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BUSINESS STRATEGY DURING RADICAL ECONOMIC TRANSITION:

Viet Nam's First Generation of Larger Private Manufacturers and a Decade of Intensifying Opportunities and Competition

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Executive Summary

In 1999, the author and Leila Webster of the Mekong Project Development Facility (MPDF) put together a survey of Vietnam's leading private manufacturing firms. One of the most noteworthy findings for many readers of the resulting report was the simple realization that Vietnam indeed had some private companies of substantial size. These extraordinarily entrepreneurial firms had grown to their current size from origins as very small family businesses, overcoming challenges including constantly changing regulations and severe limitations on access to credit and information. At the same time, however, hostile business conditions had also pushed most into a small set of low-value-added activities, leaving them highly vulnerable to shrinking margins and volatile global markets.

A decade later, Vietnam's business environment has changed radically and no one doubts the potential of the country's private companies. Especially in the commercial centers that were the geographic focus of the study in 1999, the challenges facing private sector development are today very different. Thanks to the economic growth private companies have helped re-energize since introduction of the new Enterprise Law in January 2000, labor costs and labor force instability have both been on the rise—undermining the low-cost, labor-intensive manufacturing business model. More and more, it has become important for entrepreneurs to innovate and to better understand the consumers of their products. In provinces beyond these major growth centers, job creation, of course, remains the primary economic concern.

This report revisits the sample of private domestic manufacturers surveyed in 1999 to see how they have fared as regulatory obstacles have fallen and market competition intensified. The most clearcut finding is that in terms of survival, job creation, and revenues growth, the most successful firms have been the minority that were always focused on domestic rather than global markets. Furthermore, of those that have completely reoriented their businesses (and survived), the change has always been from export-orientation to a focus on the domestic market. Interestingly, firms located in Hanoi have been substantially more likely to fail, as have firms headed by men. Growth of both revenues and employment has been lower among survivors owned by older entrepreneurs and among those structured as joint-stock companies back in 1999.

Overall, surviving sample firms have continued to grow at extraordinary rates. Nevertheless, the findings of the report show that most are struggling mightily with the challenge of strategic renewal. Dramatic environmental change means adherence to the business strategies that worked in the 1990s is unsustainable. While most firms have yet to act significantly, the report identifies three main positive strategic responses in the sample: i.) moving location; ii.) moving up the value chain; and iii.) moving industries. Particularly successful cases include firms that have engaged knowledgeable business partners, e.g. global buyers and private equity investors, in their efforts at strategic renewal. The report concludes by noting that government can best facilitate innovation by its leading firms by focusing on provision of quality core public services.

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I. Introduction

At the start of 1999, prospects for Vietnam's domestic private sector appeared dim. New company registration was stalling (see Figure 3.1 in Section III) and the general public thought little of those firms already in operation (Webster and Taussig 1999; MPDF 1999). A decade later, the picture has changed dramatically. Today, domestic private companies employ twice as many workers as state-owned enterprises (SOEs), represent a substantial source of tax revenues, and have even begun to develop widely known brand names across a range of products and services. Key to this turnaround was a series of major reforms in the sphere of private sector development, highlighted by a new Enterprise Law introduced in January 2000 that wiped away most bureaucratic obstacles to new firm entry.[1] State rhetoric has also seen a slow drift from insisting on the state sector's "the leading role" in the economy to more perfunctory recent references to simply its "important role" (Cheshier 2008).

[1] Other major government initiatives include the abolishment of export licenses in 1998, the long-anticipated opening of a stock market and signing of a bilateral trade agreement with the United States in 2000.

Most analyses on the post-Enterprise Law implementation era have focused on the extraordinary rise in the number of private companies, the vast majority of which are quite small—qualifying them under the ever-popular title of "SMEs". [2] Cheshier and Penrose (2007) began to fill the void of research on larger Vietnamese firms with their analysis of the strategies of Vietnam's 200 largest firms. They justify their focus on the largest firms by noting that these are the firms most likely to absorb new foreign technologies and by referring to the central role played by larger firms in the "miraculous" economic development of Japan, South Korea, Taiwan and Thailand. Financial services companies have also begun to publish reports on substantial shareholding companies listed on the stock market or traded in Over-The-Counter operations.

This report looks to complement the emerging literature on Vietnam's larger businesses by concentrating on firms first born due to private rather state initiative. More specifically, the focus is on private sector startups for which success began *before* the Enterprise Law. The particular sample of firms investigated here is a set of 95 leading private manufacturers originally surveyed in January 1999 (Webster and Taussig 1999). This baseline of analysis allows for more dynamic analysis of firm-level change within the context of significant environmental change. At the time of the 1999 survey, sample firms represented fully 15-20% of all of Vietnam's active, registered private manufacturing companies with at least 100 workers.[3] With advantaged SOEs crowding domestic markets, 80 percent of these top firms were oriented towards foreign markets.

Against this background, the report provides insight into whether or not early entry has proven a beneficial resource in the context of not only substantial deregulation of domestic markets, but also significant further steps in global integration. At a perhaps more ambitious level, the report also aims to provide insight into whether—and, if so, how and to what effect—successful early entrants have adjusted their business strategies to radical change in the business environment. Which strategic approaches have been most effective in dealing with shifting environmental conditions? And which firms are best equipped for implementing such strategic changes? These questions are intended to shed light on the growth constraints faced by these established firms. In attempting to address these questions, the report engages a rich, but also conflicted, literature on research about business strategy and the capacity of firms to adapt to their environments.

II. Literature Review: Business Strategy During Economic Transformation

The limited literature on business strategy in transition economies has focused primarily on the struggles of privatizing state enterprises and the advantages of incumbent elite business groups. In the even more limited literature on the strategy of private sector startups in these emerging markets, there is a distinct lack of careful analysis of how strategies are influenced as the environmental conditions shift and what this might mean for the longer-term performance of early entrants. As such, it makes sense to begin with relevant literatures on strategy in industrialized country settings and consider in what ways one might expect results to differ in the transition economy context.

[2] See also Taussig (2005) for an argument that there has been too much focus in Vietnam on SMEs and a criticism of the common insinuation that, when it comes to entrepreneurship, only "small is beautiful".

[3] The lack of precision on this share reflects, in part, some questions about the comprehensiveness of GSO data. GSO data for 1998 recorded only 465 private manufacturing firms with more than 100 workers. This data was collected in the summer of 1998. GSO data for 1999 appears to be problematic and so cannot serve as a point of reference. One reason for questioning the GSO number is that, in the run up to the January 1999 survey, the MPDF compiled a database of 457 private manufacturing firms in just the 7 target provinces.

The first of two main streams of literature relevant to the experience of Vietnam's first generation of successful private manufacturers is the literature on first mover advantages (Lieberman and Montgomery 1988). There is reason to believe pioneering entrepreneurs, such as the 95 private companies surveyed by Taussig and Webster in 1999, should benefit from first mover advantages in terms of both tangible and intangible resources—especially the latter, e.g. reputation and entrepreneurial orientation. Firms with established business resources are in position to quickly capitalize on substantial improvements to the business environment: e.g. increased access to capital and foreign markets, continued rapid growth in domestic markets, and the improving overall sense among public policy makers and the public that entrepreneurs are central to Vietnam's growth potential. There is ample research confirming that early entry has been a significant competitive advantage for foreign investors in emerging economies like China (e.g. Pan, Li and Tse 1999; Luo 1998, 1999).

However, there are also disadvantages to early entry into business (Lieberman and Montgomery 1998). In particular, the resources required to operate and succeed in the especially hostile initial phase of market reforms may be quite different from those required in subsequent, more competitive phases. The very success of Vietnam's economic development over the past decade has significantly impacted core competitive advantages, especially those relating to low labor costs—and nowhere more so than in the growth centers where early success stories were clustered. As a result, firms face the challenge of leveraging business resources of one era into the new resources required for success in the next. For example, political connections crucial to success in the difficult business environment of the 1990s also gave entrepreneurs privileged access to the accumulated experience and reputation valued in the more competitive present day setting. Even so, actually translating available resources into strategic renewal requires a dynamism that is frequently lacking in incumbent firms.

The second literature stream of interest explores strategic renewal, i.e. the ability of firms to respond appropriately when external incentives change. At one extreme, there are the population ecologists, who provide extensive historical evidence that organizations are simply not built for change and thus changes in dominant business approaches come not through adaptation but through a Darwinian process of exit by organizations of the old type and increased entry of new forms (e.g. Hannan and Freeman 1984). At the other extreme is the positioning school, made famous by Michael Porter, which portrays firms as capable of not only keeping a constant eye on competitive dynamics across industries, but also reacting to changes in those dynamics with dramatic moves in and out of unrelated industries (e.g. Porter 1996). Particularly relevant for such firms, though, is the extent to which they possess resources that are equally useful across different industries (Montgomery and Wernerfelt 1988; Penrose 1958), e.g. political connections or access to finance.

Generally speaking, academic research indicates that the risks of venturing into new industries outweigh its benefits. Schoar (2000), for example, uses business unit-level data to show that traditional business units tend to suffer when corporations venture into new industries and that the overall effect on corporate profitability is negative. Research by Villalonga (2004) indicates that this is particularly true if diversification is into new industries unrelated to the corporations traditional industry focus. These findings are consistent with a longer history of theoretical work by business strategists (e.g. Wernerfelt and Montgomery 1988). They are also consistent with research on established firms trying to enter into newly emergent industries (Christensen and Bower 1996; Santos and Eisenhardt 2005).

There is evidence, however, that industry diversification in developing countries may be different. Strategy researchers have found evidence that "institutional voids" in emerging markets—e.g. underdeveloped financial systems, lack of trust amongst consumers regarding quality, government corruption—mean that businesses can build resources in one industry that are also crucial to success in technically entirely unrelated industries (Khanna and Palepu 2000; Khanna and Fisman 2004). The argument essentially is that the problems presented across industries by institutional voids are more determinant of success than those related to the specific characteristics of individual industries. This research, however, has generally neglected the role of environmental change over time, resulting in calls for research that helps understand the initial formation of business groups in emerging markets (Khanna and Rivkin 2006; Aya and Vissa 2005).

In the US setting, at least, leading incumbents have frequently struggled in their responses to environmental change, such as the emergence of new technologies and nascent industries. Particularly famous is the case of Hewlett Packard and its inability to capitalize on innovations in disk technology made by its own internal research division (Christensen 1997). In the case of developing countries like Vietnam, though, disruptive environmental change is at least as likely to be the result of regulatory reform or changing relative position within the global economy as it is to be the result of innovation. In contrast, however, to most other developing countries, leading private companies in Vietnam have had limited political power to insulate themselves from such competitive pressures because of their relative lack of political power.

Despite the obvious contextual differences, the conclusions of much of the US-based research appear quite relevant to the Vietnamese case. A significant factor dictating whether or not incumbents are able to adjust successfully appears to be the extent to which required strategic change involves reorienting towards different customers (Christensen and Bower 1996). Another factor influencing the ability of incumbents to deal with environmental change is how that change affects the value of accumulated knowledge: in cases where change means the old rules have been thrown out the window, experience can suddenly become a handicap (Tushman and Anderson 1986). The question here therefore is: does the experience of success in the hostile business environment of Vietnam in the 1990s provide firms with a competitive advantage that can be applied in today's more efficient, institutions-based markets or are they hamstrung by their old way of thinking?

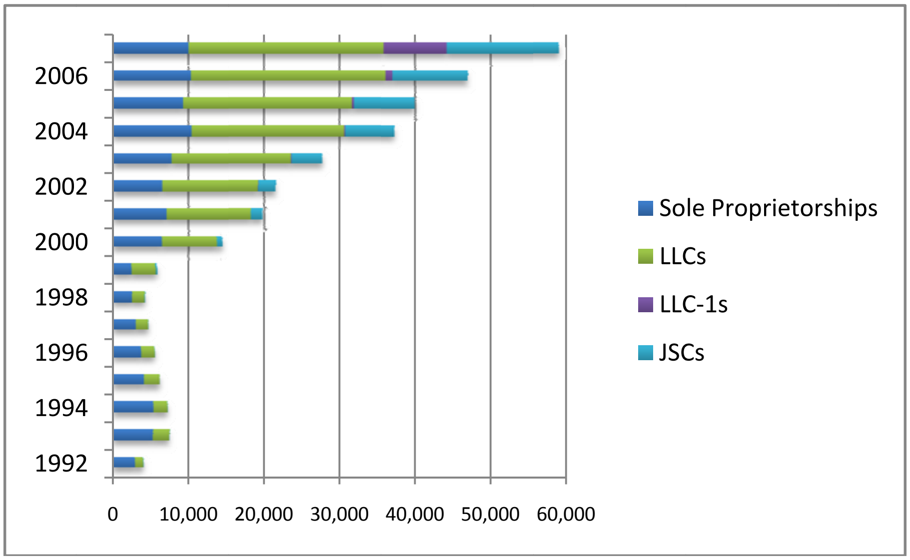
III. The Vietnamese Context: The Enterprise Law and the Decade Since

1. Growth of the Domestic Private Sector

As noted in the introduction, Vietnam's business environment and business sector have undergone radical transformation during the ten years since the private manufacturers studied in this report were first surveyed. That original survey was carried out just months before Vietnam's National Assembly passed a new Enterprise Law that would usher in a new era for private sector development. Within just the first year, average days to register a new business fell from 12 weeks to just two—with the average coming down as low as two days in some areas. Similarly, bureaucratic entry costs were brought down 95 percent, from an average of VND 10 million to VND 550,000 (VCCI 2000). A particularly memorable example of entry barriers cut by the Enterprise Law was the removal of a requirement that local authorities vet the curriculum vitae of prospective entrepreneurs to determine the future viability of their venture.

The reaction to the Vietnamese government's more business friendly policy approach was immediate and substantial. As is immediately clear in Figure 3.1, growth in number of companies exploded after introduction of the Enterprise Law in January 2000. Growth in the number of private manufacturing companies was even higher at 23 percent annual growth, relative to 21 percent for all private companies (See Figure 3.2). It is also worth noting the changing status of private companies relative to other ownership types over this period: From 2000 to 2007, domestic private companies' share of industrial output grew from 9.8 percent to 24.3 percent—nearly a 150 percent increase (See Figure 3.3). This increase came largely at the expense of SOEs.

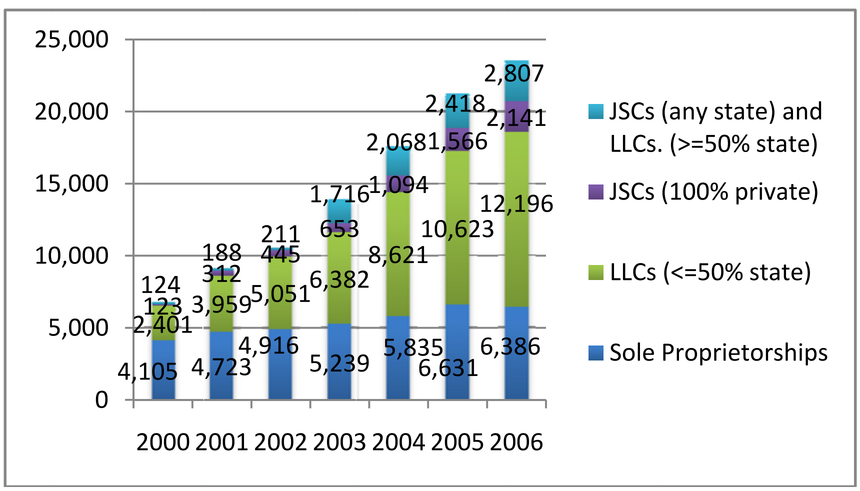
Figure 3.1. Private Company Registrations, 2000-2007 *



Source: CIEM (2008)

** Note: The Partnership legal form is not included here because of their extremely small numbers.*

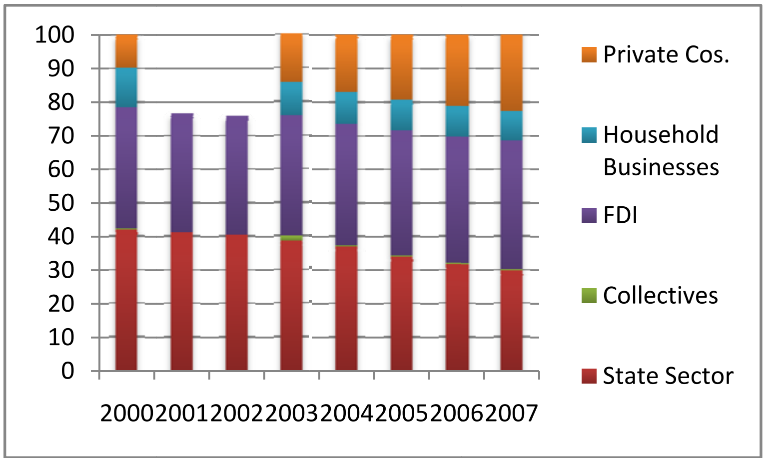
Figure 3.2. Private Manufacturing Companies in Operation, 2000-2006 (GSO) *



Source: GSO (2008)

** Note: The Partnership legal form is not included here because of their extremely small numbers.*

Figure 3.3. Share of Industrial Output (%), by Enterprise Legal Form, 2000-2007 *



Source: GSO (2008)

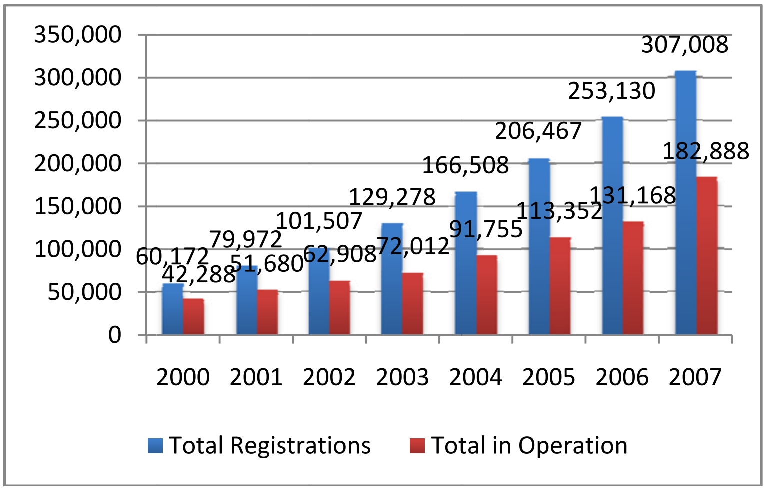
** Note: The Partnership legal form is not included here because of their extremely small numbers. Also, distinction between private companies and household businesses is not available for 2001 and 2002.*

Growth in the number of private companies overwhelmingly occurred in the legally more sophisticated categories of limited liability (31%) and joint-stock companies (65%). This is significant, as the so-called "corporate private sector" has proven crucial to development in countries like Taiwan and South Korea, which serve as economic models for Vietnam (Riedel et al. 2000). A crucial characteristic of shareholding legal forms, in particular, is their ability to grow by tapping into equity markets. Successfully following this model, however, is going to require significant further development of Vietnam's legal infrastructure for corporate governance (Nguyễn Đình Cung 2008). Towards this end, it is worth noting that there has been a significant rise in recent years in the number of court cases initiated by private companies, indicating increasing faith in the court system. This has been particularly true in commercial centers like the provinces home to the firms surveyed in this report (Malesky 2008).

In addition to the increase in number of private companies and in their relative share of the overall economy, the other major result of the Enterprise Law has been substantially higher mortality rates among private companies. As of the end of 2000, the number of private companies in operation represented 70.3 percent of the aggregate number of firms registered since Vietnam first legislated the existence of companies in 1991 (See Figure 3.4).[4] By 2007, this share had fallen substantially to 59.6 percent, indicating a 45 percent increase in the mortality rate of firms in the post-Enterprise Law. Seen together, the greater ease of entry and greater peril thereafter indicate that Vietnam's business environment is becoming more market-oriented. The increase in the role of markets in deciding which entrepreneurs compete and succeed, relative to that of government, has implications for business strategy that are explored in subsequent sections of this paper.

[4] To start with, the GSO enterprise survey appears to have encountered difficulties in 1999, so detailed numbers are generally only on offer for 1998 and then from 2000 onwards. As a result, it's a bit difficult to do a clean before and after cut relative to implementation of the Enterprise Law in January 1999. Researchers that have worked directly with the raw data from the GSO survey have also expressed significant concerns about noise in the data. Efforts to clean the data, connect observations across years, and make an anonymized longitudinal version more readily available to researchers are still underway. Another issue that arises is changes in the survey questionnaire and thus the variables in the dataset, including changes to the legal forms under which companies are categorized.

Figure 3.4. Company Registrations and Company Survival, 2000-2007

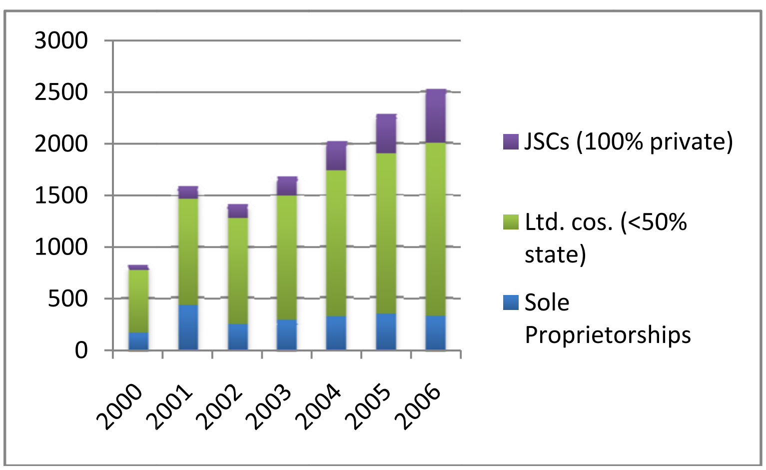


Source: VCCI (2008)

2. The Biggest Firms

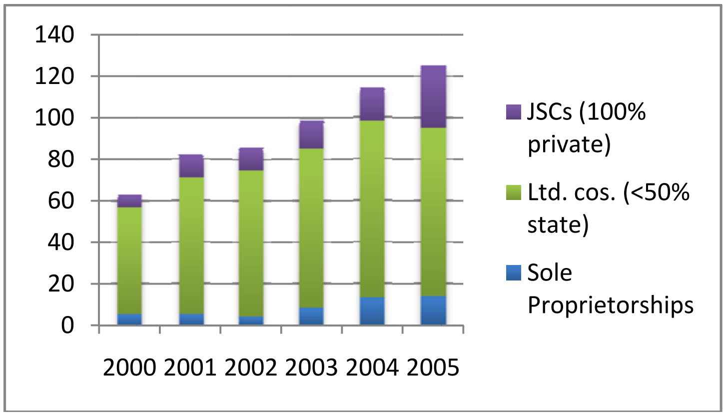
Private companies have taken an increasingly large share of substantially sized manufacturing operations in Vietnam. By 2006, the domestic private share of all manufacturing companies employing 100 or more workers nearly doubled relative to 2000, increasing from 32.7 percent to 59.5 percent. The domestic private share of manufacturers employing 1,000 or more workers also grew from 24.6 percent in 2000 to 33.8 percent in 2005. There are limitations, of course, to using employment as the only metric for identifying the country's largest firms. However, the magnitude of these growth rates attests to the growing presence of private companies in Vietnam, especially among the segment of large firms.

Figure 3.5. Private Manufacturers with 100 or more workers, 2000-2006 (GSO)



Source: GSO (2008)

Figure 3.6. Private Manufacturers with 1,000 or more workers, 2000-2005 (GSO)



Source: GSO (2008)

A couple recent efforts to identify and analyze Vietnam's largest firms, however, show that domestic private firms have still only barely cracked into the country's true business elite. First, in 2007, UNDP identified and ranked the country's largest 200 companies (Cheshier and Penrose 2007). Second, in both 2007 and 2008, the VietnamNet-affiliated Vietnam Report collaborated with Prof. John Quelch at Harvard Business School for an expanded "Top 500" (www.vnr500.com.vn). Domestic private companies accounted for only 10.5 percent of UNDP's 200 firms and 14 percent of the top 200 and 25.6 percent of the top 500 firms in the Vietnam Report listing. In both cases, many included private firms were equitized firms in which the state still maintains a substantial share.[5] In the Vietnam Report, fully private firms account for just 9 percent and the highest ranked private sector startup was listed at 69.

An issue stressed heavily in Cheshier and Penrose (2007) is the frequency of diversification across unrelated industries among the country's biggest firms. The authors highlight, for example, the case of now private and publically listed FPT, which began as a state food processor, then thrived as a software and IT services provider, before eventually even looking to capitalize on its success and resources by moving into financial services. For FPT and others, diversification involved a steady movement away from export markets and manufacturing and towards greater focus on domestic markets and services. This indicates that while Vietnam's country-level comparative advantage lie in relatively skilled, relatively cheap labor, company margins are likely substantially higher in domestic services.

Non-manufacturing firms play a substantial role, both in the "Top 200" and the "Top 500". Fully 42.5 percent of firms in the "Top 500" are services firms and 30 percent characterize themselves as primarily trading firms. For fully private firms, these shares are 52 percent and 34 percent, respectively. Furthermore, being higher ranked appears to actually increase the chances that a firm is not in manufacturing. This seems to be true for both state and private companies, though not for foreign owned firms. Systematic analysis was not done to prove the statistical significance of this observation. Looking at the only three private firms in the top 100, though, two are in trading.

In summary, the past decade has seen tremendous positive change in the number and dynamism of Vietnamese private companies. While domestic private firms that have cracked into the country's true business elite are still extremely rare, the number of success stories is growing—with some private brands even becoming household names. These positive developments are clearly related to the substantial policy and regulatory improvements undertaken by Vietnam's government at the start of the decade and (to a lesser extent) since. What is still not well understood, however, is what the key ingredients are that

[5] 3.5% were LLCs or sole proprietorship firms, while 8% were JSCs.

distinguish Vietnam's entrepreneurial success stories. In the rest of this paper, we try to shed some light on this issue by focusing in on the experience of a particular subgroup of Vietnam's domestic private sector: entrepreneurs who found success in the more treacherous business environment of the 1990s.

IV. A Follow Up Survey of Vietnam's First Generation of Leading Entrepreneurs: Early Success Meets increased Competition

1. Looking Back

Webster and Taussig (1999) presented a highly mixed picture of what they described as "Vietnam's Undersized Engine". The engine in question was the relatively small set of Vietnamese entrepreneurs able to overcome the country's hostile business conditions to grow to reasonably substantial scale. Leading obstacles to firm-level growth ranged from lack of crucial inputs—especially credit from a highly underdeveloped, state-dominated banking system and information flows about foreign technologies and market opportunities—to an institutional context that actually seemed to punish success. The authors dubbed the latter issue "The Tall Poppy Syndrome", whereby firms that sprouted up as leaders were often punished with excessive government attention. This can be understood as the reasonably natural result of bureaucrats faced with the deadly combination of limited resources, limited incentives, and vast responsibility.

In a familiar setting of a stalling Vietnamese economy, plagued by a confluence of domestic and international problems, the aim of the 1999 "Undersized Engine" report was to emphasize the potential to jump start growth by unshackling the country's ample entrepreneurial resources.[6] The first generation of successful entrepreneurs were found to have overcome highly unfavorable conditions to record impressive growth in job creation during the 1990s: median annual growth in employment since official registration was an impressive 23 percent. Variation in number of employees was largely the result of organic, post-registration growth, rather than firms that began with disproportionately substantial resources. As such, an enabling environment for growth of manufacturing firms was seen as particularly relevant for coping with the country's rapidly growing labor force.

Indeed, even the largest firms in the sample—employing 1,000 or more workers—were no larger, on average, at registration than was the rest of the sample. One garments company, for example, began in 1992 with 30 sewing machines and 50 employees. By 1999, it was up to 750 sewing machines on its garments production line, and another 800 on its new shoe production line—allowing it to increase employment to 2,225 full-time workers. Fastest growing were shoe manufacturers, which increased employment at a rate of 60 percent per anum post registration.

As noted in the previous section, number of employees may not be the ideal measure of firm size. Labor levels and growth were the focus of the 1999 report's analysis because of not only the socio-economic importance of job creation, but also the questionable reliability of discussions about typical financial performance indicators, such as revenues and profits.[7] A negative characteristic of these focal firms, however, was that the vast majority of these pioneers were essentially just competing on cost of labor in industries with very low barriers to entry. Consistent with the warnings of Porter (1990), this raised

[6] In preparation for the original 1999 survey, MPDF first created a database that aimed to include all private companies with 100 or more workers in the seven target provinces of Binh Duong, Dong Nai, and Ho Chi Minh City in the South, Danang in the Center, and Hai Phong, Hanoi, and Thai Binh in the North. Lists were then created for each province and firms were randomly selected from these population frames and sent introductory letters, signed by the heads of MPDF and the IFC's Vietnam office, asking to schedule in-person meetings with the survey team. The final response rate was approximately 40%. Response rates appear to have been lowest in the South—and possibly lowest among ethnic Chinese entrepreneurs. The survey itself was carried out over a three week period in January 1999. For more details, see Webster and Taussig (1999).

[7] This problem persists today. Not only did numerous firms in this study choose not to report revenues, but private companies were also less likely to report revenues and EBIT in the "Top 500" report described earlier in the paper.

concerns for the authors of their longer-term viability—especially for those operating in global markets. This strategy faced additional challenges in the context of the aforementioned "tall poppy syndrome", where a larger work force appeared to almost exponentially increase costs associated with government regulation.

The authors of the "Undersized Engine" report saw little evidence that entrepreneurs were moving up the value chain, instead concluding that most were highly dependent on a limited number of East Asian trading agents for access to not only output markets, but also everything from designs to raw materials. This finding was consistent with research in economic sociology which finds that repeated transactions tend to lead to a dependency and a lack of consideration of better alternatives that overall have a negative impact on performance (Burt 1992; Goerzen 2007). As such, the report concluded that the only way in which entrepreneurs would be able to maintain growth would be through explicit strategic change that focused on either: a) learning how to take on higher value functions of the production process, such as design; or b) transition into entirely different, and more differentiated, products.

Concerns about dependency and longer-term viability remain today for much of the surviving sample of firms. It appears that most of the surveyed firms have not taken substantial steps in either of the two above prescribed directions.[8] Amongst the subset that have been most successful over the past decade, however, strategic change does seem to have been critical. The first of the above two recommended actions is far more evident among these leading firms, although the latter may indeed have been crucial for averting failure among other firms. Firms that moved to more differentiated strategies are also likely to have sacrificed growth in favor of higher return on investment but, as noted above, the research team deemed reliable numbers on profit margins too difficult to obtain.

The rest of this chapter lays out the study's findings as follows. The next section considers first a basic comparison of the sample across the January 1999 and the November 2008 surveys. This is followed by analysis of the factors determining which firms survived and which did not and then another section on which factors helped determine which firms grew the most. The final section reviews the strategic actions witnessed in the sample, which firms were most likely to take these actions, and what their outcome tended to be.

2. Comparing the Sample in 1999 and in 2008

As described in greater detail in the following section, not all 95 firms included in the 1999 survey were still around to be surveyed in 2008. Furthermore, not all survivors were willing to either meet with members of the research team or to fill in a survey questionnaire form within the allotted research period.[9] Clearly potential biases due to this latter issue must be kept in mind when interpreting the new data.[10] Anecdotally speaking, a substantial number of firms that refused to meet with the research team cited economic troubles that the Vietnamese economy was going through at the time of the survey as a main reason to do so. On the other hand, a couple interviews with more successful firms fell through specifically because of the entrepreneur's busy work schedule.

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[8] Unfortunately, only one single interview was done with a previously surveyed entrepreneur whose company had gone out of business. As a result, the report lacks information on whether strategic reorientation contributed to the death of firms (as it has been shown to do by authors in the population ecology literature).

[9] One non-systematic factor affecting responses was the enormous disruption caused by the huge November 2008 floods in Hanoi.

[10] One method for doing this is a Heckman model (Heckman 1979). The author duplicated regressions on the performance of survivors using a Heckman approach, wherein the first stage was a probit on whether or not data on the second stage dependent variable (i.e. labor or revenues) had been secured. Results did not differ significantly from the straight forward OLS coefficients included in the report. This use of the Heckman is certainly not a full-proof means of dealing with bias, as economists will point out the lack of an instrumental variable. Economic sociologists counter, however, that while a Heckman model without an instrumental variable is theoretically flawed, it has repeatedly been shown to be empirically valid.

Potential biases notwithstanding, evidence shows that the first generation has continued to grow under the second stage of Vietnam's economic reforms. Growth of revenues, in particular, has been extraordinary, with the sample mean increasing from VND two billion in 1998 to VND 67 billion in 2008 (approximately VND 37 billion in 1998 terms, given a consumer price index of 6 percent per year over the same decade). This represents a compounded annual growth rate of 44.2 percent (approximately 33.9% in real terms). Furthermore, in a clear indication that the "tall poppy syndrome" is not what it once was, the maximum revenues in the sample increased by a multiple of over 20x over the ten year period, going from VND 30 billion to nearly VND 700 billion (approximately VND 390 billion in 1998 VND). Employment per firm, on the other hand, grew a relatively modest compounded rate of 3.9 percent per year.[11]

Figure 4.1. 1998 v. 2008

	1998				2008				1998-2008 Compounded Growth
	Obs.	Mean	Median	Max	Obs.	Mean	Median	Max	
Revenues (VND billion)	93	2	1	30	51	67	35	693	44.2%
- Firms w/ 100- 299 workers in 1999	59	2.3	1	30	33	77.5	27	650	42.5%
- Firms w/ 300 or more workers in 1999	34	1.6	1	8	18	55.5	111	693	47.6%
Employees	95	357	200	1,225	68	662	300	9,000	3.9%
- Firms w/ 100- 299 workers in 1999	59	142.8	130	290	41	376.1	200	2,000	6.5%
- Firms w/ 300 or more workers in 1999	36	708.2	500	2,225	27	1,096.6	450	9,000	-0.0%
Revenues from Exports	95	76.9%	97%	100%	37	76.3%	90%	100%	--
Long-term Loan Access	94	37.2%			36	48.7%			--
Years in Operation	95	10.3	8	40	79	20.3	19	49	--

3. Who is Still Standing?

The life and death of firms is a natural part of a functioning market economy. Higher turnover of firms has, in fact, long been directly linked to higher economic growth (Hause and Rietz 1984). Population ecologists have amassed substantial evidence that enterprise mortality increases in times of significant environmental change. And so it happens that 16 of the 95 "Undersized Engine" firms went out of business over the past decade.

The simple descriptive statistics in Figure 4.2 show striking differences between the 1998 characteristics of firms that survived and those that did not. Results are consistent with the general thesis that Vietnam's business environment has changed dramatically. Firms that subsequently survived until 2008 earned only just over half the revenues in 1998 of firms that did not survive the coming decade, although the surviving group actually employed 20 percent more workers per firm. Survivors were also less export-oriented in 1998. Mortality appears to have particularly been an issue for those located in Hanoi. Surviving entrepreneurs were more than twice as likely to be women, as well as more likely not to have gone to

[11] Note that more data is available on employment than revenues, reflecting that fact that of the firms contacted only by phone, 17 were willing to provide only information on workers.

college, to be a member of the Vietnamese Communist Party, and to have been open to the idea of selling shares to a strategic outside investor.

Figure 4.2. Select Summary Statistics on Sample Survival

	Survivor (79)	*Non-Survivor (16)*
Mean Revenues, 1998	VND 1.79 billion	VND 3.37 billion
Mean Employees, 1998	368	303
Accessed Long-term Loan by January 1999	38.5%	31.3%
Share of Revenues from Exports	75.9%	82.2%
Share of Raw Materials imported	53.9%	62.6%
Based in Hanoi	20%	43.8%
Female Entrepreneur	27.8%	12.5%
Entrepreneur with High School or Less Education	32.9%	25%
Entrepreneur with Party Membership	24.1%	18.8%
Entrepreneur Open to Selling Shares to PE firm	72.2%	56.3%

While correlation of these variables is not actually particularly high, there is reason to believe some are related to one another.[12] For example, domestic-oriented firms earned substantially less revenues than their export-oriented counterparts in 1998. It is also true that, for historical reasons, entrepreneurs in Hanoi, are substantially more likely to have received a university degree. So, on this latter point, is the negative effect we see on education perhaps explained by the correlation of entrepreneurs with education with those operating in Hanoi's relatively difficult business environment (compared to HCMC and Binh Duong)? Or is it better explained by the possibility that in the past, at least, education in Vietnam was not practically relevant to business administration? Regression analysis allows us to separate out these relationships between explanatory variables and pinpoint more precisely how a particular characteristic relates to subsequent survival.

The ideal statistical method for this analysis is what is known as survival analysis, which increases the explanatory power of analysis by considering variation in the time to failure. Unfortunately, the research team was unable to identify the year of death for all of the firms that did go out of business. As a result, the most appropriate method is a probit analysis, with death as the dichotomous dependent variable. Regression results are displayed in Figure 4.3. Results confirm that the following characteristics increase a sample firm's chances of having survived the past decade (in order of strength of evidence): i.) *not* being located in Hanoi; ii.) being headed by a female entrepreneur; iii.) *not* being export-oriented; and iv.) being in the garments or textile industry. Only being located in Hanoi is significant across all models.

Assuming all other variables are at their mean, the coefficient on Location in Hanoi can be interpreted to mean that a sample firm based in Hanoi in 1999 had a 61.2 percent chance of surviving the coming decade. Firms based elsewhere, in turn, had 96.3 percent probability of making it through the same time period. Making the same assumptions on all other variables, the regression also indicates that a female entrepreneur had a 99.5 percent chance of success, compared to a 85.1 percent probability for a male counterpart. Holding all else constant, the probability of survival was 88.8 percent for export-oriented firms (compared to 98.9% for domestic-oriented firms) and 97.4 percent for garments and textiles firms (compared to 86.8% for all other industries).

The positive effects on survival of less dependence on imported raw materials and access to long-term financing come close, but fall short of the weakest threshold for statistical significance, i.e. a p-value of below 0.10. Contrary to expectations and implications of initial cross tabulations, measures of company size, age, and legal form, as well as entrepreneur age, education, and Party membership all turn out to not be significant predictors of subsequent survival. Additional regressions including other industry and

[12] Correlation table available from author by request.

location controls were also run, but were neither significant nor did they change significantly the coefficients on other variables.

The relatively poor survival rates of firms based in Hanoi is consistent with the idea that change in the business environment has been especially radical in the country's capital. This makes sense given that private sector development was far more advanced in the South in the 1990s (Webster and Taussig 1999). The higher mortality rates of export-oriented firms, in turn, may simply reflect the fact that growth of demand in domestic markets far outpaced growth of demand in global markets over the decade in question. It may, however, also indicate that first mover advantage is more valuable for firms oriented towards the market where reforms are affecting the most change. It also seems relevant to note that domestically oriented firms are more likely to intimately understand their end markets and to therefore be much less dependent on intermediaries.

Figure 4.3. Probit Regression on Firm Death over the Previous Decade

The regression table below includes 4 probit regression models, each applied to a dichotomous dependent variable indicating that a company went out of business (i.e. 1=out of business by 2008; 0=still in business in 2008). As such, a positive coefficient indicates that the variable may contribute to a higher likelihood of going out of business. Standard errors are included in parentheses. The first model includes only independent variables describing firm size in 1998. The second model then adds in variables for other firm-level characteristics and the third model adds in variables for entrepreneur characteristics. The fourth model removes 4 variables for which there was not complete coverage of all 95 firms so as to check the robustness of findings when all 95 firms are included in the regression.

1998 Characteristics	**Initial Size Model**	**Firm-Level Model**	**Full Model**	**Robustness Check Model**
Firm Size				
1999 Employment, Logged	0.0903	0.0917	0.117	
	(0.133)	(0.143)	(0.165)	
1999 Revenues, Logged	-0.172	-0.214	-0.131	
	(0.182)	(0.234)	(0.260)	
Other Firm Characteristics				
Years Since Establishment, Logged		-0.469	-0.369	-0.369
		(0.365)	(0.290)	(0.290)
Located in Hanoi in 1999		1.023**	1.498***	1.068**
		(0.420)	(0.557)	(0.424)
Joint Stock Company in 1999		0.278	0.102	-0.270
		(0.881)	(1.078)	(0.960)
Garment or Textile Company in 1999		-0.905**	-0.821	-0.620
		(0.459)	(0.516)	(0.398)
Majority Revenues from Exporting in		0.827	1.083*	0.815
		(0.575)	(0.632)	(0.509)
Share of Inputs Imported in 1999		0.00721	0.00780	
		(0.00557)	(0.00596)	
Long Term Loan (1 year or more) Accessed by 1999		-0.428	-0.662	
		(0.456)	(0.537)	
Entrepreneur Characteristics				
Female Entrepreneur			-1.541**	-0.795*
			(0.671)	(0.464)
Entrepreneur Age			-0.00115	-0.00178
			(0.0266)	(0.0242)
Communist Party Member Entrepreneur			-0.513	-0.456
			(0.584)	(0.504)
Years Education Beyond High School			-0.0589	-0.0312
			(0.102)	(0.0855)
Constant	-1.321	-1.603	-1.703	-0.526
	(2.112)	(2.583)	(3.156)	(1.281)
Observations	92	90	90	95
Pseudo R-squared	0.0175	0.1789	0.2748	0.1538

**** p < 0.01 ** p < 0.05 * p < 0.1*

4. Who Continued to Succeed in the New Millennium?

The above finding that leading export-oriented firms were less likely to have survived the past decade is particularly noteworthy because of how central export-orientation was in 1999—not only to being included among the country's leading private manufacturers but also to being among the largest of those leaders. Majority export-oriented firms represented 80 percent of the original "Undersized Engine" sample and, on average, earned 38 percent higher revenues and employed 67 percent more workers in 1999 than the rest of the sample. The difference is even more substantial if the focus is on the median firms for each group, where the difference was 73 percent and 121 percent, respectively. Using the median, of course, has the virtue of reducing the impact of extreme cases—in this case, a couple of particularly successful domestic-oriented firms.

These figures notwithstanding, an initial slicing of the data to compare companies that were exporters with those that were more domestically oriented, as well as comparing companies based in Hanoi with those that were not, indicates that growth over the past decade may indeed have been driven by the same characteristics that drove survival. While a definitive statement is not possible in the absence of data on post-Enterprise Law entrants, conditions do appear to have shifted substantially from favoring growth in export sectors to favoring domestic orientation. In stark contrast to 1998, export-oriented firms in 2008 averaged a stunningly low 2.2 percent the revenues of domestic-oriented firms. This is the result of ten year average annual growth rates of 9 percent for export oriented firms and 65 percent for domestically oriented firms. Looking at median firms for the two groups, the exporter still earned just 27 percent the revenues of its domestic market-oriented counterpart in 2008.

The difference regarding employment is also substantial, with the average exporter workforce at only 44 percent that of the average domestic-oriented company. Annual growth rates over the past decade were 17 percent for exporters and 3 percent for domestic market firms. Also consistent with the survival findings, the average firm located in Hanoi in 1999 had revenues that were only 22 percent and a workforce that was only 53 percent that of the average of the rest of the field. Unlike the case of exporters, however, these numbers are actually an extension of the lesser performance recorded by Hanoian members of the sample in 1999. Indeed annual growth among Hanoian firms is only barely lower than for the rest of the sample (5.7% versus 6.2%).

In thinking about these numbers, it is important to remember that this is a very particular subgroup of Vietnam's domestic private sector. While specific numbers on the aggregate export performance of Vietnamese private companies is difficult to attain, it seems clear that the overall trend has been towards greater numbers and increased growth. But from the survey data, it also appears the private firms that most successfully exported in the 1990s have not shared in this overall trend. Identifying exactly why this is true is not possible with the data collected in the survey, but it does indicate that the key ingredients for success over the past decade may no longer the same as they were in previous decade. It also indicates relatively new private firms are driving current export growth.

Figure 4.4. Mean Revenues and Employees by Market-Orientation and Location

1999 Characteristics	*1998*		*2008*	
	Revenues	Employees	Revenues	Employees
Export-oriented?				

- Yes	VND 2.2 billion	388	VND 5.1 billion	519
- No	VND 1.6 billion	233	VND 230.4 billion	1,167
Located in Hanoi?				
- Yes	VND 1.6 billion	222	VND 21.7 billion	384.6
- No	VND 2.2 billion	398	VND 98.5 billion	727.8

Another interesting factor that has been the focus of much research on business in developing countries is political connections. Political elites have been shown to have an edge in a variety of developing country settings, including even former communist party members in no-longer communist transition economies (e.g. Rona-Tas 1994; McDermmott 2002). In general, the evidence shows that the weaker the rule of law, the more effective are political connections (Faccio 2006). In Vietnam, in particular, there is strong evidence that banks provide favored access to credit for firms with political connections (Malesky and Taussig 2008). Furthermore, a noteworthy finding in the original "Undersized Engine" report was that, despite explicit Party directives barring entrepreneurial activity, more than a fifth of sample owners self-identified as Party members.

Consistent with where one would expect connections to be of most effective use, the 1999 study found that party members were more than twice as likely to be focused on domestic markets than non-party members. Given the generally poorer performance of domestically focused firms in 1999, this orientation may have contributed to the overall lesser performance of connected owners noted in the original survey report and was interpreted at the time as possible evidence of their relative lack of entrepreneurial skill. Party member owned firms performed significantly worse on both the labor and the revenue standard, even when considering only non-exporters.

Cross tabulations on the connection between party ownership and performance based on the 2008 survey data are mixed. Quite surprisingly, though, the earlier-noted substantially higher growth of domestically oriented firms in the sample appears to be largely driven by firms owned by non-Party members. This fairly directly undermines the popular hypothesis that political advantages are a crucial resource in domestic markets. In fact, this appears at first glance to be further evidence that, on average, Party member firms are less dynamic, i.e. in this case, less skilled at seizing on the opportunities of explosive domestic market growth—despite their clear preferential access to other key resources such as credit and access to government policy makers and regulators.

Figure 4.5. Survivor Performance 1998-2008, by Connections and Market-Orientation

	1998		*2008*	
	VCP	No VCP	VCP	No VCP
Export market	VND 1.3 billion, 395 workers	VND 2.4 billion, 386 workers	VND 60.7 billion, 369 workers	VND 53.7 billion, 554 workers
Domestic market	VND 1.1 billion, 146 workers	VND 1.9 billion, 284 workers	VND 44.4 billion, 390 workers	VND 354.4 billion, 1,847 workers

Again, it is useful to look to regression analysis to separate out the individual effects of correlated factors. Simple OLS regressions on 2008 revenues and employment confirm the strongly significant role of market-orientation (See figure 4.6).[13] Holding all else constant, revenues for the average export-oriented firm grew at a compounded annual rate of 24.4 percentage points less than their domestically oriented counterpart.

[13] The author ran an additional OLS regression on 2008 revenues that also included a variable for export-orientation in 2008. This variable is naturally highly correlated with the 1999 export variable (0.64). Despite this and despite the substantially smaller number of observations, the p-value on the coefficient for 1999 export variable (p=0.14) almost reaches the weakest threshold for significance. The 2008 export variable, in turn, is not even close to being distinguishable from zero.

Growth of their workforce was also 9.4 percentage points less. Greater reliance on imported raw materials also has a significantly negative coefficient in the regression on employment, but falls short in the regression on revenues.

The control for garments and textiles, in turn, shows up as significantly positive in the labor regression, but insignificant (and negative) in the revenue regression. This latter finding can be interpreted to mean that garments firms are indeed creating jobs at a relatively high rate, but the firm-level returns on this extra job creation may be relatively low. As in the probit on survival, however, Party membership is not only insignificant as a predictor of performance, but the coefficients are very small and even point in different directions for revenues and employment.

Interestingly, another variable that does show up as significant—though in this case negatively so—in the revenue regression is age of the entrepreneur. Compounded annual revenues growth was 1.1 percentage points less for each additional year of age of the entrepreneur. This can be interpreted as reflecting either the lesser dynamism of older entrepreneurs or, perhaps, the difficulties of leadership transition. Family businesses, which dominate the sample, have been found to rarely fare particularly well through generational transition (Villalonga and Amit 2006). It is perhaps not surprising that these problems might be amplified by radical environmental change. Regressions including family ownership share as an explanatory variable were also run, but did not prove to be informative. This is likely related to limited variation on this variable: family ownership for the sample surveyed in 1999 was, on average, 83 percent.

Figure 4.6: OLS Regression on Compounded Annual Growth in Revenues and Employees

The below table includes two sets of OLS regression models—the first set using compounded annual growth in revenues over the 1998-2008 period, the second set using compounded annual growth in firm employees over the same period as the dependent variable. As a result, a positive coefficient indicates the variable may contribute to a higher level of annual growth. Standard errors are included in parentheses. In each set: i.) the first model uses only explanatory variables describing firm size from the original survey; ii.) the second model adds in other firm-level variables; and iii.) the third model incorporates entrepreneur-level variables.

		Revenue Growth			***Employment Growth***	
	(1)	(2)	(3)	(4)	(5)	(6)
Dependent Variable	*Annual Compounded Growth, Revenues*	*Annual Compounded Growth, Revenues*	*Annual Compounded Growth, Revenues*	*Annual Compounded Growth, Employment*	*Annual Compounded Growth, Employment*	*Annual Compounded Growth, Employment*
Firm Size						
1998 Employment, Logged	0.0574*	0.0853**	0.0766**	-0.0408**	-0.0371**	-0.0368*
	(0.0340)	(0.0353)	(0.0332)	(0.0155)	(0.0178)	(0.0184)
1998 Revenues, Logged	-0.188***	-0.173***	-0.168***	-0.0167	-0.0137	-0.0142
	(0.0267)	(0.0235)	(0.0233)	(0.0118)	(0.0110)	(0.0120)
Other Firm Characteristics						
Years Since Establishment, Logged		-0.0035	0.014		-0.0362	-0.0306
		(0.0683)	(0.0750)		(0.0306)	(0.0342)
Located in Hanoi in 1999		-0.11	-0.0985		0.00184	0.00527
		(0.0978)	(0.0939)		(0.0377)	(0.0396)
Joint Stock Company in 1999		-0.470**	-0.348		-0.295***	-0.279***
		(0.2070)	(0.2190)		(0.0847)	(0.0939)
Garment or Textile Company in 1999		-0.00285	-0.0711		0.0727**	0.0664*
		(0.0743)	(0.0766)		(0.0341)	(0.0370)
Majority Revenues from Exporting in 1998		-0.266***	-0.244***		-0.103***	-0.0941**
		(0.0787)	(0.0750)		(0.0367)	(0.0389)
Share of Inputs Imported in 1998		-0.00147	-0.000495		-0.00124**	-0.00111*
		(0.0011)	(0.0011)		(0.0005)	(0.0006)
Long Term Loan (1 year or more) Accessed by 1999		0.0611	0.0474		0.0193	0.0184
		(0.0675)	(0.0642)		(0.0322)	(0.0332)
Entrepreneur Characteristics						
Female Entrepreneur			-0.0153			-0.0227
			(0.0761)			(0.0370)
Entrepreneur Age			-0.0107***			-0.00227
			(0.0038)			(0.0020)
Communist Party Member Entrepreneur			-0.0112			0.00499
			(0.0742)			(0.0375)
Years Education Beyond High School			-0.00388			0.0000979
			(0.0128)			(0.0067)
Constant	2.735***	2.693***	3.116***	0.489***	0.630***	0.719***
	(0.3970)	(0.4190)	(0.4590)	(0.1750)	(0.2010)	(0.2270)
Observations	49	47	47	66	64	64
R-squared	0.523	0.722	0.783	0.135	0.349	0.376

*** $p < 0.01$ ** $p < 0.05$ * $p < 0.1$

V. Analysis of the "Undersized Engine" Firms' Business Strategy

1. An Overview

Interviews provided evidence that most surviving firms in the sample are focused on the competitive advantages of incumbency. In particular, managers are looking to capitalize on knowledge and other resources accumulated over time. Accumulated resources include product expertise and operational efficiency, as well as reputation for quality and reliability vis a vis business partners. Firms have continued to apply these resources towards low-cost positioning strategies, rather than strategies of differentiation. Indeed, very few sample firms are significantly engaged in R&D or product innovation of any sort. The crucial question facing these managers is whether adherence to low-cost strategies reflects an appropriate reading of present internal and external conditions or, less constructively, a rigid path dependency based on what had worked best under the more hostile business environment of the 1990s.

Certainly a strategic focus on applying accumulated knowledge seems sensible, given that survivors in the sample now have valuable track records of, on average, 20 years in their particular industries. And a reputation for reliability and quality forged with global buyers over time has also been shown to be a crucial resource for development of businesses in developing countries—especially in globally integrated industries like garments and footwear that dominate the sample (Gereffi and Korzeniewicz 1999; Schmitz and Knorringa, 2000). As noted in the previous chapter, however, the single-minded focus on cost exhibited by sample firms was pointed out as a looming danger in Webster and Taussig (1999). A decade later, the cause for concern regarding the degree to which cost still dominates firm strategy is substantially greater.

The popularity of low cost strategy is directly consistent with Vietnam's comparative advantage in relatively competent, low cost labor and the continued entry of new workers from the agricultural sector. There are multiple reasons, however, why this local resource may not be what it was back in the 1990s. In the eyes of numerous entrepreneurs in the sample, Vietnam is experiencing a decline in the work ethic of its young work force. Two thirds of surveyed firms cited lack of reliable labor as one of the biggest problems they face. One entrepreneur with a background in government service argued that this was a failing of the country's education system.

The labor problem faced by low cost producers in the sample, however, may be easier to understand as a product of success rather than one of failure. For the past ten years, Vietnam has been one of the very fastest growing economies in the world. This growth has led to unusually broad-based improvements to incomes and living standards, with income per capita increasing from barely USD 390 in 2000 to USD 890 in 2008. Moreover, much of that economic growth has been centered in the precisely the same commercially dynamic provinces that were home to the first entrepreneurial success stories. As a natural result, local costs for labor and for land have risen especially fast in these areas, directly undermining the viability of a low cost-based business strategy.

Increasingly, manufacturers in the sample have looked to labor from less affluent areas—frequently even from other provinces—in order to keep labor costs low. As reflected in the complaints of many—if not most—entrepreneurs in the sample, such a reliance on migrant workers introduces new costs and management challenges by decreasing the reliability of labor. Common strategic goals such as "moving up the value chain" are greatly complicated when labor reliability is on the decline rather than on the rise. As such, if regional economic growth is to continue, firms applying these focused low cost strategies would seem to be locking themselves in at quite low links along the value chain. And eventually, without strategic action, they are likely to go out of business and be replaced by producers located in areas with easier access to the same low cost labor.

This Darwinian market process of death of old firms and birth of new firms more appropriately oriented to current conditions is generally quite acceptable from an objective public policy perspective. At the level of the individual firm, however, the realization that strategic inaction in the context of rapid economic growth is a clear and simple recipe for eventual failure is clearly reason for grave concern. In a couple cases in the survey sample, the firm seems already to be surviving by the sheer will power and operational management skill of an older founder, meaning that the reckoning will come when this person reaches retirement age and nobody is willing or able to replicate their crucial role. The death of these firms easily fits into the population ecology model of organizational change.

But most firms in the sample show the potential, at least, for successful strategic adaptation to the changing environment and many are actively engaged in experimentation. Three main strategic adjustments are identifiable within the sample:

- Moving Locations: Continuance of the traditional low-cost business model, but movement of production to lower cost locations;
- Moving Up Value Chains: Related diversification into higher value added products and services in the same industry; and
- Moving Industries: Unrelated diversification within the firm (or outside the firm, but within the family of the owner) into entirely new industries—especially higher margin domestic market-oriented services industries including distribution/sales and real estate.

These three strategies are clearly not exclusive and especially more successful firms in the sample appear to be pursuing more than one.

2. Moving Locations

Three of the surviving 79 firms fully moved their base of operations to an entirely different province. One case, the move of a quite successful domestic market oriented firm from Ho Chi Minh City to Hanoi, may have actually been as much about personal considerations as business considerations. The other two cases, however, which both involved moves from Hanoi to neighboring Bac Ninh province, clearly represent strategic decisions to move to a lower cost location with less labor mobility. In one case, the entrepreneur was producing goods that required greater than normal training and moved to an area where two other family members had also set up businesses in the same industry. This likely reflects a ready local supply of workers with appropriate skills and perhaps somewhat of a cluster approach.

Amongst the subset of firms that were visited directly, a number had made the strategic decision to open new branches in lower cost locations—while continuing to maintain operations in their original location. One garments exporter in Ho Chi Minh City expanded by setting up a substantially larger factory in Danang, where labor costs are much lower, but infrastructure is still quite good. Another garments firm in Hanoi recently came to terms with Bac Ninh authorities regarding a large piece of land that will allow a similarly large expansion in production capacity and has plans to make the Hanoi-Bac Ninh move within the next couple years. A firm operating in the footwear industry described the cost problem for them as being less the lack of available labor than the result of a minimum wage for members set in each district by the industry association. As a result, they set up their new branch in a district where the association allowed for a lower wage.

Another model for dealing with rising local costs was that followed by a firm, which substantially increased its production of fake eyelashes for export, while still dramatically cutting in-house labor from several hundred workers to less than 50. This company instead shifted production towards thousands of workers in villages in some of the poorest provinces of Vietnam. During the interview, the entrepreneur wondered aloud why development organizations would not want collaborate with him to scale up income generation possibilities for poorest of the poor in remote parts of the country. Multiple footwear and garments producers similarly increased their reliance on outsourcing to smaller factories for their lowest quality requirement products—essentially renting out their privileged access to foreign markets.

There are, of course, risks to uprooting a business and moving to a new location. For one, relationships and reputation built over time in one locality do not necessarily transfer. In one case in the sample, a business moved out of an urban area to a more rural district where a larger piece of land was available that would allow for an increase in the firm's number of workers. Several years later, however, an access road promised by district level authorities has still not been built, seriously undermining the expected cost advantages because large trucks are unable to reach the factory grounds.

3. Moving Up The Value Chain

A characteristic that united the top two revenue earners among the entrepreneurs interviewed directly for this follow up study was that both were not only significantly growing their volume of production, but they were also producing increasingly tailor-made and higher-end products. One a garments manufacturer and the other a furniture maker, neither was actually designing their own products, but both had full-time design staff that regularly worked with global buyers on implementing production of new products. The garments producer, in particular, is working with a leading global buyer on its evolving system for production of designs submitted online by consumers themselves. In each case, there is clear evidence firms are benefitting from knowledge transfer from these foreign business partners.

Another characteristic shared by these two successful entrepreneurs was that not only did neither mention the reliability of labor as a major issue of concern, but both further argued that being victim to an unstable labor force is a symptom of poor management. Each stressed that developing a positive and improving work environment is a crucial part of their business plan for increasing the predictability of their production capacity and for getting more value out of training and learning-by-doing. Some workers leave, said one, but often they come back and help others understand that conditions are better with us.

This workforce stability appears to indeed be a point of real competitive advantage for these firms, both of which are export-oriented and located in areas of particularly rapid economic growth. This local economic growth has led to rapidly growing input costs and competing service sector jobs—factors that both tend to undermine the low cost strategy. Each of the two firms is serving very demanding foreign customers that see worker conditions at supplier companies, as well as other non-traditional business issues such as suppliers' environmental impact, as highly relevant to the value of their globally renowned branded products. As a result, improving work place conditions has the further virtue of strengthening trust and mutual dependence with a special type of buyer that tends to transfer valuable information and technology to only their closest business partners. This is consistent with the predictions of transaction cost economics theory and with research in economic sociology showing that knowledge spillovers are significantly more likely in more tightly knit business relationships (e.g. Coleman 1990; Uzzi 1996; Fleming et al 2007).

Another characteristic shared by these two firms was pursuit of international certifications regarding not only labor conditions, but also factory efficiency and—in the case of the furniture maker—use of appropriate raw materials. Each has already achieved industry appropriate certifications and expressed specific goals for further accreditation. It is worth noting that serious concerns have been raised about the seriousness and enforceability of such standards (Kim 2008). But these successful entrepreneurs nevertheless described these outside accreditations as useful resources not only for marketing their firms to new customers, but also—and seemingly, more importantly—for defining a particular vision regarding the pursuit of quality for middle management and other employees throughout the organization.

Some standards are also quite specific to the individual firm's particular global buyer relationships. One entrepreneur explained that achieving a particular certification level would make his firm stand out relative to competing suppliers in other countries and thereby increase the chances that its global buyer will agree to a more strategic relationship aimed at implementation of newer innovations. This indicates that such standards can have the added benefit of allowing entrepreneurs to benchmark their performance *vis a vis* direct competitors throughout the world. This, too, adds to predictability of the business environment and the ability to make longer term-oriented strategic decisions.

In addition to global buyers, another type of business partner found to be associated with strategic movement up the value chain by firms in the sample is interaction with private equity firms. Only two firms in the sample had actually taken on a private equity investor, but both are export-oriented firms with clear focus on a single industry and high-end industrialized country customer segment. This, of course, is somewhat surprising considering the far greater growth of domestic-oriented firms. The association between performance and private equity is generally recognized as happening not only through funds' provision of scarce capital, but also two characteristics they share with global buyers: accurately identifying and certifying higher qualifying firms and working closely with managers to further increase the quality of these firms (Hochberg et al 2007).

Least controversial is the argument that private equity firms are specialized in selecting high potential firms led by managers with particularly strong entrepreneurial skills or with unique business resources. Indeed, more successful firms in the sample were clearly more likely to have had discussions with private equity funds looking to make an investment.[14] This argument attributes no causal role for private equity in determining subsequent superior performance by its portfolio companies. Private equity firms expect abnormally high returns and so do unusually rigorous due diligence before deciding to invest in a firm. Indeed, in Vietnam, making it through the private equity vetting process is not only impressive because the meaning it conveys about the quality and potential of the firm and its business strategy, but also of the unusual open-mindedness of its management in agreeing to bridge the enormous gap between the secretive family business-oriented business model and taking on an active strategic investor. It is likely that the certification of making it through this process is especially useful for export-oriented firms.

The second, but more disputed, advantage of private equity is its capacity to add value by applying general expertise in engineering increased operational efficiency and financial leveraging, as well as tapping into industry-specific global networks of customers and service providers. Some experts have, in fact, pointed out that the value adding component is especially important in emerging markets private equity, as investees may otherwise subsequently be more likely to take advantage of weak local institutions to share less of the profits of their growth.

One way in which emerging markets private equity firms frequently try to help provide value added is through human resources. Both of the sample firms that have taken on a private equity investor stand out in having also hired on foreign workers into their management ranks. This, however, is not always a clear good. In listing out key challenges faced by his firm, one entrepreneur made the strikingly honest, no-

[14] This is based not only on a question in the survey questionnaire, but confirmed through a review of the sample by a well-established private equity investor.

nonsense assertion to this report's author that business talent and knowledge and the willingness to live in Vietnam seem to be negatively correlated characteristics among foreigners.

4. Moving Industries

As noted earlier in this report, the tremendous economic growth and unshackling of the private sector seen over the past decade has been paralleled by a clear shifting of the most attractive business opportunities from accessing far-flung and highly competitive export markets to serving rapidly evolving new domestic markets. For Vietnam's first generation of successful manufacturers, many of which were export-oriented since their initial startup, this transition has presented a real challenge. Success in the 1990s gave these entrepreneurs privileged access to a range of scarce and widely applicable resources, including in-house capital, reputation with banks, knowledge on how to manage a large-scale business, and experience working with government authorities. But moving into new business areas also involves clear risks, not the least of which is the risk of neglecting the business that has served the entrepreneur so well and for which the entrepreneurs accumulated expertise is most relevant.

The current situation of one Hanoian member of the sample offers a particularly clear business case for considering the allure of diversification. This is the entrepreneur mentioned earlier that recently negotiated access to a new, larger, lower cost piece of land in Bac Ninh province. The entrepreneur owns the substantial piece of land in Hanoi that her factory currently sits on and believes the move to Bac Ninh will free up this scarce resource for more appropriate uses. A Vietnamese member of the research team also marveled at how rarely was such a substantial, continuous piece of urban land ever under the ownership of a private individual. For both the entrepreneur and the local researcher, there was great opportunity for a real estate or other local market-oriented use of this land. And profits that should certainly not be wasted by selling the land on to a specialized land developer. This sense may be heightened by the current crisis and uncertainty in global garments markets.

It is widely acknowledged in Vietnam that substantial savings have been invested into land markets since the advent of *doi moi* reforms—and more recently into the stock market. The research team, however, was not able to come up with a systematic approach to studying the degree to which individual sample businesses had taken some of their winnings and invested them in real estate or in listed shares. In some cases, though, entrepreneurs did disclose that they themselves or nuclear family members had set up new companies entirely dedicated to real estate development. In one case, in particular, the family running a Hanoian garments firm expressed that, in the current environment, the family strategy was to simply maintain manufacturing activities at their current level, while focusing resources on growth of the higher margin activities of their more newly established real estate company.

For three companies in the sample, the move into real estate was not a diversification move, but actually a full shift from one industry to another. The one uniting characteristic between the former shoe manufacturer, former furniture maker, and former seafood processor that all completely changed their company operations from manufacturing into real estate is that all three were based in urban areas. Unfortunately the research team was unable to meet with any of the three to discuss which resources they felt were most important to successfully carrying out their dramatic strategic shifts.

A hypothesis that surprisingly does not seem to be borne out in the data is the idea that political connections help to predict diversification. The political connection and diversification hypothesis is that entrepreneurs that are Party members have a resource that is valuable across all industries and, therefore, with economic conditions shifting towards making rapidly growing domestic markets particularly attractive, connected entrepreneurs should be more likely to engage in diversification and to be more successful when they do so. Nevertheless, much as there is no evidence that politically connected entrepreneurs in the sample performed better than their unconnected counterparts, so there is also no evidence that party membership had any particular influence on diversification.

Specific examples of connected entrepreneurs show that there was enormous variation among party member entrepreneurs. One interesting example is a connected entrepreneur whose family already had multiple businesses in garments. This entrepreneur, however, established a business in a highly regulated domestic industry. It is not hard to imagine that Party affiliation was helpful in originally setting up this business. However, today, this business was easily one of the most professionally managed companies in the sample, with multiple foreign experts hired on in technical positions and an aggressive strategy for both brand development and the identification and fostering of strategic partnerships. This can be seen as an example of the fungibility of resources, i.e. how a political advantage can be turned into a lasting business advantage powerful enough that it replaces the original reliance on political connections. Recognizing this fungibility in itself, however, represents a dynamic type of thinking that not all entrepreneurs are likely to possess.

VI. Conclusions

The past decade has seen surprisingly strong development of Vietnam's domestic private sector. Highlights include rapid growth in the number of private companies, a couple years with the world's fastest growing stock market, and increasingly popular local brands. This study adds to our understanding of this period of high growth, by analyzing the particular experience of Vietnam's first generation of successful entrepreneurs—as represented by the sample of 95 private manufacturers surveyed for the International Finance Corporation and Mekong Private Sector Development Facility's 1999 "Undersized Engine" project. While some firms were overwhelmed by the dramatically changing landscape, most continued to significantly outperform the market, with survivors averaging compounded annual revenue growth of 44 percent. Vietnam and the world's recent economic troubles, however, do likely mean that these numbers have adjusted downward in the year since field research was carried out.

Most successful, by far, have been those entrepreneurs who ten years ago were already focused on domestic opportunities. Contrary to expectations, this is not at all related to the fact that politically connected entrepreneurs were more likely to be focused on domestically opportunities. Instead, the finding appears to be that, more broadly, competition is lower and margins higher in domestic markets. This is also why limited industry diversification activities have all involved shifts from export-orientation to domestic activities—rather than the more typically told story of emerging markets entrepreneurs learning at home and then expanding abroad.

Researching Vietnam's largest companies in late 2006 and early 2007, Cheshier and Penrose (2007) identified three main business strategies: i.) upgrading core business activities; ii.) expanding export markets; and iii.) unrelated diversification. The "Top 200" report focused much of its attention on the third of these strategies—especially movement into domestic markets for financial services and real estate—because of concerns that firms might be taking on too much risk, while neglecting core competencies. Events since UNDP published this research have clearly borne out these concerns, showing the dangers of unrelated diversification for both individual firms and the economy as a whole.

The assumption of the author in revisiting the sample of leading private sector manufacturing firms interviewed in 1999 as part of the "Undersized Engine" project was that these firms, too, would have been strongly influenced by the diversification impulse. This was especially expected to be the case for politically connected entrepreneurs, given a belief that such ties matter irrespective of industry. In this context, the sample firms, in fact, proved to be extremely focused in their strategies—in fact, probably too much so. While three sample firms did completely abandon export-oriented manufacturing in favor of real estate and construction services, most of the rest stuck with the expertise in management of low cost labor that allowed them to grow to relatively large scale in the tough environment of the 1990s.

Diversification activities were instead largely limited to related moves such as a garments firm adding a footwear production line and various firms increasing the importance of trading activities—within the same industry—relative to production activities. Evidence on extra-firm entrepreneurial activities by the owners of sample firms and their family members indicates that even newly established firms more often than not stayed within, or at least quite close to, the original firm's traditional realm of expertise. As a result, in contrast to the expected issue of unrelated diversification, the primary concern that emerges out of this research relates to the strategic inertia and path dependence of experienced entrepreneurs in the rapidly changing context of today's Vietnam.

For those firms that waver from their original business plan, the study identifies three main types of strategic adaptation: i.) moving location; ii.) moving up the value chain; and iii.) moving industries. It makes sense to consider the latter two of these three first, because they fit very closely with the main strategies identified in the "Top 200" research. As was the case for "Top 200" firms and the upgrading of core business activities, so movement into higher margin segments of the value chain is essentially a pure positive. Indeed, moving up the value chain was the strategy most clearly associated with better performance within the sample over the past decade.

Unlike the unrelated diversification activities that plagued the "Top 200", however, the movement of a few "Undersized Engine" firms into new industries appears to have been the result of reasonable long-term-oriented analysis of the best use of scarce firm resources. This divergence between the two reports relates to the differences in ownership and legal form of the two sets of firms the reports considered. "Top 200" firms were primarily state-owned and publically listed firms, whereas the firms studied in this report are 100% private and, in most cases, "family businesses".

The problem of excessive diversification seen in Cheshier and Penrose (2007) relates to the classic principle-agent problem of keeping the incentives of managers in line with the desires of ownership. In the case of state firms, there are likely managers looking to gain personal benefit from the plentiful resources at their control (Fforde 2007). For managers with such intentions, unrelated diversification activities would have the dual benefits of both short-term profit advantages and muddying the waters to make oversight by government bureaucrats more difficult. Given weaknesses in Vietnam's current corporate governance legislation, it is possible that similar dynamics may be at work in some publically listed firms as well (Nguyễn Đình Cung 2008; CIEM 2008; Harvard Vietnam Program 2008).

For most of the firms in the sample studied for this report, there is no analogous principle-agent problem. In nearly all cases, the original founder or their offspring hold majority stake in the company, and in most cases the remaining share are held by other family members. As a result, managers know that foolish, short-sighted use of scarce resources has direct personal consequences. If foreign partners proved uninterested in a collaborative relationship that allowed for movement up the value chain, an export-oriented manufacturer interested in passing a viable business down to their children was likely to look at the context of rising local factor prices and see two main viable options: moving industries or moving locations.

The strategic option of moving locations still faces many obstacles in Vietnam. First of all, it is easy to understand that family business owners will frequently prefer not to transplant their entire lives. More relevant to public policy makers, however, are the persistent and real differences in infrastructure and governance across localities that put the viability of such moves into question. Binh Duong has shown how an enlightened local approach to supporting entrepreneurship can go hand in hand with broadly lifting the living standards in a poor rural area. Binh Duong was the first province to introduce a one-stop shop for company registration and has consistently plowed extra tax revenues back into local investment in roads, bridges, and electricity. Additional policies supporting local business development included state investment into worker training and a "*dám noi, dám làm*" ("dare to speak, dare to act") campaign to increase the accountability of local officials (Malesky 2004). Yet, while improvements have clearly been made under the Enterprise Law, the case of Binh Duong still stands out as extraordinary (Dapice 2003).

So what does this all mean from a policy perspective? Certainly the relatively lower growth rates of export-oriented firms is not evidence against the export-oriented path that Vietnam has appropriately chosen. The fact is that world markets are highly competitive and, over time, margins in Vietnam will come down as competition continues to increase there as well. Increased competition will mean higher mortality rates for businesses, but it will also mean lower prices, better products, and increased productivity. The best thing government can do in this context is to soften the blow of failure—and thereby increase the potential for rebound—through provision of better and broader reaching public services. The above-mentioned, activist approach taken by Binh Duong, for example, is consistent with the type of government intervention that economists across the ideological spectrum can get behind and have keyed even superstar success stories like that of Silicon Valley (Saxenian 1994).

With regard to the author's perception of a need for greater strategic dynamism amongst leading entrepreneurs, there is probably not a great deal that government can do to have a direct impact. This will occur over time as entrepreneurs learn and as younger entrepreneurs with more experience in a market economy take the lead. But there are also indirect measures that would be positive. Continued progress in allowing major global buyers to easily set up shop and make connections with Vietnamese entrepreneurs will stimulate greater competition between buyers and allow entrepreneurs to avoid undue dependence on any one or two particular customers. And further steps to promote corporate governance and the rights of shareholders will encourage better informed strategic investors to play a greater role. Along these same lines, Vietnam could go further in enabling the fledgling private equity industry.

Overall, the experience over the past decade of Vietnam's "Undersized Engine" entrepreneurs is that major strategic change of any sort is difficult and is rare. This is true around the world and possibly no less so under the pressures of environmental change. For a large share of the sample, environmental changes have greatly challenged firms' overarching business model and, despite their success to date, the future looks very challenging. For a far smaller share, the decision to begin in the pre-Enterprise Law era with a focus on the particularly challenging arena of domestic markets has paid off enormously as the state has begun to retreat and domestic wealth has grown. This somewhat uninspiring path dependence is consistent with empirical research on both organizations and individuals. Noteworthy exceptions exist always and are very much present within the sample studied here, but it is hard to identify what enables these standouts to break the mould other than to proclaim them as possessing the intangible quality of exceptional entrepreneurial skill.

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