Chapter - III

The Banking System in Bangladesh

3.1 Banking in Bangladesh

Because of its shared history with India and Pakistan, the historical background of banking in Bangladesh is similar to these countries. Banking activity commenced in Bengal when the Agency Houses at Calcutta started banking operations for the convenience of their constituents. Prominent among these trading firms were establishmEnts like Alexander & Co. and Fergusson & Co. However, banking operations of this early type did not resemble formal banking. Thus the earliest formal bank in British India was the Bank of Hindustan, which commenced banking operations under the directions of the British rulers.

3.1.1 Origins of National Banking Institutions

Shortly after the partition of British India into Pakistan and India in 1947, an Expert Committee was appointed to study banking issues in the context of the new state of Pakistan. Under recommendations from the Expert Committee, the erstwhile Reserve Bank of India continued to function in Pakistan up to 30 September 1948. Thereafter the State Bank of Pakistan was established as an independent state banking institution on 1 July 1948.[1]

The province of East Pakistan became the independent country of Bangladesh in December 1971. No banks had been headquartered in East Pakistan prior to independence, and only branches of the State Bank of Pakistan, i.e.the central bank, functioned in the country. Another dozen local and foreign commercial banks had also been functioning with 1299 branches in East Pakistan.[2] Over the duration of the Liberation Struggle, all banks continued to remain under the control of Pakistan. These were abandoned when the Pakistani authorities left the country. The new Government of Bangladesh promulgated the Bangladesh Bank Order, 1971 [Acting President's Order No.2 of 1971] [3] to rehabilitate the war-devastated banking sector. Under this Order, the State Bank of Pakistan was deemed and declared the Bangladesh Bank, the new central bank of the new country. All assets, offices and branches of the State Bank of Pakistan were declared as assets, offices and branches of the Bangladesh Bank. The Order also declared that all currency notes and coins issued by the State Bank of Pakistan and Government of Pakistan would continue as legal tender and would be deemed to have been issued by the Bangladesh Bank, until otherwise directed by the Government of Bangladesh. Thus the new banking structure of Bangladesh was given a legal shape by the Bangladesh Bank Order.

On Independence Day, i.e. the 16th of December 1971, 12 banks were operating in Bangladesh.[4] These were, namely

(i) The National Bank of Pakistan
(ii) The Bank of Bahawalpur Ltd.
(iii) The Premier Bank Ltd.
(iv) The Habib Bank Ltd.
(v) The Commerce Bank Ltd.
(vi) The United Bank Ltd.
(vii) The Union Bank Ltd.
(viii) The Muslim Commercial Bank Ltd.
(ix) The Standard Bank Ltd.
(x) The Australasia Bank Ltd.
(xi) The Eastern Mercantile Bank Ltd.
(xii) The Eastern Banking Corporation Ltd.

To avoid the crises that might arise due to the political changeover, the Government of Bangladesh promulgated a second law under the Bangladesh (Administration of Banks) Order, 1971 [Acting President's Order No.3 of 1971][5] making administrative provision for those banks whose head-offices were in Pakistan. An Adminstrator was appointed under this Order for the management and control of all such banks. Arrangements were also made to vest all the powers of the Board of Directors of these banks in the Government of Bangladesh, and to take care of other incidental matters under due provisions of the same law.

3.1.2 Nationalisation of Banks and After

Soon after Independence, the Government adopted a socialist development strategy for Bangladesh, under which it aimed at building a society in which wealth would be distributed as equitably as possible. As financial institutions, the banks in the country were custodians of private savings and also mobilised resources for the country while accepting deposits and channelising them into credit flows for national and industrial development. Accordingly, the Government of Bangladesh decided to nationalise all banks in order to implement its development strategy and promulgated the Bangladesh Bank (Nationalisation) Order, 1972 [President's Order No.26 of 1972] on 26 March 1972.[6] The major provisions of the Nationalisation Order, 1972 mainly dealt with the powers to make banking rules and regulations, the mode of transfer of the undertakings of existing banks, the reorganisation of existing banks and their constitution into six new banks, the management of the new banks, and the terms and conditions of service of the employees of existing banks under the new banks. Under the Order, all 12 existing banks were nationalised and reorganised into six separate institutional entities.

3.1.2a Transfer of Undertakings of Existing Banks

Six new banks were constituted under Articles 4 and 5 of the Nationalisation Order, 1972, each having all the legal characteristics of a corporate body such as a common seal and continuous succession subject to the provisions of the law. Each new bank was empowered to acquire, hold and dispose of property in its own name. The undertakings of existing banks were transferred and vested with the new banks in accordance with pattern below.

Table 3.1: Pattern of Reorganisation of Banks under the Nationalisation Order, 1972

[in lakh Taka]

Existing Banks	Authorised New Bank	Paid-up Capital	Capital
The National Bank of Pakistan The Bank of Bahwalpur Ltd. The Premier Bank Ltd.	Sonali Bank	500	200
The Habib Bank Ltd. The Commerce Bank Ltd.	Agrani Bank	500	100
The United Bank Ltd. The Union Bank Ltd.	Janata Bank	500	150
The Muslim Commercial Bank Ltd. The Standard Bank Ltd. The Australasia Bank Ltd.	Rupali Bank	500	100
The Eastern Mercantile Bank Ltd.	Pubali Bank	500	100
The Eastern Banking Corporation Ltd.	Uttara Bank	500	100

Source: Bhuiya [1994]: *Bangladesh Laws on Banks and Banking*, p.490

All tools and instruments, and ways and means of the existing banks were taken over under the Nationalisation Order. The Order also contained provisions on the authorised capital, functions, accounts and audit activities of the new banks. The general direction and management of the business affairs of the new banks was vested in their Board of Directors, which according to Article 10 of the Nationalisation Order, 1972, was to comprise "the Managing Director and six Directors, to be appointed by the Government, at least three of whom shall be from amongst persons who, in the opinion of the Government, have experience and shown capacity in the field of finance, banking, trade, commerce, industry or agriculture." Subject to

other provisions of the Order, a Director other than Managing Director, would hold office for three years and would be eligible for reappointment. The Board was empowered to exercise all powers and take all actions that the new banks were authorised to exercise.

Table 3.2: Present Structure of Banking in Bangladesh

A. Bangladesh Bank

[Central Bank of the Bangladesh]

B. Nationalised Commercial Banks

1. Sonali Bank
2. Agrani Bank
3. Janata Bank
4. Rupali Bank Ltd.

C. Specialised Banks

1. Bangladesh Krishi Bank
2. Rajshahi Krishi Unnayan Bank
3. Bangladesh Samabaya Bank Ltd.
4. Bangladesh Shilpa Bank
5. Bangladesh Shilpa Rin Sangstha
6. Bank of Small Industries and Commerce
7. Ansar VDP Bank Ltd.
8. Grameen Bank
9. Employment Bank

D. Local Private Banks

1. Pubali Bank Ltd.
2. Uttara Bank Ltd.
3. Al-Arafa Bank Ltd.
4. Arab Bangladesh Bank Ltd.
5. National Bank Ltd.
6. City Bank Ltd.
7. United Commercial Bank
8. IFIC Bank Ltd.
9. Islami Bank Ltd.
10. South-East Bank Ltd.
11. Dhaka Bank Ltd.
12. Eastern Bank Ltd.
13. Social Invest Bank Ltd
14. Dutch Bangla Bank .
15. Prime Bank Ltd.
16. Al-Baraka Bank Ltd.
17. Credit & Commerce Bank

E. Foreign Banks

1. American Express Bank Ltd.
2. Standard Chartered Bank Ltd.
3. Grindlays Bank Ltd.
4. Habib Bank Ltd.
5. State Bank of India
6. Bank of Indo Suez
7. National Bank of Pakistan
8. Muslim Commercial Bank
9. Citibank N.A.
10. Faysal Islami Bank of Bahrain
11. Hanyil Bank Ltd.
12. Society General
13. The Hong Kong and Shanghai Banking Corporation Ltd.

3.1.2b Denationalisation

With the passage of time, the Government of Bangladesh recognized the need for denationalising some of the nationalised commercial banks [NCBs] to develop an efficient financial system for the country. After accordingly amending the relevant provisions in the Nationalisation Order, Pubali Bank and Uttara Bank were transferred to the private sector in 1984, and have since been redesignated as the Pubali Bank Ltd. and the Uttara Bank Ltd. On 14 December 1986, Rupali Bank was also transformed into a Public Limited Company by reducing Government equity to 51 percent and opening 49 percent of the bank's shares to public subscription. The bank was then redesignated as the Rupali Bank Ltd.[7] During the process of financial reforms in Bangladesh, an Expert Committee composed of the Managing Directors of all banks and financial institutions and headed by the Finance Secretary was also constituted by the Government of Bangladesh to suggest amendments and modifications to the Banking Companies Ordinance, 1962, which was adjudged to have outlived its purpose, particularly in view of the socioeconomic conditions facing the independent nation. In recognition of the changed situation, the Government abrogated the said Ordinance of 1962 and, in accordance with the recommendations of the Committee, the new Banking Companies Act, 1991 [Act No.14 of 1991] has thereafter guided the banking sector in the country.[8]

3.2 Present Structure of Banking in Bangladesh

In 1972, when all commercial banks in Bangladesh were nationalised, three specialised banks, namely the Bangladesh Krishi Bank, the Bangladesh Shilpa Bank and the Bangladesh Samabaya Bank, were established to cater to the specialised banking and credit needs of the agricultural, industrial and cooperative

sector in the country. After the institutional changes that have subsequently taken place, 4 Nationalised Commercial Banks [NCBs], 9 specialised banks, as well as 17 locally-owned private banks and 13 foreign-owned banks now function within Bangladesh.[9] The present structure of banking in Bangladesh has been outlined schematically above, and the functions and operations of the different banking institutions will now be examined.

3.2.1. The Bangladesh Bank

The Bangladesh Bank became the central bank of the country after the provincial branch of the State Bank of Pakistan was deemed as the Bangladesh Bank. Because of the period spent in recovering after the Liberation War, establishment of an organised and full-fledged Central Bank was delayed until promulgation of the Bangladesh Bank Order, 1972 [President's Order No.127 of 1972] on 31 October 1972. Through the Order, the Bangladesh Bank became the new country's central bank on permanent basis with retrospective effect from 16 December 1971.[10] The entire paid-up capital of Tk.3.00 crore of Bangladesh Bank was contributed by the Government of Bangladesh. Various other statutory funds have been created from time to time by the Bangladesh Bank from its annual operating profits. Apart from its Head Office branch in Dhaka, the Bangladesh Bank operates through two other branches in the city and one branch in each of the principal districts of Chittagong, Rajshahi, Khulna, Bogra, Sylhet, Rangpur and Barisal.

The functions and responsibilities of Bangladesh Bank are similar to those of the central banks in other developing countries. The Bangladesh Bank has the sole authority to issue bank notes and regulates the issue of currency in Bangladesh. This power enables the Bank to control the money supply of the country. The Bank also resorts to credit controls and other supportive measures for the efficient and successful implementation of the monetary polices of Bangladesh. The Bank is obligated to transact the banking business of the Government and thus accepts money on account of the Government and also makes payments on behalf of the Government. The Bank looks after the financial transactions of the Government of Bangladesh and manages the public debt. It also makes exchange remittances and carries out other banking operations. Moreover, as the banker to the Government, the Bangladesh Bank advises the Government on policy measures for overall monetary management and development of the nation. The Bangladesh Bank also supervises and controls the activities of commercial banks of the country under the powers assigned by the Bangladesh Bank Order, 1972. It acts as a banker to the commercial banks, who maintain deposit accounts with the Bangladesh Bank and also draw credit from the Bangladesh Bank in times of necessity. The Bangladesh Bank thus acts as a lender of the last resort by providing rediscounting facilities to the country's commercial banks.

The Bangladesh Bank is responsible for maintaining the internal and external value of the currency of the nation, namely the Taka. It is also concerned with the development of a sound and healthy commercial banking system, for which it ensures effective coordination and control of credit through appropriate monetary and credit policy measures. Additionally, it acts as the promoter of financial institutions in the country so that its policies can be effectively implemented to the service of economic growth, in terms of guidelines and policies formulated by the Government. The foremost duties of the Bangladesh Bank are to see that all banking business in the country is carried out on sound financial principles and to help in the provision of banking facilities throughout Bangladesh.

3.2.2 The Nationalised Commercial Banks

Before the liberation of Bangladesh in 1971, all commercial banks operating in the territory with the exception of the National Bank of Pakistan [NBP] and the Eastern Mercantile Bank Ltd, [EMBL] were privately-owned. The National Bank of Pakistan was partly owned by the Government and partly by private banking interests. After the Government's decision in 1972 to nationalise all banks in the country, the private banks operating were reorganised into six new NCBs, as described above. In partial reversal of this move, two NCBs namely Pubali Bank and Uttara Bank were privatised in 1983 while the Rupali Bank was partially privatised in 1986 when it became a Public Ltd. company.[11]

In keeping with the Government's economic thinking at the time, all NCBs were assigned a developmental role and asked to pay their fullest attention to ensuring the fulfilment of the socioeconomic objectives of Government policies. Special emphasis thus came to be laid on expansion of their branch

networks across the country in order to extend the scope of their activities beyond traditional banking. It was envisaged that, besides providing credit for trade and commerce, the NCBs would liberally grant loans to national priority-sectors such as agriculture, non-traditional exports and small industries, as well as to numerous small borrowers and unemployed youths, as well as to less-developed regions within the country. Beginning with latter half of the 1970s, considerable importance was attached to the extension of banking services into interior rural areas. This policy of branch expansion became a notable success as NCB rural branch networks reached the doorsteps of the rural population of Bangladesh in order to mobilise rural savings. As a consequence of the policy thrust, the NCBs now have a network of 3617 branches spread over Bangladesh.[12] Substantial expansion in the rural banking network immediately led to a significant increase in rural bank deposits from Tk.231.62 crore in June 1978 to Tk.307.86 crore in December 1978, representing an increase of Tk.76.24 crore (32.91 percent). Over the same duration, urban bank deposits expanded by Tk.292.51 crore (19.29 percent), touching Tk.1.808.58 crore at the end of the period.[13] The rising trends have strengthened since then, and deposits mobilised from the rural areas rose to Tk.11,170.84 crore by the end of March 1998. As a result of the high rate of increase in rural deposits, the share of rural deposits in total bank deposits in Bangladesh rose from 13.25 percent in 1978 to 22.7 percent in 1998.[14]

A number of factors have worked jointly to ensure expansion of rural banking operations in Bangladesh. Through powers assigned under the Banking Companies Act, 1991 [Act No.14 of 1991],[15] only the Bangladesh Bank can issue licences to commercial banks for opening new branches and conducting banking business. No commercial bank can commence business without obtaining a licence for each of its branches. Under conditions imposed by the Bangladesh Bank in exercise of these powers, all commercial banks were required to open two new rural branches for every new urban branch for which a licence was issued. Implementation of this condition soon ensured the rapid proliferation of rural branches in the country. A separate rural branch expansion programme was also drawn up subsequently which required the banks to extend their operations to all the Unions of the country within a specified timeframe. Again, in pursuance of the Government decision in 1977 to expand agricultural financing operation in the country, all NCBs had to aggressively extend their rural branch networks and expand their involvement in rural banking. The consequent increase in the number of rural branches has been very rapid over the late-1970s and the 1980s. Overall, there has been tremendous growth in banking facilities in Bangladesh during the post-independence period, well reflected in the expansion of NCB branches from 1,299 in 1972-73 to 5,973 by 1998-99.[16]

3.2.3 Specialised Banks

Of the nine specialised financial institutions listed above, three - namely, the Bangladesh Krishi Bank [BKB], the Rajshahi Krishi Unnayan Bank [RAKUB] and the Bangladesh Shilpa Bank [BSB] are nationalised banking institutions which are entirely Government-owned. Six others - namely, Bangladesh Shilpa Rin Sangstha [BSRS], Bangladesh Samabaya Bank Ltd [BSBL], Bank of Small Industries and Commerce [BASIC], Ansar VDP Bank Ltd., Grameen Bank and Employment Bank - have been working as development banking institutions.[17] The BKB was established in just after liberation under President's Order No.27 of 1973 to take over the functions of the former Agricultural Development Bank of Pakistan, and to cater to the needs of agricultural finance and agro-based industries in Bangladesh. RAKUB was established separately in 1987 to provide agricultural credit and thus contribute to the agricultural development of the Rajshahi area, which at that time was a relatively backward region. BSB was established on 31 October 1972 under the President Order No.129 of 1972 to take over the assets and liabilities of the erstwhile Industrial Development Bank of Pakistan [IDBP]. Similarly, BSRS was also established on 31 October 1972 under the President Order No.128 of 1972 after merger of three predecessor institutions, namely the Pakistan Industrial Credit and Investment Corporation [PICIC], the National Investment Trust [NIT] and the Investment Corporation of Pakistan. The other specialised financial institutions, namely Grameen Bank [GB], Bank of Small Industries and Commerce [BASIC], Ansar VDP Bank Ltd. and the Employment Bank were established on October 1983, January 1989, November 1995 and September 1998, respectively.

Among these, the Grameen Bank has acquired an international reputation for its promotion of microfinance activities in Bangladesh. Its loan portfolio mainly comprises small trading loans which the Grameen Bank extends to the targeted poor. Since the targeted poor are mostly landless, the Grameen Bank does not generally disburse agricultural credit. BASIC engages in all general banking services, but lays special emphasis on financing medium-term fixed and working capital loans for the development of the

small-scale and cottage industries sector. The Ansar VDP Bank Ltd. works for the development of rural economy, and has so far covered the broad rural financing area of fisheries development, livestock & poultry rearing and ancilliary activities like horticulture, shrimp culture, cottage industry development, etc.[18] The Bangladesh Shilpa Bank and Bangladesh Shilpa Rin Sangstha have emerged as the two major sources of term finance for industry in Bangladesh. They provide both credit facilities and equity support to industrial enterprises in the country, with the main objective of accelerating industrial investment and industrial growth in Bangladesh. Besides extending financial support, they also provide technical advice to industrialists on the setting up of new industrial projects. Assistance is also provided through these institutions to industrial concerns for balancing, modernising, replacing and expanding [BMRE] their capital structure.

3.2.4 Local Private Banks

The policy outlook of the Government of Bangladesh regarding the potential role of the private sector began to change after 1976. With changes in economic policy, the need was felt for allowing the entry of local private banks in order to encourage competition among the NCBs and to increase financial support for the growing private sector in the country. Disinvestments in some public sector enterprises during that period added further momentum to the policy changes. Accordingly, the Government of Bangladesh revised its banking policies and decided to allow operation of local private banks on a limited scale and initially permitted six private banks to begin operations in 1983. As shown above, the number of such local private has now increased to seventeen.[19]

Under terms originally outlined by the Company Act, 1913, any private bank must be registered as a public limited company before commencing banking business. The Sponsors and Directors of a bank must be reputable persons with existing involvement in trade, commerce and industry. The Chief Executive, who must be appointed with prior approval of the Bangladesh Bank, must have working experience of not less than 15 years in responsible positions in the banking sector. All requirements of the Banking Companies Ordinances, 1972, and relevant provisions of the Bangladesh Bank Order, 1972, and the instructions issued thereunder by the Bangladesh Bank also apply to the private banks in Bangladesh.

Despite their increasing presence since 1983, private banks in Bangladesh have not yet been able to generate effective competition with the NCBs.[20] It has also been reported that certain private banks have not been adhering to the rules and regulations of Bangladesh Bank.[21]

3.2.5 Foreign-owned Banks

Thirteen foreign-owned banks operate at present in Bangladesh, American Express and Grindlays Bank being the largest among them. The foreign banks still account for a relatively small percentage of banking deposits and advances in Bangladesh, but are active in international banking and the foreign exchange sector. Before commencing business in Bangladesh, a foreign bank is required to deposit an amount not less than Tk.5 million with the Bangladesh Bank. This deposit should be brought to Bangladesh through transfer of external funds through normal banking channels. On the date of commencing business, a foreign-owned bank is required to submit a certificate of this deposit to the Bangladesh Bank, accompanied by a statement of its existing assets and liabilities in Bangladesh. A foreign bank is also required to comply with all relevant provisions of the Banking Companies Act, 1962, the Bangladesh Bank Order, 1972, as amended in 1992 and other banking legislations and regulations currently in force in Bangladesh. The location and place of business of a private bank cannot be changed without prior concurrence from the Bangladesh Bank.

3.3 The Growth of Banking and Financial Facilities in Bangladesh

The banking sector in Bangladesh has shown remarkable growth during the last 29 years, after all banks functioning in Bangladesh were assigned a development role vis-a-vis the nation, and were directed to expand their networks over the entire country in order to facilitate lending to the priority sectors. Since most Bangladeshi banks are now owned corporately by the Government of Bangladesh or by by Bangladeshi nationals and operate under the common guidelines of the Bangladesh Bank, there has been coordinated development of the banking sector since the liberation of Bangladesh in 1971.

Table 3.3: Expansion of the Branch Network of Banks in Bangladesh

Institutions	Number of Branches 1978-79	1998-99	*Addition over 20 years*
Nationalised Banks	2979	3617	*638*
Specialised Banks	262	1175	*913*
Private Banks	-	1150	*1150*
Foreign Banks	20	31	*11*
Total	3261	5973	*2712*

Sources: (i) Mongia [1982]: *Banking Around the World*, p.82
(ii) Khan [1999]: *Resume of the Activities of the Financial Institutions in Bangladesh*, 1998-1999, p.i

3.3.1 Expansion of Branches

By decision of the Government in 1977, the nationalised commercial banks were required to expand their branch networks into the rural areas in order to become more involved in agricultural financing. The number of rural branches multiplied rapidly during the late 1970s and 1980s. The six NCBs opened 666 new branches in 1977-78 and another 447 branches in 1978-79 raising the total number of NCB branches to 2979 at the end of 1978-79. Because of the priority attached to the spread of banking into rural areas, as many as 348 out of the 447 new branches opened in 1978-79 were located in rural Bangladesh. Similarly, the Bangladesh Krishi Bank opened 55 branches and Bangladesh Shilpa Bank **opened branches** during the year 1978-79, raising the total number of their branches to 252 and 10 respectively. The total number of branches of commercial banks including 20 branches of the foreign banks which operate in Bangladesh, increased to 3261 at the end of June 1979.[22]

The pace of branch expansion over the years can be assessed from the table above. Over the course of time, banking business in Bangladesh has expanded considerably, and the proliferation of bank branches throughout the country is very noticeable. At present, 43 banks function in Bangladesh, among which are 4 Nationalised Commercial Banks [NCBs], 9 specialised banks, 17 private banks and 13 foreign banks. The total number of bank branches has now reached 5973, of which 2351 (39.36 percent) are located in urban areas and 3622 (60.6 percent) in rural areas.[23]

Table 3.4: Growth of Bank Deposits & Bank Credit in Bangladesh 1972-73 to 1997-98

[in crore Tk.]

Period (uptil June)	Total Bank Deposits*	Deposits as % of GDP	Total Bank Credit	Credit as % of GDP	Money Supply [M2]	M2 as % of GDP
1972-73	712.4	-	544.25	-	989.10	-
1973-74	913.40	12.06	752.20	9.93	1244.50	16.43
1974-75	1014.30	8.16	828.60	6.66	1259.60	10.13
1975-76	1134.20	10.28	957.90	8.68	1396.90	12.66
1976-77	1438.20	12.40	1204.70	10.39	1739.90	15.00
1977-78	1706.20	17.75	1531.40	10.55	2141.00	14.75
1978-79	2193.40	12.60	1961.80	11.27	2760.00	15.86
1979-80	2680.30	13.67	2663.10	13.58	3244.90	16.55
1980-81	3342.90	14.45	3204.0	13.84	4136.00	17.87
1981-82	3803.30	14.68	4270.0	16.49	4548.70	17.56
1982-83	4948.80	16.82	4912.50	16.70	5898.30	20.05
1983-84	7087.30	19.95	6745.40	18.99	8385.80	23.61
1984-85	9139.20	22.46	9001.80	22.12	10534.20	25.89
1985-86	10800.20	23.16	10763.40	23.09	12338.10	26.46
1986-87	12805.90	23.75	11611.80	21.54	14353.10	26.62
1987-88	15143.90	25.36	13838.10	23.17	16408.00	27.48
1988-89	17860.00	27.08	16395.10	24.86	19078.10	28.92
1989-90	20481.00	27.77	19588.10	26.56	22297.60	30.23
1990-91	23078.40	27.66	21898.80	26.25	25004.40	29.97
1991-92	26561.60	29.30	22304.10	24.60	28525.90	31.47
1992-93	29746.40	31.38	24056.30	25.37	31535.60	33.26
1993-94	33937.90	32.94	24210.00	23.50	36403.00	35.33
1994-95	39073.00	33.39	29207.10	24.96	42212.30	36.07
1995-96	41867.00	32.17	34681.20	26.65	45690.50	35.10
1996-97	46555.10	33.18	38598.90	27.77	50627.50	36.08
1997-98	51745.40	33.58	44077.80	28.60	55724.10	36.16

*Notes: * Including government deposits but excluding inter-bank items.*
Sources: Compiled from Bangladesh Bank, *Annual Reports* [various issues] & Ahmed [1999]:24:12

It is clearly seen that under the impetus of the branch expansion programme of the Government, the combined branch network of all banks including foreign banks has grown from 3261 branches in 1978-79 to 5973 branches in 1998-99. The opening of 1150 branches by private banks in that single year also provides clear indication of the growth of private sector banking enterprise in Bangladesh.

3.3.2 Bank Deposits and Bank Credit

As a consequence of the expansion in the branch network, bank deposits and credit have also grown considerably. Selected indicators of the growth in bank activities between 1972-1973 and 1997-1998 have been provided in the preceding table. In 1972-73, the combined deposits of all scheduled banks [excluding inter-bank items] amounted to only Tk.712.40 crore.[24] Bank deposits have since recorded a sharp increase to Tk. 51,890.40 crore in 1997-98. Marked growth occurred in time deposits which increased from Tk.1230.32 crore in June 1979 to Tk. 39,980.60 crore in June 1998. Demand deposits increased to Tk. 7,735.20 crore in 1998 from the level of Tk. 883.08 crore in 1979. Government deposits also went up to Tk. 4172.60 crore during the same period. On the other hand, total outstanding bank credit rose sharply from Tk. 544.25 crore in 1972 -73 to Tk. 19,588.10 crore by 1989-90 and touched the level of Tk.44,077.80 crore by 1997-98. Of the components of bank credit, advances increased by Tk. 4794.80 crore or 12.9 percent and the bills purchased and discounted went up by Tk. 324.20 crore or 19.3 percent in 1997-98.[25]

Table 3.5: Growth of Banking Operations in Bangladesh

Year *[ending June]*	BANK DEPOSITS Demand Deposits	Term Deposits	Total Bank Deposits	BANK ADVANCES Bank Advances	Bills	Total Bank Credit	Post Office Savings Bank Deposits	Total Bank & POSB Deposits	*Deposits as % to Total Bank & POSB Deposits*	*Advance-to-Deposit Ratios on All Bank Deposits*	*Advance-to-Deposit Ratios on Term Deposits*
1986	29743	74102	103845	104564	3070	107634	950	104795	*99.09*	*0.030*	*0.041*
1987	31863	90903	122766	112891	3227	116118	1070	123836	*99.14*	*0.026*	*0.035*
1988	26327	113603	139930	133415	4690	138105	1873	141803	*98.68*	*0.034*	*0.041*
1989	28451	136174	164625	158867	4770	163637	1409	166034	*99.15*	*0.029*	*0.035*
1990	31805	159289	191094	190324	5465	195789	2551	193645	*98.68*	*0.029*	*0.034*
1991	35919	178006	213925	212457	6408	218865	2692	216617	*98.76*	*0.030*	*0.036*
1992	41846	202687	244533	215858	6978	222836	2689	247222	*98.91*	*0.029*	*0.034*
1993	45825	224730	270555	231924	7628	239552	3954	274509	*98.56*	*0.028*	*0.034*
1994	57511	252359	309870	239227	7454	246681	7503	317373	*97.64*	*0.024*	*0.030*
1995	66143	290329	356472	280859	11212	292071	12125	368597	*96.71*	*0.031*	*0.039*

Source: BBS [1997]: *Statistical pocketbook of Bangladesh*, p.292

The growth in total bank deposits has been slower than the growth in post-office savings deposits over the last decade, indicating that small savings in Bangladesh haveseen rapid increase. However in absolute terms, total bank deposits rose more than three-fold between 1986 and 1995. Advance-to-deposit ratios on all bank deposits have remained more or less steady over the period, although advances have risen two-fold in terms of current prices. In 1986, term deposits were only twice as large as demand deposits. Considerable acceleration has been witnessed since then, and term deposits with the banks in 1995 were four times as large as demand deposits, with the difference of value amounting to Tk.22,418 crore. In spite of this accleration, the advance-to-deposit ratios for term deposits do not however show significant change between 1986 and 1995, reflecting that the increase in such deposits has not been matched by increased bank lending.

The main reason for the accelerating trend in term deposits may thus lie in the present fund management practices of banks, under which deposits collected by the branches must be sent for investment to the bank head offices against guaranteed but minimal returns. The more long-duration and risky investments are made at the head office level. It is these high profile investments that allow the banks to record operating profits after combined interest charges on branch and head office deposits have all been taken care of. While this practice multiplies term deposits, it also ensures that more of the advances go to the bank's larger clients, while the credit needs of the region from which the deposits were initially mobilised may in fact remain unattended. Increases in time deposits may also be a response to the perception of additional risk by the banks. This would explain how raised statutory liquidity requirements increase the proportion of longterm deposits, while proportionately reducing advances. Since total bank deposits in 1995 amounted to Tk.35,647.20 crore, greatly exceeding total bank credit of Tk.29,346.40 crore, it would also appear that a large deposit amount valued at Tk. 6300.80 crore had remained idle in the hands of the banks. This amount

would constitute a leakage from the national economy, which if invested properly, should have generated additional national income as well as additional operating profits for the banks.

Table 3.6: Divisional Distribution of Financial Resources of the Bangladesh Banking System

Division		Deposits in Year ending June 1993 *[Tk.million]*	Deposits in Year ending June 1993 *[Tk.million]*	Deposits in Year ending June 1993 *[Tk.million]*	Advances in Year ending June 193 *[Tk.million]*	Advances in Year ending June 1993 *[Tk.million]*	Advances in Year ending June 1993 *[Tk.million]*
Barisal Division		7176	8311	9274	3816	4324	5183
	Urban	3755	4329	4799	1682	1838	2196
	Rural	3421	3982	4475	2134	2486	2987
Chittagong Division		81423	92327	105280	50209	54794	65537
	Urban	54820	62260	71031	40064	43720	53240
	Rural	26603	30067	34249	10145	11074	12297
Dhaka Division		165822	187901	217523	165099	169011	196125
	Urban	149243	168255	194534	149036	151424	175434
	Rural	16579	19646	22989	16063	17587	20691
Khulna Division		19716	21729	24563	22734	26129	29417
	Urban	12779	13777	15674	17111	19954	22206
	Rural	6937	7952	8889	5623	6175	7211
Rajshahi Division		25315	29216	32602	26434	29034	33533
	Urban	13696	15816	17671	9355	10081	11733
	Rural	11619	13400	14931	17079	18953	21800
Total Bangladesh		**299452**	**339484**	**389242**	**268292**	**283292**	**329795**
	Urban	234293	264437	303709	217248	227017	264809
	Rural	65159	75047	85533	51044	56275	64986

Division	Category	1993 % Share in Total Bank Deposits	1994 % Share in Total Bank Deposits	1995 % Share in Total Bank Deposits	1993 % Share in Total Bank Advances	1994 % Share in Total Bank Advances	1995 % Share in Total Bank Advances
Barisal Division		*2.40*	*2.45*	*2.38*	*1.42*	*1.53*	*1.57*
	Urban	1.25	1.28	1.23	0.63	0.65	0.67
	Rural	1.14	1.17	1.15	0.80	0.88	0.91
Chittagong Division		*27.19*	*27.20*	*27.05*	*18.71*	*19.34*	*19.87*
	Urban	18.31	18.34	18.25	14.93	15.43	16.14
	Rural	8.88	8.86	8.80	3.78	3.91	3.73
Dhaka Division		*55.38*	*55.35*	*55.88*	*61.54*	*59.66*	*59.47*
	Urban	49.84	49.56	49.98	55.55	53.45	53.19
	Rural	5.54	5.79	5.91	5.99	6.21	6.27
Khulna Division		*6.58*	*6.40*	*6.31*	*8.47*	*9.22*	*8.92*
	Urban	4.27	4.06	4.03	6.38	7.04	6.73
	Rural	2.32	2.34	2.28	2.10	2.18	2.19
Rajshahi Division		*8.45*	*8.61*	*8.38*	*9.85*	*10.25*	*10.17*
	Urban	4.57	4.66	4.54	3.49	3.56	3.56
	Rural	3.88	3.95	3.84	6.37	6.69	6.61
Total Bangladesh		***100.00***	***100.00***	***100.00***	***100.00***	***100.00***	***100.00***
	Urban	78.24	77.89	78.03	80.97	80.14	80.30
	Rural	21.76	22.11	21.97	19.03	19.86	19.70

Source: BBS [1997]: *Statistical Pocketbook of Bangladesh*, p.293

3.3.3 Spatial Distribution of Banking Resources in Bangladesh

The economy of Bangladesh has been witnessing a mismatch between bank deposits and credit programmes, a decline in the levels of agricultural credit, a high proportion of loan overdues as well as net transfer of resources from rural to the urban areas.[26] According to the Bangladesh Bank, the overall flow of bank advances to rural has significantly decreased in the country, although the rate of deposit collection has improved. The regional distribution of the financial resources of the Bangladesh banking system is examined in the table above.

The table shows that the total bank deposits increased by Tk.8979.00 crore or 29.98 percent from Tk.29,945.20 crore to Tk.38,924.20 crore during the period 1993-95, while the total bank advances increased by Tk.6150.30 crore or 22.92 percent from Tk.26,829.20 crore to Tk.32,979.50 crore during the same period. It is also evident from the table that the advances fall by 7.06 percent against deposits during 1993-95.

However when the data on bank deposits and credit are broken down by the five major divisions in the country and by their urban or rural character (data for the newly-created Sylhet division being shown with Chittagong division), certain distortions become noticeable. It is notices, for instance, that annual bank deposits are always higher in Dhaka division (55 percent) followed by Chittagong (27 percent), Rajshahi (8.5 percent), Khulna (6 percent) and Barisal divisions (2.3 percent). Urban deposits surpass rural deposits in all divisions, averaging 79 percent every year. Dhaka division draws more than half of all bank advances, followed by Chittagong, Rajshahi, Khulna and Barisal divisions. Fourth, the percentage of share of rural advances during 1993-95 was lower than the percentage of share of rural deposits in total bank deposits during the same period. All these factors establish the inequality between urban and rural bank operations.

Table 3.7a: Bank Deposits and Credit Advances to Selected Urban Centres in Bangladesh

Urban Centre	Zila	Division	1993 % Share in Divisional Deposits	1994 % Share in Divisional Deposits	1995 % Share in Divisional Deposits	1993 % Share in Divisional Advances	1994 % Share in Divisional Advances	1995 % Share in Divisional Advances
Barisal	*Barisal*	Barisal	*29.96*	*30.04*	*28.07*	*24.74*	*22.90*	*22.88*
Noakhali	*Rangamati*	Chittagong	*1.71*	*1.84*	*1.88*	*1.08*	*1.08*	*1.01*
Chittagong	*Chittagong*	Chittagong	*42.72*	*42.85*	*43.13*	*67.96*	*104.53*	*69.77*
Comilla	*Comilla*	Chittagong	*3.35*	*3.38*	*3.12*	*2.29*	*2.19*	*2.12*
Chandpur	*Chandpur*	Chittagong	*1.02*	*1.01*	*0.94*	*1.02*	*0.95*	*1.07*
Sylhet	*Sylhet*	Sylhet	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Mymensingh	*Mymensingh*	Dhaka	*0.96*	*0.93*	*0.93*	*0.45*	*0.47*	*0.50*
Dhaka	*Dhaka*	Dhaka	*81.73*	*80.97*	*81.08*	*82.09*	*81.29*	*80.98*
Faridpur	*Faridpur*	Dhaka	*0.53*	*0.54*	*0.51*	*0.41*	*0.45*	*0.49*
Narayanganj	*Narsingdi*	Dhaka	*2.30*	*2.36*	*2.27*	*4.80*	*4.62*	*4.55*
Khulna	*Khulna*	Khulna	*33.05*	*30.45*	*31.04*	*54.23*	*55.65*	*5.21*
Jessore	*Jessore*	Khulna	*11.55*	*11.57*	*11.68*	*9.26*	*10.08*	*12.50*
Kushtia	*Magura*	Khulna	*5.62*	*5.96*	*6.24*	*3.28*	*3.07*	*3.25*
Bogra	*Bogra*	Rajshahi	*7.72*	*7.34*	*7.96*	*7.88*	*7.46*	*7.42*
Rajshahi	*Rajshahi*	Rajshahi	*10.02*	*11.43*	*10.79*	*3.81*	*3.91*	*3.73*
Pabna	*Pabna*	Rajshahi	*5.76*	*5.42*	*5.50*	*5.60*	*5.44*	*5.29*
Rangpur	*Rangpur*	Rajshahi	*6.08*	*5.83*	*6.45*	*4.49*	*4.36*	*4.33*

Source: BBS [1997]: *Statistical Pocketbook of Bangladesh*, p.294

The date on urban bank deposits and advances at selected centres in Bangladesh shows that almost all divisional headquarters, namely Barisal, Chittagong, Sylhet, Dhaka, Khulna and Rajshahi, contribute the largest share of deposits and draw the largest advances. Most economic activities in each region of Bangladesh are clustered around the divisional headquarters. Hence, the number of bank branches is not distributed uniformly across divisions, and is usually highest at the divisional headquarters. Once again, because of metropolitan character of Dhaka, deposits and advances in Dhaka division outstrip the levels recorded at other divisions. Rajshahi division lags behind in all respects, possible because of low cropping intensity and prevalence of single cropping in that division.

Table 3.7b: Urban Credit-Deposit Ratios at Selected Urban Centres in Bangladesh

Urban Centre	Zila	Division	CD Ratio 1993	CD Ratio 1994	CD Ratio 1995
Barisal	*Barisal*	Barisal	0.44	0.40	0.46
Noakhali	*Rangamati*	Chittagong	0.39	0.35	0.33
Chittagong	*Chittagong*	Chittagong	0.98	1.45	1.01
Comilla	*Comilla*	Chittagong	0.42	0.39	0.42
Chandpur	*Chandpur*	Chittagong	0.62	0.56	0.71
Sylhet	*Sylhet*	Sylhet	0.19	0.18	0.17
Mymensingh	*Mymensingh*	Dhaka	0.47	0.45	0.48
Dhaka	*Dhaka*	Dhaka	1.00	0.90	0.90
Faridpur	*Faridpur*	Dhaka	0.78	0.75	0.87
Narayanganj	*Narsingdi*	Dhaka	2.08	1.76	1.81
Khulna	*Khulna*	Khulna	1.89	2.20	0.20
Jessore	*Jessore*	Khulna	0.92	1.05	1.28
Kushtia	*Magura*	Khulna	0.67	0.62	0.62
Bogra	*Bogra*	Rajshahi	1.06	1.01	0.96
Rajshahi	*Rajshahi*	Rajshahi	0.40	0.34	0.36
Pabna	*Pabna*	Rajshahi	1.01	1.00	0.99
Rangpur	*Rangpur*	Rajshahi	0.77	0.74	0.69

Source: BBS [1997]: *Statistical pocketbook of Bangladesh*, p.294

Credit-deposit ratios are highest in the four districts of Chittagong, Dhaka, Narayanganj and Khulna, indicating that credit mobilisation has been successful in these districts. Chittagong district has economic importance because of the port location and the establishment of Chittagong Export Processing Zone [EPZ]. Dhaka district has additional economic importance as the capital city and industrial base of Bangladesh. Khulna is important because of its port and because of increased shrimp cultivation and Narayanganj for industrial belt *i.e.* textile and hosiery.

The other districts could not utilise at least half of their bank deposits because of uneven regional development patterns. Since advances exceeded deposits in some districts, this would also indicate shifting of deposits from regions where they were less utilised to regions with high credit demand. Thus the divisional credit-deposit ratios for rural and urban areas show that, with the exception of Barisal and Rajshahi division, the CD-ratios favour urban areas, which may partially be because bank branches are not uniformly distributed over the country. Since most economic activity in Bangladesh is urban-based, banks are reluctant to disburse credit to rural areas, since it is not cost-effective for the banks to do so, and since it is harder to recover loans in rural areas. In the rural areas of Rajshahi division, the higher mobilisation of credit is a possible impact of RAKUB. The distribution of financial resources of the banking system in the country thus suggests a net transfer of resources from the rural to the urban sector, under the mediation of the banking system in Bangladesh.

Table 3.7c: Divisionwise Credit-Deposit Ratios in the Bangladesh Banking Sector

		CD Ratio- in June 1993	CD Ratio in June 1994	CD Ratio in June 1995
Barisal Division		*0.53*	*0.52*	*0.56*
	Urban	0.45	0.42	0.46
	Rural	0.62	0.62	0.67
Chittagong Division		*0.62*	*0.59*	*0.62*
	Urban	0.73	0.70	0.75
	Rural	0.38	0.37	0.36
Dhaka Division		*1.00*	*0.90*	*0.90*
	Urban	1.00	0.90	0.90
	Rural	0.97	0.90	0.90
Khulna Division		*1.15*	*1.20*	*1.20*
	Urban	1.34	1.45	1.42
	Rural	0.81	0.78	0.81
Rajshahi Division		*1.04*	*0.99*	*1.03*
	Urban	0.68	0.64	0.66
	Rural	1.47	1.41	1.46
Total Bangladesh		*0.90*	*0.83*	*0.85*
	Urban	0.93	0.86	0.87
	Rural	0.78	0.75	0.76

Source: BBS [1997]: *Statistical pocketbook of Bangladesh*, p.294

3.4 Financial Sector Reforms in Bangladesh

The financial system of Bangladesh is still underdeveloped with a weak banking sector. The Government has acknowledged the need for financial reforms since 1980s to ensure an effective role for the financial sector in the economic development of the country. In 1984, the Government constituted a National Commission on Money, Banking and Credit, which submitted its report to the Government in June 1986 after comprehensively reviewing the banking and credit system of Bangladesh.. Based on its recommendations, the Government initiated the Financial Sector Reform Programme [FSRP] in 1990 and undertook certain measures to reform the national banking system.[27] Certain reform measures had also been initiated by the Government in the late 1980s.

3.4.1 Reforms relating to Interest Rates

Major reforms on the liberalization of interest rates were undertaken in November 1989. Prior to that year, deposit and lending rates had been set by Bangladesh Bank. The aim of liberalization programme was to introduce flexibility into the determination of deposit and lending rates. Under the new system, Bangladesh Bank fixed ceilings and floors between which individual banks were allowed to set their own interest rates on both deposits and lending in the stipulated band. Further flexibility in interest rate determination was

introduced from June 1992, when the interest rate bands on lending were completely removed except for the agricultural sector (permissible lending rates of 10-14 percent), the small-scale and cottage industries sector (permissible lending rates of 9-12 percent) and export sector (permissible lending rates of 8-10 percent).[28]

Except for credit operations by Bangladesh Krishi Bank and Rajshahi Krishi Unnayan Bank, the refinancing window at the Bangladesh Bank has been closed completely and a rediscount window on the bank rate has been opened instead for commercial banks. The bank rate was gradually lowered from 9.75 percent in January 1990 to 5.5 percent in March 1994. It was again raised from 5.5 percent to 8.00 percent on 24 November 1997, in order to reduce the dependence of commercial banks on the Bangladesh Bank, and to motivate them to generate their own financial resources to conduct their business and credit programmes.[29]

3.4.2 Classification and Provisioning of Loans

The continuing crisis that has resulted from the cumulation of bank loan defaults has emerged as one of most serious constraints to economic development in Bangladesh. All NCBs have advanced a huge amount of unrecoverable bad loans. Provision had not been made earlier for assessing the quality of the credit portfolios of the banking sector such. Bangladesh Bank, as a part of the financial reforms initiated in 1989, introduced regulations that required commercial banks to annually classify their loans. Under this regulation, all loans were to be reviewed and sorted into four categories, viz., unclassified loans, substandard loans which were overdue by one year, doubtful loans which were overdue by three years, and bad loans or losses which were overdue by more than five years. The probability rates for recovery of substandard, doubtful and bad loans were set at 90 percent, 50 percent and nil, respectively.[30]

3.4.3 Capital Adequacy

In 1989, Bangladesh Bank introduced legal norms for the capital adequacy of banks. The main objective of the capital adequacy requirement was to protect the depositors from any losses resulting from bad financial decisions by bank managements, particularly in the case of private banks. Capital adequacy requirements for the NCBs were less compelling, because the Government's implicit position as guarantor for the depositors. Capital adequacy norms for the NCBs were largely met through the infusion of new capital by Government, and for the first time, the Government issued bonds of Tk.1700 crore to recapitalize nationalised banks. [31] The private banks were required to raise new capital either through contributions of additional paid-up capital by their owners or through market operations. The minimum capital requirement for them was set at 8 percent of the banks' risk- weighted assets.

3.4.4 Reform of Legal Framework

In Bangladesh, economic development has been badly hindered by mounting bank loan defaults. Human inefficiencies, debt rescheduling, industrial sickness, and frequent waivers of agriculture loans, etc., are the principal causes of the loan default problem. Effective measures have since been taken by the Government to remove legal deficiencies in the existing laws relating to the recovery of bank loans, particularly from large defaulters. Thus in 1986, an action programme was initiated by Government for the legal recovery of overdue industrial and agricultural loans. Under the Financial Loan Courts Act which was passed by Parliament, the Government has established Financial Loan Courts from whom the banks can obtain decrees against defaulters. An amendment to the Financial Loan Courts Act also allows the prosecution of defaulters. The Banking Companies Act has also been amended, mainly to limit the size of loans to individuals and to restrict inside loans to the bank directors. A Bankruptcy Act has also been passed and Bankruptcy Courts have been set up in Dhaka and Chittagong.[32]

3.5 Longterm Prospects for the Banking Sector

Bangladesh's banking system is still underdeveloped and currently has an inadequate regulatory framework and a huge mass of unrecoverable loans. Banking operations have also been afflicted by weak management and political interference, etc. However, it is also true that the banking system in Bangladesh has experienced continuous improvement over the 30 years that have elapsed after independence. The main objective behind the nationalisation of commercial banks, namely to foster economic development through

nationwide branch expansion, appears to have been largely achieved. The banking sector has shown better performance over this period, in terms of growth in deposit mobilisations and credit disbursements. As the Government has a continuing stake in the stability of the banking sector, it can be hoped that the banking system in Bangladesh will improve further in the years ahead.

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