Chapter 1

Introduction

Introduction

International trade is a driving force governing the world economic growth. It has become an important component of a nation's economy. Since World War II, growth in international trade has exceeded world economic growth (Doz, 1987). From the mid-1950s, the growth in world trade significantly exceed the growth in world GNP (Porter, 1986b). Every nation's economy is interdependence with the economies of foreign nations by complex flows of goods, capital, technology, and enterprise (Root, 1994). Prior to 1981, world trade expansion enabled individual trading countries to economic prosperity, growth and stability. After the decline in international trade in 1981, the world economy went into recession (Rugman, Lecraw and Booth, 1985). All trading countries, individual firms and the people within these countries suffered the consequence. After the recession, years of above average expansion in international trade among East Asian countries brought forward economic prosperity and well being. By early 1990s, Hong Kong, the Republic of Korea, Singapore, and Taiwan moved from developing to newly industrialized economies (NIEs). The second-tier, Thailand, Malaysia, and Indonesia were following the NIEs in the transformation.

A declining growth in international trade in 1996 had major impact on the economic growth and stability of East Asian countries. A negative growth in Thailand's export contributed to loss of confidence by creditors and investors. Together with misallocation of investment, risky form of financing, excessive levels of debt to equity ratio, and continuation of current account deficit, Thailand's economy was in vulnerable position. By mid 1997, Thailand was unable to protect its currency against foreign attack and was forced into financial crisis and economic meltdown. The closely tied economic and trade integration caused the crisis to spread to neighboring countries. There were warning sign prior to the South East Asia crisis. The UNCTAD's 1996 Trade and development Report pointed out that the export expansion of Thailand, Malaysia, and Indonesia were not sustainable. The South East Asian countries' competitiveness laid in resource intensive and labor intensive industries. This competitiveness can easily be challenged and taken over by a lower production cost competitors. Inability to upgrading and enhancing their export products has put these countries in highly vulnerable position.

The depreciation in Thai baht had lower the export price of Thai products. Thai neighboring countries, exporting similar products were forced to devalue their currency to lower the export price in order to remain competitive. Currency devaluation put South East Asian countries in financial crisis and economic downturn. The South East Asian countries needed to reduce their trade deficit to minimize the balance of payments problems. There is a need for a reduction on imports. As Asian countries have a closely linked markets and economies, cuts in import of some countries affected the trade performance of the rest of the countries in the region. The declining economic condition, thus, spread through out East Asian. Asian held close to 30 percent of the total world trade. A sharp decline in demand from these countries caused a decrease in global demand. The diminishing purchasing power is having an impact on the rest of the world. It is the first time that a financial crisis in developing countries has a profound effect on industrialized countries (Yilmaz, 1998). Crisis started in Thailand spreads to East Asian countries and further spreads to other parts of the world causing a significant drop in global growth. Because all countries have become highly integrated and interdependence, crisis in one country can spread and have impact on the rest of the world. Declining world demand will have the reverse contagion effect that could lead the world into a recession.

Pattern, structure, and competition of international trade have become more complex and more volatile (Yoffie, and Gomes-Casseres 1994). The world is now experiencing the full extent of trade integration and economic interdependency. External factors have profound effect on individual countries. It is important for individual country to enlarge the benefits and lessen the costs of trade interdependency through rational policies. It becomes vital to understand and response constructively to changes in the world trade environment. A major determinant of a national economic performance is the ability of the nation to response to export opportunities (Rugman, Lecraw and Booth, 1985). While international commitment to a free market is benefit to the world economic system, each country must carefully laid out its international trade policies in order to maintain its economic stability and prosperity.

Statement of the Problem

Pressures of globalization have reflected in pressures to liberalization in trade, finance, and investment. It becomes increasingly difficult for an individual country to control, manage, and govern its economy. Free flow of foreign direct investment (FDI) and external debt financing, without effective prudential regulation and supervision of banking system, have made a country vulnerable to external forces (Yilmaz, 1998). From early 1990s, the investment bubble continues to grow. There have been increasing investment in non-productive sectors such as real estate, speculative equity and security markets, and non-competitive industries. Mismanagement of external debt has led to deterioration in external balance. Lacking of strong economic foundation, the country is left defenseless against external attack.

Export has become an important component of Thai economy. The proportion of export to the country's GDP has been higher than 30 percent since 1994 (Thailand Export Focus 1997, 1998). Loss in international competitiveness of Thai products reflected in negative growth in export in 1996. Optimistic analysts disregarded the alarming indication of serious fundamental economic problem as the effect of slow growth in world demand. Emergent problems of real estate price deflation, mismanagement of loans, and increasing non-performing loans lead to domestic financial crisis in Thailand. Domestic problems added to international trade problems, Thailand was forced into currency turmoil, payments difficulties, and external debt crisis.

There have been disagreements among economists as to the effective policies for the economic recovery. Questions arise whether the IMF's liberalized policy to overcome economic crisis is applicable to the Asian crisis. It seems that financial liberalization has proved to be ineffective in solving the crisis. The regional economic situation appears worsen. The expected V-shaped economic recovery seems farfetched. The question becomes whether the U-shaped recovery is possible. Krugman (1998) suggests the use of government temporary intervention on financial control against freely flow financial liberalization. More arguments are that financial intervention has negative effect on creditors and investors causing further financial difficulty. These above policies and arguments, however, rely on psychological effects to restore short run economic confidence.

In order to remain economic solvency, the problem of current account deficit required immediate attention. Earliest measure to rectify the current account balance is through import cuts. While import cuts can be used to overcome current account difficulty, it cannot restore economic wellbeing. The rooted fundamental problem has not been addressed. A long run solution lies in constructing a strong economic foundation. The country is required to build on sustainable export expansion. Exporting and international business activities are critical to the success of a country economy (Rugman and Hodgetts, 1995). To survive and success in increasingly high international competition, firms require to adopt more effective and efficient operational approaches (Welch and Luostarinen, 1988). With the dynamic changing of world trade, structure, pattern, and environment, Thailand has lost competitive advantage in products that previously brought about its economic prosperity. The country survival depends on enhancing and upgrading export products in order to secure its position in international market.

A country cannot excel in producing all products. It is important to select appropriate industries and build on these advantages to obtain sustainable competitive advantage. It is important to identify opportunities to develop a competitive advantage and then capitalize on those opportunities (Wortzel and Wortzel, 1991). The selection of appropriate industry has two essential considerations, first is the industry satisfy the international demand, and second is the ability of firms in the country to enhance and upgrade the industry. The choice becomes more difficult as the structure and the pattern of world demand changes over time. Drucker (1986) identifies changes in the world economy and points out the shift in economic dynamics from national economy to world economy. A country and companies within the country must be internationally competitive and base their objectives on exploiting the opportunities according to the changes in the world economy.

Yoffie and Gomes-Casseres (1994) observed and commented on various aspect of international trade. First, from late 1950s to 1975, the growth in international trade was at an average rate of 7 percent per annum. This figure exceeded the growth in the world GNP. Second, after 1975, the world trade fluctuated and the growth in international trade declined. In most years, the growth in international trade became lower than the growth in GNP. Third, the composition of trading products changed from raw materials and agricultural products to manufactured products. Forth, the geographic pattern of trade has been changing. Trade across the Pacific has exceeded trade across the Atlantic.

Thailand had long history of exporting agricultural produces. From 1940s to 1970s, rice had been Thai major export items. The 1970s were period of agricultural boom. Thailand enjoyed double digits growth in export. Early 1980s, prices and demand of agricultural produces fell, so did the Thai export growth. It became clear that in order to continue to be active in international trade, a country must make necessary adjustment so as to satisfy the changing world demand. As structure of world trade shift from raw agricultural products to manufacturing products (Drucker, 1986), Thailand made adjustment and followed the suit. Thailand export structure shifted to processed food, textiles and garments, electronics, jewelry, leather products, wood products, computer components, and auto parts. Most of these products were resource intensive or labor intensive in nature. The competitive advantage laid in abundant of resources and low cost of labor. These advantages were not sustainable and can easily be challenged by lower production cost countries.

Purpose of the Study

In the Seventh National Economic and Social Development Plan, the government acknowledged and supported five industries. These industries were food processing, textile, steel, petrochemical, and electronic. Major export industries have been food industry, machinery and mechanical appliances industry, electrical circuits and parts industry, electrical appliances industry, and textile and garment industry. Of all industries, food industry has the highest share at approximately 20 percent of the total export. Thailand is an agricultural country possessing fertile soil, adequate rainfall, and tropical climate. Over 60 percent of labor force have been in agriculture and agriculture related industry. According to the National Food Institute (NFI), there are more than 8,000 factories related to food processing in 1997. National Food Institute points out that Thailand is the major food exporter in Asia. Thailand is ranked among top exporters of the world in food commodities. Food industry, therefore, has favorable composition to expand and is seen as having potential to be developed.

Purpose of this study is to test theories on international competitiveness. The study aims to confirm that Thailand has the ability to develop, enhance, and upgrade its food industry so to obtain international competitiveness. The paper identifies weaknesses and strengths of the existing food industry. Weaknesses, strengths, opportunities, threats, and success factors differ from industry to industry and differ from one environment to another. According to Porter's Diamond Model, there are four determinant factors and two external variables governing the competitiveness of an industry in a country. These determinant factors are factor conditions, demand conditions, firm strategy, structure, and rivalry, and related and supporting industries. The two external variables are the role of chance and the role of government. Porter defines a country development into four stages of development. These stages are factor driven stage, investment driven stage, innovation driven stage, and wealth driven stage.

The study attempts to identify whether Porter's four determinant factors and two external variables are attributes governing the international competitiveness of Thai food industry. And to what extend does each of Porter's Diamond factors, factor conditions, demand conditions, firm strategy, structure, and rivalry, and related and supporting industries, contribute to the level of competitiveness of Thai food industry. Roles of Thai government in supporting its food industry are examined. Chance events effecting the competitive position of food industry are inspected. Suggestion and recommendation on the findings are offered to the business sectors, government, students, and researchers.

Objectives of the Study

Objectives of the study are:

1. To verify whether Porter Diamond Model can be used to explain export success of Thai food industry.
2. To identify the extent to which the attributes of Porter Diamond Model contribute to the level of export success of Thai food industry.
3. To identify other factors governing the export success for Thai food industry.
4. To suggest means to improve export performance for Thai food industry.

Rationale and Theoretical Framework

Aaby and Slater (1988) and Chetty and Hamilton (1992) review over one hundred studies on export performance and conclude that these studies found that there are relationships between export performance and three variables, firm's characteristics, firm's competencies, and firm's strategy. The three variables are variables internal to the firm. Porter (1990) defines competitiveness differently according to parties of interest. Firms define competitiveness as the ability to compete in world markets with a global strategy. Government defines competitiveness as a positive balance of trade.

Economists define competitiveness as a low unit cost of labor adjusted for exchange rates. Porter's competitiveness study selects and explores industries with large share of total exports. Viewing competitiveness in term of ability to compete internationally, competitiveness can be defined as ability to export which can be measured by export performance.

Porter's diamond framework illustrates correlation between international competitiveness and four attributes. The four attributes are attributes internal and attributes external to the firm. They are factor conditions, demand conditions, firm strategy, structure, and rivalry, and related and supporting industries. Porter's four attributes can be viewed as a detail expansion of the three variables internal to the firm, characteristics, competencies, and strategy with the addition of variables external to the firm, demand conditions, level of competition, and other factors and industries related to the industry being study. This study tests export performance through the four attributes of diamond framework.

While Porter describes diamond framework as applicable to national level of analysis, he admits that individual firms, not the industry or the nation, determine the level of competitiveness. Porter identifies competitive industries by the nation's companies that are internationally successful. Competitive firms in an industry of a country determine national's industry competitiveness. In order to test the diamond framework, information gained from firm level analysis must be used to identify and confirm the applicability of the framework.

Porter suggests that outward FDI is valuable in creating competitiveness, while inbound foreign investment is a drawback to the national competitive advantage. The remark is opposed by Safarian (1968), Rugman (1980), and Crookell (1990) where they agree that there are no different between performance level of foreign owned firms and domestically owned firms. Under trade and investment liberalization concept, all firms regardless of their ownership structures operating in a country enjoy same benefits and constraints under the same operational environment. Thailand's liberalization policy allows all firms operating in the country to compete on equal ground. It is assumed that there is no advantage created by different ownership structures.

Porter explained that nation develops along the four stages of development. These stages are factor driven stage, investment driven stage, innovation driven stage, and wealth driven stage. Porter suggests that it is crucial to identify the country's development stage and develop the country accordingly in order to develop its competitive advantage. Factor and investment driven stages are not sustainable competitive advantage. Therefore, the goal for companies is to reach the innovation stage. Most countries are in factor driven stage. Some countries can move to higher stages while others remain in factor driven stage. Within a country, the level of development of an industry is not necessarily being at the same level as other industries. Levels of development of firms in each industry are also varied. Therefore, in viewing development stage, it is more meaningful to describe industry development stage instead of national development stage.

The above rationales lead the study to base on 4 assumptions.

1. International competitiveness can be measured by export success.
2. Diamond framework is applicable at firm level analysis.
3. There is no different between performance of FDI, joint venture, and domestically own firms.
4. The development stages apply at industry level.

Definition of Terms

Operational definition of terms used in this study are defined as follows

International trade is term used to describe the exchange of goods and services with foreign countries.

Exports are goods and services produced in one country and send to another country.

Imports are goods and services produced in one country and bought in another country.

Competitive advantage is the product or market allocation decisions that generate economic rents. Kogut (1985) and Porter (1986b) defines competitive advantage as a function of either providing comparable buyer value to competitors but performing activities efficiently, or performing activities at comparable cost but in unique ways that create greater buyer value than competitors and command premium price. In short, firm with competitive advantage either can produce products at lower cost than its competitors' or can produce differentiated products to satisfy consumers' requirements.

International competitiveness is defined as firm's ability to develop and improve goods and services to compete in a foreign market better than other firms (Rugman and Hodgetts, 1995). It can be measured by the firm's ability to export its products.

Export Success is defined in term of export sales profitability, growth in export sales value, and proportion of export sales value to total sales value of the firm.

Basic factors are defined by the availability of raw material, quality of raw material, cost of raw material, availability of labor, quality of labor, and cost of labor.

Advanced factors are defined by the availability of competence employees, R&D and technician staff, human resource training, product development, production technology, and technology development.

Demand conditions are defined by the size of domestic market, the growth rate of domestic market, the sophistication of domestic demand, and the degree to which domestic demand internationalized.

Firm's structure and strategy are defined by organization structure, management commitment, sales plan, customer plan, customer relationship, prompt delivery, quality and quantity control, cost, and differentiated strategy.

Level of domestic competition is defined by the intensity of domestic competition.

Related and supporting industries are the degree to which these industries are competitive, and the degree to which they can support the need of food export industry.

Government roles are policies towards export promotion, R&D promotion, taxes, regulations, and education policies.

Roles of chance are uncontrollable events effecting the competitive position. These events are new inventions, new technological breakthroughs, new standard imposition, wars, natural disaster, oil shocks, change in exchange rates, and change in foreign importing rules and regulations.

Scope of the Study

Porter (1990) comments that nature and characteristics of one industry differ from another industries. The people within one nation differ from other nations in term of culture, beliefs, values, determinations, and management style. Environments under which firms or industries operate also differ from one country to the others. In order to determine success factors governing a nation's industry success, each attribute within an industry within a country must be studied and analyzed. To gain an insight understanding of an industry within a country, this research performs a detailed study to determine what are success factors of one selected industry in Thailand.

The study selects an industry with potential to success. Criterion for selection based on past export performance of the industry. With the long history of Thai agriculture success and good export performance of Thai food industry, this research studies food related exporting firms based in Thailand. Four attributes of diamond framework are tested for their contributions to the success of food export. The effect of chance events and the impact of government roles and policies on the success of food export are considered.