A couple of years ago, Bangladesh's narrative was positive: here was a country taking advantage of China's move up the value chain with an international manufacturing industry boosting the country's economic growth. But industrial accidents, violent protests and the fear of political instability have threatened Bangladesh's reputation in the eyes of the international community. On the domestic front, financial frauds have exposed serious governance failures, while the banking industry grapples with the introduction of Basel II standards.

The collapse of the Rana Plaza factory in Dhaka in April 2013, killing more than 1000 garment workers, put Bangladesh in the international spotlight. One banking executive describes the accident as a "hiccup" – albeit a major and tragic one – in the context of Bangladesh's progress as a relatively young and developing country.

At the time of independence in 1971, the country was labelled a "basket case" that would always face poverty and famine and be dependent on foreign aid. The country's initial aspirations were to be self-sufficient and feed itself, but now Bangladesh aims to take advantage of its demographic dividend of a young population to become a middle-income country. And with a population of 165 million, Bangladesh has the potential of a sizeable domestic consumption market. The country has become a developmental role model for financial inclusion and the empowerment of women, and despite the country's deficient infrastructure and poor governance, many senior bankers remain positive about its potential.

NPLs have recently gone up because of the Basel II classification policy, and also because the economy itself is going through a lull. **Syed Mahbubur Rahman**
Bangladesh’s banking industry has evolved as the country’s economy has grown. Since its banks were nationalised on independence 42 years ago, private banks have been established, with activity coming in four waves. This has given Bangladesh’s banking industry a competitive landscape with banks at various stages of maturity. Governance issues, non-performing loans (NPLs) and capital levels are the major issues for the industry as it evolves and moves toward a stage of development to fall in line with international standards.

**CONTROVERSY STRIKES**

The country’s banks have been affected by controversies and two Bangladesh banks were mentioned in the US Senate’s investigation of HSBC and money laundering and the financing of terrorism. In the July 2012 report by the US Permanent Subcommittee on Investigations, it was stated that HSBC continued to supply Islami Bank and Social Islami Bank with US dollars “despite evidence of links to terrorist financing.”

Islami Bank responded saying the allegations were untrue: “We would like to make it categorically clear that Islami Bangladesh Limited has never financed any individual or institution involved with terrorist activities and hence the issue is totally baseless and misleading.”

Likewise, Social Islami Bank denied any links to terrorist financing and in a statement reiterated that it “shall, in no way, entertain any kind of business or any relations with any entities that have been sanctioned by the UN or the US.

On a domestic level, Bangladesh’s banking sector has been affected by other scandals that have undermined confidence. The central bank, in its financial stability review for 2012, noted: “In a nutshell, the overall macroeconomic environment was favorable, and the financial intermediation process demonstrated considerable resilience amid unfolding of some financial scams in the industry.”

The state-owned Sonali Bank became embroiled in a scandal when some of its former managers were accused of collusion and embezzling the bank’s funds. In May 2012, Bangladesh Bank – the central bank – uncovered a fraud in which the bank is alleged to have misappropriated about Tk36bn ($464mn) in loans and letters of credit to various companies, the majority of which went to the local Hallmark Group (not connected in any way to overseas companies of that name). Bangladesh’s Anti-Corruption Commission took action, filing charges against a number of Hallmark executives and Sonali officials, some of whom were imprisoned.

“It was only one branch where money was misappropriated by the manager and there were some lapses in supervision,” says Pradip Kumar Dutta, managing director and CEO of Sonali Bank. “We have already overcome this challenge and we have taken several measures.” Mr. Dutta became the bank’s CEO in June 2012 after the scandal broke and those held responsible were dismissed. Mr. Dutta adds: “We have already created a monitoring and inspection division and now we are inspecting branches every six months, where before it was being done once every two years.”

**GOVERNANCE CONCERNS**

Beyond this case, there are wider governance issues and concerns about political influence at state-owned banks as board members are appointed by the government. The central bank does not have sole responsibility for the regulation of state-owned banks, which also fall under the remit of the finance ministry.
But the central bank now has the authority to dismiss the board of a state-owned bank if it is warranted. And in February 2013, the central bank introduced large loan-monitoring software to enhance its monitoring capabilities. Under the new system, banks will have to maintain a database of the large borrowers and make that information available to the central bank.

A number of banks now have monitoring systems that allow them to see the current status of their loan portfolio and alert them if any branch goes over its lending limit. Helal Ahmed Chowdhury, managing director and CEO of Pubali Bank, says of the banks’ new systems: “The monitoring is very strong, yet there is a lot of scope for improvement.”

**REPERCUSSIONS FOR BANKS**

The problems at Sonali Bank had repercussions for the industry, as there were worries about the letters of credit being sold on to other banks. S M Aminur Rahman, CEO and managing director of Janata Bank, says: “With the scams in the banking sector there was panic in the market, and private and government banks were not willing to do more business. Now the government has fully controlled the situation.”

Rashed Masood, Citi country officer for Bangladesh, notes that the financial infrastructure and regulatory framework are still evolving in Bangladesh. “Recently, the Bank Companies Act has been amended to strengthen supervision and risk management, which is a step in the right direction,” he says.

While Sonali’s reputation may have suffered, at least in the short term, confidence was not undermined to the extent that there was a bank run. “We have overcome the problem and people still have trust in us,” says Mr Dutta.

Aside from the bad loans from the Sonali scam, the banking industry has been facing rising NPLs and low capital levels with the introduction of Basel II standards. Take Janata Bank, for example. Mr Rahman explains that Janata had a shock when Basel II reclassified bad loans from six months overdue to three months. Janata has suffered a capital shortfall as a result and needed government help to keep its levels to the minimum requirement. “Next year if we are doing good business then we can arrange this capital ourselves with no government support,” says Mr Rahman.

Syed Mahbubur Rahman, managing director and CEO of Brac Bank, says: “NPLs have recently gone up because of the Basel II classification policy, and also because the economy itself is going through a lull.” He adds that Brac Bank is in the process of gaining approval for a $55m capital raising, which is scheduled for the end of this year.

Mr Masood at Citi notes that the capital constraints in the banking sector will increase when the industry moves to Basel III. “There has to be better planning to raise capital through various sources, not just for private sector banks but also for state-owned commercial banks. Budgetary support is not a permanent solution and the capital shortfall is likely to continue in the process,” he says.

Md Ehsan Khasru, managing director and CEO of Prime Bank, says that banks need to understand where they are making returns, rather than simply looking at the volume of profits. “Now the time has come to be thinking about economic capital allocation. Prime Bank is bringing that economic capital framework to derisk our balance sheet. Every bank should think about derisking their balance sheet and making it sustainable for taking expected and unexpected loss,” he says.

This point is echoed by Abrar A Anwar, head of client coverage, wholesale banking, at Standard Chartered Bank Bangladesh, who says: “The banks are now in a situation where they have to be highly efficient to make a living.”

**BANGLADESH’S POTENTIAL**

Despite the problems of NPLs and capital levels, there are areas of potential. Mohammad Abdul Mannan, managing director and CEO of Islami Bank, says: “One of the unique features of the banking industry in our country is the commercial banking industry making the poor bankable.” He adds that Islami Bank has so far extended microfinance to 800,000 people in Bangladesh.

Mr Mannan also points to the growth in Islamic banking. “Aggregate assets and deposits of Islamic banks in Bangladesh have nearly doubled in the past four years. By the end of 2012, aggregate assets and deposits crossed the Tk100bn threshold, comprising about one-fifth of total banking sector assets and liabilities. This share of Islamic banking looks set to grow further with time, given its faster growth than conventional banking,” says Mr Mannan. He goes on to outline Islami Bank’s philosophy. “We are not greed based; we believe in need-based banking,” he says, adding that the bank has an approach of distributive justice where deposits are taken from the general public to benefit society.

A similarly ethical vision can be found at Brac Bank, which believes in a sustainable model and has a motto of ‘people, planet
and profit. Brac Bank's Mr Rahman explains that the bank is targeting the "missing middle" - the small and medium-sized enterprises (SMEs) that are too large for microfinance lending but too small for typical bank loans. "SMEs are loan hungry," he says. "We are bringing unbanked people into the banking industry, who have not had access to finance." He adds that the lending is unsecured as people in this segment often do not have collateral.

"At Brac Bank, 51% of our loan portfolio should be in the SME segment; that is the unwritten understanding of our board members. It has challenged our growth as we cannot always get sizeable SME business," says Mr Rahman. He adds that more than 90% of the SME segment is small businesses, which are labour intensive to target. "Our credit distribution model is unique and has pushed up the cost-to-income ratio. Our net interest margin is higher than other banks but our costs are also higher and we cannot have the same profitability as other banks."

ADVANCING TECHNOLOGY
As Bangladesh's banking sector develops, so too does its use of technology. Mr Khasru says that Prime Bank has been improving its technology platforms, as have others. "We have invested money in automation to improve control and monitoring. A process of change management has taken place to centralise the operations of Prime Bank," he says. Mr Chowdhury at Pubali Bank likewise notes that the bank has been focusing on IT expansion, capacity building and training to develop a comprehensive platform.

Citi's Mr Maqsood believes that Bangladesh's banking industry is still at an early stage of evolution in terms of automation, digitisation and product offering. "As in any such industry, there are anomalies and teething problems as new technologies are added and banks try to integrate in the system," he says.

K Mahmood Sattar, managing director and CEO of the City Bank, explains that the bank, which is a first-generation bank, underwent a restructuring and modernisation process in 2007. In 2009, the bank became Bangladesh's American Express franchise holder, a role that gives it a platform to reach out to international and high-end customers. "There are opportunities to exploit. We are now in a position to be a domestic bank with a capability to finance and service the same customers that the international banks do. The vision is to be a financial supermarket; we do not want to be a niche operator," he says.

FOREIGN PRESENCE
Of the foreign banks in Bangladesh, Standard Chartered is the most embedded in the market and has been operating there for more than 100 years. Bangladesh is also a key market for the bank at the group level. Mr Anwar says the bank is aligning its business with entrepreneurs who are expanding and need access to international capital.

Unlike Standard Chartered, Citi and HSBC do not have a retail presence in Bangladesh. Citi's Mr Maqsood explains where he sees the opportunities in the market: "We expect to see further opportunities for capital raising, consolidation, and mergers and acquisitions (M&A), and we have a strong record of helping Bangladesh's companies, including leading the largest bond, equity and M&A transactions in Bangladesh to date."

Mr Maqsood is upbeat about the opportunities in the country. "Bangladesh is definitely set for the next stage of development. We expect to see corporate restructuring as well as advisory opportunities locally and a 'go global' trend among entrepreneurs in the near future. Bangladesh is home to an emerging breed of corporate champions who will eventually go global, so do not be surprised if the Samsung or Huawei of tomorrow comes from Bangladesh," he says.

Mr Chowdury at Pubali Bank points to the potential of Bangladesh's information and communication technology sector and pharmaceutical industry, to which Mr Khasru at Prime Bank adds that companies in the country's pharmaceutical industry are now ready to go overseas. "The time has come to go cross-border," he says, adding that as the central bank's reserves are relatively large, at about $16bn, there is discussion about whether the central bank will make it possible to take capital outside the country. "We do not need all the reserves - we could allow for some to go to good corporates to go outside Bangladesh," he says.

For now, however, many investment decisions have been put on hold because of the country's imminent general elections and concerns about political stability. Mr Dutta at Sonali Bank says: "Usually in the year of the elections, there are fewer loans. People are observing and need to wait and see [how the political situation develops]."

Although investments have been put on hold and Bangladesh has serious issues to address to improve its reputation in the eyes of the international community, the mood of the bankers is still upbeat. Standard Chartered's Mr Anwar says: "We believe there is a huge opportunity that is still untapped. It is just waiting to happen."
ABUL MALAABDUL MUHITH

Bangladesh's finance minister discusses the country's stable gross domestic product growth, achievements in tax revenues and why he is confident that Bangladesh will become a middle-income country in the next five years.

WRITER Jane Cooper

The finance minister of Bangladesh, Abul Maal Abdul Muhith, is about to head off to his home district for four days. It will be a chance to touch base with his constituents ahead of the country's upcoming elections.

But for now, he reflects on the government's objectives that were laid out after prime minister Sheikh Hasina was elected in December 2008. "This government came to power five years ago, which was a critical time for the world as well [as Bangladesh]. We had time to think in our election manifesto and this is what we more or less followed. The position we took was that we should give emphasis on domestic demand, agriculture and rural development. And the country was going through a serious power crisis, so that had to be given high priority," says Mr Muhith.

STEADY GROWTH

Despite the global recession, Bangladesh has managed to maintain its stable outlook with ratings agencies, and a report by Standard Chartered notes that the country has not recorded negative growth in the past 27 years. In more recent years, Bangladesh's growth in gross domestic product (GDP) has been consistent, hovering around the 6% mark. World Bank figures show that in 2009, GDP growth was 5.74%; in 2010 it was 6.07%; 2011's figure rose to 6.71%; and in 2012 it was 6.32%. "Our biggest success is not in the growth, but the stability in growth," says Mr Muhith.

Per capita income in Bangladesh is about $1700 per annum, a figure that Mr Muhith expects to increase. "I am confident that the process we started - of leap-frogging in development - is going to continue and Bangladesh will be a middle-income country in the next five years," he says.

Mr Muhith points to the country's developmental achievements in the past 20 years, for example, in reducing infant mortality by combating diarrhoea and introducing improvements in immunisation and nutrition. By the end of 2012, Bangladesh had already met several targets of the UN's Millennium Development Goals, such as reducing poverty and improving education. In a meeting with Bangladesh's prime minister during the UN general assembly in September 2013, UN secretary-general Ban Ki-moon praised the country's leadership on these goals, as well as its empowerment of women.

Growth in the government's tax revenue has been another achievement for Bangladesh. "In 1983 we collected 5% of GDP as revenue, in 2009 we collected a little less than 11%. Now we are collecting 14% as revenue. Thirty years' growth has been achieved in just five years," he says.

HARD TASK

But challenges for Bangladesh remain, not least because of the global economic environment. "The global recession has been quite strange - it is not leaving us," says Mr Muhith. "We have managed quite well in exports, but the trade picture globally is not that good."

Remittances from overseas workers, which contributed to Bangladesh's current account surplus in 2012, have declined. "Remittances growth has suffered in the past four years," says Mr Muhith. According to data from the central bank, inflows of remittances in August 2013 were $1.01bn, down from $1.24bn the month before, and down from $1.88bn year on year.

Inflows in the form of foreign direct investment (FDI) started strongly at the beginning of this fiscal year, Standard Chartered Global Research notes that FDI into Bangladesh is mainly in the ready-made garment, banking and energy sectors. In the first two months of fiscal 2013, FDI stood at $317m, representing year-on-year growth of 36%.

In Mr Muhith's meeting room there is a copy of the morning's newspaper, which carries a front-page story on violent protests the day before. When asked to comment on the dispute - and subsequent riots - over the minimum wage for garment workers, Mr Muhith says: "We adjusted wage rates three years ago when [the rate] was doubled. I think the garment industry was too conservative with its declaration that it would only increase wages by 20%. In my mind that is absurd and the demand of the workers to take the minimum to Tk8000 [$100 a month from a current level of Tk3000 a month] is also absurd. Unfortunately the garment industry generated this demand and many others are taking advantage of it," he says, adding that he expects the matter to be resolved with a compromise.
Development economics is not just about academic theory, and Dr Atiur Rahman, Bangladesh’s central bank governor, is proof that it is possible to put theory into practice. With an established reputation as a pro-poor economist – with a PhD thesis on ‘peasants and classes’ – the former university professor is now practising what he has been preaching, and previously teaching, at the University of Dhaka.

On taking the helm of Bangladesh Bank in May 2009, Mr Rahman sought to translate his research into transforming the central bank’s approach. “In our five-year vision, our strategy was that we must focus on financial inclusion – that became my major agenda,” he says.

**HAPPY MEAL**

Mr Rahman’s appointment came as the effects of the global financial crisis were taking hold. “The international external demand for Bangladesh’s products was sluggish so we looked instead to focus on higher domestic demand,” he says.

In his role he has been focusing on areas such as green banking, socially responsible financing and mobile payments. On the question of whether a central bank governor should extend his mandate in this way – rather than focusing on price stability and financial matters – Mr Rahman says: “We did all of these [things] not at the cost of the main job of macroprudential policy and financial stability – they are our mainstay, they remain our main course. The others are the salad and the dessert – together they are a good dinner.”

And the salad and dessert is now being eaten by those outside the central bank. “We have succeeded in making socially responsible and environmentally responsible financing mainstream – it is now in the mainstream of the financial sector,” says Mr Rahman. And with the main course, his efforts have paid off. “The financial stability has been unprecedented. We have more than 6% growth, inflation is down, we have a current account surplus, a stable foreign exchange rate and access to finance is widespread,” he adds. “We did not expect to achieve such good results in such a short time.”

**FOOD FOR THOUGHT**

Food inflation is something Mr Rahman keeps a close eye on. “Food imports can become a difficult proposition. In 2008, food inflation was high – it was 16% [but we] brought it down to 8%,” he says. And to move the country away from relying on food imports, the central bank has implemented a policy where banks have to lend a minimum of 2.2% of their loans to Bangladesh’s farmers. Mr Rahman says that even the foreign banks operating in Bangladesh have to meet the minimum requirement of agricultural lending. “If they do not have branches they can give loans through microfinance institutions. If they fail to do it, I take away the targeted amount and put it in the reserves at a lower rate of interest. All banks have to do this, not just the public banks. It is good business for them as well,” he says.

In addition to encouraging lending to the agriculture sector, the central bank has brought unbanked farmers into the banking system by introducing bank accounts that can be opened with as little as 10 taka ($0.12). The central bank has also been focusing upon encouraging the flow of credit to the country’s small and medium-sized enterprises (SMEs).

On the question of whether the governor is focusing on providing credit to SMEs instead of encouraging consumer credit, he says: “When demand exceeds supply then the supply should take priority – it is not about suppressing demand.” Mr Rahman explains that he suppressed bank credit being used for luxury items as his focus is to stimulate industries that are more productive and have social value. One bank executive explains that this principle means that banks are prioritising, for example, the financing of a bus over a luxury car because the former is more beneficial to society as a whole.

Mr Rahman says that in the case of luxury cars – which were financed 80% by a bank and 20% with the consumer’s own money – that ratio has now been reversed so that consumption is limited to the level of disposable income. Also, he notes that if bank money is not used for companies in the luxury goods industry, it frees up credit for SMEs and consumers. “It is a balancing act. It’s not that we are against consumer credit,” he says.