Privatization, Financial Liberalization, and Bank Performance: Evidence from Bangladesh

By Md. Ataur Rahman & Md. Tarek Masud Rana

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Abstract- This study examines the impact of privatization and financial liberalization on the banking sector and the contribution of private commercial banks in Bangladesh economy. We use most of the CAMELS measures to find out the performance of sample bank categories based on capital adequacy, asset quality, management efficiency, earnings and profitability, and liquidity. We examine 495 observations collected from 55 banks including 6 state-owned banks, 40 private commercial banks, and 9 foreign commercial banks during 2009-2017. This paper mostly agrees with the existing literature that privatization and financial liberalization has a significant positive influences on banking sectors performance. This paper also discloses that private commercial banks belong the sound management skills rather than other categories of the banks except for foreign commercial banks in Bangladesh. The findings of the research will help the government and the central bank to take a crucial financial decision to improve the financial performance of the banking sector in Bangladesh.

Keywords: camels, privatization, liberalization, bangladesh.

GJMBR-B Classification: JEL Code: B26
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I. INTRODUCTION

The banking sector is the most emerging sector for every country. It is the heart of an economy like Bangladesh. To ensure the economic growth for a country or changing development scale especially developing country like Bangladesh, proper utilization of the financial resources is obligatory. Last two decades a huge number of developing, industrialized and transition countries have liberalized their financial and banking system (Fanelli and Medhora, 1998). Privatization of this sector is the prominent weapon of financial liberalization. By this way, competition will exist in the financial market and government intervention will ensure it very much. Enhancing the efficiency and performance of the banking sector privatization is the modern concept. Bangladesh government controlled this financial sector until 1982. In 1983 government initiated to inaugurate private commercial bank in Bangladesh. According to Levine (1998), banks ownership structure and industrial role in the economy is a vital variable in the way of economic growth and financial development. In a developing country, privatization of the banking sector will help to occur financial liberalization that will change the whole financial sector. World Bank stated that the privatization process made accounting system more transparent need to develop the economic performance and improved the facilities to ensure the desired goal. Overall privatization process of banking sector improves the banking facilities and efficiencies as well as it will create the opportunities. Privatization is the way of the denationalization process, changes of ownership from the public sector to the private sector. The efficiency of Public owned banks is less than that of privately owned banks (Berger et al., 2005), and publicly owned banks associated with sorry looking economic performance (La Porta et al., 2002). In the developing countries, public controlled banks may influence to less intermediation, lower employment in small enterprises and lower GDP in the economy (Berger et al., 2004). Both in developing and developed countries privatization bank supervised to be followed by (Nakane and Weintraub, 2005; Beck et al., 2005) few performance improvements. It also pronounces the procedure of renovation of companies from being publicly transacted to becoming privately held. The manner of privatization of banking sectors means the modifications of banking ownership from government to a private owner. Financial liberalization is the financial form of financial market. It was the position of the financial market when all kind of restriction of a financial market went up. The financial liberalization that took place in the developing countries in the 1980s and 1990s was part of the general transfer toward giving markets a greater role in development. Financial liberalization also the circumstance of changing of several factors in finance: exploitation, expenses and the ineptitudes involved with employing finance as a factual of populist, state-led progress, querying for financial resources, public demands for optimum finance and less hidden tax and subsidies, and heaviness on the financial system. (Hanson and Ramachandran, 1990). The interest rate, branch restraints, technological amelioration, admittance to finance, private banks, and reserve requirement will be reformed on that liberalization situation. This time interest will help to equate demand and supply of the market demand.

II. THE OBJECTIVE OF THE STUDY

To show the effect of privatization and the financial liberalization on the performance of the banking sector in Bangladesh is the core objective of this paper.
Following particular objectives also help us to ensure our main objective:

- Measuring the performance of Bangladeshi bank based on asset quality, capital adequacy level, management capability, earnings quality, and liquidity position.
- Evaluating category wise strength and weakness of bank performance operating in Bangladesh.

### III. Review of Related Literature

The efficiency of the financial arena is essential for ensuring economic growth (Levine, 1997). The function of the banking sector is to direct the proper allocation of resources and use these in the most productive sectors in an efficient way that will provide the optimum result. The contribution of the banking sector and financial institutions in economic development has been shown in lots of studies. Cornett et al. (1992) showed the performances between the public bank and privately owned bank in Thailand, Philippines, Malaysia, South Korea, and Indonesia for the period 1994–1997. In a cross-country study, La Porta and Lopez-De-Silanes, (2002) find that the performance of public banks is low than that of private banks. That study analysis has shown private owned bank had much more efficiency rather than a public sector bank. For the sake of Argentina, Clarknand Cull (2001) mentioned the way of privatization process and showed the success of the regional bank privatization depended on the usefulness of the buyers. Galal et al. (1994), La Porta and Lopezde-Silanes (2002) supported that the way of privatization procedure help to the betterment of banking performance. These authors also mention that the allocation of credit and efficiency are better in the privatized banks. Privatization of government enterprise is highly productive on the time of ownership and controlling power is switched to private sectors. This significant performance and efficiency of this sector measures among others and they are used in their literature (Perevalov et al., 2000). The government stated banks as an organ of the commanding heights procedure was supported by authors as like Lewis (2013) and Gerschenkron (1962). Gelos and Roods (2004) used the methodology to assess the competition of the transition banking sector. Different studies (Bhattacharya et al., 1997) have judgment the skill of banks using the mathematical programming strategy of Data Envelopment Analysis (DEA). Unal and Navarro (1999) showed the technical judgment of banking sector privatization in Mexico and supply a brief explanation of that procedure. They recommend that the shortage of pre-mention legal and regulatory framework was the main impediment of success in the privatization banking sectors set by the government. Meyendorff and Snyder (1997) argued that the transactional strategy of banking privatization in three nonbanks from Russia and Central Europe. Gerschenkron (1962) states that governments can control financial sectors for direct savings of the people in developmental sectors of their countries where financial organizations are not good enough developed in productive sectors. Makler (2000) stated few factors spoil the Brazilian effort to privatize the state bank. The main problem in state bank are lower competition, much political intervention and lack of corporate governance, these problems are the main obstacle of government bank success(Clark et al., 2003). Verbrugge et al. (1999) illustrated the performance of the private bank in 25 developing and growing economic countries. In their study, they find that after privatization the profitability, operating efficiency, non-interest revenue and leverage condition was improved on that particular country.

### IV. Research Methodology

#### a) Data Collection

In this study, we collected secondary data from the annual report of some specific banks during the years 2009-2017 and used to measure the performance of banks in Bangladesh. We also collect secondary data from different articles, Bangladesh Bank, and other secondary sources.

#### b) Sampling Design

We collect a sample of 495 observations from 55 banks including 6 government-owned bank, 40 private commercial banks, and 9 foreign banks during 2009-2017. For this study, the banking sector is divided into three categories. These are State-Owned Commercial Bank (SCBs), Private Commercial Bank (PCBs), and Foreign Commercial Bank (FCBs).

To find out the impact of privatization and financial liberation on the performance of the banking sector in Bangladesh, most of the CAMELS measures have been analyzed. This framework includes the analysis of five groups of measures concerning the performance of banking financial institutions. These five measures of financial ratios include:

- Capital adequacy
- Asset quality
- Management soundness
- Earnings and profitability
- Liquidity

### V. Findings and Analysis

#### a) Capital Adequacy

Capital adequacy highlights the whole capital position of the bank in the financial institution. The banks in Bangladesh are directed to maintain the minimum capital requirement, at least 10 percent of risk-weighted assets or 4 billion as capital (which one is higher). Capital adequacy of a financial institution is measured by the capital to risk-weighted asset ratio and presented in the following Table 1 and Figure 1.
From the above Figure 1, we observe that capital adequacy ratio of SCBs shows mixture behavior from 2009-2013 but gradually declining from 2013 to 2016, finally increasing in 2017. In the private sector bank, the ratio of capital to the risk-weighted asset is stable over the period of 2009-2017 and higher than SCBs. Foreign commercial bank’s capital to risk-weighted asset ratio condition is so much better than all sectors of the bank in Bangladesh. In the year 2009 the ratio is 28.1 and significantly declines to 15.5 in 2010 then shows increasing stable behavior. The foreign commercial bank is improving their performance in our country but their capital and overall contribution in our financial sector are not significant.

b) Asset Quality

Loans and advances are the key factors in the asset composition of the whole commercial bank. When management gives more focus on loans and advances, it will increase the vulnerability of asset to credit risk. Asset quality of the financial sector is the major determinant of financial health, especially of earning ability. Non-performing loan ratio is the key measurement technique of asset quality.
From Figure 2, non-performing loan to total loan ratio of SCBs is gradually increasing significantly but in 2011 it is minimum (11.3 percent). NPL to total loan ratio is also increasing gradually for both private commercial bank and the foreign commercial bank over the period but less than that of state-owned commercial banks.

c) Management Soundness

The growth of financial institution is depends on sound management system of the financial sector. The ratio of expenditure to income will help to measure the soundness of any financial institution. It is difficult to decide any conclusion on the bases of management based solely on the quantitative indicators. Qualitative competences, senior or mid-level management, response to the change in any circumstances are being considered of management soundness.

Table 3: Expenditure to income ratio (in percent) during 2009-2017

<table>
<thead>
<tr>
<th>Year</th>
<th>SCBs</th>
<th>PCBs</th>
<th>FCBs</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>75.6</td>
<td>72.6</td>
<td>59.0</td>
</tr>
<tr>
<td>2010</td>
<td>80.7</td>
<td>67.6</td>
<td>64.7</td>
</tr>
<tr>
<td>2011</td>
<td>62.7</td>
<td>71.7</td>
<td>47.3</td>
</tr>
<tr>
<td>2012</td>
<td>73.2</td>
<td>76.0</td>
<td>49.6</td>
</tr>
<tr>
<td>2013</td>
<td>84.1</td>
<td>77.9</td>
<td>50.4</td>
</tr>
<tr>
<td>2014</td>
<td>84.1</td>
<td>75.8</td>
<td>46.8</td>
</tr>
<tr>
<td>2015</td>
<td>84.5</td>
<td>75.5</td>
<td>47.0</td>
</tr>
<tr>
<td>2016</td>
<td>90.2</td>
<td>73.5</td>
<td>45.7</td>
</tr>
<tr>
<td>2017</td>
<td>87.9</td>
<td>74.5</td>
<td>45.5</td>
</tr>
</tbody>
</table>

Source: Bangladesh Bank
Table 4: Indicator of earning and profitability (in percent) during 2009-2017

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>ROA (SCBs)</td>
<td>1.0</td>
<td>1.1</td>
<td>1.3</td>
<td>-0.6</td>
<td>0.6</td>
<td>-0.6</td>
<td>-0.04</td>
<td>-0.16</td>
<td>-0.63</td>
</tr>
<tr>
<td>ROE (SCBs)</td>
<td>26.2</td>
<td>18.4</td>
<td>19.7</td>
<td>-11.9</td>
<td>10.9</td>
<td>-13.6</td>
<td>-1.5</td>
<td>-6.0</td>
<td>-19.4</td>
</tr>
<tr>
<td>ROA (PCBs)</td>
<td>1.6</td>
<td>2.1</td>
<td>1.6</td>
<td>0.9</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.03</td>
<td>0.68</td>
</tr>
<tr>
<td>ROE (PCBs)</td>
<td>21.0</td>
<td>20.9</td>
<td>15.7</td>
<td>10.2</td>
<td>9.8</td>
<td>10.3</td>
<td>10.8</td>
<td>11.1</td>
<td>7.5</td>
</tr>
<tr>
<td>ROA (FCBs)</td>
<td>3.2</td>
<td>2.9</td>
<td>3.2</td>
<td>3.3</td>
<td>3.0</td>
<td>3.4</td>
<td>2.9</td>
<td>2.56</td>
<td>2.15</td>
</tr>
<tr>
<td>ROE (FCBs)</td>
<td>22.4</td>
<td>17.0</td>
<td>16.6</td>
<td>17.3</td>
<td>16.9</td>
<td>17.7</td>
<td>14.6</td>
<td>13.1</td>
<td>10.8</td>
</tr>
</tbody>
</table>

Source: Bangladesh Bank

Figure 4: Return on asset ratio

Figure 5: Return on equity ratio

d) Earning and Profitability

Most commonly used indicator for measuring the profitability of any banking institution are the return on asset (ROA) measured by net profit divided by total asset and return on equity (ROE) measured by net profit divided by total equity. Performance of all categories of sample banks are presented in Table 4 and illustrated graphically in Figure 4 and 5.
From the above Figure 4 and 5, it is clear that the profitability ratio measured by ROA and ROE for all categories of sample bank is following the declining trend. In the case of SCBs, continuously it goes to negative figure for the last couple of years. The private commercial bank’s profitability is still a positive figure but in a declining trend. Foreign commercial bank’s profitability ratio is much stronger than that of SCBs and PCBs.

e) Liquidity

The liquidity of any financial institution can be assessed using the loan to deposit ratio. A rising loan to deposit ratio indicates liquidity problems for a bank. The liquidity position of all categories of sample banks are summarized in the following Table 5 and explained graphically in Figure 6.

<table>
<thead>
<tr>
<th>Table 5: Indicator of liquidity (in percent) during 2009-2017</th>
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<tbody>
<tr>
<td></td>
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<tr>
<td>Loan to Deposit ratio (SCBs)</td>
</tr>
<tr>
<td>Loan to Deposit ratio (PCBs)</td>
</tr>
<tr>
<td>Loan to Deposit Ratio (FCBs)</td>
</tr>
</tbody>
</table>

Source: Bangladesh Bank

From the above Figure 6, it is clear that the loan to deposit ratios of all categories of sample banks follow increasing trends from 2009 to 2014. The liquidity condition of SCBs, PCBs, and FCBs all are gradually declining from 2014 to 2017.

VI. Conclusion

We applied the CAMELS method in this study that facilitates to identify the effect of privatization and financial liberalization on the banking sector. Sample from a different bank in Bangladesh has been analyzed during 2009-2017. The result shows that the improvement of financial health due to the privatization and liberalization policies influence so far in Bangladesh. We found strongly that private bank contributes a great significance of our banking sector. Private bank overall performance is better than other sectors of the bank in our country. This privatization process and financial liberalization influence the economic growth in Bangladesh. The private banking sector is the most potential financial sector in Bangladesh to accelerate economic growth of the country.

References Références Referencias


