

# Banking Sector Reforms in Bangladesh and Its Impact

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# Agenda of the Presentation

- Objectives of the Study
- Research Methodology
- Background of the Reforms
- Banking Sector Reforms in Bangladesh
- Impacts of Reforms on
  - Financial Development
  - Performance of Banking Sector
- Conclusions and Policy Inferences

## Objectives

- Review the banking sector reform programs;
- Assess the development of the financial system;
- Compare the financial performance of the banking system; and
- Suggest some policy measures for strengthening the restructuring mechanism.

## Research Methodology

- Banking sector is divided into four groups
- Main sources of data are secondary
- Data collected from different sources are compared with those of BB departmental database
- Development in the financial system is assessed by time series data since 1993.
- Trend analysis of time series data since 1997 is done to indicate the banks' performance.
- Banks' performance is assessed using the components of CAMEL framework.

# Background of Reform

1972 to 1982

- Aim to achieve economic objectives of govt.
- Rigid government control
- Fixed interest rates
- Directed credits
- Directed expansion of branches
- Branches increased
- Population per branch reduced
- Poor credit analysis
- Lending rates were low
- Poor debt recovery
- Profitability declined
- Operational efficiency deteriorated

# Background of Reform

1983 to 1989

- Two NCBs denationalized
- PCBs allowed to operate
- Excessive government interference
- Regulations based on economic consideration
- Absence of prudential regulation
- Inadequate legal support for debt recovery
- Customer service improved
- Undue influence of the vested interest groups
- Profitability of the industry declined
- The four NCBs were technically insolvent

## Instigation of Reforms

National Commission on Money, Banking and Credit was formed in 1986 in order

- to identify the major problems, and
- to suggest remedial measures for the efficient management of the banking system

# Reforms Programs

## Financial Sector Reform Program

### Objectives

- To remove distortions and bring competitiveness in the financial sector,
- To make NCBs commercially viable for subsequent privatization, and
- To help PCBs to increase their market share in total commercial banking.

## Commercial Bank Restructuring Project

### Objectives

To identify the urgent course of actions needed for continuing the development of commercial banks.



## Major Reform initiatives

### Policy Reforms

- Risk-Based Capital adequacy
- Loan Classification and Provisioning
- Credit Risk Grading
- Interest Rate Deregulation
- Performance Planning System

### Institutional Reforms

- Off-site Supervision
- Credit Information Bureau
- Large Loan Reporting System

### Legal Reforms

- The Banking Companies Act, 1991
- Artha Rin Adalat Act, 1990
- Bankruptcy Act, 1997

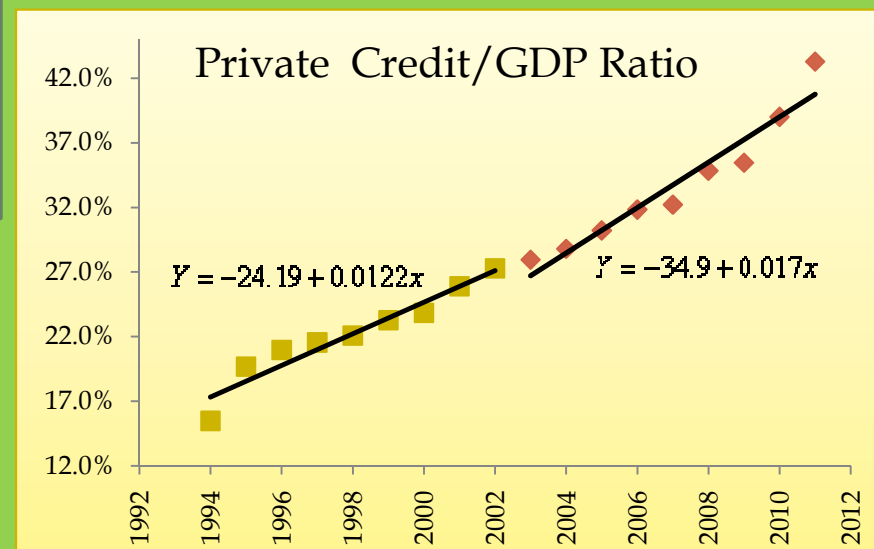
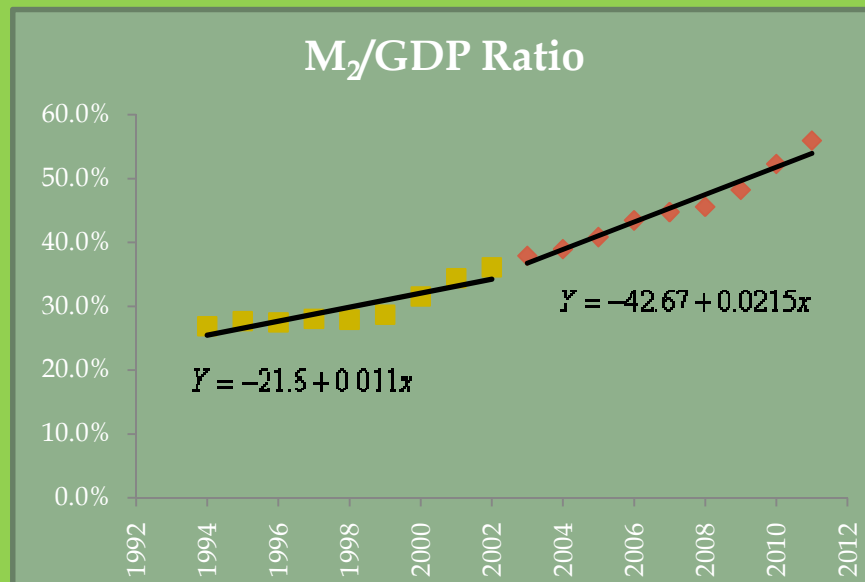
# Impact of Reforms

## Financial Sector Development

- Financial Deepening
  - Size and Depth
  - Mobilization of savings
  - Improvement in the cash flows towards the banking system
- Competitiveness within the industry
- Profitability of the banking industry

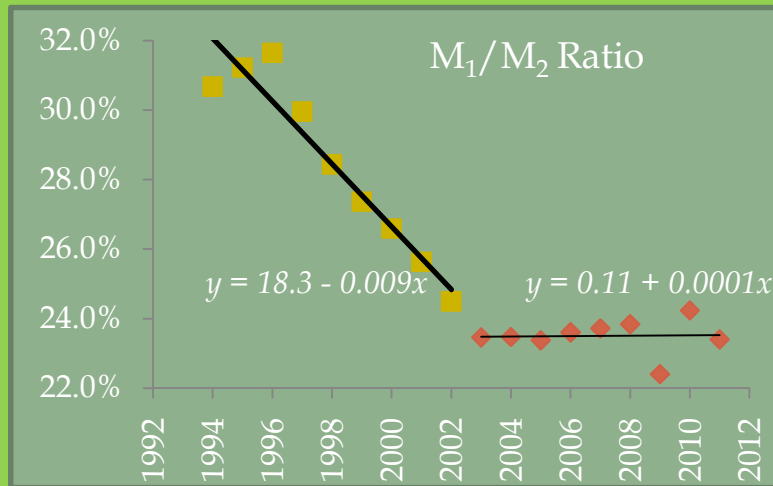
# Impact of Reforms on Financial Sector

## Size and Depth

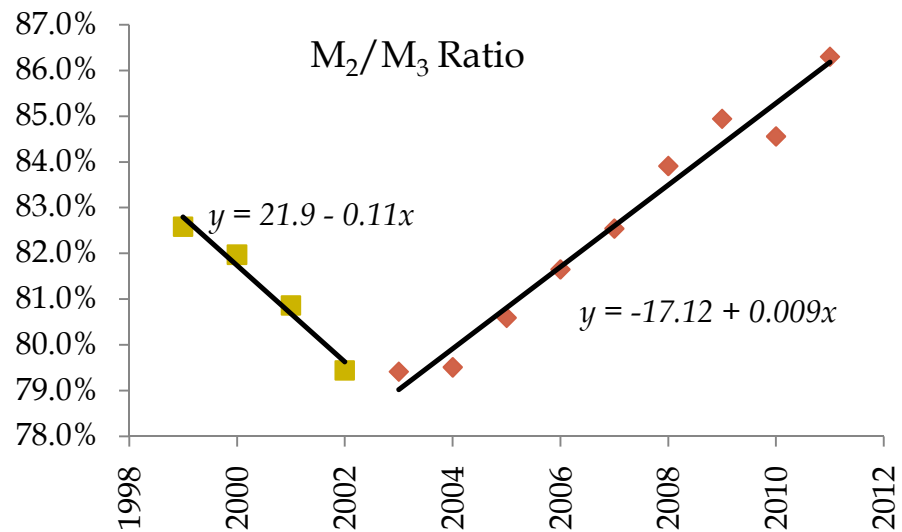


# Impact of Reforms on Financial Sector

## Mobilizing Savings

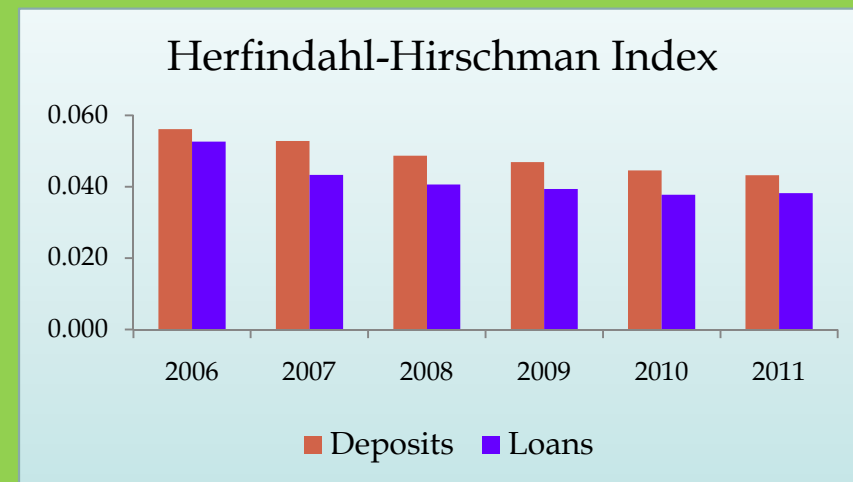
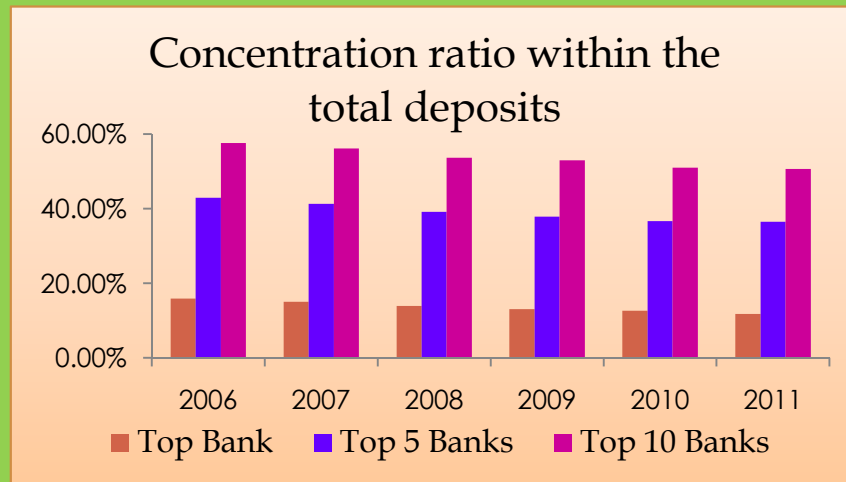


## Cash flows to Banking System



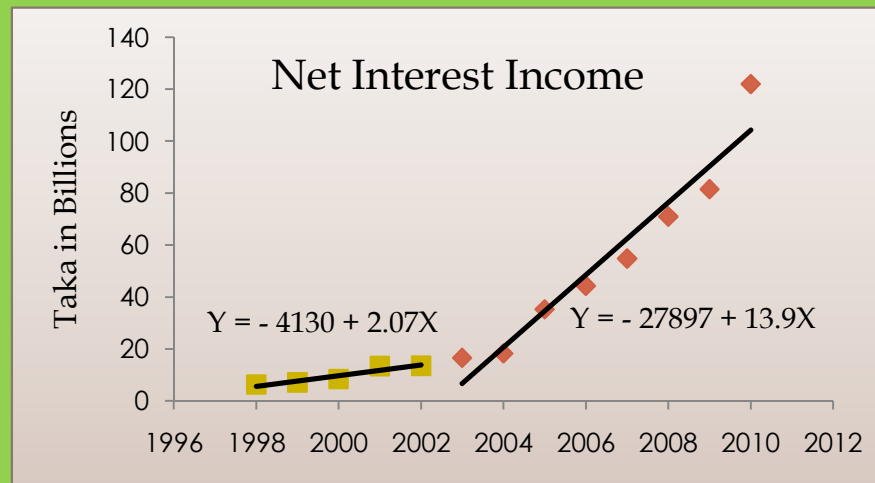
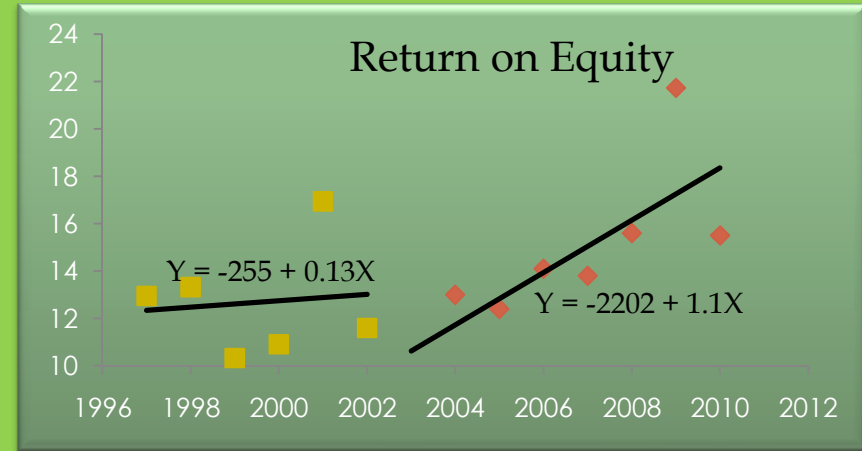
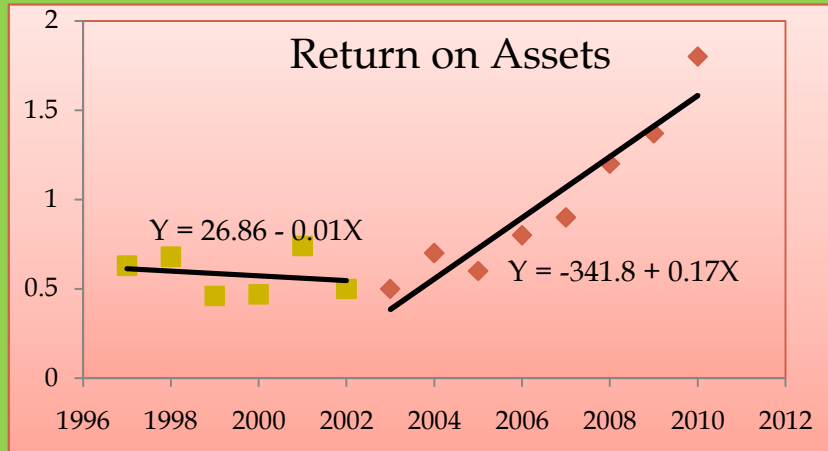
# Impact of Reforms on Financial Sector

## Competitiveness of the Banking Industry



# Impact of Reforms on Financial Sector

## Profitability of the Banking Industry



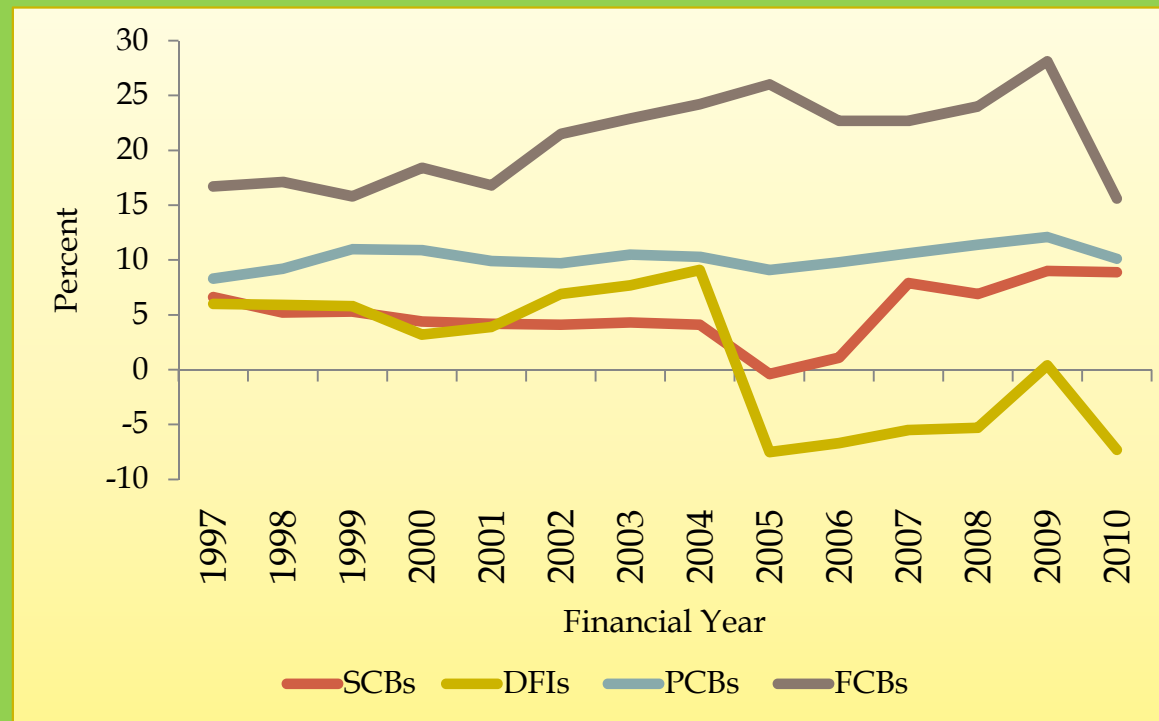
# Impact of Reforms on Bank Performance

## Measures of Performance

- Capital Adequacy
- Asset Quality
- Management Efficiency
- Earning Performances
- Liquidity

# Impact of Reforms on Bank Performance

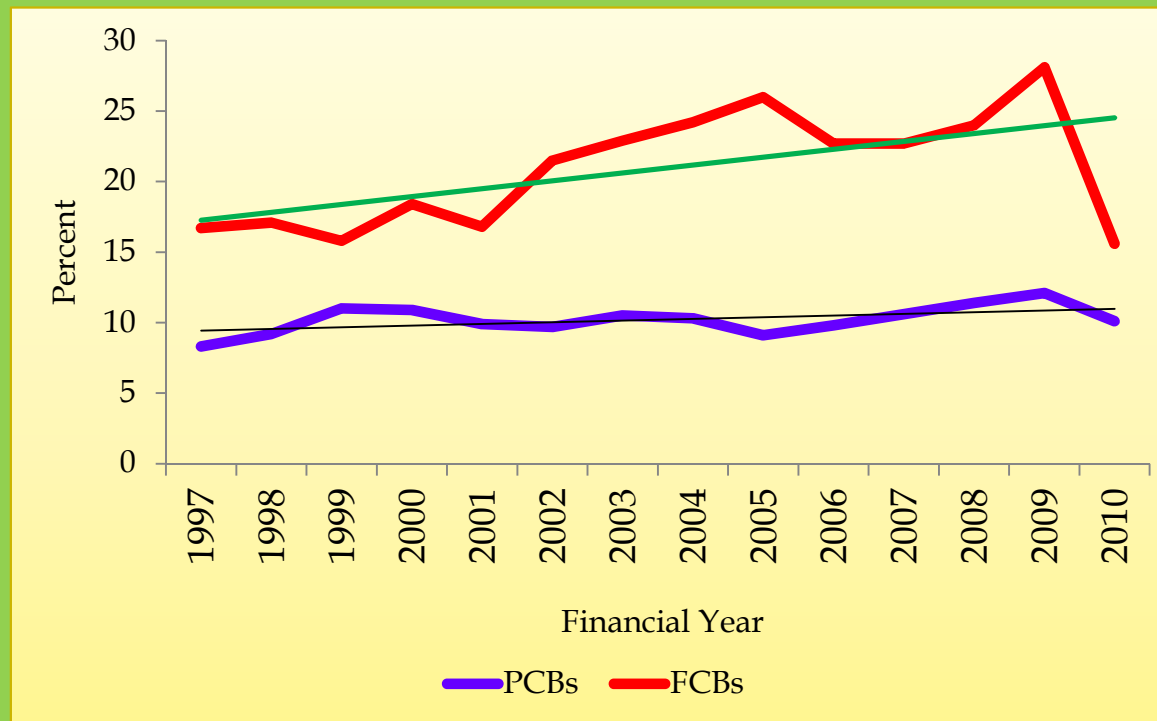
Capital Adequacy: Capital to Risk Weighted Assets Ratio





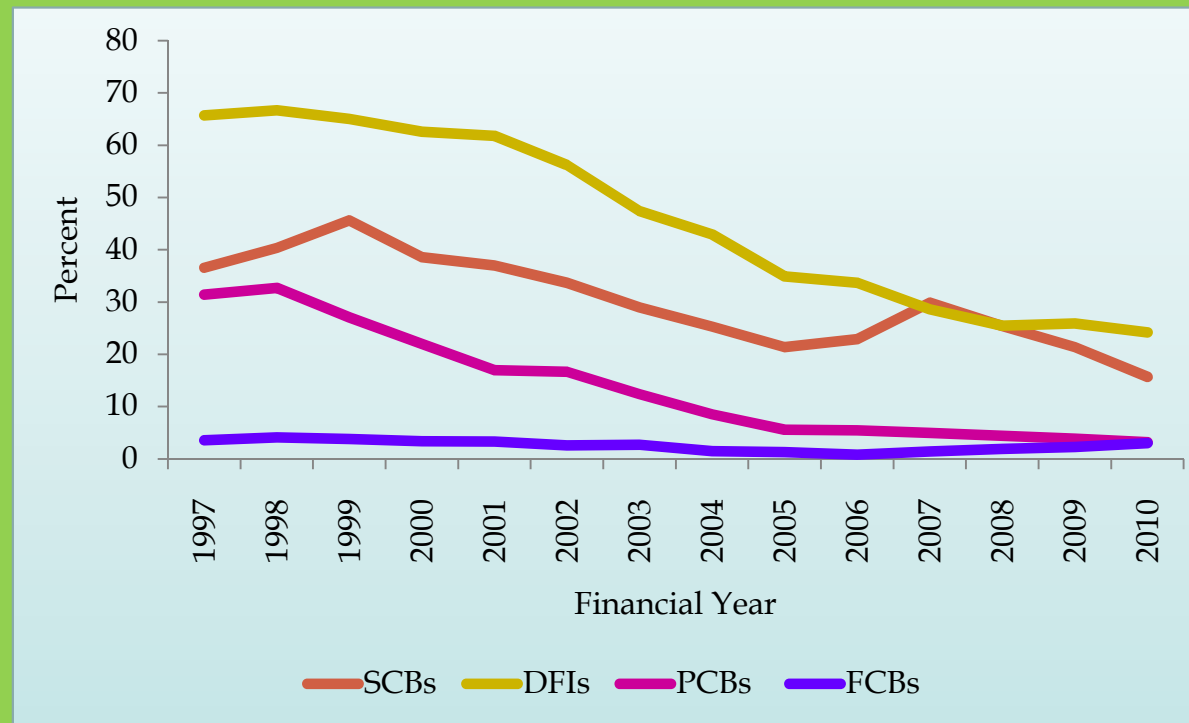
# Impact of Reforms on Bank Performance

## Capital Adequacy: FCBs and PCBs



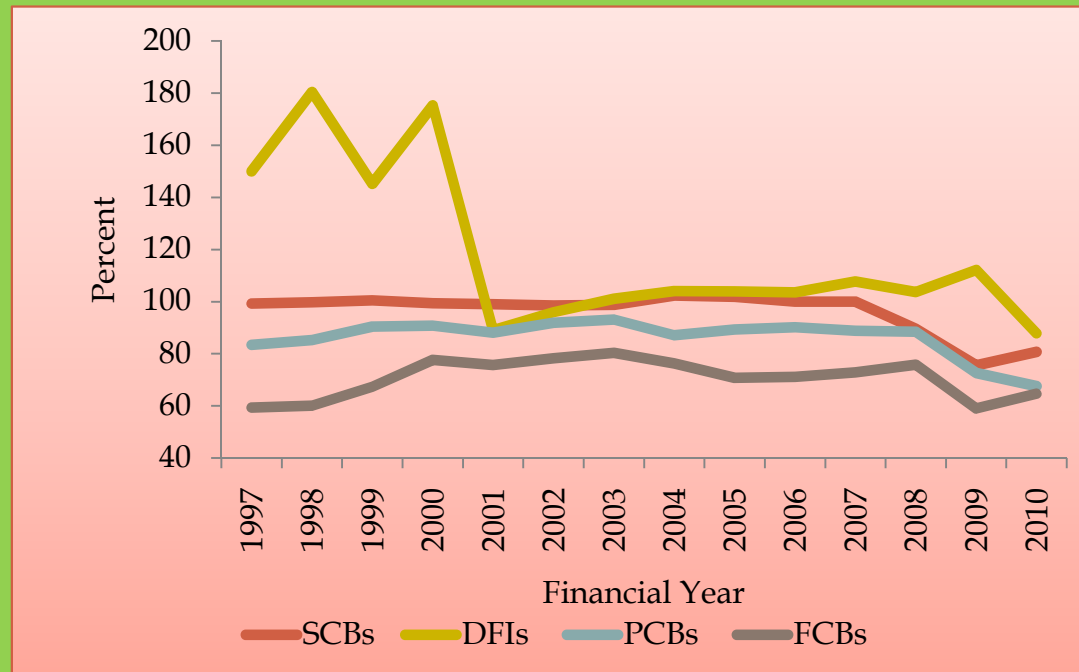
# Impact of Reforms on Bank Performance

## Asset Quality: Non-Performing Loans to Total Loans Ratio



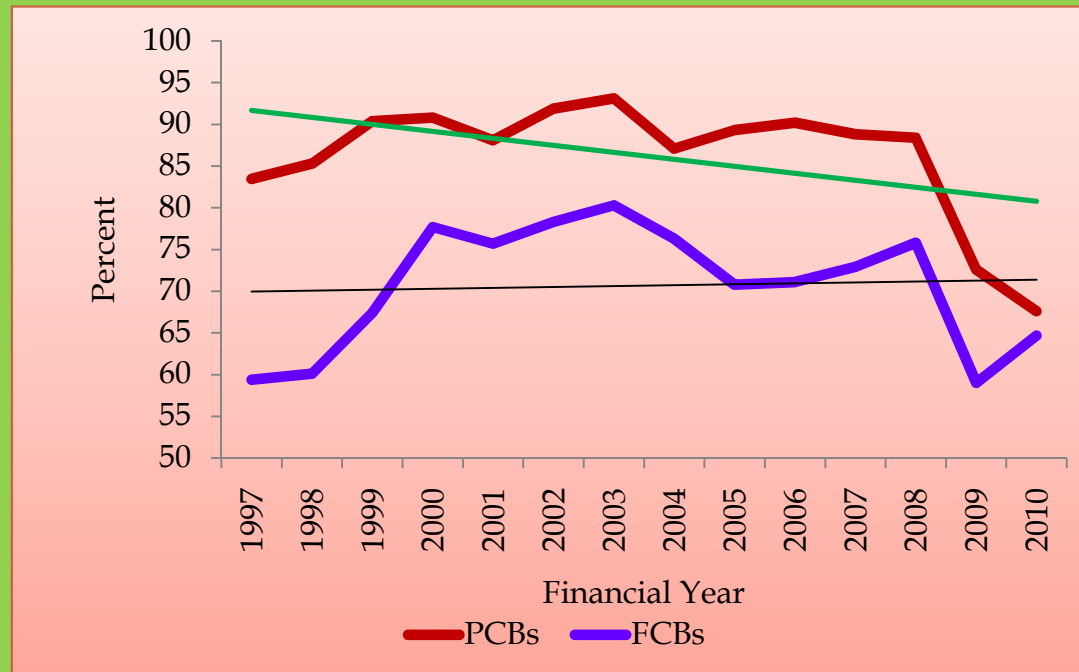
# Impact of Reforms on Bank Performance

## Management Efficiency: Expenditure-Income Ratio



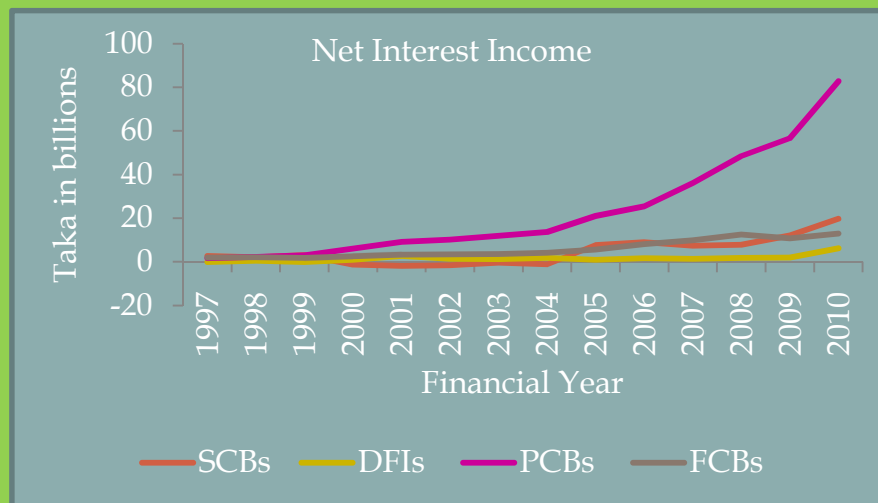
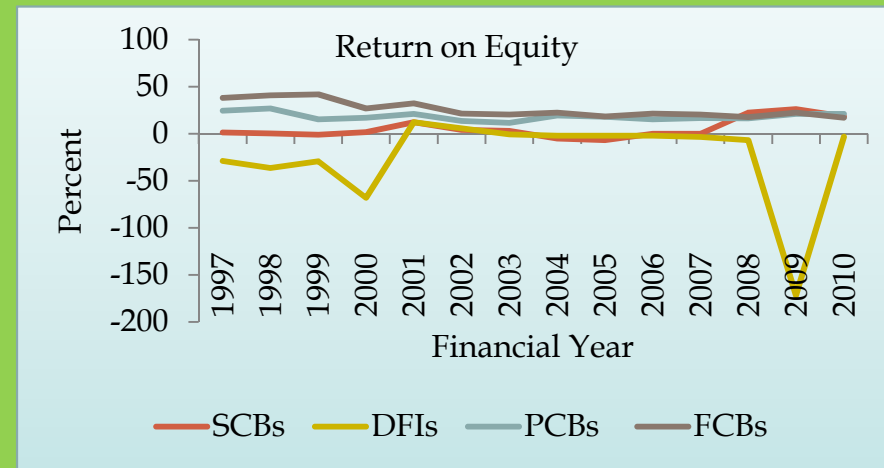
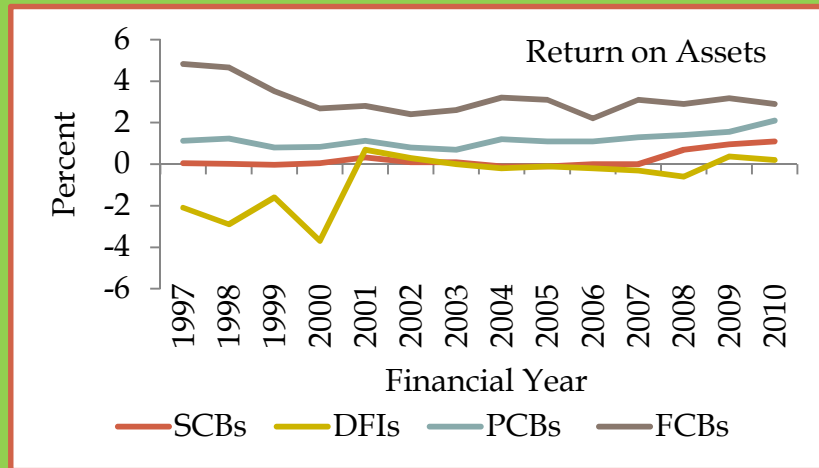
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## Management Efficiency: FCBs and PCBs



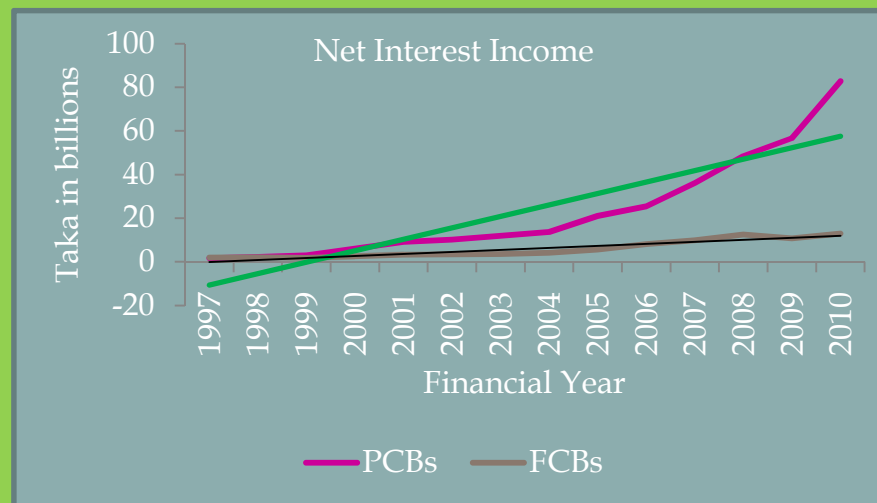
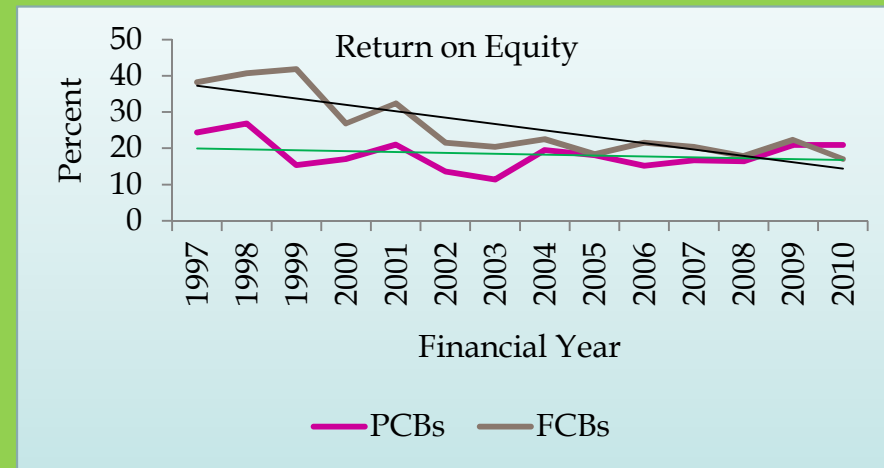
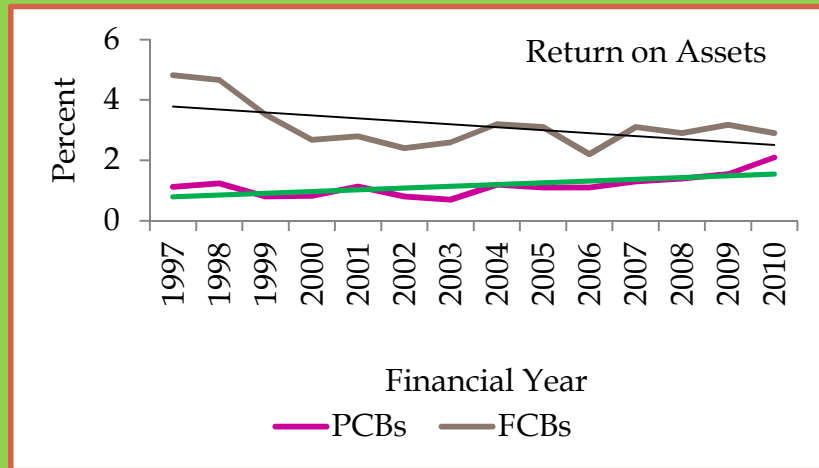
# Impact of Reforms on Bank Performance

## Earning Performances: ROA, ROE and NII



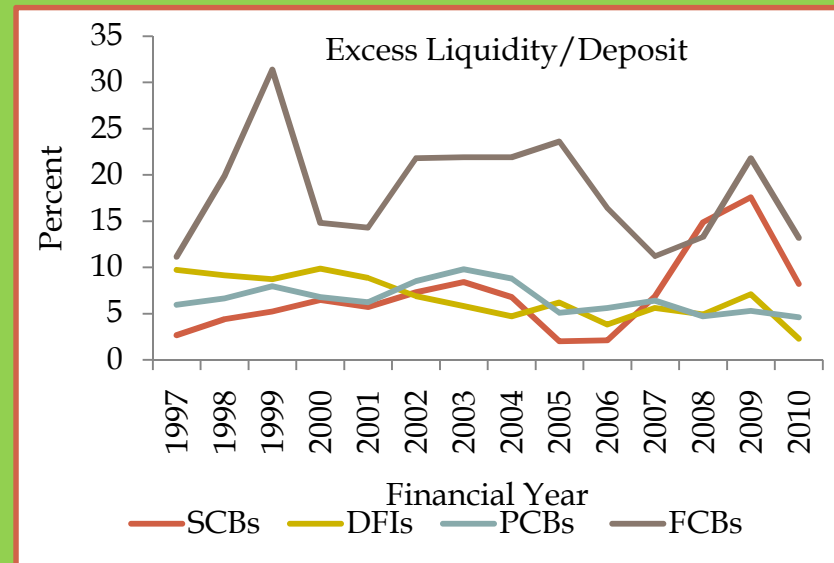
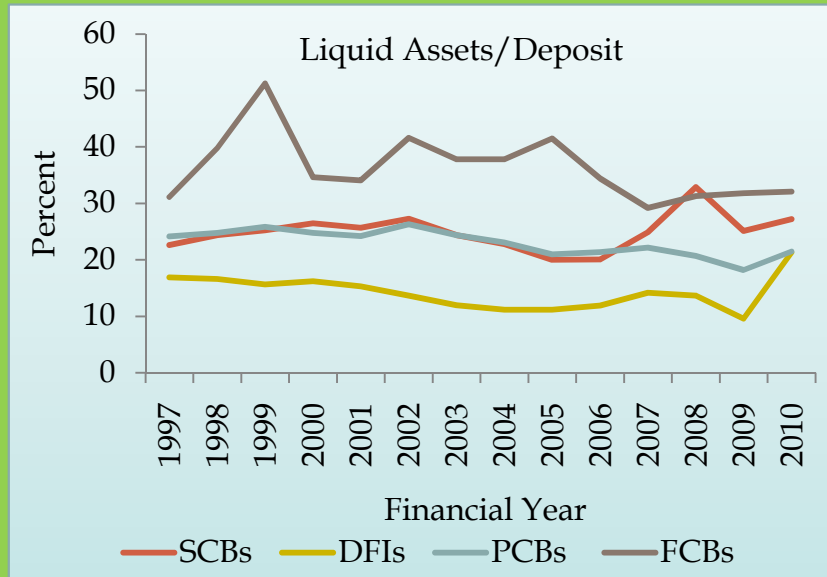
# Impact of Reforms on Bank Performance

## Earning Performances: FCBs and PCBs



# Impact of Reforms on Bank Performance

## Liquidity: Liquid Assets/Deposits



## Conclusion

- Following restructuring initiatives, financial system has been developed in terms of
  - Financial deepening,
  - Competitiveness within the industry, and
  - Profitability scenario of the banking industry.
- Defaulted loans can be identified easily and monitored continuously for recovery and necessary provision can be made;
- Classified loans, provision shortfall and loan losses are now more transparent;



## Conclusion

- An improvement and better performance of capital adequacy of banks helped to restore the interest of the depositors and shareholders;
- Management performance in monetary terms is on increasing trend;
- In terms of profitability the banking sector had mixed experience;
- All types of banks have much liquid assets excess of their requirements.

## Conclusion

- The performances of the foreign banks are better in comparison to the local banks in some aspect.
  - FCBs could be able to maintain a CRAR which is higher than that maintained by the domestic banks.
  - Non-performing assets of FCBs are negligible comparing with their assets.
  - Though FCBs maintained a substantial amount of liquidity, their profitability is higher than the domestic banks.
  - FCBs were capable to control their expenditure-income ratio lower than the domestic banks.

## Conclusion

- FCBs are performing much better than the domestic banks perhaps due to following reasons:
  - FCBs have to comply additionally with the policies and guidelines issued by their head office,
  - They are exploiting the international best practices in their operation,
  - They are audited by their head offices regularly which help them to have more controlling systems,
  - They get support from their head office in analyzing risks including credit risks and operational risks,
  - They can easily track the recovery of loans as they have limited branches and customers, and advanced MIS and AIS.

## Recommendations

1. **Solvency:** The undercapitalized banks should be allowed/motivated to raise new capital from the capital market.
2. **Management of NPL :** All bad or non-performing loans of banks can be put under separate management within the same institution.
3. **Auditing:** An international standard based audit of the loan portfolio, assets and liabilities, and capital adequacy may be performed.
4. **Road-map:** Banks with problems and weakness may be asked to submit a plan of corrective actions along-with a time schedule to overcome the problems.

## Recommendations

- 5. Strengthen legal enforcement:** Special tribunals having simplified procedures, quick disposal, and effective enforcement have to be ensured.
- 6. Reduction of Interference:** Government interference, political involvement, pressure from the trade unions, connected lending have to be reduced for smooth functioning of the banks.
- 7. Technological Advancement:** Technological up-gradation of the banking system is must for a better and an efficient banking sector in Bangladesh.
- 8. Extensive Training:** Large scale training program for both central bank and commercial bank officials should be arranged to achieve effective outcome from the reforms.



Thanks