

Thailand: Rationalization and Corporate Governance of Specialized Financial Institutions

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Executive Summary

Thailand's Fiscal Policy Office (FPO), with supervisory and policy guidance responsibility for State Financial Institutions (SFIs), has been increasing the efficiency and transparency in SFIs through improved corporate governance and rationalization. It has embarked on a program of restructuring and strengthening of corporate governance systems in the SFIs by segregating accounts and developing appropriate government support systems for Public Service Accounts (PSAs), and it is implementing a comprehensive reporting and monitoring system for all SFIs. After the Asian economic crisis of 1997, SFIs were identified as potentially playing a key role in alleviating the economic and social stress experienced by the poor.

The Asian Development Bank (AsDB) has collaborated with Thailand's Ministry of Finance (MOF) to restructure and build the capacities of four SFIs. Overall, the monitoring system is enabling FPO staff to more effectively handle and manage data reported by SFIs, and to use their analysis to improve management decision making. Lessons learned should be generalizable to other partner country governments seeking to provide financial support to small and medium-scale enterprises (SMEs) and other organizations served by SFIs.

Background

The Asian financial crisis of 1997 had major ramifications for the economy of Thailand, particularly for the financial sector. Specialized Financial Institutions (SFIs) were identified as potentially important for alleviating economic and social stress experienced by the poor. SFIs also represented an important tool through which the government could implement fiscal and quasi-fiscal policies. In 1999, the Asian Development Bank (AsDB) collaborated with the Ministry of Finance to restructure and build capacity in selected Thai SFIs. The Fiscal Policy Office (FPO), with supervisory and policy guidance responsibility for SFIs, began to increase efficiency and transparency in SFIs through improved corporate governance and rationalization.

Project components and objectives

This project has involved: (i) restructuring and strengthening of corporate governance systems in SFIs, (ii) segregating accounts and developing appropriate government support systems for Public Service Accounts (PSAs), and (iii) implementing a sound reporting and monitoring system for SFIs. The newly developed systems include reporting (data entry system), a monitoring and analysis system, and a data analysis interface.

Problems/Issues Addressed by the Program

Limitations of existing reporting and monitoring system of SFIs at FPO. The government has historically relied on SFIs to provide credit to sectors of the economy not usually served by commercial banks. The previously existing FPO monitoring system relied primarily on periodic reports and selective monthly financial indicators submitted by SFIs. Developing a computer-based early warning system that would allow early identification and intervention for fiduciary and related problems among the country's SFIs was given top priority. The FPO was tasked to improve the reporting and monitoring systems, and to take steps that would ensure that the new systems would be complied with.

Financial sector crowding. In the wake of the crisis, financial sector restructuring and reform were critical for building market confidence and ensuring a sustainable economic recovery. As SFIs have expanded their scope, there has been a growing overlap (and potential competition) with more mainstream private financial institutions. However, SFIs serve market niches not adequately reached by traditional financial institutions and help build private markets, generate tax revenues, and empower poor people.



Importance of organizational effectiveness. The FPO has proven its effectiveness through careful implementation. Not only does it play a key role in providing resources, it helps build capacity in the SFIs as well. Four SFIS were targeted for support. While allocating resources to the SFIs in a manner consistent with the government's public policy goals, FPO has taken steps to ensure that allocated resources are carefully targeted and kept distinct from other (commercial) goals of the SFIs.

Restructuring of SFIs. The AsDB loan component of the project supported the development of restructuring plans for the SFIs, while a grant component helped to rationalize the government's role within the financial sector, improve governance of SFIs, and develop strategies for financing small- and medium-scale enterprises (SMEs). The approach focuses on grant-funded help to rationalize the purpose and structure of the SFIs and to establish an appropriate corporate governance framework for them.

Objectives Pursued

Three specific components are involved:

- Restructuring and strengthening corporate governance systems in SFIs
- Segregating accounts and developing appropriate government support systems for Public Service Accounts (PSAs)
- Implementing a sound reporting and monitoring system for SFIs within FPO

The objective of the monitoring system is to create systematic reporting systems and procedures for SFIs. The standardized disclosure, reporting, and monitoring systems for SFIs clearly specify the types, format, content, organization, and time frames for reporting. This includes systems to help SFIs provide their reports online, either on a regularly scheduled basis or on a "real time" basis. These systems include:

- **Reporting (data entry system)** – SFI staff will be able to report periodic data through an online system using a normal Internet connection.
- **Monitoring and analysis system** – FPO staff can access SFI reports readily for analysis, monitoring, and planning.
- **Data analysis interface** – The FPO administrator can analyze financial data in various ways, including correlating and cross-tabulating variables, specifying breakdowns by specific variables, and "drilling down" to identify underlying patterns in the data. Findings of requested analysis can be provided in statistical form, and can then be por-

trayed graphically to support policy and financial decisions.

Design and Implementation

Restructuring and strengthening the corporate governance system for SFIs. *The Best Practices Code for SFI Corporate Governance* identifies best practices according to which SFIs should be governed and controlled. This code:

- is consistent with Thai legal frameworks applicable to SFIs;
- conforms to international best practice standards in corporate governance, yet is customized to Thai conditions;
- allows SFIs to gradually come into compliance with the Code; and
- is congruent with other Thai corporate governance initiatives.

Accounting systems and government compensation for Public Service Accounts. The PSA system differentiates policy accounts from normal commercial accounts. The project will include development and implementation of "Guidelines for a Proposed Public Service Account in the SFIs." These guidelines identify appropriate accounting methodologies and identify areas requiring government policy decisions. The guidelines also provide a basis for identifying potential problem areas (e.g., moral hazard and differentiation problems), as well as recommendations for dealing with those potential challenges.

Types of data in the system. The system includes the following types of data:

- **Financial information** – Historical financial data, accessible in various formats and combinations.
- **Key Performance Indicators (KPI)** – The monitoring system supports KPIs as identified by the Ministry of Finance.
- **Corporate governance database**
- **Early warning system** – This part of the system will use analysis of historical financial data, including the use of graphs with "drill down" options, for analysis of financial information.
- **Portfolio dataset** – A comprehensive database on SFI loan and asset quality, as well as other indicators of the portfolio quality and performance for SFIs.
- **Analyzing and reporting capabilities** – Reporting capabilities that allow FPO to more easily generate accurate and informative monthly reports to senior management for decision making.



Problems Encountered

Accounting systems and government compensation for Public Service Accounts. SFI activities involve a mixture of commercial and policy activities; the latter, driven by government policies or directives, involve Public Service Accounts (PSAs). The PSAs are the government's policy programs based on concessional terms and conditions to the target group. This diversity creates challenges for FPO in accurately monitoring SFI performance. Before the project, it was difficult to differentiate the various parts of the business stream – PSA vs. commercial – and to determine the distinct contributions of each to SFI performance. This observation provides a strong rationale for developing two distinct accounting systems/principles, one for PSA activities and one for commercial activities. Such activity-specific systems allow for more accurate performance measurement, a clearer differentiation of results for commercial versus policy activities, and more reliable budgeting for future activities. Some SFIs have already developed activity-specific systems; however, these have only been used internally and will need to be independently verified to ensure accuracy and accountability.

Limitations of current reporting and monitoring system. The government has historically relied on SFIs to provide credit to sectors of the economy not usually served by commercial banks. However, SFIs have gradually been extending their services into new areas in response to a changing business environment and opportunities. As a consequence, FPO's existing systems for performance evaluation of SFIs need systematic review and updating. For longer-term policy purposes, the monitoring system should provide information for determining SFI self-sustainability, requirements for government support, and appropriate regulations. Further, the current FPO system relies primarily on periodic reports and selective monthly financial indicators submitted by SFIs. Ideally, FPO should have in place a computer-based early warning system that would allow early identification and intervention for fiduciary and related problems among the country's SFIs.

Factors for Success

Capacity development. This system was supported by applied training for FPO officials on both the technical and policy sides. Overall, the monitoring system will empower FPO staff to more effectively handle and manage data reported by SFIs, and to use their analysis of that data to improve management decision making.

Flexibility. To enhance SFI compliance to the new corporate governance code, generic articles of association for SFIs have been drafted. These articles are modeled on best practices in Thailand's corporate sector, but with specific clauses added as required by SFI's enabling acts and other regulations. The key elements of the SFI corporate governance code will be "mapped" onto the articles of association. The generic articles are intended to be easily adapted for individual SFIs.

Accounting systems and government compensations for Public Service Accounts. After presentations and discussions of the proposed system with all SFIs, it became clear that the widely differing mandates, scope, and processes of the various SFIs would be a major challenge. In addition, certain issues need to be decided and resolved through discussions and negotiations between the Ministry of Finance (MOF) and the SFIs. As a consequence, the project team has approached each SFI to help clarify accounting issues. In particular, the focus has been on key success factors for the project, which include both (i) revenue and cost allocation issues, and (ii) computer and information technology issues. In this regard, all SFIs were asked to prepare initial and PSA project proposals consistent with the principles of the project. Results suggested that almost all of the SFIs understood FPO's objectives in the PSA area. FPO has now created mechanisms for further implementation, including assisting MOF to clarify PSA transactions.

Conclusions and Applicability to Other Programs

Restructuring and strengthening corporate governance system. The FPO is now sharing its work on the corporate governance code for SFIs with other agencies and all SFIs. In the meantime, FPO has worked with the Bank for Agriculture and Agricultural Cooperatives (BAAC), which has unofficially adopted and implemented the articles of association in compliance with its enabling act and other regulations. The experiences of BAAC will be invaluable in improving the articles of association for other SFIs. Training workshops for SFIs on implementing and complying with the SFI CG Code were held in 2004. These workshops will allow FPO staff, State-Owned Enterprises Policy Office (SEPO) officials, and SFI executives and staff to review and adjust the code in more detail. The adjustments in the code would be to make them more suitable for the SFIs and concerned agencies. Thus, FPO and other agencies are working to make the project fit the needs of recipients.



Reporting and monitoring system. FPO has now issued a mandate to all SFIs requiring them to report relevant information under the new reporting and monitoring system; further, all SFIs have accessed the online reporting system. Certain problems have been identified during the trial period, and steps are being taken to address those challenges and complete the system. At this point, the top priority is to evaluate all progress to date, including conducting comprehensive data analysis and identification of key policy issues for moving forward.

Broader applicability. This project was purposely based on an aggressive approach to strengthen the SFIs' core structures and prevent serious problems. In the process, FPO's perspective has become broader and more forward-looking. The project is highly congruent with FPO's mission and vision, which are geared toward taking a more proactive role in innovative development projects. Lessons learned should be generalizable to other partner country governments seeking to provide financial support to SMEs and other organizations served by SFIs.

For more information

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