Asia-Pacific
Economic Cooperation

2012/SOM1/EC/009
Agenda Item: 5

Making It Easier for SMEs' Getting Access to Finance in Thailand

Purpose: Information
Submitted by: Japan

First Economic Committee Meeting
Moscow, Russia
14-15 February 2012

MAKING IT EASIER FOR SMES' GETTING ACCESS TO FINANCE IN THAILAND

February, 2012

Reported by Japan

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Preface

In light of taking a comprehensive approach that focuses our work on trade liberalization "at the border", improving the business environment "behind the border" and enhancing supply chain connectivity, APEC Leaders in 2009 endorsed an APEC-wide improvement of 25 percent in five key areas of doing business by 2015; 1) Starting a Business; 2) Getting Credit; 3) Enforcing Contracts; 4)Trading Across Borders; and 5) Dealing with Permits, with an interim 5 percent improvement by 2011.

Japan, as the champion economy of "Getting Credit" initiative, implemented Phase 1 program through holding the Workshop on Getting Credit for Small and Medium Enterprises (SMEs) in 2010 for the purpose of sharing information and experiences on how to strengthen legal rights and improve credit information.

On March 2011, Thailand and Japan decided to implement the Phase 2 program with diagnostics to identify concrete actions which make it easier for SMEs' getting access to finance in Thailand..

After that, Japan prepared the diagnostic report which consisted of current situations around SMEs in Thailand and some possible recommendations toward enhancing SMEs' access to finance in Thailand in terms of strengthening the legal architecture for secured lending such as collateral and bankruptcy law and promoting credit information sharing.

This report was drafted by Organization for Small & Medium Enterprises and Regional Innovation of Japan (SMRJ) and modified by Government of Japan and Government of Thailand.

1. Current Status and Issue of SME Finances

1.1. Implementation and Supervisory framework

1.1.1. Jurisdictional and Supervisory Authorities

In terms of monetary policy in Thailand, the Office of SME promotion (OSMEP) is responsible for formulating recommendation on financial support measures for SMEs and coordinating all concerning agencies so that all efforts on financial support for SMEs will be integrated under the same work plan and direction. The Bank of Thailand (BOT) is in charge of policy-making and supervising the whole financial sector including SME finance while the Ministry of Finance (MOF) supervises the Specialized Financial Institutions (SFIs) which provide financial support for feeble SMEs in the target groups of government's policy. Regarding finance policy for SMEs, governmental financial institutions such as the SME Development Bank, Government Saving Bank, and the Export and Import Bank of Thailand (ThaiEXIM) provide financing, and the Small Business Credit Guarantee Corporation (SBCG) provides the credit guarantee for the financing.[1]

Until 2008, the basic scheme of finance policy for SMEs stemmed from the "Financial Sector Master Plan," endorsed by the Cabinet in January 2004. The Master Plan consisted of three parts: "enhancing access to financial services," "improving efficiency of the financial sector," and "consumer protection."

However, the global financial crisis that occurred just before the Master Plan was terminated in 2008 brought about radical change in the economic environment both inside and outside of Thailand. Therefore, in order to maintain the soundness of the domestic financial institutions and stabilize the domestic economy, MOF and BOT formulated the "Financial Sector Master Plan II" for 2010 through 2014. The new Master Plan also consists of three parts: "reduction in operational cost of the entire financial system," "promoting competition and enhancing access to financial services," and "strengthening the financial infrastructures."[2]

a) Reduction in operational cost of the entire financial system

- Cost for laws and regulations

[1] "Survey on the legal systems of easing of regulations in Asian financial sector" by JETRO (2007)
[2] the website of Bank of Thailand

- Cost for Non-Performing Loans (NPLs) and Non-Performing Assets (NPAs)

b) Promoting competition and enhancing access to financial services

- Promoting competition among financial institutions consists of three phases: "The First Phase (2010-2011) to improve efficiency of the existing financial institutions," "The Second Phase (2012-2013) to promote competition by permitting the establishment of branches by foreign financial institutions and implementing gradual deregulation," and "The Third Phase (2014) to evaluate efficiency of the financial system according to the development of international trade and inward investment."
- Enhancing access to financial services for the various domestic groups.

c) Strengthening the financial infrastructures

- Improving risk management abilities and measures of financial institutions.
- Improving information systems regarding risk management of financial institutions.
- Revision of the laws supporting risk management of financial institutions.
- Strengthening IT infrastructure and IT capabilities.
- Strengthening human resource development in financial systems.

1.1.2. Financial Institution

a) Governmental Financial Institutions

As for the Government's Financial Institutions (SFI) in Thailand, they include the SME Development Bank, the Government Saving Bank and the Export and Import Bank of Thailand (ThaiEXIM), which provide financing to SMEs, and the Small Business Credit Guarantee Corporation (SBCG). These organizations provide financing and/or credit guarantees corresponding to specific policy targets.

Table 1: Government's Special Financial Institutions in Thailand

Name of financial institutions	Regulators	Company profiles and principal tasks
SME Development Bank of Thailand	MOF、BOT、MOI	Established in 2002; 109 branch offices; loan balance equivalent of approximately45 .6billion baht (as of 2008)
		Providing loans according to SMEs' needs
The Export and Import Bank of Thailand (ThaiEXIM)	MOF、BOT	Established in 1993; 643 workers (as of 2009); loan balance equivalent of approximately 53.2 billion baht (as of 2009)
		Providing services related to trade and investment, especially for economic developments in the Mekong region.

Name of financial institutions	Regulators	Company profiles and principal tasks
Government Saving Bank	MOF、BOT	Established in 1947; 930 branch offices; loan balance equivalent of approximately 644.0 billion baht. (as of 2008)
		The financial institution guaranteed by the government under the supervision of MOF, and underlying the savings, development of the social economy, and especially the economy of Thailand.
Bank for Agriculture and Agricultural Cooperatives	MOF、BOT	Established in 1966; 13,000 workers; 577 branch offices
		Providing loans to farmers and agricultural unions
Government Housing Bank	MOF、BOT	Established in 1953; 147 branch offices; loan balance equivalent to approximately 617.4 billion baht (as of 2008)
		Providing housing-related financial services
Islamic Bank of Thailand	MOF、BOT	Established in 1994
		Specializing in Islamic Finance
Small Business Credit Guarantee Corporation	MOF、MOI	Established in 1991
		Providing credit guarantee for SMEs
Secondary Mortgage Corporation	MOF、BOT	Established in 1997.
		Purchasing mortgages from the governmental/private financial institutions that provide loans to home buyers, and seling them as mortgage securities.

Source: compiled from "Survey on the legal systems of easing of regulations in Asian financial sector" by JETRO (2007) and the websites of each bank
Note: 1 baht = about 0.03 USD (as of August 2011)

Mr. Pongsak Chewcharat, former President of SME Development Bank of Thailand, addressed a group in Japan in January 2008.[3] He said that governmental financial institutions, including SME Development Bank, were established in order to facilitate SMEs in obtaining credit, noting that SMEs accounted for 99% of all enterprises, estimated to be 1.87 million companies in Thailand,.

b) Private Financial Institutions

The private financial institutions are classified into commercial banks, retail banks and foreign bank branches by the Financial Institutions Businesses Act (FIBA) of 2008. These private financial institutions are supervised by BOT and MOF.

The major private financial institutions in Thailand include the Bangkok Bank Public Company Limited, Krung Thai Bank Public Company Limited, Kasikornbank Public Company Limited, Siam Commercial Bank Public Company Limited, and TMB Bank Public Company Limited.

[3] "Regional Finance in Recent Period and the Way Forward" jointly organized by Financial Research Training Center of Financial Services Agency and Keio University(January 2008)

c) Non-bank and others

There used to be a total of 23 non-banks, consisting of 18 finance companies and 5 credit foncier companies engaging in real estate finances.

However, according to the "Financial Sector Master Plan" endorsed by the cabinet in 2004, private financial institutions were required to choose a business category -- as either a commercial bank or retail bank. As a result, the total number of commercial banks was reduced to fourteen, and four banks were newly launched as retail banks in 2006. The 23 non-banks that existed before 2004 were reorganized into four finance companies and two credit foncier companies in 2006.

Table 2: The transition of the number of financial institutions in Thailand (Including non-bank) (At the end of 2003 and 2006)

		End of 2003	2006
Private financial institutions	Commercial bank	13	14
	Retail bank	—	4
	Commercial bank (including offshore)	24	—
	Branch office of foreign bank	18	17
Non-bank, etc.	Specialize in offshore	4	—
	Finance company	18	4
	Credit foncier company	5	2

Source: "Ajiken World Trend No.144" published by IDE-JETRO
Original source: the material of Bank of Thailand

As of 2011, there are following ten categories of private banks that operate the business of Non-bank in Thailand:

- Development finance institutions
- Finance and leasing companies
- Factoring companies
- Insurance firms and pension schemes
- Mortgage institutions
- Securities markets and securities firms
- Micro finance institutions
- Postal savings institutions
- Forex bureau and discount houses
- Venture capital

1.2. The Major Financing and Guarantee Systems

The financing and guarantee systems the governmental financial institutions provide for SMEs are as follows:

1.2.1. SME Development Bank

SME Development Bank provides various types of financing based on policy objectives such as tourism, One Tambon One Product (OTOP), and employment maintenance measures. The employment maintenance scheme, a countermeasure for SMEs against the global financial crisis, is supported by the government budget and administrated by the Bank in cooperation with the Ministry of Labor and Social Welfare. Since financing under the scheme is intended to maintain employment levels, the SMEs that get financing under the scheme are not allowed to dismiss any employees until repayments have been completed.

Since the Bank is the executing body supporting SMEs that have difficulty in getting credit from major private banks and therefore tend to face management crises, the NPL ratio of the Bank seems to increase.[4]

In addition to financing SMEs, the Bank also provides them with services for management capacity building, such as marketing counseling with the cooperation of SME management consultants and business development (business meetings). For example, if the Bank finds its lenders holding problems during annual interim audits, the Bank provides them with free counseling by its SME management consultant. Additionally, in cases in which they get counseling from outside experts, the Bank bears 20% of the counseling fee on condition that the Bank considers the counseling to be successful.

The Bank also undertakes projects such as capitalization (collateralization) of machinery and intellectual property through a program of assets capitalization (collateralization). Capitalization of machinery enables lenders to utilize machinery, which is registered on MOI's Central Machine Registry, as collateral. Also, capitalization (collateralization) of intellectual property enables lenders to utilize registered patents, utility models, trademarks and copyrights as collateral.

[4] According to the interviews to SME Development Bank（March 2010）

1.2.2. The Export-Import Bank of Thailand (ThaiEXIM)

The Export and Import Bank of Thailand (ThaiEXIM) provides financing for local SMEs when they export products, accepting a letter of credit (L/C) issued by the importers as collateral. Under the scheme, ThaiEXIM automatically deducts the amount of repayment (principal and interest) from the importers' trade settlements, making it relatively easy for ThaiEXIM to collect its debts. Moreover, because this represents short-term financing with about a three-month term, ThaiEXIM has less risk of holding bad loans.

1.2.3. Small Business Credit Guarantee Corporation (SBCG)

The Small Business Credit Guarantee Corporation (SBCG) promotes SME financing by adding credit guarantees to the private commercial banks' financing. SBCG provides credit guarantees and collects a guarantee charge equal to about 1.75% of the loan amount. The banks that provide financing handle all of the necessary paperwork.

1.2.4. Private Financial Institutions

Regarding SME finance, private financial institutions in Thailand mainly provide the following financing and credits for SMEs[5]:

a) Short-term fund

- Overdraft
- Promissory note
- Financing of working capital

b) Long-term fund

- Financing of equipment capital
- Mortgage loan

c) Bank guarantee

- Credit acceptance letter (AVAL)
- Shipping guarantee

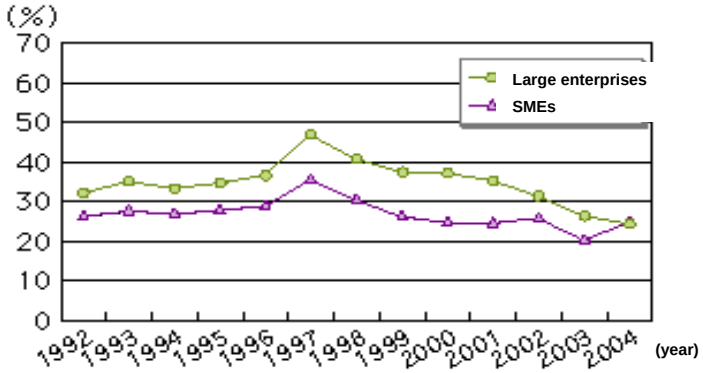
1.3. The data on SME finance

The chart below shows that as a result of credit uncertainty, regardless of the size of a company, the borrowing ratio from banks has decreased since 1997, just before the

[5] "Survey on the legal systems of easing of regulations in Asian financial sector" by Ministry of Finance (2007)

Asian Financial Crisis.[6] However, SME's borrowing ratio increased after 2003, partly because more financial institutions, including the SME Development Bank established in 2002, eased financing requirements, and SMEs increasingly received loans from banks.

Figure 1: Transition of proportion of loans from banks to the total assets in Thailand

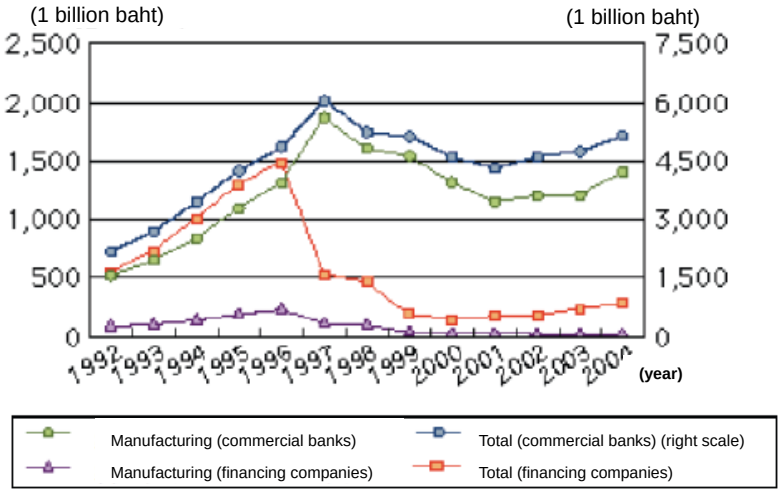


Note: Compiled from data on companies registered on the Stock Exchange of Thailand
Source: White Paper on International Economy and Trade of Japan (2005)

Additionally, looking at the change in loan amounts from private commercial banks and non-bank financing companies, the loan amounts from financing companies decreased rapidly immediately after the Asian financial crisis. Among SMEs whose performances siginificantly suffered due to the Asian Financial Crisis, it became preferable to receive financing from private commercial banks with lower interest rates rather than financing companies with extremely high interest rates.

[6] Trade White Paper 2005 P.187

Figure 2: Transition of loan amount of commercial banks and financing companies in Thailand



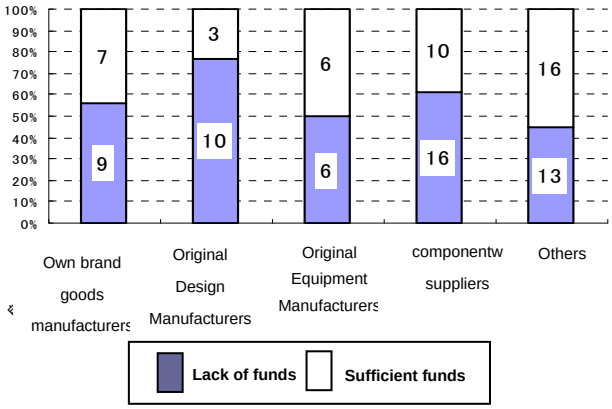
Note: Complied from the data on the companies registered on Stock Exchange of Thailand
Source: White Paper on International Economy and Trade of Japan (2005)

According to a survey of 153 local SMEs in Thailand that was conducted by the Center for SME Studies, the Institute for Development of Socio-Intelligence, and Senshu University, the enterprises engaging in planning and contract manufacturing had a tendency to encounter a lack of funding. The main reason cited was that because these enterprises require continuous operation from planning to production, they also require funding at each stage of the process. Additionally, it often takes time to receive payments from consignors, so they have difficulty obtaining operating capital until payments from the consignors are complete.

However, comparing the two charts below, which deal with lack of funding vs. companies that are utilizing bank loans, the ratio of "having loan from banks" was higher across all categories. This might show that local SMEs were able to increasingly borrow from banks, improving their funding capacity.

Figure 3: Lack of funding situation

(the ratio of the companies that answered "we lack funding")

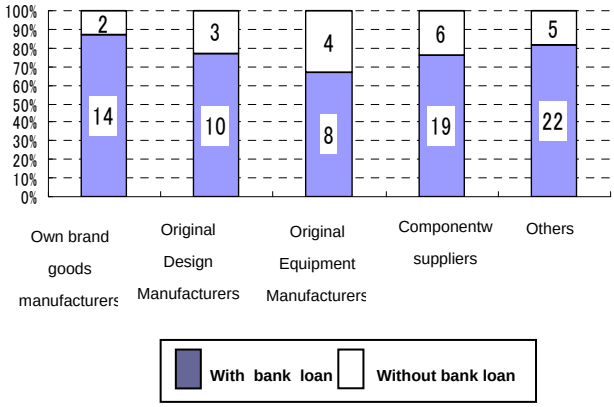


N=153

Source：Center for SME Studies, Institute for Development of Socio-Intelligence, Senshu University（2007）

Figure 4: Getting bank loan

(the ratio of companies that answered "we use bank loans")



N=153

Source：Center for SME Studies, Institute for Development of Socio-Intelligence, Senshu University（2007）

1.4. Feature of private financial institution financing

Traditionally, private financial institutions in Thailand have required physical collateral, mainly in the form of real estate and/or a guarantor for financing. Moreover, in situations where real estate was used as collateral, the banks have minimized risk by emphasizing the ease with which this collateral could be bought or sold.

However, banks have become more flexible in recent years with regard to accepting

some current assets, such as inventory or receivables, as collateral from qualified borrowers. For example, this concept can be seen in the collateral scheme of introducing the capitalization of assets (collateralizing), as currently implemented by the SME Development Bank.

For the credit application, the private financial institutions require that borrowers provide a bank transaction record, balance sheet, and the company registration to qualify for new financing. The financing institutions require that borrowers submit the registration that was issued within the previous month. Additional factors taken into account by financial institutions include: a business owner's "management skills"; a personal evaluation; "earning potential," as estimated from the business plan; and "added value."[7]

Control of NPLs and adaptation of the capital adequacy requirement are imposed on banks in accordance with international rules. Therefore, some private financial institutions became too sensitive to the risks, and as a result, SME financing became restrained due to higher risks and the focus on better financing projects with larger enterprises where the risk of NPL is lower.[8]

On the other hand, there are some private financial institutions that value the SME finance market, working to expand financing for SMEs. For example, a private commercial bank worked to expand the portion of SME financing several years ago by introducing the scoring method,[9] a simplified credit application for financing at levels under 12 million baht, and by shortening the credit decision process period from 1 month to 3 days. This reduced the administrative burden on the borrower and the expenses associated with small lending. In order to attract new SME customers, another private commercial bank set up an SME finance section a few years ago that provides counseling and seminars for SMEs.

[7] According to the interviews (February 2010)

[8] According to the interviews (February 2010)

[9] The scoring means estimating risk of bankruptcy and determining credit line with use of database of business information combining financial information and qualitative information. This contributes to reduction of reviewing time and improvement of accuracy for providing credit.

1.5. Current Status and Issue of SME Finance (Government/Financial Institution)

It is widely known in Thailand that SMEs are willing to accept bank loans despite high interest rates or time-consuming process because SMEs need working capital to keep themselves in business and they consider banks' high rates as relatively better than super high rates of the loans from informal lenders.

One general feature of SME finance is that continuous renewal of short-term funding ends up becoming long-term funding, and the shortage of working capital is minimized by the frequent use of overdrafts.

Given these circumstances, it is necessary for SMEs to have the financial know-how needed to stabilize cash flows for non-manufacturing industries and to implement additional financing from governmental financial institutions in the event that the amount of financing to the SME exceeds the limit available with the overdraft.

The government of Thailand carried out emergency economic measures as a response to the 2008 global economic recession. The Small Business Credit Guarantee Corporation (SBCG) extended the terms of the credit guarantee to 5 years in March 2009 and reduced the guarantee charge to 1.55% (from 1.75%). Furthermore, SBCG implemented measures in October 2009, in which the guarantee charge became zero, the upper limit of the guarantee increased from 20 million baht to 40 million baht, and the terms of the credit guarantee could in certain cases be more than 5 years.

Flexible and positive approaches toward SME financing, such as accepting inventory or receivables for short-term financing collateral, started to be seen among private financial institutions. However, inventory and receivables only have collateral value when companies are doing well. Since there was a drop in economic activity and consumption during the recession, the inventory could lose its collateral value. Therefore, financial institutions with flexible approaches could incur larger risks. It is necessary to hold discussions among the related parties, including both government and banks, to cope with these problems.

2. Current Status of SME funding

In many cases, local SMEs in Thailand establish operations using unorganized financing, and then apply for a loan from the bank only after the business is successful, creating a need for investments in plants and equipment.

In Thailand, when an SME receives a bank loan, the bank lends money using the SME owner's property as collateral. However, it is possible for SMEs to receive short-term financing from local banks without such collateral in cases where the loan amount is small. On the other hand, because mid to long-term financing is not available without collateral, it is often the case that companies will renew the short-term loan repeatedly when they need mid to long-term loans for their equipment capital.[10]

In addition, it is necessary for SMEs to get financing to pay for raw materials or for advance payments to consignors for large scale orders. In such cases, they usually use the overdraft. SMEs obtain the working capital by taking advantage of short-term financing. Although it is not visible in the statistics, the amount of money borrowed from relatives or acquaintances tends to be quite large. For this reason, the following financial management system of SMEs can be observed:

- Limited ability to prepare for bank loans, such as by drafting business plan
- Fear of bank intervention in the SME's management
- Misappropriation of funds for the business owner's personal use

On the other hand, SMEs' low sense of responsibility toward repayment is pointed out by banks.[11]

[10] "Survey on the diversification of financing method of SME in Thailand" by The Japan Economic Research Institute(2008)

[11] According to the interviews

3. Reccomendations Making It Easier for SMEs' Getting Access to Finance

As indicated above, we made some recommendations toward enhancing SMEs' access to finance in Thailand in terms of the government, financial institutions and SMEs themselves:

3.1. Financial policy for SMEs

It is recommended that SME access to financing be improved through further enhancements of the credit guarantee system. Regarding the current system of credit guarantee allocation to major private commercial banks, it is recommended that the system be made more efficient, for example, by allocating more credit guarantees to private commercial banks that lend extensively to SMEs. Regarding the measures of NPLs attributed to the manufacturing industry or OTOP, it is strongly recommended that the government provide increased management guidance to companies. In general, the non-manufacturing sector is managed on a smaller scale than manufacturing industries. It is difficult for financial institutions to conduct credit decisions because the responsibilities between business management and finance management are not clearly differentiated. Because fixed liability for equipment capital is small and cash liquidity is relatively favorable, many business owners misunderstand the responsibility for repayment and tend to accumulate short-term liabilities. In order to address these borrowing activities of the non-manufacturing sector, it is recommended that debt ratios be reduced based on financial institutions' guidance and consultations with strong supports of OSMEP.

It is also recommended to facilitate legal infrastructures and credit information systems which make it easier for SMEs to get funded on their movable or intangible assets, and provide business opportunities among SMEs and other service sectors such as business consultancy.

3.2. Financial institutions

Financial institutions want to expand equipment capital financing. However, this process is complicated by the prerequisite for land collateral. Land collateral is required because financial institutions are limited in their ability to assess the value of SMEs or new businesses. It is indispensable to reform the entire industry's understanding by compiling successful cases in which the finance risk was lowered by combining management guidance and a diversified credit decision process with actual financing.

3.3. SMEs

Major issues for SMEs are inability to prepare documents appropriate for credit applications with financial institutions, lack of tangible collateral and knowledges on services that are available, insufficiency of smart ideas and plans for businesses, and inefficient use of loans. It is highly recommeneded to educate SMEs' owners at both the central and local levels with strong support of OSMEP or chamber of commerce, and it has been well progressing

Moreover, regarding SMEs involved in OTOP activities, it is often the case that the organizational structure needed to function as an enterprise is underdeveloped. It is important to continuously evaluate the repayment capacity of enterprises and to classify enterprises based on the risks associated with their repayment capacity, while strengthening the management infrastructure of SMEs with relatively limited risks by providing them with management guidance.