Banking sector reform and its effects on the performance of commercial bank in Bangladesh

A Dissertation

by

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Abstract

Bank is very old institution that is contributing towards the development of any economy as well as plays a vital role of financial intermediary of a country. Bank is treated as an important service industry in modern world. But due to globalization and free market economy, this industry is facing severe competition in Bangladesh, and implementation of the clauses of WTO will further increase this competition. This research plan is to investigate the major reforms undertaken in the banking sector of Bangladesh; the affect of banks overall service quality, product quality, and to evaluate their impact on the financial development and individual performances of the banks. Development of financial system is measured by financial deepening, competitiveness and profitability within banking sector. Individual performance of the banks are measured by "Capital Adequacy, Asset Quality, Management Efficiency, Earning Performance and Liquidity" of the banks. The study reveals that the financial system in Bangladesh has been developed to some extent. However, we observe a mixed result for different types of banks in case of performance evaluation of the banks. While the local banks failed to achieve satisfactory improvement, the foreign banks were able to improve their performance considerably perhaps for having strong and efficient management, and additional compliance with the policy, guidelines, standards issued by their head office.

BANKING SECTOR REFORM AND ITS EFFECT ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN BANGLADESH

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CHAPTER ONE

INTRODUCTION

1.1 Background

It is well recognized that the financial system plays a crucial role in the process of economic development. The government helps make this possible by adopting sound macroeconomic policies, including a sound fiscal as well as monetary policy, acting to establish financial markets where they do not yet exist, and providing prudential regulation of the financial system. It has been said that financial markets represent the "brain of the economic system". Inefficiencies in the financial market and institutions inhabit the formal financial sector from performing the proper intermediation services which have adverse effects on the economic development. Financial institutions perform three basic functions like: centralization of credit evaluation and monitoring, offering transformation services that convert claims issued by borrowers into instruments that investors are willing to hold through banks and banks provide access to payments system and to a clearing house for transactions. The reforms of the financial sectors in the industrially advanced countries were triggered to a major extent by the phenomenon called "globalization" of the banks and financial markets. Due to adoption of interventionist development strategy by the government of developing countries during the period preceding the reforms, mainly in terms of directing the resources of the financial institutions to state enterprises and priority sectors at below market interest rates left them financially "repressed" and well as "distressed".

Financial Institutions/Banks working in Bangladesh vary in size, ownership, function, area of concentration and services provided. However, most of them have the same objective of profitability, providing quality service and economic development. Bank restructuring or reform is an inevitable process when the existing structure of bank cannot fulfill the desired level of economies of scale in operation. In the backdrop of the prevailing poor performance and weak capacity for financial intermediation of banks in Bangladesh, we have experienced the banking sector reforms broadly under the Financial Sector Reform Program (FSRP) and subsequently under Banking Sector Reforms (BSR) and Commercial Bank Restructuring Project (CBRP) throughout last decade of the previous century.

Markets and financial institutions in many developing countries are highly unorganized, often externally dependent, and spatially fragmented. Many LDC commercial banks are merely overseas branches of major private banking institutions in developed countries. Their orientation, therefore, like that of multinational corporations, may be more toward external and less internal monetary situations. The ability of LDC governments to regulate the national supply of money is further constrained by the openness of their economies, in some cases the pegging of their currencies of the dollar or basket of MDC currencies, and the fact that the accumulation of foreign-currency earnings is a significant but highly variable source of their domestic financial resources. As a result the experiences of developing countries in financial sector reforms have been mixed; some were successful, while other was less so. In particular, Latin American countries initiated radical financial reforms beginning from mid 1970s, but there efforts generally ended with financial distress, which caused the re-imposition of regulations. Financial liberalization progressed very cautiously in Korea and Taipei, China and yet achieved a reasonable extent of success. The experiences of many developing countries in relation to their financial reforms provided an opportunity to reconsider various aspects of it. The experiences gathered so far forced the attention of the policy makers and practitioners from financial reforms per se to the identification of appropriate preconditions and proper timing and sequencing of financial reforms. Bangladesh, too, has started adopting a number of financial sector reform measures since 1990 as a part of its overall economic stabilization and structural adjustment program. Though privatization and denationalization of the financial institutions started well before 1983, it is to be seen whether the reform measures so far taken are sufficient to overcome the existing problems of financial sector or what else to be done in order to put financial sector reforms on right track for achieving the goals of reforms.

1.2 Objectives of the study

The main objective of the study is to analyze the magnitude of the reform measures that are already been taken and currently in process to explore the financial results so far achieved in the banking arena of the financial. While the specific objectives of the study are:

→To review the reform policies so far implemented.

→To examine the impact on the financial performance of the banking system in Bangladesh before and after implementation of the banking sector reform and Deregulation programs.

→ To identify different problem areas of the banking sector of Bangladesh still needed careful restructuring for better performance and formulate some policy suggestions for the restructuring mechanism.

1.3 Scope of the Study

The study has highlighted the reform measures already taken and its magnitude in the improvement of performance of the banks in the area of capital adequacy, asset quality, profitability and productivity, liquidity and identify the different problem areas of the banking sector that still need to be addressed for reform. For this purpose three Nationalized Commercial Bank (NCBs) and two Private Commercial Bank (PCBs)) to be taken as samples in this to analyze the effect of reforms on the financial performance of the respective banks to be analyzed. Financial analysis is based on the audited financial reports and some other statements submitted to Bangladesh Bank.

1.4 Methodology

The organizational part is based on a critical review of secondary Data. The secondary data is collected from various publications and annual reports of Bangladesh Bank. For the project part of the study is conducted on the basis of secondary data that were available in different annual reports of particular banks and different statements submitted to Bangladesh Bank. In addition, information collected from departmental database is used to complement and enrich the secondary publish data in order to reach a logical conclusion. The whole study has covered from pre-reform stage and post-reform stage. I have considered the period from 1985 to 1990 as pre-reform stage and 1990 to 2011 as post- reform stage. For the study data is collected for particular sample banks individual form i.e. Sonali, Janata, and Agrani Bank as Nationalized Commercial Banks (NCBs), IFIC and The City Bank for Private Commercial Banks (PCBs). In this study, basically quantitative data is collected considering the variables like capital base, deposit growth, credit growth, classified loans advances condition, profitability, productivity or operational efficiency, liquidity, etc. to justify the financial performance of the banks. After collecting data, the processed information or calculated ratios or trends are compared among the periods under consideration as well as the level of performance to

the standard levels regarding different indicators of bank performance evaluation. Thus the financial performance of banks during pre-reform situation and post-reform situation is compared and analyzed to reach a reasonable conclusion about the impact of reforms. Besides while discussing different reform measures taken it has tried to identify some of the problem areas of banking reforms still require concentration.

1.5 Limitations

Banking Sector Reform is extremely extensive in nature. To evaluate the effect of Reform measures on the whole banking sector, it is required to study the banking System as a whole. But here because of its widespread nature and time limitation I shall work only on some representative banks of different groups. So, performance of these banks may not depict the total scenario of the banking sector. On the other hand, this report tries to concentrate only on the financial performance issues while evaluation of the reform measures also requires some other considerations. The particular study is extremely extensive in nature. Hard effort to be given to make the study trustworthy, worthwhile and meaningful; even then, there exists some limitations.

Lack of appropriate measurement yardstick and complexity of the interlinks of the Reform measures among different parts of the economy and information availability Constitutes one of the major limitations of this report. Last but not the least, the financial information was collected from secondary sources and accuracy could not be verified which may cause deviation from the reality if information is not correct.

CHAPTER TWO

BANGLADESH BANK: AN OVERVIEW OF THE ORGANIZATION

Bangladesh Bank: An Overview of the Organization

2.1 Historical Background

The central bank of Bangladesh (Bangladesh Bank) was established on 16th December 1971, the day the country achieved independence as the central bank under the Bangladesh Bank (Temporary) order, 1971. It is a corporate body, having perpetual succession and a common seal of State Bank of Pakistan for the territory of Bangladesh in the wake of liberation of the country. The office of Deputy Governor of State Bank of Pakistan in Dhaka operates as its Head Office. The order was passed by the acting President on the 25th December,1971 and published in the notification No. 583-pub, dated the 26th December, 1971 of the Ministry of Law and Parliamentary Affairs, with effect from the 16th of December,1971. The order was repealed, later on, by "The Bangladesh Bank Order, 1972". It is the statutory to regulate, control, and facilitate economic activities through proper formulation of Monetary Policy.

2.2 Objectives of Bangladesh Bank

A strong, sound, and developed financial system is the primary requirement for sustainable economic growth of a country. The basic objectives of financial policy for economic growth are to encourage savers to hold their savings in the form of financial rather than unproductive tangible assets and to ensure that investment is allocate efficiently to the socially most productive uses, and to provide incentives to increase savings, investment, production and employment.

To achieve these objectives, policy makers encourage the development and expansion of a sound financial system. In this system central bank is the highest authority body entrusted with the responsibilities to formulate proper monetary and financial policy of the country. As the central bank of the country, the objectives of Bangladesh Bank, as outline in order are:

- To regulate the issue of currency and keeping of reserves.
- To manage the monetary and credit system of Bangladesh with a view to stabilizing domestic monetary value.

- Preserving the per value of Bangladeshi Taka.

These are the traditional objectives of Bangladesh Bank as the central bank of the country.

The central Bank has also promotional and controlling objectives in order to ensure the smooth development of a sound financial system. Such objectives are:

- Promoting and maintaining a high level of production, employment and real income in Bangladesh.
- Fostering growth and development of our productive resources in the best national interest.

2.3 Functions of Bangladesh Bank

The main objectives of Bangladesh Bank is to perform the traditional central banking roles of note issue and banker to government and banks. It formulates and implements monetary policy manages foreign exchange reserves and supervises banks and non-bank financial institutions. It also provides deposit insurance to small depositors. It has been playing multi-functional roles like, general functions, controlling activities and promotional activities over other Banks and financial institutions.

2.3.1 General Functions

The major responsibilities are:
Issuance of notes: ensure note circulation throughout the country to facilitate trade and commerce.

Banker to the other Banks: receive statutory cash reserve requirement and extends borrowing to the schedule banks, offers refinance, counter finance facilities etc. to schedule banks.

Banker to the government: accepting money to deposit without interest from Government and collection of money for the Government from local authorities, banks and other persons. It also extends borrowing to the Government.

Lender of the last resort: through purchase, sale and rediscount of bill of exchange promissory notes and treasury bills lending money to scheduled bank when required.

These functions are carried out by the following major departments:

Public Accounts Department: This department acts as a banker to government and maintains

heads of accounts of government. Government receipts and payments are made from these accounts.
Deposit Accounts Department: As a Banker of other commercial Banks, Bangladesh Bank maintains accounts of all schedule Banks.
-Account of notes and value against notes in circulation

-Accounts of small coins
-Accounts of government stocks of surplus coin, one and two taka notes.

Issue department: This department is also responsible for the maintenance of currency chests and resource remittance all over the country.

2.3.2 Controlling Activities

Bangladesh Bank undertakes several controlling and promotional activities through its functional departments are:

Credit Control: To ensure the most efficient allocation of resources in the most productive uses and to ensure the balanced growth of economic factors, central bank formulates credit norms, and restricts credit and facilitates credit to any specific sector in the best national interest.

Formulation of Monetary Policy: With a view to enhance the economic activity and the growth of the economy, Bangladesh Bank formulates monetary policy, conducive to the overall country's economy by the following tools:

-Reserve requirements for the Banks.
-Change in Bank Rate.
-Open Market Operations.

ForeignCurrencyRegulation: ForeignExchangePolicydepartment,ForeignExchangeInspectionDepart-ment and Foreign Exchange Investment Department is mainly responsible to formulate such Policies.

2.3.3 Promotional Activities

It involves creation, promotion and maintenance of high level of production, employment and real income in Bangladesh. Some of the promotional activities so far taken by the central bank are as follows:

Promoting Industrial Finance: The Bangladesh Bank continued to supervise the financing and implementation programs of various small and cottage, large and medium-scale industrial projects through Industrial Credit Department under foreign credits/grants.

Promoting Agricultural and Rural Credit: Bangladesh Bank provides policy guidelines for the commercial banks for proper and timely disbursement of agricultural credit, ensuring proper use of credit, improving recovery position, ensuring strict adherence to the existing rules of credit disbursement and effective supervision and monitoring of overall credit program.

Interest Subsidy to the Banks: In order to increase overall productivity and employment in the country by encouraging investments in the small and cottage industries, the provision for

extending interest subsidy at a rate of 3.0 percent to this sector against term loans of the banks are undertaken by the Bangladesh Bank.

Export Incentives: Export sector is a priority sector in Bangladesh. Bangladesh Bank from time to time provides policy guidelines to be followed by the banking sector in extending export credit. Incentives include reduced interest Band for Export credit. Bangladesh Bank has created an Export Development Fund (EDF) with joint collaboration of the Government of Bangladesh and the International Development Association (IDA).

Liaison with Foreign Agencies: Bangladesh Bank has to keep close relationship with foreign agencies like IDA, IFC, ADB, IDB etc. to attain long term loan to facilitate the development activities through banking channel.

2.4 Reforms Undertaken by Bangladesh

The financial system of Bangladesh, which was in a state of total disarray at the dawn of liberation in 1971, was reorganized soon after independence. Bangladesh Bank, the Central Bank of the country, pursued liberal monetary policy since liberation in 1972 mainly for reconstruction and rehabilitation of the country. In 1974/75, under inflationary pressure it was compelled to shift towards tight monetary policy. From late 1970s to late 1980s liberal monetary policy was pursued once again. The policy package included administered interest rates, credit ceiling and directed credit programs, combined with generous refinancing facilities on loans to priority sectors. Most of the nationalized and DFIs faced massive loan defaults, financial losses and erosion of their capital base. Overtime, lack of operational efficiency, low productivity and high operational costs gave rise to "default culture" which was virtually non-existence in the early 1970s. In the early 1980s, the problems of banks were recognized and subsequently steps were taken in a phased manner to address those problems.

In this context, a National Commission on Money, Banking and Credit was formed in 1984 to review the whole gamut of monetary and credit situation of the country and to prepare recommendations for financial sector. Moreover, in order to make necessary recommendations to ensure proper management and to improve efficiency of the nationalized banks and especially to create better environment for smooth disbursement and recovery of loans, a high level' Task Force' was set up. Consecutive devastating floods of 1987 and 1988, and other natural calamities had very negative impact on the national economy as well as the financial market.

The main objectives of this Financial Sector Reform Program (FSRP) was to ensure a more effective role of banking sector in supporting the country's development programs and in mobilizing and allocating resources. The major objectives of the FSRP were:

Adoption a flexible market oriented interest rate policy.

Providing incentives for to priority sectors and making subsidies in these sectors explicit and transparent.

Promoting better monetary management by moving towards flexible and indirect instruments of monetary control.

Putting the banking sector on a sound financial footing by restructuring the capital and establishing appropriate accounting principles of banks, and strengthening Central Bank's supervisory and regulatory role in the banking system.

Improving the quality of loans through establishment of efficient recovery procedures and stricter legal environment.

Developing human resources for banking sector and

Improving the capital market of the country.

The overall aim of the FSRP was to gradually move towards a free market economy, ensuring thereby a larger private sector. The first phase of the reform concluded at the end of 1996. Reforms in the interest rate policy were initiated in the early phase of the reform program through a series of steps, which automatically reduced the central Bank's intervention in this area. Under the deregulated rate structure, banks were allowed to fix their own interest rates for deposits and lending within a band set from time to time by the Bangladesh Bank. A great deal of flexibility was introduced into the interest rate structure by (a) increasing the frequency of interest rate charges by individual banks (from semi-annually to monthly), (b) removing the ceiling on deposits and (c) allowing multiple rates within a lending category.

Until 1990, Bangladesh had a comprehensive system of control on the level and structure of interests. The administered nominal rate structure was changed infrequently with the result that real rates were
fluctuated with changes in inflation. Underlying objective was to limit the cost of bank credit in general and to priority sectors in particular. During the period 1985-90, nominal interest rates on deposits did not Change although the annual inflation rate varied from over 14% in 1985 to less than 5% in 1990.While deposit rates during the period were relatively very high in real terms nonetheless, the relationship between deposit and lending rates and the complexity and rigidity of administered interest rates undermined the role of interest rates in mobilizing savings to meet investment demand and in allocating inevitable resources efficiently among competing users.

Before 1989, the requirement for loan loss provisioning was minimal. In late 1989, Bangladesh Bank introduced appropriate rules for assessing loan quality and Provisioning for bad debts. All loans were required to be reviewed and put into four categories, viz. unclassified, sub-standard, and doubtful and bad/loss. Required Provisions were 1% for unclassified, 10% for sub-standard, 50% for doubtful and 100% for bad debts. It was stipulated that for loans, which are classified, accrued Interest be suspended and only the interest actually received by the bank be taken into account. The standard of classification has since been further tightened by the Bangladesh Bank to bring it in conformity with international norms. Subsequently, a phase-wise loan classification and provisioning system was introduced to upgrade Loan classification quality to international standard, which is being implemented at five phases starting from December 1994.The capital base of most banks before the introduction of FSRP was far from adequate although the capital adequacy requirement was minimal. FSRP required banks to maintain a minimum of 6% of their total deposit liabilities as capital. To raise the four Nationalized Commercial Banks (NCBs) at the

required level after making loan loss Provision the Government issued a 15-year non-negotiable interest bearing treasury Bonds worth over Tk. 17 billion in 1991 to the NCBs. The private banks were also required to raise their capital base as per the new requirements of capital adequacy.

Reform in the financial system led to the promulgation of Money Loan Court Act in 1990. The Financial Institution Act. 1993 which vests the Bangladesh Bank with full responsibility of supervising the activities of non-bank financial institutions was also put in place. In order to improve the operational efficiency of NCBs, the FRSP introduced a number of programs. These included: Performance Planning System (PPS), New Loan Leger (NLL), Management Information System (MIS), Computerization, Human resource development, Lending Risk Analysis (LRA) Techniques etc. Monitoring and supervision by the Bangladesh Bank has been Streamlined with the establishment of credit Information Bureau (CIB), CAMEL (Capital Adequacy, Asset Quality, Management, Earnings and Liquidity) ratings, "Early Warning System", establishment of problem Bank Unit. The Bangladesh Bank has also strengthened off-site and on-site supervision of the banks.

The reform of banking sector under the FSRP ended in 1996. However, with a view to making the banking sector more organized, dynamic and efficient in the light of Experiences gathered and the weaknesses identified through the FSRP already Implemented, several measures were taken during the past two years. It may be mentioned that although there were some signs of improvements in the financial Sector due to reform, the aspect of loan recovery was not adequately addressed. To improve the recovery situation of overdue loans a high-powered "Task Force" was established in Bangladesh Bank. Task Force was also established in each of the Scheduled Banks. Amendment of Money Loan Court Act, 1990 was promulgated in February to strengthen the legal environment for recovery of overdue loans. Bank Company Act, 1991 was amended in March, 1997 by which any individual or Organization having overdue loans in his/its own name or in the name of organization In which he/it has interest can be declared as defaulter borrower. The amendment also contains the provision of restricting loans to defaulter director and sues cases against the defaulter borrowers by the banks or financial institutions. Moreover, a new "Bankruptcy Law" was approved by the parliament under which two Money Loan Courts and two Bankruptcy Law Courts were set up in the country to expedite the recovery of overdue loans.

In this perspective, a Commercial Bank Restructuring Project (CBRP) has started since 1st May 1997. The main objectives of CBRP are:

Improve the legal framework for debt recovery;

Strengthen bank management particularly accountability, auditing and loan management practices and procedures as well as staff capabilities;

Modernize the technology employed in the sector;

Restore capital adequacy of banks based on risk weighted assets;

Fundamentally improve the income position of banks to ensure that, after restructuring, they will be able to sustain operations and grow profitably;

Undertake restructuring of banks if necessary, and

Strengthen Bangladesh Bank and its supervision capacity, in order to create a competitive, efficient, financially sound and profitable banking system.

To reap the benefits of financial sector reform monetary policy must be made consistent with fiscal policies of the government. Besides, appropriate Human Resources Development measures should be taken. From this point of view restructuring of commercial banks is going to be undertaken by the central bank.

As an important component of Adjustment and Reforms Programs, BB effected important changes in the exchange rate policy and exchange control regime in the last several years. These changes included:

- The enlargement of the currency Basket in relation to which Real Effective
  Exchange Rate (REER) of Taka is monitored for the purpose of fixing its
  Nominal rate,
- Gradual reduction of differential between Secondary Exchange Market (SEM) and official market exchange market since January, 1992.
- Shift from monthly to weekly and finally to daily monitoring of REER (since 1993) and announcing of exchange rate of Taka in relation to US $. (the intervention currency),
- Parting with earlier practice of fixing rates for the authorized dealers by BB since 1993,
- Raising spread between buying and selling rates of US $ by BB and also raising foreign exchange holding limits of authorized dealers to facilitate development of inter-bank foreign exchange market.
- Relaxation of exchange control provisions in phases and finally making Taka fully convertible on current account since 1994.

CHAPTER THREE

BANKING SECTOR REFORM AND ITS EFFECTS ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN BANGLADESH

Theoretical structure of banking sector reforms

Theoretical structure of performance evaluation of Banks

Banking Sector Reform in Bangladesh

Dimensions of Performance of Banks Reforms

Banking Sector Reform and its Effects on Financial Performance of Banks in Bangladesh

3.1 Theoretical Structure of Banking Sector Reform

3.1.1 Banking Reforms Defined.

Banks are the foundation of the financial system of any country. Because of close relationship between economic and financial development, the banking system must be made robust, resilient and sound for efficient intermediation of financial Resources. For this reason, sound macro-economic environment, effective bank Management strategies and prudential financial regulations are the means to ensure the appropriate contribution of banks to the growth and development of a country. Bank Restructuring or reform is an inevitable process when the existing structure of bank cannot fulfill the desired level of economies of scale in operation. However, lack of any one or all the prerequisites would not only bring disaster for banking and financial system, it sometimes might cost the real sector severely. These sorts of banking sector problems have been epitomized by the analysts and donors as banking fragility, crisis, distress, Failure, collapse, insolvency and so on, which call for " banking reforms" on the part of The concerned banking system. Sheng (1996) defines banking sector reform or Restructuring of banks can be defined as "the package of macro-economic, micro- Economic, institutional and regulatory measures taken to restore fragile banking systems to financial solvency and discipline".

The process of bank restructuring composed of four main phases such as diagnosis, Damage control, loss allocation and rebuilding profitability and creating the right Incentives. The ***diagnosis*** if done correctly, would help the banks to know the extent and causes of loss by applying the uniform accounting and auditing standards-for all Banks. Damage control is basically meant for stopping the flow of future losses either By liquidating, enforcing hard budget constraint, changing management etc. Loss Allocation among different parties (owners, borrowers, depositors, regulators and Government) is the most difficult part of bank restructuring. In fact, the success mostly depends on loss allocation. ***Rebuilding profitability and creating the right incentives*** Requires good policies, reliable management and a strong institutional framework.Sheng also refers to

two types of restructuring mechanisms: one is market based solution Such as shareholder capital injection, sale or merger, liquidation without deposit Compensation, etc. and the other is involved with the government intervention like Liquidation with deposit insurance, formation of asset recovery trust, supply side Solution, etc. Dziobek and Pazarbasioghu (1988) refer to two types of bank restructuring mechanisms: financial and operational restructuring. According to them, the aim of restructuring programs is to restore solvency and profitability of the banks. The former (solvency) would emanate chiefly from short-term restructuring measures Such as capital injection, long-term loans, swapping bonds for non-performing loans, while a return to profitability more difficult and longer term operational restructuring Such as improved cost effectiveness, better internal governance, effective risk Management, etc

The subject matter " Banking Reform and Restructuring" has not been presented here From corporate control point of view, which is concerned with concepts like take-over Merger, acquisition and so on. Rather, the subject is considered from the viewpoint of Structural composition. A financial (banking) structure is said to be composed of two Interrelate parts: financial infrastructure and financial superstructure. The former consists of legal framework, accounting and disclosure norms, and supervisory structure internal Control and monitoring, and so on; while the latter includes all types of financial Instruments and institutions. Financial development theories claim that financial super-Structure cannot flourish and sustain without having an appropriate financial Infrastructure, and on the other hand, infrastructure is meaningless without the development of superstructure. For financial/banking development, any sort of Imbalance between infrastructure and superstructure is not desirable, and therefore, should be corrected. From that point of view, bank restructuring comprises any Restructuring or reform measures either in banking infrastructure or superstructure or both for keeping banking development in desired direction and speed.

3.1.2 Background for Reforms

After liberation, during the late eighties of the last century the banking system of Bangladesh because of less orientation to competition, political influence and directed Lending and rigid regulations was extremely characterized by piled up non-performing Loans, decreased profitability, inadequacy in capital, shortfall in maintaining provisions For classified loans, and lack of managerial efficiency, poor level of customer service, Etc. In the backdrop of the prevailing poor performance and weak capacity for financial Intermediation of banks in Bangladesh, we have experienced the banking sector reforms broadly under the Financial Sector Reform Program (FSRP) and subsequently under Banking Reform Committee (BRC) and Commercial Bank Restructuring Project (CBRP) throughout last decade of the previous century. There are some propositions about the banking sector in Bangladesh sketched below that describe its most important Characteristics, which led to banking reforms.

During the period, 1972-1982, financial network of banking system increased commendably. The total number of branches increased 13.36% annually during 1973-1983. At the same time, population per branch reduced remarkably from 50,946 to 20,761. The urban rural proportion of branches, deposits and credit improved significantly in favor of rural areas during the period and thus satisfied the economic Objectives of the government about extension of banking services to the rural area and Extension of generous credit to public manufacturing enterprises. It is imperative that as

The financial network of a country increases, the case of implementing prudential and Information regulations is much more important than economic regulations for the Matter of improving on the operation of financial markets. Nevertheless, this did not happen, rather economic regulations monopolized whole regulatory structure of financial System. Consequently, financial institution pursued a policy of rapid credit expansion (during 1972-1982) to priority areas in response to government directives with little Regard to loan quality. Sound credit analysis was replaced with socio-economic consideration. Many rural branches were opened without considering viability aspect. Lending rates, especially for priority sectors, were kept as such a lower level, which did Not cover the risk and actual cost factors. As a result, a huge proportion of assets Portfolios of the financial institutions became overdue. Debt recovery performance was also poor due to inadequate laws for debt recovery and ineffective debt recovery efforts On the part of the financial institutions themselves. All these had been reflected through decline in the profitability of the nationalized commercial banks (NCBs). The Profitability (defined by net profit deflated by balance sheet total) of NCBs fell down from 0.32% 1973-74 to 0.23% in 1982-83. This deterioration of the operational efficiency of NCBs surfaced in spite of their inappropriate accounting system (that is Accrual system of income recognition). Not only operational efficiency, level of customer services of the bank also deteriorated during the period mainly determined to complete government monopolization of banking services. The balance sheet of the Performance of the banking sector during 1972-1982 was thus mixed-success in Achieving economic objectives of expanding financial network and providing easy credit to priority areas, but failure as far as ensuring prudential of information regulations, Viability and customer services of the banks concerned.

Since, 1983, the government of Bangladesh started talking "ownership reform" measures in the financial sector. Two out of six NCBs were denationalized and a number of private Commercial banks (PCBs) were allowed to operate by the government. It was thought that these measures of denationalization and privatization would generate competition Improve the level of customer services and operational efficiency of the banking sector. However, the regulatory framework, which was totally dominated by economic regulations, were neither replaced by prudential and information regulations nor the legal framework for debt recovery as well as recovery efforts of the banks were improved at all. As a result, though the post- 1983 period witnessed some improvement in the customer Services (especially counter services in urban areas) of NCBs, yet their operational efficiency rather declined further, instead of improving, even after continuing to recognize their income on accrual basis. The profitability of banking institutions fell from 0.32% to 0.11% during 1982-83 to 1989-1990. The period also witnessed unprecedented undue influence of vested interest groups in the credit decision making process of the financial institutions (both nationalized and private) resulting is not only misdirection of credit but also repayment of credit. Surprisingly, the financial institutions were not even required to report loan classification and provisioning and loan losses in their financial reports. It, thus, indicates that post ownership reform period (1983-1989) not only observed further deterioration in the operational efficiency, but also deterioration in real intermediary efficiency of the banks. Therefore, banking in Bangladesh during 1972-1989, was characterized by excessive government interference, absence of prudential and information regulation and inadequate legal support for debt recovery, which were ultimately reflected in declining profitability of the banking system. In

between the period, denationalization and privatization of commercial in 1983 could not Improve the situation, rather than further eroded credit discipline and operational efficiency and finally, real intermediary capacity of the banking system. Since the government owned most of the assets of the banking sector. The boards and managers of these banks were not profit maximizers, do not feel any significant pressure to maintain capital adequacy, reduce cost, or earn high returns on their capital. The four Nationalized Commercial Banks (NCBs) were technically insolvent.

3.2 Theoretical Structure of Performance Evaluation of Banks

An economy belonging to either developed or developing areas of the globe is significantly influenced by how well its banking industry performs. Any organization is Born to serve the interests of not only the people who make up it, but also those who are outside the organization and hence, a bank being a service entity is no less an exception. The Performance of banks is important to the individual consumers of bank deposit and Loan services, stockholders, employees, government regulators, management and to the entire economy. Broadly speaking, bank performance is important to individual consumers of bank deposit and loan services as well as to the performance of the entire economy.

In fact, bank performance concerns almost all in and outside the bank consequently, there arises a crucial need for an evaluation of performance, and this presupposes analysis and measurement of performance requiring a conceptual framework which is sound enough to consider the various facets of bank performance from organizational, managerial, economic, social and constituents viewpoints. Here bank performance evaluation is discussed concerning the following areas:

- Performance defining
- Measures of performance
- Areas of performance
- Focus of performance
- Performance standards and scoring

3.2.1 Performance defining

Performance can be defined as the overall result of organizational activities. This definition is certainly made with an eye upon a manufacturing enterprise, but it may be applicable to bank; organizations too.

3.2.2 Measures of Performance

Measures are the quantified surrogates of the trends and magnitudes of each performance area. The appropriate choice of measures largely determines the degree of proper representative ness of multidimensional behavior of the specific performance area. The list of measures used in the performance evaluation of banks is as follows:

❖ Profit & profitability includes gross income, Net Profit, Return on Assets(ROA), Return on Equity(ROE), Net Interest Margin(NIM), Profit per unit of Deposit, Yield

on Advances, Income –Mix, Income and Expenditure pattern, Deposit Interest as % of Total Expenses, Establishment expenses as % of Total expenses, Spread, Costs Earning Ratio, etc.

- Business Output includes Total Deposit, Growth in deposit, Real & Nominal deposit, Deposit per Employee/Branch, Rural deposit vs. Urban deposit Ratio, No. of Deposit Accounts, Total Loans & Advances, Priority sector advances, Total assets, Advances per Account/Employee/Branch, Purpose or sector-wise advances, etc.
- Branch Expansion includes Branch growth, Branch expansion & population coverage, Branch expansion per village, Rural Vs. Urban expansion, Expansion Index,. etc.
- Employee Productivity includes income per employee, Business per employee, Profit per employee, Deposit & Advances per employee, etc.
- Risk Management includes Credit Risk Measures, Liquidity Risk Measures, and Market Risk Measures, Interest Risk Measures, Earning Risk Measures, Solvency risk measures and fraud Risk Measures.
- Recovery includes recovery performance of the classified loans & advances, priority sector recovery rate, Recovery rate of the extreme/Loss category loans & advances.
- Efficiency measures include Budgeted vs. Actual performance analysis.
- Liquidity measures include Statutory Liquidity requirement (SLR) maintenance, Cash Reserve Requirement (CRR) Maintenance, Loan- Deposit Ratio, Liquid asset to Total assets Ratio, etc.

3.2.3 Areas of performance

According to the study on the existing literature on performance evaluation a list can be constructed to focus upon the areas of performance in banks as chosen by the different author's experts. Performance Areas of Banks identified in selected literature:

- Profit and profitability
- Branch expansion
- Business output
- Employee productivity
- Risk management
- Recovery
- Solvency
- Efficiency
- Liquidity

It is worth-mentioning that some factors of performance such as employee relations with management, morale and efficiency of employees, firms reputation with its customers, bank's prestige in the community, quality and continuity of management are as the intangible in performance evaluation.

It is being mentioned that risk measurement is an integral component of bank performance. The assessment of bank risk is the second essential element in the process of evaluating bank performance [Fraser & Fraser, 1990]. Risk needs to be defined first to decide on its being treated as an area of performance. Risk can be defined as the chance of injury, damage or loss or hazard. It is also measure of variance around an expected value. Risk to banker means the perceived uncertainty connected with some event. Therefore, it is obvious that risk, which is inherent in any kind of human endeavor,

indicates the causal aspects of deviation from expected performance. Solvency, Liquidity and loan recovery positions rather represent the most important performance variables institutions like banks.

3.2.4 Focus of Performance Variable

As the different categories of performance variables mentioned earlier, the variables of performance can be classified as under in order to specific what variables to be focused on in the process of evaluation:

- Output variables: Deposit, Loan, Foreign exchange business, Remittance business, collection & payment business, investment, etc.
- Outcome Variables: Profit/ Dividend, EPS, etc.
- Controllable Variables: Within the control of management
- Uncontrollable Variables: Not within the control of management

Performance evaluators should specify the category of performance as well as the performance variables to be focused on. The western studies widely use the outcome variables.

3.2.5 Performance Standards and Scoring

A performance standard generally refers to an expected level of performance. Performance measures give quantitative expression. The evaluation is required to ascertain whether the observed figures are acceptable or not. Suppose, a bank register a 10% increase in its deposit over the last year's figure. The percentage increase in a measure but the issue is to what extent this growth is acceptable. One must manage through the period of transition with the highest standard of standard of performance always as a guide. Here comes the question of establishing Standards of performance. Standards should however be categorical in terms of a minimum level, a range of levels and a maximum level or as the case may be.

3.3 Banking Sector Reforms in Bangladesh

3.3.1 Financial Sector Reform Program (FSRP)

Before adopting the reform measures for the financial sector in 1989-90, a National Commission on Money, Banking and Credit was appointed by the government in 1986 in order to identify problems and suggest means for the efficient management of the banking system of Bangladesh. World Bank team made an in-depth study of the financial sector and suggested reforms relating to:

- Fixation of interest rates on deposits and advances;
- Classification of overdue loans;
- Restructuring of capital of NCBs and PCBs; and
- Market orientation of banking transactions.(Task Force Report, 1991)

Largely based on these findings and recommendations, Bangladesh Bank adopted a number of reform measures since 1989-90.

- Decontrol of deposit and lending rates and making them flexible according to market forces;
- Strengthening of criteria/ procedures for loan classification and provisioning;
- Greater autonomy or self- regulation by banks and non-bank financial institutions;
- Improvement of capital positions of NCBs and PCBs;
- Replacement of refinance facilities with a single discount window;
- Rationalization of branch network;
- Strengthening of Bangladesh Bank's role in the field of supervision of bank's;
- Protection of banks from shouldering the cost of subsidized loan and transferring the cost to the government;
- Adoption of indirect and market oriented monetary policy instruments;
- Strengthening the operations of NCBs and PCBs;
- Ensuring legal environment by enacting Bank Companies Act, 1991 and Financial Loan Court Act, 1991;
- Opening of current account and making taka convertible;
- Computerization of Banks.

The Financial Sector Reform Program (FSRP), which was launched by Bangladesh government in 1990, had a major aim to improve the operations of NCBs through:

- Development of new banking technologies;
- Computerization of banking operations;
- Changing the back-dated internal banking practices;

During 1992-96, FSRP consultants developed the following new management and operational tools and disseminated these tools and techniques through extensive training programs to a large number of bank officers:

- Lending Risk Analysis (LRA)
- Large Loan Reporting System(LLRS)
- New Loan Leger Card (NLLC)
- Performance Planning System(PPS)
- Management Information System(MIS)
- Bank Supervision Technique, especially off-site supervision through CAMEL rating of the banks, etc.

3.3.2 BRC/CBRP Restructuring Measures

Just before the expiry of FSRP term, the government formed one Banking Reform Committee (BRC) to evaluate the situation arising in NCBs and place recommendations to the government for bringing back financial discipline and improving efficiency of the NCBs. In May 1997, a Commercial Bank Restructuring Project (CBRP) funded by the World Bank has also been undertaken to take stock of progress on key issues and identify urgent actions that need to be taken for the development of commercial banks in Bangladesh. By this time two World Bank Mission visited Bangladesh, one in May 1997

and the other in November 1997 and made a number of recommendations to the government, based mostly on BRC's on going work.

The first WB Mission has also observed that because of "poorly paid, de motivated and weak Bangladesh Bank and NCB staff, excessive influence of CBA, absence of autonomy and accountability, rent seeking, poor internal governance and management, over-staffing and over-branching, and weak legal system to enforce repayment of huge bad loans, the banks cannot be relied upon to perform their most important functions- safety of deposit. The Mission has therefore, suggested a "paradigm shift" for the banking sector of Bangladesh and proposed following programs and actions:

- An aggressive institutional renewal program for Bangladesh Bank;
- Fundamental reforms of NCBs;
- Strengthening of the legal process and institutions for expediting recovery of debt;
- Better internal governance both in NCBs and PCBs;
- Compliance with capital standards, penalties for insider and imprudent lending,
- Announcement of banking policy statement, etc.

The second WB Mission visited Bangladesh in November 1997. In the meantime, a number of measures, namely formation of a legal working group, hiring of auditors for valuation audits of NCBs, formation of a Bank Supervision Committee, special recovery efforts, and a committee on "union problems" have been taken. Based on the proposed guidelines of the first mission, measures already taken and banking situation arising in – between, the second WB Mission has given a set of urgent and short and short to medium term measures to be taken in relation to Bangladesh Bank reforms, reestablishing credit discipline, reforms of NCBs, PCBs and overall governance quality of the banking system.

- Since its formation in October 1996, the BRC has submitted detailed reports along with recommendations on various issues like;
- Amendment of Bangladesh Bank order, 1972 to give Bangladesh Bank legal autonomy over its affairs, reforms of supervision system of Bangladesh Bank to bring back financial discipline,
- Reforms of Bangladesh Banks(nationalization) order, 1972 to give autonomy to NCBs Boards so that they can run NCBs on commercial consideration,
- Deposit Insurance Scheme to protect depositors interest,
- Amendments to Bank Companies Act, 1991 to effectively handle problem banks,
- Precluding crony (insider/connected) lending and ensuring credit discipline and so on.

It is to be mentioned here that though the ultimate or combined objective of each of the reforms is the same (development of the banking system), yet in terms of individual or specific objectives, they (reforms) differ from one another.

- **Policy Reforms**
  - Risk-Based Capital adequacy
  - Loan Classification and Provisioning
  - Lending Risk Analysis (LRA)
  - Interest Rate Deregulation
  - Performance Planning System (PPS)
- **Institutional Reforms**
  - Off-site Supervision (CAMEL Rating)

- Credit Information Bureau (CIB)
- Large Loan Reporting System (LLRS)

- **Legal Reforms**
  - The banking Companies Act. 1991
  - Artha Rin Adalat Act, 1990
  - Bankruptcy Act, 1997
- **Current Reform** - 2003 onwards

After the expiry of BRC/CBRP program, the government of Bangladesh continued undertaking different measures and individuals to make the banking system robust and competitive. A summary of these measures is given below:

- Formation of Audit Committee by individual banks to assist the Board in fulfilling its oversight responsibilities.
- Provision for appointing two independent directors representing the depositor's interest.
- Measures to strengthen risk management through recognition of different components of risk, assignment of risk-weights to various asset classes.
- Several provisions of the three important Acts relating to Banking, viz. the Bangladesh Bank Order, 1972, the Bank Company Act, 1991 and the Banks Nationalization Order, 1972 have been amended during the period 2003 with a view to further strengthening the activities of the banking sector, bringing dynamism and extending greater autonomy to the central bank.
- Enactment of the Artha Rin Adalat Ain 2003 to provide mainly for speedy procedures for obtaining decrees and execution. Provision was also made for Alternative Dispute Resolution to ensure early settlement of disputes through settlement conference and negotiations.
- Development of basic risk management model for selected areas of banking operation.
- Promulgation of "Money Laundering Prevention Act, 2012 repealing Money Laundering Prevention Act, 2009 and Anti Terrorism (Amendment) Act, 2012".
- Highly priority is accorded to ensure Corporate Governance in Banks.
- Introduction to uniform account opening and KYC profile form for all banks. Besides, the National Payment System Council (NPSC) was reorganized to support the development of sound and efficient payment, clearing and settlement systems, and to serve as a forum for cooperation in domestic and international payment matters.
- Mapping of External Credit Assessment Institutions (ECAIs) rating with the Bangladesh Bank Rating Grade.
- Introduction to New Capital Accord (Basel II) and Risk Based Capital Adequacy (RBCA) for Banks, and preparation to introduce Basel II".
- Prudential guidelines for consumer financing and small enterprise financing have been issued.
- Market to Market Based Revaluation of Treasury Bills & Bonds Held by the Banks.
- Introduction of CAMEL supervisory rating system, move towards risk-based supervision, consolidated supervision of financial conglomerates, strengthening of off-site surveillance through control returns.
- Corporatization of nationalized commercial banks (NCBs)
- Stress Testing became mandatory for the Schedule Banks.

3.3.3 Policy Reforms

3.3.3.1 Risk-Based Capital Adequacy

Capital is an important internal insurance to cover losses of loans, and, hence capital adequacy is a measure of soundness and financial health of a bank, which deserves very much importance in current competitive and innovative banking to command credibility with bankers and customers at home and abroad. Keeping this in mind, minimum capital adequacy guidelines based on Capital to Liabilities approach was incorporated in section-13 of the Banking Companies Act, 1991. Subsequently, the Banking Companies Act, 1991 was amended in 1995 and it incorporated risk-based capital in section 3 ka. Bangladesh Bank announced Risk Weighted Capital adequacy system(vide their BRPD circular No. 01 dated 08-01-1996) on the basis of recommendation of the Bank for International Settlement (BIS), Basle, Switzerland where banks were advised to report at end of June, 1996, their capital ratios tighter with summery information about components on a risk assessed basis. The risk based capital system primarily deals with credit risk and explores the possible ways to handle other risks. It is, in fact, a significant prudential regulatory instrument in assessing bank's capital position and disciplining their market behavior.

3.3.3.2 Loan Classification and Provisioning

There is a crying need for banks to systematically and realistically identify their problem assets and provide adequate reserves for possible losses. To accomplish this, Bangladesh Bank issued guidelines in 1989 (vide BCD circular No.- 34 dated 16-11-89) regarding classification and provisioning procedure. Subsequently, a revised policy was introduced in 1994 (vide circular No. 20 dated 27-12-94) to be implemented by banks in 5 phases commencing from 31st December 1994. The introduction of this program is aimed at bringing loan loss provisioning and classification in line with the international standard by the end of 1988, prior to 1989, there were no clear-cut policy guidelines to enforce adequate provision by the banks. In a majority of cases, banks simply did not identify problem assets, establish realistic provisions for potential losses or suspend interest on non-performing assets. As a result, the balance sheet did not reflect the bank's actual condition and the income statement overstated profit upon which dividends and taxes were paid. However, during mid-eighties a norm was fixed by Central Bank to raise tile level of provisions by 0.5% of total loans each year till it reaches 4%. Obviously, it had no relation to loans classified.

3.3.3.3 Lending Risk Analysis (LRA)

Lending Risk Analysis is one of the new management and operational tools improving the credit risk calculation initiated by FSRP in 1993. Bangladesh Bank made it mandatory for commercial banks to exercise it for granting loans above Tk. one crore. It is focuses on determination of the degree of risk of non-repayment by a particular loanee and thus has been helping the bank management in taking loan decisions on the basis of the risk scores. This improved methodology for analyzing lending risk is undoubtedly a unique technique for the banks of this country in the present day context. All NCBs (as well as

PCBs to some extent) are exercising LRA techniques for granting loan above Tk. one crore. Even some banks are using this technique for granting loans below Tk. one crore on their own initiatives. Sonali Bank and Janata Bank have reduced the LRA limit from Tk. 1.00 crore to50 lac. Agrani Bank uses this technique for loans above 25 lac, followed by National Bank Ltd for loans above Tk. 20 lac. Rupali Bank has reduced the limit to Tk. 75 lac. In the near future, other banks may follow the same, as it is a better technique compared to the existing traditional techniques like general credit report, 3c's analysis, project feasibility study, etc. According to the FSRP's own estimate, as in July, 1995 around 1500 new large loans (of NCBs) have been sanctioned by applying LRA technique. Though determining a particular risk level, ERA technique is supposed to ensure that low risk borrowers should pay lower lending prices and high-risk borrowers are paying higher prices. But, in practice, this sort of risk based pricing is yet to take root in our banking system.

3.3.3.4 Interest Rate Deregulation

To create a fair market place and a "level plying field' for competition between banks gradually and to remove distortions in the way of determination of real prices of money, Bangladesh Bank announced a new policy guidelines in 1989 (vide BCD circular No. 33 dated 16-11-89) on interest rate deregulation. Prior to this deregulation, deposit and lending rates were fixed by the Bangladesh Bank. At that time, the banks had no freedom to change the rates. Since 1989, the banks were allowed to set their own interest rates for deposits and lending within a band set from time to time by the Bangladesh Bank. In 1992 (vide BCD circular No 7 dated 09-03-92) the bands were removed from all but three of the 11 lending sectors (export, agriculture and small industry) and banks were permitted to set any rate for advances that they felt appropriate. The central bank also removed ceiling on deposits and allowed multiple rates within a lending category and increased the frequency of interest changes by individual banks (from every six months to every month). In 1997 (vide circular No. 01 dated 11-02-97) the floor rate of the deposits was also removed.

3.3.3.5 Performance Planning System (PPS)

It is one of the important management tool developed by the financial sector reform program and subsequently adopted by the NCBs. As a management tool it comprises, firstly, setting a concrete goal on the part of a banker based on his priorities and followed by a well-defined action plan to achieve that goal. Though this goal statement and action plan, not only the concerned banker can keep himself up to date in terms of his performance, but it also facilitates the boss to monitor the progress of his subordinates including those concerning loans. PPS has been introduced in all NCBs for recovery and other functions. It is gathered that Sonali Bank introduced PPS in 1993 and covered 1233 branches, while Janata Bank introduced it in the year 1994, and they covered all the 893 branches except the overseas branches. Agrani Bank introduced it in 1993 and they also covered 903 branches. Rupali Bank ltd introduced PPS in 1995 and covered all 517 branches except foreign branches. The above information indicates that all the branches of NCBs (excepting their overseas branches) have been covered by PPS.

3.3.4 Institutional Reforms

3.3.4.1 Off-site Supervision (CAMEL Rating)

Bangladesh Bank has also introduced off-site supervision of some key indicators such as capital, assets, quality, earnings ability, liquidity, etc rather than on-site supervision. For this purpose, Bangladesh Bank has introduced a number of reporting forms and returns to be submitted by the commercial banks regularly. On the basis of those returns, Bangladesh Bank prepares a composite rating, known as CAMEL rating, for each bank. This CAMEL rating is also used for giving Early Warning Signal (EWS) to a particular bank having problems. The meaning of CAMEL is given below:

C = Capital Adequacy : 8% of Risk weighted assets with at least 4% of core capital

A = Asset Quality : Amount & nature of non-performing assets, provision, etc.

M = Management Effectiveness : Knowledge, experience, administrative, leadership ability, organizational and honesty.

E = Earning Performance : Sound control of expenses, budgeting discipline etc.

L = Liquidity : Asset/ liquidity management procedure/policies, reliability of funding source etc.

3.3.4.2 Credit Information Bureau (CIB)

CIB report is considered to be one of the basic information for consideration of a loan. CIB has been established in Bangladesh Bank for providing reports to the commercial banks to know the status of a borrower in regard to his liabilities outstanding with any other banks/branches before considering his loan proposal. The aim of the report is to avoid duplication of the borrowers. It is mandatory for all banks to collect data from CIB before sanctioning any loan proposal above Tk. 50.00 lac. Apart from this, to maintain record of the borrower’s performance, NCBs report to Bangladesh Bank regularly on their progress in collection of the larger overdue loans and on larger loans sanctioned since 1 January, 1990.

3.3.4.3 Large Loan Reporting System (LLRS)

Large Loan Reporting System has been introduced in NCBs to monitor large loans more closely on a regular basis. In NCBs, 78 percent of new large loans have been reported by LLRS as on July, 1995. Now, almost all large loans are reported by LLRS. In the mean time, Bangladesh Bank has established Large Loan Review Cell (LLRC) to review all newly sanctioned, renewed and reschedules banks over Tk. 1 crore. Such a review will determine if a loan carries undue risk. If the loan is judged to be carrying an undue risk, then LLRC will advise the related bank to take immediate appropriate actions.

3.3.5 Legal Reforms

Inappropriate accounting standard for recording the present performance position of loans hinders the process of reflecting the actual financial position or health of the banking financial institutions. Without knowing the actual financial position, the bank management and supervisory authorities can not undertake appropriate actions for improving the financial health. On the other hand, the ultimate lenders (depositors) will also not be informed adequately about the financial health because of the inappropriate accounting standard. To overcome this sort of undesirable situation an adoption of appropriate accounting standard is necessary. The measures, regulations in regard to transparency, as adopted in our financial system have been described below:

In case a borrower is unable to repay, whether willingly or unwillingly, the lenders must recourse on the borrowers to get back their money, otherwise the immediate lender (banker) will not be able to refund money to the ultimate lenders (depositors). In the context of Bangladesh, lenders, recourse base was not only weak but also delay-prone. In order to this weak recourse base, some new legal frameworks have been institituted.

3.3.5.1 The Banking Companies Act, 1991

The Banking Company Act, 1991 is very effective legal initiative to bring back all financial institution under one umbrella. A frequent cause of loan problem is thought to be the credit granted to bank insiders and to individuals or firms connected though ownership or with the ability to exert control, whether direct or indirect. (Example of connected parties includes a firm's partners, major shareholders, subsidiaries, affiliated companies, directors and executive officers; firms are also connected where the same family or group controls them). Such credit may not meet the same standards as that extended to outside borrowers and the amount of credit often exceeds prudent levels. Frequently, the managerial attitudes of the related or subsidiary companies deteriorate because of the easy and systematic access to credit. In addition, banks tend to support connected companies that are in trouble rather than recognizing them as problem borrowers, invariably, the close linkages result in losses.

To preclude the problems of connected lending, The Banking Companies Act, 1991 and subsequent amendment in 1995 contained in section 27 to ensure that loans to connected parties are not granted at arm's length, on terms not more favorable than those extended to similarly situated outside borrowers, that proper internal controls and credit limits are in place and that concentrations of credit are avoided. Bangladesh Bank issued a circular (vide BCD circular No. 15 dated 18-07-95) regarding restriction on loans and advances to private bank director's, It is reported that out of the total 293 private bank directors, 115 directors had taken Tk. 1063.60 crore loans till December 31, 1996. Of the amount, Tk. 104.75 crore was defaulted loans while Tk. 499.37 crore had been rescheduled. The bank had issued notices on 26 directors for their defaulted loans, 10 directors repaid their loans.

Recently the Banking Companies Act, 1991 was further amended, where it is stipulated, " a person can no longer be a bank director if he is a defaulter with his own bank or any other bank". According to the amended act, a director will lose his office if he fails to repay loans or interest on loans from any bank or financial institution within two months

of being served with notice for their overdue status. He will also lose his office if he fails to repay loans, which he has guaranteed, or fails to execute any duty relating to loans for, which he has vouched. The amended act states that once a director's post falls vacant, the bank's dues will be recovered by selling off the defaulter's shares.

Meanwhile, Bangladesh Bank is seriously considering reinforcement of the rules to prevent the rescheduling of defaulted loans more than twice. This prudent regulation should be tightened to ensure the safety and soundness of the banking system, which will go a long way in creating positive impact on loan portfolio of the banks.

3.3.5.2 Artha Rin Adalat Act, 1990

Artha Rin Adalat Act, 1990 is one of the important new legal frameworks in order to create a positive impact on bank's loan portfolio management. If banks are to remain viable, the legal system must be able to balance the rights of banks to foreclose on collateral with the rights of individuals and firms so that debts can be recovered in timely manner.

Before establishing of Artha Rin Adalat in 1990, banks had to file cases in sub-judge commercial court, assistant judge courts, and certificates cases to the authorized certificates officers in districts and thanas throughout the country under Public Demand Recovery Act, 1913 and thousand of cases have been pending for years together in various courts. This legal framework was found quite inadequate to cope up with the challenges of rapidly changing financial environment. Enforcement of loan contracts in loan contracts in default was too slow to have much disciplinary effect on borrowers.

As a result, the government enacted Artha Rin Adalat Act, 1990. The number of Artha Rin Adalat throughout the country has been increasing. Subsequently, the Artha Rin Adalat Act was amended in 1990, 1992, 1994 and 1997.

3.3.5.3 Bankruptcy Act, 1997

The banks and the other financial institutions in our country have for a long time been urging for passing of Bankruptcy Act to deal with their claims expeditiously. The Bankruptcy Act, 1997 has already been passed by the parliament "under the Bankruptcy Act the government has set up two exclusive Bankruptcy Courts, One in Dhaka and other in Chittagong. In order to familiarize the judges, layers, accountants and bankers with the new Act and speed up the process, the central bank technical assistance project organized a workshop, which provided intensive training to the participants. Because of the Act and the training the new bankruptcy courts are functioning well. It is recognized by the local and international participants in engage workshop that the Act is a self-contained Act.

3.3.6 Current Reform- 2003 onward

3.4 Dimensions of Performance of Banks Due to Reforms

3.4.1 Capital Adequacy of Banks

Capital position of a bank reflects its ability to absorb risk deriving from its internal and external economic environment and creates confidence among depositors by the ability to protect their money from losses. The usual equity to assets ratio averages only 4 to 9%. Banks analysts generally look at capital as the foundation for stability. It is also considered as one of the major financial soundness indicators of a bank. BB has commenced the implementation of Basel 2 from January 2009 and provided banks with a guideline on "Risk Based Capital Adequacy for Banks " (Revised regulatory capital framework in line with Basel 2 vide BRPD circular no. 9/2008) to make the banks capital more risk sensitive and shock absorbent. The grater the capital base, the more protection for depositors and other creditors. But there is a cost associated with capital when operating margins are under pressure, increases in capital can reduce profitability. According to the Banking Companies Act, 1991 a Bangladesh banking company shall have paid-up capital and reserves, which shall not be less than eight percent (8%) of the total Risk Weighted Assets (RWA) of the banking company, although at present time the percentage of Risk Weighted Assets is 10%; and when the ratio is 5% or below then it is considered unacceptable.

Capital Adequacy of Banks (NCBs)

SONALI BANK (Amount in crore Tk.)

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Required capital (10% of Risk weighted assets)	-	-	546.74	1083.08	1871.15	3398.54
Actual capital	27.74	275.24	477.54	564.22	-2222.66	4263.73
Shortfall/Surplus	-	-	-69.2	-518.86	-4093.81	865.19
Total capital to RWA	-	-	6.99%	4.17%	-11.88%	12.55%

JANATA BANK (Amount in crore Tk.)

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Required capital (10% of Risk weighted assets)	-	-	383.88	659.86	959.02	3108.75
Actual capital	14.7	111.56	272.82	313.36	99.31	3179.30
Shortfall/Surplus	-	-	-111.06	-346.5	-859.71	70.55
Total capital to RWA	-	-	5.69%	3.80%	1.04%	10.23%

AGRANI BANK (Amount in crore in Tk.)

	Pre-reform Stage	Post-Reform Stage

	1985	1990	1995	2000	2007	2011
Required capital (10% of Risk weighted assets)	-	-	355.08	502.71	904.00	2153.52
Actual capital	9.62	113.69	278.69	354.11	-874.94	2551.75
Shortfall/Surplus	-	-	-79.29	-148.6	-1778.94	398.23
Total capital to RWA	-	-	6.28%	5.64%	-9.68%	11.85%

Capital Adequaqy of Banks (PCBs)

IFIC BANK (Amount in crore Tk.)

	1985	1990	1995	2000	2007	2011
Required capital (10% of Risk weighted assets)	-	-	77.58	87.47	240.05	777.36
Actual capital	12.41	28.19	48.29	110.73	304.49	778.63
Shortfall/Surplus	-	-	-29.29	23.26	64.45	1.07
Total capital to RWA	-	-	4.98%	10.13%	12.68%	10.01%

THE CITY BANK (Amount in crore Tk.)

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995 2000		2007	2011
Required capital (10% of Risk weighted assets)	-	-	45.33	57.96	250.46	1170.31
Actual capital	6.49	25.04	28.52	46.68	327.66	1497.71
Shortfall/Surplus	-	-	-16.81	-11.28	77.20	327.40
Total capital to RWA	-	-	5.03%	6.44%	13.08%	12.80%

From the above it is observed that at the pre-reform stage there were no monitoring guidelines whether banks are maintaining adequate capital or not. But after taking the reform measures particularly after the introduction of risk-based capital adequacy a proper monitoring system for banks capital was established.

We can see from the tables that in case of National Commercial Banks (NCBs) in the entire three banks capital shortfall was increased which shows the true picture of the banks. This is to mention as a reason that in all the cases total capital was increased but

the rate of increase of risk-weighted assets was higher. In the year 2000,2007,2011 the capital adequacy ratios were Sonali 4.17%, -11.88% ,12.55% Janata 3.80%,1.04%,10.23% and Agrani 5.64%, -9.68%, 11.85% all of which are below the required 10%(at that time 8%) in the year 2000 but after that the trend has been increasing.

In case of Private Commercial Banks (PCBs) City bank experienced capital shortfall of Tk. 16.81 crore, 11.28 crore respectively in the year 1995 and 2000 & in the year 2007 and 2011 the overall capital shortfall has come to a positive figure as 77.20, 327.40 crore respectively. But among the representative PCBs though IFIC bank had a capital shortfall of Tk. 29.29 in 1995 it was able to overcome the problem by the year 2000, 2007 & 2011 subsequently and had a capital surplus of Tk. 23.26,64.45 & 1.07 crore. In the year 2000, 2007& 2011 the capital adequacy ratios were IFIC 10.13%, 12.68% & 10.01% and The City 6.44%, 13.08 & 12.80 respectively.

3.4.2 Asset Quality of Banks

The Non-Performing Loans Ratio is the most important indicator to identify the problem inherent in asset quality. Over the last few years, it has been the weakness in the credit portfolio that has caused the most serious difficulties for a number of financial institutions around the world. The overall condition of quality of risk assets shows the actual strength of financial institution in any country.

Asset quality is related in relation to (1) the level, distribution and severity of classified assets; (2) the adequacy of valuation reserves; (3) demonstrated ability to administer and collect problem credits; and (4) the level and distribution of non-accrual and reduced rated assets. According to the international Banking Standards the classified loan rate (total loans to classified loans) should be less than 5%. In evaluating assets quality, consideration should also be given to any undue degree of concentration of credits of investments, the nature and volume of special mention classification, lending policies and the adequacy of credit administration procedures.

Asset Quality Of Banks (NCBs)

SONALI BANK

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Total Loans & Advances	2754.12	4431.05	6582.99	13328.06	19400.62	31895.25
Classified Loans & Advances(CL)	-	-	2508.08	5160.15	6859.40	5705.23
% of CL	-	-	38.10%	38.72%	35.36%	17.89%
Required Provision	-	-	1450.31	2780.56	3915.45	3846.01

Provision Maintained	-	-	758.97	956.22	3287.02	4442.00
Shortfall/Surplus	-	-	-691.34	-1824.34	628.43	595.99

JANATA BANK

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Total Loans & Advances	1699.12	2616.33	4196.08	8095.29	11171.87	24292.43
Classified Loans & Advances(CL)	-	-	1111.79	2498.17	1923.16	1093.62
% of CL	-	-	26.50%	30.86%	17.21%	4.50%
Required Provision	-	-	533.82	1092.33	1019.02	907.92
Provision Maintained	-	-	165.59	412.7	1068.04	964.27
Shortfall/Surplus	-	-	-368.23	-679.63	49.02	56.35

AGRANI BANK

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Total Loans & Advances	1285.78	2193.36	4649.93	7654.84	11088.46	17918.16
Classified Loans & Advances(CL)	-	-	1620.80	2936.85	3178.89	1917.24
% of CL	-	-	34.86%	38.37%	28.67%	10.70%
Required Provision	-	-	771.43	1186.50	1386.46	1011.70
Provision Maintained	-	-	234.41	502.88	1201.92	1026.60
Shortfall/Surplus	-	-	-537.02	-683.62	184.54	14.90

Asset Quality of Banks (PCBs)

IFIC BANK

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Total Loans & Advances	137.65	517.27	958.86	1623.38	2752.91	6209.85
Classified Loans & Advances(CL)	-	-	415.01	613.08	229.99	257.80
% of CL	-	-	43.28%	37.77%	8.35%	4.15%
Required Provision	-	-	157.13	301.45	131.04	177.74
Provision Maintained	-	-	157.13	358.32	132.62	178.38
Shortfall/Surplus	-	-	0	56.87	1.58	0.64

THE CITY BANK

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Total Loans & Advances	65.69	299.79	446.02	996.46	2613.27	7489.94
Classified Loans & Advances(CL)	-	-	336.67	394.28	151.86	264.43
% of CL	-	-	75.48%	39.57%	5.81%	3.53%
Required Provision	-	-	187.23	185.15	75.22	229.12
Provision Maintained	-	-	74.74	106.31	106.65	229.12
Shortfall/Surplus	-	-	-112.49	-78.84	31.43	-

From the tables it is clearly seen that at the pre-reform stage there were no specific guidelines about loan classification and provisioning. At that time loans and advances of the banks were usually stated at net of provisions made for bad and doubtful debts. Surprisingly, the banks were not even required to report loan classification and provisioning and loan losses in their financial reports and that is why although the existence of huge classified loans it is not shown at the pre-reform stages. But after taking the reform measures particularly after the introduction of loan classification and provisioning policy through BCD circular no. 34, 1989 (currently BRPD circular no. 16, 1998) a proper monitoring system for banks loan portfolio was established.

It is also seen from the tables that in case of Nationalized Commercial Banks (NCBs) in all the three banks classified loan rates were increased from the year 1995 to 2011 and the average classified loan rate is around 35% whereas the international standard is 5%.

In case of Private Commercial Banks (PCBs) in all the two banks the rates of classified loans were decreased dramatically from the year 1995 to 2011.

Provisioning maintenance among the NCBs and PCBs only IFIC Bank depicts different picture. All other banks in the above category had a huge provision shortfall. IFIC Bank had no provision shortfall in both 1995 and 2011.

3.4.3 Management Efficiency of Banks

It is difficult to quantify the efficiency of bank management: however, evaluation of management performance in financial terms requires the assessment of different ratios like deposit per employee, loans per employee, assts per employee and net profit per employee, etc the single most important reason why financial institutions get into trouble is management failure. When a financial institution is under stress due to external economic factors, management can save or loss of the bank. For better management it requires a well thought out strategic plan, with realistic goals. Management's performance must be evaluated against virtually all factors considered necessary to operate the bank within accepted banking practices and in a safe and sound manner. Thus management is evaluated with respect to (a) technical competence, (b) leadership and administrative ability, (c) compliance with banking regulations and statutes, (d) ability to plan and respond to changing circumstances, (e) adequacy of and compliance with internal polices, and (f) depth and succession. The assessment of management also takes into account the quality of internal controls, operating policies, and the involvement of the directors and shareholders.

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Management Efficiency of Banks (NCBs)

SONALI BANK

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Total no. Employee	2571	25258	25340	26275	22542	21891
Deposit per Employee	0.14	0.23	0.44	0.77	1.46	2.31
Asset per Employee	0.21	0.34	0.62	0.90	1.86	3.28
Loans per Employee	0.11	0.18	0.26	0.51	0.86	1.46
Net profit per Employee	0.0020	0.0003	0.0028	0.0005	0.0102	0.0454

JANATA BANK

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Total no. Employee	13421	15423	17620	16846	13859	15020
Deposit per Employee	0.15	0.25	0.38	0.62	1.43	2.40
Asset per Employee	0.26	0.42	0.41	0.76	1.70	2.99
Loans per Employee	0.13	0.17	0.24	0.48	0.81	1.62
Net profit per Employee	0.0021	0.0003	0.0001	0.0001	0.022	0.029

AGRANI BANK

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Total no. Employee	11128	12953	13756	13261	11345	12085
Deposit per Employee	0.16	0.25	0.46	0.73	1.20	1.97
Asset per Employee	0.23	0.35	0.70	0.88	1.50	2.89
Loans per Employee	0.12	0.1693	0.3380	0.5772	0.98	1.48
Net profit per Employee	0.0029	0.0000	0.0000	0.0000	0.023	0.020

Management Efficiency of Banks (PCBs)

IFIC BANK

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Total no. Employee	510	934	1565	1757	1997	2383
Deposit per Employee	0.35	0.67	0.84	0.94	1.42	3.01

Asset per Employee	0.87	1.10	1.37	1.50	1.99	3.85
Loans per Employee	0.27	0.55	0.61	0.92	1.38	2.60
Net profit per Employee	0.0061	0.0063	0.0051	0.0090	0.048	

THE CITY BANK

	Pre-reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Total no. Employee	474	923	1833	1621	1991	2772
Deposit per Employee	0.27	0.49	0.43	0.85	1.98	2.82
Asset per Employee	0.39	0.62	0.51	0.91	2.45	4.18
Loans per Employee	0.14	0.32	0.24	0.61	1.31	2.70
Net profit per Employee	0.0101	0.0138	-0.0076	0.0041	0.0149	0.076

It is observed from the above tables that deposit per employee, asset per employee, and loans per employee were increased from the pre-reform stage to the post reform stage gradually in almost all the banks. This was happened as a result of extra-ordinary growth in deposits, credit as well as total assets. On the other hand, excepting the cases of NCBs net profit per employee was increased gradually because of deregulation of interest rates in loan pricing and liberty to select clients and businesses in the post-reform years.

3.4.4 Earning Ability of Banks

There is no right amount of earnings, although positive is better than negative. Rather, it is important to see whether the level of earnings is adequate, and what the trends are. It is also mention worthy that the source and quality of the earnings are crucial. Earning of a bank is evaluated with respect to (1) the ability to cover losses and provide for adequate capital; (2) earnings trends; (3) peer group comparisons; and (4) quality and composition of net income. A standard measure of performance of banks is Return on Assets (ROA), which reflects how well management is investing the resources of the bank. Return on assets consists of the assets utilization ratio and net profit margin. For banks, the internationally accepted minimum level of ROA is 6%. The net interest margin (NIM) identifies the basic earnings capacity of the bank and is also a measure of operating efficiency. While, Return on Equity (ROE) reflects the return on equity capital invested and is strongly influenced by the amount of financial leverage. With this connection, it is needed to mention that, the internationally accepted minimum level of ROE is 15%.

Earnings Ability of Banks (NCBs)

SONALI BANK (Amount in crore Tk.)

	Pre-Reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Net Profit	49.91	5014	71.57	13.22	231.11	995.72
Return on Assets(ROA)	0.95	0.06%	0.46%	0.06%	0.66%	1.43%
Return on Equity (ROE)	201..74%	1.87%	14.99%	2.34%	9.47%	17.75%

JANATA BANK

	Pre-Reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Net Profit	28.55	4.88	1.26	1.12	314.54	444.49
Return on Assets(ROA)	0.80%	0.08%	0.02%	0.01%	1.16%	0.96%
Return on Equity (ROE)	194.22%	4.37%	0.46%	0.36%	34.71%	14.83%

AGRANI BANK

	Pre-Reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Net Profit	32.32	0.16	0.5	0.56	264.62	249.99
Return on Assets(ROA)	1.25%	0.0035%	0.01%	0.0048%	0.02%	0.72%
Return on Equity (ROE)	335.97%	0.14%	0.18%	0.16%	41.22%	13.79%

Earnings Ability of Banks (PCBs)

IFIC BANK

	Pre-Reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Net Profit	3.12	5.93	8.01	15.74	96.49	83.50
Return on Assets(ROA)	0.70%	0.58%	0.37%	0.60%	2.42%	0.91%
Return on Equity (ROE)	25.14%	21.04%	16.59%	14.21%	31.69%	10.73%

THE CITY BANK

	Pre-Reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Net Profit	4.77	12.7	-13.84	6.66	29.81	211.84
Return on Assets(ROA)	2.59%	2.21%	-1.47%	0.45%	0.61%	1.83%
Return on Equity (ROE)	73.50%	50.72%	-48.53%	14.27%	9.10%	14.14%

Above tables shows that the picture of profitability of the banks under consideration at the pre-reform stage and post-reform stage are of different nature. Some banks experienced loss before reforms and subsequently profit at post-reform stage while some banks had profit before reforms and loss after the reforms. However, if we consider particular bank from each category we can see that in case of Nationalized Commercial Banks (NCBs) Sonali Bank had profit through out the pre-reform and post-reform period under consideration. ROA and ROE were within the acceptable limit except the year of 1995 and 2000. The profitability of Janata Bank decreased gradually though it did not reach to loss within the period. ROA and ROE of the post-reform stage were much below the acceptable level as well as the pre-reform stage. Agrani Bank experienced a dramatic downturn in their profitability throughout the period. ROA of the year 1990 and 2000 were almost zero. It is evident from the data that ROA situation of the NCBs was worse in the post-reform time than the pre-reform time. But after a long time the scenario have been changing. In the year 2007 and 2011 the ROA is 0.02 & 0.72 respectively. The

main reason of this downturn condition was due to non-availability of provision system in the pre-reform stage.

In case of Private Commercial Banks (PCBs) IFIC Bank showed a consistent increasing performance of their profitability throughout the period under consideration. The City Bank could make profit before the reform measures were taken, but they faced loss in the year 1995. The ROA and ROE were better in the pre-reform stage.

3.4.5 Liquidity of Banks

The Statutory Liquidity Requirement (SLR) is one of the quantitative and powerful tools of monetary control of the central banks. Changes in SLR can have a marked effect on money and credit situation of a country. Liquidity is protection against unexpected run-offs of deposits, credit balances, customer funds, prohibitively high funding costs or other funding emergencies. It is an issue of meeting needs as they come due. Given the liquid nature of a financial institution's balance sheet, however, using ratios based even on the most current financial statements is insufficient. However, for liquidity performance evaluation concerned areas include: is the growth of core liabilities keeping pace with asset growth and how dependent is the bank on purchased money. The typical total loans to total deposit ratio measures the extent to which risk assets are funded by deposits or, seen another way, to what extent a bank can lend deposits. We can evaluate liquidity with respect to (1) the volatility of deposits; (2) degree of reliance on interest-sensitive funds and frequency and level of borrowings; (3) availability of assets readily convertible into cash; and (4) access to money markets and other ready sources of cash. If the central bank raises averages reserve requirement of the commercial banks, this would create a reserve deficiency or decrease in available reserve of depository institutions. If the banks are unable to secure new reserves, they would be forced to contact both earnings and deposits which would result in a decline in the availability of credit and increase the market interest rates. The reserve would happen if the central bank lowers its reserve requirements.

Liquidity of Banks

SONALI BANK

	Pre-Reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Statutory Liquid Assets to Total Time & Demand Liabilities(SLR)	28.56%	34.71%	26.33%	28.72%	20.57%	35.87%
Total Liquid Assets	1087.34	2455.46	4728.46	11342.28	5566.59	16220.83
Total Loans to Total Deposits	79.65%	77.21%	59.40%	65.82%	58.97%	63.21%
Total Liquid Assets to Total	31.45%	42.78%	42.66%	56.01%	16.92%	32.14%

Deposits						

JANATA BANK

	Pre-Reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	201128
Statutory Liquid Assets to Total Time & Demand Liabilities(SLR)	36.58%	38.26%	26.85%	24.27%	21.85%	32.20%
Total Liquid Assets	796.79	1693.92	2856.23	3671.63	3648.65	10165.32
Total Loans to Total Deposits	83.78%	66.55%	63.04%	77.34%	56.24%	67.72%
Total Liquid Assets to Total Deposits	39.29%	43.09%	42.91%	35.08%	18.36%	28.13%

AGRANI BANK

	Pre-Reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Statutory Liquid Assets to Total Time & Demand Liabilities(SLR)	34.98%	37.81%	31.26%	28.90%	19.84%	39.01%
Total Liquid Assets	643.48	1397.18	2893.42	4231.56	2616.54	8536.24
Total Loans to Total Deposits	73.80%	68.81%	73.30%	78.76%	81.58%	75.25%
Total Liquid Assets to Total Deposits	36.93%	43.83%	45.61%	43.54%	19.25%	35.85%

Liquidity of Banks (PCBs)

IFIC BANK

	Pre-Reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Statutory Liquid Assets to Total Time & Demand Liabilities(SLR)	43.73%	32.46%	26.89%	22.33%	25.49%	21.92%
Total Liquid Assets	120.55	225.10	540.99	570.28	662.72	1478.65
Total Loans to	72.11%	82.52%	72.92%	97.93%	97.15%	86.57%

Total Deposits						
Total Liquid Assets to Total Deposits	67.53%	35.91%	41.14%	34.40%	23.39%	20.61%

THE CITY BANK

	Pre-Reform Stage		Post-Reform Stage			
	1985	1990	1995	2000	2007	2011
Statutory Liquid Assets to Total Time & Demand Liabilities(SLR)	40.82%	37.43%	28.45%	23.85%	23.58%	22.70%
Total Liquid Assets	66.76	222.22	310.67	530.26	811.74	1703.35
Total Loans to Total Deposits	51.99%	66.14%	56.84%	72.19%	66.43%	95.70%
Total Liquid Assets to Total Deposits	52.84%	49.02%	39.59%	38.41%	20.64%	21.76%

The tables show that every bank either Nationalized Commercial Banks or Private Commercial Banks had maintained Statutory Liquidity Requirement (SLR) in the period of pre-reform and post-reform stage. Rather, most of the banks had excess liquidity before the reform measures taken. On the other hand, since the standard loan-deposit ratio is 80%, except in some cases of Janata and IFIC Bank, the loan-deposit ratio of all the banks were below the standard in both pre-reform and post-reform stages.

CHAPTER FOUR

CONCLUSION AND RECOMMENDATIONS

CONCLUSION
RECOMMENDATIONS

4.1 Conclusion

The problems inherent in the banking sector of Bangladesh have been developing over many years. Bangladesh Bank and Government have prompted a number of the reforms measures with a view to bring the situation under control. These reforms at least have been successful in identifying systematic problems and threats and in identifying the specific problems in individual banks. Most importantly, public confidence in the banking system has in large part been improved.

Before banking sector reforms, banks were following the regulatory norms imposed by the Bangladesh Bank and government. The banking business was fully dominated by economic regulation rather than prudential and information regulation. The banks were recognizing their income on accrual basis without considering the fate of the overdue loans. Since there was no appropriate criterion for loan classification and provisioning , many non-performing loans were considered performing ones. Which resulted in insufficient provision and high accounting profit. The loan classification and provisioning and loan losses were not even required to report in their financial reports.

Because of new loan classification and monitoring policies defaulted loans could be identified easily and monitored continuously for recovery and necessary provision could be made. On the other hand, because of new reporting guidelines from Bangladesh Bank prepared on the basis of International Accounting Standard (IAS-30) made the default picture including classified loans, provision shortfall and loan losses more transparent to the general mass and consequently made the bank management more accountable.

Financial performance of banks in Bangladesh during the period under consideration was not improved conspicuously in the post reform stage; but actual capital as percentage of required capital, maintenance of liquidity and operational efficiency and profitability improved a bit. The higher loan classification and provisioning shortfall in the post-reform stage is because of gradual adoption of internationally accepted loan classification policies and accounting procedures and non-recovery of classified loans. These ultimately affect the profitability as well as the financial strength of the banks.

At the end of the day, it can be concluded from the financial picture depicted in the analysis part of the report there were no definite monitoring guidelines for capital adequacy, loan

classification and provisioning, operational efficiency, off-site supervision of performance of banks in Bangladesh in the pre-form stage. The results from this research show that the adoption of risk-based capital adequacy is certainly an improvement and made better the of capital adequacy of banks in the post-reform era and helped to restore the interest of the depositors and shareholders. In case of management performance in monetary terms was also increased from the pre-reform to the post-reform period. But complaints on the quality of customer service rendered by the banks are not ignorable. Apart from the inadequacy of skilled manpower, factors like inter-union rivalries amongst staff, cumbersome procedures for taking disciplinary actions against corrupt employees, etc. have rendered the personnel management functions in the banks somewhat ineffective. In terms of profitability the banking the banking sector had mixed experience during the period under consideration. Profitability of Nationalized Commercial Banks (NCBs) nosedive downturn because of higher provision maintenance from their income and accounting of interest income on classified loans as interest suspense, which was earlier shown as income in the pre-reform stage. While the profitability of Private Commercial Banks and showed an increasing trend in the post-reform stage because of deregulation of interest rates in loan pricing and involve in diversified businesses. Liquidity performance of banks indicates that initially there was a huge liquid asset in the banking sector which was decreased to some extent in the post-reform time because of expert fund management and prudential guidelines provided by the central bank through the reform measures.

In brief, we can conclude that because of reform measures banks are now goal oriented, more equipped with information and analysis, commercial profit driven rather than social profit driven and more independent to decide strategy for growth. In terms of making things accountable and transparent, the impact of reform is excellent. At the same time if recovery is ensured, then overall financial position would also improve and sustainable.

Bank restructuring is a process, not an event; moreover, it is a continuous process. As the objective conditions of a banking system are always subject to change, the need for adoption of a newer set of restructuring measures arises. Bank restructuring is a structured/sequential process; therefore, if restructuring measures are taken bypassing the sequence, then these would be destined to fall through. The restructuring measures so far taken are definitely not sufficient considering the gravity of the situation: crony lending are yet to be stopped; lenders recourse are yet to be enforced properly on borrowers, still huge capital and provisioning shortfall are there, internal management and union problems are still rampant.

4.2 Recommendations

The restructuring measures taken so far are definitely not sufficient considering the gravity of the situation. Based on the above discussion the following steps may be taken as reform or restructuring measures for the development of the banking system of Bangladesh:

- Banking reform or restructuring measures suggested under different reform programs have to be adopted in a sequential and prompt manner and wherever necessary in a modified form.
- The aim of any restructuring process is to attain solvency first. Though capital position of the system has improved slightly in the recent years, yet a number of NCBs, PCBs and DFIs are significantly undercapitalized. If injection of new

capital in not possible then the banks should be allowed/motivated to raise new capital from the security market.

- To overcome the basic problem of the banking industry, all bad or non-performing loans of banks can be put under separate management within the same institution allowing it to focus exclusively on problem assets in a more efficient and productive way than is usually possible by keeping the traditional organizational structure in place. The sole function of the management in handling problem assets would be to dispose off those assets in a cost effect manner.
- An international standard based audit of the loan portfolio, assets and liabilities, and capital adequacy may be performed in order to make full and proper disclosure of the financial position of the banks.
- Banks with problems and financial weakness may be asked to submit a plan of corrective actions along with a time schedule to overcome their problems instead of following a procrastinated procedure of discussing and signing Memorandum of Understanding (MOU) with the problem banks and afterwards supervising the problem banks' compliance level.
- Banking supervision would become useless, if enforcement of lenders on borrowers is insufficient because of weak legal framework. Though a number of right steps have been proposed and adopted so far, even then the legal process appears to be delay-prone and cumbersome, for which something like special tribunals having simplified procedures, quick disposal, and effective enforcement are badly needed.
- Political involvements, including pressure from trade unions have to be reduced in the banks for the fairness of the functioning.
- For improving the credit deposit ratio; it is needed to bring financial innovations like factoring, asset securitization, loan selling, etc. in the commercial banking operations.
- For developing the asset utilization ratio, portfolio of asset structure should be rearranged by removing the non-earning assets or transforming the non-earning assets into earning one.
- A re-look on the accounting procedure for classification of loan, interest charge and write-off could be given.
- It is theoretically considered and also evident from the data analysis that the profitability of employees of foreign banks is much better than that of the overall banking sector. Local commercial banks can also employ qualified and efficient employees with higher salary package for achieving the better output.
- Technological up gradation of the banking system is must for better and efficient banking sector in Bangladesh.
- One of the major causes of non-fulfillment of the entire objectives of the reform measures is lack of proper and extensive training. Arrangement of large scale training program from both central bank and commercial bank is must to get the concrete result from the reform programs.
- Lastly, the problem of Bangladesh financial system is widespread and not related to banking system only. So restructuring only NCBs and PCBs keeping other financial institutions such as Development Financial Institutions (DFI) and Non-Bank Financial Institutions (NBFIs) infected can in no way disinfect banks. Therefore the scope of the reform measures should also be extended to other parts of the financial system, for sustainable banking reform.

Finally, it can be argued that though the result so far achieved are not very encouraging, yet it can not be denied that the foundation for financial sector reforms has been laid. What now we are required to do is to move along with the existing reform measures covering the whole banking system for the long cherished goal of financial discipline.

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ABREVIATION AND ACRONYMS

BB-	: Bangladesh Bank
BIBM-	: Bangladesh Institute of Bank Management
BIS-	: Bank for International Settlement
BRC-	: Banking Reform Committee
BSM	: Bangladesh Shilpa Bank
BKB-	: Bangladesh Krishi Bank
CAMEL-	: Capital, Assets, Management, Earnings and Liquidity
CBRP-	: Commercial Bank Restructuring Project
CRR-	: Cash Reserve Requirement
DFIs-	: Development Financial Institutions
EDF-	: Export Development Fund
FBs-	: Foreign Banks
FSRP-	: Financial Sector Reform Program
FSC-	: Financial Sector Credit
FCBs-	: Foreign Commercial Banks
FLCs-	: Financial Loan Courts
GDP-	: Gross Domestic Product
IDA-	: International Development Agency
IMF-	: International Monetary Fund
IPI-	: Integrated Performance Index
LRA-	: Lending Risk Analysis
LLRS-	: Large Loan Reporting System
MOF-	: Ministry of Finance
MMUT-	: Monetary Management and Technical Unit

MPC- : Monetary Policy Committee

MOU- : Memorandum of Understanding

MIS- : Management Information System

NCBs- : Nationalized Commercial Banks

NBFIs- : Non-Bank Financial Institutions

NIM- : Net Interest Margin

NLL- ; Non Loan Ledger

NLLC- : New Loan Ledger Card

PPS- : Performance Planning System

PCs- : Personal Computers

PCBs- : Private Commercials Banks

RAKUB- : Rajshahi Krishi Unnayan Bank

REER- : Real Effective Exchange Rate

ROA- : Return On Asset

ROE- : Return On Equity

SEM- : Secondary Exchange Rate

SLR- : Statutory Liquidity Requirement

USAID- : United States Agency for International Development

WB- : World Bank