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Projection of Non Bank Financial Institutions and Money Market: Bangladesh View

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Abstract

The non-bank financial institutions (NBFIs) constitute a rapidly growing segment of the financial system in Bangladesh. The NBFIs have been contributing toward increasing both the quality and quantity of financial services and thus mitigating the lapses of existing financial intermediation to meet the growing needs of different types of investment in the country. At present, 29 NBFIs are operating their business across the country of which one is government owned, 15 are privately owned local companies, and the remaining 13 are established under joint venture with foreign participation. Non-banking financial companies/institutions, or NBFIs, are financial institutions that provide financial services including banking but do not hold a banking license. These institutions are not allowed to take deposits from the public. The development of non-bank financial institution as financial intermediaries complementary to commercial banks is noticeable in Bangladesh. This paper aims at addressing the market structure of the sector and its change over time by adopting growth measures based on asset, loan, income and expenditure. The study reveals a positive growth of NBFIs over the years in advances, income, assets and others financial aspect and a good contribution in the GDP growth of Bangladesh.

Keywords: Non-Bank financial Institutions (NBFI), Securities & Exchange Commission (SEC), Development, Growth, Gross Domestic Product (GDP)

Objectives of the Study

- To understand the concept of Non Bank Financial Institutions,
- To evaluate the financial condition of NBFIs'
- To develop a research cell for analyzing status of the market and economy,
- To identify the key relationship between NBFIs and the financial market,

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- To know the basic terminology of NBFIs,

Methodology

All the information incorporated in this paper has been collected both from the primary sources and as well as from the secondary sources. In order to compute the development and growth, asset and loan , income and expenditure figures are used in this study to ascertain the growth over time in different financial aspect NBFIs .The data are collected from various issues of 'Bank and Financial Institutions' Activities', a yearly publication of the Ministry of Finance of the government of Bangladesh. All NBFIs reported in this publication in a particular year are considered for that year by the present study. This paper adopts collective procedures of economic records for addressing the growth and development of financial situation of NBFIs using time succession data whereas collective procedures consider the market share of all non-banks operating in an industry.

Literature Review

From the very beginning of bank financial institutions plays very significant role in economic and infrastructure development of Bangladesh. The history of NBFIs is not as old as BIFs but with the passage of time NBFIs become an integral part of the financial system of Bangladesh. Goldsmith (1969) stresses opine that NBFIs alongside the banking sector contributing prominently in influencing and mobilizing saving for investment. Sufian (2007) opines that with the development of health of NBFIs health of capital market is also increase. He also added that as the key player in the development of capital market efficient and productive NBFIs lead the market based economy move forward. With regard to the literature concerning the non-banking sector, limited number of studies has been conducted so far in Bangladesh.

Hossain and Shahiduzzaman (2002) focuses on the importance of non-banking sector as a vehicle for the economic development of the country and identifies the underlying problems existed within the sector. Ahmed and Chowdhury (2007) deal with different features, contribution, and challenges faced by NBFIs in Bangladesh. At the same time they also focus on performance analysis of NBFIs by adopting traditional financial indicators like current ratio, debt-equity ratio, productivity ratio, return on equity, etc. and report that in spite of the presence of several constraints existed in the sector NBFIs have been performing considerably well.

Nasreen and Jahan (2007) conduct a research on leasing companies only regarding the accounting practice. However, none of the above mentioned studies analyze the growth of the non-banking sector of Bangladesh over a long period of time and their contribution of economic growth, which creates an opportunity to deal with through an investigation.

Introduction

The essence of a market based financial system is the well-organized and efficient capital market. The stock market is the first and foremost forum in which individuals can trade risk and return, firms can raise capital and stockholders can maximize the value of their shares. At present, the worldwide capital market provides an excellent mechanism for mobilizing savings for industrialization. Through the efficient pricing of the shares in the market, the wealth of the company is maximized and individuals get prize for their sacrifice of present consumption. On the other hand, primary market gives the opportunity to the firms to generate capital from the public and also provides individuals participation in the firms' ownership. The development of the secondary market for equity does not contradict with the development of the banking sector. In many countries of the world especially the countries of the continental Europe and Japan have started their reforms based on bank-dominated system first. So a full pledged reform program of financial sector includes the development of both bank and non-bank finical institutions in the financial system so that the overall savings and investment activities improve significantly. Non-bank financial institutions are permitted to work as merchant banker. In this situation, they have to take a separate license from the Securities and Exchange Commission (SEC).

Merchant banking activities involves activities like a manager of the issue, underwriter, bridge financer and portfolio manager etc. NBFIs can venture in such types of risky businesses because of their particular types of sources of fund, which facilitate them to provide institutional support to the capital market. On the other hand, bank's money is the depositors money and so that they go for less risky short-term financing. For this reason banks are subject to high regulations and NBFIs are little or no regulations around the world and thereby can go easily for risky investment such as merchant banking, venture capital etc. NBFIs are not permitted to use 'bank' in their names and use companies.

Their funding is not covered by the government protection. These distinct natures make the NBFIs separate from the BFIs and place a separate arena in the financial market place. However, one may argue for the commercial banks involvement in the capital market as it follows, the universal banking system, such as that of many continental European countries, Germany in particular.

In the universal banking system, banks provide both commercial and investment banking services. The principal arguments are to lend from the equity and to provide economics of scale to the banking companies. The weaknesses identified by them are first, it gives significant equity stake to the commercial bank and reach a certain proportion without approval from the central bank. Secondly, commercial banks feel lack of expertise and experience to assess the potential risk and return of the investment in the market. Commercial banking activities are less risky than the security operation and risky security business may affect the commercial banking activities. Again there is no evidence of economies of scale in the universal banking. So, capital market development needs the simultaneous development of associate institutions like NBFIs. NBFIs capture the second position in the world capital market in volume in the early 1990s. NBFIs activities in this market involves investment and merchant banking , including the portfolio management, issue managing, underwriting and bridge financing, consultancy or advisory services, selling of financial data, corporate agents in merger and acquisition, investment counseling etc. NBFIs are required to take a separate licensee from the SEC to do the activities related to the capital market.

The development of a country depends on the development and growth of all economic entity. The financial system is the ultimate engine for achieving economic prosperity of a country, and is involved in the mobilization of financial resources from the surplus to the deficit sector. Though in the initial stage bank financial institutions plays a vital role in mobilization of funds in most of the countries, particularly in developing countries. However, the development of both banks and non-bank financial institutions are necessary for assuring a strong and stable financial system for the country as a whole (Pirtea, iovu, & Milos, 2008; raina & Bakker, 2003). In addition, NBFIs add power to the economy in such a way that enhances the resilience of the financial system to economic crisis (Carmichael & Pomcerleano, 2002). These NBFIs offer wide range of products and services to mitigate the financial intermediation gap and thereby, play an important complementary role of commercial banks in the society (Shrestha, 2007; Sufian, 2008; Vittas, 1997).

According to Ahmed and Chowdhury (2007), the fundamental limitations existed in the banking sector are, in fact, laid down the foundation of the accelerated development process of NBFIs. Firstly, the regulations adopted by the central bank of a country do not allow banks to embrace financial services for all areas of business; secondly, banks always face a mismatch in maturity intermediation since they have to fulfill the long-term financing needs with short-term resources; and finally extending the operational horizon through product innovations is not always possible for banks. These areas create new opportunities for the NBFIs to grab with utmost success. As a result, the NBFIs are nowadays treated as an important sub-sector of the financial system, which has been expanding rapidly and attaining importance on a continuous basis due to their ability to meet the diverse financial requirements of business enterprises (Islam & Osman, 2011).

The development, growth and their changes over time as well as impact on the economy have been analyzed by many researchers to evaluate the structure of the banking industry. Various changes in the banking industry initiated by the financial reform policy make the analysis even more important to the policy makers. However, the research on various issues of NBFIs remains substantially scarce (sufian, 2008), in spite of the fact that recent emergence of NBFIs as financial intermediaries is noticeable not only in developed countries but also in developing countries. Empirical evidence to evaluate the development and growth of the non-banking sector stays even more insignificant, particularly in the context of developing countries.

Although both direct and indirect forms (In case of direct finance, deficit budget units collect funds from surplus budget units through stock market, whereas in case of indirect finance, banks and NBFIs play the role of financial intermediaries between deficit budget units and surplus budget units.) of financial intermediation are available in Bangladesh, similar to many developing countries the indirect form dominates the other form in the financial market to a great extent (Beck & Rahman, 2006; Uddin & Suzuki, 2011). The journey of NBFIs was started in 1981, ten years after the independence of the country. A private sector NBFI, namely, Industrial Promotion and Development Company (IPDC) was the pioneer in the sector in Bangladesh. Over the years, the non-banking sector has grown in numbers as many state-owned, private, and joint-venture firms started to join the sector, and by the end of 2010 a total of 35 firms were reported by the Ministry of Finance as NBFIs.

The size of the non-banking sector in respect of both absolute and relative terms has also expanded. For instance, the absolute size of the non-banking sector, measured in terms of assets, was BDT (BDT stands for Bangladesh Taka, and Taka is the local currency of the country) 78.84 billion in 2000 and by the end of 2010 it became BDT414.11 billion. On the other hand, the relative size of the non-banking sector, measured in terms of assets relative to gross domestic product (GDP), increased to 5.96 per cent in 2010 from 3.85 per cent in 2000. Moreover, the importance of non-banking sector has been accelerated rapidly due to the development of new areas of business operations like leasing, term lending, housing and real estate financing, merchant banking, factoring, and so on by NBFIs (Ahmed & Chowdhury, 2007; Debnath, 2004; Hossain & Shahiduzzaman, 2002; Nasreen & Jahan, 2007). But the research on concentration and competition of the non-banking sector remains entirely unexplored. At this backdrop, this study is undertaken to assess the degree of concentration and competition and their changes over time and thereby, looked at fulfilling the demanding gap with regard to the issue.

The contribution of this paper can be expressed in three ways. Firstly, it addresses to analyze the growth of the non-banking sector of Bangladesh through analyzing the changes of different financial aspects over last 11 years of time, and by doing this it shows the scenario of Bangladesh with the growth of NBFIs. Secondly, the findings of this study will generate some guidelines for the policy makers to formulate policies and strategies with regard to the structure of the non-banking sector since the growth of NBFIs also influences the GDP growth. Finally, it also raises some issues to deal with through further research.

Overview of the Non-banking Sector of Bangladesh

The Bangladesh Bank (BB), as the regulator of NBFI operations in the country, has been pursuing policies and taking measures to ensure healthy and efficient expansion of NBFI activities in the country. In order to bring the NBFIs under an effective risk management system, BB identified four core risk areas in September 2005 covering credit risk management (CRM), asset and liability management (ALM), internal control and compliance (ICC), and information and communication technology (ICT). The BB also provided guidelines for the NBFIs to develop structures and undertake measures to improve their institutional risk management system in core risk areas.

In line with core risks management guidelines, BB also introduced risk based audit system generally known as 'system audit' for the NBFIs. For the purpose, the Department of Financial Institutions and Market (DFIM) conducted a special inspection on the basis of these core risk areas in IDLC and Union Leasing Company Limited in July 2007.

After modifications of the audit process based on the findings of this first phase inspection, the second phase inspection has started in January 2009 in IPDC and Prime Finance Limited. The remaining NBFIs would be brought under the audit system in phases. BB also plans to rank the NBFIs on the basis of their compliance status of core risk management guidelines. Against the backdrop of the global financial crisis, NBFIs have been asked to be cautious in their financial management. As a part of better management, BB has instructed the NBFIs whose classified loan to total outstanding loan ratios has risen sharply to take adequate steps to realize the default loans. The BB has asked the NBFIs to take measures to rationalize investment portfolios and overcome other adverse trends such as provision shortfalls. The NBFIs have been instructed to comply with the Anti-Money Laundering Ordinance 2008 and inform the Anti- Money Laundering Department of BB of any suspicious transactions. The BB has also taken initiatives for ensuring better corporate governance of the NBFIs through streamlining the managing boards for enhancing efficiency and accountability. The NBFIs on their part need to diversify in financial instruments and commercial papers to raise adequate funds from the market so that they can minimize their dependence on borrowing from the inter-bank money market at higher interest rates in times of need. In this respect, assistance needs to be provided to the NBFIs for securitizing and selling quality financial assets.

Since the NBFIs serve as important complements to the banking sector in meeting the financing needs that are not well suited to the banks, the development of the NBFIs is crucial to ensuring a sound financial system in the country. It is important to view the NBFIs as a catalyst to economic growth and provide necessary support and guidance for their development within a longer term framework which would improve financial intermediation and enable the NBFIs to play their due role in overall development of the country

Bangladesh Bank is the central bank of the country and therefore, is responsible for regulating and supervising the bank-based system.

At the same time, as a supreme authority of the indirect form of financial intermediation, Bangladesh Bank is also responsible for controlling the activities of all NBFIs. On the other hand, the stock exchanges are operated under the guidance and monitoring of Securities and Exchange Commission (SEC), Bangladesh.

During the initial stage of development, the NBFIs were governed by Bangladesh Bank as per the provision stated in Chapter V of the 'Bangladesh Bank Order 1972'. Later on, a new order was promulgated by Bangladesh Bank in the name of 'Non Banking Financial Institutions Order' in 1989 with a view to assuring better regulation and supervision of the sector. However, regulatory deficiencies of this order with regard to the activities of NBFIs and statutory liquidity requirement urged the central bank to announce a new act in 1993 in the name of 'Financial Institutions Act' (Ahmed & Chowdhury, 2007; Barai, Saha & Mamun, 1999). From then on, all NBFIs in Bangladesh have been licensed and controlled under this act.

Although the major business of most of the NBFIs is lease financing, still a handful number of NBFIs involves in different financing activities, namely, term lending, house financing, merchant banking, equity financing, venture capital financing, project financing, financing to pilgrimage, etc. NBFIs also extend services to various sectors like textile, agriculture, small and cottage, chemicals, trading, pharmaceuticals, transport, food and beverage, leather products, and construction and engineering.

Structure of Financial Activities

The flow chart of the structure of financial activities is as follows:

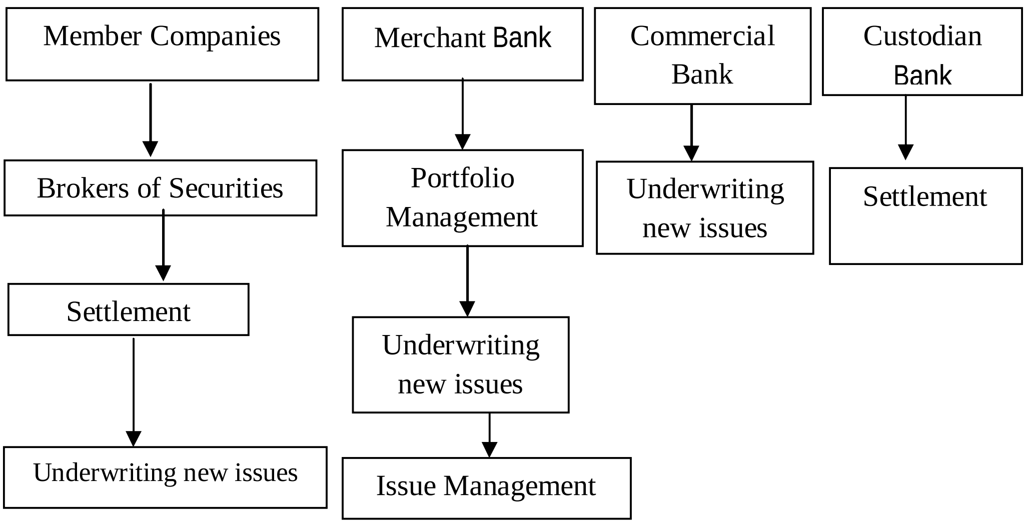


Table 1: Position of Non-Banks in for the Period of 2000-2010 (Amount in Million BDT)

Type of Ownership	Deposits		Loans and Advances		Assets	
	Amount	%	Amount	%	Amount	%
Joint Venture	24,216	11.32	61,222	22.13	76,986	18.59
Privately Owned	159,903	74.74	158,880	57.43	249,561	60.27
State Owned	29,835	13.94	56,548	20.44	87,561	21.14
Total	213,954	100.00	276,650	100.00	414,108	100.00
Type of Ownership	Income	Expenditure	No. of Non-Banks		No. of Employees	
Joint Venture	7,371	4,699	10		876	
Privately Owned	21,270	16,050	20		27,255	
State Owned	9,287	4,785	5		2,740	
Total	37,928	25,534	35		30,871	

Source: Collected from Ministry of Finance publication Bangladesh, few missing data are composed from the annual reports of respective NBFIs.

Table 1 represents the position of different types of NBFIs in Bangladesh in the year 2010.

At present, 29 NBFIs are operating their business across the country of which one is government owned, 15 are privately owned local companies, and the remaining 13 are established under joint venture with foreign participation. Among all NBFIs, privately owned NBFIs hold the majority of the market share by capturing 74.74 per cent, 57.43 per cent, and 60.27 per cent of deposits, loans and advances, and assets respectively. State owned NBFIs collectively retain higher market share than joint venture NBFIs in terms of deposits and assets, but lower market share in terms of loans and advances.

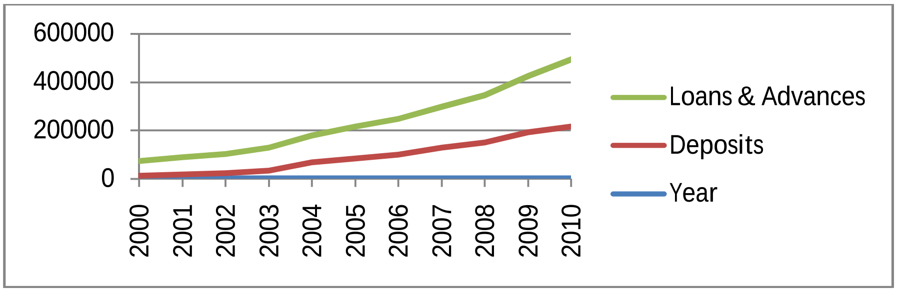
Table 2: Comparative position of different financial aspect of NBFIs over the years (From year 2000 to year 2010, (Amount in million BDT except no. of non-banks)

Year	Deposits	Loans &Advances	Assets	Investment	Total Income	Total Expenditure	No. of Employees
2010	213954	276650	414108	83751	37928	25534	30871
2009	190111	233523	361160	72158	46155	34928	30076
2008	148118.77	194821	281997.51	48825.31	39890.36	30951.88	30496
2007	126990.79	169761	246359.46	40185.03	32606	26676.35	31062
2006	100210	146688	198251	33821	27064	21485	24261
2005	82935	131687	156936	23570	22529	17684	17257
2004	67592	109506	131623	18706	17330	13212	14651
2003	32848	94523	105495	17764	15193	11886	13750
2002	22367.85	78745.02	84618.81	14812.43	13915.56	12144.08	14541
2001	17309.15	71151.9	91269.91	13715.19	11536.75	10016.78	14509
2000	12909.2	60368.99	78839.27	13153.63	9330.24	7986.11	13307

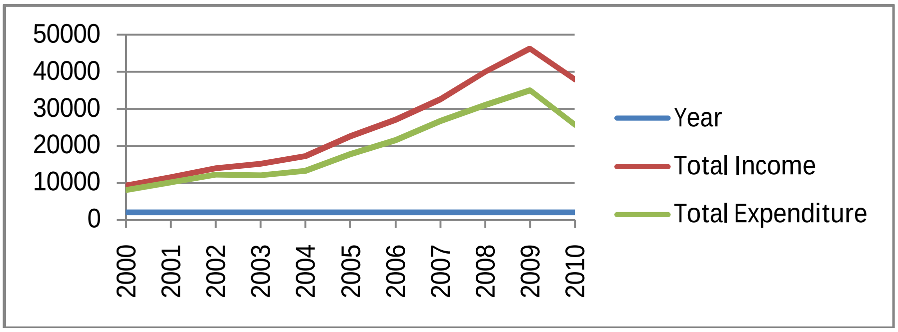
Source: Collected from Ministry of Finance publication Bangladesh, few missing data are composed from the annual reports of respective NBFIs.

Table 2 provides a comparative financial position of different years as indicators of growth over mentioned period of time. From the table it is quite clear that financial base of the non bank financial institution become well off with the channel of time.

(a) Growth overtime in Deposit and Advance:

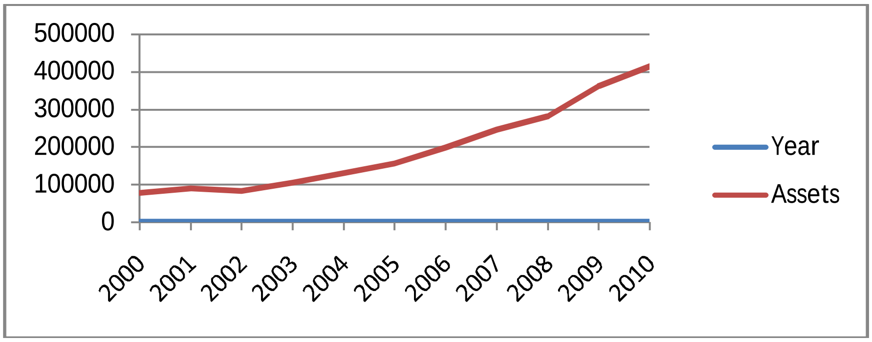


(b) Growth overtime in Total Income and Expenditure:

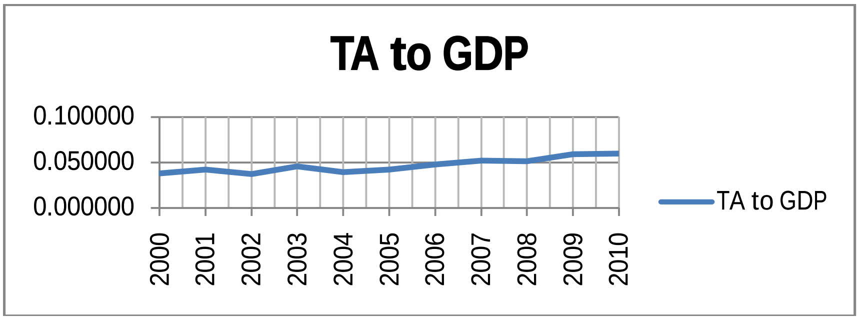


Source: Collected from Ministry of Finance publication Bangladesh,

(c) Growth of Asset over time



(d) TA to GDP ration



Source: Collected from Ministry of Finance publication Bangladesh,

Table 3: Total Assets, GDP & Total Asset to GDP ratio (All figures in Million Tk. Except Ratios)

Year	2000	2001	2002	2003	2004	2005
Total Asset	78839.27	91269.91	84618.81	105495	131623	156936
GDP	2049276	2157353	2252610	2300580	3329730	3707070
TA to GDP Ratio	0.038472	0.042306	0.037565	0.045856	0.03953	0.042334242
Year		2006	2007	2008	2009	2010
Total Asset		198251	246359.5	281997.5	361160	414108
GDP		4157280	4724770	5458220	6147950	6943240
TA to GDP Ratio		0.047688	0.052142	0.051665	0.058745	0.059642

Source: Collected from Bangladesh Bureau of Statistics (BBS) and Bangladesh Ministry of Finance (MOF).

With regard to the measure of competition, two types of approaches are commonly available: structural approaches and non-structural approaches. This paper relies on the structural approaches for assessing the competition. According to the structural approaches, a market with a high level of concentration is associated with a lower level competition and vice versa (Deltuvaite, Vaskelaitis, & Pranckeviciute, 2007; Wanniarachchige & Suzuki, 2010).Thus, these structural approaches usually link competition to concentration (Bikker & Haaf, 2002).

Pragmatic Results

The NBFIs are increasingly coming forward to provide credit facilities for meeting the diversified demand for investment fund in the country's expanding economy. According to the available data (provisional), private sector credit by NBFIs grew at the rate of 38.7 percent and stood at Tk.108.6 billion at the end of December 2008 which was Tk.78.3 billion in December 2007 The outstanding position of industrial lending by NBFIs also increased by 10.4 percent to Tk.61.4 billion at the end of December 2008 compared with Tk.55.6 billion in December 2007. However, overdue as a share of outstanding industrial loans increased to 8.0 percent in December 2008 from 6.8 percent in December 2007. This shows that the NBFIs need to streamline their loan disbursement methods with focus on low risk industrial segments and instill better monitoring mechanisms in order to reduce risks associated with their assets. Nevertheless, the contribution of NBFIs to industrial financing still remains very small. During July-December 2008, the share of the NBFIs in total disbursed industrial loans was only 4.2 percent. More than 80 percent of the loans disbursed by NBFIs were term lending as their capital structure provides better support for term financing rather than working capital financing.

Total classified loan of all NBFIs stood at Tk.7.1 billion in December 2008 against their total outstanding loan of Tk.106.1 billion showing a classified loan to total outstanding ratio of 6.7 percent which was 7.1 percent at the end of December 2007. The return on equity (ROE), which shows the earning capacity of shareholder's book value investment, shows significant variation across NBFIs. In June 2008, the highest ROE is observed for IDCOL (24.1 percent) followed by Prime Finance (22.9 percent) and DBH (20.9 percent).

On the other hand, ROEs of several NBFIs were lower than the industry average and the interest rate on deposits indicating requirements on the part of these NBFIs to access both low cost funding and ensure better portfolio management to improve performance.

Total assets of NBFIs showed a growth of 28.2 percent and stood at Tk.90.2 billion in June 2008 compared with Tk.70.4 billion in June 2007. Leased assets constituted about 36.5 percent of total 72 assets of the NBFIs while term financing and working capital generated 27.3 percent and 16.1 percent respectively. It shows that among different types of assets of NBFIs, working capital has increased significantly which indicates better capacity of the NBFIs to mitigate any financial mismatch by balancing current assets with current liabilities. However, three out of the existing 29 NBFIs showed negative position of working capital during the period which indicates that they need to be more efficient in their current liabilities and liquidity management. Up to June 2008, Delta Brac Housing (DBH), which holds about 83 percent of total housing finance of NBFIs, ranked the top in terms of share in total assets (11.2 percent) of the sector followed by the IDLC Finance Limited (9.4 percent). There exists considerable variation in terms of asset holding by NBFIs as 57.3 percent of the assets of the entire sector is accounted for by top nine of them while the bottom nine holds only 9.4 percent of total assets.

Conclusion

Mounting number of NBFIs over period indicates the esteem and acceptability of NBFIs in the financial market of Bangladesh. NBFIs functions not only provides demand side of fund a substitute sector of financing besides bank financial institution but also facilitate an sound competitive environment in the financial market.

Time-honored and highly standardized product design strategy creates a vacuity for NBFIs to widen their activities with custom design-quick adapt product strategy; more customers oriented non conventional financing activities. Role of NBFIs is also become very vital especially in the moments of economic misery that seems to be a cushion in the economy. Diversified investment sectors, long term investment plan, more customer customized products etc. contributes to the overall economic steadiness and growth of NBFIs in the economy as well mitigate systematic risk in a large extent.

The purpose of this paper is to have a close look of the structure of the financial market of Bangladesh and close surveillance of the changes of the market over time through deliberation and competition measures of NBFIs.

In this paper we have analyze the structural insights and proportionate positions and competition of NBFIs in Bangladesh firstly and then find some policy options and guidelines for the policy makers though observation of the result of empirical study. This paper observes the competition of NBFIs through structural approach in the industry as well as challenges in competition over Bank Financial institutions. Finally, mentioning the area of further study. Scarcity of fund, high cost and low-cost deposit mobilization of Bank Financial Institution lead the NBFIs in more competitive situation and influence negatively the growth of NBFIs. Government patronization, Investment friendly policy of Bangladesh Bank for NBFIs, more coordination with Bank financial institution, easy and simplified procedures of reporting to Bangladesh Bank etc. will help in NBFIs in business development and growth of the industry.

This study can be completed in two ways. Firstly, a consequent investigation can be done to make out the impact of competition on the presentation of NBFIs. Secondly, in its place of focusing only on time-honored financial indicators, the performance of NBFIs can be addresses by adopting both financial indicators and leading edge measures of performance to take hold of a clear representation.

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