

# RURAL ENTERPRISES FINANCE : A CASE STUDY OF THE BANK OF AGRICULTURE AND AGRICULTURAL COOPERATIVES (BAAC) IN THAILAND<sup>1</sup>

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## I. THE BACKGROUND AND OBJECTIVES OF THE SURVEY

The promotion of the rural non-farm economy, especially the rural enterprises<sup>2</sup>, in the rural areas of Asia has been emphasized in recent years against the backdrop of rising unemployment caused by changes in the rural economic structure (conversion to non-agricultural employment) and the economic crisis, etc. As a result, microfinance and various other policy measures have been studied and implemented.

The objective of this survey is, within the rural enterprise promotion policy, to examine the financial support provided to those enterprises that have moved beyond the microfinance level. The case studied<sup>3</sup> is that of a prominent rural financial institution, the Thai Bank of Agriculture and Agricultural Cooperatives (BAAC)<sup>4</sup> in Thailand, which has been financially supported by JBIC since the 1970s. BAAC has been authorized to provide loans to the non-farm sector,

including rural non-farm enterprises, by amendments to the Act in 1999.

## CHAPTER 1. CHANGES IN THE STRUCTURE OF THE THAI REGIONAL ECONOMY

### 1.1 INDUSTRIALIZATION SPREADS TO THE REGIONAL AREAS

The Thai economy grew more than 8% a year from 1987-1995, centered on the manufacturing industry. Changes in the industrial structure spread from Bangkok Metropolitan Region throughout the country. Trends in the ratio of added value in the manufacturing industry from 1986-1995 shows that it rose significantly in many regional areas, while it peaked in Bangkok Metropolitan Region, where there already was an excessive concentration (Fig. 1).

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1 This is an executive summary of the JBIC Research Paper No.7 (Japanese only) "A Case Study of the Bank of Agriculture and Agricultural Cooperatives(BAAC)." Researchers in charge of this survey are JBIC: Naohiro Kitano and Seiji Nishii, Consultants: Yuuji Kurokaya, UNICO and Tomoo Mochida, OMPAC. This research was conducted with the cooperation of Takashi Matsuya, JICA expert and Dr. Fumiharu Mieno, associate professor of Hosei University. In July 2000, the outcome of this research was feedbacked to the senior management of the BAAC.

2 This includes the processing of agricultural products, textiles and other rural industries, transport and other service industries, and agricultural product distribution and other commercial industries. Enterprises in rural area marketplace, are also included.

3 In addition to interviews with related institutions in the areas concerned, it also involved the interview of more than 30 rural non-farm enterprises.

4 BAAC is one of the governmental financial institutions which was established in 1966, reforming and succeeding BAC(Bank for Cooperatives), based on the BAAC law. Its main purpose is to supply agricultural credit for farmers, farmer-groups and farmers' cooperatives. BAAC holds approximately 70% of Thailand's farmers as its customer. In advance of BAAC law amendment in 1999, financing agriculture-related activities was commenced by law amendments in 1992. BAAC has 13 thousand employees and leads 1500 branch offices. Policy decisions are made in the board of trustees whose chief is the Minister of Finance. Besides JBIC, Asia Development Bank(ADB) finances BAAC.

**Fig. 1: The ratio of added value in the Thai manufacturing industry to all production 1986-1995 (1988 prices)**

Manufacturing industry	Number of employees
Micro Enterprises	1 ~ 4
Small Enterprises	5 ~ 19
Medium Enterprises	20 ~ 199
Large Enterprises	200 or more

Commercial sector and service industry	Number of employees
Micro Enterprises	1 ~ 4
Small Enterprises	5 ~ 19
Medium Enterprises	20 ~ 99
Large Enterprises	100 or more

Source: Interviews with ADB (Asian Development Bank)

## 1.2 THE INCREASING PROVISION OF INFRASTRUCTURE

Infrastructure such as roads has been developed during this period across the country. This greatly spurred economic activity and boosted the quality of life. For example, there were 22,404 kilometers of paved roads in 1981. This had more than doubled to 46,331 kilometers by 1995. Progress of roads development in those areas such as the Northeast and North Regions was equivalent to that of the rest of the country (Fig. 2).

During this time, there was a dramatic increase in the number of vehicles not only in Bangkok Metropolitan Region, but also in other regions. A look at the average number of pick-up trucks per household in the rural areas of the Northeast Region shows a sharp increase in the areas adjoining trunk roads linking regional cities during the six-year period from 1986-1992 (Fig. 3). It is assumed that by farmers having their own means of transportation, there was a major improvement in access to the market for harvested agricultural products and the products of rural non-farm enterprises. Additionally, the improvement

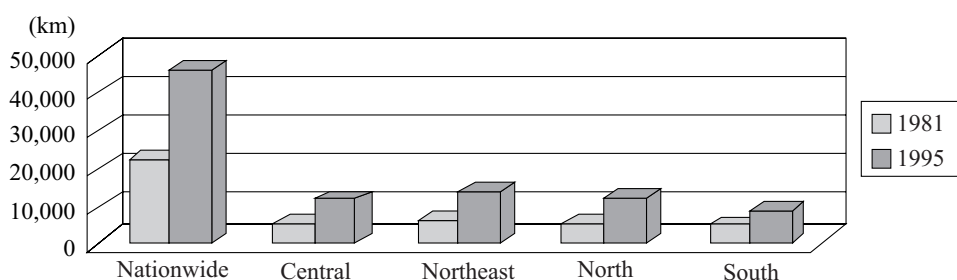
of access to regional cities resulted in an expanded commuting area and improvements in non-agricultural income.

During this economic growth, the average ratio of non-agricultural income in the farm household economy nationwide rose from 60% in 1986/1987 to 67% in 1991/1992 (Fig. 4). The average income per farm household climbed from 22,306 Baht in 1986/1987 to 34,163 Baht in 1991/1992.

This is thought to be largely due to the increase in local employment opportunities caused by the greater presence of the manufacturing industry, primarily in the Central Region. The increase in non-farm income in the Northeast is due to the increase in remittances from family members working in urban areas, like the Bangkok Metropolitan Region or overseas.

## 1.3 THE IMPACT OF THE ECONOMIC CRISIS

Meanwhile, the economic crisis since 1997 had a sharp impact on rural areas. It reduced the employment opportunities in these areas, as the number of

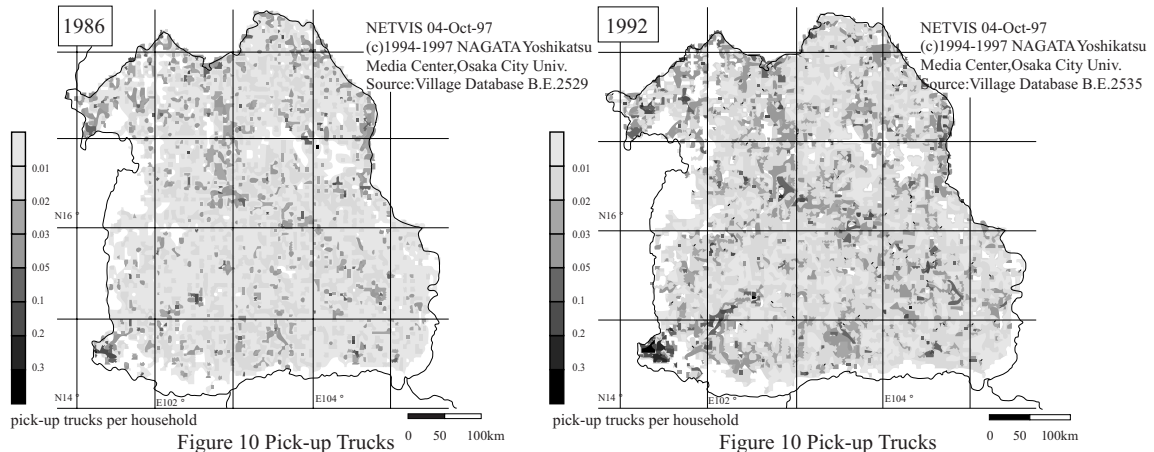
**Fig. 2: Length of paved roads by Region (1981-1995)**

Source: Ministry of Transport and Communications

employed persons in the agricultural sector fell 1.3% year-on-year in August 1998, and 5.5% year-on-year in August 1999. In addition, the real average income of rural areas plummeted, though not at the same level as in the cities (Fig. 5)<sup>5</sup>. Therefore, the creation of

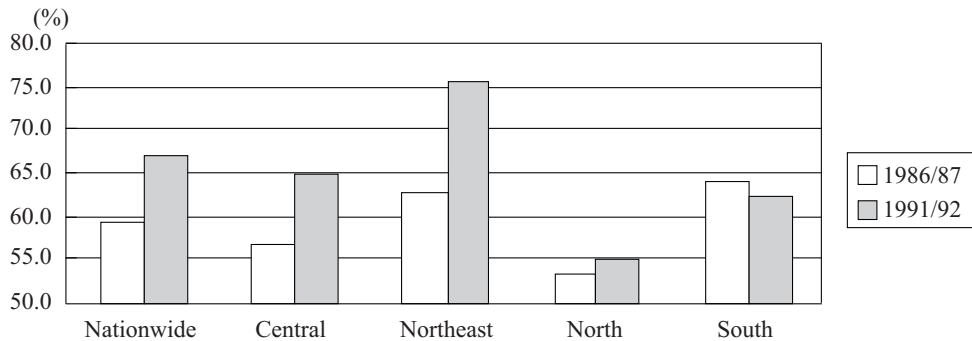
employment in rural areas by promoting rural non-farm enterprises and other non-farm activity, and the stabilization and improvement of the quality of life have become important policy issues.

**Fig. 3: Spread of pick-up trucks in the Northeast Region of Thailand (1986-1992)**



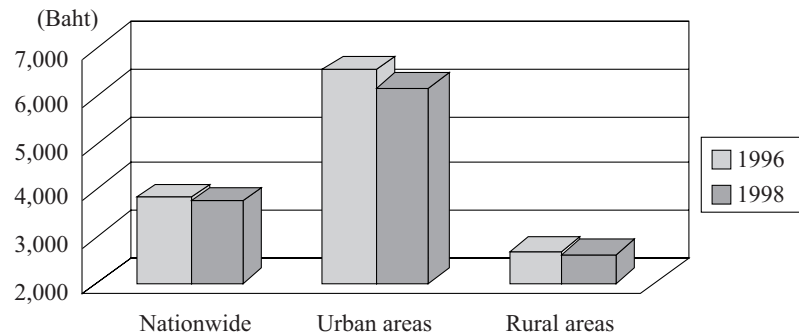
Source: Nagata (1996)

**Fig. 4: The ratio of non-agricultural income in the Thai farm household economy (Average per farm household) 1986/1987 ~ 1991/1992**



Source: NESDB

**Fig. 5: Real average income (1996-1998)**



Source: World Bank (2000)

5 The real wages in the agricultural sector, with those of 1997 as 100, fell to 85 in 1998, while those in the manufacturing industry fell only to about 95.

## CHAPTER 2. THE STATE OF RURAL NON-FARM ENTERPRISES

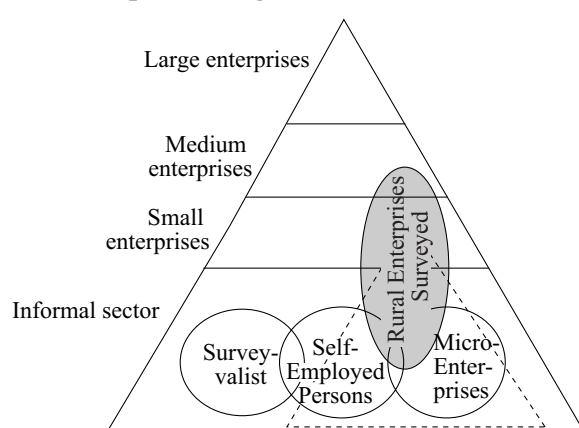
### 2.1 THE DEFINITION OF RURAL NON-FARM ENTERPRISES

There is no clear definition for rural non-farm enterprises in Thailand. In this report, we define the rural non-farm enterprises surveyed as medium- and small-sized enterprises and microenterprises operated by residents of rural areas primarily consisting of the

farming population (Fig. 6)<sup>6</sup>.

For a breakdown by size, we classified the enterprises based on the number of employees due to the restricted data available (Table 1)<sup>7</sup>. The breakdown of rural non-farm enterprises by sector compiled by the BAAC shows that some enterprises can be started with a relatively small investment, and that a wide range of economic activities are included in addition to the manufacturing industry (Table 2).

**Fig. 6: The positioning of the rural non-farm enterprises surveyed**



Source: Compiled based on Webster et al. (1995)

Note: \*1. Webster et al. define survivalists as the people engaged in various economic activities on a part-time basis, the self-employed as the people manufacturing items for sale, purchasing items for resale, or providing services, and microenterprises as extremely small enterprises engaged in ordinary activities within a certain range at a specified location for a specified time.

\*2. The entities shown with the broken line are those individuals, microenterprises, and medium- to small-sized enterprises thought to be potential recipients of BAAC financing, including microfinancing. The entities in the shaded area are positioned as rural non-farm enterprises in this survey.

**Table 1: Definition of medium- and small-sized enterprises**

Manufacturing industry	Number of employees
Micro Enterprises	1 ~ 4
Small Enterprises	5 ~ 19
Medium Enterprises	20 ~ 199
Large Enterprises	200 or more
Commercial sector and service industry	Number of employees
Micro Enterprises	1 ~ 4
Small Enterprises	5 ~ 19
Medium Enterprises	20 ~ 99
Large Enterprises	100 or more

Source: Interviews with ADB (Asian Development Bank)

6 The survey subjects in this report principally are assumed to have been one step above the microfinance level. In the case of BAAC, the maximum financing amount in the pilot microfinance project with GTZ was set at 100,000 Baht. The borrowers were the self-employed persons or the microenterprises shown in Fig. 6. Being a farmer was not a requisite in the loan conditions. The emphasis in this report is on those enterprises at a slightly higher level.

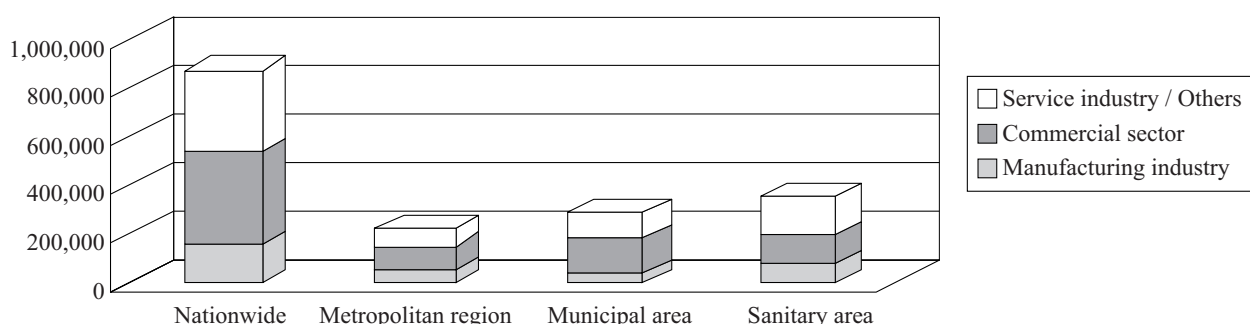
7 The definition of medium- and small-sized enterprises differs with each institution, such as Bank of Thailand and International Finance Corporation of Thailand (IFCT). This paper, out of the provisional proposal of the Ministry of Industry (which divides microenterprises and small enterprises based on the number of employees, registered capital, and sales), expediently adopted the definition based on the number of employees.

**Table 2: Breakdown of rural non-farm enterprises**

Industry	Sectors
Industrial	Drinking water, ice production, furniture, bending iron making, brick, confections, rice mills, rice noodle machines, noodles, casting product processing, cement products, wooden buckets
Commercial	Miscellaneous goods, retail, supermarkets, sales of construction materials and equipments, electronic devices, spare parts, furniture, noodles and agricultural implements, restaurants
Service industry	Parking lots, motorcycle repair shops, gas stations, beauty parlors and barber shops, construction industry, tailors, transportation business

Note: Enterprises eligible for non-agricultural financing from BAAC.  
Source: BAAC

**Fig. 7: National distribution of enterprises and industries in Thailand**



Source: 1996 National Survey of Business Enterprises

## 2.2 OVERVIEW OF RURAL NON-FARM ENTERPRISES

There are no statistics that comprehensively cover rural non-farm enterprises in Thailand. Therefore, for the sake of convenience, we used the “1996 National Survey of Business Enterprises” published by the Thailand National Statistical Office to examine the current state of medium- and small-sized enterprises as well as microenterprises such as in the manufacturing industry, the commercial sector, and the service industry. This survey revealed a total of about 850,000 business enterprises nationwide. Of these, the highest number of business enterprises were those whose scope of operations was the sanitary area<sup>8</sup> (about 350,000 enterprises) (Fig. 7)<sup>9</sup>. Other statistics

indicate that the number of rural enterprises is about the same as the number of enterprises operating at the sanitary area level. Combining the number of these two and subtracting the number of large enterprises from the total leaves a rough figure for the number of rural non-farm enterprises.

A breakdown by sector shows that the ratio of small microenterprises is extremely high in all the sectors. This trend is particularly pronounced inside the Metropolitan Region. For example, a look at the distribution of enterprises by size in the manufacturing industry shows an extremely high proportion of microenterprises at the sanitary area level (Fig. 8). It is estimated that roughly the same trend holds true for rural areas.

8 Thailand is constituted of Bangkok Metropolitan Region and 75 Changwats(Provinces). Under the Provinces, there lies administrative units called Amphoe(Districts). Within each District, the most developed Area is called a Skapibaan(Sanitary Area), and among Sanitary Areas,the center respective of the Province is called a Tessabaan(Municipal Area). Other areas are regarded as rural areas.

9 These statistics cover enterprises with more than one employee in the manufacturing industry, commercial sector, and the service industry. (The survivalists and self-employed persons of Fig. 6 are not included.) They only cover enterprises down to the municipal and sanitary area levels, however. The only statistics of the same type available for rural areas are limited to enterprises in the manufacturing industry with at least 10 employees.

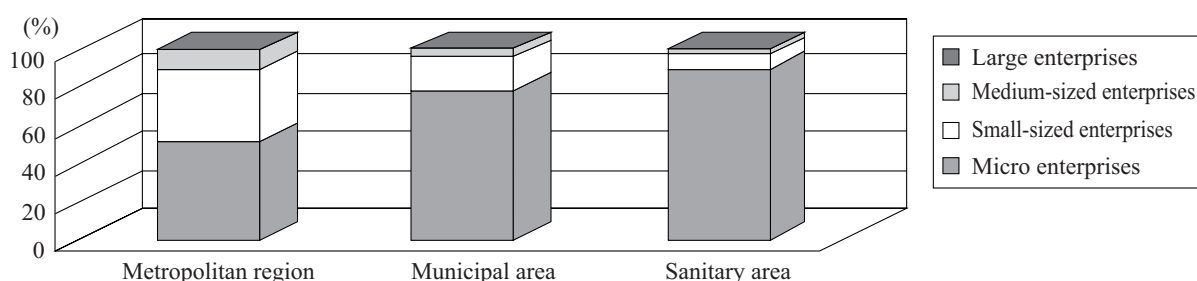
### 2.3 THE STATE OF RURAL NON-FARM ENTERPRISES

A look at the constituent elements of the number of employees of the 34 enterprises in this on-site survey arranged by BAAC shows that 12 are classified as microenterprises (Table 3). Most are thought to be enterprises for the family livelihood<sup>10</sup>.

The companies visited responded that the financial institution that provided financing was BAAC in most cases, as to be expected. In some cases, however, the enterprises borrowed from both BAAC and another financial institution (Table 4).

The sites selected for visits were rural non-farm enterprises, which are in principle supposed to receive at least 500,000 Baht in financing. However, in fact, about 50% of the sites received less than 500,000 Baht in financing. The enterprises that identified the financing amount are classified by the amount they borrowed, as shown in the following table. Most of the enterprises borrowed less than 1 million Baht (Table 5). The financing was to be used as funds for facilities or operating expenses etc., most of the enterprises visited received loans for facilities expenses

**Fig. 8: The distribution of enterprises by size in the manufacturing industry**



Source: 1996 National Survey of Business Enterprises

**Table 3: Distribution by size of the enterprises surveyed**

Size of enterprise	Number of enterprises
Micro enterprises	12
Small-sized enterprises	14
Medium-sized enterprises	8
Total	34

Source: On-site survey

**Table 4: The financial institution, etc., providing the loan**

Financial institution	Number of enterprises receiving loans and from which responses were received
BAAC	27
SIFC	3
IFCT	3
Northeastern Agricultural Development Office	1
IPC	1
Government-affiliated financial institution	1
Bangkok Bank	3
Ayutthaya Bank	1
Private sector lenders	1
Total	41

Note: These are financial institution, etc., currently providing financing. There are some enterprises that have borrowed from more than one financial institution. Therefore, the total number of enterprises above is greater than the number of enterprises surveyed.

Source: On-site survey

<sup>10</sup> Kiyonari (1990) classifies medium-, small-sized and micro-enterprises into four groups. They are, (1) Conventional companies, (2) Corporate family enterprises (Operations primarily comprised of the owner and employees who are family members), (3) Enterprises for the family livelihood (Primarily similar to those in (2) but are not evolved to the company level in which operations and household expenses are separate), and (4) Subsidiary and auxiliary family enterprises (Economic activities to supplement household expenses). In this paper, the subjects are primarily those enterprises in (1), (2), and (3).

**Table 5: Distribution of financing amounts**

Amount borrowed (Baht 10,000)	Number of loans
0 ~ 6	2
7 ~ 15	4
16 ~ 30	8
31 ~ 50	12
51 ~ 100	11
101 ~ 499	6
500 or more	6
Total	49

Note: \*1. Of the companies visited, there are those that received loans from financial institutions other than BAAC, those that received loans from more than one financial institution, and those that received more than one loan from the same financial institution.  
 \*2. The amount of the loan was obtained through an interview. For BAAC customers, the loan amount was confirmed and modified, to the extent possible using a customer list.  
 \*3. Some businesses among the rural non-farm enterprise borrowed separate funds for agricultural purposes. These figures are not included in the table.

Source: On-site survey

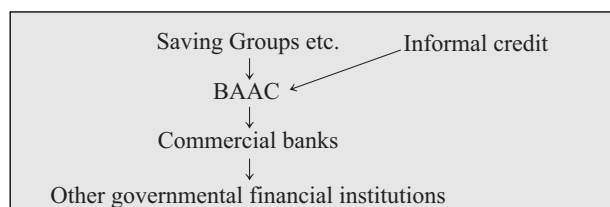
This is just one example of an extremely diverse range of rural non-farm enterprises. This enterprise manufactured dried red peppers. The business was begun from drying raw red peppers unsold in the market to dispose of them.

**< Converting unsold raw red peppers in the market to dried red peppers >**

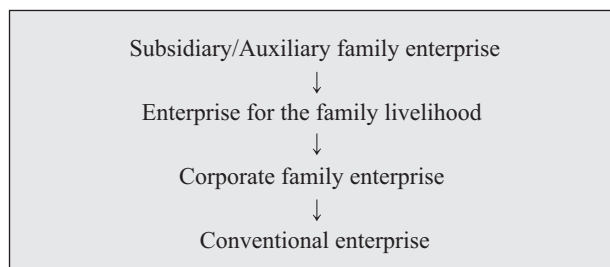
The area near Mr. P's home, particularly the eastern district, is land on mountain slopes used to produce red peppers. Mr. P's wife originally bought raw red peppers from farmers and sold them in the market. Ten years ago, they had difficulty disposing of the large volume of unsold peppers, and got the idea of drying them. The business started when they were successful at grinding the red peppers, since they had no electricity, by stepping on them using tools and selling them in the market. They own four pick-up trucks. Their sons and daughters drive the trucks as far as Bangkok and its environs, where they sell the red peppers. Nowadays, these dried red peppers are used in cooking as frequently as raw red peppers, so there is an established market for the product. The enterprise borrowed money from BAAC for equipment to dry the red peppers, machines to grind the peppers (several both large and small machines in both cases), and for a facility that is both a plant and a warehouse.

**2.4 STRATIFIED FINANCIAL ACCESS**

Based on the on-site survey, the following stratification can be seen for the access to agricultural loans in Thailand. The levels at the left-hand side combine informal funding. As the line moves to the right the amount of the loans increases<sup>11</sup>. The characteristics of the dynamic process of development from a microenterprise to a small enterprise in Thailand include using funds acquired informally to start a microenterprise, saving the proceeds from the enterprise after repaying the loan, purchasing land to begin with, and using that land as collateral to formally borrow money from a bank and expand.



The concept of stratified financial access can be seen in the following reciprocal relationship:



11 Satsaguan (1998) uses the TDRI survey in Nakhon Rachasima as a basis to point out that BAAC is gradually becoming more important than informal financing. In 1986, the ratio of formal financing to informal financing was 44% to 56%. Of the 44% in formal financing, BAAC's share was 18.8%. Ten years later, in 1996, the ratio of formal financing to informal financing was 60.4% to 39.6%. Of the 60.4% in formal financing, BAAC's share was 38.8%.

In addition, the scale of informal financing in rural Thailand has rapidly diminished. There are two reasons cited for this. First, non-agricultural income has become the primary income source for Thai farmers, and the farmers' income has become more stable than in the past. Second, BAAC and other institutions providing formal financing have opened branches throughout the country and are playing an increasingly important role in rural areas.



## CHAPTER 3 BAAC FINANCIAL SUPPORT FOR RURAL NON-FARM ENTERPRISES

### 3.1 THE RAPID GROWTH OF BAAC'S AGRICULTURE-RELATED FINANCING

Agriculture-related financing was initiated with the 1992 amendment of the BAAC Act. There are broad interpretations in the field regarding who is eligible for such financing, and loans already have been provided in many sectors with the provision that the borrowers be farmers.

BAAC has sharply increased its share of agriculture-related financing since 1995. There also has been financial support from the Asian Development Bank. As of the end of 1997, the amount of loans to individual farmers accounted for 6.9% of the total (Table 6).

There was a significant slowdown in the rate of year-on-year lending growth after 1997, however, and in 1998 and 1999, this rate was less than that of the growth rate in loans to individual farmers for other purposes. This is attributed to the emergence of the problem with delinquent loans in mid-1997, and lending was sharply curbed as a result.

### 3.2 THE AMENDMENT OF THE BAAC ACT

In a December 1998 Cabinet meeting, the Thai government established a credit line of 40 billion Baht for loans to medium- and small-sized enterprises from the Bank of Thailand and government-related financial institutions. A total of 2 billion Baht was allocated to the BAAC. Further, the amendment of the BAAC Act that approved non-agricultural financing

by the BAAC was approved by the Parliament in 1999. The primary points of the amendment are as follows.

- (1) The definition of farmer was expanded to include spouses, parents, and children of farmers
- (2) The definition of non-farm financing was expanded to include industry, commerce, and the service industry
- (3) Financing (medical costs, home building costs) is provided for training in improving agricultural technology and for improving the living standard
- (4) Financing is provided for joint ventures between farmers and non-farmers
- (5) The ceiling on loan amounts is raised (from 5 million Baht to 15 million Baht)
- (6) The range of BAAC sales activities is expanded (Agriculture-related businesses in addition to deposits and lending)
- (7) The integration of five sets of rules into one, and condensing 13 loan categories into five

This amendment continued to confirm and provide order to the financing, for non-agricultural activities, that had been implemented on-site since 1992. Also, with the passage of this amendment, BAAC launched an effort after October 1999 to strengthen the system by such measures as combining agriculture-related financing and non-agricultural financing, thereby enhancing the inspection and screening process with the cooperation of GTZ, the Asian Development Bank, and the EU. In the past, each employee of the business division of the branches had been responsible for an average of 700 customers, but now they are arranging to have an average of about 200-300 customers for both agriculture-related financing

**Table 6: The share of agriculture-related loans among all loans to individual farmers (year-end)**

Year	Balance of agriculture-related loans to individual farmers (Baht 1 million) (1)	Balance of BAAC loans to individual farmers (Baht 1 million) (2)	The ratio of agricultural loans (1) / (2)	Annual growth rate	
				Agriculture-related loans (1)	Agriculture loans (2)-(1)
1993		75,608			
1994	1,580	97,680	1.6%		27.1%
1995	4,991	127,243	3.9%	215.9%	27.2%
1996	10,641	162,640	6.5%	113.2%	24.3%
1997	12,325	177,545	6.9%	15.8%	8.7%
1998	13,097	192,823	6.8%	6.3%	8.8%
1999	13,794	222,797	6.5%	5.3%	10.7%

Source: BAAC Annual Report 2000 (Draft)



**Table 7: BAAC interest rate structure\***

Customer Category		Method for determining interest rate	Aug/1999 Interest rate	Dec/1999 Interest rate
(1) Prime (AAA)	Three years without an overdue	MLR	10.5%	9.00%
(2) Very good (AA)	Two years without an overdue	MLR+1.00	11.50%	10.00%
(3) Good (A)	One year without an overdue	MLR+2.00	12.50%	11.00%
(4) General (B)	New applicant for a new loan	MLR+3.00	13.50%	12.00%
(5) Default1 (-)	Overdue made and prolongation of requital deadline admitted	MLR +3.00+1.00	14.5%	13.00%
(6) Default2 (-)	Overdue made and prolongation of requital deadline rejected	MLR+3.00+3.00	16.50%	15.00%

Source: BAAC

**Table 8: Breakdown of the number of enterprises by the amount of the loan sought**

Total all industries Amount of loan sought	Number of enterprises				
	Industrial sector	Commercial sector	Service industries	Total	Ratio
0 ~ 100,000 Baht	504	1,339	904	2,747	41.2%
100,000 ~ 200,000	294	613	509	1,416	21.2%
200,000 ~ 500,000	337	730	583	1,650	24.8%
500,000 ~ 1 million	114	240	180	534	8.0%
1 million ~ 5 million	84	125	88	297	4.5%
5 million ~ 10 million	4	8	2	14	0.2%
10 million ~ 20 million	2	0	4	6	0.1%
Total	1,339 20.1%	3,055 45.8%	2,270 34.1%	6,664 100.0%	100.0%
Average amount of loan sought (Baht 1,000)	378	295	319	320	—

Note: It is assumed that all of the enterprises in the above table received part of the funds for expanding their business through a loan.

Based on such an assumption, the number of responding enterprises is classified by the amount of funds they sought.

Source: BAAC

and non-agricultural financing.

Also, in August 1999, a system of interest that doesn't depend on internal subsidy was introduced into BAAC. In December 1999, interest rate was raised to 1.5% (Table 7). On the other hand, although the cost of non-farm financing is higher than that of farm financing in general, no more raise has been made.

### 3.3 DEMAND FOR FUNDS FOR NON-AGRICULTURAL ACTIVITIES

BAAC conducted a survey of fund demand for non-agricultural activities in all provinces from July - August 1999. Of the 6,887 places of business they interviewed, 97% hoped to borrow money. A breakdown of the sectors of these places of business shows that 46% were in the commercial sector, 34% were in service industries, and 20% were in the industrial sec-

tor. A breakdown by the amount of financing sought showed that approximately 60% of the rural non-farm enterprises hoped for loans of more than 100,000 Baht (Table 8).

### 3.4 THE POTENTIAL FOR RURAL NON-FARM ENTERPRISES AND THE ROLE OF BAAC

As previously explained, BAAC's agriculture-related outstanding loan volume is still less than 10%, yet the survey of fund demand is thought to show a substantial latent need for funds. BAAC has a wider national network of branches than either Small-sized Industry Financial Cooperation(SIFC) or commercial banks. Also, many of the enterprise households operating rural non-farm enterprises are engaged in enterprises for the family livelihood or corporate family enterprises that rely exclusively on BAAC for their

formal funding source.

Further, there are thought to be high needs for assistance in creating business and financial plans and introducing modern business and production management when providing equipment and facility funds in conjunction with the expansion of the enterprise. Therefore, a role BAAC could play in promoting rural enterprises is discovering and supporting promis-

ing rural enterprises and serving as a bridge when those rural enterprises expand the scope of their operations.

In addition to BAAC, each relevant Ministry has a fund support program for non-agricultural economic activity. In general, however, the scope of these programs is small and their effectiveness is limited (Table 9).

**Table 9: Financial support and the primary institutions providing financial support for non-farm economic activities**

Institution name	Content of support
NESDB	Deposits Regional Development Funds (RDF) to the GSB.
Interior Ministry (CDD)	Support for forming a savings group. The group might borrow from BAAC and GSB.
Ministry of Commerce (DIT)	(1) Community Stores / Community Business Loans of operating funds to the group (procurement funds). The loans have no interest, repayment periods of a maximum of three years, initial loan size of 30,000-50,000 Baht per loan. It is possible to increase these later to 100,000 Baht. (2) Agricultural Commodity Market Financing for private sector businesses that want to establish a market for agricultural products in regional areas. The loans have no interest, a repayment term of three years, with a 50 million Baht ceiling on the loans.
Ministry of Industry (1) IPC (2) PID	Working Capital Fund for Family Enterprise and Handicraft Project Loans of primarily operating capital to groups or individuals. The annual interest rate is 6%, the repayment period is a maximum of four years, and the loan size is from 30,000 Baht to 1 million Baht. For loans of less than 100,000 Baht, a guarantee is needed from a group or two public officers. For loans of more than 100,000 Baht, physical collateral, particularly land, will be required.
Ministry of Agriculture and Agricultural Cooperatives (CPD)	These loans provide agricultural cooperatives with training and mutual assistance, water supply facilities and other infrastructure, and support for funding and technology. Loans to the cooperatives have 2-6% annual interest (different rates are applied depending on the type of loan), repayment periods of 1~15 years, and a loan size range of 100,000 Baht to 10 million Baht for each loan. The interest rates for loans from agricultural cooperatives to members are an additional 3% on top of the procurement cost from CPD.
Government Saving Bank	(1) NESDB's Regional Development Fund (RDF) Loans to groups with at least 25 people. As of August 1999, the interest rate was 7%, the repayment period a maximum of five years, and a loan ceiling of 1.5 million Baht. Other requirements include joint liability and land collateral. (2) GSB Social Development Fund Loans to groups with at least 25 people. Interest rates are based on MLR and are from 10-12%. The repayment period is a maximum of five years. The ceiling for RDF loans is 1.5 million Baht. Application for loans in excess of that amount or applications that do not fulfill the RDF funding requirements will be subject to examination. Other requirements include joint liability and land collateral. (3) Loans to medium- and small-sized enterprises (began June 1999). The loan size is over 100,000 Baht with requirement of a collateral.

## CHAPTER 4 THE ROLE OF BAAC AND PROPOSALS

### 4.1 THE COMPARATIVE ADVANTAGE OF BAAC AND TASKS FOR THE FUTURE

#### 4.1.1 The comparative advantage of BAAC

##### (1) The largest branch network in Thailand

During the period from 1980s-1990s, BAAC worked hard to expand its branch network. Including field offices, it now has more than 1,500 offices. This is a much higher total than the 600-branch networks of the second-ranked GSB, which is affiliated with the government, and the Thai Farmers' Bank, a commercial bank. In addition, at this point, IFCT has only 10 branches and SIFC has just five.

##### (2) Deposits and lending

BAAC offers both deposits and lending services in rural areas while providing agricultural financing at the same time. It has a firm base as a financial institution. Lending demand has exceeded the tempo of increase in deposits until now, so it has rapidly increased its business by receiving long-term, low-interest loans from JBIC, the Asian Development Bank, and other institutions, and also borrowing from commercial banks, while receiving capital infusions from the government. Deposits have been growing steadily in recent years, accounting for 34% of the liabilities of the B/L as of the end of May 1999. Their reliance on other funding sources is decreasing.

##### (3) Security system

BAAC has promoted agricultural financing in the form of the joint liability group. The advantages are that repayment is ensured by mutual oversight and the borrower can obtain funds with no security deposits. The advantage for the lender is that screening can be simplified. This joint liability group method is an extremely effective means and has made BAAC loans widespread and deep-rooted as a funding source in rural areas.

##### (4) Government support

Not only has the Thai Ministry of Finance taken a capital stake in BAAC, it also has invested ODA funds in the bank. It also provides support by allo-

cating 20% of the deposits in commercial banks through BAAC to financing in rural areas. Under such state protection, BAAC has grown as a monopolistic agricultural financing institution.

#### 4.1.2 Tasks for BAAC

##### (1) The delay in administrative rationalization

While BAAC has introduced a computer system, there are still hardware deficiencies, such as a lack of terminals. In addition, there is still a lot of room for improving the administrative system itself. Rationalization of office work, including on-line functions, is essential in view of reducing costs as well.

##### (2) Credit Risk Management

Because of the joint liability group system, BAAC remains weak in its screening process, the most important task for financial institutions. The bank needs to strengthen the screening capabilities of its employees. For expanding their non-agricultural financing, they must enhance their inspection of the assets put up for collateral and establish a system for disposing of them.

### 4.2 PROPOSALS FOR THE THAI GOVERNMENT

#### (1) Formulating comprehensive measures to promote rural non-farm enterprises and the promotion of cooperation by related institutions

It is of the utmost importance that comprehensive measures be formulated to promote rural non-farm enterprises and to promote cooperation among the related institutions to provide more effective support for rural non-farm enterprises.

In this regard, it is worth studying the policy proposal presented by BAAC in November 1998 for ties between related institutions. At the central governmental level, this called for the establishment of a Committee for the Joint Promotion of Rural Non-Farm Enterprises with its secretarial office located within BAAC. In addition to BAAC, the members of this Committee would be the Ministries of Finance, Industry, Agriculture, Commerce, Interior, and Labor and Social Welfare. The participation of the private sector also would be sought, including representatives of farmer entrepreneurs and NGOs.

In addition, in light of the progress in the decentralization of government power, Joint Promotion Committees at the provincial level would be established with the participation of Provincial Industrial Office, Industrial Promotion Centers, BAAC branches and other government financial institutions, representatives of farmer entrepreneurs, and NGOs. The primary role of these Committees would be to create a system for offering an overall program of financing with technical and business guidance<sup>12</sup>.

The strong support of the Ministry of Finance would be required for the establishment of this Joint Promotional Committee.

It is also necessary to clarify the relationship between these Committees and National SME Promotion Committee<sup>13</sup>, which is going to be founded based on the SME Promotion Act (cleared the diet in January 2000), to be set up in the future.

#### (2) The role of BAAC in promoting rural non-farm enterprises

The point could be made that BAAC is the most effective financial institution providing financial support to the rural non-farm enterprises discussed in this paper. It is possible, however, that the area of operations for Government Saving Bank (GSB) and SIFC will overlap with those of BAAC in the future<sup>14</sup>. Competition with commercial banks is also a possibility. Thus, it is desirable that functions be divided, such as by all government-affiliated financial institutions establishing lending frameworks (both upper and lower limits) and assigning roles to elicit the unique characteristics of each lending institution. Also, it is desirable to ensure the working of competitive principles by overlapping the setting of upper and lower limits on the loans and allowing several institutions to make loans in the same sector.

#### (3) Understanding the current state of rural non-farm enterprises

As noted before, it can be said that the full and accurate statistical understanding of the current state of rural non-farm enterprises has not been obtained. In the future, when conducting such surveys as the National Survey of Business Enterprises of 1996-1997, it would be desirable to incorporate surveys of all business offices nationwide with more than one employee in the manufacturing industry, agricultural sector, commercial sector, and service industry including those in rural areas. This would ensure the inclusion of rural non-farm enterprises in all sectors. In the event of personnel and budgetary restraints, one possibility would be to select several provinces for a start and conduct an opinion survey, etc. to determine the policy needs.

### 4.3 PROPOSALS FOR BAAC

#### (1) Enhancing client services<sup>15</sup>

##### 1) Providing TA (Technical Assistance) through BAAC

As noted in the foregoing, cooperation with the programs of the Ministry of Industry and others will be an important task in the future. At the same time, BAAC has programs, to foster rural non-farm enterprises, that can be utilized independently, linked to its non-agricultural lending activities. This is expected to have a specific effect that will encourage the full operation of BAAC's function for financing non-agricultural enterprises.

Not making BAAC itself, which makes judgments on financing, the entity implanting this program, but, for example, the Chamnien Saranaga Institute of Agricultural and Rural Development (CIARD), a subsidiary work of BAAC providing technical assistance, will be worth examining (Tsuji 1995).

12 In the Nakhon Ratchasima Area Industrial Development Planning Survey conducted by JICA and scheduled for completion by March 2000, an industrial development plan is to be formulated for Nakhon Ratchasima province and the four surrounding provinces (Chaiyaphum, Surin, Buri Ram, and one other). It is planned to study these points while linking it with this survey.

13 As for the SME development policy, please refer to JBIC Research Paper No.8-1 (Jan. 2001).

14 Meanwhile, IFCT has a much larger average lending amount, and it is considered that problems are not likely to occur with BAAC regarding the allocation of roles and responsibilities.

15 ADB is currently providing TA for screening, oversight, and risk management, including enhancing ATM by building and strengthening an on-line system.

A desirable approach to achieve this would be to start with a pilot enterprise and gradually expand the range of the program. It also would be desirable for the program to have a balanced content including such business expertise as bookkeeping skills, with the production technology support provided in the technical assistance.

## 2) Providing close and detailed advice

As a result of the 1999 amendment of the BAAC Act, BAAC can now provide lending for education and medical expenses. It is also necessary to establish a system for providing various services, including financial management advice for household expenses in general, and explanations of the new lending options, including non-agricultural lending. Considering the active participation of female entrepreneurs in rural non-farm enterprises, it would be worth thinking about establishing a system in areas with a high degree of public safety in which women would be appointed as credit officers to provide very detailed and personalized services.

## 3) Providing information to farmers

For farmer entrepreneurs, there is a blockage in conducting these businesses. The problems that could be cited include the lack of market information and insufficient marketing.

To deal with these issues, the BAAC Board of Directors (the chairman is the Minister of Finance) announced a new policy for BAAC in November 1999. This would (i) provide support for promoting the marketing activities for the agricultural products and non-agricultural activities of the farmers; (ii) it would construct a database system for agricultural product prices and expenses, etc. for farmers; (iii) BAAC would establish an information center with the objective of providing information to farmers.

It could be considered to support the strengthening of BAAC's operations to provide information to farmers. In that instance, it would be imperative to cover such aspects as the content of the support it-

self, instead of merely providing the physical resources<sup>16</sup>.

## (2) Strengthening the appraisal and supervision procedures for rural non-farm enterprise financing

The work providing financing to rural non-farm enterprises, particularly the funds for facilities, will require such new tasks as formulating business and fund plans and the screening and monitoring of those plans. Support for training the employees can be expected from Japan, the EU, and GTZ, etc. Meanwhile, greater technical cooperation will be sought from Japan for creating an appraisal and supervision system, securing on-site operations, and the evaluation of individual cases.

What Japan could do is to dispatch financial specialists with practical experience through JICA's expert system. In this case, it would be most useful for the experts to have experience with secondary regional banks, shinkin banks, the People's Finance Corp., and the Agriculture, Forestry, and Fisheries Finance Corp which is the member institutions of APRACA, described later. To avoid duplication with the work of other donors, there should be a thorough coordination in advance regarding the specialists dispatched between the Thai authorities and the related donors concerning TOR.

## (3) Reinforcing lending to agricultural cooperatives

The Ministry of Agriculture intends to utilize agricultural cooperatives as the entity for implementing rural industrialization centered on the processing of agricultural products. Many agricultural cooperatives, however, are incorporated in bureaucratic organs and lack an entrepreneurial spirit. From the perspective of cooperation with other organizations, it is important for BAAC to gradually increase its lending to selected superior agricultural cooperatives, and to work with the Ministry of Agriculture and others to conduct pilot programs, etc. in which the agricultural cooperatives foster initiatives for rural industrialization.

16 For example, USAID provided support for creating a system in the Philippines to provide market information for agricultural products. There were insufficient maintenance and management funds, however, so it has been reported that the system is not operating as intended.

## (4) Promoting further South-South cooperation

BAAC's work as a rural lending institution has earned international acclaim. As previously noted, CIARD is conducting South-South cooperation in which the Asian Pacific Rural Agricultural Credit Association (APRACA) is undertaking training projects for rural and agricultural financing in other Asian countries. The scope of these activities is limited, however. It would be considered significant from the perspective of South-South cooperation for CIARD to use Japanese cooperation to convey the experiences of BAAC, including those from supporting rural non-farm enterprises, to such other Asian countries as Laos, Cambodia, and Vietnam<sup>17</sup>.

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17 For example, JICA conducted in FY1999 a Survey for Planning Environmental improvements to the Small-scale Rural Villages in the Impoverished Region of the Mekong River Basin in Laos as the next step for rural development planning survey projects in Laos. This will study training of the employees of Laotian rural financial institutions in a third country.

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