

ADB

BANGLADESH
Quarterly
Economic
Update

March 2007

Asian Development Bank

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Asian Development Bank
March 2007

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NOTES

- (i) The fiscal year (FY) of the Government ends on 30 June.
- (ii) In this report, "\$" refers to US dollars.

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MACROECONOMIC DEVELOPMENTS

Highlights

- Gross domestic product (GDP) is projected to grow by 6.5% in FY2007.
- Increasing traffic is creating an enormous challenge for the country to improve the capacity of the Dhaka–Chittagong Transport Corridor.
- Despite prudent fiscal management, revenue collection continues to be disappointing.
- Even with a cautious monetary policy, broad money growth remains high because of excess liquidity in the banking system.
- Robust growth in overseas workers' remittances contributed to the higher current account surplus, offsetting the increased trade deficit.
- Inflationary pressures heightened with accelerating food prices.

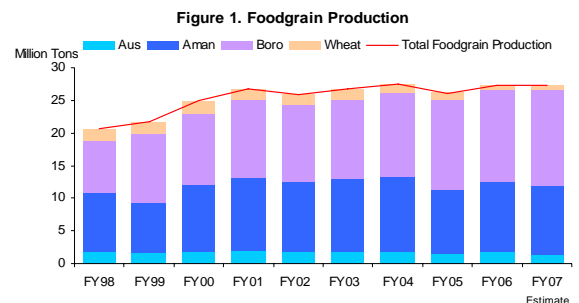
Sectoral Performance and Economic Growth

1. The economic performance continues to remain strong, driven by improved domestic and external demand. The growth is supported by a dynamic garment sector, and acceleration in private consumption, bolstered by a record increase in overseas workers' remittances.

Agriculture

2. *Aus*, the first rice crop of the year, was planted on 0.9 million hectares. Production of 1.51 million tons was 13.7% less than the 1.75 million tons in FY2006. This was the result of insufficient rain during the flowering stage of the crop and continued diminishing area of cultivation, giving way to competing and more profitable crops and vegetables such as *boro* (winter rice crop), maize, summer vegetables, and spices.

3. *Aman* (summer rice crop) was cultivated on 5.3 million hectares, slightly less than the 5.4 million hectares planted in FY2006. But the yield rate was stable. *Aman* cultivation was hampered in many parts of the country by the drought during the full transplant period and shortage of fertilizer, insecticide, and other inputs. In addition, the price of diesel was high and the supply of electricity inadequate for the operation of irrigation pumps. This year's *aman* production is estimated at 10.6 million



tons, a decrease of 1.9% from the 10.8 million tons produced in FY2006.

4. The planting of the boro crop, which is traditionally the largest crop of the year, is complete. Encouraged by higher domestic prices, farmers have brought more land under boro cultivation. The Department of Agriculture Extension (DAE) set an all-time record boro farming target this season following bumper production of the crop last year. DAE and other government agencies encouraged the use of high-yielding variety seeds by ensuring adequate supply of seeds and necessary inputs, including fertilizer and insecticide. Plantation areas under boro crop increased to 4.4 million hectares, an increase of 7.3% over FY2006. Despite the sterility of paddy reported in some districts and disruption in the delivery of key agricultural inputs, notably diesel and fertilizer, the boro crop is estimated at 14.5 million tons, compared with 14 million tons in FY2006, provided that weather conditions remain favorable.

5. Because of the increasing commercial viability of maize cultivation compared with wheat, farmers are substituting maize for wheat in their crop rotations. But maize production still remains very low. The area under wheat cultivation has declined, and along with an unusually long dry spell and high cost of production, wheat production is likely to decrease. Wheat production is estimated at 0.67 million tons, down from 0.74 million tons in FY2006.

6. Agriculture growth during FY2007 is set to moderate from the postflood high growth of FY2006 (Figure 2). Latest estimates of summer and winter crop production suggest that the total production of food crops will be about 27.3 million tons, about the same as in FY2006. The outlook for summer fruits, pulses, winter vegetables, spices, and fisheries is promising.

Industry and Services

7. The industry sector continues to maintain robust performance because of steady growth in export-oriented manufacturing. The services sector is also expanding in line with rapid growth in industry (Box: Mobile Phone Market). Manufacturing sharply rebounded as implied by the turnaround in manufacturing exports, imports of industrial raw materials and capital machinery, and expansion of industrial credit.

8. Measured by quantum indices, output of medium-sized and large manufacturing enterprises expanded by 11.2% during the first 7 months (July–January) of FY2007, compared with the same period in FY2006 (Figure 3). The increase in production was broad-based covering both export and domestic market-oriented enterprises. The output of small-scale manufacturing also

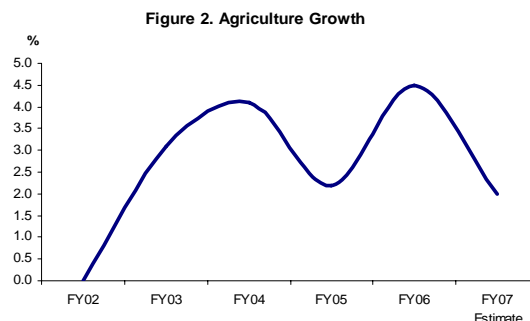
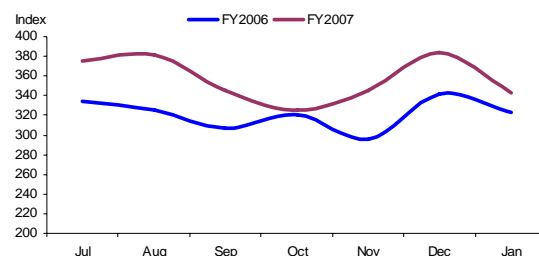


Figure 3. Quantum Index of Medium & Large Scale Manufacturing Production (Base: 1988-89=100)



registered strong performance with first half of FY2007 production increasing by 11.2% compared to the same period of FY2006 (Figure 4). Although growth in manufacturing is encouraging, production could be higher if infrastructure bottlenecks are addressed, particularly power shortages.

9. The garment industry continues to thrive, driven by robust growth in knitwear and woven exports. So far, the phaseout of the multifiber arrangement (MFA) has not had an adverse impact on the industry. During July–February of FY2007, exports of knitwear and woven garments increased by 26% and 19% over the same period of FY2006. The political disruption and blockades at the end of 2006 resulted in some order cancellations and the withdrawal of potential buyers, thus reducing anticipated growth. But the improved political situation and rapid turnaround in port efficiency after the transfer of the container terminal to the private sector is expected to yield better results in the coming months. With the streamlining of customs, easing of banking, and upgrading of infrastructure including port services, industry is optimistic about doubling garment exports in 3 years.

10. The country’s economy relies too heavily on the garment industry for foreign exchange earnings, jobs, and income. Knitwear and woven garments together account for 76% of the country’s export earnings (Figure 6). From its current position, the garment industry cannot afford to be sidelined, as the economywide effect would be devastating. With the MFA phaseout and countries like the People’s Republic of China (PRC) and India building strong capacity, a substantial part of the Bangladeshi workforce risks job loss if the industry fails to remain competitive. The industry may face another challenge if the United States Congress passes the antisweatshop bill, which seeks to impose a ban on the sale of imported products made in factories with labor or social compliance issues.

11. The garment industry needs to improve its international market orientation and its ability to cope in the fast-changing environment. Image building and branding can achieve high value addition and strengthen the industry’s international reputation as a quality supplier of apparel. Investments in skills, design, and advertising are essential to develop reputed Bangladeshi brands and designer items. With major buyers and vendors repositioning themselves to minimize total cost, Bangladesh must not rely only on labor cost as its core competency. To maintain its strong position in the market and reduce risks, the country needs to diversify its apparel products. At present, a small range of products such as shirts, trousers, T-shirts, sweaters, and jackets make up more than 60% of exports. Vigorous marketing efforts are needed to enter markets for other products that Bangladesh can produce competitively. Apart from the European Union and United States, which absorb the major share of Bangladesh

Figure 4. Quantum Index of Small Scale Manufacturing Production (Base: 1995-96=100)

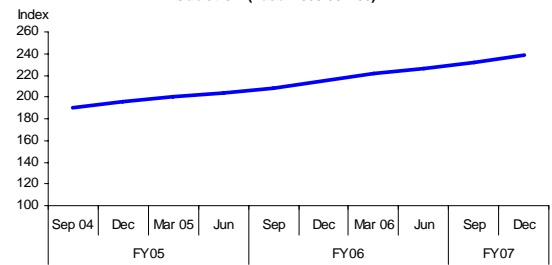


Figure 5. Growth in Exports

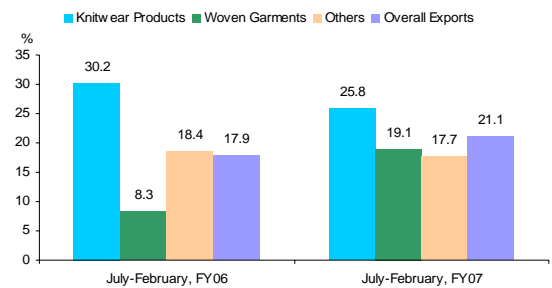
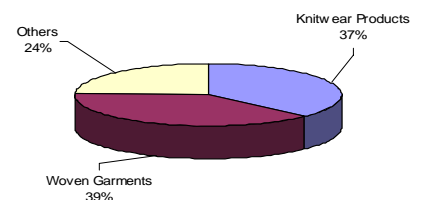


Figure 6. Share of Exports (Jul-Feb, FY07)



exports, other potential markets need to be aggressively pursued. Japan, which is one of the largest importers of readymade garments, holds enormous potential. Bangladesh needs to penetrate this market, but faces stiff competition from the PRC. East Asia and other growing markets, such as, Australia, New Zealand, and Norway need to be exploited to their full potential.

Mobile Phone Market

Mobile telecommunications, supported by a network covering about 97% of the country’s population and 82% of the land area, has become one of the most vibrant services subsectors in the economy. The number of subscribers doubled in 1 year—up from 11 million in 2006 to about 22 million in March 2007, and is forecast to increase to 44 million by 2009. Investment in the mobile phone industry amounts to about \$3.4 billion. This industry directly employs 14,000 and indirectly creates jobs for 650,000. The prompt increase in mobile phone subscriptions has raised the country’s telecommunications density to about 16% from only 7% a year ago. This hugely benefited residents of remote areas who were previously marginalized from availing of the service. A major increase in foreign direct investments by large multinational telecommunication companies coupled with good initiatives by local entrepreneurs rapidly propelled the industry forward. The huge demand for mobile phones followed deregulation of telecommunications and the development of partnerships of private mobile phone companies with experienced international operators. Given the limited capacity of the fixed-line telephone system, serving only slightly more than 1 million subscribers, mobile phone companies have the opportunity to cater to a robust market.

Availability of phones in rural areas has created new opportunities for income generation through self-employment by providing villagers with access to modern information and communication technologies. This helps boost the income of poor households by providing real-time business and market information, promoting health care awareness, developing agribusiness, and raising social status. It also enables migrant family members working internationally to stay in touch with relatives and friends. Innovative value-added services such as community information centers—providing Internet access, voice communications, videoconferencing, and other information services in rural areas—have facilitated improved connectivity and faster access to information. Health information services offered by some operators, which allows registered subscribers to consult a licensed physician for general or emergency medical advice, is adding huge benefits to customers living in areas with inadequate health care facilities. Other information such as listings of medical centers and pharmacies, and short messaging of pathology/radiology tests from selected diagnostic centers are making life easier for many. It has broadened access to banking, education, and entertainment services.

Rapid growth in the mobile industry has enticed a new UAE-based operator—Warid Telecom—to obtain a license and invest; it will commence operations shortly. Collaboration with companies with global exposure has helped the industry bring more modern technologies and business management expertise. This has translated

Figure 7. Mobile Operators’ Market Share

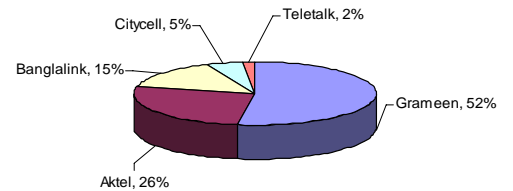
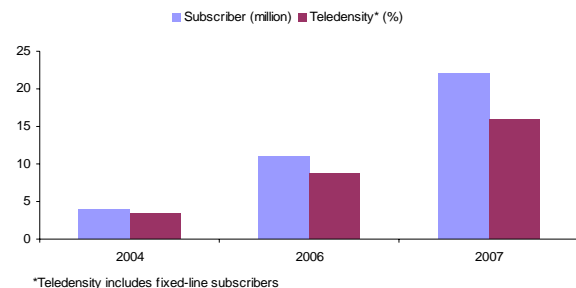


Figure 8. Mobile Subscriber and Teledensity



*Teledensity includes fixed-line subscribers

into a reasonably good quality service and robust turnover. Healthy competition among multiple operators, namely Grameenphone, Aktel, Banglalink, Citycell, and Teletalk, has significantly driven tariffs down in the past few years, largely benefiting end-users. Large turnover companies with rapid growth can also help boost the country's capital market by selling shares through initial public offerings.

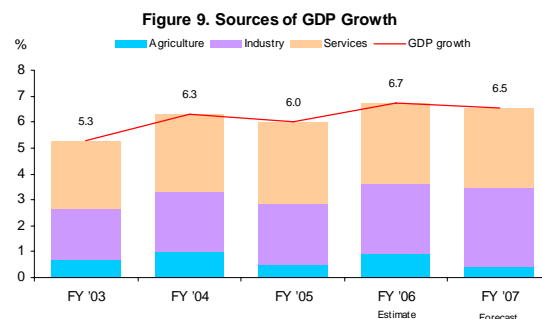
Improving the quality of the network nationwide and offering affordable prices to the poor still remain the major challenges for the mobile phone industry. The commencement of operations by the sixth UAE-based operator is expected to intensify competition and push an industrywide price cut; as well as improve network quality. The community information services network needs to be broadened nationwide to cater to the huge information needs of rural subscribers. These outlets, equipped with computers, printers, and Internet access, can be used as workers' remittance distribution centers to strengthen remittance flow through the formal channel. A huge amount of remittances still enter the country through informal channels, primarily because of inadequate bank branches in rural areas, depriving the economy from the benefits of remittances. The Philippines has been a major success in implementing a mobile phone-based remittance distribution system, which can be remodeled in Bangladesh. This can ensure safer and faster delivery of remittances through the legal system and reduce illegal transfers.

To channel more investments into the mobile business, the regulators need to foster a rational and transparent regulatory regime and an investment-friendly climate. Policies need to be consistent and predictable to create equal opportunities for all operators in the public and private sectors. Setting up the Bangladesh Telecommunication Regulatory Commission (BTRC) was a positive step. As the watchdog, BTRC needs to ensure that a stable and enabling environment is maintained, and rapid policy changes that discourage investments are not made.

While the mobile phone business generates high revenues and employment in the country, it also calls for large and continuous investments in network infrastructure and technology development. An encouraging sign is that the major companies are reinvesting to finance expansion and growth to provide better services. With this encouraging growth in the mobile sector, the telecommunication density of Bangladesh will continue to increase rapidly, stimulating the growth of other businesses.

Economic Growth

12. GDP is projected to grow by 6.5% in FY2007, down from 6.7% in FY2006 because of moderating agricultural growth following the postflood high growth of FY2006 (Figure 9). Industry continues to grow steadily—a tribute to strong performance in export-oriented manufacturing. In line with this, the services sector is expected to record strong growth. The country faces several downside risks in its near- to medium-term prospects. These include political disruption affecting the economy and



infrastructure constraints. The country needs to significantly improve infrastructure, including power and transport, to sustain higher GDP growth over the medium term.

13. Infrastructure is the key challenge to sustainable growth in Bangladesh. Adequate, modern, and well-maintained systems of transport and other essential services are the major requirements for the country to achieve its optimum potential. Transport networks are vital to provide access to local and global markets, support private sector development, and create opportunities for citizens—especially those in poor and remote communities—to participate in economic growth and improve their standard of living.

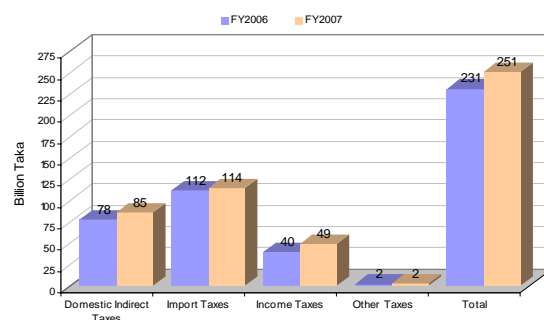
14. The country is facing an enormous challenge to improve the capacity of the Dhaka–Chittagong Transport Corridor to meet the demands of accelerating traffic (pages 12–17). Freight traffic through this corridor is expected to grow at sustained rates of more than 8% a year in the coming decade. Serious weaknesses in the corridor’s transport logistics have impeded its ability to take what could be a crucial facilitating role in expansion of the country’s external trade and in regional transport connectivity. The corridor is facing serious congestion problems because of shortage of capacity and inefficient operation. These may be costing the country 20% of its foreign trade potential and reducing potential GDP growth by 1%.

15. Bangladesh needs a comprehensive development strategy for the Dhaka–Chittagong Transport Corridor, which provides potential subregional linkages to Myanmar, Thailand, PRC, northeastern states of India, through Jamuna Bridge and the proposed Padma Bridge to West Bengal, and to Bhutan and Nepal through India. Because of its strategic location, this corridor can play a significant role in the subregional transportation system by providing direct and shorter transport links by rail, water, and road. Developing a multimodal transportation system combining road, rail, ports, and inland water will help increase export-led growth in Bangladesh, and its integration with South Asia and beyond.

Fiscal Management

16. Despite prudent fiscal management, revenue collection continues to be disappointing. Revenue collection by the National Board of Revenue (NBR) during July–March FY2007, increased by only 8.5% compared with the corresponding period of FY2006 (Figure 10). Political disruption during October 2006 to early January 2007 in the lead-up to the formation of the caretaker Government and related uncertainties slowed economic activity and contributed to revenue shortfall.

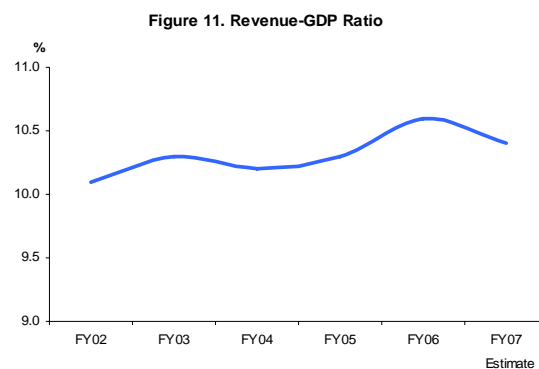
Figure 10. Revenue Collection by NBR (Jul-Mar, FY'06 & FY'07)



17. During July–March FY2007, growth of import-based taxes declined sharply to only 2%. While domestic indirect taxes increased moderately at 10.1%, income taxes recorded healthy growth of 23.2% and other taxes 19.1%. Among the import-based taxes, supplementary duties recorded the worst performance with minus 26.3% growth, while both import value-added tax (VAT) and customs duty grew by only 5.4%. Reductions in customs duty and supplementary duties affected collection at the import stage. Withdrawal of the supplementary duty and imposition of specific duty on sugar with reduced incidence, affected revenue. The reduction of supplementary duty on motor vehicles and other items from 35% to 25% and for certain other items from 25% to 15% reduced collection on these accounts. Reduction of customs duty on pulses, peas, ginger, and spices first from 13% to 5% and then to 0% (from September 2006) affected collection of customs duty. Imports with a zero rate of duty and those cleared without duty (under bonded warehouse) increased compared with the same period of the previous year. Import growth was also higher for items with lower rates of duty. Duties and taxes unpaid by the Bangladesh Petroleum Corporation on petroleum and petroleum products cleared from customs also reduced collection. A sizable amount of duties and taxes remains unrealized because of court cases. Reduction in customs duties, although had a negative impact on fiscal position, is likely to facilitate trade and have a positive influence on the economy in the medium-term. Among the domestic indirect taxes, domestic VAT increased robustly by 17.9%, but supplementary duties showed almost zero growth.

18. Although rate reduction for supplementary duties is one explanation for its dismal performance at the import stage, the fact that supplementary duties performed badly also at the domestic stage, calls for closer scrutiny to derive insights from tax policy and tax design points of view. A coordinated analysis of all indirect taxes is needed to get a clearer picture and to stop the decline in revenue. The increased collection of domestic VAT and income taxes could not offset the large decline in import-based taxes.

19. Despite the intensified tax collection efforts with strengthened supervision and monitoring, the ambitious NBR revenue target growth of 19.2% in FY2007 seems increasingly unlikely to be achieved. Revenue is expected to decrease by 0.2 percentage points of GDP in FY2007 (Figure 11). The recent drives to increase the number of income taxpayers are likely to increase collection in the coming years. Ongoing tax reforms, including modernizing NBR along functional lines and strengthening audit functions, are also needed. Lists of tax exemptions, exclusions, and incentives need to be reviewed to expand the tax base. Tax administration should be made more results focused with updated income tax and VAT laws. With a low revenue-GDP ratio of 10.6%, which is lower than in most countries in South Asia, the scope for increasing revenue is significant.



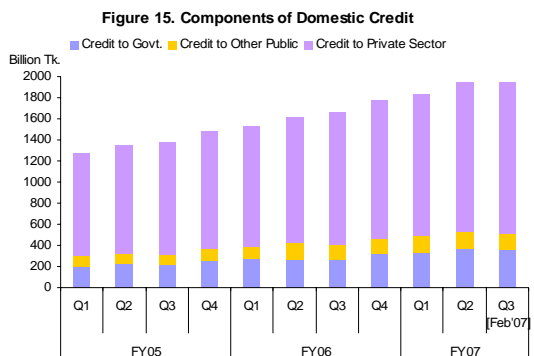
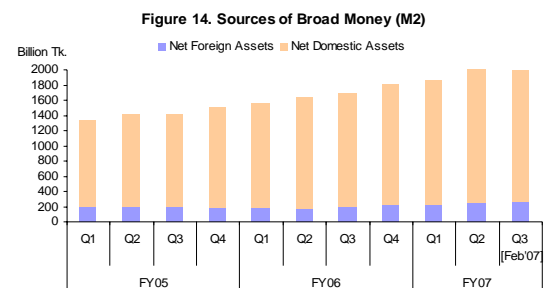
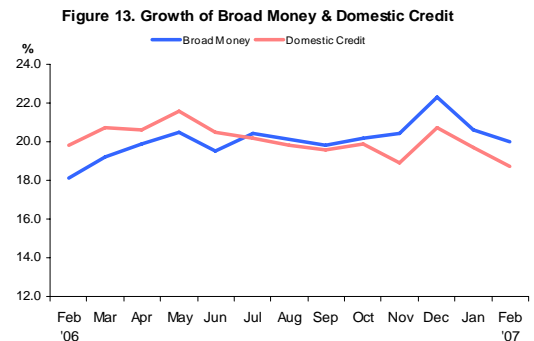
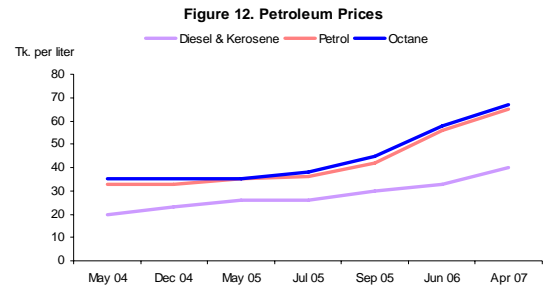
Revenue must increase to mobilize resources for investment in infrastructure and human capital development and avoid debt burdens.

20. Weak project processing and implementation capacity continues to undermine the efficiency of public expenditure management and delay efforts to reduce poverty. Slow progress in implementing the annual development program (ADP), the main vehicle for implementing the Government's development agenda, means that the ADP is likely to fall significantly short of the budget target. The slow disbursement of foreign assistance and increase in current expenditure necessitated a cut in the ADP. Close monitoring of the Government's poverty reduction strategy is needed, including strengthening project implementation capacity to realize the strategy's targets.

21. The recent (April 2007) upward adjustments in petroleum prices by 15% to 21% for various products will reduce Bangladesh Petroleum Corporation (BPC) losses (Figure 12). The increase in urban power tariff by 5% and bulk tariff by 10% effective March 2007 will reduce losses of the Bangladesh Power Development Board (BPDB) and reduce the gap between urban and rural tariffs. The widespread subsidy for energy products has generated substantial fiscal and quasi-fiscal costs for the Government. The quasi-fiscal costs arise from government guarantees for loans negotiated by BPC from domestic and international banks. These guarantees will eventually become the Government's contingent liabilities. The underpricing of energy products thus poses considerable risks to fiscal management. The Government policy of subsidizing natural gas, power, and petroleum products has exacerbated the financial conditions of Bangladesh Oil, Gas, and Mineral Corporation; BPDB; BPC; and the nationalized commercialized banks (NCBs). All forms of energy subsidy need to be gradually phased out to allow the domestic economy and individual consumers to adapt to higher energy prices. A more appropriate energy pricing policy will free up government resources for infrastructure development and enhance social safety nets for the poorer segment of the population.

Monetary Developments

22. Although the central bank favored a cautious monetary policy, excess liquidity in the banking system aided by a sharp increase in net foreign assets resulted in broad money registering annual growth of 20% in February 2007 (Figure 13). Domestic credit grew strongly at 18.7%, while net foreign assets increased by 42.1% because of the healthy growth of exports and remittances, compared with negative growth of 5% during the previous year. Driven by higher credit demand, banks' lending rates increased from 11.3% in December 2005 to 12.6% in December 2006, and deposit rates increased from 5.9% to 7%.



Growth of credit to the Government increased to 12.6% during July–February FY2007, largely to offset revenue shortfall, up from the 6.8% during the corresponding period of FY2006. Growth of credit to the “other public sector” moderated because of reduced BPC bank borrowing to finance oil purchases. Private sector credit grew steadily at 17.3% during the fiscal year to February 2007, indicating underlying high domestic demand for credit. Consistent with this pattern of credit growth, reserve money increased at 27% during the period, up from 23.5% in the previous year.

23. To moderate inflationary pressures and maintain currency stability by reducing excess liquidity, Bangladesh Bank exerted upward pressure on the yield of government securities, with the weighted average yield of 28-day treasury bills increasing from 7% in December 2005 to 7.3% in March 2007. The yields on 5-year and 10-year treasury bonds increased from 10.5% and 11.7% in December 2005 to 10.9% and 12.5% in March 2007. With the cautious monetary policy approach, the reverse repo rate, which is the main monetary tool for draining funds out of the monetary system, increased from 5.5% in December 2005 to 6.5% in March 2007. The money market remained stable with call money rates falling from 10.8% in June 2006 to 7% in March 2007.

24. Further development of the financial sector is essential to efficiently mobilize savings and channel them to productive uses. Despite improvements, gross nonperforming loan (NPL) ratios of the NCBs and specialized banks remained high (December 2006) at 23% and 34% (Figure 17). The risk-weighted capital asset ratio for NCBs is only 1.1% (December 2006), far below the required 9%. Provisioning by the NCBs is also significantly short of requirements. The restructuring and divestiture of NCBs proceeded at a slower than expected pace. After the long initial delay, the privatization process for Rupali Bank is nearing completion with the expected signing of the sale and purchase agreements soon. The Government has decided to corporatize three other NCBs putting them under Bangladesh Bank’s supervision, which will now be regulated like all other commercial banks. An advertisement has been placed to recruit managing directors from the market for two NCBs (the other already has a managing director-chief executive officer recruited from the market).

Balance of Payments

25. Exports continue to show robust performance despite recent political disruptions that affected factory production, transport movement, and port operations. Exports increased by 21.1% during the first 8 months of FY2007 over the corresponding period of FY2006 (Figure 18). Exports growth was driven by knitwear (25.8%) and woven garments (19.1%) during July–February of FY2007. Exports of frozen foods and leather recorded

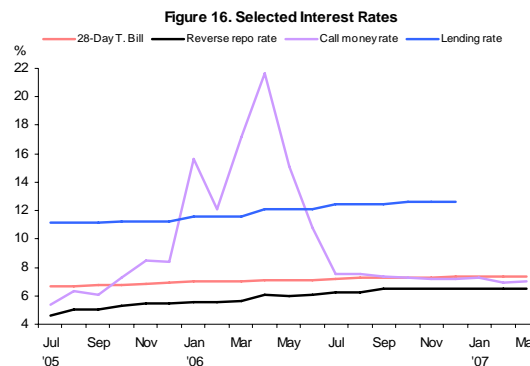


Figure 17. Gross Nonperforming Loan Ratios by Type of Bank



Figure 18. Exports, Imports, and Trade Balance

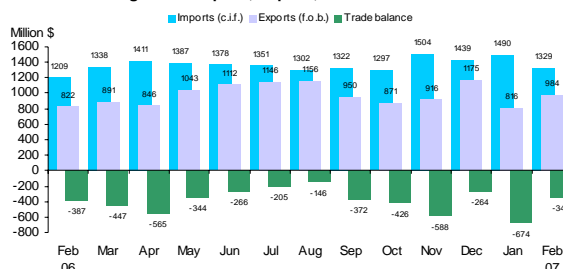
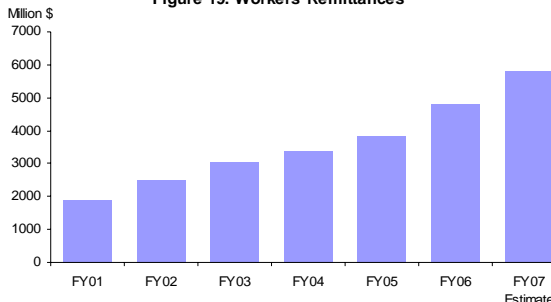


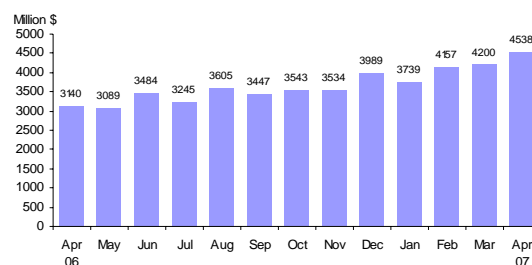
Figure 19. Workers' Remittances



risers, but other traditional items, such as tea, raw jute, and jute goods showed declining trends. Import growth was 21.0% in July–February of FY2007 compared with the corresponding period of FY2006. Although imports of rice declined, imports of wheat and other food items, oil, intermediate goods, and capital goods notably increased. Based on information on opening of letters of credit (L/C) during July–March of FY2007, imports show signs of slowing with the total value of L/C increasing by 14.4% over the corresponding period of FY2006.

26. During July–February FY2007, the current account of the balance of payments showed a surplus of \$484 million, up from the surplus of \$423 million in the corresponding period of FY2006. Robust growth in workers’ remittances (27.6%) contributed to the surplus, offsetting the higher trade deficit, which increased to \$2,098 million from \$1,773 million during the same period of FY2006 (Figure 19). The current account surplus along with the large surplus in the financial account (\$331 million) led to a surplus of \$577 million in the overall balance during July–February of FY2007 compared with a deficit of \$59 million in July–February of FY2006. Foreign direct investment during the first 8 months of FY2007 declined to \$325 million from \$489 million in the same period of FY2006 due to political uncertainty. Foreign exchange reserves crossed \$4,000 million in February 2007 and continued to increase to \$4,538 million at the end of April 2007 from \$3,484 million at the end of June 2006 (Figure 20).

Figure 20. Gross Foreign Exchange Reserves



Inflation and Exchange Rates

27. Inflationary trends heightened during recent months with point-to-point inflation rising to 7.4% in March 2007, from 6.8% in July 2006 (Figure 21). During this period, food inflation increased from 7.4% to 8.5%, while nonfood inflation declined slightly to 5.8% from 5.9%. Acceleration in food inflation is mainly attributed to higher food-grain prices in both the domestic and international markets, together with reduced imports and lower domestic production of food grains (Figures 23 and 24). High monetary and private sector credit growth also fueled inflationary pressures. The drive against hoarding and administrative efforts to control prices of essentials might have added to inflation by disrupting import and supply. The recent increase in fuel prices could cause temporary inflationary pressures due to the rise in transport cost. Sound macroeconomic management, combining a cautious monetary policy stance by Bangladesh Bank and controlled budgetary borrowing, will be essential with more flexible exchange rate management to reduce inflation to more acceptable levels. Monetary policy also needs to counter inflationary trends generated by large foreign inflows through exports and remittances.

Figure 21. Inflation (Point-to-Point)

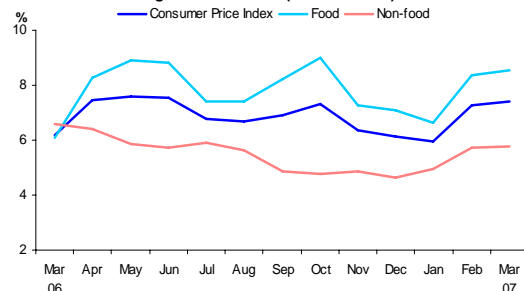


Figure 22. Inflation, 12-Month Moving Average

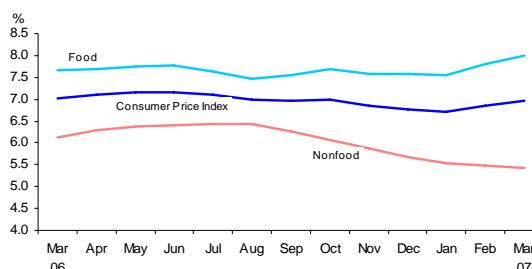
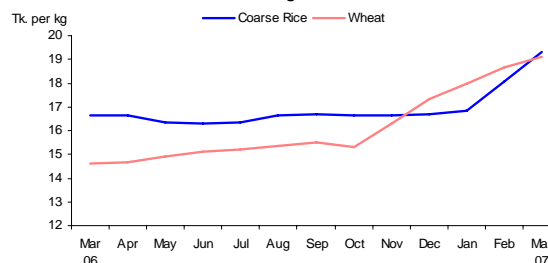


Figure 23. Domestic Open Market Retail Prices of Foodgrains

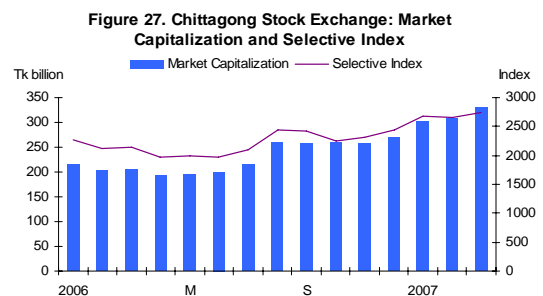
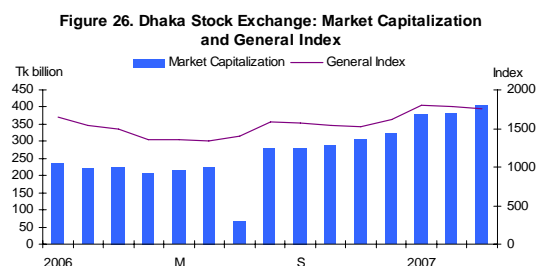
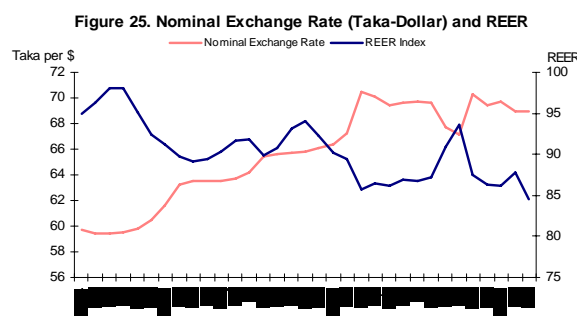
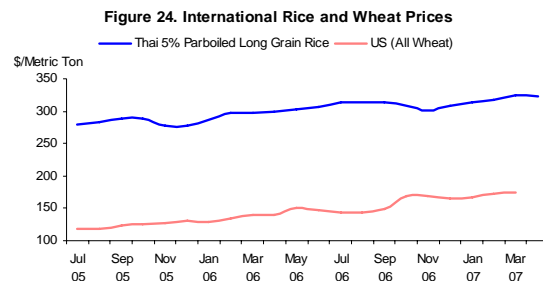


28. Mirroring improvement in the balance of payments, the taka appreciated against the dollar by 2% between the average rate in November 2006 and that in March 2007, with the weighted average exchange rate of the taka decreasing from Tk70.3/\$1 to Tk68.9/\$1 (Figure 25).

Capital Market

29. Although the capital market gained significant momentum in January 2007 after the new caretaker Government took office and political disruption stabilized, it remained stagnant in the months to follow. The Dhaka Stock Exchange (DSE) general index dropped to 1,760.88 in March 2007 from 1,805.12 in January, registering a slight decline of 2.5% (Figure 26). But DSE market capitalization increased slightly to Tk405.5 billion in March from Tk377.4 billion in January. The sluggish mood in the market was induced by a sharp fall in trading activity—suggested by a 21% decline in DSE monthly turnover from January to March. The Chittagong Stock Exchange (CSE) selective categories index experienced a slim rise of about 2.8%—up from 2,674.52 in January to 2,750.45 in March 2007 (Figure 27). CSE market capitalization also increased by 9.1%, but turnover dropped 24% because of thin trading.

30. The role of capital markets in channeling funds to productive investments is crucial to achieve higher economic growth and faster poverty reduction. Bangladeshi companies with a high bias for bank finance are missing out from exploiting the potential benefits of capital markets. The dominance of bank loans also translates into low risk exposure by borrowers and high risk for the lending banks and financial institutions. It exposes banks to asset-liability management risk. An active capital market can ensure a proper financing balance and reduce risks borne by banking. A sound capital market requires depth with a wide range of financial instruments to cater to varying risk return liquidity preferences of investors and to ensure that the adverse effects arising from disturbance in one sector do not replicate to others. Although some new instruments such as government bonds have been introduced in the stock exchange, not much trading has taken place. Introducing new modalities as well as creating a secure trading environment is essential to boost capital market activity. Most merchant banks and brokerage houses do not exercise due diligence of companies, depriving investors from getting independent assessments. This prevents investors from identifying quality securities. Research capacity needs to be strengthened to broaden investor participation and ease the initial public offering process for new firms.



THE DHAKA–CHITTAGONG TRANSPORT CORRIDOR¹

31. The Dhaka–Chittagong Corridor, which connects the two largest cities in the country, Dhaka—the capital—and Chittagong—the largest commercial and port city, is the most important transport corridor in Bangladesh. It covers 16% of the country, 50% of the population, 57% of the nation’s GDP, and two thirds of the nation’s import-export flows. Chittagong Port handles about 90% of the country’s international traffic. The corridor includes roads, rail, and inland waterways. The road carries 51% of the current freight traffic in the corridor, the inland waterway 43%, and the railway 6%. The railway carries most of the container traffic; no containers are carried by the waterways. Development of the transport network in the corridor is facing major challenges, which if not addressed will severely constrain the country’s growth prospects.

Constraints in the Transport Corridor

32. The Dhaka–Chittagong Corridor provides potential subregional linkages to Myanmar; Thailand; PRC; northeastern states of India, through Jamuna Bridge and the proposed Padma Bridge to West Bengal; and to Bhutan and Nepal through India. Because of its strategic location, this corridor can play a significant role in the subregional transportation system by providing direct and shorter transport links by rail, water, and road. Developing a multimodal transportation system combining roads, rail, ports, and inland water will help accelerate export-led growth in Bangladesh, and its integration with South Asia and beyond.

33. But serious weaknesses in the transport logistics in the corridor have been impeding its ability to take what could be a crucial facilitating role in expansion of the country’s external trade and in regional transport connectivity. The corridor is facing serious congestion problems because of shortage of capacity and inefficient operation. These may be costing the country 20% of its foreign trade potential and reducing potential GDP growth by 1%.

Table 1: Time and Cost of Importing and Exporting in Bangladesh and Other Countries

Country	No. of Docs for Export	Avg. Days for Export	Avg. Cost for Export(\$)	No. of Docs for Import	Avg. Days for Import	Avg. Cost for Import (\$)
Bangladesh	7	35	902	16	57	1,287
Indonesia	7	25	546	10	30	675
Lao PDR	12	66	1,420	16	78	1,690
Singapore	5	6	382	6	3	333
Thailand	9	24	848	12	22	1,042
Range	5–12	6–66	382–1,420	6–16	3–78	333–1,690

Docs = Documents.

Source: World Bank. 2007. *Doing Business 2007*. Washington, DC.

34. A study, undertaken as part of an Asian Development Bank (ADB) technical assistance (footnote 1), takes a broader definition of the logistics. It covers not only the physical movement

¹ This article is based on the April 2007 report of Asian Development Bank-supported technical assistance: Asian Development Bank. 2004. *Technical Assistance to the People’s Republic of Bangladesh for Chittagong Port Efficiency Improvement*. Manila.

of goods (e.g., procurement, transport, consolidation, transshipment, storage, and packaging) but also the processing of documents, coordination among participants, monitoring of activities, and financing of transactions that facilitate this movement. Logistics time and costs for Bangladesh imports and exports are higher than those of comparable countries (Table 1). Importing and exporting in Bangladesh takes significantly more time, and costs more than the average of the benchmark countries.

Chittagong Port

35. Bangladesh has two major sea ports: Chittagong and Mongla. Chittagong Port, situated in the estuary of Karnaphuli River is the principal port. It handles about 26 million tons of general cargo in addition to 800,000 twenty-foot equivalent unit (TEU) containers a year. Traffic in recent years increased annually by about 9.1% on average for general cargo and 11% for containers. This traffic exceeded the port's designed capacity in 2006, especially for container handling. During 2006, the container terminal at Chittagong Port could only handle about 110 TEU lifts per berth per day, well below the 230 suggested by United Nations Conference on Trade and Development (UNCTAD) as a productivity standard. But this productivity doubled in March 2007 after operation of the Chittagong container terminal was transferred to a private sector operator. With this improvement, the port's capacity for container handling has increased, but improvements are required to allow efficient handling of the 1,000,000 TEU projected for 2007. Chittagong Port is connected with the hinterland by rail, roads, and inland waterways. Chittagong Port also manages an internal container depot (ICD) located in the Dhaka metropolitan area, which it connects to by rail. The ICD has a container handling capacity of 82,000 TEU a year. Most containers are loaded and unloaded in the port because of limited off-dock facilities and costly railway service to move containers.

36. To meet the projected increase of container transport, Chittagong Port is in the process of major improvements, including completion of a new container terminal (New Mooring Container Terminal) and other facilities, such as road connections to the port and improvements to its information and container management systems. These will be ready in the next 2 years. The Government has also decided to contract out the operation and management of the New Mooring Terminal to the private sector. The Chittagong Port Authority (CPA) is increasing storage fees for containers to free up the port storage yard, and has started operating the port on three shifts with reduced labor gangs. In addition, the port and the Chittagong Customs House have been undergoing operational improvements that have increased their efficiency, including allowing more containers to be unstuffed off dock and introducing a "green channel" for selected goods. Many improvements in cargo transfer procedures are still needed to speed up transfers. CPA also needs to work with the mainline operators of container ships to monitor the reduction in ship turnaround time, which is linked to the port congestion charge. This charge cannot be eliminated by decree as it is a real economic cost for the shipping lines. However, it should be eliminated by increasing container loading and unloading efficiency.

37. Rail connections to the port should be expanded to allow for three to four times the current container traffic. The rail yard outside the port should be developed to a modern intermodal yard, handling both rail and truck traffic as well as providing adequate truck parking. The current rail loading area inside the port should be moved out to this rail yard and be served by a secure chassis shuttle system from the port. Dhaka ICD should improve its operations and acquire the equipment to handle at least 50% more containers. Two more rail-linked ICDs should be built in the Dhaka area outside downtown to meet future demand and relieve the container stuffing and stripping problem at Chittagong Port.

38. Because of its location, Chittagong Port can be the gateway to promote trade in the region. It has the potential to become a high revenue-generating port provided it is properly overhauled and realigned to keep up with fast-increasing import and export demand. Developing Chittagong Port with the requisite road and rail links would help foster export-led growth in the country and integrate the economies of Bangladesh and its neighbors. Upgrading of this port is particularly important from a subregional cooperation perspective with the eastern Indian states, Nepal, and Bhutan.

Highway

39. The 233 km Dhaka–Chittagong highway, mostly two lanes (84%) with some four-lane (16%) sections, is congested and overused. It is mostly undivided, and carries about 51% of the freight ton-km in the corridor. This highway is heavily congested in the vicinity of numerous towns along the route, especially at the conjunction points with Dhaka and Chittagong. Traffic on the highway averages 16,000 vehicles per day, not including nonmotorized vehicles and pedestrian traffic (which is heavy near Dhaka and Chittagong). These have a significant slowing effect on traffic. Among the motorized vehicles, about 42% are freight vehicles; about 80% of these are open or closed trucks. However, few (less than 1%) of these trucks carry containers. The average travel time for trucks between Dhaka and Chittagong is about 6 hours. Trucks need almost 3 hours to travel through Dhaka because the city has no bypass road and congestion is heavy. Like most national roads in Bangladesh, the Dhaka–Chittagong highway is not adequately maintained. The structures along the highway are designed for maximum 30-ton vehicles. This is a major constraint for the shipment of large containers by road. The axle-load limit in the corridor is set at 10.2 tons; this limit is not adequately enforced by the police, which results in further deterioration of the highway and adds to the maintenance needs. The highway has one toll plaza near Meghna Bridge. The remaining sections are free to road users.

40. To make this corridor more efficient and safer for traffic, the Roads and Highways Department (RHD) is conducting a study—Access Control of the Dhaka–Chittagong Highway—which will find solutions to the problems caused by human encroachment on the road and the crisscrossing of this corridor by regional and local roads. According to international standards, the current traffic volume on the Dhaka–Chittagong highway has already exceeded its designed capacity. RHD is carrying out a development scheme—the four-laning of the Dhaka–Chittagong highway; and making provisions for bus and truck bays and facilities to avoid human encroachment from roadside markets and bazaars. When these projects are completed, the capacity of the road corridor will increase substantially.

41. Major road subsector reforms are needed to improve the efficiency of the Dhaka–Chittagong Corridor. Ongoing improvement of the Dhaka–Chittagong highway needs to be complemented by (i) developing a policy to encourage container transport in the corridor, which should also stress the appropriate number of axles for large container trucks, (ii) completing the four-laning, and (iii) planning for the development of an expressway in the corridor possibly with private sector participation. Over the medium-long term, options include developing six-lane connections to the urban areas of Dhaka and Chittagong, and a Dhaka bypass (or ring) road, which would connect the corridor efficiently to other parts of the country and improve connections to Dhaka’s industrial areas.

Railway

42. The 331 km railway system in the Dhaka–Chittagong Corridor comprises meter gauge lines—62.5% with single track (199 km) and 37.5% with double track (121 km). A dedicated shunting yard is located near Chittagong Port. This corridor has the heaviest rail traffic in the country, although it is not dense by international standards. It carries half of Bangladesh Railways' ton-km to only 15% of the route-km. The railway carries about 6% of the corridor's freight ton-km, including containers and bulk cargo. About 9% of the container traffic that arrives in Chittagong Port is transported by railway to Dhaka ICD.

43. Bangladesh Railway's wagons carry a maximum load of 40 tons, and trains can operate with no more than 30 of these. Average train speed on the corridor is low—about 23 km/hr (or 14 hours for 320 km). Traders in the corridor expect a much better service as well as reduced tariffs from the railway. But because of capacity constraints and container wagon shortages, the railway has difficulty competing with road transport. Container traffic to Dhaka ICD reached 81,033 TEU in FY2006, the limit of its handling capacity, with annual growth of 9.2%.

44. With decreasing market share, the railway line in this corridor appears to have additional physical capacity, but it is limited by many operational, equipment, and maintenance constraints. The railway capacity needs to be realized by doubling tracks in some sections, upgrading the signaling system, enhancing track maintenance, purchasing suitable rolling stock (e.g., container flats), and improving management and operational efficiency.

45. The ADB-supported Railway Sector Investment Program will improve rail performance by implementing (i) policy, organizational, and capacity-building reforms to make Bangladesh Railway more commercially focused, and improve governance and accountability; and (ii) investment in infrastructure and rolling-stock capacity improvement in commercially important corridors, such as Dhaka–Chittagong and Dhaka–Darsana–Khulna.² This program is part of a multidevelopment partnership, comprising ADB, World Bank, and Japan Bank for International Cooperation in financing priority investments from the Government's investment plan. Development of infrastructure and rolling stock will not only support higher economic activity inside Bangladesh but will create opportunities for cross-border transportation of goods and passengers in the region and facilitate major cross-country investment.

Inland Waterway

46. The inland waterway link between Dhaka and Chittagong is about 305 km with a minimum depth of 4 meters. River sections comprise 70% of the waterway and open bays about 30%. The main route is from Chittagong to Narayanganj via Phakal. The inland waterway in the Dhaka–Chittagong Corridor carries about 43% of total corridor freight ton-km, mainly petroleum products, grain, edible oils, and dry bulk products (e.g., fertilizers and clinker). The link currently has no capacity for container traffic because of the lack of well-equipped terminal facilities for transfer at either end of the corridor. Barge travel time from Chittagong to Dhaka is about 20 hours. The inland waterway provides the cheapest mode for cargo transportation in the corridor, and has huge potential for improving corridor transport. However improvements must be well planned, organized, and developed in line with port facilities and vessels, tankers, and coaster service.

² ADB. 2006. *Report and Recommendation of the President to the Board of Directors on a Proposed Multitranche Financing Facility and Technical Assistance Grant to the People's Republic of Bangladesh for the Railway Sector Investment Program*. Manila.

47. If the waterway share of traffic in the corridor is to increase, ICDs must be expanded, for handling both containers and cargo. The planned project for a river ICD in the Dhaka area (Pangaon), with a high capacity road connection, needs to be implemented as soon as possible. A site for a second river-related ICD, with suitable land linkage to Dhaka, needs to be identified. Container reloading facilities in Chittagong Port for ocean-going and inland waterway vessels and corresponding facilities for transfer of containers for land transport in Dhaka ICDs need to be developed by the private sector. Bangladesh Inland Water Transport Corporation and the private sector are constructing prototype vessels, but the private sector must take the main responsibility for increasing the container vessel fleet. Improvements to navigational aids in the corridor will be needed to handle additional traffic and night navigation. When these facilities are complete, waterways should be the cheapest mode of transport in the corridor, and the waterway share will increase.

Options and Challenges

48. Infrastructure is the key challenge to sustainable growth in Bangladesh. Adequate, modern, and well-maintained systems of transport and other essential services are the major requirements for the country to achieve its optimum potential. Transport networks are vital to provide access to local and global markets, support private sector development, and create opportunities for citizens—especially those in poor and remote communities—to participate in economic growth and improve their standard of living. Numerous studies have demonstrated the positive impact of infrastructure on economic growth. Best-performing economies in Asia, such as the PRC, India, Malaysia, Singapore, and Viet Nam have invested significantly in infrastructure.

49. Based on the projected annual GDP growth rates of 6.5%–7.0% and a freight transport elasticity of 1.0, total national freight traffic demand is estimated at 28.5 billion ton-km for 2009/10 and 39.0 billion ton-km for 2014/15. On the basis of various assumptions, the nation's traffic is forecast to become slightly more concentrated in the Dhaka–Chittagong Corridor, to 35% of total national traffic in 2009/10 and 38% in 2014/15. Consequently, total corridor traffic is estimated at 10.0 billion ton-km in 2009/10 and 14.8 billion ton-km in 2014/15, or 34.1 million tons in 2009/10 and 50.7 million tons in 2014/15. Traffic in the corridor for all modes has reached capacity. Even with more balanced use of modes, overall transport capacity in this corridor will need to increase over current capacity by at least 50% by 2009/10 and by 100% by 2014/15. This is a daunting task and will require a comprehensive strategy for development of the corridor.

50. The country is facing a gigantic challenge to improve the capacity of the corridor to meet the accelerating traffic demand. Freight traffic through the corridor is expected to grow at sustained rates of more than 8% a year in the coming decade. The corridor is undergoing a number of improvements, particularly with the port container terminal expansion and information systems improvement. Projects are also under way to improve the railway and study road expansion to four lanes. Three ICDs in the Dhaka area are being studied for implementation (two for rail and one for inland waterways). But the currently planned improvements will not sufficiently meet the expected increase in traffic. The rail and waterway modes are expected to reach capacity in 5 years and exceed it in 10 years. The road, even with four-lane development, will reach its capacity in 10 years. In addition, authorities are not significantly addressing inefficiencies in the logistics system, except at Chittagong Port where some improvements were achieved in early 2007.

51. Improvements can be made in several areas over the short term. These include easing the documentation requirement for opening letters of credits, harmonizing freight forwarders with international standards, streamlining custom clearance procedures, improving capacity of private ICDs in Chittagong, and eliminating the stuffing and unstuffing of containers in the port. Over the medium to long term, establishment of freight forwarding as an industry and improvement in the training of logistics service providers need to be considered. A significant amount of work remains to reduce customs constraints on the logistics system.

52. Bangladesh needs a comprehensive corridor development strategy for an effective and efficient network improvement program to meet future traffic demand. Several projects are being implemented to improve the transport network in the Dhaka–Chittagong Corridor. But more efficient coordination of all efforts, based on a strategy, is required. The formation of a transport/logistics interest group to pursue these efforts with stakeholders would greatly increase the possibilities of a more integrated approach to address the main constraints for corridor development.

Conclusion

53. Despite considerable gains over the last 10 years, Bangladesh remains one of the world's poorest nations with 40% of the population living in poverty. Although the economy has been growing, and poverty has been reduced, accelerated export-led growth is necessary if Bangladesh is to become a middle-income country in 10 years. The implication of accelerated growth is that the Dhaka–Chittagong Corridor will face a potentially huge increase in activity including for regional transport connectivity. But the current transport capacity in the corridor is far from future traffic demand. Bangladesh needs a comprehensive Dhaka–Chittagong Corridor development strategy for significant improvements for the port, roads, rail, and waterways.

BUSINESS PROCESS OUTSOURCING: HIGH POTENTIAL

54. Business process outsourcing (BPO) is the contracting of a specific business task to a third-party service provider. The most common examples of BPO are call centers, human resources, accounting, and payroll services. BPO has been experiencing high growth, fueled primarily by significantly enabling changes especially in data communications technologies, the increase in the competition they brought about, and the drive for companies to cut cost. The global market for information technology enabled services (ITES) including BPO is estimated at \$1,000 billion in 2007. Growing at a rate of about 30%, BPO includes a wide range of functions along a company's production or service line. It enables client companies to streamline operations and focus on core businesses, while creating huge business opportunities for BPO vendors.

55. BPO has now become mainstreamed in the developed countries' procurement culture. The evolution to a complete BPO market with the availability of multiple levels of service capacity is a complex process, which calls for long-term critical factors such as education, technological trends, information technology (IT) capacity, adaptability and flexibility, and a competitive cost structure. With improvements in information and communication technology (ICT), a major part of BPO services is now directed to offshore developing countries, creating jobs for young, diligent, and committed workers, especially among educated women, and boosting export earnings. Asia has been a major destination for BPO with India, Philippines, and PRC being the large players. Bangladesh, with a few vendors, has essentially missed out on this profitable business opportunity. The robust growth in global BPO offers huge potential for Bangladesh, if it can build service capacity and catch up with competitors.

Global Trends in Outsourcing

56. Companies outsource services primarily with the objective of slashing costs and downsizing operations or getting a specialist to perform a complex job. Services are outsourced domestically or to offshore developing countries where labor costs are relatively low. Outsourced services may span from simple data entry tasks to complex finance, banking, insurance, human resources, e-training, health care, mortgage, credit card, asset management, customer care, logistics and distribution, real estate, sales and marketing, and web-related services (Table 2).

57. Most BPO services are basic back-office functions consisting primarily of data entry, data transfer, or data conversion tasks; tasks such as moving data from a document or database to a general ledger; and billing services. These tasks require basic clerical skills and can usually be fully accomplished offsite. They are well defined, and their successful completion can be easily measured. Some BPO vendors also perform advanced data and accounting services that include both basic administrative functions and data conversion tasks. As the BPO vendor establishes itself as a reputable business, it gradually evolves to offer more complex value-added services.

58. BPO vendors from Bangladesh are still relatively small and have limited capacity. They usually perform basic services, such as data entry, and some programming and software development. Largely inadequate ICT infrastructure and poor quality of education are holding back the country's potential to compete with leading BPO exporting countries.

Drivers of Offshore Outsourcing Growth

59. Sharply falling costs of computing and communicating have spurred the emergence of new business models, often radically changing the very nature of competitive strategies for many businesses. The outsourcing marketplace has been competitive since its inception. Large American companies first began outsourcing their noncore IT services to domestic vendors to have these performed outside, without building in-house expertise. Some of the earliest outsourcing was done by America-based insurance companies, sending back-office work to the Caribbean. Outsourcing services to Asian countries started in earnest in the mid to late 1990s, when American companies began to outsource software programming services to India. After the outsourcing of programming and other basic functions worked well, an increasing number of ITES and IT tasks were outsourced offshore, including help-desk support, and applications development and management.

Table 2: List of Typical BPO Services

<p>Banking Services Account opening services Account information capture Customer queries Check clearing Check payment reconciliation Statement processing ATM reconciliation Investment account management Management reporting Loan administration Credit debit card services Check processing Collections Customer account management</p> <p>Mortgage Services Application verification and processing Disbursals and collections Payment reconciliation Account information updates Mortgage loan servicing</p> <p>Finance Services Document management Billing Shareholder services Claims processing Accounts receivable Accounts payable</p>	<p>Credit Card Services Applications screening and card issuance Customer account management Collections and customer follow-up Account queries and limit enhancements Accounting and payment reconciliation</p> <p>Insurance Services Policy owner services Claims processing Transaction and reinsurance accounting Statutory reporting Annuities processing Benefit administration Customer information capture Risk assessment and premium computation Policy processing and account monitoring Claims management Payment reconciliation</p> <p>Asset Management Services Account creation Account maintenance Transfers and additions Dividend payments Brokerage payment MIS reporting Customer service</p>	<p>Web-Related Services Website design Website management Site personalization Site marketing Search engine, directory optimization, and positioning services Catalog/content management Web analytics Database design Web security services and integration with CRM Back-office systems for inventory management Web enablement of legacy applications Electronic bill presentment and payment services Graphics/animation Web-based email processing Web-based help desk Web-based chat support E-learning: web-based online education services E-publishing</p> <p>Sales and Marketing Services Telemarketing services Direct marketing and sales campaigns</p>	<p>Health Care Medical transcription services</p> <p>Customer Care Customer service Customer analysis Call centers Consumer information services Customer relationship management</p> <p>Human Resources Services Payroll and benefits processing Training and development Retirement investment and benefits management Hiring and staffing Recruitment screening, administration and relocation services Payroll processing Compensation administration Benefits planning Administration and regulating compliance</p>
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General ledger Accounting services Treasury operations management			
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CRM = Customer Relations Management, MIS = Management Information System.

Source: United Nations Conference on Trade and Development. 2003. *E-Commerce and Development Report 2003*.

60. BPO service providers slowly emerged in many countries, including Bangladesh, Brazil, India, Philippines, PRC, Romania, Russian Federation, Singapore, Thailand, Venezuela, Viet Nam, and others. These countries are increasingly considered as outsourcing destinations by enterprises in the United States, United Kingdom, and other European countries, as they offer good quality BPO services at a very low price. While most vendors in the developing countries provide basic BPO services such as data entry, a few have now matured to a significant standard to be able to provide high-end services.

61. BPO services growth in these countries has been propelled by a combination of factors, including improvements in ICT and the skills base of workers. It has been greatly facilitated by the increasing demand from enterprises located mainly in the United States and Europe to outsource supporting business functions at low cost to focus on their primary functions. Gradually, as confidence started to mount, businesses that used to outsource only low-end back-office functions began to contract out more primary functions related to human resources, finance, payroll administration, training, telemarketing, order entry, billing, and other tasks. While large firms remain the pioneers, small and medium-sized enterprises also choose outsourcing as a major business policy to bypass the cumbersome process of setting up internal departments. This has created an increasing demand for BPO services from the developing region.

The Asian Experience

62. Many Asian countries like India, Philippines, PRC, Singapore, Thailand, and others have gathered much experience in BPO and ITES and are taking advantage of the new opportunities to diversify and improve their economy. India is often cited as the leading BPO destination. ITES and BPO service providers in India are well recognized by the outsourcing clients, which makes India a major destination for software contracts. The bulk of its clients are from the United States and various regions of Europe. Low labor costs, skilled English speaking workforce, business-friendly ICT environment, and favorable time zone differences with the client countries are the main reasons behind India's large-scale success. Indian exports of information technology and ITES stood at \$17.9 billion in 2005, of which BPO contributed 28%. Growing at about 59%, export of ITES and BPO from India is expected to reach between \$21 billion and \$24 billion by 2008, employing more than 1.1 million.³ The outsourcing industry has demonstrated its large-scale viability and success in India. It plays a big role in creating jobs, particularly for women, who may be employed at the low-end of the service, working in call centers or performing data entry and other operations requiring low skills. With Internet connectivity, it even allows them to work at home at their own convenience and earn money for the family. This gives India a huge boost toward poverty reduction.

63. Global growth in moving BPO services offshore has benefited the Philippines too. The BPO market in the Philippines stood at \$2.39 billion in 2005, employing more than 163,000. It experienced cumulative investments of \$911 million between 2000 and 2006, and expects to

³ United Nations Conference on Trade and Development. 2003. *E-Commerce and Development Report 2003*.

employ 1 million by 2010. Contact centers (call centers) at \$1,792 million make up their largest BPO service, followed by software development at \$204 million, back office at \$180 million, medical transcription at \$70 million, and engineering design at \$48 million.⁴ High population, cultural affinity with the major markets, and advanced telecommunications infrastructure are the key factors driving the robust BPO growth in the Philippines. Aided by strong regulatory support and a steady flow of investments, the BPO industry in the Philippines is expected to continue its rapid growth trend, enabling many to earn a decent living.

Opportunities for Bangladesh

64. Bangladesh largely lags the major BPO exporters mainly because of limited capacity of firms, unskilled human resources, and poor infrastructure. But the country can transform into a good destination for BPO if it can follow the examples of India or the Philippines and make some policy shifts to develop a solid ICT platform and a sound education system. Availability of a low cost workforce with the ability to perform basic functions stands as a fair comparative advantage for Bangladesh over competing countries like India, Philippines, and PRC, but it lags in education and skills. With adequate training and professional development, the workforce can turn into a valuable asset. At present, the market for software, ITES, and some basic BPO services stands at about \$170 million for Bangladesh. The country can initially build on this base and improve capacity to move to high value-added activities. Start-up capital expenditures are low in the BPO business, which makes it a promising niche for small and medium-sized entrepreneurs.

65. Some Bangladeshi vendors have entered the ITES and BPO export markets that involve back-office functions consisting primarily of data entry, data transfer, data conversion, billing, software development, and other services. These tasks can be carried out by low-skill workers and do not call for professional experts. These are mostly repetitive tasks, and do not require much training and development of the workforce. Vendors currently offering basic functions can gradually gather more experience and aim to offer advanced data processing services and more comprehensive solutions. This will enable the firms to generate more revenues and narrow the performance disparity with competing firms of the region.

66. Experienced vendors should eventually plan to move toward taking over management functions or operations and become responsible for managing an entire process for their clients. But to offer these high value-added services, Bangladeshi vendors need to establish a strong international reputation and brand equity. Investment in infrastructure, knowledge, and expertise is essential to improve country competitiveness and perform such complex and daunting tasks. Several issues need to be addressed at the firm and macro levels to adequately respond to the constraints facing Bangladesh.⁵

Quality of Service

67. Because BPO services have evolved in complexity, they present greater risks to clients in quality delivery of services compared with the relatively simple IT services. When considering the creation of a BPO business, Bangladeshi vendors should first focus on one service type at a basic skill level as an entry point. Once they master this level, services can be expanded to

⁴ Magtibay-Ramos, Nedelyn. March 2007. *An Analysis of the Philippine Business Process Outsourcing Industry*. ERD Working Paper, Asian Development Bank, Manila.

⁵ Major Source: United Nations Conference on Trade and Development. 2003. *E-Commerce and Development Report 2003*.

include more sophisticated functions. Starting at a lower skill level reduces the cost and risk. Trial runs and phase-in services ensure quality implementation. Beginning with low-risk projects and paying special attention to the transition are critical for successful evolution to a bigger vendor. Focusing on a few projects to provide high-quality services and gradually learning the business mentality of BPO clients, building confidence, and promoting country capacity and brand are equally important.

Effective Communication

68. Effective communication between clients and the BPO vendors is critical to successfully execute deals. Comprehensive understanding of the tasks to be accomplished is a key factor for proper completion. Offshore outsourcing, in particular, increases the need for accurate guidelines to understand a client's mindset, needs, and the nature of work. When selecting vendors, clients put huge emphasis on the language skills of destination countries. Bangladeshi vendors need to communicate early and often with foreign counterparts to establish good business relationships. They should make sure that project work requirements are well known, and success criteria and outcomes are clearly defined. They should also have measurable performance indicators in place to evaluate performance on a regular basis.

Cultural Bridging and Networking

69. Cultural understanding is an important element of effective communication. BPO clients look for vendors that have a similar culture and mindset to ensure the feasibility of a long-term business rapport. In offshore outsourcing, challenges arise when two sides are not conscious of each others cultural differences, which may result in disruption of business. This explains why BPO deals are often executed through migrant residents of host countries who are confident enough to outsource business to their respective countries for the first time. This greatly helps to establish a network between clients and offshore vendors. To get more business deals, Bangladeshi vendors need to target and organize their nationals working abroad, who understand the cultural gaps and can help find potential clients. They should also try to strengthen networks with out-of-country universities, private-sector leaders, and consular and foreign trade authorities.

Marketing and Branding

70. Bangladeshi vendors need to develop aggressive marketing techniques, particularly by using ICT and the Internet to market their products and services to foreign companies. A comprehensive website proposing well-defined services, clear prices, competitive cost advantages and service quality, and a client reference list will help create a trustworthy environment. Many companies in the United States and Europe do not know where to search for a reliable partner. Bangladeshi vendors should develop partnerships with major global clients and reputable vendors to establish their company as a brand name. They need to be updated on the latest technology trends to remain competitive. They should also establish points of presence in the countries where the majority of their clients are located and participate in international business events and conferences to find potential clients and learn about strategies and good practices. Participating in international events will enable them to demonstrate their capacity and outsourcing potential. Obtaining a global certification label will be critical to market high value-added BPO services from Bangladesh and to compete with well-known vendors.

Infrastructure and Regulatory Support

71. The expansion of BPO services in Bangladesh will largely depend on the country's capacity to identify potential focus areas and make the required investments in telecommunications infrastructure and regulatory framework to attract international clients. With limited land-phone and Internet connections, ICT infrastructure remains the main impediment to establishing an outsourcing business outside Dhaka. Fostering the development of ICT in both urban and rural areas will be the key to unlocking the development potential of BPO in Bangladesh. To overcome ICT constraints, regulators need to encourage computerization and automation in enterprises and should support cost-effective technologies such as voice-over-Internet protocol (VoIP) that lower telecommunications costs. They can develop an effective e-government system, which will include national portals to market the country's BPO capabilities. The Government may also consider offering tax incentives and financial support to develop an efficient outsourcing industry. Tailoring a national development strategy for BPO is crucial to take full advantage of the profitable outsourcing marketplace.

Quality of Education

72. Quality of education demands massive improvement to develop skilled workers with good spoken English. Bangladesh needs a massive overhaul of the entire education system to gear it toward a high degree of professional development. Regulators and educators need to jointly prioritize IT and e-education in higher studies and reform the curriculum of universities and schools to include subjects in support of the technology-enabled and export-oriented services sector. The developing countries that are recognized for their outsourcing capacities have certain standards in their education system. India, for example, offers competitive and up-to-date IT education and attracts many foreign students from the Asian region. This enriches their knowledge base and human resource capability. To keep pace with competitors, Bangladesh needs quick reforms to upgrade the quality of education.

Future Challenges

73. As the industry becomes increasingly competitive, it will demand a better trained workforce and skills. Improving quality will be crucial for Bangladeshi vendors, as clients from developed countries are used to and expect high quality service. The next level of services will involve the ability to follow rule-based as well as decision-making processes. These processes are clearly defined and their successful completion demands a certain level of discipline and focus. Account opening services are an example of a rule-based process service. Screening credit card applications and issuing cards are examples of a decision-making process. Services that include direct contact with clients, such as telemarketing, e-publishing, and customer support, will require significantly high professional skills. Excellent communication and basic knowledge about the client country's culture will be even more important. Specialized business skills and relationship building will be essential when offering consulting or advisory services. As skills and knowledge requirements increase, value of service and profits also increase. With an increasing number of developing countries offering low-cost skilled labor, Bangladeshi vendors—offering basic services—need to upgrade the scope and level of their work.

74. Most companies seek vendors that can offer different levels of services under one roof. Attracting clients in the future will demand diverse capacity of firms aided by the availability of some key factors in the country, including quality education, technology support, and easy adaptability to the clients' way of thinking. Several BPO vendors in India and the Philippines have gained enough capacity and experience to offer diverse high-end services, such as those

required by banking and insurance companies. To better capitalize on existing opportunities, Bangladesh too needs to focus on offering high value-added functions, rather than striving to increase earnings only through greater volume. But for this to materialize, Bangladeshi vendors must invest heavily to boost their capacity and workforce skills, define business plans, and develop marketing strategies. Regulatory support needs to be in place to accelerate outsourcing services growth in the country. To establish international credibility, Bangladesh needs to offer a stable political environment too as political risk is an important factor in decisions to move work offshore.

Conclusion

75. Competitive advantages and economic pressures are increasingly encouraging companies located in developed countries to look for partners in developing countries. This trend will continue in the medium to long term. To gain from this, Bangladesh needs to thoroughly assess its infrastructure and education requirements, identify scopes and define strategies, and develop marketing channels to promote local competencies and find clients. Existing BPO vendors need to look for funding possibilities to finance growth and identify potential local, regional, and international partners. They should implement training programs aimed at improving service quality, performance, and knowledge of new technologies. Creating nationwide awareness about the new opportunities in BPO and ICT is necessary as many potential entrepreneurs are not yet familiar with them. While offshore outsourcing opportunities are increasing rapidly, the capacity of BPO vendors in Bangladesh remains low. BPO has offered huge opportunities for many people in the Asian region to find employment and improve standards of living. Bangladesh too should explore this promising market to create jobs, stimulate growth, and accelerate the pace of poverty reduction.

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