Growth of Non Bank Financial Institutions Over Time and Contribution to Economy: Evidence from Bangladesh

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Abstract

Non-banking financial companies, or NBFIs, are the 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. Started in 1981, the size of the nonbanking sector has been increased in both absolute and relative terms. However, the research on the sector remains substantially insignificant. Most importantly, growth of the non-banking industry and its contribution in the economic development have been a lacking in the available existing literature. Keeping this in mind, this paper aims at addressing the growth of the industry and its change over time by adopting growth measures based on asset, loan, income and expenditure figures with a sample period of 11 years from 2000-2010. 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

Index terms— development, growth and non-bank financial institutions.

1 Introduction

he 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; **??**aina & 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; **??**ittas, 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.). 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 nonbanking 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 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 nonbanking sector since the growth of NBFIs also influences the GDP growth. Finally, it will also raise some issues to deal with further researches.

The later part of this paper is organized in the following manner: section two describes the available literature concerning the growth on NBFIs over time. It also focuses on the previous studies carried out in Bangladesh to tackle the issues relating to the nonbanking sector. Section three elaborates the overview of the non-banking sector of Bangladesh. Section four introduces the data and methodology adopted for the study. Section five displays the findings and empirical results of the study and section six concludes with creating some future research opportunities.

2 II.

3 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 BFIs but with the passage of time NBFIs become an integral part of the financial system of Bangladesh. Goldsmith (1969) opine that NBFIs alongside the banking sector contributing prominently in influencing and mobilizing saving for investment Beck and Rahman(2006) has shown the robust relationship between the development of financial intermediaries and economic growth. They also added that financial intermediaries not only contribute to the economic growth but also control the reverse causation of economic growth.

Islam & Osman (2011) examined the long-run relationship between per capital real GDP and the NBFIs based on Malaysian market. They revealed that there is a long run stable relationship between per capita real employment. From their empirical result they showed that NBFIs is a vital component of the financial sector through which flow of financial resource effectively channelized from the surplus units to the deficit units and promote long-run sustainable economic growth.

Pirtea, Iovu & Milos (2008) expressed that with the development NBFIs financial system and domestic capital market also develop that in tern contribute to the overall economic developemnt of the country. Thus sustainable economic growth largely depends on the development of efficient financial intermediation.

Vittas (1997) opine that creating new marketable securities in the area of leasing, factoring and venture capital NBFIs creates long-term financial resources and provide a strong stimulus to the development of capital market.

With regard to the literature concerning the nonbanking sector, limited number of studies has been conducted so far in Bangladesh. Hossain and Shahiduzzaman (2002) focused 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. **??**ufian (2007) opine that BFIs and NBFIs enhance the overall growth of the economy with the support of efficient money and capital market and NBFIs plays important role in providing complementary facilities offered by the commercial banks. **??**ufian(2007) also opine 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 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) conducted a research on leasing companies only regarding the accounting practice. However, none of the above mentioned studies analyze the growth of the nonbanking 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.

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.

Table 1 represents the position of different types of NBFIs in Bangladesh in the year 2010. The total number of NBFIs is 35 in 2010 out of which 10 are domestic and foreign joint venture NBFIs, 20 are privately owned NBFIs, and 5 are state owned NBFIs. In 2000, the total number was 28 out of which 9 were domestic and foreign joint venture NBFIs, 14 were privately owned NBFIs, and 5 were state owned NBFIs. 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. Again proportionate incomes are -Joint venture companies 19.43 percent, privately owned companies 56.08 percent and state owned companies 24.49 percent respectively in 2010. Also expenditure proportions are 18.40 percent, 62.86 percent and 18.74 percent of joint venture, privately owned and state owned companies respectively.

4 Overview of the Non-Banking Sector of Bangladesh

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.

From the initial stage NBFIs were governed by 'Bangladesh Bank Order 1972' as per provision stated in Chapter V. In 1989 a new order Promulgated name 'Non Banking Financial Institutions Order' for proper supervision and better regulation of this 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.

IV.

5 Data and Methodology

This Study adopts cumulative measures of financial data for addressing the growth and development of financial position of NBFIs using time series analysis. Line Graphs, Ratios and Statistical measure such as Correlation coefficient used to describe the growth and development of NBFIs and show relationship between the growth of NBFIs and whole economy at large. Source : Constructed by the Authors based predominantly on Ministry of Finance publication, few missing data are collected from the annual reports of respective NBFIs.

Graph 1 : Growth overtime in Deposit and Graph 1 showing that, the gap between deposit and Loan and Advances widening in subsequent years than early years which refers NBFIs efficiency in mobilizing their deposit to investment. On the other way it can be said that NBFIs are widening their areas in giving loan and advance than before and their total amount of loan and advances also increase in recent years which is about 276.65 billion taka in 2010, more than 358.27% than year 2000. There is a very high degree positive correlation between Total asset & TA to GDP ratio. Though increment of GDP is influence by the overall performance of the economy still there is a significant relationship between the growth of an industry and GDP. Contribution of GDP from this industry (NBFIs) is about 6% refers NBFIs plays active role in the development of whole economy. From Table 3 we can say that there is a very high degree positive relationship between loan and advance and total asset, intern growth of total assets contribute in GDP.

With regard to the measure of growth & development it is mentionable that the correlation among the three areas that is correlation between Loan & Advance and Total Assets, correlation between Deposits and Investment & correlation between Total Assets and Total Assets to GDP ratios are positive. These relationships indicate that the amount of returns is backed by the proper investment which intern contributes a great role for the economic growth.

Banks & NBFIs are both the key elements of a sound and stable financial system. Banks usually dominate the financial system in most of the countries because business, household & the public sectors all rely on the banking system for a wide range of financial products to meet their financial needs. However, by providing the additional and alternative financial needs, NBFIs have already gained considerable popularity both in developed and developing countries. In one hand these institutions help to facilitate long term investment and financing, which is often a challenge to the banking sector and on the other; the growth of NBFIs widens the range of products available for individuals & institutions with resources to invest.

In this paper we have examined the correlation between loan and advances & the total assets, correlation between deposits & investment, correlation between total assets & total assets to GDP ratios. The empirical evidence suggest that the financial indicators of NBFIs, deposits, investments and total assets are in part responsible for the future change in the per capita real GDP in Bangladesh. Importantly, the results indicate that NBFIs are the dominant market players of the financial sectors through which the financial resources are effectively channeled for savers to the users in the economy.

Increasing number of NBFIs over period indicates the popularity and acceptability of NBFIs in the financial market of Bangladesh. NBFIs operation not only provides demand side of fund a alternative sector of financing besides bank financial institution but also facilitate an sound competitive environment in the financial market. Traditional and highly standardized product design strategy creates a vacuum for NBFIs to widen their activities with custom design-quick tailor product strategy; more customers oriented non conventional financing activities. Role of NBFIs is also become very vital especially in the moments of economic distress that seems to be a cushion in the economy. Diversified investment sectors, long term investment plan, more customer tailored products etc. contributes to the overall economic stability and growth of NBFIs in the economy as well mitigate systematic risk in a large extent.

In this paper, it is observed that the loan and period is increasing according to the deposits. This increased the income for the NBFIs. Again with the passage of time NBFIs become more efficient in collecting deposits from least cost sources which increase its gap between the income and expenditure.

Finally GDP in Bangladesh is increased over the last 11 This study can be extended in two ways. Firstly, instead of focusing only on traditional financial analysis, the growth of NBFIs addresses by financial growth picture of the industry, and secondly, a subsequent investigation can be done to identify the growth of NBFIs in other economic indicators like GNP, Income per capita and so on in relation with the growth of financial parameters of NBFIs. [1]

Figure 1:

[1] 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.2 BDT stands for Bangladesh Taka, and Taka is the local currency of the country.

1

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 :						

Figure 2: Table 1 :

ition of Non it -banks in 201 nks

	Deposits Depo
mount	%
16	
3	

[Note: collected from various issues of 'Bank and Financial Institutions' Activities', a yearly publication of the Ministry of Finance of the government of Bangladesh, and is published in local language in the name of 'Bank O Arthik Pratisthansamuher Karjaboli'. All NBFIs reported in this publication in a particular year are considered for that year by the present study.]

Figure 3: C

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Figure 4: Table 2

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Year	Deposits	Loans &Advances	Assets	Investment	Total Income	Total Expenditure	No. of Employees
2000	12909.2	60368.99	78839.27	13153.63	9330.24	7986.11	13307

Figure 5: Table 2 :

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Year	2000	2001	2002	2003	2004	2005
Total Asset		91269.91	84618.81	105495	131623	156936
GDP	2049276	2157353	2252610	2300580	3329730	3707070
TA to GDP Ratio	0.038474	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
Correlation between Loan & Advance and Total Assets					0.994442691	
Correlation between Deposit and Investment					0.970512149	
Correlation Between TA & TA to GDP ratio					0.98974167	

Source : Constructed by the authors based on the data of Bangladesh Bureau of Statistics (BBS) and Bangl
Ministry of Finance (MOF).

Figure 6: Table 3 :

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