

Investment Risk Management of Islamic Cooperatives in Thailand: A Case Study of Ibnu Auf Cooperative Limited

Mohammadtahir Cheumar¹, Wan Nazjmi Mohamed Fisol², Yusuf Haji-Othman³, Norhayati Abdullah⁴, Sulaiman Dorloh⁵, Umar Akem⁶

^{1,2,3,4} Universiti Islam Antarabangsa Sultan Abdul Halim Mu'adzam Shah (UniSHAMS), Malaysia.

⁵Sultan Idris Education University, Perak Darul Ridzuan, Malaysia.

⁶Ibnu Auf Technological College, Satun, Thailand

Abstract

Cooperative movement in Thailand has a long history with the establishment of Wat Chan Cooperative way back in 1916. The objective then was to save Thai farmers from losing most of their agriculture land to the middle men and money lenders, resulting from inability to settle their debts. Today more than 7000 cooperatives exist in Thailand alongside other established institutions of intermediation such as the commercial banks, Islamic bank and credit companies forming an important component of the vast landscape of Thailand financial infrastructure. Islamic cooperative on the other hand is a new entry to the financial system, emerged in 1987 starting with the establishment of Islamic Savings Cooperative of Pattani Limited by Den Tokmena, a former senior government officers and Vice Minister of Health Care and Home affairs of Thailand. The existence of Islamic cooperatives, in particular in the southern region is not without problems. Many contemporary and long-standing issues are haunting the Islamic cooperatives in particular on the unfavourable regulatory and supervisory frameworks that have not been supportive of their growth and development. Similar to the case of Islamic bank of Thailand (IBank), Islamic cooperatives in Thailand do not have a “level playing field” with their conventional counterparts. The issues are worsened with higher risk exposures that Islamic cooperatives are facing due to the nature of their products and services that have to be *Shariah* compliant. Many Islamic cooperatives are facing problems of inadequate capital and tight liquidity position, together with incompetent staff and poor corporate governance. This study is an attempt to evaluate the natures and severity of investment risks of their products and services that have to be *Shariah* compliant in Islamic cooperatives in southern Thailand: Ibnu Auf Cooperative Ltd., and hence to propose workable strategic mitigation plans.

Keywords: *Islamic cooperative, risk management, Islamic investments*

Introduction

There were 7,043 cooperatives with an individual membership of 11,470,013 or about 18% of the total Thai population compared to the only 31 Islamic cooperatives with membership of less than 200,000, operating mainly around the southern provinces of the Kingdom (Patrawart, J and Sriurai, S ,2016). Cooperative societies exist in Thailand alongside other established institutions of intermediation such as the commercial banks, Islamic bank and credit companies forming an important component of the vast landscape of Thailand financial infrastructure. Islamic cooperative on the other hand is a new entry to the financial system, emerged in 1987 starting with the establishment of Islamic Saving Cooperative of Pattani Limited by Den Tokmena, a former senior government officers and Vice Minister of Health Care and Home affairs of Thailand. In his visit to Manila in 1983, attending *Shariah* Administrative Conference of Asia, Den Tokmena was very impressed with the establishment of Phillippines Amanah Bank, the first Islamic bank in Asia. Upon his return to Thailand, Den Tokmena wanted to establish an Islamic bank, but the idea was rejected by the government, and an immediate alternative Den Tohmena establish an Islamic cooperative in 1987. By 1988 Islamic Savings Cooperative of Pattani (ISCP) had 360 registered members, and within 10 years (1998) the membership had increased to 8,186, with branches in 12 districts in the Provincial Pattani.

Thailand is a multi-religious country with Buddhists being the majority and Islam the minority with only around six million followers. Majority of the Muslims occupy and reside around the five Southern Regions of Thailand. In Southern Thai, the traditional financial institutions mostly revolved around the institutions of pawnshop and towards the 80's the Cooperative Societies were established by the Muslims in the region. These two main financial intermediaries exist to these days alongside the existence of modern financial institutions. Long before these commercial banks embarked in Islamic banking business, *Shariah* compliant financial services in Thailand were initially made available through Muslim cooperatives in the southern region. Initially there are four of such cooperatives, which are still in active operation until today and they are Islamic Savings Cooperative of Pattani, Ibnu Affan Saving Cooperative, As_Siddiq Savings Cooperative, Saqaffah Islamic Savings Cooperative, and Al-Islamiah Savings Cooperative (Yamirudeng, K.M. 2013, Haron, S. &Yamirudeng, K.M., 2003). Cooperative movement in Thailand has a long history with the establishment of Wat Chan Cooperative way back in 1916. The objective then was to save Thai farmers from losing most of their agriculture land to the middle men and money lenders, resulting from inability to settle their debts. Today thousands of cooperatives exist in Thailand alongside other established institutions of intermediation such as the commercial banks, Islamic bank and credit companies forming an important component of the vast landscape of Thailand financial infrastructure.

Islamic cooperative on the other hand is a new entry to the financial system, emerged in 1987 starting with the establishment of Islamic Savings Cooperative of Pattani Limited by Den Tokmena, a former senior government officers and Vice Minister of Health Care and Home affairs of Thailand. The existence of Islamic cooperatives, in particular in the southern region is

not without problems. Many contemporary and long-standing issues are haunting the Islamic cooperatives in particular on the unfavourable regulatory and supervisory frameworks that have not been supportive of their growth and development. Islamic cooperatives in Thailand is very much at their “infancy” stage, being in existence for less than 30 years compared to the conventional cooperatives which existed since 1916, (CPD Tahiland, 2016). Although the basis of operations of Islamic cooperatives is different from their conventional counterparts, they are subjected to the same laws and regulatory requirements under the Co-Op Act of 1999 (formerly under Cooperative Act of 1968). This has created additional burdens of risks to the Islamic cooperatives as the laws of the country do not recognise Islamic contracts (Ngah, B.N, 2017). The scope of services for an Islamic cooperative is very wide and being an institution of financial intermediaries for the members, the cooperative engages in businesses ranging from trading to investments, apart from meeting the financial needs of the members.

Types of Cooperatives in Thailand

In 1999, cooperative act as ‘Cooperative Act, B.E. 2542’ was issued and has been enacted since then, the cooperatives in Thailand are officially categorized to seven (7) types, namely (i) Agricultural Cooperative, (ii) Land Settlement Cooperative, (iii) Fisheries Cooperative, (iv) Consumer Cooperative, (v) Saving and Credit Cooperative, (vi) Service Cooperative, and (vii) Credit Union Cooperatives. However, by the year 2016, there exist 9 types of cooperatives in Thailand, including Islamic cooperatives as reflected in Table 1.1 below

Structure and Composition of Cooperative Societies in Thailand -2014

Overall composition of cooperative societies in Thailand is reflected in Table 1.1 below.

Table 1.1: Annual Statistics of Cooperatives, Agricultural Groups and Vocational Groups in Thailand 2014

Cooperatives	Number of Active Cooperative	Number of Memberships
1.Agricultural	3,712	6,601,495
2.Fishery	79	15,317
3.Thrift & Credit	1,396	2,771,351
4.Land Settlement	90	188,427
5.Consumer	174	731,042
6.Services	1,134	461,104
7.Credit Union	508	710,812
All Type	7,093	11,275,804

Source: Co-Op Promotion Department, Thailand, 2016

As reflected in the above Table 1.2, the biggest cooperatives are the Agriculture cooperatives with a membership of more than 6.6 million or 58% of the total cooperative membership in the Kingdom of Thailand.

Organizational Structure of Cooperative in Thailand

In term of scope of operations, conventional cooperatives tend to be very specific in their activities commensurate with their names and objectives of establishment.

Cooperative in Thailand are very vertically organized in a three-tier system; primary cooperatives at district level and federations at provincial and national level. The primary cooperative consists of individual members while members of provincial and national federations are cooperatives. The members elect the board of directors through the general meeting with maximum number of 15 persons for cooperative development policies formulation. The board of directors, then, appoints a manager and staff to run the cooperative business. Five or more cooperatives at primary or provincial level can form a provincial or national federation together to undertake joint activities on behalf of their affiliations such as processing and trading of agricultural products. At national level, there is the Agricultural Cooperative Federation of Thailand of which all 76 provincial agricultural cooperative federations are affiliate. There are also the Sugarcane Growers Cooperative Federation of Thailand, Swine Raisers Cooperative Federation of Thailand, Dairy Cooperative Federation of Thailand and Onion Growers Cooperative Federation of Thailand. Thrift and Credit Cooperatives, and Consumer Cooperatives are affiliated in a national federation of their own. All types of cooperatives at all levels, according to the Cooperative Act, B.E.2542, have to implicitly be affiliates of the Cooperative League of Thailand (CLT). The CLT in functioning as an apex body of the whole cooperative movement. It does not run as a business enterprise, but acts as a facilitator, coordinator and provides educational support in the promotion of all cooperative progress (CPD, 2012). For Islamic cooperatives however, much wider scope of activities, Islamic cooperatives are exposed to a much wider risk spectrum compared to their conventional counterparts.

This study is specific to the examination of risk profile of Islamic cooperatives in Thailand based on their credit and investment activities.

Statement of Problems

Although most Islamic cooperatives in Thailand are profitable but profitability among them is wide ranging from a net profit of 5% to 45%. Past studies on Islamic cooperatives as well as Islamic banking in Thailand revealed similar problems as listed below;

1. Unfavourable regulatory and supervisory frameworks, (Fereydoony, M. 2012).
2. Capital inadequacy, (Mahamud, T. 2016).
3. Islamic liquidity management, (Mahamud, T. 2016).
4. High investment risk, (Ngh, B.N. 2017).

5. Incompetence human resources, (Mahamud, T. 2016).
6. Poor corporate governance, (Ngah, B.N. 2017).

As Fereydoony (2012) cited incompatible laws as a major obstacle to the development of Islamic financial institutions in Thailand. Lacking in Islamic financial infrastructure, such as Islamic liquidity market (ILM) to enable Islamic cooperatives to manage their shortages as well as their liquidity surplus has caused serious inefficiency in liquidity management, (Mahamud, T. 2016). Although all cooperatives are free to deposit their funds with any financial institutions in Thailand but Islamic cooperatives are restricted in accepting “interest” on their deposits, in which case “interest” income from conventional banks is to be disposed-off to charitable organizations. Investment in Government marketable instruments such as government bonds and government securities are forbidden as all government instruments are conventional-based and interest bearing. *Sukuk* issuance is still a pending matter in Thailand, for which IBank is still struggling with its first *Sukuk* issue (IBank annual report, 2013).

Islamic cooperatives, unlike their conventional counterparts are not allowed under *Shariah* laws to pay fixed return to their depositors and investors while at the same time members are expecting higher returns on a continuous basis. This has resulted in the cooperatives experiencing higher cost of funds compared to conventional banks or even the Islamic banks, (Ngah, B.N. 2017). *Mudharabah* depositors in Islamic cooperatives tend to lose their money as “*Rabbul-mal*” in the event that the cooperatives incurred losses. In 1998, *Muamalat* Savings Cooperative of Thailand collapsed due to numerous reasons including investment failures. There is a very high risk of investment as discovered by Ngah (2017) under Islamic contracts of *Musyarakah* in project financing as compared to *Murabahah* or even *Ijarah* contracts which are based on prices marked-up. Islamic cooperatives involved in many joint-venture investment either with their members or with corporations outside their membership. Some of the JV’s suffered losses due to several causes which include lacking in technical competencies among the management of most cooperatives, (Mahamud, T. 2016). Lacking in financial prudence and poor corporate culture and poor *Shariah* governance have also been cited as among the major problems facing Islamic financial institutions including Islamic cooperatives, (Shodiq, M., 2014). Staff competencies have also been a global issue in Islamic finance, including the Islamic cooperatives and as such the Thailand’s Cooperative Act of 1999 spelt out very clearly of the needs for all cooperatives to develop the knowledge and competencies of their members and staff.

Research Questions

Based on preceding discussion this paper has the following questions that need to be addressed;

1. What are the types of investment risks exposed to Islamic cooperatives in Thailand?
2. How Islamic cooperatives can mitigate such risks?

Shariah compliant commercial banks and FC lies in two aspects of ownership-common bond and mutuality. Common bond often results in FC members' knowledge of creditworthiness of other members and allow exercise of moral suasion on member mortgagors as they may feel greater social pressure to repay outstanding instalments.

Moreover, FC management usually has access to inside information about the financial position and job security of *Shariah* compliant mortgage financing applicants, which is not generally available to other types of financial intermediaries. A consequence of this information advantage is that, these FCs may be more efficient, either because they hold fewer bad *Shariah* compliant mortgages in their portfolio, or are able to spend less time and cost in processing applications and monitoring outstanding defaults. The tight bond restriction however, comes at the cost of a less diversified *Shariah* compliant mortgage financing portfolio, potentially negating the peer monitoring advantage (Esho, 2001). In the past, FC' common bond and mutuality organisational structure have addressed asymmetric information problems by requiring that these institutions to extend mortgage finances only to members. Member mortgagors' personal financial information regarding size and share account balances is often supplemented by the personal knowledge of the member-mortgagor. Prior to the general availability of online credit reports, this common bond and mutuality arrangement reduced costs of extending and monitoring *Shariah* compliant mortgage financing to member-mortgagor whose financial statements and financing records had been difficult to acquire (Srinivasan and King, 1998). Today, on the other hand, apart from few institutions that still specialise in specific customer groups, FCs have no restrictions with respect to their clients. They have since evolved into larger firms, which transact with many mortgagors who are not members and which are run by professional managers. In other words, members are usually customers, but not all customers are members (Gorton and Schmid, 1999). Additionally, in an economy where people change jobs and locations regularly, the inter-temporal and inter-personal commitment that defines the 'common bond' may be even harder to preserve (AlMuharrami and Hardy, 2013).

Most cooperatives are dependent on the internal resources of capital (i.e., share capital, member's fees, and retained earnings). Since FC' asset and liability holding defines its size; it should be positively related to its willingness to extend *Shariah* compliant mortgage financing. One would expect small FC to be less willing to offer *Shariah* compliant mortgage financing to its members. A small FC must either commit a relatively large portion of its portfolio to *Shariah* compliant mortgage in order to spread the highly specialised overhead costs thinly, diversified into other types of banking activities or else, completely stay out of the *Shariah* compliant mortgage market (Peterson and Kidwell, 1983). On the other hand, larger FCs are in a position to spread overhead costs over a larger volume of financing and can obtain portfolio diversification more easily. Thus, they may be more willing to make *Shariah* compliant mortgage financings.

Performance of Islamic Cooperatives in Thailand

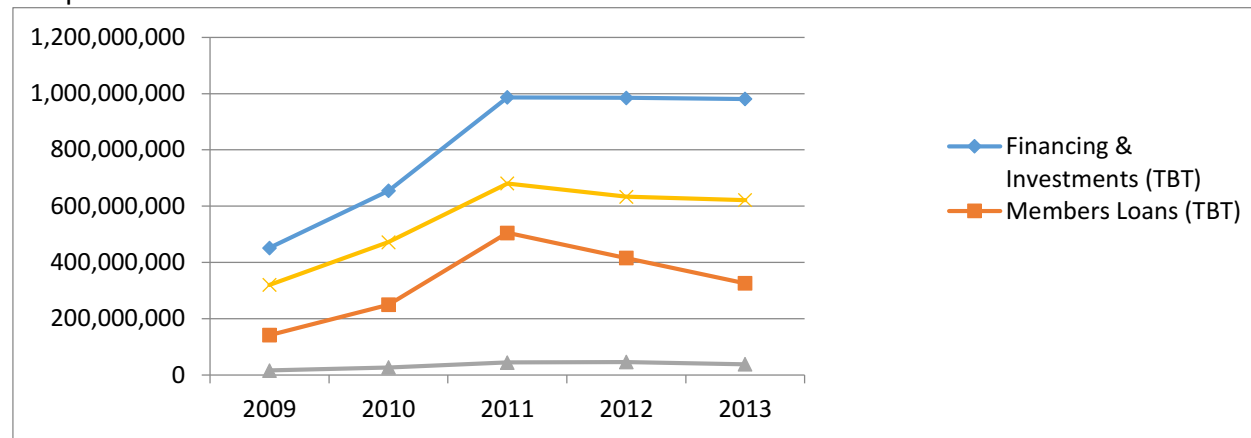
Based on limited data available Performance of Islamic Cooperatives in Thailand in term of ROA and ROE are presented below:

Table 1.4: Ibnu Auf Cooperative Ltd. 2009-2013

#	ITEMS	Financial Year					Growth 5 Years %
		2009	2010	2011	2012	2013	
1	Number of Membership	22,668	25,193	26,156	27,650	28,160	23.80%
2	Reserve Capital (TBT)	10,009,639	11,715,455	14,646,022	19,829,138	24,422,385	140%
3	Share Capital (TBT)	220,946,570	290,426,050	450,014,500	568,129,300	634,510,100	188%
4	Total Co-op Funds (TBT)	248,670,141	330,028,737	509,190,226	633,800,908	697,245,775	181%
5	Financing & Investments (TBT)	451,674,806	654,384,801	986,474,409	984,782,620	981,081,771	177%
6	Total Assets (TBT)	700,344,948	984,413,539	1,495,664,637	1,618,583,528	1,678,327,546	139%
7	Members Loans (TBT)	141,788,641	249,828,382	504,803,410	415,589,131	326,067,906	129%
8	Total Deposits (TBT)	320,354,614	472,181,491	680,525,672	633,665,173	621,492,390	94%
9	Total Revenue (TBT)	28,588,246	44,263,465	77,101,201	73,166,431	73,966,480	155%
10	Total Expenses (TBT)	12,435,767	17,632,490	33,018,604	27,333,961	36,112,681	
11	Net Profit (TBT)	16,152,479	26,630,974	44,082,596	45,832,470	37,853,798	137%
12	Net Profit Margin %	57	59	57	61	51	
13	Return on Capital (ROE %)	7	9	9.7	8	5.9	
14	Return on Assets (ROA %)	2.3	2.7	2.9	2.8	2.3	
15	Zakat Co-op	553,563	835,708	1,559,506	1,975,558	1,200,000	117%

Source: Ibnu Auf Annual Report

Chart 1.1: Financing & Investment, Members loans, Net profit and Total deposit of Ibnu Auf Cooperative Ltd. 2009-2013



Source: Ibnu Auf Annual Report

Financial Planning in Risk Management

Prudence, responsiveness, empathy, and transparency are some of the imperative values strongly linked to risk management. FC on the other hand, tend to lean on the more conservative side of risk management as their business model flows from their underlying principles of maximising members' surplus (Goglio and Alexopoulos, 2014). By involving itself in the *Shariah* compliant mortgage financing intermediation however, FC will be investing in the real economy and create spill over effects to all stakeholders. In the following sub-sections, we explore the types of risks faced by FC in offering *Shariah* compliant mortgage financing. In particular, we examine default risk, profit rate risk, and liquidity risk (Md. Zabri et al., 2015).

Conclusion

Therefore, such as claims of FC's ability to sustain such business models can be little more than rhetoric as there is a need for closer examination by asking a few critical questions, among others: how to increase the funds? To what end in sacrificing the basic cooperative's principles? It is through answering these questions that greater transparency and accountability of *Shariah* compliant mortgage financing by FC in Southern Thailand can be achieved and this type of product can genuinely make a contribution toward helping low to middle-income Muslims communities.

Corresponding Author

Mohammadtahir Cheumar, Center for Islamic Finance Education and Research (CIFER), Sultan Abdul Abdul Halim Mu'adzam Shah, Kedah, Malaysia.

Email: tahir@unishams.edu.my

References

- Al-Muharrami, S., & Hardy, D. C. (2014). Cooperative And Islamic Banks: What Can They Learn From Each Other? In J. Ortega (Ed.), *International Perspectives on Participation Advances in the Economic Analysis of Participatory & Labor-Managed Firms* (Volume 15., pp. 73–94). Emerald Group Publishing Limited.
- CPD (2012). Cooperative Promotion Department, Ministry of Agriculture and Cooperative. Available at: http://cpdhost.cpd.go.th/cpd/cpden/osc_th.html. Retrieved on 27 February 2018.
- CPD (2016). Co-Op Promotion Department, Thailand, 2016
- Denzin, N. K. (1978). *The research act: A Theoretical introduction to sociological methods* (2nd ed.). New York: McGraw Hill.
- Ebrahim, M. S. (2009). Can an Islamic model of housing finance cooperative elevate the economic status of the underprivileged? *Journal of Economic Behavior & Organization*, 72(3), 864–883.
- Esho, N. (2001). The determinants of cost efficiency in cooperative financial institutions: Australian evidence. *Journal of Banking & Finance*, 25(5), 941–964.
- Fereydoony, Mehdi. (2012). *The Compatibility of Islamic Business Law with International Business Commercial Law, The Case of Islamic Bank of Thailand*; Faculty of Law, Thamassat University, Thailand
- Gorton, G., & Schmid, F. (1999). Corporate governance, ownership dispersion and efficiency: Empirical evidence from Austrian cooperative banking. *Journal of Corporate Finance*, 5(2), 119–140.
- Haron, S. and Yamirudeng, K. M. (2003). Islamic Banking in Thailand: Prospects and Challenges. *International Journal of Islamic Financial Services*, 5 (2): 1-11.
- IBank annual report (2013). Islamic Bank of Thailand Annual Report (Thai). Also available at: <https://www.ibank.co.th/files/shareholder/attachments/a6a6d6da30b8c6827329c25b2aff19dc.pdf>. Retrieved on 6/10/2020.
- Ibnu Auf Annual Report (2009-2013).
- Mahamud, T. (2016) "A study of strengths and weaknesses of islamic cooperatives in Thailand," *International Journal of Scientific and Technical Advancements*, Volume 2, Issue 1, pp. 11-13, 2016.
- Mahamud, T. (2016) "A study of strengths and weaknesses of islamic cooperatives in Thailand," *International Journal of Scientific and Technical Advancements*, Volume 2, Issue 1, pp. 11-13, 2016.
- Md. Zabri, Mohd. Zaidi (2015). An Analytical Framework to Examine Shari'ah-Compliant Mortgage Financing by Financial Cooperatives in Malaysia. *Journal of Islamic Finance*, Vol. 4 No. 2 (2015) 018 – 030. IIUM Institute of Islamic Banking and Finance ISSN 2289-2117 (O) / 2289-2109

- Ngah, B.N, (2017). Comparative Performance of Islamic Bank of Thailand and Pioneering Islamic Banks in Indonesia and Malaysia: Multidimensional Performance Measures and Compliance to IFSB Prudential Standards. PhD. Thesis, Kuliyah Muamalat, KUIN.
- Patrawart, J and Sriurai, S ,2016. The New Challenges in the 2nd Century of Agricultural Cooperatives Development in Thailand; Conference paper 11th ICA Asia Pacific Regional Research Conference on Cooperatives and Sustainable Development 15th November, 2016-Hotel Ashoka, New Delhi, India.
- Peterson, R., & Kidwell, D. (1983). Credit union participation in the mortgage markets. *Nebraska Journal of Economics and Business*, 22(1), 45–57.
- Shodiq, Muhammad (2014). Beyond Liberalization of Islamic Banking in Thailand: A Comparative Study with Indonesia and Malaysia; Available at: <http://islamifinanceglobal.blogspot.my/2014/05/beyond-liberalization-of-islamic.html>.
- Srinivasan, A., & King, B. F. (1998). Credit Union Issues. *Economic Review*, 83(3), 32–41.
- Taylor, R. A. (1971). The Credit Union as A Cooperative Institution. *Review of Social Economy*, 29(2), 207– 217.
- Yamirudeng, Kumajdi (2013) Factors Influencing Selection of Islamic Banking in Thailand: The Mediating Effect of Confidence. PhD Thesis, Universiti Utara Malaysia, Sintok. Available at <http://etd.uum.edu.my/view/creators/Kumajdi=3AYamirudeng=3A=3A.html> Retrieved on 12 Mar 2017.