Chapter 3

THE DEVELOPMENT OF THE FINANCIAL SYSTEM IN THAILAND

3.1 Introduction

The Thai financial system consists of many kinds of financial institutions. Among them, commercial banks are by far the most important institution in terms of both total assets and total credit extended. Since banks were first established in Thailand (a foreign bank's branch was the first bank established in 1888), the commercial banking system has evolved and became the country's most important financial intermediary. The first Thai bank started operations in 1906 and with strong government protection, they have been expanding their activities much more than the branches of foreign banks. By the end of 1995, Thai banks captured over 90 percent market share of the banking industry. The predominant status of commercial banks in the Thai financial system can be observed through the comparison of the total assets of each main financial institution in Table 3.1.

During the years 1989-1995, the Thai monetary authorities introduced many financial liberalization schemes and the Thai commercial banks have faced a stronger competitive environment. However, they can still maintain their dominant intermediation role. The second largest and fastest growing institution is the finance companies. The first full-fledged finance company started its operations in 1969. Despite some up and down periods, the role of finance companies has increased dramatically in the past 10 years. The combined assets of commercial banks and finance companies account for about 90 percent of the whole financial market. Besides these two major institutions, there are several specialized financial institutions such as the Government Savings Bank (GSB), The Bank for Agriculture and Agricultural Cooperative (BAAC), the Government Housing Bank (GHB), and the Industrial Finance

Table 3.1: Major Financial Institutions Total Assets

unit : million baht

	1989	*%*	*1990*	*%*	*1991*	*%*	*1992*	*%*	*1993*	*%*	*1994*	*%*	*1995*	*%*
Commercial Banks	1,4263.67	73.7	1,806.56	74.2	2,169.91	73.5	2,555.62	71.2	3,204.64	70.3	4,065.06	70.1	5,045.08	69.4
Finance and Securities	281.7	14.5	365.6	15.0	481.0	16.3	689.86	19.2	931.34	20.4	1,223.46	21.1	1,588.13	21.8
Government Savings bank	125.7	6.5	132.81	5.4	140.16	4.8	150.86	4.2	165.48	3.6	183.90	3.2	210.49	2.9
Bank for Agriculture and agricultural Co-operatives	45.0	2.4	54.80	2.2	67.23	2.3	76.94	2.2	105.74	2.4	122.68	2.1	159.96	2.2
Government Housing Bank	27.81	1.4	35.78	1.5	45.39	1.5	57.07	1.6	78.26	1.7	111.80	1.9	154.06	2.1
Industrial Finance Corporation of Thailand	29.60	1.5	37.90	1.6	47.85	1.6	57.14	1.6	70.40	1.6	90.19	1.6	118.12	1.6
Total	1,936.48		2,433.54		2,951.54		3,587.49		4,555.86		5,797.09		7,275.84	

Source : Computed from various issues of the Annual Report of the Bank of Thailand

Corporation of Thailand (IFCT). All of these specialized institutions have combined assets of less than 10 percent of the whole market.

The development of the financial system in Thailand can be classified into four phases. The first stage is the period before 1961 where the necessary conditions for the financial development had to be established. The second stage is the period between 1961-1968 when the first National Economic and Social Development Plan was introduced and the country experienced high and sustained economic growth. The third stage is during the years 1969-1989 where there were many shocks in the world market and the country became more concerned with the international environment. The fourth stage is the "liberalization stage" starting from 1989 onward. During this time, many liberalization policies were implemented, including plans for relaxing exchange controls, deregulating interest rates, and improving the basic financial infrastructure. Also many financial institutions were established during this time such as the SEC, mutual fund companies, and the Bangkok International Banking Facilities (BIBF). All of these developments are expected to lead to a higher competitive environment in the Thai financial system.

3.2 The First Stage (before 1961)

In the early period of the Thai financial system, most of the activities had been set up to facilitate the international trade of the country. The first group of commercial banks were the European banks, led by the British and French. The Hong Kong and Shanghai Banking Corporation (British) was the first bank, commencing operations in 1888. The main tasks of these banks were to support their nations' international trade. The Chinese banks were the next group of foreign banks, starting their business to support the Chinese trade. However, in 1906 the first Thai bank was established under the name of the Book Club, later changing its name to the Siam Commercial Bank.

In 1942, the Bank of Thailand (BOT) was established under The Bank of Thailand Act enacted on April 28, 1942. The bank carries the usual powers and functions of a central bank in any other country.

During the first stage of banking operations, the role of foreign banks were much more important than the local Thai banks. However, during the Second World War, all foreign banks except the Japanese banks had to cease operations. Although operations resumed after the war, the role of the Thai banks became more important and outperformed their foreign banks counterparts. Also, with the strong protection of the government, Thai banks were expanding their activities much more than the foreign banks. Right after the war, there were 12 commercial banks in the country--7 Thai and 5 foreign bank branches. The banking activities were moving beyond the major tasks of financing international trade but because of limited investment opportunities and the very low per capita income at that time, the banks still did not perform the full functions of financial intermediaries. During this era, time and saving deposits were insignificant relative to the size of the GDP. Table 3.2 shows that during 1950-1954, the narrow money (M1) indicator accounted for an average of 18 percent of GDP and the broad money (M2) indicator was of 19 percent of GDP on average. The difference between the ratio of M1 and the ratio of M2 is merely 1 percent. The percent of bank credit was also very low and most private investments were financed by private savings. The financial markets were very fragmented.

Table 3.2: Initial Condition Indicators (Ratio to Gross Geographical Product)

	M1	*M2*	*Bank Credit*	*Saving Gap*
1947	17.8	19.5	2.2	5.3
1948	17.0	18.7	2.5	-3.2
1949	15.2	16.8	2.6	3.4
(Ratio to GDP)				
1950-54	18.0	19.0	1.4	2.4*

Source : Computed from various issues of the Annual Report of the Bank of Thailand.

(Reproduce from Nidhiprabha 1991)

However, at the end of this period, investment opportunities had improved. The interest rate on government bonds was raised from 6 to 8 percent in 1956. This higher rate had made the bonds more attractive to hold for both individuals and commercial banks which was an important factor contributing to the development of financial institutions and banking habits in later periods.

3.3 The Second Stage (1961-1968)

The first National Economic and Social Development Plan was introduced in 1961. The main objective of this plan was to stimulate economic growth in the private sector by building up the basic infrastructure. As a result, the country experienced high and sustained economic growth during this time. The average annual growth rate of real GDP was around 8 percent and the share of investment in GDP rose from 15.1 percent in 1961 to 25.2 percent in 1968.

The Commercial Banking Act was introduced in 1962. This Act gives the BOT statutory power in regulating commercial banks. During this period, banking operations proceeded smoothly and in line with the economic expansion of the country. Competition among banks was restricted by both the regulations barring new entrants and by the regulations controlling the number of new branches. The number of banks were limited to 30 commercial banks, consisting of 16 Thai banks and 14 foreign banks. Since the end of this period, no license for a new bank has been issued.

Table 3.3: Average Financial Ratios

	M1/GDP	*(TD+SD)/GDP*	*M2/GDP*	*Growth rate of new branches of commercial bank*
1950-1954	0.18	0.01	0.19	11.3
1955-1960	0.19	0.03	0.22	18.5
1961-1968	0.15	0.10	0.25	4.8*
1969-1984	0.12	0.25	0.37	7.5
1969-1979	0.13	0.22	0.35	7.9
1980-1984	0.09	0.35	0.44	5.7**

Note: SD = Saving Deposit

TD = Time Deposit

* *1962-1968*

** *1980-1982*

Source : Computed from various issues of the Annual Report of the Bank of Thailand.

(Reproduce from Nidhiprabha 1991)

The imposition of the ceiling on deposits and lending rates led to an absence of price competition among banks. The commercial banks were the dominant financial institution and gained more confidence from the public. Commercial banks grew rapidly in both the number of offices throughout the country and in terms of deposits. The ratio of time and saving deposits to GDP grew from 3 percent during 1955-1960 to 10 percent during 1961-1968 (see Table 3.3). In this second stage, Thai banks had no rivals; the oligopolistic market structure in the banking industry could clearly be seen.

3.4 The Third Stage (1969-1989)

The period beginning in 1969 is considered the beginning of the modern stage of financial development. For the first time, the ratios of time and saving deposits to the GDP were higher than the ratio of M1 (see Table 3.3). The sharp increases in the ratios of the time and saving deposits (quasi money) to GDP demonstrated the high degree of financial deepening. This means that the traditional role of money as a medium of exchange becomes less important than the role of money providing a means of wealth accumulation (Nidhiprabha 1991).

Also in 1969, the first full-fledged finance companies emerged as a new kind of non-bank financial institution. The finance companies were not allowed (and are still not allowed) to accept deposits in the same form as the deposits taken by a commercial bank. Instead, finance companies obtain funds by issuing promissory notes which yield a higher rate of return than commercial banks' deposits. The share of financial savings mobilized by finance companies increased from 4.8 percent during 1971-1974 to 12.2 percent during 1981-1984. The share of credit extension also rose from 12.8 to 16.6 percent during the same period of time. Most of the finance companies' lending during this period were in the form of short-term consumer financing and cheque discounting activities. Commercial banks still controlled most of the market share in both deposits and lending (see Table 3.4).

Table 3.4: Relative Roles of Financial Intermediaries

	Savings Mobilization		*Credit Extension*	
	1971-74	*1981-84*	*1971-74*	*1981-84*
Commercial Banks	73.5	72.5	76.1	71.4
Finance Companies	4.8	12.2	12.8	16.9
Government Saving Bank	15.9	9.0	0.7	0.5
Other Financial Institutions	5.8	6.3	10.4	11.2

Source : Nidhiprabha (1991)

During the third stage of the financial development, the country faced many external shocks. The first shock came when the fixed exchange rate system, the Bretton Woods system, collapsed in 1971, leading to increased exchange rate volatilities. Then in 1973 came the first oil shock followed by a global recession in the first half of the 1980s. Consequently, the commercial banks had to be more conservative in their operations. However, some Thai banks and finance companies faced critical problems due to mismanagement and fraud. The Commercial Banking Act was amended twice during this period. The first amendment in 1979 and the second amendment in 1985 were both aimed at enabling the BOT to deal with troubled financial institutions in a more effective way. The amendments also led to the establishment of the Financial Institutions Development Fund as a separate legal entity. The main objective of the Fund is to bail out troubled banks and finance companies in a crisis. During this period, the Asia Trust bank was in deep trouble and the BOT had to step in and bail out the bank. The bank then changed the name to the Siam Bank and later merged with the Krung Thai bank, reducing the number of Thai banks to 15 (Table3.5).

Table 3.5: List of Commercial Banks in Thailand

Banks incorporated in Thailand	*Banks incorporated abroad*
1. Bangkok Bank Public Company Ltd.	1. The Bank of Tokyo-Mitsubishi Ltd.
2. Krung Thai Public Company Ltd.	2. The Sakura Bank Ltd.
3. Thai Farmers Bank Public Company Ltd.	3. Citibank N.A.
4. The Siam Commercial Bank Public Company Ltd.	4. The Hongkong and Shanghai Banking Corp. Ltd.
5. Bank of Ayudhya Public Company Ltd.	5. Standard Chartered Bank
6. The Thai Military Bank Public Company Ltd.	6. Deutsche Bank AG.
7. First Bangkok City Bank Public Company Ltd.	7. Bank of America N.T. & S.A.
8. Siam City Bank Public Company Ltd.	8. The Chase Manhattan Bank, N.A.
9. Bangkok Metropolitan Bank Public Company Ltd.	9. Banque Indosuez
10. The Bangkok Bank of Commerce Public Company Ltd.	10. ABN-AMRO Bank N.V.
11. Bank of Asia Public Company Ltd.	11. Overseas-Chinese Banking Corporation Ltd.
12. The Thai Danu Bank Public Company Ltd.	12. The International Commercial Bank of China
13. The Union Bank of Bangkok Public Company Ltd.	13. Sime Bank Berhad
14. Nakornthon Bank Public Company Ltd.	14. Bharat Overseas Bank Ltd.
15. The Laem Thong Bank Public Company Ltd.	

Source : Commercial Banks in Thailand 1997 (published by Bangkok Bank Public Company Ltd.)

Another development during this period was the legislation establishing "The Security Exchange of Thailand" (SET), enacted in May 1974. The market was set up to promote long term capital funds for investment. On April 30, 1975 the SET started its first day of trading. Its official name was changed to "The Stock Exchange of Thailand" in 1991. Several measures have been introduced by the government to encourage large corporations to have their shares traded on the SET. Tax incentives have been provided for listed companies and for individual investors. Growth was slow during the first ten years of operations due to public unfamiliarity with the market and the fluctuations in the economy. Despite the slow start, the significant rises in the ratio of market capitalization can be observed beginning in 1986 (see Table 3.6). The SET expanded during 1986-1989 because the Thai economy was recovering, coupled with the new tax incentives to encourage both domestic and foreign investors.

By the end of this period, the country had already recovered from the economic fluctuations. The highest form of financial development was achieved through the expansion of the capital markets. More options were offered for both lenders and borrowers and the country was ready for the new financial era.

Table 3.6: Market Performance (Corporate Securities)

Year	*Turnover Value (Million Baht)*		*SET Index*			*Market Capitalization (Million Baht)*
	Total	*Daily Avg.*	*High (Date)*	*Low (Date)*	*Close*	
Early Years						
1975	559.54	3.37	100.12 (23/7)	84.08 (30/12)	84.08	5,394.12
1976	993.54	4.01	83.96 (2/1)	76.44 (17/3)	82.70	7,260.13
1977	26,282.10	106.84	205.80 (7/11)	82.48 (4/1)	181.59	19,231.59
1978	57,065.75	231.97	266.20 (24/11)	180.79 (1/8)	257.73	33,088.28
1979	22,450.55	90.53	259.82 (2/1)	146.12 (12/11)	149.40	28,384.02
1980	6,543.22	26.41	148.23 (2/1)	113.33 (9/9)	124.67	25,521.81
1981	2,521.20	10.21	129.03 (12/2)	103.19 (8/9)	106.62	23,471.22
1982	5,877.97	23.89	138.77 (13/9)	102.03 (14/4)	123.50	29,438.95
1983	9,120.55	36.93	148.36 (29/7)	122.88 (13/1)	134.47	34,793.62
1984	10,595.19	42.72	144.83 (3/12)	128.69 (18/4)	142.29	47,431.85
1985	15,333.99	62.59	158.08 (31/7)	132.76 (24/12)	134.95	49,456.82
First Boom						
1986	24,993.46	101.19	207.98 (26/12)	127.26 (19/6)	207.20	75,200.01
1987	122,138.49	494.49	472.86 (16/10)	203.14 (16/2)	284.94	138,155.40
1988	156,457.23	633.43	471.45 (8/8)	287.71 (4/1)	386.73	223,645.24
1989	377,028.18	1,526.43	879.19 (29/12)	391.23 (3/1)	879.19	659,493.07
Present						
1990	627,232.75	2,539.40	1,143.78 (25/7)	544.30 (30/11)	612.86	613,515.27
1991	793,068.01	3,237.01	908.90 (22/4)	582.48 (16/1)	711.36	897,181.86
1992	1,860,070.52	7,530.65	963.03 (5/11)	667.84 (19/5)	893.42	1,485,018.49
1993	2,201,148.18	8,984.28	1,682.85 (30/12)	818.84 (1/6)	1,682.85	33,251,393.35
1994	2,113,860.65	8,628.00	1,753.73 (4/1)	1,196.59 (4/4)	1,360.09	3,300,756.44

Source : The Stock Exchange of Thailand

3.5 The Fourth Stage (1989 - present)

Until the late 1980s, the Thai financial system was under relatively strict government control. Thai monetary authorities placed strong emphasis on maintaining financial stability, thus resulting in many stringent rules imposed on the operations of the financial institutions, especially the commercial banks and finance companies. However, as the trend of financial deregulation sweeps through the world, the government has to prepare the Thai financial system for the changing environment and higher competition in the global markets.

The process of financial liberalization in Thailand started after 1988 when the country successfully recovered from the economic and financial problems of the mid-1980s. The BOT implemented its first three-year financial reform plan covering 1990-1992. The plan had four basic components:

1. Deregulating the interest rate, exchange control and asset management; relaxing controls over financial institution operations--for example, permitting opening of new branches and the extension of banking activities;
2. Developing the supervision and examination systems;
3. Developing new financial instruments and services; and
4. Developing more efficient payment systems.

According to the plan, the monetary authorities gradually lifted the interest rate ceilings. The long-term deposits rate were lifted in 1989, the fixed deposits rate in 1990, saving deposits and lending rates in 1992. The relaxation of exchange controls was also gradually implemented from 1990 through 1994.

In the early 1990s, commercial banks were allowed to conduct more businesses related to financial instruments, include managing, issuing, underwriting, and trading private debt instruments. Commercial banks were also allowed to enter the business of financial advisory services, acting as a selling agent for mutual funds, and as securities registrars. Other types of financial institutions could also expand their operations into different areas. For example, finance companies were permitted to enter the leasing business in 1991; in 1992, finance companies could become brokers for selling government bonds, as well as providing service and advice for companies that want to be listed on the SET. The finance and securities companies were allowed to broaden their businesses the same as the finance companies and in addition they could provide custodial services and become a registrar and securities purchasing agent.

In the area of development of supervision and examination systems, the BOT replaced the conventional capital risk asset ratio with the Bank for International Settlement (BIS) standard for capital adequacy. The replacement took effect in 1993 and commercial banks are required to maintain a capital risk asset ratio of not less than 7 percent, of which at least 5 percent must be first-tier capital (paid-up capital, retained earnings, reserves appropriated from net profit and statutory reserves). These ratios were adjusted to 8 percent and 5.5 percent respectively in 1994.

The SET Act was replaced by the Securities and Exchange Act (SEA) to help develop the area of financial instruments. One of the important issues of this Act is to allow any company to raise funds from the public by issuing financial instruments, formerly the sole right of public companies. Another outstanding features of the SEA is the establishment of the Securities and Exchange Commission (SEC) as the sole supervisor of the entire securities industry including the over-the counter centers. Plus, a credit rating agency was created to address the issues of disclosure and evaluation of financial information. The SEC also allowed creation of many mutual fund companies and let the funds act as links between small investors and the capital markets by selling small unit funds to the public and investing those funds in the markets. The Bond Dealers' Club (BDC) was founded in September 1994 within the structure of the Association of Securities Companies (ASCO). The primary objective of the club is to build up the fundamental structure for debt instruments trading in the secondary market. Trading on the BDC market started on November 1994, with 62 members; by 1995, the number of members had increased to 87.

The last plan is the development of the payment system which aims to reduce the cost of payment and improve the efficiency of the transfer of funds by introducing other means of payment rather than cash. Evidence of this plan can be seen through the introduction of *Bahtnet* for inter-banking transfer; creation of *Thaiclear* for cheque clearing and media clearing, and the relaxation of the rules governing opening new Automated Teller Machines (ATMs).

In February 1995, Cabinet approved the 5-year financial system master plan, covering 1 March 1995 to 29 February 2000. The objectives of the plan are as follows:

1. To increase the efficiency and enhance the competitiveness of the financial system;
2. To maintain the stability of the financial system;
3. To accelerate rural development through monetary services;
4. To induce higher national savings for long-term economic development; and
5. To develop Thailand into a financial center and to internationalize the domestic money and capital market.

However, due to the political and economic situations, most of the implementation has not materialized except the last objective. In order to promote the country as an international financial center for the Southeast Asia region, since 1992, financial institutions have been allowed to set up an offshore financial services company through the Bangkok International Banking Facilities (BIBF). Qualified Thai banks, foreign bank branches, and new banks can be granted licenses which permit them to do the following activities as offshore banking units: accept deposits in foreign currencies; lend in foreign currencies to both residents and nonresidents; and do cross-currency foreign transactions. All these transactions can be done with relevant tax incentives.

At the end of 1996, 52 banks were granted permission: 15 Thai banks, 19 foreign banks and 18 foreign bank branches. Total lending volume through the BIBF reached 1,289,733 million baht, with about 36 percent distributed to the industrial sector and 28 percent to financial sector (Table 3.7).

Table 3.7: Total BIBF Lending classified by business sector, as of December 1996

units: thousand baht

Type	Out-In		Out-In		Total	
	Out-standing	Percent	Out-standing	Percent	Out-standing	Percent
1. Agriculture	6,166,017	0.76%	468,573	0.10%	6,634,590	0.51%
2. Mining	9,887,901	1.22%	21,487	0.00%	9,909,388	0.77%
3. Industrial	390,539,081	48.37%	72,091,782	14.95%	462,630,863	35.87%
4. Construction	21,542,201	2.67%	36,764,355	7.62%	58,306,556	4.52%
5. Commerce	115,507,972	14.31%	28,592,034	5.93%	144,100,006	11.17%
6. Banking and Finance	119,620,802	14.81%	236,018,373	48.94%	355,639,175	27.57%
7. Real Estate	41,377,230	5.12%	75,642,361	15.68%	117,019,546	9.07%
8. Public Utility	39,810,852	4.93%	18,124,026	3.76%	57,934,878	4.49%
9. Services	60,763,713	7.53%	14,558,913	3.02%	75,322,626	5.84%
10.Consumer	2,235,789	0.28%	--	0.00%	2,235,789	0.17%
Total	807,451,558	100.00%	482,281,859	100.00%	1,289,733,417	100.00%

Source : Bank of Thailand

A new specialized bank, the Exports and Imports Bank (EXIM) was formed in 1993. The primary objective is to assist exporters of Thai products and importers of capital goods through low cost financing. Besides the capital endowment of US$100 million, it is allowed to raise additional funds by issuing debt instruments, discounting, trading in financial papers, and borrowings from within and outside the country.

3.6 Conclusion

The Thai financial system has continued to evolve. In the early stages of development, there was a strong influence from foreign countries especially the British and the French. However, the role of Thai banks became more important after the Second World War when most of the foreign banks had to cease operations.

In 1961, the nation's first National Economic and Development plan was implemented and the operations of the commercial banks become the major force in the financial system and helped accelerate economic growth. The role of other financial institutions has been enhanced after the country became more modernized. The birth of the finance companies and the creation of the stock market in 1970s are strong evidence. However, because of the economic fluctuations that occurred in the 1980s, the growth rate of both institutions were not so impressive until the later 1980s.

By the late 1980s, the waves of financial liberalization that occurred throughout the world made the Thai authorities introduce and implement many liberalization schemes. One effect of these reform policies is the stronger competitive environments in the financial markets. Local financial institutions are expected to improve their operations in order to maintain their market shares and ensure long-run economic viability. The improvement should lead to more efficiency in banking operations which in turn should lower the costs of economic activities and expand the growth of the country.