

Thailand

AJDF Category B (Krung Thai Bank Limited, The Industrial Finance Corporation of Thailand)

Report Date: March 2001

Field Survey: August 2000

1. Project Profile and Japan's ODA Loan



Site Map: The whole of the Kingdom of Thailand



Valve Factory (Paton Thani area)

(1) Background

- 1) The Thai economy has shown a high aptitude for change, shifting from an agriculture-centered monoculture economy through a period of import-substitution industrialization, to an export-oriented economy which has supported the recent high growth. The move towards export-oriented industrialization under the Sixth Plan (August 1987 ~ September 1991) was continued in the Seventh Plan (October 1991 ~ September 1997), which was the main objective for the Thai economy's shift toward industrialization. In that process, the wide-ranging local group of small and medium enterprises has played a major role and was positioned as a pivot to independence and sustainable growth in Thailand's economy.
- 2) The key agencies in Thailand's institutional banking for small and medium enterprises have been the Industrial Finance Corporation of Thailand (IFCT, established in 1959), and the Small Industries Finance Corporation (SIFC, established in 1991). However, their funding is small scale, and they can only be used by a limited range of small and medium enterprises. Therefore enterprises have mainly had to use the available finance from commercial banks, namely short-term loans on a rollover basis, turn to high-interest informal loans, or rely on their own funds. The local labor-intensive industries, which have been the core of Thailand's export-oriented industries, were beginning to take root, and it was very important to relieve bottlenecks on the financial aspect if they were to be encouraged to sustained growth rather than stifled. This situation prompted assistance to nurture export-oriented Thai small and medium enterprises as one element of the fund circulation measures agreed at the Japan – ASEAN Summit.

(2) Objectives

The project aimed to nurture the Thai small and medium industrial sector by providing the medium and long-term capital investment funding for the growth and development of small and medium enterprises,

through the Industrial Finance Corporation of Thailand (IFCT) and the Krung Thai Bank Limited (KTB), which are governmental finance agencies..

(3) Project Scope

The ODA loan provided the funding source for the sub-loans needed for the implementation of this project, and also funded the procurement of related services.

Sub-loan terms

- Eligible industries: The eligible industries were not specified, but the main industries planned for are as listed below.
Textiles, processing of agricultural produce, foodstuffs, carpentry and furniture, paper products and printing, rubber and plastic products, construction materials, metal products, glass products, etc.
- Eligible borrowers: Companies with fixed asset value (before borrowing) not exceeding 160 million Baht.
- Loan applications: Funding for equipment investment
- Terms and conditions: Sub-loan interest: 10%
Duration: 3~10 years (including a grace period of 1~3 years).
Loan value: Up to 100 million Baht/ loan.
- Loan percentage: 70% in principle.

(4) Borrower/Executing Agency

Kingdom of Thailand / The Industrial Finance Corporation of Thailand (IFCT) and Krung Thai Bank Limited (KTB)

(5) Outline of Loan Agreement

| | |
|-----------------------------------|--|
| Loan Amount/Loan Disbursed Amount | ¥34,375 million / ¥34,375 million |
| Exchange of Notes/Loan Agreement | August 1992 / September 1992 |
| Terms and Conditions | Interest rate: 2.5%, Repayment period: 30 years (grace period: 10 years), General Untied |
| Final Disbursement Date | March 1998 |

Notes: The ODA loan was re-lent equally to the IFCT and the KTB.
IFCT: ¥17,187,500,000
KTB: ¥17,187,500,000

2. Results and Evaluation

(1) Relevance

The Thai economy had aimed to nurture export-oriented small and medium enterprises, and after the 1985 Plaza Accord foreign companies, especially the Japanese which were prompted by the high appreciation of Yen rapidly increased their investment in Thailand. That investment spurred strong growth in the small and

medium business sector.

The project provided small and medium enterprises, which were in a weak position for securing finance, with the funds they needed in order to encourage continuing transition and sustained growth in the export-oriented economy, which has supported the country's recent rapid growth. It was in line with the Seventh National Plan for Economic and Social Development whose objective was to nurture local export-oriented small and medium enterprises, as well as the present Eighth Plan, which pays special attention to small and medium enterprises. These facts indicate that this project retains its importance to the Thai economy.

(2) Efficiency

According to the initial plan, the ODA loan was to be re-loaned from the Thai Ministry of Finance in two equal portions of ¥17.188 billion (approximately 4.2 billion Baht) to the IFCT and the KTB, which were the executing agencies. The allocation between the two banks was later adjusted as a disparity emerged between their implementation records, such that the IFCT was allocated ¥18.495 billion (4.705 billion Baht) and the KTB was allocated ¥15.88 billion (3.811 billion Baht). The entire amount of the ODA loan was disbursed between the two banks.

This AJDF finance program was scheduled to continue until 1995. The ODA loan disbursement plan was scheduled for execution over three years from 1992 to 1994, but it was actually executed over six years from 1993 to 1998 (see Table 1). The original disbursement deadline was January 1996, but that was extended by a total of two years and nine months to October 1998.

Table 1 Actual and Scheduled Loan Disbursements

Units: Millions of ¥ (MY) and millions of Baht (MB)

| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | Total |
|-----------------------------|--------|--------|--------|-------|--------|-------|-------|--------|
| Planned finance amount (MY) | 11,459 | 11,458 | 11,458 | - | - | - | - | 34,375 |
| (MB) ^(Note) | 2,338 | 2,337 | 2,337 | - | - | - | - | 7,012 |
| Loan disbursed amount (MY) | - | 1,768 | 4,711 | 8,655 | 10,230 | 6,885 | 2,126 | 34,375 |
| Disbursement by IFCT (MY) | - | 1,635 | 4,116 | 6,865 | 3,416 | 843 | 1,619 | 18,495 |
| (MB) | - | 380 | 999 | 1,788 | 805 | 208 | 525 | 4,705 |
| Disbursement by KTB (MY) | - | 132 | 595 | 1,790 | 6,814 | 6,042 | 506 | 15,880 |
| (MB) | - | 31 | 146 | 443 | 1,593 | 1,390 | 208 | 3,811 |

Note 1) Exchange rate: 1 Baht = ¥4.9.

2) Planned amounts for each agency: ¥34.375 billion { IFCT: ¥17,187,500,000 4.2 billion Baht
KTB: ¥17,187,500,000 4.2 billion Baht

3) The KTB was unable to disburse the entire amount, thus on 27th March 1998 it petitioned the Ministry of Finance in Thailand to have another agency use the remainder. As a result, the amount disbursed by the IFCT was increased.

The booming growth of the Thai economy in the 1990s was accompanied by strong demand for finance, but disbursement did not grow initially. The reason, at least for the IFCT, was that besides the AJDF funds, it had also received a separate two billion Baht from the Bank of Thailand (BOT) for nurturing small and

medium enterprises, and priority was given to disbursing that. Another reason was that the KTB, as a state-owned commercial bank, was involved in a wide variety of operations, but as it was not a policy based finance agency like the IFCT it had little experience of special finance systems such as this project, and it got off to rather a slow start.

(3) Effectiveness

1) The content of support for small and medium enterprises

Finance was provided to approximately 341 small and medium enterprises (between the two banks) in fields such as food processing, metal processing, rubber and plastics, furniture and carpentry, and construction materials and equipment. Of these recipients, approximately 80% were regional small and medium enterprises located outside Bangkok. They received loans to fund capital investments for new or expanded facility, in line with the aim of developing small and medium businesses. The characteristics of the two finance agencies were largely as described below.

(1) Target sectors

The IFCT mainly directed loans to basic fields, with approximately 66% going to the top five fields, which were food processing, rubber and plastics, construction materials and equipment, metal processing, and agriculture, fishing, mining and quarrying. KTB sub-loans spread their loans over a wide range of sectors, with only approximately 36% loaned to their top five fields, which were wooden furniture and paper, rubber and plastics, cement and concrete, metal processing, and chemical products.

(2) Shares by scale of end user

Eligible borrowers were limited to companies with total assets not exceeding 160 million Baht. The figures do not reveal any marked characteristics, but the distribution by borrower size shows that the IFCT's end users tended to include more small companies, while medium companies were more numerous among KTB end users.

Table 2 Shares for Each End User Size Class

| | IFCT | KTB |
|-------------------------------------|------|-----|
| Total assets: Up to 20 million Baht | 49% | 42% |
| 20~100 million Baht | 41% | 49% |
| 100~160 million Baht | 10% | 9% |
| Workforce size: Up to 50 | 49% | 42% |
| 50~300 | 43% | 56% |

2) The state of end user business activity

As Table 3 shows, in terms of factory numbers foods and drinks are the largest group among Thai small and medium enterprises, with a 42% share. The next most numerous groups are machinery and metals. Under this AJDF finance, an overview of the two banks' result shows that loans were mainly allocated to fields such as food processing, rubber and plastics, construction materials and equipment, metal processing, farming, fishing, mining and quarrying, wooden furniture and paper, cement and concrete, and chemical products. This distribution indicates that finance was provided in line with the direction of Thailand's recent industrial development.

Table 3 Shares for Each Type of Small and Medium Enterprises (1998)

Units: %

| | No. of factories | Value of investment | No. of workers |
|--|------------------|---------------------|----------------|
| Foods and beverages | 42.2 | 12.0 | 14.2 |
| Textiles etc. | 4.2 | 5.5 | 15.7 |
| Wood products, paper and printing | 9.3 | 8.8 | 13.0 |
| Chemicals, rubber and plastic products | 3.4 | 9.8 | 6.9 |
| Metals and non-metals | 12.4 | 13.7 | 14.8 |
| Machinery and transport equipment | 15.8 | 14.1 | 15.5 |
| Other | 12.7 | 36.1 | 19.9 |
| Total | 100.0 | 100.0 | 100.0 |

Source The Thai Ministry of Industry, Industrial Promotion Office

3) Effect on encouraging investment of small and medium enterprises

The end users used nearly all the AJDF funds on new investment and expansion investment, which contributed to the encouragement of investment of small and medium enterprises.

Table 4 Breakdown of Invested Funds

| | IFCT | | KTB | |
|----------------------|------------------------------|-----------|------------------------------|-----------|
| | Amount (millions of Baht) | Share (%) | Amount (millions of Baht) | Share (%) |
| New investment | 2,348.0 | 50.0 | 2,471.9 | 66.6 |
| Expansion investment | 2,227.3 | 47.0 | 1,190.0 | 32.0 |
| Renewal investment | 130.4 | 3.0 | 50.0 | 1.4 |
| Total | 4,705.7 | 100.0 | 3,711.9 | 100.0 |

Small and medium enterprises constitute a large proportion of the Thai economy, and the Thai government is making strenuous efforts to promote their development. However, some of those enterprises have suspended their operations or fallen into bankruptcy by facing a harsh business environment in the aftermath of the economic crisis. Many are unable to obtain loans due to a credit squeeze from financial institutions. After lending from this AJDF ODA loan has finished, the Thai government promulgated the Small and Medium Enterprises Stimulus Law in February 2000, and it set up Small and Medium Enterprises Stimulus Committee chaired by the prime minister. Policies are being coordinated within the government, executive systems are being built, and special finance frameworks are being set up for the provision of loans to small and medium enterprises through government-affiliated financial institutions (see Table 6). These efforts are stepping up support for small and medium enterprises. At present, some companies are regaining their strength as the Thai economy recovers, but if local small and medium enterprises are to be more strongly nurtured and made more competitive, they will need not only financial support but also support through various policies in areas such as taxation, market development and skills.

4) Contribution to the nurturing of regional small and medium enterprises outside the Bangkok capital region

Most activity in the Thai economy is concentrated in the Bangkok capital region, but under this AJDF project the IFCT directed nearly 80% of its finance to support regional small and medium enterprises, while the KTB did so with over 80% of its finance.

5) The creation and promotion of employment

The sub-projects financed by this project were mainly used for new and expansion investment, which led to the creation of new jobs. However, the collation of data to identify job creation effects was not made a condition of the finance, and there is no data showing combined totals for the two banks. The IFCT compiled its own data, which shows that 39 out of 243 borrowing companies created a total of 2,063 new jobs. There is no data for the KTB.

(4) Impact

1) Introduction of new technology

Some of the export-oriented companies succeeded in introducing new production technologies in order to meet the consumer and quality standards of export markets. For example, a valve manufacturer, which was one of the KTB end users and entered into technical cooperation with a Japanese company, has been recently increasing the exports to Australia rapidly, and was able to meet Australian standards and supply high-quality valves suiting the needs of that country's market. It is also aggressively pursuing the introduction of new technology and quality control, including the acquisition of ISO9002.

2) Environmental and social impact

Before receiving IFCT finance, some of the end users had problems such as the following:

- Failing emission standards under the Thai Industry Law with emissions, such as factory waste water with in excess of the BOD standard.
- Dust within factories.
- Industrial waste.
- Odor from pig farm sheds and broiler chicken factories.

In line with the Thai Industry Law standards, the IFCT identified these situation at the time of appraisal, and guided borrowers to make improvements in the course of loan negotiations, although such efforts were not made conditions of finance. All the companies receiving finance complied with the Thai Industry Law standards.

3) Implementation of an impact study

The Thai Ministry of Finance was supposed to prepare an impact study report on behalf of the executing agencies, the IFCT and KTB, and submit it to the Japan Bank for International Cooperation (JBIC). However, the report has not been submitted, thus the Thai government has not analyzed the impact of this project.

(5) Sustainability

1) Executing agency

(i) Organization

The International Finance Cooperation of Thailand (IFCT)

The IFCT was established by the IFCT Law in 1959 as a financial institution to provide mainly medium and long-term finance to the private industrial sector. Public agencies account for a high proportion of its shareholdings, and it functions as a policy based banking agency working for the development of the industrial sector. In April 1999, 42.2% of its shares were owned by the Thai government and governmental institutions (20.65% owned by the Ministry of Finance, 14.65% by the GSB, and 7.1% by the Krung Thai Bank). In a capital increase in July 1999, the Ministry of Finance increased its share to 29.81%. Of its capital value, 51% is Thai capital and 49% is foreign. Among the 8,087 shareholders, 61.45% are Thai and 38.55% are foreigners.

The IFCT had 952 staff and 28 branches at the end of 1999.

The Krung Thai Bank (KTB)

The KTB was formed in 1966 by a merger between the Provincial Bank and the Agricultural Bank. It is now the country's second largest commercial bank, after the Bangkok Bank, and the government and government agencies hold over 95.8% of its shares. It serves as a governmental bank, performing tasks such as rescuing other financial institutions on the basis of the government request. At the end of 1999 it had 18,169 staff, comprising 6,476 at head office and 11,693 in branches. Of the KTB's branches, 643 are in Thailand, and eight are overseas, as are two overseas staff offices. There are also 53 KTB business centers within and outside Thailand.

(ii) Operation and maintenance scheme

Both the IFCT and the KTB pay close attention to credit management, the supervision of loan projects and the early solution of non-performing loan problems. To that end, sub-project factories are visited twice a month by the staff responsible for them, who check on the status of the factories and talk with their managers.

(iii) Non-performing loan problems and their handling

(Non-performing loan problems in Thailand)

Non-performing loans (NPLs) held by all financial institutions increased after the economic crisis, reaching a peak of 45.02% at the end of 1998. From the start of 2000 the numbers began to fall gradually, to an estimated level of 22.7% by November of that year.

The following three methods are now being used in Thailand to deal with NPLs, amid strenuous efforts to rebuild the economy.

- A: Debt restructuring (debt reschedule, prepayment, interest rate reduction, capitalization of debts etc.) to reduce the size of NPLs.
- B: Foundation of affiliated Asset Management Companies, to which NPLs are transferred.
- C: Sale of debts to third parties such as foreign banks.

Since many of the creditors of the AJDF project are rural small and medium enterprises, the number of the companies failing into the economic crisis increased and NPLs proliferated rapidly. Therefore both executing agency banks are currently in consultation with the Ministry of Finance over the remedies to deal with the NPLs.

Both banks are basically applying debt restructuring remedy (debt reschedule, and prepayment in rare cases). They do not write debts off or reduce or waive interest. They have assumed that, as the economy is tending towards recovery, it is very likely for those borrower companies to revive their profitability by improving the business environment.

(The overall NPL of the IFCT)

The share of NPLs within the total outstanding balance of loans stood at 35.2% at the end of 1998, but by the end of 1999 the figure had fallen to 27.8%. This drop was the result of cooperation with companies' efforts at business reconstruction in the form of extended debt reschedule, capitalization of debts, and other debt restructuring methods (in 1999, 126 contracts worth 17.921 billion Baht in total were restructured). The IFCT perceives that it has been solving the NPL problem steadily.

Of the 243 companies which received finance from the IFCT under this AJDF project, 121 companies, nearly half, were in arrears at the end of December 1999. The total amount in arrears was 1.218 billion Baht, equivalent to 26% of the total value of approved loans, which was 4.705 billion Baht. These arrears are mainly being dealt with through extensions of repayment dues.

(The overall NPL of the KTB)

According to the KTB's annual report, the share of NPLs within the total value of outstanding loans has been increasing since 1997, reaching 48.1% at the end of 1998, which was higher than 45%, the average of financial institutions in general. The NPL rate rose higher, peaking at 59.8% in June 1999 before falling back to 49.6% by the end of the year, with the beginning of a gradual improvement. In 2000 the KTB intended to do its utmost to solve the NPL problem, encouraging debt restructuring by using Asset Management Company (AMC) to separate its NPLs, and pursue management reforms with the aims of raising its quality by modernizing the bank's management and raising its accounting practices to international standards, and cutting costs and raising profitability. As mentioned above, these measures are being applied in various ways with the support of the Ministry of Finance.

As the nature of its banking operations differs from that of the IFCT, the KTB was left with a very large value of NPLs after the economic crisis in August 1997, and it was at a loss as to how to deal with them. In August 1998 it was directed by the Ministry of Finance to pursue financial reconstruction. From 1999 it responded by carrying out numerous reform measures, including reorganization, efficiency improvement and the removal of directors. The KTB is now considering improvement of its management practices with a view to privatization. In September 2000 the KTB transferred NPLs to the Sukhumvit Assets Management Company Ltd. (SAMC), with the approval of the Ministry of Finance, which was founded and is managed by joint force of KTB and the Financial Institutions Development Fund (FIDF). As a result, it reorganized some of the NPLs on its books. However, there has been criticism that this is no more than a way of massaging the balance sheet by passing off the NPLs to an AMC founded for the purpose within the group. The KTB has also set up Asset Management Business Unit which gives special supervision for loans in arrears more than six months.

There has been widespread criticism within Thailand against the idea of selling the NPLs in a lump to a third party, such as a foreign bank, and such a measure would lose the bank its established client base, obliging it to slash its capital. Therefore the step of transferring the NPLs to the SAMC can be regarded as an unavoidable measure. It appeared that some of the NPLs transferred to the SAMC were from this ODA project. As a result of the transfer, the balance of AJDF-related funds owed to the Ministry of Finance by the KTB fell to only 314 million Baht at the end of 2000.

(Note) Of 15 local commercial banks, seven have been put under temporary state ownership or have been merged with state-owned banks. Three of those were sold to foreign banks, and two introduced new management methods on receiving majority investment from foreign banks, in efforts to become more competitive.

2) The sustainability of the sub-loan borrowers and their related projects

The end users are regional small and medium enterprises, and many of them have total assets of less than 20 million Baht and workforces of fewer than 50 people. Therefore large numbers of them were hit hard by the economic crisis, and many of them in arrears are seeking debt restructuring or additional financial support. The same situation applies to the sub-projects carried out by this project's end users, and many companies have received debt relief measures from the two executing agency banks. The IFCT and the KTB are directing end users to reconstruct their businesses on a more sound footing, in an effort that overlaps with their own NPL disposal problems, and they are very cautious in their project supervision and debt management. At the end of 1999, 121 of the IFCT's end user projects were in arrears on payments that came due, representing 26% of the value of finance provided. Approximately 15% of all end users were in arrears of one year or more. The Thai government is providing financial support to help small and medium enterprises recover their strength, and financial institutions overcome their NPL problems. From the start of 2000 nearly all those end user in arrears of six months or more had their debt payment methods changed and their contracts altered, so that they would no longer be regarded as NPLs. There appears to have been some improvement due to the progress of the economic recovery.

Table 5 Status of IFCT End User Projects (Dec/1999)

| | Value and No. of loans | Share |
|---|------------------------|----------------------------|
| No. of loans (A) | 243 | |
| Cumulative value of loans (B) | 4,705 million Baht | |
| Loan balance at the end of 1999 (C) | 2,349 million Baht | |
| Amount already repaid (D) | 2,330 million Baht | (D/A) 49.5% |
| Value in arrears at the end of 1999 (E) | 1,218 million Baht | (E/B) 25.9% |
| Corresponding No. of loans in arrears (F) | 121 | (F/A) 49.8% |
| Breakdown of the corresponding value in arrears | | |
| Less than six months in arrears (G) | 267 million Baht | (G/E) 21.9% |
| 6~12 months in arrears (H) | 265 million Baht | (H/E) 21.7% |
| One year or more in arrears (I) (74 loans) | 687 million Baht | (I/E) 56.4% (I/B) 14.6% |

3) The revolving fund

The Thai Ministry of Finance, as the borrower for this project, was supposed to set up a special account (the AJDF Thailand Fund) within the Ministry and manage the revolving fund. The recovered capital was to be re-loaned under the same program and the same terms that applied under this project (for other IFCT

projects the special account was established within the IFCT and managed by the IFCT, but for this project the AJDF finance portion was to be managed by the Ministry of Finance). The management of this special account enables the Ministry of Finance to supervise the state of implementation of the project by the IFCT and KTB, which are the executing agencies. The supervisory report is to be submitted to JBIC annually, but the reports have not been submitted lately. When the reports were requested during this study, the reply was that the data had not been adequately collated and neither were the reports managed.

Comparison of Original and Actual Scope

| Item | Plan | Actual |
|-------------------------|---|---|
| Project Scope | | |
| Provision of sub-loan | <ul style="list-style-type: none"> • Sub-loan via the Industrial Finance Corporation of Thailand • Sub-loan via Krung Thai Bank, Ltd. | <p>Same as left</p> <p>Same as left</p> |
| Implementation Schedule | 1992 ~ 1995 | 1993 ~ 1998 |
| Project Cost | | |
| Foreign currency | ¥34,375 million | ¥34,375 million |
| Local currency | | |
| Total | ¥34,375 million | ¥34,375 million |
| For ODA loan portion | ¥34,375 million | ¥34,375 million |
| IFCT portion | ¥17,187.5 million | ¥17,187.5 million |
| KTB portion | ¥17,187.5 million | ¥17,187.5 million |
| Exchange rate | 1 Baht = ¥4.9 (April 1992) | 1 Baht = ¥3.86 (Average for 1993 ~ 98) |