

SME Policy in Thailand: Vision and Challenges

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IPSR Publication No. 251
ISBN 974-664-457-2

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July 2000.*

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Cataloging-in Publication Data

Sevilla, Ramon C.

SME Policy in Thailand: Vision and Challenges/ Ramon C. Sevilla and
Kusol Soonthornthada

(Mahidol University. Institute for Population and Social Research
Publication; no. 251)

ISBN 974-664-457-2

I. Business enterprises- -Thailand- -Government policy. I. Kusol Soonthornthada.
II. Mahidol University. Institute for Population and Social Research. III. Title IV. Series

HD2346.T5 S511S

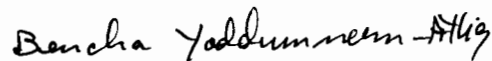
Published in 2000, 500 copies

Published by: Institute for Population and Social Research
Mahidol University, Salaya Campus
Nakhon Pathom 73170
Thailand
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Preface

As one of IPSR's main research areas, the study of "Small and Medium Enterprises" (SMEs) represents IPSR's commitment to address new issues that may ultimately have significance for population development. This preliminary study of Thailand's recent interest to support SMEs is a timely one now that the country is still groping for surefire solutions to revive its industrial sector after the financial crisis of 1997 and transform it to become more competitive in the international market.

In terms of numbers and employment generating potentials, SMEs represent the backbone of Thailand's industrial infrastructure. While the government is correct in giving this sector the attention it rightfully deserves, the SME policy at the moment still needs plenty of fine tuning to maximize overall benefits and contribute to industrial deepening. This is all the more cogent considering that the SME vision embodies an entirely new approach in Thailand's industrial strategies and therefore requires the creation of new institutional competencies. Moreover, the country cannot afford to spread its limited resources thinly over a wide range of sectors. Although this research is in the preliminary stage, we hope that the questions raised in this report will help inform the crucial debates that should follow between policy makers and stakeholders in order to make the SME policy more effective and responsive to the needs of these firms.



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Acknowledgements

This preliminary research would not have been made possible without the seed grant provided by the Institute for Population and Social Research (IPSR), Mahidol University and the wholehearted support of Associate Professor Dr. Bencha Yoddumnern-Attig, Director of IPSR. Many thanks goes to Ms. Chanphen Tanasuppakornkul, a doctoral student at IPSR who worked as research assistant, for arranging interviews, collecting background information and interpreting. The administrative support of Acharn Auraphan Hungchangsinh, Head of Administrative Office at IPSR and her staff greatly facilitated the logistical aspects of the fieldwork. We also thank the many resource persons and industry key informants who gave so generously of their time and confidence. Unfortunately, because of our assurances of confidentiality, they cannot be acknowledged individually. Last, but not least, our thanks goes to Dr. Alan Gray for his comments on our draft.

Abstract

The aim of this preliminary study is to develop a better understanding of the background and objectives of the recently formulated SME policy of the Thai government. A total of 27 respondents representing industry associations, government agencies and political parties were interviewed to obtain a sense of the “fit” between the proposed government policy and the actual situation on the ground. The research was approached from the point of view of assessing the relevance of applying the “industrial cluster” paradigm to SME development in the case of Bangkok. It is too early to tell whether the SME Promotion Law will prove successful since it was only approved by parliament last January 12, 2000 while the SME Master Development Plan was approved by the Cabinet last April 11, 2000. However, we identified important problematic issues in the SME promotion law in its present formulation that needs to be clarified and resolved. We conclude with a few tentative observations and recommendations for clarifying SME objectives and stress the need to encourage closer public-private coordination in SME policy formulation and implementation.

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I. Introduction:

We began this research with the intention of gaining a better understanding of the Thai government's interest in promoting the Small and Medium Enterprise (SME) sector after the calamitous financial crash of 1997. We envisioned starting with a preliminary inquiry into this topic to delineate the general background of policy formulation and identify the main problem areas affecting SMEs in order to get a sense of the "fit" between the proposed government policy direction on one hand, and the actual situation on the other. We were also interested in assessing whether the industrial cluster development model would have potential applicability for SME development in Thailand. After gaining a better understanding of the SME situation in Thailand, subsequent undertakings were planned to conduct more detailed case studies of one or two specific SME sectors. This would enable us to develop a deeper understanding of the restructuring process under the present economic crisis, its policy implications for industrial rejuvenation and sustainable competitiveness, and its impacts on job creation and workplace practices. The criteria for selecting sectors for the succeeding case studies include: first, indications of a willingness to cooperate in the detailed case study by industry representative interviewed; second, on the industry potential for employment creation; third, on the potential for strategic linkages to critical higher value added industries; and fourth, on the industry's promise for building sustainable collaborative relations among industry members.

This report covers the preliminary phase of our research.

II. Research Methodology:

The preliminary phase primarily involved an extensive reading of the theoretical literature related to SMEs and industrial clusters, and interviews of industry association and government agency representatives. We selected the industry representatives for the survey based on their SME industry sector's inclusion in the Ministry of Industry's Dept. of Industrial Promotion's (DIP) list of 13 sectors¹ for SME development.

Since we were unable to arrange interviews with representatives from all the top ten industry sectors in this list, we included an unrepresented sector which we thought had the potential for employment creation and indigenous

entrepreneurial innovation – the agricultural machinery and farm implements group which produce basic equipment for the local agricultural sector. We also included one service sector (tourism) SME representative since this particular sector is not included in the DIP list. The survey began in mid-April and ended in early October 1999. All together, twenty-seven (27) respondents coming from various government offices and a diverse range of industries were interviewed. The interviews relied on an open ended type of questionnaire that dealt with various aspects of industry structure (e.g. composition, firm linkages, business association practices and activities, international competition, etc), public-private sector relationships, and firm's views on government industrial policy on SMEs.

III. Research Questions:

The following questions guided the research during the preliminary phase:

- 1) Does a coherent vision and purpose buttress the new government policy?
 - a) What is the underlying logic for the selection of the targeted SME sectors for assistance and their ranking in priority? Are these sectors those that already have the greatest potential to become internationally competitive? Within the selected sectors, does the policy attempt to differentiate the strengths of various SMEs so that those who are less likely to adapt and therefore at most risk are given priority assistance? What about those sectors excluded from DIP's list?
 - b) Does Thai ownership of firms in this SME sectors matter?
- 2) Is the policy formulation so far supported by a consensus among the primary stakeholders themselves (the SMEs) in terms of general agreement as to the objectives and means, and therefore by a willingness of all parties to cooperate?
- 3) Broadly speaking, what are the main characteristics* in the industrial and organizational structure of the SME sector that have a bearing in inhibiting or enabling government support and collaboration? (*These include such aspects as composition, the structure of linkages, and spatial distribution of SMEs.)
 - a.) What is the role of business associations in creating a cooperative culture?

- b.) Is the notion of development based on “industrial clusters” relevant in the case of Bangkok?
- 4) What are the main limitations in government resources in implementing its policies of supporting SMEs?

IV. The Confusion in SME Definition:

The Ministry of Industry’s Dept. of Industrial Promotion (DIP) defines three different categories of SMEs:

1. Production Sector SMEs (includes agricultural processing, manufacturing, and mining).
2. Service Sector SMEs.
3. Trading Sector SMEs (includes wholesale and retail).

The production and service sectors SMEs are under the responsibility of the DIP while trading sector SMEs are under the responsibility of the Ministry of Commerce.

According to a report of Bangkok Bank, there were 311,518 SMEs in 1998 or 92 per cent of total enterprises. The majority of SMEs (43.1 per cent) are in the trading sector, while only 90,122 (28.9 per cent) belong to the production (manufacturing) sector. The remainder or 87,225 belong to the services sector (Table 1) (ISMED, 1999).

What is the definition of SMEs in Thailand? In the past, many authors have noted (Nattapong et al, 1994; Allal, 1999b) that there was no single definition of SMEs in Thailand. Various agencies used different criteria such as sales per annum, net fixed assets, number of employees and registered capital (Allal, 1999b). While the employment definitions for SMEs in Thailand have remained the same since the late 80s (i.e. fewer than 200 employees) the assets definition have been upgraded to reflect changing economic conditions. For example, Nattapong et al (1994) reported that the Industrial Finance Corporation of Thailand (IFCT) and the Small Industry Finance Office (SIFO) relied on the net fixed assets criterion. Small enterprises were defined as those having fixed assets less than 10 million baht (US\$0.39 million) and a medium enterprise as one having between 10 and 50 million baht (or US\$1.9 million) in the early 90s. Up until 1998, the DIP defined medium enterprises as having employment ranging from 50 to 200 and

invested capital from more than 10 million to 100 million Baht. On the other hand small enterprises were defined as having employment not exceeding 50 workers and having invested capital (equity) not exceeding 10 million baht (Manu, no date). These classifications have been used by the MoI based on an internal agreement concluded among its divisions on December 1987 (UNICO, 1995).

On December 8, 1998, an unofficial meeting was organized by the Ministry of Industry to review the definition of SMEs. It was attended by representatives from other Ministries, banks, agencies and departments, private sector and technical experts to arrived at a classification of enterprises based on the value of fixed assets (Allal, 1999b). The Cabinet approved the following definition on December 22, 1998 that uses the net fixed assets as the only classification criterion (Table 1). The DIP representative that we interviewed assured us that this definition is accepted by all other government offices. Although we have not confirmed the general awareness of this current classification by other government agencies, particularly those dealing in funding aspects, we are inclined to believe that other offices will comply since the MoI is the designated lead agency under the fourth program of the Industrial Restructuring Plan, "Incubation & Strengthening of Small and Medium Supporting Industries".

Table 1: Definition of SMEs by Total Assets Value: (Million Baht)

Sector	Medium	Small	Number	%
Production	Not more than 200	Not more than 50	90,122	28.9
Service Trading	Not more than 200	Not more than 50	87,225	28.0
			134,171	43.1
- Wholesale	Not more than 100	Not more than 50		
- Retail	Not more than 60	Not more than 30		
		Total	311,518*	100.0

Source: Allal (1999b)

* Total is for 1998. Source is from the Institute for Small and Medium Enterprises Development (ISMED, 1999) brochure which cited these numbers from a 1998 Bangkok Bank report.

How does this definition of SMEs in Thailand compare with other countries? As a comparison, Table 2 shows the definitions in other countries. In the European Union, the recently adopted standardised definition of SMEs which

is to be used for all cases where eligibility is to be assessed and programmes are to be targeted as follow:

Criteria for number of employees:

- Micro - fewer than 10
- Small - 10 - 50
- Medium - 50 - 250

The enterprises must also satisfy financial criteria, either in terms of its turnover or in terms of its balance sheet total. The amounts are specified and will be adjusted every four years to take account of changes in the economy (Ireland NCC, 1998).

Table 2: Summary of Main Definitions of SMEs in selected APEC Economies

Country	Sector	Employment	Other Measure
Australia	Manufacturing	Less than 100 employees	
	Services	Less than 20 employees	
Canada	Manufacturing	Less than 500 employees	
	Services	Less than 50 employees	
People's Republic of China	Varies with industry	Usually less than 100 employees	
Indonesia		Less than 100 employees	
Japan*	Manufacturing	Less than 300 employees	¥100 million assets
	Wholesaling	Less than 100 employees	¥30 million assets
	Retailing-Services	Less than 50 employees	¥10 million assets
Korea	Manufacturing	Less than 300 employees	
	Services	Less than 20 employees	
Malaysia	Varies (for SMI)	Less than 75 employees	Less than RM 2.5 million
		Different for Bumiputra enterprises	
Philippines		Less than 200 employees	P 40 million assets
Singapore	Manufacturing		less than S\$12 million fixed assets
	Services	Less than 100 employees	
Chinese Taipei	Manufacturing		less than NT\$ 40 million paid up capital and less than total assets of NT\$ 120 million
	Business, Transport, and other Services		sales of less than NT\$ 40 million
USA		Less than 500 employees	

Source: Hall (1995); for Japan* data, Witton (1999).

In the course of this research, we learned that obtaining precise data on actual numbers of SMEs are hard to come by. The study undertaken by UNICO (1995) for the MoI revealed the following numbers for Small and Medium Scale Industries (SMIs -manufacturing based SMEs) in 1991:

Table 3: Number of Companies (SMIs)

	By Employment		By Amount of Fixed Assets	
	Number	(%)	Number	Percent (%)
Small	51,393	91.0	51,232	90.7
Medium	3,725	6.5	4,322	7.6
Large	1,396	2.5	872	1.5
Unidentified			88	0.2
TOTAL	56,514	100.0	56,514	100.0

Source: UNICO (1995)

These numbers reflect those enterprises (production/manufacturing) that registered with the Center of Provincial Industrial Office of the MoI and exclude small rice milling companies. Thus, SMEs constituted about 98 per cent of the firms in the Thai manufacturing sector in 1991. This is the same proportion cited by Nattapong et al (1994) for 1990. In terms of geographical distribution, 45 per cent are located in the Bangkok Metropolitan Region, namely Bangkok, Samut Prakarn, Samut Sakhon, Pathum Thani, Nonthaburi, and Nakhon Pathom. By contrast, for large-scale companies, the proportion is estimated at about 60 per cent (UNICO, 1995).

In the summary data handout prepared for our interview with MoI Minister Suwat Liptapalop on June 8, 1999, we found another set of statistics based on registration data of enterprises from the Dept. of Industrial Works (DIW). This source estimated about 130,000 out of the 135,000 enterprises (or 96 per cent) fall in the Small and Medium Industries (SMI) category as redefined by the DIP (using fixed assets definition as in Table 1). The importance of these Small and Medium Industries (SMIs) is underscored by the following: they comprise 70 per cent of industrial employment, produce 50 per cent of exports and account for 60 per cent of value added for GDP. On the other hand, the estimated number of all other informal sector enterprises that have not registered with the DIW or the Dept. of Commercial Registration of the

Ministry of Commerce is around 800,000. Of these, 90 per cent are considered to be SMEs.

Finally, more specific numbers were obtained from a Bank of Thailand report on SMEs (Pongsanarakul & Chaisit, 1999:2) as follows (Table 4 and 5):

Table 4: Number of registered firms, Department of Industrial Works*, 1998

	Number	%	Investment (Baht Million)	%	Employment	%
SME**	124,771	97.9	1,218,856	52.0	1,605,815	50.4
Large	2,631	2.1	1,125,111	48.0	1,580,588	49.6
Total	127,402	100.0	2,343,967	100.0	3,186,403	100.0

* Data as of 11 February 1999.

** Note: SMEs defined as those with a labor force not exceeding 200.

Table 5: Proportion of SME by Products, Investment, and Employment 1998

	By Products (%)	By Investment (%)	By Employment (%)
Food & Beverage	42.2	12.0	14.2
Textile/Leather	4.2	5.5	15.7
Wood/Paper/Printing	9.3	8.8	13.0
Rubber/Chemical/Plastics	3.4	9.8	6.9
Ferrous/Non-Ferrous	12.4	13.7	14.8
Machinery & Accessories for transportation	15.8	14.1	15.5
Others	12.7	36.1	19.9
Total	100.0	100.0	100.0

V. Understanding the Logic for the Promotion and Development of Supporting Industries and SMEs.

There is little dispute that during the economic boom of the last decade, Thailand's industrialization benefited considerably from the globalization of capital. Currency appreciation of the Japanese Yen due to the 1985 Plaza Accord led to an outward search for Japanese investment expansion in East and Southeast Asia. Given the unstable political conditions of rival countries (e.g. China and the Philippines at this juncture and their lower infrastructure levels (e.g. Indonesia), Thailand was in the best position to offer itself as a low cost production base to foreign investors (Sato & Aoki, 1989).

Thailand's attractiveness to foreign direct investment led to rapid inflows of capital not only from Japan but also Taiwan, Hong Kong and later, Singapore in the late 80s and 90s (Daniere, 1991). This "golden age" (Olam, 1987) was not only the result of external conditions in the world economy but also to internal factors that derived from Thailand's economic development history (Dixon, 1996; Falkus, 1995). These internal factors include Thailand's relative political stability and a record of steady economic growth that resulted from prudent macroeconomic management which favored market oriented industrialization led by the private sector (Christensen et al, 1993; Dixon, 1995; Narongchai and Somsak, 1990). Although the majority of the foreign investments were concentrated in mature products following the "product-life cycle hypothesis"², there was nevertheless a rising export orientation in the production of Japanese companies in ASEAN in the 80s (Takeuchi, 1993). By contrast, investments during the 60s and 70s were primarily geared to gain access to domestic markets insulated by import substitution policies and natural resources (Takeuchi, 1993). The trend was first for exports to go to the traditional markets of Europe and the US, then, because of anti-dumping rulings and protectionism in western markets, to the Japanese home market. As incomes in Southeast Asian economies rose, exports shifted to increased intra-ASEAN regional sales as these economies developed from mainly serving as low cost production bases into major consumption markets (Iijima, 1993; 1995).

In this period of rapid inflows of foreign direct investment (FDI), the manufacturing sector was the main beneficiary, accounting for around 50 per cent during the period 1987-90 (Suphat, 1995). Those manufacturing sectors that benefited substantially were electrical appliance, textiles, chemical and

petroleum products, and transport-equipment industries. Such investments have to some extent contributed to the diversification of the country's industrial structure (Suphat, 1995).

One of the main contradictions of this export-oriented industrialization (EOI) growth model is its

“built in need for imported capital goods and technology for industrialization, and thus an imminent balance of payments problem created by the difficulty of earning sufficient foreign exchange to pay for these exports.”
(Bell, 1996:54)

It is precisely these large imports of machinery and intermediate products that is the root cause of the chronic current account deficit³. Chronic current account deficits have constrained not only Thailand but also most countries of the ASEAN that have single-mindedly pursued the EOI model (Watsaya, 1997). Watsaya (1997) points out that the sharp increase of Thailand's current account deficit as percentage of GDP from 5.6 per cent in 1994 to 8 per cent and 7.9 per cent in 1995 and 1996 respectively, was the basic factor that led to the speculative attack on the Thai baht in 1996. Investors perceived then that Thailand faced similar circumstances as Mexico did in 1994 when it devalued the peso.

The permanent balance of payments problem that stems from the current account deficit results in dependence on tourism and remittances from Thai workers overseas as ways to cut the deficit (Bell, 1996). However, the rapid increase in outbound tourism of newly affluent Thais during the boom negated the increase in foreign tourism receipts (Shearer, 1995). At the same time, only long-term solutions were possible to address the country's lack of a merchant marine fleet, which contributed to a large drain on the country's resources. Payment by Thai exporters to foreign shippers accounted for nearly half of the 1994 current account deficit (Shearer, 1995).

The problem of high import dependence in Thailand's industrialization drive takes on added significance when we consider Japan's role in Thailand's foreign trade. Not only is Japan the biggest source of imports, it is also the second biggest market for Thai exports after the U.S. This highly dependent trading relationship is demonstrated by Japan's disproportionate share in Thailand's trade deficit (82 per cent in 1993) (Shearer, 1994). This untenable

state of affairs prompted Prime Minister Chuan Leekpai to lead a six-day trade mission to Japan in late 1994 to push more agricultural exports and encourage greater Japanese investments in the production of components within Thailand (Shearer, 1994).

Given this background, the argument for fostering and strengthening supporting industries is a perfectly logical response to the need to correct and improve the country's trade balance by increasing domestic value added. At the same time it would serve as a means to strengthen the industrial structure as a whole (Mukoyama, 1993). Mukoyama (1993) defines supporting industries specifically as "an aggregate of industries that supply raw materials, parts and services needed for the productive activities of final goods industries, manufacturing machine industries and machine parts industries" (p.58).

Due to their specialized nature, most of supporting industries fall into the category of SMEs; however, not all SMEs are necessarily supporting industries. Some, like rural cottage industries engage in what may be termed as final production of the finished product using manual skills (e.g. brick making, pottery, ceramic handicrafts – such as stoneware mugs & earthen ware, silk weaving). There are also production type SMEs, i.e., SMEs not involved in component manufacture, but in semi-automated assembly of finished products as for example subcontracting establishments in the shoe industry, most segments of leather based products and jewelry.

An important feature in the development of Thailand's industrial structure that helps to explain government policy is the fact that while production diversified during the period of rapid industrial expansion, no significant industrial deepening occurred (Nattapong et al, 1994). In order to have a better grasp of the scope of SME development objectives we need to recognize two aspects in Thailand's industrial structure. Specifically, these are the high import dependency of the industrial sector – which refers to the absence of critical supporting industries, and weak inter- and intra-sectoral linkages (forward and backward integration). Weak inter-sectoral linkages imply either the absence or lack of development of efficient upstream industries both of which have tangible impacts on the competitiveness of downstream industries. On the other hand, weak intra-sectoral linkages imply limited development of subcontracting linkages either because of missing components (absence of critical supporting industries) in the commodity chain

(Gereffi & Korzeniewicz, 1994) or the lack of technological capabilities of existing supporting industries to produce price competitive and high quality products.

The sudden economic downturn came at a most inopportune time as the twin forces of liberalisation and globalisation were at full force in opening up local industries to unrelentingly fierce international competition. This has strongly underlined the formidable task for government to formulate viable strategies to promote and support its industries “in the context of competitive currents from which national governments are increasingly unable to shelter them” (Scott, 1996:406). As former competitive advantages based on cheap labor are rapidly eroded by the entry of new lower cost countries and as the need to break into ever more demanding⁴ export markets becomes even more urgent, existing industries must therefore upgrade or die. This requires not only the restructuring of large manufacturing industries but small and medium sized enterprises (SMEs) as well. These SMEs may or may not be integrated with the former but overall, they characterize the bulk of a country’s industrial structure (UNICO, 1995). Successful case studies of innovative sectors in many parts of the world that have continued to thrive during the crisis indicate that these consist of SMEs often found to cluster sectorally and geographically (Scott, 1996). It is precisely through clustering and networking that helped raise the competitiveness of these SMEs (Humphrey and Schmitz, 1995, Schmitz, 1995a).

One of the Ministry of Industry’s principal strategies in its Industrial Restructuring Plan is the “Program for Incubation and Strengthening of Small & Medium Supporting Industries (SMIs) 1998-2002” that aims to increase global competitiveness, industrial employment dispersion and reduction of industrial pollution (DIP, n.d.; Ministry of Industry, 1999). SMEs in Thailand represent up to 98 per cent of enterprises and account for nearly 75 per cent of all industrial jobs (Charudee and Yuwadee, 1998) and 50 per cent of the value of goods manufactured (Busaba, 1998a).

These views lead us to the conclusion that the basic principles underlying an industrial policy towards SMEs consist of: first, fostering the creation of new supporting industries (the missing links in the value chain) by attracting new investors or encouraging spin-offs; second, strengthening the capabilities of existing firms (*cf.* Meyer-Stamer, 1999b). Despite the seemingly straightforward implications of such policy objectives, there are potential

ambiguities in the details of implementation. Outcomes tend to be shaped by factors that derive primarily from the accumulated industrial structure and ownership patterns, the corresponding institutional configurations for mediating business and state interests, and competition among different sectors for limited state resources.

Although government attempts to promote the SME sector began over a decade ago, the proposed legislation failed to gain support from parliament (Busaba, 1998b). There are a number of reasons why these “long ignored SMEs find themselves in the political spotlight” all of a sudden after the crash of 1997. In order to develop a broader understanding of the background surrounding renewed attention on SMEs that coincided with the onset of the economic crisis, we need to depart from a purely economic logic and consider the larger political economic context of industrial policy formulation in Thailand. A reading of newspaper reports between 1997 and 1998 can help shed light on the political economy of forces and events that have shaped this renewed attention on SMEs.

Part of the rationale is the collapse of the big industries during the economic crisis (Wichit, 1998a). Logically therefore, attention has shifted to the smaller and medium enterprises (SMEs) whose contribution to the economy cannot be ignored and who are in danger of going under as a result of financial stress and fall in demand. SMEs account for more than half of the nation’s GDP and more than 75 per cent of jobs in the real sector⁵ (Busaba, 1998). The real sector is the most important sector in the economy, providing the most employment, income generation and is therefore considered the most important determinant of economic prosperity in the long run (Chet, 1998).

A second reason relates to the political fortunes of various parties whose fate ultimately depends on the large constituency of voters associated with SMEs. A survey commissioned by the DIP revealed that most SMEs are located in Bangkok and the central region (Pichaya, 1997). For this reason, employment in SMEs represent a potentially significant voting block of urban and middle class residents that political parties can ill afford to ignore, especially if the fallout from the economic crisis spreads and beleaguers a large number of SMEs that cannot make a transition to exports (The Nation, 1998b). The chairman of the Federation of Thai Industries warned in early 1998 that more than 3 million people working in SMEs were in danger of

losing their jobs if the government and banks could not find ways to relieve the debt burden of these enterprises (The Nation, 1998a). For this reason, political parties such as the Democrats, Chart Pattana and Thai Rak Thai have competed to articulate policies to assist SMEs. In particular, the Thai Rak Thai party representing itself as a champion for urban middle class voters (Sopon, 1998) has been promoting SMEs as its main theme for the general election (Soonruth, 1998). It has maintained an attractive Internet web site specifically for SMEs.

There is a third possible reason, one that originates from the massive inflow of Japanese investment during Thailand's economic boom. The relocation of many major Japanese manufacturing companies and Japanese supporting industries have created a cluster of industries that, through the years, produced a growing (though still limited) complex of linkages and complementarities. It therefore makes business sense for the Japanese to protect their investments in Thailand and enhance its prospects for long term competitiveness. In conjunction with regional market segmentation strategies of Japanese firms, the development of domestic supporting industries helps promote the competitiveness of Japanese products by lowering the cost of inputs. At the same time, this helps to improve trade balance, increase domestic value added, and promote regional development (Mukoyama, 1993), while promoting the image of Japanese investment in the host country. It is perhaps for this reason that in the early 1990s, with the Japanese dominated industrial complexes growing in size particularly in Thailand and Malaysia, the Japanese government began to provide support for the development of supporting industries in ASEAN countries as part of the "New Asian Industrial Development Plan" (Mukoyama, 1993).

However, it is implicit that the "supporting industries that are most needed today" refer to modern subcontract small and medium industries which supply parts and materials to large factories and companies in such representative sectors as processed food, textile goods, electric and electronic parts, auto parts and metal processing industries (Mukoyama, 1993:65). Moreover, it is understood that in order for these local SMEs to upgrade their technological standards, they would have to cooperate or enter joint ventures with foreign (i.e., Japanese) owned SMEs. Where local counterparts are non-existent local counterparts, incentives will be provided for foreign SMEs to invest in the country (Takeuchi, 1993). Thus, there is strong suggestion to conclude that from the very beginning, Japanese interest and support

(euphemistically called “economic cooperation” Mukoyama, 1993:72) for SME policy in Thailand were specifically related to manufacturing sectors that Japanese investment is concentrated or where there is a potentially big market for Japanese machinery suppliers⁶. This signifies a potentially strong bias in the overall direction of SME sectoral prioritization guided by a rationality that favors particular sectors over others.

The backlash of the economic downturn in the Thai economy has spread far and wide and has come around to intensify the economic problems faced by its major investment patron, Japan. In response to the regional crisis, the Japanese adopted the burden of responsibility for restarting the growth engines of the battered Southeast Asian economies. Given the continued restructuring of the Japanese economy (i.e., the relocation of industries to lower cost production sites) and the momentum of accumulated experience gained in local production process, barring any major political disturbance in Thailand, the Japanese are unlikely to abandon the extensive industrial infrastructure developed by its companies in Thailand prior to and during the boom era (Sukanya, 1997; Woo, 1997). The \$30 billion Miyazawa bailout fund that Japan has committed to assist the economic recovery of the region injected new capital to revive failing productive sectors that once drove the export-led growth of the region. Thailand has welcomed this new loan money to help Thai SMEs and improve the enduringly laggard education sector without which no significant upgrading can occur in the industrial restructuring process. In 1998, Thailand is reported to have applied for \$2.25 billion from the Miyazawa fund (Nophakhun, 1998). In doing so, Thailand immediately earned the praise of the Japanese ambassador, Hiroshi Ota who endorsed the idea that SMEs are the most appropriate sector to benefit from the Japanese \$30 billion regional recovery programme (Parista, 1998).

Another powerful influence in shaping Thailand’s SME policy is the World Bank, which specifically includes this sector under its private sector promotional program around the world (World Bank, n.d.). In a seminar to discuss the initial framework of the SME Development Master Plan held in August 1999 a World Bank study was presented that outlined six ultimate targets and three basic strategies⁷ that the Government should aim to attain and implement to assist SMEs (Nation, 1999). Not to be forgotten is the ADB whose total loan of \$1.2 billion for a 5-year industrial restructuring programme in Thailand will have its first instalment directed to SMEs (Watcharapong and Nophakhun, 1998). Half of this loan is intended to ease

the liquidity of Thai industries while the other half will be used to restructure industries to increase their competitiveness (Nitsara and Watcharapong, 1997).

These seemingly unconnected events leading to this new policy direction has set in motion a number of measures. First and foremost, a new SME legislation proposed by the Ministry of Industry which was endorsed by the Cabinet in late December 1998. (Wichit, 1998b). The draft SME Promotion Bill was eventually approved by Parliament on January 12, 2000⁸. Among the various promotional measures envisaged, the law intends to offer tax and interest incentives to qualifying SMEs (Watcharapong and Nophakhun, 1998). New financial mechanisms that will provide new funding sources are also planned, such as the new trading board⁹ that was established in early 1999 by the Stock Exchange of Thailand that will list SMEs (Nuntawan, 1998). On April 11, 2000, the Cabinet approved the master plan to develop SMEs as proposed by the Industry Ministry (Nation, 2000). The master plan covers the direction and concept of SME development in the industrial sector, the strategy and extent of SME development and the mechanics of implementation (Nation, 2000).

While this new policy direction is important, there are those who think that it maybe too late for those SMEs facing a heavy debt load (Sopon, 1998) particularly since the distributing mechanism for new loans takes time to arrange. In fact, according to the chairman of the Federation of Thai Industries, twelve thousand SMEs shut down in 1998, many involved in manufacturing (Nareerat, 1999). The burden faced by SMEs was emphasized by the deputy finance minister who revealed that SMEs accounted for up to 90 per cent of all bank non-performing loans (on a borrower basis) in 1999 (Cholada, 1999). SMEs were also hit harder by the economic downturn compared to larger firms¹⁰ (Amin, 1999). If this had been the situation two years after the onset of the economic downturn, surely whatever emergency loan disbursements may have been available could not have reached firms in need most of urgent financial relief. Moreover, many SMEs may not have qualified for these loans (Sopon, 1998). These include especially those in the low value added sectors that use technologically unsophisticated production methods and microenterprises who are not considered commercially attractive borrowers by financial institutions (Finnegan, 1999).

VI. Cautionary remarks on the present direction of the government's SME policy.

The Dept. of Industrial Promotion has selected the following industrial sectors and grouped them "by importance and urgency for SME Development".

SME development is of utmost importance and urgency.

sector 01	Food & Animal Feeds
sector 02	Textile & Garments
sector 07	Plastic Products
sector 09	Electrical & Electronic Appliance
sector 10	Auto & Autoparts

SME development is of moderate importance. Some schemes/projects should be undertaken.

sector 03	Leather Products & Footwear
sector 04	Wood Products & Furniture
sector 06	Rubber & Rubber Products
sector 08	Ceramics & Glass
sector 11	Gems & Jewelry

SME development is not of immediate urgency, but some SME promotion activities should be initiated.

sector 05	Chemicals & Pharmaceuticals
sector 12	Iron & Steel
sector 13	Petrochemicals

Source: (URL) <http://www.dip.go.th/dip97/ssme1.htm>

Based on the assessment of our preliminary research, we express some cautionary remarks on the present direction of the government's SME policy. We hope these comments will contribute to the debate that helps refine the policy towards more focused, realistic and achievable ends. These comments address in particular the implications of the SME sectors selected in the development plan.

- 1) There is a tendency to select or target SME sectors that have recorded high export growth in the past. All the top ten sectors ranked in the list of the country's top ten export earners in recent years. These sectors

tend to have the most relatively developed industrial infrastructure, having attained the minimum scale economies from supplying the domestic market and developed in varying degrees of density a network of producers. An example would be those industries that grew out of the import substitution phase to exports such as textiles that produce a whole range of products for the low to high end export markets.

- 2) It is noteworthy too that among the top 10, there is a finer division between the “group for urgent development” and the “group where development is of moderate importance”. The division may be related not only with the relative ranking in the competitiveness potential, but as in the case of the gems and jewelry sector, the relative degree of institutional development within the sector that gives it voice and collective bargaining strength in its dealings with the government and foreign buyers. This may imply that these two divisions tend to have established stronger institutional bases for promoting their collective interests and creating varying degrees of collective efficiency (Schmitz, 1995a).
- 3) Not only do these top ten sectors have a record of high export growth; they also tend to produce higher value added products, such as electrical appliances, electronics, and computer parts. These would imply that enterprises included in these sectors incorporate a relatively much higher level of technology in their production process.
- 4) Following the above, the selected sectors suggest a bias towards small and medium enterprises that are not only in the formal (modern) sector but are also those primarily engaged in manufacturing – that is, **SMIs (Small and Medium Industries)**. Thus, although the SME classification includes Trading and Service sectors, they do not appear in the 13 target sectors. This reflects the general orientation of the MoI whose business development services clientele have been mostly enterprises belonging to the formal sector and those duly registered with the relevant authorities (Allal, 1999a). Maitree (1999) notes that studies and surveys commissioned by the government that have focused on the nature and problems of SMEs have been mostly directed towards SMIs. It is therefore important to bear in mind the significance of this limited focus for the outreach of the Ministry of Industry’s. According to Allal (1999a) this would represent approximately only 3 to 4 percent of all

enterprises in the production sector. If enterprises in the trade and services sectors are included, the percentage of enterprises serviced by the ministry may be lower than 1 percent (Allal, 1999a).

- 4a) We have not found a clear explanation as to why sectors 05, 12, and 13 (the last division) would be included as SME sectors when these sectors are most likely to consist of large firms.
- 4b) A large missing component in these target sectors consists not only the unrepresented trade and service sectors but also what are called micro-enterprises (subsumed under “small enterprises”) and those in the informal sector. A recent ILO report on Micro and Small Enterprises in Thailand emphatically calls attention to the significant number of smaller enterprises which do not fit into the conventional enterprise support program of the government (Maitree, 1999). A micro-enterprise is defined as having less than 10 workers while small enterprises are those that have between 10 and 50 workers (Maitree, 1999). A medium sized enterprise by contrast are those which have between 50 and 200 workers (Witoon, 1999).
- 4c) The bias against these micro-enterprises is shown by the fact that MoI statistics (of registered firms) do not separate enterprises with 5 or fewer workers and registered capital between 1 and 10 million baht. Consequently, it is difficult to distinguish micro from small and small from medium (Allal, 1999b). The 1996 NSO listing of industrial and business establishments show that 74.7 per cent of establishments have 1-4 workers, followed by 22.5 per cent for enterprises with 5-49 workers (Allal, 1999b). As mentioned previously, the absence of a clear focus that distinguishes micro and small enterprises is indicative of the clientele orientation of most organisations within the MoI which Allal (1999a) points out is made up of formal, small and medium-sized enterprises with the average size of the small enterprises probably closer to the upper limit of 49 workers than the lower limit of 5.
- 4d) Similarly, White (1999) noted that 77.2 per cent of BMA registered businesses in 1996 employed fewer than ten workers.

According to White (1999), these micro and small enterprises contribute to national development goals not just in terms of its aggregate size but also in job creation (particularly self-employment); services (e.g., catering, repairs, transportation); products (e.g., garments, food, handicrafts); mobilisation of savings and internal financial resources for productive enterprise activities, and the start of a development path towards “larger” SMEs.

- 4e) Informal sector enterprises are those which are not formally registered with any public authority. They are made up mostly of microenterprises of 1-4 workers (Allal, 1999b). Allal (1999b) notes the significance of the informal sector as shown by NSO statistics which clearly show its importance both in terms of the number of enterprises with a 51 per cent contribution to employment in the manufacturing, trade and services sectors. Furthermore, Allal (1999b) cites the 1997 NSO statistics on industrial and business establishments that employment generated by the informal sector in the manufacturing, trade and service sectors is approximately 3.5 times that generated by the formal sector – with a higher representation of women employed in the informal than formal sector. Thus, a major segment of enterprises – those belonging to the Micro and Informal sector that generate a large proportion of all existing and new jobs **are not** included in the target sectors for SME development.
- 4f) Finally, given the selection of targeted sectors, it raises the question about how many of the firms in these sectors are presently and expected to emerge in the rural areas. This is a particularly important issue since the industrial restructuring plan has a very explicit spatial component in its framework when it includes a “program for dispersion and relocation of labor-intensive and low polluting industries to the regional and rural areas to support job distribution and income generation” (Ministry of Industry, 1999:44). This objective echoes the strategies laid out in the Seventh National Plan which advocates the encouragement of rural industries and rural entrepreneurs (Manu, n.d.). There is some evidence to suggest that many of the SMEs in the rural areas or even in regional centers outside the Bangkok

Metropolitan area are less likely to have formed significant links (if at all) with large firms or foreign affiliates since they serve primarily local markets (e.g. metal works, machine shops) or are direct exporters (e.g. food processing) (Chirawatana, 1999; Pranee, 1999). As such, they are outside the ambit of the SME development plan in its present formulation.

- 5) The selective focus of this program – export oriented SMIs (manufacturing based SMEs) - raises a number of specific issues regarding the limitations of the policy direction, particularly in assisting domestic market oriented SMEs meet the challenges of structural adjustment.
 - 5a) First, the inherent capital intensiveness and relatively advanced technology required in the targeted sectors would inevitably lead to technology and marketing channel dependencies with multinational or foreign companies. There is little in the way of existing industrial policy plans to suggest that a system of indigenous innovation will be stimulated (Freeman, 1995) or coordinated “systematically” (Lall and Teubal, 1998). Rather, the objective of developing industries that are more competitive seems to entail local industries merely becoming adept at mastering efficient production processes that are tailored to local conditions. One questions whether such a structure of linkages that could very well become the foundation for SME promotion will enable the country to proceed beyond the “ersatz” capitalism that Kunitz (1988) wrote so critically about in his analysis of Southeast Asian industrialization. Even if Thailand were to eventually internalize (i.e., localize) a majority of the components that go into a product, the cost of capital goods (machinery) and other attendant costs (like technology licenses, royalties) may still continue to exert a significant burden to the balance of payments problem. It is clear from this example that as a country “plugs in” to the circuits of global production without a significant scientific and technological base old problems of technological dependence are intensified as the increasing technological complexity embodied in machines widens the gap between a mere user and producer of technology. As such, good intentioned visions such as those enunciated in Thailand’s Master Plan for Industrial Development

for 2012 which calls for identifying “new comparative advantages which may be in the area of **low-import export industries**, high-tech and high value added products” (Manu, no date. Emphasis added), cannot but appear contradictory.

- 5b) Second, attendant to the very nature of this type of industrialization that relies on imported western technology, the policy as it stands right now appears to be indifferent to issues of ownership. We were unable to obtain a clear answer to our question regarding the thinking underlying the policy for SME development – whether it differentiates SMEs by firm ownership: 100 per cent Thai owned, those under varying proportions of joint-venture, and those SMEs (predominantly SMIs) completely owned by foreign capital. Without these distinctions, the policy may end up retarding local entrepreneurship and indigenous technological development as firms promoted may end up being those precisely which are partly or wholly owned by foreign investors. Although data is not available, we surmise that a closer examination of the top 10 SME sectors would reveal that these are the sectors where joint ventures and sole foreign ownership may be consistently higher than in unrepresented sectors. For partly owned enterprises whose business strategies are largely determined by global strategies of the parent company, Thai workers may indeed over time improve in making effective and efficient use of process technologies resulting in positive spillovers via the labor market. However, this will slow the trend towards localization of machine production, and, especially when such manufacturing stages are not relocated in the locality, the acquisition of higher skills in design and R&D.
- 5c) Third, the global strategic concerns of multinationals (MNCs) in terms of firm location, regional complementation, and market segmentation who are part owners of these SMIs may dictate the local business strategy of local partner firms and its relative position in the value chain. MNC or foreign partners’ presence in key sectors in turn may inordinately influence industrial policies to favor one sector over others, while also exerting continuous pressure on the part of the government to maintain

and renew conditions for profitable accumulation. This translates into a strong lobby for major investments to upgrade or build new infrastructure (e.g., communications, transportation, environmental management) and social capital (e.g., education, labor compromise) which tend to reinforce the strong urban bias in development policy to the detriment of the agricultural sector and rural areas.

- 5d) Fourth, while these selected industries are representative of those that may hold the best promise for achieving the capabilities required for global competition and market liberalization, we do not know what is going to happen to sectors producing for the domestic mass consumer market. Where will they fit in the whole scheme of things?

VII. What is the primary requirement to launch the government's program to promote SMEs?

The key to starting off the government's SME policy is the approval of the Draft SME Promotion Bill proposed by the MoI by the Parliament before the current session closes. This bill was approved in principle by the Cabinet on December 22, 1998. The urgency of passing this bill is underpinned by the underlying principle that requires the formation of an *SME Promotion Committee* to set things going. This high-level committee will be the central policy making body that will be responsible for SME development. The Committee will be chaired by the Prime Minister with the Minister of Industry as co-chairman and the Ministers of Commerce, Agriculture and Finance as members. Other membership includes representatives of specialized agencies and the private sector.

On the other hand, implementation will be under the responsibility of a "special executive agency" the *SME Promotion Office*, a semi-autonomous governmental agency. Its responsibilities would include, among others, recommending a definition of SMEs and target groups for promotion to the Committee, coordinating the formulation of an SME Promotion Action Plan, preparing the SME Status Report, managing an SME Promotion Fund and act as the Secretariat to the SME Promotion Committee. The Office would be empowered to carry out lending, make investments, hold shares, and

provide financial assistance to SME promotion agencies. It is not clear whether the Office will also make loans directly to SMEs (Allal, 1999a).

Thus, the SME Promotion Office will be responsible for refining the definition of SMEs and elaborating the details of the policy for SME promotion as well as formulating the plan of action for its implementation. In essence then, the SME Promotion Office will elaborate the SME vision now spelled out by the Dept. of Industrial Promotion, integrate the contributions from different organizations and the private sector represented in the SME Promotion Committee, and then present these detailed plans to the SME Promotion Committee.

In addition to the creation of the policy committee, the SME Promotion Bill also specifies these additional mechanisms: (MOI, 1999:64)

- A system and legal accountability for the compilation and dissemination of information, planning (at both conceptual and operational levels), monitoring and evaluation.
- An SME Promotion Fund to support implementation of SME assistance programs by public and private-sector organizations, with sufficient flexibility to ensure timely action and extensive reach towards target SMEs.
- Mechanisms for provision of incentives and privileges to SMEs, with appropriate terms and conditions, together with mechanisms to prevent misuse of such privileges.

The SME Promotion Action Plan as stated in the bill is comprehensive in its coverage of the different areas or measures that need to be planned:

Source: (URL) <http://www.dip.go.th/dip97/ssme.htm>

- (1) Financial support and assistance to SMEs.
- (2) Establishment / development of capital market for SMEs.
- (3) Development of entrepreneurs and SMEs personnel.
- (4) Research, development and dissemination of modern technologies appropriate for SMEs, including adaptation to local / traditional know-how.
- (5) Product development and product quality standard upgrading.
- (6) Market promotion and marketing support; domestic and global market expansion; promotion of product image; product design development; packaging.

- (7) Development of modern management practices, with emphasis on efficiency and transparency.
- (8) Informational support; promotion of the use of information technology.
- (9) Promotion of linkages between SMEs and LEs.
- (10) Promotion of association among SMEs for mutual assistance and joint business undertakings.
- (11) Development of regional / rural / community-based SMEs.
- (12) Promotion and strengthening of private sector organizations whose functions relate to the promotion and support of SMEs.
- (13) Infrastructure for investment of SMEs.
- (14) Incentives for promotion and redressing inherent disadvantage of SMEs.
- (15) Promotion and technical support for energy and environmental conservation, and hygiene.
- (16) Amendment of legislations and regulations which are obstacles or cost-burdens to SMEs.
- (17) Promotion and support regarding intellectual property rights.
- (18) Other promotional measures to encourage new SME establishments, to assist in the survival of existing SMEs and promote their growth and competitiveness.

Although the SME Law was finally approved by parliament only last January 12, 2000 and the SME Master Plan approved by the Cabinet on April 11, 2000, it is still too early to discern the outlines of any definite or concrete government plan nor a clear idea of the future structure and functions of Dept of Industrial Promotion (which acts on behalf of the SME Promotion Office in the interim period) and those of the proposed new bodies (Allal, 1999a). However, there are some general pronouncements that give us some insights of future policy directions, as in the document prepared by the Director General of the Dept of Industrial Promotion, Manu Leopaiprote, "Promotion of SMEs in Thailand" available at the DIP web site: URL: <http://www.dip.go.th/dip97/ssme2.htm>

1. Reduction of Government's role in providing direct assistance to SMEs. The role of government should be limited as facilitating the delivery of services by others, promoting networking of service providers and help coordinate the network's activities. Furthermore, decision making should be decentralized to local governments.

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2. Private sector empowerment. The private sector should take over some functions of the state, to be a sources of specialized services and regulate its own rank.

Allal (1999a) has commented positively to these views since they converge with those advocated internationally by the majority of SME development specialists in recent years.

A close reading of the “Strategies for Incubation & Strengthening of Small & Medium-scale Industries under the 5-Year Industrial Restructuring Plan 1998-2002 (DIP web site: URL: <http://www.dip.go.th/dip97/ssme1.htm>) shows the key elements grouped under six sub-headings:

1. Alert SMEs to changes
2. Support Industry Associations and Business Linkages
3. Provide Incentives and Source of Funds
4. Improve Efficiency of Small Industry Financing Institutions
5. Provide Technical Assistance
6. Develop and Strengthen the Roles of Public Organizations and SME Development Agencies

If the trends in policy formulation expounded by DIP’s Director General are applied, then the above six strategy areas would have to be accomplished through close public-private consultations, monitoring, sponsorship and advocacy. All of these point to the necessity of supporting bottom-up¹¹ rather than top-down approaches if the private sector is to be empowered. UNIDO’s involvement in cluster/network-related projects in eleven countries follows the spirit of this principle by its emphasis on the promotion of efficient relations between enterprises and between enterprises and institutions in order that enterprises overcome their isolation and reach new competitive advantages beyond the reach of individual small enterprises. UNIDO’s programme also emphasizes the development of local institutions to act as facilitators of the networking process, or as “system integrators” (Ceglie and Dini, 1999). Achievement of such kinds of joint public-private cooperation may lead to the development and realization in Thailand of what Meyer-Stammer (1998) the “systemic competitiveness” paradigm. It is incumbent upon us to examine the experience of other countries that have followed alternative paths in industrial organization that enabled their economies to achieve competitiveness in the niche markets of the global economy.

The main theme in the brief literature survey below indicates that the linchpin of successful industrial development in countries with a high level of global competitiveness relates to the way their industries are organized and the presence of cooperative institutional arrangements that enhance economic performance. It is in these areas that we need to elaborate further by examining the notion of industrial clusters (and its concomitant facet of business associations) and assess whether such a concept can be of relevance in the case of Thailand.

VIII. A Brief Literature Review of Industrial Clusters/Industrial Districts

While Thailand achieved remarkable growth¹² in its industrial sector during the rapid expansion of the economy in the late 80s and 90s, the financial crash of 1997 (Siamwalla & Sobchokchai, 1998) and the lingering economic slowdown has caused a serious reexamination of the country's industrial development plans. The crisis has made it painfully clear that Thailand's industrialization has reached a watershed – a fact heightened by the inability of the industrial sector to restart the economy on the firm road to recovery combined with the rapidly approaching deadline for full trade liberalization under AFTA's timetable. Policy makers realize that Thailand at this crucial juncture can no longer rely on cheap labor producing simple mass produced products that primarily compete on price since this advantage has long been lost to other lower cost producing countries. Instead, Thailand must squarely face new realities that require the development of new comparative advantages for sustainable industrial development through a process of industrial upgrading that will improve productivity and competitiveness. In so doing, it will enable its industries to produce more high value added; specialized products for increasingly differentiated export niche markets. This has been the main impulse for the Ministry of Interior's formulation of the National Industrial Restructuring Plan in 1998, which runs to 2002.

As seen previously, SMEs constitute an important component in the industrial restructuring plans which aim to promote industrial deepening of Thai industry through expansion of the supporting industry network and institutions.

The emphasis on expansion of interfirm linkages resonate the successful experiences of European small-firm industrial districts which have taken the “high road” to achieving international competitiveness while maintaining good working conditions and employment standards (Sengenberger & Pyke, 1991). Piore and Sabel (1984) argued that the “industrial district” model consisting of geographically and sectorally concentrated networks of small and medium sized enterprises brought about an alternative to the established but failing large-firm Fordist model of industrial production. Porter (1990) lent credence to this notion by recognizing that clustering is an important feature in dynamic industrial development.

The so called “high-road” approach to competitiveness of these small and medium sized firms is essentially achieved through innovation, adoption of new technologies, development of new or better products, and speedy reaction to market changes. These are in stark contrast to the “low road” path of competition based primarily on low wages and disregard of labor standards (Schmitz & Muscyk, 1994). Schmitz (1995a) identified the main attributes of industrial districts as follows:

- geographical proximity
- sectoral specialization
- predominance of small and medium firms
- close interfirm collaboration
- interfirm competition based on innovation rather than lowering wages
- a socio-cultural identity that facilitates trust relations between firms and between employers and skilled workers
- active self-help organizations
- supportive regional and municipal government.

In essence, the message driven by the success stories in Europe is that globalization and localization are parallel and mutually reinforcing processes. Firms that do better in a globalized market are rooted in well-established networks of supporting firms and institutions (Meyer-Stamer, 1999a). There are however a number of caveats in the policy implications of the transferability of European cases to other settings. According to Schmitz & Muscyk (1994), first, none of the industrial districts came about as a result of planned action that originated from a local or regional industrial strategy¹³. All the successful European cases trace their origins to spontaneous development. A second policy implication from the European experience admonishes that governments or government-sponsored institutions cannot

create an industrial organization that competes on the basis of collective efficiency. Instead, once private initiative has achieved a minimum concentration¹⁴ of industrial activity and expertise, public agencies can play an important supporting role in enhancing industry's ability to innovate and expand. Thus, Schmitz & Muscyk (1994) suggest that the timing of potential institutional interventions must take into consideration the needs of different stages of cluster development¹⁵. Finally, the transferability of the industrial district experience is very limited where small industry has to be built up from scratch. The European experience has greater relevance to those institutions that seek to foster industrialization in areas, which have already achieved the minimum thresholds and critical duration of local small industry.

The cautionary comments cited above on the transferability of the industrial district model to other countries focus our attention to one of the basic preconditions for an industrial district – the clustering together of firms. This can serve as a starting point for considering whether clustering is of relevance to the organization of manufacturing in developing countries (Humphrey & Schmitz, 1996). While Humphrey and Schmitz (1996) concluded that clustering is common in a wide range of developing countries and sectors, they note an enormous diversity in terms of their specialization; interfirm division of labor, institutional support and export penetration. In many developing countries, while traces of clustering can be observed, the most common type of manufacturing clusters are embryonic or petty-commodity clusters (Knorringa & Meyer-Stamer, 1998). These are clusters that passively reap the benefits of incidental external economies arising from agglomeration (Schmitz, 1995a) as in the case of “survival” (or stagnating) clusters (Altenburg & Meyer-Stamer, 1999; Knorringa & Meyer-Stamer, 1998). These types of clusters are based on horizontal specialization, i.e., firms that make the same type of products or the “lonely,” non-integrated, non-networked firms¹⁶ of Poon (1990). They are not based on interfirm division of labour within the commodity chain that is at the heart of the industrial district model (Knorringa & Meyer-Stamer, 1998) nor on entrepreneurial competence and dynamism (Altenburg & Meyer-Stamer, 1999).

In developing countries, the low level of development and difficulties of communication with backward and forward linked industries may induce industries to internalize as many phases of the production cycle to reduce their dependency on unstable, low quality supply (Rabellotti, 1995). This results in vertically integrated firms with few linkages to supporting industries. Despite

these tendencies, Rabellotti (1995) found a direct relationship with profit performance and decentralization in a study of footwear districts in Mexico. However, since a well developed network of suppliers has not yet developed in the footwear districts in Mexico¹⁷, as they do in the Italian model of industrial districts with its strong division of labor, the Mexican industrial districts are much farther from the ideal “textbook” model.

The stimulus for rapid changes in clusters may arise from integration of firms to international markets which can dramatically change the characteristics of products that firms must produce (e.g. higher standards of quality assurance, reliability and delivery) as well as expand the range of opportunities open to firms (Humphrey, 1995). Clusters of firms can acquire the characteristics of an industrial district if it enters a trajectory that requires a shift from passive to “collective efficiency” based on both local external economies and consciously pursued “joint action” or “sustained collaboration” (Harrison, 1992) by cluster participants (Schmitz, 1995a). According to Humphrey and Schmitz (1996), such joint action can be of two types. First, individual firms cooperating (e.g. sharing equipment or developing a new product) and second, groups of firms joining forces in business associations, producer consortia, and the like. Levy et al (1994) noted from their four country¹⁸ study of technical and marketing support systems of SMEs that:

“..... the leading source of support comes from private channels – from buyers and traders, from similar firms, suppliers and subcontracting principals, and from the determined efforts of SMEs themselves.” (p.39 – emphasis added)

Rabellotti and Schmitz’s (1999) further advances this observation in their study of the internal heterogeneity of industrial districts in Italy, Brazil and Mexico. They observed that medium sized and some large enterprises were the most dynamic in mobilizing for collective efficiency. Other initiatives may also be introduced by decentralized organizations such as trade groups, other local institutions such as the chamber of commerce or local government that may act to improve conditions for firms in the cluster for example. by lobbying governments, providing information, specialized courses and consultant services, setting up trade fairs or technical institutes, etc. (Levy et al, 1994; Humphrey, 1995).

There is a growing literature on business associations that show their potential in contributing to economic performance by supporting members with a range of “market complementing” and “market-enhancing” functions (Doner and Schneider, 1998). These include horizontal coordination among producers; vertical coordination of upstream and downstream linkages; the setting and enforcement of product standards; and the provision of information and technical training. Doner and Schneider (1998) stress the need to explore further the nature of organisation within business associations to understand under what conditions some are “developmental” that they stimulate private enterprise and interfirm cooperation, while in others, they lead to collective failure. They have proposed a research to examine several dozen associations in different sectors in selected countries of Asia (including Thailand), Africa, Latin America, and the Middle East (Doner and Schneider, 1999).

Finally, it is important to take a dynamic view in our understanding of the industrial district phenomenon both in the advanced countries and in developing countries. Far from being a static model, Bagnasco (1995) notes that the industrial district model is in danger of being taken over and its linkages disarticulated by a new type of organization called a “network-firm”. Over time, as large firms emerge in clusters, the pattern of linkages between firms may also alter, as for example when they tend to vertically integrate their operations and reduce their dependence on linkages with firms in the cluster (Humphrey, 1995). Collective action in the cluster which may be significant in the development of the cluster may change over time to weaken the original socio-cultural basis of cooperation (Schmitz, 1995b) and lead to “collective failure” (Nadvi, 1999). This may arise, as a result for example, of changes in cluster composition (Knorringa, 1999), increasing differentiation (Nadvi, 1999) and the concomitant inability to resolve new conflicts of interest (Schmitz, 1999). Local development capacity for innovation may be limited by shortcomings in the national telecommunications systems and capital requirements for modern innovation processes may be beyond the capabilities of family-owned businesses (Sengenberger and Pyke, 1993).

New institutional barriers may emerge which sets limits to the acquisition and deployment of craft skills which traditionally serve as an important foundation for technological dynamism of clusters in developed economies (Sabel, 1995). Sabel noted a tendency over time to create skill hierarchies, which limit the very reintegration of conception and execution, that is the cardinal virtue of this model of production¹⁹. Skills hierarchies have a perverse effect in

creating hierarchical obstacles to the effective, decentralised use of expertise on the shop floor. Moreover, the more rapid pace of innovation undermines the boundaries between groups of generalists leading to a proliferation of “horizontal” conflicts among groups that stake out conflicting claims to general competence from their own specialisations. In these instances, craft systems can therefore be crippled by jurisdictional disputes or skill hierarchies. In the face of such difficulties, we should heed the call of Maskell and Malmberg (1995) who argue that regions must be able to adjust their institutional endowments to meet contemporary demands via a process of “unlearning”. This process necessitates the disintegration and removal of formerly important institutions, which now acts as a hindrance to further development. However, this may end up jeopardizing the interest of some individuals or larger groups with the power to impede the process, thus leading to regional “lock-ins”. Maskell and Malmberg conclude that a region’s ability to renew its capabilities is indeterminate unless path-dependent lock-in situations are broken and knowledge-creating activities are restored by entrepreneurial activity inside as well as outside the firm. This echoes similar arguments made by Bagnasco (1995), Rabellotti (1995), Nadvi (1999) and Altenburg and Meyer-Stamer (1999) about looking at industrial clusters in a dynamic perspective since growth trajectories, as far as empirical studies reveal, seem to be less straightforward and secure in creating wealth and employment for a region.

IX. Summary of Findings & Recommendations:

In reference to the underlying questions, that guided our research (Section I), we submit these tentative answers. More specific comments are possible only after detailed case studies of individual sectors are conducted.

1) On the coherence of vision and purpose of the new government policy:

As indicated in our cautionary comments regarding the present direction of SME policy (Section IV.), we express reservations about the suitability of the prioritization of selected SME sectors relative to the potentiality of other sectors not selected and more importantly, the large sector of microenterprises unaccounted for. In particular, we noted the lack of distinction between SMEs linked to large firms and foreign affiliates (i.e. SMEs with an export orientation) and those purely Thai owned that primarily serves local markets. The absence of a discourse on the contradictory elements embodied in this

issue may potentially undermine the consensus needed to support government policy in the long term. Since at the very least, there is a clear implication of “picking winners” here, there should also be some thinking on how to recompense the “losers”, or make sure there are tangible spillovers from the selected sectors²⁰. As the overwhelming influence of globalizing forces increasingly turn the country’s attention outward, there is also a corresponding diversion in thinking away from the need to resolve the more fundamental issues of the mechanics of supporting, strengthening and consensus building along the formal/informal sector²¹ divide. Thus, unless the composition of private sector membership in the SME Promotion Committee and the SME Promotion Office is broadened to involve a wider mix of sectors, it is unlikely that the vision expressed by the SME policy can be enlarged. Absent sectors cannot give voice to their concerns.

The following recommendations are related to what we consider are problematic issues of the SME policy in its present formulation.

- Need to fine tune and clarify SME definition (or SMIs if the present exclusive emphasis were to be followed). A blanket definition (in terms of fixed assets) of what constitutes an SME across all industrial sectors is misleading because of extremely differentiated conditions. Some industries consist of firms with relatively low registered capital (e.g. 5 million baht) but turnover may top 1 billion baht per year (i.e. food processing industry). In another case, such as in autoparts industries that produce relatively sophisticated components, capital investment requirements may far exceed the upper 200 million limit stipulated for SMEs but number of workers may be less than 200. Another case encountered was a company that had 700 workers (before the crisis) distributed in four different factories, each specializing on particular stages of the production process.
- Need to determine the composition of existing industrial structure for each of the designated sectors. If the established industrial structure is already characterized by the dominance of large vertically integrated companies (e.g. large ceramics companies producing porcelain, bone china, bathroom ware), the potential for cluster development is limited since supporting industries are no longer needed. In other words, the prospects for deverticalization are nil especially when scale economies are very important. The only possibility in such cases is for the substitution of

imported raw materials with locally produced ones (e.g. coloring dyes for ceramics and other specialized chemicals). However, investment costs due to high technology requirements may put this out of reach of new SMEs (less so, if joint ventures, or 100 per cent foreign owned), or the scale of production for domestic market may be insufficient to warrant localization. Government attention should then focus on other simpler product segments in the industry – encourage spin-offs by providing low interest loans and technical assistance to stimulate job creation while at the same time strengthening existing firms in their particular market segments (e.g. in ceramic handicraft industry - those involved in simpler production processes, like mug making -stoneware, souvenirs, etc.).

- Need to distinguish assistance to SMEs that are Thai owned, joint ventures, or 100 per cent foreign owned amidst some accusations that the Board of Investments (BOI) is “selling” the country by creating competition for local industries instead of helping them upgrade through joint ventures. It is important to note that the BOI is also providing incentives for 100 per cent foreign owned SMEs. Between 1992-1996, the total BOI granted privileges for investment amounted to 630 billion baht (Bangkok Post, 1999a). Ownership patterns may correlate strongly with the heterogeneity of SMEs in terms of technological and workforce capabilities (Tan & Batra, 1995).
- Need to distinguish between SMEs involved in indivisible process oriented manufacturing (e.g. plastic processing) and those where the manufacturing process can be disaggregated or broken down into distinct phases which can therefore encourage specialization and a fine division of labor. In this way, we can determine the scope and limits of industrial cluster development, i.e. the potential for vertical integration and what industries need to be promoted to complete the value chain.
- Need to understand why the network of subcontracting is relatively underdeveloped such that a realistic level of inter-firm linkages can be planned and supported with the required institutional conditions (training, financing, public-private coordination). In auto parts for example, an informant reported an estimated figure of less than 10 per cent of autoparts and components for the first tier sourced from small SMEs, while only 20-30 per cent of the first tier supplier base come from medium SMEs. The rest come from large autoparts producers.

- Need to understand specific characteristics of each industry. For example, the nature of subcontracting varies not only among different industries, but even along product lines within the same industry (e.g. different segments in footwear and mass produced ceramics, plastic products for electrical, electronic, and automobiles). In the plastic component industry for example, some larger firms may decide to subcontract the simpler components, but keep the more complicated high precision plastic molding and mould making in-house. While component subcontracting occurs in some products (indicating a potential for industrial district development); in others, subcontracting consist of the entire product (e.g. footwear, leather-based products, and ceramic handicrafts), particularly in those subsumed under labor intensive craft based industries. In addition, in some industries, SMEs can only be found in certain types of production because of the nature of technology and the size of investment required for different product segments (e.g. in plastic products some firms specialize only in mold making, certain types of plastic processing – injection, injection blow molding, blow molding, inflation, thermoforming, etc.).
- Since one of the components of the “SME Promotion Action Plan” is to develop regional/ rural/community-based SMEs, promotion of subcontracting linkages must therefore endeavor to incorporate as many of these non-urban based enterprises. This can either be based on either encouraging new entrepreneurship and/or upgrading existing ones. However, due to investment, training and technology constraints, a distinction must be made between the objectives of export promotion (or defense of local market share) based on technological innovation and best manufacturing practice from those simply that are within the realm of employment generation for poverty alleviation (Knorringa and Meyer-Stamer, 1998). How these distinctions will be translated into practice is a task that needs to be discussed and determined jointly among policy makers and stakeholders.
- Need for enhanced understanding of industry structure and dynamics of each sector. The propagation of new industrial organizational paradigms by the DIP such as “small lot and specialized production”²² must be grounded in a thorough understanding of the individual sectors’ industry structure. There appears to be a suggestion of reliance on flexible manufacturing technologies in this new paradigm being promoted.

However, this may not be all too relevant for different types of existing subcontracting relations that are predicated on phases of production or whole lot production subcontracting that rely predominantly on labor intensive methods in conjunction with simple machines (e.g. lower end footwear). The essential lesson for the *SME Promotion Office* is therefore to treat each sector on a case by case basis. SME development agencies should assign special units for each individual sector to track its competitiveness determinants and performance, maintain close contact with industry/business associations in order to proactively address industry needs. Competencies and experience gained in the promotion of one sector can be transferred to others.

- Need to clarify the concrete implications of the DIP's grouping "by importance and urgency for SME Development". What exactly is the difference between the first group ("SME development is of utmost importance and urgency") and second group ("SME development is of moderate importance") in terms of government attention and investment preference? Finally, the DIP must clarify why Chemicals & Pharmaceuticals; Iron & Steel; and Petrochemicals are included as SME sectors when these are likely to consist mostly of large firms.
- 2) On the policy support consensus from the primary stakeholders (the SMEs) themselves on the objectives and means of the proposed SME policy; and their willingness to cooperate:

We did not attempt to quantify the responses from the qualitative interviews since we were unable to obtain interviews with the industry representatives from all the sectors in the DIP list of SME sectors for development. There appears to be lack of close coordination and consultation between the Ministry of Industry and individual industrial sectors about SME policy. Many of the industry representatives were unaware of their sector's inclusion in the DIP's SME list of top 10 sectors ranking or their sector's position in either of the two divisions: a) SME development is of utmost importance and urgency, b) SME development is of moderate importance; some projects should be undertaken. When told of their placement in either of the two divisions, those placed in the latter disagreed since they expected their sector to be given top priority for development. Neither were the industry representatives aware of the overall framework of the government's strategy for SME development. A number of industry representatives complained of the top-down nature of MoI

planning and reported that many SMEs prefer not to deal with the government.

We think this may be indicative of an underlying problem of lack of communication between the Ministry of Industry and industry associations. One could also argue that the interviews were undertaken during a time of uncertainty (in 1999) and the SME Bill was still awaiting parliament's approval. Thus consultations were unavoidably insufficient since the status of the policy was still in a state of flux. Most of the SMEs were also concerned about their own individual survival as the crisis deepened, and correspondingly, as their associations drifted along not knowing what to do to assist their members during the business doldrums. In particular, apart from the slack in demand, it seemed that at least for the larger SMEs who overinvested during the boom, overcapacity was a serious problem coupled with the formidable burden of varying degrees of problematic non-performing loans (NPLs)²³. Only a detailed case study can determine the full magnitude of this overcapacity problem and the more controversial (and difficult to research) topic of NPLs.

This situation however could affect the credibility of the government's avowed policy intentions since the SMEs themselves did not know or only vaguely knew (at least in this 1999 period) the policy directions of the Thai government in this matter. On the other hand, industry representatives' knowledge of the policy may not be the best indicator for the flow of information because a majority of them belonged to the formal industry associations associated with the Federation of Thai Industry (FTI) where membership and leadership in the various associations tended to be biased towards larger, more powerful firms. In fact, SME membership in the FTI represents only a small proportion of the actual number of SMEs that exist. By contrast, non-FTI affiliated organisations like the Thai Leather Goods Association and the Thai Footwear Association, who both trace their origins to informal voluntary groups by and for SMEs, were much more aware of developments in the policy arena.

In the future, we recommend improvement in public-private consultations so that planning will be perceived as participatory rather than "top down". A system of networking must be devised such that stakeholders can have a say on the planning of any activities to support and strengthen their sector's competitiveness. Ways and means must be found to organize unorganized

SME sectors and widen SME participation especially in sectors that were not selected by DIP. The MoI should consider tapping UNIDO's experience in promoting networking among SMEs and industrial clusters in developing countries (*cf.* Ceglie and Dini, 1999).

3) On the main characteristics in the industrial and organizational structure of the SME sector, that has an inhibiting or enabling influence on government support and collaboration.

- Except for the tannery industry and some segments of the components industry for footwear and leather based products there does not seem to be any discernible spatially concentrated clustering of industries for a given sector within the Bangkok Metropolitan Region (BMR). The only exception are perhaps the cluster of newer SMEs that have located around the newer automobile assembly plants and electronic firms within specialized industrial estates in the peri-urban areas²⁴ (Webster, 2000). At present, the situation in Bangkok can be described as a series of "emerging" clusters involving individual industrial sectors (leather industry) and inter-sectoral clusters (automobile industry, plastics industry, mold and die, electronics and electrical appliances). The spread out locational character of individual firms in almost all the sectors interviewed indicate the effect of a relatively good transport infrastructure within the Bangkok metropolitan area that reduces transport costs. The manager of a small machine parts company interviewed suggested a subcontracting and delivery catchment area to be circumscribed within a 150 kilometer circle within the Bangkok Metropolitan Region (BMR)²⁵ where transportation costs are still considered relatively low. Several "emerging" clusters both sectoral and cross-sectorally linked, e.g. plastics, electronics, electrical appliance, automobile, mold and die industries in varying stages of development can be found within this 150 kilometer circle²⁶. In the footwear industry, the only discernible dense cluster of components manufacturers, wholesalers and subcontractors is reported to be located around Wong Wian Yai in Thonburi. However, despite the thrill of confirmation of the existence of a so called "cluster", we were told the said cluster only represented firms producing components for the lower segment of footwear production. An industrial cluster approach for SMEs could start with the more focused sectors like Gems and Jewelry, Footwear and Leather Goods Products, and Textiles. An intersectoral

industrial cluster approach would be much more difficult to launch given the organizational complexity of coordinating multi-sectoral stakeholders.

- Generally speaking, we observed that those firms producing for exports or supplying large firms were much more progressive in their thinking regarding quality standards and overall business management practices than those producing solely for local markets were.

Institutional Issues

- Weak and generally underdeveloped organizations (industry/business associations) due to:
 - Diversity of product lines (e.g. in the Plastic Industry Club of FTI, the two main divisions in the membership are plastic processors and upstream raw material producers. Within plastic processors, there are many different segments catering to different markets such as plastic bags, kitchen ware, auto parts, etc... Similarly, the Food Industry Club of FTI has twelve (12) sub-groups catering to different product segments. In the Rubber Based Industry Club of FTI are four (4) diverse sectors: automotive tires and tubes, industrial rubber parts, automotive rubber components, latex products)
 - Spatial segmentation of markets (e.g. provincial vs urban; local vs foreign)
 - Few members in some industrial sectors who can afford FTI membership (e.g. there are only 3 large agricultural farm machinery implements producers in Thailand. The Farm Implements Group of FTI consist only of twenty-five (25) members - 10 are implement makers and 15 produce component parts for spares.)

This will have significant implications in the objective of encouraging the formation of industry group associations by the government. How is organizing to be carried out? Who will take the lead in organizing? What assistance will be provided to strengthen these organizations, particularly in such basic issues as funding of organizational activities since all these organizations are dependent primarily on low membership fees?

- The problem of representation. Do existing FTI Industry Clubs speak for the entire industrial sector where an SME belongs²⁷? According to our interviews, the FTI has twenty-seven (27) industry clubs, of which only twenty (20) have SMEs. As a conduit of industry interests to the

government bureaucracy the FTI organization engenders a slow process because of committee structure and conflict of interests (e.g. different subsectors within the same industry and between upstream and downstream industries). FTI does not seem to have developed so far an effective mediation mechanism as far as these diverse interests are concerned (note: excepting perhaps the textile industry which has made some progress in this area). Finally, an important insight obtained from the research relates to the problem of how to reach out to the main bulk of SMEs, who are not members of either FTI Industry Clubs or non-FTI related industry associations.

- Large companies tend to dominate the leadership in these industry/business associations. Specific concerns of SME tend not to be articulated unless it is a general issue that affects other members as well.
- There are varying degrees of institutional capacity and experience in cooperation²⁸ within industry associations that may be encouraged further to improve collective efficiency. Promotion of networking activities should be sensitive to these varying levels of organizational development in order to reinforce positive organisational habits and discourage negative ones (Ceglie and Dini, 1999; Kaplinsky, 1995). At present, the success of such existing collaborative efforts appear to depend upon:
 - Enduring and dedicated leadership, usually coming from a large company who have a real interest in promoting the sector as a whole (e.g. jewelry industry).
 - Initiatives taken by large multinational companies in the industry (e.g., automobile industry cooperative clubs are quite strong because of Japanese initiative and leadership). However, in this instance, this may have little impact in helping smaller second- and third-tier companies who cannot meet the exacting standards of multinational customers (e.g. the more stringent QS9000) and who are at present not connected to the network of automotive parts suppliers to multinational assemblers (i.e., firms producing for the replacement equipment market, or REM).
 - Similar ethnic origins of owners and proximity. (e.g., tannery industry)
 - The presence or absence of tariff protection in the industry. Removal of tariffs can be a good stimulus for the association to work together to help restructure their industry. For example, the problem of the

automotive industry parts producers became more serious after Jan 1, 2000, when local content requirements were removed and tariff reduced to not exceeding 20 per cent and to 0-5 per cent by 2003. This allows manufacturers greater flexibility to source their products throughout the region, buying the highest quality parts at the best prices (Busrin and Yuthana, 2000). Normally, the production costs of local manufacturers are about double those of their foreign rivals, yet imported parts are still cheaper even after 80 per cent import duty is added (Cholada and Soonruth, 1999).

- Trust is selective, based on personal friendships, kinship, and/or ethnic ties.
- Sharing of facilities is non-existent or very limited.
- Few or no services provided by Industry Associations at present.
 - No consultancies
 - Insufficient or no computerized database of members
 - Small staff, one or two persons working full-time helping the association president
 - Problem of low membership dues
 - No benchmarking
 - Little or no innovation, mostly copying. No system developed for understanding trends in the market, domestic and especially foreign.
 - We strongly recommend that the design assistance programs of DIP (e.g. assistance in footwear and leather goods industries by Italian designers, organized by DIP) be expanded to as many firms as possible and to other sectors as well (e.g. furniture). This is especially important for sectors whose products have short product cycles and are subjected to rapid shifts in fashion trends. This is the case for example in some of the upper product segments of the leather goods industry have to come up with a new collection every two months otherwise they will not be able to compete. The key is to help those in the middle and lower segments so that they can upgrade themselves and enter into ever more higher value added markets.
- The expansion of SME supporting industries in the case of joint ventures or those under licensing agreements may be limited by technical agreements with parent companies. These agreements may dictate production only for domestic markets or in accordance with the parent

company's global sourcing strategies. These arrangements therefore minimize their exposure to market driven demand for sophisticated products.

- 4) On the main limitations in government resources for implementing its policies of supporting SMEs:
 - The structure of the *Institute for Small and Medium Enterprises Development* (ISMED)²⁹ seems less ideal. Reliance on academics to activate SME information networks and training may not be the most optimal way since academics are not primary stakeholders nor can we assume that they have sufficient business experience. The academic institutes in the ISMED network may also not have the most up-to-date training facilities suitable for hands on training in areas relevant to industry needs. Responsibility would be better off assigned to industry or business associations in conjunction with their respective training institutes³⁰ (existing or planned) to encourage them to take initiatives. The confusion of SME policy objectives – whether to help SMEs in general or SMIs in particular is resurfacing in the kind of proposals received by ISMED for specialized training, e.g. request for training in souvenir making for tourists in Bang Saen. There is also the problem of maintaining a focus on the big picture for SME development since funding of these eight academic institutes in the ISMED network is on a project by project basis.
 - The utility of BOI's BUILD (*BOI Unit for Industrial Linkage Development*) should be expanded to cover other sectors since right now it is only focusing on the automobile industry and electronics/electrical appliance industries. It appears that BUILD's usefulness applies mostly to newly established large multinational firms in search of potential new local vendors. The value of BUILD's matching services for new suppliers is lessened if a leading firm already has a long record of localization and outsourcing.
 - Although no in-depth studies have been done so far in this issue, the responses gleaned from the interviews suggest that one of the pre-requisites for a successful SME policy undertaking is also to upgrade the capabilities of service and supporting government agencies in the field of organizing, incubation, networking, marketing, business intelligence and international promotion, coordination, creation of in-house competencies

in various industrial fields, etc. This requires a serious rethinking of the proper role of the DIP vis-à-vis SME promotion once the SME Promotion Office commences full operation.

Training Issues

- Generally, the low level of skills among workers and owners of small firms was confirmed. Among owners and supervisors, low level of education generally results in low management skills. Lack of formal craft teaching institutions result in lack of proper qualifications for technical personnel (as in tool and die, plastic processing).
- High cost of training and certification. ISMED should try to make fuller use of the advanced technical training facilities of Thai-German Institute (TGI). However, the government needs to find ways to subsidize the high cost of training to encourage more firms (i.e., SMEs) to join and especially once the Miyazawa fund ends. Most of the firms taking advantage of the training at TGI belong to large multinational corporations who can afford the high training fees. Cost of ISO certification is beyond the reach of the majority of SMEs. At present, there is a government program (probably tied to the Miyazawa fund) to subsidize half the cost of getting an ISO 9000 (at least 1.5 million baht price tag). This should be further expanded. In the automobile industry for example, only 10 per cent of the 600 suppliers in Thailand have ISO 9000, 14000 or 18000 approval (Wijayasinha, 1999).
- There needs to be better control and planning for Miyazawa funding for training. One informant revealed in our interviews the assignment of 100 companies to a university where the professors did not even have any idea of what particular topic to teach.
- The government should use some of the Miyazawa funding to upgrade BSID (Bureau of Supporting Industries Development - under the DIP) facilities to develop a center of excellence for SMEs/SMIs. BSID will then work in parallel with TGI's expertise (since TGI caters predominantly to large companies who can afford the high training fees). At present, the facilities of BSID (from the former MIDI) are largely obsolete. A revitalized modern training facility at BSID should serve as

the backbone for specialized ISMED hands-on training courses that need to be rapidly extended.

- The program for training tax deduction from the Ministry of Labour and Social Welfare should be expanded in its scope and budget, in order to assist skills upgrading of the SME workforce. Many of the SMEs/SMIs interviewed were not familiar that such arrangements exist nor of the details of its procedures.
- The development of the new specialized industrial training institutes should be completed as soon as possible in terms of staffing and provisioning of necessary equipment. We understand that government budgetary support for these new institutes is only for the first five years. Beyond that, however, is unknown. Thus, there is uncertainty about their long-term viability. For this reason we strongly suggest that the government encourages and supports cooperative training arrangements proposed and undertaken by associations themselves that use member facilities to encourage close cooperation and trust building. We also recommend that industry associations themselves should be allowed to have greater responsibility for managing and determining the direction of these specialized training institutes since they know the needs of their particular business better than the government. However, government should back this up with an assistance package that is based either on some type of public-private sector matching funds and/or some type of performance based grants.

X. Concluding Remarks:

The Thai government has become more interested in SMEs and there is no questioning its seriousness in doing so now that the SME Promotion Law has been approved. As this preliminary research has revealed, creating a policy for SME development is fraught with both challenges and risks. The main challenge refers to the objective of carrying Thailand's industrial transformation forward from one based on an earlier comparative advantage of cheap labor to one increasingly based on skills, knowledge and high value added production. The inexorable march of globalization has underlined the unforgiving logic that Thailand must constantly renew its industrial competitiveness to succeed in the fiercely contested global markets.

A complicated dilemma faced by many developing countries is how to balance its own development needs with the requirements of multinational corporations and highly mobile international capital upon whom they must depend on if they are to latch on to global networks of production. As a manifestation of Thailand's increasingly outward orientation to accommodate globalization pressures, the SME Promotion Law in its present formulation is underpinned by a vision that strongly favors those sectors that have built a reputation for robust export performance in the past. By contrast, not enough thought has been devoted to what needs to be done to support those industries that cater to the domestic market and are for the most part locally owned, especially those with product markets that will allow them to remain sheltered even under liberalization.

The essential problem that has given rise to the seeming confusion and practicality of goals proceeds from the lack of transparency and close participation of concerned sectors in the process of policy making. As we have noted, a complex issue that has not been addressed in the SME policy relates to the issue of those sectors that have not been included in the two designated groups for SME development. These sectors include a large group of small firms that belong to the unorganized micro-enterprise sector, which has the greatest potential for employment creation and reducing poverty.

One important observation from this research is the need to improve policy planning with better information. In particular, there seems to be lack of sophisticated understanding of the structure of each individual industrial sector, for example, the pattern of inter-firm linkages and the value chain in production. This can best be rectified by giving substance to the principle of "private sector empowerment" as enunciated by DIP Director General Manu Leoparote. This can be achieved by strengthening existing industrial group associations, or where there is none, help organize them. Stronger associations can enable them to take initiative in planning cooperative actions tailor fitted to their needs rather than accepting a top down generic approach that may fail to benefit them. A decentralized endeavor with government fulfilling a facilitative role will go a long way in expanding and strengthening civil society in Thailand while at the same time encourage greater commitment among stakeholders, and improve the credibility of government's intentions. Moreover, such an approach will serve as a necessary complement to the insufficient administrative resources of supporting agencies given the existing lack of expertise and downsizing trends in the civil service. This

should also include closer industrial and academic cooperation. Academics can play an important role in assisting these industrial groups to analyze an increasingly enormous amount of data needed for competing successfully in international markets. Their technical skills are especially required for the collective basic R & D efforts of these industry associations. More importantly, academics can help research the important but grossly neglected issue of industrial relations to formulate the crucial complementary restructuring in this area that will facilitate the transition to best manufacturing practices while at the same time ensuring workers' welfare (Macdonald, 1997; Sengenberger, 1990).

There are actually good opportunities for ameliorating some of the policy weaknesses in the present SME Law. Both the SME Promotion Committee and SME Promotion Office must commit themselves to a broader participatory planning process in order to flesh out the overly ambitious pre-set agendas and focus the program of implementation in the next couple of years. This will require integrity in the political compromises that will have to be made in light of limited resources and rapid changes in the global economy. It goes without saying that it is crucial for the succeeding government to continue to uphold the vision of supporting SMEs if the policy is to bring forth tangible results and usher a new round of growth for the country in the coming decade.

Based on our preliminary research, we are convinced that the industrial cluster approach presents a promising new paradigm of industrial restructuring in Thailand particularly for SMEs. However, the main challenge lies in the difficult task of building networks (basic organizing), strengthening existing organizations and overcoming mistrust among firms, in order to encourage dynamic inter-firm cooperation and develop "growth promoting externalities among the firms themselves" (Tendler and Amorim, 1996:421). Considering that these represent a radically new approach for supporting government agencies more accustomed to top-down practices, a period of institutional unlearning and relearning would be necessary. This, we believe, is a critical precondition for the success of any SME program here in Thailand. There is plenty of accumulated experience in industrial cluster promotion in other countries that the SME Promotion Office can draw upon for guidance. The groundwork for detailed case study analysis on a sector by sector basis should be undertaken by research institutions in order to pave the way for participatory planning and implementation practice.

Interviews:	Date:
1. Representative, Dept. of Industrial Promotion, Min. of Industry	19 April 1999
2. Spokesperson, Thai Rak Thai Party	26 April 1999
3. Manager of a Machine Parts Factory, Chonburi	20 May 1999
4. Adviser, New Aspiration Party	24 May 1999
5. Representative, Thai German Institute	1 June 1999
6. Representative, Bureau of Supporting Industries Development	3 June 1999
7. Representative, Minister of Industry	8 June 1999
8. Representative, Thai Automotive Industry Assoc.	10 June 1999
9. Representative, Thai Tool and Die Industry Assoc.	23 June 1999
10. Representative, Thai Auto-Parts Manufacturers Association	24 June 1999
11. Asst. Managing Director of Auto Spare Parts Company	2 July 1999
Director of International Division, Auto Spare Parts Company	2 July 1999
12. Representative, BOI Unit for Industrial Linkage Development (BUILD)	5 July 1999
13. Representative, Agricultural Machinery Manufacturers Club (AMMC) FT	18 July 1999
14. Representative, Thai Tanning Association	8 July 1999
15. Representative, Thai Gem and Jewelry Traders Assoc.	21 July 1999
16. Representative, Rubber Based Industry Club FTI	22 July 1999
17. Representative, Farm Implement Group (AMMC FTI)	22 July 1999
** Visit to Thai Tannery Industry Cluster, Samut Prakarn	23 July 1999
18. Representative, Technology Promotion Institute	30 July 1999
19. Representative, Thai Frozen Foods Association	5 Aug 1999
Representative, Thai Food Processor's Association	"
Representative, Food Processing Industry Club FTI	"
Representative, Agri-Business Company	"
Representative, Thai Broiler Processing Exporters Assoc.	"
20. Representative, SME Development Committee FTI	6 Aug 1999
21. Representative, Ceramic Industry Club FTI	11 Aug 1999
22. Representative, Textile Industry Club FTI	20 Aug 1999
23. Representative, Plastic Industry Club FTI	26 Aug 1999
24. Representative, Association of Thai Travel Agents	27 Aug 1999
25. Representative, Thai Leathersgoods Association	9 Sept 1999
26. Representative, Institute for SME Development (ISMED), Dept. of Industrial Promotion	17 Sept 1999
27. Representative, Thai Footwear Association	6 Oct 1999

Endnotes

- ¹ URL:<http://www.dip.go.th/dip97/ssme1.htm>.
- ² Production is moved to lower cost countries using outdated technology to recapture long gone cost advantages in the home country and prolong the product's life profitability (Danier, 1991).
- ³ The current account deficit is the gap between the inflow and outflow of goods, services and fund transfers (Shearer, 1995).
- ⁴ The standards required for market access to western countries are not only for example, in management (ISO 9002), and environmental safety (ISO 14001), but in labor practices as well – the SA 8000, or the Social Accountability 8000 certificate. The SA 8000 is increasingly required for exporters of garments by US buyers who do not want products made by child labour or by people working in unsafe or unfair environments (Achara, 2000).
- ⁵ The real sector consist of the agricultural, industrial and service sectors (Chet, 1998).
- ⁶ Mukoyama (1993) puts this unapologetically when he writes "... it is a matter of great interest what supporting-industry development measures the government of Thailand will formulate in cooperation with the Japanese government" (p. 72). There is in addition, initiatives by European countries for SME development in Thailand, particularly from Germany, as in the Thai-German Institute which opened in February 1998. However, as European investments lag behind those from Japan, the U.S. and other newly industrialized countries (Bangkok Post, 1999b), they are not as visible as the Japanese in their efforts to shape and influence Thai industrial policy.
- ⁷ The six targets were managerial and technological upgrades, manpower development, expanding market exposure, strengthening financial capabilities, improving the business environment and cultivating micro-enterprises. On the other hand, the strategies comprised the following: development of SMEs on a sectoral basis, improving supporting industries and offering assistance to SMEs in remote and rural areas (Nation, 1999).
- ⁸ Although I have been monitoring both *Bangkok Post* and *The Nation* newspapers assiduously, I have not found any mention of such an event in these two newspapers on said date. This information was given to me by Prof. Philippe Regnier of the University of Geneva who also conducted a research on Thai SMEs at SASIN, Chulalongkorn University.
- ⁹ The Market for Alternative Investment of the Stock Exchange of Thailand began operations on 21 June 1999. See web site: (URL) <http://www.set.or.th/mai/main/MENUMAI.HTM>
- ¹⁰ Of the firms surveyed by the Office of Industrial Economics, Ministry of Industry, a higher proportion of SMEs reported liquidity problems and decreases in output, exports, employment and profit margins compared to large firms (see Slide 9 of Amin, 1999). Pongsanarakul and Chaisit (1999) also reported that 97.6% of the 2,823 factories that shut down in 1998 were SMEs, or an average of 235 SMEs went out of business per month compared to 175/month during the 1995-1997 period.

- ¹¹ Levitsky (1995) recommended that in the initial stage, the role of initiating networking be assigned to one enterprise development agency. They forewarn that “the process will require patience and will take time to develop and become accepted” (p.35).
- ¹² Thai manufactured exports surpassed agricultural exports for the first time in 1985 before the onset of the boom. The ratio of manufactured exports to the agricultural sector’s exports increased to 3 times and nearly 5 times in 1990 and 1995 respectively (Chalongphob, 1997).
- ¹³ Tendler and Amorim (1996) show that the opposite may be the case in a Brazilian case study. However, in the absence of comparative studies of success stories in other countries where the state or large customers were able to create a small firm cluster “from scratch” through a demand driven approach, it appears that the Brazilian experience is a unique case.
- ¹⁴ Knorringa & Meyer-Stamer (1998) recognized that it is almost impossible to define with precision the minimum threshold of agglomeration, depth of interfirm linkages and build up of local know how that constitute a critical mass in other settings with which to start making a meaningful comparison with industrial districts in Europe. They assert that in developing countries, most clusters clearly do not cross such thresholds, regardless of their definition.
- ¹⁵ Knorringa & Meyer-Stamer (1998) illustrate this in the case of newly emerging clusters based on external investment in the pattern of hub and spoke cluster, as in car manufacturers who bring in with them their “globally preferred supplier” (i.e. other multinational car parts manufacturers) to produce a given subsystem of a car. Since local manufacturers are to be found at best in the second and third tier, cluster policies in this context may mean anticipating the demands of new firms in terms of qualified labour and infrastructure. A carefully designed policy to upgrade local firms to work as second- or third-tier suppliers may provide some spillovers in the locality, especially in the medium term when employees of foreign firms spin off their own shops.
- ¹⁶ Sengenberger & Pyke (1991) noted that it is the isolation of small manufacturers that is the main problem, not their size.
- ¹⁷ The relationships between suppliers and shoe producers are also less collaborative than in Italy. These are mainly market linkages based simply on the factor of price.
- ¹⁸ These countries are Colombia, Indonesia, Japan and the Republic of Korea.
- ¹⁹ Sabel (1995) suggests a new form of cooperation called “learning by monitoring” which is based on the Japanese system which overcomes the distinction between conception and execution. He recognizes that this can be achieved through organisational reforms, reorientation of the provision of real services by district institutions, changes in training, and reconsideration of the provision of social welfare funds and services at the local level.
- ²⁰ The discontent among “losers” can easily be used as fodder by opposition parties to build up a following to counter government policy or demand alternatives thereby undermining the integrity of the overall policy direction. An adviser of Thai Rak Thai Party told us in the interview that its SME policy would eschew industrial sectors that led the country’s export growth (i.e. those highly

dependent on foreign technology, inputs and capital) and instead focus on supporting industries that utilize a high proportion of “Thai knowledge” and skills so as to reduce the drain on the economy (i.e. handicraft based products). See for example Corporate Thailand (1998) and compare the sectors with DIP’s list. An adviser of the New Aspiration Party did not enunciate a specific vision for its party’s SME policy during our interview, but indicated that they would try to focus more on the neglected agricultural sector if they become the majority ruling party after the next parliamentary elections. However, they shared the similar view of Thai Rak Thai that the industrial structure in Thailand was too dependent on foreign inputs and industrial promotion incentives that privilege MNCs.

- ²¹ Meyer-Stemer (1999b) notes that certain industries oriented towards domestic markets in developing countries will continue to retain entry barriers even under trade liberalization. These enterprises (both formal and informal) are usually producing for the low-end product markets and can perform fairly well even if the supporting environment is weak. Examples of persistent entry barriers are: high transportation costs; deficient communication systems; too small a market size to interest potential foreign investors; underdeveloped marketing systems with large parts of the demand being served by street vendors or on the basis of informal credit arrangements; and specialized local consumption patterns.
- ²² Brochure distributed during the seminar sponsored by the DIP “Changing The Production Process of Leather Industry for Competition in the World Market,” 27 January 2000, Siam City Hotel, Bangkok.
- ²³ According to Dr. Olarn Chaipravat, a director of Siam Commercial Bank, since before the crisis, local banks have extended loans amounting to Bt1.5 trillion to 300,000 SMEs. This represents about 30 per cent of total loans owed to Thai banks, worth Bt5 trillion. Non-performing loans for the SME sector peaked at Bt900 billion (US\$22.5 billion at 40 baht to the dollar) around June 1999 or 60 percent of the Bt1.5 trillion. Since then, an estimated Bt300 billion has turned bad. Banks are presently restructuring the remaining Bt600 billion. Olarn noted that SME loans were even higher than consumer and corporate loans (Choosak, 2000).
- ²⁴ There are no detailed studies of these industry clusters. Our impression however is that interfirm linkages are sparse and therefore these spatial concentrations do not qualify to be any near the Italianate “industrial district” model. In the Thai automobile industry, Maruhashi (1995) found that the division of labor among suppliers is not significant due to lack of economies of scale. In other words, this indicates that several layers in the value chain are missing. Balfour (2000) reports that Detroit carmakers that have settled in Rayong (in the Eastern Seaboard) lured another 50 suppliers, including TRW Steering & Suspension Co. and Bendix brakes. In the short term, these transplant OEM suppliers are unlikely to have developed few linkages with second/third tier domestic suppliers. The Thai automobile industry supplier linkages presents a striking contrast to the dense interorganizational linkages established among transplant first-tier suppliers and second-tier suppliers in the U.S. with Japanese automotive assemblers (Florida and Kenney, 1991).

- ²⁵ The BMR is defined as the Bangkok Metropolitan Administration plus the 5 surrounding provinces of Nonthaburi, Samut Prakarn, Pathum Thani, Nakhon Pathom and Samut Sakhon.
- ²⁶ Allowing for differences in the level of infrastructure, this distance (radius =75 kms) represents slightly less than half of the two-hour shipping radius, where 40 percent of transplant suppliers are located in relation to their endusers (automobile assemblers) in the study of Florida and Kenney (1991). (Assuming 55mph avg speed. Two hours equals 110 miles or a radius of 176 kilometers).
- ²⁷ Since the finalization of the passage of the SME Bill and the approval of the SME Master Plan for Development, the FTI in early May (2000) announced that its new board of directors will focus in boosting the SME sector, including helping them to trade via the Internet, upgrading workers' skills, English training for management and standardizing accounting systems to improve transparency (Nareerat, 2000).
- ²⁸ For example, the agriculture department together with 13 walk behind tractor-makers have agreed to use the same gear housing for all tractors in a bid to promote mass production of the machines at lower cost for the local and export markets (Suphaphan, 1999). It was reported during our interviews that some of these firms are members of the Farm Implements Group belonging to the Agricultural Machinery Manufacturers Club of FTI. They purchase their specially designed gears from a highly dynamic local SME involved in integrated production of farm implements for 4 wheel tractors.
- ²⁹ ISMED was officially inaugurated by Prime Minister Chuan Leekpai on June 18, 1999. As well as offering training to new and existing small and medium enterprises (SMEs) to strengthen their competitiveness, the SME Development Institute, headquartered at Thammasat Rangsit university, will conduct research and development and compile a database for manufacturers. The database will cover SME manufacturers and their financial sources. ISMED had received financial support under the Miyazawa plan with about Bt1 billion for the current fiscal year. ISMED consists of a network of 8 academic institutes, each of which will be responsible for a certain area in the country. As well as the headquarters at Thammasat, ISMED centers will be based at the universities of Chiang Mai, Prince of Songkhla, Naresuan, Burapha, Khon Kaen, Suranaree Technology and the Chulachomklao Royal Military Academy (Supunnabul, 1999).
- ³⁰ Currently, ten institutes have been established (Ministry of Industry, 1999):
1. Thailand Productivity Institute
 2. Thai-German Institute
 3. Thailand Textile Institute
 4. National Food Institute
 5. The Management System Certification Institute
 6. Automotive Institute
 7. Electrical and Electronics Institute
 8. Foundation for Cane and Sugar Research Institute
 9. Iron and Steel Institute
 10. Institute for SME Development (ISMED).

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