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**THAI VENTURE CAPITAL**

**IFI LOAN CASE STUDY**

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## THAI VENTURE CAPITAL EXECUTIVE SUMMARY

The A.I.D. Bureau for Private Enterprise (PRE), in cooperation with six Thai commercial banks, established Thailand's first capital company, Business Venture Promotion, Ltd., (BVP). PRE also provided BVP a loan of \$3 million for ten years. BVP pays PRE interest of 4% on the loan for 10 years, and 20% of all net profits earned for 15 years. Because BVP was a new business, the loan was structured to provide as little "up-front" cost as possible, while still providing the Revolving Fund with an effective rate of return equal to the commercial prime rate in Thailand. The loan agreement between A.I.D. and BVP was signed on March 30, 1987.

PRE also provided a training grant for \$50,000, and has given limited technical assistance to BVP throughout the start-up period. BVP is owned by six Thai commercial banks; these shareholders provided an additional \$3 million in equity to BVP.

BVP makes direct investments in new starts, expansion and "turn-around" companies. Qualifying investments must meet two criteria: Projects funded by BVP must be located in Thailand, and BVP's equity share of a company must not exceed 25 percent (amended to 35% in November 1989) of that company, with a total allowable investment in any single company of \$625,000.

The objectives of the Thai Venture Capital project were:

- (1) to establish a working venture capital company in Thailand to serve as a model for the venture capital industry;
- (2) to provide long-term investment capital to manufacturing and agribusinesses with good profit potential;
- (3) to strengthen local capital markets by encouraging companies to properly disclose financial operations and to list on public stock markets;
- (4) to establish a private sector mechanism for transferring U.S. technologies to Thailand.

### Project Impacts

BVP is still too new for a complete evaluation. BVP's first investment was made in May 1988, fourteen months after the company was formed. As of October 1988, BVP had made only four investments, totalling \$1,292,500. At that time only one of the investee companies was in production. All four investments were carefully considered, and the projects all show clear indications that they will become profitable companies. BVP's Managing Director plans to make at least seven investments in 1989.

BVP plays a key role in this infant industry

There is lots of interest in venture capital in Thailand, with 12 new companies started since the BVP project agreement was signed. As of November 1988, there is, however, little evidence that the venture capital industry is currently viable in Thailand, because other than BVP's four investments, almost no other companies have made any investments. Nevertheless, BVP plays a high visibility role in leading the industry, with almost all venture capitalist interviewed for the PRE studies reported that they view BVP as a leader in adapting venture capital practices to Thailand.

BVP is contributing to the development of capital markets in Thailand.

- (1) BVP encourages professional management in companies by concentrating its investments in companies run by entrepreneurs with "modern" approaches to business.
- (2) BVP builds the quality and quantity of securities available in Thailand's stock markets by using sound project appraisal techniques, and by encouraging companies to establish sophisticated accounting and control systems and by requiring companies to operate on a "transparent" basis.
- (3) BVP improves financial disclosure practices in Thailand by promoting sound accounting systems, and by encouraging entrepreneurs with a financial interest in proper disclosure.

Commercial banks played an important role in the viability of the BVP project. The six commercial bank shareholders were active investors in the project, served as a key source of new projects, and provided additional loan financing for projects. On the negative side, however, giving commercial banks an active role in a venture capital project encouraged BVP to be slow and conservative in its investment approach.

The role of the Over the Counter Market. The weakness of Thailand's OTC market could cause serious problems for the venture capital industry in Thailand and for BVP in particular. Venture capital companies rely on selling their investments through the OTC as one principal exit strategy. In Thailand, however, entry onto the OTC exchange is extremely easy, and the market is extremely small and reportedly speculative. It is possible that the failure of a single company listed on the OTC exchange could cause a severe drop in OTC stock prices, with the result that venture capital portfolios will depreciate significantly and the OTC market will lose its viability as an exit route. On the other hand, BVP's conservative investment strategy may make it more stable if the OTC market falls.

BVP did not prove to be a viable vehicle for commercializing new technologies. The Managing Director of BVP stated that for his company to make an investment, the project must use established technology, with established production costs, and products must have established markets. If A.I.D. wishes to identify viable means of involving the private sector in commercializing technologies, then significant changes may need to be made in the venture capital model currently employed in Thailand.

A.I.D. as a Dealflow Source. PRE commissioned 10 project proposals for BVP to provide an initial source of possible investments. These proposals did not result in any investments by BVP. BVP staff, as well as numerous other respondents, suggested that "to have a project, you must first have a good local entrepreneur." Sending project feasibility studies from the U.S., when they do not include an entrepreneur with real interest in the project, is not a productive dealflow source.

Importance of representing A.I.D.'s management interest. During the second year of the project, the contract expired for PRE's Personal Services Contractor in Bangkok. Because there is no full-time representative in Bangkok, it is unclear who will continue to represent PRE's management interests in BVP. It is also worthwhile to note that one reason for the success of this PRE project has been the active involvement of a Bangkok-based PRE representative and the Mission Private Enterprise Officer.

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## THAI VENTURE CAPITAL

### I. OVERVIEW OF THAILAND'S ECONOMY AND CAPITAL MARKETS

#### A. Thailand's Capital Markets

Thailand's economy is booming at an estimated 1988 GDP growth rate of around 9-10 percent. This follows impressive growth in 1986 and 1987 when the Thai economy recovered from a recession begun in mid-1984. Thailand's economy had expanded rapidly during the 1960s and 1970s, achieving an average annual GDP growth of over 7 percent and an average per capita income growth of nearly 5 percent. During this period, industry modernized and the economy was increasingly opened to foreign trade and capital flows.

The investment environment currently is characterized by such positive factors as low-cost but relatively skilled labor, rich natural agricultural resources and raw materials, a growing domestic market, conservative economic and financial management, and relatively well developed physical infrastructure. Private investment expenditures have also grown rapidly in 1987 and 1988 after sluggish growth in the mid-1980s. U.S. Embassy economic forecasts indicate there is little reason to expect any significant deceleration in Thailand's real economic growth over the next few years. That growth should stabilize at over 6 percent.

The Thai government has recognized the role of the private sector in economic development in the Sixth National Economic and Social Development Plan (FY1986-1991) by calling for cooperation between the government, state enterprise and the private sector. During the plan period, 70 percent of investment is expected to originate from the private sector, with a reduced role for state enterprises. Thailand's investment policies are administered and promoted by the Board of Investment (BOI). The BOI

offers a range of financial incentives to companies that are granted promotion privileges, including temporary exemptions from import duties and corporate income tax.

The Sixth Plan also highlights capital markets development, especially strengthening the Securities Exchange of Thailand (SET), as a major goal to help mobilize long-term funds and support privatization of state enterprises. Trading on the SET began in 1975, at that time with a total of 16 securities listed, including 2 government bonds and 14 corporate securities. The SET experienced a speculative boom in 1978 ending in a major crash in 1979, triggered by the collapse of Raja Finance and Securities Co., then one of the countries largest securities firms. In response to the crash, the government quickly created two special funds to rescue the SET through large-scale equity purchases. In addition, two funds established by the Association of Thai Commercial Banks helped to maintain the liquidity of finance and security companies. As the market stabilized, the four funds became less active in market intervention.<sup>1</sup>

#### B. Financing New Investments

Historically, Thai companies have lacked interest in public equity financing. Information and disclosure requirements deter many family-run firms from going public, as does the common practice of under-reporting income for tax purposes. Securities markets have not been a major source of corporate funding in a financial system geared toward debt financing. Nonetheless, while the SET is still small, there appears to be a trend among family business conglomerates to set up "model companies" to

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<sup>1</sup> For a more complete description of Thailand's capital markets, see Appendix 2.

qualify for SET listing to raise equity funds for their highly geared group companies.

Since the mid-1988 stock market surge, the SET has been trying to attract a greater supply of stocks. In June 1987, it moved in this direction by establishing a second board for less than blue chip companies, featuring listing requirements that are less strict than for the first board. There now also exists a small over-the-counter (OTC) market with no listing requirements. This market consists of limited trading in the shares of a few companies not quoted on the SET.

Banks traditionally have lent against collateral, not cash flow, and often require collateral in excess of 200 percent. This hampers small and new businesses from obtaining credit because they often lack the necessary collateral. Banks also are reluctant to lend to small businesses because of high transaction costs associated with small loans.

Commercial banks also make equity investments. Banks can hold up to 10 percent of the equity in a company, and more in the case of newly established firms or those in financial trouble. However, the aggregate amount of bank equity investment is limited to 20 percent of the bank's capital. In practice, banks own a small but significant portion of their assets as equity investments.

The traditional method of business financing offered by commercial banks is short- to medium-term debt financing secured primarily by land and real estate collateral. Lending criteria are biased towards security rather than project viability or entrepreneurial capability. This "collateral syndrome" poses a dilemma for new businesses that often lack sufficient collateral to secure borrowings. Venture capital plays a key role in removing this constraint because it provides equity financing

without collateral to projects that have high growth and profit potential but are riskier than is acceptable to conventional investors.

### C. Growth of The Venture Capital Industry

Thailand's current economic boom has created a favorable investment environment for venture capitalists. Model investments have high growth potential, capable management, and good prospects for future liquidity and high capital gains. Prospective investments also need entrepreneurs who are willing to dilute their ownership of the company and open to sharing the management of the business with the venture capitalist. Thailand has a number of favorable factors for venture capital (VC); these are discussed further in Appendix 2, Economic Environment and

Business Venture Promotion Co., Ltd., formed in April 1987, was the first venture capital firm in Thailand. It has recently been joined by such firms as Singapore-based SEAVI, backed by the International Finance Corporation; Seamico, which is raising \$3-4.5 million with support from the U.K.'s Commonwealth Development Corporation, Rockefeller & Co., and Thai investors; Venture Capital Company (VCC), with registered capital of B200 million (\$8 million), formed by several Thai finance/securities houses and banks; Thai Agribusiness Venture Company (TAVC), with proposed capital of B294 million (\$11.75 million), backed by the Asian Development Bank and two European government overseas investment agencies; and a venture capital firm with a \$15-30 million offshore fund underwritten by Merrill Lynch Venture Capital Inc. and a local Thai financier. Thailand's IFCT also is in the process of establishing its own venture capital fund. For further background on these firms, see Appendix 2.

## II. THE LOAN AGREEMENT BETWEEN BUSINESS VENTURE PROMOTION AND A.I.D.

### 1. Project Background

PRE first seriously considered the idea of establishing a venture capital firm in an A.I.D.-assisted country in 1983. Project planners foresaw venture capital playing several roles in private enterprise development: providing long-term investment capital; formalizing risk capital investment processes; commercializing and transferring technologies; and strengthening local capital markets. After evaluating several approaches to developing venture capital companies, the Bureau's Investment Office decided that PRE's efforts should emphasize the following:

- Local sponsorship of the project to ensure indigenous institution building;
- Substantial support from the local banking community;
- Pre-identified investments to establish a flow of deals from the outset of the project;
- Mobilization of local capital;
- Concentration on agro-industries and other high value-added businesses.

Serious efforts began in 1985 when the Investment Office asked a U.S. venture capital firm to prepare a concept paper on establishing a venture capital company in Thailand. After reviewing this and other proposals, the Investment Office decided to make offers to several leading commercial banks in Thailand to jointly establish a venture capital company. Investment Officers proposed that the banks be the shareholders and PRE provide seed capital in the form of a long term loan. Several banks decided to join the project, stating that they saw it as an opportunity to develop new business and to strengthen local financial

markets. The proposed investment focus of this venture capital firm would be agro-technologies oriented toward export and import-substituting markets.

An important factor considered during project design was the risk of a venture capital company failing and the effects that such a failure would have on local capital markets. Before negotiations for the PRE-sponsored company began, another firm, Southeast Asian Venture Investment Company, had failed, and this had made Thais wary of getting involved with new venture capital investments. The design proposed by PRE, which included major commercial banks, was viewed as safe because of the strong financial and technical backing that local banks would bring to the project. As a senior officer in one of the lead banks described it:

"We had been invited to join another venture capital company but we turned it down. We were impressed with USAID's (i.e., PRE's) approach, because we felt that a conservative approach had to be taken in order to demonstrate that the concept (of venture capital) works. We should not have any failures in this new industry."

In January 1987 negotiations with the banks resulted in an agreement that six major Thai commercial banks would establish a venture capital company, PRE would lend one-half of the funds needed to start the new company, and the six shareholders would put up the other half as equity.

The company was named "Business Venture Promotion, Ltd."; the shareholders' agreement for the new firm was signed March 30, 1987. At this time, the Industrial Finance Corporation of Thailand, which had been invited to participate, decided not to join because they claimed that venture capital in Thailand needed further feasibility analysis.

## Project Objectives

The objectives of the Thai Venture Capital project were:

- (1) to establish a working venture capital company in Thailand to serve as a model for the venture capital industry;
- (2) to provide long-term investment capital to manufacturing and agribusinesses with good profit potential;
- (3) to strengthen local capital markets by encouraging companies to properly disclose financial operations and to list on public stock markets;
- (4) to establish a private sector mechanism for transferring U.S. technologies to Thailand.

## The Loan Agreement

On March 30, 1987 the loan agreement between Business Venture Promotion, Limited (BVP) and A.I.D. was signed. The loan agreement had five key features:

- (1) A.I.D. provided Business Venture Promotion a loan of U.S. \$3.0 million;
- (2) The terms of the loan were arranged to make the loan as similar to equity as possible; this was to be accomplished by giving BVP a long term, low interest rate loan, with PRE also receiving a share in BVP's earnings;
- (3) The loan would be matched by a minimum of \$3.0 million in funds from the firm's shareholders, so that BVP would be capitalized at a minimum of \$6.0 million;
- (4) BVP would use its funds to finance potentially viable enterprises, as defined by the loan agreement; and
- (5) PRE had the right to disapprove of BVP's Chairman of the Board of Directors and Managing Director.

## Loan Terms

Summary: - PRE provides BVP with a \$3 million, 10 year loan;  
- There is a 5 1/2 year grace period on interest and principal payments. During the grace period, interest payments are capitalized, i.e., added to the loan

principal. At the end of the grace period, principal is to be repaid in ten equal semi-annual installments over the remaining 4 1/2 year period of the loan;

- BVP pays PRE interest of 4% per year for 10 years, plus 20% of all net profits earned by BVP for 15 years.

Because BVP was a new business, the loan was structured to provide as little "up-front" cost as possible, while still providing the Revolving Fund with an effective rate of return equal to the commercial prime rate in Thailand.

In addition to the low interest rate and long principal and interest grace periods, the loan agreement requires BVP to pay an "incentive fee" to PRE. This incentive fee is a share of BVP's profits that is paid to PRE, in effect, to bring the effective rate of return on the loan up to the commercial lending rate.

The incentive fee requires that BVP pay 20 percent of annual net profits, minus accumulated losses, up to a maximum total fee of \$3.05 million. The incentive fee is to be paid to PRE for fifteen years from the first disbursement under the project. Net profits are calculated according to Thai corporate law and confirmed by a certified public accountant acceptable to PRE.

#### Qualifying Investments

Under the loan agreement BVP agrees to use loan proceeds only to finance companies that meet the definitions of "qualifying enterprises" and "qualifying investments". Qualifying enterprises are firms whose ownership is controlled by Thai citizens. In addition, the agreement says that BVP must "focus" its investments on firms with total assets not in excess of \$5 million.

Qualifying investments must meet two criteria: Projects funded by BVP must be located in Thailand, and BVP's equity share of a company must not exceed 25 percent (amended to 35% in November 1989) of that company, with a total allowable investment in any single company of \$625,000.

Other than enforcing the limits on qualifying investments and enterprises, PRE has no control over the selection and management of individual venture capital investments.

#### PRE's Responsibilities in Management

The company's managing director and chairman of the board of directors must be acceptable to PRE, and no changes in these officers are allowed without PRE's consent. PRE has no other formal control over management.

#### Training and Technical Assistance Grants

In addition to the loan, PRE provided a reimbursable training grant of \$50,000. The purpose of the training grant was to provide exposure of BVP's shareholders and staff to venture capital practices in the U.S. and other major venture capital markets. In 1987, PRE also provided ten project studies for BVP to consider as possible investments.

### III. ORGANIZATION AND OPERATION OF BUSINESS VENTURE PROMOTION

The company was founded on April 1, 1987, when the six banks capitalized BVP with 80 million baht (U.S. \$3.2 million), and PRE provided a \$3.0 million loan. Siam Commercial Bank and Thai Farmers Bank each own 30 percent of the shares; Bank of Ayudhya, Thai Danu Bank, Bank of Asia, and Nakornthon Bank each own 10 percent.

BVP's staff of four persons includes Chaleo Souvannakitti as managing director, an investment officer, an administrative officer, and a secretary. The managing director reports to the Board of Directors. The Board is comprised of 10 members and chaired by Prakrit Pradipasen, Senior Executive Vice President of the Siam Commercial Bank.

#### Investment Strategy

BVP's investment strategy is to purchase 10 to 40 percent of selected companies. The loan agreement originally limited BVP to investments of less than 25 percent a company's equity, and BVP's staff found that 25 percent is generally too little to assure sufficient control of a company's management. In two of four investments that BVP made, waivers of the 25 percent limit were granted by PRE. To give the company greater flexibility in the future, the loan agreement was amended at BVP's request to allow a maximum investment limit of 35 percent. BVP's staff said that this new limit would allow the control needed while limiting BVP from becoming over-exposed to any single company.

BVP will consider investing in almost any productive enterprise, although agribusinesses and companies producing export goods are the preferred opportunities. Appropriate technologies - technologies that can be adapted from abroad and used profitably in Thailand - are also of special interest.

BVP looks for investments that have the potential for rapid growth and at least a 30 percent annual return on investment. In addition, the company has decided to take a conservative approach to its investments, emphasizing firms with strong earnings potential rather than rapid stock market appreciation. Unlike many venture capital companies, BVP receives no fees when it makes an investment.

BVP also considers the following factors in a project:

- A company must be in a growing market, and its products must have established local markets as well as potential foreign markets.
- A company's products should be distinctive and not easily imitated, and should have some kind of competitive advantages over other similar products.
- The company must have professional (i.e., non-family) management.
- The company must have the potential to be listed on the Securities Exchange of Thailand.

### Operations

As of November 15, 1988, BVP has invested a total of \$1,292,500 in four companies:

- (1) **Thai Circuit**, a producer of printed circuits (BVP investment: \$382,500);
- (2) **Thai Micro Systems**, which assembles integrated circuits (BVP investment: \$750,000);
- (3) **River Kwai Ltd.**, a canner of baby corn, bamboo shoots, and water chestnuts (BVP investment: \$120,000);
- (4) **Padriew Eggs Products Co., Ltd.**, an agribusiness producing powdered eggs (BVP investment: \$40,000).

BVP's first investment was made in May, 1988, fourteen months after the company was formed. The Managing Director, Mr. Souvannakitti, plans for BVP to make at least seven investments in 1989. He said that, at best, they would make ten investments in 1989, for a total of 60 million Baht (\$2.4 million). He claims that this increased rate of investment compared to 1988 is a result of BVP's business development efforts, and the fact that entrepreneurs are beginning to understand the role of venture capital in Thailand. He describes the company's "deal flow" as being largely a product of his business development activity.

"Deals" - prospective investment opportunities - come from five sources: the Thai Board of Investment (25% of all deals), the six shareholder banks (10%), walk-ins (entrepreneurs who hear about BVP and come to the office with a proposal) (35%), and from Mr. Souvannakitti's marketing efforts (30%). His marketing efforts include speeches, seminars, and articles in local magazines and newspapers. Mr. Chaleo offers well-attended, periodic seminars on entrepreneurship and business planning to spread information about venture capital and to generate new deals. BVP charges B30,000 (\$1,200) for prospective entrepreneurs to attend these seminars, and donates profits from the meetings to the Thai Chamber of Commerce to support SMSE development programs.

At the present time, BVP has 73 applications for equity in various stages of completion, with five projects in the final stage of evaluation. These five are:

- (1) A marble quarry and cutting plant. This would be with a Japanese co-investor, with output intended for export to the U.S. and Japan.

- (2) An eel farm. There are two possible co-investors, a Danish company and Charoen Pokapan, a major Thai agribusiness firm.
- (3) A turnaround investment in an established electric generator company.
- (4) A computer filter company. This would be with a U.S. partner.
- (5) A latex fabrication plant. BVP is seeking technology from abroad to carry out this project.

After initial discussion with an entrepreneur, Mr. Souvannakitti judges whether an investment opportunity is worth pursuing. If it appears that a good project exists, he asks the entrepreneur to provide a detailed business summary and plan of operations.

Typically, the application process takes several months while the applicant seeks additional investors and completes the business summary and plan. The major constraint for most applicants is locating additional investors.

BVP assists with that search by seeking funds, principally from BVP's stockholder banks. At the same time, BVP conducts a careful evaluation of the business plan. The evaluation process includes character references and credit checks through the member banks and the network Mr. Souvannakitti belongs to as Secretary-General of the Thai Chamber of Commerce. BVP often hires academics and technical consultants to assist in assessing a business proposal.

When an application is completed and prospective investors are secured, the application is presented to all the shareholder banks for approval. Following approval by the banks, equity funds are disbursed to the company and the business begins operations.

The next phase of BVP's investment involves monitoring the company and providing counsel as needed. Proper monitoring of the performance of a company is essential to insuring that the venture capital company will receive its share of the company's profits.

When this study was conducted, in November 1988, BVP did not have adequate reporting or monitoring arrangements in operation for its four investments. Monitoring information differed in each case, but the investment staff of BVP did not appear to have up-to-date information on cash flows, inventory, sales, profits and production costs for the two companies visited. BVP, however, is currently developing a management system to monitor its investments, and an experienced U.S. venture capitalist is working with BVP through the International Executive Service Corps to develop an investment management system. Plans have also been made to increase professional staff by as many as four individuals to handle the increased number of applications and to monitor investments.

Finally, BVP has plans to develop an international network of investors and technology suppliers to collaborate with BVP on projects. It is hoped that such a network could provide capital, technology, and the opportunity to expand export markets.

#### Exit Strategy

After an investment is held for a certain period of time, venture capital companies generally find a way to "exit" from the investment, i.e., to sell their shares. BVP has not established a clear exit

strategy. As mentioned above, however, the firm has decided to take a conservative approach to its investments, emphasizing firms with strong earnings potential rather than high appreciation on the OTC market. As the Managing Director stated:

"We take the OTC market lightly. We don't want to use the OTC as a principal exit point. We want to invest in manufacturing and sell based on the (company's) fundamentals. The OTC is just a tool for us to demonstrate the value of a company."

### Critical Management Issues

At the time of this evaluation, BVP officers were discussing the possibility of selling part of the equity of BVP to a foreign venture capital firm. This issue has important implications for PRE's involvement with the firm. If the new shareholder is an American venture capital firm, this could help BVP with its effort to establish an international deal-flow network, and might introduce much needed investment control systems. On the other hand, if it is a non-American firm, then there is some chance that BVP would focus on doing deals with non-American partners.

Another issue concerning the possible sale of BVP equity is what the company would do with the additional capital. Because BVP has been slow in making investments during 1988, it is questionable that additional capital would be needed now. If additional capital is not needed, then BVP could buy technical expertise to set up the international network and investment control systems rather than selling equity to bring in a foreign management group. It is clear that whichever route is chosen, decisions taken on this issue will have an impact on the profitability of PRE's investment.

#### IV. INSTITUTIONAL IMPACT

##### A. Capital Markets in Thailand

The BVP venture capital project has had three important impacts on capital markets in Thailand:

1. BVP was the first venture capital firm in Thailand, and has provided useful examples of venture capital operations to the firms that have started since 1987.
2. BVP provided long-term capital to new starts in manufacturing and processing industries;
3. BVP has provided a means of increasing both the quality and the quantity of equity securities available in Thailand.

Since the project agreement was signed there have been over ten other venture capital firms established in Thailand. It is clear that there is widespread interest in venture capital as a mechanism for long-term financing in the country. BVP has been a very high visibility project, with widespread local publicity of the company. There have been articles in several local newspapers, and in local and international new magazines, and several booklets on investment project analysis and business planning have been produced and distributed by BVP as part of its business development effort. Virtually all senior bankers, securities dealers and government officials interviewed for this study were aware of BVP's investment approach and current operations. The public attention that BVP has drawn to venture capital did not create the industry but, in the words of USAID/Bangkok's Private Sector Officer, has "sped up the establishment of venture capital firms".

BVP has been a model for the venture capital industry, and has stimulated greater interest in proper project planning, appraisal, and financial disclosure. The seminars and lectures given by BVP's managing director and the company's published guide book on preparation of business plans, and the newspaper articles on the company's approach to venture capital that appeared in local papers have all stimulated interest in proper business planning and the role of "professional management" in enterprise development.

As noted above, BVP's managing director stressed in his discussions with the evaluation team that every firm in which BVP invests must have four important characteristics:

- Profitability
- Professional management
- Full financial disclosure of business operations
- Willingness to list on the stock market

Thailand's stock market has been seriously hampered because many family-owned companies conceal substantial shares of their income. Lack of proper financial control systems in many firms results in tax revenue losses to the government, and lack of public confidence that corporate financial statements properly disclose earnings. This damages public confidence in stocks as investments. On the other hand, professional management, full financial disclosure and willingness to list on the stock market all contribute to the development of local capital markets.

BVP, along with other venture capital firms in the country, requires that its co-investors agree to take their investments public after several years of operation. BVP argues that listing publicly will give investors higher returns through capital gains than from operating profits. If

investors agree to list publicly and see capital gains as an important objective, the firm is much more likely to be operated with full, transparent financial disclosure.

Because BVP only invests in firms that are professionally managed and that fully disclose their financial operations, it is easier for potential investors to evaluate securities offered by these firms. Full and proper disclosure is the basis of public investor confidence in a stock market. Therefore, by establishing firms that practice proper financial disclosure and sell their equity on the stock market, BVP (as well as other firms with similar investment policies) improves the quality of securities available on public equity markets.

Thailand's recent strong economic growth and robust demand for Thai stocks have resulted in the establishment of over \$700 million in funds for both venture capital and stock market investments. A problem currently facing Thai stock capital markets is how to increase the supply of securities available to the public. By sponsoring new companies to start up, BVP contributes not only to the quality, but also to the quantity of equity securities available to the public.

This project also offers several other lessons concerning intervention in capital markets through venture capital projects. Among the most interesting are the following:

(1) The Role of the OTC Market

BVP, as well as other venture capital firms in Thailand, currently relies on selling equity on the over-the-counter-market (OTC) as one exit strategy. Many people in the venture capital industry mentioned during interviews that the development of a venture capital industry generally requires a stock market that is sufficiently developed to be a funds

source for new companies and to provide an exit route for the venture capital company. Several respondents also suggested that venture capital is not likely to succeed in countries where there is no effective OTC market.

In Thailand, the OTC market is both a strength and weakness for venture capital firms. Entry onto the OTC market is extremely easy, and the market is very small and reportedly speculative. Some people in the finance industry have suggested that the failure of a single company listed on the OTC exchange may cause a severe drop in OTC stock prices, with the result that venture capital portfolios will depreciate significantly and the OTC market will lose its viability as an exit route. On the other hand, BVP's conservative investment strategy may make the company more stable than some others if the OTC market falls.

## (2) The Key Role of The Entrepreneur

Several respondents said that the most important factors to consider in a venture capital investment are the character and abilities of the entrepreneur. To be successful, an entrepreneur must have a record of honesty in business and should have successfully managed other businesses. It is felt that an honest entrepreneur will protect the shareholder's capital, and will scrupulously give other investors their shares of the venture's profits.

According to several people in the industry, without an entrepreneur who is motivated, competent and honest, even the best business ideas are worth nothing. Therefore, these individuals contend that it is generally not worthwhile to produce business proposals for a venture capital company if there are no entrepreneurs associated with the proposals. For example, in the BVP project the ten investment proposals commissioned by PRE did

not result in any investments by BVP. BVP staff explained this lack of success by saying: "to have a project, you must first have a good local entrepreneur. These projects didn't have any entrepreneurs associated with them." Sending project feasibility studies from the U.S., when they do not include an entrepreneur with real interest in the project, is not a productive source of deals.

(3) Pluses and Minuses of Working with Commercial Banks

Respondents in Thailand's venture capital industry noted that there are several advantages and disadvantages to working with commercial banks as shareholders in a venture capital project. Banks provide four benefits as owners of venture companies: (a) banks are a good source of referrals for venture capital projects; (b) banks can provide loans to complement the equity for a venture capital project (for example, shareholder banks have made loans to three of the businesses funded by BVP); (c) bank loan officers can be helpful in evaluating potential projects; and, (d) commercial banks have expertise and networks of contacts needed to check the character and credit history of potential partners.

The following are disadvantages of working with commercial banks:

- (a) Commercial banks have overly conservative standards in selecting investments. The investment criteria that they use for venture capital investments are similar to those that they apply to commercial lending decisions. Many venture capitalists claim that very different standards are involved in venture capital investments. In the words of BVP's Managing Director, Mr. Souvannakitti: "When you enter the Investment Committee meeting (of BVP), you must take off your banking cap."

- (b) Banks often see involvement in a venture capital company as an opportunity to develop new business, and actively seek to provide loans to the companies that receive venture capital investments. If several banks are involved as shareholders, it is difficult to allocate commercial lending rights fairly among the shareholders.
- (c) Commercial banks have limitations as sources of "deals" for a venture capital company. Generally, banks will only refer projects that are considered unsuitable for the bank to invest in directly. In Thailand, commercial banks are allowed to make direct investments in companies. In other countries, commercial banks can make equity investments through venture capital subsidiaries or finance companies. Banks in these circumstances are likely to refer only projects that have been "rejected" for direct investment.
- (d) Finally, commercial banks often do not have the technical expertise (e.g., in industrial engineering or the agricultural sciences) needed to evaluate investments involving new, high technologies.

(4) More than a Few Shareholders Becomes Cumbersome

In Business Venture Promotion company, the six shareholder banks were directly involved in every investment decision. Involving these shareholders in all decisions has proved to be cumbersome and slow. Two alternative approaches are (a) to involve only a few institutions (three at most) as shareholders; and (b) to limit the powers of the shareholders to setting investment guidelines, while turning individual investment decisions over to management.

(5) Legal Impediments to Growth of Venture Capital

According to Mission staff, a major impediment to further development of the venture capital industry is the Thai Government's legal restrictions on the stock market. For example, venture capital companies are not allowed to sell shares publicly. It was suggested that A.I.D. attempt to help the government revise the legal framework to make venture capital more viable. Efforts to improve regulations governing venture capital investments could be carried out as part of the Mission's ongoing financial markets policy dialogue effort, or through PRE's Financial Sector Development and Private Enterprise Development Support projects.

(6) Difficulties Associated with Investment Limits

The original limit on BVP's investments to 25 percent of the equity in a company required BVP to search for multiple co-investors for most projects. Searching for co-investors slows down the investment process. In addition, the 25 percent rule has also made it difficult for BVP to influence the management of a company. Two suggestions were made by study respondents for future venture capital projects: (i) Make the limit flexible (as it is in the BVP project) so that waivers can be easily granted to exceed the 25 percent limit; and (ii) increase the limit to 35 or 40 percent, as was done in BVP's case.

(7) Means of Capturing Profit Shares Owed to the Venture Capital Company

Venture capital companies always run the risk that profits from operation of their investments will be diverted away from corporate retained earnings accounts. This threat is particularly serious in business environments where the practice of concealing profits is a common means of avoiding taxation. Respondents in the venture capital industry

in Thailand had several suggestions for minimizing the "leakage" from retained earnings. These include:

- (a) Take more than 25 percent of the equity of a company in order to justify active involvement in the management of a company;
- (b) Select partners who intend to list the company on the stock exchange and later use the stock exchange to exit or raise additional capital;
- (c) Set up good management information systems to provide information on operations;
- (d) Put representatives of the venture capital company on the board of directors of a company;
- (e) Select honest partners;
- (f) Employ a good auditor to monitor investments on a regular basis.

B. Impact on USAID/Thailand

The Private Sector Office of USAID/Thailand views the Thai venture capital project as an opportunity to carry out financial market development activities that cannot be done through bilateral programs. Officers in the Mission stated that the objectives and activities of the BVP project are complementary to the current Mission private sector portfolio. Specifically, the project fits into the Mission's private sector portfolio in several areas, including:

- establishing institutions to provide long-term risk capital
- transferring U.S. scientific and management technology
- building local stock markets

The Mission was not involved in designing the project but has taken a major role in its implementation. One PRE Personal Services Contractor (PSC) based in the Bangkok Mission has spent approximately 30 percent of

her time implementing and monitoring the project since its beginning, and the Private Sector Officer in the Mission has also given a significant amount of time to the project. Substantial assistance has been provided to help BVP meet the conditions required for disbursement of the PRE loan, and to help the Board of Directors function effectively. Without the assistance provided by the Bangkok-based PRE PSC and USAID Private Sector Officers, it is unlikely that the company would have been successful.

The project has strengthened the contacts between the Mission and the finance industry in Thailand, and according to the PRE PSC in Bangkok, BVP "has demonstrated that A.I.D. is a sophisticated and innovative player in financial markets." In addition, the project has shown that A.I.D. is able to contribute to the development of an ASEAN regional venture capital industry.

A third impact of the project is that it provided a mechanism for promoting U.S.- Thai joint business ventures and transferring technology from the U.S. to Thailand. There is great potential to increase U.S.- Thai trade and investment, but few mechanisms for financing joint ventures. BVP has funded two U.S.- Thai joint ventures during its first year of operations, and has served as a focal point for inquiries from U.S. entrepreneurs and investors.

An example of BVP's role in investment promotion was related by the USAID Private Sector Officer. Recently a U.S. electronics firm called the Thai Government's Board of Investment Office in New York seeking a joint venture partner to set up a components factory in Thailand. BOI/New York sent the request to the BOI office in Bangkok, and this office, knowing that BVP has already funded two electronics projects, notified BVP of the U.S. company's interest. BVP brought in a Bangkok-based investment firm

to help raise funds needed for the project, and the project is being considered now by BVP.

BVP Has Not Yet Met USAID/Thailand's Commercialization of Technology Objectives

It is important to note that the project has yet to achieve two Mission objectives for venture capital: commercialization of technology, and transfer of technology to agriculture. Mission staff have been searching for mechanisms to provide capital to new technologies that come from the Mission's Science and Technology for Development and Agriculture Technology Transfer projects. The venture capital project in Thailand was promoted in part as a means of providing risk capital for investment in technologies developed under A.I.D.-funded research and development programs.

BVP generally refuses to invest in proposals coming from Mission-funded research projects because these proposals usually involve technologies that do not have well established costs and markets. BVP, like other firms in this new industry, has stressed building confidence by investing in projects that involve established technologies. The company has avoided investing in technologies that will involve substantial marketing or development expenses. Of BVP's pending applications, only 15 percent involve high technologies (technologies that do not have established markets or known production costs), 70 percent involve established technologies, and 15 percent involve businesses in the traditional service or "no technology" industries (such as restaurants and tourism).

### Representing PRE's Management Interests in BVP

Another area of concern for the Mission regarding the BVP project is the fact that the Mission no longer has a PRE-funded PSC to help monitor and implement PRE projects. The contract for the PSC in Bangkok, one of only three Mission-based PRE PSCs worldwide, expired in September 1988.

One reason for the substantial success of the project to date is that A.I.D. staff in Bangkok have spent substantial amounts of time working with BVP staff and Directors. For example, by late 1987 BVP had still not made any investments, and the Board seemed unable to make decisions on proposed projects. Discussions between board members, the Private Sector Officer in the Mission and the local PRE PSC officer resulted in a successful proposal for smaller investment committees to be created to reduce the number of board members involved in individual project decisions. Then in early 1988, board members suggested that PRE fund feasibility studies for projects proposed to the board. In response to this issue, Mission staff suggested to the board that it would be helpful if the board looked at BVP as its shareholders' own investment, not as PRE's or as a group of stand-alone equity investments. This suggestion was well received and helped the shareholders recognize their responsibilities to fund feasibility studies as owners of BVP.

The important management issues facing BVP when this study was conducted include the following:

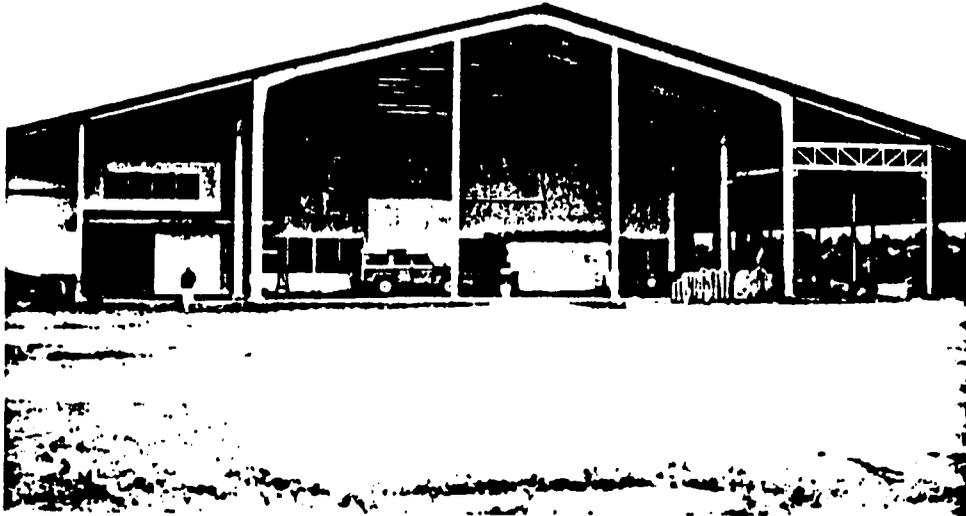
- Succession of the Managing Director in 1989;
- Need to install investment monitoring and control systems;
- Possible sale of a share of BVP's equity in order to bring in foreign management expertise and additional capital.

These issues have implications for the performance of the project. If the company is well managed, then PRE stands to receive a large return through its 20 percent incentive fee. If, on the other hand, BVP merely breaks even, PRE will only receive its 4 percent interest on the loan as a return for its investment in the project. Since there is no PRE officer in Thailand now to represent PRE's management interests in BVP, there is concern about who will assume these responsibilities.

## V. INVESTMENT PROJECT PROFILES

### A. RIVER KWAI INTERNATIONAL, CO., LTD.

River Kwai International, Co., Ltd., is a newly established food processing company located in a picturesque rural setting on the famous River Kwai 200 kilometers west of Bangkok. The plant, employing 130 people (mostly women), is in the business of canning baby corn, bamboo shoots, and water chestnuts.



River Kwai's Newly Constructed Plant

The plant is managed by Ms. Sasinand, an experienced business woman who is both the General Manager and owner of 22 percent of River Kwai Company. She also owns a vegetable brokerage business and a small commodity trading company, and has years of experience with the fruit and vegetable industry. Her production manager in the plant has ten years of food canning experience, and the company's Managing Director is an experienced businessman who owns a trading company.

Ms. Sasinand's husband originated the idea for the company because, in addition to starting a profitable business, he wanted to make an economic contribution to rural Kanchanaburi Province where he grew up. The couple's proposal to construct the plant became a reality when Siam Commercial Bank agreed to provide the loan funds and BVP agreed to provide equity.

The company was capitalized in December, 1986, at 10 million baht (U.S. \$400,000), with BVP buying 20 percent of the capital shares. The working capital loan of 9 million baht (U.S. \$360,000) and a long-term building loan of 7 million baht (U.S. \$280,000) are secured by the real estate, machinery, and equipment.

The financial package was enhanced by the promotional privileges granted to the company by the Thai Board of Investment - incentives including no import duties on machinery and equipment and a six-year income tax exemption.

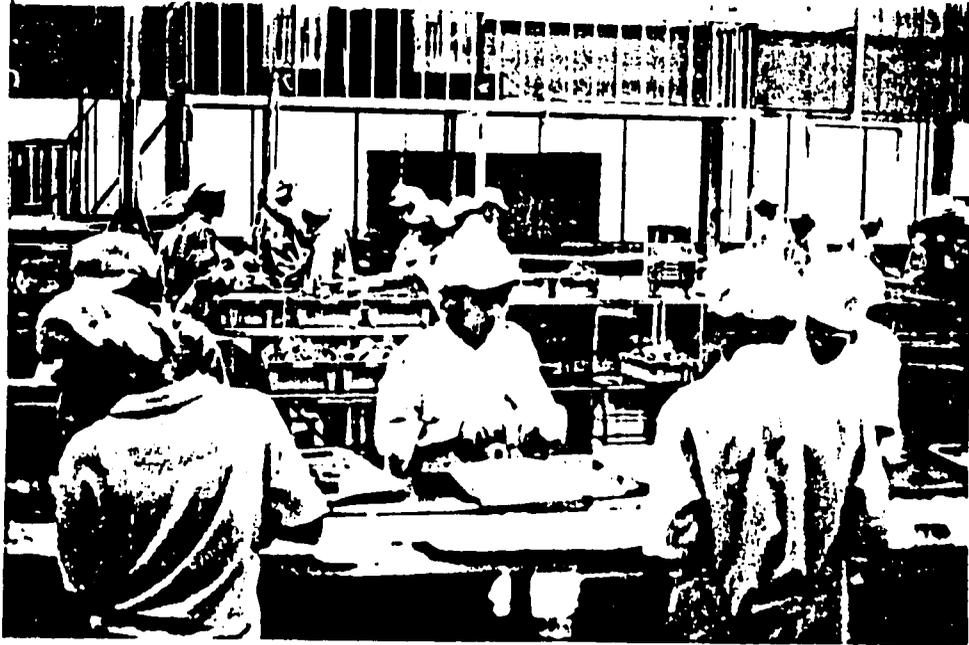
Physical advantages of the company's setting include the River Kwai and the surrounding river valley which produces the high-quality vegetables canned at the plant.



Baskets Of Baby Corn Ready To Be Steamed

The River Kwai provides water for the large boiler which produces the steam to process the vegetables. The boiler is fueled by sawdust from a local mill; the residual wood ash is then used as fertilizer on the test plots where asparagus is grown at the present time. A plentiful supply of inexpensive labor is another advantage. Plant labor is provided by local residents, mostly young women, whose main tasks are cleaning and slicing the vegetables before they are canned.

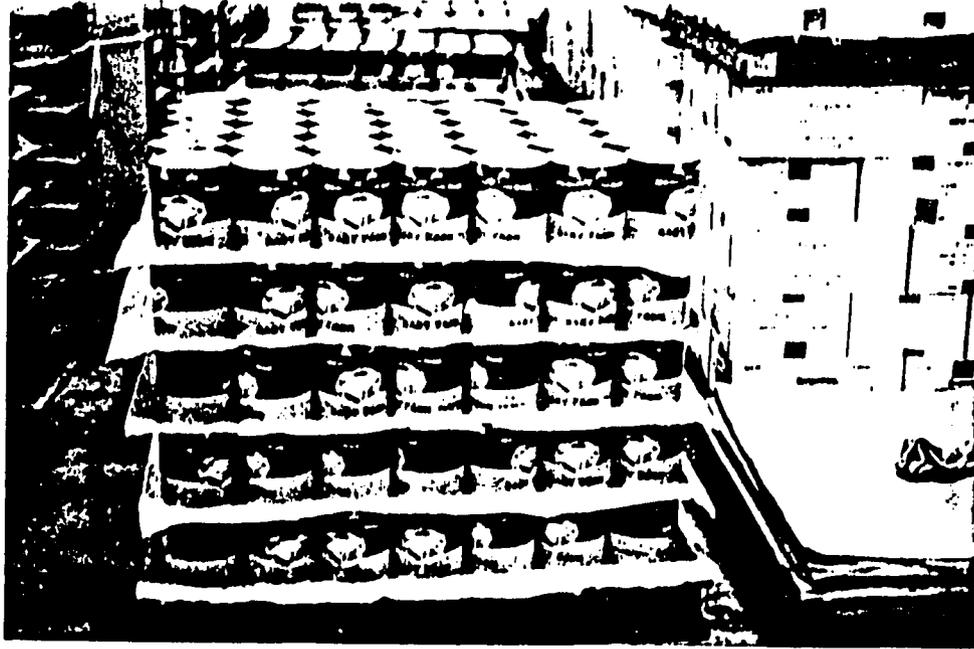
Almost all cleaning, cutting and canning operations are done by hand. Because workers in this rural area are paid the minimum wage, 61 baht (\$2.44) per day, Ms. Sasinand has even found that it is cost-effective to put labels on by hand. By setting up a labor intensive production line, the company's owners were able to both provide jobs locally and save on initial capital costs. It is also notable that at 61 baht per day, labor costs account for less than 10 percent of total production costs.



Workers Cleaning And Cutting Water Chestnuts

Most of the canned vegetables are exported. The European Economic Community represents 50 percent of the market for the canned vegetables, the U.S. an additional 30 percent, and Japan 20 percent. A Taiwanese food broker serves as the marketing outlet for the exported vegetables.

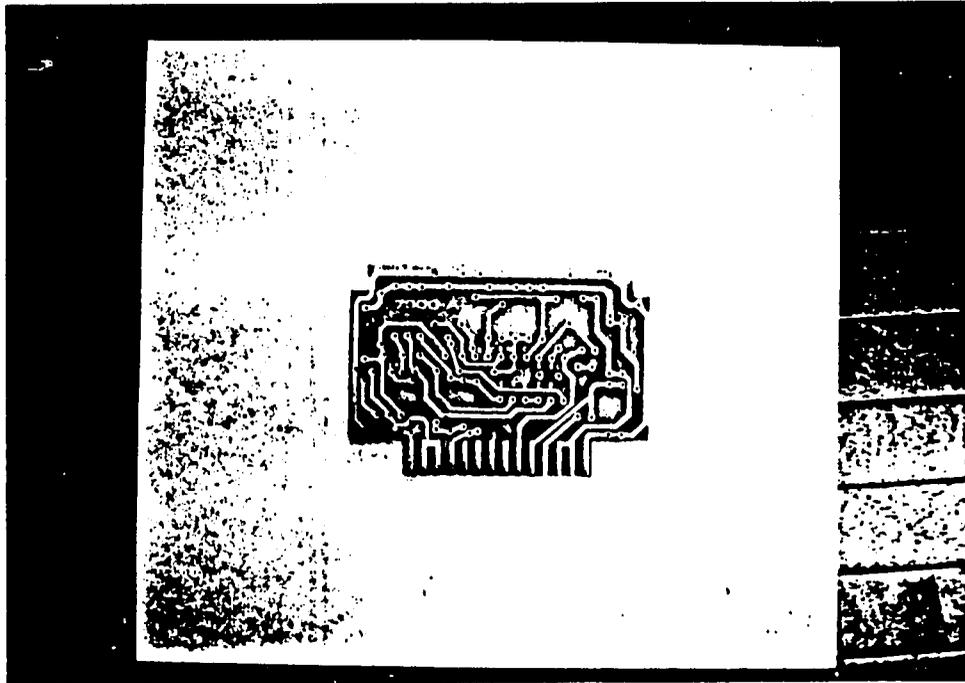
The company's financial projections show that the first year's operations will produce a return on equity in excess of 20 percent. The five-year projection for the internal rate of return is 16 percent. The supply of quality vegetables, water, and labor are factors which should assure that the projections are met.



32 Ounce Cans Of Baby Corn Ready For Shipping

B. THAI CIRCUIT COMPANY, LTD.

The Thai Circuit Company manufacturing plant is located in an industrial park 20 kilometers north of Bangkok. Production of printed circuit boards, the plant's only product, has not started, because several pieces of production equipment have not yet arrived from the U.S. The plant should begin operations by January 1989, and expectations are that the plant will be successful because of the strong demand in Thailand and abroad for printed circuits.



A Prototype For A Circuit Board  
Produced By Thai Circuit

Darragh McClure, Thai Circuit's Managing Director, is an American with 16 years of experience in the electronics field. He has been in the circuit board production business for 10 years in Thailand, has lived in Thailand for 17 years and speaks Thai.

Thai Circuit is an excellent example of a new breed of business in Thailand: companies started by entrepreneurs with #lots of technical expertise but little personal money to invest. In 1979 Mr. McClure started a small company in Thailand using state-of-the-art computer aided design techniques to produce prototype circuit boards. Because of the sophistication and expense of the technology, Mr. McClure's company needed to either expand or sell out to a larger company. In 1986 McClure and his local partners decided to expand their plant and form a new company, but they had very little capital to invest in the expansion. According to

McClure, they "knocked on every door in Bangkok" to get financing and found none of the banks or finance companies willing to invest. Finally, a small investment bank, Manistee (Thailand) Ltd., introduced McClure and his partners to BVP.



Entrepreneur Darragh McClure  
Inspecting A Circuit Design

The company was capitalized with the issuance of \$1.06 million of equity, of which 36 percent was purchased by BVP. Thai Circuit's stock is presently listed on the over-the-counter market and will be a candidate for listing on the stock market if the company is successful.

The company obtained a 20 million baht (\$800,000) line of credit at the Thai Farmers Bank to purchase equipment, a building loan from the same bank for 6 million baht (\$240,000), and a bank overdraft limited to

5 million baht (\$200,000). All credits are secured by a first mortgage on the land, building, machinery, and equipment.<sup>2</sup>

To assist the company, the Thai Board of Investment granted promotional privileges of duty free machinery, a three-year exemption from one-half of all sales tax, and a six-year exemption from income tax.

Thai Circuit's competitive advantage lies in its use of computer aided design and production technologies. In the design area of the plant, a CAD program vividly outlines the minute circuitry for a prototype circuit board on a color monitor. This program is at the core of the company's ability to quickly respond to a customer's need for custom-built circuit boards. A large, computer-operated drill press is another sophisticated piece of equipment used in the manufacture of circuit boards. Until the rest of the plant's equipment is installed, however, the company cannot fill any large orders. Photographic equipment, conveyor belts and other machines have been ordered, and when they arrive production will begin. Thai Circuit's customers are all Thai-based electronics companies, and therefore the company has the advantage of freight and tariff barriers against foreign competitors.

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<sup>2</sup> It is important to note that this package included a five year project loan with a 15 month grace period on repayment. Several respondents in the finance industry mentioned that this is a breakthrough in lending for relatively small projects in Thailand. BVP has been an important agent in helping banks to learn how to carry out project lending.



Darragh McClure Standing Near Thai Circuit's  
Computer Controlled Board Drilling Machine

Thai Circuit currently has 68 employees, and hopes to bring this up to a total of 200, many of them women, once full production is reached. Because labor is cheap compared to the plant's equipment, the factory will operate 24 hours a day, thus maximizing the use of expensive equipment. Under this plan, workers will work only four ten hour shifts per week.

Thai Circuit is projected to be profitable by the end of the first year and, at that time, to produce a net profit on equity of 43 percent. The internal rate of return over a five-year period is projected to be 50 percent. These ambitious projections could miss the mark if Mr. McClure's plant takes too long to come on line and customers now waiting to place orders find other sources of supply. The next six months will be a critical period for the company.

**Appendix 1**

**Study Team Members**

**Robert Gandre, Financial Markets Specialist**

**John Gardner, Banking and Finance Specialist**

**Dr. Allen Eisendrath, Team Leader/Business Specialist**

## Appendix 2

### A. General Economic Environment

Thailand's economy is booming at an estimated 1988 GDP growth rate of around 9-10 percent. This follows on the heels of impressive 7.3 percent growth in 1987, and a moderate export-led 4.3 percent growth rate in 1986 when the Thai economy recovered from a recession begun in mid-1984. Thailand's economy had expanded rapidly during the 1960s and 1970s, achieving an average annual GDP growth of over 7 percent and an average per capita income growth of nearly 5 percent. During this period, industry modernized and the economy was increasingly opened to foreign trade and capital flows.

The investment environment currently is characterized by such positive factors as low-cost but relatively skilled labor, rich natural agricultural resources and raw materials, a growing domestic market, and conservative economic and financial management. Private investment expenditures were up by 20 percent in 1987 after two years of sluggish growth. U.S. Embassy economic forecasts indicate there is little reason to expect any significant deceleration in Thailand's real economic growth over the next few years. That growth should stabilize at over 6 percent.

The Thai government has recognized the role of the private sector in economic development in the Sixth National Economic and Social Development Plan (FY1986-1991) by calling for cooperation between the government, state enterprise and the private sector. During the plan period, 70 percent of investment is expected to originate from the private sector, with a reduced role for state enterprises. Thailand's investment policies are administered and promoted by the Board of Investment (BOI). The BOI offers a range of financial incentives to companies that receive promotion

privileges, including temporary exemptions from import duties and corporate income tax.

Investment applications to the BOI reached new heights in 1988. Through the first 10 months, the BOI received 1,755 applications with a combined investment value of B408.65 billion (\$16.35 billion). This compares favorably to 1987's record year when the BOI received 937 applications worth B151.2 billion (\$6.05 billion). In October 1988 alone, there were 193 applications worth B159.5 billion (\$6.4 billion), more potential investment than for all of 1987.

#### B. Capital Markets in Thailand

The Sixth National Plan highlights capital markets development, especially the Securities Exchange of Thailand (SET), as a major goal to help mobilize long-term funds and support privatization of state enterprises. Established in 1975, the SET experienced a speculative boom in 1978 ending in a major crash in 1979. The crash followed the unexpected collapse of a large finance company providing margin finance to stock market investors. In response to the crash, the government quickly created two special funds to rescue the SET through large-scale equity purchases.

The SET Index fell from a high of 266 in November 1978 to a low of 103 in August 1981. Over the next few years the market traded in a range from 120-160 until 1986 when a combination of economic growth, lower oil prices and interest rates, and new tax incentives encouraged new investment. The SET Index reached a record high of 472 just prior to the October 19, 1987 worldwide stock market crash, following which it dropped 48.5 percent to 228. Trading activity then picked up over the first six months of 1988, with record daily average trading volume of B774 million

(\$31 million) comparing favorably to the B52 million averaged from 1981 through 1986. The Index reached the 470 level again in August 1988 before falling back to the low 400s in November 1988 as funds moved out of the market for speculative real estate investments.

Historically, Thai companies have lacked interest in equity financing. Information and disclosure requirements deter many family-run firms from going public, as does the common practice of under-reporting income for tax purposes. Securities markets have not been a major source of corporate funding in a financial system geared toward debt financing. Nonetheless, while the SET is still small, there appears to be a trend among family business conglomerates to set up "model companies" to qualify for SET listing to raise equity funds for their highly geared group companies.

As of November 1988 there were 127 companies quoted on the SET, with total market capitalization of B235 billion (\$9.4 billion or 20 percent of GNP). Of this total, however, the ten largest companies represent about 52 percent of capitalization, and the seven largest banks and finance companies represent 35 percent. Further illustrating the market's narrowness, the ten most actively traded stocks listed on the SET represented 75 percent of total market trading volume in 1986 and 52 percent in 1987. Local investment bankers estimate that only between 15-25 percent of the market is actively traded.

Foreign investment accounts for 10-15 percent of total market turnover, with foreign investors either buying directly or purchasing stocks through seven Thai investment funds listed on foreign stock exchanges. These seven investment funds have a total market value of \$437 million.

Since the mid-1988 stock market surge, the SET has been trying to attract a greater supply of stocks by relaxing company listing criteria. In June 1987, it moved in this direction by establishing a second board for less than blue chip companies, featuring listing requirements that are less strict than for the first board. There now also exists a small over-the-counter (OTC) market with no listing requirements. This market consists of limited trading in the shares of a few companies not quoted on the SET.

### C. The Financial System

The Thai financial system is in a relatively advanced stage of development. It operates in an environment where market forces influence rates of interest and the flow of credit. The Bank of Thailand (Central Bank), however, heavily influences interest rates by setting interest ceilings on deposit and lending rates.

The financial sector consists of an organized segment including commercial banks, and a large unorganized sector, including moneylenders and mutual credit funds. The unorganized sector accounts for about 30 percent of all savings. Most financial institutions are privately owned but there are also several government-owned lending institutions. In 1987, the whole financial system provided total credit of B1,090 billion (\$43.6 billion) to the economy, 17.6 percent more than in 1986.

Thailand's financial system includes the Bank of Thailand, 29 commercial banks, 94 finance and securities companies, 25 leasing companies, 1,059 agricultural cooperatives, 595 savings cooperatives, 336 pawnshops, 12 life insurance companies, and a number of specialized government institutions.

### Bank of Thailand

The BOT is responsible for central banking functions and has supervisory responsibility for the financial system. It also administers exchange controls, establishes bank reserve requirements, issues 180 day bonds for sale to commercial banks, and lends to banks through the securities repurchase market. The Bank sets deposit and loan ceiling rates to control inflation and the supply of credit to the economy.

Interest rates as of mid-November 1988 were as follows:

Demand Deposits	No Interest
Ceiling rate for Time Deposits (1 year)	9.5
Actual rates for Time Deposits (1 year)	8.5-9.5
Actual rates for Savings Deposits (Passbook)	5.5-7.5
Yield on Government Bonds (5 year)	8.0
Yield on Treasury Bills (up to 6 months)	7.3-7.7
Loan and Overdraft ceiling rate	15.0
Actual Lending rates:	
Minimum Overdraft rate (floating)	11.5-12.0
Minimum Lending rate (fixed)	11.5-12.0

At present, due to the low liquidity in the banking system, interest rates are approaching ceiling levels. The BOT has informed commercial banks to slow their credit extensions to avoid overheating the economy, particularly loans to real estate speculators. It also refused to raise limits on bank foreign currency holdings, thus preventing banks from sourcing new foreign loans to convert into baht liquidity. On the other hand, the Bank is providing additional liquidity by reducing commercial bank requirements for the holding of government bonds from 16 to 14

percent of their deposits. Yields on government bonds are normally below market yields, and are only subscribed to by commercial banks that have statutory liquidity ratio requirements, and by "captive" financial institutions such as the Government Savings Bank, life insurance companies and pension funds.

### Commercial Banks

The Thai financial system is dominated by 15 domestic and 14 foreign commercial banks, with the four largest Thai banks (Bangkok Bank, Krung Thai Bank, Thai Farmers Bank and Siam Commercial Bank) together dominating commercial banking business. Through their historical links with other financial institutions, industrial groups and commercial organizations, the largely family-run domestic commercial banks have a pervasive influence on virtually every aspect of the economy. For example, some 50 percent of all finance and securities company assets are believed to be linked to domestic commercial banks through subsidiary relationships.

Total commercial bank assets reached B920 billion (\$36.8 billion) as of year-end 1987, accounting for just over 70 percent of total financial sector assets. Foreign banks, however, account for less than 5 percent of bank assets and deposits. Total bank deposits stood at B753 billion (\$30.1 billion), with non-interest bearing demand deposits making up 7 percent, savings deposits 31 percent, and time deposits 62 percent of total deposits.

Bank private sector lending totalled B673 billion (\$26.9 billion) in 1987, accounting for 80 percent of total private sector credit. Bank lending is mainly in the form of overdraft facilities that are renewed annually, often becoming "evergreen" loans. The BOT requires a ceiling of B50 million (\$2 million) on overdraft lines of credit to a client; lending

over the line must take other forms, such as term loans and discounts of promissory notes. About 40 percent of bank credit finances foreign and domestic trade, and 25 percent goes to the manufacturing sector. The BOT requires that a minimum 20 percent of total bank credit be extended to agriculture and agro-industries.

Banks traditionally have lent against collateral, not cash flow, and often require collateral in excess of 200 percent. This hampers small and new businesses from obtaining credit because they often lack the necessary collateral. Banks also are reluctant to lend to small businesses because of high transaction costs associated with small loans.

Commercial banks also make equity investments. Banks can hold up to 10 percent of the equity in a company, and more in the case of newly established firms or those in financial trouble. However, the aggregate amount of bank equity investment is limited to 20 percent of the bank's capital. In practice, banks own a small but significant portion of their assets as equity investments. Siam Commercial Bank, for example, holds approximately 50 direct equity investments.

#### Government Banks

The Government Savings Bank, with assets of B100 billion (\$4 billion), accounts for 7.5 percent of financial sector assets. It holds over 10 percent of household savings institution deposits and lends more than 90 percent of its funds to the government through securities purchases and advances to state enterprises. The Government Housing Bank has total assets of only B15 billion (\$0.6 billion), or just 1 percent of financial sector assets. The bank implements government housing policy by lending to the public for purchase of land and houses and funding low income housing projects.

## Non-Bank Financial Institutions (NBFIs)

### Finance and Securities Companies

These companies comprise the second largest segment of the financial sector, with assets of B160 billion (\$6.4 billion), or over 12 percent of sector assets. They engage in a wide range of activities including consumer installment credit, commercial finance, housing and development finance, securities brokerage and dealing, investment management, and underwriting. They cannot accept deposits, but mobilize savings by issuing promissory notes. Most credits granted by finance companies are short-term call loans and discounted bills from industrial firms. Rates offered on promissory notes and loans are regulated by the central bank, and are higher than commercial bank rates.

### Other NBFIs

Among remaining NBFIs, agricultural cooperatives, savings cooperatives, and pawnshops account for 2-3 percent of financial sector assets. Leasing companies, which finance the purchase of immovable property, account for less than 1/2 percent of assets. More importantly, insurance companies with 1987 total assets of B24 billion (\$.96 billion), less than 2 percent of the system's assets, and government pension funds have the potential to become serious investors in the capital markets. They, however, are regulated by the Ministry of Commerce which requires them to invest heavily in low risk securities.

### Development Financial Institutions

The Industrial Finance Corporation of Thailand's (IFCT) main business is lending medium- and long-term funds to private sector industries for acquisition of fixed assets. In addition, it has made some

40 equity investments. Although the IFCT's total assets of B22.5 billion (\$0.9 billion) are a small proportion (about 1.5 percent) of financial sector assets, the IFCT fulfills a key role as the provider of longer term industrial project finance. Most of the IFCT's assistance has been to medium and large scale projects. It intends to place greater emphasis on the small and medium scale enterprise (SMSE) sector through its proposed venture capital fund. The IFCT also manages the Credit Guarantee Fund for Small Scale Industries created in 1985. Under this, it has provided 134 guarantees worth B85 million (\$3.4 million) for bank loans to viable small firms lacking a track record and sufficient collateral.

The Small Industries Finance Office (SIFO) provides term credit to SMSEs. Credit amounts granted per client are small, and through mid-1986 loans totalled only B430 million (\$17.2 million). SIFO's growth has been slow owing to its high default rate - 61 percent in 1983 - and this has led to a decline in loan application approvals.

BAAC is a government bank established in 1966 to provide loans, sometimes at subsidized interest rates, to farmers and agricultural cooperatives. Most loans are short- and medium-term, but some term loans over 3 years are extended. BAAC has total assets of over B35 billion (\$1.4 billion), or about 2.5 percent of sector assets. It may also make equity investments on a limited scale, especially in agro-industry projects.

#### The Venture Capital Industry

The traditional method of business financing offered by commercial banks is short- to medium-term debt financing secured primarily by land and real estate collateral. Lending criteria are biased towards security rather than project viability or entrepreneurial capability. This

"collateral syndrome" poses a dilemma for new businesses that often lack sufficient collateral to secure borrowings. Venture capital plays a key role in removing this constraint because it provides equity financing without collateral to projects that have high growth and profit potential but are riskier than is acceptable to conventional investors.

Thailand's current economic boom has created a favorable investment environment for venture capitalists. Model investments have high growth potential, capable management, and good prospects for future liquidity and high capital gains. Prospective investments also need entrepreneurs who are willing to dilute their ownership of the company and open to sharing the management of the business with the venture capitalist. Thailand has a number of favorable factors for venture capital (VC):

- 1) Funding Sources: Major commercial banks and other financial institutions have invested in venture capital funds already. Though not current practice, insurance companies and pension funds could be future funding sources for venture capital funds if legislative changes are made to allow higher risk investments.
- 2) Management: Thailand has a broad base of banking and financial skills to develop into the specialized skills required in the venture capital industry.
- 3) Organization: Statutory and regulatory provisions governing business organizations are well developed.
- 4) Deal Flow: Recent patterns of economic growth provide attractive investment opportunities in agribusiness, electronics, textiles, plastics, and industrial component manufacturing. BOI-promoted investments receive economic incentives that should reduce project risk for venture capital firms.
- 5) Yield: The potentially high yields offered by venture capital equity investments should prove attractive to investors in a country where interest ceilings of from 15 to 18.5 percent are placed on debt instruments.
- 6) Monitoring/Advising Investee Companies: The Civil and Commercial Code requires that a company prepare annual audited financial statements.

- 7) Divestment: Thailand offers several possible routes for divestment. The exit strategy yielding the highest potential return is to list a company on the SET. While listing requirements are relatively stringent on the first board, the second board's requirements are less strict and encourage listing of new companies with good prospects. In addition, a new OTC market established by two leading local securities firms provides a possible early exit vehicle for investors. The OTC market operates on the basis of a securities company setting a price on the shares of unlisted companies held by intending sellers for the benefit of both sellers and interested buyers. However, the OTC market has no listing requirements, relatively few market participants, and is speculative. Another exit vehicle is the private placement market through which securities companies, like TISCO, place the investee company with equity investors who take out the venture capital firm.

Venture capital financing, however, also faces some serious impediments in Thailand, including the following:

- 1) Funds Sources: Potential domestic investors include commercial banks and securities companies that are more cautious about business risks than are venture capitalists. Thai investors also expect a faster turnaround on their investments than do typical venture capitalists. While Thai investors prefer a 3 to 5 year maximum time horizon for investing, venture capital firms normally remain committed to investments for 5 to 10 years.
- 2) Management: Some specialized skills and disciplines required by venture capital financing are not available in Thailand. This shortcoming could be remedied by the recruitment of experienced foreign management by venture capital firms, although fee and other compensation levels demanded by foreign venture capital fund managers have deterred some Thai investors from hiring or co-investing with those firms.
- 3) Organization: Thai venture capital firms currently are exposed to higher taxation rates than their counterparts in Europe and the U.S. In particular, limited partnerships, the preferred organizational structure in the U.S., are subject to double taxation in Thailand.
- 4) Deal Flow: Although there clearly are projects with seemingly high potential growth rates, there does not yet exist a structured framework, such as an incubator or feeder fund linked to Thai R&D organizations like TISTR, for identifying venture capital projects. Venture capital firms must identify capable entrepreneurs and attractive projects from deal sources such as commercial banks,

investment banks, the Board of Investment, management's contacts, and walk-ins. A potentially important source of deals is foreign venture capitalists with access to commercialized technologies from outside Thailand.

- 5) Monitoring/Advising Investee Companies: SMSE accounting and auditing standards often are not satisfactory for effective monitoring by third parties. In general, entrepreneurs tend to be secretive and do not fully disclose profitability or costs. Since they run their companies on a family basis, they often resist diluting management control or receiving advice from outsiders. A venture capital firm often seeks to provide hands-on management assistance, especially to start-ups. This includes hiring professional managers to run the company, and hiring consultants to prepare business plans, financial statements and to prescribe reporting formats to enable the venture capital firm to monitor its investment. The venture capital firm normally expects to be represented on the Board of Directors of each investee company.
- 6) Divestment: The returns anticipated from listing investee companies on the SET depends on the state of the stock market. If the SET were to suffer a serious crisis of confidence as has happened in the past, going public could be less rewarding than in today's environment. Alternative divestment methods such as a privately placed sale, hostile takeover, friendly merger, or buy-back agreement with majority shareholders would not enable the venture capital firm to realize returns as high as from sale via the stock market.

#### Competition in the Venture Capital Market

Numerous venture capital companies are being set up in Thailand in the wake of the current manufacturing investment boom. International and local firms are planning on putting together from \$55-70 million in funds for Thai-based entrepreneurs. These firms, however, are still at an experimental stage. Thailand lacks any regulatory framework for venture capital firms and has not exempted them from a 35 percent tax on capital gains as other countries do. Nevertheless, financial authorities have expressed support for the venture capital concept.

Business Venture Promotion Co., Ltd., formed in April 1987, was the first venture capital firm in Thailand. It has recently been joined by such firms as Singapore-based SEAVI, backed by the International Finance Corporation, which plans on establishing a \$8-10 million Thai-dedicated fund; local corporate finance advisor Seamico, which is raising \$3-4.5 million with support from the U.K.'s Commonwealth Development Corporation, Rockefeller & Co., and Thai investors; Venture Capital Company (VCC), with registered capital of B200 million (\$8 million), formed by several Thai finance/securities houses and banks led by Thai Financial Syndicate; Thai Agribusiness Venture Company (TAVC), with proposed capital of B294 million (\$11.75 million), backed by the Asian Development Bank and two European government overseas investment agencies; and a venture capital firm with a \$15-30 million offshore fund underwritten by Merrill Lynch Venture Capital Inc. and Thai financier Chote Sophonpanich. Thailand's IFCT also is in the process of establishing its own venture capital fund.

Venture capital firms and funds will have to develop their own working model for operating effectively in the Thai capital markets. Most firms, including SEAVI, Seamico, and TAVC, express the prevailing view of proceeding cautiously in making investments. They all appear ready to adopt a Western approach to the business, professing a longer-term view on realizing capital gains, and desire to provide a limited degree of assistance to management. Espousing a contrary approach, VCC has been formed with a view to moving more quickly and aggressively in identifying project opportunities and packaging them for investors. VCC advisor Rakesh Saxena points out that VCC already has made several investments and claims it would like to make up to 60 investments in 1989. VCC also seeks to gain control of ventures through joint investments with like-minded co-

investors. Lastly, VCC intends to promote the OTC market as an early exit vehicle for some of its ventures. Other venture capital firms claim this investment approach is too short-term and leaves ventures vulnerable to profiteering and corporate raiders before they reach full production capacity.

An unknown factor for local venture capital firms at this time is the extent of the role that foreign venture capitalists can play in developing the Thai market. The most immediate impact here may come from the new Merrill Lynch Fund.

## FINANCE

## Venturing into a boom

Thailand's new venture capital firms bloom in an uncertain climate

By Paul Handley in Bangkok

Venture capital firms are hurriedly setting up shop in Thailand in the wake of the country's manufacturing investment boom. International and local institutions have put together nearly Baht 1 billion (US\$39.5 million) in funds for Thai-based entrepreneurs, primarily those involved in the electronics and agro-industry sectors.

Such firms, however, are still at an experimental stage. Thailand lacks any regulatory framework for venture capital firms and has not exempted them from a 35% tax on capital gains as other countries do. Nevertheless, the country's financial authorities are keen on seeing the industry grow. Several projects have so far been set up with the aid of venture capital firms, and one is now quoted on Bangkok's over-the-counter (OTC) market.

The Baht 160 million Business Venture Promotion (BVP) fund was formed early last year by six Thai banks and the US Agency for International Development. It has since been joined by Singapore-based SEAVI, backed by the International Finance Corp.; the Thai Agribusiness Venture Co. (TAVC), backed by the Asian Development Bank and three European national overseas investment agencies: Venture Capital Co. (VCC), formed by local finance institutions, and an as yet unnamed fund to be set up by local corporate finance adviser Seamico with support from the Commonwealth Development Corp., New York investment banker Rockefeller & Co., and a major Thai portfolio investment group.

Other venture capital companies, including one set up by financier Chote Sophonpanich and funded offshore, are also under consideration.

BVP, which has so far backed four ventures, has a skeleton staff and relies on outsiders to help research and package potential projects. Likely projects are often sent its way by Thailand's

Board of Investment or its shareholder banks. In fact, it often acts as more of an investment agency. BVP sometimes finds itself hamstrung by its shareholders, which insist on approving each project. This has made BVP a slow mover in an often fast-paced business.

BVP's four projects include the Thai Circuit, a producer of printed circuit boards, and Thai Micro Systems Technology, which assembles integrated circuits. The remaining two are agriculture-related ventures involving a powdered-egg producer and a canner of corn and bamboo shoots. All needed support for expansion plans.

For the electronics ventures, BVP relied on local corporate finance advisory firm Manistee to put the deals together. BVP also linked up with Thai Financial Syndicate (TFS), an aggressive local finance and securities company, to support the low-tech, purely Thai agribusiness deals. Other firms are supplying the capital, packaging the deals, finding co-investors, and even making a market in the shares themselves.

TFS, with several other small banks and finance houses, is forming VCC, with registered capital of Baht 200 million. It will aim to pull together co-investors, like BVP, for local projects. VCC, according to adviser Rakesh Saxena, wants to move more quickly in packaging projects for investors. Because of its backers, it should be able to investigate project proposals and potential markets more easily than BVP.

Unlike US practice, VCC and like-minded co-investors want to keep shareholder control of ventures. Because of weaknesses in the Thai commercial code, anyone with less than 50% of a firm is not protected from majority decisions. Moreover, there is no "key man" insurance in Thailand, or protection if the main force behind a company drops out. And limited local resources invariably mean that

key figures are difficult to replace.

According to Saxena, another problem faced by Thai venture capital groups is the restricted number of exit points — ways to reorganise an operation or restructure its finances — should a project turn sour. For example, Thai ventures are usually aimed at a particular foreign market. If that market shrinks, it is often difficult for the venture to find another. In the US, most projects target the huge local market, which offers much more flexibility.

The VCC-TFS approach has benefits. TFS actively promotes the OTC market. "You have to create an OTC market to make venture capital work in Thailand," says Vicharat Vichitvadakan of Capital Securities and Finance, consultant to TAVC. Thai Circuit's par-100 shares are currently quoted at Baht 200 on the OTC board. When a major partner in the project bowed, Manistee took the 18% stake to TFS which syndicated it out.

Other local venture capitalists claim such an approach is short term and leaves ventures vulnerable to profiteering and raiders, even before they achieve full capacity. They say that outsiders are already making inquiries about taking a major stake in or control of Thai Circuit.

SEAVI and Seamico adopt a more Western approach. Both take a longer-term view on realising gains, and both prefer a more supportive role to management. "We must also have the ability to get clients out of trouble," says a Seamico executive.

Seamico's US\$4.5 million fund will focus on expanding companies, which are involved in medium technology production. This is considered of more benefit to Thailand. Hi-tech projects need a major foreign partner who can guarantee the technology and the market.

Singapore-based SEAVI is planning a US\$8-10 million Thai-dedicated fund. It has already provided capital for a Singapore videotape venture which is setting up a plant in Thailand.

TAVC, which plans a fund of Baht 294 million, aims to put at least half of its resources into agribusinesses. TFS will raise half of the funds locally. The firm will be managed by international venture capital giant Ventana. □

APPENDIX 3

OVER THE COUNTER PRICES				
As of November 17, 1988				
Name of Securities	Quotation		Last Sale	
	Bid	Offer	Price	Date
Laem Thong	—	230	—	—
Krungthai Bank	—	100	—	—
Custom Pect	115	200	155	—
Siam Panich	—	8	—	—
Phayathai H I	—	290	290	—
Phayathai H II	—	180	180	—
Universal Food	135	150	120	—
Wilson Insurance	420	—	—	—
TRT Garment	480	520	—	—
Land & House	85	—	85	—
Central Plaza	180	—	—	—
Asa Securities	—	300	—	—
Minor Corp	215	250	295	—

From National Finance & Securities Tel 217-8593, 217-9822 Khun Phak.

Name of Securities	Quotation		Last Sale	
	Bid	Offer	Price	Date
Thai Fin Synd	170	270	250	20/04/88
Laem Thong	140	—	—	—
Wilson Ins	350	—	—	—
TS Life Ins	—	41	35	10/11/88
Sri Ayudhya Life	—	180	—	—
Thai Finance Trust	—	53	—	—
Phoenix Pulp	85	—	—	—
Thai Circuit	250	350	320	20/10/88
Swedeh Motor	—	—	—	—
Thai Micro System	120	125	47	08/11/88
SPLL Siam Panich Leasing	—	10	—	—
TA Glass	—	—	—	—
Judds Devt Co	35	—	—	—
Land & House	88	80	—	—
Head Thip	290	—	—	—
Minor Corp	—	220	—	—
Wang Petchaboon	—	250	—	—
Union Leasing	150	205	—	—
Navarat Aquac	95	—	—	—

From The Financial Syndicate Tel 223-0156 to 7, Khun Thammasak.

Bangkok Over The Counter Market Prices, Quoted in The Nation, November 17, 1988

Thai Micro Systems and Thai Circuit are both companies in which Business Venture Promotion, Ltd. has invested.

# TFS plays role in 3 company purchases

THAI Financial Syndicate has signed acquisition agreements in principle with three operating companies this month, *Business Post* learnt yesterday.

The acquisitions, on behalf of different groups of investors, will be "friendly", a term used to suggest full approval by existing management and owners. The transactions will help inject fresh funds and quality expertise in companies with established cash flows and market potential.

TFS adviser Rakesh Saxena confirmed that one of the companies involved was Bangkok Arts and Crafts, a cutlery supplier, for whom Chase Manhattan Bank is acting as the structuring agent. Another company, which he refused to identify by name,

is an operating semiconductor company in need of financial and technical input.

"The trend is expected to grow and we expect to conclude at least half-a-dozen more deals by early 1989," said Mr Saxena.

These acquisitions come in the wake of minority stakes in venture capital companies like Thai Circuit and Thai Micro Systems and participation in start-up ventures in publishing, agriculture and tourism.

"By January 1989, Venture Capital Company — in the final stages of incorporation — should be fully operational and we will spend the next few weeks tightening our analytical capabilities," said Mr Saxena.

"Personally, I expect to see more

value in this segment of the market than at the Securities Exchange of Thailand in the foreseeable future."

Mr Saxena also said "some people are living with the concept that equity positions are being built by TFS. That is wrong. Whether TFS may or may not buy into a particular deal, it does act as an investment banker — along with other companies like Thai Fuji and Bara Finance — to package, evaluate and structure deals for a group of investors.

"Furthermore, the investor groups can change from transaction to transaction."

According to reliable reports, the core placement and sourcing abilities for deals structured through TFS-Bara-Thai Fuji are derived from TFS president Vichai Assarat, Union

Bank of Bangkok executive vice president Goanpot Asvinvichit, Bangkok Bank of Commerce senior vice president Akachai Athicomnanta, Bara Finance president Seri Chintanassri, Thai Danu senior vice president Nopporn Ruengskul and Mr Saxena.

Late yesterday, Mr Saxena told *Business Post* he was planning to approach the management of Thai Circuit on behalf of certain investors for a complete buy out at a price which would incorporate all the goodwill the company had gained in its short existence.

He said the investor group was looking for a printed circuit board manufacturer which could complement its overall operations in related areas here and abroad.

Bangkok Post article (November 18, 1988) on venture capital company actions. Note that Business Venture Promotions, Ltd. holds shares in Thai Micro Systems and Thai Circuit.

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