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### Disclaimer

The booklet contains reports prepared by the participants of International Exposure Programme in Thailand & Vietnam on Financing to SMEs. This report has been prepared based entirely on secondary data and no primary research was undertaken. The views expressed are those of the authors and neither belongs to the organizers of the programme nor the institutions they represent.

## FOREWORD

Considering the vital role played by Small & Medium Enterprises (SMEs) in economic development, the policy makers, financial institutions and commercial banks of East Asian countries have begun actively pursuing the development of SME sector. This was particularly noticeable in the transition economies viz. Thailand and Vietnam. Hence, to study the models of SME financing and the methods applied by the banks in these countries to overcome the constraints faced while financing to SMEs and to draw lessons for Indian banks, the College of Agricultural Banking, Reserve Bank of India, Pune conducted the captioned exposure programme for bankers, financial institutions, policy makers and other institutes engaged in supporting/building capacity of SME sector. The programme was conducted during February 25 to March 6, 2008. While major part of the programme was conducted in Thailand & Vietnam in collaboration with Asian Institute of Technology (AIT), Bangkok, a reputed education and training institute in Asia Pacific region, a two day in-country programme was organised in India to review the status of the sector and facilitate cross country comparisons. A balanced mix of 18 senior officials (8 practical bankers, 2 officials from FIs, 2 Faculty Members from banking sector, one official from the RBI, 4 officials from MFIs and one official from GoI) participated in the above program which was designed and coordinated by 2 Programme Directors from the CAB. The participants who were divided into four sub-groups to study different aspects of SME financing in the visiting countries, submitted reports at the end of the programme. These reports are based on the presentation, reading material and the secondary data provided during the exposure programme. These four reports, along-with schedule of sessions during the programme, are furnished in this booklet.

These reports indicate that though definitions of SMEs differed in these countries, striking similarities were observed in problems being faced by SMEs as well as bankers in financing them. The problem of access to finance, collaterals, obsolete technology/machineries/equipments, deficiency of business development services, marketing, infrastructural bottlenecks, poor financial and managerial knowledge and inadequacy of inputs/skilled labour are the common problems being faced by the SMEs. Perception of high credit risk leading to high level of non-performing loans (NPLs), high cost of servicing and monitoring, information asymmetry, non-availability of collaterals/credit history, inadequate managerial competence and financial understanding were found common among bankers/FIs in these countries.

Major objective of compiling and disseminating these reports is to share the learnings acquired by the participants during the exposure programme. The findings and recommendations

may be valuable inputs in framing SME lending policies of FIs/banks and may help them in introducing new products/systems to serve the needs of SMEs. The major learnings are summarised below. Some of the groups have also submitted recommendations to FIs/banks/government agencies for expansion or diversification of appropriate financing to SMEs.

### **Lessons for India**

The exposure programme provided an opportunity to participants to look at SME financing from a different perspective. After noticing that in these developing countries, though SMEs face similar problems and banks also consider financing to them as risky proposition, banks and government are earnestly trying to promote, support and develop SMEs, the participants have formed an opinion that in India also banks have to provide them handholding services in addition to extending financial services. The other major take away for the bankers from India is that survival of SMEs during initial years of set up is more important than their profitability. They noted that it is not a compulsion under priority sector to finance to this sector, but a business opportunity for banks. Some of the important recommendations for effective SME Financing include establishment of SME unit in all banks, applying appropriate and simple evaluation techniques, promoting greater linkages and dialogues between FIs/banks/trade associations/and government agencies, improving information access to SMEs, promoting informal debtor-creditor workout mechanism for SMEs, developing alternative markets for SME financing , etc.

Pune  
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Shrimohan Yadav  
Programme Director  
(Deputy General Manager  
& Member of Faculty)

# **GROUP REPORT -1**

Submitted by:

**Shri Mandeep**  
**Shri Suresh Goyal**  
**Shri Jai Kumar**  
**Shri T E Thiruvengdam**

Vice President, HSBC (Team Leader)  
Director Finance, NSIC  
DGM, Corporation Bank  
GM-Legal, REPCO Bank

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## **I. OVERVIEW OF SME SECTOR IN THAILAND AND VIET NAM**

### **A. SIZE AND CHARACTERISTICS OF SME SECTOR**

SME are considered the engine of economic growth in most Asian economies by virtue of their sheer number and significant economic and social contributions. The role of SME in industrial development in Asia is more pronounced than in the West. In countries such as Japan, Taiwan, South Korea and China, SME are the backbone of the industrial and manufacturing sectors. Their number and contribution to total employment in these economies are well over 95% and 70% respectively.

Likewise in these 2 economies, SME generally account for upwards of over 90% of establishments, between 20-40% of total domestic output and employ between 75-90% of the domestic workforce. Different definitions of SME are used in each country but for the purpose of this report, the general definition of a small enterprise employing less than 100 people and a medium enterprise employing less than 250 people can be adopted.

### **B. CONTRIBUTION OF SME TO THE ECONOMY**

In spite of the significance of these indicators, the SME sector's value added contribution to the economy for most South East Asian countries has yet to commensurate with the sector's size and socioeconomic potential. In Singapore, the most developed of these countries, the value added of SME is only 24% of the economy's total value added and 16% to export earnings while their productivity is half that of large establishments. Malaysian SME contributed only about 26% to manufacturing value added and 6% of value added to GDP. In Thailand, commonly cited as a successful model for SME development, the SME contribution is more significant at just below 40% of GDP and total industrial export, while in Vietnam it also hovers at the same range.

Comparatively in the developed nations, SME contribute 50% of total value added in the European Union (for example, in Germany, SME contribution to Gross National Product is 57% and 30% to direct exports), between 40% and 50% of manufacturing output in Japan, Republic of Korea and Taipei, China and in the United States, 30% to sales value.

SME play strategic roles in private sector development in Asia, especially in the aftermath of the 1997 Asian Financial Crisis. As economies modernise and industrialise, SME provide the much-needed inter-firm linkages required to support large companies to ensure that they remain competitive in the world markets. SME are also the main generator of employment in Asia, creating employment of up to 90% of the domestic workforce in many countries. With support from all stakeholders, not least the financial sector, a competitive and innovative SME sector will hold out much gain in terms of higher income growth, fuller domestic employment, gainful integration into the global economy and greater equity in terms of wealth distribution.

### **C. KEY INSIGHTS**

#### **a. THAILAND**

##### **1. General Economic Overview**

Having recovered from the 1997-1998 Asian Financial Crisis, Thailand was one of East Asia's best economic performers in 2002. GDP grew 5.4% and 6.7% in 2002 and 2003 respectively and has steadily been climbing upwards. The country's economy has been greatly supported by the SME sector.

- (i) SME make up a large portion of Thailand's national economy in terms of output, employment and effective utilization of regional resources.
- (ii) Although the banks have benefited from the acceleration of economic activity over the past few years, the non-performing loan (NPL) ratios remain in the double digits. In particular, the private commercial banks continue to be riddled with high levels of NPL.
- (iii) The central bank has taken several steps to expedite the resolution of NPL by Thai banks, including tightening provision requirements on long-standing NPL and amending laws to allow the government asset management company to acquire NPL so as to free up the banking sector.

## **2. Positive Policy Developments**

Realizing the importance of the contribution of SME to the national economy in the wake of the Asian crisis, the Thai government has established a number of initiatives to assist in SME financing including:

- (i) Setting up the SME Bank, the Small Industry Credit Guarantee Corporation and the Venture Capital Fund Management under the Office of SME Promotion(OSMEP).
- (ii) Establishing the Market for Alternative Investment (MAI) to enable access to capital for smaller companies.
- (iii) Central Credit Information Service Company Limited and the Thai Credit Bureau Company Limited were established to collect and facilitate information sharing for SME.

## **3. Key Insights: Supply Side Issues Regarding SME Access to Finance**

Thailand has a comprehensive range of private and Government financing channels and programmes that specifically cater to SME. While the government has explored and implemented alternative financing sources such as venture capital, SME bank and equity market, these initiatives are still new and have limited outreach at present. The banking sector remains the main source of external financing for most SME. Banks in general are not averse to financing SME. Nevertheless, there are still barriers to SME financing including:

- (i) The high level of NPL in the banking system, limited level of capitalisation and the rapid growth in the number of SME in Thailand has put a strain on banks' ability to effectively fund SME.
- (ii) Onerous and lengthy loan documentation process required by banks.
- (iii) Bank officers lack the necessary knowledge and skills to properly evaluate SME risk
- (iv) Most banks in Thailand undertake risk grading of their SME loans using technologies that lean to subjective assessment. Credit scoring has limited application for the present.

## **b. VIET NAM**

### **1. General Economic Overview**

While Viet Nam has made significant progress since the mid-1980s, completing the transition to a market based economy is an on-going long-term process. Even accounting for the progress made to date, there are still many shortcomings and constraints including the following:

- (i) An uncompetitive economy, low domestic savings and low purchasing power.
- (ii) Economic structural change is believed to be slow and unemployment remains a concern.
- (iii) Many problems persist with the investment infrastructure and the tendency towards Government subsidization and protection of selected economic sectors.

- (iv) Reforms of the state sector especially with respect to the state-owned enterprises have not been sufficient. Hence crowding out of the private sector remains a concern.
- (v) Many issues persist regarding private sector development and in particular lending to SME.
- (vi) In spite of the ongoing efforts at structural reform, domestic and foreign investment confidence remains weak.
- (vii) Compounding the issues is the need to strengthen institutional capabilities and to further develop the legal and regulatory framework to promote private SME development and broaden the financing programmes.

## **2. Positive Economic Policy Developments**

Recognising the importance of continuing the reform effort, the Government approved the Socio-Economic Development Strategy, 2001-2010 and the Socio-Economic Development Plan, 2001-2005. The plans outline the Government's strategy to further develop the Vietnamese economy, in particular the private sector, for the next decade. Meanwhile the international community continues to provide financial and technical support to assist Viet Nam's on-going structural reforms.

Recent efforts to step private sector development include the following

- (i) Creating an enabling business environment for private enterprise and SME development since 2001.
- (ii) Several decrees that officially recognize the significance of the private sector and pro-private sector policies have been adopted.
- (iii) At the same time, newly issued legal documents to improve the policy environment for lending and facilitating commercial banks to adopt commercial principles in lending activities have been issued.

## **3. Key Insights: Supply Side Issues Regarding SME Access to Finance**

Most SME rely on informal sector financing to meet their needs. The main source of formal financing is bank lending. While the state-owned Commercial Banks (SOCBs) are beginning to extend more credit to the SME, most SME still do not have access to bank financing for several reasons.

- (i) Commercial banking in Viet Nam is still in the basic stages of development. Banks are unable to effectively mobilize domestic savings for lending purposes; in addition loan officers have weak credit assessment skills, are not commercially oriented and lack incentives to increase lending to the private sector.
- (ii) Existing credit programmes are not designed for SME.
- (iii) The SOCBs tend to favour state-owned enterprises over private sector firms in terms of credit allocation. The SOCBs also lack autonomy to make commercially viable decisions.
- (iv) In practice, the only form of collateral banks will accept from SME is property. However, land titling is a complex issue and without land use rights most firms have difficulties obtaining credit from banks.
- (v) The regulatory guidelines governing the banking sector are quite weak. Many institutional support infrastructure that enable credit guarantee, facilitate asset registration and the realization of collateral, promote corporate governance and financial transparency have either only been recently introduced or still do not exist.
- (vi) The quality of information and information facilities are highly lacking.

## **II. STATUS OF SME FINANCING: REVIEW OF FACILITIES AND INFRASTRUCTURE**

### **Introduction**

SME financing (especially by the formal sector) has always remained an intractable problem in most countries. Financing resources are typically in short supply in developing economies, support measures for SME have limited outreach at high cost and financial intermediaries favour large enterprises. Further, institutional limitations such as underdeveloped or inefficient legal framework and regulatory infrastructure pose significant barriers to effective financing. This is especially so in the transition economies where social perceptions and administrative attitudes are not yet wholly judicious to private enterprise. As a result, SME' share of available financing resources is disproportionately less than their relative contribution to employment, value added and economic growth. Recognising the importance of the SME sector, governments have initiated various programmes to assist and strengthen SME development, including access to financing. Thailand has an SME master plan that attempts to address the entire gamut of SME development issues from both the demand and supply perspectives. There are few initiatives that are solely private sector driven since SME are generally perceived as higher credit risk by financial institutions.

Given varying degrees of economic development and financial sector intermediation amongst the 2 countries, it is more pragmatic to discuss the status of SME financing separately for Thailand and Viet Nam. This is because many of the aspects of SME financing facilities and infrastructure ranging from sources of funding, types of programmes and their implementation, tools and technologies of financing, information access, and their outcomes are influenced by the stage of development of each country's financial and economic systems.

### **A. SOURCES OF SME FINANCING**

SME draw financing from a variety of sources. Around 75-90% of SME in Thailand rely on internal savings, retained earnings and borrowing from family, friends and money lenders (collectively known as 'informal sector') as opposed to the 3-18% which have access to formal sector finance (banks, capital markets, venture capitalists etc). For start-up companies, the rate of funding from the formal bank sector is even lower. These figures generally compare poorly against the SME contribution of 20-40% to total domestic output and 75-90% of the domestic workforce.

#### **1. Government Programmes for SME Financing**

The public sectors in Thailand have been actively promoting SME development in the last two decades. Common commercial credit programmes initiated by the public sector and implemented throughout Thailand include interest subsidies, credit guarantees, insurance schemes, loan quotas, export financing, and also promissory notes. These programmes are delivered to the SME either via private bank and non-bank institutions such as cooperatives and associations and/or state-owned bank institutions and government line agencies. Direct intervention efforts by the government take the form of grants, tax breaks and holidays, creation of dedicated development financial institutions and various business development services to enhance the competitiveness and skill level of SME.

The degree of banking intermediation in Vietnam is low. The banking sector is dominated by state-owned banks. Given the country is still in transition to market-based economy, the low level of formal financial sector development and poor legislative and regulatory infrastructure, among other constraints, the

economic landscapes is presently dominated by state-owned and micro enterprises (comprising mostly households and cottage industries). As such, there are limited programmes to address SME financing. Government lack the financial capacity to provide internal funding for SME development, are not experienced to manage such programmes and/or are pre-occupied with financing state-owned enterprises while the private sector banks are reluctant to do so due to insufficient legislations to protect their interests. It is the informal sector that plays a paramount role.

## **Outcomes**

By and large, the general consensus is that the government's programmes and support measures have not been as successful as originally intended, as indicated by the low penetration rate of less than 20% in formal financing and the 20-30% contribution to value added. It has been argued that these government measures have generated unfavourable trade-offs and negative externalities such as crowding out of private sector banks and viable businesses, and the emergence of a dependency syndrome and non-repayment culture, to more than off-set the massive subsidies and resources committed to the sector.

The most successful of financing programmes are the ones funded by international agencies. The international community provides credit, guarantees and equity investment to support SME development. These agencies work in conjunction with government ministries and agencies to administer various lending programmes to SME. In Viet Nam, these include the EU SME Development Fund, JBIC SME Finance Programme and the SME development programme that is administered by the Asian Development Bank (ADB). Funds are channeled through the state-owned banks and private commercial banks.

Numerous credit guarantee schemes (including export financing) have been in operation in Thailand. Guarantee schemes are important means to facilitate access to financing for viable SME without adequate collateral. In the case of interest subsidy and credit guarantee schemes in Thailand, the government either provides the subsidy or guarantee to SME loans made by private banking institutions.

The Thailand model of having a dedicated state-owned SME bank is a successful one. As an indication of its popularity, the bank had nearly 30,000 customers in 2007 (6,200 customers in 2003 and 1,800 customers in 2002). All of them fall under the SME category.

## **SME Bank of Thailand**

The Small Industrial Finance Corporation (SIFC), the forerunner of the SME Bank, was established in 1992 as a state-owned financial institution under the Ministries of Finance and Industry. It is responsible for the promotion and development of Thai SME and as the main funding arm of the Thai government for SME. Besides low-interest financing for business expansion and joint ventures, it also offers consultancy services and supports the SME with venture capital fund. In addition, it is the government's policy-loan vehicle for loans to energy saving projects, SME entitled to ISO standards, research and development projects, and in promotion of particular target sectors<sup>1</sup>.

In Dec 2002, the SIFC was re-established as the SME Bank of Thailand with the passing of the SME Development Bank of Thailand Act to offer SME full financial services. Its mandates are "to conduct business with the aim to develop, promote, and assist SME in the establishment, operation, expansion or improvement of their businesses through the provision of loans, guarantees, venture capital, counseling and other necessary services as prescribed by the Act".

It operates under both the Ministry of Finance and the Ministry of Industrial Development. It defines a SME as one having between 15 and 200 employees and an asset value of between B30 million and B200 million. In this context, the loan size provided to the SME ranges between B0.5 million and B100 million. The Bank offers business development training services such as its New Entrepreneur Creation (NEC) programme and Market Research and New Product Development Training alongside financing products that include general loans for a term of not more than 15 years for business expansion and upgrading purposes; factoring; leasing; letter of guarantee and packing credit. The SME Bank also provides joint venture funding to support SME projects so that SME may be free from the burden of interest-bearing loans in funding their projects. The joint venture funding is less than 49% of the equity or project value, subject to a maximum of B50 million for each SME.

Due to the need to follow Government instructions to lend at low interest rates to the SME, the SME Bank's profit margin is less than the commercial banks. There is also the additional expense of developing and guiding the entrepreneur, due to its status as a policy-based institution. The default rate of the SME loans registered 26% in 2004 (21% in 2003 and 19% in 2002). As an indication of the popularity of the bank among SME, the bank had nearly 30,000 customers in 2007 (6,200 customers in 2003 and 1,800 customers in 2002). All of them fall under the SME category.

## **2. Banking Sector Financing**

Notwithstanding the low rate of penetration, financing by banking institutions form the most important source of external financing for SME. This is due to the dominance of the banking sector as the main intermediary in the financial systems of these countries. The average share of bank financing for SME in Viet Nam is about 25%. For Thailand, indications suggest an average range of over 40% with steady improvements made from year to year.

Each of these countries has a fair number of state owned and private financial institutions providing financing including to SME. There are also numerous non-bank financial institutions (NBFIs) such as finance companies, credit & leasing companies, cooperatives and thrifts, credit unions etc that are involved in SME financing. These banks and NBFIs also participate as conduits for government funds for SME.

### **Financing Programmes and Tools**

The banking sector has a wide range of generic short, medium and to a lesser extent, long term credit and various supplementary financing instruments including trade credit, export financing, factoring and discounting. Some banks also provide special loans targeted at priority sectors and key segments of the population as identified by the Government. In Viet Nam, the commercial banking sector comprises of state-owned commercial banks (SOCBs), joint stock banks (JSBs), joint venture banks (JVBs) and representative offices or branches of foreign banks. There are also several credit cooperatives/credit funds, microfinance Institutions and financing companies. Commercial bank lending, however, is dominated by the SOCBs, which command 70% of domestic lending market share in 2002. The JSBs are believed to be an important source of credit to SME. One such example is the Viet Nam EXIM Bank, which supports export business in Viet Nam. JSBs and JVBs offer a wide range of banking services including provision of credit to private enterprises. Letters of credit are offered by some commercial banks to facilitate trade financing but the SME are unlikely to be the main beneficiaries. Lending to SME is guided by the official Decree/Act in both Thailand and Viet Nam. Having an official definition cemented by an act of parliament is a critical first step to coordinated efforts to SME development and to effectively facilitate financing programmes for the sector. Industry sector plays an important role in influencing the overall bank lending direction. Banks usually target or avoid industries in accordance to

the prevailing economic performance. In Thailand, banks generally prefer manufacturing and trading and are adverse to real estate related sectors. In Viet Nam, banks favour export oriented manufacturing over construction related sectors.

**Opinion on SME financing.** The banks that we interacted with, by and large, opined that SME loans have higher risk. The common reasons for regarding SME loans as higher risk include lack of capital, skills and professionalism, poor transparency and limited market access. The main reason that some banks have started treating SME as lower risk is due to the diversification and risk lowering effect of a large number of small SME loans in the portfolio (the risk of small numbers). Moreover SME loans are usually secured.

### **Common Financing Approach/Lending Technologies.**

In financing SME, the most popular approaches adopted by banks are transaction, collateral and relationship lending. Collateral lending is the most common approach of banks in Vietnam, while transaction lending prevails in Thailand. Transaction lending means the practice of treating loans in bulk unlike retail loans. The difference in practice between the two can probably be explained by the relative development of banks in Thailand where technologies such as programme lending and credit scoring are deployed to move high volumes of small loans. Conversely the SME sector is still very new in Vietnam. Hence, such technologies as used by big banks elsewhere are neither available nor applicable here. The supplementary form of financing such as factoring and trade credit is less commonly used for SME lending. Regardless of the lending technology adopted, banks are still demanding collateral from SME. The most common form of security is plant and property, followed by home mortgage pledged by the entrepreneur. Trade receivables and stock in trade are not popular forms of security for SME loans, in line with the less common practice of factoring, trade credit and other supplementary forms of financing for SME.

### **Processes and Documentation.**

In evaluating SME loans, banks require various documentation, chief of which are the business plan, financial statements and bank statements. Other documents include proof of income, asset ownership, contracts and proof of payment habits. For those that cannot do so, the banks indicate that they do not automatically reject the application. Instead the normal practice is to approve the loan with conditions, find alternative evidence of credit worthiness or to assist the borrower to prepare the necessary documentation. Presumably, this is only done for SME for which banks have conducted preliminary checks and are found to be bankable. In appraising SME loans, banks rely on various sources of information. Informal checking with other banks is a popular means of verification. In Thailand, banks can check through some form of central database either maintained officially or by private information providers. The average processing time for an SME loan varies significantly from bank to bank. Empirical evidence suggests that commercial banks are faster in processing a loan compared to state-owned banks. This could be due to the greater flexibility of private banks. In countries that rely on international agency funding, the processing time could be prolonged by the need to seek approval from various levels of committee both internal and external.

### **Common Problems/Impediments faced by Financial Providers.**

The main impediments faced by banks in financing SME include lack of collateral, lack of bankable business plan, lack of experience, poor financials, lack of track record of the firm or owner, bad credit record, and lack of information on SME. Not surprisingly, no one admitted to not being familiar or lacking the appropriate expertise to evaluate SME.

The impediments faced by banks are the same reasons why SME loans are rejected.

### 3. Capital Markets

A move away from bank intermediation in favour of capital markets has long been considered by some countries. This promising approach seems to address the chronic lack of long-term credit available to SME. Nevertheless, given the onerous legal, regulatory and administrative requirements on firms targeting the capital markets, the lack of support from the investment community (brokers, dealers etc) and the generally nascent capital markets in these countries with significant imperfections (e.g., high transaction costs, lack of liquidity, and depth of instruments), this move has many challenging hurdles from an implementation aspect.

**Equity Market.** Though not as advanced as the developed markets in terms of depth and liquidity, equity market does exist to tap this source of funding for SME. Small-cap equity market exists in Thailand (MAI) to cater to medium-sized and start-up/high technology enterprises respectively. The MAI is a much-needed avenue to facilitate SME equity financing in Thailand. As of 2007, there were around 50 listed companies on the MAI. The exchange in Thailand is still evolving. Weak financial market sentiments, tightening of listing requirements and perhaps the lack of quality companies intending to list on the bourse may have constrained growth since its establishment.

**Bond Market.** The bond market in these countries is not yet a viable avenue for SME financing. Given the relatively high transaction and administrative cost involved, the appetite for high-grade bonds (resulting in high premiums for lower-rated bonds), and the general reticence of SME to ‘open up’ their books to agency scrutiny, the bond market will remain the domain of large and strong corporations in the near future.

**Outcomes.** The equity market route has not made much headway with SME financing due largely to tight listing and disclosure requirements, relatively high transaction and administrative cost (at listing and on-going basis) and reluctance of SME (especially family run businesses) to go public.

### 4. Venture Capital

The availability of venture capital in these economies is limited. Mekong Capital Ltd is a private cross-boarder investment company that undertakes equity investment in Viet Nam, Lao PDR and Cambodia. Mekong Capital manages a US\$18.5 million Mekong Enterprise Fund launched in April 2002. The fund is co-financed by the Asian Development Bank (ADB), the Northern European Development Fund, the Swiss Economic Department, the Norwegian Industrial Cooperation Fund and the Belgian Investment Company. It is set up to operate over 10 years, with 65% of its investments to be made in Viet Nam. The Fund aims to invest in private export oriented businesses that are well managed and with impressive track records. In Viet Nam, a second venture capitalist is Vietnam Enterprise Investment Ltd (VEIL) managed by Dragon Capital. VIEL has US\$53 million in 2003 and intends to raise its capital by another US\$50 million<sup>4</sup>. Both funds seek to invest in larger SME.

As a whole however, this financing modality suffers from a poor track record in developing countries due principally to lack of viable exit routes for the venture capitalist. Venture capitalists typically look at investments that yield a minimum of 30% return on investment per annum. According to the Venture Capital Association of Thailand, out of the 700 companies that applied for venture capital funds, only 26 companies (3.7%) were successful. This was due to a combination of factors like stringent requirements on the part of the venture capitalists, the lack of innovative ideas and the weak markets their products

were destined for. Unlike banks, the venture capitalists do not require stringent documentation from the SME. Instead, they rely more on the evaluation of the ideas and concepts of the SME.

**Outcomes.** The venture capital industry has not been very successful in these countries due to the lack of viable exit routes and the reluctance of the SME to invite venture capitalists to sit on the management team, which is a requirement of the investment process. Investments that yield a minimum return of 30% per annum, as preferred by the private venture capitalists may be quite unrealistic given the soft domestic and world economic environments in the past few years.

## **5. Trade Financing**

Trade financing in the form of trade credit, equipment leasing and to a certain extent, factoring are popular with SME in Europe but not so popular in Thailand and Vietnam. In terms of the portfolio composition by facility type, term loan is the dominant facility offered to SME in these countries comprising almost 50% of all facilities to SME in Thailand and 65% of SME loans in Viet Nam banks.

Generally, factoring, and leasing are less common facilities offered to SME.

## **6. Informal Sector Financing**

The informal sector comprises lending between family and friends, savings and credit associations, and moneylenders (alternatively known as grey or black markets). The informal sector is the main channel of credit for SME in Vietnam and to a lesser extent, in Thailand.

In Viet Nam, informal channels fund up to 70-80% of SME needs compared to 20-30% funded by the formal channels (as estimated by Hanoi SME Association). SME are also known to pay a “commission” to third parties that are able to obtain a bank loan on their behalf.

## **B. AVAILABLE CREDIT INFORMATION FACILITIES**

The significance of access to credit and business information for SME financing cannot be understated. Financial providers rely on this information to assess the creditworthiness of potential borrowers, price loans and manage their portfolio. In these countries, financial providers rely on various sources to obtain and/or verify information on their borrowers. Checking (whether formal or informal) among banks is an important source of information. Thailand and Viet Nam have established central credit bureaus to provide the required information to financial institutions.

**1. Thailand:** There are currently two credit bureaus, the Central Credit Information Service Co. Ltd, sponsored by the Thai Bankers’ Association which focuses on company information and the Thai Credit Bureau, sponsored by the Ministry of Finance, which focuses on individual data. Established in 1999, the Thai Credit Bureau, which has 47 members presently, owns the most extensive database on debtors, including some SME, in Thailand. The database is estimated to cover approximately 80% of the debtors’ information in the country. The bureau disseminates both positive and negative information. Members can obtain information on most SME from the Thai Credit Bureau, provided that they have some sort of credit facilities with the financial institutions. The merger of the two credit bureaus over the next 12 months is expected to improve their commercial viabilities.

**2. Viet Nam:** The Credit Information Centre (CIC) was established in 1999 as an independent unit under the State Bank of Vietnam (SBV). The functions of the CIC include providing data to SBV as well as to support credit institutions in credit decision-making. The CIC tracks the following information: customers’ legal profile, financial status, outstanding loan, loan guarantee, loan security and bad debt.

The CIC has 600,000 customer profiles of which 20% are enterprises and remainder is individuals. The main users of CIC information are the banks, Government and government agencies, the SBV and other financial institutions.

In addition, there are various databases on SME that are maintained by private or public agencies and which are accessible to the public, some at a minimal fee. Available databases include those maintained by the Agency for SME Development, Viet Nam Chamber of Commerce and Industry, Hanoi SME Association and the Business Promotion and Service Center.

### **C. ADEQUACY OF FINANCING SOURCES AND TOOLS**

Governments have increasingly played a proactive role in SME financing in these countries via banks (loan quotas, interest subsidies, tax breaks, and guarantees), specialized development financial institutions (usually state owned), and direct funding under various schemes and programmes. Generally there are adequate financing programmes and initiatives by governments. The issue does not pertain to quantity but to the appropriateness and success of implementation of these initiatives.

Inasmuch as government's role is important for SME development, there is some evidence that government practices and intervention (e.g., lending subsidies for state-owned financial institutions, restrictions on foreign institutions) appear to 'crowd-out' more efficient financing by private-sector institutions and could lower overall credit availability to SME.

### **D. IMPACT ON SME DEVELOPMENT**

The shortage of financing and poor implementation of funding programmes could well have impaired SME competitiveness in terms of their ability to capitalise on business opportunities. SME require working capital and investment funds to sustain production and expand capacity. Without adequate formal financing options, SME are forced to rely on internally generated profits and retained earnings that can take considerable time to accumulate. The inability to expand production capacity results in missed opportunities that in turn limit the rate at which firms can grow. Continued reliance on informal financing can be too costly for working capital and longer-term investment needs. This in turn inhibits firm growth and further delays much needed income and employment generation.

The lack of financing opportunities could also have widened the gap between the modern sector, driven by much larger private sector establishments in the manufacturing exported oriented businesses, and the traditional sector, characterised by smaller outfits in localised industries. Unequal access to funding makes it more difficult to deepen the broad base, or in the case of transition economies to modernise the economy and foster industrialisation via developing inter-firm linkages.

The many issues require time and determination on the part of all stakeholders to resolve. Public-private sector partnership remains an important factor in developing successful and effective policies and tools to assist SME development and financing.

### **E. SUPPLY-SIDE SHORTCOMINGS AND CONSTRAINTS IN SME FINANCING**

From the supply side perspective, these countries share some common shortcomings and constraints that have effectively impeded the ability of SME to access needed funds. However, due to differences in economic and financial development, many constraints as discussed below are unique to either Thailand or Vietnam.

## 1. Public Sector Constraints

**Crowding out of private sector:** In as much as government's role is important for SME development, there is some evidence that government's involvement and intervention (e.g., lending subsidies for state-owned financial institutions, state-owned development institutions, restrictions on foreign institutions) appear to 'crowd-out' more efficient financing by private-sector institutions and could lower overall credit availability to SME

In Viet Nam, the state-owned commercial banks (SOCBs) are perceived to favour large state-owned enterprises over SME in terms of credit accessibility and allocation. This is because these SOCBs perceive the former as being lower risk given the government's stake, among other factors. The dominance of the SOCBs in the banking sector creates a market distortion where overall credit available for lending to SME is lowered and further impedes fair competition among the players. Many public sector initiatives that are implemented through state-owned financial institutions also have limited outreach.

To resolve the issue of crowding out by the public sector, perhaps the government should just play a facilitator role in areas of lending where the private bank intermediation infrastructure and facilities are sufficient. Also, effective public-private partnerships where government funds are channeled through private financial institutions may also reduce this problem.

**Implementation Issues:** Various shortcomings and barriers hamper the effectiveness of government initiatives. These include coordination difficulties between numerous agencies and between programmes with overlapping objectives (this is especially relevant in countries without a one-stop centre for SME); cumbersome procedures leading to delays in disbursement (although this is also a common complaint against private financial institutions); and narrow target of specific sectors to support which create an unequal access to financing which may affect the development of broad-based and linkage-driven industry clusters.

## 2. Private Banking Sector Constraints

**Collateral Requirements:** Based on our discussions, ~85% of loans made by financial institutions to SME are secured for various reasons including higher risk perception and legal barriers with respect to loan recovery. SMEs face difficulties in meeting banks' collateral requirements. Not only are valuation methods conservative (where it is common for banks to ask for 167% collateral coverage), due to the higher risk perception of SME, some banks will not accept from SME the same type of collateral as they would from large borrowers e.g., sales or project contracts. With the lack of supplementary financing instruments such as factoring and leasing available to SME that would alleviate the need for collateral, banks' insistence on collateral requirements is a major impediment to financing.

**Weak Credit Skills and Practices:** From our discussions with regulatory agencies and industry players, the lack of credit skills to evaluate SME is a common problem throughout these countries, though not many bank officials in our survey would admit to this. Prior to the Asian Financial Crisis, many financial institutions pursued large corporate loans as their main clientele. This was because large loans enable banks to grow their market size and profitability more rapidly. In contrast, SME loans are seen as less attractive because a bank would incur substantial amount of cost to process the loan, while the absolute dollar returns are much smaller compared to large corporate loans. This is a subtle incentive within the system that bank managers themselves may not be entirely aware of. Hence, pre-crisis, many a banking portfolio in Asia was skewed to large borrowers. It was only in the last decade that SME development and

financing have come to the foreground. But loan officers have only been trained and equipped to manage and evaluate large borrowers with proper accounting records and information. Many lack the knowledge and necessary skills required to manage SME, which are more informationally opaque. Applying the same techniques of large corporate evaluation to SME obviously result in many SME not being able to meet bank lending criteria.

In Viet Nam, loan officers of dominant SOCBs are seen to be not well-equipped nor inclined to conduct proper risk assessment on private enterprises given their entrenchment in lending to state-owned enterprises (which are perceived to be lower risk). At the same time, the relatively short time that the banks have been operating in a market based environment has prevented the credit institutions and bank staff from fully developing expertise in credit assessment, credit extension and borrower monitoring practices and credit and risk management.

It is worth noting that the commercial banking sector in the transition economies is still in the basic stages of development. Inexperience and the relatively short time frame for the evolution of more sophisticated financial instruments and lending technologies have hindered commercial banks from meeting the expectations of modern corporate banking in a market based economy. At its most basic level, the commercial banking sector is lacking considerable experience even in mobilizing savings effectively let alone have the skills required for credit risk assessment, adequately pricing risky investments and assets and monitoring corporate performance.

**Cumbersome Loan Processing and Documentation:** The loan procedures in many financial institutions may be quite complicated, onerous and lengthy for SME. This is especially the case for borrowers requiring small loan amounts. The SME has to produce a business plan that can be costly to prepare, produce other documentations and then wait, from weeks to several months as the case may be, for the loan to be approved. For all that trouble, in the transition economies, the SME has to repay the loan in one year! All this adds to the cost of business, which can be substantial relative to the size of the enterprise.

**Legacy of High NPL levels:** At the peak of the Asian Financial Crisis in the late 1990s non-performing loans (NPL) in the banking sector in these countries nearly doubled their pre-crisis levels. NPL levels have fallen significantly since 2001 but still remain sizable in Thailand and Vietnam. The high levels of NPLs have weakened banks' capitalisation levels and limits overall capacity to lend, and coupled with weak economic sentiments in the past few years, this has created an air of risk-adversity among financial institutions.

### **3. Structural Constraints**

**SME Definition.** The definition of SME varies widely among countries and within each country, differs between financial and other lending institutions. However both these countries have now formalised/legalised the SME definition- Thailand (SME Act 2000) and Viet Nam (Decree No.90/2001).

**Lack of Depth in Financing Sources.** Bank financing remains the main source of external financing. Alternative sources of financing such as venture capital, equity and capital markets are not yet sufficiently developed. These are viable sources of long-term stable funds that will allow businesses to match their long-term funding needs and to establish an optimal debt-equity capitalisation structure. As discussed earlier, the over-reliance of SME on internal and informal sources of funding would result in the slow development of the firm.

**Weak Savings Mobilisation in Transition Economies.** In the transition economies, there is an apparent lack of public confidence in the banking sector and in the national currency. Domestic households are

holding cash savings in foreign currency and or in precious metals kept in safe-boxes at home. Estimates in 2001 suggest that in Viet Nam for instance, over US\$2 billion is in circulation in the informal market. Some believe that an additional US\$8 billion to US\$10 billion in hard currency and gold is hoarded by local consumers. The lack of confidence in the banking institutions has resulted in the banking sector's small deposit base, which is very short term. This in turn limits the banks' ability to extend medium to long-term loans to borrowers including SME.

## **F. OVERVIEW OF DEMAND SIDE CONSTRAINTS**

The difficulties faced by banks in financing SME are all too familiar. The main problems are the lack of (quality/sufficient) collateral, bankable business plan, track record of firm or owner, poor financial condition or performance of SME, and lack of knowledge and information on SME and their industries. In addressing the supply side of SME financing, the discussion would not be balanced without addressing the demand side constraints. Although a full discussion is beyond the scope of this report, discussions indicate the following difficulties faced by SME in accessing bank financing:

- (i) Banks' insistence on collateral (up to 85% of SME loans are secured)
- (ii) Lengthy and tedious loan processing (in some banks, the process from approval to drawdown could take several months)
- (iii) Stringent documentation requirements
- (iv) Complicated procedures in applying for loans, including from government schemes (many SME entrepreneurs are not formally educated nor have the resources to help them with bank procedures)
- (v) High interest rates
- (vi) Inability (knowledge and financial means) to prepare required business plan
- (vii) Lack of knowledge about available financial assistance schemes for SME (this could be due to lack of publicity by the promoters)

Based on the overview of the problems faced by both the demand (SME) and supply (bank) sides, it would appear that the problems are intractable: SME cannot meet the requirements of banks, without which banks are unable to lend. Banks tend to treat small businesses as they would large business borrowers by exacting the same degree of due diligence and standards of compliance. This may be argued as rightly so since all business borrowers regardless of size are risky assets to banks. However, SME are not the same as large enterprises. Needless to say, SME would fail to meet the grade of what is essentially the broiler plate meant for large businesses. Which leads to the perception that SMEs are riskier than large enterprises? And so which justifies the need for additional safeguards in the form of collateral, higher interest rates and so forth.

To bridge this gap in financing, governments step in with mechanisms such as interest subsidies and guarantee schemes for banks to fund SME. However, the banking sector is by far the most developed and would likely remain the main source of external financing for SME in the near future. All other factors aside, banks must examine their internal structures and processes to treat SME as distinct business entities if they are to benefit from the sector's potential.

### **III. REVIEW OF LEGAL AND REGULATORY ENVIRONMENT: CONSTRAINTS AND SHORTCOMINGS OF THE INSTITUTIONAL SUPPORT FRAMEWORK**

#### **1. INTRODUCTION**

The regulatory and policy frameworks and institutional support infrastructure exert a direct impact on the financial markets, its players and hence financing access and efficiency of funding by SME. These framework and infrastructure include the legal, judicial, bankruptcy, accounting, tax, regulatory and information environment. Equally important is the enforceability of such laws. For example, strong accounting and legal enforceability standards are necessary conditions for the feasibility of loan contracting, a condition which if present can be used by banks to offset the problem of information opacity of many SME. Empirical evidence suggests a statistically important link between the existence of third-party information exchanges and credit availability.

The purpose of the legal and regulatory overview in this chapter is to identify the major institutional support framework shortcomings in each country and where relevant, the common barriers, that hinder measures to improve SME financing by the financial sector.

#### **2. THAILAND**

Thailand has sufficiently well developed and adequate institutional support framework to support SME financing. Laws relating to bankruptcy, land registration and regulations relating to accounting and taxation and prudential banking are well in place to enable clear and speedy enforcement of interests of both creditors and debtors. Thailand has in place various laws and regulations pertaining to SME in its bid to promote the sector.

#### **3. VIET NAM**

While Viet Nam has made considerable progress in the transition from a centrally planned economy, there are still several shortcomings. These include weak regulatory guidelines governing the banking sector and the SOCBs' lack of autonomy to make commercially viable decisions; many supporting facilities and or laws that enable credit guarantee, facilitate asset registration and the realisation of collateral, promote corporate governance and financial transparency have either only been recently introduced or still do not exist. Land titling is a complex issue and without land use rights most firms have difficulties obtaining credit.

**The Role of the Central Bank.** There are several concerns with the regulatory framework governing the banking sector that may indirectly impact SME financing. The US Embassy in Hanoi reports that the central bank is not an independent entity. It operates under government guidance. Besides those of regulator, the central bank has management as well as shareholder roles in the SOCBs. As discussed earlier, the SOCBs dominate the banking sector. While the Government has removed obstacles for the private sector to operate and have access to bank credit, various forms of regulatory prejudice still remain, particularly in prudential regulation. Policy biases still tend to favour state-owned enterprises over SME in terms of access to credit.

**Weak Banking Regulations.** The guidelines and laws on supervision and monitoring of the banking sector are underdeveloped. The central bank does not have clear standards/guidelines for monitoring many aspects of credit operations. This includes banks' credit risk management system, underwriting

standards, delegation of authority, adequacy of collateral, division of responsibilities to ensure adequate checks and balances and adequacy of provisions and assessment of counterpart risks. As a result, the large private commercial banks are unable to operate with autonomy, risk prudence or in a coherent manner.

**Land Titling.** The issue of land titling is a complex issue in Viet Nam. Land-use rights are registered at the People's Committee of the commune, ward or township where the land is located. Land-use right certificates are then issued by the General Department of Land Administration (GDLA). The Government is presently attempting to unify the land registration system in the country, a step which is critical to encourage SME lending as titling enables banks to realise collateral related to land.

**Leasing.** Some concerns regarding the provision of leasing are the lack of insurance for leased assets, enforceability of the breach of leased contracts and laws regarding asset seizure in the case of default are weak. The ADB reports that registration processes need to be improved to safeguard the interest of secured party financiers over lessees for leased assets.

**Laws on Insolvency, Debt Recovery and Realisation.** The present laws on insolvency, debt recovery and realisation of collateral are under-developed and should be revised to provide for clearer, consolidated and comprehensive rules on the recovery process. There is need to improve the skills and capacity of the judiciary to handle insolvency issues. Outside of insolvency, there is a need to establish a mechanism for predictable, transparent and affordable enforcement of both unsecured and secured credit claims.

## **V. RECOMMENDATIONS AND STRATEGIES**

The following are some of the practical recommendations that may be appropriate for adoption.

### **A. STRATEGIES FOR EXPANSION OR DIVERSIFICATION OF APPROPRIATE FINANCING FOR SME**

#### **1. Improve outreach of credit guarantee mechanism**

In many of the countries with successful SME financing programmes (such as Japan, Chinese Taipei, Germany), credit guarantee mechanisms are a strong feature of the development framework. These guarantee schemes are usually well supported by government or industry funds. In Japan for instance, the credit guarantee corporations are present in every prefecture thus ensuring a wide outreach and there is a reinsurance mechanism to ensure their viability. Such strong support mechanisms are lacking in credit guarantee schemes in Thailand, Vietnam and India. Governments can look into improving the scope and outreach of their credit guarantee schemes. The credit guarantee schemes could be made available to all institutions involved in SME financing and sufficient funding of the schemes should be a key priority. One important element though is that successful credit guarantee schemes require appropriate risk sharing.

#### **2. Promote greater engagement of Non-Bank Financial Institutions (NBFI) in SME lending**

In most countries, efforts to improve SME financing are still being pushed through the larger commercial and development banks. This is because these bank institutions generally dominate the banking sector. While these bank institutions may have greater resources, they do not necessarily have the outreach or inclination to lend to SME. Moreover, many of the larger bank institutions are too entrenched with corporate lending practices, have little experience in the middle and lower end segment of the credit market and have a biased view with regard to SME.

On the other hand, non-bank financial institutions such as finance companies, rural or thrift banks and cooperatives may be more suited to SME lending as these NBFIs have more experience in lending to the SME sector given their traditional focus on retail and small business segments of the credit market. Moreover, many of the facilities available at NBFIs (such as factoring and leasing) are more suited to SME' funding needs. Hence, promoting greater engagement of NBFIs in SME lending may bring about increased lending to SME. Authorities in the individual countries could facilitate greater involvement of NBFIs by providing them incentives such as tax deductions for certain expenses, branching privileges and capital allowances. At the same time, these incentives could also be provided to banking institutions to encourage greater SME lending. The authorities could also encourage banking institutions to link up with NBFIs where the latter can act as conduits in promoting bank facilities to SME.

#### **3. Develop alternative markets for SME financing**

Countries, which have more developed financial markets, can look into developing the debt and equity markets as alternative sources of funding for SME. The existing listing requirements of equity exchanges catering to smaller companies are hardly SME-friendly.

Debt markets in the region too are closed to SME. Access to these markets could be facilitated by relaxing requirements and lowering transaction costs for smaller enterprises. Alternatively, governments could assist institutions involved in SME financing (such as the credit guarantee corporations) to access

capital markets for funding. If the government could provide support such as direct or indirect guarantee, subordination or liquidity lines for bond transactions, these institutions would be able to raise long-term funds at a competitive rate to fund SME loans.

Venture capital financing is another viable channel especially for start-up companies. However, in these countries, the venture capital industry is not well promoted as such. Perhaps, more incentives could be provided to venture capital companies whether public or private sector owned, to play an increasing role in SME financing.

## **B. STRATEGIES FOR INSTITUTIONAL STRENGTHENING OF FINANCIAL INSTITUTIONS**

### **1. Improve credit evaluation skills of bank officers**

The feedback of most bank respondents and regulatory agencies is that bank credit officers lack understanding of SME and do not have the requisite skills to evaluate SME. Many banking institutions apply the same techniques of evaluating large companies to smaller ones without any adjustment for the inherent differences. Moreover, banks are more stringent with SME on documentation requirements. For a start, there needs to be a paradigm shift in mindset – SME have unique characteristics that differentiate them from large established corporations. Credit officers or analysts in banks must realise this. Secondly, the techniques and appraisal methods appropriate to evaluate large corporations are not relevant for small enterprises. This means that banks must adjust their evaluation techniques accordingly and apply relevant ones to suit each group of borrowers. A good reason for applying relationship banking to small and medium enterprises is that SME are not as well structured and are more opaque than larger firms. To improve their skills, banks could provide more training on SME to their credit officers. Banks should tap on internal personnel or consultants who have long experience dealing with retail and small scale lending (especially at branch level).

### **2. Establish SME unit in banks**

To encourage lending to the sector, banks (that are not specialised in SME lending) could consider setting up an SME division or department to provide specialised services to SME. Specially trained credit officers could staff such a unit. For large financial institutions that already have such divisions, they are usually perceived to be less important or glamorous compared to corporate lending divisions. Elevating the importance or status of retail or SME divisions would encourage greater interest and focus on the SME sector. The authorities could encourage this by providing certain banking privileges to such banks.

### **3. Apply appropriate evaluation techniques**

As discussed earlier in this report, credit scoring can improve turnaround time, reduce default risk and generally increase profitability of low value high volume and homogenous loans (particularly consumer loans). These benefits are more apparent for larger banking institutions. However, whether credit scoring in itself will improve access to financing for SME is debatable. Lack of information and weak financial capacities would still inhibit SME from gaining access regardless of the technique used by banks. Moreover, as credit scoring thrives on good information and objective assessment, informationally opaque borrowers otherwise with good credit standing may be denied access to loans. Hence, our recommendation is for financial institutions to apply evaluation techniques that are appropriate to their circumstances. In this regard, relationship banking would seem to be more appropriate in SOUTH EAST ASIAN-4 where there is a weak information infrastructure.

#### **4. Promote greater linkages and dialogue between financial institutions and SME/Trade associations/SME centres**

Financial institutions typically do not have strong linkages with SME/Trade associations or chambers of commerce. As a result, the financial services provided by financial institutions may not be adequate or appropriate to meet the needs of SME. Forging greater linkages and dialogue between financial institutions and SME associations would promote better understanding and facilitate financing for SME. In this respect, banks (as a group or individually) could organise road shows to various SME associations or chambers of commerce to introduce their services. Conversely, seminars or trade exhibitions held by industry associations could include banking institutions. The authorities could support these activities with their presence and/or sponsorships.

### **C. STRATEGIES FOR CHANGES TO THE LEGAL AND REGULATORY ENVIRONMENT TO IMPROVE SME FINANCING**

#### **1. Consistent and legalised definition of SME**

In countries that do not have consistent or legal definitions of SME, it would greatly improve the effectiveness of development and financing programmes (especially if implemented by different line agencies or institutions) if different definitions can be standardised and legalised. This would also facilitate better planning and targeting of sectors by financial institutions. This step has already taken place in both Thailand and Vietnam.

#### **2. Improve information access to SME**

Although the information infrastructure in Thailand is better than in Vietnam, there is little in the way of sharing and access to the available information by the different stakeholders. Credit or trade information developed by government agencies, central credit bureaus, national registries and financial institutions are not freely shared due to regulations restricting access to such information. The lack of information access is a significant barrier to initiatives to improve SME financing. For instance, the ability of banks to develop good credit models for the SME segment is impaired by the lack of data. In this respect, one recommendation to improve information access is for central banks (who are usually owners of credit information databases) to facilitate disclosure of data on a composite or group basis and without disclosing the identity of the SME. The availability of such data would greatly assist studies, model calibration and research by financial institutions and others in developing a better understanding and risk profile of the SME sector.

#### **3. Conduct studies and publish information on SME**

At present, there is a dearth of information in respect of SME financing in both countries. More studies on SME financing should be commissioned by governments and regulatory authorities in charge of SME financing and the findings should be made available to the public. Research and surveys on sources of funding, funding trends, facilities utilised, cost of capital, problems with financing etc should be conducted and published on a regular basis. This information would be very valuable for all those involved in SME financing.

#### **4. Provide incentives for banks to lend to SME**

To promote greater SME lending, the regulatory authorities could consider granting certain incentives to financial institutions that actively promote SME financing and have achieved a sizable SME loan book.

To maintain prudential banking standards, such incentives could be for a certain period of time and in non-financial form e.g., branching privileges, tax deductions on certain expenses etc.

#### **5. Promote informal debtor-creditor workout mechanism for SME**

Various countries have commercial courts and arbitration centres to settle commercial disputes. However, the process is not necessarily less time consuming or onerous than the court process. Many financial institutions are reluctant to lend to SME not only because of lack of creditors protection and enforcement of collateral rights, but also due to the lengthy process of arbitration and settlement. This skews the profitability of a small loan against its potential risks. Perhaps the attractiveness of SME lending can be enhanced by establishing informal workout mechanisms for SME loans. Such a mechanism could be implemented through a special agency that is empowered to act to an intermediary between debtor and creditor.

#### **6. Establish SME Accounting Standards**

One of the most common problems faced by SME is the difficulty in preparing financial statements and to comply with the requirements set out by the respective accounting standards in each country. Many small businesses struggle with understanding the complex requirements of the accounting standards and have little means to engage professional accountants to prepare proper accounts. As a result, lending institutions have to rely on other means to verify the financial health of the SME and this could lead to a higher risk premium being charged on the loan.

In South East Asian countries, they require SME to comply with the same accounting standards that apply to all registered companies. Simplifying or amending current standards to suit small businesses would allow more SME to comply with disclosure requirements and increase the level of their transparency.

### **D. CONCLUDING REMARKS**

As access to finance is a product of both supply and demand side constraints, all of these recommendations would work best in the context of a comprehensive framework. Solutions to resolve financing constraints must be addressed in conjunction with supportive development policies for improving market access, industrial linkages, information facilities, harnessing technology and enhancing knowledge and skills of SME. Often, one of the key factors of success of countries with a successful SME sector is the presence of a comprehensive, well-coordinated framework (usually implemented by a one-stop agency) and pervasive support mechanisms for SME development. In addition, the legal and regulatory framework poses significant barriers to SME financing and is in need of updating and reform.

# **GROUP REPORT -II**

Submitted by:

**Shri Inguva Viswanath**  
**Shri Anem Chandramouli**  
**Shri H Subramaniam**  
**Shri Arijilli Satheesh**

Chief Manager , Bank of India (Team Leader)  
Assisantt General Manager , SIDBI  
Assistant General Manager, State Bank of India  
Field Manager, Bhartiya Samruddhi Finance Ltd.

## **INTERNATIONAL EXPOSURE PROGRAM ON FINANCING SMEs**

Considering the vital role played by SMEs in economic development, the Policy makers and Commercial banks of East Asian countries have begun actively pursuing the development of SME sector. Countries with Transitional Economies<sup>1</sup> are also focusing on this sector. The European Bank of Reconstruction and Development (EBRD) identifies the economies of Cambodia, China, Laos, Mongolia, Thailand, Vietnam as transitional economies in Asia.

### **1. PRESENT REFERENCE**

As a part of study of the models of SME financing in the Asian countries, the College of Agricultural Banking (CAB), Pune has selected Thailand and Vietnam and designed a program for bankers, financial institutions, policy makers and other institutions engaged in supporting/capacity building of SME Sector. The aim of the program was to

- study models of SME financing in these countries
- to study the methods applied to overcome the constraints faced while financing to SMEs
- to study the system of financial and non-financial support extended, &
- to draw lessons for India.

A balanced mix of 18 officials (10 bankers, two officials from FIs, one official from IIBM, one official from RBI, three officials from MFIs, one official from GoI) participated in the above program, coordinated by two Faculty Members from the CAB. The participants were divided into four groups to study different aspects of SME financing in the target countries. Our group looked into the *Strategies for Introducing Financial Products* in the visited countries.

### **2. THAILAND AND VIETNAM**

Thailand and Vietnam exhibit similarities in the sense that both

- have Agro Based Economies
- are developing countries
- depend heavily on foreign aid

Industries in both the countries are mainly agro-processing units and/or assembling units working for Multinational Industries. Industries of these countries are just now coming out of these constraints and are trying to establish their own Marketing Brands.

Units are categorized into SMEs based on the number of employees and/or investment in fixed assets. Unlike in India, Trade is also considered as SME and so is the activity related to marketing of agricultural produce by the farmers.

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<sup>1</sup> Transitional Economy is an economy which is changing from a centrally planned economy to a free market. Transition economies undergo economic liberalization (letting market forces set prices and lowering trade barriers), macroeconomic stabilization where immediate high inflation is brought under control, and restructuring and privatization in order to create a financial sector and move from public to private ownership of resources

Both the countries are in the process of:-

- liberalizing economic activity, prices, and market operations, along with reallocating resources to their most efficient use;
- developing indirect, market-oriented instruments for macroeconomic stabilization;
- achieving effective enterprise management and economic efficiency, usually through privatization;
- imposing hard budget constraints, which provides incentives to improve efficiency; and
- establishing institutional and legal framework to secure property rights, the rule of law, and transparent market-entry regulations.

### 3. SMEs IN THAILAND

The Small & Medium Enterprise Development Bank of Thailand (SME Bank) offers the following products to SMEs:-

- a) **Machine Fund Project Loans** to take care of procuring /repairing/replacing machinery and also for installing Energy Saving Measures. Interest subsidy @3% for a period of 5 years is made available for these loans.
- b) **Super Prime Project Loans** as strategy to encourage new top SME clients to use the Bank's services and existing top SME clients to continue using the Bank's services.
- c) **Super Prime Liquidity Loans** to borrowers that have good debt repayment records with the bank in helping SMEs to expand their operations.
- d) **Business Recovery Loans** to facilitate borrowers' business recovery to address their liquidity problems.
- e) **Joint Marketing Initiatives** to help groups of SMEs in selling their products through wider range of marketing and distribution channels.
- f) **Linkage of SMEs through Cluster Approach** to leverage their combined strengths.
- g) **Targeted lending** to various segments like Taxi Drivers, Ex-Prisoners, Family Members of Armed Forces.

All applications for financial assistance must be sponsored by Trade Associations, Local Government, Ministries, etc. The applicants must be registered for Tax Payment (PAN Card Holders).

The Office of the SME Promotion (OSMEP), Thailand, has established a Venture Capital Fund (Baht 5 billion) to assist the SMEs. Only corporate SMEs are eligible for assistance under this fund. Size of the SME should not exceed investment of Baht 200 million, or 200 employees. Typical target groups are Fashion & Design based units, Information & Communication Technology ventures, Food/Herbs processing units, Automotive sector, Tourism related activities, Energy & Nano Technology etc. So far 105 units have been assisted since inception in July 2003.

The OSMEP has established several funds such as Capacity Building Fund, Consultancy Fund, Intellectual Property Fund, Internationalization Fund to provide subsidies to SMEs in their endeavors in strengthening themselves organizationally.

Generally all Universities in Thailand either have SME Academic Wings or run specialized programs aimed at developing SMEs e.g. the Thammasat University has an Institute for SME Development (ISMED) which runs a Value Creation & Design Centre to develop innovative marketing

practices including packaging techniques, an SME Service Centre to assist SMEs in their capacity building endeavors. The ISMED has developed Business Competitiveness Diagnosis (akin to Risk Rating Matrices developed by CRISIL in India) methodology to analyze the performance of an SME unit and also to suggest improvement measures.

The country is divided into Provinces, Districts, and Sub-Districts (Tambones). Tambones are further subdivided into villages, about 10 per tambon. Tambon within cities or towns have no subdivision into villages, but into communities.

In the case of Cluster finance, the Thai Government has adopted the policy of One Tambon – One Product (OTOP). This approach helps in intensive development of a product/region.

#### **4. SMEs IN VIETNAM**

Vietnam's economy is presently centrally driven. Therefore support to SMEs is in the form of various Funds established by the Government. They are:-

- a. Fund for SMEs Credit Guarantee which is administered by Provincial People Committee and provides cover up to 80% of the Loan-Collateral Gap (stipulations are that the collateral should at least be 30% of loan and the loan is not "bad debt").
- b. Export Support Fund which covers cost on banks' loans related to losses due to price fluctuations in the product exported.
- c. Development Assistance Fund which provides Long Term and Medium Term Investment lending at preferential rate. This fund also provides Post-Investment Interest Subsidy, Credit Guarantee and Short Term Export Promotion Credit to certain sectors.

(These funds are being phased out gradually so that the SMEs become self-reliant)

The Vietnam Academy of Agricultural Sciences plays a pivotal role in the agro-based economy of Vietnam.

The Vietnam Bank for Agriculture and Rural Development (VBARD) is a commercial bank and primary financial institution in Vietnam which offers services to all agro-related SMEs. They are offering all products akin to those prevailing in our country including ancillary services such as electronic payment systems, leasing finance, lending against securities/gold, credit cards etc. SMEs Associations support VBARD in monitoring SMEs' loans and in dealing with sick units. Irrespective of the delegation of lending powers, there is a cap on a single loan transaction at branch level.

There are no ownership rights on any property in Vietnam. Entire land is state owned. Leasing rights can be assigned further as security for loans. Though it creates problems (in providing collateral), it facilitates realisation of security in case of default. State Owned Enterprises (SOEs), in view of their Government patronage, are considered major competitor to private enterprises in Vietnam. However, now the government is in favour of promoting private enterprises.

#### **5. COMPARISON WITH INDIA REGARDING FINANCIAL PRODUCTS TO SMEs**

In India, the concept of SME materialized in 2005 and formally took shape by virtue of enactment of the MSMED Act 2006. The Act defines SMEs as those units in Manufacturing or Services

Sector and classification into Micro/Small and Medium is based on the level of investment in Plant & Machinery/Equipment. All the Public Sector Banks have adopted this definition whereas some of the Private Sector/Multi National Banks have adopted different parameters such as Credit Limit Range, Turnover Range etc.

Some of the Financial/Non-financial Products made available to SMEs in India are:-

(i) Schemes for Capital Investments

Term loans for acquisition of fixed assets, Loans for acquisition of ISO 9000 Series Certification, Loans for acquiring Energy Saving Equipment, Solar Water Heater Scheme for Domestic, Industrial, & Commercial users, Co-financing arrangement with SIDBI for joint financing

(ii) Schemes for Working Capital Needs

Dealer finance, Vendor finance, Receivable finance, Factoring, Venture Capital (by SIDBI), Securitization, Non-Project Specific loans, Short Term Standby facility at concessional rate of interest, Export Finance Schemes like Packing Credit, Foreign Bill Discounting, Foreign Currency Loans, Non-Fund Based Limits - Bank Guarantee and LC, Cash Management Services

(iii) Special Schemes With Incentives

- Collateral Free assistance up to Rs.5 lacs for Micro & Small Manufacturing Enterprises.
- CGTMSE Scheme for Micro & Small Manufacturing/Services Enterprises for Collateral Free credit up to Rs.50 lacs
- Loans to Specified Industries in Small Enterprises (Manufacturing) Sector for technology upgradation under Credit Linked Capital Subsidy Scheme (CLCSS).
- Loans to facilitate technology up gradation of Small Enterprises (Manufacturing) Sector under Technology Upgradation Fund Scheme (CLCS-TUFs) for Small Scale Textile & Jute Industries.
- Loans to facilitate technology up gradation of Power Looms in Small Enterprises (Manufacturing) sector under CLCS-TUF scheme.
- Capital Subsidy Scheme for Food Processing Industries.
- Margin Money scheme of KVIC under their Rural Employment Generation Programme (REGP).
- Business Segment Specific Schemes like financial assistance to Medical Practitioners.
- General incentive to women entrepreneurs by way of lower pricing and relaxation in lending norms.

(iv) Other Initiatives

- Focused attention to SME units at Specialized SME branches.
- Special Cells at controlling offices for quick disposal of loan applications.
- SME Marketing Teams at potential centres.
- Overseas Branches located at major cities to provide services relating to Import/Export business.
- Any where banking for on line transfer of funds and Real Time Gross Settlement (RTGS).
- On Line Tax Accounting System for Tax remittance by SMEs.
- Self Employment Training Centers for entrepreneurial development training.

- Cross selling of Personal banking Products, Bank assurance, Credit cards, D-mat - Online equity trading, Online access to Commodity Exchanges,
- Facilitate Credit Rating by External Rating Agencies accredited to the NSIC.
- Internet Banking, Tele Banking, Mobile Banking, SMS Alerts (Cheque clearances/ bouncing), ATMs,
- Call centres, Service Support Agents (like DSA),
- Financial Assistance to NBFCs, Government Agencies, Micro Credit Institutions etc., for door-step delivery of credit,
- Foreign Exchange services including money changing, travelers' cheques, pre-paid cards and wire transfer services through the Postal Department.
- Conduct workshops for entrepreneurs to upgrade their financial /technical/managerial skills, provide information regarding various Government/SIDBI/RBI schemes.

## **6. SUGGESTIONS FOR THAILAND AND VIETNAM**

As compared to Vietnam, Thailand has a relatively well developed financial system to cater to the needs of SMEs whereas Vietnam is still in nascent stage and has a long way to go. However some of the products/practices prevalent in India can be emulated in these two countries. These are:-

- Collateral Free Assistance
- Margin Money Scheme for Rural Industries
- Catering to the needs of SMEs at Specialized SME branches.
- Self Employment Training Centers for entrepreneurial development training.
- Cross selling of Personal Banking Products
- Bank Assurance
- Commodity Exchanges
- Encourage Establishment of NBFCs to extend the reach of FIs.

# **GROUP REPORT -III**

Submitted by:

**Shri Waikar Prakash**  
**Shri S V Raghavan**  
**Smt. Joshomayee Devi**  
**Shri P. Nithyanandan**  
**Shri J Satyanarayana**

Chief Manager, Union Bank of India (Team Leader)  
Assistant General Manager, Indian Bank  
Associate Professor, Indian Institute of Bank Management  
Assistant General Manager, Reserve Bank of India  
Chief Manager, Indian Overseas Bank

# International Exposure Programme in Thailand & Vietnam on Financing to SMEs

## 1. INTRODUCTION

Considering the vital role played by Small and Medium Enterprises (SMEs) in Economic Development in East Asian Countries the Commercial Banks and the policy Makers have actively pursued growth of the SME sector. This was particularly noticeable in the transition economies of Thailand and Vietnam. Hence to study the various issues involved in financing the SMEs in these countries the College of Agricultural Banking, Reserve Bank Of India, Pune in collaboration with AIT Extension of the Asian Institute of Technology planned a short term training cum exposure visit programme for bankers, financial Institutions, policy makers and other institutes engaged in supporting /building capacity of SME sector. Major objectives of the programme were to study the models of SME financing in Thailand & Vietnam, methods applied by the Banks to overcome the constraints faced while financing to SMEs and to draw the lessons for India.

**Methodology adopted for the programme :** Interaction and exchange of experiences with Government Officials, SME Institutes, bankers (engaged in in formulating policies and strategies, promotional and support schemes to overcome the constraints faced by the entrepreneurs) and entrepreneurs running the enterprises.

## 2. THAILAND:

### (i) Definition of SMEs in Thailand

Business Activity	Employment		Fixed Assets (US \$ in Mio)	
	Small	Medium	Small	Medium
Production	Up to 50	51 to 200	Up to 1.5	1.5 to 6.00
Service	Up to 50	51 to 200	Up to 1.5	1.5 to 6.00
Wholesale	Up to 25	26 to 50	Up to 1.5	1.5 to 6.00
Retail	Up to 15	16 to 30	Up to 0.9	1.0 to 2.00

### (ii) Enterprise Profile in Thailand (in the year 2006):

Particulars	Enterprises (No. of Units)	Employment (No. of Persons)	GDP (USD in Mio)	Export Value (USD in Mio)
Large Enterprises & Others	4292 (0.2%)	2687938 (23.3%)	104045 (61.1%)	89660 (68.7%)
SMEs	2274525	8863334	81280	37921
Micro Enterprises	(99.5%)	(76.7%)	(38.9%)	(29.1%)
Total	2287057	11551272	206242	130415

SME is a most important sector in the economy of Thailand. It constitutes 40% of GDP, engages 75% of the workforce of Thailand. The Government has established an exclusive outfit to look after the development of SMEs viz. Institute of SME Development (ISMED). ISMED provides business information and Professional Management Development Services to SMEs. It also provides Training Services, Professional Services, Support Services, Policy Matter Services, etc. These services are provided to SMEs to enable them to become more competitive, innovative and make aggressive use of branding.

The Thai Government has also established an “Office of SMEs Promotion (OSMEP) which is mainly responsible for promoting SMEs. Functions of OSMEP are as under:

**1. Self Reliance-**

- 1.1 To make the entrepreneur to stand on their own feet through optimum utilization of resources mainly human capital through developing self immunity, skill & Knowledge and adaptability.
- 1.2 To guide them from the viewpoint of demand and supply in the economy about the proposed product to be manufactured like import substitutes etc.

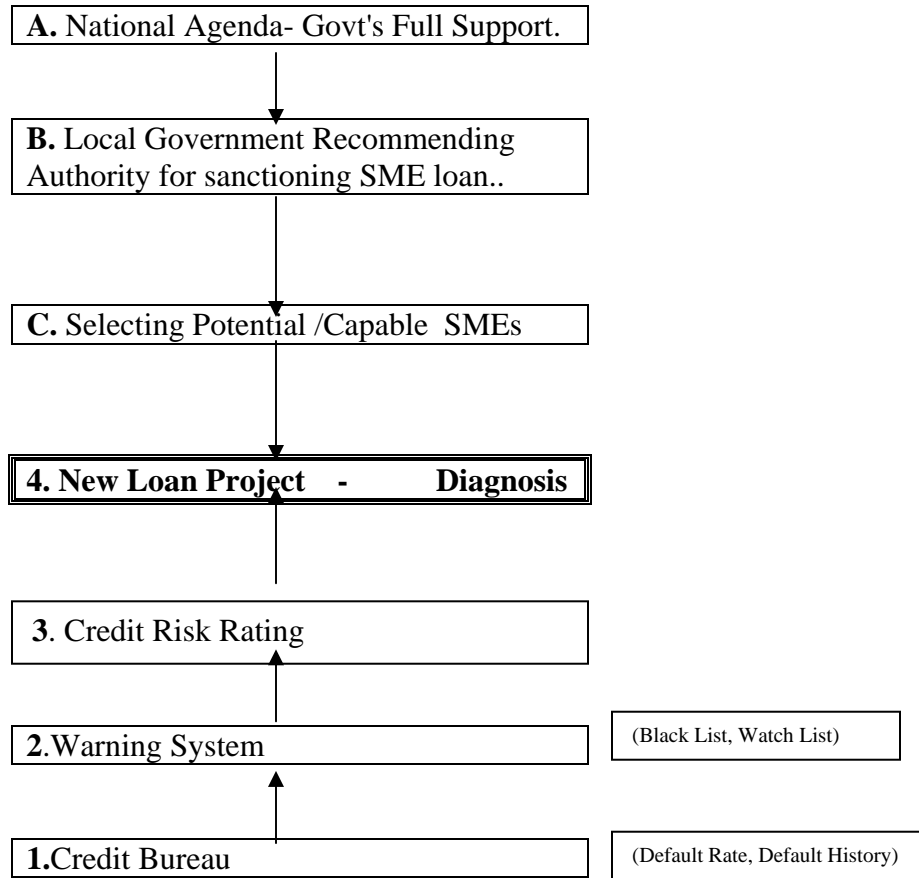
**2. Sustainability-**

- 2.1 Giving the guidance to the entrepreneurs regarding HR creation for maintaining good labour relations.
- 2.2 Giving input on Knowledge, technology and innovation.
- 2.3 Making them aware of the best practices in good governance, Corporate Governance etc.

In Thailand, the Government through these agencies has chalked out the specific strategies for promotion of SMEs and to address the issues of intellectual infrastructure, productivity, competitiveness, etc.

**(iii) Business Model for Thai SME Bank:**

The Thai Economy is reviving very fast since the setback from the last financial crisis in 1997. The Thai Baht is rapidly rising currency in the region. Thai economy has envisaged a vision of Gross National Happiness (GNH) which is an attempt to define quality of life in more holistic and psychological terms than Gross National Product. Accordingly the Thai SME Bank has devised a simple SME financing Model which is as under:



The uniqueness of the SME model is that the potential loan proposals are mobilized by the marketing officers of the SME bank. Then they are subjected to scrutiny through the lists of defaulted borrows i.e. due diligence is fully observed. Besides, government sponsored proposals are required to be recommended by the local governors. This mechanism casts a greater responsibility on the borrowers to repay the dues as well as accountability on the authorities who recommend these loans.

The bank, in addition to the financing to SMEs, is also engaged in advisory and planning services which are considered as a step forward into the future. In Thailand, more emphasis is laid on employment generation potential of SMEs and accordingly various supportive programmes are implemented for promotion of SMEs.

The banks are also aggressively engaged in financing to the clusters. The main clusters are:

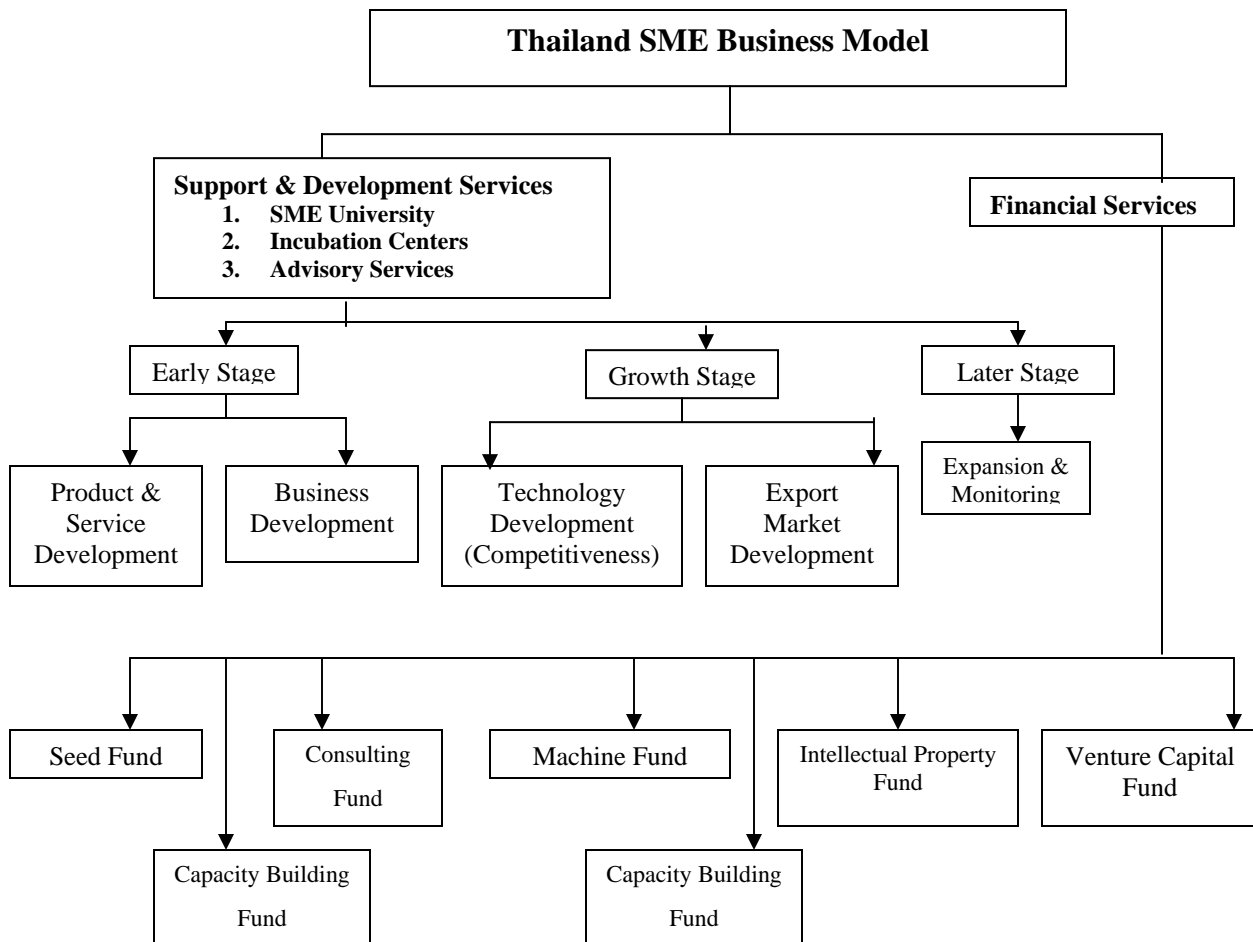
1. Automotive.
2. Fashion
3. Agriculture & Foods.
4. ICT & Software.
5. Tourism
6. Others.

Bank's pattern of driving SME is:

- Making the entrepreneur think—(New Ideas, Products, Markets, etc.)
- Focus on processes/Methodology than on items, investment on innovation.
- Make them do i.e. enabling the execution through participation of all concerned (Collective inclusion).

Bank's development Programmes:

- Enhance trust in each other-instead of competing among them.
- Create Unity.
- Social Welfare Programmes—Food Safety, One Village One Product (OTOP), SME Promotion Plan, Crisis/Disaster Recovery Plan, etc.



Government has created various funds for supporting SMEs, the major funds are as under: -

**(a) Machine Fund: -**

Objectives: -

1. Supporting Industry Development
2. Machine Modification
3. System Installation
4. Machine Replacement.

Operations:-

- OSMEP subsidizes 3% interest Rate with maximum 5 year repayment programme.
- FTI (Federation of Thai Industries) is a major agency in Technical analysis and evaluation.
- Loan approval by FIs.

**(b) Capacity Building Fund:-**

Objective:-

1. Supporting SMEs in developing business in areas as management, IP and marketing etc.
2. Enhance SMEs' capabilities and standards to increase opportunities in international Markets.
3. To add value to SMEs business, products and services.

Conditions:-

- Financial support in the form of grant
- Maximum Subsidy-50%-upto 5,00,000 THB.

**(c) Consultancy Fund:-** Consultancy Process –Subsidy is 50% upto 5,00,000 THB.

**(d) Internationalization Fund:-**

Objectives:-

1. Financial Support to SMEs in participation of foreign trade Fair, Business Matching, Market research etc.
2. Maximum Subsidy-50% with 2,50,000 THB.

**(iv) Findings:**

1. Thailand is an Emerging Market Economy (EME) and reviving from the shocks of recessionary conditions, Bird flu, Tsunami calamity, etc. Against this backdrop, the survival factor has become the most important. Accordingly the SME business model has been shaped.
2. The main emphasis is on sustaining the SMEs particularly the micro enterprises. Hence, all possible efforts are taken to make them stand on their own feet. The government gives

them support for Information Technology and provides aid for modernizing the machinery.

3. The survival of the SME is being done even at the cost of prudential norms.

**(v) Learnings:**

In India, the SME development programme is far ahead. However, for development of microenterprises, the marketing efforts initiated by the Thai Government is appreciated as in their model the bankers identify the potential micro units and which in turn have to be recommended by the Local Governors. This mechanism arrests the defaults/early delinquency rates. Besides, it also helps in identification of genuine borrowers and in proper selection of the entrepreneurs. In our country while financing the artisans, cottage industries, rural industries and microenterprises, if a tie up with the village panchayts is made for identification/selection of the borrowers, it will help in reduction of mortality rate of these units.

A model OTOP (one district one product) is being practiced in Thailand. Although it is not possible to implement this model everywhere in our country, with slight modification, a cluster based approach can be implemented. A model suitable for the locality coupled with proper training of technology relevant to the product of that locality and encouragement to job creators as well as job seeker may go in a long way.

### **3. VIETNAM**

- (i) Definition of SME:** Enterprises with registered capital of less than VND 10 Billion  
Or  
with number of employees less than 300.  
*(Employment less than 20 is known as Micro.)*

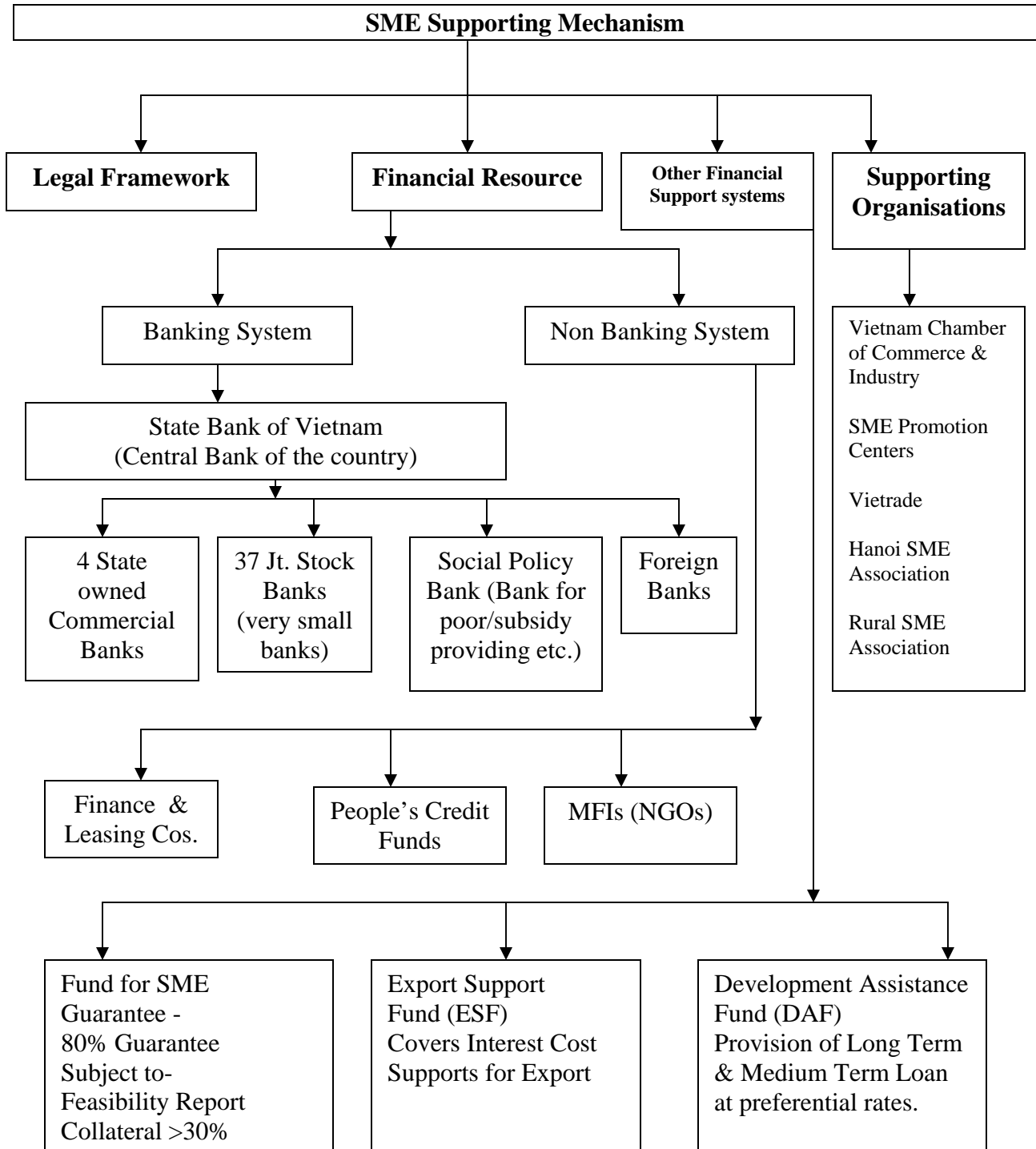
**(ii) Enterprise Profile in Thailand:**

<b>Sectors:-</b> Industry-	17%
Construction-	14%
Services—	55%
<b>Total Units-</b> 1, 60,569	
State Owned-	3.5%
Private Sector-	96.5%

**(iii) Difficulties faced by SMEs:-**

1. Access to finance due to lack of collaterals
2. Banks are not interested in small quantum of loans
3. Constraints on land
4. Shortage of information
5. Disadvantage in Technology, Machines & Equipments
6. Deficiency in human Capital

**(iv) SME supporting mechanism:**



**(v) National Agenda:**

1. Proposed annual growth rate of SME 30% to 40%
2. Priority to Agri SMEs.
3. Support SMEs through central and provincial SME associations.
4. Banks' support SMEs in project proposals and financial management.

**(vi) Offered Loan Products:**

1. Term Loans
2. Credit Guarantees
3. Leasing Services.

**(vii) Findings:**

1. Vietnam is being ruled by communism and recently i.e. from year 2002 the government has started opening of the economy and private entrepreneurship is being encouraged. Hence the SMEs in the country are in a start up level as far as commercialization is concerned. Besides the major difficulty is that the land is owned by the community instead of the individual and he only gets the user right. As a result he cannot offer land as collateral and hence cannot get the bank finance. Although the government is supporting it is yet to achieve the adequacy on this count.
2. The entrepreneurs are running their SME businesses from the support of four levels 1) Banks-loans 2) VLSS –research Institute – for latest technology 3) members of the commundard for about force 4) Government –for support marketing of the product, exporting etc.
3. Government's more focus while supporting the SMEs is ensure that more and more workforce is deployed and the industry is surviving through the odds.
4. While doing so the prudential norms are not much emphasized. As a result NPLs percentage is much more.

**(vii) Learnings:**

1. Vietnam is a fast emerging economy and the practices adopted by the country are mostly kept in place by us.
2. Still their efforts to ensure that the industry survives at any cost i.e. by restructuring the loan, giving additional finance, etc. has to be appreciated.
3. Besides, the country has got good system for providing the advisory services. It is well known that SME requires a handholding up to a sustaining point and that has been already taken care by the system.
4. In our model it is necessary to include this aspect of providing handholding and providing advisory services while providing the finance to the unit.

# **GROUP REPORT -IV**

Submitted by:

**Shri D L N Murthy**

**Shri Ajay Mehta**

**Shri Basil Lions**

**Kum. Poornima Busi**

**Shri B. Venkata Ramana**

DGM, Corporation Bank (Team Leader)

Chief Manager, Punjab National Bank

Associate Vice President , Bharatiya Samruddhi Finance Ltd.

Manager, Export- Import Bank of India

Officer, Asmitha Microfin Limited

**FINANCING TO SME SECTORS: A GLOBAL PERSPECTIVE**  
**(SPECIAL EMPHASIS ON THAILAND AND VIETNAM)**

The SME sector has been identified as an "Engine of Growth" in our country both in terms of employment generation and improving production. This sector alone contributes about 40% of the total industrial output. The Government of India has recently announced a few policy initiatives to enhance the credit flow to the SME sector to help it grow at a higher pace, but the SME sector is still confronted with lot of problems in resource mobilisations. This sector is neither in a position to go to public to mobilise resources nor able to convince the financing agencies about their strength. This sector is facing acute problems in getting cheap resources. Such problems are not in India alone but almost all the countries are witnessing bottlenecks in framing effective strategies to strengthen the SME sectors.

Recently our bank in association with the College of Agricultural Banking, RBI, Pune, has arranged for a study tour programme at Thailand and Vietnam to understand the strategies of effective financing model towards SME sectors in these countries, during the period of February 25 to March 6, 2008. During our visit, we have also visited the following points as part of our study:

**(A) In Thailand:**

- SME Development Bank
- A Glass Factory under SME category
- 

**(B) In Vietnam:**

- Bank of Agricultural & Rural Developments
- Hanoi Farmers' Union
- A small Food Processing unit (Viet Duc Food Joint Stock Company)
- A Silk Development unit (Van Phuc Village)
- 

A brief synopsis of our experience in understanding the SME financing model in these two countries is presented as below;

**STATUS IN THAILAND:**

- The definition of SME is based on number of persons employed and capital invested.
- The entire manufacturing segment in Thailand is constituted by almost 98% of SSI/SME firms, which accounts for nearly 89% of employment generation. The entire Thai-economy is mostly industry dependent.
- This sector contributes around 60% of the GDP of the entire country.
- After Asian crisis, the government has started giving due importance to the SME sector. This sector mostly depends upon the formal and informal sources of finance from foreign institutions and local family bodies. The government has devised a set of measures to encourage private investment to improve financing to SMEs.
- The private bodies including the overseas financial institutions, foreign banks, venture capitals are very much prevalent in lending to the SMEs.

- Through the financial and advisory supports, the Government has newly established SME Development Bank by partial support from private foreign institutions, which provides various services to the SMEs in the economy, including debt financing, equity financing, SME counselling, innovative and diversified loan products and other financial services.
- Unlike other developing countries in the world, the Thailand Government has not introduced any capital subsidy, interest subsidy and guarantee scheme to promote such highly contributing sector at present.
- The government also has not set up any specific legislation for protection of SSI/SME sectors so far.
- Most of the SME firms have been encouraged to set up in collaboration with the foreign firms/individuals in order to reap the export avenues as well as to attract cost effective foreign resources.

### **STATUS IN VIETNAM:**

- There is no fixed definition for SME, however where the number of persons employed are below 200, such firms are usually categorised as SME.
- The Vietnam economy is mostly agriculture oriented. The agriculture consists of around 70% of the overall GDP of the country. This country is the second largest exporter of rice in the world.
- Contribution of industrial segment towards the GDP of the country is growing presently and the SME sector contributes about 15% of the overall GDP. The SME sector is mainly acting as vehicle for poverty alleviation in rural areas.
- The state owned enterprises also plays a significant role in generation of employment. The state level enterprises are also very prevalent in large segment and SSI/SME sectors.
- The industries under SME categories have been offered cheap finance by way of subsidy of interest under guarantee scheme at the initial period and subsequently when the industries are growing, the interest subsidy is gradually removed.
- The Japanese Bank for International Cooperation (JBIC) facilitated by the Ministry of Planning and Investment along with State Bank of Vietnam has extended assistance to the various SME units at concessional terms.
- The industries under SME are referred under compulsory rating by independent rating agencies and based on the risk associated with the firms, the financial institutions offer their sanctions based on terms and conditions associated with the risk parameters. Such rated SME Units are eligible to get easy and cheap finance from Asian Commercial Banks and from Bank of Industry and Development of Vietnam.
- The Government has extended the Development Assistance Fund for utilization towards guarantee for extending finance to the SME units. In respect to some selected industries, the interest subsidy has been introduced. The provision of long and medium term investment lending at preferential rate is also in vogue.
- The Government has established the Export Support Fund, covers interest costs on bank loans related to losses when the world market prices for agricultural products and the value of the final output of the various small and medium food processing units drop. It also supports number of export goods that suffer from high risk or low competitiveness.

- The fund for SME Credit Guarantee has got the provision to sanction loans up to 30% collateral coverage on selective basis on feasible projects.
- In spite of all the in-house promotional policies, the overall industrial scenario as well as the infrastructures is yet to improve. The country is still depending mainly on agriculture and agri-alied industries.

### **VIEWS AND OPINIONS:**

The state of the affairs of the financing towards SSI/SME sectors in both the countries are summarised as below:

<b>SL. NO.</b>	<b>PARTICULARS</b>	<b>THAILAND</b>	<b>VIETNAM</b>
01.	Entrepreneurships	Through foreign firms are encouraged. Pure Indigenous firms are Less in number.	Preferences are towards the agri-related entrepreneurship.
02.	Availability of cheap resources	Resources available through foreign investments. Mostly the cheap resources are in dearth.	Resources are pumped in by the government by way of various schemes towards SME segment, but the resources are inadequate in comparing to Demand.
03.	Contribution of SME sector to the economy	Significant	Insignificant
04.	Whether the Number of SME firms are more	Moderate	Very less
05.	Contribution towards overall employment	Moderate	Low
06.	Govt. schemes for promotion of SME is available	No	Yes
07.	Support of FIs for promoting SMEs.	High	Low
08.	Overall Progress on the development of SME Sector	Low	Low

Based on the above, it tantamount that in both the countries the significant overall growth in SME industries have not evidenced over the years though the resources are now available by way of foreign investment (in case of Thailand) and by way of government promotional schemes (in case of Vietnam).

### **The reasons for such bottlenecks are summarised as below:**

- Lesser scope for indigenous entrepreneurships and inadequate atmosphere for encouragement for individual business.
- Though the SME sectors are contributing significant role in the overall GDP and there are enormous potential available, the government has not nurtured this sector appropriately.
- The government has not created the adequate conducive environment to attract foreign resources and to channelise such resources productively for the benefit of the economy.

(d) The legal framework to protect this segment is missing at present. The SME sector is undergoing the stages of uncertainty on account of no appropriate legislations for SME.

In view of the above, although the SME sector constitutes an important place in the economy of both the countries, the SME sectors were not evidenced adequate growth in countries like Thailand and Vietnam.

In India, the scenario is absolutely different. Currently a variety of schemes including Priority Sector lending, Single Window Scheme, Composite loan Scheme, Credit guarantee Fund Scheme, Credit Linked Capital Subsidy Scheme, Equipment Finance Scheme, Micro Credit Scheme, National Equity Fund Scheme, Laghu Udyami Credit Card Scheme etc. have already put in place by Government over years. It is now time to fine tune those schemes and widening the areas of operations. Further, the legislation framework in the form of MSMED Act 2006 is already in vogue, but the applicability and seriousness of the society towards this act is still required.

At present there are wide variety of institutions, which are providing various services to the SSI/SME sectors. There appears to be no need for any new specialised institutions to serve the SSI/SME sectors at this juncture. What is required is a reassessment of the roles played by various institutions and adoption of a more focussed approach towards the development of this sector.

Moreover India, the proper counselling centre for SSI/SME entities are not available and proper guidance from the funding institutions are also not in practice. Hence, the encouragement towards the first generation technically sound entrepreneurs is much less in number. The Government must take due initiatives to create new entrepreneurs by way establishing counselling centres at the state level or at financial institutions level. All the MSME units shall be compulsorily rated by the independent bodies like SMERA. The rating shall be accepted by all the financial institutions across India and the same shall be linked to rate of interest and other banking concessions. On the other hand, such rating agencies shall also be accountable for their rating exercise. Necessary enactment may be required.

Banks, Financial Institutions as well as the NBFCs should come forward with basket of products to suit the varieties of needs of the MSME units in India. Apart from the traditional products of CC, OD, TL, BG, LC, the funding institutions should introduce the products like – Dealer Finance, Vendor Finance, Receivable Finance, Venture Finance, Securitisation etc.

In India, in spite of having different schemes available for MSME Sectors, the cost of funds for MSME sectors are always at northbound. This sector requires the cheap resources at the doorsteps. Hence the proper participation of the foreign institutional investors for funding in SSI/SME sectors in India is very much required. The individual banks and financial institutions shall invite foreign funds with the objective for onward lending towards SSI/SME sectors. The rationale for funding towards the SME sectors being - low NPA history and ensuring protection of funds, better utilisation and good returns.

In India, such SSI/SME sectors are practically under- privileged and under- utilised at present. If these sectors are nurtured further towards extending supports out of the available schemes and existing measures, this sector will reach the desired level and could contribute substantially to the overall GDP of India and generate more employment.

**Schedule of topics covered during the  
International Exposure Programme in Thailand & Vietnam on  
Financing to Small and Medium Enterprises**

<b>Programme Director(s)</b>
Shrimohan Yadav K R P Rao

<b>Programme Objectives:</b>	
1.	To study the models of SME financing in visiting countries
2.	To study methods applied to overcome the constraints, faced while financing to SMEs
3.	To study the system of financial and non-financial support extended
4.	To draw lessons for Indian banks/ FIs policy makers and Developmental Agencies

<b>AT- CAB, RBI, Pune during February 24 to 26, 2008</b>
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<b>Sunday, February 24, 2008</b>		
19.00 onwards	Pre Dinner Session – Inauguration, Ice breaking; Special Dinner Hosted by the Principal	Principal & Programme Directors
<b>Monday, February 25, 2008</b>		
09.45 – 10.15	Registration	Programme Directors
10.15 – 11.15	Briefing about the logistics arrangements	Programme Directors
11.30 – 13.15	The Status and Role of SMEs in Indian Economy – Implications of the Micro, Small and Medium Enterprises Development Act, 2006	S Yadav
14.15 – 15.45	RBI Guidelines & Instructions on Lending to SMEs; Various Committee Reports	K R P Rao
16.00 – 17.30	Interaction with entrepreneurs to understand their expectations and practical difficulties.	Entrepreneurs. Moderator: S Yadav
<b>Tuesday, February 26, 2008</b>		
09.45 – 11.15	Role of SMEs in economies of visiting countries / global perspective	K R P Rao
11.30 – 12.30	Services of government agencies for SMEs promotion and coordination of developmental schemes	S Yadav
12.30 – 13.00	Interaction with the Principal	Principal & PDs
14.00 PM	Departure to Mumbai Airport	

**At -Asian Institute of Technology, Bangkok during 27 February to March1, 2008**

**Agenda of Activities and Itinerary**

**Day-1: Wednesday 27<sup>th</sup> February 2008**

- 10:30 Registration in Room 202, AIT Conference Center
  
- 11:00 Opening Ceremony:  
Welcome addressed by Dr. Sahdev Singh, Program Director, AIT Extension  
Opening addressed by Dr. Jonathan Shaw Director
  
- 11:30 Program orientation by Dr. Sahdev Singh
  
- 12:00 Welcome Lunch
  
- 13:30 *Seminar-1: Role of SMEs in Economies of Thailand*, by Dr. Maytee Leelawat,  
Executive Vice President (Operation), Institute for Small and Medium Enterprises  
Development
  
- 15:00 Coffee/Tea Break
  
- 15:30 Program Continue
  
- 16:30 Recess

**Day-2: Thursday 28<sup>th</sup> February 2008**

- 08:15 Travel to *The Office of SMEs Promotion*
  
- 09:30 Arrive. Briefing and discussion on role and responsibility of the office, SMEs  
promotion master plan and SMEs promotional policies and strategies, regulation  
of SMEs, services for SMEs promotion and coordination of development schemes
  
- 12:00 Lunch and Recess to *SMEs Bank*
  
- 14:00 Arrive. Briefing and discussion on promotional and support schemes for SMEs,  
role of bank in addressing the problems of finance to SMEs, issues and challenges  
on financing SMEs, credit guarantee, credit rating and methods to deal with sick  
units and recovery of loan
  
- Observe the operations initiated by the SMEs Bank

16:30 Recess and return to AIT

**Day-3: Friday 29<sup>th</sup> February 2008**

06:45 Leave for Crystal Company in Rayong Province

09:30 Arrive. Briefing and discussion with the company owner

11:30 Recess and travel to Chonburi Province (Lunch on the way)

13:30 Visit OTOP Group in Muang District, Chonburi Province

**Day-4: Saturday 1<sup>st</sup> March 2008**

09:00 Breakfast and Check out

09:30 Travel back to AIT and sight seeing in Bangkok

16:00 Arrive and check in at AITCC

**Day-5: Sunday 2<sup>nd</sup> March 2008**

Travel to Hanoi, Vietnam

<b>At -Vietnam Academy of Agricultural Sciences during 3 to5 March, 2008</b>
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**Day-6: Monday 3<sup>rd</sup> March 2008**

07:30 Leave for Vietnamese Academy of Agriculture Sciences (VAAS)

08:15 Arrive. Meeting with the President

09:15 Group Photo and Coffee/Tea Break

09:30 Seminar Session 2: *General Economic and Financial Sector Development in Vietnam with special reference to Rural SMEs* by Dr. Nguyen Thi Lan Huong, Senior Expert of Ministry of Agriculture and Rural Development and Manager of Center for Environment and Rural Development

12:30 Lunch

13:30 Seminar Session 2: *Roles and Functions of Bank of Agriculture and Rural Development* by Dr. Doan Thanh Huong, Senior Expert, Bank of Agriculture and Rural Development

15:30 Coffee/Tea Break

15:45 Program Continue

17:00 Recess

**Day-7: Tuesday 4<sup>th</sup> March 2008**

07:30 Travel for Hanoi Farmers' Union

08:00 Arrive. Briefing and discussion with Hanoi Farmers' Union member

09:30 Visit a cooperative

11:00 Visit an ecological tourist farm, which got a financial supports from various institutions

12:00 Lunch

14:00 Visit Bank of Agriculture and Rural Development. Briefing and discussion with bank's staffs.

15:30 Visit enterprise best practice

16:30 Recess

**Day-8: Wednesday 5<sup>th</sup> March 2008**

08:00 Travel for Viet Duc Food Joint Stock Company

08:30 Arrive. Briefing and discussion with leaders and staffs of the company.

12:00 Lunch

13:30 Visit a local SME production site in Van Phuc Silk Village

18:00 Recess

19:00 Program Evaluation, Closing Ceremony and Farewell Dinner

**Wednesday 6<sup>th</sup> March 2008**

Travel back to India

### Group Members (Participants)

<b>GROUP -I</b>	<b>Shri Mandeep</b> (Team Leader)	Vice President	HSBC
	<b>Shri Jai Kumar</b>	Director - Finance	NSIC
	<b>Shri Suresh Goyal</b>	DGM,	Corporation Bank
	<b>Shri T E Thiruvengdam</b>	GM-Legal,	REPCO Bank
<b>GROUP-II</b>	<b>Shri Inguva Viswanath</b> (Team Leader)	Chief Manager	Bank of India
	<b>Shri A Chandramouli</b>	AGM	SIDBI
	<b>Shri H Subramaniam</b>	AGM	State Bank of India
	<b>Shri Arijilli Satheesh</b>	Field Manager	Bhartiya Samruddhi Finance
<b>GROUP-III</b>	<b>Shri Waikar Prakash</b> (Team Leader)	Chief Manager	Union Bank of India
	<b>Shri S V Raghavan</b>	AGM	Indian Bank
	<b>Smt. Joshomayee Devi</b>	Associate Professor	Indian Institute of Bank Management
	<b>Shri P. Nithyanandan</b>	AGM	Reserve Bank of India
	<b>Shri J Satyanarayana</b>	Chief Manager	Indian Overseas Bank
<b>GROUP-IV</b>	<b>Shri D L N Murthy</b> (Team Leader)	DGM	Corporation Bank
	<b>Shri Ajay Mehta</b>	Chief Manager	Punjab National Bank
	<b>Shri Basil Liongs</b>	Ass. Vice President	Bharatiya Samruddhi Finance
	<b>Kum. Poornima Busi</b>	Manager	Export- Import Bank of India
	<b>Shri B. Venkata Ramana</b>	Officer	Asmitha Microfin Limited