CHAPTER 4

CAPITAL MARKET DEVELOPMENT IN THAILAND

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INTRODUCTION

After the Thai economy sparked off the Asian financial crisis in 1997, Thailand's stock and bond markets seem to have experienced unprecedented growth by most measures, including issuance and turnover of securities. This chapter investigates the actual path of capital market development in Thailand, examines its fundamental shortcomings as well as its potential, and analyses the factors and regulations that pertain to the development of the capital market. The next section introduces the instruments and regulations in the debt market. The third section summarises the market's growth and evolution to include equity and secondary market trading and interprets the recent surge in the securities market. The next section discusses particular characteristics of the Thai capital market, some of which may be stumbling blocks to continued development. The fifth section covers the government's latest policy actions, and the concluding section summarises the weaknesses in the market and presents some suggestions for policy approaches to improve the Thai capital market's potential for future development.

MARKET FOR DEBT SECURITIES

Debt securities, specifically government debt securities were the original instrument of Thailand's capital market. Public authorities in Thailand may issue several types of debt securities including government bonds, state enterprise bonds, Bank of Thailand bonds, Financial Institution Development Fund bonds, Property Loan Management Organisation bonds, Treasury bills, and promissory notes. Bank of Thailand bonds were meant to handle domestic liquidity or monetary policy, while Financial Institution Development Fund bonds and

Property Loan Management Organisation bonds were intended to help resolve particular crises and are no longer issued. In their stead, the government occasionally resorts to issuing government or Bank of Thailand bonds, and state enterprises issue state enterprise bonds.

In accordance with the Budgetary Act of 1959, the Thai government can borrow by issuing securities only in case of budget deficit or when expenditures exceed revenues. Those borrowings cannot exceed the sum of 20 percent of total fiscal spending and 80 percent of the expenses allocated to debt amortisation. Each state enterprise has its own regulation on borrowing, but government guarantees are subject to certain conditions. If the state enterprise is a company, the government guarantee limit is four times capital for a financial state enterprise company and six times capital for a non-financial state enterprise company. If the borrowing state enterprise is not a company there is no limit on the government guarantee. Treasury bills are short-term securities issued under discount for the purpose of administering the Treasury balance and fiscal policy. The borrowing public entity is free to select any pattern of maturity, timing, and auctioning method that it deems suitable for its status and/or market conditions.

Most private entities (except financial institutions) are not subject to constraints on borrowing from the capital market. They can issue several types of short-term commercial paper including bills of exchange, bankers' acceptances, promissory notes, negotiable certificates of deposit. As for longer maturity securities, before 1992 only public and exchange-listed companies were eligible to issue bonds. With enactment of the Securities and Exchange Act in 1992 limited companies, which constitute the majority of Thai business entities, became able to issue corporate bonds.

EVOLUTION AND GROWTH OF THE CAPITAL MARKET

Recognising investors' need for liquidity, over the last quarter century the central authorities established a number of secondary markets and undertook measures to facilitate trading different types of securities. First, the Stock Exchange of Thailand (SET) was originated in 1974 for trading common shares. Then, in 1979 the Bank of Thailand initiated the repurchase market to accommodate financial institutions' temporary liquidity shortages and simultaneously implement monetary policy.

The capital market saw many more institutional changes and experienced significant growth from the mid 1990s. In 1993 the first credit rating agency, the Thai Rating Information Service Co., Ltd. (TRIS), was founded to help investors evaluate bond and share issuers. The Bond Dealers' Club (BDC) was put into action in 1994 to entertain secondary trading of public securities and corporate bonds. Banks were permitted to engage in bond underwriting in 1993. Since then, banks' role in underwriting has grown remarkably, from 4 percent of the total value of bonds registered at BDC in 1995 to 46 percent in 2000. Banks also became major dealers in the secondary bond markets between 1998 and 2000.

The growing volume of transactions and responsibilities led to upgrading the BDC to become the Thai Bond Dealing Centre (TBDC) in 1997. From that time, secondary trading of securities rose impressively. Trading value jumped from 72 billion baht in 1998 to 1,592 billion baht in 2001 (Table 4.1). The turnover ratio surged from 9 percent in 1998 to 105 percent in 2001 (Table 4.2). Nevertheless, in 2001 corporate bonds still constituted only 5 percent of trading value, compared with government bonds, which accounted for 57 percent of turnover, and state enterprise bonds, which represented 8 percent (Table 1).

Table 4.1
Trading and Outstanding Value of Thai Bond Dealing Centre, 1995-2001
(Millions of baht)

	1995		1996		1997		1998		1999		2000		2001	
	Trading value	**Out-standing**	**Trading value**	**Out-standing**	**Trading value**	**Out-standing**	**Trading value**	**Out-standing**	**Trading value**	**Out-standing**	**Trading value**	**Out-standing**	**Trading value**	**Out-standing**
All government debt	931	8,500	4,833	18,500	15,235	36,500	63,202	637,904	398,378	905,216	1,283,722	1,059,684	1,500,926	1,254,961
Government	-	-	-	-	-	-	43,090	330,446	341,084	538,846	1,027,781	586,261	916,473	618,176
State enterprises	-	-	-	-	-	-	7,533	286,458	50,784	356,370	207,864	407,347	140,383	414,448
Guaranteed	-	-	-	-	-	-	6,636	253,696	42,535	309,091	191,688	345,340	123,871	357,278
Non-guaranteed			-	-	-	-	897	32,762	8,249	47,279	16,176	62,007	16,512	57,170
Treasury bills	-	-	-	-	-	-	-	-	3,777	-	47,414	62,000	350,837	110,000
BoT/FIDF/PLMO	931	8,500	4,833	18,500	15,235	36,500	12,579	21,000	2,732	10,000	662	4,076	93,233	112,337
Corporate debt	50,597	89,228	195,775	130,189	90,955	132,591	8,896	125,841	32,819	179,387	73,400	209,883	91,294	251,720
Total	51,528	97,728	200,608	148,689	106,190	169,091	72,098	763,745	431,197	1,084,602	1,357,121	1,269,567	1,592,219	1,506,682

Note: The Bond Dealers' Club, BDC, was established in November 1994. It was upgraded to a Bond Exchange and renamed Thai Bond Dealing Centre (BDC) in April 1998. At that time it registered government and state enterprise bonds. In 1999, T-bills were registered for information purposes only; they are not included in the outstanding value of registered bonds. Since 1 October 2000 the outstanding value of total registered bonds includes T-bills.
Source: Thai Bond Dealing Centre.

Table 4.2
Turnover Ratios of Bonds in the Thai Bond Dealing Centre
(Percent)

	1995	1996	1997	1998	1999	2000	2001
All government debt	10.96	26.12	41.74	9.91	44.01	121.14	119.60
Government	-	-	-	13.04	63.30	175.31	148.25
State enterprise	-	-	-	2.63	14.25	51.03	33.87
Guaranteed	-	-	-	2.62	13.76	55.51	34.67
Non-guaranteed	-	-	-	2.74	17.45	26.09	28.88
Treasury bills	-	-	-	-	-	76.47	318.94
BoT/FIDF/PLMO	10.96	26.12	41.74	59.90	27.32	16.25	82.99
Corporate debt	56.71	150.38	68.60	7.07	18.30	34.97	36.27
Total	52.73	134.92	62.80	9.44	39.76	106.90	105.68

Note: Turnover ratio = yearly trading value/outstanding value
Source: calculated from Table 1.

Long-term Trend or Post-crisis Blip?

The growth in secondary market turnover in the late 1990s could be taken as a sign of the Thai capital market's development, likewise, the increased issuance of securities by both the government and the private sector. For example, total annual issues of debt securities increased from 81.5 billion baht in 1993 to 866.9 billion baht in 2001 (Table 4.3). However, such statistics must be qualified in light of the aftermath of the 1997 crisis, before interpreting them as indicators of the general trend of the Thai capital market.

Table 4.3
Issuance of Thai Debt Securities, 1993-2001
(Billions of baht)

	1993	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**
Government bonds	0	0	0	0	0	400	333.7	94.1	149.2
Treasury bills	0	0	0	0	0	0	77	240.9	441.4
State enterprise bonds	60.4	57.1	55.2	57.4	49.3	46.7	95.3	111.7	57.6
Guaranteed	0	50.8	55.2	43.1	41.3	46.7	90.1	90.4	57.5
Non-guaranteed	0	6.3	0	14.3	8	0	5.1	21.3	0.1
FIDF/PLMO bonds	0	0	29.5	139.9	191.5	55	0	0	112
Corporate bonds	21.1	59.8	47.5	36.2	40.9	37.8	289.3	151.2	106.7
Total	81.5	116.9	132.2	232.4	281.7	539.5	795.3	597.9	866.9

Source: Thai Bond Dealing Centre

First, consider the surge in government securities issues in the late 1990s. The Thai government was unable to issue any debt securities at all for nine consecutive years from 1988 to 1996 because the cash balance was in surplus (Table 4.4). Then, after the financial turmoil in 1997, the government offered massive assistance to ailing financial institutions in many formats such as re-capitalisation through the Bank of Thailand’s Financial Institution Development Fund. All of the government bond issues in 1998 and almost 90 percent of the issues in 1999 were such re-capitalisation bonds (Table 4.5). Another reason for substantial public borrowing at the end of the 1990s was the government’s intention to revive the economy from the pervasive downturn. Thus, while government securities issues were the dominant source of capital market expansion in the late 1990s, this phenomenon may not be long lasting, especially because of the legal constraints on the amount of securities the government may issue.

Table 4.4
Thai Government Cash Balance
(Millions of baht)

	Cash Balance	GDP	Cash Balance/GDP (%)
1985	-38,966	1,056,496	-3.69
1986	-34,150	1,133,397	-3.01
1987	-8,861	1,299,913	-0.68
1988	36,098	1,559,804	2.31
1989	65,335	1,856,992	3.52
1990	107,046	2,183,545	4.90
1991	107,707	2,506,635	4.30
1992	72,811	2,830,914	2.57
1993	59,713	3,170,259	1.88
1994	97,651	3,634,500	2.69
1995	126,117	4,192,697	3.01
1996	43,303	4,622,832	0.94
1997	-71,051	4,740,249	-1.50
1998	-129,292	4,628,431	-2.79
1999	-154,362	4,615,388	-3.34
2000	-109,869	4,900,330	-2.24

Source: Bank of Thailand and National Economic and Social Development Board.

Table 4.5
Government Bonds Issued for Re-capitalisation by Type, 1998-2000

	1998		1999		2000	
	Billion baht	% gov't bonds	Billion baht	% gov't bonds	Billion baht	% gov't bonds
Re-capitalisation bonds	400.0	100.0	297.8	89.5	25.0	45.4
FIDF	400.0	100.0	100.0	30.0	0.0	0.0
Reopened FIDF	0.0	0.0	149.0	44.8	0.0	0.0
Tiers 1 & 2						
Banks	0.0	0.0	39.0	11.7	24.7	44.8
Finance companies	0.0	0.0	9.7	2.9	0.3	0.6
Government bonds total	400.0	100.0	332.8	100.0	55.0	100.0

Source: Bank of Thailand.

Moreover, the increase in capital market issues in the late 1990s also reflected the severe adjustment of the private sector to the 1997 crisis. After Thailand accepted assistance from the IMF the central bank subjected commercial banks to tighter rules on loan classification and provisioning as well as write-offs. Commercial banks became cautious about extending credit, and bank credit contracted in each year from 1998 to 2000 (Table 4.6). In order to re-capitalise, banks either had to issue more shares or merge with foreign partners. At the same time, some large non-bank private corporations tapped domestic capital markets both because bank credit was less accessible and because local interest rates declined markedly while exchange rates fluctuated. New equity issues reached all time highs in 1998 and 1999 (Table 4.7). And new debt issues increased in 1999-2000 as private companies issued domestic bonds in order to refinance their foreign debt obligations (Table 4.7). But, while corporations issued almost ten times more bonds in 1999 than in 1998, in 2000 corporate bond issues were only half what they were in the previous year (Table 4.8). This raises the question of whether Thailand's capital market will continue to develop once commercial banks have re-capitalised and once large corporations have refinanced their debt. In other words, the capital market boom may not be sustainable.

Table 4.6
Capital Market Mobilisation and Changes in Commercial Bank Credit, 1993-2000

	1993	1994	1995	1996	1997	1998	1999	2000
Funds raised in capital market								
Current prices (billion baht)	122.55	250.49	255.82	242.23	90.54	232.03	599.62	242.66
1988 prices (billion baht)	95.64	185.77	158.39	163.43	58.55	137.44	351.14	141.41
Share of gross investment (%)	9.78	17.27	13.16	12.79	5.74	22.57	61.14	22.20
Change in commercial bank credit								
Current prices (billion baht)	512.59	762.76	793.12	604.86	1204.3	-821.3	-105.9	-526.5
1988 prices (billion baht)	400.01	565.68	556.21	408.10	778.76	-486.49	-65.59	-320.71
Share of gross investment (%)	40.91	52.60	46.22	31.94	76.40	-79.90	-11.42	-50.35

Source: Securities and Exchange Commission.

Table 4.7
Newly Issued Securities by Type of Instrument, 1993-2000

	1993	1994	1995	1996	1997	1998	1999	2000
				Billion baht				
Equities	60.23	138.00	138.65	106.43	49.62	194.25	277.23	72.30
Debt instruments	21.46	82.54	0.60	92.33	38.15	31.06	313.30	112.89
Equity-linked instruments	39.99	27.51	16.10	40.53	2.77	6.72	7.69	7.45
Warrants	0.88	2.44	0.47	2.95	0.00	0.00	1.40	0.00
Total	122.56	250.49	255.82	242.24	90.54	232.03	599.62	242.66
				% share				
Equities	49.1	55.0	61.4	43.9	54.8	83.7	46.2	29.8
Debt instruments	17.5	33.0	31.3	38.1	42.1	13.4	52.2	67.1
Equity-linked instruments	32.3	11.0	7.1	16.7	3.1	2.9	1.3	3.1
Warrants	0.7	1.0	0.2	1.2	0.0	0.0	0.2	0.0

Source: Securities and Exchange Commission.

Table 4.8
Corporate Bond Offerings by Type, 1995-2001

	1995	1996	1997	1998	1999	2000	2001
				Billion baht			
Straight issues	70.60	92.33	38.15	30.05	308.17	146.92	106.67
Convertible issues	16.13	40.53	2.77	6.20	7.69	7.45	0.01
Total	86.73	132.86	40.92	36.25	315.86	154.37	106.68
				% share			
Straight issues	81.40	69.49	93.23	82.90	97.57	95.17	99.99
Convertible issues	18.60	30.51	6.77	17.1	2.43	4.83	0.01

Source: Securities and Exchange Commission.

CHARACTERISTICS OF THE BUSINESS AND FINANCIAL ENVIRONMENT AND THE CONTINUED DEVELOPMENT OF THAILAND'S CAPITAL MARKET

Several characteristics of Thailand's business and financial environment may pose stumbling blocks to the continued development of the capital market.

First, Thai private businesses continue to rely heavily on financing from banks rather than the capital market. Private business mobilised far fewer funds from the capital market than they obtained from commercial banks. Overall from 1988 and 2000 funds raised in the Thai capital markets averaged 118 billion baht per year, roughly half the 242 billion baht per year raised through bank credit (Table 4.9). Thai businesses' preference for bank financing contrasts with preferences in other economies. From 1988 to 2000 51 percent of gross fixed capital formation in the United States was funded by capital markets, and the figure was 43 percent in the U.K. (Table 4.10). In Thailand, capital markets contributed only 11 percent. The picture is reversed for commercial bank credit. Bank credit financed 26 percent of investment spending in Thailand compared to only 15 percent in the United States. The fact that Thai businesses lag behind in direct financing through the capital markets suggests that owners tend not to have sufficient knowledge or understanding about the role, responsibility, and working mechanism of capital markets and regulations. Consequently, they depend on borrowings from financial institutions, especially commercial banks, for most of their fund-raising.

Table 4.9
Business's Fund Mobilisation in Thailand's Capital and Money Markets

	Annual average		
	1988-1992	**1993-2000**	**1988-2000**
Capital market funds			
Funds raised (billion baht)	49.08	161.47	118.24
Share of total private investment (%)	6.73	17.52	13.95
Commercial bank credit			
Funds raised (billion baht)	262.66	229.50	242.25
Share of total private investment (%)	36.03	24.90	28.58
Capital market funds/commercial bank credit (%)	18.69	70.36	48.81

Note: calculated from 1988 price.
Sources: NESDB, BOT, SEC, and SET.

Table 4.10
Comparison of Capital and Money Market Fund Raising in Selected Economies, 1988-2000

	Capital Market Fund Raising		Commercial Bank Credit	
	% of GDP	**% of GFCF**	**% of GDP**	**% of GFCF**
Japan	4.32	14.57	3.73	12.57
South Korea	8.80	25.23	8.41	24.10
Singapore	6.07	17.52	11.24	32.45
Thailand	3.87	11.68	8.62	26.01
U.K.	7.26	43.59	0.01	0.05
United States	9.64	51.74	2.93	15.72

Notes: GDP is gross domestic product and GFCF is gross fixed capital formation. U.S. data for 1990-99; U.K. for 1994-98; and Japan for 1988-97.
Sources: U.S. Census Bureau, *Statistical Abstract of the United States: 1998;* London Stock Exchange; Tokyo Stock Exchange, *Annual Securities Statistics: 1997;* Financial Supervisory Board of South Korea; Monetary Authority of Singapore; NESDB, BOT, SEC and SET.

Moreover, although Thai businesses relied on the domestic market to a growing extent after 1997, capital market utilisation was not well diversified across sectors. A total of thirty business sectors tapped the capital market, but the great majority of funds raised were clustered in only a few sectors. From 1988-2000 only three sectors, financial institutions, construction, and real estate, commanded 67 percent of capital market funds, far more than their 12 percent share of GDP (Table 4.11). At the same time, industry, imports, and exports accounted for only 16 percent of funds, roughly one half their combined 31 percent value added to GDP. The distribution of commercial bank credit did not show such a bias toward the finance, construction, and real estate sectors, but instead showed a profile that corresponded well to GDP composition.

Table 4.11
Allocation of Capital Market Funds and Bank Credit by Sector
(Percent of total funds raised 1998-2000)

	Share of GDP	**Capital Market Funds**	**Bank Credit**
Industries, exports, and imports	31.58	16.85	36.65
Services, consumption, and public utilities	19.96	10.38	22.42
Wholesale and retail trade	16.54	1.98	16.71
Finance, construction, and real estate	12.06	67.34	21.09
Agriculture	10.22	0.00	2.50
Mining	4.12	3.45	0.62
Administration and defence	3.01	0.00	0.00
Housing rental	2.51	0.00	0.00
Total	100.00	100.00	100.00

Note: Composition of GDP at constant prices.
Source: NESDB, SEC, BOT.

Another characteristic is the small number of private companies in Thailand that appear willing to spread their ownership and minimise their cost of funds by financing directly through the capital markets. As of mid-2000 the Stock Exchange of Thailand (SET) listed 383 firms. These listed firms accounted for slightly more than one-fourth of the total capital of Thai companies but only 0.17 percent of the total number of companies (Table 4.12). The vast majority of Thai companies still seem to prefer more expensive indirect financing through financial intermediaries. That was true even among large firms that were eligible to for listing. Of the 3,261 public and limited companies in Thailand that met SET listing requirements—at least 200 million baht paid-up capital and a history of satisfactory profits—only 10 percent were actually listed in the stock market (Table 4.12). The paid-in capital of large listed firms comprised only 40 percent of the total capital of firms eligible for listing (Table 4.12). Most eligible unlisted firms were in manufacturing (22 percent) and property, construction, renting, and business services (24 percent) sectors (Table 4.13).

Table 4.12
Listing Ratios among All Companies and Eligible Companies, by Number and Paid-in Capital, end 1999

	All Public and Limited Companies	Listing-Eligible Companies
Total number of companies	226,060	3,261
Listed on SET	383	346
Listed companies share of total	0.17%	10.6%
Total capital (million baht)	4,982,221.63	3,567,889.2
Listed on SET	1,321,490.96	1,356,470.8
Listed companies share of total	26.52%	38.0%

Note: Companies listed on SET as of 30 June 2000. Listing-eligible companies are companies with at least 200 million baht paid-up capital as of June 2000.
Source: Ministry of Commerce and SET.

Table 13
Number and Capital of Companies Eligible for SET Listing by Sector, end 1999

	Eligible Companies		Capital of Eligible Companies	
	number	%	million baht	%
Manufacturing	668	22.9	571,482	25.8
Property, construction, renting, business services	700	24.0	459,550	20.8
Wholesale, retail trade, auto and motorcycle repair	474	16.3	372,500	16.8
Financial institutions	192	6.6	205,708	9.3
Communication, transportation, storage	73	2.5	77,979	3.5
Hotels and restaurants	99	3.4	48,624	2.2
Entertainment, personal services	49	1.7	42,914	1.9
Energy	30	1.0	36,238	1.6
Healthcare services	70	2.4	29,400	1.3
Agriculture	49	1.7	22,942	1.0
Education	18	0.6	6,916	0.3
Other	493	16.9	337,164	15.2
Total	2,915	100.0	2,211,418	100.0

A crucial unresolved issue among private firms in Thailand concerns corporate governance and transparency. Although proper corporate governance procedures and transparency cannot be implemented or spelled out through explicit rules because they are moral issues, these issues acutely affect the performance of both listed firms and potential listing candidates. Poor governance and inadequate transparency, which can easily generate negative repercussions, are prevalent in Thai businesses, even among some listed companies. They are, to some extent, part of the business culture and they are difficult to rectify by government regulation or supervision, especially in the midst of economic difficulties because unlike money markets, capital markets involve numerous parties.

In terms of capital market instruments, Thailand still relies considerably on equity-related instruments to mobilise funds, in contrast to fund-raising in developed economies which is predominantly through debt. Only 43 percent of funds raised in Thailand's capital market from 1988 to 2000 were debt-related compared to over 80 percent in the United States and Japan and 75 percent in Korea (Table 4.14). That is primarily because Thai bond markets were opened up later than the stock market. Also, the supply of government bonds is limited since the government may only issue them to finance a budget deficit. The debt portion gained momentum in Thailand after the SEC Act went into effect in 1992 and private corporations increased their offerings of straight and convertible bond issues (Table 4.15).

Table 4.14
Equity versus Debt Composition of Capital Market Funds Raised in Selected Economies, 1988-2000
(Percent of total capital mobilised)

	Equity-related	Debt-related
Japan	11.27	88.73
Singapore	49.19	50.81
South Korea	24.91	75.09
Thailand	56.14	43.86
United States	17.72	82.28

Note: US refers to 1990-99; Japan refers to 1988-97. Thailand equity-related funds include common shares, preferred shares, and warrants and debt-related funds include debentures and convertible debentures.
Source: U.S. Census Bureau, *Statistical Abstract of the United States: 1998,* Tokyo Stock Exchange, *Annual Securities Statistics: 1997*, Financial Supervisory Board of South Korea. Monetary Authority of Singapore, BOT, SEC, SET.

Table 4.15
Amount and Share of Funds Tapped in Capital Markets by Type of Instrument, 1988-2000

	1988-1992		1993-1997		1998-2000	
	billion baht	%	billion baht	%	billion baht	%
Equity-related	51.32	90.68	99.93	53.63	168.18	48.94
Debt-related	5.27	9.32	86.40	46.37	175.49	51.06
Total	56.60	100.00	186.33	100.00	343.67	100.00

Source: BOT, SEC and SET.

On the investor side, institutional and high net-worth investors are the overwhelmingly predominant players in the Thai market, commanding over 95 percent of newly issued corporate bonds (Table 4.16). Commercial banks hold over one-third of all government securities, as investments or to satisfy reserve requirements (Table 4.17). The household sector, in contrast, shows less confidence and/or little knowledge about capital market instruments. According to 1993 and 1998 surveys by the central bank, the savings of Thai households went mostly and increasingly to bank deposits, not to equity or to other financial institutions (Table 4.18). The lack of participation by non-institutional investors is a significant factor holding back capital market development in Thailand.

Table 4.16
Investors in Newly Issued Corporate Bonds, 1995 and 1999

	1995		1999	
	Millions of baht	%	Millions of baht	%
Institutional and high net-worth investors	84,103	96.97	314,652	99.62
Domestic	27,214	31.38	287,801	91.12
Foreign	56,889	65.59	26,851	8.50
Retail investors	2,627	3.03	1,206	0.38
Domestic	1,619	1.87	1,201	0.38
Foreign	1,008	1.16	5	0.00
Total	86,730	100.00	315,858	100.00

Source: Securities and Exchange Commission

Table 4.17
Amount and Distribution of Investment in Government Debt Securities by Type of Investor, 1995-2001
(Millions of baht)

	1995	1996	1997	1998	1999	2000	2001
	Million baht						
Bank of Thailand	12,301	20,608	75,232	214,942	153,120	129,101	146,296
Commercial banks	166,303	157,795	136,949	282,475	414,498	446,999	457,466
Government Savings Bank	14,184	24,460	21,838	47,748	148,129	187,761	169,999
Financial institutions	70,763	75,402	41,680	72,023	61,791	60,456	53,368
Insurance companies	6,785	6,511	14,632	31,040	62,198	93,768	126,767
Others	10,909	11,646	17,692	64,805	124,914	201,142	268,208
Total	281,245	296,422	308,024	713,034	964,650	1,119,227	1,222,104
	% of Total Investment in Government Securities						
Bank of Thailand	4.37	6.95	24.42	30.14	15.87	11.53	11.97
Commercial banks	59.13	53.23	44.46	39.62	42.97	39.94	37.43
Government Savings Bank	5.04	8.25	7.09	6.70	15.36	16.78	13.91
Financial institutions	25.16	25.44	13.53	10.10	6.41	5.40	4.37
Insurance companies	2.41	2.20	4.75	4.35	6.45	8.38	10.37
Others	3.88	3.93	5.74	9.09	12.95	17.97	21.95
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Bank of Thailand and calculated by author.

Table 4.18
Composition of Household Savings, 1993 and 1998
(Percent share)

	1993	1998
Deposits	74.9	94.5
Life insurance	18.9	1.4
Equity	1.3	0.3
Provident funds	0.3	2.1
Other	4.6	1.7
Total	100.0	100.0

Source: Survey of the Bank of Thailand, 1993 and 1998.

Furthermore, regulations restrict the capital market activity of some institutional investors. In particular, prudential regulations on non-bank institutional investors affect these institutions' trading activity in the secondary bond market. For example, insurance companies may not hold more than 10 percent of any single company's bonds by value, and their holdings may not exceed 10 percent of their total assets for insurance company bonds and 30 percent of total assets for non-insurance company bonds. Provident funds are limited to investing no more than 5 percent of total funds in a single company's corporate bonds. Finally, mutual funds may not invest more than 5 percent of their total net asset value in any company’s corporate bonds and they may invest at most 15 percent of total net asset value in corporate bonds rated lower than the top four rating agency rankings.

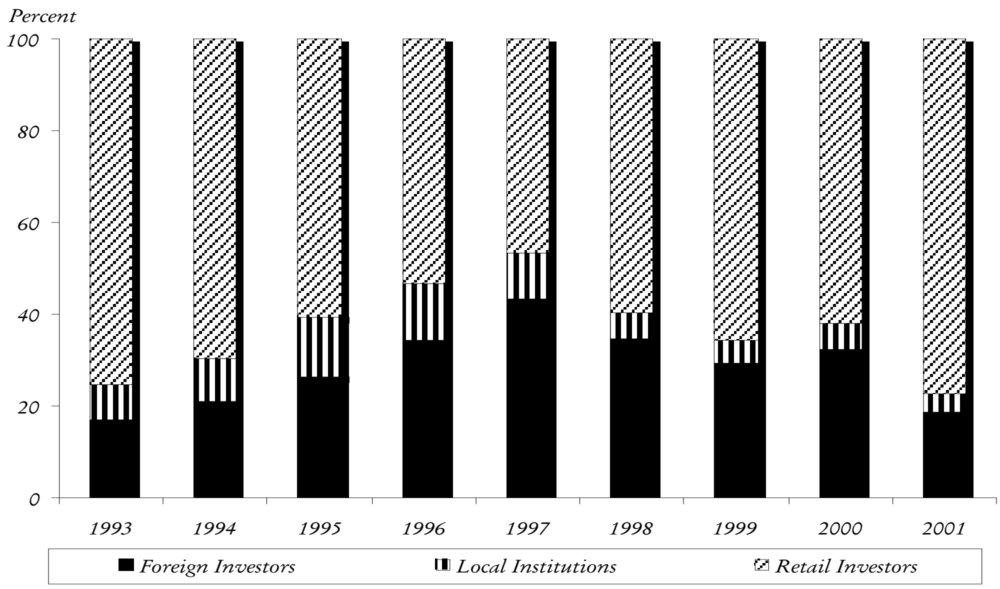
A final characteristic of the Thai capital market is the heavy reliance of the equity market on foreign investors. Foreign investors were responsible for roughly one-third of the turnover value in the Thai stock exchange during the 1990s (Table 4.19 and Figure 4.1). Ever since Thailand opened the capital account in the early 1990s, portfolio moves by foreigners have been a primary determinant of the SET index. The large presence of foreign investors meant that interest rate differentials became a significant stimulant to market activity and so did exchange rate fluctuations together with related factors such as current account status, and foreign exchange reserves. A strong adverse repercussion from such a situation is that it discourages or scares off most local investors, except speculators. Fluctuations of stock market indices in foreign countries had more influence as well. Movements of huge amounts of foreign investment funds also affected the baht exchange rate after the currency was floated in 1997 and fluctuations in the exchange rate in turn affected the real sector. In short, though foreign capital may have strengthened the growth path of Thailand's capital market, it also increased the market's vulnerability to external conditions and shocks.

Table 4.19
Amount and Composition of SET Turnover by Type of Investor, 1993-2001

	1993	1994	1995	1996	1997	1998	1999	2000	2001
	Millions of baht								
Net turnover value									
Foreign investors	52,419	-41,737	47,302	13,377	55,437	30,227	-3,134	-33,068	-6,426
Local institutions	23,928	13,405	-756	-17,056	-22,453	-3,239	-2,872	-948	-538
Retail investors	-76,346	28,332	-46,546	3,680	-32,984	-26,987	6,006	34,016	6,963
	%								
Share of total turnover									
Foreign investors	16.97	20.94	26.33	34.25	43.25	34.62	29.41	32.19	18.62
Local institutions	7.77	9.55	13.07	12.41	9.94	5.64	4.90	5.69	3.95
Retail investors	75.27	69.51	60.60	53.34	46.81	59.75	65.69	62.12	77.43

Note: Data for 2001 are preliminary. Net turnover value = value of purchases - value of sales.
Share of total turnover = (value of purchases + value of sales for investor type/total turnover) * 100.
Source: SET.

Figure 4.1
Composition of SET Turnover Value by Type of Investor



RECENT POLICY MOVES

Towards the end of the 1990s the government began to accept the principle of market discipline. According to this way of thinking, if market forces function efficiently, movements of securities prices will reflect the most relevant data and status of firms. Hence, government should allow and encourage market forces to function freely, so that securities prices can promptly signal any emerging problems to both regulators and firm owners.

Based on this new point of view Thai authorities took a number of policy actions to improve the functioning of the capital market. From 1997, the SEC allowed investors to conduct short selling and securities lending. Short selling provides investors an opportunity to make profits when the market goes down, whereas securities lending is meant to support short selling activities. In June 1999, recognising the fact that many Thai businesses are small, the SET established the "Market for Alternative Investment," or MAI, to attract small- and medium-sized enterprises (SMEs). The MAI follows the same trading and settlement procedures and trading hours as the main market, but the minimum paid-up capital to list on the MAI is only 40 million baht compared to 200 million baht for listing on the main market. As further incentive for SMEs to utilise the capital market, the corporate income tax rate for companies listed on the MAI is only 20 percent, compared to 25 percent for firms listed on SET, and 30 percent for non-listed companies.

Among the actions taken since 1999 are the following:

- The government authorised the organisation of inter-dealer brokers in 2000 in order to enhance liquidity and facilitate transactions in the secondary debt market.
- The SET modified the listing criteria in June 2000 to make them more flexible. In place of the requirement that a prospective company have no accumulated losses, it allowed prospective companies to qualify under one of three criteria: net profit of at least 30 million baht in the pre-listing year, sales revenues of at least 2 million baht in the pre-listing year, or market capitalisation of at least 1.5 billion baht.
- SET replaced its cheque payment and electronic book entry delivery and clearing system with a delivery-versus-payment system in September 2000. Under the new system clearing members, which are custodian banks, can make or receive payments directly to Thailand Securities Depository through the Bank of Thailand's BAHTNET system.
- Brokerage commission fees were liberalised in October 2000 to stimulate competition and provide investors with more alternatives, with commission rates varying in accordance with the services provided.
- The authorities co-ordinated efforts to expedite privatisation of some state enterprises such as electricity power plants, the petroleum authority, and Thai

Airways in order to upgrade the quality of securities available to investors in the market. At the end of 2000 Ratchaburi Electric Power Plant became the first such privatised enterprise to list on the SET.

- To cultivate investors, in 2000, the SEC set up a capital market information centre where investors can gather information before making their investment decisions. The SEC promotes various activities to provide information access, education and training, and investor protection. The agency has also developed a capital market information website.
- In January 2001 the SET launched regulations for Internet trading, under which securities companies with computer support and information security systems may be permitted to offer Internet trading services to their customers. Afterwards, the SET organised a new company called SETTRADE.COM, which provides Internet trading services for securities companies in order to promote Internet trading and to reduce risk and investment expenses for securities houses.
- Fitch Ratings was approved in February 2001 as the country's second credit rating agency. This addition addresses investors' need for credit rating information to help them assess risks and returns with greater accuracy and confidence.
- Commencing March 2001, the SEC began easing the application process for companies that have won promotion from the Office of the Board of Investment In order to encourage listing of private companies.
- Along with other liberalisation measures, in March 2001 the SEC permitted securities companies to expand their scope of businesses to include life insurance broking, back office service provision, computer vending, and mutual fund business via subsidiaries.
- Some mutual funds such as the Thai Trust Fund were established in 1997 to enable foreigners to invest in companies that had reached the allowable limit on foreign shareholding. Similarly, in mid-2001 a non-voting depository receipt (NVDR) was introduced as a new type of security. Holders of NVDRs have all the same rights as shareholders except the vote.
- Foreseeing the importance of long-term savings as a shock absorber for the economy, in the last quarter of 2001 the SEC established retirement mutual funds (RMFs) as a vehicle to encourage long-term savings for retirement. RMFs are eligible for tax privileges similar to those for provident funds if savers satisfy certain conditions such as a five-year investment history and no redemption until the owner reaches age 55.

CONCLUDING REMARKS

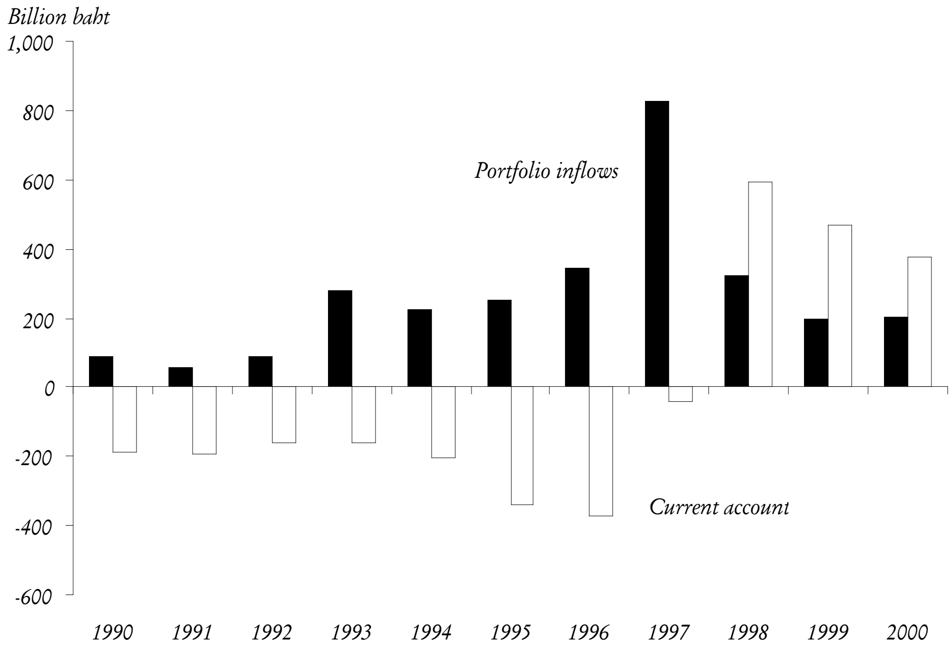
Statistics and stories from the decade of the 1990s suggest that Thailand's capital markets performed satisfactorily. The volume of debt securities issued by the public and private sectors (Table 3), the turnover value of foreign investment (Table 19), and the recent series of liberalisation measures all point in the direction of a well-developing capital market. Upon closer scrutiny, however, several factors appear that may limit or constrain the future development of the capital market.

In the public sector, stringent rules on government borrowing create uncertainties in bond issuance, debt rollover, maturity profile, benchmark yield curve, and actual use of funds. The government cannot issue bonds for purposes such as allocating, channelling, or lubricating capital flows, only for financing a deficit. Moreover, the reserve requirements that the government imposes on financial institutions leave lenders and investors in the general public and the secondary markets with fewer government securities to trade. Worse yet, the implementation of monetary policy in the official repurchase market further distorts genuine market forces.

In the private sector, there are several areas of concern as well. First, even though the SEC Act of 1992 allows limited and not necessarily public companies to issue corporate bonds, only large, leading firms actually did so. One reason is probably that corporate bonds tend to be a costly source of funds unless the size of the issue is large enough. In addition, to issue bonds a company also needs an adequate credit rating, which excludes the more than 90 percent of Thai businesses that are SMEs from becoming issuers. At the same time, very few SMEs utilised MAI, the market set up exclusively for smaller firms. This carries the worrying implication that perhaps Thai corporate culture does not favour listing or public ownership, or that family connections are too strong. Another concern is the prudential restrictions imposed on corporate bond investment and trading in the secondary market by insurance companies, provident funds, and mutual funds. Institutional investors such as these play a far larger role than households do in furthering the development of an economy's capital markets.

While foreign capital is an alternative source of stimulus in the market, it could make the market excessively volatile for several reasons. First, foreign investors bring an additional and unnecessary degree of market fluctuation because they tend to diversify their portfolios among various countries and when a shock occurs in one country, they move investments to other countries to cover their losses or positions. Second, foreigners tend to be naive and sensitive because ordinarily they are less well acquainted with domestic corporations and the local situation. Most threatening to Thailand is the large volume of transactions by foreign investors. For example, aggregate portfolio investment inflows to Thailand are quite large compared with the current account balance (Figure 4.2). Hence, in the current flexible exchange rate regime, foreigners' investment decisions affect both stock market sentiment and the exchange rate, which have powerful repercussions on both the real and financial sectors of Thailand's economy.

Figure 4.2
Portfolio Investment Inflows vs. Current Account, 1990-2000



Like foreign investment capital, financial liberalisation can be a double-edged sword. On one hand, greater freedom to undertake new businesses may mean more income and growth for domestic securities firms and banks and improved consumer welfare through heightened competition. On the other hand, liberalisation may threaten domestic firms that are not prepared to handle the higher level of risk that it brings. Securities firms and commercial banks need adequate experience and expertise to handle large, volatile transactions without becoming over-exposed. The experience of financial bubble and ultimately crisis following Thailand's liberalisation of the early 1990s is a sorrowful lesson about the need for proper timing of liberalisation of immature commercial banks and finance companies. Altogether, foreign investment in and liberalisation of domestic securities business may accelerate the pace of capital market development in Thailand. Nevertheless, we must be mindful that they also increase the market's vulnerability or susceptibility to dangers or shocks, especially when local agents are not well prepared.

Liberalisation immediately leads to controversial issues about regulation. Different sectors deserve different rules, and so do different objectives. Before authorities implement any rule they should explicitly spell out and rank its target sectors and objectives. Moreover, a sector or objective that has top priority at one time may not deserve the top rank at another time. That is, authorities should also take the time dimension into consideration. Regulations of different sectors and agents should also be optimally co-ordinated so that neither loopholes nor biases arise with respect to certain groups or agencies.

Corporate culture is another consideration in the development of Thailand's capital market. Rules or regulations acceptable in some cultures or countries may not be compatible with conditions in other cultures or countries. The authorities cannot simply adopt rules and regulations from other places wholesale: they need to modify them to suit domestic business and corporate culture. For example, SMEs, which typify Southeast Asian businesses, are reluctant to use capital market financing because they hesitate to publicise their ownership and debts in order to tap needed funds. To accommodate SMEs' preference to work within a narrow circle in the same profession or community, Thai authorities might encourage SMEs to form a kind of co-operative that would gain a capital market listing based on the aggregate performance of the individual members. By designing listing or issuance criteria appropriately, it should be possible to recycle funds to SMEs via the domestic capital market in a way that would be compatible with SMEs preferences and at the same time be sufficiently productive and stable to satisfy investors.

In summary, the prevalence of SMEs, the large volume of foreign portfolio investment, and the liberalisation of the domestic securities business constrain Thai central authorities in regulating the capital market. Imposing stringent entry rules to protect the stability and safety of the capital market will deter participation by SMEs and foreign investors, which would severely limit the future development of the capital market. On the other hand, making entry rules too loose could give rise to securities company failures and rapid, wild market fluctuations. Therefore, the government has to be extremely careful in choosing the optimal blend of regulations along the path of capital market development.

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