

MICRO- AND SMALL  
ENTREPRENEURS IN URBAN  
NORTHERN THAILAND AFTER  
THE ASIAN CRISIS

The Meaning of Microfinance

by

Klaus Peter Dickhoven

A thesis submitted in partial fulfillment of the  
requirements for the degree of

Dipl.-Oec.

University of Hohenheim

July 31<sup>st</sup>, 2000

1. Supervisor: Prof. Dr. Renate Ohr
2. Supervisor: Prof. Dr. Franz Heidhues

## 8. SUMMARY AND RECOMMENDATIONS

### 8.1 Summary

The present paper is the outcome of

- a rough overview of the eruption of the Asian crisis in Thailand and its immediate effects on the labor market (macro level),
- a description of the supply side of financial sources for micro and small enterprises under consideration of special programs that promote self-employment in the urban area (institutional level), and
- a systematic analysis of self-employment activities among micro- and small entrepreneurs through a field survey among a sample of eighty-five microentrepreneurs working in the informal sector and forty-two micro- and small entrepreneurs operating in the formal sector (household level).

#### 8.1.1 The Asian Crisis and Its Immediate Effects on the Labor Market

The Asian crisis began in the middle of 1997 in Thailand as the fix of the Baht to the US dollar came under increasing pressure. By July, the authorities were unable to defend the peg and the currency commenced a sharp devaluation. This led to a sharp collapse of real general domestic product that has turned unexpectedly from over 7 per cent per annum to minus 8 per cent in 1998. Following substantial lay-offs (e.g. number of employees excluding government employees: minus 22 per cent in Chiang Mai Province between February 1997 and February 1999) and a sharp rise in unemployment occurred. During the same time period the proportion of own-account workers or self-employed on the total work force grew from 25 per cent to 31 respectively, whereas the proportion of private employees dropped from 47 per cent to 38.5% in 1999 (Chiang Mai Province). Hence, the crisis encouraged a shift from private employment to self-employment activities.

#### 8.1.2 Financial Sources for Micro- and Small Entrepreneurs

With reference to latest microfinance discussion, one can differentiate among the formal, semi-formal, and informal financial sector. The formal financial sector is

characterized by being subject to capital, reserve, and liquidity regulations by the central bank in contrast to the semi-formal and informal financial sector. Financial institutions within the formal and semi-formal sector require contrary to informal financial institutions official authorization and are obliged to obey certain regulation (e.g. tax liability). Following is an overview of financial sources.

Table 8.1 – Overview of Financial Sources for both Micro- and Small Enterprises

Organization	below market interest rates	lend to micro enterprises	lend to small enterprises	non-traditional collateral
<b>Informal Financial Sector</b>				
Family Members	✓	✓	✓	✓
Friends	✓	✓	✓	✓
Moneylenders	×	✓	✓	✓
Private Pawnbrokers	×	✓	✓	✓
Rotating Savings and Credit Associations	×	✓	✓	✓
<b>Semi-formal Financial Sector</b>				
Bureau of Cottage and Handicraft Industries	✓	✓	×	✓
Credit Unions	×	✓	×	×
Department of Public Welfare	✓	✓	×	✓
Official Pawnshops	✓	×	×	×
Small Industry Finance Corporation	×	×	✓	×
Small Industry Credit Guarantee Corporation	×	×	✓	✓
Urban Community Development Organization	✓	✓	×	✓
<b>Formal Financial Sector</b>				
Bank for Agriculture and Agricultural Cooperatives	×	✓	×	✓
Commercial Banks	×	×	✓	×
Government Savings Bank	×	✓/×	✓	×
Industrial Finance Corporation of Thailand	✓	×	✓	×

✓	yes
×	no

Source: inspired by Paetkau, M. (July 1999): Financial Support for Micro and Small Enterprises in Thailand. Working Paper 4. ILO: Bangkok.

### 8.1.3 Field Survey

The major findings of the field survey on micro- and small entrepreneurs are summarized under previously used headings:

#### 8.1.3.1 Characteristics of the Entrepreneurs

The informal microentrepreneurs are on average thirty-six years old and well-educated when considering age at the same time. Within the younger age group between 21 and 30 years 19% went to high school, 42% got a vocational training and even 29% earned a university degree. The following groups that pursue a typical pattern of characteristics have been identified: (a) Students, (b) Jobless Former Wagerworkers, (c) Wagerworkers, and (d) “old” microentrepreneurs.

The average age of the formal micro- and small entrepreneurs is forty-two years; interestingly, restaurant owners are on average considerably younger than silver handwork owners. This phenomenon most likely results from differences in initial start-up costs and working capital. The formal self-employed enjoyed a thorough education. For instance, within the younger age group between 21 and 30 years almost half (44%) earned a university degree.

#### 8.1.3.2 Market Entry

Despite migration, only a very small proportion of the informal microentrepreneurs and the formal self-employed were born outside Chiang Mai or one of the other provincial capital cities. This suggests that entry is difficult for migrants. One of the most important obstacles is access to credit/required capital stock. Start-up costs reached on average 33,000 Baht (current market value) in the informal sector, 455,000 for micro enterprises, and 769,000 Baht for small enterprises in the formal sector. In virtually all cases, start-up funds came from personal savings. Even though initial capital required for most activities within the informal sector may be relatively small, business is risky (e.g. heavy fluctuations in demand) and require specific financial, managerial, and technical capabilities that should not be underestimated and define another obstacle in entering the market. In contrast to the informal self-employed, the formal entrepreneurs had been able to save from a relatively high income from previous occupations.

#### 8.1.3.3 The Level of Technical Capabilities Involved

Differences in the acquisition process of technical capabilities were identified. The large majority of both populations used a trial and error approach. When considering age at the same time, it can be seen that 90% of the members of the young group (21-30) of the informal microentrepreneurs went to high school, did a vocational training or earned a university degree. Nevertheless, only 23% of them were able to acquire technical skills through attending classes. Percentages of the second population are similar and thus show that contents of attended classes hardly cover any of the technical capabilities needed to run a micro- or small business.

#### 8.1.3.4 Finances and Household Budget

Informal financial sources play a dominant role in start-up finance. Within the informal sector two groups of microentrepreneurs experience major difficulties in start-up finance: students and former wageworkers who have lost their job because of the crisis. Micro- and small entrepreneurs operating in the formal sector face additional

constraints because of a much higher investment required in comparison to business activities in the informal sector.

In addition, at least two distinct groups among the informal microentrepreneurs could be identified. The first has relatively much higher earnings than the average of the total, whereas the latter one earns below the average income. Type of business and product hereby define the first demarcation line; for example, retail generates high income in contrast to food business and manufacturing. Within the formal sector, neither observation nor interview was an appropriate source to assess enterprises' profitability. Thus, no further conclusion can be drawn.

55% of the informal microentrepreneurs and 52% of the formal micro- and small entrepreneurs noted an improvement of their respective household budget. Within the subcategory food of the consumptive expenditures the majority of the two populations spent less than in 1996. In contrast, expenditures for education, transport & communications, and miscellaneous (subcategory non-food) increased considerably. Both populations have spent almost 50% more on investment in business (non-consumptive expenditures).

#### 8.1.3.5 Employment and Economic Environment

The eighty-five informal microentrepreneurs provide employment for forty-eight family members and twenty-five non-family members (ratio of 0.86 persons/enterprise). The number of non-family wageworkers per informal micro enterprise more than tripled from 0.086 persons to 0.29 persons. On average permanent and seasonal wageworkers realize a tax-free income that slightly exceeds the minimum wage of 137 Baht in Thailand. On the other hand, the formal micro- and small entrepreneurs employ on average sixty-four family members and one hundred and thirty-one non-family member, i.e. 4.6 persons per enterprise (1.7 persons per formal micro enterprise and 9.4 persons per small enterprise respectively). Income of wageworkers in the formal sector clearly exceeds the Northern Thai Region minimum wage. Within the informal sector 60% of the non-family wageworkers come from rural areas; this proportion is hardly smaller within the formal sector (50%) and may indicate higher market entry barriers for rural migrants.

As a result of the Asian crisis, overall demand has declined throughout the country. 50% of the informal microentrepreneurs and 68% of the second population noticed a decline in aggregate demand in comparison to 1996. Businesses that mainly

serve foreign customers could extend their sales; however, the majority (51% of informal and 68% of formal entrepreneurs) is selling fewer goods than in 1996. Besides the demand constraint, perceived competition among the self-employed has been analyzed. On this issue, almost 77% of the informal microentrepreneurs and 68% of the formal entrepreneurs felt that competition has increased since 1996. However, this phenomenon has more to do with the fact that product differentiation is insufficient.

#### 8.1.3.6 General Difficulties

The comments of entrepreneurs operating in the informal sector are similar to those given by the micro- and small entrepreneurs in the formal sector. Unsatisfactory aggregate demand has been mentioned most; however, this has more to do with the fact that product portfolio is the same or very similar among the self-employed. Thus, it is almost impossible to differentiate one's products by other factors (e.g. product quality) than price. Particularly informal microentrepreneurs also reported weather conditions as main obstacle.

#### 8.1.3.7 Registration (Informal Sector)

Microentrepreneurs operating in the informal sector face the additional constraint of not having a legal status. Not only can they be treated unlawfully by members of public service but they are also unable to apply for governmental support programs since they do not fulfill the criterion of being registered that is usually required. According to the survey, most informal microentrepreneurs feel that they are not required to register (e.g. too low profits, mobile vending). The jurisdictional situation is not clear on this issue: business activities on the night market do have the character of street vending and thus should be exempted from registration requirement. However, daily profits often significantly exceed 20 Baht/day that have been set as minimum level.

## 8.2 Recommendations

1. It is recommended to set a policy frame that stimulates aggregate demand. This can be reached through continuing the efforts in reaching a more equal income distribution, since low-income groups usually have a higher consumption and lower savings rate than middle-/high-income groups. In this connection it is crucial not to tax self-employment activities of the informal microentrepreneurs. The survey shows that this type of entrepreneurs is very heterogeneous, i.e. one group would not be able to pay any taxes and need to close their micro-business

with harmful social effects. The other group, on the other hand, would be taken the possibility to further expand and thus realize positive employment effects that are crucial in times of economic recession. Nevertheless, a registration (without tax liability) would help the government to better assess the development of the informal sector and thus enabling the government to react more adequately to the needs and preferences of this particular group that contributes to economic growth.

2. Measures should be undertaken to encourage product differentiation among micro- and small entrepreneurs. According to the sample, most of the sampled units complained of a too high competition among themselves; however, this can be only partly put down to new market entrants. More important, offered products and services are the same or very similar so that only price can be used to differentiate one's products from the competitors'. The Thai government, therefore, should support training programs that increase entrepreneur's capabilities (with emphasis on technical capabilities). Then, micro- and small entrepreneurs can differentiate themselves from each other and enjoy better business prospects.
3. The sample shows a very high proportion of well-educated persons on the total number of entrepreneurs. Nevertheless, most of the sampled units acquired technical skills through the trial and error approach. Thus, the Thai government should prove whether high schools, vocational training facilities, or universities should put more emphasis on the importance of entrepreneurial skills and capabilities in their respective syllabus.
4. Even though effective credit demand may be currently low because of the weak economic situation, it is indispensable to take measures that will improve entrepreneur's access to credit. As soon as the Thai economy will slowly recover, credit demand will rapidly grow. Especially, government-owned financial institutions such as the Government Savings Bank need to completely revise their organizational structure so that they can better serve micro- and small entrepreneurs

In conclusion, self-employment activities should be promoted for several reasons: One, the present study shows that micro- and small businesses are able to adapt more flexible to unfavorable economic conditions than middle-sized or large companies. For example, they adopt measures that not only ensure their own viability but also the growth of the economy as a whole. Two, they provide a considerable employment potential as they produce labor-intensively, while capital investment is rather low. Last, it serves as an essential contributor to economic growth.