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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION

REPORT AND RECOMMENDATIONS

OF THE

PRESIDENT

TO THE

EXECUTIVE DIRECTORS

OF THE BANK

AND TO THE BOARD

OF THE CORPORATION

ON A

PROPOSED LOAN BY THE BANK TO,

AND INVESTMENT BY THE CORPORATION IN,

THE INDUSTRIAL FINANCE CORPORATION OF THAILAND

February 28, 1964

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

INTERNATIONAL FINANCE
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CORPORATION ON A PROPOSED LOAN BY THE
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1. I submit the following report and recommendations with respect to a proposed Bank loan, in various currencies amounting to US\$ 2.5 million, to the Industrial Finance Corporation of Thailand (IFCT), under the guarantee of the Government of Thailand, and a proposed IFC investment of ~~1~~4 million (about US\$ 192,000) in the Ordinary Shares of IFCT.

PART I - BACKGROUND

2. A review of the organization and operations of the Industrial Finance Corporation of Thailand (IFCT), which had been incorporated in 1959, was requested by the Government late in 1961. From this review, the Bank and IFC developed recommendations to the Government and IFCT for measures to reorganize IFCT, to strengthen its management and to increase its capital. Subsequently, requests were made for financial assistance from the Bank and IFC to supplement its resources in accordance with the recommended financing plan. Several missions visited Thailand, in the first place to lay out the steps necessary to reorganize IFCT and then to assess the progress made in carrying them out. An Appraisal Report, dated February 12, 1964 is attached (p. 1).

3. The proposed loan and investment were negotiated by a delegation headed by H.E. Sukich Nammanheminda, the Thai Ambassador in Washington, and Nai Yom Tantsetthi, General Manager of the Industrial Finance Corporation of Thailand. Negotiations were completed on December 5, 1963.

4. If the proposed loan is made, it will be the 12th loan in Thailand, and will increase the total amount lent by the Bank to \$ 174 million, net of cancellations. The status on **January 31, 1964** of loans previously made was as follows:

Year of loan	Borrower	Purpose	Amount (equivalent in \$ million)
1950	Kingdom of Thailand	Railway Rehabilitation	3.00
1950	Kingdom of Thailand	Irrigation	18.00
1950	Kingdom of Thailand	Port Improvement	4.40
1955	State Railway of Thailand	Railway Rehabilitation	12.00
1956	Port Authority of Thailand	Port Improvement	3.26
1957	Yanhee Electricity Authority	Hydro-electric power	66.00
1961	State Railway of Thailand	Railway Rehabilitation	14.60
1962	Kingdom of Thailand	Petchburi Irrigation	3.40
1962	Kingdom of Thailand	Third Chao Phya Irrigation	5.60
1963	Yanhee Electricity Authority	Second Yanhee Project	6.60
1963	Kingdom of Thailand	National Highways Project	<u>35.00</u>
Total net of cancellations and refundings of which has been repaid			171.86 <u>20.03</u>
Total now outstanding			151.83
Amount sold			\$8.85
of which has been repaid			<u>\$2.55</u>
Net amount now held by Bank			145.53

5. Of the total loaned to Thailand \$64.0 million has not yet been disbursed. However, the Bank has entered into agreements to reimburse commercial banks \$8.6 million for payments to be made out of letters of credit, leaving a net amount of \$55.4 million not yet disbursed or committed. Initially there was considerable delay in arranging contracts concerning the 1961 Railway Rehabilitation Loan, but contracts to commit most of the loan are now being arranged. Otherwise disbursements are generally in accordance with expectations.

6. No IDA credits have been made in Thailand.

7. The proposed investment would be the second by IFC in Thailand. The first was a loan in 1959 of \$300,000 to The Concrete Products and Aggregate Company, Ltd. (CEPAC). This loan was sold in 1961 to Siam Cement Company, Ltd., CEPAC's parent company, at a price 4% above face value.

PART II - DESCRIPTION OF THE PROPOSED LOAN AND INVESTMENT

8. Purpose: To augment the resources of IFCT so as to enable it to make an increasing and more effective contribution to the financing of private industry in Thailand.

Bank Loan

- Amount: The equivalent of US\$ 2.5 million in various currencies.
- Guarantor: The Kingdom of Thailand.
- Interest, including Commission: To be determined for each part of the Loan when credited to the Loan Account in respect of a particular project.
- Commitment Charge: 3/4 of 1% per annum.
- Term: Each part of the Loan to be repayable over a term suited to the project or projects, but not to exceed 15 years from the date the Loan Account is credited.
- Repayment: By semi-annual payments on April 1 and October 1.

IFC Investment

- Amount and Form: 4,000 Ordinary Shares of IFCT of ~~1~~1,000 par value each, to be subscribed and purchased at par and paid in full at the time of subscription and purchase.

PART III - THE INDUSTRIAL FINANCE CORPORATION OF THAILAND

9. With advice from the Bank and the United States Government, and with financial assistance from the Governments of Thailand and of the United States, IFCT was established in 1959. Although established by statute, IFCT is organized as a private corporation whose shareholders are financial institutions and individuals. It was set up primarily to assist in the establishment, expansion and modernization of private industrial enterprises, and to encourage the participation of private capital, both internal and external in such enterprises.

10. IFCT's early operations were affected by the usual difficulties of setting up a new institution with untrained staff and by the problems normally faced in introducing modern investment criteria and business practices in an economy at an early stage of industrial growth. These difficulties were accentuated by the death of Prince Vivat, IFCT's sponsor and first Chairman, a few months after its opening. IFCT was also restricted by a desire to move cautiously while building up staff and procedures. In its first two years, IFCT made only 10 investments, committed half its resources and developed a reputation for waiting rather than acting energetically in the development of investment business. In the course of 1961 the Government asked for Bank help in correcting the drift in IFCT's affairs.

11. In July 1962, the Bank and IFC, having sent a mission to Thailand, concluded that the prospects in light manufacturing industries were good and that there would be substantial scope for an IFCT equipped to provide long-term finance and technical and managerial help. A series of measures were recommended to reorganize and expand IFCT. These included:

- (a) enlargement of its financial resources in order to enable it to make a greater contribution to the establishment, expansion and modernization of private industrial enterprise in Thailand;
- (b) provision of a capital structure to give adequate leverage to the share capital and to provide the prospect, in due course, of a reasonable dividend on shares along with a conservative reserve policy, and thus to give promise of a financially sound institution capable of attracting investors and borrowing from conventional sources on its own credit;
- (c) strengthening of IFCT's staff and organization in order to enable it better to appraise and follow up loan projects and to make sound investment decisions.

These proposals were agreed by the Government and IFCT and considerable progress has already been made in carrying them out.

12. Since October 1962 IFCT's resources have increased from $\text{฿}34.2$ million (US\$ 1.7 million) to the present level of about $\text{฿}65.5$ million (US\$ 3.2 million) as the result of an additional subordinated loan from the Government and of new subscriptions to shares. Plans now in process of completion will increase this total to about $\text{฿}190$ million (US\$ 9.5 million), partly by the issue of additional shares and partly by borrowing on conventional terms from the Kreditanstalt für Wiederaufbau and, if the loan is approved, from the Bank. The loan agreement with the Kreditanstalt was signed on December 20, 1963. Excluding reserves, which totalled $\text{฿}2.35$ million at the end of 1962, IFCT's resources will have developed on the completion of the share issue and loan negotiations as follows:

	<u>Oct. 1962</u>	<u>Late 1963</u> (Baht millions)	<u>Proposed</u>
Share capital			
Thai-owned	4.1	14.7	13.9
Foreign-owned	2.0	2.7	12.1
IFC	-	-	4.0
Sub-total	<u>6.1</u>	<u>17.4</u>	<u>30.0</u>
Loans			
Subordinated Government loans	28.1	48.1	48.1
Conventional debt			
World Bank	-	-	52.0
Kreditanstalt	-	-	57.2
Sub-total	<u>28.1</u>	<u>48.1</u>	<u>157.3</u>
Total	34.2	65.5	187.3

13. The new share issue is to be subscribed by IFC and by foreign private investors, both new shareholders attracted by the participation of IFC and existing shareholders who will increase their present holding. Ten important financial institutions (American, British, German and Japanese) have indicated their intention to take major positions in IFCT. As the requests for subscriptions far exceed the number of shares to be subscribed, the amounts allotted to private investors will have to be reduced. The full amounts requested could have been allotted only if the total share capital were increased, but in this event foreign investors would have been in a majority position.

14. At present seven directors form the Board responsible for the direction of IFCT. The Regulations have been amended to increase the Board to nine directors. One would continue to be appointed by the Government so long as any loan by the Government, or guarantee of IFCT's external borrowing, remains in force; the remaining eight directors would be elected by the shareholders, the regulations providing that any shareholder or group of shareholders holding 12-1/2% of the shares can secure the election of one director. It is expected that the shareholders' directors will comprise four representatives of Thai shareholders, three members nominated by foreign investors, who will hold about 40% of the shares, and one member nominated by IFC (see paragraph 23 below).

15. The present General Manager, appointed in May 1962, has increased the effectiveness of IFCT. For reasons of health he will shortly retire. A successor, who has had training abroad in business, finance and administration and has had good banking and business experience in Thailand, has been appointed. One of the basic problems still facing IFCT is the development of an adequate and competent staff. On the recommendation of the Bank and IFC an adviser has been retained for two years, beginning January 1, 1964. He will advise the management on general matters relating to policy, operations and administration, and will give particular attention to staff development.

16. A statement of IFCT's principal operating policies was approved by its Board on November 15, 1962. That statement was revised during recent negotiations. The new text, recently approved by IFCT's Board, appears as Annex 4 of the Appraisal Report (No. 1).

17. The statement provides that IFCT will finance only soundly managed undertakings and that its financial assistance may be provided in a number of ways including equity participations as well as loans. IFCT will observe prudent restrictions as to its equity participations and the size of its commitments to particular enterprises. The policy statement commits IFCT to a conservative reserve policy and restricts borrowing on conventional terms to not more than three times the sum of its equity and subordinated debt. IFCT will not take the exchange risk on its borrowings from abroad. With respect to this last provision it may be noted that IFCT will attempt to pass the exchange risk to those who borrow from it, but to cover cases where this is not possible, the Government, under an agreement already entered into with IFCT, will take the exchange risk for a nominal fee.

18. By September 30, 1963, IFCT had a portfolio of ¥29.3 million (US\$ 1.4 million) and commitments amounting to ¥7.1 million (US\$ 0.34 million). It has operated at a profit since it was set up. The net earnings reflect, to a large extent, the effect of the subsidy provided by interest free loans from the Government. Audited net profits amounted to ¥1.1 million in 1961 and 1962, and unaudited figures for the first nine months of 1963 show a net profit of ¥1.5 million. In 1963 IFCT declared its first dividend: a 5% stock dividend.

19. IFCT's short history does not provide a firm basis for projections of its business, but I believe its prospects are good. The scale of its operations has increased substantially since reorganization began in May 1962, and the arrangements agreed upon make it reasonable to expect that IFCT's operations will be guided by competent management and carried out by better trained staff. Given the good prospects for continued growth of Thailand's manufacturing sector and IFCT's intention to offer lower interest rates on its foreign currency loans, it is not unreasonable to expect the annual rate of commitment to rise from about ¥25 million to possibly ¥40-50 million over the next few years, so as to commit IFCT's prospective resources in about four years. It is expected that after provision for staff expansion, profits will be sufficient to allow for a prudent accumulation of reserves and a reasonable dividend on share capital.

PART IV - THE PROPOSED IFC INVESTMENT

20. IFC would acquire, at par, 4,000 Ordinary Shares of IFCT, of ¥1,000 par value each, making a total of about US\$ 192,000. The shares would be paid for in full at the time of acquisition. As the shares are not actively traded, a market quotation is not available, but when the share capital is increased to ¥30 million the book value should be slightly above the par value.

21. Only 12,603 new shares are available for distribution. Hence only 8,603 could be subscribed by foreign investors if IFC were to subscribe 4,000. The pattern of ownership resulting from that subscription would make it difficult for the foreign investors to divide themselves into three groups each holding the minimum 12-1/2% of the shares necessary to assure one Board seat for each group and three for the foreign investors as a whole. Arrangements are therefore being made for a sale of around 825 shares now owned by the Agricultural Bank, a government-controlled institution which is now IFCT's largest shareholder. This proposed transfer is reflected in the table on page 5. The Agricultural Bank wishes to sell its shares to private investors as soon as it can, and it is ready now to sell up to 1,512 shares (which would still leave it with a seat on the Board). However, sale of so large a number to foreign investors would endanger the pre-agreed distribution of Board seats as between Thais and non-Thais. The proposed sale of 825 shares by the Agricultural Bank would materially facilitate the grouping of foreign shareholders and, at the same time, would not endanger the Thai majority position.

22. The 825 Agricultural Bank shares could be sold to the private foreign investors while the IFC took up new shares. However, it is simpler for the IFC to buy them, allowing all the private foreign investors to be dealt with in the same way, and the result is the same. The Agricultural Bank wishes to charge a price which would take into account the dividend it would forego for the period from January 1, 1964, until the date of the sale, but the IFC has proposed that the Agricultural Bank as a government institution should forego this very small sum or, alternatively, it should be paid by IFCT as part of the cost of financing its reorganization. Accordingly, IFC would acquire the total 4,000 shares at par, approximately 3,175 by subscription and the rest by purchase.

23. IFC's shareholding would amount to 13-1/3% of the share capital. The right of any shareholder or group of shareholders to nominate one director for each 12-1/2% of the share capital held, up to a maximum of three directors, will allow IFC to nominate one director, if it chooses to do so. The Government and IFCT wish IFC to take a seat on the Board. The ability to obtain the required additional foreign subscriptions from a diversified group of investors, which is necessary for IFCT's recapitalization program, has depended on the enlargement of the Board and on IFC's willingness to be on it. Moreover, Board membership will tighten the association between IFC and IFCT and facilitate the provision of the technical help which IFCT needs. In the circumstances, I believe an IFC Director would serve an important and constructive purpose, and I therefore propose to nominate one.

24. Thai institutions and individuals will hold about 46% of the planned share capital, but it is intended that foreign shareholders should be in a minority position. The Government and IFCT have stated that they do not consider IFC a foreign investor for this purpose. Other foreign investors will hold about 40% of the share capital. It is understood that IFC will not sell its shares to non-Thais if, as a result of such sale, a majority of the shares would be foreign-held.

25. Transfers of shares must be approved by IFCT's Board of Directors. The Regulations as they have been revised will give the Board power to refuse a transfer only to prevent any single shareholder or group of affiliated shareholders from obtaining effective control of IFCT or a majority of the shares passing to non-Thai ownership.

PART V - APPRAISAL OF THE PROPOSED LOAN

Justification of the Project

26. Industrial output and investment have expanded in Thailand in recent years. This development has been encouraged by a satisfactory rate of economic growth and by political stability. In addition, the Government has provided direct incentives, such as tax and tariff concessions, and tariff protection where appropriate. It is expected that the manufacturing sector will continue to grow. Industries ancillary to agricultural and forestry production and enterprises producing goods now being imported are likely to increase.

27. The demand for industrial finance could be considerable. At present, finance for industry is usually obtained from commercial banks in the form of short-term loans which are successively renewed. The Government has proposals under consideration for assistance to small enterprises, but other entrepreneurs have little alternative if they do not wish to borrow for a short period at the high rates of interest which are current. The average entrepreneur also finds that equity capital and underwriting services are very hard to obtain.

28. IFCT is designed to fill this gap in the provision of medium- and long-term loans, equity capital and other services. There is no other substantial institutional source of medium- and long-term capital in Thailand. IFCT, with increased resources, experienced management and better trained staff, should be able to play a more effective part than hitherto in the growth of the manufacturing sector and the diversification of the economy.

Economic Situation

29. A report entitled "Current Economic Position and Prospects of Thailand" (FE-32a) was circulated to the Executive Directors on October 29, 1963 (R63-127).

30. In the past five years, Thailand has achieved an average growth rate in real output of around 6%. A boom in exports has been a major factor in this growth, but it now seems probable that exports will increase slowly over the next few years, and that this will lead to a slowdown in the growth rate of total income. Fixed investment has risen in recent years to around 17% of GNP and national savings to about the same rate. Public sector investment has risen especially fast and further substantial increases are being planned.

31. Manufacturing has also shown accelerated expansion in the past few years. There is evidence of a rate of increase much faster than the overall growth rate of 6%, and an average growth rate of manufacturing of 8-10% over the next five years is considered a reasonable estimate. This can be expected to increase the need for capital and services to foster industrial development.

32. With export growth likely to be slower, and imports rising in response to increased investment expenditures, it seems probable that Thailand's external position will soon become much tighter. Exchange reserves are nearly equivalent to the cost of a year's imports, so that Thailand can afford some drawdown in its reserves, and can also afford to increase its external debt.

33. Thailand's present foreign debt amounts to \$292 million with a peak debt service in 1966 of about 6% of prospective export earnings. Thailand will be well able to service the proposed loan and all other public external debt at present envisaged.

PART VI - LEGAL INSTRUMENTS AND LEGAL AUTHORITY

34. The following draft documents are attached:

- (a) Loan Agreement between the Bank and IFCT (No. 2);
- (b) Guarantee Agreement between the Kingdom of Thailand and the Bank (No. 3);
- (c) Subscription Letter between IFC and IFCT (No. 4).

35. Also attached is the Report of the Committee provided for in Article III, Section 4(iii) of the Articles of Agreement of the Bank (No. 5).

36. The provisions of the Loan Agreement give the Bank substantially the same rights as it normally obtains when lending to industrial finance companies. Under Section 3.02 (b) IFCT would be allowed to make loans out of the Bank loan up to \$50,000 without the Bank's prior approval up to a total amount of \$500,000.

37. The Guarantee Agreement follows the usual pattern.

38. The proposed loan and investment would not become effective until the present share issue has been fully subscribed, so that the equity, including IFC participation, is increased to \$30 million. The investment would not become effective until the Bank loan had become effective.

PART VII - COMPLIANCE WITH THE ARTICLES OF AGREEMENT

39. I am satisfied that the proposed Bank loan complies with the requirements of the Articles of Agreement of the Bank and that the proposed investment by IFC complies with the requirements of the Articles of Agreement of IFC. The Government of Thailand has advised IFC that it has no objection to the proposed investment by IFC.

PART VIII - RECOMMENDATIONS

40.

I recommend:

- (a) that the Bank make a loan to the Industrial Finance Corporation of Thailand, with the guarantee of the Kingdom of Thailand, in an amount in various currencies equivalent to \$2.5 million, at such rates of interest and substantially on such other terms and subject to such other conditions as are specified in the draft Loan and Guarantee Agreements attached, and that the Bank's Executive Directors adopt a resolution to that effect in the form of the draft resolution attached (No. 6);
- (b) that the proposed IFC acquisition of 4,000 of IFCT's Ordinary Shares, in the amount of $\frac{1}{4}$ million, be approved on substantially the terms outlined above, conditional upon legal arrangements satisfactory in form and substance to IFC's management, and that the Board of Directors of IFC adopt a resolution in the form attached (No. 7).

George D. Woods
President

Washington, D.C.
February 28, 1964