Performance Evaluation Report

Reference Number: PPE: THA 2011-22
Project Number: 32437
Loan Number: 1735
September 2011

Thailand: Restructuring of Specialized Financial Institutions

Independent Evaluation Department

Asian Development Bank
CURRENCY EQUIVALENTS

Currency Unit – baht (B)

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<th>At Appraisal (14 November 1999)</th>
<th>At Completion (26 October 2005)</th>
<th>At Independent Evaluation (14 November 2010)</th>
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ABBREVIATIONS

ADB – Asian Development Bank
BAAC – Bank for Agriculture and Agricultural Cooperatives
BIS – Bank for International Settlements
BOT – Bank of Thailand
CAR – capital adequacy ratio
EXIM – Export–Import Bank of Thailand
FPO – Fiscal Policy Office
FSMP – Financial Sector Master Plan
GDP – gross domestic product
GHB – Government Housing Bank
GSB – Government Savings Bank
IAS – International Accounting Standards
IED – Independent Evaluation Department
IFCT – Industrial Finance Corporation of Thailand
IMF – International Monetary Fund
IT – information technology
KPI – key performance indicator
LPA – loan portfolio audit
MIS – management information system
MOF – Ministry of Finance
NPL – nonperforming loan
OSMEP – Office of Small and Medium Enterprises Promotion
PCR – project completion report
PSA – public service account
ROA – return on assets
RRP – report and recommendation of the President
SBCG – Small Business Credit Guarantee Corporation
SEPO – State-Owned Enterprise Policy Office
SFI – specialized financial institution
SICGC – Small Industry Credit Guarantee Corporation
SIFC – Small Industry Finance Corporation
SMC – Secondary Mortgage Corporation
SMEs – small and medium-sized enterprises
SME Bank – Small and Medium Enterprise Development Bank
SOE – state-owned enterprise
TA – technical assistance
TMB – Thai Military Bank
NOTES

(i) In this report, “$” refers to US dollars.
(ii) The fiscal year (FY) of the Government ends on 30 September.
(iii) For an explanation of rating descriptions used in ADB evaluation reports, see ADB. 2006. Guidelines for Preparing Performance Evaluation Reports for Public Sector Operations. Manila.

Key Words
adb, thai, thailand, evaluation, finance, financial institutions, small medium enterprises

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The guidelines formally adopted by the Independent Evaluation Department (IED) on avoiding conflict of interest in its independent evaluations were observed in the preparation of this report. T. Ito assisted as international consultant and Duangrat Yaiphairoj as national consultant. To the knowledge of the management of IED, there were no conflicts of interest of the persons preparing, reviewing, or approving this report.
BASIC DATA
Loan 1735-THA: Restructuring of Specialized Financial Institutions

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**Key Project Data ($ million)**

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**Borrower**

Kingdom of Thailand

**Executing Agency**

Ministry of Finance

**Mission Data**

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ACCSF = Asian Currency Crisis Support Facility, ADB = Asian Development Bank, ADTA = advisory technical assistance, TA = technical assistance.

<sup>a</sup> The TA grant was signed and became effective on 19 September 2000. It was completed in March 2006 and was financially closed on 29 June 2006. Of the TA grant amount of $3.0 million, $2.813 million was disbursed.
EXECUTIVE SUMMARY

Background

During the Asian financial crisis of 1997–1998, the Government of Thailand’s first priority was to steer Thai commercial banks back to profitability. The government turned to revitalizing specialized financial institutions (SFIs) only after 2001 when the commercial banks returned to profitability. Although the SFI’s played a key role in providing financial services to sectors not adequately served by commercial banks—such as small and medium enterprises (SMEs), agricultural and rural enterprises—and also contributed to the government’s social and development policies, there was little clarity on the quantum of financial and technical support required to stimulate them.

Asian Development Bank’s (ADB’s) technical assistance (TA) project approved on 21 December 1999 was to support the rationalization of the government’s role in the financial sector and establish corporate governance framework among SFIs. It focused on four SFIs and the TA package comprised: (i) a TA loan of $4.5 million from ADB’s ordinary capital resources, and (ii) a TA grant of $3.0 million funded through the Asian Currency Crisis Support Facility. The purpose of the project was to (i) rationalize the government’s role in the financial sector and establish a corporate governance framework for SFIs, (ii) determine SFIs’ financial and operational requirements to strengthen capacity and financial soundness, and (iii) formulate strategies and operational plans for SMEs financing. The TA loan aimed to support the restructuring of the four SFIs through Part 1 for the Small Industry Finance Corporation (SIFC), the Small Industry Credit Guarantee Corporation (SICGC), and the Industrial Finance Corporation of Thailand (IFCT); and Part 2 for the Bank for Agriculture and Agricultural Cooperatives (BAAC). The TA grant comprised component 1 to rationalize SFIs and strengthen their corporate governance, and component 2 to develop a financing strategy for SMEs.

These SFIs evolved: (i) in 2002, SIFC transformed into the Small and Medium Enterprise Development Bank (SME Bank); (ii) SICGC was later renamed the Small Business Credit Guarantee Corporation (SBCG); and (iii) IFCT merged with the Thai Military Bank in 2004.

The final consultants’ outputs under the TA grant component 1 were reports on the improvement of the SFIs’ corporate governance, conceptualization of the public service account, and development of the SFIs’ monitoring and complementary information technology systems at the Ministry of Finance (MOF). The consultants did not focus on SFIs’ autonomy or subsidies and other privileges accorded to SFIs as initially envisaged. This reflected the project’s priority adjustments during the course of implementation in response to the change in the policy environment under the new political leadership in Thailand from February 2001. Under the TA grant component 2, as originally planned, the consultants (i) recommended several policy and institutional measures to promote SMEs financing, (ii) assisted the government to implement some of the recommended measures, and (iii) conducted a training course on strategic management of SFIs and designed an overseas training program that was to have been conducted after project completion.

The actual progress in achieving the intended outcomes of the ADB TA package, coupled with the continued government emphasis on framing two SFI master plans rolled out to cover a 10-year period, clearly bring out the insufficiency of the ADB support package. In this context, this ADB supported project (along with parallel World Bank support for some other Thai SFIs) is best viewed as a means to bring to the forefront some of the more challenging issues that Thailand’s SFIs face.
Performance Assessment

**Relevance.** The targeted results of the project were consistent with the government’s development priorities and ADB’s operations in Thailand at the time of approval. However, the project is rated *partly relevant* because of certain design issues: (i) weak assessment of SFIs and SMEs conducted at-entry by ADB; (ii) inappropriate outcome setting in some areas, and inadequate resource allocation for coordination across project activities; (iii) inadequate participation of the beneficiary SFIs in designing the project and a weak “buy-in” element; and (iv) inadequate policy discussions with the government and relevant development partners during project design and appraisal.

**Effectiveness.** The project is rated *less effective* although most inputs were appropriately delivered. The original consultant for component 1 of the TA grant did not perform satisfactorily, partly because the priorities and policy directions from the new government beginning February 2001 changed considerably.

The project outcomes were mixed and the outputs contributed partly to achieving the outcomes. For instance, under the TA loan (Part 1), although the consultants conducted the diagnostic reviews for the SIFC, SICGC, and IFCT, and provided various recommendations for their operational planning and capacity building—the consultants did not conduct procedures that are generally considered as comprising financial audits (as originally envisaged). Being a key element of the TA loan, the absence of full-fledged financial audits for three SFIs impeded the realization of desired outcomes. On the other hand, under the TA loan (Part 2), the consultants delivered the outputs for BAAC in five areas as envisaged at appraisal: diagnostic review, financial audit, loan portfolio audit, restructuring plan development, and workout and capacity building assistance.

In general, the government’s role in SFIs has not been rationalized as originally envisaged, although the MOF’s monitoring of SFIs and their corporate governance and risk management have improved. The financing strategy for SMEs developed by the consultants was positively accepted by the beneficiary institutions, but not formalized as a national strategy. The financial needs of the SIFC, the SICGC, and the IFCT were not objectively assessed. The need for further recapitalization of the SME Bank and SBCG remains to date. On the other hand, following a thorough financial audit and loan portfolio audit, BAAC was better prepared to introduce asset classification and provisioning norms in accordance with International Accounting Standards (IAS) 39, and did so by 2007. The other SFIs have yet to comply with IAS 39 requirements for these matters.

**Efficiency.** The project is rated *less efficient*. Inputs were inefficiently used, partly because of the merger of the IFCT with a commercial bank, as well as the pretermination of the original consulting team for the TA grant. In addition, there was inadequate formal midcourse adjustment on the outputs and terms of reference in response to the change in government policy direction as well as significant delays of over 2 years during implementation of the project as a whole. Delays were also caused by the time-consuming process of engaging consultants.

**Sustainability.** The project is rated *likely sustainable* considering that (i) the present government framed the SFI master plan, 2010–2014, which sets out policy measures to maintain the project outcomes and to cope with the outstanding issues of SFIs; and (ii) the SFIs’ performance over the last 15 years has clearly demonstrated their resilience to changing economic and political conditions.
On the basis of this evaluation, the project is rated *partly successful*.

**Other Assessments**

**Impact.** The impact is rated *significant*. The project’s expected impact was to restore market confidence and help sustain the economic recovery, but the performance indicators identified in the TA framework (formulation of the government restructuring plans for SFIs, establishment of the corporate governance framework for SFIs, and establishment of the financing strategy for SMEs) were actually akin to project outputs. Consequently, there are no useful performance indicators by which the project’s impact (or the project’s contribution to the impact) can be assessed. Although the government did not accord a high priority to SFI revitalization when ADB began discussing the matter soon after the Asian financial crisis of 1997–1998, and information collection and analysis at appraisal was not sufficiently rigorous, this project did provide a basis for the government to prepare a framework and master plans for strengthening SFI’s to perform their intended functions, as well as to strengthen monitoring and supervision. This rating also reflects the indirect role played by SFIs in safeguarding SMEs and farmers in order to contribute to the Thai economy’s recovery process following the 2008 global financial crisis, rather than the project’s contributions to achieving the impact.

**ADB performance.** Given the inadequacies of project appraisal and management of information gathered during project implementation, ADB’s performance is rated *partly satisfactory*. It is noted however that the frequency, composition, and length of inception and review missions were according to standard and timely; and that ADB demonstrated responsiveness and high client orientation throughout the project implementation phase.

**Executing agency performance.** The performance of the Fiscal Policy Office (FPO) is rated *satisfactory*. The rating reflects (i) the role of FPO staff, which enabled the project to continue despite changes in political leadership and policy direction; (ii) the adequacy of support provided for ADB supervision and review, and (iii) continued follow-up actions since 2004 to maintain and substantiate the project outcomes and to address the remaining issues under the SFIs master plan. However, this evaluation also notes the time-consuming process of engaging consultants, FPO advice on the insufficiency of midcourse corrections in consultant terms of reference, and the difficulties faced by the FPO in executing the contractual arrangements.

**Issues and Lessons**

The major outstanding issues for SFIs and of the project are as follows:

(i) **Role of specialized financial institutions was not specified.** The objective of rationalizing the government’s role in the financial sector particularly relating to SFIs was not realized through the project. However, the objective that SFIs focus on underserved communities and do not crowd out the private sector activities in commercial banks and other financial service providers is a specific objective of the Government’s SFI master plan, 2010–2014.

(ii) **No specific authority was assigned to monitor specialized financial institutions.** Although the project did enable the MOF to improve its monitoring of the SFIs, further clarity is required regarding the supervisory roles of the Bank of Thailand, the MOF’s FPO, the MOF’s State-Owned Enterprise Policy Office, and the Office of the Auditor General. The government intends to address this while implementing the SFI master plan.

(iii) **Guidelines for public service accounts of specialized financial intuitions have not been formulated.** The project is considered to have made a beginning
regarding the separation of SFIs’ policy-based public service accounts lending transactions from the normal commercial transactions. In recognition of the enhanced transparency and accountability that such separation would bring to SFIs, the FPO and State-Owned Enterprise Policy Office have been made responsible for formulating clear and transparent guidelines, and promulgating existing regulations on state subsidies and compensation.

(iv) **Comprehensive database for small and medium-sized enterprises has yet to be developed.** Since the project highlighted the nonavailability of reliable SMEs lending data as a constraint to promotion of SMEs financing, certain SFIs have been tasked to develop a comprehensive SMEs database under the SFI master plan.

The report identifies the following key lessons:

(i) A thorough information gap analysis is needed at entry. Where information gaps exist, it becomes difficult to identify the specific needs of beneficiary institutions at the project preparatory stage.

(ii) The scope of financial and portfolio audit must be agreed at appraisal. If financial audits that are conducted each year do not conform to IAS, the results of portfolio analyses based on small samples cannot be used as a basis for restructuring and operational planning.

(iii) Baseline and quantitative performance indicators are required in the TA framework. If quantitative and other appropriate performance indicators are not developed up front, and a suitable baseline is not developed, it becomes difficult to gauge the results of the project.

(iv) A mechanism is needed to coordinate activities across project or TA components. If a complex project with overlapping responsibilities across components does not have an effective coordination mechanism built into the project design, the project implementation can be constrained.

(v) Terms of reference must be adjusted in case of change in policy direction. If the terms of reference of the consultant for component 1 of the TA grant had been refocused soon after the new government had articulated its changed policies regarding SFIs, it may have been possible to avoid the pretermination of the consultant (along with avoiding the accompanying time and cost overrun).

(vi) Better information and knowledge management is needed within ADB. An effective information and knowledge management system should be in place to ensure that TA outputs are properly stored within ADB, and can be easily retrieved.
I. INTRODUCTION

A. Evaluation Purpose and Process

1. This report presents the evaluation of the Asian Development Bank’s (ADB) support provided for the Restructuring of Specialized Financial Institutions Project. Undertaken about 5 years after project completion in March 2006, this evaluation provides a good opportunity to study project outcomes. The report also provides lessons for the preparation for the forthcoming country partnership strategy final review.

2. A desk review of the report and recommendation of the President (RRP),\(^1\) the project completion report,\(^2\) and other documentation available at ADB headquarters was followed by an independent evaluation mission to Thailand to consult and gain information from the government, the specialized financial institutions (SFIs) concerned, and other stakeholders. The draft evaluation report was shared with the Southeast Asia Department, the executing agency, and the concerned SFIs for feedback and comment.

3. The project comprised the technical assistance (TA) loan and TA grant (footnote 1). As the TA loan and grant contributed to the same outcomes in pursuit of a common goal, they have shared a common TA framework since approval. Therefore Independent Evaluation Department (IED) evaluated the performance of the TA loan and TA grant together. Appendix 1 presents the design summary and performance targets of this TA framework.

4. This report evaluates the performance of the project on the basis of the following criteria and sub-criteria:\(^3\)
   (i) relevance of project design and formulation in terms of consistency with the government’s priorities and strategy, ADB’s strategy and program for Thailand, along with government participation and ownership, the addressing of challenges and opportunities as diagnosed, and the extent of coordination and complementarity with activities of other development partners;
   (ii) effectiveness in terms of the appropriateness of inputs delivered and quality of outputs and the contribution of the TA loan and grant toward achievement of project outcomes;
   (iii) efficiency in achievement of the project outputs from the perspective of input requirements, efficiency of processes deployed, quality of midcourse corrections and the accompanying dialog, and timeliness of work completion; and
   (iv) sustainability of outcomes, in the context of continued political will to institute a policy environment that helps maintain the project outcomes, and the degree of resilience of project outcomes to changing economic and political conditions.

B. Technical Assistance Objectives

5. The project aimed to achieve three outcomes:
   (i) rationalizing the government’s role in the financial sector and establishing a corporate governance framework for SFIs,
   (ii) determining financial and operational requirements of SFIs to strengthen their financial soundness and capacity, and

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(iii) formulating strategies and operational plans for small and medium-sized enterprises’ (SMEs’) financing.

6. The TA framework identified the performance targets of these outcomes, respectively, as the following:
   (i) incorporation of autonomy, commercialized operations, and objective performance measurement in the SFIs’ institutional frameworks and structures, and rationalization of subsidies and other privileges provided to SFIs;
   (ii) identification of SFIs’ capital adequacy needs and capacity gaps, and formulation of strategies and teams to resolve nonperforming loans (NPLs), followed by initial undertaking of debt workouts;⁴ and
   (iii) preparation of a strategic plan to promote SMEs financing and a blueprint for its implementation.

II. DESIGN AND IMPLEMENTATION

A. Rationale

7. The Asian financial crisis of 1997–1998 called for extensive restructuring and reforms to the financial sector to bring about renewed market confidence and ensure sustained economic recovery in Thailand (Appendix 2). Under an assistance package led by the International Monetary Fund (IMF), several development partners, including the World Bank and ADB, worked closely to address the financial crisis in Thailand. The Government’s first priority was to improve the financial health of the commercial banking sector. The return of Thai commercial banks to profitability in 2001 signaled a turnaround of the crisis, and allowed the government to shift attention toward a longer-term and comprehensive reform program through the Financial Sector Master Plan (FSMP) (Appendix 2). At appraisal, there were eight SFIs. These institutions played a key role in providing financial services to sectors not adequately served by commercial banks. They focused on revitalizing SMEs, agricultural and rural enterprises, and contributed to the government’s social and development policies. The government sought to implement a series of measures to restore their viability, which the financial crisis had impaired.

8. In line with its stated goal of broadening access to financial services, the SFIs have been gaining importance since the FSMP Phase I, 2004–2009 came into effect. The SFIs have served as vehicles for several government fiscal initiatives, especially when their targeted clients’ revenues were drying up (Appendix 3). The government also developed the SFI master plan, 2010–2014 and continues to support SFIs to address gaps left by commercial service providers, enhance their efficiency, and develop clear business plans that are consistent with the SFIs’ long-term goals. In recognition of the SMEs’ potential contributions toward employment creation and economic growth, the government has been trying to promote SMEs by setting up the Office of Small and Medium Enterprises Promotion under the SMEs Promotion Act, 2000 (Appendix 4).

B. Formulation

9. The government requested ADB assistance in the restructuring and recapitalization of commercial banks and SFIs in April 1998.⁵ During a meeting between the Thai finance minister

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⁴ A debt workout may involve capital injection or other financial restructuring of a lender whose financial health is adversely impacted by large NPLs. A debt workout may also include write-offs of part of the NPLs, or an arrangement between the lender and a troubled borrower that enables the repayment process to continue (e.g., by extending the term of the loan, temporarily reducing interest rates, reducing or skipping a few scheduled repayments, adding missed repayments to the loan balance, or modifying the repayment schedule in other ways).

⁵ During a meeting between the Thai finance minister...
and senior ADB staff on 30 July 1998, the finance minister requested ADB to consider an equity investment of $50 million in one of the intervened commercial banks, with a program loan attached, as well as cofinancing support and TA to assist the government to explore a strategic partner for the intervened banks. In early 1999, ADB informed the government of its intention to support diagnostic reviews and exhaustive studies of restructuring options for targeted banks and SFIs, before committing direct support to their recapitalization.

10. The fact-finding mission fielded from 4 to 9 April 1999 agreed with the government on the scope of the project to comprise (i) restructuring of SFIs, (ii) resolving NPLs, (iii) a creditor–debtor forum, (iv) a financing strategy for SMEs, (v) privatization of Bank Thai, (vi) capacity building, and (vii) corporate governance. The total TA cost was to be $10 million. The Staff Review Committee meeting held on 28 April 1999 supported an ordinary capital resource loan of $5 million and a grant of $5 million, while noting that the proportion of loan and grant might vary later. On 26 May 1999, ADB Management authorized the project mission to conduct loan negotiations for a TA loan of $9.00 million and a TA grant of $3.65 million.

11. ADB fielded a consultation mission on 19 October 1999 to present possible options on the proposed assistance to the finance minister, when it was agreed that the TA loan would be about $4.00 million, and an effort would be made to maintain the grant at $3.00 million. The reduction of the TA loan amount was accompanied by dropping the work on Bank Thai and EXIM from the project scope. In addition, the finance minister did not want to use loan funds to engage international consultants to work with the Small Industry Finance Corporation (SIFC) and Small Industry Credit Guarantee Corporation (SICGC), and requested ADB to allocate a grant fund to develop the restructuring plans of these organizations. ADB did not accommodate this request, and on 21 December 1999, ADB approved a $4.50 million TA loan from ordinary capital resources and $3.00 million TA grant from the Asian Currency Crisis Support Facility.

12. ADB requested the World Bank to comment on the aide-mémoire of the fact-finding mission of the proposed project. In May 1999, the World Bank emphasized the need to distinguish clearly between the shareholders’ monitoring by the Ministry of Finance (MOF) and the financial system.

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5 Refer to the back-to-office report of the contact/consultation mission fielded from 23 to 26 February 1999.
6 In early 1998, four Thai commercial banks (Bangkok Metropolitan Bank in January; Bangkok Bank of Commerce, Siam City Bank, and First Bangkok City Bank in February) were considered critically undercapitalized because they could not meet the renewed loan–loss provisioning rules and recapitalization deadlines set by the Bank of Thailand (BOT). By May 1998, BOT had intervened in these four banks (after writing off their bad loans) by reducing shareholders’ capital to the legal minimum, and by converting loans from the Financial Institution Development Fund (set up under BOT in response to the financial crisis) into equity and injecting additional capital.
7 According to the summary record of this discussion that was available to the evaluation team, the finance minister emphasized the positive externalities of ADB’s association in the recapitalization in terms of confidence building, which would enhance the government’s ability to mobilize resources to recapitalize other banks and restore the financial system.
8 This followed a contact and consultation mission in February 1999, when it was tentatively decided that (i) ADB would take responsibility for Bank Thai, EXIM, the Industrial Finance Corporation of Thailand (IFCT), the Small Industry Finance Corporation (SIFC), and the Small Industry Credit Guarantee Corporation (SICGC); and (ii) the World Bank would support Krung Thai Bank, BAAC, the Government Housing Bank, and the Government Savings Bank as well as assist in strengthening the SFI supervision of the BOT. It is noted that Bank Thai and Krung Thai Bank were state-owned commercial banks. In addition to the restructuring support for SFIs, the finance minister also requested ADB to focus on SME development. The $20 million TA loan proposed by ADB was considered too large, and the finance minister suggested indicative figures of $5 million in grant and $5 million in loan.
9 The evaluation team could not find any relevant documents explaining why the proposed TA loan and grant amounts had been changed since the Staff Review Committee meeting.
10 According to the finance minister, the reasons for the reduction in scope were as follows: (i) discussions between BOT and a foreign investor on the acquisition of Bank Thai were in progress; and (ii) EXIM’s loan portfolio conditions had been enhanced by improved export performance, and the MOF had already recapitalized EXIM.
supervisory monitoring by the Bank of Thailand (BOT), with reference to the proposed project subcomponent of establishing monitoring and surveillance systems for the MOF to track SFI performance, formulate policy and undertake corrective action, and develop coordination mechanisms with BOT. However, ADB did not initiate policy discussions with the MOF, BOT, and the World Bank on this important matter,\footnote{No further information is available to the evaluation team on ADB’s follow-up on the World Bank comments.} and kept the subcomponent unchanged. Through more extensive policy discussions, ADB could have better complemented the ongoing World Bank’s assistance to BOT regarding SFI supervision.

13. This evaluation is of the view that during the latter part of the relatively long project formulation period (April 1998 to December 1999), ADB could have gathered specific information on the selected SFIs. The RRP mentions that the initial consulting task would be to do a brief preliminary review of each SFI to assess the work already done by the government, external auditors, management, and advisers regarding their restructuring to strengthen the finances and operations of these institutions. According to the RRP, “this will define the scope of further work.”\footnote{RRP, para. 22.}

C. Cost, Financing, and Executing Arrangement

14. At appraisal, the total cost of the TA components funded by the TA loan from ADB was $6.44 million equivalent, comprising foreign exchange costs of $3.68 million and local costs of $2.76 million equivalent. The ADB TA loan was to finance $4.50 million (including $3.92 million for consultants) of the total TA cost of $6.44 million. The actual TA cost was $6.29 million equivalent, of which $3.92 million (all for consultants) was funded by the TA loan from ADB. The government cancelled the remaining of $0.58 million, or 13% of the total TA loan amount.

15. At appraisal, the total cost of TA components funded by the TA grant was $4.32 million equivalent, comprising foreign exchange costs of $2.40 million and local costs of $1.92 million equivalent. The ADB TA grant was to cover $3.00 million (including $2.40 million for consultants) of the total TA cost of $4.32 million equivalent. The actual TA cost was $4.71 million equivalent, of which $2.96 million ($2.84 million for consultants and the remaining for seminars, training, workshops, and equipment) was actually funded by the TA grant.

16. The Fiscal Policy Office (FPO) of the MOF was the executing agency as envisaged at appraisal. The concerned SFIs undertook day-to-day implementation of the TA loan, and a steering committee provided overall policy guidance and direction for work under the TA grant. The steering committee was chaired by the director general of the FPO, and included representatives from the Ministry of Industry, the concerned SFIs, and BOT. The IFCT (later merged with the Thai Military Bank), the SIFC (later transformed into the Small and Medium Enterprise Development Bank [SME Bank]), the SICGC (later renamed the Small Business Credit Guarantee Corporation [SBCG]), and Bank for Agriculture and Agricultural Cooperatives (BAAC) functioned as implementing agencies of the TA loan. The FPO and the Office of State Enterprise (later renamed the State-Owned Enterprise Policy Office [SEPO]) functioned as implementing agencies for the TA grant. The steering committee discussed key consultant outputs, as originally planned.
D. Consultants and Scheduling

17. The RRP noted the broad range of consultants that would be selected and engaged for the TA loan and TA grant work:13 (i) international experts in financial restructuring, financial audits, banking, treasury, debt workout, information technology (IT), and legal aspects; and (ii) national experts in financial audits, banking, IT, and legal matters.

18. Technical assistance loan. The RRP indicated that the consulting work would commence in April 2000, and the restructuring plans for SFIs were to be completed within 6 months. Although the government was to have selected and engaged consultants as is normal practice for an ADB loan, in this case the government engaged the consultant that ADB had selected.14

19. The TA loan was divided into two parts prior to consultant selection: Part 1 for the IFCT, the SIFC, and the SICGC; and Part 2 for BAAC. For Part 1, the contract negotiations first concluded in December 2000 were revisited at the request of the government when it decided to renegotiate the financial terms. The negotiations finally concluded in April 2001. The consulting team, however, was mobilized before the contract negotiations finally concluded.15 For Part 2, contract negotiations began in February 2001 and concluded in May 2001.

20. The Part 1 scope of work was completed in March 2003, nearly 2.5 years later than the original target date of October 2000; Part 2 was completed in November 2002, with a delay of over 2 years. The delays were a consequence of various factors, the most salient being (i) the time-consuming process of engaging consultants;16 (ii) the complex project design, with overlapping responsibilities between work under the TA loan and TA grant; (iii) the infeasibility of phasing of the various subcomponents and subparts of the TA loan as originally intended; and (iv) the absence of a project implementation coordination unit. BAAC’s refusal to sign off on the indemnification letter required to conclude the financial audit conducted under the project also contributed to delays in completing the Part II work program.17

21. Toward the end of the TA loan implementation period, the consulting firm for Part I raised a dispute against the government over the delayed payment and sought assistance from ADB’s Board of Directors.

22. Technical assistance grant. The TA grant had two components: rationalization of and corporate governance for SFIs (component 1), and strategies for SMEs financing (component 2).

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13 Typically, a TA loan recipient is responsible for consultant selection and engagement, while in a TA grant, ADB selects and engages consultants on behalf of the recipient.

14 It was first decided that ADB would select and engage consultants instead. Immediately after the TA loan signing on 12 May 2000, ADB started the process of selecting consultants for the TA loan (even before loan effectiveness on 10 August 2000). However, in September 2000, the government requested ADB to allow it (the government) to be responsible for engaging the consultants while the government reaffirmed its agreement to have ADB select the consultants. ADB accepted this request as a minor change in the implementation arrangement.

15 According to the BTOR of the review mission dated 16 April 2002, in the absence of a formal contract, the consulting team did not obtain full cooperation from the IFCT regarding sensitive audit and financial information. This resulted in a lower level of effort than desirable for the diagnostic phase of the project, at least for the IFCT.

16 This evaluation is of the view that the planned time lines of the TA loan could have been considered realistic if (i) the at-entry study during appraisal had been sufficiently thorough and highlighted the information gaps, and (ii) there had been better coordination across the various TA loan parts and TA grant components.

17 This reflected “BAAC’s concern to preserve the confidentiality of its financial position, which was greater than anticipated... This issue was resolved, and the indemnification letter signed, on an undertaking by the Mission that the financial audit and loan portfolio review would remain confidential within the ADB.” (BTOR of review mission from 8 to 9 November 2001).
The RRP noted that ADB would select and engage (i) individual experts for component 1—an international and a national expert on financial policy and strategy, and an international corporate governance expert; and (ii) an international consulting firm for component 2 that offered an international SMEs financial strategy expert, an international SMEs development policy expert, an international venture capital expert, an international SMEs financial expert, a national SMEs financial specialist, and a national SMEs operations and venture capital expert.

23. According to the RRP, the consulting work for both components was to commence in April 2000 and be completed within (i) 6 months for formulation of an SFI corporate governance framework under component 1, (ii) 2 years for SFI rationalization and restructuring under component 1, and (iii) within 6 months for the SMEs financing strategy under component 2. In reality, however, contract negotiations concluded 8 months behind schedule for component 1 and 9 months behind schedule for component 2.

24. The contract with the original consulting team for component 1 was preterminated in April 2002, and a new set of consultants was successively engaged from June 2002 to July 2003. The government and ADB observed that the original consulting team’s final output had limited success in synthesizing and distilling the results of the rest of the project and in developing an independent assessment and proposals for improving governance. Therefore, the original expectation of an extended phase that required a full-time adviser to oversee implementation of governance improvement measures had become redundant. On this basis, the government and ADB expressed their dissatisfaction with the consulting team.

25. SFIs subsequently provided the project completion review (PCR) mission with some positive feedback: (i) the IFCT found the consultants’ work quite useful, and worked with them in developing corporate governance norms; (ii) the SME Bank (formerly the SIFC) found the transferred knowledge was useful, especially in developing its own corporate governance norms, and the consultants’ recommendations resulted in restructuring of internal audit, facilitating standard risk management, and developing a public service account (PSA); and (iii) BAAC found the consultant’s work quite useful, and changed the composition of the Audit Committee as recommended.

26. Component 1 was completed in January 2005, with a delay of 2 years and 9 months from the RRP estimate, reflecting this change of the consulting team and a refocusing of the TA during the course of implementation. Component 2 was completed in September 2001, with a delay of 11 months against the original target, mainly because of the delayed commencement of the consulting work.

18 According to the BTOR of 2 November 2001 (comments on the draft final report for component 1).
19 According to the BTOR of 18 March 2002 (comments on the final report for component 1).
20 According to the new consulting team’s final report for Phase 1 (component 1 of the TA grant) dated 24 October 2002, the TA loan (Part 1) had also produced a comprehensive set of recommendations for the design of a generic integrated structure for risk management for the SIFC, the IFCT, and the SICGC, including recommendations for their implementation. However, the recommendations were less clear as to which of the various types of risk should have priority, and the nature of detailed steps that should be taken to progress from the current system to the recommended system. This appears to have posed some problems for the SFIs in the implementation of a complete risk management system although some SFIs, such as the IFCT and the SIFC, were able to make progress in implementing specific risk management subsystems (such as the establishment of a risk management department and asset-liability committee).
E. Design Changes

27. **Technical assistance loan.** In February 2001, the then new government initiated a round of brainstorming sessions on its economic policies that put pressure on the MOF to come up with suitable implementation measures. Although the FPO requested ADB to reevaluate whether the project should focus only on the SIFC and the SICGC, it was agreed that (i) the project would continue to focus on the original four SFIs, and (ii) the allocation of resources under both the loan and the grant would reflect the relative needs of the beneficiary institutions, their access to alternative resources, and the priority given by the government to initiating major restructuring plans. The evaluation team did not find any project documents that suggested any change in the loan TA agreements, consulting contracts, or terms of reference as a consequence of this memorandum of understanding.

28. **Technical assistance grant.** Subsequent to the pretermination of the original consulting team, the government and ADB agreed on the future direction of the TA grant (component 1) by setting the following targets: (i) establishing an SFI monitoring system within the FPO, (ii) building the FPO’s capacity to monitor the SFIs, (iii) establishing PSAs for SFIs to segregate directed credits from commercial operations, and (iv) building SFIs’ capacity to enable them to perform their functions more effectively. As such, the strengthening of SFIs’ autonomy and the phaseout of subsidies and other privileges accorded to SFIs (as initially targeted) were not given any priority.

29. A phased approach to implementation was also agreed. In the first phase, the core team, comprising an international corporate governance expert and an international financial institution expert, was tasked to (i) consolidate the outputs generated by the various components/parts of the project; (ii) finalize concrete policy recommendations to improve governance; (iii) identify key implementation targets; and (iv) prepare terms of reference for activities and experts required for the second phase. The implementation plans were to be prepared in the second phase, and to be implemented in the third phase. At the end of the first phase, the core team identified the need for an international monitoring and performance expert, a national IT expert, and a national accounting and finance expert, for the second and third phases.

F. Outputs

30. **Technical assistance loan outputs.** According to the original project design, the TA loan’s outputs were (i) financial audits of the selected SFIs, (ii) operational diagnostic reviews of the selected SFIs, (iii) resolution of NPL issues of the selected SFIs, and (iv) defined strategic roles of the selected SFIs and their operational plans.

31. The evaluation mission could access only the consultant’s inception report and midterm report. However, the procedures performed during the TA consulting work did not constitute an audit in accordance with generally accepted auditing standards, and it was not possible to express an audit opinion on the financial information presented to the TA consultants. This evaluation is of

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21 In fact, the FPO requested ADB to reevaluate the project design to ascertain whether it should focus entirely on the SIFC and the SICGC. The ensuing reevaluation conducted by the FPO and the review mission underscored the interlinkages between the loan parts and grant components, and concluded that dropping the IFCT and BAAC would undermine the project’s rationale as well as the justification for providing the TA grant.

22 This information refers to the BTOR of the review mission dated 16 April 2001. The BTOR further noted: “it was agreed that since IFCT was a relatively well run institution, with a governance structure considerably more sophisticated than other SFIs, this would be reflected by a correspondingly lower level of effort and allocation of resources for its restructuring relative to SIFC and SICGC.”

23 According to the requirements of the TA framework, the consulting team delivered outputs in five areas: diagnostic review, financial audit, loan portfolio audit, restructuring plan, and workout and capacity building support.
the view that the lack of rigorous financial audits reduced the significance of the TA no matter how broad the scope of other TA outputs (such as the diagnostic reviews and recommended measures for operational plans) may have been.\textsuperscript{24} An incomplete or insufficient grasp of the financial positions of the targeted SFIs limited the usefulness of the diagnostic review, and impeded the formulation of approaches and strategies to manage NPL related issues.\textsuperscript{25} Nonetheless, the diagnostic of SFIs’ risk management systems appears to have been among the most significant outputs delivered under this component. Further details are in Appendix 5.

32. Based on the diagnostic review of BAAC, the financial audit, and the LPA, the consulting team provided a set of recommendations on the BAAC’s NPL management as well as proposed capacity building initiatives in broad areas that included governance, planning, human resource management, banking services, risk management, and a management information system (MIS). Feedback on TA outputs subsequently provided to the PCR mission was as follows: (i) BAAC implemented some of the consultant recommendations such as rolling corporate and business plans, and acknowledged the TA’s contributions toward improved operational efficiency; and (ii) BAAC relied on the MOF’s policies regarding the adoption of recommended changes on asset classification and provisioning. Appendix 5 contains further details.

33. \textbf{Technical assistance grant (component 1) outputs.} The original TA framework presented the expected outputs of this component: (i) to rationalize government intervention in the financial sector and SFIs, (ii) to develop a corporate governance framework for SFIs, and (iii) to conduct capacity building.

34. At the completion of TA implementation, the consultant classified its outputs into three main areas: (i) corporate governance, (ii) PSA, and (iii) a monitoring and IT-based MIS system. In the area of the corporate governance, to date the MOF has not formalized the SFI Corporate Governance Code (CG Code), and the BAAC has not adopted the Articles of Association prepared for it as the pilot SFI. According to the consultant,\textsuperscript{26} the two key reasons for the slower-than-expected progress in implementation of the SFI corporate governance systems were (i) the unresolved issue of who (the FPO or the SEPO) has or should have responsibility for the corporate governance development of SFIs; and (ii) the FPO’s top priority during the TA implementation period—the development of the PSA and the monitoring MIS/IT system—which caused it to commit less resources and time to deal with corporate governance related matters.

35. However, the evaluation team noted that over the years, BAAC, the SME Bank, and the SICGC made efforts to strengthen their corporate governance by introducing several committees and subcommittees under their boards. Meanwhile, as a result of the change in the priority areas of the TA, reflecting the new government policy direction, no study was conducted under the TA grant on the existing subsidies and other privileges accorded to SFIs (such as tax exemptions and a BOT reserve requirement). Further details are in Appendix 5.

36. \textbf{Technical assistance grant (component 2) outputs.} The expected outputs of this component were (i) to determine various modalities and schemes, and develop a regulatory and

\textsuperscript{24} The consultant recommendations focused on (i) IT development, treasury operations, and risk management (for the IFCT); (ii) business strategy, IT development, risk management, and treasury operations (for the SIFC); and (iii) business strategy, IT development, and risk management (for the SICGC).

\textsuperscript{25} For the IFCT and SIFC, the consulting team conducted loan portfolio reviews of sample borrowers, but did not present any meaningful findings of such reviews in the midterm report. For the SICGC, the midterm report highlighted a few issues without indicating the research method used.

\textsuperscript{26} ADB. 2002. \textit{Restructuring of Specialized Financial Institutions}. Consultant’s final report for Phase 1, Manila (Grant 3355-THA, 24 October).
incentive framework for SMEs financing; (ii) to determine and evaluate options for setting up financial institutions to support SMEs development; and (iii) capacity building for SMEs financing.

37. The consultant’s final report\textsuperscript{27} classified the proposed SMEs financing strategy into three areas: debt financing, equity financing, and financial advisory services. These aspects of SMEs financing strategy are discussed further in Appendix 4. The consultant’s report also highlighted the shortage of reliable SMEs lending data as a constraint to promote SMEs financing—an issue that has not been addressed sufficiently well thus far. Feedback on TA outputs subsequently provided to the PCR mission was that (i) the IFCT found the transferred knowledge useful for improving its SMEs center, and it set up the single-window SMEs assistance facility on a pilot basis; (ii) the SME Bank found the transferred knowledge useful for its restructuring program and developing a business model, and it had adopted several recommendations; and (iii) the SICGC found the transferred knowledge useful in setting up a warranty policy for SMEs, although it had not implemented any of the recommendations.

G. Policy Framework

38. The project was approved in 1999 in the context of a commitment by the government of the day to a reform process that would increase the SFIs’ operational autonomy and financial sustainability. The government had given an implicit undertaking that where reform was not possible, the institutions would be phased out. However, the new government that came to power in 2001 adopted a policy direction that posed challenges to the project’s implementation. For instance, the new government decided to recast the SIFC as the SME Bank, and provide debt relief on loans owed to BAAC. While these decisions appeared to preclude the need for any further study under the project, they also underscored the project’s importance in providing the government with impartial analysis to set the parameters for a realistic assessment of some of the decisions.\textsuperscript{28}

39. The then new political leadership did not seek ADB’s advice on key policy issues affecting SFIs. The project was thus sustained by the value placed on it by senior policy makers in the civil service in their efforts to propose rational policies and alternatives to the political leadership. This underscores the difficulties that were to be expected in attempting to implement the project’s findings and recommendations.

III. PERFORMANCE ASSESSMENT

A. Overall Assessment

40. Overall, the project is rated \textit{partly successful} (Table: Overall Performance Assessment). The project’s \textit{partly relevant} rating reflects a combination of: (i) consistency at appraisal with the priorities of the government and ADB, and that it remains relevant in spite of changing political leadership during the past decade; (ii) design weaknesses that stem from insufficient assessment of issues related to SFIs and SMEs (for instance, financial strengthening, risk management, governance of SFIs and impediments to SMEs promotion); and (iii) not properly defining the scope of work and gauging the government commitment. The project is rated \textit{less effective}. Even though inputs were by-and-large appropriately delivered, the outputs contributed only partly to achieving the outcomes (for instance, procedures followed in the work on financial audits did not

\textsuperscript{27} ADB. 2001. \textit{Restructuring of Specialized Financial Institutions.} Consultant’s report, Manila (Grant 3355-THA, September).

\textsuperscript{28} BTOR, 16 April 2001.
conform to generally accepted accounting standards), resulting in mixed project outcomes. The project is rated *less efficient* on account of inefficient use of resources (for instance, the need to change consultants mid-way, and costs associated with selecting a new consultant team and time required by the new consultant to familiarize with the project), and significant delays of the order of 2.5 years or more for both the TA loan and the TA grant. Yet, this evaluation rates the project as *likely sustainable*, in recognition of its resilience to a changing policy environment, and the fact that the SFI Master Plan prepared by the government in 2010 is designed to maintain whatever was accomplished through the project as well as address other outstanding issues of SFIs.

### Overall Performance Assessment

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<td>Effectiveness</td>
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<sup>a</sup> Highly successful > 2.7, Successful 2.7 > S ≥ 1.6, Partly Successful 1.6 > PS > 0.8, Unsuccessful < 0.8.

Source: Independent Evaluation Mission.

#### B. Relevance

41. The project is rated *partly relevant*. The following aspects were considered: (i) the level of consistency of the expected project results with government priorities and ADB’s country program; (ii) the quality of the at-entry assessment of SFIs and SMEs conducted by ADB; (iii) the degree of appropriateness of the outcomes defined in some areas of the TA framework, and the adequacy of resource allocation for coordination across project activities; (iv) the extent of participation of the beneficiary SFIs in the design of the project and their buy-in; and (v) the level of adequacy of policy discussions with the government and relevant development partners during appraisal and implementation.

42. The evaluation team notes that (i) in response to the financial crisis of 1997–1998, the government prioritized the SFIs’ restructuring after restructuring of private banks and finance companies, and (ii) ADB’s operations in Thailand during the crisis focused on financial sector reforms and liquidity support through two SFIs—BAAC and EXIM. In this regard, the expected project’s results were consistent both with the priorities of the government at the time, as well as ADB’s country strategy. However, under the new political leadership from February 2001, the government shifted its policy direction on SFIs from encouraging operational autonomy and financial sustainability to making them vehicles for the government’s fiscal initiatives and social objectives. Nonetheless, this evaluation notes that SFIs have gained importance since the mid-2000s.

43. ADB’s at-entry assessment of SFIs and SMEs was weak. The following gaps in the RRP are most prominent in the context of complexities of the project design, which required multiple outputs across four SFIs, several consultant teams, a strong project coordination function, and substantial information: (i) no baseline indicators on SFIs and SMEs finance, and no measurable targets for any performance indicators were specified in the TA framework; (ii) insufficient assessment of the constraints in SFIs’ risk management and governance, the issues in regulatory and supervisory frameworks for SFIs, and the impediments in promoting SMEs finance; and (iii) the lack of discussion regarding the existing information and analytical gaps, which should have been identified up front to facilitate expeditious delivery of key consultants’ outputs. Moreover, phasing of the various subcomponents and subparts, as originally intended, became difficult.
owing at least in part to the overlapping responsibilities between the two parts under the TA loan and the two components under the TA grant.

44. According to the TA framework, a determination of SFIs’ operational requirements is a key project outcome; the corresponding outputs were the conduct of an operational diagnostic review and formulation of operational plans. Operations is a broad concept, and the operational diagnostic reviews and operational plans delivered under the TA loan lacked focus and detailed analysis/prescriptions in some areas. Similarly, governance is a broad concept, which is why the scope of the TA grant had to be narrowed down significantly during the course of implementation. In general, outcomes should have been more clearly distinguished from outputs. For instance, “improved SFIs’ financial performance” rather than “determination of SFIs’ financial requirement” would have been a more appropriate outcome. Likewise, “increased financing for SMEs,” rather than “formulation of the financing strategy for SMEs” would have been a more suitable outcome.29

45. In the absence of a project implementation coordination unit in the project concept, the government expected the consulting team for the TA grant (component 1) to coordinate activities under the TA loan and component 2 of the TA grant. However, the terms of reference did not clearly indicate coordination as a task for the component 1 consultant.

46. It appears that during appraisal, the project team did not adequately consult with the concerned SFIs to reflect their views in the project design. Moreover, during the appraisal stage, the government requested a reduction in the TA loan amount, the stated rationale being that the government was reluctant to engage international consultants with loan funds. This should have raised a serious question on the level of government commitment to the project.

47. In commenting on the project design during appraisal, the World Bank emphasized the need for a clearer distinction between shareholders’ monitoring by the MOF and the supervisory monitoring by BOT of the SFIs. However, ADB did not initiate policy discussions with the MOF and BOT on this important matter, and coordination with the World Bank does not appear to have been actively pursued through the project implementation period.

C. Effectiveness

48. The project is rated less effective although inputs were appropriately delivered in accordance with the original project design for most components. The achievement of the project outcomes was mixed, and project outputs contributed only partially to achieving project outcomes.

49. The project beneficiaries acknowledged the contributions of some of the consultant deliverables. An exception was the consulting team that had been originally engaged under the TA grant (component 1)—when close to completion of the final consultant report, the FPO expressed its dissatisfaction with the team performance, and pointed to the limited success in synthesizing the results from other parts of the project and in developing independent assessments on improvements in SFI governance. The evaluation team found that the financial and portfolio audits for the IFCT, the SIFC, and the SICGC had not been independently conducted as envisaged. As key elements of the TA, the fact that the procedures performed during the TA loan consulting work for financial audits and portfolio audits did not constitute an audit in accordance with generally accepted auditing standards, reduced the significance of the TA loan.

29 However, the measurement of such outcomes would have required the development of a comprehensive SME database, which could have been defined as one of the key project outputs.
50. With reference to performance targets\textsuperscript{30} specified in the TA framework and other relevant benchmarks,\textsuperscript{31} the achievement of project outcomes is as follows: (i) the government’s role in the financial sector has not been rationalized as initially envisaged, while the MOF’s monitoring of SFIs and the SFIs’ corporate governance and risk management have improved; (ii) the operational requirements of the four SFIs and BAAC’s financial needs were identified, but the financial needs of the IFCT, the SIFC, and the SICGC were not assessed objectively; and (iii) the beneficiary institutions positively accepted the financing strategy for SMEs developed by the consultants, but it was not formalized as a national strategy.

51. BAAC introduced asset classification and provisioning norms in accordance with IAS 39 in FY2007. This reflected BAAC’s relatively prudent approach to loan loss provisions (as measured by their proportion in total average loans outstanding).\textsuperscript{32} Beginning FY2005, BAAC has disclosed the Bank for International Settlements (BIS) ratio in its annual reports, and recorded its steady increase from 10.8% at the end of FY2005 to FY13.8% at the end of FY2009.\textsuperscript{33} It is reasonable to assume that the financial and portfolio audit conducted under the TA loan helped the MOF to accurately grasp BAAC’s financial position at the end of FY2000, and contributed to its subsequent decisions to infuse capital to BAAC.\textsuperscript{34}

52. Some other contributions of the project outputs are that they helped (i) the MOF to create a system to monitor SFIs; (ii) the MOF to conceptualize the PSA; (iii) BAAC to identify its operational requirements in some areas, e.g., corporate governance and risk management, and to improve those operations; (iv) the SME Bank and the SICGC to identify their operational requirements (but their operations have not significantly improved); and (v) some SFIs to introduce various measures to promote SMEs financing (although most such measures have not been mainstreamed).

D. Efficiency

53. The project is rated less efficient, in view of inefficient use of resources, significant delays in TA implementation, and inadequate formal midcourse adjustments on TA outputs and terms of reference in response to a change in the government’s policy direction.

\textsuperscript{30} The evaluation team’s key findings on the performance targets are that (i) SFIs’ autonomy and commercial orientation have not been enhanced as initially envisaged; (ii) objective measurements of SFIs’ performance by the MOF (the FPO and SEPO) have been strengthened through the establishment and improvement of reporting and monitoring systems, and the introduction of the KPI-based evaluation; and (iii) subsidies and other privileges in some areas, such as tax exemptions and no BOT reserve requirement, accorded to SFIs have remained to date.

\textsuperscript{31} The benchmarks include the slower-than-expected progress of the PSA implementation and the SFIs’ efforts to strengthen their corporate governance by introducing several committees and subcommittees with specific mandates under the boards.

\textsuperscript{32} As a proportion of total loans outstanding, BAAC raised loan loss provisions from 11.8% at the end of FY2000 to 16% at the end of FY2005 (despite a downward trend of its NPL ratio during this period), and further to 23.7% at the end of FY2009 (although the NPL ratios had remained within a fairly narrow band of 8.0%–10.4% from FY2005 to FY2009.

\textsuperscript{33} To achieve this, BAAC had increased its shareholders’ equity from B22.5 billion at the end of FY2000 to B44.0 billion at the end of FY2004 and B73.6 billion at the end of FY2009, by increasing its authorized capital from B30 billion to B40 billion in FY2004 and to B50 billion in FY2007 complemented by the yearly accumulations of retained earnings.

\textsuperscript{34} The financial audit team under the TA loan (Part 1) estimated BAAC’s capital need to be B19.6 billion to maintain the BIS ratio at the BOT’s minimum requirement for banks (8.5%).
54. Additional costs are associated with pretermination of the original consulting team under the TA grant (component 1) because the second consulting team needed time to review various project documents.

55. The TA loan was completed in March 2003 with a delay of nearly 2.50 years, and the TA grant was completed in March 2006 with a delay of 3 years. In addition to delays that can be attributed to problems of project design, these significant delays were also caused by (i) the time-consuming process of engaging consultants (TA loan), and (ii) pretermination of the original consulting team (TA grant, component 1).

56. Although this evaluation appreciates that the project was sustained in the face of policy changes introduced by the new political leadership in 2001, it is of the opinion that ADB should have reviewed with the new government shortly after it came into power the expected outputs to “rationalize the Government’s role in the financial sector” (and the corresponding performance targets that referred to “SFIs’ autonomy” and “rationalization of subsidies and privileges accorded to SFIs”). This could have enabled the original TA grant (component 1) consultants to adjust their work plans to the priorities of the new government’s priorities and perhaps helped to avoid some of the subsequent problems.

E. Sustainability

57. The project is rated likely sustainable, given its resilience to a changing policy environment, and the establishment of an SFI master plan, 2010–2014 with the objective of maintaining the project outcomes and addressing other outstanding SFI issues.

58. Thailand has experienced several changes in political leadership since the project began to be implemented, and such transitions have been associated with a significant change and/or some uncertainty in policy direction, most SFIs have continued to emphasize their support to the underserved sectors. Nonetheless, the results in terms of financial performance and sustenance varied significantly across the SFIs. For instance, the SME Bank’s portfolio performance deteriorated significantly from 2002 to 2006 while BAAC became more financially sound during the same period. However, the recovery of the SME Bank’s portfolio performance since 2008 suggests its organizational resilience. The present government aims to enhance SFIs’ efficiency and guide them in developing clear business plans.

59. The government established the SFI master plan to strengthen SFIs in performing their roles and improve their performance. In particular, the SFI master plan aims to (i) develop the role of SFIs to fill the gaps in the financial system efficiently, (ii) develop an efficient supervision and assessment mechanism for SFIs, and (iii) assist the SFIs to maximize their potential. To achieve these strategic targets, the government intends to

(i) segment and improve the roles of SFIs to meet financial gaps and eliminate operational overlaps;
(ii) enhance collaboration and cooperation among SFIs;
(iii) prepare contingency plans for each SFI to cope with volatile economic conditions;
(iv) formulate clear and transparent PSA policies;
(v) formulate capital injection policies on a yearly basis;

35 For all quotes in this para., refer to RRP (footnote 1), paras. 13–17.
36 The SFI master plan (2010–2014) indicates government commitment to achieve the intended outcomes of the TA loan and grant in the foreseeable future.
37 For instance, para. 28 provides a brief overview of pressures from the newly formed government in February 2001, on reducing the scope of the project.
(vi) formulate prudential regulations for SFIs;
(vii) clarify the supervisory roles among the FPO, the SEPO, BOT, and the Office of the Auditor General;
(viii) revise the criteria and key performance indicators (KPIs) for the assessment of SFI operations;
(ix) develop a more transparent and efficient system to assess executive administration;
(x) formulate the improvement plans of supervising agencies to facilitate effective supervision of SFIs;
(xi) exchange knowledge, information, and organizing seminars among the supervising agencies;
(xii) promote joint adoption of the IT system;
(xiii) construct the database for the development of SMEs;
(xiv) exercise rigorous risk management;
(xv) conduct research to find ways to entice customers back into the financial institution system; and
(xvi) coordinate with relevant agencies to assist target groups in advising and providing the necessary knowledge and resources.

IV. OTHER ASSESSMENTS

A. Impact

60. The project’s expected impact was to contribute to restoring market confidence and help sustain the economic recovery. The TA framework identified the following performance indicators: (i) formulation of the government restructuring plans for SFIs, (ii) establishment of the corporate governance framework for SFIs, and (iii) establishment of a financing strategy for SMEs. This evaluation is of the view that these are akin to project outputs and should not be included as performance indicators for project impact.

61. The project impact is rated significant. This reflects the extent to which market confidence has been restored and economic recovery to date, but does not reflect the project’s contribution in achieving the impact.

62. Banking fundamentals have been strengthened since 2002, with most banks reporting higher capital levels and lower NPL ratios. The average BIS ratio for Thai banks was about 16% at the end of 2009—well above the regulatory minimum of 8.5%. More sound financial performance, a better balanced asset structure, and improved risk management have enhanced asset quality, resulting in a steady decline of the NPL ratio from 15.7% at the end of 2002 to 5.3% at the end of 2009. The introduction of IAS 39 and application of discounted cash flow and fair market valuations to loans has also urged banks to reduce their distressed assets and contribute to a lowering of NPLs net of provisioning. All these data suggest the significant revival of market confidence in the financial system in Thailand since the time of project approval.

63. In 2007, the IMF reported that “despite the steady growth in bank lending since 2001, the share of bank credit in the economy remains below pre-crisis levels.” By the end of 2005, bank credit was 80% of gross domestic product compared with 128% at the end of 1997. Most of this decline can be accounted for by sharply lower corporate borrowings, NPL sales to asset management companies, and write-offs. The IMF reiterated the trend of financial disintermediation with the following observations in 2010: “In part, the shrinkage of the financial sector merely

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reflects the declining need for finance, as investment rates have subsided. But staff research suggests that the causality has also run the other way, with credit constraints inhibiting investment. The causality issue aside, the lower investment resulted in lower growth; in the 7 years ending 2007, growth averaged 5.0% compared with the average annual growth rate of 8.5% in the 7 years from 1990.

64. Following the global financial crisis of 2008 and the political confrontation in 2007, the Thai economy was in deep recession. Despite these, a vibrant economic recovery has taken hold with growth for 2010 reaching 7.8%. The IMF attributed Thailand’s rapid recovery to its sound economic framework and its overall financial strength on all sides (bank, corporate, and public), while noting the key role that SFIs played in safeguarding SMEs and farmers in the recovery process. The IMF views that the fundamental strength reflected the legacy of a decade of effort following the Asian crisis, aimed at building a stable and robust economy. The achievements under the project formed an integral part of such government efforts.

65. SFIs are considered to have contributed to poverty reduction in various ways. However, meaningful information of such contributions was not readily available to the independent evaluation mission; and the scarcity of relevant SMEs related data means that it is not possible to assess the impact of SFIs to date on SMEs development. The SFI master plan attempts to address this gap. The restructuring of BAAC, the SME Bank, and the SICGC pursued under the project has not resulted in any major staff retrenchment.

B. ADB Performance

66. ADB’s performance is rated partly satisfactory. This rating reflects the inadequacies of project appraisal and management of information gathered during project implementation, and inadequacies of the formal, midcourse adjustment in TA outputs and terms of reference. The quality of the completion report could also have been much improved. Nonetheless, this evaluation notes (i) the adequacy and timeliness of ADB supervision during project implementation—which includes the frequency, composition, and length of inception and review missions; and (ii) ADB’s responsiveness and high client orientation throughout the project implementation phase.

C. Executing Agency Performance

67. The FPO’s performance is rated satisfactory. The rating reflects (i) the role of FPO staff, which enabled the project to continue despite changes in political leadership and policy direction; (ii) the adequacy of support provided for ADB supervision and review; and (iii) continued follow-up actions since project completion to maintain and substantiate the project outcomes and to address the remaining issues under SFIs master plan. This evaluation also notes the time-consuming process of engaging consultants, FPO advice on the insufficiency of midcourse corrections in consultant terms of reference, and difficulties faced by the FPO in executing the contractual arrangements.

40 The evaluation team could not find the draft final or final consultant reports of the TA Loan in the project files.
41 According to this evaluation, ADB should have initiated changes in consultants’ terms of reference in response to the adjusted priority and targets under the TA grant (component 1) so that consultants could swiftly catch up with changing clients’ needs.
42 The completion report did not adequately analyze the quality (and nondelivery) of key outputs in the areas of SFI restructuring and the financing strategy for SMEs.
V. ISSUES, LESSONS, AND FOLLOW-UP ACTIONS

A. Issues

68. **Role of specialized financial institutions was not specified.** The SFIs' lending activity expanded rapidly after 2007 when they sought to support SMEs and farmers at a time when commercial banks had turned cautious in their lending. Given that SFIs are backed by the government and remain financially viable, the IMF points out that they are “distorting the playing field among financial institutions and firms,” and recommended that the government should clarify the roles of SFIs and ensure them to focus on gaps (i.e., underserved communities) to not crowd out the private sector (i.e., commercial banks and service providers). In line with this recommendation, the government is to support SFIs to enhance their efficiency and develop clear business plans that are consistent with their long-term goals. Toward achieving this objective, the government developed the SFI master plan and set up the SFI supervisory committee. The SFIs are responsible for (i) segmenting their markets as prescribed by the supervisory committee, (ii) improving their operations to fill financial gaps and eliminate operational overlaps, (iii) collaborating and cooperating with each other, and (iv) preparing contingency plans to cope with volatile economic conditions.

69. **No specific authority was assigned to monitor specialized financial institutions.** As the SFI supervisory authority, the MOF works under the framework of the respective enabling act of each SFI, and has been tightening the prudential regulations for SFIs in key areas such as capital adequacy, liquidity assets, asset classification, and provisioning. Although the IMF in 2009 noted that SFI supervision has been appropriate thus far, it is of the view that if, going forward, the SFIs continue to operate as major deposit-taking institutions, they should be supervised in the same manner as commercial banks, and that the present bifurcated approach to examination and supervision of SFIs creates a potential source of reputation risk for both BOT and the MOF. In 2010, IMF also recommended the separation of the ownership related and regulatory related supervisory functions. Recognizing these issues, the SFI master plan includes the development of an efficient supervision and assessment mechanism. This mechanism is intended to enable the government to (i) clarify the supervisory roles of the FPO and BOT, and other related roles of the SEPO and the Office of the Auditor General; (ii) revise the criteria and KPIs currently used for the assessment of SFIs; (iii) develop a more transparent and efficient system to assess the executive administration of SFIs; (iv) develop, staff knowledge, and supervision instruments; and (v) exchange knowledge among the supervisory agencies.

70. **Guidelines for public service accounts of specialized financial intuitions have not been formulated.** This evaluation is of the view that the PSA would potentially enhance the accountability and transparency of SFI operations, although the MOF has faced difficulties in implementing the PSA. Therefore, under the SFI master plan, the FPO and the SEPO have been jointly tasked to (i) formulate clear and transparent PSA policies, and (ii) promulgate regulations on state subsidies and compensation formulated by the Public Transaction Committee, which was established in August 2009. SFIs have been guided to submit their PSA projects to the committee each year, and the committee is to review these projects before it presents the estimated compensation amounts to the cabinet for approval on an annual basis. This evaluation is of the view that the SFI supervisory committee should review the effectiveness and efficiency of the PSA

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44 On the basis of the limited scope of ADB assistance to only three SFIs, it is not possible to have a similar inference.

system, including the procedures to approve the PSA projects, in the course of implementation of the SFI master plan.

71. **Small and Medium Enterprise Development Bank may need recapitalization.** In 2009, the SME Bank restructured its asset quality management function by separating the NPLs arising from regular loans, and assigned a department that could monitor the clients closely to detect an NPL problem swiftly. The SME Bank also established the Loan Restructuring Committee, which is required to meet at least once a week. As a result, the SME Bank successfully lowered its NPL ratio from 49.5% at the end of 2008 to 37.2% at the end of 2009, and became marginally profitable in 2009 with a return on assets (ROA) of 0.2%. The SME Bank’s BIS ratio was 10.2% at the end of 2009, with a capital injection of B2.5 billion by the government in September 2009. In facing the economic downturn in 2009, the SME Bank launched a number of loan schemes as an integral part of the government stimulus plan. Loans under these schemes were flexible in terms of the applicant’s qualifications, interest rates, or collateral. As a result, the SME Bank’s loans outstanding increased from B43.7 billion at the end of 2008 to B56.9 billion at the end of 2009 and B74.8 billion by the end of October 2010, while the SME Bank became unprofitable and undercapitalized again. Under these circumstances, another round of recapitalization would be necessary for the SME Bank to meet the provisioning norms of IAS 39 as required under the SFI master plan.

72. **Small Business Credit Guarantee Corporation may need recapitalization.** The SBCG has been consistently unprofitable from 2002 to 2008; during this period, its ROA moved to reflect increases in claims in 2002, 2004, and 2006. The SBCG’s ROA rose to 3.5% in 2009, mainly as a result of reduced expenditure on claims and reduced allocation of allowance for doubtful accounts. However, the SBCG’s policy has remained inflexible and its interest margin has remained below 1%; this has constrained its growth potential. From this perspective, the introduction of risk based-pricing would be necessary. In view of the rapid operational expansion since 2009, further recapitalization may also be needed for the SBCG to meet the provisioning norms of IAS 39 (required under the SFI master plan).

73. **Bank for Agriculture and Agricultural Cooperatives’ nonperforming loans have increased.** BAAC introduced the asset classification system and provisioning norms of IAS 39 in FY2007, and has steadily increased its capital adequacy and profitability. Its BIS ratio was 13.8% and its ROA was 1.1% at the end of FY2009. BAAC had also managed to lower its NPL ratio from 10% in FY2005 and FY2006, to about 8.0% in FY2007 and FY2008. However, following the economic downturn, its NPL ratio rose again to 10.4% by the end of 2009. BAAC’s most recent annual report (for FY2009) does not explicitly indicate the PSA; instead it shows (i) accounts receivable pending reimbursement from the government and from secured loan projects of B116.7 billion as an asset item (equivalent to 15.3% of the total assets), and (ii) obligations relating to crop pledging schemes amounting to B80.5 billion as an off-balance sheet item.

74. **Comprehensive database for small and medium-sized enterprises has yet to be developed.** Recognizing the inadequacies of reliable data on SMEs, the SFI master plan tasks the SFIs with developing an SMEs database. This evaluation is of the view that SFIs should work closely with the Office of Small and Medium Enterprise Promotion and other credit bureaus toward achieving this objective.

B. **Lessons**

75. Although the government did not accord a high priority to SFI revitalization when ADB began discussing the matter soon after the Asian financial crisis of 1997–1998, and information
collection and analysis at appraisal was not sufficiently rigorous, this project did provide a basis for the government to prepare a framework and master plans for strengthening SFI’s to perform their intended functions, as well as to strengthen monitoring and supervision. The evaluation team also identifies the following lessons:

(i) **A thorough information gap analysis is needed at entry.** The project appraisal team expected the project consultants to identify information and analytical gaps, and the specific needs of beneficiary institutions at the inception stage of TA implementation. Such a preparatory study should have been undertaken during the processing and appraisal stages (para. 43).

(ii) **The scope of financial and portfolio audit must be agreed at appraisal.** BAAC’s post-project achievements underscore the importance of financial and portfolio audits as the basis for restructuring and operational planning. The scope of such important yet sensitive undertakings should be discussed in detail with the concerned agencies during appraisal (paras. 49–51).

(iii) **Baseline and quantitative performance indicators are required in the technical assistance framework.** The lack of baseline and quantitative performance indicators affected the measurement of results and management of the project. It is imperative for a project appraisal team to identify suitable indicators during appraisal (para. 43).

(iv) **A mechanism is needed to coordinate activities across project or technical assistance components.** The absence of an explicit mechanism to coordinate activities across TA components and parts constrained the project implementation. A complex project with overlapping responsibilities across components, such as the project, needs an effective coordination mechanism (para. 45).

(v) **Terms of reference must be adjusted in case of change in policy direction.** The change in policy direction under the renewed political leadership resulted in some adjustments of priorities on the activities and outputs under the project. However, the terms of reference of the concerned TA grant (component 1) were not adjusted accordingly. By formally adjusting the terms of reference, the consulting team may have caught up in a better manner with the clients’ changing needs, and perhaps clarified some of the issues causing the subsequent pretermination. This experience suggests the importance of a basic rule—any adjustment in scope of activities and outputs during the course of project implementation should be reflected in the terms of reference as early as possible (para. 56).

(vi) **Better information and knowledge management is needed within ADB.** This evaluation was constrained by the limited availability of consultant reports. An effective information and knowledge management system should be in place to ensure that TA outputs are properly stored within ADB, and can be easily retrieved (para. 66).

C. **Follow-Up Actions**

76. No separate follow-up actions were identified for the borrower or for ADB.
### TECHNICAL ASSISTANCE FRAMEWORK

<table>
<thead>
<tr>
<th>Design Summary</th>
<th>Performance Targets</th>
<th>Monitoring Mechanisms</th>
<th>Assumptions and Risks</th>
</tr>
</thead>
</table>
| **A. Goal**    | To restore market confidence and ensure sustainable economic recovery | The government restructuring plans for state-owned banks and specialized financial institutions (SFIs) are formulated. A corporate governance framework for SFIs is established and strategies to assist small and medium-sized enterprises (SMEs) gain access to financing are developed. | Economic reports, official statistics
Consultants reports
Asian Development Bank (ADB) review missions
Government reports—minutes of tripartite meetings | Risk: The restructuring process is slowed by lack of cooperation among government agencies and the SFIs concerned and poor coordination.
Assumption: The steering committee is organized early and performs its assigned tasks. |
| **B. Objective/Purpose** | Framework and institutional structure are established incorporating SFIs’ autonomy, commercialized operations, and objective performance measurements. Subsidies and other privileges accorded to the SFIs are rationalized. | Consultant’s reports
Tripartite meetings
Corporate governance framework for SFIs | Risk: The government and SF’s resist reform due to possible loss of privileges.
Assumption: This is overcome with appropriate dialogue, interaction with consultants, and support of ADB and other donor agencies. The SFIs cooperate to facilitate the consultants work and openly address their problems. |
| 1. Rationalize the government’s role in the financial sector and establish corporate governance framework among SFIs | Capital adequacy requirements are defined and institutional strengthening needs of SFIs and capacity building requirements are identified and addressed. Strategies for asset resolution are formulated, organization and team for resolving nonperforming loans (NPLs) are set up, and preparatory actions are carried out for undertaking debt workouts. | Consultant’s reports
Tripartite meetings
Restructuring plans and implementation reports
Action plans for resolving NPL | |
<table>
<thead>
<tr>
<th>Design Summary</th>
<th>Performance Targets</th>
<th>Monitoring Mechanisms</th>
<th>Assumptions and Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. Formulate strategies and operational plans, including options for small- and medium-sized enterprises (SMEs) financing</td>
<td>Strategic plans are prepared, and a blueprint for implementation is laid down incorporating SMEs development objectives.</td>
<td>Consultant's reports</td>
<td>Risk: Management and employees oppose the restructuring plan.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tripartite meetings</td>
<td>Assumption: This can be overcome with appropriate dialogue with management and employees and timely public relation initiatives. Government decisions are taken to adopt specific policies and strategies to guide planning and SMEs development plans are completed.</td>
</tr>
<tr>
<td>C. Output</td>
<td></td>
<td></td>
<td>Risk: Government and SFIs are reluctant to implement corporate governance measures.</td>
</tr>
<tr>
<td>1. Corporate governance</td>
<td>Government's role and rationale for involvement in financial sector and among SFIs are formulated.</td>
<td>Consultant's reports</td>
<td>Assumption: Ownership is promoted through early and close participation by the government and SFIs in the formulation of the corporate governance framework.</td>
</tr>
<tr>
<td>a. Rationalize government intervention in financial sector and SFIs</td>
<td></td>
<td>Government pronouncements</td>
<td></td>
</tr>
<tr>
<td>b. Develop corporate governance framework for SFIs</td>
<td>Corporate governance framework for SFIs which include institutional and incentive structure is developed and implemented.</td>
<td>Periodic progress reports of consultants</td>
<td></td>
</tr>
<tr>
<td>c. Conduct capacity building</td>
<td>Corporate governance core principles are adequately communicated and internalized through effective workshops for government officials, regulators, and SFI executives, and interaction with consultants.</td>
<td>Corporate governance framework for SFIs</td>
<td></td>
</tr>
<tr>
<td>2. SFIs Restructuring</td>
<td>Financial condition of each SFI is reviewed and recapitalization needs are determined</td>
<td>Consultant's reports</td>
<td></td>
</tr>
<tr>
<td>a. Conduct financial audit for each selected SFI</td>
<td></td>
<td>Audit reports of SFIs</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>ADB missions</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>Tripartite meetings</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Workshop</td>
<td></td>
</tr>
<tr>
<td>Design Summary</td>
<td>Performance Targets</td>
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<td>Assumptions and Risks</td>
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</tr>
<tr>
<td>b. Conduct operational diagnostic review of each selected SFI</td>
<td>Diagnostic review of each SFI covering organization, functions, processes, institutional capacity, and operational weaknesses is conducted. Measures to promote operational efficiency and managerial capacity, and improve risk management and enhance competitive strengths are determined.</td>
<td></td>
<td>Risk: There is resistance and lack of cooperation from borrowers, and poor implementation of current bankruptcy and foreclosure laws.</td>
</tr>
<tr>
<td>c. Resolve NPLs</td>
<td>Portfolio analysis of each SFI has been conducted. Segregation of viable from unviable loans is carried out. Asset management company is established, as needed. Creditor-debtor forum(s) is held and satisfactory feedback is received, Most suitable option for asset disposal and asset resolution is determined, Capacity building on corporate restructuring and debt workout is carried out and reference manual on the subject is prepared.</td>
<td>Portfolio review report for SFIs Bank of Thailand reports News reports on creditor-debtor forum(s)</td>
<td>Asset recovery might be lower than expected due to unfavorable market conditions. The capacity to undertake debt workouts at the institutional level is weak. Assumption; Adequate government support and SFIs cooperation are provided as essential inputs. Dialogue with borrowers is pursued. Lines of communication are kept open.</td>
</tr>
<tr>
<td>d. Define strategic role and prepare operational plan for SFIs</td>
<td>Role, organizational structures and long-term plan for each SFI are laid down including measures that the SFIs can take to support SMEs development.</td>
<td>Consultant's reports ADB review missions Tripartite meetings</td>
<td>Risk: Lack of cooperation of SFIs and inadequate government support. Assumption: Objectives are made clear from the beginning; SFIs are</td>
</tr>
<tr>
<td>Design Summary</td>
<td>Performance Targets</td>
<td>Monitoring Mechanisms</td>
<td>Assumptions and Risks</td>
</tr>
<tr>
<td>----------------</td>
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</tr>
<tr>
<td>3. Financing Strategy for SMEs</td>
<td>Measures to help SMEs access debt and equity capital through channels such as venture capital or guarantee facilities have been defined.</td>
<td></td>
<td>Risk: The process could be delayed if the restructuring of SFIs to support SMEs development will involve the merger of functions of existing SFIs.</td>
</tr>
<tr>
<td>a. Determine various modalities and schemes, and develop regulatory and incentive framework, for SMEs financing</td>
<td>Options evaluated and feasibility studies undertaken for specialized SMEs bank or fund and guarantee corporation.</td>
<td>Feasibility reports</td>
<td>The introduction of a new regulatory framework to support the development and access to capital of SMEs might involve new legislation which could be a time consuming process.</td>
</tr>
<tr>
<td>b. Determine and evaluate options for setting up financial institutions to support SMEs development</td>
<td>Training programs on SMEs financing and development have been provided to government officials and SFIs staff.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>c. Capacity building for SMEs financing</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**D. Inputs**

<table>
<thead>
<tr>
<th></th>
<th>Consultants are commissioned on schedule and expertise meet technical assistance (TA) requirements.</th>
<th>Team leaders' reports</th>
<th>Assumption: Consulting firm has the required capacity, track record, and reputation to ensure that commitments are met.</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Experts services</td>
<td>Provided as committed and without delay and suitable for Consultant's requirements.</td>
<td>Consultant's reports</td>
<td>Assumption: Due to the critical nature of the assistance in response to the prevailing crisis, government authorities give high priority and strong commitment to the TA.</td>
</tr>
<tr>
<td>b. Government contributions</td>
<td></td>
<td>Inception missions ADB missions</td>
<td></td>
</tr>
</tbody>
</table>

FINANCIAL SECTOR DEVELOPMENT IN THAILAND

A. Progress in Reforms

1. Responses to the Asian Financial Crisis, 1997–2001

1. The Government of Thailand started to consider the need for systematic reforms based on the recognition that weaknesses inherent in the financial system had intensified the 1997–1998 financial crisis, spawning a banking crisis in addition to the currency crisis. The government’s immediate focus was on emergency measures to stabilize the financial system, such as the closure of more than 50 nonviable banks and finance companies, recapitalization of financial institutions by both private and public initiatives, debt restructuring and resolutions, asset liquidation, and consolidation of weak financial institutions with stronger ones. Complementary to these efforts, the Bank of Thailand (BOT) realigned its organizational structure with the new risk-based supervisory framework. The return of banking profitability in 2001 signaled a turnaround of the crisis, allowing the government to shift its attention to formulate a longer term, comprehensive reform program—the Financial Sector Master Plan (FSMP).

2. Asian Development Bank’s (ADB’s) immediate responses to the financial crisis in Thailand included the Rural Enterprise Credit Project,¹ the Financial Markets Reform Program,² and the Export Financing Facility.³ These three financial sector interventions during the financial crisis laid the grounds for the project. The Rural Enterprise Credit Project aimed to give liquidity to the financial system through the Bank for Agriculture and Agricultural Cooperatives (BAAC), and the Export Financing Facility aimed to provide liquidity through the Export-Import Bank of Thailand (EXIM). The Financial Markets Reform Program, as a program loan, addressed structural issues that constrained the sustainable development of the financial market.


3. In early 2002, the BOT established the FSMP Steering Committee, to guide the FSMP development process. Based on empirical studies, the steering committee finalized three main goals, and identified core and supporting reform measures that would help authorities realize these goals. The three FSMP goals were (i) to broaden access to financial services, (ii) to increase the efficiency of the financial sector, and (iii) to improve customer protection and transparency. The core FSMP reform measure was to rationalize the structure of the financial system, with a four-pronged approach: (i) improving the basic infrastructure of the financial system, (ii) improving the competitiveness of individual financial institutions, (iii) removing regulatory impediments to financial sector development, and (iv) improving systemic efficiency through strengthening of market-based mechanisms. This core measure was to serve the fulfillment of the first two FSMP goals, while the supporting measures were to facilitate the achievement of all three FSMP goals. Owing to the wide scope of these measures, the

¹ ADB. 1997. Report and Recommendation of the President to the Board of Directors: Proposed Loan to Thailand for the Proposed Rural Enterprise Credit Project. Manila (Loan 1540-THA, for $200 million, approved on 18 September).
² ADB. 1997. Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grants to Thailand for the Financial Markets Reform Program. Manila (Loan 1600-THA, for $300 million, approved on 19 December).
³ ADB. 1998. Report and Recommendation of the President to the Board of Directors: Proposed Loan to Thailand for the Export Financing Facility Project. Manila (Loan 1612-THA, for $50 million, approved on 26 March).
government decided for a three-phase implementation of the FSMP to start in 2004. Phase II was scheduled to begin in 2010, with Phase III after 2014.


4. Broadened financial access. As envisaged in the FSMP, the Ministry of Finance established the Committee on Microfinance System Development to promote options for grassroots financing. The government-owned specialized financial institutions (SFIs) such as the Government Savings Bank (GSB) and the BAAC also started to play a role in microfinance activities. To encourage the extension of credit to underserved sectors, in 2006 the BOT amended its guidance to begin allowing banks to assign lower risk weights to fully collateralized mortgage loans of up to B3 million, fully collateralized small and medium-sized enterprises (SMEs) loans of up to B50 million, and uncollateralized retail loans up to B100,000. These revisions allowed banks to set aside less loan loss reserves, and freed up funds for use in extending additional credits.

5. Increased efficiency. One of the key achievements of Phase I was an overhaul of the commercial bank licensing system. Prior to the FSMP, regulators issued multiple types of licenses to numerous financial institutions that provided many of the same services to customers. The BOT also restricted foreign banks’ operations and strictly limited the number of new domestic and foreign market entrants. Recognizing that this system restricted competition also meant recognition of the potential and need for increased efficiency. The new licensing system codified under the Financial Institutions Business Act, 2008 replaced more than a dozen existing laws governing financial institutions’ business and consolidated the governance of these institutions under a single law. In conjunction with the legal changes, the statutory ceiling on foreign investment in Thai commercial banks was raised from 25% to 49%. The Financial Institutions Business Act also clarified the BOT’s responsibility as the sole regulator of financial institutions and empowered the central bank to conduct consolidated supervision over financial conglomerates. Moreover, the revision of Bank of Thailand Act in 2008 ensured the BOT’s autonomy and independence from the government. Another key achievement concerning this goal included the progressive implementation of the International Accounting Standard (IAS) 39 from 2006 and Basel II from 2008, which enhanced the banks’ risk management practices.

6. Improved consumer protection and transparency. The replacement of Thailand’s blanket deposit guarantee system with a limited deposit guarantee was a key decision made during the FSMP Phase I. The renewed system is overseen by a newly formed Deposit Protection Agency, which all commercial banks are required to join as members. From August 2011, the blanket deposit guarantee will be phased out and be replaced by a limited deposit guarantee system over a 5-year period. The BOT also implemented measures to increase the transparency of products and services by requiring banks to post on their websites the interest rates for deposits and loans and fees.


7. Planning for Phase II of the FSMP started in 2007, when the BOT formed a committee to conduct an interim review of Phase I. The committee found that (i) there has been an overall improvement in the efficiency and soundness of the system; (ii) operating costs of financial institutions remain high; (iii) the range of services has expanded, but access gaps remain; and (iv) the financial infrastructure to support risk management of financial institutions remains inadequate. Recommendations for Phase II of the FSMP therefore focused on addressing these remaining weaknesses by (i) promoting competition and financial access, (ii) reducing operating
costs, and (iii) strengthening financial infrastructure. Development of the Thai economy and its continuing integration to the global economy will require an increasingly sophisticated financial system. From this perspective, the government developed the capital markets development master plan in 2010 to complement the FSMP Phase II.

8. The International Monetary Fund’s (IMF’s) views that the FSMP “successfully consolidated the banking sector, producing larger institutions, with high capital adequacy ratios, good profitability, and strong risk management system.” The IMF in 2010 further noted that “the FSMP II takes valuable steps towards opening up the banking system to new entry” and “as competition in the sector increases, and the profitability of lending to larger companies diminishes, banks are likely to lend to SMEs and micro enterprises.” However, in 2010 the IMF also underscores the need for caution in directing credit to underserved sectors, especially the rapid expansion of SFIs’ activities since 2008 as vehicles for such credits. This issue is discussed further in Appendix 3.

B. Structure and Performance

1. Financial Sector Structure

9. Thailand’s financial sector is relatively large, with assets nearly 180% of gross domestic product (GDP) at the end of 2007 (Table A2.1). It is bank-centered, although the role of capital markets and nonbank financial institutions is growing. Commercial banks account for 60% of financial sector assets, and SFIs account for another 14%. Nonbank financial institutions hold the remaining 26% of financial assets; many of them are subsidiaries of local banking groups (Table A2.2).

Table A2.1: Thailand’s Financial Sector Assets

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (B billion)</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>10,004</td>
<td>217.0</td>
</tr>
<tr>
<td>2006</td>
<td>13,965</td>
<td>178.7</td>
</tr>
<tr>
<td>2007</td>
<td>14,924</td>
<td>175.9</td>
</tr>
</tbody>
</table>

B = baht, GDP = gross domestic product.

Table A2.2: Structure of Thailand’s Financial System (% of total financial assets)

<table>
<thead>
<tr>
<th>Item</th>
<th>1996</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposit-taking financial institutions</td>
<td>89</td>
<td>79</td>
<td>74</td>
</tr>
<tr>
<td>Commercial banks</td>
<td>55</td>
<td>62</td>
<td>60</td>
</tr>
<tr>
<td>Private banks</td>
<td>39</td>
<td>41</td>
<td>40</td>
</tr>
<tr>
<td>State-owned banks</td>
<td>12</td>
<td>13</td>
<td>12</td>
</tr>
<tr>
<td>Foreign-majority owned banks</td>
<td>5</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Specialized financial institutions*</td>
<td>7</td>
<td>14</td>
<td>14</td>
</tr>
<tr>
<td>Finance companies</td>
<td>18</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Others</td>
<td>9</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Nonbank financial institutions</td>
<td>11</td>
<td>21</td>
<td>26</td>
</tr>
</tbody>
</table>


9. The deposit-taking financial system underwent major restructuring after the mid-1990s (Table A2.3). This included the (i) closure and merger of a number of finance companies; (ii) implementation of the FSMP I, resulting in new entrants, mergers, and the formation of new banking conglomerates; and (iii) ownership changes from private bank recapitalization, government intervention in banks, and the sale of two banks to foreign investors. Despite some remaining entry restrictions, the banking sector is not so concentrated, with the Herfindahl index at 910.5

Table A2.3: Structure of Thailand’s Financial System
(number of financial institutions)

<table>
<thead>
<tr>
<th>Item</th>
<th>1996</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banks</td>
<td>29</td>
<td>34</td>
<td>34</td>
</tr>
<tr>
<td>SFIs(^a)</td>
<td>4</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Of which deposit taking SFIs</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Finance companies</td>
<td>91</td>
<td>6</td>
<td>5</td>
</tr>
</tbody>
</table>

\(^a\) SFI = specialized financial institution.

SFI = specialized financial institution.


2. Banking Performance

10. **Volume.** The IMF in 2007\(^6\) found that in spite of the steady growth in bank lending since 2001, the share of bank credit in the economy remained below crisis levels. Bank credit had declined to 80% of GDP at the end of 2005 from 128% at the end of 1997. Most of this can be accounted for by sharply lower nonfinancial corporate borrowing, NPL sales to asset management companies, and write-offs. The IMF reiterated the recent trend of financial disintermediation as well as the limited growth in the capital market, with an explanation that in part, the shrinkage of the financial sector reflects the declining need for finance, as investment rates have subsided.\(^7\) However, it notes that staff research suggests that the causality has also run the other way, with credit constraints from banking and other sources (such as capital markets) inhibiting investment (Table A2.4). On the basis of a cross-country study of external funding ratios of firms, the IMF shows that (i) listed Thai firms are not able to obtain as much external funding for their projects as in some other southeast Asian countries; and (ii) unlisted SMEs find it even more difficult to obtain the funding needed to grow—banks are reluctant to lend to them, since there are hardly any venture capital or microfinance firms to provide it (footnote 4). Consequently, very few have been able to graduate to the stock market.

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\(^7\) IMF. 2010. *Thailand: 2010 Article IV Consultation – Staff Report*. Washington, DC.
Table A2.4: Thailand’s Credit, Investment, and Gross Domestic Product

<table>
<thead>
<tr>
<th>Item</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit to private sector growth (nominal)</td>
<td>% change</td>
<td>8.0</td>
<td>4.5</td>
<td>4.8</td>
<td>8.8</td>
</tr>
<tr>
<td>Headline CPI</td>
<td>Period average, %</td>
<td>4.5</td>
<td>4.7</td>
<td>2.3</td>
<td>5.5</td>
</tr>
<tr>
<td>Real private investment</td>
<td>% of GDP</td>
<td>...</td>
<td>...</td>
<td>16.6</td>
<td>16.7</td>
</tr>
<tr>
<td>Real GDP growth</td>
<td>%</td>
<td>4.5</td>
<td>5.1</td>
<td>4.9</td>
<td>2.5</td>
</tr>
</tbody>
</table>

( ) = negative, ... = not available, CPI = consumer price index, GDP = gross domestic product.

11. **Soundness.** Banking fundamentals have strengthened since 2002, with most banks reporting high capital levels and lowering nonperforming loan (NPL) ratios. The average risk-weighted capital adequacy ratio for Thai banks was about 16% at the end of 2009, well above the regulatory minimum of 8.5%. A better balanced asset structure and improved risk management have enhanced asset quality, leading to a steady decline in the NPL ratio to 5.3% at the end of 2009 from 15.7% at the end of 2002 (Table A2.5). The introduction of IAS 39, applying discounted cash flow and fair market valuation to loans, also urged banks to reduce their distressed assets and contributed to lowering NPLs net of provisioning.

12. **Profitability and efficiency.** Banks had progressively improved their profitability with return on assets (ROA) of 1.4% in 2005 compared with 0.3% in 2002, driven by higher margins and moderate loan growth (Table A2.5). However, banks’ ROA temporarily fell to 0.8 in 2006 and 0.1 in 2007 due to large provisioning requirements arising from the phased introduction of IAS 39. Banks’ ROA rose again to 1% in 2008 and 2009. According to BOT, the Thai banks overall appear less profitable than banks in neighboring economies. This may relate to the fact that banks’ efficiency indicators, e.g., non-interest expenses to average assets and staff cost to non-interest expenses, have shown little improvement since the mid-1990s. The FSMP II, therefore, envisages the improvement of banks’ operational efficiency by lowering costs arising from regulations that have become inconsistent with their current business model, enhancing economy of scale and scope, and increasing competition.

Table A2.5: Thailand’s Banking Sector Indicators

<table>
<thead>
<tr>
<th>Item</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Soundness:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regulatory capital to risk weighted assets</td>
<td>13.6</td>
<td>14.0</td>
<td>13.0</td>
<td>13.2</td>
<td>13.6</td>
<td>14.8</td>
<td>13.9</td>
<td>15.8</td>
</tr>
<tr>
<td>Tier 1 capital to risk-weighted assets</td>
<td>10.0</td>
<td>10.5</td>
<td>10.0</td>
<td>9.9</td>
<td>10.7</td>
<td>11.9</td>
<td>10.7</td>
<td>11.7</td>
</tr>
<tr>
<td>NPLs to gross loans</td>
<td>15.7</td>
<td>12.9</td>
<td>10.9</td>
<td>9.1</td>
<td>8.1</td>
<td>7.9</td>
<td>5.7</td>
<td>5.3</td>
</tr>
<tr>
<td>NPL net of provisions to tier 1 capital</td>
<td>69.3</td>
<td>38.7</td>
<td>38.6</td>
<td>25.7</td>
<td>19.0</td>
<td>16.6</td>
<td>16.6</td>
<td>16.6</td>
</tr>
<tr>
<td>Profitability and efficiency:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on average assets (after tax)</td>
<td>0.3</td>
<td>0.7</td>
<td>1.3</td>
<td>1.4</td>
<td>0.8</td>
<td>0.1</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Net interest margin</td>
<td>1.8</td>
<td>2.0</td>
<td>2.5</td>
<td>2.8</td>
<td>3.1</td>
<td>3.1</td>
<td>3.1</td>
<td>...</td>
</tr>
<tr>
<td>Non-interest expenses to average assets</td>
<td>2.2</td>
<td>1.9</td>
<td>2.1</td>
<td>2.2</td>
<td>2.4</td>
<td>2.6</td>
<td>2.6</td>
<td>...</td>
</tr>
<tr>
<td>Staff costs to non-interest expenses</td>
<td>28.3</td>
<td>33.8</td>
<td>32.5</td>
<td>32.0</td>
<td>31.3</td>
<td>31.5</td>
<td>31.5</td>
<td>...</td>
</tr>
</tbody>
</table>

... = not available; NPL = nonperforming loan.
SPECIALIZED FINANCIAL INSTITUTIONS

A. Overview

1. Operations and Supervision

1. Specialized financial institutions (SFIs), which have operated in Thailand under specific development mandates, have gained importance in recent years, serving as vehicles for a number of government fiscal initiatives. SFIs’ total loans outstanding increased by 117% from the end of March 2003 to the end of 2009 (Table A3.1) compared to an increase of 56% in total deposit taking institutions’ claims on the private sector from the end of 2002 to the end of 2009. All eight existing SFIs are fully or largely government-owned, and several SFIs still receive occasional capital injections from the government either to address capital shortfalls from loss-making activities or to foster the expansion of SFIs’ operations.

Table A3.1: Total Loans of Thailand’s Specialized Financial Institutions (B billion)

<table>
<thead>
<tr>
<th>Item</th>
<th>GSB</th>
<th>BAAC</th>
<th>GHB</th>
<th>IFCT (^a)</th>
<th>Islamic Bank</th>
<th>EXIM</th>
<th>SME Bank</th>
<th>SMC</th>
<th>SBCG</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>End March 2003</td>
<td>269</td>
<td>289</td>
<td>374</td>
<td>155</td>
<td>10</td>
<td>13</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1,141</td>
</tr>
<tr>
<td>End December 2009</td>
<td>985</td>
<td>674</td>
<td>657</td>
<td>n.a.</td>
<td>42</td>
<td>51</td>
<td>58</td>
<td>3</td>
<td>9</td>
<td>2,478</td>
</tr>
</tbody>
</table>


\(^a\) IFCT merged with the Thai Military Bank, a commercial bank.


2. SFIs remain exempted from corporate tax (30%), specific business tax (3.3%), stamp duty, and the Bank of Thailand’s (BOT’s) reserve requirement. As state-owned enterprises (SOEs), SFIs are subject to commitment of revenue remittance. SFIs’ privileged access to the BOT refinancing facility and the mandatory deposits of commercial banks (corresponding to bank’s non-compliant portion of priority lending set by BOT) have been abolished. Over the past 7 years, the government and SFIs have been working on establishing a public service account (PSA) to account separately for the cost of delivering noncommercial services by SFIs. This led to the issuance of a cabinet resolution on PSA on 5 August 2009 that aimed to (i) establish SFIs’ self-sustainability so that public service can be carried out efficiently, and (ii) ensure effective supervision of SFIs from the Ministry of Finance (MOF). The cabinet resolution defines the scope of public service as (i) transactions that involve disaster relief, economic stimulation, or improving quality of life; and (ii) transactions with relaxed conditions (fee waiving, low interest, longer loan terms), or transactions assigned exclusively to the SFIs by the government. To facilitate the PSA implementation for new PSA projects, the government set up the Public Transaction Committee, to which SFIs submit their PSA projects for approval on an annual basis.

1 Refer to IMF. 2010. International Financial Statistics Year Book 2010, Washington, DC. “Total deposit taking institutions” comprise commercial banks, the Government Savings Bank (GSB), Bank for Agriculture and Agricultural Cooperatives (BAAC), Industrial Finance Corporation of Thailand (IFCT), Government Housing Bank (GHB), Export-Import Bank of Thailand (EXIM), and finance companies. From 2003, the data include the Small and Medium Enterprise Development Bank (SME Bank), Islamic Bank, savings cooperatives, and money market mutual funds.
3. The three largest SFIs—the Government Savings Bank (GSB), the Bank for Agriculture and Agricultural Cooperatives (BAAC), and the Government Housing Bank (GHB), which account for 93% of SFIs’ assets (Table A3.2)—have a long history of operations in deposit mobilization and consumer, agriculture, and housing finance. From 2003 to 2009, the GSB increased its loans outstanding by 266%, BAAC by 133%, and GHB by 76% (Table A3.1). The rapid expansion of the GHB’s loans, including housing and SMEs loans, was partly offset by the reduction of the GSB’s investments in government and SOE securities.2 The risk-weighted capital adequacy ratio (CAR) or the Bank for International Settlements (BIS) ratio for all three SFIs was well above the regulatory minimum of 8.5% at the end of 2009. While the GSB’s nonperforming loan (NPL) ratio was kept low at 2.2%, at the end of 2009 BAAC’s ratio was 10.4% and GHB’s ratio was 12.5%, compared with 5.3% for the whole banking system (Table A3.3).

Table A3.2: Total Assets of Thailand’s Specialized Financial Institutions
(B billion)

<table>
<thead>
<tr>
<th>Item</th>
<th>GSB</th>
<th>BAAC</th>
<th>GHB</th>
<th>IFCT</th>
<th>Islamic Bank</th>
<th>SME Bank</th>
<th>SMC</th>
<th>SBCG</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>End March 2003</td>
<td>622</td>
<td>403</td>
<td>374</td>
<td>205</td>
<td>1</td>
<td>53</td>
<td>15</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>End December 2009</td>
<td>1,080</td>
<td>746</td>
<td>692</td>
<td>45</td>
<td>66</td>
<td>64</td>
<td>2</td>
<td>9</td>
<td>2,704</td>
</tr>
</tbody>
</table>


a IFCT merged with the Thai Military Bank, a commercial bank.

4. The remaining five SFIs were established with specific development purposes: (i) trade financing—Export–Import Bank of Thailand (EXIM); (ii) lending to small and medium-sized enterprises (SMEs)—(a) Small and Medium Enterprise Development Bank of Thailand (SME Bank), reestablished from the Small Industry Finance Corporation (SIFC) in 2002; and (b) the Small Business Credit Guarantee Corporation (SBCG), renamed from the Small Industry Credit Guarantee Corporation (SICGC) in 2005; (iii) promoting the development of a secondary mortgage market—Secondary Mortgage Corporation (SMC); and (iv) servicing Islamic customers—Islamic Bank. All these smaller SFIs, except Islamic Bank, do not take deposits and rely mostly on the debt instruments guaranteed by the government. The two newly established SFIs expanded their loans outstanding rapidly from 2003 to 2009: from B13 billion to B53 billion for SME Bank, and from B1 billion to B42 billion for Islamic Bank. All these SFIs were adequately capitalized with a CAR above 10% by the end of 2009 (Table A3.3). The SME Bank’s NPL ratio was exceedingly high at 37.2% at the end of 2009 while the NPL ratios of the remaining four SFIs were 8%–12%, higher than the banks’ average of 5.3%.3

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2 GHB progressively decreased its investment in securities by 30% from 2003 to 2008.
Table A3.3: Asset Quality and Capital Adequacy of Thailand’s Specialized Financial Institutions at the end of 2009 (%)

<table>
<thead>
<tr>
<th>Item</th>
<th>GSB</th>
<th>BAAC</th>
<th>GHB</th>
<th>Islamic Bank</th>
<th>EXIM</th>
<th>SME Bank</th>
<th>SMC</th>
<th>SBCG</th>
</tr>
</thead>
<tbody>
<tr>
<td>NPL Ratio</td>
<td>2.2</td>
<td>10.4</td>
<td>12.5</td>
<td>9.0</td>
<td>8.2</td>
<td>37.2</td>
<td>11.9</td>
<td>10.2</td>
</tr>
<tr>
<td>BIS ratio</td>
<td>13.2</td>
<td>11.8</td>
<td>12.5</td>
<td>10.7</td>
<td>21.0</td>
<td>10.3</td>
<td>91.9</td>
<td>n.a.</td>
</tr>
</tbody>
</table>


5. The Industrial Finance Corporation of Thailand (IFCT) was established in 1959 to assist industrial enterprises by providing long-term, medium-term, and working capital loans; equity investment; and guarantees. The IFCT managed to reduce the NPL ratio from a peak of 40% during the financial crisis to about 17% in 2000. It had been concentrating on relatively large, industrial companies but started looking more toward second tier borrowers, especially SMEs, because of tough competition with commercial banks during the post-crisis period. To expand its lending to SMEs, the IFCT streamlined the loan appraisal process for SMEs loans. In 2004, it merged with the Thai Military Bank, a commercial bank (Box A3). Prior to the merger, the IFCT’s major shareholders included the government and SOEs holding a stake of 30% and the Thailand Securities Depository Company Limited for Depositors (foreign) 18.84%.

Box A3: Merger of Industrial Finance Corporation of Thailand with Thai Military Bank

Thai Military Bank (TMB) was established in 1957. Most of shareholders in the initial stage were military personnel both in and out of service. In 1994, the TMB was transformed into a public company. As of 13 August 2004, TMB’s major shareholders were the Ministry of Finance (MOF) holding a stake of 31.23%, DBS Bank A/C 003 16.1%, and the Royal Thai Army 3.47%.

The TMB’s competitive strategy at that time was to become a universal bank with high potentiality and economy of scale, offering full-fledged services to cater for all customer groups and cover all regions through its countrywide network. To achieve this, the MOF, TMB’s other shareholders, the Industrial Finance Corporation of Thailand (IFCT), and Thai Danu Bank entered into a merger deal. The deal corresponded with the adoption of the Financial Sector Master Plan developed by the MOF and the Bank of Thailand.

The post-merger bank named TMB, emerged as the fifth largest commercial bank in Thailand with total assets of B670.0 billion (compared with IFCT’s total assets of B205.0 billion and TMB’s total assets of B379.0 billion at the end of 2003). However, TMB posted losses in 2006 and 2007 as a result of significant loan loss provisioning to meet International Accounting Standard (IAS) 39 (against the nonperforming loans inherited from the three institutions) requiring the issuance of 25,000 million new shares worth B37.6 billion in 2007. Netherlands-based ING Bank subscribed the major portion of this capital increase. The partnership with the ING Group is reported to have contributed to the improvement of TMB’s operations and financial position.


6. The MOF, as the economy’s oversight agency, supervises SFIs within a special framework. Within the MOF, the Fiscal Policy Office (FPO) is responsible for policy issues, recapitalization, and PSA; the State-Owned Enterprise Policy Office (SEPO) is responsible for corporate governance, internal audit, and performance evaluation; and the FPO and the SEPO are jointly responsible for prudential regulations and monitoring. The MOF has delegated authority
to the BOT to conduct on-site examination of the SFIs on an annual basis by applying risk-based supervision, and off-site monitoring on a biannual basis. The BOT evaluates SFIs’ performance in line with the same risk management approach and regulation applied to commercial banks, and provides the MOF with recommendations on SFIs’ performance through the examination report. The Office of the Auditor General is responsible for financial auditing of SFIs.

7. The MOF started upgrading its reporting and monitoring system for all SFIs, supported under the TA Grant. Currently, SFIs provide the dataset containing their financial information directly to the FPO database. The information in the dataset includes, among others, contingent arrangements, NPLs, provisions, and interest rate risk. Based on the dataset, FPO staff regularly updates the summary of SFIs’ operational and financial performance and submits a report to the director-general of the FPO each month. The SEPO also tightened its monitoring by introducing key performance indicators (KPIs) and entrusting performance benchmarking and evaluation tasks on SFIs to a rating agency on a quarterly basis. In this way, the MOF has tightened the reporting and monitoring systems of SFIs.

8. As the SFIs’ supervisory authority, the MOF works under the framework in each Enabling Act for SFIs, and identifies their prudential regulation. The MOF has been increasing prudential regulation for SFIs in key areas such as capital adequacy, liquidity assets, asset classification, and provisioning. The IMF in 2009 noted that “the way SFIs has been supervised has been appropriate.” However, it also views that “if, going forward, the SFIs continue to operate as major deposit-taking institutions, they should be supervised in the same manner as commercial banks. The current bifurcated approach to examination and supervision of SFIs creates a potential source of reputation risk for both the BOT and the MOF.”

2. Challenges Ahead

9. The IMF in 2009 was of the view that “the operation of SFIs in the overlapped market does not undermine the role of the private financial sector, but it is considered as a benchmark for commercial banks to improve their operations.” On the other hand, it pointed out that “having a different regulatory regime for SFIs and according the SFIs special privileges can contribute to level-playing concerns and distort competition.” More recently, the IMF in 2010 noted that “the lending activity of SFIs has expanded rapidly over the past 2 years, as they have sought to support SMEs and farmers during a period when revenues were drying up and commercial banks were turning cautious in their lending. While these SFIs, being state backed, remain financially stable, they are distorting the playing field among financial institutions and firms.” It continued: “first and foremost, the roles of the SFIs needs to be clarified, to ensure they truly focus on gaps in the market and do not crowd out the private sector. Then measurable performance targets should be set, and outside audits conducted and published, so that public can monitor whether the targets have been achieved. Finally, the governance structure should be improved by separating the ownership and regulatory/supervisory functions, both currently undertaken by the MOF.”

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4 BOT started the examinations of BAAC and SIFC from 1999 and SICGC from 2003.
10. **Specialized Financial Institutions Master Plan.** Under the FSMP Phase II, the government aims to support SFIs in addressing gaps left by commercial service providers, while enhancing their efficiency and developing clear business plans that are consistent with their long-term goals. To achieve this objective, the government developed the SFI Master Plan, 2010–2013, which comprises three strategies: (i) developing the role of SFIs to fill the gaps within the financial system efficiently, (ii) developing an efficient supervision and assessment mechanism for SFIs, and (iii) developing the potential of SFIs. In line with these strategies, the SFI master plan includes the following measures:

(i) setting up an SFI supervisory committee;
(ii) segmenting and improve the roles of SFIs to fill financial gaps and eliminate operational overlaps;
(iii) enhancing collaboration and cooperation among SFIs;
(iv) preparing contingency plans for each SFI to cope with volatile economic conditions;
(v) formulating clear, transparent, and scrutable PSA policies;
(vi) formulating capital injection policies on a yearly basis;
(vii) formulating prudential regulations for SFIs;
(viii) clarifying supervisory roles among the FPO, the SEPO, BOT and the Office of the Auditor General;
(ix) revising and devising the criteria and KPIs for the assessment of SFIs’ operations;
(x) developing a more transparent and efficient system to assess executive administration;
(xi) formulating improvement plans of supervising agencies to facilitate effective supervision of SFIs;
(xii) exchanging knowledge, information, and organizing seminars among the supervising agencies;
(xiii) promoting joint adoption of the information technology (IT) system;
(xiv) constructing the database for the development of SMEs;
(xv) exercising rigorous risk management;
(xvi) conducting research to entice customers back into the financial institution system; and
(xvii) coordinating with relevant agencies to assist target groups in advising and providing the necessary knowledge and resources.

B. **Profiles of Selected Specialized Financial Institutions**

1. **Bank for Agriculture and Agricultural Cooperatives**

   a. **Scope of Operations**

11. BAAC was established in 1966 as a government-owned bank to provide credit to farmers at affordable interest rates, either directly or through agricultural cooperatives and farmers’ associations. In 1993, BAAC started lending to farmers for agriculture-related activities such as cottage industries. The amendment of the BAAC Act, 2006 authorized BAAC to provide nonfarm credits to individuals, groups of people, community enterprises, all types of cooperatives, and organizations aiming to boost incomes and serve the well-being of rural population. Currently, BAAC is working on the rollout of its microfinance arm.

12. The Government of Thailand from 2001 to 2006 tasked BAAC to implement several government-initiated schemes, with emphasis on a new approach to its service delivery: “More
than just loans.” Such schemes included the (i) Village Funds,\(^\text{10}\) (ii) several projects to support marketing of clients’ products,\(^\text{11}\) and (iii) Debt Suspension and Debt Burden Reduction for small-scale farmers. The Debt Suspension and Debt Burden Reduction project aimed to solve the debt problems of 2.3 million small-scale farmers, along with laying out a rehabilitation system over a 3-year period, 2001–2003. The participating farmers were supported in their efforts to improve production efficiency to increase their income and be in a position to pay back their debts at the end of the project. A total of 87.4% of the participants of this project managed to repay their debts by the end of March 2005. In 2008, the new administration entrusted BAAC with the task of clients’ occupational rehabilitation and development in line with the Agricultural Debt Waiver and Debt Relief Scheme, involving over 292,000 small farmers and poverty-stricken people. Since the mid-2000s, BAAC has implemented several projects to support quality and productivity improvement in farming\(^\text{12}\) while organizing training in various areas of agriculture and related fields such as entrepreneurship, management, accounting, and food processing and marketing.

13. To mitigate the negative impact of crop price volatility on farmers, BAAC introduced the Crop Pledging Scheme\(^\text{13}\) for rice in 1981, and expanded this scheme to cover several other crops. Having implemented the pledging scheme, the government realized this scheme could deteriorate both farmers’ discipline and the country’s competitiveness in the world market. From this perspective, the government introduced the Farmers’ Revenue Assurance Scheme and Rice Price Stabilization Scheme to replace the Pledging Scheme in 2009.\(^\text{14}\) BAAC has been entrusted with implementing these new schemes.

14. Emergency relief for farmers has been another important BAAC mandate. It served as an aid center for victims hit by (i) the Tsunami in December 2004 in six southern provinces, and (ii) the floods from May to October 2006 in 53 provinces.

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\(^\text{10}\) The village funds were established as revolving funds available for investment in job creation and income-generating projects and in areas that would reduce expenses, as well as for emergency purposes. BAAC was tasked with overseeing more than 16,000 village funds in areas that were not covered by the GSB branches, and supported the transformation of 200 strong village funds into community financial institutions.

\(^\text{11}\) BAAC encouraged client farmers to set up Agricultural Marketing Cooperatives at the provincial level in the late 1980s. The cooperatives formed the Thai Agribusiness Company as their apex organization in 1992, aiming to gain bargaining power in farm supply purchasing and agricultural product marketing. BAAC assisted the cooperatives and the Thai Agribusiness Company in supporting marketing of client products.

\(^\text{12}\) Such projects include the Organic Rice Farmers’ Field School Project, the Model Farmer Project, the Fluid Manure Project, and the Product Quality Development Project.

\(^\text{13}\) The concept of the Pledging Scheme was to control the flow of supply of farm produce to market to maintain reasonable crop prices. The pledged crops had to be kept at farms or government warehouses. When the crop price rose, farmers could redeem their crops and sell them. In some situations, if the price did not change, farmers could decide not to redeem their crops, leaving them to the government.

\(^\text{14}\) The Farmers’ Revenues Assurance scheme served as farm risk protection against substandard prices for the country’s major cash crops—rice, cassava, and maize—while ensuring a stable income for participating farmers by providing compensation for the difference between guaranteed and referred mean prices. For FY2009, about 3.8 million farmers were entitled to receive compensation worth B35,369 million. The Rice Price Stabilization Scheme, a 6-month project, was developed to help raise the market price of rice, which was lower than the referred mean price announced by the government. Beginning in November 2009, the scheme enabled rice mills and enterprises to purchase from rice farmers at a higher price and, at the same time, generated competition within the rice market. BAAC’s role was to extend credit support as funds for rice seeds and white rice processing to farmers to stimulate overall economy. As of 31 March 2010, total credits were worth B3,067 million.
b. Lending Volume and Outreach

15. BAAC increased its loans outstanding by 126.0% from B223.4 billion at the end of FY1999 (March 2000) to B504.9 billion at the end of FY2009. The pace of BAAC’s credit expansion changed between FY1999–FY2004 and FY2005–FY2009 (Table A3.4). In the former period, loans outstanding expanded by 69.5%, with yearly fluctuations (annual growth ranged from 2.4% in FY2002 to 19.7% in FY2000). In the latter period, the credit expansion was moderated at 33.0%, with less yearly fluctuations (annual growth ranged from 4.8% in FY2007 to 6.8% in FY2008) compared with the 22.1% increase in the total deposit taking institutions’ claims on the private sector from the end of 2005 to the end of 2009. However, the following data indicate greater achievements in outreach in the latter period: (i) the number of loan accounts increased by 7.5% from 5,006,671 at the end of FY1999 to 5,381,734 at the end of FY2004, and further by 14.6% to 6,167,732 at the end of FY2009; (ii) the number of farmers registered as branch clients increased by 10.3% from 3,502,051 at the end of FY1999 to 3,862,558 at the end of FY2004, and further by 16.4% to 4,496,475 at the end of FY2009; and (iii) the number of branches and field offices increased by 1.9% from 1,546 at the end of FY1999 to 1,576 at the end of FY2004, and further by 27.5% to 2,009 at the end of FY2009.

Table A3.4: Bank for Agriculture and Agricultural Cooperatives
Credit Volume and Outreach Indicators

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in loans outstanding (%)</td>
<td>69.5</td>
<td>33.0</td>
</tr>
<tr>
<td>FY1999</td>
<td>5,006,671</td>
<td>5,381,734</td>
</tr>
<tr>
<td>FY2004</td>
<td>3,502,051</td>
<td>3,862,558</td>
</tr>
<tr>
<td>FY2009</td>
<td>1,546</td>
<td>1,576</td>
</tr>
<tr>
<td>No. of loan accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No. of farmers registered as branch clients</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No. of branches and field offices</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY = fiscal year, No. = number.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sources: Bank for Agriculture and Agricultural Cooperatives (various annual reports).</td>
<td></td>
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</tr>
</tbody>
</table>

c. Financial and Portfolio Performance

16. BAAC’s loan portfolio was less affected by the 1997–1998 financial crisis than commercial banks and finance companies, reportedly because the impact of the crisis was less severe on the agriculture sector than on other sectors. The devaluation of the baht, however, had a serious impact on BAAC’s profitability because its external borrowing was not fully hedged, leaving BAAC significantly undercapitalized. In response, the government raised BAAC’s share capital from B11 billion at the end of November 1998 to B17 billion at the end of March 1999. Since then, BAAC progressively raised its share capital, reaching B74 billion at the end of FY2009—mainly contributed by the government. BAAC started disclosing its BIS CAR from FY2005, and steadily increased its CAR from 10.8% at the end of FY2005 to 13.8% at the end of FY2009 (Table A3.5). The proportion of deposits in BAAC’s total liabilities had also increased steadily from 75% at the end of FY2000 to 96.4% at the end of FY2007, and reduced slightly to 92.9% at the end of FY2009.

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15 BAAC’s fiscal year starts on 1 April and ends on 31 March; for instance, FY1999 started on 1 April 1999 and ended on 31 March 2000.

16 IMF. 2010. *International Financial Statistics Year Book, 2010*. Washington, DC. “Total banks” comprise commercial banks, the GSB, BAAC, the IFCT, the GHB, EXIM, and finance companies. From 2003, data include the SME Bank, Islamic Bank, savings cooperatives, and money market mutual funds.
Table A3.5: Bank for Agriculture and Agricultural Cooperatives
Soundness and Funding Indicators

<table>
<thead>
<tr>
<th>Item</th>
<th>FY2000</th>
<th>FY2005</th>
<th>FY2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>BIS ratio (%)</td>
<td>…</td>
<td>10.8</td>
<td>13.8</td>
</tr>
<tr>
<td>Deposits/total liabilities (%)</td>
<td>75.0</td>
<td>96.4</td>
<td>92.9</td>
</tr>
<tr>
<td>Loan loss provisions/average loan outstanding (%)</td>
<td>11.8</td>
<td>16.0</td>
<td>23.7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td>Nonperforming loan/average loan outstanding (%)</td>
<td>9.9–10.4</td>
<td>8.0</td>
<td>10.4</td>
</tr>
</tbody>
</table>

… = not available, BIS = Bank for International Settlements, FY = fiscal year.
Source: Bank for Agriculture and Agricultural Cooperatives (various annual reports).

17. BAAC used asset classification and provisioning norms that were different from those applied by commercial banks until FY2006. According to such norms, its total loans outstanding in arrears decreased significantly from B32,684 million at the end of FY2000 to B18,527 million at the end of FY2001, to B15,634 million at the end of FY2005. On the other hand, BAAC increased its loan loss provisions (as a percentage of the total average loans outstanding) from 11.8% at the end of FY2000 to 13.6% at the end of FY2001, to 16.0% at the end of FY2005 (Table A3.5). This relatively conservative approach to provisioning during this period set the foundation for the introduction of asset classification and provisioning norms in accordance with International Accounting Standards (IAS) 39 in FY2007. According to BAAC’s annual reports, which started indicating an NPL ratio from FY2008 based on the renewed asset classification, BAAC’s NPL ratio had been lowered from 9.9%–10.4% (FY2005–FY2006) to about 8.0% (FY2007–FY2008). However, the most recent data from the MOF indicates that BAAC’s NPL ratio rose to 10.4% at the end of December 2009, presumably as a result of the economic downturn. In accordance with IAS 39, BAAC had progressively raised the loan loss provisions (as a percentage of the total average loans outstanding) from 16.0% at the end of FY2005 to 23.7% at the end of FY2009.

Table A3.6: Bank for Agriculture and Agricultural Cooperatives
Profitability and Efficiency Indicators

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on assets (%)</td>
<td>0.1–0.3</td>
<td>0.4–0.6</td>
<td>0.9–1.1</td>
</tr>
<tr>
<td>Net interest margin&lt;sup&gt;a&lt;/sup&gt; (%)</td>
<td>3.6–4.7</td>
<td>5.3–5.4</td>
<td>4.5–5.6</td>
</tr>
<tr>
<td>Administrative expenses/average annual assets (%)</td>
<td>2.1–2.3</td>
<td>2.1–2.5</td>
<td>2.0–2.1</td>
</tr>
</tbody>
</table>

<sup>a</sup> Net interest margin = (interest income – interest expenses)/average annual assets.
Sources: Bank for Agriculture and Agricultural Cooperatives (various annual reports).

18. BAAC’s profitability, measured by the return on assets (ROA), improved steadily from 0.1%–0.3% (FY1999–FY2003) to 0.4%–0.6% (FY2004–FY2006), to 0.9%–1.1% (FY2007–FY2009), despite the introduction of IAS 39 in FY2007 (Table A3.6). It appears that the increase in net interest margin contributed to the improved profitability during FY2004–FY2006, and the restrained administrative expenses contributed, at least in part, to further improvement from FY2007 to FY2009.

19. BAAC’s FY2009 annual report does not explicitly indicate the PSA. Instead, in the balance sheet at the end of FY2009, it indicates (i) net accounts receivable pending reimbursement (for government–secured loan projects), amounting to B116.7 billion as an asset item (equivalent to
15.3% of the total assets); and (ii) “obligations relating to Crop Pledging Schemes” 17 amounting to B80.5 billion as an off-balance sheet item.

d. Governance and Management

20. According to a Royal Decree on Good Social and City Activity Service Method Criteria issued in 2003, BAAC set up its vision, mission, policy, staff functions, and ethics; and prepared the five-year and annual operating plans as the working procedure for the institution in FY2004.

21. To improve its corporate governance, BAAC’s board of directors has set up the following committees and subcommittees since FY2003: (i) Subcommittee of the Policy Plan Preparation/Policy and Strategy (FY2003); (ii) Audit Committee (FY2004); (iii) Employee/Activities Relations Committee (FY2004); (iv) Debt Quality Development Committee (FY2005); (v) Risk Management Committee (FY2005); (vi) Committee for Performance Assessment of the President/President’s Performance Evaluation and Criteria Consideration (FY2005); (vii) Subcommittee for Determination of Extent in Accordance with the BAAC Act, Revised version (FY2006); (viii) Subcommittee of Research and Development (FY2007); (ix) Subcommittee of Legal Counsel (FY2007); (x) Screening Committee for BAAC President (FY2008); (xi) Subcommittee for Considering BAAC President Remuneration (FY2008); (xii) Core Banking System Monitoring and Supervision Committee/the Committee to Investigate the Core Banking System Implementation (FY2008); (xiii) Corporate Social Responsibility Committee (FY2009); and (xiv) Organizational Structure and Human Resource Subcommittee.

22. BAAC’s FY2006 annual report referred to its management frame and good governance comprising nine main characteristics—quality creation, economical and cost-effective, environment preservation, co-thinking and co-working, open, transparent, honest, equitable, responsible, and promote learning. From FY2006, BAAC’s annual reports started referring to promotion of the code of conduct of the board of directors, the executives and officers, the creation of an operational guidelines manual concerning conflicts of interest, and the “Clear and Clean BAAC following Sufficiency Economy Philosophy” Project, among others.

23. BAAC has categorized risk into six areas that encompass both financial and nonfinancial risk, in line with the risk management guidelines of BOT and the Ministry of Finance, and the internal control guidelines of the Auditor General Committee: (i) credit risk, (ii) market risk, (iii) liquidity risk, (iv) strategy risk, (v) operation risk, and (vi) compliance risk (FY2005–FY2006).

24. In recent years, BAAC has initiated a systematic enterprise risk management structure through the appointment of a board of directors as well as executive officers as the Risk Management Committee whose areas of responsibility cover policy making, defining risk limits, and monitoring the adequacy of the risk management system in use. Furthermore, BAAC directors are appointed as members of various back-up committees such as the Audit Committee and the Debt Quality Development Committee. At the department level, major activities and risk factors are grouped into six main categories and 13 subcategories, with executive officers acting as members of various risk monitoring committees, such as the Asset and Liability Committee responsible for marketing and liquidity risk monitoring, the Credit Committee responsible for credit risk management monitoring, and the IT Committee responsible for IT risk management monitoring.

2. Small and Medium Enterprise Development Bank

a. Operations, Lending Volume, and Outreach

25. In 2002, the SME Bank Act was enacted, reestablishing the SIFC\textsuperscript{18} as the SME Bank under the supervision of the MOF and the Ministry of Industry. The SME Bank’s mandate has been to promote and assist small and medium enterprises to start, expand or improve their businesses by providing loans, guarantees, venture capital, counseling and other necessary services as prescribed by the Act.

26. The SME Bank was designated a key mechanism to implement the National Master Plan for the Promotion of SMEs, 2004–2006. The SME Bank (i) streamlined and standardized loan approval processes,\textsuperscript{19} and introduced diverse loan schemes, such as loans under the asset capitalization project\textsuperscript{20} to assist SMEs that lack collateral, and trade financing to assist SMEs expanding into the international market; (ii) reorganized its loan departments based on business categories or clusters, so that loan officers can gain expertise in their respective clusters; (iii) initiated a loan scheme to promote innovation, an electronic platform for SMEs to access information, dissemination of knowledge on production and marketing, as well as channels to help promote their products and entry into e-commerce; (iv) supported SMEs exporters through various loan packages,\textsuperscript{21} including Thai-Kitchen-to-the-world loans;\textsuperscript{22} and (v) provided financial support and business counseling to new entrepreneurs.

27. The SME Bank rapidly increased its loans outstanding from B11.3 billion at the end of 2002 to B41.0 billion at the end of 2005 to meet government policy loan objectives (Table A3.7). This resulted in deterioration of the loan portfolio performance, with the NPL ratio reaching 43.5% at the end of 2006, which caused the stagnation of SME Bank lending activities from 2006 to 2008 (Table A3.8). In facing the economic downturn in 2009, the SME Bank launched a number of loan schemes as an integral part of the government stimulus plan and to help alleviate the burden of SMEs operators that were affected by the economic downturn. Such loan schemes included (i) SME Power credits,\textsuperscript{23} (ii) SME Power for Tourism,\textsuperscript{24} (iii) loans to help sustain employment and minimize layoffs,\textsuperscript{25} and (iv) loans to support targets and strategies that were prioritized by the government.\textsuperscript{26} Loans under these schemes were flexible in terms of applicant’s qualifications,

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\textsuperscript{18} Under the financing strategy to promote small industries, approved by the Council of Ministers in 1964, a loan processing office for small industries was established under the Ministry of Industry’s supervision. This office later became the Small Industries Finance Office. In 1991, the government promulgated the SIFC Act, and the Small Industries Finance Office became the SIFC with registered capital of B300 million. In 2000, the government initiated policies using the SIFC as the primary mechanism to assist SMEs and increased its equity to B2.5 billion. To promote SME financing, the government facilitated the transformation of the SIFC into the SME Bank.

\textsuperscript{19} In May 2003, the SME Bank launched the Fast Track Loan to promote grassroots business and new entrepreneurs who need capital of not over B500,000 and had no collateral.

\textsuperscript{20} In October 2003, the SME Bank started the Assets Capitalization Loan Scheme, under which the SME Bank accepted intellectual property as collateral for loans of B50,000–B5 million per borrower.

\textsuperscript{21} In August 2003, the SME Bank launched the Exporters’ Loan scheme, under which the SME Bank offered packing credits of up to B3 million per borrower, and fast track loan of up to B1 million per borrower for participation in trade exhibition and sales activities in foreign markets.

\textsuperscript{22} In October 2003, the SME Bank started the Thai Cuisine to the World Loan scheme, which is open to businesses in the food cluster, including food processors, exporters, importers, wholesalers, retailers, as well as Thai restaurants located in foreign countries. The maximum loan amount for each borrower was B100 million.

\textsuperscript{23} The SME Power credits scheme helped relieve SMEs in crisis, or insufficient business liquidity.

\textsuperscript{24} The SME Power for Tourism scheme assisted SMEs in tourism and related businesses.

\textsuperscript{25} This scheme supported SMEs affected by the economic crisis to be able to continue business and prevent lay-offs, maintain employment, or hire more people.

\textsuperscript{26} This scheme supported the food industry, grassroots groups, new business operators, and SME development.
interest rates, or collateral. As a result, SME Bank loans outstanding increased from B43.7 billion at the end of 2008 to B56.9 billion at the end of 2009, to B74.8 billion at the end of October 2010.

Table A3.7: Small and Medium Enterprise Development Bank
Credit Growth and Outreach

<table>
<thead>
<tr>
<th>Item</th>
<th>Loans Outstanding (B billion)</th>
<th>Number of Loan Accounts</th>
<th>Number of Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>End-2002</td>
<td>11.3</td>
<td>2,725</td>
<td>...</td>
</tr>
<tr>
<td>End-2005</td>
<td>41.0</td>
<td>18,010</td>
<td>98</td>
</tr>
<tr>
<td>End-2008</td>
<td>43.7</td>
<td>21,791</td>
<td>99</td>
</tr>
<tr>
<td>End-2009</td>
<td>56.9</td>
<td>24,066</td>
<td>98</td>
</tr>
<tr>
<td>End-October 2010</td>
<td>74.8</td>
<td>38,796</td>
<td>95</td>
</tr>
</tbody>
</table>

... = not available, B = baht.
Sources: Small and Medium Enterprise Development Bank annual reports.

Table A3.8: Small and Medium Enterprise Development Bank Key Financial Ratios

<table>
<thead>
<tr>
<th>Item</th>
<th>2002–2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nonperforming loans/average loans outstanding (%)</td>
<td>19.3–22.5</td>
<td>43.5</td>
<td>44.4</td>
<td>50.0</td>
<td>37.2</td>
</tr>
<tr>
<td>Loan loss provisions/average loan outstanding (%)</td>
<td>2.8–4.0</td>
<td>10.0</td>
<td>11.4</td>
<td>13.9</td>
<td>9.1</td>
</tr>
<tr>
<td>BIS capital adequacy ratio (%)</td>
<td>0.2–1.4</td>
<td>(5.1)</td>
<td>(2.0)</td>
<td>(5.3)</td>
<td>0.2</td>
</tr>
<tr>
<td>Return on assets (%)</td>
<td>3.6–5.4</td>
<td>2.6</td>
<td>1.5</td>
<td>0.9</td>
<td>1.6</td>
</tr>
<tr>
<td>Net interest margin (%)</td>
<td>2.5–3.9</td>
<td>2.2</td>
<td>2.1</td>
<td>2.9</td>
<td>2.4</td>
</tr>
</tbody>
</table>

... = not available, ( ) = negative, BIS = Bank for International Settlements, SME Bank = Small and Medium Enterprise Development Bank.
Sources: SME Bank annual reports.

28. The number of SME Bank clients’ loan accounts increased from 2,725 at the end of 2002 to 18,010 at the end of 2005, and 38,796 at the end of October 2010. In terms of the number of loan accounts, 93% of the SME Bank’s loans were below B5 million and over 82% of loans were provided to borrowers located in Bangkok, at the end of September 2010. In terms of loans outstanding, 32% were in the manufacturing sector, 23% in the trading sector, and 17% in the hotel sector, at the end of October 2010. The number of SME Bank branches increased from 79 to 98 during 2005, remained the same at the end of 2009, and decreased to 95 at the end of October 2010.

b. Financial and Portfolio Performance

29. Data provided by the SME Bank show that the 1997–1998 financial crisis resulted in a rise in the SIFC’s NPL ratio to 52.6% at the end of 1999, which had been progressively lowered to 19.3%–22.5% during 2002–2005 (Table A3.8). Correspondingly, the SME Bank had lowered the loan loss provisions ratio (percentage of loan loss provisions against the total average loans outstanding) from 4.0% to 2.8% while maintaining profitability, with the ROA progressively reduced from 1.4% to 0.2% during the same period. However, the SME Bank’s NPL ratio again rose to 43.5%–49.5% during 2006–2008, reflecting the rapid expansion of its lending during 2002–2005 as well as the introduction of the renewed asset classification norms

27 The evaluation team noted that SME Bank annual reports had indicated the NPL ratio from early 2000s. However, the annual reports did not clarify the SME Bank’s definition of a NPL and provisioning norms.
in 2006. In response to BOT’s guideline on the introduction of the renewed provisioning norms in accordance with IAS 39, the SME Bank raised its loan loss provisions ratio to 9.8% at the end of 2006, and to 13.9% at the end of 2008. However, the SME Bank still could not meet IAS 39 provisioning norms, and became unprofitable from 2006 to 2008. This was aggravated by the continuously declined interest margin from 2002 to 2008, which more than offset the continuous reduction of administrative expenses (against the average total assets) from 2002 to 2007. As a result, its CAR was lowered to 7.6% at the end of 2008, below the regulatory minimum of 8.5% despite almost yearly capital injections by the government from 2004.

30. In 2009, the SME Bank restructured its asset quality management by separating NPLs from regular loans, and assigned a department to monitor the clients closely and freely to detect an NPL problem swiftly. The SME Bank also established the Loan Restructuring Committee, which has been required to hold a meeting at least once a week. The SME Bank lowered its NPL ratio from 49.5% at the end of 2008 to 37.2% at the end of 2009, and reduced its loan loss provisions ratio from 13.9% at the end of 2008 to 9.1% at the end of 2009. As a result, the SME Bank became slightly profitable in 2009 with ROA at 0.2%, and its BIS CAR was 10.2% at the end of 2009 with a capital injection of B2.5 billion by the government in September 2009. However, the SME Bank’s latest data (end of October 2010) indicate that it became unprofitable and undercapitalized again despite further reduction of NPLs and loan loss provisions.

31. The latest SME Bank annual report (FY2009) does not explicitly indicate the PSA. The data provided to the evaluation team by the SME Bank classify 46.0% of its total loans outstanding as policy directed loans (end of October 2010). The data also show that policy loans’ NPL ratio was 5.0% compared with the remaining loans’ NPL ratio of 41.9%. SME Bank staff noted that an extent of NPLs classified as non-policy loans had been approved under political influence.

32. The latest SME Bank annual report (for FY2009) indicates, at the end of 2009, “other contingencies” amounting to B24.0 billion (equivalent to 37.7% of total assets) as an off-balance sheet item arising from two derivative transactions.

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28 “At the beginning of 2006, the SME Bank had total NPLs of B7,938 million. During the year, substandard NPLs increased to B9,343 million. (This increase resulted from new BOT guidelines and the implementation of new IAS 39 standards). At the same time, some clients that restructured loans in 2005 could not meet repayment terms and became NPLs” (SME Bank. Annual Report, 2006. Bangkok [p. 25]).

29 The SME Bank raised the allowance for doubtful debts to 100% from 50% in 2006, but has kept the allowance for substandard debts at 20%, which need to be raised to 100% to meet IAS 39 norms.


31 In 2009, the SME Bank set up a reserve fund to fully cover doubtful debts in accordance with IAS 39 by 2012.

32 The SME Bank’s audited financial statements at the end of 2010 need to be reviewed to assess the reasons for such financial outcomes.

33 The 2009 annual report notes: (i) “On 7 July 2008, the Bank annulled the contract of cross currency swaps with a commercial bank, with the amount of $270 million (10,381.5 million Baht) from 7 August 2006 to 7 August 2011, based on the average rate of interest for 6-month fixed deposit from four commercial banks, plus 6.55% and limit range of the interbank rate Libor. In case the Libor is in excess of the denominated limit range, there would be a penalty, on condition that the interest would be paid in every 6 months; as of February and August. But these commercial banks proceeded a litigation at the Court against the Bank in order that the Bank make a debt repayment in accordance with the contract of interest rate swaps (IFS),” and (ii) “On 18 January, the Bank annulled the contract of cross currency swaps with a commercial bank, with the amount of $26 million (1,225.9 million Baht) from 20 February 2006 to 30 December 2010, based on the average rate of interest for 6-month fixed deposit, on the condition that the interest would be paid in every 6 months, as of June and December. But the commercial bank made a breach of contract by not paying the interest to the Bank on 30 December 2009.”
c. Governance and Management

33. The SME Bank 2003 annual report indicated that it had set up the Audit Committee, the Venture Capital Committee, and the Risk Management Committee. The 2003 annual report also noted that the SME Bank defined management of risks in five areas: (i) strategic risks, (ii) credit risks, (iii) market risks, (iv) liquidity risks, and (v) operational risks.

34. The SMEs 2006 annual report referred to a wide range of activities that promoted good corporate governance, including the establishment of (i) a good corporate governance leadership group that focused on operations, responsibilities, decision-making processes, and leadership expectations and standards; (ii) criteria to measure good corporate governance made part of management level employment performance evaluations; (iii) a risk management plan (including the development of a concept and polices on how to protect the organization's operations from political interference, and the education of employees at all levels to understand the importance of loss prevention and mitigation); and (iv) procedures that permitted the SME Bank to welcome internal and external suggestions, complaints, and opinions.

35. In 2007, the MOF requested BOT to review the SME Bank's operations, and the SME Bank's board of directors considered BOT's findings by establishing a committee and engaging external consultants to review its overall credit granting system. Moreover, to enhance corporate governance, the SME Bank established subcommittees to handle specific issues including audit, risk management, venture capital, and employees relations. Subsequently, the SME Bank established the Information Technology Committee and the Asset and Liability Management Committee, and set the limit for a foreign exchange net open position to tighten its management of risks involved in derivatives transactions.

3. Small Business Credit Guarantee Corporation

a. Operations, Lending Volume, and Outreach

36. The SICGC was established in 1991 under the SICGC Act to take over the operations of the Small Industry Credit Guarantee Fund. The SICGC started operations in 1992 with a registered capital of B400 million. In 2000, the MOF added capital of B4.0 billion, making up a total capital of B4.4 billion. The SICGC was renamed the SBCG in 2005. In 2008, it called partial share payment of B302.4 million from the shareholders who had expressed their intention to take up new shares. In 2009, the SBCG further increased its capital base by B2.1 billion, mainly contributed by the MOF, bringing its paid-up capital to B6.7 billion. Its main shareholder is the MOF, which holds over 95% of the shares. Other shareholders include the GSB, SME Bank, the Financial Institutions Development Fund, and private and state-owned banks.

37. Aiming to support viable SMEs that were short of collateral to obtain more loans from financial institutions, the SBCG has offered three basic guarantee schemes to financial institutions to support SMEs borrowing. The schemes do not vary much in terms of their

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34 The 2003 annual report notes that “during the year 2003, SME Bank did not engage in any transaction of foreign currencies, assets or liabilities, and thus was not exposed to currency exchange risks.”

35 In 2007, the SME Bank changed the Risk Management Committee structure to include an independent senior manager, the SME Bank president, and two members of the board of directors. The SME Bank also established a Risk Control and Management Department to control and manage overall risks that are independent of departmental operations. The 2007 annual report noted that “foreign exchange rate risks arises because the Bank undertakes foreign currency-based transactions including borrowing, contractual commitments and foreign currency derivative instruments.”
eligibility requirements. Each scheme is priced at the same 1.75% per annum guarantee fee and covers only the non-collateralized portion of the loan with a coverage limit of 50% of the total loans. The three schemes vary in the way they are administered. In 2009, the SBCG introduced the portfolio guarantee scheme, which is a pool of all SMEs’ loan accounts from each bank that have been backed up by the SBCG’s guarantee. Under the portfolio guarantee scheme, the SBCG covers up to 15.5% of loan loss on its guaranteed amount. The government fully subsidized the first year fee of 1.75%.

38. The SBCG increased its guarantees outstanding by over 320% from B4.1 billion at the end of 2001 to B17.3 billion at the end of 2005. The number of guarantee accounts increased from 1,663 to 8,025. Subsequently, the SBCG slowed the pace of increase in guarantees outstanding to 26.6% from 2005 to 2008—its guarantees outstanding stood at B21.9 billion and the number of guarantee accounts remained at 8,631 at the end of 2008. This was the period during which the BOT guided Thai banks to meet IAS 39 norms on provisioning. The MOF initially guided the SBCG to meet IAS 39 norms by the end of 2009, which restrained SBCG guarantee operations. In 2009, however, the MOF urged the SBCG to promote its operational expansion while extending the deadline of adopting IAS 39 until the end of 2012. In response, the SBCG rapidly expanded its guarantees outstanding to B39.9 billion at the end of 2009, and to B62.8 at the end of August 2010. Correspondingly, the number of guarantee accounts increased to 13,084 at the end of 2009 and to 32,324 at the end of August 2010. This operational expansion had not been accompanied with a corresponding increase in the numbers of branches and staff.

Table A3.9: Small Business Credit Guarantee Corporation: Guarantee Volume and Outreach

<table>
<thead>
<tr>
<th>Item</th>
<th>Guarantee Outstanding (B billion)</th>
<th>Number of Loan Accounts</th>
<th>Number of Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>End of 2001</td>
<td>4.1</td>
<td>1,663</td>
<td>8</td>
</tr>
<tr>
<td>End of 2005</td>
<td>17.3</td>
<td>8,025</td>
<td>9</td>
</tr>
<tr>
<td>End of 2008</td>
<td>21.9</td>
<td>8,631</td>
<td>9</td>
</tr>
<tr>
<td>End of 2009</td>
<td>39.9</td>
<td>13,084</td>
<td>9</td>
</tr>
<tr>
<td>End of August 2010</td>
<td>62.8</td>
<td>32,324</td>
<td>...</td>
</tr>
</tbody>
</table>

... = not available, B = baht.
Sources: Small Business Credit Guarantee Corporation annual reports and Small Business Credit Guarantee Corporation.

39. In terms of geographical distribution, over 48.1% of the total guarantee amount was provided to borrowers located in Bangkok, at the end of 2009. In terms of sector distribution at end-2009, 21.3% of the total guarantee amount was directed to the services sector, 11.5% to the food and beverage sector, and 10.6% to the metal, metal products, and machinery subsector.

b. Financial and Portfolio Performance

40. The SBCG had been constantly unprofitable from 2002 to 2008, and its ROA had been negative (Table A3.10). The significant losses in reflected occasional increases in claims expenses (in 2002, 2004, and 2006); allocation of significant allowances for doubtful accounts

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36 SBCG charges interest on claims receivables at the rate of 7.5% per annum.
37 The maximum guarantee amount under the portfolio guarantee scheme is set at B40 million per case per financial institutions.
on the income statements (in 2006); and decrease in investment returns from private funds. In 2009, the SBCG recorded the ROA at 3.5%, mainly contributed by lowered claims expenses and the allocation of allowances for doubtful accounts. However, the SBCG’s interest margin remained constantly below 1%, reflecting its inflexible products pricing policy.

Table A3.10: Small Business Credit Guarantee Corporation Key Financial Ratios

<table>
<thead>
<tr>
<th>Item</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on assets (ROA) (%)</td>
<td>(9.4)</td>
<td>(0.4)</td>
<td>(3.3)</td>
<td>(0.6)</td>
<td>(5.9)</td>
<td>(0.8)</td>
<td>(1.5)</td>
<td>3.5</td>
</tr>
<tr>
<td>Claims expenses (B million)</td>
<td>581</td>
<td>193</td>
<td>1,067</td>
<td>503</td>
<td>1,014</td>
<td>360</td>
<td>289</td>
<td>81</td>
</tr>
<tr>
<td>Allowance for doubtful accounts on IS (B million)</td>
<td>128</td>
<td>165</td>
<td>107</td>
<td>163</td>
<td>396</td>
<td>284</td>
<td>250</td>
<td>154</td>
</tr>
<tr>
<td>Guarantee fees (B million)</td>
<td>96</td>
<td>147</td>
<td>188</td>
<td>258</td>
<td>322</td>
<td>357</td>
<td>362</td>
<td>398</td>
</tr>
<tr>
<td>Return from private funds B million</td>
<td>232</td>
<td>287</td>
<td>175</td>
<td>149</td>
<td>270</td>
<td>344</td>
<td>173</td>
<td>281</td>
</tr>
<tr>
<td>Claims receivables (B million)</td>
<td>738</td>
<td>326</td>
<td>594</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Allowance for doubtful accounts on BS/liabilities on guarantees (%)</td>
<td>7.8</td>
<td>7.4</td>
<td>6.8</td>
<td>5.8</td>
<td>6.9</td>
<td>7.6</td>
<td>8.8</td>
<td>5.2</td>
</tr>
<tr>
<td>Claims receivables (B million)</td>
<td>578</td>
<td>743</td>
<td>850</td>
<td>1,012</td>
<td>1,400</td>
<td>1,683</td>
<td>1,933</td>
<td>2,088</td>
</tr>
<tr>
<td>Liabilities on guarantees (B million)</td>
<td>7,454</td>
<td>10,026</td>
<td>12,548</td>
<td>17,318</td>
<td>20,281</td>
<td>22,266</td>
<td>21,855</td>
<td>39,884</td>
</tr>
<tr>
<td>Total shareholders’ equity (B million)</td>
<td>4,051</td>
<td>4,160</td>
<td>3,838</td>
<td>3,781</td>
<td>3,402</td>
<td>3,450</td>
<td>4,703</td>
<td>6,703</td>
</tr>
<tr>
<td>Gearing ratio (= liabilities on guarantee/total shareholders’ equity)</td>
<td>1.8</td>
<td>2.4</td>
<td>3.3</td>
<td>4.6</td>
<td>6.0</td>
<td>6.5</td>
<td>4.6</td>
<td>6.0</td>
</tr>
<tr>
<td>Net interest margin (%)</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.3</td>
<td>0.6</td>
<td>0.6</td>
<td>0.7</td>
<td>0.4</td>
</tr>
<tr>
<td>Administrative expenses/average annual assets (%)</td>
<td>...</td>
<td>2.1</td>
<td>2.2</td>
<td>1.9</td>
<td>2.1</td>
<td>1.9</td>
<td>1.9</td>
<td>1.5</td>
</tr>
</tbody>
</table>

… = not available, ( ) = negative, BS = Balance Sheet, IS = Income Statement.
Sources: Small Business Credit Guarantee Corporation annual reports.

41. The proportion of claims receivables (or the allowance for doubtful accounts on the balance sheet) against its liabilities on guarantees (or contingent liabilities, treated as an off-balance sheet item) mirrors the SBCG’s overall portfolio performance. This ratio had been lowered from 7.8 at the end of 2001 to 5.8 at the end of 2005, partly because of the rapid expansion of guarantees outstanding, and had increased to 8.8% at the end of 2008, reflecting the slowed growth of the guarantees outstanding. Claims receivables had increased by 75.1% from the end of 2001 to the end of 2005, and by 91.0% from the end of 2005 to the end of 2008, showing a slight deterioration in banks’ collection performance of loans guaranteed by the SBCG. In 2009, the proportion of claims receivables against its liabilities on guarantee dropped to 5.2%, reflecting the significant increase in the SBCG’s liabilities on guarantees. The MOF refers to the gearing ratio (= liabilities on guarantee / total shareholders’ equity) as a benchmark to set the level of the SBCG’s capital, which had been kept at 4.6–6.5 from 2005 to 2009.

c. Governance and Management

42. The SBCG set up the Audit Committee and the Executive Committee prior to 2001. It established the Risk Management Committee in 2004 and the Independent Directors Committee in 2008.

43. The SBCG’s 2008 annual report noted that its board in principle approved the introduction of risk-based pricing for guarantee operations as an integral part of risk management. The evaluation team noted that the SBCG was still in an exploratory stage to substantiate the board’s decision on risk-based pricing.
SMALL AND MEDIUM-SIZED ENTERPRISES

A. Backdrop

1. The Ministry of Industry’s Department of Industrial Promotion classifies small and medium-sized enterprises (SMEs) into three sectors: (i) production, including manufacturing and mining; (ii) service; and (ii) trading, including wholesale and retail.

2. Various agencies have used different criteria—based on the number of employees, annual sales revenue, net fixed assets, and registered capital—to define SMEs. Of these, the employment-related definition is most widely accepted, as it is not affected by changes in inflation rates or other economic parameters, and it is relatively easy to measure and keep track of the changing number of employees. The need for audited financial statements is also circumvented. Table A4.1 shows the definition of SMEs used by the Office of Small and Medium Enterprise Promotion (OSMEP), and the clear distinction between small enterprises and medium enterprises. This distinction in terms of number of employees may not be the same as adopted by some other organizations, although for SMEs as a whole, all concerned organizations adopt the same definition.1

Table A4.1: Definition of Small and Medium-Sized Enterprises

<table>
<thead>
<tr>
<th>Enterprise Type</th>
<th>Small Enterprises</th>
<th>Medium Enterprises</th>
<th>Small and Medium Enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production</td>
<td>100 or less</td>
<td>101–200</td>
<td>200 or less</td>
</tr>
<tr>
<td>Service</td>
<td>100 or less</td>
<td>101–200</td>
<td>200 or less</td>
</tr>
<tr>
<td>Wholesale</td>
<td>25 or less</td>
<td>26–50</td>
<td>50 or less</td>
</tr>
<tr>
<td>Retail</td>
<td>15 or less</td>
<td>16–30</td>
<td>30 or less</td>
</tr>
</tbody>
</table>

Source: Office of Small and Medium Enterprises Promotion.

3. In spite of relative clarity and stability regarding the employment-based definition of SMEs, there is considerable uncertainty regarding the number of SMEs, which reflects essentially that (i) various government agencies, including the Ministry of Commerce, Ministry of Industry, and Ministry of Labor, have mandates to register various types of SMEs; (ii) not all SMEs actually register, and the government bodies have differing capability and outreach to facilitate and ensure registration; (iii) a large number of SMEs are added each year, some of which do not need any financial support from recognized financial institutions or commercial banking channels; and (iv) a significant number of SMEs closures also occur each year.

4. Nonetheless, it is generally acknowledged that (i) the number of SMEs has been increasing rapidly since the 1990s; and (ii) at present, SMEs account for over 99% of Thai companies.2 According to the limited data available to the independent evaluation mission, about 124,800 SMEs were registered with the Ministry of Industry in 1998,3 while by 2009–2010, about 2.82 million SMEs were registered with the Ministry of Commerce.4

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1 For instance, the Small and Medium Enterprise Development Bank (SME Bank) defines small enterprises engaged in manufacturing and services as those with 50 or less employees. However, like OSMEP, the SME Bank also defines SMEs engaged in manufacturing and services, as those with 200 or less employees.


4 Thailand Business News 2010 (footnote 2).
OSMEP estimates the number of SMEs in Thailand on the basis of data available from various sources. It reconciles data from the following three distinct sources to arrive at reasonably robust time series data for the number of SMEs in the country: (i) census data compiled by the government’s National Statistical Office once every 10 years; the most recent year for which the census was conducted is 2006; (ii) registration data from the three relevant government ministries (commerce, industry and labor); and (iii) OSMEP’s own database of SMEs, which is being created as OSMEP’s multi-pronged SMEs support program unfolds. The reconciled and internally consistent time series data on the number of SMEs by type and location is available to the independent evaluation mission only for 2009. SMEs employment data is also available only for 2009. The data available for 2009 is presented in Table A4.2.

Table A4.2: Salient Small and Medium-Sized Enterprise Data, 2009

<table>
<thead>
<tr>
<th>Item</th>
<th>Number of SMEs</th>
<th>Number of Employees</th>
<th>Average Number of Employees per SME</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangkok</td>
<td>578,718</td>
<td>3,331,664</td>
<td>5.8</td>
</tr>
<tr>
<td>Central</td>
<td>559,839</td>
<td>2,438,360</td>
<td>4.4</td>
</tr>
<tr>
<td>Southern</td>
<td>391,489</td>
<td>840,466</td>
<td>2.2</td>
</tr>
<tr>
<td>Eastern</td>
<td>150,131</td>
<td>576,139</td>
<td>3.8</td>
</tr>
<tr>
<td>Northeastern</td>
<td>746,439</td>
<td>1,465,712</td>
<td>2.0</td>
</tr>
<tr>
<td>Northern</td>
<td>469,094</td>
<td>1,049,013</td>
<td>2.2</td>
</tr>
<tr>
<td>Total</td>
<td>2,896,106&lt;sup&gt;a&lt;/sup&gt;</td>
<td>9,701,354</td>
<td>3.5</td>
</tr>
</tbody>
</table>

SMEs = small and medium-sized enterprises.

<sup>a</sup> Includes 396 SMEs whose location is not known.

Notes:
1. The Central Region comprises (i) the upper central region 1 provinces of Nonthaburi, Ayutthaya, Pathum Thani, and Saraburi; (ii) the upper central region 2 provinces of Lop Buri, Sing Buri, Chai Nat, and Ang Thong; (iii) the sub-central region provinces of Chachoengsao, Samut Prakan, Nakhon Nayok, Sa Kaeo, and Prachin Buri; (iv) the lower central region 1 of Ratchaburi, Suphan Buri, Nakhon Pathom, and Kanchanaburi; and (v) the lower central region 2 provinces of Phetchaburi, Prachuap Khiri Khan, Samut Songkhram, and Samut Sakhon.
2. The Southern Region comprises (i) the Southern Gulf region provinces of Chumhon, Nakhon Si, Thammarat Phatthalung, and Surat Thani; (ii) the Andaman coast provinces of Krabi, Trang, Phang Nga, and Phuket; and (iii) the south border region provinces of Narathiwat, Pattani, Yala, Songkhla, and Satun.
3. The Eastern Region comprises the provinces of Chon Buri, Rayong, Chanthaburi, and Trat.
4. The Northeastern Region comprises (i) the upper northeastern region 1 provinces of Udon Thani, Nong Bua Lamphu, Nong Khai, and Loei; (ii) the upper northeastern region 2 provinces of Sakon Nakhon, Nakorn Phanom, and Mukdahan; (iii) the northeastern central region provinces of Kalasin, Khon Kaen, Maha Sarakham, and Roi Et; (iv) the lower northeastern region 1 provinces of Chaiyaphum, Nakorn Ratnasima, Buri Ram, and Surin; and (v) the lower northeastern region 2 provinces of Yasothon, Si Sa Ket, Amnat Charoen, and Ubon Ratchathani.
5. The Northern Region comprises (i) the upper north 1 provinces of Chiang Mai, Lampang, and Mae Hong Son; (ii) the upper north 2 provinces of Chiang Rai, Phayao, Phrae, and Nan; (iii) the lower north region 1 provinces of Phitsanulck, Tak, Suknothai, Uttaradit, and Phetchabun; and (iv) the lower north region 2 provinces of Nakhon Sawan, Uthai Thani, Kamphaeng Phet, and Phichit.

Source: Office of Small and Medium Enterprise Promotion.

Time series data on gross domestic product (GDP) contribution of SMEs (Table A4.3) shows that most SMEs are small enterprises, and that the SMEs’ contribution to GDP has been declining since 1999. Given their importance in terms of employment generation and contribution to GDP, SME’s have received significant government attention, including support in the project—where the proposed SMEs support and financing strategy covered three areas: debt financing, equity financing, and financial advisory services for SMEs.

In the area of debt financing, the consultant recommended (i) the Small Industry Finance Corporation (SIFC) to use commercial banks to onlend SIFC funds to SMEs by offering
concessional loans to commercial banks;\(^5\) (ii) the Small Industry Credit Guarantee Corporation to expand its range of risk sharing products with different fee rates and fee structures, and (iii) the IFCT to become a commercial bank so that it can provide broader services to its customers while diversifying its funding sources and reducing funding costs. In the area of equity financing, the consultants recommended that the government should encourage venture capital investment in SMEs by (i) reducing investor risk through measures such as tax incentives, shared financing, and funding of pre-listing appraisal and advisory services; (ii) increasing liquidity by creating secondary markets for small and less established companies; and (iii) utilizing its venture capital program to encourage more innovation by earmarking a portion of the SME Venture Capital Fund for early stage investments.\(^6\) In the area of financial advisory services, the consultants supported the implementation of (i) a pilot program to provide coordinated services to SMEs from a single location,\(^7\) and (ii) the development of a SMEs portal site.\(^8\) The consultant also conducted a training course on strategic management of SFIs, and designed an overseas training program that was to have been conducted after TA completion.\(^9\)

**Table A4.3: Other Small and Medium-Sized Enterprise Data**

<table>
<thead>
<tr>
<th>SME Contribution to GDP</th>
<th>1999</th>
<th>2005</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total GDP (B billion)</td>
<td>4,904,725</td>
<td>7,092,893</td>
<td>9,050,715</td>
</tr>
<tr>
<td>GDP from SMEs (B billion)</td>
<td>2,062,176</td>
<td>2,789,592</td>
<td>3,417,861</td>
</tr>
<tr>
<td>SMEs' share of GDP (%)</td>
<td>42.0%</td>
<td>39.3%</td>
<td>37.8%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Number of SMEs by Type in 2009</th>
<th>Small Enterprises</th>
<th>Medium Enterprises</th>
<th>SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade</td>
<td>1,368,459</td>
<td>3,029</td>
<td>1,371,488</td>
</tr>
<tr>
<td>Services</td>
<td>971,014</td>
<td>4,538</td>
<td>975,552</td>
</tr>
<tr>
<td>Production</td>
<td>542,556</td>
<td>4,496</td>
<td>547,052</td>
</tr>
<tr>
<td>Others(^a)</td>
<td>2,012</td>
<td>2</td>
<td>2,014</td>
</tr>
<tr>
<td>Total</td>
<td>2,884,041</td>
<td>12,065</td>
<td>2,896,106</td>
</tr>
</tbody>
</table>

GDP = gross domestic product, SMEs = small and medium-sized enterprises.

\(^a\) Type not known.

Source: Office of Small and Medium Enterprise Promotion.

**B. Role of the Office of Small and Medium Enterprises Promotion**

8. In recognition of the contribution of SMEs to employment creation and economic growth, the government set up OSMEP under the SMEs Promotion Act, 2000. OSMEP manages and finances three basic types of programs to assist SMEs and increase its outreach among SMEs:

(i) **Programs to broaden relationships with a large number of small and medium-sized enterprises.** In keeping with this objective, OSMEP compiles and disseminates data and information on parameters and issues pertaining to business planning, facilitating access to finance, etc. Such issues are of interest to a broad range of SMEs. For specific types of SMEs (i.e., those engaged in any specific

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\(^5\) The consultant also recommended the SIFC to establish expeditiously a Risk Management Department directly under the President while noting that it was vital for the SIFC to develop standards for risk management, which the organization will abide by regardless of political or personal preferences of the management so that prudent practices be maintained and the capital base of SIFC be protected.

\(^6\) The government set up the SME Venture Capital Fund in August 2000 with an initial investment of B1 billion to explore effective means of providing equity financing to commercially viable and strategically important SMEs.

\(^7\) This was labeled the one-stop-shop program. The consultants worked with FPO staff to develop a proposal for a pilot program to examine how a network of one-stop-shops could be designed and introduced in Thailand.

\(^8\) The consulting team entered into a contract with a local IT company to prepare a prototype SME portal site, and developed terms of reference for the creation of a full-fledged internet portal.

\(^9\) The consulting terms of reference included only the design of an overseas training program.
subsector such as food processing or handicrafts), OSMEP conducts or manages special studies/analyses to enhance their access to market opportunities. OSMEP may also offer a direct subsidy (financial support) to specific types of enterprises to enable them to participate in exhibitions or events both within and outside of Thailand.

(ii) **Program of advisory assistance to small and medium-sized enterprises.** Organizations such as government departments, state-owned enterprises, chambers of commerce and industry, other industry associations, and promotion councils, are required to submit proposals to OSMEP for specific types of advisory services targeted at certain types of SMEs. OSMEP evaluates the degree of alignment of the proposals with the government’s SMEs master plan and annual action plans, before it decides whether to support a particular proposal.

(iii) **Program of financial assistance to small and medium-sized enterprises.** OSMEP retains the option to provide up to 100% of registered equity capital for establishing new SMEs. OSMEP also plays a venture capitalist role. Thus far, OSMEP has supported and mentored about 60 SMEs as a passive investor; it has exited from five and remains involved with 55. From about 1,000 applications obtained for venture capitalist support, another 40 SMEs have been approved for support by the Policy Investor Board.

9. OSMEP prefers to support high growth sectors and enterprises for its venture capitalist and other programs. At present, OSMEP’s preferred sectors include (i) five sectors identified by the government in the late 1990s, soon after the Asian financial crisis (food, automobile, tourism, software, and functional design); (ii) additional sectors in the government’s expanded list (herbs, traditional medicines, alternative energy, spa); and (iii) hotels, restaurants, etc. in the coastal areas of southern Thailand, which had been affected by the tsunami in December 2004.

10. It is difficult for OSMEP to find information on unregistered SMEs. However, as OSMEP makes no distinction between registered and unregistered SMEs while arriving at decisions on whether to support them, OSMEP has been able to build a sizeable database of unregistered SMEs units. As of November 2010, OSMEP’s database included some 100,000 SMEs units; and since inception, it had offered assistance to about 10,000 SMEs units. This is a small fraction of the number of registered SMEs units.

C. **Specialized Financial Institutions’ Support to Small and Medium-Sized Enterprises**

11. While some established and financially viable SMEs are able to access commercial banks, many need to rely on specialized financial institutions (SFIs) or are not in a position to access any financial sector institution. Relevant information regarding the extent to which OSMEP supports SMEs that cannot or do not access the normal commercial banking channels is not readily available.

12. However, the SFIs support only a small fraction of all SMEs: (i) as of September 2010, the Small and Medium Enterprise Development Bank (SME Bank) had extended support to

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10 Independent evaluation mission is given to understand that thus far, OSMEP has provided 100% of registered equity capital for setup of three new SMEs; and 50% of registered equity capital for the setup of another three new SMEs.

11 In most cases, suitably experienced OSMEP staff provides the necessary mentoring. Only if highly specialized knowledge is required, does OSMEP rely on external specialists and experts for mentoring.

12 For support through all its programs, OSMEP establishes and transparently applies certain technical and financial criteria to screen applicants. SMEs’ registration status is not included in this list of criteria.
about 38,200 SMEs, or less than 2% of all registered SMEs; and (ii) by the end of 2009, the
Small Business Credit Guarantee Corporation (SBCG) had guaranteed loans for an even
smaller number of SMEs. Significant data on SME Bank SMEs clients is in Table A4.4 and on
SBCG SMEs clients in Table A4.5.

Table A4.4: Small and Medium-Sized Enterprise Borrowers of the
Small and Medium Enterprise Development Bank

<table>
<thead>
<tr>
<th>Item</th>
<th>2005</th>
<th>2009</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of SMEs borrowers, of which:</td>
<td>6,179</td>
<td>4,015</td>
<td>2,237 SMEs borrowers in 2006; 2,200 in 2007; 2,042 in 2008</td>
</tr>
<tr>
<td>Small Enterprise borrowers</td>
<td>5,701</td>
<td>3,495</td>
<td>1,924 small enterprise borrowers in 2006; 1,914 in 2007 and 1,868 in 2008</td>
</tr>
<tr>
<td>Medium Enterprise Borrowers</td>
<td>478</td>
<td>520</td>
<td>313 medium enterprise borrowers in 2006; 286 in 2007; 174 in 2008</td>
</tr>
<tr>
<td>SMEs in Bangkok metropolitan area</td>
<td>2,647</td>
<td>845</td>
<td></td>
</tr>
<tr>
<td>SMEs in provincial areas</td>
<td>3,532</td>
<td>3,170</td>
<td></td>
</tr>
<tr>
<td>Manufacturing SMEs</td>
<td>1,187</td>
<td>750</td>
<td></td>
</tr>
<tr>
<td>Service SMEs</td>
<td>3,068</td>
<td>2,236</td>
<td></td>
</tr>
<tr>
<td>Retail and Wholesale SMEs</td>
<td>1,443</td>
<td>733</td>
<td></td>
</tr>
<tr>
<td>Construction SMEs</td>
<td>182</td>
<td>146</td>
<td></td>
</tr>
<tr>
<td>Agriculture SMEs</td>
<td>299</td>
<td>150</td>
<td></td>
</tr>
</tbody>
</table>

SMEs = small and medium-sized enterprises.
Source: Small and Medium Enterprise Development Bank.

Table A4.5: Cumulative Number of Small and Medium-Sized Enterprise Loans
Guaranteed by the Small Business Credit Guarantee Corporation

<table>
<thead>
<tr>
<th>Item</th>
<th>1999</th>
<th>2004</th>
<th>2009</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of SMEs Loans guaranteed, of which:</td>
<td></td>
<td></td>
<td></td>
<td>Massive increase to reach 37,008 by 2010</td>
</tr>
<tr>
<td>Small enterprise loan guarantees</td>
<td>1,898</td>
<td>9,923</td>
<td>24,635</td>
<td></td>
</tr>
<tr>
<td>Medium enterprise loan guarantees</td>
<td>1,245</td>
<td>3,208</td>
<td>5,228</td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>510</td>
<td>1,351</td>
<td>2,266</td>
<td></td>
</tr>
<tr>
<td>Service</td>
<td>116</td>
<td>1,947</td>
<td>5,111</td>
<td></td>
</tr>
<tr>
<td>Wholesale</td>
<td>19</td>
<td>1,986</td>
<td>7,803</td>
<td></td>
</tr>
<tr>
<td>Retail</td>
<td>8</td>
<td>1,431</td>
<td>4,227</td>
<td></td>
</tr>
<tr>
<td>Located in Bangkok metropolitan area</td>
<td>504</td>
<td>2,514</td>
<td>7,016</td>
<td></td>
</tr>
<tr>
<td>Located in provincial areas</td>
<td>1,394</td>
<td>7,409</td>
<td>17,619</td>
<td></td>
</tr>
</tbody>
</table>

SMEs = small and medium-sized enterprises.
Note: There are many microenterprises in urban areas (such as street vendors that may employ as less as 1–2
people) and in rural areas (such as nonfarm activities initiated by farming families). The urban microenterprises
are normally served by the Government Savings Bank and the rural ones by the Bank of Agriculture and
Agricultural Cooperatives—although during 2006–2008, the Small and Medium Enterprise Development Board
had also supported microenterprises as required by the government of the time.
Source: Small Business Credit Guarantee Corporation.
1. **Expected technical assistance loan outputs (Parts 1 and 2).** According to the original project design, the outputs of the technical assistance (TA) loan were (i) financial audits of the selected specialized financial institutions (SFIs), (ii) operational diagnostic reviews of the selected SFIs, (iii) resolution of nonperforming loan (NPL) issues of the selected SFIs, and (iv) defined strategic roles of the selected SFIs and their operational plans.

2. **Actual technical assistance loan (Part 1) outputs.** The evaluation mission could access only the consultant’s inception report and midterm report. Along with the change of personnel in the executing and implementing agencies since project completion, this constrained the evaluation of the loan outputs. According to the inception report, the following priorities were to be established: (i) for all three SFIs included in Part 1, to assess the extent to which the financial statements deviate from International Accounting Standards (IAS) and assess the adequacy of financial provisioning and reserves vis-à-vis requirements under the IAS\(^1\) (referred to as “IAS gapping” in the inception report); and (ii) for the Small Industry Finance Corporation, to assess capital requirements to meet portfolio expansion related targets, relevant sensitivity analysis, and capital requirements to meet IAS norms of provisioning and other reserves (referred to as “capital planning” in the inception report). However, the midterm report acknowledged that the procedures performed during the TA consulting work did not constitute an audit in accordance with generally accepted auditing standards; and that the midterm report or any other report prepared as part of the TA could not express an audit opinion on the financial information presented to the TA consultants. This evaluation is of the view that the lack of rigorous financial audits reduced the significance of the TA, no matter how broad the scope of other TA outputs (such as the diagnostic reviews and recommended measures for operational plans) may have been.\(^2\)

3. **Other TA outputs.** An incomplete or insufficient grasp of the financial positions of the targeted SFIs limited the usefulness of the diagnostic review, and impeded the formulation of approaches and strategies to manage NPL related issues.\(^3\) Nonetheless, the diagnostic of SFIs’ risk management systems appears to have been among the most significant outputs delivered under this component. Feedback subsequently provided to the PCR mission was that (i) the Small and Medium Enterprise Development Bank (SME Bank) had implemented the consultants’ recommendations on credit operations, the risk management information technology (IT) framework, and reorganization; and acknowledged sufficient knowledge transfers; (ii) the Small Industry Credit Guarantee Corporation (SICGC) could not implement consultant recommendations as much as expected because the recommendations were too general and lacked sufficient detail, but acknowledged knowledge transfer in the areas of business strategy, risk management, credit guarantee processes, and risk-based pricing; and (iii) the Industrial Finance Corporation of Thailand (IFCT) had adopted a risk management framework as recommended by the consultants, but could not adopt other recommendations as they did not provide sufficient detail for implementation planning.

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\(^1\) The adequacy of provisioning norms and reserves is to be assessed in conjunction with the diagnostic work on the loan portfolio.

\(^2\) The consultant recommendations focused on (i) information technology (IT) development, treasury operations, and risk management (for the Industrial Finance Corporation of Thailand [IFCT]); (ii) business strategy, IT development, risk management, and treasury operations (for the SIFC); and (iii) business strategy, IT development, and risk management (for the Small Industry Credit Guarantee Corporation [SICGC]).

\(^3\) For the IFTC and SIFC, the consulting team conducted loan portfolio reviews of sample borrowers, but did not present any meaningful findings of such reviews in the midterm report. For the SICGC, the midterm report highlighted a few issues without indicating the research method used.
4. **Actual technical assistance loan (Part 2) outputs.** Evaluation of the outputs was constrained by the fact that the evaluation mission could access only the inception report, the midterm report, and the loan portfolio audit review report. According to the requirements of the TA framework, the consulting team delivered outputs in the five areas: (i) diagnostic review, (ii) financial audit, (iii) loan portfolio audit (LPA), (iv) restructuring plan development, and (v) workout and capacity building assistance. Based on the diagnostic review, the financial audit, and the LPA (Box A5), the consulting team provided a set of recommendations on the Bank for Agriculture and Agricultural Cooperatives’ (BAAC’s) NPL management as well as the proposed capacity building initiatives in broad areas that included governance, planning, human resource management, banking services, risk management, and a management information system (MIS). Feedback on TA outputs subsequently provided to the PCR mission was that (i) BAAC implemented some of the consultant recommendations, such as rolling corporate and business plans, and acknowledged the TA’s contributions toward improved operational efficiency; and (ii) BAAC relied on policies of the Ministry of Finance (MOF) regarding the adoption of recommended changes on asset classification and provisioning.

**Box A5: Key Findings from the Bank for Agriculture and Agricultural Cooperatives**

The financial audit and the loan portfolio audit (LPA) were conducted well, and served the project outcomes, especially toward determination of the Bank for Agriculture and Agricultural Cooperatives’ (BAAC) financial requirements. The “financial audit” revealed that the decrease of BAAC’s regulatory capital adequacy ratio, or the Bank for International Settlements ratio, from the computation by BAAC at 8.45% to 0.61%, was mainly due to the proposed adjustment of additional loan loss provisions for doubtful accounts amounting to over B20 billion. On this basis, the financial audit team estimated BAAC’s additional capital need of B19.6 billion to maintain the Bank for International Settlements ratio at the Bank of Thailand’s minimum requirement for banks (8.5%).

The LPA estimated about 30% of gross farmer loans as nonperforming loans at the end of March 2001, compared with 15.3% reported by BAAC. On this basis, the LPA team recommended additional loan loss provisions of at least B32.5 billion. In addition, the LPA highlighted an increased risk of loss in the Debt Suspension Program portfolio, which effectively provided a grace period of 3 years for all payment and 3-year extension of maturities for B53 billion of the farmers’ loan portfolio.

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4 The diagnostic team evaluated the following aspects of BAAC operations: (i) governance, (ii) strategic planning and budgeting process, (iii) personnel and human resource development, (iv) credit risk management process, (v) management information systems, (vi) risk management, and (vii) banking services development.
5. **Expected technical assistance grant (component I) outputs.** The original TA framework presented the expected outputs of this component: (i) to rationalize government intervention in the financial sector and SFIs, (ii) to develop a corporate governance framework for SFIs, and (iii) to conduct capacity building. The findings on the TA outputs under this component are based on the reviews of various reports prepared by the second consulting team, which are available in the project files.5

6. At the end of Phase 1, the second consulting team grouped the expected TA outputs into two sections: (i) a corporate governance framework, and (ii) corporate governance systems for the four SFIs. Section 1 comprised four outputs: (i) an SFI monitoring system at the Fiscal Policy Office (FPO) and State-Owned Enterprise Policy Office (SEPO), for pilot implementation in Phase 2; (ii) a Code of Best Practice in Corporate Governance for SFIs (SFI CG Code) and recommendations for its phased compliance (for pilot implementation in Phase 2); (iii) prototype Articles of Association for SFIs, in compliance with the SFI CG Code, which could be tailored to and adopted by the four targeted SFIs (for pilot implementation in Phase 2); and (iv) Implementation Guidelines for the SFI CG Code (for pilot implementation in Phase 2). Section 2 comprised (i) improved corporate governance structures and practices, underwritten by the adoption of the SFI CG Code and articles of association (for pilot implementation in Phase 3); (ii) an improved integrated risk management system framework, focused on upgrading of the credit risk management system (for pilot implementation in Phase 3); (iii) a public service account (PSA) system (for pilot implementation in Phase 2); (iv) an improved disclosure and reporting system (for pilot implementation in Phase 2); and (v) recommendations on measures to strengthen the system of internal control (for pilot implementation in Phase 3). Analysis and recommendations on the phaseout of subsidies and other privileges to SFIs (as part of the work to rationalize government intervention in the financial sector and SFIs) was excluded from the output list, and reflected a change in government priority.

7. **Actual technical assistance grant (component I) outputs.** At completion of the TA implementation, the consulting team classified its outputs into three main areas: (i) corporate governance, (ii) PSA, and (iii) monitoring and MIS/IT system. In the area of corporate governance, the key consultants’ outputs included the SFI CG Code, the draft articles of association, and other related documents customized for BAAC as the pilot SFI. To date, the MOF has not formalized the SFI CG Code, and BAAC has not adopted the articles of association. According to the consultant (footnote 5), the two key reasons for the slower-than-expected progress in implementation of the SFI corporate governance systems were (i) the unresolved issue of who (the FPO or SEPO) has or should have responsibility for the corporate governance development of SFIs, and (ii) the FPO’s top priority during the TA implementation period—development of PSA and the monitoring MIS/IT system—as a result of which it committed less resources and time to deal with corporate governance related matters. However, the evaluation team noted that since the early 2000s, BAAC, SME Bank, and the SICGC have made efforts to strengthen their corporate governance by introducing several committees and subcommittees under their respective boards. Meanwhile, because of the change in the priority areas of TA, reflecting the new government policy direction, no study was conducted under the

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5 The second consulting team found that (i) the weaknesses identified by the original consulting team had been broadly accurate, but (ii) their recommendations had been piecemeal and lacked an overall framework. No coherent and consistent set of corporate governance principles had been compiled in accordance with which improved systems could be based in the SFIs (ADB. 2002. Restructuring of Specialized Financial Institutions. Consultant’s final report for Phase 1, Manila (Grant 3355-THA, October). Upon review of the original consultant’s final report, the evaluation team agrees with the second consultant’s findings. The evaluation team also noted that according to its stated terms of reference, the original consultant team allocated a significant part of its resources to the analysis of rationalization of government intervention in the financial sector and SFIs.
TA grant on the existing subsidies and other privileges accorded to SFIs (such as tax exemptions and a BOT reserve requirement).

8. The consultants developed the analytical framework for the PSA and a generic functional system on the basis of extensive discussions with the FPO and the four pilot SFIs (BAAC, SME Bank, SICGC, and Export–Import Bank of Thailand [EXIM]). The consultants also assisted the four pilot SFIs to make full PSA submissions to the FPO, and assisted the FPO in the review of those submissions. On this basis, the four SFIs subsequently submitted the Government Compensation Request and stated their estimates of compensation requirements for the next fiscal year; BAAC and the SICGC also submitted details of the proposed methods of compensation for the FPO’s consideration. It was expected that by the end of Phase 2, it would be possible to fine-tune the PSA system on the basis of these submissions, and the application of the PSA already undertaken by SFIs. Further training of FPO staff in financial analysis, and mainstreaming of the PSA system were expected to be the key deliverables in Phase 3. However, in keeping with the FPO’s advice, most of these expected deliverables were dropped.6 In the area of monitoring and MIS, in Phases 2 and 3, the consulting team developed the reporting system (for SFIs’ data entry) and the monitoring system (for the MOF) comprising the following datasets: (i) PSA and financial information, (ii) key performance indicators (KPIs) related to the performance evaluation systems used by SEPO, (iii) corporate governance dataset, (iv) early warning indicators, (v) portfolio dataset, (vi) executive summary, and (vii) value for money dataset. The consultant’s report noted that the priority for further initiatives in the PSA and monitoring system should lie in consolidating what has been achieved, and in ensuring that the FPO is capable of using the system that has been developed. The MOF has not fully operationalized the PSA thus far.7 On the other hand, the MOF has tightened its monitoring of SFIs by tasking a rating agency to conduct KPI-based evaluations regularly.

9. **Expected technical assistance grant (component 2) outputs.** The expected outputs of this component were (i) to determine various modalities and schemes, and develop a regulatory and incentive framework for small and medium-sized enterprises’ (SMEs’) financing; (ii) to determine and evaluate options for setting up financial institutions to support SMEs development; and (iii) capacity building for SMEs financing.

10. **Actual technical assistance grant outputs (component 2).** The consultant’s final report8 classified the proposed SMEs financing strategy into three areas: (i) debt financing, (ii) equity financing, and (iii) financial advisory services. In the area of debt financing, the consultant recommended (i) the SIFC to use commercial banks to onlend SIFC funds to SMEs

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6 According to ADB. 2004. *Restructuring of Specialized Financial Institutions*. Consultant’s draft final report for Phase 3. Manila (Grant 3355-THA, March), the FPO considered that the Phase 3 deliverables on the PSA were largely superfluous owing to the short time lines between completion of Phase 2 and Phase 3 (November 2003–January 2004). Besides, the FPO wanted the TA project’s time and resources to focus on deliverables for the monitoring and MIS/IT system requested.

7 Both BAAC and the SME Bank pointed to the independent evaluation mission the (i) difficulties that they have experienced to reach consensus with (and obtain approval from) the MOF in delineating the existing policy loan portfolio from the commercial portfolio, and (ii) a need for realigning their organizational structures to facilitate the PSA system. In addition, BAAC pointed out that the reimbursements from the government to compensate for its policy lending have lagged, and that at the end of March 2010, B130,466 million was reflected in its books as accounts receivables from the government.

by offering concessional loans to commercial banks;\(^9\) (ii) the SICGC to expand its range of products by offering a bouquet of risk coverage with different fee rates and fee structures, and (ii) the IFCT to become a commercial bank so that it could provide broader services to its customers while diversifying its funding sources and reducing funding costs. In the area of equity financing, the consultants recommended the government to encourage venture capital investment in SMEs by (i) reducing investor risk through measures such as tax incentives, shared financing, and funding of pre-listing appraisal and advisory services; (ii) increasing liquidity by creating secondary markets for small and less established companies; and (iii) utilizing its venture capital program to encourage more innovation by earmarking a portion of the SME Venture Capital Fund for early stage investments.\(^10\) In the area of financial advisory services, the consultants supported the implementation of (i) a pilot program to provide coordinated services to SMEs from a single location,\(^11\) and (ii) SMEs Portal Site development.\(^12\) The consultant also conducted a training course on strategic management of SFIs, and designed an overseas training program that was to have been conducted after TA completion.\(^13\)

11. The consultant report highlighted the shortage of reliable SMEs lending data as a constraint to promote SMEs financing—an issue that has not been addressed sufficiently well thus far.

12. Feedback on TA outputs subsequently provided to the PCR mission were that (i) the IFCT found the transferred knowledge useful for improving its SMEs center, and it also set up the single-window SMEs assistance facility on a pilot basis; (ii) the SME Bank found the transferred knowledge useful for its restructuring program and developing a business model, and it had adopted several recommendations; and (iii) the SICGC found the transferred knowledge useful in setting up a warranty policy for SMEs, although it had not implemented any of the recommendations.

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\(^9\) The consultant also recommended the SIFC to establish a Risk Management Department expeditiously directly under the President while noting that it is vital for the SIFC to develop standards for risk management that the organization will abide by regardless of political or personal preferences of the management so that prudent practices will be maintained and SIFC’s capital base protected.

\(^10\) The government set up the SME Venture Capital Fund in August 2000 with an initial investment of B1 billion to explore effective means of providing equity financing to commercially viable and strategically important SMEs.

\(^11\) This was labeled the one-stop-shop program. The consultants worked with FPO staff to develop a proposal for a pilot program to examine how a network of one-stop-shops could be designed and introduced in Thailand.

\(^12\) The consulting team entered into a contract with a local IT company to prepare a prototype SME portal site, and developed terms of reference for the creation of a full-fledged internet portal.

\(^13\) The consulting terms of reference included only the design of an overseas training program.