

# Improving governance in state banks

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RECENTLY, we heard the finance minister saying in parliament that the impact of the Hall-Mark scam is felt by other banks as well. This statement actually defies claims of many who asserted that the scam was an isolated incident having little implications for the banking sector.

The Centre for Policy Dialogue (CPD) organised a dialogue on governance in the banking sector in the beginning of November where it was highlighted that the amount is rather quite significant for resource-poor Bangladesh.

Some people, including bank officials, told us later that the CPD's dialogue was not helpful for the banking sector as it could affect the reputation of the banking industry. I could not but feel sorry for those who consider constructive discussions harmful and think that our reputation is still upheld after such a proven disgraceful incident.

The think-tank mentioned in its presentation that the Hall-Mark incident is not only a case of financial loss but also a deep dent on the confidence and trust of the customers of Sonali Bank. It is not the loss of the goodwill of a particular bank only, but also of the total banking industry.

Such an erosion of reputation of banks could have multiple chain effects, leading to a reduction in deposit, high interest rate and a fall in share prices of the concerned bank, which in turn can constrain the role of the banking sector in catalysing the growth of the economy.

It is undeniable that the banking sector, the dominant industry in Bangladesh's financial sector, has flourished during the last three decades as a result of increased

demand of the growing economy. If one looks at the pace of development of the banking industry, total asset has grown by 324.2 percent, while deposit has increased by 326.9 percent during 2001-11.

Total deposit is currently 51 percent of GDP. The ratios of money supply, total deposits and total domestic credit to GDP have shown a steady increase over the years, indicating an increased financial depth.

Financial inclusion, though still low compared to the developing countries, have expanded since the independence. Population per bank branch has decreased from 57,700 in 1972 to 17,660 in June 2011, though this does not undermine the fact that a large number of people still remain outside the banking services.

Over the last few years, the country's banking sector has made progress in terms of meeting indicators such as capital adequacy, asset quality, management quality, earnings, liquidity and sensitivity to market risks (CAMELS).

However, the seemingly good performance does not capture the reality which raises doubts as regards the real health of banks, particularly of the state-owned ones. The government embarked on a policy of liberalisation, by denationalising the nationalised commercial banks in the 1980s in view of the deteriorated performance and inefficient resource management. The reform process got momentum in the 1990s and continued afterwards.

The latest major reform programme was the corporatisation and restructuring of the state-owned banks in 2007. This led to some improvements initially. For example, the state banks, for the first time, earned profit in 2008; the amount of non-performing loans

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|------------------------------------------------------------------------------------------------------|
| What is the value of<br>Tk <b>3,606.48</b> crore?                                                    |
| Unauthorised loan of Tk <b>3,606.48</b> crore of Sonali Bank/Ruposhi Bangla branch is equivalent to: |
| 320.6pc of Sonali Bank's paid-up capital                                                             |
| 6.6pc of Annual Development Programme of FY2012-13                                                   |
| 15.9pc of social safety net funds in FY2012-13                                                       |
| 38.6pc of health allocation in FY2012-13                                                             |
| 16.8pc of allocation for education in FY2012-13                                                      |
| 0.3pc of projected GDP of FY2012-13                                                                  |
| 15pc of Padma Bridge finance requirement                                                             |
| 42.9pc of the envisaged support by World Bank for Padma Bridge                                       |
| COMPILED BY THE AUTHOR                                                                               |

came down and expenditure-income ratio reduced.

However, the core strength of these banks remained weak. For example, performance in terms of efficient resource allocation through disbursement of credit to productive sectors, prudent risk analysis, supervisory and management quality, improved customer service and the overall governance continue to depict rather disappointing picture. In this context, a set of key recommendations are presented below.

First, the absence of a comprehensive risk management policy in many banks makes it difficult to handle fraud and other extraordinary cases. Core risk management guidelines of Bangladesh Bank are hardly followed by the state banks.

The manual for loans and advances containing policies, pro-

cedures, processing and reporting transactions, review of security and collateral and responsibilities at different levels is not followed by many banks due to which it becomes difficult for banks to handle and manage clients with various levels of exposures.

Second, the internal control department which is supposed to be a critically important department is weak in state banks. This is partly due to incentive failure which prevents hiring of qualified persons for this department. As the nature of the job involves patient scrutiny of compliance, people are reluctant to work here, and those who do, are often in a way dumped in this department.

Third, the practice of appointing directors for the board of the state-owned banks based on the political loyalty and affiliation has to be changed. The "Fit and proper test criteria" of the Bangladesh Bank Guidelines 2010 for the nomination of directors should be implemented fully. Due to political baggage, directors of state banks cannot perform their duties independently and remain morally obliged to listen to political instructions.

Fourth, the recent scam has also exposed the total failure of the senior managers of the bank in discharging their duties. In the state banks, the major preoccupation of the CEOs is to "manage" the board to keep their jobs. Unfortunately, it is also difficult for them to do otherwise in a setting where many decisions are influenced by political instructions. As a result, these officials lack creativity and initiatives towards developing good business plan, effective people management programme, regulatory compliance practice and effort towards clients' satisfaction.

The board should only guide

and support the CEO to achieve bank's targets and evaluate his performance on the basis of key performance indicators. The general managers should be transferred from one state bank to another not only to help transfer good practices, but also to reduce the possibility of fraudulent and unethical practices.

Fifth, the human resource (HR) departments of state banks remain weak and powerless to take decisions on recruitment and promotion, partly due to a lack of capacity and external influence. The HR policy of banks should not only arrange for appropriate training but should also involve the reward and punishment practices.

Sixth, an issue related to the HR development is the automation and implementation of management information system in banks. It is apprehended by experts with fair amount of certainty that there may be many more Hall-Mark like cases that wait to be uncovered in other banks. The mess may become unmanageable, if these are not dug out through transparent and automated banking practices.

Seventh, the supervisory and monitoring role of the central bank needs to be significantly strengthened and the Banking and Financial Institutions Division should be dismantled to get rid of dualism in the regulatory mechanism for smooth functioning of the banking sector.

Finally, a commission for the financial sector is being planned by the government for its improvement. It is expected that recommendations of the commission will be implemented with due sincerity.

The writer is the head of research at the Centre for Policy Dialogue.

## India's GDP growth languishes

REUTERS, New Delhi

INDIA'S economy extended its long slump in the last quarter, with lower-than-expected growth keeping it on track for its worst year in a decade and underscoring the urgency of politically difficult reforms to spur a revival.

The economy grew 5.3 percent from a year earlier in the July-September period, provisional gross domestic product (GDP) data showed on Friday, below the 5.5 percent posted for the three months ending in June.

"It is essential that the reform agenda is carried forward with vigour and that the recently announced measures are implemented," leading business chamber FICCI said.

Indian Prime Minister Manmohan Singh's chief economic advisor forecast full-year growth of between 5.5 and 6 percent, which would be the slowest since 2002/3.

"It will be between the two, because in order to get 6 percent we really need very strong growth in the second half," advisor C Rangarajan told TV network CNBC.

A growth rate below 6 percent for the third quarter in a row is damaging for a country that aspires to at least 8.5 percent expansion to provide jobs for its burgeoning population, and makes it tougher for Singh to fund flagship welfare programmes.

The quarterly number was lower than a Reuters poll had forecast and matched the January-March quarter, which was the weakest growth rate in three years. However, economists say inflation worries mean the Reserve Bank of India (RBI) is unlikely to cut interest rates when it meets on December 18.

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