



Better banking for economic success



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A strong banking sector is critical to economic growth and development in a developing country. A robust and well-functioning banking system facilitates the efficient allocation of resources to individuals, organisations, and projects that can use those resources effectively. Access to capital is critical, among other reasons, for the undertaking of infrastructure projects by the government; entrepreneurial activities and job creation by citizens; and improvements to agricultural output and technology use by farmers. Multiple studies have shown that banking and financial sector development is a necessary condition for economic development. Banks promote capital formation, investment in new enter-

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prises, promotion of trade and industry, savings, and development of agriculture.

In Asia, states with strong banking sectors, such as Singapore and Hong Kong, have consistently achieved high rates of economic growth and development. Closer to home, a 1997 study of the relationship between financial sector development and economic

growth in India, Pakistan, and Sri Lanka, showed a direct causal link between financial sector development and economic growth. In India, improvement, reform and liberalisation of banks and other financial institutions paved the way for rapid development throughout the 1990s and 2000s. Thus, in order for Bangladesh to achieve its goal of reaching Middle Income Country status by 2021, it is critical to focus on improvements in the banking sector.

Bangladesh's banking sector can be classified into four main categories: state-owned commercial banks (SCBs), specialised development banks (SDBs), private commercial banks (PCBs), and foreign commercial banks (FCBs). The sector is regulated by the country's central bank, Bangladesh Bank (BB). Established in 1972, Bangladesh Bank is responsible for monetary and credit policies, and for regulation and supervision of banks (along with non-bank financial institutions). These institutions comprise Bangladesh's banking sector, and along with insurance companies and non-bank financial institutions form the financial sector.

Bangladesh's financial sector went through various stages of reform and development to reach its current state. Immediately after independence, in 1971, Bangladesh's banking system consisted of two branches of the former State Bank of Pakistan, seventeen large commercial banks, and fourteen smaller commercial banks. Most of the banks were owned by West Pakistani interests, and almost all were concentrated in urban areas. After independence, the government nationalised the entire banking system and began to reorganise and rename several of the banks. Only the three foreign-owned banks that were present were allowed to continue operations as before. Throughout the 1970s, 75 percent of all credit provided by this banking system was for trade or public financing.

Loan advances to the private sector for agriculture and manufacture accelerated with the government's encouragement in the late 70s and early 80s. In 1982, commercial banks were denationalised, and in 1984, the National Commission on Money, Banking and Credit was established. These developments set the tone for further reforms and increased impor-

ance of the private sector throughout the 1990s and early 2000s. In the 1990s, wide-ranging reform measures were taken under the World Bank's Financial Sector Reform Project, and a large number of private commercial banks were awarded licenses. In the early 2000s, further reforms were launched, through the Central Bank Strengthening Project, focused on developing an effective regulatory system; and the Enterprise Growth and Bank Modernisation project, focused on corporatising the four large state-owned commercial banks to improve their performance and make them competitive in the private sector.

Over the course of these years and partly as a result of these reforms, the Bangladesh banking sector has shown significant improvements and developments since liberation. Credit and investment assets of scheduled banks increased from Tk 7.07 billion to Tk 4625.85 billion from 1972 to 2011. From 1990 to 2013, the number of bank branches in the country went up from 5,539 to 8,427. In 2013, 57.26 percent of these branches were located in rural areas, showing an increase in banking services available to the rural population. The emergence of the specialised banks also helped in providing necessary banking services to the agricultural and industrial sectors. Microcredit lenders, such as Grameen Bank, are a particular example of success in the Bangladeshi banking industry. Microcredit lenders focused particularly on rural areas, and allowed individuals without access to collateral to access capital for business ventures.

Bangladesh Bank also introduced several programmes to help provide capital to small and medium enterprises (SMEs). The central bank now has a specialised SME and Special Programmes Department to facilitate the development and support of SMEs by the banking sector. Several guidelines and policies were put into place to encourage loans to SMEs. In 2010, Bangladesh Bank prescribed an indicative target of Tk 23,995 crore for banks to meet SME loan disbursement. Furthermore, it created guidelines for individual banks to reach this policy through specific targets for different branches and regions. It also suggested prioritising small enterprises and women entrepreneurs. Bangladesh Bank also established a three-tier moni-

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toring system (consisting of the BB head office, BB Branch Offices and the Banks) to ensure that the banking sector meets the targets. SMEs are extremely important to a developing country's economy. This is because they create new jobs, which the World Bank listed as Bangladesh's most important step on the path to becoming a middle income country; and they can help reduce economic inequality and provide a boost to the country's economy. Thus, a focus on SME loans and loans for women entrepreneurs is a positive signal for the development of Bangladesh's banking sector.

The banking sector has also taken steps in its adoption and use of new technology to increase efficiency and provide convenient customer service. In September 2011, Bangladesh Bank introduced guidelines on Mobile Financial Services for Banks, and advocated for banks to lead the adoption, while advocating for mobile operators and microfinance organisations to be active partners. Since then, Bangladesh Bank has authorised 28 banks to offer full mobile financial services. 19 banks have already developed and adopted a mobile banking strategy and started providing services to their customers (the largest of these services being bKash, BRAC Bank, DBBL Mobile Banking and Dutch-Bangla Bank Limited). By February 2015, there were over 2.5 crore registered mobile banking clients in Bangladesh, and the average value of daily transactions was USD

47.44 million. Adoption of mobile banking technology makes banking more convenient and accessible for customers, and particularly improves accessibility for customers in rural or remote areas who do not have easy access to a physical bank branch. Thus, the adoption of mobile financial services is also a positive development in Bangladesh's banking sector. In order for the banking sector to perform to its full potential, provide services to more customers and help Bangladesh move towards middle-income country status, the banking sector should continue to develop and invest in better technology for mobile financial services.

However, in spite of these positive steps, Bangladesh's banking sector also has some big weaknesses and areas that need improvement, and these have led to major setbacks in its development. A major weakness is lack of regulatory oversight and enforcement with regard to security and risk management. A prime example of this was the 2016 Bangladesh Bank heist, where hackers successfully stole USD 101 million from Bangladesh Bank's account with the Federal Reserve Bank of New York. The consequences could have been even worse. Instructions were issued via the SWIFT network to remove USD 951 million from Bangladesh Bank's account. The remaining amount was only saved because the Federal Reserve Bank of NY blocked the remaining transactions, at Bangladesh Bank's request.

Such cyber-attacks and attempts to steal funds are not uncommon in today's technology-oriented world. Large organisations, particularly those that deal with financial transactions, are targets of frequent, repeated and sophisticated cyber-attacks. Even within the context of Bangladesh's banking sector, this attack was not new or unexpected. In 2013, hackers successfully stole USD 250,000 from Sonali Bank, and in 2015, two other hacking attempts were recorded on banks in other countries. For an organisation as large as Bangladesh Bank, the question is not if, but when, there will be a cyber-attack targeting it. In spite of this, Bangladesh Bank's lack of preparation for such cyber-attacks was evident in how the events unfolded.