Research Monograph

On



"“The banking system of Bangladesh-Prospects & Challenges”

A thesis submitted to the Department of law, Sonargaon University in partial fulfillment of the requirement for the award of the degree of Master’s of Law (2 years)

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STUDENT DECLARATION

I hereby do solemnly declare that the work presented in this dissertation paper has been carried out by me and has not been previously submitted to any other University /College /Institution/Organization for academic qualification or professional degree.

I hereby assure that the work that has been presented here does not breach any existing copyright law.

I further undertake to indemnify the University against any loss or damage arising from breach of the forgoing obligations.

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CERTIFICATION

This is to certify that the thesis on is the bonafide record of the project work done by Mahbuba Ali ID NO: LLMP2203027004 (2years) in partial fulfillment of the requirements for the award of the degree of Master's of Laws (2years) Sonargaon University.

I do here by certify that the project work has been carried out under my direct supervision and guidance.

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Table of Abbreviations

A
ATM : Automated Teller Machine
B
BB : Bangladesh Bank
BLA : Bangladesh Law Association
C
CCR : Cash Reserve Requirement
D
DFI : Development Financial Institution
F
FY : Financial Year
FCB : Foreign Commercial Bank
N
NCB : Nationalized Commercial Bank
P
PLS : Profit Loss Sharing
PCB : Private Commercial Bank
S
SSL : Secure Sockets Layer
SDB : Specialized Bank
SOCB : State Owned Commercial Bank

“The banking system of Bangladesh-Prospects &Challenges”

Abstract:

The banking sector in Bangladesh plays a pivotal role in the economy by facilitating economic growth, creating employment opportunities, promoting financial inclusion, supporting government financing, facilitating international trade and investment, ensuring financial stability, and driving technological innovation. Its contributions are essential for sustainable development and prosperity, underscoring its significance as a key pillar of Bangladesh's economic framework. Continued regulatory reforms, investment in technology, and focus on inclusive finance will be crucial for the sector to further enhance its economic impact and resilience in the future. The banking sector of Bangladesh is poised for continued growth, driven by technological advancements, regulatory reforms, and efforts to enhance financial inclusion. Addressing challenges such as NPLs, cyber security risks, and economic stability will be crucial for sustaining growth and maintaining the sector's resilience in the face of evolving global and domestic dynamics. The current trends and developments in the banking sector of Bangladesh reflect a shift towards digitalization, financial inclusion, regulatory reforms, and sustainable finance. These trends present opportunities for banks to innovate, expand services, and contribute to economic development while navigating challenges to ensure long-term stability and growth. Corporate governance in banks and financial institutions in Bangladesh is critical for ensuring transparency, accountability, ethical conduct, and effective risk management. By adhering to best practices, regulatory requirements, and ethical standards, banks can enhance stakeholder confidence, maintain financial stability, and contribute positively to the economy and society at large. Ongoing oversight, evaluation, and adaptation of governance frameworks are essential to navigating challenges, fostering growth, and maintaining resilience in a dynamic and competitive banking environment.

Aim of the study:

To deal with various spheres of rights. Scope of the Study: The project will be covering the meaning of rights, the peculiarities of rights, elements of legal rights, classification of rights, kinds of legal rights, relationship between legal liberty and legal right and so on.

Research Methodology:

For this project the research is doctrinal. The information and data for the project will be from various books, articles and other online resources. The research will include publication research, and other relevant sources, and will include both present and historical information related to topic. The case study of various past cases related to the topic will be referred in this project. Articles and laws related to the topic and also if there is an amendment in the previous law will also be taken into consideration.

Limitations:

The important limitation of this study is the reliance on secondary data. As the study is not empirical so the information and research is confined to books, online resources, articles in the newspapers and magazines.

1.1:Introduction:

Banking system plays very important role in the economic life of the nation. The health of the economy is closely related to the soundness of its banking system. Although banks create no new wealth but their borrowing, lending and related activities facilitate the process of production, distribution, exchange and consumption of wealth. In this way they become very effective partners in the process of economic development. Today modern banks are very useful for the utilization of the resources of the country. The banks are mobilizing the savings of the people for the investment purposes. If there would be no banks then a great portion of a capital of the country would remain idle. A bank as a matter of fact is just like a heart in the economic structure and the Capital provided by it is like blood in it. As long as blood is in circulation the organs will remain sound and healthy. If the blood is not supplied to any organ then that part would become useless, so if the finance is not provided to Agricultural sector or industrial sector, it will be destroyed. Loan facility provided by banks works as an incentive to the producer to increase the production. Many difficulties in the international payments have been overcome and volume of transactions has been increased. Cheques, drafts bills of exchange and letters of credit are very important instruments of the banks. The banks collect these instruments drawn on banks in other cities or countries and proceeds according to the accounts of the customer's concerns.

1.2: A little history of banking system:

A bank is a financial institution licensed by a government. Its primary activities include providing financial services to customers while enriching its investors. Many financial activities were allowed over time. The level of government regulation of the banking industry varies widely, with countries such as Iceland, having relatively light regulation of the banking sector, and countries such as China having a wide variety regulations but no systematic process that can be followed typical of a communist system.[1] The name bank derives from the Italian word banco “desk/bench”, used during the Renaissance by Jewish Florentine bankers, who used to make their transactions above a desk covered by a green tablecloth. However, there are traces of

[1] *Swamy, M. R. & Vashudevan, S. V. (1985) A Textbook of Banking. New Delhi: S. Chand & Company, P.7*

banking activity even in ancient times. In fact, the word traces its origins back to the Ancient Roman Empire, where moneylenders would set up their stalls in the middle of enclosed courtyards called macella on a long bench called a bancu, from which the words banco and bank are derived. As a moneychanger, the merchant at the bancu did not so much invest money as merely convert the foreign currency into the only legal tender in Rome—that of the Imperial Mint.

The earliest evidence of money-changing activity is depicted on a silver drachm coin from ancient Hellenic colony Trapezus on the Black Sea, modern Trabzon, and c. 350–325 BC, presented in the British Museum in London.[2] The coin shows a banker's table (trapeza) laden with coins, a pun on the name of the city.

1.3: Definition of Bank:

The Jews in Jerusalem introduced a kind of banking in the form of money lending before the birth of Christ. The word 'bank' was probably derived from the word 'bench' as during ancient time Jews used to do money -lending business sitting on long benches. First modern banking was introduced in 1668 in Stockholm as 'Svingss Pis Bank' which opened up a new era of banking activities throughout the European Mainland. In the South Asian region, early banking system was introduced by the Afghan traders popularly known as Kabuliwallas. Muslim businessmen from Kabul, Afghanistan came to India and started money lending business in exchange of interest sometime in 1312 A.D. They were known as 'Kabuliwallas'.

Bank is a financial institution and intermediary, which collect deposits through its different deposit mechanism and provide loans and advances among the loan Clients/ investors with the view to earn profit. Thus a bank is a financial intermediary and a dealer of loans and debts. In financial concept, banking means safe custody of money and at the same time an institution for money transaction. To regulate the banking business some financial laws of the government are followed, the old ones are the British Stamp Law, 1881 and English Exchange Bill, 1882. Other laws include the English Financial Act of 1915 and Indian Company Act of 1931 and the Indian Banking Regulation Act of 1949.

[2] *Swamy, M. R. & Vashudevan, S. V. (1985) A Textbook of Banking. New Delhi: S. Chand & Company, P.9*

The concept of Banking is an old civilization. Banking activities in its earliest crude form of lending and exchange prevailed during the ancient period. The legend of huge treasure of the Great King Solomon, the man of great wisdom, son of David (Alaihee-aas-Salam)[3] and the activities of taxation and banking during his reign in 1005 B.C.

The business of banking is in many English common law countries not defined by statute but by common law, the definition above. In other English common law jurisdictions there are statutory definitions of the business of banking or banking business. When looking at these definitions it is important to keep in minds that they are defining the business of banking for the purposes of the legislation, and not necessarily in general. In particular, most of the definitions are from legislation that has the purposes of entry regulating and supervising banks rather than regulating the actual business of banking. However, in many cases the statutory definition closely mirrors the common law one.

Examples of statutory definitions:

"Banking business" means the business of receiving money on current or deposit account, paying and collecting cheques drawn by or paid in by customers, the making of advances to customers, and includes such other business as the Authority may prescribe for the purposes of this Act; (Banking Act (Singapore), Section 2, Interpretation).

"Banking business" means the business of either or both of the following:

Receiving from the general public money on current, deposit, savings or other similar account repayable on demand or within less than [3 months] … or with a period of call or notice of less than that period.

Paying or collecting cheques drawn by or paid in by customers. The Indus Valley Civilization, the Roman Civilization, the Greek Civilization, the Egyptian Civilization, the Mesopotamian Civilization, the Babylonian Civilization, the Vedic

[3] *Siddique4, S. H. & Islam, A. F. 2001 Banking Sector in Bangladesh it's Contribution & Performance Journal of Business Research 3*

Indian Civilization, the Muslim Civilization played important roles in giving birth to and flourishing of Bank.

Whoever, being an individual firm, company or corporation generally deals in the business of money and credit is called bank. In our country, any institution, which accepts, for the purpose of lending or investment deposits of money from public, repayable on demand or otherwise, and with transferable by checks draft order and otherwise can be termed as a bank.

The purpose of banking is to ensure transfer of money from surplus unit to deficit units. Bank is all countries work as the repository of money. The owners look for safety and amount of interest for their deposits with Banks. Entrepreneurs try to obtain money from the banks as working capital and for long-term investment. These entrepreneurs welcome effective and forward-looking advice for investment. Banking sector thus owe a great to the deposit holders on the hand and the entrepreneurs on the other. They are expected to play the role of friend, philosopher, and guide for the deposit holders and the entrepreneurs. Since liberation, Bangladesh passed through fragile phases of development in the banking sector.

The nationalization of banks in the post liberation period was intended to safe the institutions and the interest of the depositors. Those handling the banking sector have borne the burden of putting banks on reliable footings. Despite all that was done, some elements of irregularities appeared. With the assertion of the role of the Central bank, The Bangladesh bank started adopting measures for putting banking institutions on right track. Yet the performance of public sector management of banks left some negative effects in the money market in particular and the economy in general. The agility among the borrowers manipulates the banking sector as a whole. In effect, a default culture appeared on the scene.

The opening of private and foreign participants to the banking sector was intended to obtain desirable results from banking.

Unfortunately, for the people, at large banking sector is yet to obtain the credit for

efficiency, credibility, and growth.

The clever, among the user of banking services, have influenced the management of banks, for obtaining short-term and long-term loans. They sometimes showed inflated to get money for investment in business and industry. Few diverted their loan money to purposes different from the loan proposals, and invested in non-profitable units have failed to repay their loans to the banks. For this reason new entrepreneurs are not getting capital while defaulting entrepreneurs have started obtaining either relief in the form of rescheduling of the repayment program or additional inevitable money for diversified units.

2.1 : The banking System of Bangladesh

The banking system at independence consisted of two branch offices of the former State Bank of Pakistan and seventeen large commercial banks, two of which were controlled by Bangladeshi interests and three by foreigners other than West Pakistanis. There were fourteen smaller commercial banks. Virtually all banking services were concentrated in urban areas. The newly independent government immediately designated the Dhaka branch of the State Bank of Pakistan as the central bank and renamed it the Bangladesh Bank.[4] The bank was responsible for regulating currency, controlling credit and monetary policy, and administering exchange control and the official foreign exchange reserves. The Bangladesh government initially nationalized the entire domestic banking system and proceeded to reorganize and rename the various banks. Foreign-owned banks were permitted to continue doing business in Bangladesh.

The insurance business was also nationalized and became a source of potential investment funds. Cooperative credit systems and postal savings offices handled service to small individual and rural accounts. The new banking system succeeded in establishing reasonably efficient procedures for managing credit and foreign exchange. The primary function of the credit system throughout the 1970s was to

[4] *Theory & Practice of Banking (B-101), Bangladesh Institute of Bank Management Dhaka 2000*

finance trade and the public sector, which together absorbed 75 percent of total advances. The government's encouragement during the late 1970s and early 1980s of agricultural development and private industry brought changes in lending strategies. Managed by the Bangladesh Krishi Bank, a specialized agricultural banking institution, lending to farmers and fishermen dramatically expanded. The number of rural bank branches doubled between 1977 and 1985, to more than 3,330. Denationalization and private industrial growth led the Bangladesh Bank and the World Bank to focus their lending on the emerging private manufacturing sector.

Scheduled bank advances to private agriculture, as a percentage of sects oral GDP, rose from 2 percent in FY 1979 to 11 percent in FY 1987, while advances to private manufacturing rose from 13 percent to 53 percent.

The transformation of finance priorities has brought with it problems in administration.

No sound project-appraisal system was in place to identify viable borrowers and projects. Lending institutions did not have adequate autonomy to choose borrowers and projects and were often instructed by the political authorities. In addition, the incentive system for the banks stressed disbursements rather than recoveries, and the accounting and debt collection systems were inadequate to deal with the problems of loan recovery. It became more common for borrowers to default on loans than to repay them; the lending system was simply disbursing grant assistance to private individuals who qualified for loans more for political than for economic reasons. The rate of recovery on agricultural loans was only 27 percent in FY 1986, and the rate on industrial loans was even worse. As a result of this poor showing, major donors applied pressure to induce the government and banks to take firmer action to strengthen internal bank management and credit discipline.

As a consequence, recovery rates began to improve in 1987. The National Commission on Money, Credit, and Banking recommended broad structural changes in Bangladesh's system of financial intermediation early in 1987, many of which were built into a three-year compensatory financing facility signed by Bangladesh with the IMF in February 1987. One major exception to the management problems of

Bangladeshi banks was the Grameen Bank, begun as a government project in 1976 and established in 1983 as an independent bank. In the late 1980s, the bank continued to provide financial resources to the poor on reasonable terms and to generate productive self-employment without external assistance. Its customers were landless persons who took small loans for all types of economic activities, including housing.

About 70 percent of the borrowers were women, who were otherwise not much represented in institutional finance. Collective rural enterprises also could borrow from the Grameen Bank for investments in tube wells, rice and oil mills, and power looms and for leasing land for joint cultivation. The average loan by the Grameen Bank in the mid-1980s was around Tk 2,000 (US$65), and the maximum was just Tk18, 000 (for construction of a tin-roof house). Repayment terms were 4 percent for rural housing and 8.5 percent for normal lending operations. The Grameen Bank extended collateral-free loans to 200,000 landless people in its first 10 years. Most of its customers had never dealt with formal lending institutions before. The most remarkable accomplishment was the phenomenal recovery rate; amid the prevailing pattern of bad debts throughout the Bangladeshi banking system, only 4 percent of Grameen Bank loans were overdue.

The bank had from the outset applied a specialized system of intensive credit supervision that set it apart from others. Its success, though still on a rather small scale, provided hope that it could continue to grow and that it could be replicated or adapted to other development-related priorities.

The Grameen Bank was expanding rapidly, planning to have 500 branches throughout the country by the late 1980s. Beginning in late 1985, the government pursued a tight monetary policy aimed at limiting the growth of domestic private credit and government borrowing from the banking system. The policy was largely successful in reducing the growth of the money supply and total domestic credit. Net credit to the government actually declined in FY 1986. The problem of credit recovery remained a threat to monetary stability, responsible for serious resource misallocation and harsh inequities. Although the government had begun effective measures to improve financial discipline, the draconian contraction of credit availability contained the risk

of inadvertently discouraging new economic activity. Foreign exchange reserves at the end of FY 1986 were US$476 million, equivalent to slightly more than 2 months' worth of imports.

This represented a 20-percent increase of reserves over the previous year, largely the result of higher remittances by Bangladeshi workers abroad. The country also reduced imports by about 10 percent to US$2.4 billion. Because of Bangladesh's status as a least developed country receiving concession loans, private creditors accounted for only about 6 percent of outstanding public debt. The external public debt was US$6.4 billion, and annual debt service payments were US$467 million at the end of FY 1986.The Banking Industry is Bangladesh is one characterized by strict regulations and monitoring from the central governing body, the Bangladesh Bank. The chief concern is that currently there are far too many banks for the market to sustain. As a result, the market will only accommodate only those banks that can transpire as the most competitive and profitable ones in the future.

Currently, the major financial institutions under the banking system include:
Bangladesh Bank
Commercial Banks including Islamic Banks
Leasing Companies
Finance Companies

2.2 : Scheduled Banks in Bangladesh:

After the independence, banking industry in Bangladesh started its journey with 6 nationalized commercialized banks, 2 State owned specialized banks and 3 Foreign Banks. In the 1980's banking[5] industry achieved significant expansion with the entrance of private banks. Now, banks in Bangladesh are primarily of two types:

Scheduled Banks: The banks which get license to operate under Bank Company Act, 1991 (Amended in 2003) are termed as Scheduled Banks.

Non-Scheduled Banks: The banks which are established for special and definite

[5] *Theory & Practice of Banking (B-101), Bangladesh Institute of Bank Management Dhaka 2000*

objective and operate under the acts that are enacted for meeting up those objectives, are termed as Non-Scheduled Banks. These banks cannot perform all functions of scheduled banks.

There are 56 scheduled banks in Bangladesh who operate under full control and supervision of Bangladesh Bank which is empowered to do so through Bangladesh Bank Order, 1972 and Bank Company Act, 1991. Scheduled Banks are classified into following types:

State Owned Commercial Banks (SOCBs): There are 4 SOCBs which are fully or majorly owned by the Government of Bangladesh.

Specialized Banks (SDBs): 4 specialized banks are now operating which were established for specific objectives like agricultural or industrial development. These banks are also fully or majorly owned by the Government of Bangladesh.

Private Commercial Banks (PCBs): There are 39 private commercial banks which are majorly owned by the private entities. PCBs can be categorized into two groups:

Conventional PCBs: 31 conventional PCBs are now operating in the industry. They perform the banking functions in conventional fashion i.e interest based operations.

Islami Shariah based PCBs: There are 8 Islami Shariah based PCBs in Bangladesh and they execute banking activities according to Islami Shariah based principles i.e. Profit-Loss Sharing (PLS) mode.

Foreign Commercial Banks (FCBs): 9 FCBs are operating in Bangladesh as the branches of the banks which are incorporated in abroad.

Bangladesh Bank (BB) has been working as the central bank since the country's independence. Its prime jobs include issuing of currency, maintaining foreign exchange reserve and providing transaction facilities of all public monetary matters. BB is also Bangladesh Bank (BB) has been working as the central bank since the

country’s independence. Its prime jobs include issuing of currency, maintaining foreign exchange reserve and providing transaction facilities of all public monetary matters. BB is also responsible for planning the government’s monetary policy and implementing it thereby.

The BB has a governing body comprising of nine members with the Governor as its chief. Apart from the head office in Dhaka, it has nine more branches, of which two in Dhaka and one each in Chittagong, Rajshahi, Khulna, Bogra, Sylhet, Rangpur and Barisal.

The number of banks in all now stands at 53 in Bangladesh. Out of the 53 banks, 4 are Nationalized Commercial Banks (NCBs), 28 local private commercial banks, 12foreign banks, 5 are Development Financial

Institutions (DFIs) and the rest of 4 are other bank Sonali Bank is the largest among the NCBs while Pubali is leading in the private ones. Among the 12 foreign banks, Standard Chartered has become the largest in the country. Besides the scheduled banks, Samabai (Cooperative) Bank, Ansar-VDP Bank, Karmasansthan (Employment) Bank and Grameen bank are functioning in the financial sector.

The number of total branches of all scheduled banks is 6,038 as of June 2000. Of the branches, 39.95 per cent (2,412) are located in the urban areas and 60.05 per cent (3,626) in the rural areas.

Of the branches NCBs hold 3,616, private commercial banks 1,214, foreign banks 31 and specialized banks 1,177.

2.3 : Services (Accounts, FDR, PDS, Deposit Scheme) Current Account:

Generally this sort of account opens for business purpose. Customers can withdraw money once or more against their deposit. No interest can be paid to the customers in this account. If the amount of deposit is below taka 1,000 on an average the bank has authority to cut taka 50 from each account as incidental charge after every six months. Against this account loan facility can be ensured. Usually one can open this account with taka 500. One can open this sort of account through cash or check/bill. All the banks follow almost the same rules for opening current account.

Savings Bank Account:

Usually customers open this sort of account at a low interest for only security. This is also an initiative to create people's savings tendency. Generally, this account is to be opened at taka 100. Interest is to be paid in June and December after every six months. If money is withdrawn twice a week or more than taka 10,000 is withdrawn (if 25% more compared to total deposit) then interest is not paid. This account guarantees loan. Almost all the banks follow the same rules in the field of savings account, except foreign banks for varying deposit. On an average, all the banks give around six percent interest.

Special Services of Bank:

Some Banks render special services to the customers attracting other banks.

Internet Banking:

Customers need an Internet access service. As an Internet Banking customer, he will be given a specific user ID and a confident password. The customer can then view his account balances online. It is the industry-standard method used to protect communications over the Internet. To ensure that customers' personal data cannot be accessed by anyone but them, all reporting information has been secured using Version and Secure Sockets Layer (SSL).

Home Banking:

Home banking frees customers of visiting branches and most transactions will be automated to enable them to check their account activities transfer fund and to open L/C sitting in their own desk with the help of a PC and a telephone.

Electronic Banking Services for Windows (EBSW):

Electronic Banking Service for Windows (EBSW) provides a full range of reporting capabilities, and a comprehensive range of transaction initiation .

The customers will be able to process all payments as well as initiate L/Cs and amendments, through EBSW. They will be able to view the balances of all accounts, whether with Standard Chartered or with any other banks using SWIFT. Additionally, transactions may be approved by remote authorization even if the approver is out of station.

Automated Teller Machine (ATM):

Automated Teller Machine (ATM), a new concept in modern banking, has already been introduced to facilitate subscribers 24 hour cash access through a plastic card. The network of ATM installations will be adequately extended to enable customers to non-branch banking beyond banking.

Tele Banking:

Tele Banking allows customers to get access into their respective banking information 24 hours a day. Subscribers can update themselves by making a phone call. They can transfer any amount of deposit to other accounts irrespective of location either from home or office.

2.4 : SWIFT

Swift is a bank owned non-profit co-operative based in Belgium servicing the financial community worldwide. It ensures secure messaging having a global reach of 6,495 Banks and Financial Institutions in 178 countries, 24 hours a day. SWIFT global network carries an average 4 million message daily and estimated average value of payment messages is USD 2 trillion. Swift is a highly secured messaging network enables Banks to send and receive Fund Transfer, L/C related and other free format messages to and from any banks active in the network. Having SWIFT facility, Bank will be able to serve its customers more profitable by providing L/C, Payment and other messages efficiently and with utmost security.[6] Especially it will be of great help for our clients dealing with Imports, Exports and Remittances etc.

Monetary & Credit Policy:

The monetary and credit policy for the financial year that ended in June, 2000 was formulated with the objective of full utilization of domestic resources and rapid economic growth through priorities for agriculture, industry, export, and expansion and strengthening of the private sector, at the same time keeping inflation within tolerable limits. A modern expansionary monetary and credit policy was adopted in order to make good the losses to agriculture, industry, and infrastructure by the devastating floods of 1998.

After the flood the economy remained sluggish in the first quarter of 1999-2000 and the private sector demand for credit shrank. In view of this, the Annual Development Program (ADP) was expanded and development activities in the private sector were geared up. As a result, the public sector absorbed credit at an accelerated rate. Though credit to the private sector picked up towards the end of the year, the overall annual growth was smaller than programmed, although gross domestic credit expanded a little faster than projected. Money supply increased by 15.3% in 1999-2000 compared to the expansion of 8.6% in the preceding year.

[6] *Rosenberg, R. (2009). Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track. Consultative Group to Assist the Poor. The World Bank*

Narrow Money:

Narrow Money increased by Tk. 2,631.90 crores or 15.3% to Tk.19881.30 crores in 1999-2000. Of the components of Narrow Money, currency outside banks went up by Tk.1489.40 crores or 17.2% to Tk.10176.00 crores, and demand deposits went up by Tk.1142.50 crores or 13.3% to Tk.9705.30 crores.

Broad Money:

Broad Money increased by Tk.11735.70 crores or 18.6% to Tk. 74,762.40 cores in 1999-2000 compared to the increase of 12.8% in the preceding year. Of the components of Broad Money, Narrow Money increased by 15.3% and time deposits rose by 19.9% compared to the increase of 8.6% in Narrow Money and 14.5% in time deposits in the preceding year. The shares of currency outside banks, demand deposits and time deposits in Broad Money stood at 13.6%, 13.0%, and 73.4% respectively on 30th June, 2000 compared to 13.8%, 13.6% and 72.6% respectively on 30th June, 1999. Expansion of credit to the private sector, government sector (net), public sector, and other assets (net), along with a surplus in net foreign assets contributed to the expansion of Broad Money.

Reserve Money:

Reserve Money increased by Tk.2321.80 crores or 15.7% to Tk.17064.50 crores in 1999-2000 compared to the increase of 8.3% during the preceding year. Of the components of Reserve Money, currency outside banks increased by Tk.1489.40 crores or 17.1% compared to the increase of Tk.533.30 crores or 6.5% during the preceding year. Scheduled banks balances with the Bangladesh Bank increased by Tk.770.90 crores or 15.3% in 1999-2000 compared to the increase of Tk.488.20 crores or 10.8% in the preceding year. Their cash in tills increased by Tk.61.50 crores or 6.0% as against the increase of Tk.103.60 crores or 11.2% in the preceding year. The increase in Bangladesh Bank's credit to the government (net) by Tk.1,738.10 crores and net surplus in the foreign sector by Tk.1,262.40 crores played the main role in exerting expansionary influence on the Reserve Money.

However the decline of Tk.333.60 crores and Tk.44.90 crores in the borrowings by the scheduled banks and other financial institutions respectively along with the fall of Tk.300.20 crores in other assets (net) partly offset the expansionary impact of those sectors.

Domestic Credit:

Total domestic credit increased by Tk.8581.20 crores or 13.6% to Tk. 71,489.00 crores (including adjustment of bonds issued by the government) in 1999- 2000 as compared to the increase of Tk.7267.60 crores or 13.1% in the preceding year. Expansion of credit to the government, private, and public sectors to the extent of Tk.3524.30 crores (31.3%), Tk.4906.10 crores (10.7%), and Tk.150.80 crores (2.5%) respectively contributed to the expansion in total domestic credit in 1999-2000. Credit to the government and private sector had increased by 21.3% and 13.8% respectively, while credit to the public sector declined by 3.7% in the preceding year.

Bank Credit:

The outstanding level of bank credit (excluding foreign bills and inter-bank items) increased by Tk.5,123.30 crores or 10.3% to Tk.54,646.10 crores in 1999- 2000 as compared to the increase of 12.4% in the preceding year.

Of the components of bank credit, advances increased by Tk.4892.70 crores or 10.3% and the bills purchased and discounted went up by Tk.230.60 crores or 11.3%.

Bank Deposits:

Bank deposits (excluding inter-bank items) increased by Tk.11044.70 crores or 18.6% to Tk.70, 278.70 crores in 1999-2000 compared to the increase of 14.2% in the preceding year. Of this increase , time deposits went up by Tk.9,103.80 crores or 19.9% to Tk.54,881.10 crores, government deposits by Tk.723.60 crores or 14.8% to Tk.5,615.20 crores and demand deposits by Tk. 1,142.50 crores or 13.3% to Tk.9,705.30 crores. On the other hand, restricted deposits increased by Tk.74.80 crores in 1999-2000.

Cash Reserve Requirements (CRR):

Statutory CRR with Bangladesh Bank was lowered for the scheduled banks to 4.0% of their liabilities (demand plus time deposits) (excluding inter-bank deposits) from 5% with effect from 1st October, 1999.

Bank Rate:

The Bank Rate was lowered from 8.0% to 7.0% on 29th August, 1999 and remained unchanged through 30th June, 2000.

3.1 : The Prospects and challenges:

The letters of intent (LoIs) `have already been issued to the sponsors of such approved banks. There have been many significant developments in the economy of Bangladesh since 2000-2001, the central bank stated, explaining the economic context and rationale behind issuing licenses in favor of new banks. The economy has grown and the banking system has become more competitive but there are still a large number of under-banked people in Bangladesh. Recent estimates from a survey conducted by the Institute of Microfinance (IoF) found that only 45 per cent of the nearly 9000 households surveyed do have access to banks and micro-finance institutions (MFIs) for loans.

The population per branch (21065) and the ratio of loan accounts per 1000 adults (42yrs) suggest that the outreach of the formal financial sector in Bangladesh is lower than that in India (14485 and 124 respectively) and Pakistan (20340 population per branch and 47 loan accounts per 1000), according to the statement of IoF. Bangladesh Bank assumes that the new banks will help increase the quality of banking services by increasing competition in the banking sector. They will also be able to meet the unfulfilled demand for credit by the private sector whose needs have grown in line with a fast expanding economy.

The central bank noted that, for new banks the ratio of opening rural and urban branch will be 1:1 which will help increase bank branches in rural areas and improve financial inclusion. But the home truth is; no bank can expand in the rural areas before concentrating and making business in urban areas. Earlier, the issue of granting licenses to new banks caused many to raise their eyebrows. Questions were being asked by authentic experts, bankers and people even on the board of directors of the central bank about the wisdom of allowing more banks, a sector that had been struggling hard to cope with the problem of liquidity shortage for years together. The banking sector is already saturated with 47commercial banks. There was no logic to allow new banks at this moment of the country. The new comers will create an unhealthy competition in banking services, affect stability of the sector and cause profitability of the existing banks to suffer. The entry of more banks will trigger a flight of huge fund including Tk 36.00 billion from existing banks to place as paid-up

capital against new banks; this will lead to further deteriorations of the stringent situation already prevailing in the banking sector.

The similar incident will take place for quality employees of the existing banks. All these will lead to a greater mismatch between their credit and deposit ratio and acute shortage of good bankers.

The banks will be forced to go for risky investment after collecting deposit at high rate from an already saturated market. It will seriously affect the overall bank- business and the industry as well.
Banks are to facilitate all kinds of economic activities and finance many other needs of the people, in both urban and rural areas. But overcrowding of the banking sector is not at all desirable as this, instead of meeting those objectives, would create problems for the sector itself, particularly the existing operators in the sector. This might even adversely impact the vital sectors of the economy in the process.

It was unlikely that the board of directors of Bangladesh Bank were not aware of that fact. Yet they were trying to select the right ones since the government is unrelenting in its decision to allow new banks. Opening up of new banks on political consideration, as reported time and again, may reduce the confidence of the clients in banks as well as impair the management quality of the overall banking sector. Meanwhile, some speculators state that as soon as new banks kick off their operations a heavy pressure on deposits of existing banks would be exerted. The latter are likely to see a flight of deposits while their existing loan liabilities including non-performing loans (NPLs) will remain at an unchanged level. This is likely to cause a mismatch between their deposits and outstanding amount of credits or loan portfolio. Now that the central bank already approved new banks and issued the LoIs, it will be just beating about the bush to say anything to the contrary. Rather, now it is better to design how all these banks can be managed smoothly. In this regard the following measures may be implemented:
The new banks should introduce new and innovative services and should scale up their products for the sake of making the government decision meaningful.
There is no denying that the quality of the sponsors largely influences the quality of

operation of banks as such sponsors play an important role in the decision-making. So, the central bank will have to closely examine the track records of the sponsors and it must not give in to political pressure of any sort on this issue. The quality of the bank directors should be maintained scrupulously.
The central bank may concentrate its attention on the color of money of the proposed directors who will be investing as the paid-up capital.

The central bank must have to play the role of a watchdog in case of shopping the investment clients of new banks from existing banks by approving the higher limit then the present outstanding.

The central bank must have to be vigilant in examining the proposed investment clients of new banks, particularly those whose cases have to be rescheduled. Getting rescheduled, the sick clients in the existing banks become very much performing in new banks for the time being in the backdrop of opening new banks in the market.

The central bank needs to require to consider several other issues, prior to giving effective permission to new banks, including ownership quality.

The vital issue that deserves priority attention of both central bank and the government is better banking coverage of the hitherto neglected rural areas. The new banks may be asked to serve the rural people extensively.

On the top of everything, both the central bank and the government will have to ensure the entry of stronger players in the banking arena and keep close watch on the effects of such an entry on the overall banking industry.

The Bangladesh Bank and Bangladesh Institute of Bank Management (BIBM) have to take preparation on structuring the banks by training up the bankers. Because market will be oversaturated as soon as the new banks start operations. The precipitations of banks may appear at the bottom of the banker of banks in Bangladesh. Time has arrived; the possibility of merger of weak banks cannot be laughed away.

Still we hope for the best. The newly approved three NRB commercial banks namely, NRB Commercial Bank Ltd, NRB Bank Ltd and NRB Bank Ltd will bring USD150.00 million as paid up capital of the non-resident Bangladeshis (NRBs). Expectations of the people about the six approved PCBs, such as Union Bank Limited, Modhumoti Bank Limited, the Farmers Bank Limited, Meghna Bank Limited, Midland Bank Limited and South Bangla Agriculture and Commerce Bank Limited, are quite high. Now the nation is passionately staring at the functions of the new-born banks with a ray of hope of even development of the people of all the strata in the days to come.

3.2 : Concluding Remarks:

In fact, the banking system followed true financial liberalization policy since the beginning of 1990s especially with the introduction of FSRP. Since then, several legislations related to the financial sector were enacted and amended to support the reform process. The newly enacted laws responded to the need for promoting a sound and orderly financial markets by providing appropriate legal framework for the licensing, organizing, operating, and supervising of a broad range of financial services companies.

All the depository institutions were brought under the regulatory jurisdiction of Bangladesh Bank and all of them are monitored and supervised by the central bank by issuing prudential regulations.

The reform measures have had major impact on the overall efficiency and stability of the banking system of Bangladesh. A good number of banks and other financial institutions with various types of financial instruments emerged up. The institutional network and volume of operations of the financial sector have expanded and diversified. A number of scheduled banks have gone up from 11 in 1980 to 47 in 2011. The banks' involvement in non-traditional activities and the increase in profits from these activities have contributed to improvements in banking sector performance in terms of profitability, cost efficiency, and earnings efficiency. Banks were allowed to engage in diverse activities including securities and foreign exchange transactions, brokerage and dealing activities, and other fee-based business.

The expansion of the scope of banks business has certainly helped offset a decline in net interest income from advances. This has an important policy implication for the sequencing of financial liberalization. Likewise number of non-bank financial institutions have also been increased.[7] Additionally, the development of new financial instruments and services, introduction of regulatory framework and institutionalization of savings facilitated for economic growth and development. The present capital adequacy of banks is comparable to those at international level. There has been a marked improvement in the asset quality with the percentage of gross non-performing assets (NPAs) to gross advances for the banking system reduced from 41.1 percent in 1999 to 7.1 percent in 2011. The reform measures have also resulted in an improvement in the profitability of banks. The Return on Assets (ROA) of the banks rose from 0.0 percent in the year 2000 to 1.3 percent in 2011. Further SCBs have steadily improved their cost efficiency (measured by expenditure income ratio) after 2008 even though FCBs and PCBs generally performed better than SCBs and DFIs in terms of profitability and cost efficiency in their initial stage. This suggests that the banking sector reforms since 1990 have exerted increased pressure and, thus had a positive moderate impact on the performance of SCBs and tiny impact on DFIs. However, it should be stressed that this does not imply that the reforms have had wholly satisfactory results, for the following reasons.

First, the banking system is still found to be geographically fragmented, distorted and noncompetitive even in the post-reform period. The public sector banks (SCBs and DFIs) have remained more or less dominant in the banking sector. Still SCBs and DFIs hold 32.9% of deposits and 34.6% of advances of the banking sector of Bangladesh.

Second, profitability of SCBs has remained small where in case of DFIs it is less than 1.0 percent even worst (negative) during the whole period. This is because public sector banks have continued to suffer from poor management skills, over branching, and overstaffing. Although their NPLs ratios have gradually declined, the ratios have

[7] *Chakraborty, P., the Negotiable Instrument Act, 1881, Swarna Prokashani, Dhaka.*

remained high.

Some public sector banks (mainly DFIs) have been suffering from the shortage of capital, demanding further recapitalization. Third, given that SCBs and DFIs enjoy scale of advantages because of their nationwide branch networks (especially compared with PCBs and FCBs, which tend to compete in the retail market). The current approach, therefore, for improving their performance without rationalizing them may not have further and substantial benefits for banking sector. As 30 years have passed since the reforms were initiated and SCBs and DFIs have been exposed to the new regulatory environment and pressures, it may be time for the government to take a further step for promoting the quality of managements and assets of banks and for closing unviable branches.

Fourth, problem of banking system is "systemic" not related to the banking system only. Reforms only in the SCBs, keeping away the DFIs and non-bank financial institutions (NBFIs), may not generate desired results. Therefore, the scope of reforms should also be extended to other organs of the financial system to make the financial system more resilient and stable. In addition, initiatives are required to be taken to address the problems of sick banks and to improve the performance of SCBs and DFIs by way of adopting effective risk management techniques and undertaking efficient monitoring of their credit portfolios. So the Government should give the highest priority to take reform measures for reforming DFIs and NBFIs and liberalizing the whole commercial banking sector, through careful consideration of the various aspects indicated above in the next reform agenda. Finally, in the current scenario, banks are required for constantly pushing the frontiers of risk management compulsions arising out of increasing competition, as well as agency problems between management, owners and other stakeholders.

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