

## Initial Project Information Document (PID)

**Report No: AB166**

<b>Project Name</b>	BANGLADESH-State Owned Enterprise and Banking Sector Reform
<b>Region</b>	South Asia Regional Office
<b>Sector</b>	Other industry (25%); Banking (25%); General finance sector (25%); Agro-industry (25%)
<b>Theme</b>	State enterprise/bank restructuring and privatization (P)
<b>Project</b>	P081969
<b>Borrower(s)</b>	BANGLADESH MINISTRY OF FINANCE
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### 1. Country and Sector Background

The **SOE sector** in Bangladesh consists of: (i) 41 public sector corporations and boards, having 200 subsidiary enterprises, in a wide range of sectors; two government departments involved in commercial activities; and eight public financial institutions, including four nationalized commercial banks (NCBs). In FY2000, SOE assets amounted to US\$ 16 billion or 32 percent of GDP and SOE investments were equivalent to 7 percent of gross domestic investment.

The costs of poor SOE performance have been high as its performance has been consistently poor, contributing less than 1 percent of GDP in FY2000. The net losses of the loss-making entities averaged US\$ 150 million annually during fiscal 1991-2001, with an accumulated loss of US\$ 1.66 billion, i.e. about 3.7 percent of GDP. SOEs, while being a drag on economic growth, were also a major burden on the banking sector. SOE employment has been costly for the entire economy. Until the recent closure (in FY03) of some major SOEs and the concomitant retrenchment of about 57,000 workers, there had been about 256,000 SOE workers. The factors contributing to poor performance are well-known: lack of hard budget constraints, easy access to credit, weak corporate governance, wage and employment rigidities, and weak management.

*Status of Privatization.* Governments have attempted to address the problems of the SOE sector over the past two decades. Initial moves toward disinvestment were made in the early 1980s, followed by additional privatization efforts in the early 1990s. Despite this, progress has been slow and the results limited, leaving Bangladesh behind compared to other countries in the region and in the world. Fortunately, there is now a growing consensus among different stakeholders that Bangladesh can no longer maintain its usual approach to privatization. There is also broad based support for the GOB to urgently and significantly downsize its SOE sector, including the closure of loss making units. After the present Government came to power in October 2001, it amended the privatization policy in an effort to dynamize the Privatization Commission (PC).

*Closures.* Also, given the poor response to its privatization effort, the Government has decided to take more visible and bolder steps like closing down some of the bigger and more difficult loss making manufacturing SOEs and retire the workers. Several SOEs, including the emotionally and politically charged Adamjee Jute Mills (employing over 25,000 workers) has since been closed. The closure was preceded by a transparent and efficient pay-off to the workers.

*Voluntary separation scheme.* GOB has put in place a voluntary separation scheme (VRS) for labor to help with the closure and privatization process. The package is widely accepted and the overall response has been positive, with more workers reportedly coming forward than originally targeted (in jute for example). By June 30, 2003 -- the government had provided a VRS package to 57,283 workers in the SOE sector.

*Government efforts to convert closed SOEs into productive assets.* While closing down enterprises the Government also wants to facilitate productive employment generation in the private sector. As such, it is planning to turn some of the bigger 'closed' enterprises like the Adamjee Jute Mills (310 acres of prime industrial land) and Chittagong Steel Mills (over 200 acres) into industrial parks/export processing zones so as to facilitate setting up of private industries.

**The Nationalized Commercial Banks (NCBs).** The banking sector in Bangladesh is dominated by the four Nationalized Commercial Banks (NCBs) that held 47 percent of the total industry assets as of December 2001. The four NCBs are: Sonali Bank; Agrani Bank; Janata Bank; and Rupali Bank Limited. These NCBs have been to be poorly managed, technically backward, saddled with stifling labor practices and social responsibilities, and under political interference.

The NCBs have very low net interest margin to net assets (NIMA) as their cost of funds is relatively high. They operate through an extensive branch network of more than 3,500 branches and have an excessively large labor force numbering more than 64,000 employees. At present all four of the banks are reasonably liquid. Their implicit deposit guarantee is enhanced by their government ownership, which makes their deposit base fairly stable over time. Their management, constrained excessively by their highly unionized and organized labor force, is of poor quality – with managing directors having quite short tenures.

## **2. Objectives**

The objective of this project is to trigger urgently needed reforms within the State Owned Enterprises (SOEs) and the Nationalized Commercial Banks (NCBs) -- as part of a wider reform of rolling back state ownership and control within the Bangladeshi economy.

### 3. Rationale for Bank's Involvement

The World Bank has considerable experience in privatization of SOEs around the world. It can therefore bring a considerable body of knowledge and experience to this process. As worker payouts have proved to be a big stumbling block to previous privatization and liquidations, in combination with the fiscal constraints of the Government of Bangladesh, the World Bank can bring much needed fiscal support to this highly costly (but high pay off) process. The World Bank also has considerable experience with counseling and retraining schemes for retrenched workers which could be applied in Bangladesh. With respect to banking reform, the South Asia region of the World Bank has a growing experience with Management Team undertaking restructuring work in troubled state owned banks.

### 4. Description

*i. Support to Voluntary Retirement Schemes.* So far 57,283 employees (including 25,718 in Adamjee Jute Mills) have been retrenched -- a reduction of about 17 percent – at a cost of US\$130.0 million (\$3,000 per employee). Over the next two to three years, the Government plans to retrench a further 93,000 employees from 100 units identified for privatization. The project (likely to be co-financed by DFID) will support retrenchment costs.

*ii. Retraining and Counselling Services for Retrenched Staff of SOEs.* Providing adequate counselling and re-training support to retrenched workers are important social priorities under the proposed project. The project will support this component.

*iii. Refurbishment of Abandoned Assets of Loss Making SOEs.* The Government wants to convert the closed SOEs, like the Adamjee Jute Mills (310 acres) and Chittagong Steel Mills (over 200 acres), that are not feasible for privatization in their present state or where they lacked potential buyers, into more productive industries. The Government is yet to come out with comprehensive plans and policies to facilitate alternate utilization of these assets. It is, therefore, proposed that this component support the government in developing plans for alternative use of these facilities -- including some renovation, some up-gradation of facilities, and some dismantling of obsolete equipment to make them attractive for possible private sector investment.

*iv. Strengthening of the Privatization Commission, the Board of Investment, the Export Processing Zone Authority, and the Ministry of Industry.* This component would support capacity building of the Privatization Commission, particularly in the areas of asset valuation; appraisal, monitoring and evaluation of SOEs planned for privatization, through training, services of external consultants, provision of office equipment/facilities. Similarly the Board of Investment (BOI), The Bangladesh Export Processing Zone Authority (BEPZA), and the Ministry of Industry also have important roles to play in the privatization, investment promotion, production elements of private sector activity in Bangladesh, and as such will be supported under the project.

*v. Commencing Reform in the Nationalized Commercial Banks (NCBs).* The project supports an initial program of reform in the NCB's. The specific activities agreed under the second phase for each of the four NCBs include the following:

*Rupali Bank Ltd.* -- This smallest NCB is the first candidate for privatization. The special audit initiated now will provide the true financial condition of this bank, which will then be the basis for a due diligence by an investment bank to prepare it for privatization. The cost of hiring the

investment bank will be supported by this project.

*Agrani Bank* -- To assist Agrani in formulating its resolution plan based on the results of the special audit, a management firm, whose cost would be supported under this project, would be contracted. The management firm would be bound by the interim MOU and would be entrusted to develop the business plan for moving the bank towards its ultimate resolution plan.

*Sonali and Janata Banks* -- In contrast to the Agrani Bank assistance through a wholesale management change, these two NCBs would be provided with individual management experts under specific Terms of Reference. These experts would also be bound by the interim MOUs and would assist the CEO in developing the business plan to move them towards their ultimate resolution plan.

*Staff Rationalization* -- The implementation of the resolution plans would require rationalization of existing staff at the four NCBs. To provide for an orderly exit of these staff, a separation package will be offered to permanent employees, offering benefits similar to that offered to other public service employees. The project will support the costs relating to staff rationalization.

***vi. Public Awareness, Monitoring & Evaluation, and Tracking.*** In order to deal with the negative public perception of privatization and to generate widespread support for the privatization process a public awareness campaign financed under the project. There is also a need to monitor and evaluate the reform agenda supported by this project and a small amount of funds will be dedicated to this important purpose to ensure that the project is meeting its stated aims. Funding will also be made available under the project to carry out both social and environmental tracking -- related to the privatization process.

## **5. Financing**

### **Source (Total ( US\$m))**

BORROWER (\$0.00)

IDA (\$368.00)

**Total Project Cost: \$368.00**

## **6. Implementation**

The VRS and the retraining and counselling support services will be coordinated by the Ministry of Finance. The Privatization Commission (PC) will continue with its mandate for privatization of SOEs. The restructuring of the Nationalized Commercial Banks will be led by the Ministry of Finance in consultation with Bangladesh Bank -- the central bank of Bangladesh. All components of the project will be overseen from within the Ministry of Finance.

## **7. Sustainability**

The current government appears to be strongly committed to SOE reform as demonstrated by the bold steps that it has already taken without up-front assistance from the donor community. There is every reason to believe that they will continue to support the SOE privatization program.

### **8. Lessons learned from past operations in the country/sector**

Technical assistance projects tend to have limited impact and are difficult to implement in Bangladesh. Consequently, the current operation has only limited TA components and only where there is demonstrated commitment to implement the reform agenda. This was also another reason for building in some of the Management Team TA for the Nationalized Commercial Banks into the current project rather than building it into a separate operation where it is likely to have formed the bulk of such an operation (thereby making it a high risk operation).

### **9. Environment Aspects (including any public consultation)**

**Issues** : Disposing of industrial assets may well present the Government and the project team with environmental issues. The main concern surrounds selling or re-letting assets which have been contaminated or degraded by previous industrial usage.

### **10. List of factual technical documents:**

World bank report - Bangladesh: Review of Public Enterprise Performance and Strategy, May 2003

### **11. Contact Point:**

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**Note: This is information on an evolving project. Certain components may not be necessarily included in the final project.**