

The Development of Commercial Banking and Financial Businesses in the Provinces of Thailand

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I Introduction

This paper will discuss indigenous financial businesses in the provinces of Thailand that were built up by Chinese entrepreneurs. I will argue that although commercial banking in Thailand was started by people in Bangkok who were involved in the export of rice, some of these indigenous financial businesses matured sufficiently to have developed into commercial banks. Despite this potential, Chinese merchants who came to have the desire to establish local (or regional) banks in the provinces faced strong opposition from the government, which prevented the establishment of a single local bank. This paper argues that local banks would have enjoyed several advantages over large-scale banks in Bangkok, and that, if we accept that competition in the financial sector is a good thing and that it is desirable for the Thai economy to be more decentralized, then the monetary authorities should have been more responsive to those local entrepreneurs who were eager to exercise their entrepreneurship in commercial banking. Local banks could well have contributed greatly to economic development in the provinces, where the demand for credit was ill filled.

II The Formation of Commercial Banking in Thailand

II-1. The Birth of Commercial Banks in Thailand : A Close Relationship with Export Trade

Generally speaking, financing the export of agricultural and primary products gave birth to commercial banking in developing countries. In these countries, the development of early commercial banking was intimately related with the export and import trade, and banking industries were developed by foreign banks within the confines of port cities and other commercial centers [IBRD 1989 : 47 ; Viksnins 1980 : 7].

Thailand was not an exception. The expansion of trade after the Bowring Treaty, which marked the opening of Thailand to the world market in 1855, gave birth to commercial banks in Thailand [Krirkkiat 1986 : (8-1) ; Phannii 1986 : 254]. Commercial banks originally started as agents, and then developed into branch offices, of European banks.

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These were established in Bangkok and were closely related with trading [Rozentel 1970 : 104]. During the 1860s, within roughly a decade of the Bowring Treaty, two British banks in the East, the Hongkong and Shanghai Banking Corporation and the Chartered Bank of India, Australia and China, appointed agents in Bangkok [Collis 1965 : 90 ; King 1988 : 130 ; Mackenzie 1954 : 195]. The first branch of a European bank was established in Bangkok by the Hongkong and Shanghai Banking Corporation in 1888, and the second one was opened in 1894 by the Chartered Bank.

During the first few decades after these European banks opened branches in Bangkok their main business concerned the purchase from the Chinese rice millers in Bangkok of dollar bills drawn against shipments to Hong Kong and the Straits [Collis 1965 : 92 ; Mackenzie 1954 : 196]. Between 1888 and 1941, most of the banks were engaged in financing the movement of crops, especially rice, from the provinces to Bangkok and from Bangkok to foreign markets [Paul Sithi-Amnuai 1964 : 38].

From 1888, when the first bank was established in Bangkok, to 1941, commercial banking in Thailand was generally controlled by foreigners [*ibid.* : 33]. During this pre-1941 era, many commercial banks were established by Chinese merchants in Thailand with the backing of rice exporters and rice millers. However, most of these faced management problems and were forced out of the market [Krirkkiat 1986 : (2-10)-(2-11) ; Noppaphorn 1989 : 9].

II-2. The Period of Formation of Thai Banks : 1941-1950

Paul Sithi-Amnuai [1964 : 163] points out that the decade between 1941 and 1950 was "a period of formation of the Thai banks." This was partly due to the fact that during the Second World War, when Thailand became an ally of Japan, the Thai authorities confiscated the branches of five Western banks [Krirkkiat 1986 : (2-15)-(2-16)]. The Thai government, at the same time, encouraged native Thais to establish commercial banks in place of foreigners. During the period from 1941 to 1945, five new Thai banks were founded, each with a small amount of capital, by merchants [*ibid.* : (2-17) ; Phannii 1986 : 54, 57]. Chinese merchants who had been compradores of foreign banks were also involved in setting up these Thai banks [Noppaphorn 1989 : 49].

A postwar boom in exporting intensified the competition in the banking sector. Another five Thai banks were established by 1950, enticed "by the large profits to be made in financing the booming postwar export trade" [Rozentel 1970 : 105]. Several Western banks, which resumed operations after the war, also contributed to heating up the competition.

III Financial Businessmen in the Provinces

III-1. Entrepreneurs in the Provinces in the Period of the Formation of Thai Banks

It should be noted that entrepreneurs of the provinces contributed to a certain degree to the

formation of commercial banks in Bangkok during the period between 1941 and 1950. Entrepreneurs engaged in the tin and rubber industries of the South were involved in the establishment and management of Thai banks which were established in the middle of the postwar boom in exports of raw materials such as rubber and tin.¹⁾

The reason why local entrepreneurs in the South, rather than the Northeast or the North, participated in the establishment of Thai banks is because Chinese entrepreneurs in the South were able to grow sufficiently through exporting tin and rubber, especially during the immediate postwar export boom, to invest in the commercial banking sector.

As described above, the birth of commercial banking in Thailand was intimately connected with export trade in particular. For many decades after the Bowring Treaty, between 80 and 90 percent of total exports consisted of the four primary products ; rice, tin, teak and (later) rubber [Ingram 1971 : 93-94]. Of these commodities, rice, which represented between 50 and 70 percent of exports, was the most significant. Not only was Bangkok located in Central Thailand, the major rice-producing region, but Bangkok Port was the dominant port and trading center of the country. According to Suehiro's estimation [1989a : 222-223], more than 90 percent of exports from Thailand were shipped from Bangkok Port during the period between 1895 and 1923. This is why early commercial banking in Thailand was started and managed exclusively in Bangkok, and merchants of rice-related industries played an important role in the development of banking.

The South produced tin and rubber for export and, for about three decades after 1920, these accounted for between 10 and 30 percent of total exports. Tin, at least until the 1930s, was the second most important export product after rice [Ingram 1971 : 94 ; Phuangthip 1991 : 205]. Tin mining in the South was developed, after 1855, by local Chinese entrepreneurs, some of whom were tax-farmers there, although after the turn of the century an invasion of Westerners marked the tin industry of the South [Phuangthip 1991 : 209-214]. On the other hand, "Western capital and entrepreneurship have not played an important part [Ingram 1971 : 103]" in the rubber industry, which increased in importance in the total amount of exports particularly after the mid-1930s, because of a government policy to prevent foreign participation in this sector. During the early years of rubber planting, the Thai government was opposed to the introduction of foreign capital and foreign labor to this industry. As a result, the rubber trade was almost completely left in the hands of Chinese merchants [*ibid.*: 104 ; Donner 1978 : 481-482]. Therefore, the South had industries through which local Chinese entrepreneurs could grow, and some of these entrepreneurs were involved in giving birth to banking in Thailand.

1) The Laem Thong Bank (established in 1948) had a prominent tin businessman of Cangwat Phangnga (Cutti Bunsuung) on the first board of directors, the Agricultural Bank (1950) was joined by an important tin businessman and another rubber trader of Cangwat Phuket as directors, and the Bangkok Metropolitan Bank (1950) had a big businessman who managed rubber trading and several other businesses in Cangwat Nakhon Si Thammarat and Surat Thani as a shareholder [Phannii 1986 : 95-98 ; Phuangthip 1991 : 211].

However, the contribution which these Southern entrepreneurs made to the formation of Thai banks was limited. This was because the financing of tin and rubber exports was dominantly arranged in bank offices in Penang. Almost all Thai-produced tin was shipped, in the form of ore, to the smelters in Penang and Singapore, from where it was then exported to Europe [Phuangthip 1991 : 162-163]. More than 90 percent of rubber exports were shipped from Southern ports, such as Phuket and Nakhon Si Thammarat, in the 1920s and 1930s [Sompop 1989 : 110]. As might be expected from this, exporting finance of tin and rubber was managed by the Chartered Bank and the Hongkong and Shanghai Banking Corporation in Penang [King 1988 : 129 ; Phuangthip 1991 : 177-178]. In 1909, the former bank established a branch in Phuket "for business, most of it consisting of cashing the dollar cheques drawn on Penang by the dredging companies" [Mackenzie 1954 : 217]. This Phuket branch was set up as a branch of the Penang office when foreign trade expanded [Phuangthip 1991 : 177-178]. Therefore, exports of tin and rubber were exclusively connected with the economy of the British Straits Settlements, not with that of Bangkok, and the tin mining and rubber industries in the South did not induce local entrepreneurs to set up local banks in the South. As a whole, it contributed far less than the rice industry in Bangkok to the formation of Thai commercial banking.

The North produced teak, one of the four major export commodities, but the least important among them after the middle of the 19th century. In general, European firms have controlled the teak industry, particularly its export trade [Ingram 1971 : 105-107 ; Plaiao 1987 : 7 ; Sompop 1989 : 127-128]. Teak was exported both through Bangkok Port, and through an inland transportation route running from North Thailand to ports in Burma. However, Bangkok Port exported a much larger amount of teak than the latter [Suehiro 1989a : 222-223]. Plaiao [1987 : 33] argues that after the construction of the railway from Bangkok to the North (to Nakhon Sawan in 1905 and to Chiang Mai in 1921), the flow of trade from the North was diverted to Bangkok instead of Burma, and that the economic relation with Bangkok was strengthened in place of that with Burma. Compared with rice in the Center or tin and rubber in the South, the teak industry in the North had little effect in stimulating local Chinese merchants to launch into commercial banking because the Chinese did not play an important role in the development of the teak industry and because much of the teak was exported through Bangkok Port by European firms.

The Northeast contributed to the increase of rice exports from Bangkok Port after 1900, when the railroad was constructed from Bangkok to Nakhon Ratchasima. However, the amount of rice shipped by the Northeast was not at all equal to that of the Center. In the Northeast, where rice, the only exportable product, was transported to Bangkok Port for export, trade-related industries such as banking faced great hurdles on the road to development.

As a whole, the contribution of local entrepreneurs in the provinces to the formation of Thai banks during the pre-1950 period seems to have been limited. All Thai banks were based in Bangkok. Local merchants had not been able to cooperate in setting up and

managing a single local bank or regional bank in any province.²⁾

III-2. Protection Rather Than Competition : Post-1950 Commercial Banking Policy

Until the mid 1950s, the Thai government did not exercise rigid control over the establishment of banks. The capital required to establish a bank was small (250,000 Baht) [Paul Sithi-Amnuai 1964 : 93]. During the period between 1947 and 1950, competition among commercial banks became very severe. Not only were several new Thai banks established, stimulated by a postwar boom in exporting, but foreign bank branches resumed operations after the war. The number of commercial banks in Thailand, including branches of foreign banks, soared from 10 in 1946 to 25 in 1950. The average deposits among commercial banks was 79.10 million Baht in 1946, but plunged to less than 40 million Baht during 1947-1950 [Krirkkiat 1986 : (2-35), (2-37)-(2-38), (2-41)].

Faced with this situation, the government came to attach greater importance to stability than to competition in the banking sector, and began to restrict the approval of new banks [*ibid.* : (2-35)]. In 1955, the Cabinet passed a resolution to restrict the establishment to new banks [Emery 1970 : 567]. Since then, foreign bank branches were restricted to one per country (except in cases of reciprocity), and the establishment of only two Thai banks has been approved.³⁾ One was the Thai Military Bank, established in 1957, the other was the Asia Trust Bank, established in 1965. The Asia Trust Bank changed its name to the Sayam Bank later, and was merged with the Krung Thai Bank in 1987.

A policy conducive to the stability of the commercial banking sector has thus characterized the Thai banking system, particularly since the mid-1950s. According to Krirkkiat [1986 : (8-2)], there have been no bank failures since 1941. If a bank verged on crisis, the government and other banks helped it out of its financial difficulties. The government was concerned to prevent the bankruptcy of any bank, because of the adverse effect that this would have on the economy. In 1962, the Commercial Banking Act, which aimed at securing the stability of the banking system, was passed [Supachai 1977 : 38].

III-3. The Development of Branch Banking

While restricting the establishment of new banks, the Thai government adopted the branch banking system in order to extend banking services to the provinces. As Table 1 shows, the branch banking system spread throughout the country, particularly after 1955. Paul

2) Although the Bank of Ayudhya, which was established in 1945, was the first and only bank to be registered in a province (Ayutthaya Province), it moved its head office to Bangkok in 1948. In addition, the largest original shareholder of this bank was Pridi Phanomyong's younger brother [Krirkkiat 1986 : (6-11); Noppaphorn 1989 : 57-58; Suehiro 1989b : 133, 246-247]. Therefore, it could be said that this bank was established by Pridi's group, and thus was a Bangkok-based bank from the beginning.

3) Excluding the Krung Thai Bank, which was set up in 1966 by merging two banks, the Provincial Bank (the Thai Bank Company, originally) and the Agricultural Bank.

Table 1 Numbers of Bank Offices

Year	Bangkok*	Provinces	Total
1940	11	4	15
1945	16	8	24
1950	30	32	62
1955	42	73	115
1960	113	238	351
1965	161	313	474
1970	234	413	647
1975	323	572	895
1980	461	1,017	1,478
1985	565	1,271	1,836

Source: Krirkkiat [1986 : (3-20)], Nopalak [1983 : 17], Thailand, Bank of Thailand [1961 ; 1966 ; 1971 ; 1976 ; 1980, 2529]

Note: The number of bank offices includes head offices.

* Bangkok and Thonburi until 1970.

Sithi-Amnuai [1964 : 123-124] explains that banks were induced to establish branches in the provinces by the strong demand for agricultural exports that was caused by the Korean War. However, the monetary authorities began to impose restraints on the establishment of branch offices by the introduction of the Commercial Banking Act of 1962, which required banks to secure permission from the Minister of Finance in order to set up new branches [Nopalak 1983 : 22-24 ; Noppaphorn 1989 : 137]. The act also specified that only Thai banks could open branches in the provinces. Since this date, foreign banks have been prohibited from expanding outside of Bangkok [Supachai 1977 : 38]. Since 1975, when the government relaxed the eligibility requirements to apply for permission to open branches in the provinces (excluding *amphoe muang*), and encouraged commercial banks to establish branch offices there [Thailand, Bank of Thailand 1976 : 87-88], the number of branches in the provinces has increased at a faster rate than those in Bangkok, as Table 1 shows. This policy also intensified the degree of monopoly in the banking sector : a big Thai bank, such as the Bangkok Bank, gained an advantage over small and medium-sized banks by expanding its market share through increasing the number of branches [Krirkkiat 1986 : (7-4)].

In spite of the spread of branch banking services throughout the country, commercial banks have often been criticized for failing to promote economic development in the provinces. This is explicitly shown in the difference in the credit-deposit ratio between Bangkok and the provinces (Table 2). Until the mid-1970s, branch offices in the provinces were a channel through which credit was transferred to Bangkok. More than half of the deposits collected by such branch offices were not lent locally. In 1969, the Bank of Thailand tried to stem the drain of funds from the provinces to Bangkok, stating that it would take into account "the amount of credit each bank provided to local communities

Table 2 Credit-to-Deposit Ratio of Commercial Banks (%)

Year	Bangkok	Provinces	Whole Kingdom
1962-1968*	100.79	38.52	87.54
1969-1974*	99.74	43.91	82.31
1975-1982*	120.99	64.05	97.89
1983	116.69	75.25	99.49
1984	115.75	77.37	96.04
1985	108.35	72.57	94.13
1986	99.52	66.94	86.98
1987	104.80	65.55	90.02
1988	112.21	70.44	96.16
1989	115.24	72.38	98.60
1990	121.43	76.07	103.35
1991	117.30	79.24	102.79

Source : Nopalak [1983 : 54] and statistics based on information which the author collected at the Bank of Thailand.

Note : *Average Value.

during the past” when deciding whether to approve the establishment of new branches [Nopalak 1983 : 51]. However, this seems to have been an ineffective method to solve the problem of the drain of funds from the provinces, as Table 2 shows [Kanitta 1976 : 14].

In 1975, the monetary authorities changed tactics, and decided to allow the establishment of bank branches in areas of the provinces apart from *amphoe muang* on the condition that a local lending requirement (at least 60 percent of local deposits) was fulfilled [Kanitta 1978 : 3 ; Thailand, Bank of Thailand Northeastern Regional Branch 2518-2519 : 37]. This was effective in raising the credit-deposit ratio of the provinces as Table 2 reveals.

It is not uncommon in developing countries for commercial banks to serve rural areas and small borrowers very poorly [McKinnon 1973 : 68]. In general, businesses in rural areas (or in the provinces of Thailand) are so small that the potential default risk is high and information on them is costly to obtain. When the authorities artificially set the real interest rate at a low level (in Thailand's case through a legal interest rate ceiling on bank loans), this interest cannot cover the processing costs and potential risks of banks in small-scale lending.⁴⁾ Bank loans are allocated among favored borrowers such as big-business operators (in Bangkok, in the case of Thailand) and those who have political connections, and small borrowers can obtain only limited loans from commercial banks [*ibid.* : 73 ; Nopalak 1983 : 84-85]. The government control of interest rates causes a distorted allocation of bank loans, which is shown in the discrepancy between Bangkok

4) In developing countries, the government regularly intervenes in the financial sector in order to channel cheap credit into those sectors to which the government has given high priority. A credit ceiling for commercial banks is the most common type of intervention [IBRD 1989 : 38, 54].

and the provinces in the credit-deposit ratio.

III-4. Compradores and Bank Agencies in the Provinces

The expansion of branch banking did not eliminate the possibility of bankers growing in the provinces, although Thailand failed to develop this possibility. The *compradore* system or agency arrangement, which commercial banks adopted when they branched out of Bangkok, gave Chinese merchants the opportunity to build a foundation on which to establish financial businesses in the provinces.

The *compradore* system was originated by European banks as a method to overcome a lack of information about local markets in Thailand. Chinese who were influential in business circles were employed as *compradores* to mediate between local businessmen (who were potential customers) and European banks. Branch offices of Thai banks with Western managers also used *compradores* [Plaiao 1987: 61]. However, through the years, the function of the *compradores* changed, and some Thai banks began to use them as well, particularly when they extended their businesses to the provinces. They guaranteed loans for local customers whose creditworthiness was unknown to Bangkok-based banks [Krirkkiat 1986: (4-4); Paul Sithi-Amnuai 1964: 176; Rozental 1970: 171-173, 175]. According to Rozental [1970: 171-172], in 1966, *compradores* numbered over 120, and most of them were employed in the provinces.

Thai commercial banks arranged another system when they expanded branch banking in the provinces. This was the agency system. Local influential entrepreneurs (Chinese, in most cases) were appointed as managers of agencies. The manager of the agency, which was lent the bank's name and its creditworthiness, was granted greater latitude in management than branch managers who were under control of headquarters [Paul Sithi-Amnuai 1964: 130-131; Rozental 1970: 167, 169]. In 1962, the number of agencies accounted for about 17 percent of the total number of branch offices (not including head offices) of Thai commercial banks [Noppaphorn 1989: 151].

These two devices were used in order to reduce the transaction costs involved in financial transactions. Before a loan is offered, commercial banks are required to collect a great deal of information about borrowers and their planned projects in order to investigate their creditworthiness and profitability. Administration costs accumulate as banks process a contract carefully so that borrowers will not impute the risk of a project on them. Commercial banks must cover these costs, which are necessary regardless of the loan size [Horiuchi 1990: 37-41; IBRD 1989: 34]. The transaction costs exhibit "increasing returns to scale." The costs involved in collecting information on small-scale customers in the provinces were high, relative to the size of the loan, for Bangkok-based banks. Commercial banks with no experience in the provinces thus came to employ local Chinese merchants who were well informed about local businesses and people, intending to utilize the valuable personal information of these merchants which had been accumulated through commercial transactions. The *compradore* and agency systems show that the special

knowledge of Chinese merchants can be traded as a commodity on the financial market.

However, citing occasional abuses caused by compradores and agencies, the government took action against them. In 1967, the Bank of Thailand imposed the condition, in granting permission for a new branch, that a newly established branch office should be a real branch, not an agency, and should not employ compradores [Thailand, Bank of Thailand 1972 : 61]. Since then, both agencies and compradores have become less important and have virtually disappeared.

Although the agency system began to fade away, agency managers far from abandoned their financial businesses. Some continued to manage branch offices by changing their position from agency manager to branch manager [Plaaio 1987 : 108-109], and others began to operate another type of financial undertaking, that is, finance companies.

Plaaio [*ibid.* : 100-102, 109-110] cited the case of a prominent Chinese family in the North which had been involved in the money lending business there since the 1930s, and became the agency of the Siam City Bank and the Bangkok Bank of Commerce after the Second World War. Their financial business expanded so rapidly that this family operated 13 agencies of the latter bank in some Northern provinces. After 1967, when the Bank of Thailand worked out a scheme to eradicate the agency system, this family gave up its agencies and established two finance companies instead, both of which were started in cooperation with other influential families in the North. One of these two companies grew to have nine branch offices in five Northern provinces. However, both companies were joined later by Bangkok capital, and at least one of them was later merged with Bangkok-based finance companies. One of these Bangkok-based finance companies was the Asia Credit Ltd., a finance and securities company which was managed by the Soophonpanit family-Bangkok Bank group, and is one of the largest finance companies in Thailand. This Northern family now runs commerce and service businesses and remains one of the most prominent families in the business world of the North.

This family's establishment of finance companies can be seen as an attempt to make the most of the information that it had collected through business and social activities, information which it had previously sold to commercial banks, but was no longer allowed to do. Agency managers were motivated to maintain relationships with customers over a long period of time because collected information was investment (or accumulated capital) that might be useful in the future. Moreover, information is intrinsically difficult to trade efficiently, partly because it can be reproduced at negligible cost. The most practical way to cope with this situation is for the producer of information to use the product himself, not to leave the production and trading of information to market mechanisms [Arrow 1962 : 615 ; Horiuchi 1987 : 34, 38]. Therefore, it was quite rational for those who were agency managers to launch into the management of finance companies where they could best use their personal information.

Information about the credit status of local Chinese entrepreneurs obviously gives local financiers a strong edge over Bangkok financiers in terms of reducing transaction

costs, as will be discussed in the next section. We must, therefore, ask why the provinces have failed to develop indigenous financial institutions, such as local banks, operated by local people. Why have financial entrepreneurs of the provinces never been vigorous enough to compete with their counterparts in Bangkok?

Before answering these questions, the business of discounting post-dated cheques, in which many Chinese merchants were involved, is first analyzed. This is another example which shows that financial entrepreneurs rose rapidly through the discounting of cheques in the provinces, although in most cases they failed both to develop their financial businesses into a solid industry, and to establish organized institutions.

III-5. Discounting of Post-Dated Cheques and Chinese Merchants

With the spread of commercial banking in Thailand, post-dated cheques have been used among businessmen as a means of making payments in trading.⁵⁾ As Paul Sithi-Amnuai [1964 : 132] describes, the use of post-dated cheques became widespread throughout the country because such cheques came to gain the confidence of merchants after 1954, when a new act which criminalized the use of bad cheques was passed.

Post-dated cheques have been discounted both in the organized financial market, that is by commercial banks and finance companies, and in the unorganized market [Thailand, Bank of Thailand 1990 : 33]. Chinese merchants have been involved to a great extent in the discounting of post-dated cheques in the unorganized financial markets, not only in Bangkok but also in the provinces, because commercial banks (and finance companies, to a lesser extent) were controlled by the monetary authorities and could not fulfill the increasing demand for credit. The monetary authorities imposed an interest rate ceiling on loans, and this ceiling reduced the amount lent by commercial banks. Since the excess demand for credit could not be satisfied by banks and finance companies (that is, since "credit rationing" occurs in financial markets), less-favored post-dated cheques which commercial banks or finance companies would not discount were put into the hands of financial businessmen who may well not have had licenses. This illegal cheque-discounting business was "demand-driven" and "generated purely by the needs of the marketplace," as is generally the case for informal economic activities [Montiel *et al.* 1993 : 8].

Post-dated cheques were discounted by commercial banks for 15-19 percent per annum from 1982 to 1989 [Thailand, Bank of Thailand 1990 : Table 19]. On the other hand, Chinese merchants usually determined the discount rate by the creditworthiness of the sellers, as well as the market interest-rate level. While their discount rates were usually around 2 percent, this rose to about 10 percent (maturities are usually about three months)

5) See Paul Sithi-Amnuai [1964 : 131-134] and Rozental [1968 : 42-43] for detailed explanations about post-dated cheques.

6) Based on information offered by Prof. Krirkkiat Phipatseritham (The University of the Thai Chamber of Commerce).

when the seller has a bad reputation.⁶⁾

My research in Nakhon Ratchasima (NM) City (Theetsabaan Muang Nakhon Ratchasima) in 1991 revealed that there were many local Chinese merchants who had been engaged in the discounting of post-dated cheques as a sideline in the past. According to Mr. Ratprathiip Kiiratiurai, who has been involved in finance businesses in NM City for more than two decades, local merchants in NM City had come to use post-dated cheques widely by about 1960 due to an increase in trade between Bangkok and NM. This was why he and his father at that time began the business of discounting post-dated cheques, which were drawn on merchants of NM by businessmen of Bangkok. Until 1972, they were able to run this business without being subjected to any legal regulations. In 1972, the government began to control the activities of non-bank financial institutions, such as finance companies, by amending the Act for the Control of Commercial Undertakings Affecting Public Safety and Welfare, and those who desired to undertake financial businesses were required to obtain permission from the Ministry of Finance [The Association of Finance Companies 1991 ; Virach 1980 : 34-35]. As described later, Mr. Ratprathiip managed to obtain such permission, and his discounting business developed into a formal finance company in 1972.

Mr. Sunthon Phumthong, another Chinese merchant, who at the end of the 1970s established a company in NM City that specialized only in the discounting of post-dated cheques, states that the number of such companies run by Chinese merchants reached 27 in the Northeast by the mid-1980s. He explained that those companies were allowed by the monetary authorities only to discount post-dated cheques and not to engage in other financial activities such as collecting funds from the public and granting loans, which finance companies were allowed to arrange. His company was registered at the Ministry of Commerce as a *len chaer* company (that is, a company to arrange a rotating credit society). It is plausible that some post-dated cheques which were discounted by this type of company were drawn by Chinese merchants who were arranging a *chaer*.

However, a run involving 44 finance companies of Thailand in 1983 [IBRD 1989 : 72] threatened the solvency of these companies in the Northeast. The Bank of Thailand Northeastern Regional Branch [2527 : 1-2] reported that the *chaer* business in the Northeast faced financial difficulties in 1984 and that the number of dishonored post-dated cheques had increased, especially those which had been drawn in arranging *chaer*. All of the 27 companies described above went down, said Mr. Sunthon. At that time, his company was taken over by a Bangkok-based finance and securities company, which was an affiliated company of the Thai Farmers Bank, and became the NM branch of that finance and securities company.

In the following, a profile of Mr. Ratprathiip Kiiratiurai is given to show how one Chinese merchant has managed a financial business in a province.

Ratprathiip was born in 1952 in NM City of a father who was a second-generation Teochiu Chinese. Ratprathiip's father had been employed in a company run by Teochiu

Chinese merchants in Bangkok. That company not only provided the medium of exchange for wholesale transactions between Bangkok and Northeastern cities such as Ubon Ratchathani and NM, but was also engaged in trading between these cities, although it was an informal financial institution which served Teochiu Chinese merchants in an age when commercial banks had not yet spread. Ratprathiip's father was appointed to take charge of business with NM, and so he came to reside in NM City from around 1950. After he came to NM City, he resigned and established a general shop. In about 1960, he opened a hotel in town, and in his hotel he began the business of discounting post-dated cheques, which were mainly drawn on local merchants of NM by businessmen from Bangkok. Ratprathiip explained that the demand for credit in NM increased to the extent that a small number of bank branches could not fulfill it. His father launched into the business of discounting, making the best use of knowledge gained when he had worked for the Chinese financial company. In 1960, NM Province had only eight bank branches, although this was more than any other province in the Northeast.

Ratprathiip, after finishing his education at a college of commerce in Bangkok, started his business career by helping his father in the discounting of post-dated cheques and hotel management. When the government began to require those involved in financial businesses to apply for permission from the Ministry of Finance in 1972, Ratprathiip and his father decided to do that, and they were accorded permission to manage a finance company.⁷⁾ Their finance company was the only one in the Northeast at that time, and the 49th to be established in Thailand. Since then, he has been involved in financial businesses in NM City.

During the period when he operated a finance company, he conceived a desire to develop his company into a local bank. He was eager to deepen his knowledge of the financial business and attended several courses in financing in Hong Kong and Bangkok. However, as described above (III-2), the monetary authorities have refused to grant permission for the establishment of any new commercial banks since the mid-1960s. Knowing full well that his application to the authorities to establish a local bank would be turned down, he never applied. He stated that he would have set up a local bank if the government had relaxed regulations regarding the establishment of commercial banks.

In the end, in 1980, he decided to sell the majority of his shares in his finance company to a friend who operated a finance company in Bangkok. He explained that he had decided to make a clean break from the management of the finance company because he became too busy to continue after his election as a member of the municipal council of Amphoe Muang NM. In 1984, the finance company faced financial difficulties during a

7) Activities in which licensed finance companies take part are the collecting of funds through the issue of promissory notes and borrowing from commercial banks (they are prohibited to receive deposits). Besides providing short-term consumer credits, one of their major lending activities was the discounting of post-dated cheques [Supachai 1985 : 92 ; Thailand, Bank of Thailand 1990 : 9-10].

run on finance companies, which caused the intervention of the Ministry of Finance. At present, it operates as a branch of a Bangkok-based finance company which was established after the run through the merger of six finance companies. Ratprathiip is still a minor shareholder in the company.

His major business is now in real estate. However, he still insists on the need for local banks and is opposed to the regulation by the monetary authorities of competition in the banking sector, although he admits at the same time that local banks or the unit banking system in Thailand would have shortcomings.

My findings in NM suggest that Chinese merchants formed the backbone of an indigenous financial industry that existed in the provinces several decades ago. A competitive edge over commercial banks induced Chinese merchants to operate financial institutions, and particularly to specialize in the discounting of post-dated cheques drawn on local Chinese businessmen. First, strict regulations (such as an interest rate ceiling on loans) faced by commercial banks made it difficult for them to fulfill the needs of small borrowers. Many Chinese businessmen were small as economic units and were not looked on favorably as would-be borrowers by banks. Small loans might have been too costly for banks to arrange since the administrative costs involved are independent of the size of the loan. Informal financial agents that were free from legal regulations, on the other hand, could adjust interest rates to match the borrower's creditworthiness.

Secondly, Chinese merchants who managed businesses which required a close relation with local Chinese societies had a competitive advantage, as it was not as costly for them to collect personal information about the credit status of other local Chinese businessmen as it was for the branch offices of Bangkok-based commercial banks. Local businessmen gathered information not only from business dealings but also from social networks of Chinese people such as Chinese associations. Moreover, Chinese merchants who were involved in the cheque-discounting business could keep transaction costs low and reduce the risk of default to a great degree by the following measures. They limited the number of customers to a small circle of acquaintances or acquaintances contacted through mutual friends. This meant that information on creditworthiness was easily and cheaply obtained. In addition, they sought to maintain so-called "customer relationships," that is, they tried to maintain relations with the same customers, and their transactions were arranged by mutual consent. As such relationships developed, transaction costs were driven down further. As a whole, therefore, their businesses were based on personal relationships in the local Chinese society.

Third, they enjoyed economies of scale by specializing "in providing a single type of financial commodity" (discounting of post-dated cheques) "to a special group of customers" (local Chinese of their acquaintance) [Benston and Smith 1976 : 222]. It can be concluded that the business of cheque-discounting was a manifestation of the entrepreneurship of Chinese merchants who tried to exploit new business chances by utilizing their personal knowledge.

Benston and Smith [*ibid.* : 215-216] have revealed that the *raison d'être* for financial intermediaries is the existence of transaction costs. Financial intermediaries, in other words, are organized to reduce transaction costs. When high costs prevent the transaction of funds, a lower level of "welfare" is obtained. Therefore, the reduction of transaction costs is an important problem which confronts the economic world [Horiuchi 1987 : 25]. Chinese merchants thus arranged the discounting of post-dated cheques in order to cut down the transaction costs associated with processing loan contracts, especially for Chinese businessmen, although these costs are comparatively low. Ultimately, these financial businesses have helped to increase the efficiency of business transactions of Chinese entrepreneurs and to rectify, to some extent, a resource allocation distorted by government intervention.

Arrow [1984 : 104] emphasizes that, in a situation of imperfect information or an asymmetry of information, which may cause a "moral hazard," the importance of "non-market controls" such as relationships based on trust and confidence cannot be ignored as a method to approach optimal resource allocation in a market. It is appropriate to assume that the transaction of post-dated cheques exhibits an asymmetry of information as other financial transactions do. The drawer of post-dated cheques may have a better idea of the risks involved than does either the drawee or the payee. This gives a clear explanation to the fact that dealing in post-dated cheques was based on a belief in creditworthiness among the Chinese entrepreneurs involved (that is, a drawer, a drawee and a payee).

Since these local financial arrangements were largely informal, enforcement methods also had to be informal. These informal enforcement methods, however, should not be seen as disadvantageous to either party. Indeed, one could argue that they constituted another advantage that local Chinese financiers enjoyed over their Bangkok-based counterparts. The sanction which Chinese merchants sometimes relied on was to appeal to a person's reputation or to social ostracism [Barton 1983 : 59-60]. Ostracism meant the loss of creditworthiness among Chinese businessmen which had been previously fostered through business and social activities. Arrow [1983 : 151] stated that "in the absence of trust, it would become very costly to arrange for alternative sanctions and guarantees, and many opportunities for mutually beneficial cooperation would have to be foregone."

Chinese people who are, in a sense, both isolated and divided from Thai society rely on their creditworthiness and personal relationships not only in dealing with post-dated cheques, but also in other businesses in order to achieve optimal resource allocation. Chinese associations, through which Chinese entrepreneurs show to what extent they have established credibility in their community [Ueda 1992 : 350-351], were organized in order to deepen mutual confidence and increase the efficiency in managing businesses in a market of imperfect information. In this sense, Chinese associations are organizations which are defined as "a means of achieving the benefits of collective action in situations in which the price system fails" [Arrow 1974 : 33].

In concluding this section, it should be noted that Chinese businessmen became

involved in financial business because it was “rational behavior” for them, many of whom were small-scale and had to manage businesses in a situation of “imperfect information.”

IV Dominance of Bangkok-Based Banks in the Provinces

I have given one example of an entrepreneur (Mr. Ratprathiip Kiiratiurai) of a province who wanted to launch into commercial banking. There must be others in other provinces, entrepreneurs, for instance, with experience in operating financial businesses such as finance companies and cheque discounting, who likewise wished to make a career in commercial banking.⁸⁾ This desire to establish local banks was not fulfilled because of the government opposition to increases in the number of banks. Basically, this was the direct cause of Thailand’s failure to develop local (or regional) banks in the provinces. On the other hand, Bangkok-based banks obtained political patronage and enjoyed a situation of restrained competition, and some of them became big enough to enjoy economies of scale. However, it should be emphasized that small-scale local banks appear to have several advantages over larger banks in Bangkok.

Table 3 Numbers of Bank Branches in Nakhon Ratchasima Province

Year	Number
1940	0
1943	1
1951	2
1952	3
1957	5
1960	8
1965	9
1970	15
1975	17
1980	37
1985	47
1990	60

Source: Thailand, Bank of Thailand [1958, 1961, 1966, 1971, 1976, 1980], Thailand, Bank of Thailand Northeastern Regional Branch [2528, 2533], and based on information which the author collected at the Bank of Thailand.

IV-1. Commercial Banking Policy and Local Bankers in the Provinces

By citing the case of Nakhon Ratchasima (NM) again, I will argue that the government had already adopted a restrictive policy towards the establishment of new banks by the time when financial businessmen in the provinces had matured enough to develop their financial institutions into commercial banks. Because the authorities adopted this restrictive policy, Bangkok-based banks, which originally sprang up from the export business in Bangkok, could extend their power to the provinces in a situation of restrained competition.

Table 3 shows the numerical change of branch offices in NM Province. The first branch of a commercial bank was opened there in 1943 by the Siam Commercial Bank.

8) Noppaphorn [1986: 45] referred to another example in which the government rejected an application to establish a local bank in a province. It happened in 1969, and the applicant was a businessman in a province who had operated an agency of a commercial bank there.

This branch was the first branch in the Northeast and probably the seventh branch in the provinces in Thailand.⁹⁾ The second in NM Province was a branch of the Thai Farmers Bank, which was set up in 1951, and the third was that of the Bank of Ayudhya in 1952. As Table 3 shows, the number of branches in NM Province has increased gradually since the 1950s, with a sharp expansion during the period from 1975 to 1980, probably as a consequence of the relaxation of requirements for opening branches in the provinces (see III-3). This indicates that commercial banks responded to an increasing number of financial transactions in NM province at that time by broadening their branch networks. Mr. Ratprathiip Kiiratiurai, who established a finance company in NM Province (see III-5), stated that sometime around 1960 his father started an informal cheque-discounting business, induced by an increasing demand for credit. The fact that the number of bank branches nearly doubled from 1960 to 1970 would seem to endorse his suggestion of an enlarged demand for financial intermediaries. Moreover, when Ratprathiip and his father established a finance company in 1972, NM Province had just entered upon yet another decade of rapid increase in branch offices, in which the number of branches shot up from 15 to 37.

Seeing an expansion of branch networks, he judged that the financial business would promise good profits, and so conceived the desire to set up his own bank. The more important point concerns his competitiveness with branches of Bangkok-based banks. The transaction costs which he would have had to bear at an early stage in managing a bank would be lower than those which a similarly sized branch of a Bangkok-based bank would face (see IV-3), because he could utilize information about the credit status of local customers which he and his father had collected through managing a cheque-discounting business and a finance company. This would have been a great advantage, and was a factor that induced him to think about establishing a bank.

However, the government had begun to tighten controls over the establishment of new banks as early as the mid-1950s. This case indicates that when the time was ripe for the establishment of local banks by local businessmen, they were prevented from launching into the banking sector by the financial authorities.

9) The first six bank branches set up in the provinces were as follows (in order of time). 1. The Chartered Bank, Phuket in 1910. 2. The Bank Sayaam Kanmaacon (the Siam Commercial Bank after 1939), Thungsong (Nakhon Si Thammarat Province) in 1920, closed in 1932 because of losses. 3. The Bank Sayaam Kanmaacon, Chiang Mai in 1927. 4. The Bank Sayaam Kanmaacon, Lampang in 1930. 5. The Bank of Asia, Hat Yai in 1940. 6. The Bank of Asia, Yala in 1942. Although the Provincial Bank established a branch in Chon Buri during the period from 1942 to 1945, I could not discover the exact year when this branch was set up. Data is based on Phannii [1986: 15] and on information which I collected at the Bank of Thailand. Many of these branches in the provinces were located in the trading center of tin and rubber in the South. The reason why Nakhon Ratchasima (NM) was selected as the first site in the Northeast might be due to the military presence (the army base at NM was important during the Second World War) and the increased demand for financial services that this presence fostered.

IV-2. Political Patronage of Bangkok-Based Banks

Several works [Krirkkiat and Yoshihara 1983 : 24-26 ; Phannii 1986 : 255 ; Suehiro and Nanbara 1991 : 9] reveal that, in Thailand, big business groups have grown, more or less, by establishing close relations with the government in power. Close relations between businessmen and politically influential figures such as military generals are distinctive, particularly in the financial sector. During the 1950s and 1960s, when the military ran politics, all Thai commercial banks that had been established by Chinese merchants (except for one bank, the Wang Lee Bank) sought government patrons [Suehiro and Nanbara 1991 : 115].¹⁰⁾

The case of the Bangkok Bank in the 1950s clearly showed that it grew remarkably by having political patrons in the government. In 1953, the Bangkok Bank became the largest bank in Thailand by increasing the stock which was furnished by the Ministry of Economic Affairs (the Ministry of Commerce today), while Major General Siri Siriyothin, who was the Deputy Minister of Economic Affairs and an important person of the Phin-Phao group, was appointed as Chairman of the Bank's board of directors. The Ministry of Economic Affairs was the major shareholder at that time [The Bangkok Bank 1981 : 40 ; Suehiro and Nanbara 1991 : 114]. According to Krirkkiat [1986 : (4-39)-(4-40)], a large amount of money, particularly profit from rice exports, was deposited in the Bangkok Bank by organizations of the government from 1953 as a result of the government being the major shareholder. The Bangkok Bank [1981 : 56-57] reported that during the period between 1952 and 1960 its growth in deposits and loans was very rapid. Although the remarkable growth of the Bangkok Bank until today cannot be explained satisfactorily solely on the basis of strong political patronage [Suehiro 1989b : 254-256], that was the main cause of the growth during the 1950s and the 1960s.

Skinner [1958 : 191-192] points out that Chinese businessmen, being an ethnic minority, that is, discriminated against in Thai society, needed protection, which they obtain from the Thai elite. They bought business security by offering directorships of their firms to influential figures in the government. The Chinese businessmen gained not only protection but also special privileges through this alliance with the Thai elite [*ibid.* : 304]. Commercial bankers in Bangkok who developed intimate connections with the government

10) There were two major groups in which Chinese bankers sought political patrons : the Phin-Phao group (including Field Marshal Phin Chunhawan and Police General Phao Siyaanon), which wielded power in the Phibun government of the 1950s until 1957, when they were ousted by Sarit ; and the Sarit group (Field Marshal Sarit Thanarat, Major General Thanom Kittikhachon, Major General Praphaht Caarusatian and others), which was in power from 1957 to 1973. A number of prominent members of the Phin-Phao group took up posts, through the 1950s, on the boards of directors of the Bangkok Bank, the Siam Commercial Bank, the Agricultural Bank, and the Bank of Ayudhya. On the other hand, some generals of the Sarit group sat on the boards of directors of the Bank of Asia, the Provincial Bank, the Bangkok Bank, the Siam Commercial Bank, the Thai Military Bank, the Bank of Ayudhya, the Thai Development Bank, and the Union Bank of Bangkok [Noppaphorn 1989 : 96-97]. After 1974, commercial banks did not explicitly seek assistance from influential figures in the government by offering them directorships.

could seek favors from it. Restraining competition in the banking sector might well be one of the favors that was sought. It is plausible that Thai officials who sat on the boards of various banks accepted this opposition to the establishment of new banks, although I could not find any supporting evidence (apart from the fact that virtually only two new banks have been allowed to be established since the mid-1950s). If that was the case, the government's restrictions on new banks imposed in the mid-1950s (see III-2) could be seen as being at least partly due to the fact that influential officials resorted to this stratagem to stem competition and to protect the interests of those Bangkok-based banks with which they were allied.

Stigler [1975 : 114] describes economic regulations which are imposed by the state as follows. Although regulation is widely viewed as being "instituted primarily for the protection and benefit of the public at large or some large subclass of the public," in fact "regulation is acquired by the industry and is designed and operated primarily for its benefit." Stigler [*ibid.* : 116] gives "control over entry by new rivals," (which can be seen in the case of commercial banks in Thailand), as one of the four policies which are generally sought by an industry. "The damage to the rest of the community" caused by such regulation outweighs the benefits which that industry can draw from regulation [*ibid.* : 123]. Regulation, in other words, results in a deadweight loss to the economy.

If Bangkok-based banks sought, through their political connections, regulation over entry by new banks (including local banks) from the government, that definitely results in a distortion of resource allocation. The demand for financial services in the provinces might well have been ill filled because of the dominance of Bangkok-based banks. The discounting business of post-dated cheques, which was widespread in the provinces (see III-5), can be partly attributed to this distorted allocation of resources. If the demand for credit was ill satisfied, the efficiency and productivity of economic activities in the provinces would have been lower than if there was no regulation.

Next, it should be asked why Chinese businessmen in the provinces did not succeed in expanding their businesses through seeking political patronage as their counterparts in Bangkok did. Why did Chinese financial entrepreneurs in the provinces not explicitly buy "protection" and "special privileges" from influential figures in the government, making that an occasion to advance in financial business? This was simply because small-scale financial entrepreneurs in the provinces could not offer the same economic incentives to political patrons that large banks in Bangkok could. The rapprochement between Chinese bankers and the Thai elite was particularly outstanding in the 1950s and 1960s. At that time, the financial business of the provinces was not well developed in comparison with that of Bangkok. It is interesting to note again, in this context, that the entrepreneur (Mr. Ratprathiip Kiiratiurai) whom I found in Nakhon Ratchasima (NM) to be most interested in the financial sector has entered politics (see III-5). This could be interpreted as a quest for political patronage—if you can't beat them, join them, as it were.

It seems to me that, in NM, the evidence indicates that local financial institutions

could have developed into commercial banks in the 1970s (see IV-1). By that time, however, it became difficult to pursue political patronage explicitly, and a number of Bangkok-based banks had expanded their businesses (at least partly through political patronage in the 1950s and the 1960s) enough to enjoy economies of scale.

IV-3. Advantages of Local Banks

Economists generally argue that commercial banks enjoy an advantage of economies of scale, although the definition of "output" of commercial banks has been much debated. Benston [1972], defining "output" as the number of loans and number of savings accounts, and taking American banks as samples, concludes that in general economies of scale for commercial banks were found. Concerning Japanese banks, Royama and Iwane [1973] took gross income as an index of "output" and found that economies of scale operated particularly in regional banks (and in city banks, but indistinctly).

These arguments support, in theory, the policy of the Thai government, which preferred the branching of larger banks to the establishment of small-scale local banks. However, local banks established by local entrepreneurs who are well informed about local economic circles would have been competitive with Bangkok-based banks, particularly at an early stage, when branches of the latter had only a short history of operation in the local society. This is because local banks face smaller transaction costs, as mentioned in III-5. This means that Bangkok-based banks must bear extra costs to collect information, for example, by employing people well versed in the intricacies of local businesses.

However, it should be pointed out that a local bank enjoys this advantage only as long as it has a "monopoly" on the inside information of a local society. Mobility of staff among banks can easily destroy this monopoly. As Arrow [1962 : 615] argues, information as a commodity is reproduced "at little or no cost" once it is sold. As a consequence, small-scale local banks would face severe competition with Bangkok-based banks, which are assumed to have advantages of scale economies, once such local banks lose their cost advantages.

The second advantage which local banks could have enjoyed is "economies of scope," which are defined as cost savings effected by combining "two or more product lines in one firm," product lines which are otherwise produced separately by several firms [Panzar and Willing 1981 : 268]. Economies of scope come from the existence of sharable inputs. Commercial banks enjoy economies of scope because their information about customers is an input sharable between the commercial banking business and other financial services such as the securities business. By appropriating information gained through arranging loans for another business, such as the transaction of securities, commercial banks are able to enjoy economies of scope [Kasuya 1986 : 50]. In analogy with this, it can be argued that the operator of a finance company would enjoy economies of scope if he established a local bank, because the information which he has accumulated through managing the finance company is also useful for commercial banking. He can use that information over

and over again at no cost while the intrinsic characteristics of information hinder him from selling that information on the market.¹¹⁾ Therefore, it is rational for an operator of a finance company to use his personal information by launching into commercial banking.

Third, local banks are assumed to have an advantage concerning creditworthiness and the ability to gain deposits. It is quite possible that several influential families would join in the establishment of a local bank. As I have previously argued [Ueda 1992 : 350-352], local Chinese businessmen regard reputation and trustworthiness within the local society as their most important asset in doing businesses. If a number of prominent families invest to set up a local bank, that bank would undoubtedly win broad confidence and support from local people, which a new branch of a Bangkok-based bank could not readily gain. That would help to accelerate capital mobilization in the provinces, where the majority of savers often consist of a great number of small-scale asset holders. It would be easier for local banks to increase deposits through connections with the local people than for Bangkok-based banks to do so. This situation is similar to that of "product differentiation." In other words, although the same financial service (product) offered by both a local bank and a branch office might not be differentiated by interest rates (price), a local bank might still attract a larger number of savers if its shareholders have been successful in gaining public confidence within the local society. However, this kind of "product differentiation" becomes less effective when a local bank is established after Bangkok-based banks have made a name for themselves throughout the country. In today's Thailand, where large banks such as the Bangkok Bank occupy an indisputable position in the financial sector, it would be hard for any new local bank to build up a sound reputation from scratch. In other words, the time when this advantage would have been greatest has already passed.

On the other hand, a possible counter argument against local banks is that, even if they had been allowed to be established, they could not have maintained solvency and credibility, and so would not have been able to survive. The Director of the Northeastern Regional Branch of the Bank of Thailand insisted that if the existing financial institutions could meet the demand, the government should not permit the establishment of new local banks which might be defective in managerial efficiency, citing the past case of agency managers in the provinces.¹²⁾ The agency system (see III-4) had been criticized because of loose management. Agency managers, who in many cases were local provincial merchants, used bank deposits to finance their own businesses or accommodate their acquaintances with unsecured loans. The Director of the Northeastern Regional Branch of the

11) Information as a commodity is difficult to trade in a market because of two problems. One is the problem of allocation and the other is the credibility of information. See Arrow [1962 : 614-616], and Leland and Pyle [1977 : 383] for a more detailed explanation.

12) Based on an interview with Mr. Songkwan Suwantaemee, the Director of the Northeastern Regional Branch of the Bank of Thailand, and Mr. Praneet Chotikirativech, the Chief of the Economic Research Section of the Bank, in November 1991.

Bank of Thailand argues that any local bank established and managed by local merchants might merely act the part of such agencies in different robes.

This point should not be overlooked when we examine the role of financial institutions in economic development. In developing countries, it is of great importance for the monetary authorities to build public confidence in the financial sector in order to mobilize the capital necessary for development. Horiuchi [1987 : 31] argues that in an economy where the majority of those who deposit their savings are composed of a great number of small-scaled asset holders, commercial banks which can provide them with safety and highly divisible financial assets would play an important role in capital mobilization.

Nevertheless, at least in Thailand, I believe that the government should offer local entrepreneurs the chance to show their entrepreneurship in the financial sector, especially when individuals exist who have a strong wish to do. I would argue that the evidence indicates that small-scaled local banks would have been competitive with branches of Bangkok-based ones, at least during the period before banking networks spread out in the provinces. The rejection of applications to establish a local bank means that the monetary authorities, placing great importance on the stability of the financial sector, have taken away the possibility of further development from the provinces. This is because the demand for credit in the provinces has not been met sufficiently to increase the productivity and efficiency of business activities. As Table 2 shows, a large part of the deposits collected in the local provinces was transferred to Bangkok, especially until the mid-1970s (see III-3). Branch offices of Bangkok-based banks in the provinces functioned as "pumps" feeding capital into Bangkok. This suggests that Bangkok-based banks were not eager to explore business opportunities in the provinces, perhaps because it was much more costly to arrange loans in the provinces, mostly for small-scale customers, than to do so in Bangkok. In the provinces, Bangkok-based banks that were not informed about the intricacies of local business circles faced higher transaction costs. As a result, small-scale entrepreneurs in the provinces were ruled out as customers of banks and so confronted great difficulty in raising capital. The monetary authorities must have recognized the importance of capital mobilization, as they tried to advance it by encouraging the branching out of Bangkok-based banks throughout the country. This branch system was actually successful in mobilizing capital, as well as in establishing public confidence in commercial banking. However, much of the capital raised in the provinces was sent to Bangkok, and we have to conclude that the branch system was helpful in neither the advancement of economic development of the provinces nor the decentralization of the Thai economy.

I would hasten to add that in Thailand at present, local banks would have a very difficult time in competing with their counterparts in Bangkok because the latter have become so large as to enjoy huge economies of scale. Nevertheless, local banks could probably have flourished if the government had permitted their establishment a couple of decades ago, when they could have made the most of their advantages over Bangkok-based banks.

Since competition between local banks and Bangkok-based ones never took place, it is difficult to argue about what might have been. One possible scenario, however, is that under competitive conditions, local banks would have refrained from pursuing the same opportunities as the branch offices of Bangkok-based banks, and instead sought a special niche. Granting loans, for instance, to small-scale entrepreneurs whom the local society regarded as eminently creditworthy but whose financial needs and assets were not large enough to interest branch offices. The next section mentions briefly the case of Japanese regional banks, which have been successful in finding a niche partly because the government adopted an appropriate policy. The Japanese case suggests that even if Thai local banks had faced difficulties, the monetary authorities could have maintained stability and public confidence in commercial banks through appropriate supervision and control over them.

IV-4. *Japanese Regional Banks*

Japan has "regional banks" (*chiho ginko*) which are based and have branches, in most cases, in a single prefecture, and which develop close relationships with local communities.¹³⁾ Their depositors are local people, and regional banks mainly finance local small- and medium-scale enterprises. They are smaller than "city banks" (*toshi ginko*), which are based in big cities and have branches throughout the country. Although Japanese regional banks faced managerial problems in the beginning, as did the small banks or bank agencies of Thailand, they were successful in surviving. Regarding this point, the government's intention to establish a regional bank for each prefecture should be emphasized.

In Japan, the first bank was established in 1873. The number of applicants for permission to establish a bank increased thereafter, and the number of banks (*futsu ginko*) reached a peak of 1,867 in 1901. At that time, banks were dispersed throughout the country, not only in big cities but also in rural areas, particularly those rural areas which produced commercial crops such as silk, tea, and rice. However, many of the smaller banks were set up by local businessmen for the purpose of financing their own businesses, and some bank operators loaned their acquaintances a great amount of capital rather loosely.

After many small banks went down in the financial crisis of 1901, the government began to regulate strictly the number of banks. It adopted a policy to force small banks to merge to form larger ones. What the government intended was to make a central bank

13) See Makimura and Tamaru [1991], Otomo [1977], Sugiyama [1988] and Tsuchiya [1961] for more details about regional banks in Japan. On early commercial banking in Japan, see Cameron [1967], and Satake and Hashiguchi [1967].

for each prefecture by merging several small banks that already operated in that prefecture. During the period from 1937 to 1950, this policy was enforced on the principle of "one bank per prefecture." Consequently, the merged banks, with a large pool of capital, came to be influential financial institutions in the prefectures, developing very intimate relationships with the local economies. They are the origin of today's regional banks.

The great difference between Thailand and Japan lies in the rise of commercial banks. While Thai commercial banking had its origin in the export trade in Bangkok, the birth of banking in Japan was connected to a greater degree with domestic economic growth than with the expansion of external trade. However, even if the economies of Thai local provinces were small and less developed than the economy of Bangkok, I believe that a government policy to protect small banks in the provinces could have been effective, and that even without such a policy, a greater readiness to grant permission for the establishment of local banks could well have been effective. The reason for this optimistic view is the fact that local entrepreneurs who wished to establish local banks in Thailand actually existed, and these entrepreneurs could have enjoyed advantages over Bangkok-based banks and surely had a much sounder understanding of local potentialities than the financial authorities in far-off Bangkok.

V Concluding Remarks

The development of financial businesses and the emergence of financial entrepreneurs in the provinces has been discussed in this paper. One case in Nakhon Ratchasima among others suggests that several financial businessmen in the provinces were ready to launch into the commercial banking sector. I have argued that these local businessmen appeared to have an edge over their counterparts in Bangkok. These advantages basically lie in their personal information about local business circles, which was gained through business and social activities in local Chinese societies. For Chinese entrepreneurs struggling to grasp business chances and give full swing to their entrepreneurial skills, it was a rational decision to manage financial businesses in the provinces, formally or informally.

However, the strong opposition of the monetary authorities prevented these entrepreneurs from establishing local banks. The policy towards commercial banking was considered to be appropriate to build confidence in the commercial banking sector and to mobilize capital in Thailand as a whole. However, the strict and cautious approach of the government towards commercial banks limited competition and precluded the possibility of establishing local banks.

As a consequence, businessmen in the provinces were not provided with enough credit to meet demand by branch offices of Bangkok-based banks, which showed little interest in loaning capital to small-scale local businessmen because it was costly to collect information in the provinces. This undoubtedly depressed business activity in the provinces. On the other hand, if the establishment of local banks had been allowed, they would have

contributed to the advance of economic development in the provinces and to the decentralization of the Thai economy.

Political patronage, which Bangkok-based banks sought from the government during the 1950s and 1960s, was another cause underlying the Bangkok-concentrated financial system in Thailand. These banks seemed to win the agreement of their political patrons to virtually prohibit the establishment of new banks and to restrain competition in the banking sector. Several Bangkok-based banks have enjoyed sufficient privileges to expand their business so greatly that small-scale local banks would find it extremely difficult to compete with them today. I concluded that the control imposed by the government over the establishment of new banks has distorted resource allocation and decreased the efficiency of economic activities in the provinces.

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