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Assessing Attractiveness of Banking Industry of Bangladesh by Applying Porter's 5 Forces Model

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Abstract
Banking industry is considered as one of the most significant drivers in strengthening the soundness of an economy in terms of investment, job creation, income generation, facilitating flow of funds nationally and globally. It is assumed that the present state and attractiveness of the industry can be assessed by applying Porter's Five Forces Model. Porter's model incorporates five dimensions i.e. Competitive Rivalry, Bargaining Power of Suppliers, Bargaining Power of Buyers, Threat of Substitutes and Threat of New Entrants. It has been objectively assessed that Competitive Rivalry is negative as 57 banks operate with more than 9000+ branches where the market share is segregated. Bargaining Power of Buyers is high as the customers are very rate sensitive while Threat of New Entrants is also negative. Mobile Financial Services (MFS) are gaining huge momentum. The Bargaining Power of Suppliers is not high as there are idle fund of Tk 1140 billion and shareholders are risk averse. Threat of Substitutes is also negative considering the similar lending and deposit services by the NBFIs and MFS substituting the transfer of funds. Considering the negative dimensions (4) over positive (1), it can be inferred that currently the industry is not attractive along with other factors that have influence on the Five Forces.

Keywords: Banking Industry, Bargaining Power of Buyers and Suppliers, Competitive Rivalry, Porter's Five Forces Model, Threat of New Entrants.

JEL Classifications:L10, L22

1. Introduction
The banking industry is considered as one of the most significant drivers in strengthening the soundness of an economy in terms of investment, job creation, facilitating flow of funds nationally and globally. Similarly, the banks of Bangladesh have played their part in facilitating investment and savings as well as economic growth of urban and rural areas. The industry has grown tremendously after privatization was allowed in the eighties. After more than four decades, the number of scheduled banks now stands at 57.

However, in recent years, the growth of the profitability of the industry is in the declining trend. Besides, the industry is plagued by non-performing loan (NPL), large write-offs, scams and stagnant investment. Now, in 2016, it is imperative to ask the question whether the industry is attractive for new players or investors and what should be the strategy of the players in the particular industry considering present state of rivalry. Porter's Five Forces model gives an objective scenario of the major drivers surrounding an industry. Besides, many banks use scenario planning to anticipate and respond to volatile and disruptive environmental changes by using the model. The study is an endeavor to provide an insight in assessing attractiveness of the Banking Industry.

2. Literature Review

The Model of the Five Competitive Forces was developed by Michael E. Porter in his book, “Competitive Strategy: Techniques for Analyzing Industries and Competitors” in 1980. Since that time it has become an important tool for analyzing an industry structure in strategic processes. Porters’ model is based on the insight that a corporate strategy should meet the opportunities and threats in the organizations’ external environment. Especially, competitive strategy should be based on an understanding of industry structures and the way they change.

A survey carried out in the late 1980s revealed that only a few of the influences Porter flagged commanded strong empirical support. They asserted that despite the fact that the “Five Forces” framework focuses on business concerns rather than public policy, it also emphasizes extended competition for value rather than just competition among existing rivals, and the simplicity of its application inspired numerous companies as well as business schools to adopt its use. Porter’s Five Forces Model of competitive analysis is an illustration of how the five competitive forces can be used to explain low profitability and viable entries to an industry (Hill & Jones, 2007).

These Five Forces are the threat of new entrants, buyer power, supplier power, threat of substitutes, and rivalry among the already established firms. The intensity of these forces highly determines the average expected level of profitability in an industry and their thorough understanding, both individually and in combination, is beneficial in deciding what industries to enter, and in assessing how a firm can improve its competitive position (www.cgma.org/resources). The strength of each of the five forces is inversely proportional to the price and profits such that a weak competitive force may serve as an opportunity, while a strong one, may serve as a threat (Hill & Jones, 2007).

2.1 Threat of New Entrants

Threat of new entrants refers to the possibility that the profits of established banks in the industry may be eroded by new competitors. The extent of the threat depends on existing barriers to entry and the combined reactions from existing competitors. If entry barriers are high or the new-comer anticipates a sharp retaliation from established competitors (www.hbr.org/1979/03/how) competitive forces shape strategy threat of entry becomes low. These circumstances discourage new competitors. The major barriers to new entries are many including patents and brand identification. Besides, other major factors that control the entry of new potential competitors are: economies of scale (minimum size requirements for profitable operations), high initial investments and fixed costs, cost advantages of existing players due to experience curve effects of operation, brand loyalty of customers, scarcity of important resources such as qualified expert staff, access to raw materials and distribution channels controlled by existing players, long-term service contracts, high switching costs for customers, significant impact of government action etc.

2.2 Bargaining Power of Buyers

Buyers may threaten an industry by forcing down prices, bargaining for higher quality or more services, and playing competitors against each other. This consequently reduces profitability. The power of each buyer group depends on the attributes of the market situation and the importance of purchases from that group compared with the overall business industry. Buyers of banking services are institutions, organized groups, Non-Governmental Organizations, Faith Based Organizations, Community Based Organizations and individual clients.

2.3 Bargaining Power of Suppliers

Suppliers can pressurize an industry through price increments or quality reduction of the purchased products. Powerful suppliers can squeeze the profitability of banking industry so far that they can't recover the costs of raw material inputs. They are companies that supply raw materials, equipment, machinery, associated services and labor. Suppliers of banks may include trade unions for the supply of labor force, Automated Vending Machine suppliers, cleaning services, IT consultants, marketing agents just to mention. (Dagmar, 2001).

2.4 Threat of Substitute Products

Each bank within the industry compete with other banks producing substitute products and services because substitutes reduce the potential returns of an industry by placing a ceiling on the prices that banks in that industry can profitably charge. Identifying substitute products involves searching for other products or services that can perform the same function as the industry’s products (www.simonfoucher.com). Similarly to the threat of new entrants, the threat of substitutes is determined by factors like brand loyalty of customers, close customer relationships, switching costs for customers, the relative price for performance of substitutes, current trends.

2.5 Rivalry among established firms

Rivalry is the competitive struggle between banks in an industry to gain market share from each other (Hill & Jones, 2007). It is competing for position whereby banks use tactics like price competition, advertising battles, product introductions, quality competition and increased customer service or warranties (Hill and Jones, 2007). The competitor is the first to be dealt in competitive environment.

2.6 Statistical Analysis

An analysis of the Five Forces allows determining the attractiveness of an industry. It provides insights on profitability. Thus, it supports decisions about entry to or exit from and industry or a market segment. Moreover, the model can be used to compare the impact of competitive forces on the own organization with their impact on competitors. Competitors may have different options to react to changes in competitive forces from their different resources and competences. This may influence the structure of the whole industry.

3. Objectives of the Research

The broad objective of the study is to assess the attractiveness of the Banking Industry of Bangladesh.

Specific Objectives of the Study are to assess the

- The competitive rivalry
- Bargaining power of suppliers and customers
- Threats of substitutes
- Threats of new entrants

4. Methodology of the Research

As the objective of the study is exploratory in nature, mainly qualitative research methods have been applied to accomplish the objectives of the study.

Non-probability sampling, specifically judgmental sampling has been used. Twenty (20) selected PCB's reported data have been used to draw insight.

5. Findings

5.1 Background of the Banking Industry of Bangladesh

Four major types of banks operate in the banking industry of Bangladesh. These are:

- State Owned Commercial Banks (SOCBs)
- Specialized Banks (SDBs)
- Private Commercial Banks (PCBs)
- Foreign Commercial Banks (FCBs)

PCBs have been playing a major role in accelerating the banking channels' facilities to the population. As we can see from the following TABLE 1, more than 60% assets and liabilities are represented by 39 PCBs, we can analyze the industry structure significantly by focusing on this type of banks.

Table 1: Assets and Liabilities held by Bank Types

Bank Types	**No of Banks**	**No. of Branches**	**Total Assets (billion Tk)**	**% of Assets**	**Total Liabilities (billion Tk)**	**% of Liabilities**
SCBs	6	3669	2755.7	28.4	2105.4	28.4
DFIs	2	1405	289.4	2.9	226.1	3.1
PCBs	40	3982	6130.5	63.3	4743.5	64.1
FCBs	9	75	518.2	5.4	331.5	4.4
Total	**57**	**9131**	**9693.8**	**100**	**7406.5**	**100**

Source: Annual Report, Bangladesh Bank (2014-2015)

5.2 Assessing the Competitive Rivalry

If a high concentration of market share is held by the largest firms - the industry is concentrated. With only a few firms holding a large market share, the competitive landscape is closer to a monopoly. A low concentration ratio indicates that the industry is characterized by many rivals, none of which has a significant market share. These fragmented markets are said to be highly competitive.

Table2: Operating Profits of Selected 20 PCBs in 2015

SL	**Name of Banks**	**Operating Profit 2015(in Crore BDT)**	**% of Profits**
1	Islami	1807	16.09%
2	Southeast	835	7.43%
3	UCB	833	7.42%
4	Pubali	795	7.08%
5	AB	760	6.77%
6	DBBL	670	5.96%

SL	Name of Banks	Operating Profit 2015(in Crore BDT)	% of Profits
7	EXIM	660	5.88%
8	AlArafah	649	5.78%
9	Prime	634	5.64%
10	Bank Asia	605	5.39%
11	SIBL	580	5.16%
12	Dhaka	519	4.62%
13	NCC	419	3.73%
14	IFIC	406	3.61%
15	MTB	303	2.70%
16	Shahjalal	275	2.45%
17	Premier	225	2.00%
18	Union	112	1.00%
19	South Bangla	81	0.72%
20	Meghna	65	0.58%

5.3 Rule of Three and Four

BCG founder Bruce Henderson generalized an observation as the Rule of Three and Four: a stable market will not have more than three (3) significant competitors, and the largest competitor will have no more than four times the market share of the smallest. From Table 2, the three firm's concentration ratio i.e. (Islami+ South East+ UCB) is around 31% which shows that the industry is not highly concentrated. Besides, the largest shareholder among the sampled 20 Banks (Islami Bank) have more than 30 times profit share than that of the smallest market share holder (Meghna) among the selected banks. Hence, the banking industry is a highly competitive one characterized by sharing of small slice of profits.

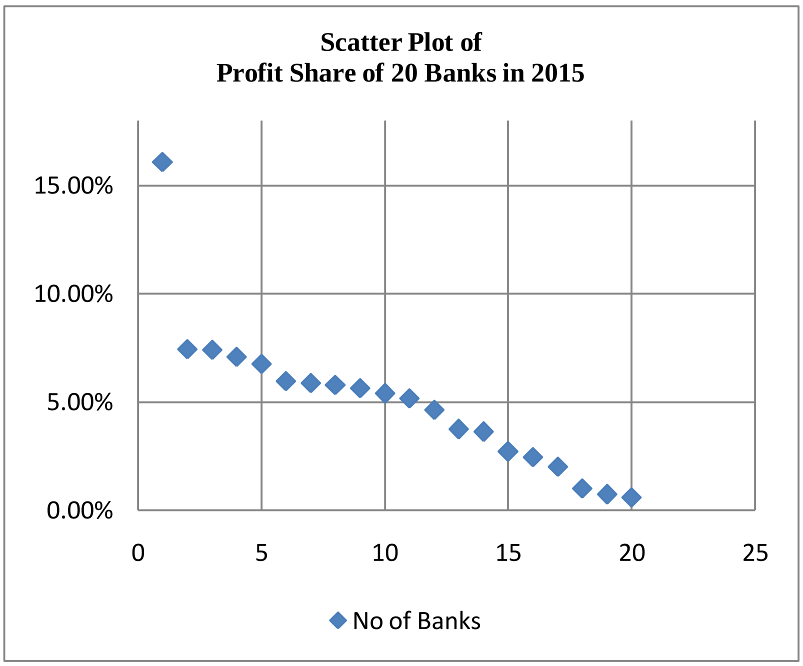


Figure 1: Scatter Plot of Profit Share of 20 Banks

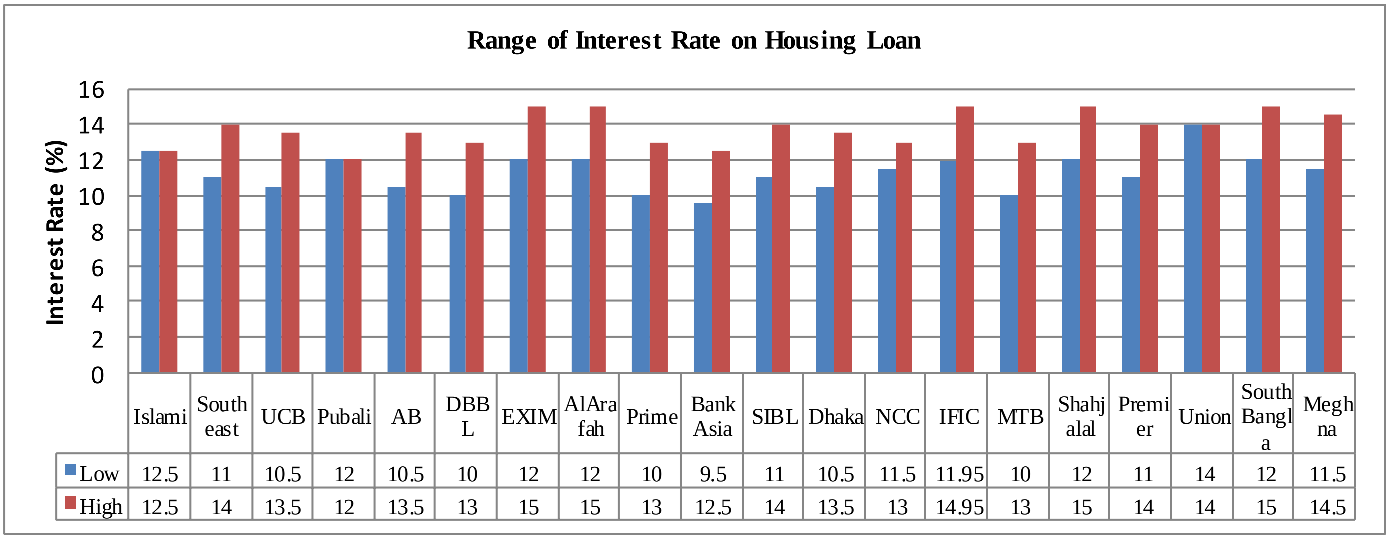
The Figure 1 also confirms this scenario as it is observed that except for 16% market share of Islami Bank, no bank has any significant market share. Rather, ten (10) banks are sharing their profit within 5% i.e. large number of firms competing for similar share of profits. This situation can be regarded as a segregated banking industry where the industry is characterized by many rivals, none of which has a significant market share.

5.4 Bargaining Power of Buyer

In Bangladesh, the volume of buyer is huge in the financial sector. Only in the banking industry, formal bank accounts exceed 5.5 crore in more than 9,000 branches.

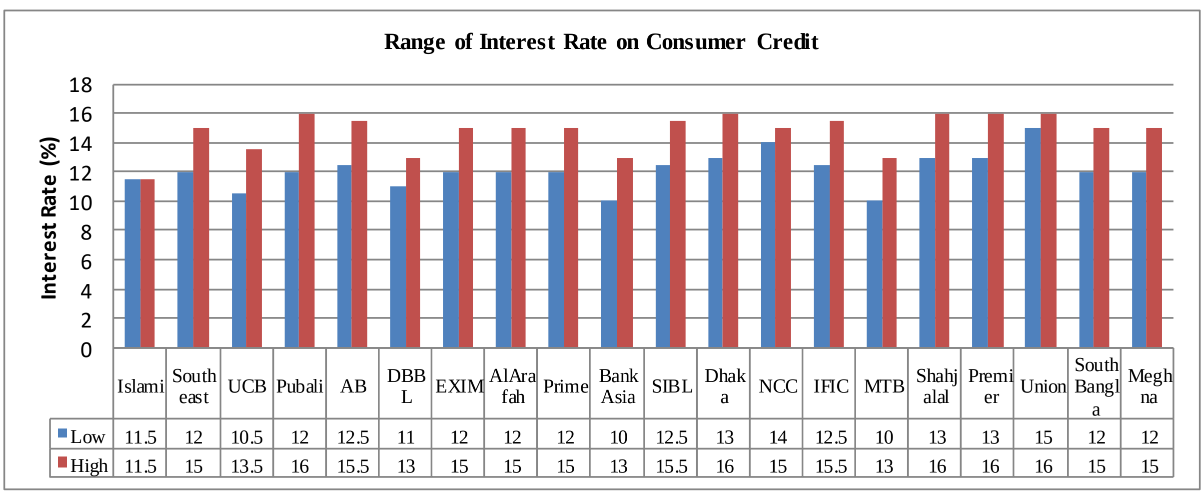
Table 3: Bank Account Statistics in 2015

Banking Account Statistics 2015		
No of Formal Banking Acct (in Crore)	No of Mobile Acct (in Crore)	Total Bank Acct (approx.) in Crore
5.5	3.19	9



	Islami	South east	UCB	Pubali	AB	DBB L	EXIM	AlAra fah	Prime	Bank Asia	SIBL	Dhaka	NCC	IFIC	MTB	Shahj alal	Premi er	Union	South Bangl a	Megh na
Low	12.5	11	10.5	12	10.5	10	12	12	10	9.5	11	10.5	11.5	11.95	10	12	11	14	12	11.5
High	12.5	14	13.5	12	13.5	13	15	15	13	12.5	14	13.5	13	14.95	13	15	14	14	15	14.5

Figure 2: Range of Interest on Housing Loan



	Islami	South east	UCB	Pubali	AB	DBB L	EXIM	AlAra fah	Prime	Bank Asia	SIBL	Dhak a	NCC	IFIC	MTB	Shahj alal	Premi er	Union	South Bangl a	Megh na
Low	11.5	12	10.5	12	12.5	11	12	12	12	10	12.5	13	14	12.5	10	13	13	15	12	12
High	11.5	15	13.5	16	15.5	13	15	15	15	13	15.5	16	15	15.5	13	16	16	16	15	15

Figure 3: Range of Interest on Consumer Credit

For understanding the pricing strategy of banking products, two most widely used loan products such as Housing Loan and Consumer Credits (Car Loan, Salary Loan, Any personal Loan etc.) have been analyzed. It is observed that in case of housing loan, most bank's interest rate ranges in between 10-14% (82% observation lies within this range). In case of consumer credit, the interest rates range in between 12-15% (70% observation lies within this range). Thus, the products are mostly similarly priced with almost similar features. It also signals that the customers are very rate sensitive as they have many alternative options.

Considering the huge volume and non-differentiated products, the bargaining power of buyer is high, specifically for the following reasons:

- Switching to an alternative product is relatively simple and is not related to high
- Customers have low margins and are price-sensitive

5.5 Threat of New Entrants

The Banking industry is a highly regulated one with many laws and regulations imposed by the Bangladesh Bank (BB). The minimum capital and reserve fund requirement is Tk 400 Crore and the paid up capital is Tk 200 Crore. Though the entry barrier has been increased it has not stopped banks entering in the industry. Since 1972-2016, the banking industry's number of players is 57 banks. However, more significant than the growth of conventional banks, another major threat is the advent and growth of Mobile Financial Services (MFS).

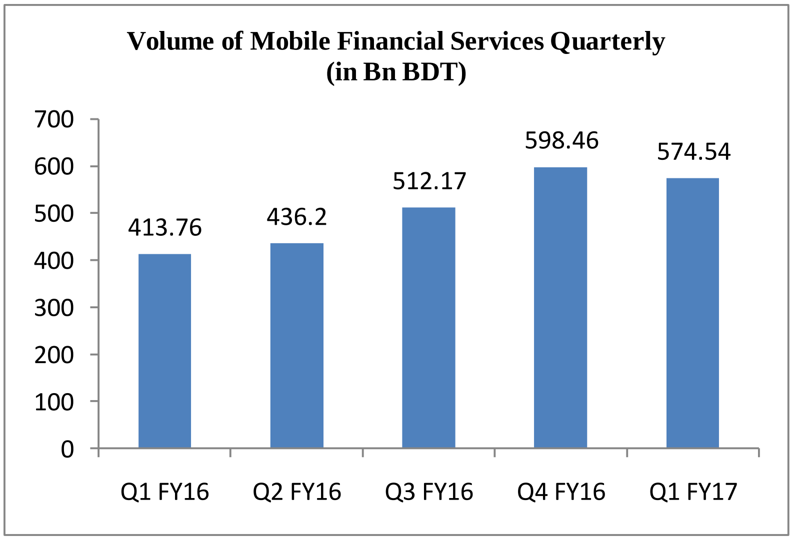


Figure 4: Volume of Mobile Financial Services Quarterly

Mobile banking has seen an unprecedented growth in recent years. According to the Bangladesh Bank data, the industry saw BDT 1.96 trillion in transactions through mobile phones in 2016 which was 53% up from the previous year. There are about 3.19 crore mobile banking accounts. New entrants such as bKash changed major determinants of the market environment (e.g. market shares, pricing, and customer loyalty). As a result, banking industry is under a latent pressure to develop and market their bank branded mobile financial services. Dutch-Bangla Bank is the second largest player in mobile money transactions in the country, holding a 9 percent market share while bKash is the market leader, with a 90 percent share

With the supportive regulatory framework of Bangladesh Bank, bKash has played huge role in over-the-counter mobile money transactions. Now depositing, withdrawing and transferring money can be done with handset. Moreover, utility bills and payment for goods and services are transacted through this service. Besides, remittance can also be received through this mobile financial service. For e-Commerce in Bangladesh, bKash has become the second biggest payment process in recent years. Such technology has shrunk the importance of banking channels in money transfer mechanism which is one of the ancillary services of Banking. MFS has impact over the banking industry on the following factors:

- Customer's dependency on Branch and ATMs for money transfer
- Customer's dependency on Bank's card
- Bank's pricing strategy for money transfer services
- Bank's acquisition of low cost deposit
- Tapping the rural customers' deposit with huge scale and network
- Remittance services

As a result, we see proliferation of mobile financial services by the banks signaling more competition for collection of deposits. Considering all these factors, the threat of new entrants is negative.

5.6 Bargaining Power of Suppliers

If we consider depositors/stockholders as suppliers of capital, it can be argued that no single customer can pose such a threat a bank will feel unbearable. As a matter of fact, the banking industry is sitting on idle cash. In 2005, the industry ended with Tk 1 trillion idle cash. As of April 2016, surplus liquidity with banks stood at Tk 1.140 trillion. Considering this scenario, the following factors prove that bargaining power of suppliers is favorable i.e. positive for the banking industry:

- The market is dominated by many suppliers rather than a fragmented source of supply
- There are substitutes for the particular input,
- The suppliers' customers i.e. banks are concentrated i.e. they provide more or less similar rates for deposits,
- The switching costs from one customer to another is not high
- Supply of labour force, Automated Vending Machine suppliers, cleaning services, IT consultatns, marketing agents are sufficient.

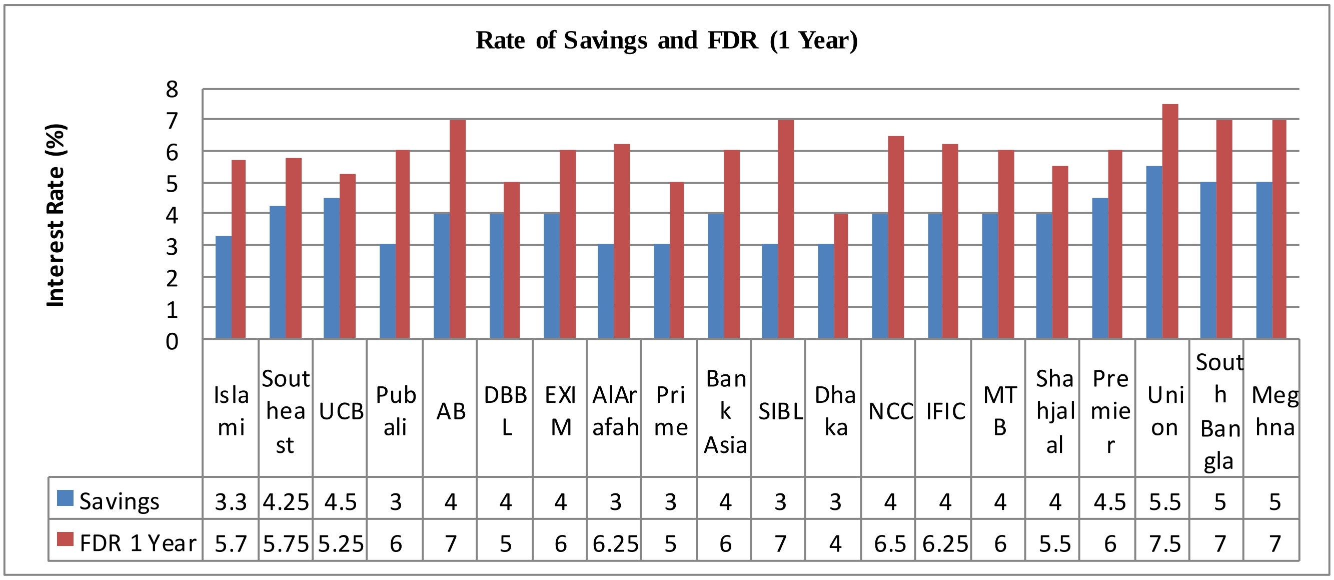


Figure 5: Rate of Savings and FDR

In case of savings, it is observed that most banks are offering interest at 4% while for FDR of more than 1 year, the interest rate is 6% for most banks. There are no significant variations in the rates offered and thus clients appear indifferent regarding switching.

5.7 Threat of Substitutes

Besides, 9000+ bank's branches, there are 18,000 branches of NGO-MFIs, 1,200 thousands post offices and 183,000 co-operative outlets totaling about 2.1 lakh branches/outlets for the 56.6 million economically active population - generating at least one financial service point per 270 people. Banks are mainly in deposit collection and lending services, and as explained in the threat of new entrants, ancillary services such as collection of deposits are being replaced by mobile banking financial services. Utility services, remittance services are also being slowly replaced by the mobile based financial service provider. Cards business and alternative delivery channels are also seeing a massive pressure from substitutes like bKash, internet banking. Virtual payment system such as PayPal is underway. All these mechanisms surely pose a threat in the role of transfer and collection of deposit. Due to the high investment cost incurred for the Banks in operating branches and ATMs, it is difficult for banks to give up the model and pursue similar strategies of mobile based financial services.

In case of lending services, Non-Bank Financial Institutions' (NBFIs) role is gaining importance. NBFIs are financing large projects sometimes with almost same lending rate of commercial banks. Not only corporate clients, the NBFIs are offering lending services for House Loan, Car Loan etc. Leasing services, insurance services with different deposit plans, mutual funds etc. are provided by the NBFIs which make the entry into the banking industry very competitive. Considering all these, the forces behind threat of substitute is negative.

6. Conclusion

It is obvious that Porter's Five Forces Model gives a bird's eye view of the competition, opportunities and in turn attractiveness of the banking industry. By this exploratory study, it may be concluded pertinently that factors of competition such as similar pricing of products and services, cut-throat competition, evolution and dominance of Mobile Financial Services, threat of substitutes pose a very strong rivalry for the existing competitors and upcoming players. Thus, riding on the current trends and achieving economies of scale will be a priority in the coming days as loyalty of the customers will be harder as switching cost will be lower. Players in the industry should periodically undertake such studies to determine the effective strategies for achieving competitive advantage.

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