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INFORMAL CREDIT AND THE DEVELOPMENT OF NON-FARM ENTERPRISES IN THAILAND

by

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EXECUTIVE SUMMARY

A. Summary

1. Informal credit is important to growth of non-farm enterprises, especially as a source of working capital.
2. In the past two decades, dependence on informal credit has changed somewhat. During the period between mid 1960s and mid 1970s, larger firms appeared to rely more on informal credit than smaller firms. However, in the past ten years, evidence shows that smaller firms have become more dependent on informal credit than larger ones.
3. Among the unorganized sources of credit, relatives and friends are the most important ones. Rotating credit societies or "business share schemes" were not found to be very important in the earlier surveys. However, the 1980/81 survey revealed the significance of share schemes for most types of enterprises under study. A personal interview conducted by the author also indicated that small firms rely heavily on the share schemes particularly for its working capital needs.
4. Another source of unorganized credit is raw material suppliers. These are quite important in most industries particularly silk enterprises in the Northeast.
5. Credit from the suppliers of raw materials is important for certain types of enterprises and is usually linked with the lender's main business of input and output marketing.

6. The informal credit system is in general very loosely structured. non-commercial lenders (i.e., relatives and friends) provide credit on a personal basis without clearly stated terms regarding the rate of interest, the length of time and the specific purpose of loan. Interest rates vary widely among different types of informal lenders.
7. Money lenders who usually provide loans through the purchase of postdated cheques also play an important role in the financing of provincial non-farm enterprises. The interest rate charged is usually fixed and also generally known among borrowers in the market. The rate is usually much higher than the institutional rate (e.g. 26-30% compared to 18-20% of the bank's rate).
8. Informal credit is closely linked with the formal credit system particularly the commercial banks. In most cases, sources of funds of the informal lenders (e.g. money lenders and share schemes) are from financial institutions (including finance companies). Usually, money lenders and share participants are businessmen who have been obtaining or using the banking services for some time. Through the OD credit line, they can relate to the borrowers. The interest rate charged are partly determined by the rates charged by the formal lenders as the rate paid to the formal lenders will become the capital cost to the informal lenders. The expansion of credit by the financial institutions can lead to an expansion of credit by the informal system (through the increase in lendable funds of the informal lenders).

9. Informal credit is used for both consumption and production purposes, with the latter being more important. However, this also depends on the type of the informal lenders. For example, credit from relatives and friends is mainly for consumption while that from share schemes appear to be largely for production. Though some credit is used for initial and fixed capital, informal credit is mainly for working capital. Interest rates in the informal credit market are usually much higher than those in the formal markets. However, the rates vary by types of informal lenders.
10. The length of time of credit is usually of a short-term period or up to one year. Credit from relatives and friends may extend beyond one year since the repayment date is not clearly specified. Repayment is found not to be a serious problem. In fact, most borrowers repay on time and the risk to the lenders is quite low. Within this type of credit market, it is considered extremely important to pay back the loan on time in order to maintain the creditability and reputation of the borrower. However, since last year, due to a number of factors particularly the credit squeeze policy of the Bank of Thailand, repayment has become a problem in the informal market. In terms of collateral, postdated cheques are generally used by money lenders and share schemes.
11. "The share scheme" has a long history. It started among the Chinese businessmen. In the past, a businessman usually participated in only one or two share group and the amount per share was not very large. However, significant changes have occurred during the past ten years.

A businessman might participate in several share groups. The amount of money per share increased markedly. Share operations have also been closely linked with commercial banks as postdated cheques are commonly used for payment among the participants. The past ten years also witnessed a great expansion of the share scheme. This might have been due to a great increase in the credit expansion by commercial banks and finance companies. However, since the inception of the credit squeeze policy in 1983, the boom period of the share scheme has come to an end. In fact, there has been a big collapse of the share system which in effect has contributed to a slowdown in the growth of the non-farm sector.

12. Main sources of loanable funds in the share system are from saving, commercial banks and other formal sources including finance companies. Credit is used for both fixed and working capital but mainly for the latter. However, more recent experiences show that much credit has been used for speculative purposes and also for consumption.
13. Financial policies have had a profound effect on the structure and performance of the informal credit market. During the credit expansion period of the financial institutions, the size of the informal market became larger. The interest rates in the informal market were quite low during the "share boom" period (when liquidity level of commercial banks was rather high and credit expansion was great). Since 1983, interest rates in the informal market have been rather high due to limited credit available.

B. Policy Implications

1) Given the existence of informal credit markets, their contributions to growth of the SSEs and a close link with the formal markets, it appears advisable for policy makers to take into consideration the role of informal credit markets in the formulation of a financial policy for the promotion of non-farm enterprises. This is to ensure that the policy will be implemented with a minimal undesirable side effect.

2) An intense effort should be made to increase access to institutional credit for the small enterprises especially those located in the rural/provincial areas. The credit should be channelled through specialized financial institutions such as The Industrial Finance Cooperation of Thailand (IFCT) and The Small Industry Finance Office (SIFO) as they are of development-oriented nature. These institutions should enlarge their operations in financing SSEs. They should also develop some imaginative means or instruments to attract lenders/entrepreneurs who have been depending largely on the informal credit to use the services offered by the institutions. An increase in institutional supply of credit will not only enlarge the size of the formal market but also give a lower cost and a greater access to informal credit for SSEs. With an adequate supply of institutional credit, dependence of SSEs on informal credit will become smaller and the terms of credit more favorable (i.e. lower interest rate) to SSEs. Finally, the credit market will become highly integrated and more efficient than before. This will then greatly facilitate the growth of non-farm enterprises.

3) The OD loans by commercial banks should be greatly reduced and finally replaced by term loan. The disadvantages of the OD loans are now quite well known. This will not be easy to do as this type of credit is generally favored by the borrowers. However, an effective measure must be found to tackle this problem. This suggests that a change in lending policy and program of the commercial banks is needed. Without the OD loans, it will be difficult to expand the credit operation of the informal credit.

4) It is quite evident that the structure of the interest rates of SSEs is such that they are varied among different lenders and the rates are relatively high. Nevertheless, repayment of informal loans does not seem to be a problem. There is need for a relatively flexible interest rate policy, particularly with regard to small enterprises. The rates should be allowed to change more freely so that it will reflect the existing and changing demand and supply situation in the market. If this is allowed to operate, more formal credit will be available to non-farm enterprises and hence a decreasing demand for informal credit. If subsidy is to be given for promotion purposes, it must be carried out carefully and selectively.

5) To increase formal credit to SSEs, it is important to reduce credit risk to commercial banks and other financial institutions. This can be done by setting up a credit guarantee scheme. In fact, this scheme has been initiated in Thailand and will be carried out in the near future (IFCT will implement the program during the initial period). With the credit guarantee scheme in operation, it is expected

that institutional credit will be increase as financial institutions will find it more profitable and less risky to do business with the usually high-risk small enterprises.

6) The long-term objective of the financial reform is to minimize the role of the informal credit market. This however must be done carefully since informal credit has considerably to the growth of non-farm enterprises. Policy measures implied/indicated above may be used in order to achieve the objective.

I. INTRODUCTION

Finance is usually one of the major problems facing non-farm enterprises, especially small and medium sized firms. Other problems include raw material quality, markets, and labor (see Table 1). With a rather limited data on the financial aspects of SMEs, relatively little is known about the demand for and the supply of credit. In fact, some people argue that credit is not a constraint to growth of SMEs. The real constraint is sometimes identified as the market or the demand for their products. However, the results from many surveys of entrepreneurs or business firms indicate that finance or credit has been a major problem especially under a changing economic situation (ROFFAP, 1981)^{1/} Though there may not be a consensus with regard to whether or not credit is a constraint to the development of SMEs, the problem relating to finance is undoubtedly important. Without access to credit of suitable terms and conditions, it will be difficult for SMEs to expand their operations. Moreover, it is generally understood that small-scale industries do not get access to institutional credit and hence they must depend heavily on informal sources of credit. The role of informal credit in the development of SSEs should therefore be of great interest to policy makers.

^{1/} See some reports of the Rural Off-Farm Employment Assessment Project (ROFEAP), Kasetsart University, 1979-81. For example, Angsumalin (1981) and Onchan (1981)

1) The Structure of the Financial System in Thailand

An efficient financial system is essential to a country's economic development. This is well recognized by policy makers and planners in Thailand. Over the past two decades, significant changes in the financial structure have occurred and a lot of improvement has been made. The relatively high rate of economic growth of the country must have partly contributed to the tremendous development of the financial system. In recent years, the development and changes in the financial markets in Thailand have been quite striking as well as interesting. It started with the fall of a major finance company which was subsequently followed by other several finance companies. This has led the government to step in and to come up with some measures to solve the problem. The latest financial problem concerns the mismanagement of a commercial bank. This has prompted an immediate action by the government in order to maintain the country's financial stability. Furthermore, the issue of unorganized/informal financial market has also emerged since last year.

The structure of the financial system in Thailand is pictured in Figure 1. As indicated, there are two types of financial markets: the Formal/organized financial market and the informal/unorganized financial market. The organized market can be divided into the bank-type and the non-bank type. The bank-type of financial institutions include:^{1/} the Central Bank (The Bank of Thailand which was established in 1942, now having 3 regional branches), the commercial banks (established in 1906, now with 1906 branches), the Govern-

ment Savings Bank (established in 1946 with 423 branches), the Bank for Agriculture and Agricultural Cooperatives (established in 1966, with 65 branches), and the Government Housing Bank (established in 1953 with one head office and no branch).

The non-bank financial institutions include the following:

- 1) Finance companies (established in 1969, now with 109 companies and 31 branches).
- 2) Credit Foncier Companies (established in 1969 now with 30 companies and no branch).
- 3) Industrial Financial Corporation of Thailand (established in 1959 now with 3 regional offices).
- 4) Small Industry Finance Office (established in 1964, now with no branch)
- 5) Life Insurance Companies (established in 1929 now with 12 companies and 577 branches)
- 6) Agricultural Cooperatives (established in 1916 now with 1010 cooperatives)
- 7) Savings Cooperatives (established in 1946 now with 446 cooperatives)
- 8) Pawnshops (established in 1861 now with 326 pawnshops).

The other type of the financial market is the unorganized or the informal or the non-institutional market. This type of financial market is the least understood as data on this is very limited. In fact, by its very nature, it is difficult to obtain

data about this type of market. This will be made clear later. At this point, it is important to point out that the informal credit market may also be classified into two types namely commercial informal lenders, and non-commercial informal lenders. The classification is mainly based on the profit motive or the business-like operation. The commercial lenders are seeking profit or income from their lending activities while the non-commercial lenders are not, as a rule, doing it for income but it is more of a social obligation. This sometimes poses some problems as those who are supposed to be non-commercial lenders may also have a profit motive: (like some relatives or friends who give loans in order to earn an income). However, in general, it may be useful to have this kind of classification so as to analyze the behavior of different kinds of lenders.

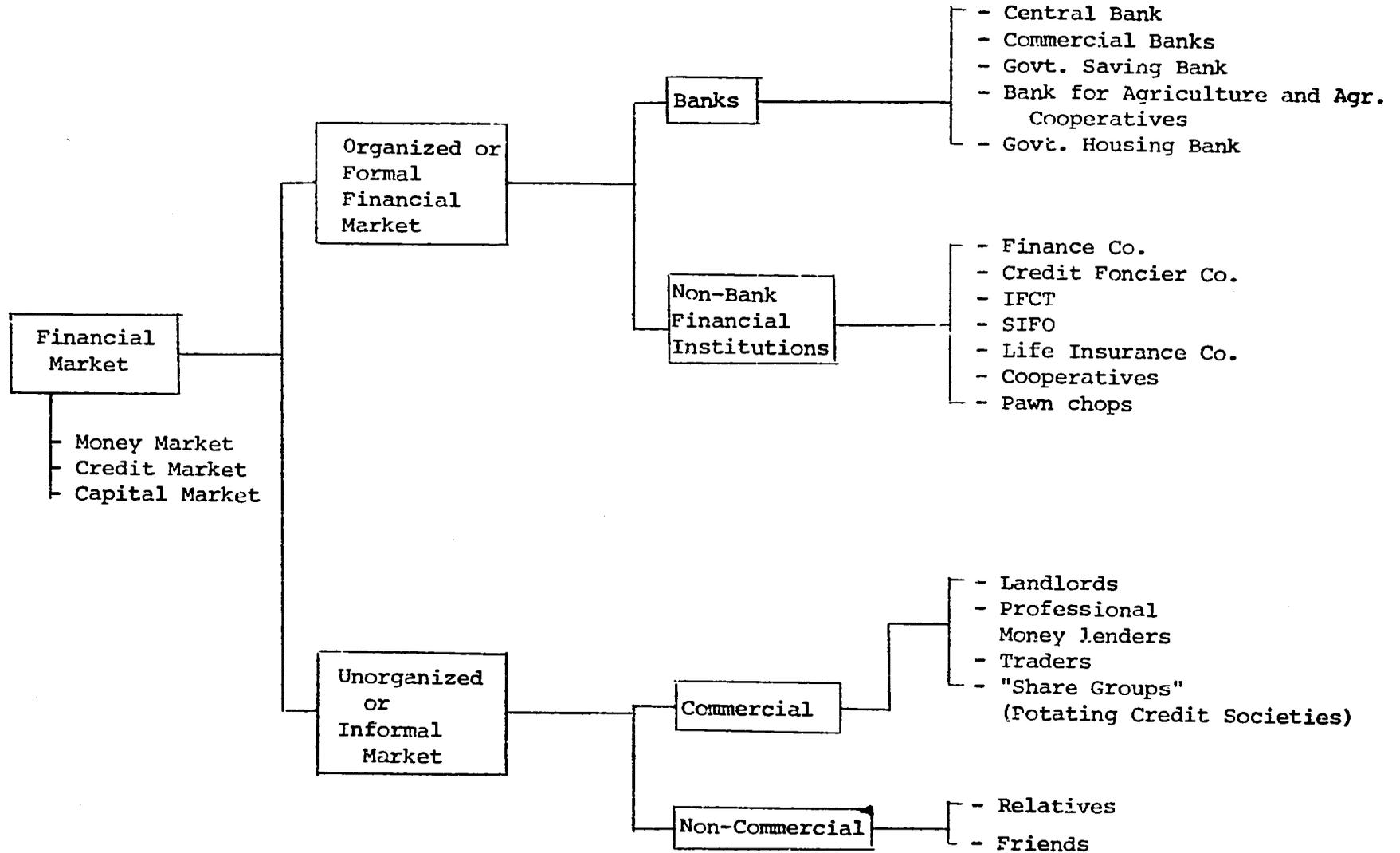
There are several types of informal commercial lenders. The major ones include: professional money lenders, landlords, traders share society/group/scheme (generally known as rotating credit society), and traders (local merchants, raw-material suppliers, etc). As regards the non-commercial informal lenders, they include relatives and friends. Given the nature of Thai culture and tradition, the borrower can turn to his relatives and/or friends for loans or assistance. This may be at the time that he sets up his enterprise and any time after that. In fact, as will be mentioned later, this is the lender of the last resort for many borrowers.

Within the financial system, in the case of non-farm enterprises, the formal financial system is probably much more important

than the informal one in terms of the quantity of the financial services provided. In fact, the exact size of the informal market is rather difficult to know. However, it is generally assumed that informal credit is important and is also quite significant. In this connection, the case of the rural credit market is much clearer as some data are available regarding the proportion of credit coming from informal sources. For example, in 1962/63, it accounted for about 90 percent of the total borrowing of Thai farmers. At present the share of the type of market has drastically decreased to around 40-50 percent. It has been generally believed that professional money lenders have been exploiting the Thai farmers by charging an exorbitant rate of interest and unfair terms of credit. However, this belief hypothesis does not appear to be supported by available evidence (see a detailed discussion on their issue in Onchan, 1983). As for the non-farm sector, the role of informal credit on the business sector is in general not very clear. This is due to a lack of a systematic investigation into this issue.

With the tremendous increase in the financial services from the financial institutions over the past two decades, the role of the informal credit should have been greatly reduced. In fact, that was a general assumption until recent years when the issue of informal credit emerged again. This has resulted in an upsurge of interest among people concerned about the significance and the effect of informal credit on the operation and the performance of the non-farm enterprises.

Figure 1 Structure of the Financial System in Thailand



2) Informal Credit System and the Financial Market Reform.

Before discussing the informal credit system and its relation to the reform of financial markets, it will be useful to look at the meaning of such a system. Rozental defines informal or unorganized markets as... "those markets over which the authorities do not exercise supervision...". He further states that these markets tend to be amorphous, informal, and unofficial, there is little legislation and regulation which covers their operation (Rozental, 1970, p.16). Because of the nature of this type of credit market, not much is known about it. However, its importance has been generally recognized.

In the process of economic and industrial development, an improvement in the efficiency of financial markets is essential so as to make them more responsive to development needs. But, the improvement will be restricted by the existence of informal financial transactions. Among other things, there are three types of concern regarding the prevalence of informal markets. First, the credit from these markets is usually used for consumption or unproductive purposes. Second, the credit, if used in production, tends to be invested in speculative activities. Finally, the link between the formal and the informal market is rather weak. To quote U Tun Wai.

"In the unorganized money markets of the developing countries, most of the borrowing are for financing consumer expenditures. About 80 or 90 per cent of the supply of funds is from non-institutional sources such as professional money lenders, traders, shop keepers, landlords, relatives and friends who charge exorbitant rates of interest. Furthermore, the link between the unorganized and the organized money market is poor, and central banks are unable to influence the terms and condition of loans in the former".^{1/}

It is quite possible that informal markets may negatively affect the economic growth of the economy. Some measures, therefore must be used to improve the efficiency of formal markets. This will also mean a decreasing importance or reducing the size and the scope of informal markets.

A question may arise with respect to the reason for the existence and/or the prevalence of the informal market. There may be several factors. For example, the available services by the formal markets are not sufficient or accessible. This may be due to a number of factors such as a shortage of capital or a lack of collateral or security for loans. In those areas where institutional credit is not available (i.e., there is no credit institution in the area), the lender will find it attractive to provide loans in terms and conditions most favorable to him. As for the borrower, he may find that the informal market is the only place where he can obtain funds for a specific purpose without collateral or security.

^{1/} U Tun Wai (1967), p. 161.

The existence of informal financial markets, as viewed by development economists (and other people concerned) appears to be quite undesirable. However, there must be some advantage to this type of market. For example, it provides services at the time and the amount needed without collateral security. It also provides credit to entrepreneurs in the areas where there is no credit institution. Some of the credit provided may be used for productive purposes at reasonable terms and conditions. Informal credit markets are quite fragmented and are different in terms of their conduct or behavior. Some types of markets may be providing useful services to the enterprises. Due to this possible nature of these markets, there is a need to understand its structure, its conduct and its performance. Without such understanding and/or data, a strategy for the improvement and/or the reform of financial markets will be difficult to be formulated.

3) The Purpose of the Study

The main purposes of this study are as follows:

- 1) To study the nature and the significance of informal credit in the financial market,
- 2) To study the structure of the informal credit system and its linkages to the formal credit system.
- 3) To study the operation of the informal credit system in general, and the "share scheme/society" in particular.

4) To study the potential effect of government financial policies on the structure and performance of the informal credit market

5) To draw some policy implications and to give some recommendations for the improvement of the financial markets.

4) Sources of Data for the Report

1. Secondary data. Though data on informal credit are rather limited, those available are useful in providing an understanding of the significance, the nature, and the scope of the informal system, and the terms and conditions of informal credit. The study by Rozental in 1965-67 is particularly useful as it pays a lot of attention to informal credit (i.e. the unorganized financial markets) in both urban and rural areas. In fact, Rozental's study is probably the only one which deals directly with informal credit in Thailand. Other studies by Saeng and Others (1976, 1978), ROFEAP (Rural Off-Farm Employment Assessment Project) (1981), and Narongchai and Associates (1982) provide useful data on the informal credit system. Moreover, the work of U. Tun Wai has also shed some light on the nature and the development of the informal system over time in LDCS.

2. Primary data. To obtain data and information on the scope, the nature, the operations, and the performance of the informal credit market, a survey has been conducted. Due to time and budget

limitations, the methodology employed leaves much to be desired. To obtain the data which are reliable and sufficient for the purpose, a random sampling technique must be employed and the structured questionnaire be designed and used. It is generally understood that data collection for an informal credit study is particularly difficult. In this regard the experience of Rozental is useful as it indicates the difficulty of selecting the sample, and the administration of the survey. Besides, the respondents (who are usually hard to locate) are not willing to give out information. Even if the data are given, the accuracy of the data obtained is always questionable.

For this study, a survey has been conducted, using a personal interview technique. A case-study technique was also employed to gain an insight into some aspects of the informal system, particularly the case of the share schemes. The survey was conducted in selected provinces : Nakornratsima, Khon Khaen, Petchabun, Chiang Mai - Lampang, Songkhla (Haad Yai), and Chonburi. The interviewees were chosen from a particular group of borrowers (i.e. businessmen and entrepreneurs) and lenders (i.e., businessmen, money lenders, credit companies, and commercial banks). An interview with formal lenders was conducted to get some information about the possible linkages between informal and formal lenders. In conducting the interview, an interview schedule was used. The interview was mostly done by senior researchers.

In total, there were about 60 businessmen/borrowers and 40 lenders (both informal and formal). The formal sources of credit interviewed included commercial banks and the Bank of Thailand's regional offices. The selection of the sample for the study was not random as it would have been very difficult to do so. The strategy, however, was to get the sample which would represent the real situation as much as possible. Since our main interest is SMIs, all enterprises interviewed fall under this category. To get the sample, a list of enterprises was obtained from the provincial chamber of commerce (where it does exist) and from the provincial industrial offices. From these lists a selection was then made. As for the informal lenders, this was a rather difficult task. No information is available on the number and the name of private money lenders, though some well known lenders may be identified. Even after getting the name, it was very difficult to get to interview them. The interview conducted, therefore, was based on the willingness of the lenders. However, even when the interview was undertaken, it turned out that several interviewees did not want to give the information. The interview therefore almost turned out to be a complete failure. The information obtained are only the general ones. However, they still are quite useful for our purpose. The interview among the commercial banks, however, was quite successful as most of them were willing to answer the questions (as long as they did not deal with figures about the banks' operations). The interviews with the Bank of Thailand in the regions were most useful with regard to the general situation on

economic and financial situations in the provinces or the regions.

Because of the nature of the survey, the information obtained cannot be systematically analyzed and presented in tabular forms. Instead, they are used in confirming some of the points and/or hypothesis as argued in the report regarding the informal credit system and its relation to the growth of the non-farm enterprises. Furthermore, with the information obtained, a better understanding of informal credit has been obtained. However, the deficiency in relation to the data, the lack of it and/or its quality, will point to the need to further study on this important aspect of the financial system.

II. THE SIGNIFICANCE OF INFORMAL CREDIT

Based on available data from previous surveys, it can be said that informal credit is quite significant and important to the growth of non-farm enterprises. The findings from the following surveys provide useful information in this regard.

1) The data from a 1965 survey showed that about 35 to 78 percent of total working capital derived from unorganized/informal sources. This was much greater than that for the total initial capital obtained from 2 to 23 per cent from these sources (Rozenal, 1970) (see Table 2-3).

2) In 1976, another survey revealed that the unorganized/informal sources provided between 9 to 20 percent of the present capital of different sizes of enterprises. This is almost the same as was the case of initial capital (Saeng and others, 1976) (see Table 4-5).

3) In 1978, a follow-up survey indicated that informal sources contributed from 5-13 percent to total present capital of different sizes of enterprises. The contribution of these sources was again quite similar for the case of the initial capital.

Clearly, the 1965 data cannot be directly compared with those of 1976 and 1976 due to the difference in research methodology employed. The interpretation of the data from these surveys must

therefore be done with caution. Quite surprisingly, the details of the data indicate that enterprises of larger size depend more on informal sources of funds (both for initial and working capital). For example, in 1965, 23 percent of the initial capital of large firms came from informal source as compared with 6.7, and 1.8 percent of medium and small firms, respectively. As for the working capital, the proportions were 78, 35 and 60 percent for large, medium and small firms, respectively.

The 1976 survey gave a somewhat similar result, though the informal sources were of less importance and there were some variations in the proportion of funds by size of firm. For example, 9% of initial capital of the large firms came from unorganized sources compared to 12, 24, and 9 percent of medium, small, and cottage industries.^{1/} This was also true in the case of present capital.

However, the 1978 data provided a different picture. Smaller firms depended more on informal sources. This applied to both initial and present capital. For example, for initial capital, cottage industries obtained 10.5 percent compared to 9.7 and 7.4 percent of small and medium firms. As for the present capital, cottage industries received 13 percent as compared with 10.1, 4.8, and 8.5 percent of small, medium, and large firms, respectively.

^{1/} Cottage industries are defined here as firms with 10 workers or less.

Based on the available data, it may then be said that in the past, larger firms seemed to depend more on informal/unorganized markets than the smaller ones. However, later data seemed to indicate a change in the sources of finance and that smaller firms have become more dependent on informal sources. This may be due to the fact that larger firms can get more access to institutional credit than the smaller ones.

With regard to the sources of credit, the survey conducted in 1980/81 (ROFEAP) revealed that non-institutional or informal sources are very important for several types of enterprises. For example, for the furniture industry, informal sources accounted for about 52 percent of the total credit. The cases of fruit and vegetable processing and silk firms were very striking as informal sources accounted for about 76 and 90 percent of the total credit, respectively. As for cement products, noodles enterprises and ready-made garments, institutional or formal sources were also important, contributing over 50 percent of the total credit.

As regards the lenders in the informal credit markets, relatives and friends were the most important sources. Share societies/schemes were not very important, though they appeared to be relatively more important especially for working capital (as indicated by 1965 and 1976 data). The 1978 survey did not give any information about share schemes.^{1/} However, the 1980/81 survey of ROFEAP revealed

^{1/} This was probably due to the fact that "Share scheme" was not explicitly specified. Therefore it must have been included under "other" sources of fund.

the significance of share schemes for most types of enterprises. For example, for the furniture industry, credit from share schemes constituted about 32 percent of the credit from unorganized sources or about 22 percent of the total credit product industry is even more striking as share schemes accounted for about 44 percent of the total credit. Share schemes were also quite popular among silk industry, ready-made garments and fruit and vegetable processing industries. Finally, another source of informal credit is the raw material suppliers which are quite important in most industries particularly silk.

With regard to "share schemes" or "chit fund", the 1965 data revealed that only small firms participated in the operation of the system. However, the 1976 data indicated that larger firms derived more funds from this source (i.e., 12 percent for large firms as compared to only 0.9 percent for cottage firms). Available data regarding the relationship between firm size and credit from share schemes are not clear. However interviews conducted by the author seem to indicate that small firms rely heavily on the share schemes, particularly for their working capital needs.

In fact, the survey conducted for this study clearly reveals that smaller firms depend greatly on informal sources of credit. The most important source comes from the share societies. It is also found that for small firms in certain provinces informal credit contributes around 20 to 40 percent of the total initial capital. As for the working capital for those firms, the contribution of

the informal credit is even greater, ranging from 40-70 percent of the total requirement.^{1/} Share schemes are particularly popular among smaller firms.

^{1/} Surprisingly, this is also the case of large cities like Nakorn-ratsima, Khon Khaen, and Chiang Mai where institutional credit is relatively in great supply. It must also be noted that these figures were obtained from the interviews of the sample firms in the selected provinces. The results appear to be consistent with the ROFEAP data but are quite different from the earlier surveys. Difference in the methodologies employed may make it not possible to compare the results. However, the conclusion derived from the survey regarding the current role of the informal credit should be reasonable.

III. THE STRUCTURE OF THE INFORMAL CREDIT SYSTEM AND ITS LINKAGES TO THE FORMAL CREDIT SYSTEM.

1) The Structure

It is rather difficult to get data on the number and size of informal lenders in a particular financial market. Though some data on this may be obtained from interviews, its reliability is questionable. The information obtained gives the impression that there are relatively few money lenders in any provincial town or city. They are usually businessmen or landlords who use the funds from their own savings and/or from the OD loans from the commercial banks. Among the businessmen and the owners of enterprises, these money lenders are quite well known. In fact, the terms and the conditions of the loans from these lenders are also generally known.

The number of the share societies or schemes are difficult to know as it may change over time (which is usually of a short period). The size of share societies also varies among different groups of businessmen. However, within provincial towns, businessmen know who are the big share organizers and how much are the values per share. For example, the highest amount per share in Chonburi was 300,000 baht.

Other types of informal lenders such as traders or merchants are also difficult to locate. And if credit is provided, how much is the amount of credit and in what terms? All of the merchants interviewed gave some kinds of credit. That is informal source gives

credit in kind (for example, in the form of raw materials to the borrowers who will pay back in cash), or in cash. The former case, however, is most dominant.

In general the informal credit system is very loosely structured. Non-commercial lenders (i.e. relatives and friends) though may be quite important as a source of capital/ credit, are a good example. Credit is usually provided on a personal basis without clearly stated terms and conditions regarding the rate of interest, the length of time and the specific purpose of loan. This makes it difficult to determine the rate of interest. It also has resulted in a wide variation in the rate of interest. However, detailed data from a systematic survey on this aspect are not available. From interviews, it was found that interest rates vary widely among these sources of credit (i.e., from zero to around the on-going rate of about 30 percent per annum in the unorganized market).

Money lenders, who usually provide loans through the purchase of postdated cheques, also play an important role in the financing of urban non-farm enterprises. The previous surveys did not provide data on this type of lender (It is probably included under the "other" type). However, some information regarding the behavior of this type of lender is available. They usually give loans to businessmen whom they know personally or who have a good reputation. They charge a higher rate of interest to high-risk borrowers. The difference is about 0.5 to 1.0 percent per month.

As mentioned earlier, credit from the suppliers of raw materials is important for certain types of enterprises. However, their behavior is quite different from the other as credit is usually linked closely with their main business of input and output marketing. The interest rate charged is relatively high as the lenders must also pay the interest to the banks.

"Share scheme" is probably the most important and the most interesting as far as the informal credit system is concerned. The data available which have been cited earlier also indicate that this source of credit has been of increasing significance over time. Given the significance and the currently changing situation of this scheme, a considerable emphasis will be given to this system in this report.

2) Linkages with Formal Credit

Informal credit is closely linked with the formal credit system particularly with the commercial banks. In most cases, sources of funds of the informal lenders (e.g., money lenders and share schemes) are from formal institutions. Usually, money lenders and share participants are businessmen who have been obtaining or using the banking services for sometime. Through the OD credit line, they can relend to borrowers. The interest rates charged are partly determined by the rates charged by the formal lenders as the rate paid to the formal lenders will become the capital cost to the professional money lenders. The expansion of credit by financial institutions has

resulted in an expansion of credit by the informal system (through the increase in lendable funds of the informal lenders). In the same token, the limit put on the supply of formal credit will also decrease the supply of credit from informal sources (less lendable funds for the lenders and lower repaying ability of the borrowers). This is quite evident as one can easily observe and/or read about the recent effect of the credit-limit policy (of 18% growth of credit by the commercial banks) on the operation of the informal credit system, particularly the case of the share schemes. The information obtained from interviews also confirms this. This will be discussed later (see also the case studies).

It should have become clear that the structure and the operation of informal and formal markets are particularly complicated due to the fact that the two markets are closely tied. The lenders in the informal markets are the borrowers in the formal markets. They will borrow as much as they can from the formal markets if the demand for credit in the informal markets is great. This means that instead of using credit for productive purposes, they may borrow for relending in the informal market. The funds therefore may be finally used either for production or consumption. Therefore, as long as informal lending has the same mix of loans for production and for consumption, this should not be a problem.

From the interviews, over 95 percent of the lenders in the informal credit market obtain loanable funds from the formal market

(i.e., commercial banks, in all cases). The rest of the funds are from own savings. All respondents agree that the "share boom" occurred (in 1983) because of the increased OD credit from the commercial banks. Undoubtedly, they are of an opinion that the collapse of the share schemes has also been attributed to the unexpected limit on the OD credit.

V. THE OPERATIONS OF THE INFORMAL CREDIT SYSTEM

As already mentioned, within the informal credit market, the lenders include share schemes, private money lenders, relatives and friends, suppliers of raw materials and others (including other merchants, landlords). It must be noted again that the lender may also be the borrower. For example, he may borrow from relatives and then relend to other people. In the share scheme, at least one participant (i.e., the last one who gets the fund) is a pure lender (or the saver), others may be the lenders at earlier periods and then become borrowers (when winning the bidding) at later periods. This certainly makes the operation of the system very complicated. The case of the share operation will be discussed separately in the next section. Here, a brief discussion will be made of the operations of the whole informal credit system. Therefore, the description will be done in a generalized fashion with some mention of special cases where appropriate. Again, the description is based on the information obtained from interviews.

Sources of Loanable Funds Informal lenders obtain funds from saving and from formal sources particularly commercial banks. Relatives and friends depend greatly on saving while other commercial informal lenders receive most funds from commercial banks (mainly through the OD credit line).

Uses of Credit Informal credit is used for both consumption and production purposes, with the latter being more important. However, this also depends on the type of the informal lenders. Credit from relatives and friends is mainly for consumption. Though it is generally argued that credit from share schemes is mostly used for consumption purposes, available data (as already mentioned) and the information obtained from the interviews indicate that a greater portion of the credit (i.e., over 70 percent) is used for productive purposes. However, in some provinces (i.e. Khon Khaen and Lampang) a considerable amount of credit is used in speculative activities such as purchases of lands and buildings (shophouses).

Though some credit is used for initial and fixed capital, informal credit is mainly (i.e., over 80 percent of the total credit) obtained for working capital. As generally found, fixed capital is financed by financial institutions. However, for smaller enterprises, informal credit is also used for fixed capital. The data from the interviews show that informal credit constitutes from 10-30 percent of the total fixed capital.

Interest rates Interest rates in the informal credit market are usually much higher than those in the formal markets. However, the rates are different among different types of informal lender. Raw material suppliers appear to charge the highest rate i.e., as high as 89 percent per year in the silk industry (see Table 8).

The data from the 1976 survey showed that relatives and friends charged 18 to 20.0 percent per annum compared to about 13 percent of commercial banks. Share societies/schemes had relatively low rates. In fact, it was as low as 3 percent per annum in the case of the large firms (see Table 9). The data also indicated that larger firms paid lower rates of interest than the smaller ones for all types of lenders (both formal and informal). This is also confirmed by the data from USAID's 1984 Small Industry Survey (see Table 10).

The interest rate structure of the share schemes is quite interesting and varies among locations/cities. In fact, the interest rates of the share schemes are rather difficult to compute. It is not really possible for the respondent to give an answer to the question on interest rates of the share schemes. Therefore, the data from the surveys must be interpreted with caution. This issue will be discussed again in the next section. At this point, it can be said that interest rates of share schemes are generally higher than those reported in the industry surveys except in the case of the "organizer" of the share group whose rates are much lower than all other sources (about 2 to 4 percent per annum only, see Table 9 and 10).

Duration of Credit The 1976 survey data gave some information on the number of years of credit by certain types of lenders. The data indicated a surprising picture. It appeared that credit was either

medium or long-term (ranging from 5 to 10 years of duration). As for the case of commercial banks, the relatively long period might have been resulted from the roll-over nature of the OD credit line (which might well be over 10 years). The duration of credit of share schemes is usually determined by the number of participants. For example, if the group has 20 member, the duration will be 20 months (in all cases studied the payment/bidding is done on a monthly basis).

The information obtained from the interviews indicate that the credit duration of most cases is about one year or is mainly short-term. Credit from relatives and friends may extend beyond one year period since usually the repayment date is not clearly specified. In fact, in some cases, it may be indefinite or the repayment will be made when the borrower is able to pay back the loan.

Collateral/Security Informal credit usually does not require collateral in the form of land, building or other types of fixed assets. However, data from the previous survey (1976) revealed that about 10 percent of the respondents had to pledge land and other fixed capital as collateral. This might have been the case of a large borrowing. Personal reputation and financial status of the borrowers appear to be the most important form of loan security. Moreover as for relatives, 23.5 percent did not have any collateral/security at all. With regard to share schemes, personal reputation and post-dated checks are the only two forms of security for credit.

The information from personal interviews also confirms these data. In fact, post-dated checks are being used by most share schemes. This is also true for the case of money lenders who accept postdated checks as security for the loans. However, two cases are found to require land as collateral. The two cases involve borrowings of over 100,000 baht.

Repayment Based on the data from the interviews, in the informal credit market, repayment usually does not pose any problem to the lenders. Most borrowers repay on time and the risk to the lenders is quite low. In fact, it is considered extremely important to pay back the loan on time in order to maintain the creditability and reputation of the borrower. If the borrower fails to repay the loan, the information will spread among the businessmen in the community/city (e.g., in a business association where most businessmen have a regular social-cum-business functions). That will be detrimental to the borrower/businessman as far as his business/financial standing is concerned. This is particularly true for the share schemes where repayment/payment is done on a monthly basis and any disruption of payment by a member of the scheme will have a serious consequence to the smooth and successful operation.

However, since the beginning of this year, due to a number of factors, particularly the credit squeeze policy of the Bank of Thailand, repayment has become a serious problem in the credit operation in the informal credit. The share schemes and the money lenders

who accept postdated checks as security for loans encounter a serious problem of repayment as bad cheques are now a common phenomenon.^{1/} Because of this, the credit operation of the informal credit system has been difficult and the credit transaction of all types of informal lenders has been greatly reduced.

The above findings regarding the repayment of informal credit may be in contrast with other reports regarding lending to small borrowers in other countries (Anderson, 1978). Usually, default rates are said to be high which then present high risks. This will discourage formal institutions from lending to small enterprises. Furthermore, because of high risks, interest rates of the informal market must be high. There is no data from a systematic survey in Thailand on this very interesting and important issue. The information obtained from interview of both borrowers and lenders does not reveal any high rate of default or high risk. Of course, the lender is usually very careful in selecting the borrowers. His personal acquaintance with the potential borrowers has contributed to the low risk. If the borrower fails to pay him on time, he can always try to collect and to put some social pressure on the borrower.

The reason that the interest rates in the informal market are very high (i.e. about 24-36 percent per annum from money lenders) may not be because of the risk factor. Rather, it reflects the high cost of capital. Usually, the lender pays about 19 percent to the

^{1/} It has been reported by the Bank of Thailand that the amount and the number of bad cheques at the end of 1984 are much greater than the previous years.

commercial banks. The fact that small enterprises do not get access to institutional credit may also contribute to the high rates. Moreover, even those who manage to obtain credit from institutions, the amount of credit received is not sufficient. Therefore, they must resort to borrowing from informal sources. This has resulted in an increase of the demand for credit and, hence, the interest rate.

VI. THE CASE OF THE "SHARE SCHEME" OR
"THE ROTATING CREDIT ASSOCIATIONS"

Definition and Evaluation of the System

The "Share schemes" or generally known as the "rotating credit association" (or the "chit fund") are said to have its origin in China and hence are popular among the Chinese businessmen. The share schemes or the rotating credit associations can be defined as an association "formed upon a core of participants who agree to make regular contributions to a fund which is given in whole or in part, to each contributor in rotation" (Ardener, 1964).

In its simplest form, such an organization might consist of ten persons who agree to meet once a month and contribute a sum of, say, 1000 baht each to a fund which will be received each month in rotation by one of the members. Every month a different member receives the fund, until at the end of ten months each member will have contributed ten monthly contributions of 1000 baht and at some point during the proceedings received a lump sum of 10,000 baht. The person receiving the first meeting becomes a debtor to all the other members and remains one until the last contribution has been made. The person who receives the fund at the last meeting is a creditor or a lender to all the other members throughout, while the other eight members move in turn from being creditors to debtors or borrowers (Barton, 1977). Therefore the essential principle involved here is "rotating access to a continually reconstituted capital fund (Geertz, 1962).

Rotating Associations may be found throughout the non-western world, particularly in Japan, China, Indonesia, India, Vietnam and other S.E. Asian countries. The associations are referred to in different names such as "chit fund groups", "hui" (China), "ho" (Vietnam), and "arisan" (Indonesia). In China and Vietnam, it can be found in both rural and urban areas whereas it is largely found in the rural areas in Indonesia. However, in the case of Thailand, the share schemes are only found in urban areas.

The present form of the "share system" has its origin from the Chinese "Yi hui" or "good-will hui" (Barton, 1977). This type of hui consists of friends and businessmen in the same line of activity and is organized for the purpose of providing mutual assistance and to maintain friendship. The person who is in need of additional finances will contact a number of his closest friends and business associates, the exact number depending on the amount of money required (typically, 10-15 persons). At the first meeting, the organizer provides a dinner for the other participants and the share value of the hui is determined. Each member then gives this amount to the organizer. Subsequent meetings are held at monthly intervals. At those times, the rest of the members draw lots to see who receives the fund, with the winner collecting one share from each of the other members and organizer.

At present, the "common hui" or the so-called "share group" is different from the "Yi hui" only in the method by which the order

members receive the fund is determined. For the share group, the order is determined by members submitting written bids at each meeting for the amount of interest they are willing to pay. The highest bid will receive the fund.

The organizer of the share group is probably the most important person as far as the success of the scheme is concerned. His recruitment of participants for a share group depends upon his reputation and social ties. He therefore must have a reputation for being reliable, of good conduct, trustworthy, and possessing a good business background. The participants place all their trust in the organizer and consider him solely responsible for guiding the share operation to a successful conclusion (Barton).

In Thailand, "share schemes" have been in operations for a long time. It started among the Chinese businessmen. Later it became popular among people of all types of occupations. Share schemes are particularly popular among small business enterprises including traders or retailers of consumer goods. Furthermore, it has also been operated among government officials and employees of private firms, especially the junior ones. The difference between share schemes of the businessmen and the non-businessmen is its main purpose and the size or value per share. The businessmen shares are mainly for business purposes while those of the non-businessmen are largely for consumption. The value per share of the businessmen is much greater than that of the non-business (For example, 10,000 baht per share as compared with 1,000 baht of the non-business).

In the past, a businessman usually participated in only one or two share groups and the amount per share was not very large. For example, an amount of 10,000 baht per share was considered to be quite large ten years ago while it would be considered quite small at the present.

However, significant changes have occurred during the past ten years. It is not uncommon for a businessman to participate in several share groups (say, ten or more). The amount of money per share has increased remarkably, ranging from 5,000 baht to over 100,000 baht per share among the small and medium enterprises. In fact the most common value per share found from the interviews is 10,000-20,000 baht. Share operations have also been closely linked with commercial banks as postdated cheques are commonly used for the payments among the share participants. Therefore, the amount of credit provided by the commercial banks through the O/D credit line will largely determine the amount of credit of the business share groups.

It is interesting to note that, a serious tight money situation occurred in Thailand in 1978/79 has led to an expansion in the informal credit market. This is indicated by the increase in the establishment of credit/share companies which essentially evolve from the share operations and perform the function of a financial intermediary. This type of company is registered with the Ministry of Commerce (not with the Ministry of Finance as is the case of finance

companies.^{1/} It is therefore not considered a financial institution. Its main function is to act as the organizer of the share groups and to collect fees from the participants.^{2/} The company organizes several groups by inviting interested businessmen and/or other people to join in the schemes. The appearance of share/credit companies has contributed to the rapid expansion of the informal credit as businessmen now have more opportunity to participate in many groups.

The main reason for the expansion of the informal credit even during the tight credit situation is that because of the shortage of funds, the interest rates in the informal markets were very high while it was relatively low in the formal markets (due to the legal ceiling). This caused an outflow of funds from the formal markets to the informal markets in two ways. The first way was that people might borrow from the banks at low rates of interest and then relend the money to get high returns in the informal markets (e.g. share schemes and share companies). The other way involved savings which directly went to the informal market instead of formal markets as it used to be.

However, even with the establishment of many credit/share companies in many provinces of Thailand, the expansion of informal credit was not very great due to the overall shortage of funds and/or savings. In fact, a great expansion of informal credit was not

^{1/} See Wanee (1981) for details.

^{2/} The company also lends money to its clients through the purchase of postdated cheques. The interest rates charged are found to be relatively high.

very great due probably to the overall shortage of funds and/or savings. In fact, a great expansion in the supply of the informal credit can occur only with the tremendous support of the formal financial markets. This is what happened in 1983 which witnessed the "boom" period of the share schemes.

The "boom period" of the share schemes occurred in 1983 when the liquidity position of the commercial banks was very good and the O/D credit was generously provided to its customers. Many businessmen heavily borrowed from the share schemes in expectation of obtaining an increasing OD credit from the commercial banks. The amount per share rose to an unprecedented level (as high as 100,000 baht per share) and businessmen also participated in several share groups. A businessman with a good reputation and collateral could get a large amount of funds from share groups without pledging any collateral except written postdated cheques. However, the repayment per month was of an enormous amount. The payment were made against the OD accounts and the money/credit received from other share schemes.

However, after a relatively short period of the boom, the "collapse" of the share operations occurred in early 1984, when the credit-squeeze policy (18% credit growth of the commercial banks) was adopted and implemented.^{1/} This policy directly affected the amount of credit or the OD received by the businessmen and hence the

^{1/} It was stated that the policy was meant to ameliorate the balance-of-trade deficit condition of the country. This policy has now been dropped.

repayments (by means of the postdated cheques) of credit to the share schemes. By its very nature of the share operation, when a member cannot pay to other members, the leader must take the sole responsibility. If the leader joins several groups (as leader or member), such burden will be tremendous. As a consequence, several share leaders (and some members) have been reported to run away to avoid repayment. This has inevitably resulted in the collapse of the whole system.

The failure of the share system has affected the business operations in many provinces of Thailand (e.g., Khon Khaen, Nakhonratchasima, Lampang, Pattalung). At present, it is found that owners of the enterprises have had a hard time finding funds for operating expenses. Many businessmen, therefore, have to depend on relatives/friends who have become lenders of last resort. Nevertheless, as the supply of credit from non-commercial sources is limited, a shortage of funds has been a serious problem particularly among small enterprises. This has resulted in a decline in the production of goods and services in many provinces (see the case studies)^{1/}

Operation of the Share System

A brief mention will be made here about the operation of the share schemes.

i) Sources of loanable funds. Funds are from saving, commercial banks and other formal sources including finance companies.

^{1/} Though official statistics on growth of the manufacturing sector are not yet available, a preliminary data for the Northeastern region indicate a lower growth rate for the sector.

Funds obtained from other share groups are also used. For business share schemes, funds from the commercial banks are most important.

ii) Uses of credit. Credit from share schemes are for both fixed and working capital but it is mainly for the latter. However, recent experiences show that much credit has also been used for speculative purposes like land & building purchases (e.g. in Khon Khaen). A portion of the credit is also used for consumption purposes (about 10 to 20 percent).

iii) Interest Rate. The structure of the rates of interest of the share schemes is of great interest in this study. This is due to the fact that not much information is available on this important aspect of the share operations. As mentioned before, the data obtained from the previous surveys (as shown in Tables 9 and 10) are not likely to be accurate and/or reliable. What a respondent (i.e. a participant of a share scheme) can give in terms of the information on the interest rate is only a guess at best.

To gain an insight into the interest rate structure of the share schemes, an attempt was made to acquire the records of the share operations from the share members. Our strategy was to get the records of different sizes of the share schemes in different locations. However, most respondents were not willing to provide the records. Only some records were obtained from some groups and in three provinces where the researchers have some personal relationship with the businessmen. The data obtained have been used to compute

the rates of interest by using the compound interest formula (which in the researcher's view is most appropriate for this case).

The results of the computation on the interest rates of seven share schemes in Nakornratchasima, Petchabun and Chonburi are shown in Tables 13-19. It can be seen that interest rates are generally low for the organizer of the share group, ranging from less than 1 percent per year to about 4 percent. This is to be expected since the organizer is the one who organizes the scheme. He must also take the sole responsibility for the repayments of all members. The rates of interest vary widely by groups, by locations and by order of bidding. For example, at Nakornratchasima, the rates of interest paid by each bidder (or member) range from 3.9 (the organizer) to 97 percent per annum for the person before the last. It also appears that later bid winners pay high rates. However, it must be noted that the data in the Tables may give a wrong impression. The indicated rate of a member must be interpreted in light of the fact that this member has already been getting some returns from the previous bid winner. This is shown in the last column of the Tables. The interest received by each member (who does not bid for the fund) is different for each bidding. The rates also vary depending on the amounts (or discounts) offered by the bidders.

As mentioned before, in participating in a share scheme, the members (except the organizer and the last member) will be both

borrowers and lenders. Therefore, they will be entitled to pay or to receive income from interests the amount of which depends on the rates of interest (which in turn depend on the demand situation within the share scheme).

It should have become clear that the interest rates paid as shown in the third column of the Table, are not the real rates. This is, the rates really paid for by the members. They must be considered along with the interests received (as indicated in the last column). The only obvious cases are those of the organizer who pays a low rate and the last member (the pure lender/saver) who receives a relatively low return on his capital fund (a little higher than the bank's rate in several cases).^{1/}

iv) Repayment. The repayment is usually very good. It was found from the interview that the payment of share participants has been excellent as very few failure cases were reported during the past few decades. However, due to the credit-ceiling policy, repayment has become a very serious problem since early 1984. To solve this problem and to prevent undesirable social consequences, provincial officials including police officers have been working closely with leading businessmen and persons from financial institu-

^{1/} It should be noted that the method used in the computation of the interest rates for the share schemes are not very satisfactory. In fact, many methods have been tried, each has its own shortcoming. The relatively simple method of compound rate of interest has been used as it appears to give the most satisfactory results given the nature of the data available and the method.

tions to map out ways to minimize the financial loss of all concerned.^{1/}
Negotiations have been made and some compromises have been reached regarding the rescheduling of payments of the credit. This occurs in certain provinces particularly affected by the collapses of the share operations. At the moment, the situation appears to be improving a little. However, the informal market, including the share companies, has been very inactive and it is expected to be so for some time to come.

^{1/} This type of effort or measure was taken in the provinces where the share operations were quite widespread. They include, for example, Nakornratchasima, Khon Khaen and Pattalung.

VII. EFFECT OF FINANCIAL POLICIES ON THE STRUCTURE
AND THE PERFORMANCE OF THE INFORMAL CREDIT MARKET

Due to the nature of the data collection as mentioned earlier, the data obtained from the interviews cannot be directly used in the analysis of the effect of financial policies. What will be discussed here are only some important aspects of the structure and performance of the informal credit market as they might have been affected by the recent policies.

As regards the number of firms (or lenders) and the size of the informal market, it is not very clear as there is no data available on this. The information obtained from the interviews indicates that the number of money lenders has not increased over the past few years. However, the size of the business (i.e., the volume of credit) seems to be larger than before. This is partly because big money lenders could get more credit from the commercial banks (mainly through the OD credit line) while the small business enterprises still might not have any access to such credit. As for the share scheme, it was found that its number increased considerably in recent years (up until early 1984). Again, this is attributed to the increased institutional credit mainly from the commercial bank. With regards to other informal lenders (e.g., raw-material suppliers and trader), it also appeared that there was a small increase in the number of lenders and the size of business.

Financial policies have had a substantial effect on the conduct and performance of the informal credit market. Informal credit was expanded greatly during the high liquidity period of the commercial banks and then decreased drastically after the implementation of the credit-squeeze policy. All types of informal lenders (share schemes, money lenders, raw material suppliers) have been affected by the policy. For example, during the "share boom" period, repayment was very good. However, after the collapse of the share schemes, it has become a very serious problem.^{1/}

Interest rates in the informal market were quite low during the "share boom" (though still quite high since the formal rate was about 17-18 percent per annum). After the big collapse, interest rates of informal credit increased markedly. For example, credit provided by money lenders through the purchase of postdated cheques which used to have interest rates of about 6-7 baht per 10,000 baht per day, now have a high rate of 9 to 12 baht. As for credit from the share groups, it has been reported that the bidding for the fund is very high. This indicates a high rate of interest. In fact, it is now said that the rates are increased by 50 to 100 percent compared to late last year. This is because most participants are afraid that the share operations will be terminated due to payment problems. Therefore, they will try hard to get the funds at the

^{1/} In fact, this was mentioned before. It should be noted that by late 1984, the informal market was very inactive. For those borrowers who could pay back usually could do it under a new arrangement/rescheduling of loan. As for money borrowers, bad cheques have led to settlements in courts.

earlier stages of the operations. The credit from shops or raw material suppliers has also substantially declined. Most of the shops under study ceased to give credit to their customers due to the problem of the shortage of funds. For the credit given, interest rates are much higher than before. This is due mainly to a high risk and a shortage of working capital on part of the merchants themselves.

VIII. CONCLUSION AND POLICY IMPLICATIONS
AND CONCLUDING REMARKS

Conclusions.

1) The informal credit system has been very significant though the formal credit market has been rapidly expanding during the past two decades. The expansion has occurred largely in urban areas. However, such a great expansion has occurred largely in urban areas. However, with such a great expansion of formal credit, informal credit remains quite significant. It does not appear that informal credit has significantly been replaced by the formal credit especially in the case of small enterprises which are found to be highly dependent on informal credit as an important source of fund particularly for working capital. However, for large enterprises, it appeared that some informal credit has been substantially replaced by formal credit.

2) The significance of the informal system reflects the inadequacy of credit facilities provided by the formal system. This is particularly true in the case of small-scale enterprises which still do not have much access to formal credit. Since most expanded credit has been given to medium and large-scale enterprises the money has been channelled through these enterprises to reach the small-scale enterprises through relending activities. The relatively large firms or big businessmen therefore have been performing the function of a financial intermediary and then charging a very high fee to the small borrowers.

3) Small enterprises rely heavily on informal market as access to formal credit is very limited. This is due to a number of factors, for example, lack of collateral and business records. The situation is even worse for small-scale enterprises in the provinces and in the outlying districts where financial services are relatively limited. As a result, rural small scale non-farm enterprises usually face a more serious financial/credit problem than their counterparts in urban areas or big cities.

4) Small enterprises can participate in the share schemes to get the credit. However, as a rule, only entrepreneurs who have good reputations or a good financial status can be the organizers who usually get the low-interest funds. The rest of the members of the group must pay high rates of interest. Therefore, small-scale enterprises end up paying high rates of interest. Besides the share schemes, they may also get credit from other non-formal lenders, for example, money lenders and merchants. However, they have to pay high rates of interest.

5) Because of the recent collapse of the share system, it is now even more difficult for small enterprises to obtain credit than before. They must try to obtain credit from their relatives or pay a high rate of interest to the money lenders who are willing to provide them with the loans. In many cases, the shortage of funds has forced the small-scale enterprises to decrease their production or business operations. In some cases, they ceased their operations.

6) Generally, small-scale enterprises have been paying high rates of interest to the lenders. It is therefore possible to make the interest rates charged to these enterprises higher or more flexible than before. Formal lenders will then be able to cover the high cost and high risk of making loans to this type of enterprises. Higher and/or flexible rates of interest can also attract more funds into the small-enterprise sector. The policy issue on the rate of interest should therefore be of attention. Some changes in this regard appear to be desirable and necessary.

7) Finally, the recent period (1983-84) should be considered "unusual" as far as informal credit is concerned. Past experiences (i.e., prior to the unusual period), indicated that the informal credit markets functioned rather smoothly. In fact, most people concerned thought that the informal credit markets contributed substantially to growth of the small-scale enterprises (SSEs). At the time when formal credit was not available, informal credit was the only substitute. In fact, informal credit markets operated rather efficiently as they provided credit at the time it was needed and on the terms and conditions quite acceptable to the borrowers. Therefore, the structure and the performance of these markets should be carefully studied. To be realistic, this type of market will remain to exist in years to come though its relative size may be declining over time. It may therefore be beneficial to SSEs if the informal markets are allowed to operate under a close watch of the government authorities

who may be able to step in any time when necessary to ensure that the SSEs get the credit on a fair terms and conditions for their business operations.

Policy Implications

1) Given the existence of informal credit markets, their contributions to growth of the SSEs and a close link with the formal markets, it appears advisable for policy makers to take into consideration the role of informal credit markets in the formulation of a financial policy for the promotion of non-farm enterprises. This is to ensure that the policy will be implemented with a minimal undesirable side effect.

2) An attempt should be made to increase access to institutional credit for the small enterprises especially those located in the rural/provincial areas. The credit should be channelled through specialized financial institutions such as The Industrial Finance Cooperation of Thailand (IFCT) and The Small Industry Finance Office (SIFO) as they are of development-oriented nature. These institutions should enlarge their operations in financing SSEs. They should also develop some imaginative means or instruments to attract lenders/entrepreneurs who have been depending largely on the informal credit to use the services offered by the institutions. An increase in institutional supply of credit will not only enlarge the size of the formal market but also will give a lower cost and a greater access to informal credit for SSEs. with an adequate supply of institutional

credit, the size of the informal credit market will become smaller and the terms of credit more favorable (i.e., lower interest rate) to SSEs. Finally, the credit market will become highly integrated and more efficient than before. This will then greatly facilitate the growth of the non-farm enterprises.

3) The OD loans by commercial banks should be greatly reduced and finally replaced by term loan. The disadvantages of the OD loans are now quite well known. This will not be easy to do as this type of credit is generally favored by the borrowers. However, an effective measure must be found to tackle this problem. This suggests that a change in lending policy and program of the commercial banks is needed.

4) It is quite evident that the structure of the interest rates of SSEs is such that they are varied among different lenders and the rates are relatively high. Nevertheless, repayment of informal loans does not seem to be a problem. There is need for a relatively flexible interest rate policy, particularly with regard to small enterprises. The rates should be allowed to change more freely so that it will reflect the existing and changing demand and supply situations in the market. If subsidy is to be given for promotion purposes, it must be carried out carefully and selectively.

5) To increase formal credit to SSEs, it is important to reduce credit risk to commercial banks and other financial institutions. This can be done by setting up a credit guarantee scheme.

In fact, this scheme has been initiated in Thailand and will be carried out in the near future (The Industrial Finance Corporation of Thailand (IFCT) will implement the program during the initial period). With the credit guarantee scheme in operation, it is expected that institutional credit will be increased as financial institutions will find it more profitable and less risky to do business with the usually high-risk small enterprises.

6) The long-run objective of the financial reform is to minimize the role of the informal credit market. This however must be done carefully since informal credit has contributed considerably to the growth of the non-farm enterprises. Policy measures implied/indicated above may be used in order to achieve the objective.

Concluding Remarks

Given the downfall of the informal financial markets, it would be of interest to investigate into what will happen with respect to these markets in the future. Would it return to normal? Undoubtedly, informal credit markets will continue to exist and will operate as before. However, the volume of business may be much smaller. Currently, it is found that there was a great reduction of about 60-80 percent of the total credit from the share schemes. Credit from other sources has also been substantially reduced, especially from the money lenders who provide credit through the purchase of postdated cheques.

The case of the share scheme is of particular interest, not only because it is a major source of credit for SSEs but also its significance with respect to the economic and social foundation. Now it appears that the trust or the confidence among close friends and business associates have almost completely been lost. Most businessmen interviewed were of the opinion that it would be extremely difficult to return to the same old tradition again.

It appears that at least in the near future (say, one to two years), the supply of credit from the informal markets will be quite limited. It is also anticipated that there will be an increasing flow of funds (savings) from the informal markets to the financial institutions. This should then be a great contribution to the growth of the financial institutions. The reform of the financial markets will also become easier than before.

However, one must again look at the current situation regarding the financing of the SSEs. Without informal credit, what would happen to the growth and the development of the SSEs? Over the past year up to now, many SSEs have faced with a shortage of funds which then affected their production and income. In fact, many SSEs have been reported to go out of business.

A short-run measure to assist the SSEs is therefore a provision of institutional credit directly to them. This can be done through specialized financial institutions like IFCT and SIFO as has been suggested before. However, considering that both IFCT

and SIFO now have only limited capability to render the services to SSEs in the provinces, a substantial change is needed in terms of the structure and the emphasis of the two institutions. This does not seem to be possible in such a short period of time. So far, both institutions have contributed to SSEs a relatively insignificant amount of credit. Even if both institutions can double their credit to SSEs, it will still be too little compared to their total credit requirements.^{1/}

Other measures are therefore needed. They may include rediscount facilities for SSEs from the Bank of Thailand and the setting of quota of credit for SSEs from the commercial banks. The former measure has been in operation for many years without any success while the latter may be introduced (as is the case of agricultural credit).

In the long-run, a policy aiming at the reform of the whole financial system for SSEs must be formulated and implemented. In this regard, the reorganization of the specialized financial institutions will be necessary while other supplementary and support institutions such as the credit guarantee scheme must be established (Also see Onchan and Augsumalin, 1984).

^{1/} See a detailed discussion on this in Onchan and Augsumalin (1984).

Undoubtedly, our immediate concern is the short-run problem of SSEs. Though some measures have been mentioned and/or suggested, they are not easy to implement and hence may not be very effective or adequate. If that is the case, an acute shortage of fund will occur among SSEs. This will cause the interest rates to be very high which will then encourage the expansion of informal credit. If this happens again, the improvement of the financial system for SSEs will be very difficult. This will then adversely affect the promotion and the development of SSEs.

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X. APPENDICES

Appendix I. TABLES

Appendix II. CASES

Table 1 Problems of Industries by Size of Employment

(percent based on number of responses)

| Size of Employment | raw-material quality | Finance | Market | Labour | Climate | Others | No problem | Total |
|--------------------|----------------------|---------------|---------------|---------------|-------------|---------------|--------------|------------------|
| less than 10 | 40 (16.8) | 39 (16.4) | 46 (19.3) | 23 (9.7) | 5 (2.1) | 63 (26.5) | 22 (9.2) | 238 (100.0) |
| 10-49 | 165 (16.1) | 139 (15.4) | 140 (15.5) | 125 (13.9) | 24 (2.7) | 268 (29.8) | 59 (6.6) | 900 (100.0) |
| 50-99 | 35 (16.7) | 39 (13.8) | 39 (18.6) | 28 (13.3) | 6 (2.8) | 64 (30.5) | 9 (4.3) | 210 (100.0) |
| 100-199 | 21 (18.3) | 12 (10.4) | 13 (11.3) | 20 (17.4) | 2 (1.7) | 40 (34.8) | 7 (6.1) | 115 (100.0) |
| 200 and over | 10 (18.2) | 6 (10.9) | 6 (10.9) | 9 (16.4) | 1 (1.8) | 18 (38.7) | 5 (9.1) | 55 (100.0) |
| Total | 251 (16.5) | 225 (14.8) | 244 (16.1) | 205 (13.5) | 38 (2.5) | 453 (29.8) | 102 (6.7) | 1,518 (100.0) |

1/ include shortage of labor; strike, etc.

Source : Saeng Sanguanruang and others, Small and Medium Scale Industries in Thailand, 1976.

Table 2 Sources of Initial-Capital of Industries by Size of Firms, 1965.

| Source of Fund | (percentage) | | | |
|-------------------------|---------------|--------|--------|---------|
| | Size of Firms | | | |
| | Small | Medium | Large | Average |
| Internal sources | 96.5 | 81.5 | 56.0 | 88.1 |
| External Sources | 3.5 | 18.5 | 44.0 | 11.9 |
| - Unorganized Sources | 1.8 | 6.7 | 23.0 | 6.1 |
| - Relatives and Friends | 1.4 | 5.4 | 0.7 | 1.4 |
| - Share societies | 0.4 | 1.3 | - | 0.4 |
| - Others | - | - | 22.3 | 4.3 |
| Organized Sources | 1.6 | 12.3 | 21.0 | 5.8 |
| - Commercial banks | 1.6 | 12.3 | 20.2 | 5.6 |
| - Non-commercial banks | - | - | 0.8 | 0.2 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 |
| Internal : External | 1:0.04 | 1:0.23 | 1:0.78 | 1:0.14 |

Source : Compiled from Alex A. Rozental, Finance and Development in Thailand op. cit, Table 7.6, p.261.

Table 3 Sources of Working Capital by Size of Firms, 1965

(Unit : Percentage)

| Source of Finance | Size of Firms | | | |
|-------------------------|---------------|--------|--------|---------|
| | Small | Medium | Large | Average |
| Internal Sources | 5.97 | 1.65 | 1.29 | 1.67 |
| External Sources | 94.03 | 98.35 | 98.71 | 98.33 |
| Unorganized Sources | 59.9 | 35.37 | 77.92 | 65.18 |
| - Relatives and Friends | 43.28 | 6.12 | 0.88 | 4.9 |
| - Share societies | 16.42 | 9.91 | - | 3.7 |
| - Others | 0.19 | 19.34 | 77.03 | 56.6 |
| Organized sources | 34.33 | 62.97 | 20.78 | 33.15 |
| - Commercial banks | 34.33 | 62.64 | 20.58 | 32.9 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 |
| Internal : External | 1:0.06 | 1:0.17 | 1:0.13 | 1:0.17 |

Source : Compiled from Alex A. Rozental, Finance and Development in Thailand, Table 7.10, P.267.

Table 4 Sources of Fund For Initial - Capital by Size of Firms, 1976.

| Source of Fund | (Unit : percentage) | | | | |
|-----------------------|---------------------|--------|--------|--------|---------|
| | Size of Firms | | | | |
| | Cottage | Small | Medium | Large | Average |
| Internal Sources | 89.6 | 65.0 | 71.2 | 61.3 | 72.6 |
| External Sources | 10.4 | 39.0 | 28.9 | 18.7 | 27.4 |
| - Unorganized Sources | 8.5 | 24.3 | 11.8 | 9.3 | 15.1 |
| - Friend & Relative | 3.9 | 12.3 | 4.6 | - | 5.8 |
| - Share Societies | 1.3 | 3.1 | 1.9 | - | 1.8 |
| - Related Shop | 0.4 | 0.7 | 2.6 | 9.3 | 3.7 |
| - Others | 2.9 | 8.2 | 2.7 | - | 3.8 |
| - Organized Sources | 1.9 | 10.5 | 17.1 | 9.4 | 12.3 |
| - Commercial banks | 1.8 | 9.4 | 16.0 | 7.8 | 11.1 |
| - Finance companies | - | 0.2 | 0.04 | 1.6 | 0.5 |
| - IFCT | - | 0.8 | 0.2 | - | 0.6 |
| - SIFO | - | 0.1 | 0.8 | - | 0.1 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Internal : External | 1:0.12 | 1:0.54 | 1:0.41 | 1:0.23 | 1:0.38 |

Source : Compiled from Saeng Sanguanruang and Others, Small and Medium Scale Industries in Thailand, Table 6.3, p.222.

Table 5 Sources of Fund For Present - Capital by Size of Firms, 1976.

| | Size of Firms | | | | |
|-----------------------|---------------|-------|--------|-------|---------|
| | Cottage | Small | Medium | Large | Average |
| Internal Sources | 86.1 | 66.7 | 63.1 | 62.1 | 64.2 |
| External Sources | 13.9 | 33.3 | 36.9 | 37.9 | 35.8 |
| - Unorganized Sources | 9.4 | 20.0 | 18.2 | 14.8 | 17.2 |
| - Friend & Relative | 4.2 | 8.9 | 8.3 | 0.6 | 5.7 |
| - Share societies | 0.9 | 2.5 | 1.1 | 12.2 | 5.2 |
| - Relative shop | 0.3 | 6.5 | 6.2 | 1.9 | 4.6 |
| - Others | 4.0 | 2.1 | 2.6 | - | 1.6 |
| - Organized Sources | 4.5 | 13.3 | 18.7 | 23.1 | 18.6 |
| - Commercial banks | 4.5 | 11.8 | 16.5 | 22.9 | 17.3 |
| - Finance Companies | - | 0.4 | 1.5 | - | 0.7 |
| - IFCT | - | 0.8 | 0.5 | 0.2 | 0.5 |
| - SIFO | - | 0.3 | 0.1 | - | 0.1 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Internal : External | 1:0.16 | 1:0.5 | 1:0.58 | 1:0.6 | 1:0.56 |

Source : Compiled from Saeng Sanguanruang and Others, Development of Small and Medium Manufacturing Enterprises in Thailand, Table 6.7, P.230.

Table 6 Sources of Fund For Initial-Capital by Size of Firms, 1978

| Source of Fund | Size of Firms | | | | |
|--|---------------|--------|--------|--------|---------|
| | Cottage | Small | Medium | Large | Average |
| Internal Sources | 72.9 | 72.0 | 82.2 | 63.3 | 74.0 |
| External Sources | 27.1 | 28.0 | 17.8 | 36.7 | 26.0 |
| - Unorganized Sources | 10.5 | 9.7 | 7.4 | - | 9.1 |
| - Friend, Relative, Share societies | 7.5 | 7.6 | 4.3 | - | 6.7 |
| - Money lenders | 2.9 | 2.1 | 3.1 | - | 2.4 |
| - Organized Sources | 16.6 | 18.3 | 10.4 | 36.7 | 16.9 |
| - Commercial banks | 16.6 | 18.3 | 10.4 | 36.7 | 16.9 |
| - Finance companies | - | - | - | - | - |
| - IFCT | - | - | - | - | - |
| - SIFO | - | - | - | - | - |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Internal : External | 1:0.37 | 1:0.39 | 1:0.22 | 1:0.58 | 1:0.35 |

Source : Compiled from Saeng Sanguanruang and Others, Development of Small and Medium Manufacturing Enterprises in Thailand, Table 3.14, P.41.

Table 7 Sources of Fund For Present - Capital by Size of Firms, 1978

| Source of Fund | (Unit : Percentage) | | | | |
|--|---------------------|-------|--------|-------|---------|
| | Size of Firms | | | | |
| | Cottage | Small | Medium | Large | Average |
| Internal Source | 75.5 | 71.1 | 52.6 | 46.3 | 61.5 |
| External Sources | 24.5 | 28.9 | 47.4 | 53.7 | 38.5 |
| - Unorganized Sources | 12.9 | 10.1 | 4.8 | 8.5 | 8.1 |
| - Friend, Relative, Share Societies | 4.5 | 8.9 | 2.9 | 8.5 | 6.3 |
| - Money lenders | 8.4 | 1.2 | 1.9 | - | 1.8 |
| - Organized Sources | 11.6 | 18.8 | 42.6 | 45.2 | 30.4 |
| - Commercial banks | 11.6 | 18.8 | 42.6 | 45.2 | 30.4 |
| - Finance Companies | - | - | - | - | - |
| - IFCT | - | - | - | - | - |
| - SIFO | - | - | - | - | - |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source : Compiled from Saeng Sanguanruang and Others, Development of Small and Medium Manufacturing Enterprises in Thailand. Table 3.19, p.68.

Table 8 Sources of Credit of Selected Small-Scale Rural Enterprises, 1980/81.

| Source | Amount | Interest Rate |
|---|-----------------------|---------------|
| A. <u>Furniture</u> (N = 12) | | |
| 1. Institutional | | |
| Commercial Banks | 154,285.71 | 18 |
| Total | 154,285.71 (48.21) | 18 |
| 2. Non-institutional | | |
| Relatives | 25,000.00 | (None) |
| Friends | - | - |
| Shares | 104,000.00 | - |
| Raw material suppliers | 36,785.91 | 70.50 |
| Total | 320,071.42 (51.79) | 70.50 |
| B. <u>Noodles</u> (N = 21) | | |
| 1. Institutional | | |
| Commercial Banks | 183,888.88 | 18 |
| Total | 183,888.88 (67.09) | 18 |
| 2. Non-institutional | | |
| Relatives | 23,250.00 | 36 |
| Friends | - | - |
| Shares | 32,600.00 | - |
| Raw Material suppliers | 34,333.00 | 49.55 |
| Total | 274,068.88 (32.91) | |
| C. <u>Fruit and Vegetable Processing</u> (N = 7) | | |
| 1. Institutional | | |
| Commercial Banks | 164,000.00 | 18 |
| Total | 164,000.00 (24.18) | 18 |

Table 8 (Continued)

| Sources | Amount | Interest Rate |
|--|-------------------------|---------------|
| 2. Non-institutional | | |
| Relatives | 312,500 | NA. |
| Friends | - | - |
| Shares | 157,500 | - |
| Raw Material suppliers | 44,000 | - |
| Total | 678,000 (75.80) | - |
| D. <u>Cement Products</u> (N = 10) | | |
| 1. Institutional | | |
| Commercial Banks | 345,600 | 18 |
| 2. Non-institutional | | |
| Relatives | 280,000.00 | 18 |
| Friends | - | - |
| Shares | 792,500.00 | - |
| Raw Material suppliers | 59,333.33 | 72 |
| Total | 1,477,433.33 (75.61) | |
| E. <u>Ready-made garments</u> (N = 12) | | |
| 1. Institutional | | |
| Commercial Bank | 391,785.71 | 18 |
| Total | 391,785.71 (54.27) | 18 |
| 2. Non-institutional | | |
| Relatives | 20,000.00 | (None) |
| Friends | - | - |
| Shares | 77,666.67 | - |
| Raw Material suppliers | 52,375.00 | - |
| Total | 721,827.38 (45.72) | - |

Table 8 (Continued)

| Sources | Amount | Interest Rate |
|-------------------------|-----------------------|---------------|
| F. <u>Silk</u> (N = 19) | | |
| 1. Institutional | | |
| Commercial Bank | 17,500 | , 18 |
| Total | 17,500 (10.28) | 18 |
| 2. Non-institutional | | |
| Relatives | - | - |
| Friends | - | - |
| Shares | 80,000 | - |
| Raw Material suppliers | 72,333.33 | 88.83 |
| Total | 152,733.33 (89.72) | |

Source : "Town Survey; Rural Off-Farm Employment Project". Center for Applied Economics Research. Kasetsart University, 1980/81.

Table 9 Average Rate of Interest by Size of Employment and Sources of Finance

(Unit : Percent per year)

| Size of Employment | Sources of Finance | | | | | Average of Total |
|--------------------|-----------------------|------------------|-------------------|-----------------|--------|------------------|
| | Relatives and friends | Commercial banks | Finance Companies | Share societies | Others | |
| Less than 10 | 18.7 | 13.3 | 21.0 | 17.0 | 18.7 | 16.8 |
| 10-49 | 19.3 | 13.4 | 14.8 | 17.0 | 19.3 | 16.3 |
| 50-99 | 18.3 | 13.6 | 17.1 | 13.2 | 18.3 | 15.5 |
| 100-199 | 20.6 | 13.6 | 16.2 | 5.5 | 20.6 | 16.2 |
| 200 and Over | 18.0 | 12.9 | 12.0 | 3.0 | 18.0 | 9.6 |

Source : Saeng Sanguanruang and Others, Small and Medium Scale Industries in Thailand, 1976.

Table 10 Interest Rates of Loans from Commercial Banks, Share Schemes, Shops/business, 1984

Unit : Person per year

| | Average | Size of Employment | | | | |
|------------------|---------|--------------------|-------|-------|-------|------------------|
| | | Less than 10 | 10-19 | 20-49 | 50-99 | <u>100+</u> |
| Commercial Banks | 17 | 18 | 17 | 16 | 15 | 17 |
| Share Schemes | 16 | 24 | 8 | 8 | 13 | NA |
| Shops/business | 15 | 8 | NA | 10 | NA | 60 ^{1/} |

1/ Only one observation

Source : USAID Small Industry Survey, 1984.

Table 11 Length of Time of Credit by Sources of Finance and Size of Employment

| Size of Employment | Sources of Finance | | | |
|--------------------|--------------------|------------------|-----------------|-------------------------------|
| | Number of years | | | |
| | Relatives | Commercial banks | Finance Company | Share ^{1/} Societies |
| less than 10 | 7.4 | 9.6 | 2.0 | 12.2 |
| 10-49 | 7.2 | 9.7 | 8.3 | 11.3 |
| 50-99 | 8.0 | 10.2 | 8.3 | 12.1 |
| 100-199 | 4.5 | 9.6 | 8.8 | 8.7 |
| 200 and over | 5.0 | 9.6 | 5.0 | 5.0 |

^{1/} It is noted by the authors that there might have been a misunderstanding regarding the interview on this question. The number of years as reported should be interpreted as years which the respondent has participated in "Share Schemes".

Source : Saeng Sanguanruang and Others, Small and Medium Scale Industries in Thailand, 1976.

Table 12 Types of Collateral by Sources of Finance, 1976

(Unit : Percent based on number of responses)

| Collateral | Sources of Finance | | | |
|---|--------------------|------------------|-------------------|-----------------|
| | Relatives | Commercial banks | Finance Companies | Share Societies |
| Land and Other fixed capital | 9.6 | 78.5 | 53.5 | - |
| Personal credit and firm's finance position | 45.6 | 16.4 | 27.6 | 42.4 |
| Overdraft account | - | 2.7 | - | - |
| Posted-check | 20.7 | 0.6 | 19.0 | 43.2 |
| No collateral | 23.5 | 1.4 | - | 14.4 |
| Others | 0.4 | 0.4 | - | - |
| Total | 100.0 | 100.0 | 100.0 | 100.0 |

Source : Saeng Sanguanruang and Others, Small and Medium Scale Industries in Thailand, 1976.

Table 13 Share Operation : 13-Member Group; 5,000 Baht Per Share,
Nakornratchasima.

(Total Value = 65,000 Baht)

| Bid Number (Person No.) | Interest of each bidding | Interest Rate Paid for each bidder <u>1/</u> | Interest Rate Received each member <u>1/</u> |
|----------------------------|--------------------------|--|--|
| 1 | 100 ^{2/} | 3.9 | - |
| 2 | 420 | 18.0 | 24.0 |
| 3 | 410 | 19.2 | 43.0 |
| 4 | 410 | 21.0 | 38.4 |
| 5 | 400 | 22.7 | 32.4 |
| 6 | 410 | 26.4 | 28.8 |
| 7 | 410 | 30.0 | 26.4 |
| 8 | 370 | 31.4 | 21.6 |
| 9 | 410 | 42.0 | 20.4 |
| 10 | 375 | 48.0 | 19.0 |
| 11 | 375 | 63.6 | 16.8 |
| 12 | 375 | 97.2 ^{3/} | 15.0 |
| 13 | - | - | 14.4 |

1/ Compound interest

2/ As a general practice, in Nakornratchasima, the organizer pay 200 baht per 10,000 baht share to each member.

3/ The number 15th member pays very high rate of interest since he has to repay the loan in only one month. This applies in any share scheme.

Source : From a record of a share group.

Table 14 Share Operation : 19 - Member Group; 10,000 Baht Per Share,
Nakornratchasima

| Bid Number (Person No.) | Interest of each bidding | Interest Rate Paid for each bidder <u>1/</u> | Interest Rate Received by each member <u>1/</u> |
|----------------------------|--------------------------|--|---|
| 1 | 200 | 2.64 | - |
| 2 | 1,113 | 16.3 | 24.0 |
| 3 | 1,205 | 19.8 | 42.5 |
| 4 | 1,275 | 21.2 | 52.3 |
| 5 | 1,175 | 20.6 | 47.4 |
| 6 | 1,215 | 22.8 | 41.4 |
| 7 | 1,065 | 21.4 | 36.8 |
| 8 | 1,166 | 25.5 | 32.4. |
| 9 | 1,200 | 28.8 | 28.8 |
| 10 | 1,060 | 27.6 | 26.6 |
| 11 | - | - | - |
| 12 | - | - | - |
| ⋮ | - | - | - |
| ⋮ | - | - | - |
| ⋮ | - | - | - |
| 19 | - | - | - |

1/ Compound interest

Source : From a record of a member of the share group. Fore this case, the record is incomplete.

Table 15 Share Operation : 14 - Member Group; 20,000 Baht Per Share,
Nakornratchasima.

| Bid Number (Person No.) | Interest of each bidding | Interest Rate Paid for each bidder <u>1/</u> | Interest Rate Received by each member <u>1/</u> |
|----------------------------|-----------------------------|---|---|
| 1 | 400 | 3.5 | - |
| 2 | 2,160 | 15.6 | 24.0 |
| 3 | 2,300 | 33.6 | 52.8 |
| 4 | 2,210 | 26.4 | 50.4 |
| 5 | 2,175 | 28.5 | 44.9 |
| 6 | 2,660 | 39.5 | 38.4 |
| 7 | 3,200 | 54.7 | 35.3 |
| 8 | - | - | - |
| 9 | - | - | - |
| : | - | - | - |
| : | - | - | - |
| : | - | - | - |
| : | - | - | - |
| 14 | - | - | - |

1/ Compound interest

Source : From a record of a member of the share group. Fore this case,
the record is incomplete.

Table 16 Share Operation : 16 - Member Group; 5,000 Baht Per Share,
Petchabun Province

(Total Value = 80,000 Baht)

| Bid Number (Person No.) | Interest of each bidding | Interest Rate Paid for each bidder <u>1/</u> | Interest Rate Received each member <u>1/</u> |
|----------------------------|--------------------------|--|--|
| 1 | 100 | 3.12 | - |
| 2 | 405 | 13.8 | 24.0 |
| 3 | 445 | 16.4 | 42.0 |
| 4 | 420 | 16.7 | 39.1 |
| 5 | 400 | 17.2 | 33.8 |
| 6 | 425 | 19.9 | 28.8 |
| 7 | 600 | 31.7 | 25.9 |
| 8 | 420 | 24.0 | 24.0 |
| 9 | 410 | 26.4 | 22.1 |
| 10 | 390 | 28.4 | 19.9 |
| 11 | 395 | 33.6 | 18.0 |
| 12 | 350 | 36.0 | 16.4 |
| 13 | 350 | 44.4 | 15.0 |
| 14 | 380 | 64.8 | 13.8 |
| 15 | 400 | 103.2 | 13.0 |
| 16 | - | - | 12.0 |

1/ Compound interest

Source : From a record of a member of the share group.

Table 17 Share Operation : 12 - Member Group; 10,000 Baht Per Share,
Petchabun Province

(Total Value = 120,000 Baht)

| Bid Number (Person No.) | Interest of each bidding | Interest Rate Paid for each bidder <u>1/</u> | Interest Rate Received each member <u>1/</u> |
|-------------------------------|-----------------------------|---|--|
| 1 | 200 | 4.2 | - |
| 2 | 1,350 | 32.9 | 24.0 |
| 3 | 1,200 | 31.7 | 64.8 |
| 4 | 1,200 | 35.2 | 56.4 |
| 5 | 1,100 | 36.0 | 50.4 |
| 6 | 1,000 | 37.2 | 42.0 |
| 7 | 850 | 36.5 | 36.2 |
| 8 | 750 | 38.4 | 31.2 |
| 9 | 780 | 50.4 | 26.4 |
| 10 | 800 | 68.7 | 23.5 |
| 11 | 1,000 | 132.0 | 21.0 |

1/ Compound interest

Source : From a record of a member of the share group.

Table 18 Share Operation : 21 - Member Group; 10,000 Baht Per Share,
Chonburi

| Bid Number (Person No.) | Interest of each bidding | Interest Rate Paid for each bidder <u>1/</u> | Interest Rate Received by each member <u>1/</u> |
|----------------------------|--------------------------|--|---|
| 1 | 200 | 2.4 | - |
| 2 | 1,550 | 21.1 | 12.0 |
| 3 | 1,450 | 20.6 | 42.9 |
| 4 | 1,400 | 20.9 | 43.8 |
| 5 | 1,460 | 23.0 | 40.6 |
| 6 | 1,475 | 24.8 | 37.6 |
| 7 | 1,575 | 28.6 | 34.8 |
| 8 | 1,520 | 29.4 | 32.4 |
| 9 | 1,540 | 32.1 | 30.0 |
| 10 | 1,620 | 36.8 | 27.9 |
| 11 | 1,550 | 38.3 | 26.4 |
| 12 | 1,495 | 40.4 | 24.8 |
| 13 | 1,410 | 42.0 | 23.5 |
| 14 | 1,350 | 45.2 | 21.9 |
| 15 | 1,410 | 54.4 | 20.6 |
| 16 | 1,250 | 55.6 | 19.2 |
| 17 | 1,320 | 61.1 | 18.4 |
| 18 | 1,500 | 103.2 | 17.3 |
| 19 | - | - | - |
| ⋮ | - | - | - |
| ⋮ | - | - | - |
| 21 | - | - | - |

1/ Compound interest

Source : From a record of a member of the share group. Fore this case, the record is incomplete.

Table 19 Share Operation : 21 - Member Group; 20,000 Baht Per Share, Chonburi.

| Bid Number (Person No.) | Interest of each bidding | Interest Rate Paid for each bidder <u>1/</u> | Interest Rate Received by each member <u>1/</u> |
|----------------------------|--------------------------|--|---|
| 1 | 200 | 0.84 | - |
| 2 | 3,800 | 26.4 | 8.4 |
| 3 | 3,280 | 23.5 | 62.0 |
| 4 | 3,400 | 25.9 | 60.7 |
| 5 | 3,400 | 27.5 | 55.8 |
| 6 | 3,450 | 29.8 | 50.5 |
| 7 | 3,520 | 32.4 | 45.9 |
| 8 | 3,660 | 36.2 | 42.0 |
| 9 | 3,870 | 41.7 | 33.9 |
| 10 | 3,700 | 42.9 | 36.4 |
| 11 | 3,870 | 49.4 | 33.9 |
| 12 | 3,870 | 54.5 | 31.8 |
| 13 | 3,950 | 62.0 | 30.0 |
| 14 | 4,000 | 70.8 | 28.4 |
| ⋮ | | - | - |
| 21 | | - | - |

1/ Compound interest.

Source : From a record of a member of the share group. Fore this case, the record is incomplete.

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Cases

on

The Financing of Small and Medium Scale Enterprises

in

Nakornratchasima, Khon Khaen and Petchabun

Case I

KORAT Furniture Co. (Korat Province).

The total fixed asset is about 3 million baht. There are 20 workers. The raw materials (woods) are mainly from the local sawmills (70% of the total value of raw materials). The furnitures produced are for households, shops, and offices.

The initial investment of 1 million baht was from owned capital. For the working capital, 60-70 percent comes from commercial banks while 30-40 percent are from "share groups".

The entrepreneur has been participating in share groups for three years. The maximum number of groups participated is 20. The average number of member per group is 16. The money per share ranges from 5,000 baht to 50,000 per baht. The interest rate is about 2 percent per month (Note : from his own calculation). He once used the service of the "Share Company" He also borrows from money lenders. However, "Share Group" has been the most important source besides the commercial banks.

The current problems include shortage of working capital (due to less O/D and limited funds from informal sources), and decreasing prices of furniture products.

Noodle-Making Firm (Korat Province)

The total asset is about 3 million baht. The firm produces about 500-600 kgs per factory (a total of 8 factories). There are 8 workers. Raw materials include rice and vegetable oils. Rice is from local rice mills while vegetable oils come from Bangkok.

The initial capital was 2 million baht, 75 percent of which was from commercial banks while the rest was from share schemes. The total amount of working capital required is about 80,000-90,000 baht per month. The important sources of working capital are share schemes (60 percent) and commercial banks (40 percent).

The owner of the enterprise started to participate in the share schemes about 10 years ago. The share schemes are organized among close businessmen and associates. He participates in 3-4 groups with 18 persons per group. The value per share is 30,000 baht with the rate of interest ranging from 2,800-5,000 baht per the total amount per year. He used to borrow from the credit companies at the interest rate of 8 baht per 10,000 baht per day.

His current problem is the shortage of working capital as it is now more difficult to get credit from both formal and informal sources. The volume of business has also been on a declining trend in recent months.

He is of an opinion that if credit from the commercial banks is sufficient, he will not use the credit from informal sources.

Sinthai Co. (Petchabun Province)

Sinthai Company produces seats, iron doors and windows and some other household items. The total asset is about 3 million baht. The initial capital was about 500,000 baht, 70 percent of which was from commercial banks while the rest come from share schemes (20 percent) and private money lenders (10 percent). This business firm has been in operation for 5 years. There are 6 workers. The total amount of working capital is about 400,000 baht which obtained from OD and share schemes.

The owner is of the company has been using informal credit from the share schemes for 5 years. Members of the scheme are close business associates. He usually participates in 3 groups with 10,000 baht per share for each group. The number of members per group is from 10-15 persons. The interest is about 1,200-2,000 baht for the amount received per year. The main reason for participating in the share schemes is to get credit for use in the business operations and to pay back loans. Credit from share schemes is more easily accessible than other sources and there is no requirement for security. Since joining this type of scheme, there has been no problem of repayment among the group members.

As regards credit from other informal sources, he borrows from the private money lenders who provide loans with collateral security and charges an interest rate of 2.5 percent per month. The

repayment period is usually as short as possible. Though the rate of interest is rate high, he still uses credit from this source since the credit from commercial banks is not sufficient.

At present, due to the shortage of working capital, he must buy a smaller amount of raw materials resulting in a higher cost of production. Besides, payment from the customers has been delayed due to financial problems. This has contributed to a decline in business operations. The credit-squeeze policy of the government has adversely affected his business and other businesses in the province as well.

Wood Manufacturing Co. (Khon Kaen Province)

The total asset is about 20 million baht. This company manufactures several kinds of wood products like floor woods, parquets, doors and windows. The raw materials are largely from the Northern provinces. The initial capital was mainly from the commercial banks with some from informal sources.

A sizeable amount of working capital is from informal sources which include share schemes, private money lenders, and raw material suppliers. As for share schemes, the owner has actively participated in it. In fact, he is the organizer of two share schemes himself (indicating that he has a good reputation and a good financial standing). In total, he participates in 15 groups. The amount per share ranges from 5,000 baht to 100,000 baht. Therefore, his credit from share schemes is quite significant. Every month, he has to repay to the schemes over 400,000 baht. This is not really a problem as he can get the money from one scheme (by winning the bidding) to pay for the other schemes. However, due to the tight credit situation recently, he has had some problems of paying back the credit as other members of the schemes have their repayment problems. There have been several cases of bad post dated cheques.

As for the OD credit, he continues receiving it. However, it is still not sufficient as he has been expanding his business in

recent years. This is a reason why he has to depend more on informal credit.

He also receives credit from share companies (sales of postdated cheques), where interest rates are relatively high.

As for credit from raw material suppliers, it is in the form of credit in kind. If he pays within 1 month, there will be no interest. However, after one month, the price of the raw materials will be increased. He thinks that the rate of interest from this source must be higher than from other sources. Therefore, he will try to purchase raw materials in cash.

Like other business firms in the province, his firm also encounters the problem of working capital shortage. This has resulted in a decrease in production and employment in his firm. He hopes to obtain more institutional credit so that his financial problem may be solved.

A.B. Farm Machinery Co. (Khon Khaen Province)

The company started business in 1975 producing simple farm implements and tools (e.g., iron plough, and spades). The initial capital was only 30,000 baht given by the owner's father.

In 1979, he obtained credit on a term loan basis to invest in fixed asset (i.e., to purchase land and machinery). He later receives OD loans for operating expenses. However, since the OD credit is not enough for the business operation, he started to depend on informal credit.

The main source of the informal credit is a share scheme, though some credit is also obtained from share companies and private money lenders.

He started to participate in the share schemes in 1979 when he joined a scheme of 50,000 baht per share. When he began to get credit from share schemes he did not depend much on OD credit. Later on when the OD credit was generously given (in 1983), he joined many schemes (about 10). In 1982-83, his farm machinery business was not very good. He used the credit from the share schemes to invest in land and building which was considered to be giving a high rate of return. His investment is therefore very speculative in nature. In fact, this type of business was very popular among investors in Khon Khaen. The extraordinary increase in the demand for

land had resulted in a remarkable increase in the land price of over 100 percent per year during 1982-83. This speculation phenomenon came to a halt in early 1984 when the credit-squeeze policy was in effect and the share schemes were in the process of collapsing.

He is of the opinion that the easy credit by commercial banks, the increasing number of share companies (and hence credit), and the expansion of "share" credit have contributed to the tremendous investment on speculative activities. Furthermore, a part of the credit has also been spent for consumption purposes. However, this is only a small portion of the total credit obtained.

The impact of the tight credit situation and the limited credit from informal sources has been very significant. For his own business, he can manage to maintain the same production level as before (in his case, demand or market for his products has not been a serious problem). However, he can not keep the products inventory anymore as his cash flow situation does not allow that to happen. He produces and then sells immediately. He now sells his products in cash to improve his financial situation. So far, he has been fortunate as his products are in great demand. Nevertheless, he still has to worry about the repayment of the informal credit and his investment on land and building which turns out to hit a slump.
