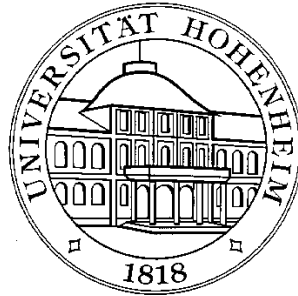


**Institute of Agricultural Economics and Social Sciences
in the Tropics and Subtropics**



**Credit for Poor and Low-Income Entrepreneurs
in Urban and Rural Northern Thailand**

Paper presented at the 4th ASEAN Inter-University Seminar on Social Development
June 16th – 18th 1999, Pattani, Thailand

Dipl.oec. Wolfram Erhardt

Discussion paper No. 99/04

July 1999

University of Hohenheim
Stuttgart
GERMANY

Table of Contents

1	INTRODUCTION.....	3
2	SMALL ENTERPRISES AND FINANCIAL INSTITUTIONS.....	4
2.1	The Research Area: Chiang Mai Province	4
2.2	Small Enterprises.....	4
2.3	Types of Financial Institutions in Chiang Mai Province	5
3	CREDIT TECHNOLOGIES OF FINANCIAL INSTITUTIONS IN CHIANG MAI PROVINCE.....	7
3.1	Commercial Banks	7
3.2	Bank for Agriculture and Agricultural Co-operatives (BAAC)	8
3.2.1	General Information	8
3.2.2	Joint Liability Groups.....	8
3.2.3	Credit Products and Credit Life Cycle	9
3.3	Co-operatives	11
3.3.1	Co-operatives in Thailand	11
3.3.2	Mae Tang Agricultural Co-operative	11
3.4	Pawnshops	13
3.4.1	Government pawnshops	13
3.4.2	Private pawnshops	15
3.5	Traders Credit	16
3.5.1	Overview	16
3.5.2	Hire-purchase dealers	16
3.6	Moneylenders.....	18
3.7	Other Financial Institutions	20
3.7.1	Len Shares (RoSCAs).....	20
3.7.2	Friends and Family Members	21
4	THE BROADER ISSUE: SMALL ENTERPRISE FINANCE AND ASSISTANCE IN NORTHERN THAILAND	22
	REFERENCES	24

List of Tables

Table 1: BAAC loan terms for individual farmers	9
Table 2: Types and number of co-operatives (as of Jan. 1997).....	11
Table 3: Loan terms of Mae Tang Agricultural District Co-operative.....	12
Table 4: Internal and external problems in the Thai co-operative sector.....	13
Table 5: Government pawnshops in Chiang Mai Province.....	14
Table 6: Interest rates of government pawnshops in Chiang Mai province.....	14
Table 7: Credit contracts of government and unofficial pawnshops.....	16

List of Graphs

Graph 1: The financial continuum in Chiang Mai Province	6
Graph 2: Credit Technology: Credit Product and Credit Life Cycle.....	7
Graph 3: BAAC's development	10

List of Maps

Map 1: Chiang Mai Province	4
----------------------------------	---

Abbreviations

BAAC	Bank for Agriculture and Agricultural Cooperatives
RoSCA	Rotating Savings and Credit Association

Contact:

Dipl.oec. Wolfram Erhardt
University of Hohenheim
Institute 490a
70593 Stuttgart
Tel.: +49-711-459-2581
Fax: +49-711-459-2582
Email: mail@wolfram-erhardt.de

The research is funded by scholarships granted by the Land Baden-Württemberg, the German Academic Exchange Service (DAAC) and a Herzog-Carl-Stipendium; their support is gratefully acknowledged.

1 Introduction

Before the recent crisis, Thailand had become synonymous with spectacular economic growth. Thailand was the world's fastest growing economy in the decade from 1985 until 1995.¹ Per capita income increased dramatically; numerous other economic indicators reflect this boom in like manner. Thailand was going to join the club of Asian Tigers and only few observers called into question that often cited "economic miracle".

Rather, to most observers the crash of the Thai economy in mid 1997 came as a complete surprise. In rapid succession the shock waves not only reached other countries throughout the Asian region but also had repercussions on both emerging and developed economies of the Western Hemisphere. What started as a currency crisis, quickly turned into a liquidity crisis pushing banks as well as private and public enterprises at the brink of collapse. In 1998, the financial crisis eased off but in the same year - ironically the year of the tiger in the Chinese calendar - the symptoms were only about to be increasingly felt in the real economy.

Some of the negative features of the past boom had persistently been concealed by the news of success. The probably most striking one being the fact that Thailand has developed into one of the most unequal societies in terms of income distribution. There are sharp disparities between urban and rural areas, industry and agriculture, poverty and wealth. It was the economic crisis that finally forced the public to pay more attention to the situation of the country's poor as well as the regional and sectoral imbalances the boom has brought about.

It is widely known that a large share of low income people in developing countries derive a considerable part of their household income from small and micro-enterprises, many of which operate outside a society's formal infrastructure. Healthy development of a small and medium sized enterprise sector - comparable to the German "Mittelstand" - has considerable and largely underestimated potential to tackle the economic disparities mentioned above.

It seems that neither poverty oriented research nor donor funded poverty alleviation programs are at the centre of interest in Thailand - a country that not only has become food self-sufficient but has turned into one of the world's most important exporters of agricultural products. As compared to most African, Latin American and many Asian countries - only little information is available about small enterprises in rural and urban areas of Thailand, about the socio-economic situation of the country's self employed poor and particularly about the financial behaviour of low-income classes. There are a number of factors that are of relevance for the development of small and medium enterprises. Among them access to finance stands out as a key element. This paper attempts to provide some insight into the supply side of small enterprise finance in Northern Thailand. It will review the institutional characteristics and finance technologies of formal and informal financial institutions in urban and rural areas. On this basis it will try to formulate policies and measures that are needed to facilitate

¹ Between 1985 and 1995, real average annual growth of GDP amounted to 8.4 percent (World Bank 1997).

access of small end medium enterprises to financial services and thus help to promote the development of this part of the economy

2 Small Enterprises and Financial Institutions

2.1 The Research Area: Chiang Mai Province

Previously, research on small enterprises was directed mainly to rural areas (under the regional aspect) and farmers (under the sectoral aspect). Furthermore, rural areas were often dealt with in a rather uniform way. Thus, the sharp socio-economic differences

Map 1: Chiang Mai Province



within and between different regions of Thailand had rarely been taken into account. Northern Thailand displays not only very unevenly developed rural areas but also accommodates major Thai cities such as Chiang Mai, Chiang Rai and Pitsanulok. Due to its marked rural-urban gradient, Chiang Mai province makes an especially interesting research region to compare urban with rural areas. The province embodies a pronounced urban centre - the provincial capital Chiang Mai is Thailand's second biggest city - , often better developed lowland villages and generally less developed villages in the up- and highlands.

In order to account for urban-rural differences, the paper analyses financial institutions along this rural-urban gradient. For the field research three villages were selected comprising two lowland villages (Muang Chum, Mae Tang district and Huai Sai, Chom Thong district) as well as one highland village (Kongsang, Omkoi district). The urban research site was confined to the boundaries of the town district (amphoe muang, see Map 1).

2.2 Small Enterprises

In this study, the term "enterprise" is meant to be a unit of economic activity that - in the form of self-employment - is directed at the pursuit of profit on a long-term basis and involves a strong element of personal or capital risk.

There is no generally accepted definition that distinguishes "small enterprises" from those of other sizes. In the Thailand case, each government institution uses a different, mostly quantitative, definition tailored to its individual needs. In general, quantitative criteria are applied to classify enterprises into different size classes, the number of employees, the value of productive assets, the sales per period or a combination of these criteria being the ones most frequently used. There is no theoretical concept, though, that would suggest a specific criterion, the number of categories or the

appropriate cut-off points. Quantitative indicators will always lead to somewhat arbitrary results. In the case of entrepreneurial activities of poverty and low-income groups in Thailand, qualitative criteria could contribute to a more suitable definition of small enterprises. Thus, low capital intensity, informality, low market entry barriers, low division of labour and the use of simple technology are some of the most important qualitative attributes of small enterprises, not only in Northern Thailand. Although it is possible to operationalise many of the qualitative criteria, they are not always applicable and do not uniformly account for the variety of small enterprises observable in urban and rural Thailand. We will, therefore, select a quantitative definition for the purposes for this paper. A small enterprise is deemed to be one, which employs up to five non-household members at the time of the survey. This definition will include other, more qualitatively oriented definitions such as "micro-enterprise", "cottage industry" and "informal enterprise". The definition will be broader, though, in that it also includes those enterprises that are small but formal and/or apply modern technology. In this way, a broader spectrum of enterprises will be addressed, i.e. also those with a presumed higher development potential than those operated by the hard-core poor.

It has been generally realised that in the case of poor and low-income entrepreneurs the private household forms a financial unit with the business sphere. Due to the fungibility of money it is not possible to trace one Baht obtained from, say the BAAC or a local moneylender to a specific investment or consumptive purpose. It is furthermore difficult, if not impossible, to draw a clear and unambiguous line between investment and consumption. The acquisition of a new television set might predominantly serve consumptive purposes; it also can convey information about markets, business prospects and labour availability. School fees will by most be considered an investment into future labour productivity. In the case of food and health expenses a separation is also difficult. Although at first sight we do not recognise a direct investment-return-cycle, food and health expenses, too, basically serve maintaining the productivity of labour - the most important and sometimes only productive factor of poor and low-income groups.

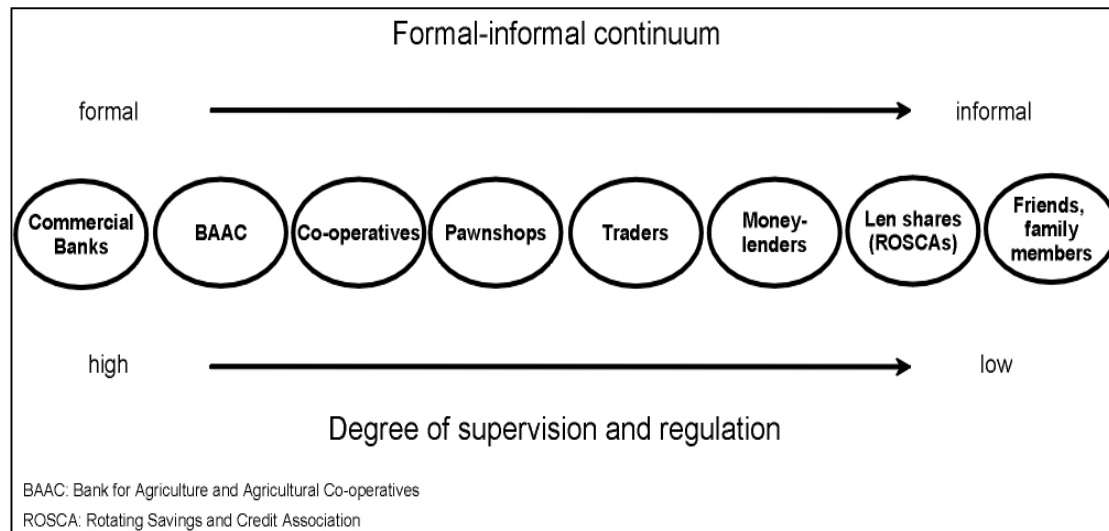
2.3 Types of Financial Institutions in Chiang Mai Province

This discussion leads us to the conclusion that we have to cover all those financial institutions that provide financial services for the business as well as the private household sphere of small entrepreneurs. As it is widely known, financial institutions are generally divided into formal and informal institutions. Informal financial institutions operate outside the legal infrastructure of an economy and are not subject to financial sector regulations such as capital, reserve and liquidity requirements, ceilings on lending and deposit rates, mandatory credit targets, as well as auditing and reporting requirements (e. g. Ghate 1988; Krahen/Schmidt 1994).

A strictly dichotomous classification is not always possible, though. It does not reflect that there is a grey area of different degrees of supervision and regulation that single financial institutions are subject to. The term "semi-formal" - as suggested by Seibel - has been used to characterise those institutions that are officially registered but not subject to banking supervision and regulation, such as co-operatives and NGOs. To account for the gradual transition from closely supervised to completely unregulated

institutions in Thailand, it seems more appropriate to view financial institutions along a formal-informal continuum. The small enterprise survey revealed that in Chiang Mai Province this continuum ranges from commercial banks and the Bank for Agriculture and Agricultural Co-operatives (BAAC), over co-operatives, public and private (illegal) pawnshops to moneylenders, traders, len shares (the Thai form of rotating savings and credit associations, ROSCAs in short) and, finally, friends and family members (see Graph 1).

Graph 1: The financial continuum in Chiang Mai Province

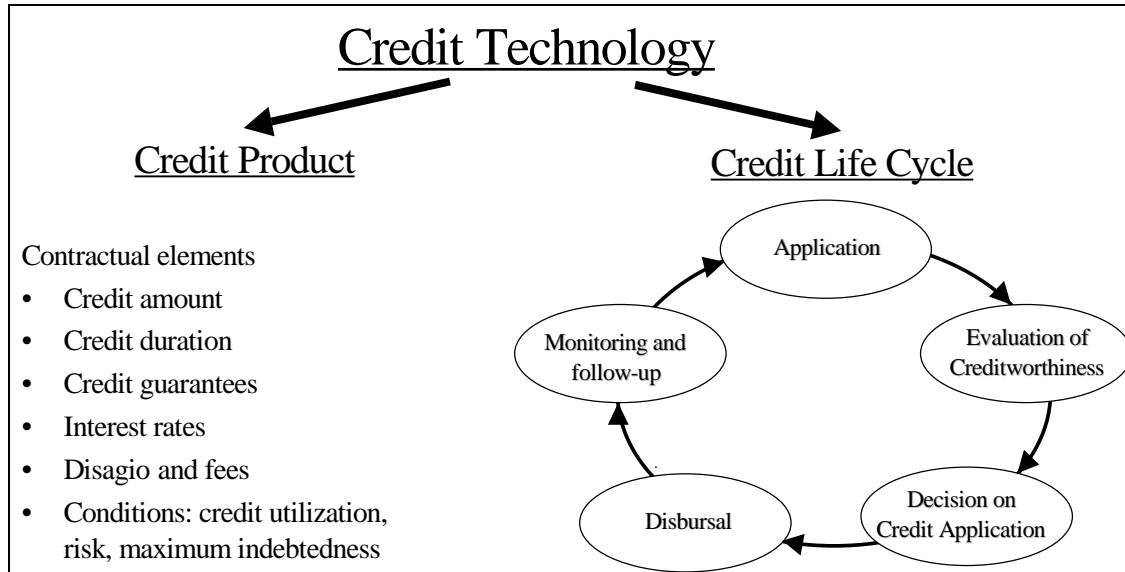


Source: Microfinance Survey 1997/1998

The entirety of financial services offered by financial institutions along the formal-informal continuum comprises - according to each individual institution - a more or less diverse mix of credit, savings, insurance, money transfer and other services. Although reference will be made to non-credit financial services, the main emphasis here will be put on the credit technologies applied by these institutions.

"Credit technology" means "the entire range of activities carried out by a credit-granting institution which include selecting borrowers, determining the type of loan to be granted, the loan amount and maturity and the way in which it is to be secured, as well as the monitoring and recovery of loans (Schmidt/Zeitinger 1994). For analytical purposes, the term credit technology combines two aspects: firstly, the credit product itself, i. e. the contractual elements credit amount, duration, cost of credit and guarantees and, secondly, in a dynamic view, the credit life cycle, i. e. the process from the application and disbursement, through the repayment of credit until the follow-up in case of non or late payment (see Graph 2).

Graph 2: Credit Technology: Credit Product and Credit Life Cycle



3 Credit Technologies of Financial Institutions in Chiang Mai Province

3.1 Commercial Banks

The credit technology of Thai commercial banks, including finance companies, coincides with those applied by banks in other developing and developed countries. The evaluation of creditworthiness is, firstly, asset-based and relies, secondly, on the credit applicant's provision of meaningful and attested documents such as balance sheets and profit and loss statements. Larger-sized, formal enterprises are usually able to comply with these requirements and tend to be more credit-worthy in the sense of traditional credit-technologies. Small entrepreneurs' access to commercial banks - especially in rural areas -, however, is often impeded by a variety of factors:

- Entrepreneurs lack assets that could be pledged as collateral (e. g. titled land and machinery)
- Small entrepreneurs do not keep any or, at most, informal records
- Commercial banks favour lower risk credits, e. g. they shy away from agriculture
- Low-educated, often illiterate entrepreneurs cannot comply with the red-tape associated with loan application
- Processing of loan applications sometimes takes unacceptably long
- Small entrepreneurs demand credit amounts that are considerably lower than minimum loan amounts of commercial banks
- The remoteness of small enterprise households from urban centres makes it necessary to undertake costly and time-consuming trips to the banking outlets
- There are socio-cultural barriers between (urban) middle and upper class bank employees and poor entrepreneurs.

These factors lead to high transaction costs. If we relate transaction costs to the credit amount (per-unit transaction costs) it becomes clear that it is particularly the small and

short-term credits - i. e. small enterprise credits - that are costly for banks as well as borrowers. For that reason, commercial banks commonly play a role only for larger-sized enterprises in urban and rural Chiang Mai Province, but generally not for low-income groups and poor entrepreneurs.

3.2 Bank for Agriculture and Agricultural Co-operatives (BAAC)

3.2.1 General Information

Realising that small entrepreneurs, particularly in agriculture, were systematically excluded from commercial bank lending, development banks were established in many developing countries. These development banks should assume the task to lend to small entrepreneurs, often at subsidised rates of interest. The performance of many of these banks did not prove satisfactory, though. Institutional inefficiencies, limited outreach and ongoing subsidy dependence led to their closure or fundamental reorganisation. Among these state-owned development banks, the Thai Bank for Agriculture and Agricultural Co-operatives (BAAC) makes such noteworthy exception that in a recent publication its approach and institutional set up was named "The BAAC Success Story" (Sacay et al. 1996).

The BAAC was founded in the year 1966 as a specialised financial institution under government ownership. The Ministry of Finance holds 99.7% of the shares. The Bank of Thailand exempts BAAC from supervision and regulation. BAAC's operations are highly decentralised in form of an extensive rural network that comprises 657 branches and sub-branches in addition to 850 field offices. The branches are largely autonomous. Credit officers are responsible for farmer training, credit application, monitoring and repayment. Besides credit, BAAC has increasingly focused on savings mobilisation (since the mid-1980s) and also offers insurance products.

3.2.2 Joint Liability Groups

The so-called joint-liability groups are BAAC's main credit delivery channel and form the centre of BAAC's credit technology for small farmers. They are operated on the village level in almost all farming villages nation-wide; some of the larger villages maintain two or more groups. Each group consists of between five and thirty members. The mutual liability means that a loan made to an individual group member becomes the joint liability of the entire group. (In practice, however, BAAC does not exclude the entire group from further credit as long as an individual loan is in default.) The joint liability substitutes traditional forms of loan guarantees which was even more important some decades ago when most of the farmers did not have any enforceable rights to their land assets. The groups do not act as financial intermediaries, though, which means that loans are made not to the group as a whole but to individual farmers. For BAAC, the groups perform the following main functions:

- Peer pressure exercised by other group members intensifies borrowers' willingness to repay and reduces BAAC's loan defaults;
- Decision on group membership by other group members makes use of in-depth knowledge of loan applicants' business and private circumstances.
- Processing and verification of data of loan applicants saves part of administrative duties otherwise to be carried out by bank personnel;

- Groups serve as information channel into the villages about new BAAC policies and products.

Although the joint liability groups clearly help BAAC to reduce risk and administrative costs some drawbacks of the group approach have to be mentioned:

- Target group level: The shift of certain elements of loan administration from the bank onto the group causes higher borrower transaction costs as compared to the individual credit approach. This negatively affects the overall value of the credit services (Heidhues et al. 1997)
- Institutional level: BAAC forgoes direct borrower information. Institutional learning processes and efficiency can be negatively affected (Schmidt and Zeitinger 1994).
- Whereas group cohesion is relatively high in the Thai rural milieu, it can be expected to be far less strong in urban areas and with increasing labour mobility.

3.2.3 Credit Products and Credit Life Cycle

BAAC provides credit to individual farmers, farmer institutions (co-operatives and farmer associations) and acts on behalf of government agencies. Individual farmers can access BAAC credit against collateral (above all mortgage of immovable property) and, as members of joint liability groups, collateral-free. The duration, maximum loan amounts and interest rates for short, medium and long-term credits are summarised in Table 1.

Table 1: BAAC loan terms for individual farmers

	Short-term	Medium-term	Long-term
Duration	Up to 12 months	Up to 3 (5) years	Up to 15 (20) years
Maximum loan amounts	Baht 15m JLG up to Baht 60,000	Baht 15m JLG up to Baht 60,000	Baht 15m
Interest rates	9% up to Baht 60,000 12.25% up to Baht 1m 14.5% over Baht 1m	9% up to Baht 60,000 12.25% up to Baht 1m 14.5% over Baht 1m	9% up to Baht 60,000 11.25% up to Baht 1m 13.5% over Baht 1m

Period 4/1996 - 03/1997

JLG = Joint liability groups

Source: BAAC (1997)

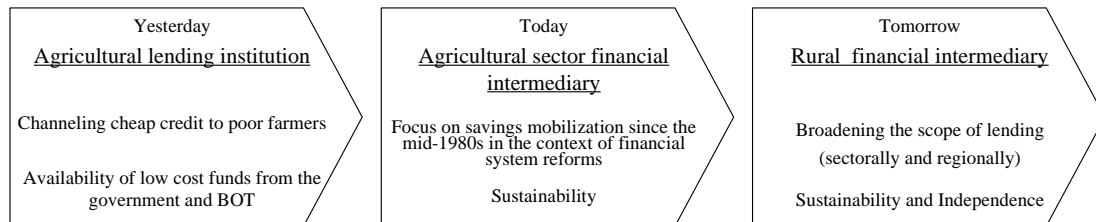
The joint liability groups play a major role throughout the entire credit cycle. Borrowers can conveniently apply for new credits at their group leader's house. The group leader is responsible for collecting all relevant client data and passing it on to the local BAAC outlet. This has been an utmost convenient and cost-efficient way for credit application - as long as farmers in a specific village had homogenous production programmes. This relatively rigid loan application process has become a problem, however, as income sources of farming households today are much more diversified, both within and outside agriculture.

The credit officer responsible for the specific village undertakes the evaluation of the loan applicant's ability and willingness to repay. The final decision on whether or not to approve the credit and any modifications in the loan terms are made by the credit officer, in case of higher loan amounts, jointly with the credit and/or branch managers. The contracts then will be signed at a village group meeting, usually held

at the village temple. Some days later, the loan will be disbursed into clients' BAAC accounts and can be withdrawn according to each borrower's needs. BAAC regulations still require credit officers to monitor the loan use. This seems to be hardly done any more, particularly since it has been realised that the loan use is barely observable anyway. Credit officers will, however, follow up on late payments and each client will only be entitled to a new credit after the old one has been repaid completely.

In reality, the joint liability seems not to be effectively enforced. In none of the three district branches responsible for our study villages, has there ever been a group called to account for the default of one of its members. Moreover, BAAC does not require each individual group member to repay his debt before any member might apply for a new credit. Rather, each group member is independently dealt with. Therefore, it has to be studied in more detail, in how far the joint liability system effectively fulfils its primary role, i. e. to exercise peer pressure in order to maximise borrowers' willingness to repay. Or is it that the groups are mainly utilised as an institutional cost saving mechanism? In this case, outright individual credits, priced at market rates of interest, could prove to be much more valuable for increasingly self-confident entrepreneurs acting in an increasingly diversified rural economy. As proved elsewhere, it is not cheap funds, often available via rigid application and disbursement processes only, what small entrepreneurs in urban and rural areas actually ask for. Poor entrepreneurs are willing to pay for adapted credit services that provide relatively small credit amounts for relatively short periods of time and that made available extremely swiftly and on an ongoing, long-term basis.

Graph 3: BAAC's development



The restricted scope of lending has been another peculiarity of BAAC lending. Until recently, solely farmers were eligible for borrowing and they could do so for agricultural purposes only. The scope of lending was broadened in 1993 to include farmers with agricultural-related activities and, only recently, non-agricultural activities. The gradual expansion of BAAC's scope of lending must be seen as a reaction to the impressive economic and social development that has taken place in rural Thailand. The rural economy is much more diversified today than, say, a decade or two, ago. Although considerable progress has been made in upgrading BAAC from a mere agricultural lending institution to an agricultural sector financial intermediary, institutional development remains to be a challenge. BAAC will continue to assume a vital role in supporting the rural areas of Thailand. Rural development is more than only agriculture, though. In order to become a genuine rural financial intermediary, BAAC has to expand sectorally to non-farming businesses and regionally to urban areas, located both upcountry and in the Greater Bangkok Area (see Graph 3). Ongoing institutional development seems to be all the more pressing considering the

fact that BAAC is already operating in a highly saturated market: it claims to reach almost 85% of all farm families countrywide (BAAC 1997).

3.3 Co-operatives

3.3.1 Co-operatives in Thailand

The first co-operative in Thailand - a small village credit co-operative in Pitsanulok - was established in 1916 (Co-operative Promotion Department 1997). Subsequently, also other types of co-operatives (such as paddy, marketing, land improvement and land settlement co-operatives) emerged and steadily spread throughout the country.

Table 2: Types and number of co-operatives (as of Jan. 1997)

Type	Number	Membership (households)
1. Agricultural Sector	3,300	4,478,259
a) Agricultural Co-operatives	3,143	4,336,512
b) Fisheries Co-operatives	62	10,056
c) Land Settlement Co-operatives	95	131,691
2. Non-agricultural Sector	1,907	2,862,616
a) Thrift and Credit Co-operatives	1,199	1,985,444
b) Consumer Co-operatives	361	762,429
c) Service Co-operative	347	114,743
TOTAL	5,207	7,340,875

Source: Co-operative Promotion Department (1997)

The small village co-operatives were merged into co-operatives on the district level by an amalgamation programme carried out in the 1960s. Today, co-operatives are organised in a three-tier apex system comprising the primary co-operatives on the district level as

well as the provincial and national federation. The six types of agricultural sector and non-agricultural sector co-operatives in Thailand as well as their total number and membership are listed Table 2.

3.3.2 Mae Tang Agricultural Co-operative

There is only one co-operative, in which small entrepreneurs in our urban and rural samples were members of, namely the Mae Tang Agricultural Co-operative. The co-operative was founded in the year 1971 incorporating several small credit co-operatives that had been operating on the village level across Mae Tang district. All members are engaged in agriculture with paddy rice, tobacco, soybean, garlic and vegetables being the main crops. The aim of the co-operative is to elevate the standard of living of farmer members by means of the following main services:

- Provision of loans
- Marketing of agricultural output
- Savings mobilisation
- Provision of farmer extension services
- Supply of agricultural inputs
- Provision of social welfare services (including a funeral association)

The initial membership of 295 farming families increased to 1,690 in the year 1997. Farmer members are organised in 31 village groups. The Muang Chum village group, for instance, has 44 members, 34 of which are residents of Muang Chum itself. The other 10 members live in villages nearby; they joined the group at a time when there had not yet been own groups in their villages. New group members will be accepted upon approval by at least two thirds of existing members. Each group has a group leader who is elected annually by group members. The co-operative has a credit committee consisting of 5 members, 2 of which are ordinary co-operative farmer members, making all relevant credit decisions together with the credit department of

the co-operative. The credit department consists of 4 credit officers, each responsible for between six and eight village groups.

The co-operative offers three credit lines comprising short, medium and long-term facilities. The loan terms as well as the number and total volume of these credits disbursed are listed in Table 3.

Table 3: Loan terms of Mae Tang Agricultural District Co-operative

Credit line	Duration (years)	Maximum amount (Baht)	Interest (% p. a.)	Credits given out in fiscal year ending 06/1996	
				Number of credits	Total value (Baht)
Short-term	up to 1	300,000	12%	760	20,745,240
Medium-term	5 - 7	400,000	12%	466	53,874,918
Long-term	7 - 15 years	500,000	14%	0	0
			TOTAL	1,226	74,620,158

Source: Microfinance Survey (1997/1998)

Only group members are eligible for credits. Contrary to the approach pursued by BAAC, group members do not assume any liability for other group members. Groups, therefore, mainly serve as marketing channel and assume part of the administrative work otherwise to be done by co-operative officers. Credits have to be guaranteed by mortgage of land, which makes it extremely difficult for smaller farmers to access these credit lines. In this context, it is less the requirement of titled land, which constitutes a problem for farmers in that area (there have been issued land titles for almost all agricultural land in the meantime). Rather it is difficult for small farmers to provide land with sufficient value particularly since the maximum credit amount is limited to 50% of the land value. There is an additional credit line, which provides simple access to credit for farmers who joined the co-operative before 1995. In joint liability groups of three farmers there has to be at least one farmer who mortgages his land with the co-operative. All three farmers are eligible for a 10,000 Baht credit each (the farmer who mortgages his land can also get a normal short, medium or long term according, see Table 3). Risks and benefits here are unequally distributed though. The farmer who pledges his land assumes the default risk for the whole joint liability group whereas his marginal benefit from the additional 10,000 Baht credit often is smaller than the benefit accruing to the other two group members without land assets.

Loan application usually takes place once a year in mid-August. (After loan processing the credit can be disbursed before the tobacco growing season starts in September/October.) The group leader assists group members in loan application and also gives comments on members' creditworthiness to co-operative officers. The co-operative's credit committee undertakes evaluation of credit-worthiness. Credits for new members are limited to 30,000 Baht in the first year, from where they increase in yearly intervals to the maximum amounts given in Table 3. According to the regulations, 70% of the credit amount has to be used for agricultural purposes, whereas 30% can be used for non-agricultural purposes, including consumption. Members are forced to invest 5% of the credit amount into co-operative shares. The remaining balance will be disbursed into members' savings account from where they can be withdrawn. Three months before credits fall due, members will receive a written notification. In case borrowers experience repayment problems the repayment

can be extended to up to three years at normal rate of interest. Only if borrowers fail to inform the co-operative about the credit extension will they be charged an additional fine amounting to 3% p. a. on the outstanding credit amount.

Although arrears are not explicitly recorded, Mae Tang Agricultural Co-operative - similar to most other co-operatives in Thailand - experiences severe repayment problems. One problem must be seen in the disadvantageous incentive structure on the institutional and borrower levels. In their pursuit of institutional interests, prominent co-operative decision-makers (e. g. members of the credit committee and village group leaders) have to take action against borrowers who do not pay on time. Their role as institutional representatives heavily conflicts with their role as friends and neighbours in the co-operative members' villages, though. In the last 10 years there has reportedly been only one case of selling a plot of land mortgaged with the co-operative. Often, the default of one or more members in a certain group adversely affects the willingness to repay also of those group members who are capable to repay. This domino effect sometimes leads to the default of entire groups.

Other internal and external problems of the co-operative system can be identified as follows (see Table 4):

Table 4: Internal and external problems in the Thai co-operative sector

Internal problems	External problems
<ul style="list-style-type: none"> • Qualification and motivation of co-operative management: education, insufficient staff incentives, corruption • Lack of co-operative owned financial institutions; therefore no liquidity balance within the co-operative system • Homogenous membership; identical credit and savings needs impede liquidity balance among co-operative members and risk diversification in the credit portfolio • Member commitment and participation 	<ul style="list-style-type: none"> • Weak co-operative promotion • Competition among rural institutions (BAAC, co-operatives, farmer groups, OTK) • Socio-economic change: Increasingly diversified households need increasingly flexible financial services

3.4 Pawnshops

Formerly mainly carried out by Chinese migrants, pawning has a long history in Thailand. The first pawnshop Act of 1937 has been amended several times. Since 1960, government owned pawnshops (Sathantanuban) were opened outside Bangkok in order to provide small credits to low-income people. At present, pawnshops in Thailand can be categorised into government and private pawnshops. Among the private pawnshops here we also classify the illegal pawning activities mostly undertaken in urban areas by goldshops and dealer in second-hand items.

3.4.1 Government pawnshops

Government pawnshops are operated either by the Welfare Department (Sathantanucroh type) or by the municipality under the Ministry of Interior (Sathantanuban type). In Chiang Mai Province there are four pawnshops of the Sathantanuban type, three of which located in the town district (amphoe muang) and the other one in Hangdong district (see Table 5).

Table 5: Government pawnshops in Chiang Mai Province

Location	Established	Staff	Transactions in fiscal year 1997	
			Number of items pawned	Value of items pawned
Town district				
Thaphae	1965	10	50,054	250,481,160
Changpueak	1976	9	37,603	188,248,000
Pratu Chiang Mai	1987	10	47,881	240,844,250
Hangdong district	1998	N/A.	N/A.	N/A.

Source: Microfinance survey (1997/1998)

Almost all assets can be pawned at Government pawnshops, particularly TV sets, video and radio recorders, watches, pens, cameras, gold and jewellery, but also clothes and even books. Bulky items are generally not accepted nor items that have to be registered for ownership transfer, such as cars, motorbikes, mobile phones and guns. Whereas gold and jewellery can be mortgaged up to 80 or 90% of their market value, consumer durables and other items quickly losing value will be pawned at a relatively low share of their actual value. Even brand new television sets, for instance, are generally mortgaged at only 2,000 or 3,000 Baht. The credit duration is principally unlimited as long as interest payments are made within intervals not exceeding 4 months. An additional grace period of 30 days is granted before items will be auctioned off. Alternatively, the credit contract ends when the pawnee redeems the pawned item (and pays principal and interest). For small credits up to 500 Baht interest rates are as low as 1.25% per month; they are somewhat higher for larger credit amounts (see Table 6).

Table 6: Interest rates of government pawnshops in Chiang Mai province

Credit amount (Baht)	Interest rate (in % per month)
up to 500	1.25%
501 - 2,000	1.50%
2,001 and higher	
first 2,000 Baht	2.00%
remaining amount	1.25%

Source: Microfinance survey (1997/98)

Interestingly, government pawnshops are the only type of formal financial institution in the town district offering financial services that are explicitly tailored to the needs of low-income people:

- Loan processing is extremely fast; it usually takes not more than ten or twenty minutes to estimate the value of the pawn, complete the administrative requirements and disburse the credit. (The requirement to present a passport in order to identify pawnees is the only formality negatively affecting access to pawnshop credits. In rare cases people without valid document, e. g. hill tribe people, have to be rejected.)
- There is no minimum credit amount; some credits are as small as 50 Baht.
- Pawnshops, finally, accept those items as guarantees that are actually available even in most poor households (though the pawned item cannot be used while it is pawned).

It can be assumed that, by number, poor people make up the most important customer base of pawnshops in Chiang Mai. But also better off people, including university students, appreciate the swift and convenient service, particularly in cases of emergencies or when business opportunities arise at short notice. In urgent cases, commercial banks cannot provide credits fast enough: loan processing usually takes several weeks. Longan traders reportedly pawn considerable amounts of gold at the

beginning of the longan season. The cash equivalent will be used in trading business and the profit thereof to redeem the pawned gold some months later.

Although pawnshops undoubtedly offer a valuable service, operations can and must be improved in several respects:

- The interest rate level and interest rate structure have to be adjusted in order to reflect the cost of lending:
 - Since a large share of pawnshop credits is extremely small in size, administrative costs of lending are relatively high. The costs of funds are high because pawnshops in part draw on overdraft credits carrying commercial rates of interest. Sustainability (essentially the need to cover the cost of lending), on the other hand, has been recognised as indispensable (also) for microfinance institutions - regardless of their specific institutional set-up.
 - From the institutional viewpoint it is hard to understand why pawnshops charge a lower interest rate for smaller - and therefore more costly - credits.
- Administration must be streamlined (e.g. computerised).
- The number of items pawned has more or less stagnated throughout the years. Pawnshops have the potential to play a predominant role in urban small enterprise finance, though. An additional credit line for urban small enterprises with an adapted credit technology could make use of pawnshops' existing orientation also towards low-income groups and the institutional network.

3.4.2 Private pawnshops

The number of private pawnshops in Thailand is relatively limited. It is prohibited for private individuals to open new pawnshops since 1977 and there is only one private pawnshop outside Bangkok, which had opened before the Pawnshop Act came into effect. There is none of these (legal) private pawnshops located in Chiang Mai Province. Goldshops and dealers in second-hand items, however, make an apparently thriving business with pawning activities that are not only informal but also illegal: It is not only the pawning business itself that is prohibited. Interest rates charged by unofficial pawnshops regularly exceed the maximum interest rate of 15% permitted by the Thai Civil Code. In order to circumvent existing legislation two (mostly written) contracts are made parallelly. A purchase contract first stipulates the transfer of ownership of the item to the goldshop or dealer. In a second contract, the customer assumes the obligation to buy the identical item back. The usually higher price in the second contract makes allowance for future interest payments. Goldshops - due to their expertise - specialise in pawning gold bars, gems and jewellery. Dealers in second-hand items principally accept the same range of items as government pawnshops do. Yet, the contract of unofficial pawnshops differs in several ways from the ones made by government pawnshops.

Although interest rates essentially depend on the quality and condition of the pawn; they are negotiable and significantly higher in the case of unofficial pawning:

- The higher the mortgage in relation to actual value the higher the risk of pawning for the pawnbroker.
- Unofficial pawning cannot draw on the privilege of subsidised funds; it rather has to cover the opportunity cost of lending

- The pawnbroker's risk of operating in a legal grey area has to be compensated.

If the customer wants to retain his or her right to redeem the pawn, interest has to be paid in monthly intervals (against to several months in the case of government pawnshops). Table 7 summarises and contrasts important elements of government and unofficial pawnshops.

Table 7: Credit contracts of government and unofficial pawnshops

	Government pawnshop	Unofficial pawnshop
Accepted items	Gold, gems, jewellery, electrical appliances, clothes, etc.	
Credit duration	unlimited	
Mortgage in % of asset value)	mostly 10-40%, gold 90% (e. g. TV 10-20%)	mostly 40-80% (e.g. TV 40-50%)
Credit amounts	<ul style="list-style-type: none"> • Minimum amounts: not regulated but usually 20 Baht • Maximum 20,000 Baht per ticket; several items can be added to one ticket and valuable items can be split into several tickets, however 	<ul style="list-style-type: none"> • Minimum amounts around 200 to 300 Baht • Maximum amounts: usually 20,000 or 50,000 Baht
Interest rates (in 5 per month)	1.25% - 2%	<ul style="list-style-type: none"> • 3% (gold) • 5% (consumer durables) • 7%-10 % (hard-to-sell items)
Max. period between interest payments	4 months (+30 days)	usually 1 - 2 months

Source: Microfinance survey (1997/98)

3.5 Traders Credit

3.5.1 Overview

Traders credit plays a role both on the input and output side of small enterprises: they either provide necessary inputs to small enterprises on credit or prefinance the marketing of their output. Often, small enterprises and traders operate in several markets. That is the case if transactions are simultaneously made in, for instance, goods and credit markets. Traders can be classified by their location into rural and urban traders, by the kind of buyers into wholesale and retail traders, by the economic sector in agricultural and non-agricultural traders and so on. Hardly will it be possible here to account for the variety of trading transactions of small enterprises that can be observed in Northern Thailand. Rather, the credit technology of so-called hire purchase dealers (see 3.5.2) - as one for microfinance scholars particularly revealing example - will be studied here in more detail. Hire purchase dealers - driven exclusively by market forces - penetrate not only urban and rural lowland but also remote highland villages in Chiang Mai Province.

3.5.2 Hire-purchase dealers

In the hire purchase system a borrower pays for a good in regular instalments while using it. On the supply side of hire purchase contracts, small and medium-sized shops compete with department store chains and even large trading companies with outlets

in the whole Kingdom. The goods traded in the hire purchase system range from fans and television sets to refrigerators and motorcycles.

Hire-purchase dealers apply a credit technology that is particularly adapted to poor households. The credit technology makes it possible for small entrepreneurs to access credits that - compared to credits from moneylenders and even the BAAC - have comparatively long durations (12, often 24 and 36 months). After a potential customer has shown his interest in acquiring an item on credit, hire-purchase companies usually would send an employee to his household. He would collect all data necessary to determine if the sources and levels of household income are appropriate to cover monthly credit payments that arise from the hire-purchase contract. As compared to commercial banks, hire-purchase dealers show much more flexibility in evaluating the creditworthiness: They do not require customers or, alternatively their guarantors, to receive their income from government sources, for instance. Borrowers have to be at least 20 years of age and have to present a photocopy of their house registration. This does not exclude most farmers in three research villages, however, from accessing this type of credit. Most of the farmers in Muang Chum, Huai Sai and even in the highland village Kongsang can provide the necessary documents. Often, products are delivered to the customer's doorstep without any (explicit) additional cost. Since instalments have to be paid in weekly or monthly intervals, transaction costs of repayment might constitute a financial burden particularly for rural households in remote areas. Money collectors, employed by the large trading companies, however, pick up the instalments at the customer's house. This considerably reduces borrower transaction costs and makes this form of credit even more interesting for poor households. Alternatively, customers can make their payments on the dealer's premises, of course.

Compared to traditional forms of lending, selling goods on credit is a costly undertaking:

- Repayment collection at the customers' doorstep involves relatively high personnel cost, especially if credits are given to rural customers.
- It is often difficult to enforce credit guarantees in hire purchase lending. In cases of emergencies, customers frequently see themselves in the predicament to sell these items before it has legally become their own. Personal guarantors mostly originate from borrowers' social milieu, thus showing the same uncertainties regarding the quality of creditworthiness.

In line with elevated administrative and risk costs, hire-purchase contracts carry relatively high interest rates. At the time of the survey in 1998, it was common to charge a flat rate of 30 to 35% per year. A 24-months contract, therefore, would bear a interest rate of up to 70% of the product value (after subtracting the initial down-payment).

In sum, hire-purchase dealers – often overlooked by microfinance researchers and practitioners - apply a credit technology that is particularly successful in reaching out to low income people, such as poor entrepreneurs. High interest rates involved in hire purchase lending once more demonstrate, that - contrary to wide spread perception - poor entrepreneurs are creditworthy, that poor entrepreneurs *can* pay high interest rates and that poor entrepreneurs *have* to pay high interest rates in order to enable

lenders to cover administrative and risk costs. Information gathering on the location and servicing customers at their doorstep is a prerequisite for successful small enterprise lending. Interestingly, hire purchase lending constitutes the only form of regulated private credit that is offered on a profit-basis and is made available in urban, rural lowland as well as highland areas of Chiang Mai province. The credit technology of hire-purchase dealers sets a powerful example for financial institutions that so far have shrank from lending to low income groups in urban and rural areas of Thailand.

3.6 Moneylenders

Moneylenders constitute the other type of financial institution in Thailand that is observable along the entire rural-urban gradient. Moneylenders here are understood to be individuals whose business it is to lend money to small enterprise households. Moneylending might be the lenders' main occupation or merely be carried out to derive a side-income. Moneylenders generally operate in a limited area such as a district, village or only one market. Moneylending activities are mostly informal, if not illegal, when, for instance, they get in conflict with usury laws. A total of 31 moneylenders were interviewed in our microfinance survey, the majority (22 individuals) lending to urban small enterprises. Six of the interviewed lenders operate in the lowland area and another three in the highlands of the province.

In the urban sample, six lenders, equal to almost one third of the sample, derive their income exclusively from moneylending. Often they were ordinary market sellers before and carried out lending activities in order to derive a side income. Others were selling goods on instalments to other market sellers and were slowly starting to give out cash credits. Three of our sample moneylenders still belong to this type. Every day they walk around the markets in order to attract new customers and collect the instalments from active clients. Typically they sell goods like clothes, jewellery or electrical appliances, upon request even specific articles and certain brands. Customers not only save the trouble and time to purchase the goods themselves. As compared to saving - often a time-consuming process - poor people can already use the item while they are repaying the instalments. Most frequently, moneylenders are shop owners or traders (12 persons) and maintain trading and credit transactions with the same customers. In the urban area, many moneylenders are of Indian descent residing in Chiang Mai in the second or third generation. Since most of them are not willing to disclose sensitive information, it was impossible to uncover the details and magnitude of lending activities of Indian clans who apparently cover large areas in the town district. Due to severe threats to the research team, it was furthermore impossible to interview another interesting type of moneylender: policemen. From other sources it became evident, however, that policemen only play a limited role in the market for small enterprise credits, as far as the number of contracts is concerned. Here, personal relations between lender and borrower and the peer pressure - generally a strong mechanism to repay - are substituted by the threat of personal harm. Policemen frequently seem to be a "lender of last resort". They go on lending to small entrepreneurs who have failed to repay the debt with ordinary moneylenders and, therefore, are not eligible for any further loans. According to other moneylenders, policemen often overestimated their power, however. Default rates were extremely high and numerous customers ran away and never paid back. In the

following, the credit technology of moneylenders will be studied who operate as individuals or jointly with their spouse.

In the rural sample, 6 out of 9 lenders are government employees, such as village headmen, teachers and district officials. Shopkeepers are second most important group of rural lenders (2 persons). The income of government employees and shopkeepers is relatively stable in the course of the months - a precondition for being able to provide liquidity to rural entrepreneurs with more uneven income streams such as farmers. There are also many farmers who lend money to fellow-villagers. Mostly they do so without charging any interest, however and generally not in the pursuit of profit. At least among our sample lenders, farmers rather give credit to kins and friends on the basis of reciprocity (for example in cases of emergencies, see also 3.7.2).

Credit contracts offered by urban moneylenders can be classified into two types, in the following called type A and type B credits:

- Type A credits are repaid in daily instalments, not secured by any form of physical or personal guarantees with durations of between 40 and 60 days. This type of credit prevails in urban markets.
- Type B credits can be compared to the credits offered by pawnshops. These credits are mostly secured by guarantees (e. g. land titles or valuables such as gold and jewellery). The duration of these credits ranges from one month to several years. More formalised and larger-sized shops, both within and without the markets, demand this type of credit.

Like elsewhere, the relationship between moneylenders and small entrepreneurs in Thailand is characterised by strong mutual trust and good information. This is reflected in the fact that moneylenders do not require any physical collateral when giving out type A credits. The social pressure is far less effective in the case of type B credits, however. type B credits satisfy the credit needs of entrepreneurs who operate outside the markets. Entrepreneurial activities outside the markets frequently involve higher investments and a longer time horizon. It is moreover not possible to supervise these borrowers as closely as market dealers. Due to a higher risk of type B credits, they usually have to be secured with physical guarantees such as land titles, gold or jewellery.

Rural moneylenders in like manner require borrowers to secure credits with physical guarantees. In case larger amounts of money are involved, borrowers have to mortgage their land with the lender. Smaller and short-term credits can be secured by simply depositing the land title with the lender. This prevents borrowers from excessively procuring funds from several sources (including commercial banks and the BAAC). Short term-credits often are given out without physical guarantees. The same applies for credits to acquaintances, friends and family members, of course, due to personal trust.

Interest rates charged by moneylenders in rural and urban areas are influenced by a variety of factors. It is almost difficult, if not impossible to quantify the interest rate in percentage terms, say, per annum or per month. As a standard, urban type A credits bear a flat rate of 20%. If a market dealer, for instance, borrows an amount of Baht

1,000 he will have to pay back a total of 1,200 Baht in daily instalments. The effective rate of interest depends on the number of days he will actually use to pay back the credit. In informal lending the loan terms are negotiable even after the credit has been disbursed. It is well possible to suspend repayment for a day or two if sales have not been sufficient. The same applies if, on a given day, a borrower is forced to make other urgent expenses or simply did not show up at the market stand all. Hence, a credit with an initial duration of 40 days is often repaid during 50 or more days. Interest rates of type B credits are considerably lower; they usually amount to 3% to 5% per month. Besides the fact that type B credits are usually secured by physical guarantees, lower interest rates can be explained by stiff competition with commercial banks in this market segment. Interest rates are furthermore influenced by the degree of closeness between borrower and lender.

New borrowers often have to provide personal guarantors originating from the social milieu of the loan applicant, ideally being borrowers themselves. Moneylenders generally undertake the evaluation of creditworthiness in a most uncomplicated manner. They generally require that loan applicants have been selling at the same place for an extended period of time already. Moneylenders have excellent market knowledge; they are capable of quickly assessing the sales and profits from a market stand of any given type and size. Loan amounts for new customers are generally low. As the relationship between moneylender and customer deepens, borrowers will have access to increasingly higher loan amounts. Moneylenders are much more interested in the sources of credit repayment than the purposes of loan use. It is therefore possible to receive loans for both investment and consumptive purposes. During loan repayment, particularly of the type A credits, moneylenders supervise their clients closely. Difficulties in repayment will immediately become evident. If borrowers experience problems throughout repayment, moneylenders are willing to adapt the repayment schedule, usually by simultaneously increasing the number of payments and reducing the amount of each single payment. By this, the mutual trust between lender and borrower deepens and lenders gradually recover the outstanding loan amount.

Lenders generally use own savings to refinance their lending business. Larger lenders often use bank overdrafts as a convenient way to quickly access additional funds when the need arises. Most lenders also have the possibility to access funds from other moneylenders. If they borrow funds at, say 3% or 5% per month to refinance type A credits, the margin will still be enough to cover administrative and risk costs and still make a substantial profit.

3.7 Other Financial Institutions

3.7.1 Len Shares (RoSCAs)

Other important financial institutions include the so-called len shares, the Thai form of rotating savings and credit associations (RoSCAs). Operated exclusively by its members, len shares function without any kind of outside intervention. In many respects they even circumvent laws and regulations that apply to other types of financial institutions, such as usury laws or restrictions regarding the acceptance of deposits. All types of len shares consist of the same set-up. A len share leader takes the responsibility to organise the len share and is liable for late or non-payment of

individual share members. Members regularly pay into the group fund, usually during group meetings which, according to group decision, take place daily, every five or ten days, fortnightly or monthly. The number of group meetings in each cycle depends on the number of shares in each len share. Some members hold two or even more shares. During the group meeting each group member pays into the fund, which will then be allocated to one group member. According to prior group decision, the sequence of fund allocation is determined by bidding (most commonly), by lottery or, in rare cases, according to decision of the len share leader.

Among the shares using the bidding mechanism it is always the person who bids the highest interest who will be allocated the group fund. There are two principal types of bidding shares: In the first type (called *share tok hak*) the winner receives the pot and pays the interest to all those group members who have not yet won the pot. If, for instance, a group of five members agrees to pay 1,000 Baht into the fund each time, and during the third meeting the highest bidder offers 50 Baht of interest, he will pay the interest to the remaining two group members who have not yet been winners in previous meetings. In the second type (*share tok dam*), however, the winner will have to make his interest payment from the next group meeting on until the current cycle is completed. This means that in our example he will receive 1,000 Baht from each group member plus the interest payments of those members who received the fund before him. He himself must pay his interest from the next meeting on until completion of the current cycle. Contrary to the first type, the group fund of the *share tok dam* will, therefore, become higher throughout the share cycle.

In both types, the share leader is eligible to receive the fund first and without any interest. This compensates him for his efforts to organise the share and for assuming the default risk of ordinary group members. Share leader often hold a second or more share in order to have the possibility to get the pot when financial needs arise throughout the cycle.

Len shares offer a useful financial service that takes a middle position between savings and credit:

- Since the group leader is the first share member to receive the fund, he is a net borrower.
- The last person in the cycle is a net saver.
- All other members hold a unique financial position between saving and credit which is determined by their individual position in the share cycle.

Len share members stress the value of quickly accessing funds when the need arises. But it is also the fun and the risk of gambling with money, which induces players to participate in len shares. Since members are required to make regular contributions to the group fund, len shares operate mainly in urban areas, to a far less extent in markets located outside the towns and hardly ever in remote rural areas.

3.7.2 Friends and Family Members

For small entrepreneurs, credits among friends and family members are the most flexible and convenient ones. Often without any interest and without fixed repayment schedule they are given on the basis of reciprocity. By their number, this source of

credit is one of the most important ones for small enterprise households; yet, amounts are often relatively low. These credits are mostly used to cover basic needs such as food and health expenses, and, if the financial means are available, to engage in business opportunities that arise at short notice. In this context, friends and family members often play an important role within the life cycle of a small enterprise: Whereas apparently own savings are used to finance the start-up of small enterprises, friends and family members become important financiers as the business volume increases. Only at a later stage, moneylenders seem to become the most important source of credit, which, given that the small enterprise becomes creditworthy in the sense of traditional credit technologies, will be substituted by commercial banks.

4 The Broader Issue: Small Enterprise Finance and Assistance in Northern Thailand

There is an astonishing variety of financial institutions along the rural urban gradient and the formal-informal continuum in Northern Thailand. The hypothesis that prior research has hardly paid attention to rural-urban differences among smaller geographical units (such as Chiang Mai Province) has proven to be true. Contrary to most other developing countries, small *rural* enterprises have far better access to formal financial services than urban ones. This is the result of the Thai government's efforts to increase rural lending, particularly through BAAC. The bank has a remarkable institutional record, above all concerning its outreach to rural areas including remote highland villages.

Despite Thailand's economic boom, there remains a thriving informal sector in rural and even more in urban small enterprise finance. It is extremely difficult to assess the overall size of informal credit markets in urban and rural areas, though. Informal intermediaries hardly disclose detailed customer and portfolio data.

Formal institutions still have a lot to learn from informal intermediaries, as regards the close relationship between borrowers and lenders and the flexibility to adapt loan contracts to the individual needs and possibilities of customers. Informal intermediaries manage to fill the niches not yet covered by the formal system. It is true that in agricultural finance BAAC has for long substituted moneylenders and traders as the most important sources of credit. They keep on going to be of importance in cases when BAAC credits are not sufficient in size, or when loan processing would take too long, such as in cases of emergencies. Another important niche of moneylenders is the intermediate financing of BAAC credits: BAAC requires borrowers to completely pay back their loans before they can apply for the next one. Numerous farmers borrow from moneylenders in order to pay back BAAC loans; the new BAAC credit will then (at least in part) be used to repay the moneylender. These borrowers will never appear as delinquent in BAAC accounts but still carry on often heavy debt burdens from year to year.

To widen its outreach in the small enterprise finance market, BAAC has to broaden its scope of lending and include also non-farmers into their lending portfolio. BAAC's policy of low interest rates and cross-subsidising smaller credits with larger and more

profitable ones supposedly has distorted competition in the rural areas and prevented commercial banks from entering the market of small enterprise credits at market rates of interest. BAAC therefore should embark on charging interest rates that cover the cost of lending of individual size classes. Appropriate staff incentives would further contribute to ongoing attractiveness of small farmer credits to BAAC and its loan officers. Thus, a broader scope of lending must not necessarily be to the detriment of farmers as it is sometimes argued.

The “rural bias”, i. e. the fact that financial assistance in the past has benefited almost exclusively farmers, has to be counterbalanced. Many *urban* small enterprises, – i. e. the ones which often have much better business prospects than, say, pure farmers – have been neglected by commercial bankers and policy makers. It seems that urban small enterprises can roughly be split into two groups. The first group, due to its ability to comply with requirements imposed by commercial banks, has access to formal credit. A large share of less fortunate small entrepreneurs has to rely on themselves and the informal financial market (which undoubtedly supplies useful services, yet at high cost). Further research (including deeper analysis of the data collected in our microfinance survey) will have to identify the factors separating these two groups. Thus will it be workable to tackle the obstacles that hinder urban small enterprises' access to formal credit and support their specific possibilities and potentials. Assistance of small enterprises has to be undertaken decisively, immanently and courageously. Providing the financial infrastructure (i. e. financial institutions, financial services and financial sector regulations) that is in line with the specific demand of urban and rural entrepreneurs will tackle one of the most important, and sometimes the only, bottleneck of small enterprise development: the availability and affordability of funds for investment and consumption. Small entrepreneurs themselves know best where the market possibilities are; they are hard working and willing to take the entrepreneurial risks associated with entrepreneurial opportunities.

References

- BAAC (1997): Annual Report 1996, Bangkok
- Co-operative Promotion Department, Technical Division (1997): Co-operative Promotion in Thailand, Bangkok
- Ghate, P. B. (1988): Informal Credit Markets in Asian Developing Countries, in: Asian Development Review, No. 6, p. 64-85
- Heidhues, Franz; Sossoh, Belle; Schrieder, Gertrud (1997): Transaction costs in group and individual lending as an influencing factor of access: The case of poverty oriented micro-finance in Cameroon. Paper presented at the XXII International Conference of Agricultural Economists (IAAE) on Food Security, Diversification and resource management: Refocusing the role of agriculture. August 10-16, 1997, Sacramento, USA
- Krahnem, Jan-Pieter; Schmidt, Reinhard (1994): Development Finance as Institution Building, Boulder
- Sacay, O.; Randhawa B.; Agabin, M. (1996): The BAAC Success Story: A Specialized Agriculture Bank Under Government Ownership, The World Bank, Washington, D.C:
- Schmidt, Reinhard; Zeitinger, Claus-Peter (1994): Critical Issues in Small and Microbusiness Finance, A paper presented to the International Donor Conference on Financial Sector Development, Vienna, 27th-28th, 1994
- World Bank (1997): World Development Report 1997, Washington, D.C.