

## Chapter 1

### Introduction

The first chapter will begin with an introduction to microcredit program then go through the statement and the signification of the problem, the objectives of the study, and the structure of the dissertation.

#### 1.1 Introduction to Microcredit Program

This section will highlight the definition of microcredit, the difference between microcredit and microfinance, and microcredit of village and urban community funds in Thailand.

##### 1.1.1 Definition of Microcredit

Microcredit has experienced a significant growth in the 1990s (Robinson, 2001). In 1997, the first Microcredit Summit was established in Washington, D.C. More than 2,900 delegates from 137 countries participated and made a commitment to reach the world's poorest families with microcredit. The Microcredit Summit Organizing Committee defines that

*“Microcredit is the extension of small loans and other financial services (such as savings accounts) to the very poor. This allows them to pursue entrepreneurial projects that generate extra income, thus helping them to better provide for themselves and their families.”<sup>1</sup>*

Later, the United Nations declared the year 2005 to be the “International Year of Microcredit” and agreed upon the huge benefit of microcredit which has been changing people's lives and on the local economy.

The outstanding microcredit program, known as Grameen Bank, provides the definition of microcredit as

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<sup>1</sup> [http://www.microcreditsummit.org/about/what\\_is\\_microcredit/](http://www.microcreditsummit.org/about/what_is_microcredit/)

*“programmes extend small loans to very poor people for self-employment projects that generate income, allowing them to care for themselves and their families.”<sup>2</sup>*

Both national and international agents define “microcredit” in the same way as a program that provides small loans for self-employment and consumption to the poor, especially rural women who do not have access to formal financial services. There are some difference between microcredit and microfinance. Microfinance has a wider definition because it includes other financial services such as deposits, payment services, money transfers, insurance and other training programs. However, this study focuses on the role of microcredit of village and urban community funds of the village funds in Thailand.

### **1.1.2 Microcredit of village and urban community Funds in**

#### **Thailand**

Lack of capital and often having limited access to other financial services are just some of the causes of poverty. The government intends to tackle poverty by having an establishment of funds which provides the budget directly to villages. The funds will be used as a source of working capital in the community, as well as for local economic and social development. Moreover, this policy promotes local capability to organize and manage their funds which can lead towards self-sustainability.

The microcredit for village and urban community fund (MVC) is the largest government microcredit program in Thailand which has been in operation since 2001. The government revolutionized the local credit market by allocating one million Baht (about \$22,500)<sup>3</sup> per village to over 77,000 villages and urban communities throughout the country. This program is the semi-formal financial institutions. It is the second-largest microfinance program in the world (Boonperm et al, 2012). Moreover, after the general election in 2011, the government announced an attractive policy to increase accessibility to the microcredit market by increasing the MVC program to two million Baht (about \$65,800)<sup>4</sup> for each village. As a result, this

<sup>2</sup> [http://www.grameen-info.org/index.php?option=com\\_content&task=view&id=32&Itemid=91](http://www.grameen-info.org/index.php?option=com_content&task=view&id=32&Itemid=91)

<sup>3</sup> In 2001, average exchange rate was \$1 = THB 44.5

<sup>4</sup> In 2011, average exchange rate was \$1 = THB 30.4

program is highly important in credit markets especially in rural areas and for people who cannot obtain access to formal financial services.

The Village and Urban Community Fund operated under the philosophy of values and wisdoms of local communities. The focus of the MVC program is on community empowerment and self-reliance, which is based on flexible and adjustable rules that meet the community's needs. It is linked between public, private, and civil society to develop the rural economy through credit market and having awareness in local communities. The official objectives, according to the "Act of National Village and Urban Community Fund B.E. 2547", are the following: First, the fund will be used as a source of fund for investment, job creation, income generation, welfare improvement and reducing expenses. Second, it will be used as an emergency fund. Third, the village fund provides deposit services for members. Fourth, it will be supplied as loans to other village funds for strengthening its economy and society. Finally, it aims to develop the economies in the rural area.

The organization consists of two levels of administration. First, the national committee of the central government, including 76 provincial and 928 district sub-committees will take care of procedures and guidelines relating to the fund at the national level. The central regulation states that the loan size cannot exceed THB 20,000 per borrower. In some cases, it can be extended to THB 50,000 and emergency loans cannot exceed THB 10,000<sup>5</sup>. The interest rate must be less than or equal to 15 percent per year. The repayment has to be made within one year<sup>6</sup>. Repayment should be guaranteed by at least two people.

Second, the local committee at the village level consists of around 9 to 15 members that have been elected from the villagers who have lived in the respective area for at least 2 years. Half of the local committee members must be women. They play an important role on the establishment of regulations, as well as procuring out the rules and procedures concerning the management of their own funds. The local committee will decide who should receive the loans. The conditions

<sup>5</sup> The "Act of National Village and Urban Community Fund B.E. 2555" The central regulation states that the loan size cannot exceed THB30,000 per borrower. In some case it can be extended to THB75,000. In addition, emergency loans cannot exceed THB15,000.

<sup>6</sup> The "Act of National Village and Urban Community Fund B.E. 2552" stated that the repayment has to be made within two years.

basically include the members' ability to repay, the purpose of borrowing, and the loan size. The close relationship between the local committee and members reduces the risk because they know each other very well. In particular, the committee is able to identify the risk of each borrower and also his or her ability to repay the loan (Boonperm, et al., 2009; Kaboski & Townsend, 2009; Menkhoff & Rungruxsirivorn, 2011).

**Table 1.1:** Number of Funds and Repayment Ratio of the Village Funds

Year	Number of funds	Repayment ratio
2001	66,188	
2002	74,286	93.85
2003	74,625	98.03
2004	77,508	95.26
2012	79,255	n.a.

**Source:** The Secretariat of the Cabinet, retrieved from [http://www.cabinet.soc.go.th/soc/Program1-4.jsp?t\\_ser=9526](http://www.cabinet.soc.go.th/soc/Program1-4.jsp?t_ser=9526). National Village and Urban Community Fund Office for the data of 2012, retrieved from <http://www.villagefund.or.th/multimedia/atthamon/newnew.pdf>

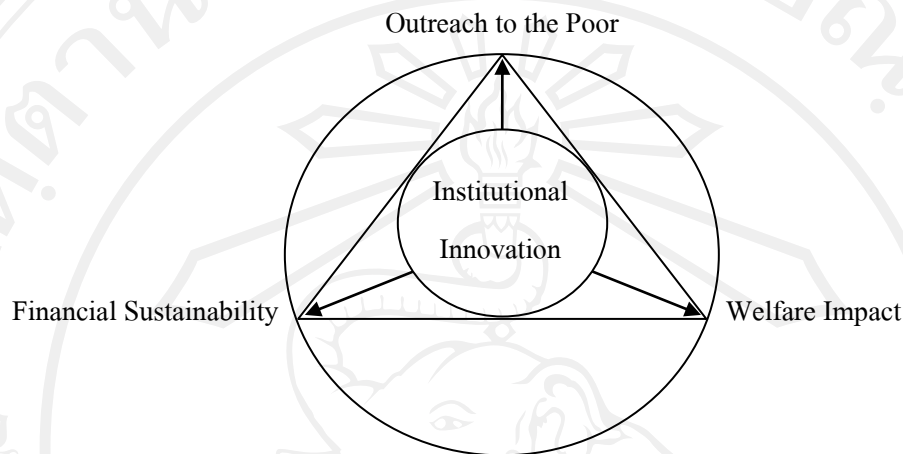
## 1.2 Statement and the Signification of the Problem

The microcredit for village and urban community fund (MVC) is the largest government microcredit program in Thailand. In addition to the huge budget, the program includes 11.22 million of members and 1.1 million of committee members. Therefore, program evaluation is an important. The answers will help the government decide on how to improve the program to be more effective in helping the poor and reduce poverty.

This study employs the concept of the triangle of microfinance which had been conducted by Zeller and Meyer in 2002 (Khawari, 2004). They extended the balance of the outreach and sustainability to the impact of microfinance on the welfare of clients and called it the “Critical Microfinance Triangle” as shown in Figure 1.

The microfinance triangle consists of an inner circle that represents the different types of institutional innovations that improve the outreach, sustainability

and welfare impact. An outer circle presents the environment and policy that influence the performance of financial institutions (Khawari, 2004).



**Figure 1.1:** Critical Microfinance Triangle

**Source:** Zeller and Meyer (2002, cited from Khawari, 2004)

Microfinance institutions (MFIs) can usefully employ this concept to manage simultaneously the problems of outreach, sustainability, and impact as they choose their target clients or create products to improve their client's welfare. This concept has also led to the main structure of an analysis of microcredit of village and urban community funds in Thailand which focuses on performance as defined from outreach, financial sustainability, and their impact.

### 1.3 Objectives of the Study

The aim of this study is to evaluate the microcredit of village and urban community funds performance in Thailand from outreach, sustainability, and impact on poverty reduction. Therefore, the objectives of this research will focus on the following:

1.3.1 To investigate the determinants of borrowers of microcredit of Village and Urban Community funds (MVC) in Thailand.

1.3.2 To investigate the determinants of the poor for loan sizes, and the accessibility to get the loan of Village and Urban Community funds in Thailand.

1.3.3 To investigate the determinants of consumption and investment loan of Village and Urban Community funds in Thailand.

1.3.4 To investigate the determinants of defaults at the household level of microcredit of Village and Urban Community funds in Thailand.

1.3.5 To investigate the determinants of overdue debt at the community level of microcredit of Village and Urban Community funds in Thailand.

1.3.6 To examine the effects of Village and Urban Community funds on home-based business through phones.

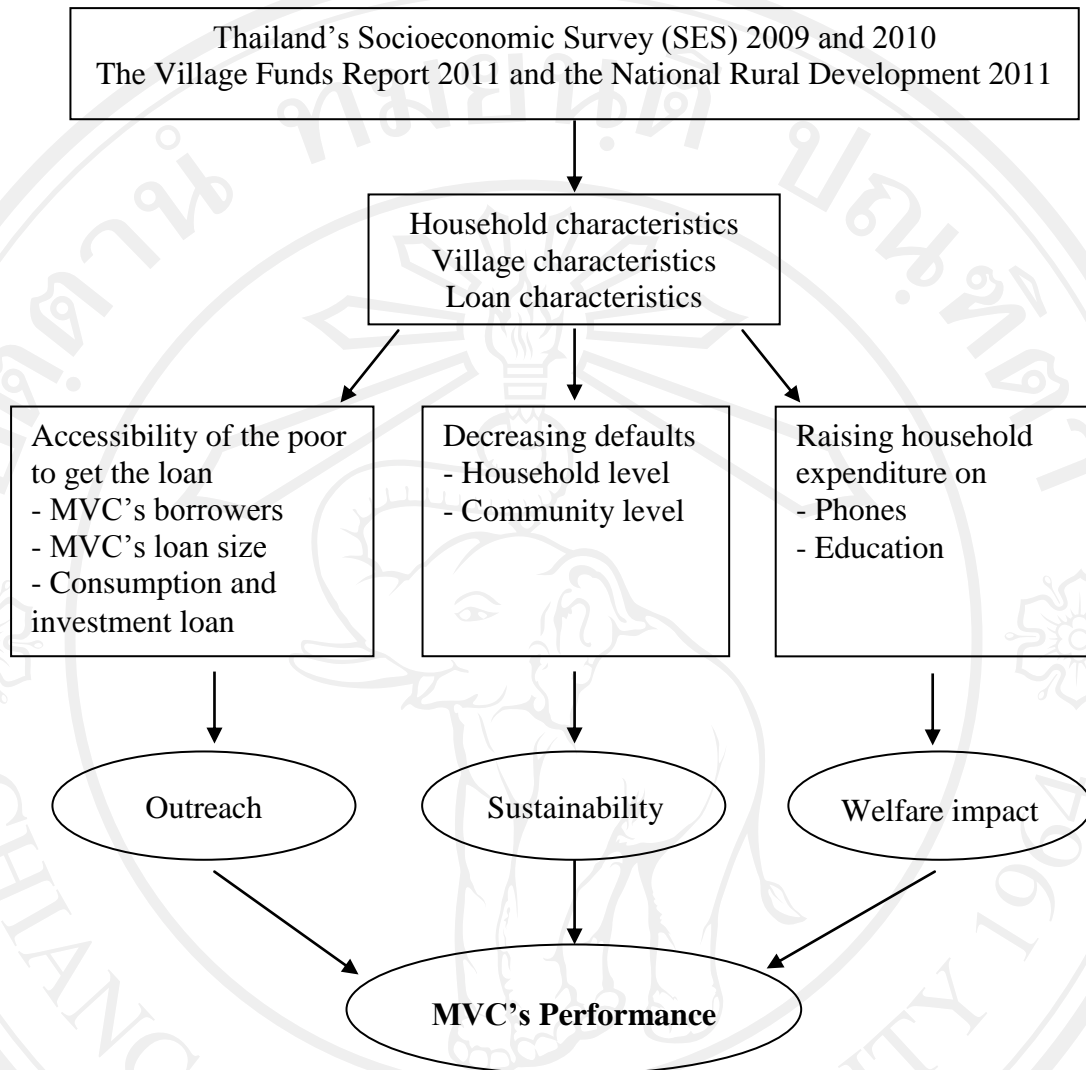
1.3.7 To examine the effects of Village and Urban Community funds on poverty reduction through phones.

1.3.8 To examine the effects of Village and Urban Community funds on poverty reduction through education.

1.3.9 To formulate policy recommendations to enhance the performance of microcredit of Village and Urban Community funds in Thailand.

There are four overall goals of this study on the performance of the microcredit of village and urban community funds in Thailand: first, to investigate empirically factors that determine the microcredit's borrowers and loan sizes as well as the accessibility of the poor to get the loan; second, to investigate empirically the factors that determine the defaults of the microcredit; third, to evaluate the impact of microcredit on poverty reduction through education and ICTs; and lastly, to formulate a consistent package of policy recommendations to enhance the performance of microcredit funds in village and urban communities.

Figure 2 shows the conceptual framework to analyze the MVC's performance. Based on the data from Thailand's Socioeconomic Survey 2009 and 2010, the researcher will receive the household characteristics, village characteristics, and loan characteristics. It will be used to analyze MVC's borrowers, loan sizes, consumption and investment loans, defaults, and their impact on poverty reduction through household expenditures on phones and education. In addition, data from the Village Funds Report 2011 and The National Rural Development 2011 (NRD54) provide information at community level.



**Figure 1.2:** Conceptual Framework to Analyze MVC's Performance

The overall of the MVC's performance in Thailand will consider and follow "the microfinance triangle" which consists of outreach, financial sustainability, and their impacts on poverty reduction. First, accessibility of funds to the poor indicates the outreach performance. Second, decreasing loan default rates can increase financial sustainability performance. Finally, raising household expenditure for education and phones may lead to increase impact of microcredit on poverty reduction. Finally, these three factors will show the overall MVC's performance.

Three main advantages of this study are as followed: first, using a large sample size from Thailand's Socioeconomic Survey (SES); second, focusing on

poverty status change, poor households in 2009 becoming non-poor in 2010, even though the SES 2009 and 2010 data sets which include useful information dealing with the MVC are not panel data, the attempt is to overcome this limitation by constructing a pseudo panel data set by using the propensity score matching technique; finally, tackling the issues by various econometric models.

The answers from this study will provide the necessary information to the government of Thailand to determine whether microcredit of village and urban community funds (MVC) should be expanded or revised in terms of targeting the poor, loan defaults, and their impact on poverty reduction. Moreover, this study will try to expose the black box of the impact of microcredit on poverty reduction through the two key factors of education and information, and communication technologies (ICTs).

In addition, the local committees at the village level may recognize the poor as the target's group of the program. They can use these results to identify the risk of loan defaults, and improve their sustainability.

#### **1.4 Structure of the Dissertation**

To assess the outreach performances of the MVC in Thailand, the binary Logit model will investigate the determinants of borrowers: which will be presented in Chapter 2. Households and individuals with similar characteristics might have different levels of entrepreneurial spirit or ability. These may lead to a difference in the probability to borrow. The independent variables include poverty index, as key testing variables, household head characteristics, demographics, socio-economics class, income and assets and other variables.

Chapter 3 assesses the determinants of loan sizes. To carry out this procedure, it should be with concernment that the data may not be randomized and face the self-selection process. Some households did not borrow the loan because they might not need the credit or did not want to get more loans, even though they had the potential to get a large amount of loan. This study applies Tobit and Heckman selection models to treat these censored data and selection bias problem.

Chapter 4 identifies the factors affecting consumption loan and investment loan. The study applies both univariate and bivariate Tobit models.

Univariate model assume the participation of a household for the two types of loan that are independent. The bivariate model proposes that the same household participate in MVC for both consumption and investment loans. This is a plausible assumption because the same household can choose to borrow for consumption and investment at the same time or they can use more than one person in a household to borrow different type of loans.

To assess the sustainability performances of the MVC in Thailand, probability of default and overdue debt account are an interesting topic for amending in order to see if the microcredit programs had been successful. Chapter 5 investigates the determinants of borrower's defaults of MVC at household level. The binary Probit model will examine factors that influence to default. In addition, Bivariate Probit model will be applied in the case of testing variable of being a poor household; it is likely to be jointly determined with loan defaults. Finally, there are four choices of repayment that represents the degree of severity of defaults. Then, Multinomial Probit model is used to identify probability of each choice.

Chapter 6 assesses the determinants of overdue debt of MVC at the community level. This chapter relies on data from the Village Funds Report 2011 and The National Rural Development 2011 (NRD54) which is different from other chapters. The Heckman Selection model was used to deal with possible selection bias problem. The independent variables include the village fund characteristics and six dimensions of community characteristics.

To assess the impact performances of the MVC, this section tries to show the matter in a different approach by introducing the effects of the MVC through phones and education. Propensity score matching is used to construct a pseudo panel data. Chapter 7 evaluates the contributions of the MVC on the creation of a home-based business through phones using Bivariate Probit model. The model is an appropriate technology for simultaneous equations model involving two binary choice variables which contains an endogenous binary variable in one of the equations.

Chapter 8 has constructed a pseudo panel data. Poor households in 2009 can find that there poverty status has changed in two ways. On the one hand, a poor household may turn to be non-poor in 2010. On the other hand, a poor household may still be poor in 2010. The Probit regression with instrumental variable or IVPROBIT

will examine factors that drive a household to get out of poverty. It will ensure that the increasing use of phones change the poverty status. The use of an instrumental variable is necessary when an independent variable may cause an endogeneity problem in the model. A recursive model may happen when poverty status change may be driven by phones. Also, it is likely that the increasing number of phones is influenced by a change in poverty status.

Chapter 9 evaluates the contributions of the MVC on poverty reduction through education using Bivariate Probit model.

Chapter 10 provides conclusions from the three performances; outreach, sustainability, and impact. Recommendations are also made for further research.

**Table 1.2:** Methodologies for the Study

Chapter	Objectives	Methodologies
2	Determinants of borrowers of MVC	Logit
3	Determinants of loan sizes of MVC	Tobit and Heckman Selection
4	Determinants of consumption and investment loan of MVC	Univariate and Bivariate Tobit
5	Determinants of borrower's defaults of MVC at household level	Probit, Bivariate Probit and multinomial Probit
6	Determinants of overdue debt of MVC at community level	Heckman Selection
7	Effects of MVC on home-based business through phones	Bivariate Probit
8	Effects of MVC on poverty reduction through phones	Probit regression with instrumental variable
9	Effects of MVC on poverty reduction through education	Bivariate Probit