groups have made huge losses due to unrelated diversification and transferred such losses to the public by increasing gas prices (Viet 2011). As of May 31, 2008, the Vietnam Textile and Garment Group invested 154 billion VND in finance, securities, and real estate, which accounted for 5.5% of the group's charter capital (InfoTV 2008). Vinashin, a state-owned shipbuilder which employed about 60,000 workers and monitored 28 shipyards, expanded their operation into 300 units, including motorbike manufacturing and hotels. In 2010, Vinashin was found to have cooked up their financial reports and incurred a debt of $4.4 billion to local and international creditors, which equaled 5% of GDP.

As of September 2011, SOEs owe roughly $21 billion, which accounts for 16.9% if credit debts. 12 SOEs incurred the debts of $11 billion, which takes up 8.76% of the total debts in the banking sector and 52,66% of debts for SOEs. Among those corporations are the Vietnam National Oil and Gas Corporation (Petro Vietnam) with $ 3,615 million, followed by the Vietnam Electricity Corporation (EVN) with $3,140 million, Vietnam National Coal- Mineral Industries Corporation Limited(TKV) with $1,025 million, and the Shipyard Corporation (Vinashin) with $980 million (VnEconomy 2012).

These groups create mechanisms and policies that favor their personal interests at the expense of the nation's welfare (Nhan Khanh 2012). They are the "backyards" of prominent political coalitions with the ability to influence government policy to manipulate the market in such industries as milk, fuel, electricity and automobiles, and especially the use of natural resources. The Vietnam Oil and Gas Group and Vinashin are believed to have the backing of Prime Minister Nguyen Tan Dung, who has gone under scathing criticism for failing to shed light on their wrongdoing.[5] Abundant natural resources, I argue,

[5] http://www.bbc.co.uk/vietnamese/business/2012/08/120802_vn_less_investment.shtml

have deepened the divide among Mr. Dung's supporters and other coalitions in their competition for resource rents, which in turns has stepped up Mr. Dung's encouragement of unrelated diversification and precluded the different coalitions in the Vietnamese government from implementing industrial policy.

Third, Vietnam needs to follow the development trajectory of East Asia but does not have a set of policies that resemble those of the latter. Vietnam seems to be following the mistakes of Southeast Asia, East Asia, and China (Harvard Vietnam Program 2008, 3). Business groups in both Vietnam and other South Asian countries gain access to capital by dominating domestic and often monopolistic markets or receiving state-granted subsidies such as profitable contracts or low-cost inputs (Harvard Vietnam Program, 49). Despite the growth in size and scope, only a few business groups in Indonesia, Malaysia, Thailand, and the Philippines managed to enter export markets or high-value added products such as advanced technology and income elastic products. Despite the distinct historical, cultural, political, and socioeconomic features of each country, Vietnam can learn from the experiences of other countries and, as argued in this paper, can offer lessons about the diversification strategies of business groups for such countries as Thailand (Doner 2009) and those in Latin America (Schneider 2009a).

VII. Conclusion

Business groups play such a dominant role in the developing world that a failure to fully address their emergence and resilience can lead to an adequate and even misguided understanding of the forces that drive these markets. In this paper, I have discussed the two prominent theories that explain the origin and persistence of business groups: government-driven policies, and economic and political volatility. However, these theories have not shed light on why some governments encourage economies of scale and some do not.

I propose that natural resource abundance and political lead to unrelated diversification. I argue that the availability of natural resources causes politicians and firms to rely on resource rents and expand operation into low-tech markets. Political fragmentation increases the number of effective veto players that block policies that promote upgrading. Natural resources also incentivize political coalitions to remain divided to vie for resource rent. The high degree of political fractionalization, nevertheless, prevents coalitions from reaching a consensus on upgrading the economy, which further induces politicians and firms to rely on natural resources and seek economies of scale diversification.

The case study of EVN supports the theory. It shows that over the 1994-1998 period when the reformers dominated the politics in Vietnam thanks to gerrymandering and when natural resource rents were still low due to the country's obsolete technology and limited funding for exploitation, the Vietnam Electricity Corporation achieved remarkable development and efficiency. However, between 2004 and 2008, when the Vietnamese government was deeply divided among three coalitions led by Prime Minister Nguyen Tan Dung, President Truong Tan Sang, and Party General Secretary Nguyen Phu Trong, EVN recklessly expanded their operation to unrelated areas while still being to acquire power at lower than market prices from coal and gas companies. The mechanism through which natural resources and political fractionalization leads EVN to diversify into non-core sectors, I argue, also applies to other state-owned business groups in Vietnam and developing economies in Southeast Asia such as Thailand.

The study, however, has two major limitations. First, the focus on EVN – an electricity corporation – can limit the study's ability to generalize from the case. Although the controlled comparison used in the study can generate inferences for a broader range of cases since it satisfies three conditions specified by Slater and Ziblatt (2008), EVN's power generation can be contingent on the use of resources, which can justify to some extent EVN's expansion into oil and gas. However, one should heed the fact that oil and gas is not the only sector into which EVN diversified. The corporation also operated in other non-core areas such as banking and real estate. Second, although the study has pinpointed the relationship between Prime Minister Nguyen Tan Dung and the oil and gas sector, it has yet to shed light on the connection between other business groups and political coalitions in the

Vietnamese government. Notwithstanding these shortcomings, this paper has offered a closer look at the economic and political factors that prompt state-owned business groups in Vietnam, and potentially in other developing countries, to diversify into non-core business activities.

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