



UNIVERSITI PUTRA MALAYSIA

**DETERMINANTS OF SHORT-TERM FINANCING
AMONG ISLAMIC SAVINGS CO-OPERATIVES IN THAILAND**

TAWAT NOIPOM

GSM 2003 5

**DETERMINANTS OF SHORT-TERM FINANCING AMONG ISLAMIC
SAVINGS CO-OPERATIVES IN THAILAND**

By

TAWAT NOIPOM

**Thesis Submitted to the Graduate School of Management, Univeristi Putra
Malaysia, in Partial Fulfillment of the Requirements for the Degree of
Master of Science**

November 2003

**Abstract of thesis presented to the Senate of Universiti Putra Malaysia in
partial fulfillment of the requirements for the degree of Master of Science**

**DETERMINANTS OF SHORT-TERM FINANCING AMONG ISLAMIC
SAVINGS CO-OPERATIVES IN THAILAND**

By

TAWAT NOIPOM

November 2003

Chairman: Shamsudin Ismail, M.Sc.

Faculty: Economics and Management

This research investigates the relationship between profitability, liquidity, and management preference and the use short-term modes of financing among Islamic savings co-operatives in Thailand. The results of this research will shed some light on whether profitability, liquidity and management preference are determinants of short-term financing in the co-operatives.

Both descriptive statistics and regression analysis are used in this study. Descriptive analysis is used to explain the relationship between short-term financing and management preference. Regression analysis is applied to obtain the relation of short-term financing to profitability and liquidity. Data used in descriptive analysis is obtained via a questionnaire. Data on short-term financing, profitability, liquidity and other two contributing factors i.e. solvency and activity is obtained from secondary data mainly income statements, balance sheets and statements of cash

flow. The raw data is transformed to financial ratios to represent profitability, liquidity, solvency and activity management. Short-term financing is calculated from the change of short-term financing over the period.

The results of the regression analysis show that the profitability, liquidity, and activity management of the co-operatives are determinants of short-term financing in the co-operatives. The results confirm opinions being expressed by most executive board members and staff of the co-operatives who agreed, during the survey session, that profitability and liquidity are the two main concerns for the co-operatives to rely heavily on short-term modes of financing. The management of the co-operatives agree somewhat that they prefer short-term financing.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi sebahagian keperluan untuk ijazah Master Sains

**FAKTOR PENENTU PEMBIAYAAN JANGKA PENDEK DI KALANGAN
KOPERASI SIMPANAN ISLAM DI THAILAND**

Oleh

TAWAT NOIPOM

November 2003

Pengerusi: Shamsudin Ismail, M.Sc.

Fakulti: Ekonomi dan Pengurusan

Kajian ini bertujuan mengenalpasti hubungan antara keberuntungan, kecairan dan keutamaan pihak pengurusan dan penggunaan pembiayaan jangka pendek di kalangan Koperasi Simpanan Islam di Thailand. Hasil kajian ini dijangka memberi petunjuk sama ada keberuntungan, kecairan dan keutamaan pihak pengurusan merupakan faktor penentu bagi pembiayaan jangka pendek dalam koperasi tersebut.

Dalam kajian ini, statistik deskriptif dan analisis regresi telah digunakan. Statistik deskriptif digunakan untuk menerangkan hubungan antara pembiayaan jangka pendek dengan keutamaan pihak pengurusan. Analisis regresi pula bertujuan untuk mengkaji hubungan antara pembiayaan jangka pendek dengan keberuntungan dan kecairan. Data yang digunakan dalam analisis deskriptif diperolehi melalui soal selidik, manakala data berkaitan pembiayaan jangka pendek, keberuntungan, kecairan dan dua faktor penyumbang lain seperti solvensi dan aktiviti pengurusan diperolehi dari data sekunder, antaranya seperti penyata pendapatan, lembaran

imbangan dan penyata aliran kewangan. Data-data mentah tersebut ditranformasikan ke bentuk nisbah kewangan bagi mewakili keuntungan, kecairan, solvensi dan aktiviti pengurusan. Penggunaan pembiayaan jangka pendek diperoleh dari perubahan pembiayaan jangka pendek dalam jangka masa berkenaan.

Keputusan analisis regresi menunjukkan ada perkaitan antara penggunaan pembiayaan jangka pendek dengan keberuntungan, kecairan dan aktiviti pengurusan dalam koperasi tersebut. Hasil kajian ini membuktikan kebenaran pandangan kebanyakan ahli eksekutif dan kakitangan koperasi. Dalam kajian yang dijalankan, mereka bersetuju yang keberuntungan dan kecairan merupakan dua faktor penting bagi koperasi untuk bergantung kepada pembiayaan jangka pendek. Dalam masa yang sama, pihak pengurusan bersetuju mereka lebih mengutamakan pembiayaan jangka pendek.

ACKNOWLEDGEMENT

I would like to express my special appreciation and gratitude to Mr. Shamsudin Ismail, Dr. Abu Hassan Md Isa and Dr. Huson Joher Aliahmed who jointly supervised this work. I would like to thank all the academic staff of the Graduate School of Management, Universiti Putra Malaysia for their sincere guidance and help.

Special thanks are also due to the management and staff of the Islamic Savings Co-operative of Pattani Limited, Ibn Affan Islamic Savings Co-operative Limited, Ibn Auf Islamic Savings Co-operative Limited and As-Siddeek Savings Co-operative Limited for providing me with all the facilities and documents needed in order to complete this research. Special appreciation must also be given to El Farouq Foundation, which provided me financial support to undertake this study.

Finally, my most heartfelt appreciation and gratitude to my father, Mr. Apichon Noipom, my mother, Hied Noipom, my wife, Rusnat Noipom and my two sons, Faadey and Weishaan for their support, encouragement and patience.

TABLE OF CONTENTS

	Page
ABSTRACT	2
ABSTRAK	4
ACKNOWLEDGEMENTS	6
APPROVAL	7
DECLARATION	9
LIST OF TABLES	12
LIST OF FIGURES	13
 CHAPTER	
 I	
INTRODUCTION	14
Islamic Principles Governing Activities of Financial Institutions	14
The Prohibition of Riba	15
Socio-economic Goals	18
Islamic Savings Co-operatives and Recent Developments In Thailand	20
General Principles	21
Co-operative Development in Thailand	24
Modes of Financing	44
Statement of the Problem	46
Objectives of the Study	49
Overall Objectives	49
Specific Objectives	49
 II	
LITERATURE REVIEW	51
Dominance of Short-term Modes of Financing	51
Objectives of Financial Institutions	56
Liquidity	57
Profitability	58
Solvency	59
Management Preference	60
Factors Driving Dependence on Short-term Modes of Financing	61
The Concerns about Liquidity	61
The Concerns about Profitability	64
The Management Preference	66
 III	
THEORETICAL FRAMEWORK & METHODOLOGY	70
Theoretical Framework	70



	Activities of Islamic Savings Co-operatives in Thailand	72
	Research Methodology	75
	Data Collection	75
	Nature of Data	77
	Sampling Design	81
	Treatment of the Data	83
	Analysis of the Data	86
IV	PRESENTATION AND ANALYSIS OF DATA	89
	Respondents' Characteristics	89
	Descriptive Analysis of the Questionnaire	93
	Awareness of Financing Used by the Co-operatives	94
	Opinion on Profitability	97
	Opinion on Liquidity	100
	Management Preference	103
	Regression Analysis	107
	Correlation Matrix	111
	Pooling Regression Results	112
V	CONCLUSION AND RECOMMENDATIONS	121
	Introduction	121
	Major Findings of the Study	121
	Limitations of the Study	124
	Implications	125
	Recommendations for Practice	127
	Recommendations for Further Research	129
	Conclusions	131
	BIBLIOGRAPHY	133
	APPENDICES	139
	BIODATA OF THE AUTHOR	168

LIST OF TABLES

	Page
Table 1: Number of Members and Total Assets	26
Table 2: The Modes of Financing Two Major Islamic Savings Co-operatives in Thailand	68
Table 3: Respondents According to Co-operative	83
Table 4: Age	89
Table 5: Monthly Income	90
Table 6: Religion	91
Table 7: Marital Status	91
Table 8: Education	92
Table 9: Summary of Descriptive Analysis	97
Table 10: Summary of Descriptive Analysis – Profitability	100
Table 11: Summary of Descriptive Analysis – Liquidity	102
Table 12: Summary of Descriptive – Management Preference	107
Table 13: Descriptive Analysis	108
Table 14: Correlation Matrix	111
Table 15: Results of Pooling Regression Analysis	113
Table 16: Summary of Hypothesis Testing	114



LIST OF FIGURES

	Page
Figure 1: The Dominance of Short-term Modes of Islamic Saving Co-operatives in Thailand	50
Figure 2: Relationship Between Goals of Business Organization and its Activities	71

CHAPTER ONE

INTRODUCTION

This section is meant to provide a general background to the principles governing Islamic financial institutions; the developments of Islamic savings co-operatives in Thailand; the statement of the problem on which this research is based; and objectives of this research. The discussion begins with the Islamic principles governing the operations of Islamic financial institutions. It is followed by a discussion of Islamic savings co-operatives and their recent development in Thailand. Next, some working definitions of modes of financing and how these modes work will be discussed. Finally, the statement of the problem and the objectives of the study will be highlighted.

Islamic Principles Governing Activities of Financial Institutions

Islam is a religion that guides man in all his undertakings. It governs all aspects of life be they economic, spiritual etc. In an economic system of Islam in which financial activities form a crucial part, Islam provides very basic principles to ensure that all activities follow Islamic values and norms. These principles are the prohibition of *Riba* and the promotion of socio-economic objectives (Ahmad, 1989). In order to gain some insight, these two paramount principles are discussed below:

The Prohibition of *Riba*

Riba is a core consideration of Muslim scholars and academicians in the operation of Islamic financial institutions. The word '*Riba*' is used interchangeably with 'interest' and 'usury' in the modern context. Ibn Mazur (1968) in his book '*Lisan al-Arab*' noted that *Riba* literally means increase, addition, expansion or growth. In Islamic Law, *Riba* technically refers to the premium that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in its maturity. The following sub-section is, therefore, devoted to a discussion of the meaning of *Riba* and its implications in Islamic banking and financial transactions. Some of the Verses of the *Quran*¹ and *Ahadith*² are listed below:

The Verses of the *Quran*

Many *Quranic* verses mention *Riba* and its related principles. A number of the verses are cited below.

" Those who devour *Riba* Will not stand (on the Day of judgment) except As stands one whom The Evil One by his touch Hath driven to madness. This is because they say: "Trade is like *Riba*." But Allah hath permitted trade and forbidden *Riba*. Those after receiving Admonition from their Lord, Desist, shall be pardoned for the past: their case is for Allah (to judge) But those who repeat (The offence) are Companions of the Fire: they will Abide therein (forever). God will deprive *Riba* of all blessings, but will give increase for deeds of charity: for he loveth not creatures ungrateful and wicked. Those who believe, and do deeds of righteousness, and establish regular prayers and regular charity, will have their reward with their Lord: on them shall be no fear, nor shall they grieve. O ye who believe! Fear God, and give up what remains of your demand for *Riba*, if ye are indeed believers. If ye do it not, take notice of war from God and his Apostle: but if ye turn back, ye shall have your capital sums: deal not unjustly, and ye shall not be dealt with unjustly.

¹ The sacred book of the Muhammadans, contains the collected revelations of Muhammad in definitive written form, "The Royal Netherlands Academy," *Encyclopedia of Islam*, 1974 ed, p 273.

² It is plural of '*Hadith*', an Arabic word, which stands for a record of actions or sayings of the Prophet Muhammad and his companions, *ibid*; p 116.

If the debtor is in a difficulty, grant him time till it is easy for him to repay: But if ye remit it by way of charity that is best for you if ye know. And fear the Day when ye shall be brought back to God. Then shall every soul be paid what it earned, and none shall be dealt with unjustly. "

(Al Baqarah, 2:275-281)

" O ye who believe! Devour not *Riba*, doubled and multiplied; but fear God; that ye may (really) prosper." (*Ali Imran*, 3:130)

"For the iniquity of the Jews, We made unlawful for them certain (foods) good and wholesome which had been lawful for them; in that they hindered many from God's way. That they took *Riba*, through

That which ye lay out for increase through the property of (other) people, will have no increase with God: but that which ye lay out for charity, seeking the Countenance of God, (will increase): it is these who will get a recompense multiplied." (*Al Rum*, 30:39)

Ahadith

Apart from the verses of the *Quran*, there are a few sayings and examples of the practices of the prophet Muhammad related to *Riba*. Some of these are listed below.

"From Jabir: The Prophet, may peace be upon him, cursed the receiver and the payer of interest, the one who records it and the two witnesses to the transaction and said: " They are all alike (in guilt)." (*Muslim*)

"Fadalah Ibn Ubayd said, " The benefit derived from any loan is one of the different aspects of *Riba*." (*Bayhaqi*)

"From *Ubada ibn al -Samit*: The Prophet, peace be upon him, said:
" Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt - like for like, and hand-to-hand if the commodities differ; then you may sell as you wish, provided that the exchange is hand-to-hand."
(*Muslim*)¹

"From *Abu Hurayrah*: The Prophet, peace be upon him, said: God would be justified in not allowing four persons to enter paradise or to taste its blessings; he who drinks habitually, he who takes *Riba*, he who usurps an orphan's property without right, and he who is undutiful to his parents."
(*Al Hakim*)¹

From the verses of the *Quran* and *Ahadith*, it is clear that Islam permits trade and prohibits *Riba*. Islam underlines that a person should not reap a reward until he expends an effort. According to Islam, the practice of *Riba* will result in injustice and viciousness among people. As a result, the goals of the Islamic economy such as the equitable distribution of income and social justice, may not be achieved. Islam rather permits trading with no *Riba* and encourages *Sadaka*³. The *Quran* also gives a warning of what *Riba* practitioners will face on the Day of Judgment.

Opinion of Muslim Scholars

Muslim scholars and academicians have been engaged in an endless discussion on *Riba*. Tabari (1954), in his well-known book ' *Tafsir Ibne Jarir Tabari* ', defined *Riba* as the increase, which accrues to the lender on account of deferred payment due to the extension in the actual period of a loan. Ibn Manzur (1968) noted that *Riba* which is prohibited includes the extra amount, benefit and advantage received on any loans. Ibn al-Mutahhar (1955), however, said that *Riba* transactions include only those involved in the exchange of commodities, in exchange for another. Most scholars agree that the prohibition of *Riba* is equally applicable to loans and barter transactions, to consumption loans, to loans advanced to physical persons and to those advanced to legal persons like a trust and the treasury, to charging a fair rate and charging exorbitantly (Ahmad, 1989).

³ The giving of alms by a Muslim is a witness to the truthfulness of his religion; Ibid; p 483.

Socio-economic Goals

According to Islam, there must be certain socio-economic goals which a business enterprise must pursue in addition to its business goals. These socio-economic goals are briefly discussed below.

Economic Well-being within an Islamic Framework of the Moral Norms of Islam

One of the unique characteristics of the Islamic economy is the simultaneous stress on both the material and spiritual aspects of life. Islam encourages people to explore the world and benefit from whatever bounties provided by God. It regards the struggle for material well-being as an act of virtue. Muslims, therefore, should explore and gain mastery over nature. Islam does not agree with begging. This, therefore, implies that the goal of attaining a suitably high rate of economic growth is one of the economic goals of a Muslim society (Chapra, 1992).

However, Islam reminds Muslims that in pursuing an economic goal, they must not ignore spiritual values. One, thus, shall never acquire wealth through unfair dealings or subject anybody to wrong and injustice. Muslims must bear in mind that whatever they do will bear fruit in this world and the hereafter. If anybody does not follow Islamic principles, they will be punished on the Day of Judgment.

Universal Brotherhood and Justice

As stated by Chapra (1992), the concept of universal brotherhood is mutual co-operation and help, particularly among Muslims who, besides being united to each other as to the rest of mankind by a common origin, are further united by bonds of common ideology, and have been characterized by the *Quran* as 'brothers-in-faith'. This universal brotherhood is closely linked to the emphasis of Islam on justice. Since Muslims are considered brothers, there shall be no injustice among them in all dealings both socially and economically. Discrimination will not, therefore, occur in Muslim society.

Apart from social justice, Islam also emphasizes on economic justice. Economic justice is actually the principle that makes the concept of brotherhood and equal treatment of all individuals meaningful. According to Islam, everyone must get his due for his contribution. The employer, for instance, gives his employees just wages so that they can live comfortably. Employees, on the other hand, must be hardworking, honest and trustworthy. They must work at their full ability to make a project successful. These employer-employee relations are always influenced by the Islamic brotherhood existing between the two.

Equitable Distribution of Income

The equitable distribution of income does not mean that everybody is rewarded equally irrespective of their contributions to society. Islam does tolerate some

inequities of income because not all people are equal in their character, ability and service to society. However, everyone in Muslim society must at least enjoy a respectable standard of living. In order to ensure the practice of the concept of the equitable distribution of income, Islam provides three main redistribute programs. These programs are just remuneration, *Zakat*⁴ and the division of the estate of a deceased person.

Freedom of Individual Choice within the Context of Social Welfare

In Islam, an individual is free and has the right to do anything within the limits of the Islamic framework. His freedom is, thus, sacred as long as it does not conflict with the larger social interest or as long as the individual does not transgress the rights of others (Chapra, 1992). An employer, for example, can earn as much profit he wants as long as he performs his obligations of just wages, distribution of quality products etc.

Islamic Savings Co-operatives and Recent Developments in Thailand

A co-operative is a business organization that plays a very important role in all countries of the world. It is a business voluntarily organized, operating at cost, which is owned, capitalized and controlled by member-patrons, sharing risks and benefits proportional to their participation (Roy, 1969). A savings co-operative is a financial institution, the members of which are of the same occupation or live in the

⁴ The alms-tax, one of the principal obligations of Islam; means a tax which is levied on definite kinds of property and is distributed to eight categories of persons; Ibid, p 654.

same area, which encourages members to save and borrow whenever there is a need, and enjoy the benefits from their participation (Department of Co-operative Society Promotion of Thailand, 1994: p 2). A savings co-operative is, therefore, a type of co-operative that plays a role as non-bank financial institution, receives deposits and mobilizes funds to business enterprises. It is however not a financial intermediary in a strict sense (Savarimuthu, 1986). In order to get some insights into the operations of savings co-operatives in Thailand, some general principles of the savings co-operative are discussed in the following sub-section.

General Principles Governing Savings Co-operatives in Thailand⁵

All co-operatives in Thailand operate under Co-operative Society Act 1999. The act is aimed at co-operatives' proper management and control. Some important aspects of the Act are listed below:

Objectives of the Savings Co-operative

As a financial institution, a savings co-operative is intended to stimulate savings among its members and to provide loans when the members need them. The co-operative promotes co-operation among the members to solve economic and social problems. The specific objectives of the savings co-operative are as follows;

1. To encourage savings among the members.

⁵ Department of Co-operative Society Promotion: Ministry of Agriculture and Co-operative Society of Thailand, "Savings Co-operatives" (1993).

A savings co-operative can encourage savings in two ways. Firstly, members may buy shares of the co-operative. This requires the members to make monthly payments for their shares. When a member leaves the co-operative, he will be eligible to refund of his contribution amount of shares. Secondly, a savings co-operative provides facilities for deposits. Members or other persons may deposit their money on the basis of fixed and savings deposits. The co-operative usually provides returns to depositors in the form of interest.

2. Grant of loans

A savings co-operative lends money, which is received from its depositors and paid by members for the co-operative's shares, to needy members. The interest rate of a savings co-operative is normally lower than the interest rate of other financial institutions. There are three types of loans granted by savings co-operatives to its members. Firstly, emergency loans are loans granted to the members who are urgently in need of money, for example, for hospitalization and the like.

The second type of loans is ordinary loans. These loans are granted to any member who needs to borrow. These loans can be for the purchase of goods and services or for members' investments. The loans shall not exceed 4-15 times of the money received by the co-operative monthly. In Thailand, the highest amount that a member can borrow is between 40,000-150,000 Baht. The borrowers must repay in 24-84 installments. For a loan contract to be complete, a borrower's application for a loan must be guaranteed by at least one co-operative member.

The final type of loans is extraordinary loans. These are loans granted to members to venture into business or to purchase real estate. The amount of these loans must not exceed 200,000-600,000 Baht and must be repaid in 10-15 years. The borrower must leave real estate or land as collateral.

Operations of Savings Co-operatives

When a savings co-operative is established, its members will elect their representatives to administer the co-operatives. The representatives are called the 'Board of Executives'. The board usually consists of 7-15 members or any number complying with the rules and regulations of particular co-operatives. The board is responsible for establishing policy and guidelines for the operations of the co-operative. The board members will meet at least once a month to discuss and fix policy and pass it to the management. The management comprises a manager, assistant manager, treasurer, finance officer etc. The management's main duty is to manage the office and to carry on activities to serve the members within the co-operative's rules and regulations.

1. Acquisition of funds

A savings co-operative acquires funds from the following sources:

- a) Sale of its shares
- b) Deposits from depositors
- c) Reserves and other accumulated savings
- d) Loans from individuals and other financial institutions

- e) Donations from other sources

2. Rights and responsibilities of members

Since a savings co-operative is collectively owned by its members, the members must exercise their rights and be responsible. Members can cast their votes and make inquiries on any matter in the co-operative's annual general meeting. In the meeting, the following main points are usually discussed:

- a. Recruitment of new members and resignation of old members
- b. Presentation of annual reports
- c. Discussion and approval of financial statements
- d. Dividend policy
- e. Approval of the next year's budget
- f. Amendment of roles and regulations and dissolution
- g. Limitation of loans
- h. Report of auditor
- i. Election of new Board of Executives
- j. Appointment of internal inspectors

Islamic Savings Co-operative Development in Thailand

Islamic banks and non-bank financial institutions have been increasingly important as alternatives to the conventional ones. In most Muslim countries as well as non-Muslim countries, Islamic financial institutions have been established. In 1996 for example, the number of Islamic financial institutions reached 166 worldwide (The