Banking Sector Challenges

by **Prof. Dr. Akbaruddin Ahmad**

Introduction: Modern banks play a pivotal role in promoting economic advancement of a country. Banks provide necessary funds for executing various programs underway in the process of economic development. They collect savings of large masses of people scattered throughout the country, which in the absence of banks would have remained idle and unproductive. These scattered amounts are collected, pooled together and made available to commerce and industry for meeting the requirements. Economy of Bangladesh is in the group of world's most underdeveloped economies. One of the vital reasons is probably its poor banking system. Government as well as different international organizations have also identified that underdeveloped banking causes some costly obstacles on the way of even economic progress of the country. Investors are frequently scared to invest because of its sluggish banking system. Hence the task of making the banking system of Bangladesh of international standard deserves the highest priority.

The traditional banking system dominates Bangladesh's financial sector. Bangladesh Bank is the Central Bank of Bangladesh and the chief regulatory authority in the sector. The banking system is composed of four state-owned commercial banks, five specialized development banks, thirty private commercial Banks and ten foreign commercial banks. The Nobel-prize winning Grameen Bank is a specialized micro-finance institution, which revolutionized the concept of micro-credit and contributed greatly towards poverty reduction and the empowerment of women in Bangladesh. The features of traditional banking system in Bangladesh are as follows:

Traditional Product & Services : In Bangladesh, the Banking system uses various instruments for making payment and transactions, such as cash, cheque, bill of exchange, promissory note, demand draft, payment order and other services including mail transfer and telegraphic transfer, letter of credit etc.

Loan Products that are given for economic purposes: Consumer Loan, Micro Credit, Terms Lending i.e. Project and Infrastructure, Housing Loan, Cash Credit and Overdraft etc. In addition to this, SME lending are also been given much priorities.

Technology: Modern and innovative technology given products, popularly known as plastic money, Debit, Credit and other ATM Cards. Currently, Banks are also giving emphasis on improving their transaction capabilities through ATM, POS (Point of Sale), Online, Internet, Tele-banking, SWIFT and Reuter.

Islamic Banks: Islamic banks have been operating in Bangladesh for about one and half decade alongside with the traditional banks. Out of over 39 banks only five banks (including one foreign

Islamic bank) and two Islamic banking branches of a traditional bank, Prime Bank Limited (PBL) have been working on Islamic principles. Like any other traditional commercial banks, they do mobilize deposits and produce loans. But their modes of operation, based on shariah, is different from the other traditional commercial banks. Islamic banks, with a view to facing the growing competition either follow-Islamic banks or the conventional banks which have launched Islamic banking practices, will have to adapt their functioning in line with modern business practices, through improvement and expansion of the range of dealing in the banking sector. Thus, it is necessary for them to provide comprehensive banking and investment services to clients and simultaneously to take advantage of modern technological breakthroughs in areas such as electronic communication, computerization etc.

FSAC: Financial sector reform started in an intensive way in the beginning of the 1990s under the Financial Sector Adjustment Credit (FSAC) which Bangladesh contracted with the World Bank. In order to address the issue of increase in efficiency, the FSAC of the World Bank in 1990 determined the following objectives for the financial sector reform programme.

- Gradual deregulations of the interest rate structure with a view to improving the allocative efficiency;
- Providing market oriented incentives for priority sector lending;
- Making subsidies in the priority sectors more transparent;
- Adoption of appropriate monetary policy;
- Improvement in debt recovery environment; and
- Strengthening of the capital markets.

FSRP & BRC: Though the Financial Sector Reform Programme (FSRP) ended in mid-1990s, yet the reform measures were continued to be pursued. After the expiry of FSRP in 1996, the Government of Bangladesh (GOB) formed a Bank Reform Committee (BRC), which submitted its recommendations in 1999. While the then government partially acted on some of the recommendations of the BRC, a large part of them remain unaddressed. FSRP forced banks have minimum capital adequacy, improve loan classification system, enhance operating efficiency of banks, implement modern accounting system and establish “Credit Information Bureau” (CIB) at Bangladesh Bank. FSRP project provided major automation program by installing mid range computer system at the 4 NCB head offices and the Bangladesh Bank. FSRP also undertake training of bank officials at home and abroad. It also provided training for BB officials to strengthen the central bank inspection and monitoring system.

Impact of Global Recession: In order to minimize the potentially negative impact of global recession, the banking system has to adopt a number of measures. These are briefly noted below:

(i) The banks should make determined efforts to increase income. They can do so by diversifying their asset base. In this context, they should consider expansion of loan to the un-banked or under banked sectors such as agriculture, small and medium industries and small scale domestic traders.

(ii) With a view to diversifying asset base, the banks must depart from the traditional practice of collateral-based lending. They should aggressively seek out new borrowers with high income potentials and viable project proposals.

(iii) Banks should also consider offering new products such as swaps, options and derivative products. However, they must make sure that they do not assume unsustainable risk from such operations. The Central Bank needs to issue guidelines in this regard.
(iv) All out efforts should be made to recover non-performing loans (NPL). It is understood that the state-owned banks have been able to reduce their NPL to total loan ratio, but mostly by rescheduling rather than cash recovery. On the other hand, NPL ratios of the privately owned banks have recently gone up.

(v) In order to increase profitability, the banks need to focus on the volume of business and total profit, not per unit profit. This implies that they should reduce the prevailing high spread between deposit and lending rate, particularly by reducing the lending rate. Some progress has been achieved in this respect, but not enough. Moreover, the banks have considerably reduced deposit rates. This poses the risk that depositors will shift into non-bank assets such as stocks, real estate etc. The price increases of these assets suggest some movement in this direction.

(vi) The banks should also look at their expenditure side to improve income-expenditure ratios. In particular, salaries and perks of employees and directors and ostentatious expenses on branch decorations should be reduced.

(vii) Finally, banks should strengthen their risk management and early warning systems so that they are not caught off-guard by developments in the real economy.

ICT: Due to incredible proliferation of Information and communication technology (ICT) the concept of money has been radically changed. Different kinds of business sectors have been merged in a single that can be accessible in a global way and that has been possible just for the proliferation of ICT. So the business takes a new name Electronic business or E-business, which has dispelled the geographical bar among countries. ICT has influenced every sectors of business. The financial institutions are now compelled to be involved in ICT to cope with the changes in the modern business trend. As a third-world developing country, Bangladesh is far behind to reach the expected level in global banking system. So it is our urgent need to upgrade its banking system.

E-Banking: Electronic banking as a segment of electronic business, which, in turn, encompasses all types of business performed through electronic networks. The terms ‘PC banking’, ‘online banking’, ‘Internet banking’, ‘Telephone banking’ or ‘mobile banking’ refer to a number of ways in which customers can access their banks without having to be physically present at the bank branch. E-banking may be understood as term that covers all these ways of banking business electronically. Bangladesh is still lagging behind to avail the opportunity of e-business. However, banking sector as a whole has been introducing online banking system which plays complementary role to spread of e-business. Internet has opened a new horizon of e-business, creating immense opportunities for marketing products as well as managing organizations banking internationally. Gradually wireless Internet system has been creating a new paradigm and electronic fund transfer can have a suitable formation. E-business can improve the quality of the services, save customers valuable time, movement from one place to another and receiving the goods accurately.

E-Business: E-business brings a new channel of distribution process. But this leads to change in the regulatory issues, cross border trade through emerging new marketing distribution channel. This reduces transaction time, boundary less trade, and accuracy. In developed nations, e-business creates an opportunity to directly selling of the product to the customer without using any intermediaries. Governments as well as different international organizations have also identified that underdeveloped banking technology creates hindrance on economic progress of the country.

Mobile Banking: Mobile phone use in Bangladesh is not a luxury now. Almost half of the country's 160 million population uses mobile phones, but very few have bank accounts. Banks should concentrate on how the big population could be brought under the banking services via their mobile handsets. It is the bank's responsibility to identify, contract, educate, equip and monitor activities of the agents regularly. There must be a clear, well documented agent selection policy and procedures. The agreement signed between the banks and the agents will primarily include business hours of the cash points/agents, standard of performance, fees permissible by Bangladesh Bank, customer service, dispute resolution procedure and proper signage.

Anti-money laundering and terrorist financing: Anti-money laundering and terrorist financing are the two major areas of risks in mobile banking. Banks and its partners shall have to comply with the prevailing anti-money laundering/combating the financing of terrorism related laws, regulations and guidelines issued by the BB from time to time.

Liquidity Crunch: The country's financial sector has been facing severe liquidity crunch, unhealthy competition for deposit collection and lack of efficient human resources. Nine new banks approved by BB will add new challenges for our economy. However, the central bank explained the economic context and rationale behind issuing new bank licences. The economy has grown and the banking system has become more competitive while 45 per cent of the population still remains unbanked in Bangladesh. Moreover, BB expects that the entrance of the new banks will add to the aggregate capital base of the existing syndications, allowing for larger loans to be granted for productive investment and job-creation. But the economic reasons propounded by Bangladesh

Bank for licensing new banks are not cogent enough because the country is facing a downturn as a result of second round effect of global recession. Moreover, in a situation of stagnation, the banking sector is now suffering from deposit shortage and investment fallout. New banks mean paid up capital amounting Tk 36 billion and money to be deposited in those banks would be withdrawn from existing banks. This may lead to further deteriorations of the stringent situation prevailing in the banking sector. There is a weak relationship between bank rate and market interest rates because of the fragmentation characterising the financial market in Bangladesh.

The Spread: With a reserve requirement of 20 percent, the spread between lending and deposit rate should be around 2 percent. However, throughout the 1990s, the spread was almost 7, if not more. Though the magnitude of non-performing asset (NPA) is largely responsible, yet it cannot fully explain the high interest rate spread prevailing in Bangladesh. In addition to high NPA, collusive behaviour and misconceived price strategy, high operational costs and over staffing (of NCBs) are also responsible for high interest spread. On the other hand, NCBs account for 75 percent of total classified loan of the commercial banking sector. Moreover, their operational and overhead costs are also high as compared to PCBs and FCBs.

Non-Performing Assets (NPA): It is imperative to reduce the NPA level and operating costs of the NCBs in order to bring down lending rates in a sustainable manner. The share of the PCBs in total lending is around 27 percent, and along with the FCBs it is around 33 percent. The rest of the lending market share (67 percent) belongs to state-owned banks.

Conclusion: It must be remembered that in the absence of a reasonably well functioning financial system in the country, all other policy overtures (e.g. fiscal incentives) provided by the government for investment promotion will be of marginal value. So financial sector reform should occupy the foremost position. It is expected that during the period leading to the announcement of next national budget, the government will find it advisable to implement a number of measures to reform the banking sector.

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