SCB Economic Intelligence Center

Comments on

Mitigation of Financing Constraints in the Thai Banking System

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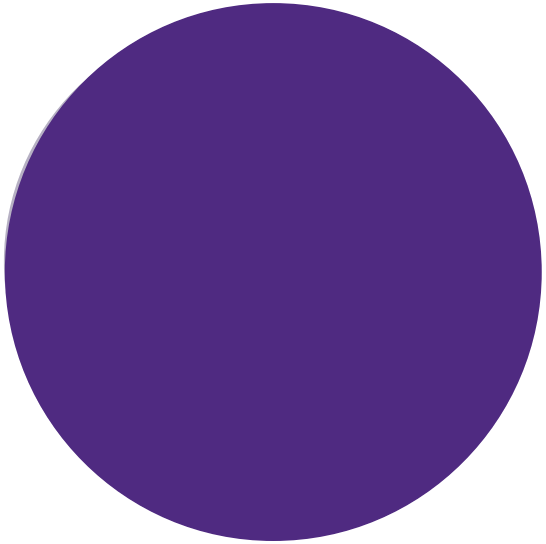
Paper Summary

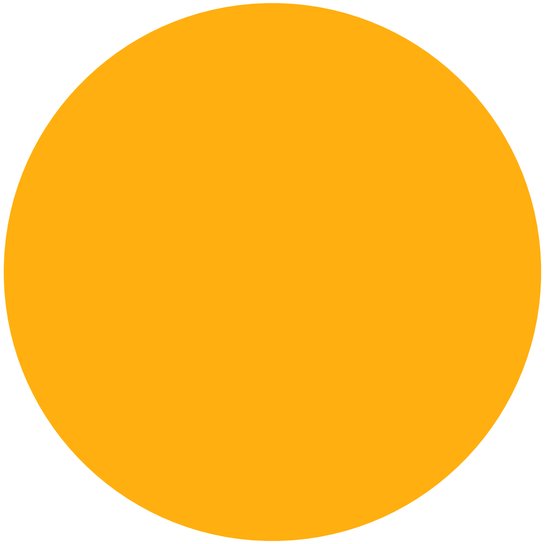
1. Literature review on financial constraints – causes and impacts.
2. The second part provides a good overview of how Thai banking system has evolved to ease financial constraints for SMEs and low-income households.
3. Provide empirical evidence of a negative relationship between firm financial performance and financing costs.

Credit market in Thailand

Lenders

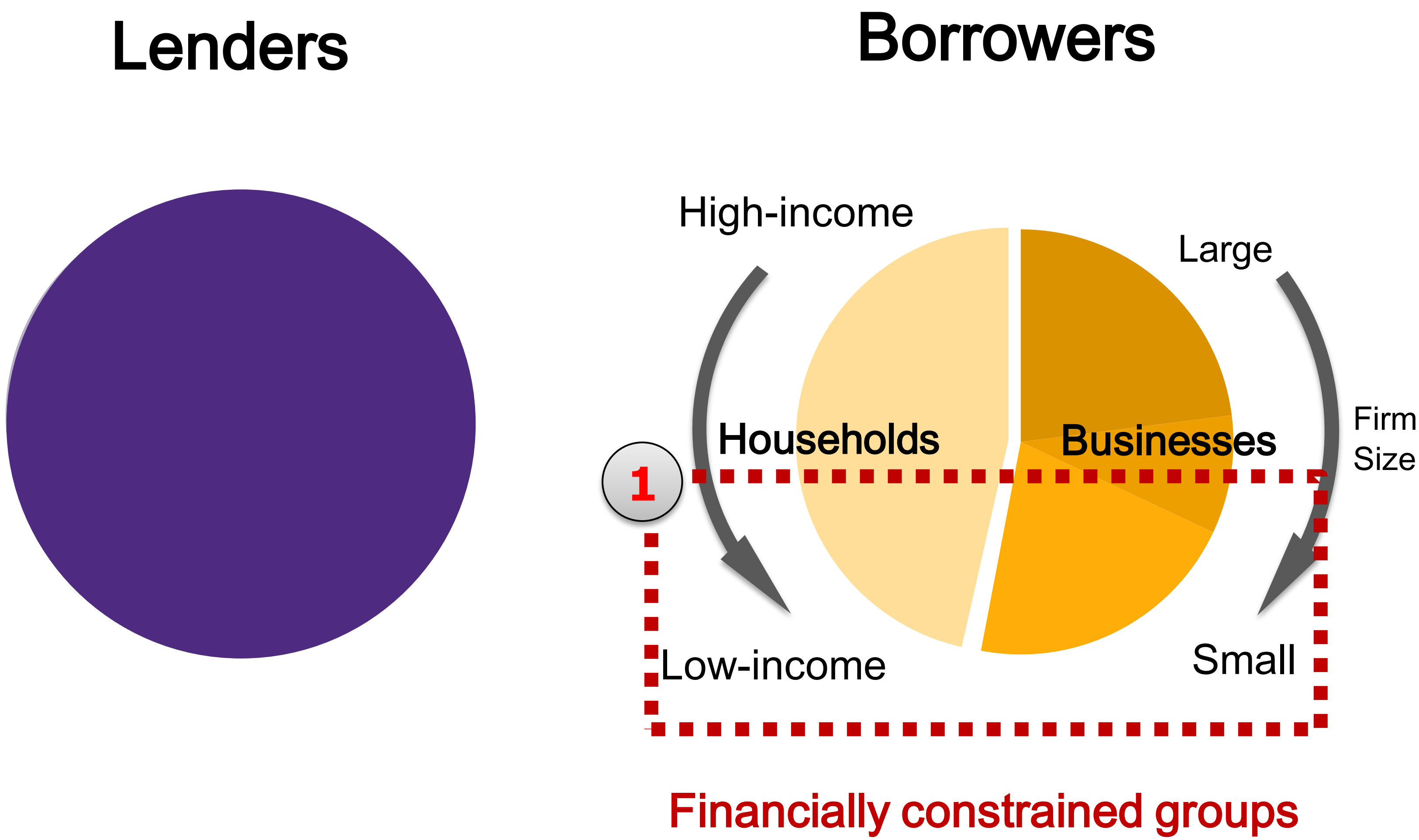


Borrowers



* The charts are for illustrative purpose and do *not* represent the size of lenders and borrowers

Credit market in Thailand



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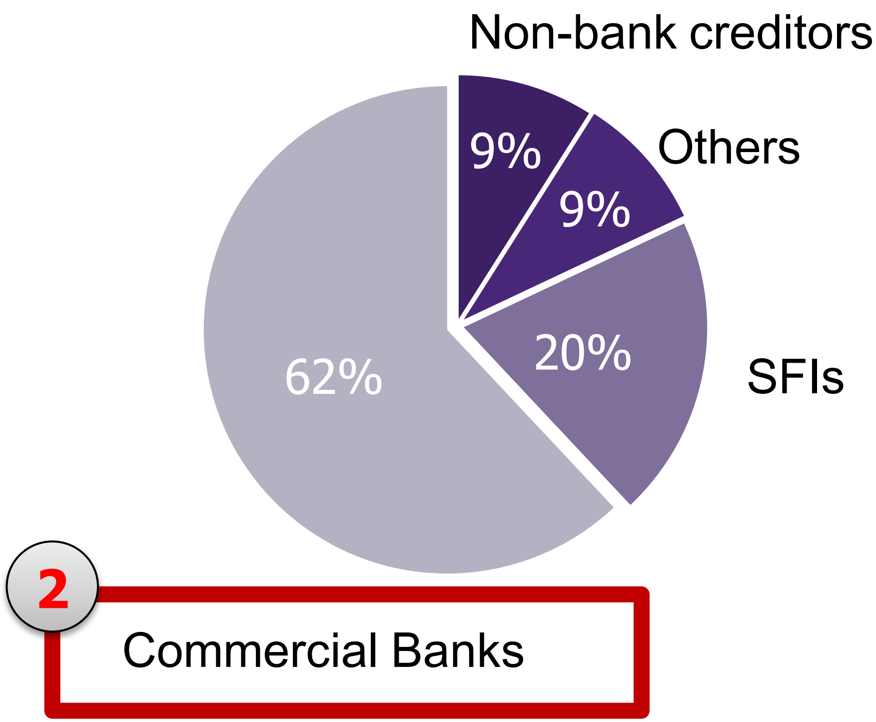

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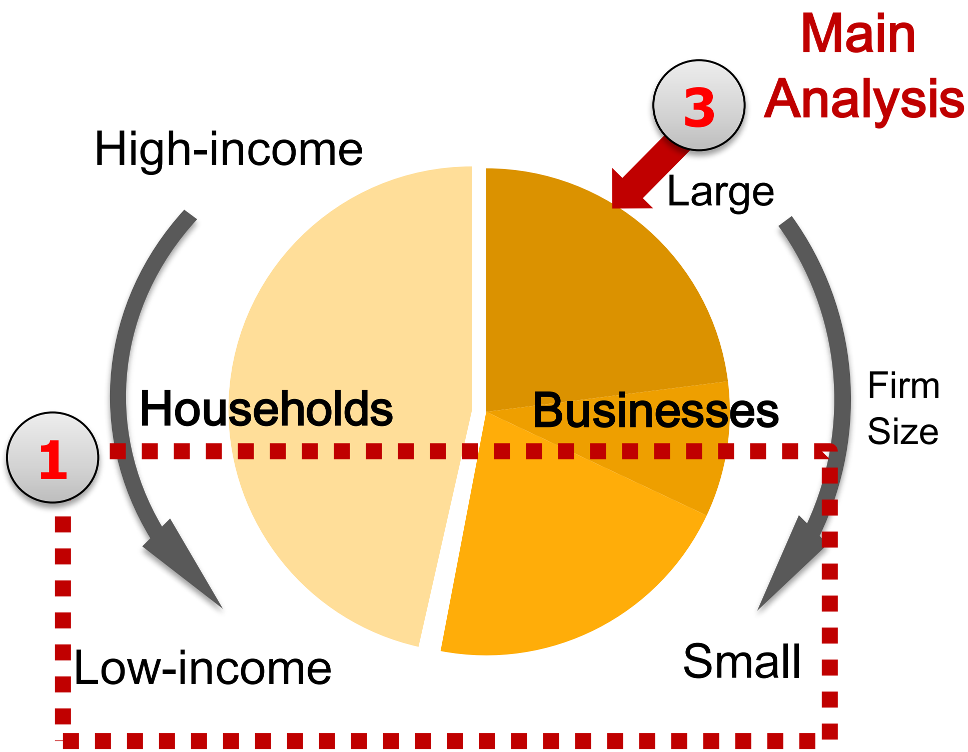

Financially constrained groups

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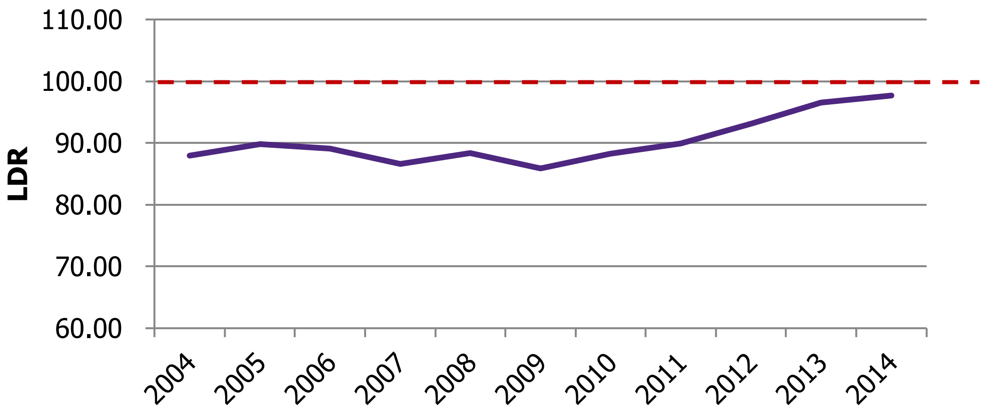
Supply-side constraints on banks

- Banks rely heavily on deposits as the main source of funding. But recently loan demand has outpaced deposit growth.

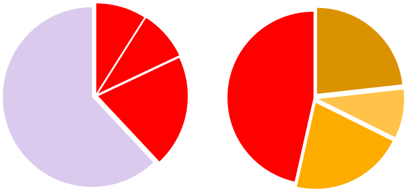


In an environment with tight credit, rationing will affect the "worst" borrowers especially SMEs and low-income households who are perceived as risky.

Easing constraints in the banking channel

- **Lifting bank funding virtual constraints**
    - One way is to diversify funding to other channels beyond deposits.
    - Banks and regulators need to communicate with investors that LDR may not be relevant wherein liquidity and capital ratios are high.
- **Changing the way banks ration credit for the constrained borrowers.**
    - Credit Guarantee Corporation can help, but the extent is still limited.
    - Create a SME database, proven successful in Japan (Yoshino, 2014).

Constraints on households and on non-banks/SFIs



- **Financial constraints for low-income households**
    - Existing organizations that serve this group such as SFIs and Village Funds could potentially employ innovative mechanisms from the microfinance industry such as group lending to improve repayment rates (Besley and Coate, 1995, Ghatak, 1999)

Suggestions on methodology

❖ **Main regression**

$$\text{Cost of finance} = \beta_0 + \beta_1 \%\text{Asset change} + \beta_2 \text{NetProfit Margin} + \beta_2 \text{Coverage Ratio} + \beta_3 \text{Structural Change} + \varepsilon$$

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Rewriting:

$$\frac{\text{Interests}}{\text{Total Liabilities}} = \beta_0 \text{\%Asset change} + \beta_1 (\text{EBIT - interests - tax}) + \beta_2 \frac{\text{EBIT}}{\text{Interests}} + \beta_3 \text{Structural Change} + \varepsilon$$

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Problems

– Impossible to interpret the coefficients (endogeniety & multi-colinearity)

– Mathematically b2 and b3 are negative regardless of the data.

Suggestions on methodology (cont.)

- Why limiting the sample to only top companies in SET and bottom companies in MAI?
- Comparing the two samples (companies in MAI vs SET)
    - Hard to compare coefficients when running separate regressions
    - Instead, pool both samples, add a dummy for MAI and interaction terms between this dummy and other variables.
    - Easier to detect differences and to test if it's statistically significant.

Interpretation of the results

- Interpreting coefficients in light of market imperfections.
    - For example, does the change in assets represent changes in risk of that firm? Or does it mean that as a company grows, the asymmetric information becomes less severe?
- Interpreting the time dummy as an institution change can be misleading.
    - What is the justification for picking the time period, 2005-2012?
    - Many other factors also changed over time, not just institution.

Future Research Questions

- Each section can be developed into a separate paper.
    - A comprehensive review of financial constraints in developing countries or only Thailand
    - Quantify the effect of banking sector development in easing financial constraints in Thailand. How much does internet banking improve productivity for firms?