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Insights and Field-level experiences of Non-Performing Loans in Bangladesh: The Case of State-Owned Commercial Banks (SOCBs)

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Abstract: *The banking industry of Bangladesh has been facing the most turbulent times of its history due to myriad forms of challenges. The crippling scenario has been contributed by multifarious reasons among others, corrupt loan practices and connected-party lending (i.e., lending to board members' firm), lack of monitoring, supervision and inefficiencies of board members especially in state-owned commercial banks, monopolization of banks by certain industrialist groups, unprecedented political interferences and non-existent punitive measures for miscreants by the highest regulatory body i.e., Bangladesh Bank. All these reasons coupled with recent implication of single-digit interest rate are putting the banking industry into vulnerable state and thereby losing the trust and confidence of the mass-people. The excessive volume of NPL will possibly jeopardize the profitability of banks and erode the accumulated capital which might lead to the systematic risks of bank failures in the days to come. To this backdrop, the authors intend to shed some lights with a deeper look on the origin and effects of NPL based on a sample of 200-survey respondents and endeavored to explore industry-insights which might be of special interests to bank owners, managements bodies, regulator i.e., Bangladesh Bank (BB) and finally the shareholders.*

Key Words: *Asset Quality, NPL, Bank Governance and Capital Shock, SOCBs*

Introduction

The proper functioning of banks' asset and liability management is one of the compulsory requirements for fostering economic growth of a country. Bangladesh is a developing country and has an underdeveloped financial market mainly dominated by the commercial banks, whereas there are 6 State-owned commercial banks operating currently. When we look at these SOCBs, we see the bleak scenario of these banks in terms poor governance issues, blatant political interference, degrading asset quality, dwindling capital and not to mention endless corruption and obsolete technology and bureaucratic decision making although they hold a

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significant market shares of our banking industry. Currently, State-owned banks are producing the high percentage of non-performing loans (NPLs) in comparison to all categories of banks (i.e., private, foreign and Islami banks). Non-performing loan is a very critical but frequent issue in the banking industry of Bangladesh from which banks no longer receive interest or installment payments as scheduled. NPL reduces the banks capabilities to provide fund for investments. NPL reduces profitability of banks and enhances the possibility of banks failures. The insights gained on NPL will help the bank to take required corrective measures and trends may help the prospective customers while choosing banks. This is also useful for other related parties such as depositors, employees, regulators etc. However, no such comprehensive study has been pursued on the State Owned Commercial Banks (SOCBs) and bringing them into the lights. This lack of research motivates to conduct the research on observations and consequences of NPL in Bangladesh especially in the SOCBs, which is supposed to fill the existing gap. Findings of this research will help the selected state owned banks of Bangladesh to understand the reasons behind increasing NPL, the consequences of NPL and will help to understand their comparative position in terms of NPL. Findings of the study will assist bank management of state owned banks to formulate policies and take actions in order to reduce NPL. This study will make contribution in outlining the prospective areas of note in the NPL area that have been overlooked in the banking industry of Bangladesh. Finally, findings of this research based on Bangladesh will provide significant insight on NPL of State-Owned banks of Bangladesh for the banks operating in other emerging economies. In this paper, focus has been given on SOCBs as maximum portion of total NPLs of the banking industry of Bangladesh is covered by them.

The study is constructed with main four parts. First part includes introduction, literature review, objectives and methodology. Second and third section comprise the analysis based on opinions from the respondents regarding the insights and consequences of NPL on SCBs of Bangladesh respectively. An analysis of classified loans of SCBs has been presented in the fourth section of this paper. Finally, the paper is completed with some concluding remarks based on the result found from the study.

Review of Literature

Lending decision is very crucial for banks because it determines the future profitability and efficiency in operation of the bank. Recently banks are becoming more conscious in customer selection to avoid the adverse impact of bad loan. The presence of nonperforming (NPLs) has been alarming in the last few years. Amounts of bad loans are alarmingly increasing in both developing and under developed countries. Balgova, M. and Nies, M. (2016) found that non-performing loan works as a hindrance for both lender and borrower. Their developed model also concludes that NPL reduces market efficiency, hinders economic growth and finally destroys banking sector. Bhattarai, Y.R., (2016) tried to find out the effect of non-performing loan on the profitability of commercial banks of Nepal. They concluded that profitability of commercial banks is influenced by many factors including NPL, bank size, GDP growth rate etc. Saba, I. (2012) tried to find out the justifications of NPL in the US banking industry. Their empirical results conclude that macro-economic factors such as interest rate, GDP per capita have relationship with the amount of NPL. They also found that interest rate of loan has an impact on NPL and the relationship is positive. Financial Reconstruction law (FRI) states that in case of Japan the total amount of NPL of all banks was 35.3 trillion yen as of the end of March 2003. But many authorities argue that the actual amount of NPL must exceed 100 trillion yen. On the other hand, the reasons behind the financial and exchange rate crisis of East Asia (Thailand, Taiwan, Malaysia and Indonesia) in 1997 may be viewed as high short-term external debts and excessive loans for real estate. Karim (2010) tried to find out the relationship between non-performing loan and bank efficiency. Their regression model concluded that higher non-performing loan reduces banks' cost efficiency that is NPL increases their cost. Reddy (2015) found that banks lending policy could have vital influence on non-performing loans. A default loan is not entirely a baseless decision. Rather a defaulter takes into account possible assessment of various costs and benefits of his decision. Akter, R. & Roy, J.K. (2017) found that non-performing loan make a several impact in their profitability. Banks do business from public deposit. For this reason bank must take proper steps before granting loan and should take proper recovery steps to recover the nonperforming loan. Makri (2014) focused on identifying the factors, which is causing nonperforming loan in Eurozone's banking systems during the period of 2000-08. At this time, Eurozone was facing with financial crisis. They want to find macro or micro which factor influence nonperforming loan. Their investigation found that macroeconomic factor (Public Debt, GDP growth and unemployment) and bank specific factors (previous year nonperforming loan, capital adequacy ratio) have strong relation with NPL.

3.0 Research Objectives:

A careful assessment of the particular subject headed to the development of the following objectives:

- ❖ To explore the trend of Non-Performing loans of State-owned banks in Bangladesh.
- ❖ To identify the major origins of non-performing loans of State-owned banks in Bangladesh.
- ❖ To analyze the negative effects of non-performing loans of State-owned banks in Bangladesh.
- ❖ To recommend some policy prescriptions to neutralize the growth of NPL and stabilize the banking sector of Bangladesh.

4.0 Methodology

The paper undertakes both quantitative and qualitative study based on the relevant literature necessary to examine motivations and effects of non-performing loans in Bangladesh. This is an exploratory study in which the method followed in data collection is depending on primary data. Primary data has been collected through questionnaire prepared by the authors. The survey has been conducted under actual field condition carried out on a sample size of 200 to capture their unbiased opinion. The details of the sample size determination have been discussed in the sample design section. The ratio analysis for understanding the trends was done using secondary data.

4.1 Sample Design:

A purposive sampling method was adopted and the study was conducted based on the structured questionnaire. The size of the population is unknown. Thus, the required sample size was determined using the Cochran's sample size formula: $n = Z^2pq/d^2$, where n refers to the desired sample size, Z is the standard normal deviation (commonly set at 1.96, which reflects to 95% confidence interval level), p is the proportion in the target population estimated to have a similar characteristic (here p = 85% from the pilot survey), q = 1–p (proportion in the target population not having the similar characteristics) and d is the degree of accuracy required (usually set at the 0.05 level). Therefore, the size of the desired sample size is 196 considering all these factors and authors have used a 200-sample for this study. Among 200 respondents, the break-up of the number of respondents was, 75 existing borrowers, 50 bankers, 20 academicians and 55 banking graduates. The respondents' responded through 'Google survey forms and structured questionnaires.

4.2 Pilot study

A pilot study was conducted among interviewees to make sure that the terminologies used were correct, appropriate and understandable. Interview was conducted in person using face-to-face method because it helps the interviewer to ask as many questions, which were not included in the interview guide depending on the answers received from respondents. Furthermore, pilot study serves to verify how the responses vary among the respondent.

4.3 Sources of Data Collection

Primary Data: In order to collect the first-hand required information and to give reflective insights into the topic, primary data has been collected by using questionnaire. A structured questionnaire was prepared for this purpose. 100 Google forms and 100 structured questionnaires were used to collect data through internet and interview. An open-ended question, rating scale, and 5-point likert scale have been used in the questionnaires.

Secondary Data: Secondary data has been collected from different annual reports of the banks, journals, books, websites, newspapers, magazines and case studies. A minimum 10 years range data has been taken which is in some cases are for 12 years.

4.4 Data Analysis:

At first, the researchers tested the questionnaire using reliability test. After the interview completion, data reduction was undertaken to identify the patterns and themes for gaining insight and better understanding. Data collected from secondary sources have been processed on the basis of different tools like trend analysis, growth analysis and ratio analysis and presented on relevant graphs. The study has been done based on a sample of 200 respondents by using Microsoft Excel software.

5.0 Trends of Non-performing Loans of the State-Owned Banks

In this section, the trends of the Non-performing loans of the State-owned banks have been discussed which will reveal how the volume of troubled asset taking the shapes and reflect the quality of the loan portfolio and the efficacy of the respective managements.

5.1 Agrani Bank Limited

The year 2012 did bring some radical changes in Agrani Bank Limited (ABL). Apart from the reduction in CAR; they also experienced a huge spike in their amount of NPL. Consequently, their amount of classified loan as % of total loan also saw a huge increase from 11.07 % to 25.03%. The abrupt jump of bad loans shocked the authors in a way, which is beyond unacceptable. These changes are shown in the graph below

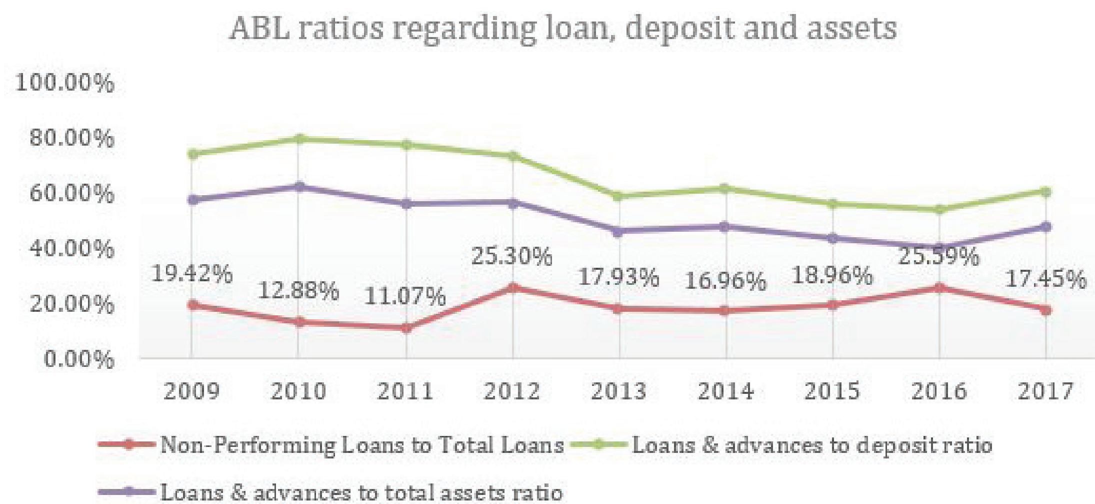

Figure 1: ABL ratio regarding the loan, deposit, and assets

Source: Authors' Calculation

The graph depicts that the loans and advance to total asset and loans and advance to deposit ratio both followed quite a similar pattern for the whole course. They were stable since the beginning until in 2012, the breakdown caused the graph to go south. A major catalyst behind this breakdown is the rise of the NPL, which is shown in the orange colored line in the graph. However, this graph does not give the true picture of how well ABL was performing before the breakdown and how inconsistent their performance has been since the breakdown. Subsequently, the following graph might clarify the opaque water a bit. As the graph shows that the number of classified loans wasn't decreasing a lot from 2005 till 2012.

In contrast, the ratio of the total classified loan was decreasing unceasingly. One of the main reasons behind this is that ABL was providing quality loans to customers who were actually creditworthy. Subsequently, their assets went up while the classified loan remained constant, which forced the total classified loan as a percentage of total loans to saw a continuous decrease for nearly 6 years straight. However, in 2012, due to change of classification rule and taken into qualitative judgment pointed out by the regulators and external auditors, classified loans have increased and accordingly, the requirement of provision has also been increased significantly which has been fully accounted for in the financial statements.

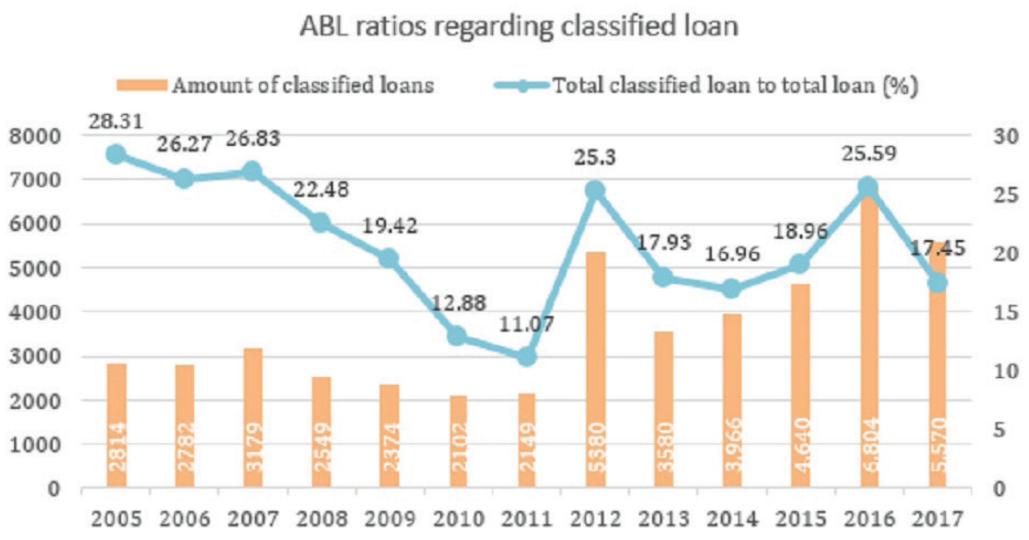

Figure 2: ABL ratios regarding classified loan

Source: Authors' Calculation

Since then, the amount of classified loan has never gone down below 3000 corer taka mark. Moreover, in 2016, the bank experienced its highest classified loan amount, which was aiming for the 7000-core mark and almost touched it. Therefore, it is obvious that since 2012 the ABL has neither been able to stabilize their performance nor to decrease their amount of classified loans.

5.2 Sonali Bank Limited

Before getting into the non-performing loan, we would like to illustrate another vital statistic of SBL. This statistic is the loan to deposit ratio. This ratio reflects how effectively and efficiently SBL can invest the collected deposit in profitable sectors in form of lending to creditworthy party.

Figure 3: Classified Loans of SBL

Source: Authors' Calculation

This ratio does start with a highly promising scenario but the promise fades away as time passes by. To be more precise, the year 2011 was the year when the bank saw the peak of the loan to deposit ratio. Since then, the ratio has been falling gradually and according to our collected data, it was standing at the 37% mark at the end of the year 2016. There are mainly two reasons behind this fall. Firstly, the amount of deposit supply has been reduced by some margin due to the fact that many people have lost their faith on the bank. The second reason is that the bank was mostly focused on collecting their bad loans and they became very cautious in sanctioning further loans. The following graph will explain why they became that much critical in sanctioning new loans because the following graph will show the trend of the NPL to total loans ratio for 6 years starting from 2010.

Figure 4: NPL to Total Loans of SBL

Source: Authors' Calculation

In the previous graph, we saw that the loan to deposit ratio was at the peak in 2011 at the same time their NPL was at the lowest among of the 6 years when it is measured against total loans. However, this scenario took a sharp turn of the opposite when the cat came out of the bag. In 2012, all the loan scandals were brought to light. Subsequently, the graph went from south to north taking a steep escalation in just a matter of the year. Afterward, the ratio has never reached any points below the 25% mark. In simple words, one-fourth of their total loan has been accounted as non-performing since 2012 and continuing. In other countries, this action would have inspired a tornado of legal actions but in our country, it has hardly created a ripple in the system.

5.3 Janata Bank Limited

The classified loan of Janata bank was very low if we compare with its fellow state-owned banks. For example, Sonali bank had the lowest classified loan to total loans ratio in 2011, which was accounted as 17 %. In contrast, the ratio of Janata bank was at its peak at 2012 yet that slightly crossed 17% mark. Janata bank has shown their lowest classified loan-to-loan ratio in 2012 and 2011. Surprisingly, that ratio nearly tripled within 1 year when the authority reviewed the NPL. Therefore there might be some regulations within the books of Janata bank also. The following graph will show the trend of the classified loan to total loan ratio.

Figure 5: Classified loan to total loan & advance of JBL

Source: Made by authors

5.4 Rupali Bank Limited

The authority of Rupali bank alleged the immense provision as the main catalyst of negative operating profit as subsequently negative ROE. We, therefore, going to start our analysis by showing the trend of the provision they kept for classifying loans during the last 6 years in the following graph.

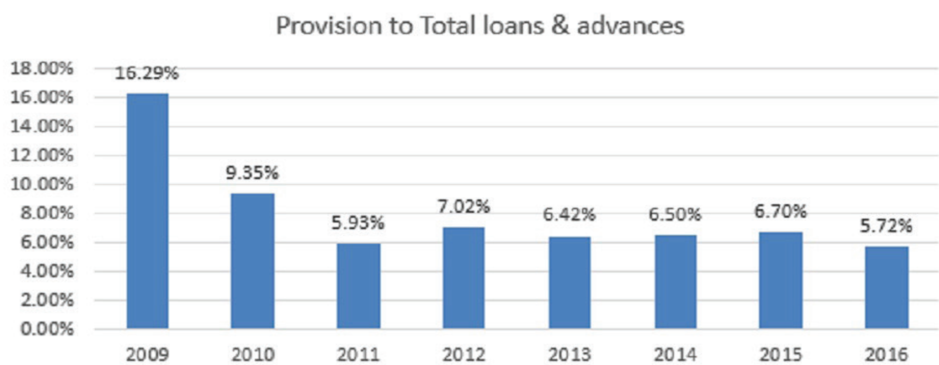

Figure 6: Provision to Total loans & advances

Source: Authors' Calculation

The chart is expressing an opinion which contradicts with the opinion provided by the top authority. The chart clearly tells us that the provision for the classified loan, measured as a percentage of total loans, has never been as low as in 2016. Therefore, it can be said with confidence that there has been any miscommunication or the authority has misrepresented the information in their annual report (Bb.org.bd, 2018). However, due to the insufficient data and inaccessible data sources, we cannot say with certainty what exactly happened in that year which forced the bank to report negative operating profit and negative ROE.

6.0 Analysis and Discussion of Survey Results

In this section, the authors have discussed the findings of the data analysis and the survey effects resulted from the responses of the people took part in the survey.

6.1 Socio-economic background of the respondents

The authors have interviewed existing borrowers who have taken loan for business purpose from the scheduled banks of Bangladesh. The profile of the respondents is as follows:

Group of Respondent	Number	Percentage of Respondents
Existing Borrower	75	37.5%
Banker	50	25.0%
Banking Graduates	55	27.5%
Academicians	20	10.0%
Total	**200**	**100%**

Interviewed existing borrowers include both genders of different age groups with diversified educational background. Both urban and rural borrowers were interviewed. For the purpose of the study, questionnaire was sent to 50 top management and middle management bankers who have experience in working with loans and advances. All of these bankers have 10 years plus working experience in the banking industry. These bankers were selected from state-owned banks, private commercial banks and foreign banks operating in Bangladesh. The authors have collected information from 55 banking graduates who have been graduated from banking discipline. These banking graduates are from University of Dhaka, University of Rajshahi and University of Chittagong. Finally, interview of 20 academicians were conducted who have research experience and interest in the area of NPL. These academicians are from University of Dhaka, University of Rajshahi and BIBM.

6.2 Insights gained from NPL of State-Owned Commercial Banks

There are numerous justifications for which a loan can be defaulted. However, in this study, authors have chosen the most significant four reasons, which might be the cause of loan default. These reasons were high interest rate, lack of accountability, inefficient supervision and regulation and borrower's inexperience.

6.2.1 Poor Bank Governance and Weak Management

Poor governance is known as the relationship between those who govern and those who are governed as a consequence of decision-making. This relationship is created as a consequence of external factors or decisions such as violation of central or acceptable norms. Strong bank governance and efficient management are highly required to control NPL of the banking industry of Bangladesh. In the survey, the respondents were asked if they think that poor bank governance and weak management are vital reason for the increased amount of NPL in the banking industry of Bangladesh. 78% respondents strongly agreed with the statement where as 22% respondents agreed with the statement.

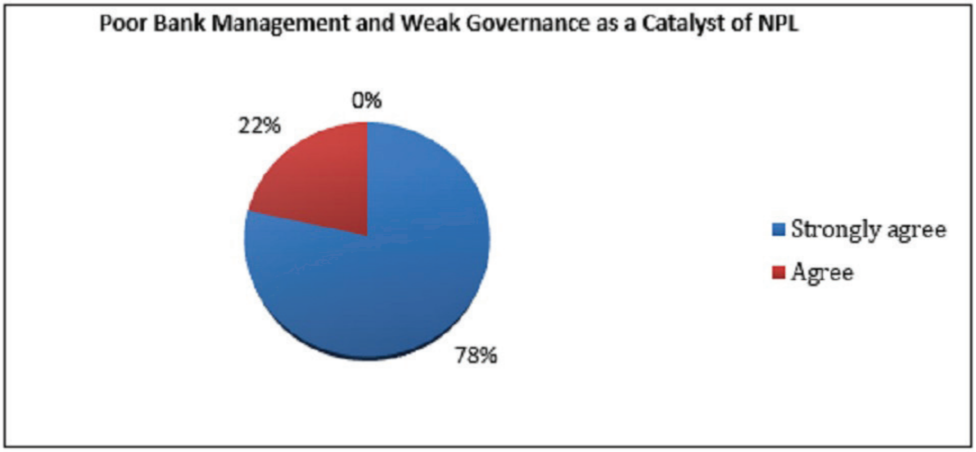

Figure 7: Poor bank management and weak governance as a catalyst of NPL

6.2.2 High-interest Rate as a catalyst of NPL

Interest rate is the amount that a lender charges to the borrower for the use of fund expressed as a percentage of the principal. High-interest rates make loans more expensive. When the rate of interest of banks is high, fewer people and businesses can afford to borrow from bank. I n the survey, the respondents were asked if they think that the high interest charged by the banks on loan becomes a burden for the borrower and eventually makes the loan non-performing.43% of the respondents remain moderate while 32% of people agreed that interest rate can be the catalyst of NPL.

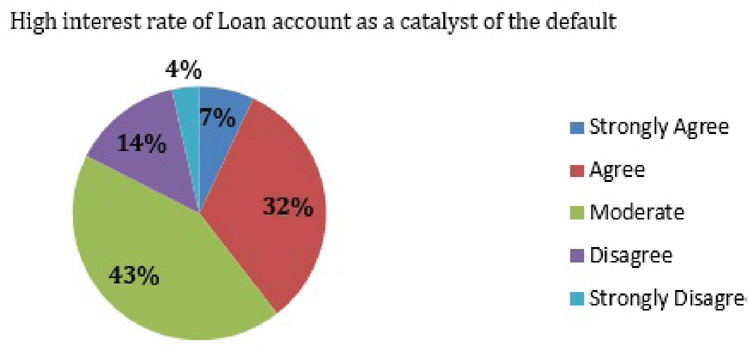

Figure 8: High-interest rate as a catalyst of Non-Performing Loan

6.2.3 Lack of accountability as a catalyst of NPLs

Accountability is the obligation of an organization or any individual to account for own activities. This is the obligation of any organization or individual to account for activities, accept responsibilities for them and maintaining transparency in disclosing results. According to the experts ranging from economists, regulators and academics, majority of the NPL of state-owned banks are a result of lack of proper accountability. The survey results also concurred with the same hypothesis. Nearly 70% of the respondents agreed on the fact that lack of accountability is a cause of NPL in the state-owned banks.

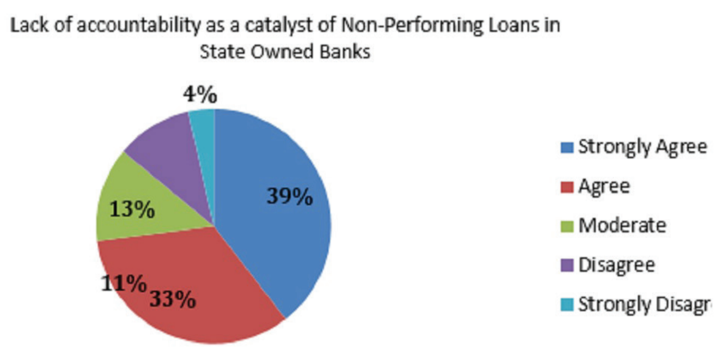

Figure 9: Lack of accountability as a catalyst of Non-Performing Loans

6.2.4 Ineffectiveness of banking supervision and regulation as a catalyst of NPL

Banking regulations are known as the written rules and guidelines that define acceptable behavior and conduct for the banking system. On the other hand, Supervision means examining and investigating the financial condition of individual banks and evaluating their compliance with regulations and laws of that particular country. So far, the origins of Non-Performing Loans were found as a fault from part of the bank. But to get in-depth knowledge about the respondent's perspective, the researchers also asked whether they think that the regulator of the financial system is playing a good role in terms of supervising the banking system. Shockingly, the answer came in negative as the majority, more precisely 50%, of the respondents believed that the current supervisory role played by the regulators are dissatisfactory. They should increase the effectiveness of the banking supervision system. The following graph will show the results provided to us by the respondents.

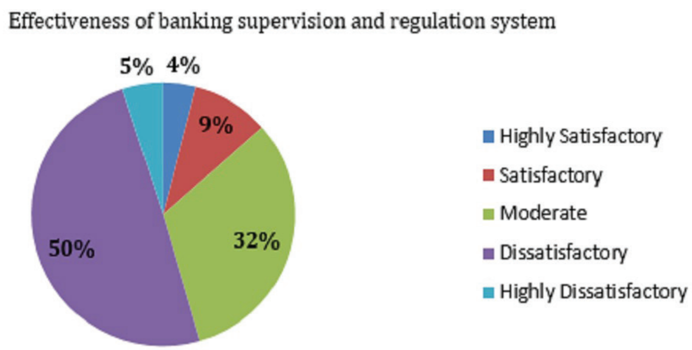

Figure10: Ineffectiveness of banking supervision and regulation as a catalyst of NPL

6.2.5 Lack of working capital &Borrower's inexperience as a catalyst for NPL

Working capital is known as the capital of a business, which is used in day-to-day trading operations. An inexperienced borrower is referred as someone who has no prior experience in the area of his/her business. The researchers asked the respondents about what they think about the borrower's part in making a loan non-performing. The researchers asked them do they agree or not with the fact that the lack of working capital and inexperience of the borrower can play a significant part turning a loan into bad asset. The result showed that the majority of the respondent agreed with our hypotheses. The following graph will evidence it.

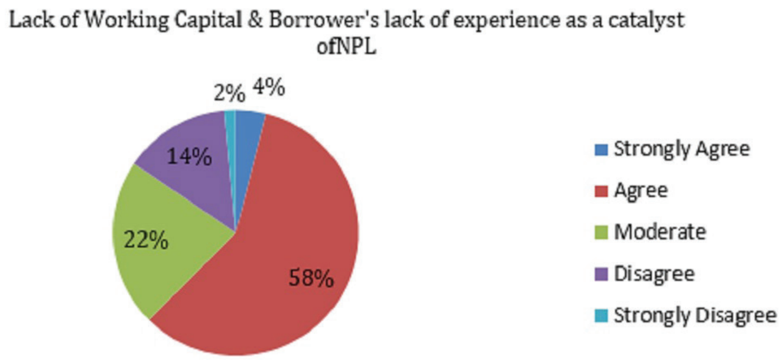

Figure 11: Borrower's inexperience as a catalyst for Non-Performing Loans

6.2.6 Political Influence and Inefficient Board Members

In Bangladesh, political influence to get loan that is not worth of sanctioning is a common phenomenon. Moreover, inefficiency, lack of integrity, lack of honesty of the board members is also crucial reason for the alarming rate of NPL in Bangladesh. We asked them do they agree or not with the fact that political influence and inefficiency of the board members can play a significant role in turning a loan into bad loan. The result showed that the majority of the respondent agreed with our hypotheses. The following graph will evidence it.

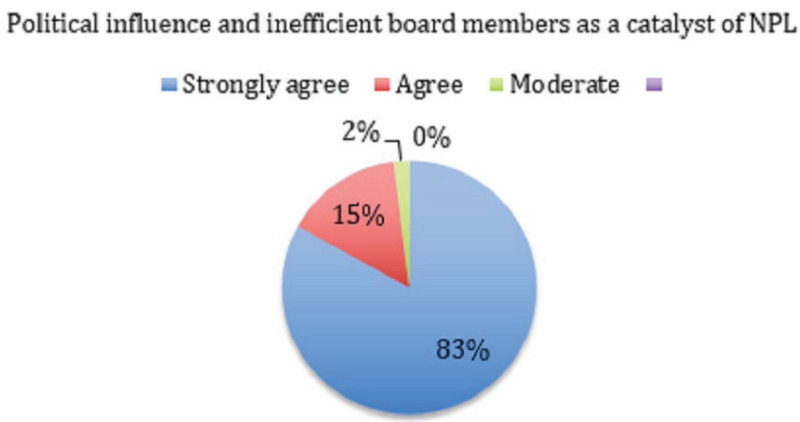

Figure 12: Political influence and inefficient board members as a catalyst of NPL

Corruption is a common issue while sanctioning the loan from the public-sector banks starting from loan application to appraisal, faking documents to security valuation and not to mention to complete absence of the loan monitoring and supervision since staffs remuneration is not attached with their performance unlike the practices of the private sector banks prevailing in our country.

7.0 Consequences of Non-Performing Loans in State-Owned Banks

Non-Performing Loans (NPLs) reduces the liquidity of banks, restricts the credit expansion, slows down the growth of the real sector with direct consequences on the performance of banks and the firm which is in default and the economy as a whole (Bhattarai, 2017).While conducting the survey on Non-Performing Loans of the state-owned banks, we have interviewed 200 respondents from several dimensions including bankers, academicians, customers, students, and business graduates. They have rendered their opinions about NPL from both open-ended and close-ended question. Of the various effects of NPL, the survey was mainly focused into five major impacts which the respondents ranked according to their opinion from most severe impact to the least. The survey result is shown as follows regarding the main impacts –

7.1 Five Major Effects of Non-Performing Loans

According to the survey result, these five impacts are described as the main consequences of Non-Performing Loan, which are described in the following section.

Liquidity Crisis

Of the 200 responses, 35% ranked liquidity crisis as one of the severe costs of NPL. When the banks cannot recover the loan sanctioned, ultimately resulting in bad loans, the banks are faced with a liquidity crisis as their asset-liquidity management decision does not go as planned. As a result, the banks cannot honor their customers' cheque, which is unfavorable to the banks' reputation and may create a bank run in the long-run. The amount of NPL of State-owned banks has increased from TK.105.7 billion in 2003 to Tk.215.1 billion in 2014. This indicates that the NPL amount almost doubled over ten years creating the crisis in funds.

Instability of Bank Operations and Economic Instability

The second most severe impact of the Non-Performing Loans of state-owned banks is found economic instability as 24% opinions came as in consent with the unstable banking operations and thus economic condition as an impact of NPL. The overall economic condition of the country becomes vulnerable when the banks cannot operate at their best by providing borrowing facilities and profitable savings opportunities for potential clients.

High-Interest Rate to New Loan

The next impact according to the level of severity is found out charging the higher interest rate for the new loan by the banks as the price of NPL as 21% of the respondents agreed in this issue. When a bank is condemned with non-performing loans and its lending capability is threatened by reason of liquidity crisis, the bank simply increases its lending percentage in order to both compensate for the loss of income from default loan and discourage new borrowers.

Lower Deposit Rate

According to the survey result, the reduction of deposit rate by the banks of the deposit accounts is another impact of NPL with 12% of responses agreeing on it. The rate of interest, given on the savings account and the time deposit accounts declines with the reduction of bank's profitability. They cannot provide an appropriate return on the deposit accounts. Thus, the common people become reluctant to deposit their savings in the banks.

1.1.1 Rejection of Loan Proposal

The fifth and last of the focused impacts came across is the bank's rejection of new loan proposals which has 8% responses showing positive agreement on it. The bank scrutinizes the loan proposals more carefully than before when it is exposed to non-performing loans and discards most of the proposals, which it finds problematic and might result in bad loans. This decision of the bank rejects many potential loan applications.

1.1 Other consequences Revealed by the Survey

Apart from the five major impacts, there are some other factors identified as the repercussions of Non-Performing Loans, which are described as below –

7.2.1 Encouraging More Non-Performing Loans

When Non-Performing Loans are not properly controlled and recovered, there is a chance of increasing moral hazard among the defaulted borrowers as they feel encouraged to take the loan from other banks and diversify the loan into other purposes again as their previous remarks have been unnoticed. From the survey result, it is clearly a serious impact as 62% of the responses agree on it.

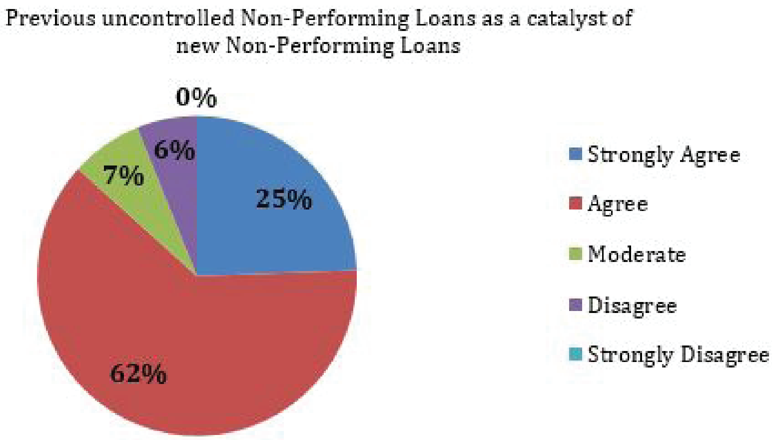

Figure 13: Previous NPL induces more NPL in future

7.2.2 Decreasing Supply of Fund

When a bank is faced with non-performing loan issues, this news spread over the market indicating that the bank is not performing well and is unable to control its loan accounts referring to ineffective management. As a result, the depositors become reluctant to deposit fund in that bank due to the safety concern of their funds and other banks and institutions also become unwilling to lend the distressed bank as there is a possibility of not recovering that loan. From the result of the survey, 32% of people agreed on this affair.

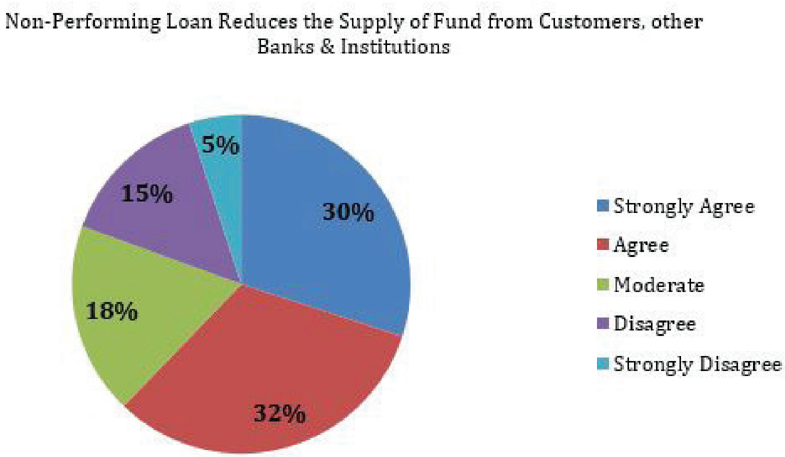

Figure 14: NPL reduces the supply of funds

7.2.3 Reduces Demand for Fund

43% of the responses came in favor of the statement that non-performing loans reduce the demand of fund from the borrowers. When banks set loan interest rate higher to recover from existing NPL, the new borrowers cannot pay the high-interest rate and fails to obtain loans to operate their venture or requirements for the longer term. Thus, the demand for loan decreases due to the high-interest rate.

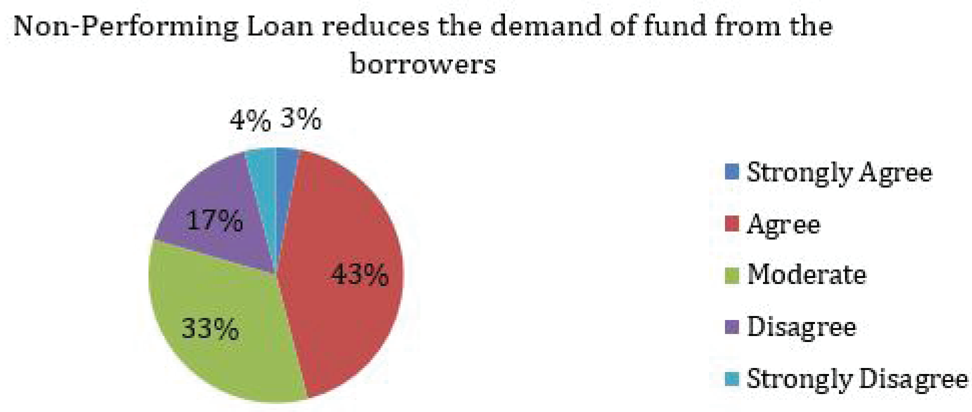

Figure 15: Non-Performing Loan in State-Owned Bank reduces the demand of fund

7.2.4 Myriad Risk Exposures

With the increase of NPL, the banks are exposed to more risks to cover up with its regular risk-management strategy. As the non-performing loans reduce the bank's capital base, it has to revise the investment and loan policy. In the survey analysis, 42% of responded regarding positively in this issue. An example of real scenario of the State-owned banks – the capital adequacy ratio of the state-owned banks increased to 7.9% from 1.1 in 2008 and was recorded highest in 2011 by 11.7% and fluctuated over the next years. Nevertheless, the ratio fell significantly to 1.2% in 2014 meaningless protection for the depositors' assets.

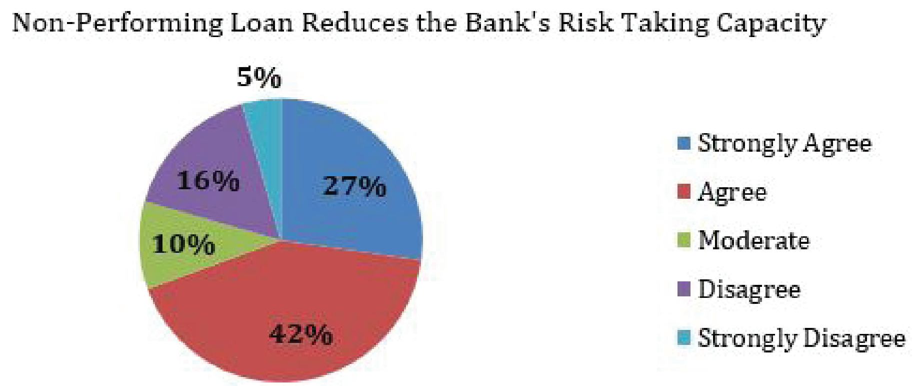

Figure 16: NPL Reduces the Bank's Risk-Taking Capacity

7.2.5 Decline in Public 4Confidence

Around 58% of responses of the survey came as affirmative and 28% gave firm conformity ultimately covering more than 80% of total responses on the topic of decreasing public confidence on government due to NPL of the state-owned banks indicating it is a serious issue with no denying. When the banks are faced with a large number of loan defaults and fail to perform, as it should have, public confidence towards the banking system becomes dubious. Of the six State-owned banks, Sonali Bank was documented as having the largest loan default in September 2015, which was Tk.12,570.21 crores. This sort of event may reduce the confidence level of public toward the banking sector indicating the government is not monitoring the State-owned banks properly.

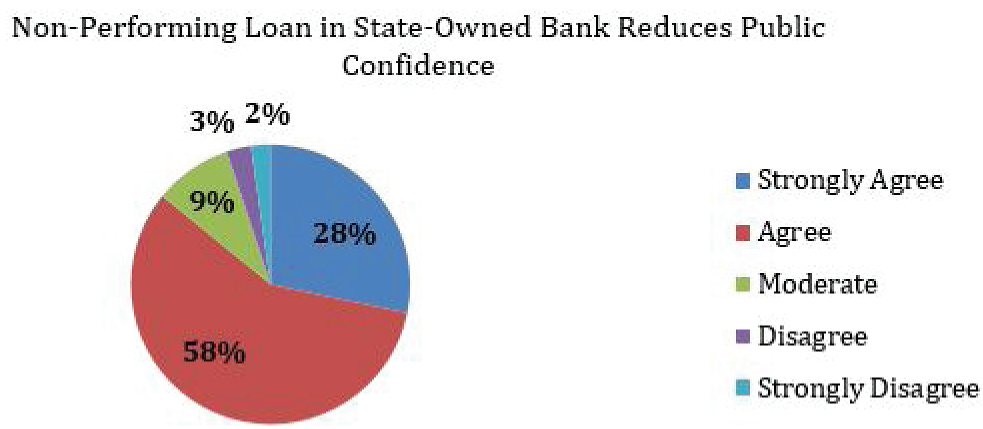

Figure 17: Non-Performing Loan in State-Owned Bank Reduces Public Confidence

8.0 Major Findings

i. We observe that majority of our respondents believe that the lack of proper monitoring of credit is the most vital cause of non-performing loans followed by the political influence. Politically appointed board members are responsible for unduly influencing the process of credit selections to non-prime borrowers and corrupt the loan disbursement procedures.

ii. The vast majority of the interviewees agreed with the fact that the inexperience of the borrower plays a significant part in turning a loan into a non-performing one. It is opinioned that even with good collaterals could not save many good projects due to the inexperience and lack of foresights of the borrowing clients.

iii. We find that around 70 percent of our respondents agreed on the fact that lack of accountability and absence of strict monitoring are the roots of NPL in many instances of project loans extended by the State-owned banks.

iv. Further to that, around 50 percent of the respondents believed that the current supervisory roles played by the regulators are dissatisfactory especially the role of Bangladesh Bank has been particularly in question in terms of proper monitoring and enforcing strict punitive actions against the miscreants.

v. Majority of the interviewees believe that high interest is responsible for a loan to become classified due to the excessive pressures excerpted on the entrepreneurs in terms of the repayment schedule along with principal and excessive interest.

vi. Our survey reveal that major consequences of NPLs are the liquidity crisis, the higher pricing of the new loans, lower deposit collection rate and rejection of new but good credit proposals due to the shortage of lendable funds and ultimately the losing the clientele base in the long-run.

vii. Our survey also reflect there are other adverse effects of NPLs namely, directly or indirectly encouraging more non-performing loans (i.e., sanctioning loans to non-prime clients with exorbitant loan pricing), declining demand for new loans (i.e., due to adverse market reputation), subdued public confidence and finally unfavorable future business outlook and reduced banks' profitability.

A Quantitative Model for Future Study:

The authors understand that there might be some limitations of our proposed study on the basis of qualitative data. The authors endeavored to complement the vast majority of quantitative literature with this qualitative study. However, in order to minimize the limitations of the qualitative work, the authors propose a governance model for future research endeavor to the pin-point the factors affecting the NPLs of commercial banks in the context of Bangladesh.

$$\frac{\boldsymbol{NPL\ Amount}}{\boldsymbol{TL}} = \boldsymbol{a_0} + \frac{\boldsymbol{NEXD}}{\boldsymbol{TD}} + \boldsymbol{NPLD\ Index} + \boldsymbol{I.R} + \boldsymbol{D.C}$$

Where,

NPL Amount/TL = Amount of Non-Performing Loan/ Total Amount of Loans

NEXD/TD = Non-Executive Directors/Total Number of Directors

(Authors expect an inverse relation with the response variable i.e., higher the proportion of non-executive director in the board, lower will be the volume of NPL).

NPLD Index= Non-Performing Loan Disclosure Index i.e., it reflects how much disclosure is added into financial statements to facilitate informed decisions by the stakeholders. Thus, researchers expect a negative relation with the target variable.

I. R= Interest Rate or price charged on the given Loan

(Authors expect a negative relationship with the explained variable, i.e., ceteris paribus, higher the price charged on loans, lower will be the possibility of repayment).

D.C= Debt Covenants i.e., terms and conditions attached with each of the given loan

(The researchers predict a negative association with the outcome variable as higher the covenants requirement, lower will be possibility of default and vice-versa).

9.0 Conclusion

The eventual and unwavering rise of NPL has been a big headache for all the stakeholders pertinent to the banking industry of Bangladesh especially the depositors, customers (i.e., prevailing and prospective), bank management, shareholders, and the regulators including the government. NPLs are essentially related to the operational proficiency of banks and in order to safeguarding smooth operations of the banking industry it is of paramount importance to identify the factors that influence the level of NPLs. This study mainly focuses to uncover the inherent natures of NPL of SOCBs through conducting survey based qualitative study unlike the previous studies that are pre-dominantly relied on quantitative studies. **Adhikari (2007)** based on a quantitative study observes that lack of credit monitoring and supervision, inefficiency of the legal system and poor recovery strategy are the reasons of skyrocketing NPLs. He recommends privatizing the State-Owned Banks, introducing securitization of problem loans and enlarging the supervisory role of the Bangladesh Bank. However, **Reddy (2015**) based on a panel data study finds that lending to non-priority sectors, smaller size and inadequately collateralized banks founds to be the determinants of NPAs in India. His study reflects that public banks, in general, have more NPAs than that of their private counterparts. Unlike these studies, through this paper, we contribute to the vast amount of NPL literature by inserting the insights garnered from the experiences of bankers, borrowers and academicians from a qualitative point of view by conducting a survey-based research. Further, our findings supplement the current literature in terms of bringing the undocumented origins of NPL based on the experiences of the relevant stakeholders particularly the bankers and borrowers into the attention of the policy makers. One of our limitations of the study is smaller sample sizes and another is that the current study is based on the qualitative observations of the pertinent bodies dealing with the credit from the lender and borrower sides. Therefore, our findings should be interpreted with caution and with relevance to the similar NPL scenarios. Future research works may endeavor to combine together the qualitative insights with the quantitative findings which might be more useful in gauging the origins of NPL and costs they produce for the banking firms not only in the short-run but also in the long-run. From the study, it can be concluded that the State-Owned Commercial Banks (SOCBs) in Bangladesh have higher NPL ratios in compared to the competing private commercial banks. In contrast to SOCBs, private commercial banks are more efficient in monitoring their classified assets and enforcing strict compliance of credit policies and regulations which is to some extent absent in case of SOCBs. The government's relevant body mainly the 'Bank and Financial Institutions Division' under the Ministry of Finance should initiate to recruit the skilled management from private sector to enhance the operational efficiency of the SOCBs and ensure the proper accountability of the banking operations where their remunerations should be set in connection to the quality of bank governance and their long-run performance. Additionally, the boards of all SOCBs should be restructured and reformed with skilled and professional board members who will oversee the operations of the management and make them responsible for their actions and performances.

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