“Development of Corporate Credit Information Database

and

Credit Guarantee System”

Small Business Credit Guarantee Corporation (SBCG)

Thailand

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(Final Report)

Executive Summary

In spite of SME's considerable importance to Thailand's economy and employment, financial access is still a critical concern for SMEs. Attempting to remedy this difficulty, several instruments are implemented. However, developments of credit information sharing and credit guarantee systems for SMEs are the utmost important since they provide benefits for SMEs on improving the issues of information asymmetry and collateral deficiency. Therefore, the main objective of this research is to examine the application of these two schemes within the environment of SMEs in Thailand.

The finding issues of this paper are mainly categorized into three sessions. The first finding is derived from a review and analysis of credit information sharing development in Thailand through the single credit bureau. The latter is a result of discuss on development of SME credit risk database in Thailand and the ASEAN +3 region. The issues of credit guarantee system in Thailand are identified at the last.

As a result of merging two credit bureaus in 2005, National Credit Bureau (NCB) becomes a single credit bureau. Based upon its latest number of consultations and two-year financial performance, Thai credit bureau has been gone through the uncertain starting period into the certain growth one. Practical learning experienced from Thailand's credit bureau development consists of the following: Firstly, the merge between Thai Credit Bureau and Credit Information Services becoming NCB in 2005 triggered a reduction of their redundancy and an increase of business scale. Secondly, Credit Information Business Act (2002) has framed consumer information security and protection, and regulated a firm operating credit information business. Lastly, considering from coverage of data records and time span of 3 years that NCB kept consumer credit records in its database, Thailand's development stage of credit information sharing is still evolved around consumer loans and yet far away from the stage of evaluating SME's credit risk.

Nowadays, financial institutes use relationship-based approach in considering a credit approval on loan request from SMEs. Though credit scoring system has been introduced to banks for credit risk assessment, the final stage of credit risk analysis or final decision on loan approving for SMEs still relies on bank's judgment system. Moreover, main data sources for

analyzing SME credit risk are rather scattered. Each financial institute follows its own approach on credit data collecting, which is considered redundancy. Mostly, credit data that loan approval is relied upon comes from three sources: data from loan application, data from bank's internal data, and other related external data. Therefore, this credit risk database center should be established as a full bureau gathering comprehensive data, i.e. both financial and non-financial information, so that it will play a role of SME credit rating agency, which predict or measure SME's credit risk. Pooling anonymous data model among members is an appropriate choice of credit risk model. Inevitably, elimination of free rider problems requires early development stage of credit risk database by SBCG before actually establishing the centre and calling for public assistance.

Credit guarantee system in Thailand, claimed as a policy tool for SME development, was reviewed. Legalized as specialized financial institutes for small business, SBCG is the single player on provide credit guarantee service for small business in Thailand. Consequently, SBCG practically positions itself as a policy-based and non-profit organization. The risk sharing schemes with banks for guaranteeing SME's deficient amounts of collateral are mainly employed, whereas the fixed guarantee pricing for all SMEs is perceived as a public tool for an equal opportunity for SMEs to access required financing. However, credit guarantors have incurred losses continuously mainly because of the fact that high payments to banks for bad debts exceed low guarantee fee incomes. Imbalance of credit information for necessary credit risk assessment along with the current credit system schemes in place has brought about problems so called moral hazard and adverse selection.

Policy implications of this study are divided as follows. 1) Policies for strengthening the foundation of credit information sharing by extending the scope of credit bureau into credit registry and rating services for SMEs. 2) Policies for developing credit risk data for SMEs by establishing a credit risk database in Thailand, for creating environment and incentives for SMEs to becoming structural business organizations and to disclose reliable financial information to public, and for generating a practical standard for SMEs' credit risk information and capital market for CDO by cooperation among members of ASEAN+3. 3) Policies for building up a new credit guarantee system by including roles in establishing standards in SMEs loan underwriting and securitization, for generating SMEs credit risk database, for revamping pricing and schemes for guarantee, and for cultivating business-oriented operation.

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Introduction

Backgrounds of Problems

I: To Mitigate a Problem of Information Asymmetry

Prior to the economic crisis of Thailand in 1997, asymmetric information problems between lenders and borrowers in credit markets had yet to be fully recognized to mitigate them. Lenders made their lending decisions based upon their proprietary databases and competitive pressures. Whereas borrowers had access to a number of credits, and some were reluctant to disclose their comprehensive information. That resulted in part of heavily indebted borrowers. The unbalanced credit markets were unable to be cleared by the price or interest rate of the loans. It was believed that the problems had exacerbated latterly the severity of loss during the course of the crisis.

Back to earlier discussion, Stiglitz and Weiss (1981) indicated that information asymmetry occurred when borrowers have different probability of repayment, but lenders could not identify “good” borrowers from “bad” ones. The interest bank charge might itself affect the riskiness of a pool of loans by either sorting the borrowers - namely adverse selection, or affecting the action of borrowers - namely moral hazard.

To address the problems information asymmetry, Pagano and Jappelli (1993) conveyed that the credit information databases development, in which information sharing mechanisms among lenders, such as credit registries or credit bureaus, could ease the problems. They illustrated how information sharing can address the problem of adverse selection. Padilla and Pagano (1997) set out that the problem of moral hazard could be reduced by information sharing mechanism among lenders.

As results of credit registry / bureau establishment around the world, Jappelli and Pagano (2002) figured out that the development of credit information databases thru credit registries was related to broader credit markets and lower credit risk. They argued that better information might lead banks to shift from collateral-based lending policies to more information-based ones (Jappelli and Pagano (2000)).

In respect with overall development of credit information in Thailand, the first objective of this paper is an examination of the current situation of credit bureaus in Thailand and their future development after their establishment. In addition, a practice toward development of credit bureau is extracted from Thailand’s experience of credit bureau development. In so far as the credit information databases development are unable to reach SME sector, economic development and sustainability is difficult to be fulfilled.

II: Due to Lack of Accurate Information and Adequate Collateral, SMEs have Difficulties to Access to Financial Services.

In spite of their enormous contribution to economy and employment, SMEs suffer from obstacles to access credit the most. The remarkable problems of asymmetric information in SME credit markets are attributable to a lack of reliable and accurate information. The second and third objective of the paper are to scrutinize adequately institutional frameworks of SME credit information database for firms in Thailand, and respectively considers regional cooperation mechanism to create harmonized information sharing system.

In Thailand, the lending to SMEs mainly depends on collateral-based financing. SMEs are widely identified as lack of adequate collateral to access credit provided by lenders, and thus presented as the main obstacle to lenders' reluctance to lending to them. In order to overcome such collateral constraints, credit guarantees becomes a substitute collateral for SMEs. Credit guarantees subsidized by government have been as a means of addressing the obstacle. Literatures, however, suggest that guarantee schemes, especially in Asia, have incurred loss. Therefore, a review of the current situation of the credit guarantee system in Thailand, and in attempt of identifying the challenges for developing the credit guarantee system become the last objective of this paper.

The paper is organized as follows. Chapter 1 presents the development of credit bureaus in Thailand. Chapter 2 discusses SME credit information database in Thailand and regional cooperation. In chapter 3, we review the credit guarantee system in Thailand. The key issues of all the above chapters are summarized and concluded in chapter 4. Policy implications are also recommended in this chapter.

Chapter 1
The Credit Information Development of Credit Bureau in Thailand and Its Practice

1.1 Theoretical and Empirical Roles of Credit Bureaus/Registries

1.1.1 Definitions of Credit Bureaus

A synonym for a credit bureau is a credit reporting agency. A credit bureau is a company that collects information from various sources and provides consumers' or businesses' credit information on individual consumers/businesses for a variety of uses. Consumer credit bureaus maintain and report on this information for individuals, while commercial credit bureaus collect and distribute this information for businesses, including small business and foreign firms.

Credit bureaus may be private enterprises or may be operated on a cooperative basis by the merchants in one locality. This privately owned, profit-making establishment that - as a regular business — collects and compiles data regarding the solvency, character, responsibility, and reputation of a particular individual in order to furnish such information to subscribers, in the form of a report allowing them to evaluate the financial stability of the subject of the report. They then serve as a clearinghouse for credit history information. This information is distributed for a fee to other credit grantors, who use it in deciding whether to approve or decline credit applications, and how much credit to offer any particular borrower.

Credit bureaus ordinarily prepare and issue reports for lending institutions and stores that investigate the financial reliability of an applicant for credit prior to the execution of the credit agreement. This helps lenders assess credit worthiness, the ability to pay back a loan, and can affect the interest rate and other terms of a loan. Interest rates are not the same for everyone, but instead can be based on risk-based pricing, a form of price discrimination based on the different expected risks of different borrowers, as set out in their credit rating. Consumers with poor credit repayment histories or court adjudicated debt obligations like tax liens or bankruptcies will pay a higher annual interest rate than consumers or businesses that do not have these factors.

1.1.2 Roles of Credit Bureaus as a Financial Infrastructure and an Information Sharing Mechanism on Economy

Credit bureau gathering data for banks, savings institutions, and other credit grantors on experience (credit history) meeting obligations of consumers and businesses, based on information reported by credit grantors. According to Daniel B. K. (2001), the range of information included on credit reports is smaller than many suppose. Credit reports usually include only the following kinds of information:

- consumer's name, address, Social Security number, place of employment, and spouse's name
- open credit lines, outstanding credit balances, credit limits, and history of timeliness of payments, amount of last payment
- bankruptcies, liens and public judgments against the consumer

Reports do not include information about one's lifestyle, religion, political affiliation, driving record, medical history (etc. some of the things that a casual acquaintance might come to know).

Many of creditors supply information to credit bureaus each month. Credit bureaus virtually always report that information faithfully. In rare cases, faithful reporting is erroneous reporting, because creditors occasionally supply inaccurate information. When a consumer disputes information in the credit report, a verification process begins. The dispute is usually submitted in writing. The verification process flows from the consumer to the bureau to the creditor and back again. The credit bureaus may serve as paragons of reliability and discreetness. They convey only the most pertinent information to only the most relevant parties in a highly standardized, impersonal, and professional manner. The credit bureaus then act as a centralized agency that serves as a hub to all creditors and merchants. The hub-and-spoke pattern of information flow greatly reduces the redundancy, inconsistency, and unnecessary variation in communication.

In other word, the credit bureaus are independent agencies and provide information about a consumer’s and company's credit history, but they don't make any actual lending decisions. They, instead, collect information from banks, retailers, and finance companies, and look at public records such as tax liens, bankruptcies, and monetary judgments. Taken together, that information can be vital in preventing late payments or even credit default that can cause the profit shortfall of the financial institutions or credit grantors. For example, credit card issuers offering pre-approved credit cards routinely determine who gets an offer by screening credit bureau reports; accepting a card on the terms offered will open an account. Since credit bureaus help credit grantors (such as commercial bank and other financial institutions) decide whether credit applications should be approved, they make opportunity to credit, employment, housing, insurance more available and more affordable to everyone in economy, recently. Although most credit bureaus currently operate on a for-profit basis, their fundamental function has not changed: providing information so that two parties, who may be perfect strangers, can trust each other and engage in mutually advantageous exchange. This type of financial services innovation then suites to complexity in economic system as reduced an incredible amount of uncertainty in markets.

As the consequence of credit bureaus' main role as a financial infrastructure and a information sharing mechanism, the great contribution of credit bureaus are derived from that data is to reduce the information asymmetry between principals and agents, and the uncertainty about past behavior of various consumers and businesses as credits applicants. By using credit bureau data has found that after the adoption of information sharing, they promote lending and borrowing. That increased lending and borrowing is then part of a cyclical relationship with economic performance or growth of GDP, because more loans mean more consumption, which means more jobs, more income, more demand for loans, and so on.

1.2 Origins of Institutional Arrangement of Credit Bureau in Thailand

1.2.1 Post-financial Crisis of 1997, Thailand Aimed to Develop Its Financial Infrastructure

The notion of a credit information center in Thailand has long been discussed by The Thai Banker's Association and the Bank of Thailand since early 1960s. However, the developing process was set in a slow pace and then time consumed. Until 1995, an important step towards founding a credit data center was made by the Ministry of Finance, Bank of Thailand, and the Securities and Exchange Commission when they agreed upon a financial system development plan. Then a committee was appointed to study and seek a suitable approach in order to establish a credit data institute. The attempt to arrange a joint venture deal with an American credit data company was almost a success. Unfortunately, an economic crisis in Thailand erupted in 1996 and many Thai financial institutes were forced to shut down. Such the economic crisis ascended the severity gradually, which obstructed the establishment of the credit data center. Yet, Minister of Finance was fully conscious of bad debt burdened within Thai financial institutes, which was considered big and urgent problem at the time.

In July 1998, Dr. Pisit Lee-arthum, deputy Minister of Finance assured the policy to establish the credit data center so that it would be used to analyze the loan and reduce the bad debt burden of financial institutes. Be in charge of the Government Housing Bank (GHB), he ordered the GHB to be the main driving force to establish a credit data center. Meanwhile, Bank of Thailand had proclaimed a policy for The Thai Banker's Association to hurriedly establish a credit information center, and then the Thai Banker's Association had set up a committee to complete the task afterwards. Therefore, the establishment of the current credit information center has originally created 2 business entities. The first track was put together by the Government Housing Bank, and later became ***Thai Credit Bureau Co., Ltd***. or TCB. The second pathway toward the establishment of credit data center was organized by Bank of Thailand together with the Thai Banker's Association, and named ***Credit Information Services Co.,Ltd***. or CIS. Both companies were established with the same objective including being the center to gather clients' data to 1) help reduce the risk, 2) increase the efficiency of giving loans, and 3) prevent bad debt or non-performing loan problems in the economic system.

The establishment of credit data centers, TCB and CIS, not only benefited borrowers regarding the time and cost savings in financial loan accessibility, a high-quality credit bureau also strengthened the backbone of financial system. Fully utilizing the credit information, financial institutions would be less disturbed from bad debt prevention, and become more confident in their loan providing business, resulting in a sound financial system in the long run.

1.2.2 Two Credit Bureaus with Different Ownerships Finally Merged to a Single Bureau

Central Information Services Co., Ltd. (CIS), founded by Bank of Thailand and Thai Banker's Association, was registered as a company on September 22, 1999 with the registered capital of 26 million baht. Its shareholders were of 13 Thai commercial banks, which were the members of Thai Banker's Association. This privately owned credit bureau gathered loan data from financial institute members, and offered them, as well as other members, credit data of both consumer and commercial for analyzing loans. Later in 2000, two essential credit data reporting systems of the CIS have been developed by 2 world-class corporations:

Consumer Credit Reporting System-developed by Trans Union International Co., Ltd., one of the world's leading credit data service companies, and Commercial Credit Reporting System-developed by Dun & Bradstreet Co., Ltd., one of the oldest and most famous commercial credit data service companies. Additionally, both system development companies had later become the important allies to augment the credit data service potential of the CIS. In 2000 Central Information Services Co., Ltd. signed a joint venture contract with both Trans Union International Co., Ltd. and Dun & Bradstreet Co., Ltd. (through Business Online PCL. a joint venture company in Thailand). The capital was then increased to 156 million baht and the company name was changed to Central Credit Information Services Co., Ltd. or CCIS on December 6, 2000. The 13 commercial banks still held the equal portion of shares totaling 50% of the whole, and the rest was held by TransUnion Inc. and Business Online PCL. for the portion of 25% each. Later the capital was increased again to be 186 million baht with the same portion of shareholdings.

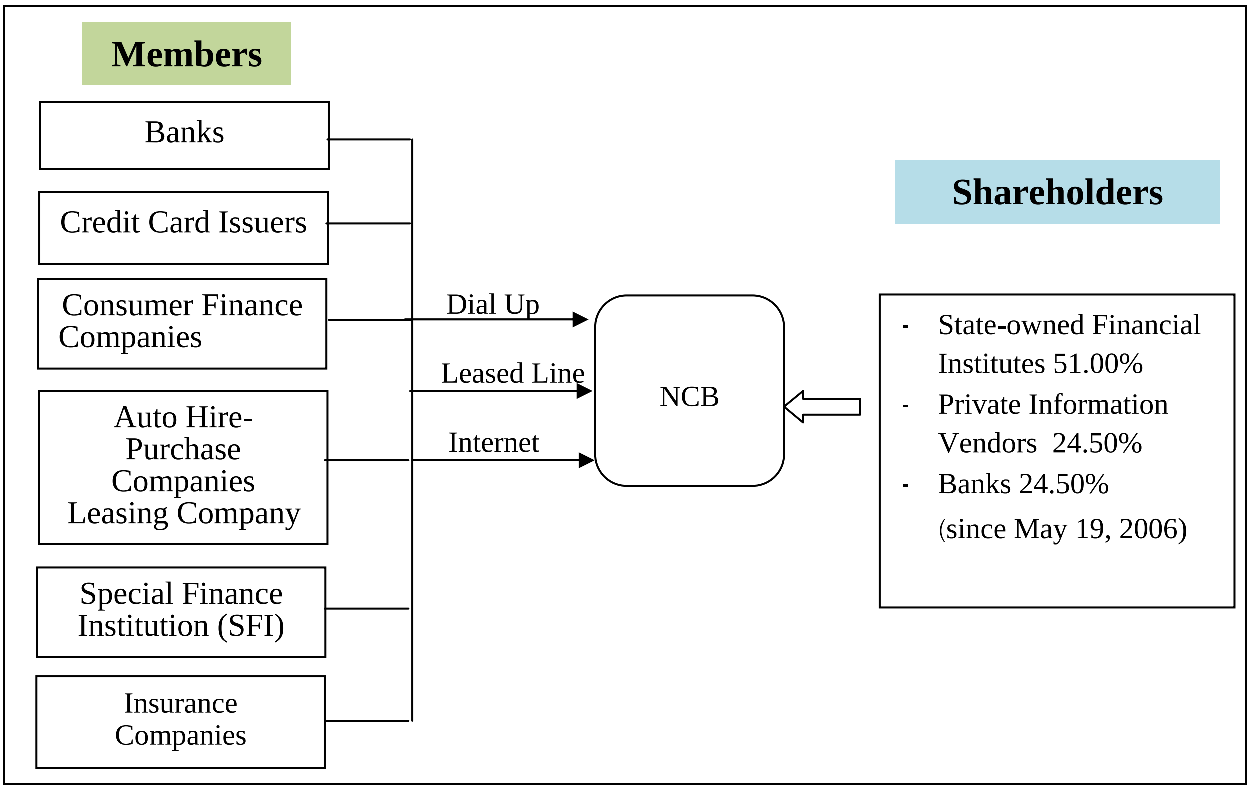
Thai Credit Bureau, founded by Ministry of Finance and Government Housing Bank (GHB) was rather a smaller credit information agent. The paid up capital was only 10 million baht, and PPC Co., Ltd.- the data process center owned the majority (51%) of the equity, while the Government Housing Bank possessed 49% of the ownership. Even though both the TCB and CIS shared the same functional objectives, the main business for the TCB was more of credit data for consumer and small business loans.

Although TCB and CIS were separately owned, they shared common business objective in credit information business. In August 2004, the two credit bureaus had signed a Memorandum of Understanding (MOU) in sharing credit information, which widened their credit data coverage and better served their stakeholders. This business cooperation later turned to be the onset of the unity of the credit data center.

In 2005 Central Credit Information Services Co., Ltd. decided to buy all shares of Thai Credit Bureau Co., Ltd., and merged their credit data business together. **National Credit Bureau Co., Ltd**. (NCB) became a joined, yet new, business entity on November 19, 2005, and increased its capital to 250 million baht. The shareholding was disseminated among former shareholders of Thai Credit Bureau Co., Ltd. and banks as well as government financial institutes.

As of May 19, 2006, the portion of the shareholders after the merger consisted of Thai commercial banks holding the same portion of the shares totaling 24.5%, Business Online PCL., and TransUnion Inc. held the same portion of 12.25% totaling 24.50%. The totals of shares held by the shareholders of the former Central Credit Information Services Co., Ltd. are of 49%. The shareholders of Thailand Credit Data Co., Ltd. hold the portion of 30% including Government Housing Bank 15% and PCC Capital Co., Ltd.15%. The rest of another 21% are held by government financial institutes including Government Savings Bank, Dhipaya Insurance PCL., and Small and Medium Enterprise Development Bank of Thailand hold the share portions of 9%, 6% and 6% respectively. Members and shareholders structures of NCB are summarized in figure 1.1 below.

Figure 1.1: Members and Shareholders Structures of the National Credit Bureau



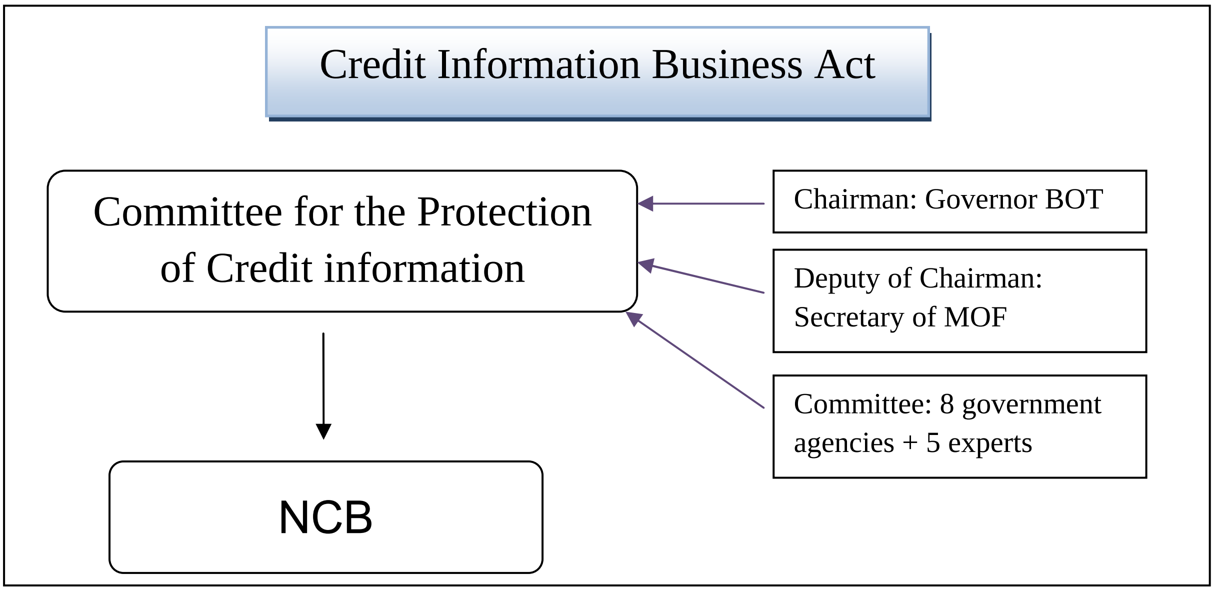
Source: National Credit Bureau, Co., Ltd.

The merging greatly benefited both former credit information agents and their stakeholders in many ways. Financial institutions which were member of both credit data agents could eliminate their redundant credit data providing procedures and operated their loan analyzing functions more efficiently. This would facilitate, as well as save the cost of, the loan requesting process, and then transferred into time and cost-saving for borrowers.

1.3 Establishment of Legal and Regulatory Framework in Thailand

Prior the Credit Information Business Act (2002), members of the credit information agent could supply, without the customer's consent, their customer information to the credit data center. Although such data providing transaction speeds up the data gathering process, it violates the human rights of their customers. The emerge of the Credit Information Business Act in 2002 was the stepping stone towards consumer information security and protection, and later, in 2006 and 2008, has been modified to better define credit information business as well as stakeholders. This Act contains certain provisions that restrict personal rights and freedom wherever it is deemed appropriate to enact the law relating to credit information business. According to this Credit Information Business Act (2002), Committees for Protections of Credit Information to oversee NCB's operation compose of the Bank of Thailand's Governor – as Chairman, secretary of the Minister of Finance – as Deputy of Chairman, and other 13 members from government agencies and experts from financial industry. Figure 1.2 below summarizes the structure of this committee. Also, the main content of the Credit Information Business Act (2002) has been summarized in table 1.1 below.

Figure 1.2: Members of the Committee for the Protection of Credit Information



Source: Credit Information Business Act, 2002

Table 1.1 Summary of Credit Information Business Act (2002)

Provision	Main Context
Chapter 1 “Establishment of the Company and Application for License”	Credit information business operator must get a license and be Thai national company.
Chapter 2 “Carrying on Credit Information Business”	Credit information business is prohibited mainly from: -gathering and recording information not related to the request of credit, or damage or obviously affected the rights and freedom of the owner of the information, -carrying on the business outside Thailand, -process the information held longer than the period as permitted, etc..
Chapter 3 “Rights and Obligations of Credit Information Company, Member, and Recipient of Service”	Credit information company must have security, demolition, classification, and verification system for credit information. The member is required to send and report credit information to company as well as rectifying the incorrect information. It must also inform to the customers. Information is use only for credit-related purposes and not disclosed or distributed to any unauthorized person or persons.
Chapter 4 “Protections to Owner of Information”	Rights of information owners to know and be informed about results of using their credit information are recognized and can be exercised.
Chapter 5 “Supervision of Credit Information Company	A Committee is established to have powers and duties determining rules, procedures fees and other charges. The Bank of Thailand is also empowered to surveillance.
Chapter 6 “Suspension and Revocation of License”	Credit information company’s license can be suspended or revoked if they commit on stipulated wrong doings.
Chapter 7 “Civil Liability” and Chapter 8 “Criminal Liability”	Credit information company and related companies are liable to pay compensation and subject to imprisonment, if failing or violating certain provisions.
Chapter 9 Transitional Provisions	

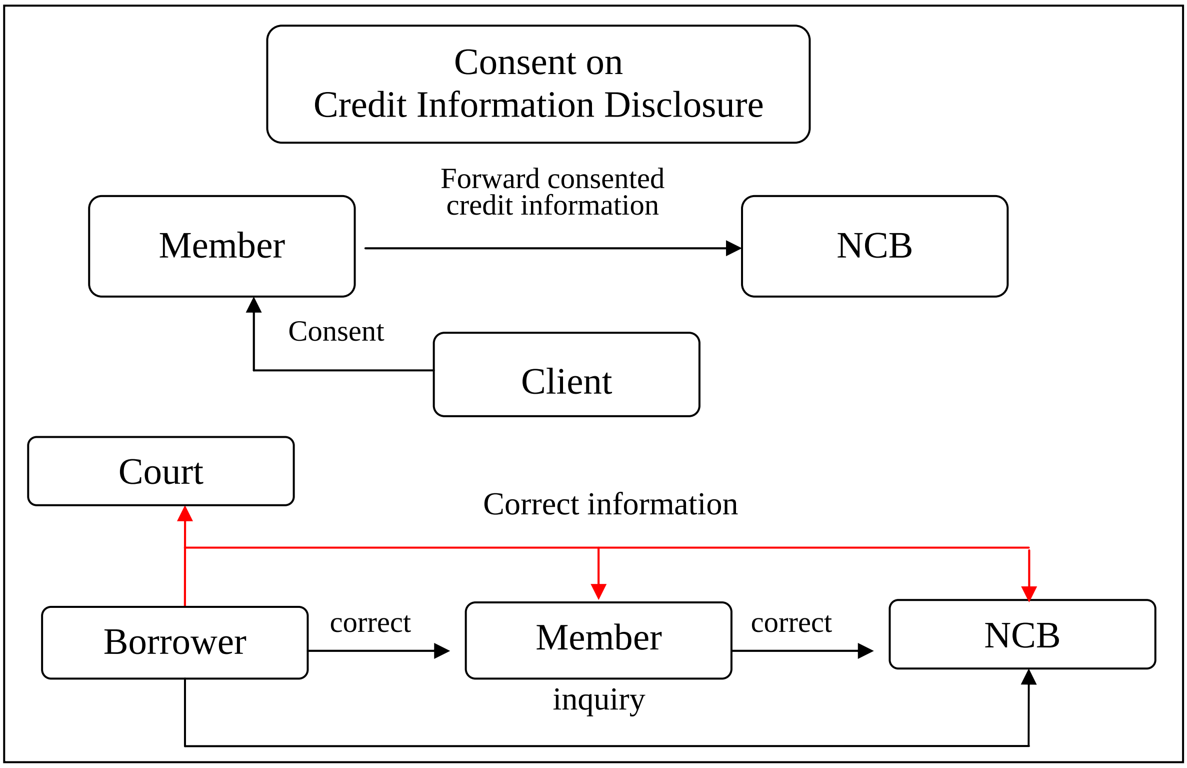
Source: Credit Information Business Act, 2002

The Credit Information Business Act specified functions and responsibilities for a credit information company which performs business relating to the control or processing of credit information in order to provide credit information to the Members or recipients of service. Upon obtained a business license from the Minister of Finance, a credit information company shall engage in credit information business regarding conduct information processing from information obtainable from the member – a financial institutions that the credit information company admits as a member, or from reliable sources of information. As a member, financial institute is required to send credit information of its customers to the credit information company in which it is a member, and must inform in writing to the customers about the sent credit information within 30 days from the sent date of Credit Information to the credit information company.

Meanwhile, credit information company shall disclose or provide credit information to, as the recipient of service, other member or juristic person who carries on a legal business of credit granting in its ordinary course of business, who wishes to use such information for the purpose of analyzing the grant of credit, the insurance and life insurance, and the grant of credit card, provided that it obtains a letter of consent from the Owner of Information, or of the record of client who applies for services from the member, regardless of whether it is the application for credit or any other services, for the disclosure or provision of credit information to the member or the recipient of service.

For the purpose of protections given to the Owner of Information, the Credit Information Business Act points out that information owner is entitled to rights to know which of his or her information is kept by the credit information company; check his or her information and request for correction of incorrect information; know causes of refusal of the application for credit or services from financial institution in the case that the financial institution uses information of credit information company as reason for refusal, etc. In the case that the credit information company or member views that information is incorrect for whatever reasons, the credit information company or the member shall correct the information without delay, and shall report the corrected Information to the relevant source of information, member or recipient of service for further correction of Information accordingly. The process of information disclosure and correction, as discussed above, is summarized in figure 1.3 below.

Figure 1.3: Credit Information Disclosure and Correction



Source: National Credit Bureau, Co., Ltd. and Credit Information Business Act, 2002

1.4 Information Items and Types Collected and Distributed by Credit Bureau

Serving banks, financial institutes, and other credit grantors, NCB, as a credit bureau, gathers credit history information on credit receivers (both individuals and firms) from NCB's members and other trust worthiness sources (mostly government agencies). As of June 2008, NCB's database consists of 59.3 records on credit information, of which 56.2 million records from individuals of 15.6 million and 3.1 million records from firms of 0.27 million. Scopes of information collected and distributed by NCB are defined in table 1.2 shown below.

Generally, credit history information can be broadly divided into 2 categories: negative information and positive (or full file information). Negative information, a.k.a. black list, only contains information on defaults, including amount outstanding, date of last payment, etc. On the other hand, credit history information that contains all open and closed credit accounts, amount approved, as well as the information on repayment, is normally referred as positive or full-file information. NCB applies this positive or full-file information approach since it allows credit grantors to more accurately asses the credit-worthiness of a borrower. Hence, credit history information on both individuals and firms gathered by NCB broadly are name, address, id number, place of employment or nature of business, credit types, lines and limits, history of timeliness of payments, and amount of last payment, etc. Moreover, NCB also follows conventional practice regarding credit information collecting. Credit information carried in NCB's database does not include information about one's income, lifestyle, religion, political affiliation, driving record, or medical history.

Table 1.2: Scope of Information Collection and Distribution by the National Credit Bureau, Co. Ltd.

Data on the individuals	**Collected**	**Distributed**
Name of borrower	●	●
Address	●	●
Unique identification number (for example, ID, tax ID, passport number, etc)	●	●
Borrower's ownership of a business	●	●
Tax statements		
Income and other personal financial information		
Court judgments		
Bankruptcies		
Other demographic and miscellaneous information (employment status, marital status, age, etc.)		
Data on individuals' loans		
Name of reporting institution	●	
Amount of loan	●	●
Type of loan	●	●
Days past due (date due)	●	●
Amount past due	●	●
Payment record longer than the previous 30 days	●	●
Interest rate of loan		
Maturity of loan		
Type of collateral securing the loan		
Value of collateral securing the loan		
Guarantees securing the loan		

Source: Information from the interview with Khun Suraphol Opasatien – Executive Vice President, National Credit Bureau Co., Ltd.

Table 1.2: Scope of Information Collection and Distribution by the National Credit Bureau, Co. Ltd. (con't)

Data on the firms	**Collected**	**Distributed**
Name of firm	●	●
Address of firm	●	●
Unique identification number (for example registration number, tax ID, etc)	●	●
Name of owner(s) of the firm	●	●
Field of business activity	●	●
Balance sheet information		
Tax and income statements of the firm		
Income and other personal information on the owner(s)		
Court judgments		
Bankruptcies		
Other demographic and miscellaneous information		
Data on the loan		
Name of reporting institution	●	
Amount of loan	●	●
Type of loan	●	●
On-time payments (information sent indicating loan was paid on-time)	●	●
Late payments – number of days past due	●	●
Amount past due	●	●
Payment record longer than the previous 30 days	●	●

Source: Information from the interview with Khun Suraphol Opasatien – Executive Vice President, National Credit Bureau Co., Ltd.

1.5 Information Collection and Verification

Regarding the data collection method, NCB collects credit history information from their members on monthly basis. Via standardized format, every credit records from NCB's member will be transferred into NCB's system within 20 days of the next month. NCB also implements a human-error preventive action by constructing error-check and data correction procedures to ensure the accuracy of those credit records before preserving them within

NCB's database for 3 years. In rare cases, creditors unknowingly supply inaccurate information, and a faithful reporting becomes erroneous reporting.

To attract its members to share correct and update information, NCB offers them a reduction of consultation fees with the following conditions in which members disseminate their credit information to it: 1) before due, 2) without wrong format, and 3) with completed information. Nevertheless those incentives can be cancelled out whenever members miss their dissemination of customer consents to NCB.

On the data distribution side, access to data is not restricted to registry members only. NCB, with a service fee and consent from credit information owner, allows both members – as credit grantors, and consumers (or credit information owner) to have access to the applicant's credit records in NCB's database. NCB has set a policy to convey only the most pertinent information to only most relevant parties in a highly standardized, impersonal, and professional manner. The format of credit information available is then positive or full-file information with some specific information crossed out, e.g., names of other credit grantors.

Consumers are able to access their credit information at NCB, as well as at private and state-owned banks' branches. When a consumer disputes information in the credit report, a verification process begins. The dispute is usually submitted in writing. The verification process flows from the consumer to the bureau to the creditor and back again.

1.6 Performance and Future Perspectives of Credit Bureau

The focal business for NCB is to provide services to members on searching for credit information on NCB's database. Thus, the main revenue for NCB derives from 2 business transactions: consumer credit report and commercial credit report. From NCB, the average number of consultations from January to June 2008 is at 1 million transactions per month, with the hit rate fee of 10-12 baht.

1.6.1 Financial Performance

In Thailand, credit information business requires heavy financial investments mainly in information technology and data storage. Merged with the Thai Credit Bureau was a successful strategic move. Credit information from all members flow into one system, and then could be administered, distributed and utilized for loan granting efficiently among members. This natural monopolistic business results in rewarding financial outcome. As shown in table 1.3 below, NCB's financial performance has been an accomplishment. Upon existing credit reporting business exclusively, the company has generated a profit margin of 30% in average, and its return on assets (ROA) and equity (ROE) are in the range of 17% to 20%. However, the current credit information services for consumer loan under-utilizes potentially great benefit of credit data. New business model, e.g., credit scoring, could be implemented to pull out the great business as well as economic value from these credit records available at the present. Besides, the consumer loan services thru existing business are closed to maturity. Hence, NCB's strategic plan should factor in this alternative business model for it' business long run sustainability.

Table 1.3: Selected Financial Item: National Credit Bureau Co., Ltd.

(unit: million baht)	**2006**	**2007**	**% Change**
Current Assets	45.06	210.51	367.1%
Land, Building, Equipment (net)	11.62	14.57	25.3%
Total Assets	**331.67**	**354.03**	**6.7%**
Total Liabilities	**18.14**	**34.93**	**92.6%**
Equity - registered & paid	250.00	250.00	
Total Equity	**313.53**	**318.09**	**1.5%**
Total Revenue	186.43	215.31	15.5%
Net Profit	62.33	59.56	-4.4%
Net Profit Margin	33.4%	27.7%	
Return on Asset (ROA)	18.8%	16.8%	
Return on Equity (ROE)	19.9%	18.7%	

Source: National Credit Bureau, Co., Ltd.

1.6.2 Future Perspectives of Operation Impediments

Since the merger, the NCB has developed the systems of processing and reporting credit data more update and efficiently. The quality of credit data regarding accuracy and updated has also been improved by increasing the potential of the information security measures. Moreover, the company has stood by principles of protecting the secret of credit information, as well as protecting the consumer's rights. In order to reach that commitment, NCB has aimed to apply for the certificate of Information Security Management System (ISMS) according to the standard of ISO 27001 within the year 2009.

NCB's strategic road map for future perspective also embrace enhancing members' and their customers' knowledge on risk and credit management towards value-added services of marketing, credit analysis, debt collection, and workout on debt restructuring.

1.7 The Current Getting Credit Rank of Thailand Against the Region

Although the overall condition for doing business in Thailand seems relatively attractive for an entrepreneur (the Ease of Doing Business in Thailand ranks 13th), getting credit in Thailand still relies more or less on personal connection. The International Finance Corporation (IFC) has gathered information affecting the getting credit circumstance in Thailand.

Table 1.4: Thailand's Getting Credit Rank and Other Factors in Comparison with Selected Countries

Getting Credit Data (2009)	Rank	Legal Rights Index	Credit Information Index	Public Registry Coverage (%adults)	Private Bureau Coverage (%adults)
Thailand (2008)	61	4	5	0	27.9
Thailand	68	4	5	0	31.8
Malaysia	1	10	6	52.9	N/A
Hong Kong	2	10	5	0	69.9
Singapore	5	10	4	0	48.3
Vietnam	43	7	4	13.4	0
China	59	6	4	58.8	0
Indonesia	109	3	4	26.1	0
Philippines	123	3	3	0	5.4
East Asia-Pacific		5.8	2	7.2	11.3
USA	5	8	6	0	100
Japan	12	7	6	0	76.2

Source: Doing Business 2009, International Finance Corporation

As shown in table 1.4, the survey reveals that legal environment facilitating credit requesting transactions and lending business in Thailand is rather weak, e.g., Thai regulation does not authorize parties to agree on out of court enforcement, not allow businesses to, without requiring a specific description of the secured assets, grant a non possessory security right in revolving movable assets, etc. Moreover, credit information in Thailand has been collected exclusive by the private-owned NCB and numbers of credit records account for only 32% of adult population. Even though this credit data coverage is better than average from the East-Asia Pacific region, it is still far behind those of Malaysia, Hong Kong, Singapore, and China. Regarding the extend to which the rules of credit information system facilitate lending, Thailand's Credit Information Index is in the neighborhood with Malaysia's and Hong Kong's, implying that the data structure of credit information collection and distribution has been well outlined. Overall, getting credit condition in Thailand can be improved in many ways. Not only regulations must be more flexible to facilitate lending transactions, credit bureau coverage must be strategically expanded to assist credit accessibility.

According to the Doing Business 2009, the IFC has ranked the Getting Credit condition for Thailand 68th, falling down from the 61st rank in 2008. However, the detailed information on getting credit conditions illustrates slightly different situation. By private bureau or NCB, the coverage on credit information has been raised by 3.9%, suggesting that credit data coverage has gradually progressed. Therefore, the only conclusion could be derived would be that the improvement in getting credit situation in Thailand is at a slower pace comparing to other countries.

1.8 A Regional Practice from Thailand's Experience

From Thailand's experience, a practice toward development of credit bureaus is summarized in Table 1.5.

Table 1.5: Practice in Credit Bureau Development

FRAMEWORK	PRACTICE
Types of Credit Bureaus (Private/Public Credit Bureau)	For the first credit bureau in a country or the early stage of development, a public credit bureau is needed to ensure information security, individual secrecy, and minimum credit information to be shared.
Ownership Structure (Shareholders/Information Providers)	It is not necessary that major shareholders are either sole banks or main information providers to ensuring each other's information sharing. The major information providers as holding a control of credit bureau operation could provide them reluctance to sharing their credit information.
Legal Framework	Lack of credit culture, ensuring members and borrowers' information security and secrecy is inevitable. Nevertheless, the more stringent on individual privacy leads to the less developed value-added services of credit bureau. Should the benefits of information sharing to consumers are proved; the consumer protection can be subdued.
Elimination of Free Rider Problem	Banks' reluctant to be the first one sharing information can be reduced or mitigated by the following incentives: public supports for first movers, information endowment, low transaction costs, their awareness.
Numbers of Credit bureaus in the Country	Due to being natural monopoly and economy of scale, credit bureaus should compete on differentiation on credit report and services in the long term.

Source: SBCG team

Chapter 2
SME Credit Information Databases Development For Thailand and the Regional Cooperation

2.1 Introduction

Among ASEAN+3 nations, Thailand is one of those in which SMEs development is highly focused during the economic development process. As the key element of economic development is to promote the expansion of the real sectors, SMEs have become vital core of the economy in terms of economic development and employment actuation in both metropolitan and regional areas. The economic stimulation via SMEs development not only increases per capita income, but also prevents regional labor migration, resulting in security of social and the whole economy. Consequently, the national development is improved and more sustainable in terms of quality and quantity. Therefore, Thai government is highly encouraged to promote SMEs expansion along with focusing on the large scale businesses.

Similar to those of other ASEAN nations, efforts to boost SMEs from several Thai governments in the past have become topics for debating on their economic impacts, and remained controversial. Traditionally, governmental assistances on SMEs focus on infrastructural and financial rather than on self efficiency and improvement. The recent policies on SMEs are perceived as overly protected, and the expansion of SMEs seems to be rapid, though the business fundamentals of these business entities are still not solidified. In fact, these SMEs are still at enfant stage of the development and their sustainability is impeded. Moreover, the supporting market mechanism is also distorted. As a result, there is no obvious academic evidence across countries regarding contribution of SMEs to economic growth (Beck, Demirguc-Kunt, and Levine, 2004).

The limited funding resources is always claimed to be the root cause against the SMEs' expansion. This is due to concerns regarding the SMEs' credit default, leading to reason why financial institutes are so restricted on loan approval. The countermeasure to this situation is to have central credit information widely available across financial institutes in order to ensure the minimum risk causing by credit default. To do so, the credit bureau is the suitable financial infrastructure innovation. Also, in order to cut back governmental assistance, SMEs development should be a market-based, rather than a governmental stabilization-based, especially in financial aspects. However, the credit bureau system in Thailand is still in the beginning stage in which the operational and database coverage is mainly for consumer credit information, not yet for SMEs credit information.

Even though a credit bureau has already instituted in Thailand, the specific credit information database for Thai SMEs is still not seriously focused. This possibly causes the major financial problem of the limited access to funding resources for SMEs due to the unknown individual credit reputation and insufficient collateral requirements. Nonetheless, the governmental intervention is still necessary in order to promote Thai SMEs' continuous expansion by providing additional loan guarantee. To reduce the government involvement, the credit information infrastructure must be specifically developed for SMEs not only in Thailand but also in the entire ASEAN+3 region. This is to pave the way to support the financial internationalization.

This chapter aims to present solutions for mentioned problems, and to induce guideline for SME Credit Information Databases Development for Thailand and Regional Cooperation. This study begins with 1) Analyzing structures and database of credit information from financial institutes, SBCG, and other relevant literatures, 2) Introducing a guideline for modalities for credit information databases centering on SMEs, and 3) Suggesting regional cooperation mechanism to create harmonized information sharing system.

2.2 SME Credit Information in Thailand

2.2.1 Definitions of SME

Definition of the Small and Medium Enterprise (SME) varies and depends on the economic and other relevant environments. Across country-wise, the definition of SME also bases upon the economic development status of each individual country in order for government to provide suitable public promotions and incentives. Technically, the number of employees, sales, and assets are the common key indicators in identifying the SME's definition. From time to time, the sales amount is also specified to classify the SMEs. Though two countries might use to same factor to define SMEs, e.g., sales and assets, the magnitude or size of these variables are also not identical.

Table 2.1: Thailand's SME Definition

Sector	Type of enterprise	Number of employees (persons)	Fixed Assets (million baht)
Manufacturing	Small enterprise	≤ 50	≤ 50
	Medium enterprise	50-200	> 50 and ≤ 200
Retailing	Small enterprise	≤ 15	≤ 30
	Medium enterprise	16-30	>30 and ≤ 60
Wholesaling	Small enterprise	≤ 25	≤ 50
	Medium enterprise	26-50	>50 and ≤ 100
Servicing	Small enterprise	≤ 50	≤ 50
	Medium enterprise	51-200	> 50 and ≤ 200

Source: Office of Small and Medium Enterprises Promotion (OSMEP)

The classification of SMEs in Asian countries is generally defined by the number of employees and amount of capitals or turnover. For Thailand, the first definition of small and medium-sized enterprise (SME), announced by the Ministry of Industry on September 11th 2002, bases on the number of salaried workers and fixed capitals. As shown in table 2.1, any enterprise with employees less than 200 persons and fixed capital less than 200 million baht, excluding land and properties, is categorized as an SME. Generally, SMEs in Thailand are classified in three sections: production or manufacturing, service, and trading (retailing and wholesaling). For multinational companies in the form of franchising and joint-venture between Thai and overseas companies, some of them may not be classified as Thai SMEs due to the capital ownership proportion in which greater than 50% may be owned by foreigners.

Table 2.2: World Bank's SME Definition

Type of enterprise	Number of employees (persons)	Total assets	Annual turnover
Micro enterprise	1-10	< $100,000	<$100,000
Small enterprise	11-50	$100,00-$3,000,000	$100,000-$3,000,000
Medium enterprise	51-300	$3,000,000-$15,000,000	$3,000,000-$15,000,000

Source: World Bank Group.

Remark: two of three variables (e.g., employees, assets, and annual turnover) must be met for an enterprise to be classified in a particular type.

Comparing to the World Bank's SME definition shown in table 2.2, Thai small enterprise's definition is roughly a combination of the World Bank's micro and small enterprises regarding terms of number of employees and asset value. In term of number of employees, the World Bank's definition of the below-medium enterprise of not more than 50 employees is similar to those of Thai description. However, the World Bank defines number of employees for medium enterprise at 100 employees, which is greater than those of Thai. In term of financial aspects, both the World Bank's and Thai's are in the same category, but the below-medium's total assets value of the World Bank seems to be narrower than that of Thai. Moreover, the medium's total asset value appears to be in wider range than that of Thai. This might be because of the World Bank's SME definition is categorized based on the economic development conditions.

2.2.2 SME's Productivity Constraints

In developed countries, such as the USA, Japan, and some of European countries, SMEs are the major driving forces for entire national economics. Also, small and medium-sized enterprises (SMEs) in Thailand play a vital role in Thai economy. They are undoubtedly a major source of entrepreneurial skills, innovation, and employment. Unfortunately, in most developing countries, SMEs have been facing difficulties, such as fund accessing, economy of scale, international competitiveness, and so on. Therefore, the manufacturing potential of SMEs in developing countries has become limited. As the stated situation, SMEs in these developing countries tend to have less important role in macro economy, comparing to those of developed countries.

Table 2.3: Enterprises' Importance and Productivity in 2007

Type of Enterprise	No. of Enterprises (% of total)	No. of employment (% of total)	GDP Mill. Baht (% of total)	GDP per capita (Mill. Baht)	
				Enterprise	Employer
SMEs	2,366,227 (99.6%)	8,900,567 (76.0%)	3,244,974 (38.2%)	1.37	.36
Large Enterprise and Others	9,141 (0.4%)	2,810,767 (24.0%)	5,239,226 (61.8%)	573.16	1.86
Total	2,375,368 (100%)	11,711,334 (100%)	8,484,200 (100.0%)	3.57	.72

Source: Office of Small and Medium Enterprises Promotion (OSMEP)

The statistical data shown in table 2.3 demonstrates the evidence of economic importance of Thai SMEs. In 2007, there were approximately 2.4 million units of Thai SMEs, contributing to 99.6% of the total number of enterprises. In the same year, the number of large scale enterprises and others was only 9,141, or 0.4% of total enterprises in Thailand. Even though the number of SMEs was far greater than large enterprises, the GDP contribution of SMEs to the whole Thai economy was significantly less. The shares of GDP from SMEs and large enterprises and others are about 38 % and 62% respectively, yielding around 24% in difference. In the other word, the GDP per capita of large enterprises and others was greater than that of SMEs about 2,000 trillion baht.

The imbalance of the number of enterprises and their GDP contribution to the whole economy reflects the limitation of productivity consolidation. Comparing between SMEs and large enterprises as shown in table 2.3, it is noticeable that the difference of number of enterprises was about 420x. As the GDP contribution implies the indifferent level of productivity, this imbalance in number of enterprises indicates the limited productivity against the expansion of SMEs inducing the less expansion of entire nation's enterprises.

However, according to most of the relevant literatures, the obvious obstacle against expansion of Thai SMEs is the fund accessibility due to the information asymmetry among financial institutes and all other participants within the lending market.

2.2.3 SME Credit Information for Lending and Guarantee

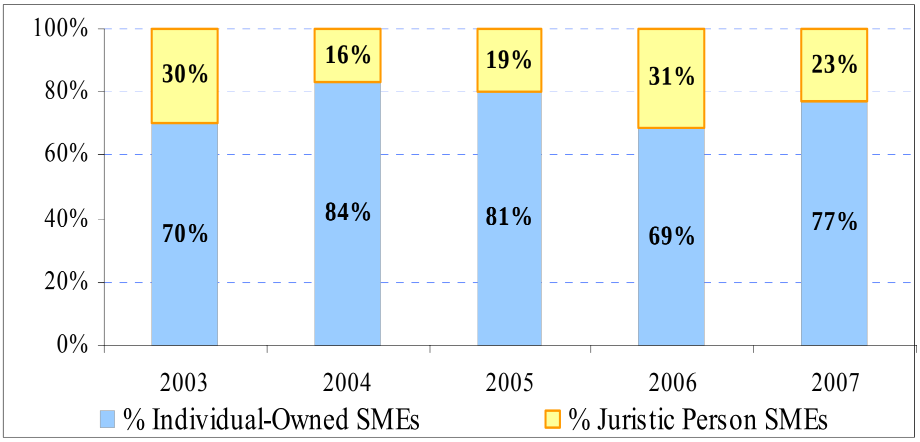
Once financial institutes found that an SME's project proposal has high potential of success but insufficient of required collateral, then the SBCG credit guarantee is created to ease the difficult situation. In order for SBCG to approve the credit guarantee service, lenders must provide the accurate analysis of SMEs' loan application. This includes trustful credit information and research regarding applicant's business potential, accompanied with the SBCG's guarantee service application. Since 2003 to 2007, there are approximately 12,000 SMEs which are the SBCG's customers. Most of those SMEs' related data, submitted to SBCG, are from customers of leading commercial banks. The relevant data that SBCG received from the leading banks can be categorized into 3 groups as the following:

- **Data from application**

Most of Thai SMEs are rather individual-owned than juristic persons as recorded in SBCG database and shown in figure 2.1 below. From 2003 to 2007, the average of individual-owned SMEs contributes for 76% of total SBCG's customers, comparing to 24%

from juristic person-typed SMEs. This could possibly imply that the majority of the Thai SMEs has low level of registered capital.

Figure 2.1: SBCG Customer Classified by Types



Source: SBCG

Data from application mostly consists of all related forms, financial statements, executive interviewing, manufacturing process and business plan. Initially, SBCG requires information from SMEs' loan application form. Most stated information is common among financial institutes in both individual and firm SMEs. From table 2.4, the application form data is almost similar in both individual and firm SMEs except for the type of office and credit card debt outstanding. This might be because these two criteria are unnecessary in indicating the business or financial performance of firms. The commonly required information consists of general data (e.g., personal data, address, types of office, business, entities, etc), financial performance data (e.g., revenue, expenses, tax, profit, etc.), and collateral data (e.g., types of collateral, owner's name, and preferences).

The financial performance data is the crucial information for financial institutes in making loan approval decision. For individual typed SMEs which have no or less inefficient data revealing mechanism, validity of their financial data could affect the loan approval process. On the other hand, firm characterized SMEs are legally obligated to submit their financial statement to the Department of Revenue for tax declaration, and their financial data disclosure and validity is not a concern for loan requesting procedure. However, the accuracy of the information in both types of SMEs' financial statement is subject to an error in cash flow. As the SBCG's main customers, the accuracy of SMEs financial information is one of the major obstacles to provide effective SME credit guarantee service.

Table 2.4: Application form data and key financial ratios Banks employed

Application form data and key financial ratios	Type of SMEs	
	Individuals	Firms
1. General data		
personal data	●	●
address	●	●
type of office	●	
shareholders/authorizing persons	●	●
type of entity and business	●	●
type of credits and purposes	●	●
2. Financial data		
Revenue and other revenues	●	●
cost of goods sold	●	●
Expenses and tax	●	●
profits (loss)	●	●
Current and fixed assets	●	●
bank deposit account	●	●
debts outstanding with other lender	●	●
credit card debt outstanding	●	
applicant's guarantees obligation	●	●
large suppliers and customers	●	●
3. Collateral data		
type of collateral	●	●
owner's name	●	●
preference	●	●
4. Key financial ratios banks employed		
debt to equity (D/E)	●	●
debt service coverage ratio (DSCR)	●	●

Source: SBCG's database

In Thailand, there is yet no tax or other incentives to convince individual SMEs to become firm SMEs, for benefits of credit system on trustable financial statement and higher standard of good financial governance. To establish financial transparency, the incentive policy to convince firm SMEs to provide accurate financial statement is also necessary. Consequently, the financial institutes have set the self-interest protection mechanism by auditing business transactions (via invoices and order forms) and interviewing dealers or distributors in order to reassure the actual gross purchasing order. Executive interviewing and company visiting are as well parts of financial statement auditing.

With lack of creditable information, most financial institutes have recently focused on creating estimation tools to accurately guesstimate the financial configurations, which would in turn be used to calculate financial ratios or a guideline for loan approval decision making. The debt-to-equity and debt service ratios are the most used.

- **Commercial banks' internal data**

This type of data is mainly from information available via transactions with current customers in both loan and deposit accounts. This information is rather crucial for large-sized financial institutes in order to indicate and detect the relationship-based loan approval. However, this information is available internally only through their own SMEs customers, and cannot retrieve from other financial institutes.

- **Other external related data**

This type of data may be in form of credit information from credit bureau, industry related data, and regional economy data, for example. Those external related data along with information from NCB database then become very useful for financial institutes in loan approval determination. Some commercial banks retrieve this external related information to adjust their potential loan granting clients' total liabilities or to remodel their credit ratings. The most usage of NCB database is mainly to detect any negative information on credit history.

Beyond the historical credit information, the specific industry information is also included into the information set in analyzing business risks. However, the industrial risk analysis could be interpreted as general situation of SMEs, and may not be suitable to all SMEs due to their heterogeneous business characteristics. In other words, the implication of this risk analysis is too generalized and not proper for specifying an SME's systematic risks.

2.3 Thailand's SME Credit Risk Database Center

Presently, there exist 2 local credit rating agencies in Thailand, TRIS Ratings, and Fitch Ratings (Thailand) or Fitch. These two rating agencies mainly provide services on risk and credit rating evaluation for both financial products and organizations. Upon publicly available information, financial institutes could learn about credit ratings of those financial instruments or corporations, and exploit that information in the risk assessment and credit granting process. Such course of actions verifies benefits of price setting mechanism from credit risk assessment. Small businesses also benefit from those credit risk assessment – they would effortlessly have access to source of fund, and then could decide either to issue financial products or to apply for a business loan. Thus, those credit ratings could also be considered as credit registry for credit markets.

Due to the fact that credit rating service is rather costly, only large corporations could be able to afford such expensive service. Moreover, credit rating process requires a great amount of reliable financial information. Therefore, clients for credit rating service on financial products or organizations mostly are large organizations, meanwhile small and medium sized businesses or SMEs are not main target customers for credit rating services.

As credit grantors for small businesses, commercial banks nowadays perform their own credit rating and risk assessment on loan applications and customers. Financial institutes requires to create own credit risk database from their current customers, as well as to request and examine on credit payment history from the National Credit Bureau (or NCB). Moreover, time and human resources are also needed to carry out credit analysis similar to those from credit risk service from credit rating agency. Capital loaded banks may put in lots of money to build their own credit risk model especially for SMEs in order to speed up credit assessment process and to cut down in manpower in the process.

Unlike other credit rating agency, this ideal credit risk database center is then to function as credit rating agency exclusively for small and medium businesses. In order to clearly understand the role and responsibility of this credit risk database, the definition of a credit risk database should be properly and acceptably defined. As a credit risk assessment center, the SME credit risk database center in Thailand refers to an organization that gathers data from members (e.g. commercial banks, consumer finance, leasing companies, other lending institutions, utility companies, etc) and then processes the collected data to measure or predict a SME's credit risk exclusively for members.

The main content of this part is to explore a possible modality in creating national database for credit risk in Thailand by using shared information from all commercial banks and other finance corporations in order to assess credit risk.

2.3.1 Modality

Although many developing countries have well established credit risk database center, those pooled credit information center still often come across several restrictions, such as implementation and controlling, registrations, or different risk concerning environment across businesses. Therefore, a well defined modality for credit risk database center should factor in those differentiations from each country. Establishing a credit risk database center in Thailand should consider the following critical factors:

- **Scope of business**

The main business for credit bureau in Thailand is to search for credit and payment history for consumers, yet this is not the case for credit risk database center, which its main function is credit risk assessment. Therefore, NCB provides different business purpose and implication to those from credit risk database center.

The ultimate goal for the credit risk database center is to formulate a credit risk model based upon available credit and payment information. Similar to the CRD in Japan, and SME credit risk model by Moodys' Investor and Standard & Poors, this credit risk model facilitates risk assessment, which its implication is to compute credit rating and probability of default. Upon gathering credit information, the credit risk database processes that information and derives credit risk model's parameters. Once independent variables from individual have been fed into the model, this credit risk database performs model processing and then estimate credit rating and probability of default for this particular individual.

- **Legal status**

As previously discussed in chapter 1, consumer information in Thailand is protected by law under the Credit Information Business Act (2002). Credit information sharing is also restricted upon this registration. Therefore, it could be postulated that the Credit Information Business Act confines credit information deployment in Thailand.

However, the scope of this registration does not specify whether the case of anonymity of credit information (or when owner of credit information is unknown) would be regarded as credit information sharing. Also, financial institutes, according to this Credit Information Business Act, are beneficiaries of credit information, regardless of ownership. Therefore, we, to be on the safe side, define that the modality for credit risk database center should also operate under consumer information protections and restrictions of the Credit Information Business Act.

- **Ownership, governance and business model**

Though business scopes of the credit risk database center depart from those of the NCB, they share similar business principle and functionality: credit information sharing and credit assessment. Moreover, stakeholders of both units are almost identical. Thus, founding the credit risk database center could follow 2 approaches – either as a business unit within the NCB or as a separated business entity, apart from the NCB.

Considering the fact that the credit risk database center should be specialized in credit risk assessment for SMEs businesses, and thus becomes an essential mechanism in supporting SMEs' businesses and sustainability, this database center should be established and operated as a different business entity. This stand-alone organization format allows flexibility and specialty for the credit risk database center. Ownership of this database center should include not only financial institutes, but also other related non-finance institutes, SME associations, government representatives, and other organizations with credit risk knowledge and technology based. Importantly, all shareholders must be Thai nationality, in accordance with the Credit Information Business Act.

- **Data types and coverage**

From business scope mentioned above, credit information and payment history are collected and processed in the anonymous format. Identification of credit information owners is securely coded for database management purpose, and thus highly classified. The credit risk database center then by no means can specify the identification of the credit information owner.

Due to credit information on SMEs is generally insufficient for analyzing creditworthiness of SMEs, the further credit information should be required. The center should be a full bureau gathering comprehensive data, i.e. both negative and positive data on financial and non-financial information. Information sharing will be developed on the information pooled across many creditors as well as public information sources the basis of the credit bureau data. Moreover, the information should be highly predictive measure of future repayment.

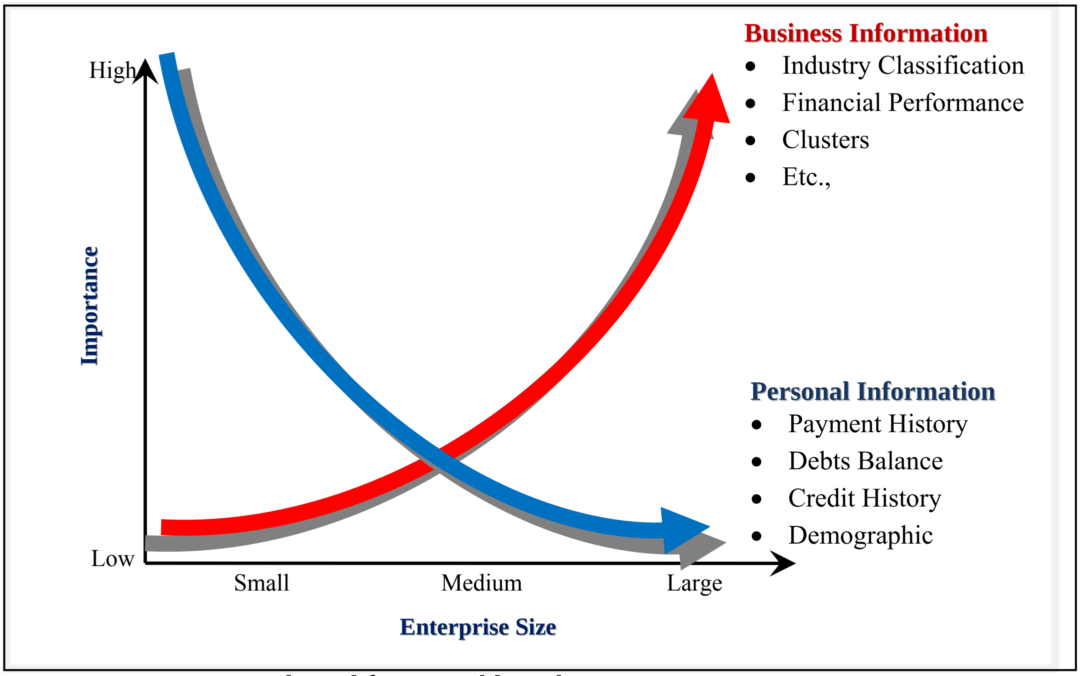
Types of required information are

- Application form from financial institutes
- Bureau data, e.g., positive payment behavior, previous searches/inquiries.

- Third party data, e.g., court judgments and bankruptcies, litigation, capital information, registered charges.
- Demographic data, e.g., applicants' personal attributes, such as age, education.
- Clustered data, aggregated information at the geographic level

Since credit information from small enterprises mostly is personal information, while business information could be obtained from large scale enterprises. Thus, types of required information also depend of the enterprise size, which also shown in figure 2.2. To better capture credit assessment, time span of this historical data, either good or bad credit profile, the time span for credit information required should be at least 5 years.

Figure 2.2: Credit Information by Enterprise Size



Source: SBCG team, adapted from World Bank Group

- **Credit risk model**

Two models that would best suit the credit risk database are custom application model, and pooled data scoring model. Custom application model, custom-developed by Fair Isaac from the client's data, is empirically derived from statistically based tools. Scores from this empirical model represent the odds that an applicant will pay as promised on a loan. For the pooled data scoring model, this model is empirically derived from database of pooled data from creditors. Though this approach may pose initial difficulties as data must be collected on a standardized format, it will result in more powerful and accurate models.

The pooled data scoring models seems to be the most suitable for the credit database center. The employed variables in this model should be the combination of personal and financial data to promote flexible adoptability to both types of SMEs (individual and firm). Moreover, this estimation model should be analyzed as classification by industrial sub-sectors. The financial data should be constructed as a composite index in case of any missing information.

- **Elimination of free rider problems**

The obvious obstacles for founding a credit risk database are not only the fact that many large commercial banks have invested in developing their own credit risk assessment, but also the establishment of credit database center is time consumed and needs the reliable credit risk model and all related data. As the stated conditions, the dedicated team or agents in charge of developing mutual data and credit risk model must be clearly defined. Otherwise, there might be no commercial banks willing to volunteer or pioneer in this credit information collaboration.

Therefore, at the beginning of the establishment, SBCG, as a government agency and SME data center, is the most proper agent in collecting data from commercial banks and pre-research the data standard and model development. If the pre-researching was a success, the formal establishment of this center would be then announced and inaugurated.

2.3.2 Creation of Credit Risk Database in Thailand

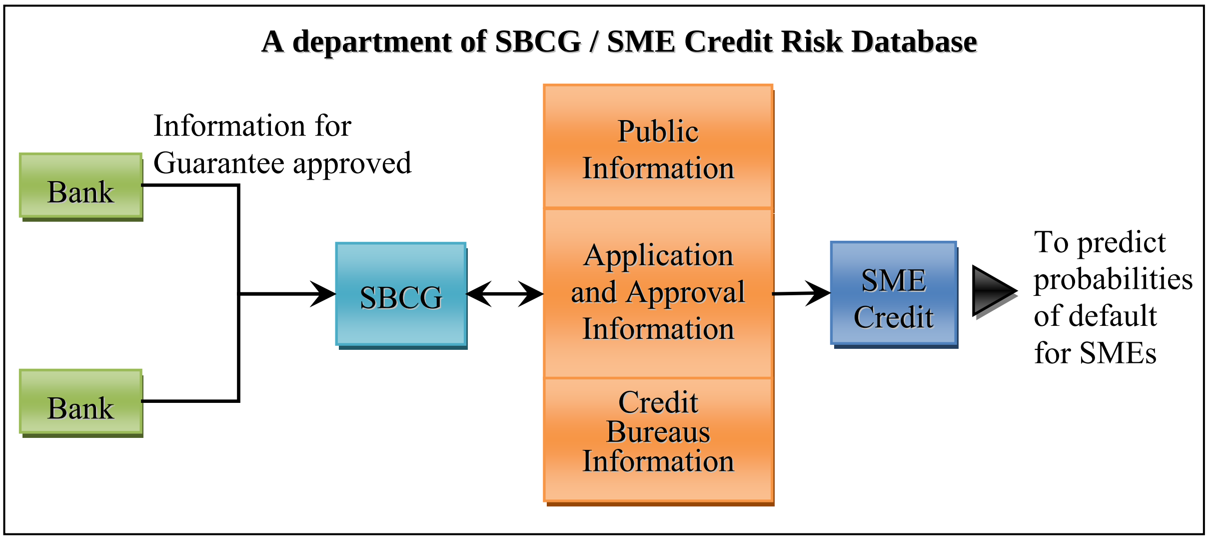
The establishment of credit risk database requires collaboration from many relevant stakeholders and should have the common implications for both public and private sectors. Modeling for credit risk database, by either custom application model or pooled data scoring model, is complicated and needs advanced econometric techniques. Since the cost of constructing the responsible teamwork or department from each bank may be costly, free rider problem would be another major obstacle in creating credit risk database. Therefore, to simplify the creating process, the development of action plan should be systematically divided into two phases; early development stage, and take-off development stage. Subsequently, the action plan would be practical and benefit to all relevant stakeholders.

1. The Early Development Stage

At the beginning, the membership of the credit risk database center would be focused solely in banking industry because they are the major loan grantors for SMEs. For better cooperation, the co-founding membership during the early development stage should be exclusively invited and limited to government-owned financial institutes such as Krung Thai

Bank (KTB), Siam City Bank (SCIB), Thai Military Bank (TMB), Small and Medium Enterprise Development Bank of Thailand (SME Bank), Export-Import Bank of Thailand (EXIM Bank), Small Business Credit Guarantee Corporation (SBCG), Government Savings Bank (GSB), Government Housing Bank (GHB), and other financial institutes which government is partially stockholder. Later on, membership of this credit risk database center would be opened to other commercial banks. The structure and process for SME Credit Risk Database as in the early development stage is illustrated in figure 2.3 below.

Figure 2.3: SME Credit Risk Database – Early Development Stage



Source: SBCG team

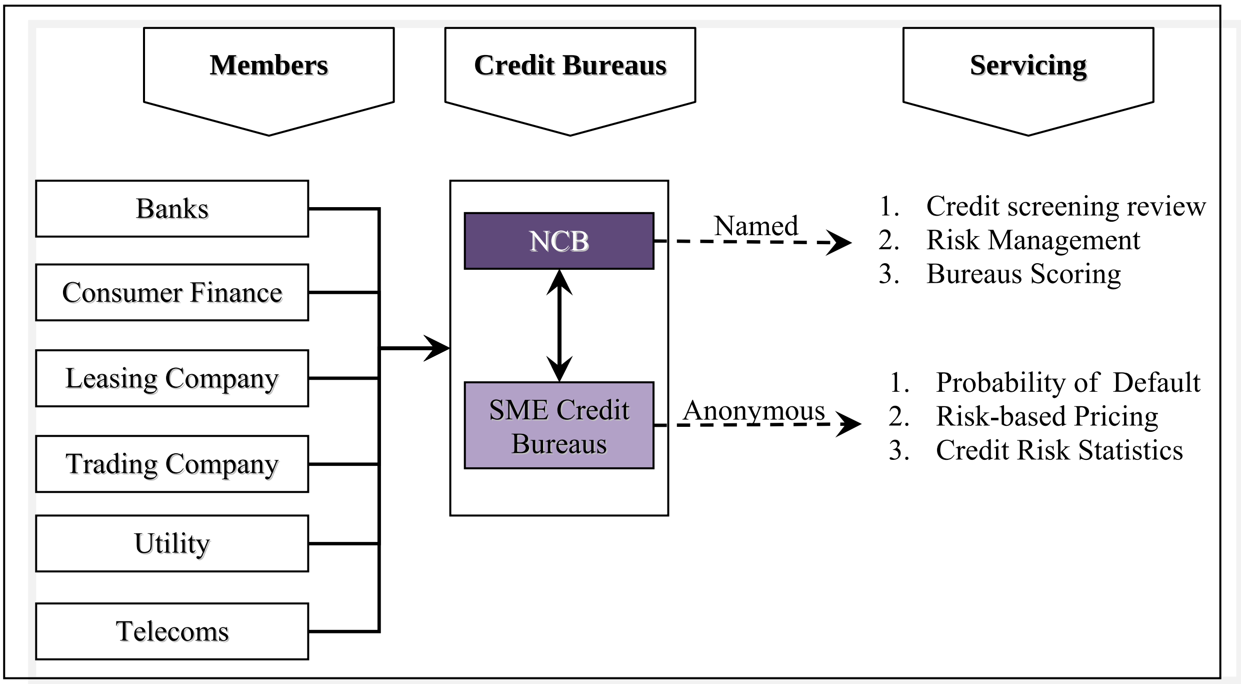
In order to meet the credit guarantee approval requirement, SME has to provide financial and other relevant information as similar to those provided to loaner banks. So, in this phase, SBCG would be strategically placed as the center of the model. Credit information, e.g., data on loan application and approval information, from each member will directly flow into SBCG. Since solely information for guarantee approved from banks is insufficient for modeling, SBCG would add other essential data for credit risk assessment; such as credit bureau information from NCB and industry and other public data from public, into the credit risk model. Then it would be a tremendous responsibility for SBCG to statistically develop a systematic model for credit risk estimation. Upon completion of the credit risk model, SBCG could predict, based upon the calculation from the model, probabilities of defaults for SMEs once they undergo credit application process.

However, the obtained model is based on the data which is covered only from member banks' information. The setting up of the wider range of credit risk database will enable the credit risk model to become more universal uses of other financial products such as leasing, consumer finance, trade credits, etc.

2. The Take-off Development Stage

The limited scope of the Early Development Stage enforces the span of data integration to come only from the member banks. To bring the credit risk database into a more universal in finance industry, other types of financial organization, such as consumer financing, leasing, or utility companies, will be collected into membership, as well as into SME credit bureau database. Wider scopes of the database are systemized to link to the NCB's credit bureau database. From credit risk modeling process, credit information from NCB will anonymously flow into the SME credit bureau. The outcome of the SME credit bureau is anonymous and serves as a forecasting model for probability of default, risk-based pricing, and credit risk statistics. As in the take off development stage, SME Credit Risk Database structure is summarized in figure 2.4.

Figure 2.4: SME Credit Risk Database – Take Off Development Stage



Source: SBCG team

The credit risk model derived from the SME credit risk database model would cover the entire system of credit and loan transactions. This would also lead to business advantages for

SMEs in terms of credit guarantee approval opportunities. Moreover, credit rating from the model would reflect SMEs' actual creditability, and then would better facilitate SMEs in financing accessibility.

2.4 Regional Cooperation Mechanism

Though the system of international finance is currently rather regional, thanks to consequences of regional trade tendency, the regional cooperation mechanism on credit information lags. For ASEAN+3 countries, the regional cooperation mechanism is still quite ineffective due to the SMEs' information black-hole, leading to questions on availability and validity of information for business forecasting. Although credit risk models are a powerful lending technology, they require access to local data of SMEs in each country. Therefore, credit information database and credit risk models should rather be regional than domestic orientation to support the regional trading and financial collaboration.

Although most ASEAN+3 countries have their own credit bureaus, each of them still has its unique modality of credit information, causing information asymmetry and weakening financial immunization of the region. The guidelines to bolster this immunization can be in two forms of regional mechanism as the following:

2.4.1 A New Cooperation Mechanism: A Credit Risk Information Center in The Region

Due to domestic legal restriction and political issues, the credit risk information in each country in ASEAN+3 is either partially disclosed or undisclosed. Also, each country designs its own criteria for loan approval under information protection regulation. To be regionally integrated, common credit risk information must be first processed, which will be common indicators of fundamental characteristics and risk regarding SME loan portfolio of each country. Thus, a regional credit risk information center should be established to be the center for data collection, as well as to provide consultation in gathering credit risk information and modeling for SMEs in each country. More importantly, this regional credit risk information center will be responsible for creating not only a systematic but also standard practice on SME loan underwriting for the region. Simply perceived as the prototype for SME loan underwriting, this practical model would eventually become the foundation for a decent credit culture for every country within this region.

The course of action in establishing a credit risk information center is proposed as the following:

1. **To identify a gap of differences in the structure of credit risk database:** These differentiations are derived from dissimilarities in legal status of SMEs in each country, inconsistency of financial data across country, and scarcity of reliable public registry.
2. **To determine country benchmark portfolio:** Country benchmark portfolio defines characteristics or portfolio of loan groups as a reference in each country, including age, collateral, credit portfolio component, combination of collateral, and age of loan.
3. **To calculate country default rates and loss rates:** Default rate signifies the magnitude of risk from SMEs' loan in each country. Meanwhile, loss rate indicates not only the list of loss from non-performing loan, but also recovery rate dimension.
4. **To study diversification or risk covariance in the region**: A study of interrelationship on credit risk from each country could generate a guideline for risk diversification in the region by minimizing credit risk portfolio. The finding of this relationship could also soften the domino effect by balancing SME credit portfolio in terms of business risk, financial risk, and liquidity risk.
5. **To build a harmonize infrastructure through best practices of SME credit information sharing and credit risk model**: The collection along with the study of the best practice of SME's credit information sharing and credit risk model allows each country to obtain a guideline for SMEs development.

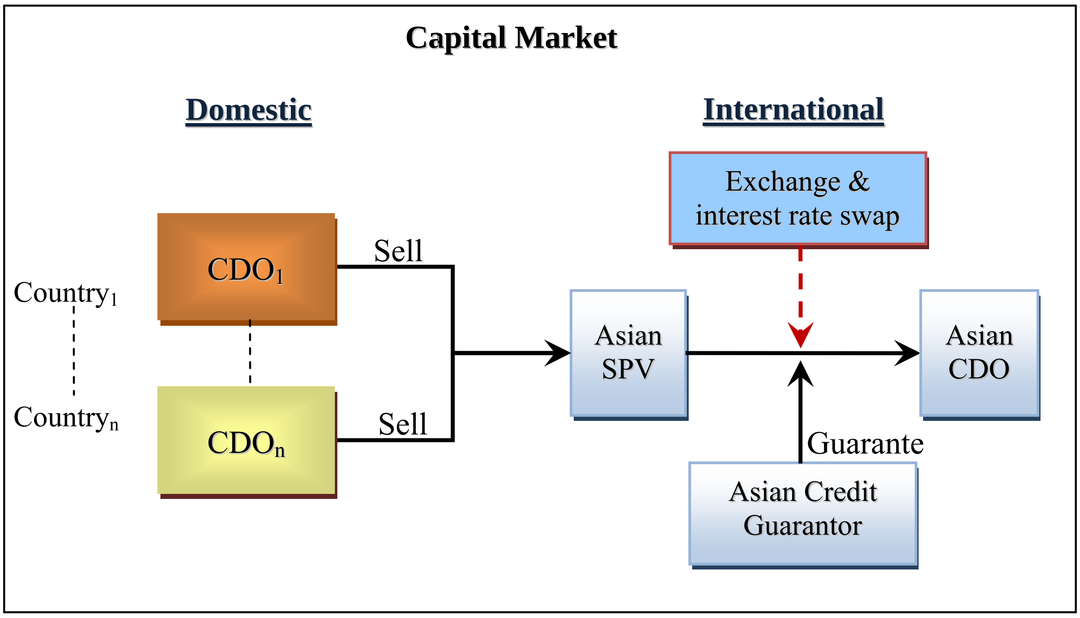
Upon processed, credit risk information could reasonably represent quality of loan underwriting in region. The best practice in credit information sharing and credit risk model could be taken as guidelines for SMEs development. Furthermore, credit risk information indicates the magnitude of SMEs credit risk in each country, enabling a pricing mechanism for securitization.

2.4.2 The Existing Regional Cooperation Mechanism: Market Making for SME CDO

SME loans of a country can be packaged into tradable securities or collateralized debt obligation (CDO), becoming a financial products that offer competitive yields and subsequently sold to institutional investors in the Asia Bond Market for cross-border investment. Therefore, pooling countries' CDO can collectively reduce the risk level of a portfolio, and create a well-diversified risk portfolio of SMEs' CDO.

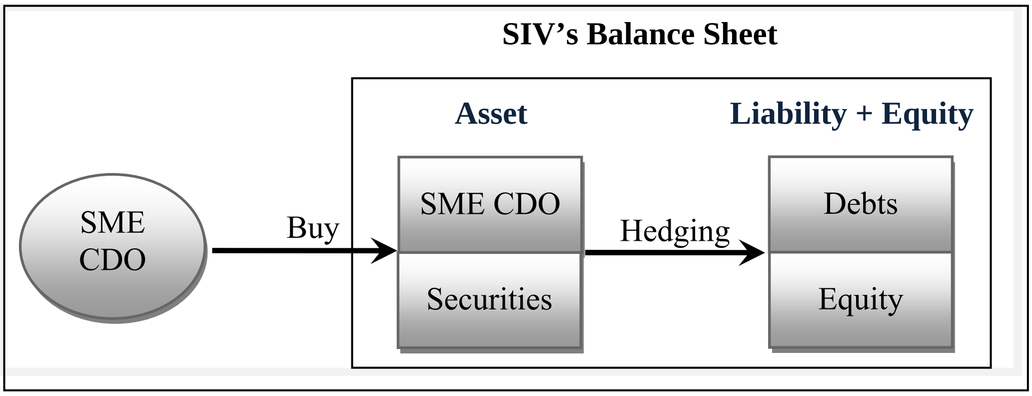
Practically, growth of securitized debt or CDO solidly depends on the credit quality of securitized debt. Still, this CDO is non-stationary due to incessant changes in volatility. It follows that the transaction mechanism on CDO must properly be structured and country-pooled CDO must perform as expected. Otherwise, trenches of structured debt CDO will experience dramatic credit deterioration and loss is as a result. As happening in the USA, the CDO market associated with poor institutional arrangement, the CDO market mechanism was somewhat distorted. This distortion is known as the main cause of the fall-out in inefficient CDO market, so-called the US sub-prime crisis, and dragged down this new form of financial instruments. Since merely a well developed in institutional arrangement might not be sufficient to promote SME's CDO market, the credit risk information is not supposed to be neglected as well. Hence, in best practice, the proposed establishment of SME's CDO in both primary and secondary markets must be as the processes shown in figure 2.5 and 2.6.

Figure 2.5: SPV for Making SME CDOs in Primary Market



Source: SBCG team

Figure 2.6: SIV for Making SME CDOs Liquidity in Secondary Market



Source: SBCG team

In order to pursue the existence of SME's CDO market, institutional arrangement cross borders must be encouraged in the following arenas:

- Establishing Asian SME CDO SPV (special-purposed vehicle) for purchasing SME loan from Asean+3 countries and bundle them to issue CDO securities in international markets.
- Establishing High Universe-Rating Third Party as credit enhancer for credit regional and credit guarantee as credit enhancer for SME CDO securities.
- Establishing Asian SME CDO SIV (special investment vehicle) for enhancing market liquidity of Asian SME CDO in secondary market.

Beside the mechanism previously mentioned, some tax-incentive instruments should additionally be in placed in each and every country. This tax exception scheme evidently provides monetary incentive for SME's loan securitization domestically as well as internationally.

Moreover, government banks in each country should act as a seller for SMEs loan portfolios securitized to CDO markets. Meanwhile, SME credit guarantors could play a significant role in supporting loan-securitization underwriting. Issuing credit guarantee on SMEs loans requested by commercial banks, SME credit guarantors could convince these commercial banks to pack their SMEs loan portfolios into collateralized debt obligations.

Chapter 3

Thailand's SMEs Credit Guarantee Systems

This chapter begins with the reviews of issues regarding SME credit guarantees from literatures in both their theory and practices. The next section features the credit guarantee system in Thailand. Identifying the challenges for developing the credit guarantee system is highlighted in the last section.

3.1 Literature Issues

Literatures have indicated that small-medium enterprises (SMEs) encounter higher financing obstacles and stronger impacts than large enterprises. Due to their insufficient collateral, SME borrowers with an equal probability of default may have an unequal probability of obtaining credit. Thus, credit guarantees schemes aim to ease the problems of SMEs' obstacles to access credit.

Credit guarantees can be defined as a type of collateral because they provide a lender with a security which can be liquidated in case of default. By enhancing the borrower's creditworthiness with guarantee as collateral, they reduce the risk incurred by borrowers. On the other hand, credit guarantees may be viewed as a type of insurance. The guarantor insures lenders against default of borrowers and charges a fee.

Across the globe, there are 3 common types of corporate governance (Beck, Klapper, and Mendoza, (2008)):

- **Mutual guarantee societies or associations** are a collective of private business and entities, which grant collective guarantees to their members' loans. The members are shareholders and/or management of the organization. The mutual guarantee associations are largely operated in developed countries in Europe, and South Americas.
- **Public guarantee schemes** have been initiated by the government or public agencies. These are generally established in developing countries as part of a public policy towards providing financing to SMEs or some other target sectors or demographic group.

- **Corporate guarantee schemes** are established and operated by private sector, including participating banks, chambers of commerce, and entrepreneurs. Funds are raised from the private sector or sometimes from public sources. Examples include guarantee schemes in Greece and Romania.

Some counties, e.g. Japan and countries in Europe, have a two-tier credit guarantee system since the governments choose to limit their intervention roles on credit markets. The first tier is a credit guarantee function that private sectors or mutual guarantee societies guarantee directly financial institutions' loans to SMEs. The other is a credit insurance function tier that government agencies or public funds reinsure those credit guarantees granted by the organizations in the first tier.

Longer the historical guarantee systems have been implemented, the better performance of the guarantee schemes. However, the private market mechanism of the guarantee system is the main venue for those long been implemented historical guarantee systems. The extent to what credit guarantee schemes succeed could be measured in 2 concepts: additionality and sustainability. A succeeded credit guarantee scheme should be able to make additional fund possible to borrowers by insuring against loss of loan to the lender. This additional loan available to borrowers when needed signifies additionality. Moreover, the credit guarantee scheme on the funding should operate on an independent basis; requiring continuous subsidies from either the government or donors is the sign of non-sustainability of the credit guarantee in the long run.

However, credit guarantee systems in many countries, especially developing ones, had experienced a great loss from credit guarantee operations. The unsuccessful credit guarantee schemes in those developing countries attracted government intervention via injecting fund into such unsustainable guarantee scheme. This led to public discussion regarding justification and cost effectiveness of credit guarantee schemes.

It has long been argued that failures of credit markets in many countries and their market schemes are unrelated. In favor of credit guarantee, government officials believed that the economy in general would benefit from the environment where small firms can gain more access to needed fund. This circumstance creates credit market imperfection - a systematic lack of finance to those small firms, would be the main cause for credit markets failures. The credit guarantee schemes in Canada, Japan, the United Kingdom, and the United States are examples of those supporters. Their loan guarantee programs are mainly intend to facilitate small firms to gain access to loans considered necessary. However, critics and governments do not see eyes to eyes. They often criticized that government's transactions on loan programs would never be able to justify cost effectiveness and sufficiency for the public fund spending in credit guarantee schemes. Moreover, a continued flow of government subsidies by means of disguised provision of free or low cost facilities and services is definitely perceived as a compromise on sustainability of credit guarantee schemes.

Although imperfections in credit markets could be easily apprehended, a justification of credit guarantee schemes is rather complicated. As SMEs stumble upon financing obstacles, a well defined credit guarantee scheme must be able to facilitate small firms in accessing needed financing. Though this market intervention would be objectionable by many critics, such credit market involvement seems to be the most appropriate operation of guarantee programs in order to facilitate fund accessibility of small firms, and eliminate the root causes behind credit market imperfections. Superior to credit guarantee schemes, a credit bureau assists small businesses in surpassing asymmetric information difficulty, thus reducing the transaction cost and uncertainty surrounding repeated lending. However, credit guarantee schemes are not always of assistance to the economy. Should the financial system be inefficient or should a non-repayment culture exist, constructing a credit guarantee scheme may do more harm than good.

Credit guarantee schemes primarily intend to bring about additionality, especially from financial feature. Small businesses often have difficulties in accessing to credit due to the fact that they lack, or is inadequate, of loan collateral. By reducing the risk to banks and assisting firms to establish a repayment reputation, credit guarantee programs help to increase commercial bank loans, either in number of business deals or amount, to SMEs clients. As a result, financial additionality incurs because of succeeded credit guarantee schemes. Financial additionality is also regarded by many other improvements in loan receiving circumstances related to credit guarantee program. More rapid loan processing due to improved lending techniques, as a result of bank's experience with guaranteed borrowers, is also considered another aspect of the financial additionality. Also, financial additionality can be achieved in terms of loan size, a longer repayment period, a decrease in the interest rate or collateral required, or an increase in the amount of non-guaranteed borrowers.

As opposed to credit guarantee schemes, many critics are afraid that credit guarantee programs will be wrongly used as substitutes for structural reforms. In other words, critics are fully aware of the difficulty of small firms to access formal funding; they do not want to see credit guarantee schemes as the first-best solution to this problem. In fact, what critics concern should not be the case. Should collateralization of the types of assets that SMEs own is systematically prevented due to deficiencies in the legal system, a legal system reform is then more appropriate than an intervention in the market for credit.

Generally, banks mistrust credit guarantee schemes and fear bureaucratic delays in processing loans. Hence, for countries where credit guarantee programs are not fully developed, like ones in emerging and developing economies, the first and main problem for credit guarantee schemes is to achieve commercial banks' participation in the schemes. However, banks' experience of many guarantee schemes, even in developing countries, yields them no reason to be less skeptical regarding this issue. Fortunately, the portion of bank loans subject to guarantees is fairly small in all countries due to the banks' skepticism and a subsequent lack of lender participation

Perceived as government's key mechanism to develop and promote business operators, credit guarantee institutions all over the world get different forms of interventions from their respective government. Upon this notion, the different forms of government involvements in the credit market yield distinctive results of their performances.

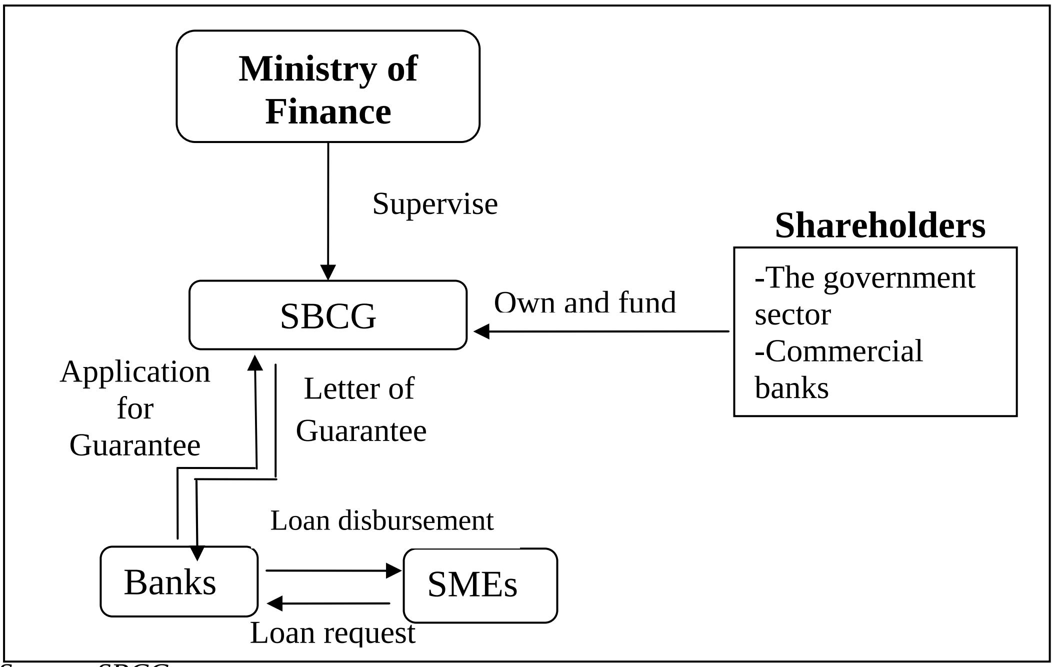
3.2 The SME Credit Guarantee System in Thailand

Prior to the early 1990s, Thailand had operated its small business credit guarantees in a type of small fund, namely Small Industry Credit Guarantee Fund (SICGF). The fund enabled viable small enterprises with collateral to obtain more loans from banks. Until the government's policy strengthening SMEs, all business and operations of the fund were taken over and legalized as a special finance institution under its own law.

By the Small Industry Credit Guarantee Corporation Act promulgated December 30, 1991, Small Business Credit Guarantee Corporation (SBCG) was established and officially started its operation in February 21, 1992. With respect to the small amount of initial registered capital of 400 million baht, a tenfold amount of capital has been injected much more tenfold to be 4.7 billion baht in 2007.

Over a decade, SBCG, as shown in figure 3.1 below, plays the role of the single credit guarantee institution in the one-tier guarantee system of the country. Like other credit guarantee schemes in emerging economies, its main objective is publicly set to assist small enterprises in obtaining a greater amount of credit from financial institutions towards achievement of the small industry development and rural employment policies. Thus, the credit guarantee system in Thailand is seen as a tool of public intervention in boosting SMEs economy, which is similar to other direct subsidies.

Figure 3.1: Credit Guarantee System in Thailand



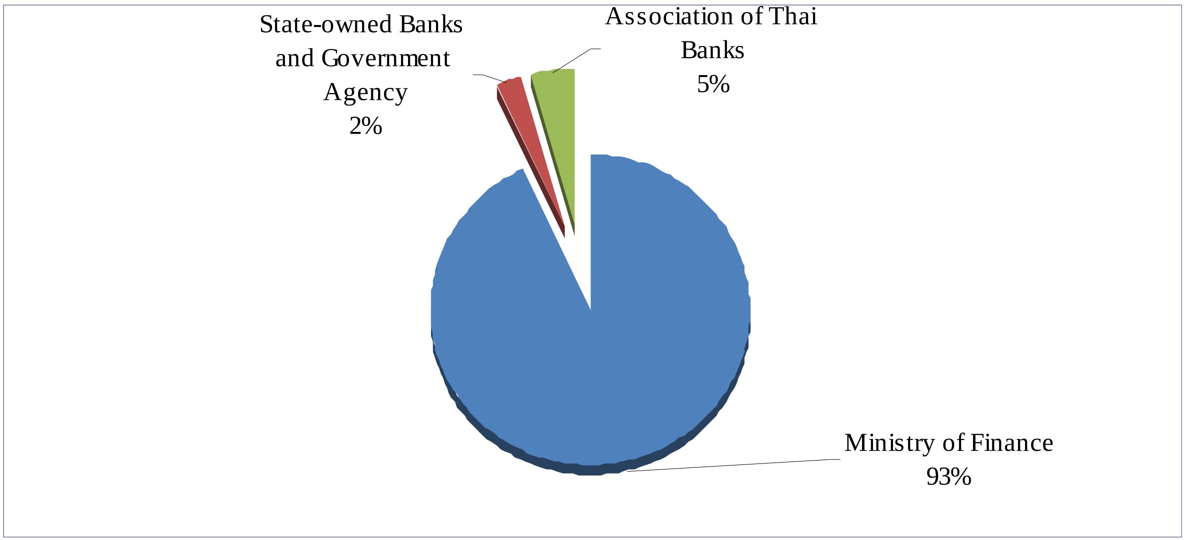
Source: SBCG

3.2.1 Ownership and Governance

Presently holding 93.62% of total shares in SBCG, the ministry of Finance becomes its predominant shareholders. The members of the Thai Bankers' Association maintain only 4.55% of totals, and the rest is held by government agencies. This causes SBCG to preserve a state-owned enterprise status. SBCG's shareholding is summarized in figure 3.2 below.

SBCG is a special financial institution (SFI) under supervision of the Ministry of Finance. Its business and operation scope is confined to the own establishment act, the Small Industry Credit Guarantee Corporation Act, A.D. 1991. It is noticed that the act allows it to discretionarily operate on small business credit guarantees. Its policies and operations are governed on the general corporate basis of representatives of its shareholders-the board of directors. As majority shareholders, Ministry of Finance engages primarily in the board of directors.

Figure 3.2: SBCG's Shareholding



Source: SBCG

Based upon its mission statements and state-owned enterprise status, the credit guarantee corporation for SMEs is positioned as a non-profit organization. It is believed that SBCG has to focus on the benefits of the country rather than on its own profits since it is the government's key mechanism to strengthen the SMEs' health and drive the social and economic growth of the country.

3.2.2 Credit Guarantee Schemes

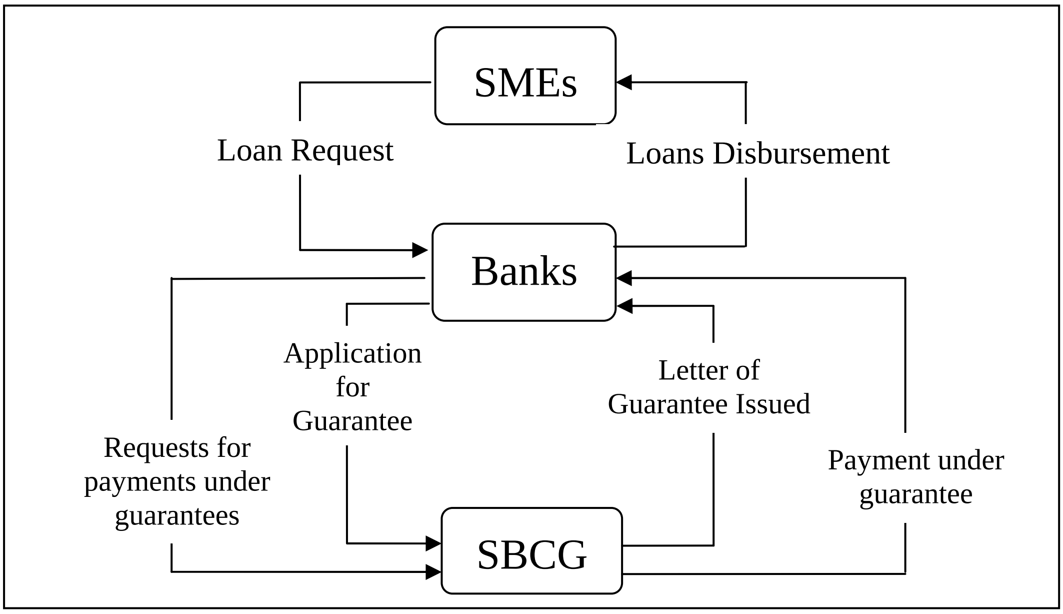
At present, SBCG provides credit guarantees on the uncollateralized portion of loan under 3 credit guarantee schemes, as the followings;

- Normal Scheme: SBCG plays the role of guarantor for small businesses when they are in need of fund. SBCG will provide the credit guarantee services to loans from commercial bank and SFIs on the non-collateralized portion of the loan for the amount of 10-40 million baht in credit limit.
- Risk Participation Scheme: Under the circumstance of continuity basis or where fund is required within time constraint, SBCG could provide risk participation services to small firms by sharing risks for loans extended with the loan providing financial institutions.
- Loan Guarantee Scheme: SBCG also provides credit guarantee for a longer term of less than 7 years loan period. To limit risk exposure on loan, credit guarantee limit is kept under 10 million baht, and conditions on loan request, e.g., assets to be used as

collateral, and shareholding equity portion, are also more restrictive than normal and risk participation schemes.

The SBCG's 2007 annual report illustrates many interesting issues on credit guarantee. First of all, most of loans guaranteed by SBCG are under risk sharing schemes. In this system, SBCG provided credit guarantee service for the non-collateral portion of loans, which are non-subrogation format of loan. The risk of loan is then split into 2 equal portions and share with the respective financial institutions. Moreover, the majority of the credit guaranteed are loans providing to non-corporate or individuals rather than corporations or companies, which are clustered in the central region. Both state-owned and private financial institutions bring in cases into SBCG. Lastly, in comparison, the collateralized part of the loan with respect to the non-collateralized ones, which then guaranteed by SBCG, is about the same portion. The flow of SBCG's credit guarantee schemes is summarized in figure 3.3.

Figure 3.3: SBCG's Credit Guarantee Schemes



Source: SBCG

3.2.3 Pricing

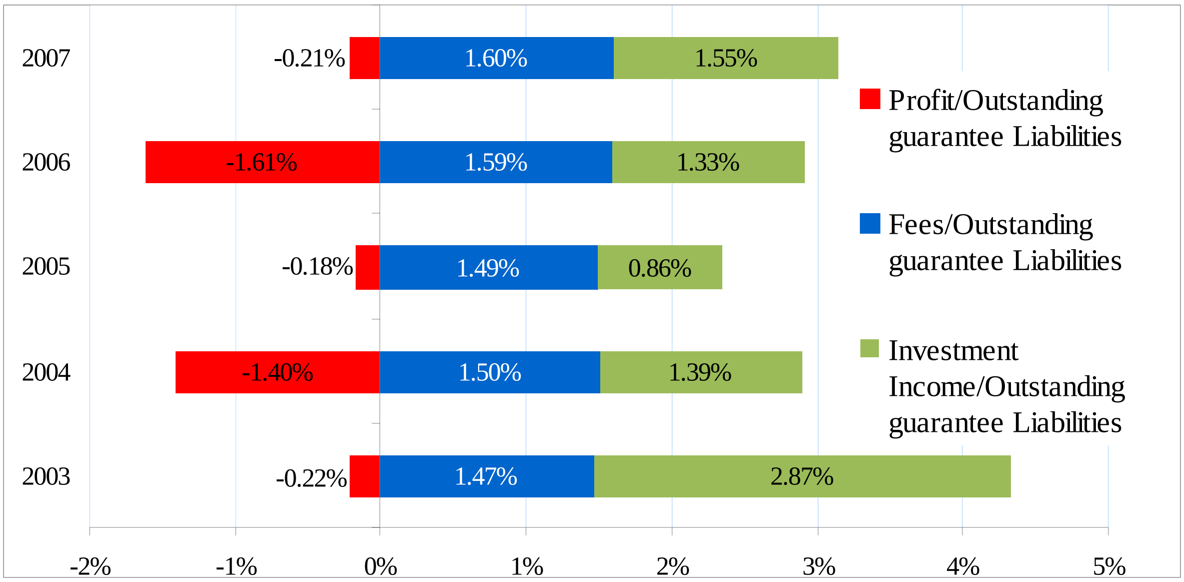
Regarding the guarantee fee, SBCG prices its guarantee services at 1.75% per annum of the guaranteed amount. This guarantee fee is set at fixed rate for every year, must be paid in advance, and is irrevocable. Upon guarantee services, loan borrowers pay out this annual service expense to SBCG through the loan-granting financial institutions.

Applying for a credit guarantee service from SBCG is uncomplicated and plain vanilla. Any small business can apply for SBCG's guarantee services when submitting a loan request at any branches or offices of the eligible financial institutions. All loan applications and documentations will be examined for good loan transactions. From time to time, loan grantors would come across potential loan applicants who are short of asset collateral or partially unsecured. Considered as candidates for SBCG's credit guarantee services, financial institutions will submit the application forms for credit guarantee along with other required documentations to SBCG.

Upon receiving the applications and necessary documentations, SBCG will perform some standard check up procedure. They examines whether those guarantee applications comply with SBCG's business guideline. In order to understand the nature of business and to perform risk assessment, the application examination process also involves visiting the borrowers' plants or sites for more business information. Should the borrowers be eligible for SBCG's services on credit guarantee, SBCG will issues the Letter of Guarantee on that particular loan borrowing to credit grantors after receiving the guarantee fee from credit recipients. This credit guarantee process certifies the risk from unsecured portion of loan is pledged by SBCG, confiding credit grantors in loan approval. Under unfortunate circumstances, which loan receivers fail to meet their debt obligated payment, SBCG then is obligated to compensate on this guarantee liability as stated in the Letter of Guarantee. When legal proceedings are filed against incompetent borrowers, financial institutes as credit lenders could request for guarantee compensation from SBCG - the balance due of the loan plus accrued interest up to the date of legal filing will be reimbursed to the loan grantors.

The fixed rate pricing charged by SBCG simplifies the credit guarantee process, and curtails the time used in loan guarantee approval. As shown in Figure3.4, this 1.75% guarantee service fee from 2003-2007 has, on average, accounted for 1.5% to outstanding guarantee liabilities, which should enable economic sustainability for SBCG. The other main source of income for SBCG derives from investment income, ranging from 0.86% to 2.87% of outstanding guarantee liabilities. However, SBCG had reported financial loss from 2003-2007, specially in 2006 when this profit to outstanding guarantee liabilities dropped down to -1.61%. In fact, this disappointing financial performance has mostly caused by non-performing guarantee liabilities, as discussed in detail further.

Figure 3.4: SBCG's Financial Performance Relative to Outstanding Guarantee Liabilities

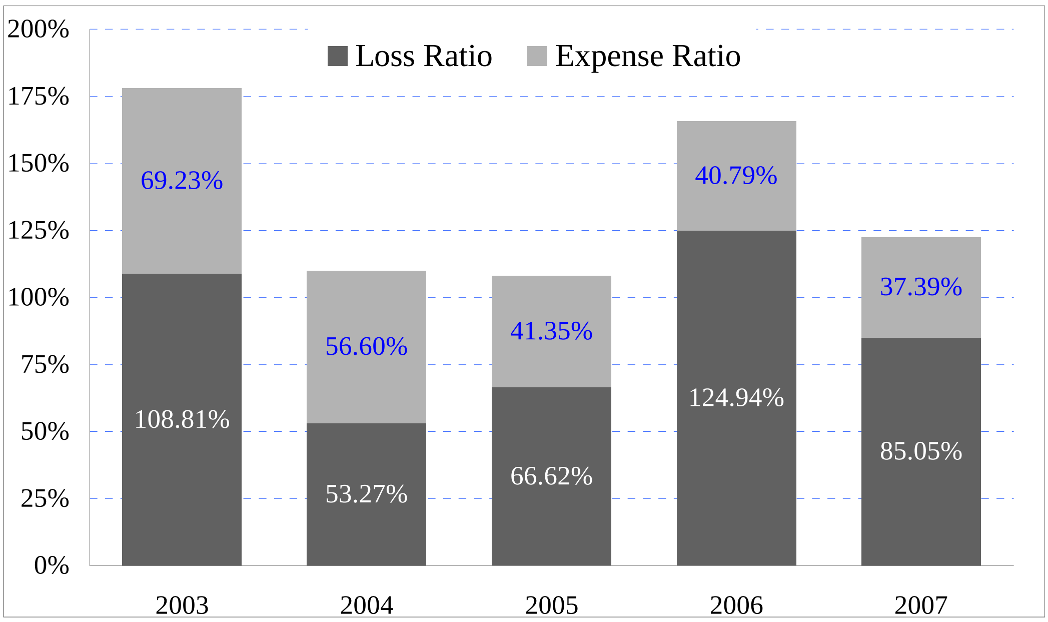


Source: SBCG

3.2.4 Performance

Underwriting performance is measured by the ratio of payments to guarantee fee income, or so called loss ratio. These ratios in 2003 and 2006 were considerably higher than 100%, implying that the institutions incur underwriting loss. Meanwhile, the expense ratio compares the guarantee service fee the operating expense, determining operational efficiency.

Figure 3.5: SBCG's Credit Guarantee System



Source: SBCG

From figure 3.5, SBCG has shown a gradual decrease in the expense ratio from 2003-2007, implying the continuous improvement in overall operational competence. Another measure of profitability could be derived when combined those loss and expense ratios together. This combined ratio is widely used by an insurance company to indicate how well it is performing in its daily operations. A ratio above 100% indicates that the company is paying out more money in claims than receiving from premiums, which has been the case for SBCG from 2003-2007. Experiencing massive loss in credit guarantee portfolio in 2003 and 2006, SBCG has demonstrated high combined ratios of 176% in 2003 and 165% in 2006. Figure 3.5 verifies SBCG's disappointing financial performance caused by non-performing credit underwriting.

3.2.5 Leverage

Leverage is calculated as the ratio of 'total outstanding guarantees' to size of guarantee fund. Leverage on guarantee funds provides a much higher grant to SMEs. Due to various extents of SME lending risks in each country, its leverage experiences various ranges. The well-endowed higher leverage levels are reached in developed countries in Europe and some countries in Asia. In contrast, credit guarantees in many developing countries, including Thailand, have relatively low leverage level.

Table 3.1: SBCG's Credit Guarantee Leverage

Year	**Leverage** (outstanding guarantee liabilities / equity)	**Equity Cushion** (equity / payment)
2003	2.41x	24.01x
2004	3.27x	32.36x
2005	4.58x	19.47x
2006	5.96x	7.99x
2007	6.45x	10.07x

Source: SBCG

From table 3.1, SBCG, classified as low level of leverage, has experienced improving credit guarantee leverage from 2.41x in 2003 to 6.45x in 2007. The gradual expansion of outstanding guarantee liabilities represents the fact that SBCG has become a more important source of credit guarantee for SMEs, validating increasing roles and responsibilities in credit guarantee system in Thailand. However, this increasing leverage comes with higher risk, especially when cushion from equity diminishes from 24x in 2003 to a mere 10x in 2007. Thus, risk concern would be the front-line for SBCG.

3.2.6 Portfolio Diversification and Risk

Table 3.2: SBCG's Non-Performing Credit Guarantees (NPGs)

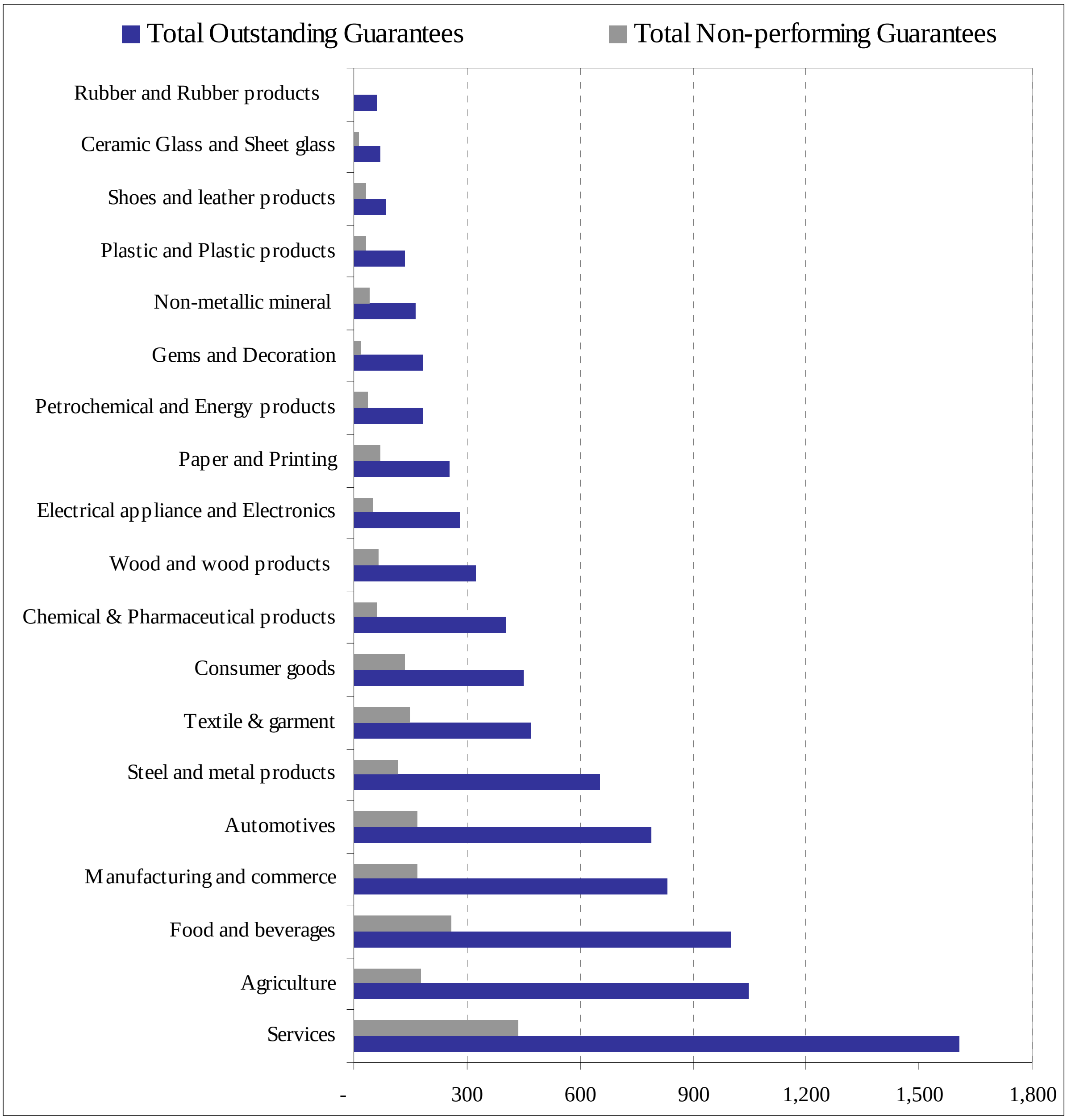
Year	Total NPGs/Total Outstanding Guarantee Liabilities	Annual NPGs/Guarantee Acceptance
2003	10.96%	0.34%
2004	10.43%	0.47%
2005	9.74%	1.31%
2006	12.04%	1.29%
2007	14.13%	0.15%

Source: SBCG

The credit guarantee circumstances in Thailand are worth-mentioning. Table 3.2 illustrates the upward trend of the total non-performing credit guarantee comparing to total outstanding guarantee liabilities. Increased from almost 11% in 2003 to 14% in 2007, this ratio indicates the mounting growth rate of the non-performing credit guarantee, as well as the risk, especially in 2007. Table 3.2 also points out that the annual guarantee acceptance, in general, expands relatively slower than the annual non-performing guarantee, except in 2007. The drop in the NPGs to guarantee acceptance to merely 0.15% in 2007 presents a swift reduction of the annual non-performing credit guarantee, relative to the annual guarantee acceptance. The increasing and diversification in credit guarantee portfolio would reduce risk from credit guarantee transactions for SBCG.

As shown in figure 3.6 below, SBCG's credit guarantee portfolio in 2007 is rather clustered in capital intensive businesses. The top 3 industries from this portfolio are Services, Agriculture, and Food and Beverages, accounting for 41% of total outstanding credit guarantees. This percentage of total outstanding credit guarantees would go up to 60% when includes another 2 big industries: Manufacturing and Commerce, and Automotives. These 5 industries also accounts for 59% of total non-performing credit guarantees, implying that risk from credit guarantees also gathering from this group. Comparing total non-performing guarantees to total outstanding, the Shoes and Leather Products business, and Textile and Garment business are considered the top 2 risky industries at 39% and 32%, respectively.

Figure 3.6: SBCG's Credit Guarantee Portfolio in 2007



Source: SBCG

3.2.7 Loss and Recovery

This topic discusses in detail the guarantee compensation payment, and the SBCG recovery payment, as the following:

I: Guarantee Compensation Payment

a. Conditions for payment

1) Normal Scheme and Loan Guarantee Scheme: Since the Normal Scheme and Loan Guarantee Scheme guarantee loans from commercial bank and Special Finance Institutions (SFIs) on the non-collateralized portion of the loan, there will be similarity in the claim reimbursement. For both schemes, SBCG will pay claim to the lender when the legal proceedings are initiated against the borrower, depending on their condition.

2) Risk Participation Scheme: In case of the Risk Participation Scheme, credit risk will be shared between financial institutions and SBCG. SBCG will pay eligible claim to the lender when the legal proceedings are initiated against the borrower until the court has passed the final judgment and the lender has completed their term.

b. Coverage payment

1) Normal Scheme and Loan Guarantee Scheme: SBCG will compensate the lender on the amount stated in the L/G plus accrued interest at the normal interest rate specified in the loan agreement up to the date of legal proceeding against the borrower or up to the date of default of no longer than six months, whichever is earlier. The financial institutions are responsible for all expenses incurred in the legal proceedings.

2) Risk Participation Scheme: SBCG will be liable for the principal at 50 percent of "the actual loss". The actual loss is the difference between the principal and the proceeds obtainable from collateral enforcement or surrender of the collateral. However, the SBCG's liable claims will not exceed the amount stated in the L/G plus accrued interest at the normal interest rate specified in the Loan Agreement or at the lower rate under the court judgment. The effective claim will cover from the date of default to not over six months, or until the date of lawsuit brought by the lender to the civil court, whichever is earlier.

II. The SBCG Guarantee Compensation

As shown in figure 3.7 below, the situation of SBCG's actual compensation rate have fluctuated over the last five years (2003 to 2007). The ratios of payments to total outstanding guarantee liability and payment to annual guarantee have shown similar tendency, increasing in the last few two years. The uptrend line from the payment to annual guarantee ratio represents the faster growth of compensation payments than that of annual guarantee, which countermeasures against the sustainability of the SMEs operations and SBCG's financial performance in the long run.

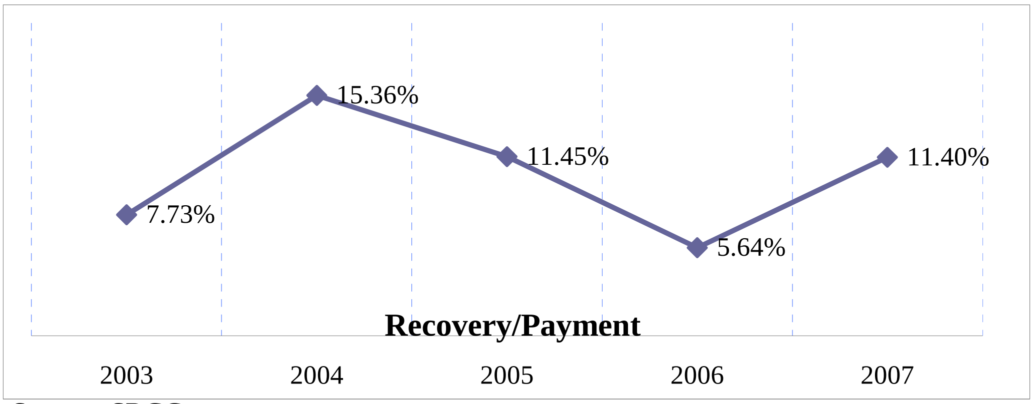
Figure 3.7: The SBCG Guarantee Compensation

Source: SBCG

III: The SBCG Recovery of Payment

The recovery to payment ratio implies borrowers' capability of repayment or the SBCG's claim recovery. The higher ratio could be either more claim recover or the less paid guarantee compensation to lenders. This also could imply the improvement of borrowers' financial situation. From the figure 3.8 shown below, the recovery to payment ratio was at its peak in 2004. It began to slow down up until 2006, and rebounded in 2007. The down turn tendency stated previously, could reflect the economic slowdown in Thailand mainly due to world oil price surge, which could affect the SMEs performance and profitability. Meanwhile, the up-turn tendency in 2007 could be the result of SBCG loan guarantee promotion to enhance the SMEs investment continuity against the economic slowdown. As the result of SBCG loan guarantee promotion, this could possibly lead to better recovery rate or less paid compensation which, again, reflects the relieving of SMEs financial liquidity.

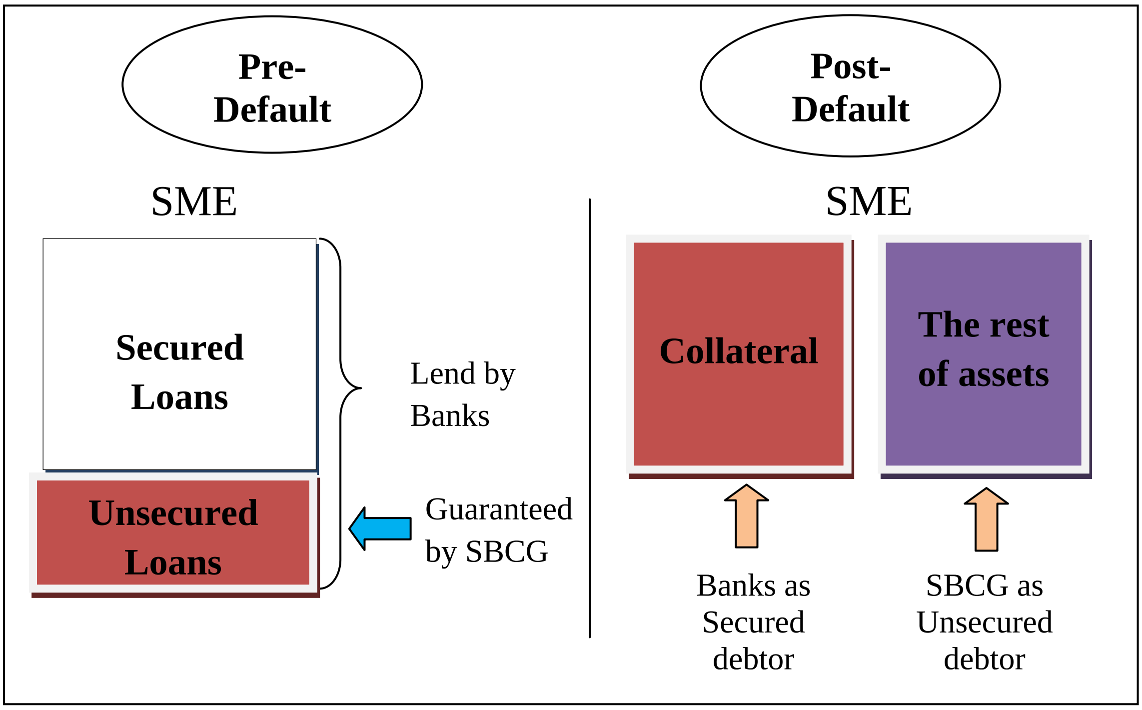
Figure 3.8: The SBCG Recovery of Payment



Source: SBCG

IV. The Non-Subrogation

Figure 3.9: SBCG's Scheme of Non-Subrogation



Source: SBCG

Under the non-subrogation terms and conditions, shown in figure 3.9, SBCG acts as a non-profit guarantor to SMEs those yield insufficient collateral assets. In other words, the unsecured loan portions are guaranteed by SBCG. Hence, SBCG acts similarly as collateral asset renter to SMEs in order to satisfy loaner banks requirement. In case of SMEs are incapable of repayment and the final court judgment has passed, the loaner banks would occupy the entire collateral portion. For non-collateral portion, the SBGC is legally enforced to respond for as well. After all, non-performed SMEs are consequently required to respond for the installation repayment to SBCG. At this situation, SBCG may experience the higher degree of financial risk, than that of loaner banks. Moreover, the degree of risk could be massive in case of SMEs' misbehavior due to moral hazard or adverse selection, for instance.

3.3 Challenges

Fundamentally, SBCG was established in order to be a stimulus provider to banks of SMEs credit market. However, as announced by the Ministry of Finance in the late October

2008, there had been a preparation of merging SBCG and SME bank. There were also politically uncertainty regarding the economic benefit and model of small business credit guarantee business. This implication indicated the ineffective perception on the benefit of credit guarantees in term of the difference between the subsidies amount and other direct finance subsidies.

As the situation stated above, merging SBCG and SME bank may not be the ultimate and effective solution. To promote better credit guarantee markets, challenges must be well dealt and obstacles must be eliminated. In order to do so, rather than merging, the challenges and obstacles should be initially identified as the following:

3.3.1 The Small Scale of SME Credit Guarantee System

The ratio of credit guarantees outstanding to GDP indicates the importance of credit guarantee institutions in economic and financial systems. From the ratio of total outstanding guarantee liability to Thai gross domestic product (GDP) shown in figure 3.10 below, which is less than 1 percent for the past five years. In the recent, the SBCG's credit guarantee outstanding accounted for only few percent of total bank credit to SMEs during the past few years. In addition, risk participations are limited to the average of 20 percent of loan coverage, this deter loaner banks to implement much more credit guarantees on new granted loans. Moreover, under the diseconomy of scale and scope of SBCG operation, this has been a SMEs impulse of building competitive landscape among banks granting to SMEs. This could reflect the limited successfulness of SBCG operation in term of new entrepreneur development and domestic SMEs investment promotion, which are both included in National Economic and Social Development Plan, in term of economic immunization.

Figure 3.10: Ratio of Total Outstanding Guarantee Liability to Thai Gross Domestic Product (GDP)

[redacted]

Source: SBCG

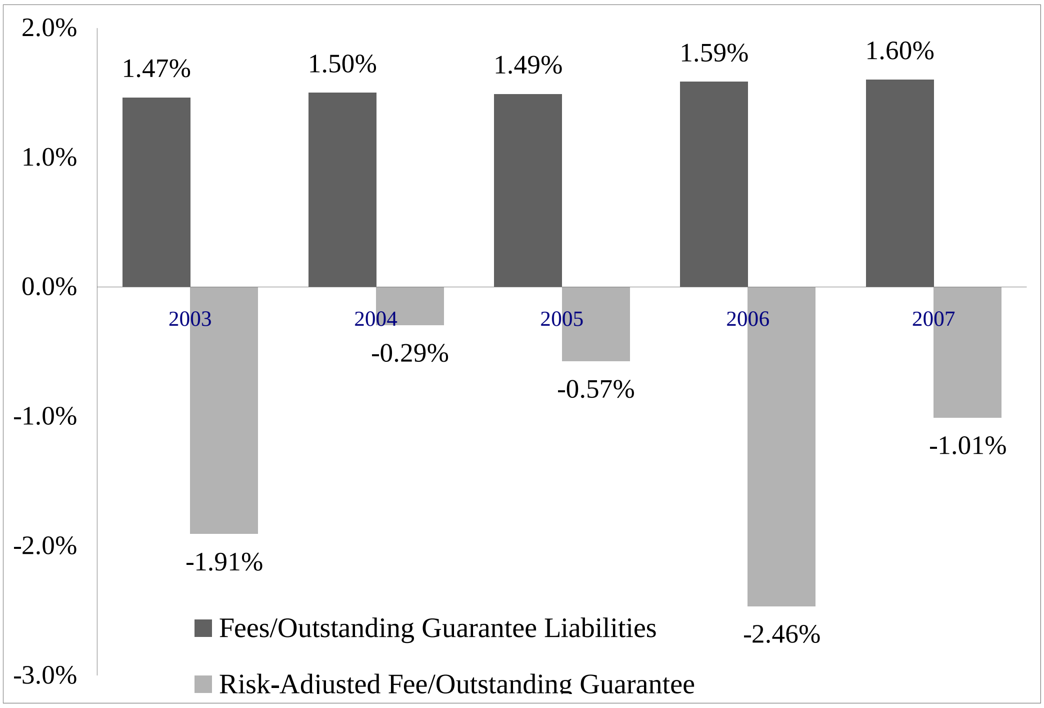
As the situation stated above, Thai government should consider the modern innovation that enhance a more effective credit guarantee system. This may include widely covered and better accessibility of business loan market mechanism. Also, the credit information infrastructure must be well established in order to provide accurate, accessible and affordable credit information and credit guarantors. Consequently, the well developed of credit guarantee system will be conducted to achieve the long term sustainability and additional opportunities to fund accessing rather than providing only low interest loan.

3.3.2 Inflexibility of Pricing

As a government-sponsored and non-profit oriented agency, therefore, SBCG fee is set at a fixed rate. In issuing guarantees, guarantor is required to accurately assess the credit risk of the business and to estimate the reasonable price of risk. Nevertheless, SBCG has been unable to fully assess due to the limitation in term of organization fundamental, thus the SBCG's loss will exceed its income. This, in turn, leads to capital reduction. However, the loss of SBCG's capital is still recognized. Practically, SBCG is hardly self-compensate its own loss because the SBCG policy and operation must be remained in order to promote SME investment to satisfy the macroeconomic target. So, the guarantee price must recently be set at affordable rate to all cases, which are unrelated to the cost of actual guarantees. Technically, in order to maintain SBCG operation, the difference in actual guarantee price is supported by government in form of subsidies as it is a major shareholder with more than 90 percent of total shares.

In order to reflect the actual situation, the fee has to be adjusted to comply with the actual risk. Hence, the factors, such as business profitability, moral hazard behavior, and information asymmetry, have to be included in actual risk estimation. In fact, SBCG's fixed rate fee has been far lower than the actual risk that takes those relevant risk factors into account. The figure 3.11 below shows the fixed fee rate comparing to risk-adjusted fee during the past five years. The risk-adjusted fee to outstanding guarantee liabilities remains negative, reflecting the consistent loss in SBCG's capital. Hence, depending on the governmental subsidies is the result. The solution to this ineffective financial performance could be the management renovation such as promoting loan market mechanism, encouraging higher degree of privatization and free price mechanism in guarantee risk pricing through commercial banks. Furthermore, the government promoted and private projects must be clearly categorized.

Figure 3.11: SBCG Fixed Fee Rate and Risk-Adjusted Fee During 2003 to 2007



Source: SBCG

3.3.3 Ineffectiveness of Risk Sharing Program

The 50-percent risk sharing program is considered to be conservative, thus, it tends to be an unattractive option to banks because their administrative costs remain high. Also, the non-subrogate scheme possibly induces loss due to the moral hazard behavior and unfaithful relevant information (adverse selection). However, in several guarantors in different countries, such as in Egypt where there are other attractive financial incentives to the participating banks, the low risk-sharing rate may not be a major disincentive. On the other hand, after 10 years of experience of guarantee schemes in Latin America, FUNDES asserts that guarantees of less than 50 percent are of little interesting to loaner banks, and those of 100 percent would attract wrongly loan transactions. In order to counteract the difficulties stated above, the well established historical credit database requires cooperation between SBCG and loaner banks. The 50-70 percent credit guarantee with subrogating scheme should be encouraged as well.

At present, the current credit guarantee does not encourage sufficient SME's loan market competition. In the same token, it promotes the large commercial banks' monopolization because the SBCG's guarantee is available cooperatively only with large commercial bank members which incapable to bear the business and liquidity risk of SMEs' entrepreneur. With relatively low degree of competitiveness, member of commercial banks may be reluctant to pass the reduction of risk on to the borrower in form of lower interest rates in order to maintain their interest spread. Therefore, the additional guarantee instrument, in form of voucher which is redeemable at any commercial banks, should be provided to prospect loaners for more convenience.

3.3.4 In Need of Regional Reinsurance Corporation

The credit guarantee industry in Thailand is encompassed into one tier scheme. In order to guarantee the borrower default, SBCG is unable to reinsure its warranty by means of a counter-guarantee. This results in SBCG's conservative risk sharing schemes. Nevertheless, the industry is still too small to establish the domestic counter-guarantor. Hence, a regional reinsurance corporation is necessary to cover a limited amount of the default risk. For example, the implicit counter-guarantees, existed in Latin American schemes, are established under the protection of the central bank.

3.3.5 No Any Roles on Underwriting and Secondary Markets

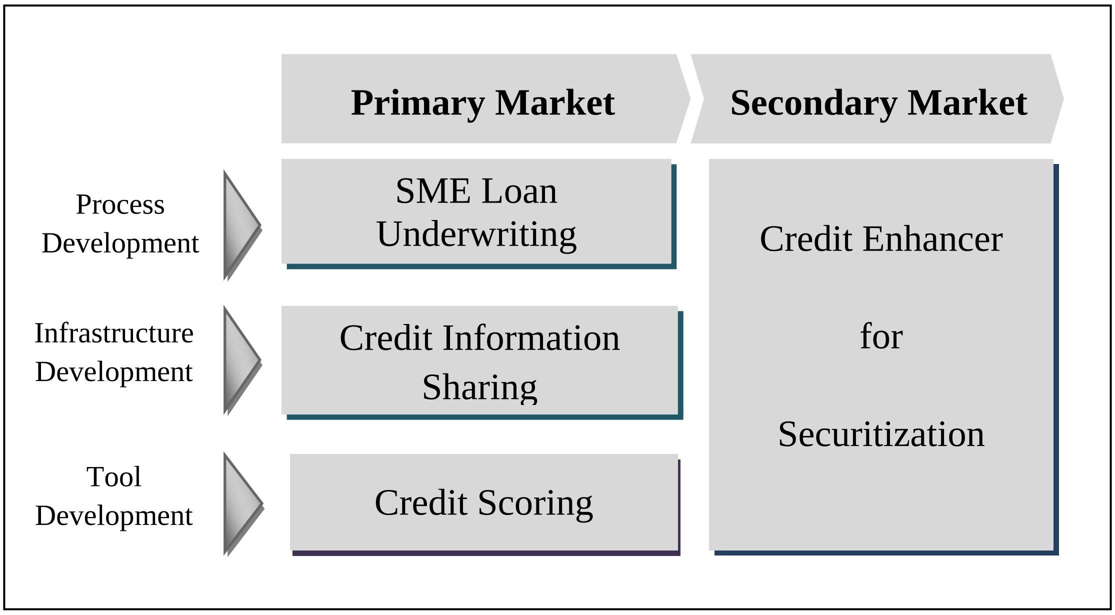
The guarantee mechanism enables us to create a capital market mechanism to transfer funds from capital markets to SMEs. In order to induce capability of SMEs' guarantor, securitization could be implemented as a financial instrument to produce financial assets into securities. To achieve this, SBCG must increase its role in pioneering capital market for SMEs loans, consisting of process development, infrastructure development and tools development (as shown in the figure 3.12 below). Initially, the primary market standard must be seriously established for underwriting SMEs' loans. This leads to the establishment of secondary market in which loan guarantee will be securitized through Special Purpose Vehicle (SPV) in term of SME's Collateralized Debt Obligation (CDOs) which is asset-backed securities and structured credit product (shown in Figure3.13). The securitization procedures are possible as the following:

i) SBCG would guarantee banks' portfolio that provide loan to SME. So, the banks' guaranteed portfolio can be securitized in capital markets. Therefore, banks who have obtained capital would be able to lend extensive loan to SMEs.

ii) SBCG could simultaneously buy banks' loan portfolio, then guarantee them in order to utilize a SPV.

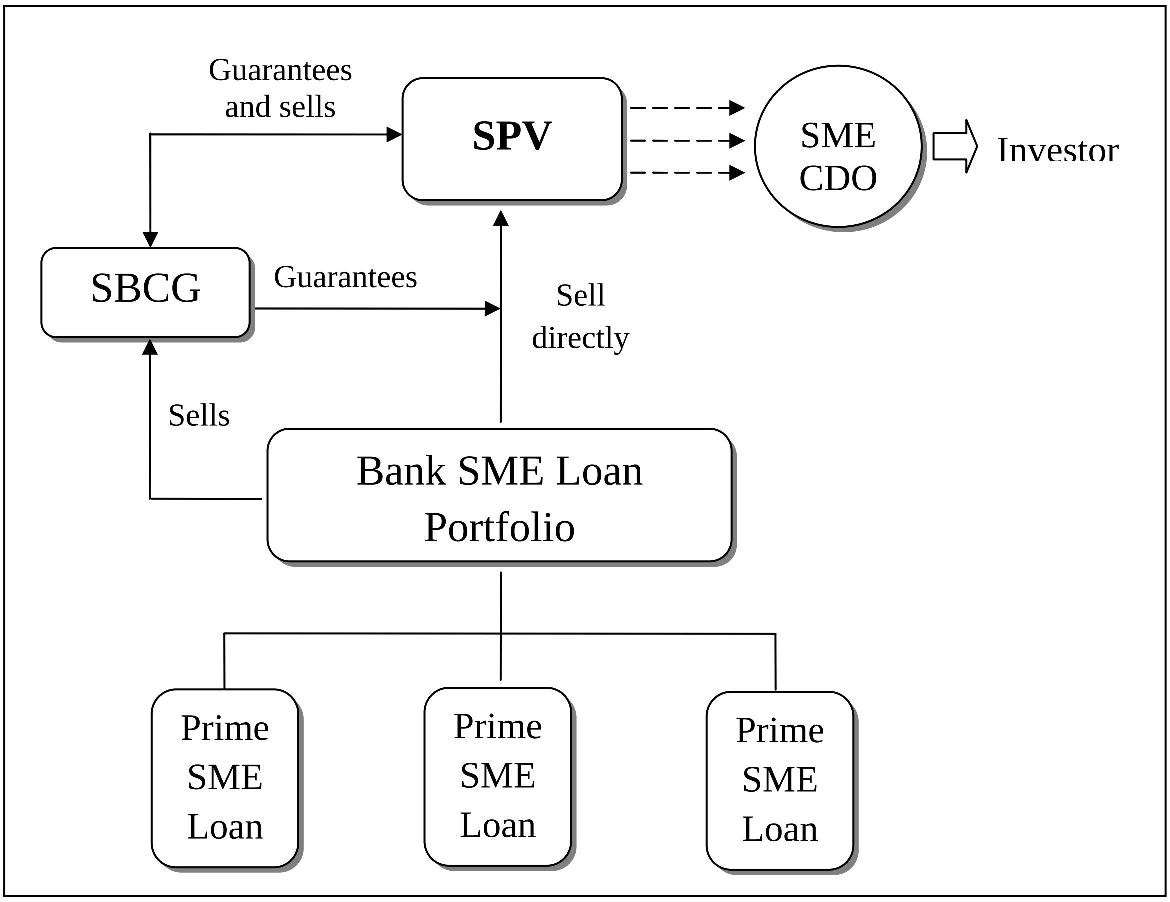
In doing so, the credit quality of underlying portfolio has been improved. At this point, securities are completely issued under its full faith and credit guaranteed and will be widely acceptable to final investors.

Figure 3.12: Roles of SBCG in Primary and Secondary Market within Credit Market



Source: SBCG

Figure 3.13: Roles of SBCG as the Credit Enhancer in Securitization



Source: SBCG

3.3.6 Unsolved Moral Hazard and Adverse Selection from Asymmetry Information

Moral Hazard occurs when the involved parties have diverging interests and take different actions carelessly. This behavior usually exists as hidden action in which a close and accurate monitoring is required but may not be possible. In borrower-and-lender scenario, the moral hazard means wide range of business management malpractices or reckless behavior comparing to the case of non-guaranteed loans. For example, SMEs as borrowers are likely, without conscious actions, to perform risky practice that leads to the higher bearing loss of creditors. The unsafe actions range from exerting less working effort to secretly switching to riskier projects in order to increase expected return. This also leads to the possibility of default resulting in a lower return or a loss to the creditors. Such mistaken concept in business transactions is caused by the delusion that SMEs are insulated from risk once their credits are insured. Thus, the issue on moral hazard becomes a great challenge by nature for SBCG in implanting its credit guarantee business for SMEs.

Adverse selection refers to reporting or disclosing the unfaithful information in order to attract the higher possibility of easy loans approval with lower financing costs. As risk premium is charged by risk measured, SMEs as borrowers have a tendency to distort or conceal risk information regarding the proposed business project from lending banks. With information asymmetry, loan guarantors, relying on banks' information, will not be able to characterize and evaluate the level of the risk accurately. Theoretically, a different degree of riskiness deserves a different cost of fund: the higher the risk, the higher the cost. In reality, the borrower with higher risk can access the guaranteed loan services at the same cost as those with less risk.

Meanwhile, credit guarantors are affected by higher rate of credit default and greater losses once default. Thus, credit guarantors, dealing with the adverse selection problem, attempt to measure risk in order to determine a suitable risk premium. However, it remains a major problem that leaves the loan guarantor in the arena of financial evaluation confusion. Thus, the guarantors require more information regarding the business project before lender take the loan guarantee. Restrictions on information disclosure need to be adopted to prevent adverse selection. In addition, the national credit bureau and standardized credit scoring system must be carefully developed and effectively implemented.

As mentioned above, this adverse selection effects loan guarantee conditions on lenders, borrowers and guarantors, leading to inefficient implementation of domestic financing promotion policies. Unavoidably, SBCG, as a channel to promote financing policies for SMEs, has endured a great deal of unpleasant consequences of this adverse selection.

Chapter 4
Conclusions and Policy Implications

Generally, small and medium size enterprises are identified as lack of adequate collateral and symmetric information to access credit provided by financial institutes, and therefore presented as the main obstacle for necessary fund accessibility. The credit lending system to SMEs in Thailand has still depended mainly on this collateral-based financing and transaction-based credit risk evaluation. In order to overcome such constraints, credit information sharing and guarantees become solutions for SMEs.

The main objective of this paper is to study the development of SME credit information sharing system from both theories and practices in Thailand. Contents of this paper were structured and elaborated in chapter 1-3 on subjects of the credit bureau, the credit information database, and the credit guarantee system. Consequently, this chapter accordingly summarizes the studies and findings on each issue. Policy implications on corresponding areas are additionally presented in this chapter.

4.1 Credit Bureau Development

4.1.1 Findings on Credit Bureau Development

The paper began the review and analysis of credit information sharing development in Thailand through its single credit bureau, namely National Credit Bureau (NCB). The challenges the credit bureau confront were also identified. Despite Thailand's relatively short experience on credit bureau development, practical learning experienced from credit bureau development were stated. The key issues are found as follows.

- **Merging two credit bureaus into single unit strengthens the early development stage of credit information sharing system in Thailand**. During the pre-merge period, both of the former credit bureaus had competed on a principal of non-differentiation. The merge in 2005 not only benefited two agents' stakeholders due to a reduction of their redundancy, but also boosted the new one's scale of business.
- **Credit Information Business Act (2002) frames consumer information security and protection, and regulates a firm operating credit information business.** According to this act, a credit information company must obtain a business license from the Minister of Finance before it could engage in credit information business

regarding conduct information processing. This valuable credit information attains from financial institutions that the credit information company admits as a member, or from reliable sources of information. This Credit Information Business Act also defined functions and responsibilities for a credit information company relating to the control or processing of customers' credit information.

- **Credit information sharing is rather attractive to consumer loan-based financial institutions.** Consumer finance, credit card, and leasing companies are majority of credit bureau members. Collected from members upon the notion of credit information sharing, this information is analyzed, leading to customers' credit behavior evaluation. Financial institutes or credit grantors then makes use of this analysis in order to prevent late payment or even credit default that can cause their profit shortfall. In other words, credit information sharing assists financial institutes in deciding which credit applications should be approved, and which should not.
- **Data collected has hardly supported commercial loans relative to consumer loans**. Though NCB's database is compiled upon credit information from both firms and individuals, items of firm data have not been collected enough to cover public information necessary for evaluating SME's credit risk. Other important information for commercial loans, such as income, business plan, collateralized assets, other financial obligations, etc., are left out from NCB's database. Moreover, number of credit records collected exclusively by NCB accounts for only 32% of adult population. Hence, the coverage of this database regarding significant information and number of records is insufficient for SME's credit risk assessment.
- **Three years of data record kept by the credit bureau are presumed not sufficient to separate good/bad samples for building up SME credit risk databases.** In fact, in order to detect an actual pattern or trend movement, or to understand the real business cycle, the time span for data assembled should be at least at 5 years period.
- **Number of consultations and performance indicates that Thai credit bureau has been underwent the uncertain starting period, and transiting into the certain growth one.** From NCB, the average number of consultations from January to June 2008 is at 1 million transactions per month. Moreover, NCB has generated a profit margin of 30% in average, and its return on assets (ROA) and equity (ROE) are in

the range of 17% to 20%. The accomplishments of NCB's financial performance along with its high number of database consultations verify its bright future.

- **Challenges that credit bureau facing embody development into value-added services, public information coverage, and much more consumer protection from consumers' worrisome over their negative credit information records.** Most consumers are often pessimistic on credit information and credit bureau. In other words, they are afraid that only negative credit information will be brought into the loan approval process. Such misunderstanding diminishes their opportunity in funding accessibility.
- **Practical learning experienced from Thailand's credit bureau development comprise of a clearer legal and regulatory framework, a reduction on conflict of interest among shareholders, free rider problem eliminated by public sector participation, information security and low fee attract members, and consumers' worrisome over negative credit information records.**

4.1.2 Policy Implications for Credit Bureau

Established since November 2005, Thailand's credit bureau or NCB is already at its growth stage of life cycle. A policy implication for the development of the NCB should focus on growth stretching strategy as the following:

- **NCB developed as credit payment history information sharing centre for all hard and soft information.** In order to pull in credit information on trade credits as well as payment history on utilities, members of NCB should also include typical cooperation and utility companies. Moreover, sources of financial information should be expanded to cover other relevant external data, e.g., bankruptcies, mortgages, or any obligations on assets.
- **In order to alleviate consumer's concern on privacy and security, NCB should provide general information and education for public regarding the protection of credit information sharing and its benefits.** Furthermore, an easy-to-access mechanism for individual to check or verify data accuracy and to correct any error on credit information should be well established, so that consumers would be less distress.
- **Rules of the game for a fair lending should be well set to built consumer's confidence and to protect consumers regarding exploitation of both positive and negative information in a credit scoring evaluation.**

- Since economy of scale is the critical success factor for a credit bureau, business transactions of credit bureau are subject to be monopoly by nature. **To avoid being natural monopoly of a credit bureau, fair competition on providing differentiated services among credit bureaus should be promoted.**

4.2 SME Credit Risk Database Development

4.2.1 Findings on SME Credit Risk Database Development

The latter objectives of the paper attempts to further discuss on institutional arrangement that SMEs credit information database sharing should be developed. In consequence, a center of SME credit risk database was proposed, and regional cooperation mechanism was considered to build harmonized information sharing system among the region. In spite of SME's importance to economy, credit risk information development for SMEs to boost credit market would work much more efficiently if the development is prioritized significantly higher than the government's direct subsidiary.

- **Banks use relationship-based approach to build up relationship with their customers.** In other words, the more transactions on deposit or lending with banks, the higher relationship banks would regard this customer. As loan requesting process is undertaken by bankers who have high relationship-based connection with loan applicants, there is a tendency that particular loan applications would be approved.
- **Banks use judgment system for final decision.** From information on credit guarantee approved that banks forward to SBCG, it can be concluded that under the loan approval process, banks still allow credit analysis officers to present their professional comments on loan applications, as well as to modify financial estimation on those applications.
- **Main data sources for analyzing SME credit risk by banks consist of three sources.** Firstly, data from application, which could be from either application forms or from applicants themselves. Data from this source are personal data, financial statements, management interviewing, manufacturing process, and business plan, etc. Later, data from bank's internal data, including transactions with current customers on both deposits and loan accounts. Lastly, other related external data, which are from credit bureau, economic and industry information in specific region, etc.

- **As credit information on SMEs is generally not sufficient for analyzing creditworthiness of SMEs, SME credit risk database centre is essential for reducing this asymmetry information obstacle.** Moreover, NCB's credit information database does not include business information, which is quite critical for SMEs credit approval decision. Therefore, this credit risk database center should be a full bureau gathering comprehensive data, i.e. both financial and non-financial information, so that it will be highly predictive measure of future repayment. Upon gathering credit information, the credit risk database derives credit risk model's parameters, and estimate credit rating and probability of default for SMEs.
- According to the Credit Information Business Act (2002), credit information sharing is restricted upon this registration. However, the scope of this registration does not specify whether the case of anonymity of credit information would be regarded as credit information sharing. **To be conventional, credit bureau status is recommended for this credit risk database center, which would operate under consumer information protections and restrictions of the Credit Information Business Act.**
- As credit information from financial institutes will directly flow into SBCG for credit risk assessment, **the operation of credit risk database is based upon mutual benefit principle between credit information providers and information processor.** It would be in best interest of both parties to cooperatively operate on security and confidentiality of the credit information. Equality between members is also another code of conduct that credit risk database center should commit to.
- **Pooling anonymous data model among members is an appropriate choice of credit risk model.**
- **Elimination of free rider problems need early development stage before establishing the centre and public assistance.**

4.2.2 Policy Implications for Credit Risk Database Development

As Credit Risk Databases Centre has not been established in Thailand, defining a framework for a policy, for the early stage, on credit risk should strategically focus on risk reduction. Regarding cooperation within the ASEAN+3 region, policy on credit risk information not only should comply with regulations from each country, but also should not be sensitive to political issues. As mentioned, the policy on credit risk database should be as the following:

- **The credit risk policy should be placed as a high priority agenda for SMEs development program**, which would lead to SMEs' sustainability in the long run and reduce government's financial subsidies to SMEs.
- **The credit risk policy should provide financial incentives for SME to transmute itself from an individual owned status to a juristic person.** Such modification on legal standing enforces SMEs to release much more financial data for a credit risk analysis, which finally would benefit both the credit guarantee system and SMEs themselves.
- **The credit risk policy should encourage academia, with cooperation from pertinent government agencies, to conduct a study on credit information sharing and credit risk modalities before a credit risk database center is officially founded.** As a time consuming process, a research should produce formats or templates for credit information sharing, and processes to eliminate redundant information. Regarding credit risk modalities, this study should develop a credit risk assessment model and define a modeling procedure based upon existing credit information.
- **In the early stage of regional cooperation, the credit risk policy should prioritize on defining and standardizing credit risk information.**
- **The credit risk policy should encourage an establishment of a secondary market for SME's CDO.** The developing process begins with formation of an institute for product development for primary market along with secondary market for the ASEAN+3 region. Pooling CDO products from each country should proportionate upon the level of completion and advance of country's credit risk database.

4.3 Credit Guarantee System in Thailand

4.3.1 Findings on Credit Guarantee System in Thailand

Besides the pursuit of credit information databases development, credit guarantee system in Thailand claimed as a policy tool for SME development was reviewed. As SBCG's single player of guaranteeing small business credits in Thailand, its roles, performance, and challenges were examined.

- **The current SME credit guarantee system has been operated under a one-tier and mono - guarantor system**. As seen a public policy tool of stimulating SMEs economy rather than a mechanism of improving SMEs credit markets' efficiency, Small Business Credit Guarantee Corporation (SBCG) becomes the single SME credit guarantee institution without any credit reinsurance company in the country.

- **The single formal guarantor is legalized as specialized financial institutes for development, and in practice positioned itself as a policy-based and non-profit organization**. Although Small Industry Credit Guarantee Corporation Act allows the SME credit guarantor to discretionarily operate on businesses of small business credit guarantees, management under supervision of the Ministry of Finance and its state-owned enterprise make it as a non-profit organization under bureaucratic management process.
- **The risk sharing schemes with banks for guaranteeing SME's deficient amounts of collateral are mainly employed.** In order to limit its exposure and assist collateral-deficiency SME, the credit guarantor focus credit guarantee service for the non-collateral portion of loans under risk sharing schemes. Nevertheless it has still exposed to non-performing SMEs and non-subrogation of their loans.
- **Fixed guarantee pricing for all SMEs is seen a public tool for SMEs' access to credit availability equally.** In consequence of its positioning as non-profit organization, the credit guarantor sets it fee guarantee services fixed at 1.75% per annum of the guaranteed amount for every SME.
- **The guarantor's continuously incurring losses limit its leverage and need capital injections from the government.** In attempt to augmenting its credit guarantee roles, the credit guarantor suffers its underwriting loss in spite of operational efficiency. The relatively low leverage reflects its caution policy on capital deterioration.
- **Despite compensation in part by investment income, high payments to banks for bad debts exceed guarantee fee incomes.** The 1.75% guarantee service fee has hardly enabled economic viability for the credit guarantor, caused by non-performing guarantee liabilities. Even the investment income cannot compensate the credit guarantor losses from bad debts.
- **More guarantee acceptance for more guaranteed debt default is reflected in the guarantor's performance**. The upward trend of non-performing guarantee has been observed from the total and annual NPG since 2003. The high default rates of banks' guaranteed loans make suspicious to their loan selection and underwriting quality.

- **Diversification cannot reduce its exposures.** For the credit guarantor's portfolio in 2007, more than a half of the credit guarantor's portfolio is concentrated in five industries - Services, Agriculture, and Food and Beverages, Manufacturing and Commerce, and Automotives. Meanwhile these five industries also contributed non-performing guarantees as close as the portfolio shares.
- **The current system is challenged by the existing pricing, employed schemes, banks' adverse selection, clients' moral hazard, guarantee size, limited roles on SME loan underwriting and securitization, and even organizational arrangement.** The challenges imply that Thailand needs a resolution of asymmetry information in SME credit markets. The credit information sharing system through SME credit bureau and credit risk database centre should be prioritized and laid out for a remarkable financial infrastructure of SME credit markets.

4.3.2 Policy Implications for Credit Guarantee System

The current credit guarantee system in Thailand appears to be at the small scale, while the existing credit guarantee schemes do not give the impression that they would clearly provide sustainability to SMEs. A conjecture that the policy in hand regarding SMEs is inefficient would then not be so far away from the truth. In other words, building stronger and more effective SMEs businesses strategically requires a better credit guarantee system. Thus, this strategic action rather demands a shift in policy on SMEs, which is introduced as the following:

- **The new credit guarantee system should take more roles in establishing standards for financial institutes in SMEs loan underwriting, as well as in setting a secondary market for SME's CDO in the capital market.**
- **The new credit guarantee system should be initiative in building up a SMEs database because it, as a credit guarantee grantor, would have a better understanding on analysis reports from financial institutes.**
- **The new credit guarantee system should objectively arrange, design, and pricing its credit guarantee schemes similarly to those in credit insurance system.**
- **The new credit guarantee system must focus on setting a mechanism to encourage a competition among financial institutes in loan granting business.**

- **The new credit guarantee system should set a mission to move away from a state-owned-operation format, while to maintain its status as a government supported entity.**

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Appendix 1

Survey of Credit Bureau (Thailand)*

By

Small Business Credit Guarantee Corporation

Part I General Information

1. Contact Person

Name	
Title (position)	
Address	
Telephone	
E-mail	
Fax	
URL of Website	

2. Organization

Name of credit bureau Its Acronym			
Year of establishment (A.D)			
Ownership structure (percentage share of total)			
Number of employees as of: October 31, 2003	Total (persons) [ ]	Full Time [ ]	Part Time [ ]

*Note: * This survey form is adapted from World Bank's, IFC's., and Yoshino's survey of private credit registries.*

Part II Scope of Information Collection and Distribution

3. Data Collected on Individuals

Is data on individuals or their loans either collected or distributed? (if reply "yes", please answer below)	☐ Yes, ☐ No	
Data on the individuals (mark all that apply)	**Collected**	**Distributed**
Name of borrower		

Address		
Unique identification number (for example tax ID, passport number, etc)		
Borrower's ownership of a business		
Tax statements		
Income and other personal financial information		
Court judgments		
Bankruptcies		
Other demographic and miscellaneous information (employment status, marital status, age, etc.)		
Data on individuals' loans (mark all that apply)		
Name of reporting institution		
Amount of loan		
Type of loan		
Days past due (date due)		
Amount past due		
Payment record longer than the previous 30 days		
Interest rate of loan		
Maturity of loan		
Type of collateral securing the loan		
Value of collateral securing the loan		
Guarantees securing the loan		

4. Data collected on firms

Is data on firms or their loans either collected or distributed? (if reply "yes", please answer below)	☐ Yes, ☐ No	
Data on the firm (mark all that apply)	**Collected**	**Distributed**
Name of firm		
Address of firm		
Unique identification number (for example registration number, tax ID, etc)		
Name of owner(s) of the firm		
Field of business activity		
Balance sheet information		
Tax and income statements of the firm		
Income and other personal information on the owner(s)		
Court judgments		
Bankruptcies		
Other demographic and miscellaneous information		
Data on the loan		
Name of reporting institution		

Amount of loan		
Type of loan		
On-time payments (information sent indicating loan was paid on-time)		
Late payments - number of days past due		
Amount past due		
Payment record longer than the previous 30 days		

5. Information Provider

Sources of Credit Data	Yes, they provide data (mark all that apply)	Most important source of data in terms of number of records provided (mark one only)
Private commercial banks		
Public commercial or development banks		
Credit union/coops		
Microfinance institutions		
Finance corporations/ leasing		
Credit card issuers		
Firms providing loans to other firms		
Retailers and merchants		
Public credit registry operated by the Central Bank or Bank Supervisory Authority		
Service providers ie. cell phone or telephone companies, utilities (electricity, water), etc.		
Public registries (court records, tax and social security payments, collateral registries, etc.)		
Other, describe_______________		

6. Scope and Definition of Data

Is there a minimum loan size for inclusion in the registry?	☐ Yes, please specify Amount [ ] ☐ No
Do you pay directly for purchasing data?	☐ Yes, please specify Amount [ ] ☐ No
Are your definitions of loan defauts the same as banks?	☐ Yes ☐ No, please explain___________
Are your definitions of loan arrears the same as banks? (i.e.1.) on time; 2) 1-30 days late; 3) 31-60 days late; 4) 61-90 days late; 5) 91-180 days late; and 6) more than 180 days late)	☐ Yes ☐ No, please explain ________________
Does your registry offer a credit score for each consumers or firms?	☐ Yes ☐ No

7. Data Collection Method

How frequently do financial institutions report data to the registry? (Select only one)	☐ Continuously as changes occur ☐ Daily ☐ Weekly ☐ Monthly ☐ Quarterly ☐ Semi-annually ☐ Annually ☐ Other (describe)
How long is the historical data preserved? (Select only one)	☐ Less than 1 year ☐ 1-2 years ☐ 3-4 years ☐ 5-7 years ☐ 8-10 years ☐ more than 10 years
How frequently do financial institutions report data to the registry? (Select only one)	☐ Current month ☐ Current year ☐ 1-2 years

	☐ 2–5 years ☐ 6–10 years ☐ more than 10 years
How much historical data is made available for distribution to clients? (Select only one)	☐ Less than 1 year ☐ 1–2 years ☐ 3–4 years ☐ 5–7 years ☐ 8–10 years ☐ more than 10 years
When are late payments/defaults erased from the records? (Select only one)	☐ As soon as they are repaid ☐ Never ☐ After a number of years, If so, how many? ________
In what format is data made available to clients? (Select only one)	☐ Each outstanding loan/credit is described individually, for each consumer or firm ☐ Loans are consolidated for each reporting institution, so that total debt with each institution is reported for each consumer or firm ☐ Loans are consolidated across the financial system, so that only one figure for total debt per consumer or firm is presented ☐ Other (describe)
Who do you consider to be the primary user of your registry? (Select only one)	☐ Banks ☐ Other financial institutions (e.g. leasing companies, credit unions) ☐ Retailers, and private firms ☐ Others________________
How is the data made available to clients? (Mark all that apply)	☐ Via internet ☐ Via modems or dedicated phone lines ☐ Via computer disks or CDs ☐ Via telephone consultations ☐ Via facsimile ☐ In person ☐ Via written documents

8. Type of Data Distribution

Is negative and/or positive data made available for distribution to clients? See explanation below	Negative only	Negative and positive
On individuals:		
On firms:		

Remark: 1) **negative data** is data on late payments, non payments, delinquencies and defaults.

2) **positive data** is information on credit outstanding, even if there are no problems with these accounts – for example, data indicating that an individual has had a credit card or loan, which has always been paid on-time.

9. Access to Data

Is access to the data restricted to registry members only?	☐ Yes ☐ No
Must institutions provide data in order to be able to access data? (Select only one)	☐ Yes, for access to any information institutions must be providing data to the database ☐ Yes, in the case of positive credit data, institutions must provide positive credit data to access positive data ☐ No, there are no reciprocity requirements for access to data ☐ Other requirements related to access, please describe:
Does your system allow identification of institutions that requested information on a specific borrower?	☐ Yes ☐ No

Is this information on credit enquiries about borrowers disclosed routinely to: (Mark all that apply)	☐ Banks/financial institutions ☐ Borrowers who request their report ☐ Information on credit enquiries is not disclosed

10. Services

Is a fee charged for access to the registry data by lenders obtaining a credit report on a consumer or firm?	☐ Yes ☐ No
What is the average time between request and release of data? (Select only one)	☐ Information is released instantly ☐ within the same day ☐ 1–7 days ☐ 7 days – 1 month ☐ 1 –3 months ☐ Over 3 months
Does your registry offer a credit score for each consumers or firms?	☐ Yes ☐ No
What is format for data supply to cooperating institutions? (Select only one)	☐ Each individual borrower/firm ☐ Loans consolidated for each reporting institution; total debt at each institution is reported for each individual borrower and firm ☐ Loans consolidated so one figure for total debt per individual borrower/firm is obtained

11. Quality of Data

Can consumers inspect their data?	☐ Yes, it is required by the law ☐ Yes, even though it is not required by law, it is done in practice ☐ No
Are there legal requirements to respond to consumer/borrower complaints?	☐ Yes ☐ No
Which of the following does the registry use to determine the accuracy of the data? (Mark all that apply)	☐ Routine checks with other data provided by financial institutions ☐ Borrower complaints ☐ Statistical checks, i.e. comparisons of monthly findings ☐ Software program to identify potential abnormalities in data ☐ Other (describe) ______________________
After an error has been reported, how long does it take on average to examine and correct the erroneous information? (Select only one)	☐ Less than 2 weeks ☐ 2 weeks – 1 month ☐ 1–2 months ☐ More than 2 months
How soon after the reporting period ends must institutions submit their data to the registry? For example, if the registry receives information on a monthly basis, do institutions submit their data for the month of October on October 31 or November 1 or November 15 or December 1, etc. (Select only one)	☐ Within one day of the end of the reporting period ☐ 2 days – 2 weeks of the last day of the reporting period ☐ 2 weeks – 1 month of the last day of the reporting period ☐ Other describe)____________ ☐ No clear rules requiring institutions to submit data within a number of days
What proportion of the data received by the registry is submitted within the	☐ More than 95% of the data is

established reporting time, the previous question? (Select only one)	received within the established reporting time frame ☐ Between 80% and 95% ☐ Between 50% and 79% ☐ Less than 50%
How quickly on average is the information received by the registry made available for consultation and distribution to clients? (Select only one)	☐ Within 1 day ☐ 2-3 days ☐ 4-7 days ☐ 7 days – 2 weeks ☐ 2 weeks – 1 month
Which of the following consumer relation services does your firm provide? (Mark all that apply)	☐ Borrower can request their own credit report ☐ Consumer relations department ☐ Complaints taken by phone ☐ Complaints taken in writing ☐ Complaints taken by internet ☐ Established (standardized) protocol for taking complaints ☐ Borrowers can add a comment to their credit report in case of disputes ☐ Other, please describe_________
. What does your firm do with respect to consumer outreach and education on the role of credit reporting in financial markets? (Mark all that apply)	☐ Borrower can request their own credit report ☐ Consumer relations department ☐ Complaints taken by phone ☐ Complaints taken in writing ☐ Complaints taken by internet ☐ Established (standardized) protocol for taking complaints
. What does your firm do with respect to consumer outreach and education on the role of credit reporting in financial markets? (Mark all that apply)	☐ Borrowers can add a comment to their credit report in case of disputes 2-3 days

12. Size of the registry

Number of individuals/firms collected in the registry as of October 31, 2008	Individuals [ ] Firms [ ] Total [ ]
Estimated number of credit reports issued by the firm as of October 31, 2008	Individuals [ ] Firms [ ] Total [ ]
Total value of credits in the registry as of October 31, 2008 (Baht):	Amount [ ]
What is the percentage hit rate for enquiries to the database (i.e. the percentage of enquires with a match in the database)?	[ ]% ☐ Unable to answer –access for subscribers is unlimited
Estimated volume of consultations to database per month: (Select only one)	☐ Less than 1000 ☐ 1001-5000 ☐ 5001-10,000 ☐ 10,001-25,000 ☐ More than 25,000 – please estimate number _______________

Part III Legal Framework

13. Legal and Authority

Is written authorization of a borrower required in order for lenders to be able to send credit information on a borrower to the credit registry?	On individual borrowers Yes ☐ No ☐ On firms Yes ☐ No ☐
Is written authorization of a borrower required in order for lenders to obtain a credit report?	On individual borrowers Yes ☐ No ☐ On firms Yes ☐ No ☐
Are banks and reporting financial institutions required by law or regulation to provide credit data to the registry?	☐ Yes, Please name the law: ☐ No

Is there a specific law governing the establishment and operation of credit registries (private and/or public) in your country? (Select only one)	☐ Yes, Please name the law: ☐ No ☐ A law on this topic is pending or under development
Is there a data protection law or other privacy law which affects the operation of credit registries (public and/or private) in your country? (Select only one)	☐ Yes, Please name the law: ☐ No ☐ A law on this topic is pending or under development
Do bank secrecy laws in your country affect your operations? (Select only one)	☐ Yes, the bank secrecy law is restricting credit reporting ☐ No, the bank secrecy law is not a problem with respect to credit reporting ☐ No, there is no law for bank secrecy ☐ A law on bank secrecy is pending or under development
Please describe how your firm relates to the public credit registry in your country run by the central bank or bank superintendent. (Mark all that apply)	☐ We are unaware of any public registry operating in our country ☐ We have no relationship of any kind with the public credit registry ☐ We receive some data from the public credit registry ☐ We provide some data to the public credit registry ☐ The public credit registry acts as a competitor to our firm ☐ The public credit registry is our ally as we work to strengthen credit reporting in our country ☐ Other________________________________

Part IVOpinions

14. Performance Review Disclosure

Please describe how the bureau reports on its work; attach the most recent annual review or equivalent.

15. Subjective Observations

Please describe views and cooperativeness of reporting institutions on the bureau and its work

Please describe any changes in the operation of the bureau being considered or planned, or thought to be desirable.

Describe what are the two to three most important factors (either internal or external) that if changed would significantly improve the operation of your registry.

Appendix 2

SBCG's Credit Guarantee Schemes and Guidelines

SBCG's Credit Guarantee Schemes

SBCG schemes

1. **Normal Scheme**
   - Must be Thai-owned SMEs operating in Thailand
   - Analysis based on case by case basis
   - Have land ownership or have a 3 year lease-hold
   - For leased land and building guarantee limit of 10 million baht
   - Guarantee up to 100% non-collateralized portion but not exceeding 50% of total loan amount and maximum guarantee amount 10-40 million baht
   - Personal guarantee required
   - Consideration period is about 22 business days from the date of receipt of completed documentation
2. **Risk Participation Scheme**
   - Must be Thai-owned SMEs operating in Thailand
   - Have assets as collateral and appraisal value not less than 50% of total loan
   - Risk shared by the financial institutions and SBCG
   - Less paperwork required & automatic approval
   - Guarantee limit of 50% of total loan amount and not exceed 40 million bath
   - 5 business days of approval period from the date of receipt of completed documentation

3. Loan Guarantee Scheme

- Must be Thai-owned SMEs operating in Thailand for at less 3 years and have positive shareholder's equity in latest year.
- The location of assets to be used as collateral with lender
- Guarantee limit of 50% of total long term loan amount and with a maximum guarantee amount per project of 10 million bath
- SMEs must have 3 years operation and positive shareholder's equity in latest year
- Long-term loans of no longer than 7 years

Source: SBCG

SBCG's Credit Guarantee Guidelines

SBCG's Guarantee Guidelines

In SBCG's credit guarantee extension, the SBCG formulated its guarantee guidelines to be in accordance with its establishment objectives and users' demand. Its guarantee guidelines are as follows:-

Eligible SMEs

The small enterprises which will be guaranteed by SBCG must have the following qualifications:-

1. The total net fixed assets (exclude land) on the date of loan application shall not exceed 200 million baht.

2. The entrepreneur shall be a natural person or juristic person who has Thai nationality, and operates his business in Thailand

All kinds of small industries and business enterprises are eligible for SBCG's guarantee service.

Eligible Financial Institutions

Financial institutions eligible for SBCG's guarantee service are not limited to only SBCG's shareholders. At present, eligible financial institutions are as follows:-

1. Commercial banks
2. The Small and Medium Enterprise Development Bank of Thailand
3. The Government Savings Bank
4. The Export-Import Bank of Thailand
5. The Bank for Agriculture and Agricultural Cooperatives

Source: SBCG