



ISSN NO. 2320-5407

Journal homepage: <http://www.journalijar.com>

INTERNATIONAL JOURNAL
OF ADVANCED RESEARCH

RESEARCH ARTICLE

Nonperforming Loan and Banking Sustainability: Bangladesh Perspective

Shafiqul Alam¹, Md. Mahbubul Haq² and Abdul Kader³

1. Lecturer, Department of Business Administration, Noakhali Science and Technology University, Bangladesh.

2. Lecturer, Department of Business Administration, Noakhali Science and Technology University, Bangladesh.

3. Senior Officer, One Bank Ltd., Bangladesh.

Manuscript Info

Manuscript History:

Received: 18 June 2015
Final Accepted: 15 July 2015
Published Online: August 2015

Key words:

nonperforming loan, banking
sustainability

*Corresponding Author

Shafiqul Alam

Abstract

This study has focused on investigating the causes of significant increase of nonperforming loans (NPLs) in the Banking industry of Bangladesh and its impact on sustainability of that industry. The study reveals that the country has been suffered from a large amount of nonperforming loans in the banking industry mainly due to fund diversion, political and board of directors' interference, political instability, engagement of corrupted bankers, aggressive banking due to enhanced competition, falling in real estate business, weak monitoring and lack of coordination among related parties. It also found that giant defaulters and corrupted bankers have been escaped from jurisdiction under laws mainly by using political shelter that results in creating negative impression on good borrowers. Ensuring the application of credit sanctioning guidelines and strengthening debt recovery strategy, the nonperforming loans must be reduced otherwise in near future it will bring a disaster in banking industry that may threaten its sustainability.

Copy Right, IJAR, 2015., All rights reserved

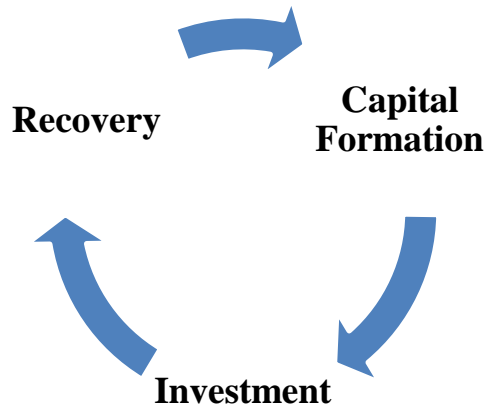
1. INTRODUCTION

Being the intermediary of money cycle banks are playing a crucial role to the growth of economy not only ours but also throughout the world. Especially commercial banks have played a major role to the economy like ours. The commercial banks are considered as a driver of money supply for the developing nations like Bangladesh. Greuning and Bratanovic (2003), argue that commercial banks play a critical role to emerging economies where most borrowers have no access to capital markets. Well functioning commercial banks accelerate economic growth, while poorly functioning commercial banks are an impediment to economic progress and aggravate poverty (Khan and Senhadji, 2001) in Richard (2011). The major functions of commercial banks are taking deposits from depositor and lending that amount to the borrowers that may be individual or organizations. By collecting their loan with interest and investing again and again commercial banks can make their profit that is considered as their financial performance. The financial performance indicators can be divided into three main group: profitability ratios which gauge a company's operating success over a given period of time; liquidity ratios which measure the short-term ability of a company to pay its debt and to meet unexpected cash needs; and solvency ratios which indicate a company's ability to meet long term commitments on a continuing basis.

Although it is expected that the loans will be recovered duly with their interest but the whole process of money cycle is not running smoothly. Sometimes the loan is not performing well. Waweru and Kalami (2009) stated that due to the nature of their business, commercial banks expose themselves to the risks of default from borrowers. These non performing loans have an immense negative impact on the economy, especially developing countries like ours. Initially non-performing loans (NPLs) may not seem to have a serious negative effect (Andrew Crockett, 2003) cited in Aziz et al. (2009). Banks remain liquid and depositors retain their confidence in the system. Over time, however,

the size of the problem grows, especially if banks are allowed to accrue interest on their non-performing loans (NPLs).

The rapid increase of non-performing loans (NPLs) has negative impact on the banks and other development financial institutions. They will try to tighten their lending in a safe way and focus on recovery of non-performing loan. Due to lending risk aversion behavior of banks many potential businesses can't take loan that lead to the economy to be stagnant. Non-performing loan impedes saving-investment process also. Choudhury et. al.



(2002: 21-54) showed a Capital formation- Investment- Recovery loop. They stated that the loan loss is a total loss of time, money and effort. Jones (2002) argued that we invest to improve our welfare, which for our purposes can be defined as monetary wealth, both current and future. And investment is not the end of the story; the invested funds are needed to be settled in a timely fashion so that the fund again gets its way to be flooded down in the economic process either by reinvestment or by immediate consumption. Loans that are considered sound at the time of sanctioning become unsound with the passes of time and turn our wheels of economic development in a backward way.

Sometimes the non performing loans are rescheduling to recover from the default borrowers. After rescheduling, the loan may or may not be collected but the financial position of the banks has been furnished because of rescheduling. Due to large number of banks in our country some bankers are engaged themselves in aggressive banking which result in higher level non performance. Some corrupted bankers engage themselves in case of plundering money from the banks through loan forgery. Weak monitoring, lack of co-ordination among regulatory authorities are also responsible for increasing non-performing loan. In many cases giant defaulters divert their fund after granting loan and they have been escaped from jurisdiction under laws. Unexpected interference has been occurred by board of directors and political leaders for loan sanctioning and distributing. For all of these reasons Bangladesh has been suffering from a large amount of non-performing loan. Recently ministry of finance has given an information at national parliament that the total amount of non-performing loan is 56 thousand crore taka. So effective recovery strategies should be taken by commercial banks as well as Bangladesh Bank so that non-performing loan can be reduced and new investment will be safe and sound. Otherwise if these problems will continue then in near future it will bring a disaster in banking industry.

2. METHODOLOGY

This study aims at assessing NPLs status and its effect on sustainability of banking industry in Bangladesh. The researchers employed qualitative method for the study. In this research secondary data were used. The kernel of the research was developed based on secondary data which were collected from different journals, publications of Bangladesh Bank, annual reports of different Bangladeshi banks, newspapers, website of Ministry of Finance of Bangladesh, Bangladesh Bureau of Statistics and different websites. The researches explored the reasons behind the surge in NPLs in last few years. For exploring those reasons the researchers have analysed secondary data. Some statistics were used from different secondary sources. The researchers have also studied the sustainability of banking industry by explaining the secondary data. The effect of NPLs on sustainability of banks was determined based on opinions of different specialists and authors published in different newspapers and journals. Moreover, the

researchers have applied their insight and practical experiences for explaining relationship between NPL and Banks' sustainability in Bangladesh.

3. LITERATURE REVIEW

Generally the prime source of commercial banks' earnings is the interest from their lending. Although it is expected that the loans will be recovered duly with their interest but the whole process of money cycle is not running smoothly. Sometimes the loan is not performing well. Waweru and Kalami (2009) stated that due to the nature of their business, commercial banks expose themselves to the risks of default from borrowers. From the very beginning of our country the banking industry are facing the non performing loan problem. Islam et al. (1999: 35-37) stated that the issue of nonperforming loans in Bangladesh is not a new phenomenon. In fact, the seeds were cultivated during the early stage of the liberation period (1972-1981), by the government's "expansion of credit" policies on the one hand and a feeble and infirm banking infrastructure combined with an unskilled work force on the other. Choudhury et al. (1999: 57) find that Government direction towards nationalized commercial banks to lend to unprofitable state owned enterprises, limited policy guidelines (banks were allowed to classify their assets at their own judgments) regarding "loan classification and provisioning" and the use of accrual policies of accounting for recording interest income of NPLs resulted in malignment of the credit discipline of the country till the end of 1989. Due to alarming amount of non-performing loan, now banking industry is trying to tighten their lending policy. As a result, on the one hand many potential businessmen may not take loan from banks that hinder to expand their businesses as well as tranquility will be faced by the economy on the other. Aziz et al. (2009) stated that the rising of non-performing loans (NPLs) has an effect to the financial institutions: they tightened their lending and switched their attentions to rehabilitating the non-performing loans (NPLs) in their books. This prevented viable businesses from obtaining funds to generate economic activities. When the rate of non-performing loan is high then it will affect the banks' profitability and lower interest income. Sometimes it may also erode the capital of the bank that ultimately threatens banking sustainability. Muniappan (2002: 25-26) argues that a bank with high level of NPLs is forced to incur carrying costs on non-income yielding assets that not only strike at profitability but also at the capital adequacy of a bank, and in consequence, the bank faces difficulties in augmenting capital resources. Bonin and Huang (2001: 197-214) also state that the probability of banking crises increases if financial risk is not eliminated quickly. Such crises not only lower living standards but can also eliminate many of the achievements of economic reform overnight.

Some banks are engaged themselves in aggressive banking to cover their present bad and loss. It does not bring good result all time. Some time it worsen the situation by increasing new NPL with present bad and loss rather than reducing the current amount of NPL. That high rate of nonperforming loan finally results in financial crises in the market because of the lending risk aversion behavior by the banks. Greenidge and Grosvenor (2010), argue that the magnitude of non-performing loans is a key element in the initiation and progression of financial and banking crises. Guy (2011) agrees arguing that non performing loans have been widely used as a measure of asset quality among lending institutions and are often associated with failures and financial crises in both the developed and developing world. Reinhart and Rogoff (2010) as cited in Louzis et al (2011) point out that nonperforming loan can be used to mark the onset of a banking crisis. Bank problems, mostly failures and financial distress have afflicted numerous banks, many of which have been closed down by regulatory authorities (Brownbridge, 1998). This in turn led to contraction of activities, decline in output, and imposition of substantial costs on the economy (Chijoriga, 1997; Brownbridge and Harvey, 1998) cited in Richard (2011).

Recently we have also seen some real experience of financial crises and the threat of banks' existence from nonperforming loan in Zimbabwe. In June 2011, Renaissance Merchant Bank of Zimbabwe was placed under 6 month curatorship after the RBZ's audit revealed an inappropriate shareholding structure, chronic undercapitalization and liquidity challenges, high level of nonperforming insider and related party exposures, persistent losses, and corporate governance and internal control deficiencies. On July 27, 2012, Royal Bank Zimbabwe Limited surrendered its banking license to the RBZ. Onsite inspection by the RBZ determined that the bank was critically undercapitalized, faced chronic liquidity challenges and liabilities to the RTGS system, had high non-performing insider loans, and had been misrepresenting information to the RBZ.

In our country giant defaulters have been escaped from jurisdiction under laws. By taking these opportunities they have plundered thousands crore taka from many banks especially from government commercial banks and development financial institutions. This practice creates a negative impact on good borrowers also. Islam et al (2005) argued that NPLs, if created by the borrowers willingly and left unresolved, might act as a contagious financial malaise by driving good borrowers out of the financial market. If NPLs are not properly addressed, bad

borrowers can create a negative psychological impact on good borrowers to prolong their payments. This situation worsens the economy where enforcement status of laws is seen as very weak. Sometimes lack of adequate information about customers creates a problem of proper selection. In our country where corruption has scattered in everywhere in that case many businessmen and business organizations engage themselves in window dressing of their financial position to cover their real information. And sometimes they provide fake documents to take loan and give false information. Auronen (2003) stated that the theory of asymmetric information tells us that it may be difficult to distinguish good from bad borrowers, which may result into adverse selection and moral hazards problems. The theory explains that in the market, the party that possesses more information on specific item to be transacted (in this case the borrower) is in a position to negotiate optimal terms for the transaction than the other party (in this case, the lender). Adverse selection and moral hazards have led to substantial accumulation of nonperforming assets (NPLs) in banks (Bofondi and Gobbi, 2003).

There are several reasons of nonperforming loan. The cause of nonperforming loan varies from country to country. Different authors find out different reasons for high nonperforming loan in different countries. Basically economic slowdown, lack of effective monitoring and supervision, poor enforcement of laws relating to settlement of NPLs, imprudent lending strategies, lack of effective debt recovery strategies, fund diversion to risky projects, weakness of legal structure, slowdown in real estate business, insider lending with high interest rates, rescheduling option, corruption by bankers and aggressive banking are the prime reasons of nonperforming loan. For instance, Cargill et al. (2004: 125-147) have identified Japan's high level of NPLs as an outcome of prolonged economic stagnation and deflation in the economy since the bursting of the "bubble" in the early 1990s. In Spain, Fernandez, Jorge and Saurina, (2000) pointed out that despite bank supervisors being aware that most banking crises were directly related to inadequate management of credit risk by respective institutions, it was difficult for supervisors from central banks to pursue bank managers to follow more prudent credit policies during economic upturn, that even conservative managers might find market pressure for higher profits very difficult to overcome. In Africa, Brownbridge, (1998) concluded that many of the bad debts in banks were attributable to moral hazards; the adverse incentives on bank owners to adopt imprudent lending strategies, in particular insider lending at high interest rates to borrowers in the most risky segments of the credit market. To the borrowers' side, they also tend to divert the funds to risky investments once they are granted the loans. In the Indian subcontinent (India, Pakistan, Sri Lanka, Bangladesh and Nepal), however, the causes of nonperforming loans are usually attributed to the lack of effective monitoring and supervision on the part of banks (as required by the BASEL principles of bank monitoring and supervisions), lack of effective lenders' recourse, weaknesses of legal infrastructure, and lack of effective debt recovery strategies. Adhikary (2005) argued that the presence of an alarming amount of NPLs both in the Nationalized Commercial Banks (NCBs) and in the Development Financial Institutions (DFIs), along with maintenance of inadequate loan loss provisions, diminishes the overall credit quality of Bangladesh. Poor enforcement of laws relating to settlement of NPLs, followed by insufficient debt recovery measures on the part of the banks, has also aggravated the financial malaise, although a decrease in NPLs is noticed since the year 2000.

Different authors have suggested different recovery strategy of nonperforming loan and central banks of different countries are also trying cordially to improve the nonperforming loan position of the banks and financial institutions. In China, turning over the NPLs to asset management companies was proved very successfully (China Daily, 2002) quoted in Waweru & Kalani, (2009). In Kenya banks shift away from concentration on security based lending and put more emphases on the customer ability to meet the loan repayment. Reduction of interest rates however, was observed to be a successful action taken by bank management. Others were mostly associated with proper appraisal of borrowers in particular use of credit limit ratios, based on cash flows, use of forecasts and feasibility studies and use of standard lending procedure (Waweru & Kalani, 2009). In 1998 the Malaysian government has set up Danaharta; the national asset management company (AMC) with the objective is to remove the nonperforming loans distraction from the financial institutions and subsequently to extract maximum recovery from the NPLs. The Malaysian government and banks have succeeded in removing the nonperforming loans from bank Balance Sheet. The Malaysian government has taken responsive actions to solve the financial problems through the creation of the Corporate Debt Restructuring Committee (CRDC), Danamodal, an organization for injecting government funds and Danaharta, an organization for purchasing nonperforming loans. In January 2012, the Governor of the Reserve Bank of Zimbabwe, Dr Gideon Gono urged banking institutions to enhance their credit risk management systems with special emphasis on credit assessment, origination, administration, monitoring and control standards. Despite ongoing efforts to control bank lending activities, non performing loans are still a major concern for both international and local regulators (Boudriga et al, 2009).

4. DEFINITION OF NONPERFORMING LOAN

Non-performing Loan is defined in different ways by different authors and institutions. Generally NPL means the loan that is not performing smoothly according to terms and conditions and becomes due for a period.

A simple definition of nonperforming loans: A loan which does not provide incomes anymore and: (1) full payment of the principal and interest is not provided, (2) their payment is 90 or more days late, (3) the maturity date has passed and the payment has not been completed. According to experts a loan is considered nonperforming when the person or the entity that has obtained it at the bank becomes a problem for its repayment. At the beginning they are the daily delays, and then they become weekly and monthly ones.

As per Section 5 (cc) of Bank Company Act 1991, 'defaulting debtor' means any person or institution served with advance, loan granted in favor of him or an institution involving interest or any portion thereof, or any interest, which has been overdue for six months in accordance with the definition of Bangladesh Bank.

According to Oxford Dictionary of Finance & Banking (3rd Edition), NPLs is a loan on which the interest or payment are overdue. In the USA, NPLs defined by regulators as a category of loan which is more than 90 days in arrear".

Based to Oxford Business English Dictionary, non-performing loans (NPLs) is a loan in which the borrower has not made a payment for a particular period of time. Therefore the bank ran into trouble with non-performing loans (NPLs).

As per BRPD circular In this case, loan becomes non-performing when it is classified as bad and loss for which Bangladesh Bank requires 100% provisioning by the scheduled commercial banks. Under Basel-II, loans past due for more than 90 days are non-performing.

Choudhury et al. (2002: 21-54) state that the non-performing loan is not a "uniclass" but rather a "multiclass" concept, which means that NPLs can be classified into different varieties usually based on the "length of overdue" of the said loans.

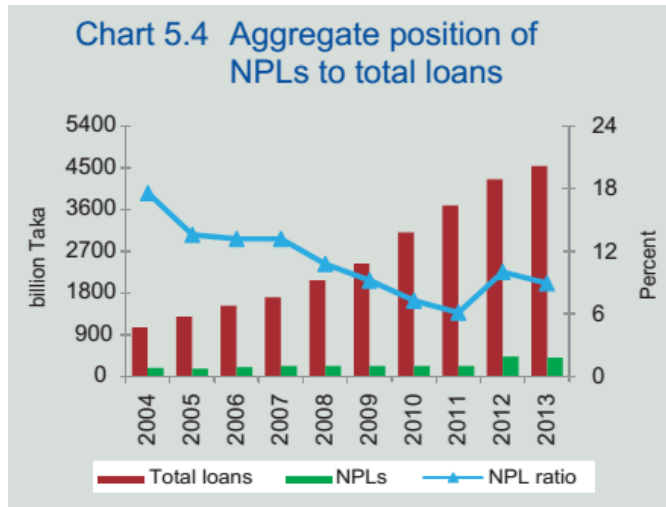
So we can say, non performing loan means loan which has expired or which has become overdue but has not been paid within 90 days of maturity or expiry date or due date. On the other hand, defaulted loans are those loans which are overdue for the period of six months or more but have not been paid yet.

5. PRESENT SITUATION OF NPL IN BANGLADESH

The banking sector of Bangladesh comprises four categories of scheduled banks. These are State-owned Commercial Banks (SCBs), State-owned Development Financial Institutions (DFIs), Private Commercial Banks (PCBs) and Foreign Commercial Banks (FCBs). Nine (9) newly licensed private commercial banks have started functioning in this year. So the number of banks increased from 47 in 2012 to 56 in 2013. These banks had a total number of 8685 branches as of December 2013.

The banking sector of our country is running with different suspect due to increasing of loan amount day by day, increasing uncollectible amount from their investment through different forms of loan, lack of monitoring to collect money from borrower, political instability etc. All these causes increase anxiety about banking sustainability. From the birth of our country, Bangladesh is facing the problem of non-performing loan. Islam et al., (1999: 35-37) states that the issue of nonperforming loans in Bangladesh is not a new phenomenon. In fact, the seeds were cultivated during the early stage of the liberation period (1972-1981), by the government's "expansion of credit" policies on the one hand and a feeble and infirm banking infrastructure combined with an unskilled work force on the other. Choudhury et al. (1999: 57) find that Government direction towards nationalized commercial banks to lend to unprofitable state owned enterprises, limited policy guidelines (banks were allowed to classify their assets at their own judgments) regarding "loan classification and provisioning", and the use of accrual policies of accounting for recording interest income of NPLs resulted in malignant of the credit discipline of the country till the end of 1989.

Although there are inherent risk of becoming uncollectible of the loan of banks but loans and advances are the major components in the asset composition of all commercial banks and interest is the major income of them. And the high concentration of loans and advances increases the vulnerability of assets to credit risk. The most important indicator intended to identify the asset quality in the loan portfolio is the ratio of gross nonperforming loans to total loans and net NPLs to net total loans. According to Bangladesh Bank, at the end of December 2013, PCBs had the lowest and DFIs had the highest ratio of gross NPLs to total loans. PCBs' gross NPLs to total loans ratio was 4.5 percent, whereas that of SCBs, FCBs and DFIs were 19.8, 5.5 and 26.8 percent respectively at the end of December 2013. The gross NPL ratios to total loans for the SCBs, PCBs, FCBs and DFIs were recorded as 23.2, 5.7, 6.2 and 33.1 percent respectively at the end of June 2014.



Source: Bangladesh Bank Annual Report

Table 5.3 NPL ratios by type of banks

Bank types	(percent)								
	2006	2007	2008	2009	2010	2011	2012	2013	End June 2014
SCBs	22.9	29.9	25.4	21.4	15.7	11.3	23.9	19.8	23.2
DFIs	33.7	28.6	25.5	25.9	24.2	24.6	26.8	26.8	33.1
PCBs	5.5	5.0	4.4	3.9	3.2	2.9	4.6	4.5	5.7
FCBs	0.8	1.4	1.9	2.3	3.0	3.0	3.5	5.5	6.2
Total	13.2	13.2	10.8	9.2	7.3	6.1	10.0	8.9	10.8

Source: Bangladesh Bank Annual Report

The ratio of NPL to total loans of all the banks had shown an overall declining trend from its peak (34.9 percent) in 2000 up to 2011 (6.1 percent). But the ratio increased in 2012 (10.0 percent), decreased again in 2013 (8.9 percent), then increased (10.8 percent) at end June 2014. It can be seen from Table 5.3 that the decline in NPLs to total loans ratio in recent years till 2011 can be attributed partly to some progress in recovery of long outstanding loans and partly to write-off of loans classified as 'bad' or 'loss'.

Table 5.3 (a) Ratio of net NPL to total loans by type of banks

Bank	(percent)								
	2006	2007	2008	2009	2010	2011	2012	2013	End June 2014
SCBs	14.5	12.9	5.9	1.9	1.9	-0.3	12.8	1.7	7.4
DFIs	23.6	19.0	17.0	18.3	16.0	17.0	20.4	19.7	26.4
PCBs	1.8	1.4	0.9	0.5	0.0	0.2	0.9	0.6	1.2
FCBs	-2.6	-1.9	-2.0	-2.3	-1.7	-1.8	-0.9	-0.4	-0.2
Total	7.1	5.1	2.8	1.7	1.3	0.7	4.4	2.0	3.9

Source: Bangladesh Bank Annual Report

But it went up again in 2012 & 2014 (end June) due to the reasons of issuance of the circular regarding new classification and rescheduling of loans and a few notable scams in the banking industry.

The SCBs and DFIs continue to have high level of NPLs mainly due to substantial loans provided by them without considering the required criteria. Different loan forgery circle are taking different types of loan by giving different fake documents with the help of some corrupted bankers. According to Bangladesh Bank, only the hallmark scandal has plundered/looted 3000crore taka from Sonali Bank Ltd. Only 500crore taka has been recovered during last 2 years and it has become uncertain to collect the rest amount from the hallmark group. On the other hand Bismillah group has looted 1500crore taka from Sonali and Basic bank from which the banks can't collect single money. Bangladesh Bank has reported that total amount of nonperforming loan has become near 56000crore taka that is very alarming news for our economy. Our finance minister has said in national parliament that upto May 2015, the non-performing loan has become 56 thousand crore taka. Out of that amount only state owned commercial has 23 thousand crore taka. During the first 5 months of 2015, 6 thousand crore taka loans have become nonperforming. Ananda Shipyard Co, Mostafa Group, Nur Jahan Group, Ellias Brothers and many others have plundered thousands crore taka from different commercial banks. Furthermore, these banks are reluctant to write-off the historically accumulated bad loans because of poor quality of underlying collaterals and the fear of punishment by central bank. Even Bangladesh Bank suspects that in some cases banks hid their real information to increase their operating profit for avoiding punishment of Bangladesh Bank. But near future it may affect severely in banking industry.

Adhikery(2005) states that an analysis of the aggregate NPLs in clusters of banks and types of loans in 2005 indicates that the highest ratio of NPLs is in the category of micro and agricultural loans of NCBs (47.09%). This is followed by term loans over a maturity of 5 years (42.68%) for DFIs. DFIs also record a staggering rate of 40.45% NPLs in case of term loans having a maturity of 5 years, followed by NCBs which have 33.83% NPLs for such loans. It can be concluded that nonperforming loans in the sector of micro and agricultural loans, as well as term loans of NCBs and DFIs, are aggravating the NPL situation of Bangladesh.

Although recovery of NPLs, however, has showed some signs of improvement, mainly because of the steps taken with regard to internal restructuring of these banks to strengthen their loan recovery mechanism and write-off measures initiated in recent years. To bring sound and safe business environment effective recovery strategies must be taken by the respected parties especially Bangladesh Bank.

6. CAUSES OF NPL IN BANGLADESH

6.1 Lack of available information about customer

Many businessmen and business organizations engage themselves in window dressing of their financial position to cover their real information. And sometimes they provide fake documents to take loan and give false information. So in some cases it has become very difficult to the banker to evaluate a borrower properly. Auronen (2003) stated that the theory of asymmetric information tells us that it may be difficult to distinguish good from bad borrowers, which may result into adverse selection and moral hazards problems. The theory explains that in the market, the party that possesses more information on specific item to be transacted (in this case the borrower) is in a position to negotiate optimal terms for the transaction than the other party (in this case, the lender). The party that knows less about the same specific item to be transacted is therefore in a position of making either right or wrong decision concerning the transaction. Bofondi and Gobbi, 2003 stated that adverse selection and moral hazards have led to substantial accumulation of nonperforming assets (NPLs) in banks. In our country some corrupted people have taken a large amount of loan from different banks by submitting fake documentation and they have also gone abroad. Those loans are aggravating to the nonperforming loan. So lack of available information is one of the prime causes of NPL.

6.2 Fund diversion

This is one of the prime causes of recent increase of nonperforming loan in our country. These are the borrowers' aspects that tend to divert the funds to risky investments for achieving more profits once they are granted loans. Most of the cases, the large loan defaulters who have taken thousands crore taka from different banks for showing one purpose but after taking loan they have diverted the fund for another purpose. Recently Hallmark group, Bismillah group, Showen garments, Mostafa Group, Nur Jahan Group, Ellias Brothers, Ananda Shipyard has

plundered thousands crore taka from different commercial banks and diverted a large portion of their granted loan amount.

6.3 Recent crash in share market

Recently in 2010 the country has witnessed an unimaginable crash in share market. Due to this disaster, forgery circle has plundered 64 thousand crore taka from market. Many investors have taken credit from brokerage house and other financial institutions to make instantaneous profit. Also many investors have taken loan from different banks by showing another purpose and diverted funds into share market at the time of bubble era but can't pay their loan after the bubble burst. This is another important cause of recent increase of non-performing loan.

6.4 Fall in real-estate business

Recently real estate business has experienced a drastic fall in their sales. In some places the price of the land has decreased. It has two effects on NPL. Firstly, many real estate companies have taken a large amount of loan to run their business and many individuals as well as organizations also have taken loan from banks by showing different purposes but after granting loans diverted funds into real estate business. Many individuals have taken house loan to buy flat or to build house. Being the downturn in their business their loan becomes nonperforming. Secondly the fall in land prices result in lowering the value of the collateral assets of the banks that is an alarming factor for the bankers.

6.5 Political instability

Political instability is a very common phenomenon in our country. But recent years it is frequently occurring. Blockade; strike such kind of long lasting political unrest severely affected in the business arena. Due to blockade, strike the sales have been decreased drastically and many businessmen can't cover their operating expenses from their income which in some cases result in erosion of their capital. So from where they will pay loan amount?

6.6 Rescheduling option

We found in our study that the giant defaulters have been given an opportunity of rescheduling their nonperforming loan to recovery. And sometimes the banks have pushed money again after becoming the loan as nonperforming to the giant defaulters. So defaulters think that they will get the rescheduling facility from banks if their loans become nonperforming. Sometimes banks consider about interest to the borrowers so that they can run their business and can pay the principal amount. This is also seen as a loophole by forgery circle. All things create a negative effect on good borrowers to delay their payment.

6.7 Weak monitoring

Both monitoring of Bangladesh Bank over commercial banks and commercial banks over borrower are not too much satisfactory. In this case Bangladesh Bank has to play a vital role. Analysts said that Bangladesh Bank has to oversee all the activities of commercial banks and monitor regularly the large loans of commercial banks. Insufficient follow up after granting loan results in increase of NPLs.

6.8 Lack of co-ordination among related parties

Analysts said that an effective and efficient co-ordination is required among top-level management of commercial banks, Bangladesh Bank and Ministry of Finance in case of loan distribution, loan granting and recovery. Lack of co-ordination among them result in making incapable of analyzing to whom the loan is distributed, to what extent the loan should be distributed to a single project and to what extent the loan can be recovered. Ultimately such kind of weak cooperation result in increasing non performing loan. Bangladesh Bank has to come forward to play a vital role for an effective co-operation.

6.9 Weak enforcement of existing laws

Although there some law enforcing authorities in our country like Artha Rin Adalat, Bankruptcy Act and PDR Act have been enacted in several times to ensure the sound banking system but the country has experienced a poor performance from them. The Artha Rin Adalat Act was enacted in 1990 only to focus on non-performing loan and ensuring safety and soundness of the banking system. Adhikary (2005) argued that Developing countries like Bangladesh, owing to the presence of corruption and opaqueness in the settlement process as well as poor enforcement of laws that usually create a fertile ground for the willful defaulters. After 6 years of the establishment of Artha Rin Adalat, the Bankruptcy Act has been enacted in 1997 to gear up the loan recovery. Adhikary (2005) stated that the percentage of settled suits has increased considerably from 11.59% in 1991 to 43.30% in 2004 but the

recovery rate is confined to 6%-8% only during the last several years. The bankruptcy court shows that the recovery rate is only 1.12% against Tk. 254662 crore in 2005 and the recovery rate of cases settled through the PDR court is also seen to be unsatisfactory (46.02%), although it shows better performance than other courts. He also argued that the main hindrance relating to the recovery of default loans at this moment seems to be the poor enforcement status of laws and slow execution of decrees.

Another important problem exists here that the giant defaulters are being escaped from jurisdiction under laws. There is some forgery circles those have plundered thousands crore taka from different banks but no substantial steps have been taken against them. In this case political consideration has been given priority rather than commercial consideration.

6.10 Political interference in case of loan sanctioning and recovering

Being the unexpected practice of interference by the ruling parties in every sector, the banking sector is not political interference free. The political parties or dominant business leaders are taking thousands crore taka from different banks especially from government banks. Azad (2006) stated that the so-called culture of loan default virtually stems from willful default by the political leaders or other dominant business leader. In our study we found that in our country many banks as well as industries are owned by the political leaders. For this reason they dominate in case of lending and in many cases fund has been diverted after granting loan that ultimately result in non-performing. We also found that sometimes they pressurize different banks to give large amount of loans to them or their designated people or organizations without/ minimum legal grounds, documentation etc. In case of recruitment for the top position of different banks the ruling parties pressurize to recruit their nominated people. Recently Ministry of Finance has recruited managing director of different government commercial banks without consent of Bangladesh Bank. But it violates the law and it is clear that such kind of recruitment has emphasized on political consideration. Khondoker Ibrahim said that such kind of MD, Chairman has plundered thousands of crore taka from banks. The large defaulters have been escaped from jurisdiction by the shelter of different political leaders. So in one sense the NPL crisis in Bangladesh can be considered as a political crisis.

6.11 Corrupted banker's engagement in case of sanctioning illusory loan

The study has identified one of the main factors that brought the rapid increase of NPLs, starting from the problems caused by the engagement of some corrupted bankers in case of loan distribution. The country has experienced visibly such kind of engagement of corrupted bankers in case of Sonali Bank Ltd. and Basic Bank Ltd. The ex-deputy governor of Bangladesh Bank Khondoker Ibrahim stated that different types of loan forgery have been occurred with the help of corrupted bankers. Such types of forgery are severe in government banks. Now it is spreading also into private banks.

7. BANKING SUSTAINABILITY

Although the word 'sustainability' has come into developed country many years ago but from the very beginning of 21st century it has been used in developing countries. Sustainability is practiced by managing environmental, social and economic impacts and considering the impacts on future generation. Most commonly accepted definition of sustainability is given by Brundtland Commission. According to **Brundtland Commission**¹ sustainability means "Development that meets the needs of the present without compromising the ability of future generations to meet their own needs". It is about making profit, protecting stakeholders' right and preserving the environment and biodiversity for future generations, and about being cautious with our natural resources and climate.

Our main focus is on rapid increase of non-performing loan, aggressive banking by different banks such as purchasing different bad and loss loans from other banks, rescheduling of different types of non-performing loan that result in increasing operating profit temporarily, re-financing to different business organizations who have become already defaulter of thousands crore taka from different banks, board of directors' and political interference in loan sanctioning that will create a big threat for banking sustainability in near future. Because of rescheduling option, commercial banks can present their bad loan as good loan and that will be collected with interest in near future. They increase their operating profit at that accounting period in which year the loan has been rescheduled. But actually many rescheduled loan can't be collected from borrowers. Finally some banks are not kept adequate provisioning for non-performing loan. There are also lack of co-ordination among commercial banks, Bangladesh Bank and Ministry of Finance in case of loan granting, loan distributing and loan collecting. The ex-deputy governor of Bangladesh Bank Khondoker Ibrahim has said that many bankers are closely related with loan forgery. Especially this is severe in government banking. If these situations will continue, then these will bring a disaster to the banking industry in near future and the economy will be severely affected.

1. The Brundtland Commission was formed in December 1983 with the Chairman of the Commission, Gro Harlem Brundtland who was the former Prime Minister of Norway. At the time, the UN General Assembly realized that there was a heavy deterioration of the human environment and natural resources. To rally countries to work and pursue sustainable development together, the UN decided to establish the Brundtland Commission. The Brundtland Commission officially dissolved in December 1987 after releasing *Our Common Future*, also known as the Brundtland Report, in October 1987, a document which coined, and defined the meaning of the term "Sustainable Development". The organization Center for Our Common Future was started in April 1988 to take the place of the Commission.

8. IMPACT OF NPLS ON OUR ECONOMY

Being the limited access to capital market for maximum organizations to finance to their business by issuing share through IPO, financial market has an immense impact on the business as well as economy. If the financial institutions can't run smoothly then it will affect to the economy severely. Right now the financial institutions are burdened from huge amount of non-performing loan that are aggravating day by day. Recently Bangladesh Bank has reported that total amount of nonperforming loan has become near 56000crore taka that is very alarming news for our economy. These NPLs has multifarious negative impact on our economy.

From the birth the country is facing an alarming rate of nonperforming loan, now banking industry is trying to tighten their lending policy because of their lending risk aversion behavior. As a result, on the one hand many potential businessmen may not take loan from banks that hinder to expand their businesses as well as tranquility will be faced by the economy on the other. Aziz et al (2009) stated that the rising of non-performing loans (NPLs) has an effect to the financial institutions: they tightened their lending and switched their attentions to rehabilitating the non-performing loans (NPLs) in their books. This prevented viable businesses from obtaining funds to generate economic activities.

When the rate of non-performing loan is high then it will affect the banks' profitability and their performance by lowering interest income with principal. In one hand the growth of the banking industry will be hindered and on the other what's about money cycle?

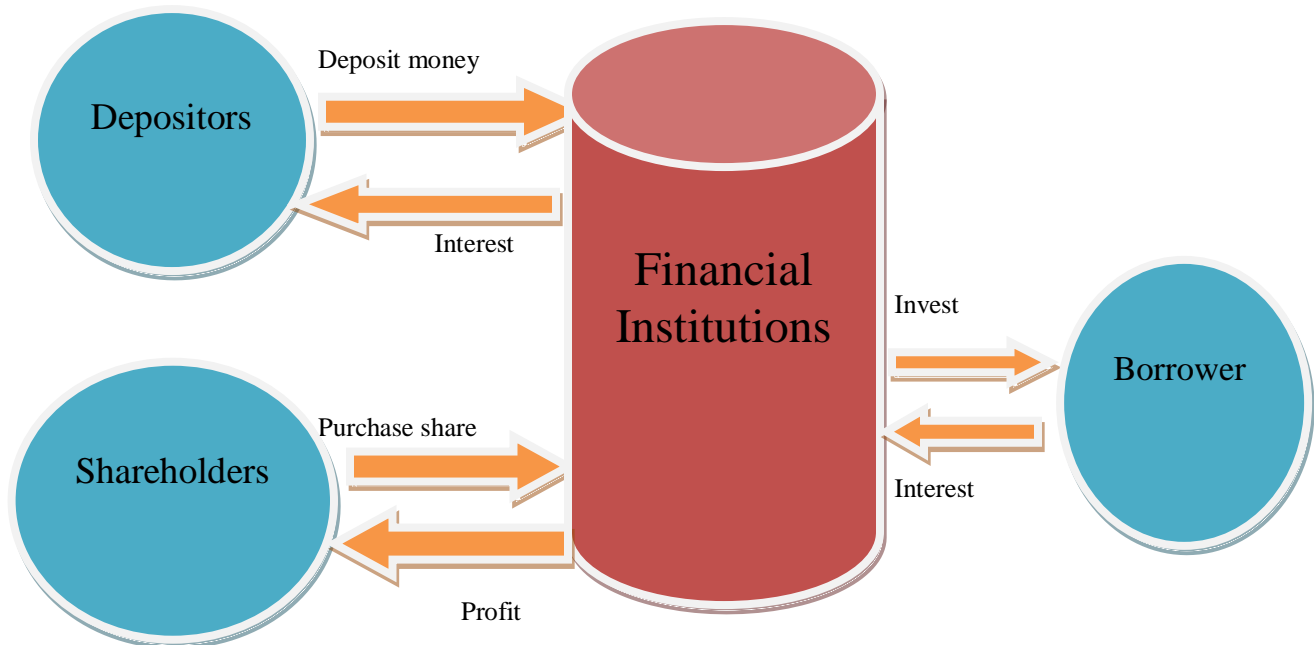


Figure: Money Cycle

If the performance will not be satisfactory then the bank may not give return to the depositors and shareholders satisfactorily. As a result depositors will be reluctant to keep savings to the banks and shareholders will realize cash by selling their share. So the money cycle will be collapsed due to high rate of non-performing loan. And due to

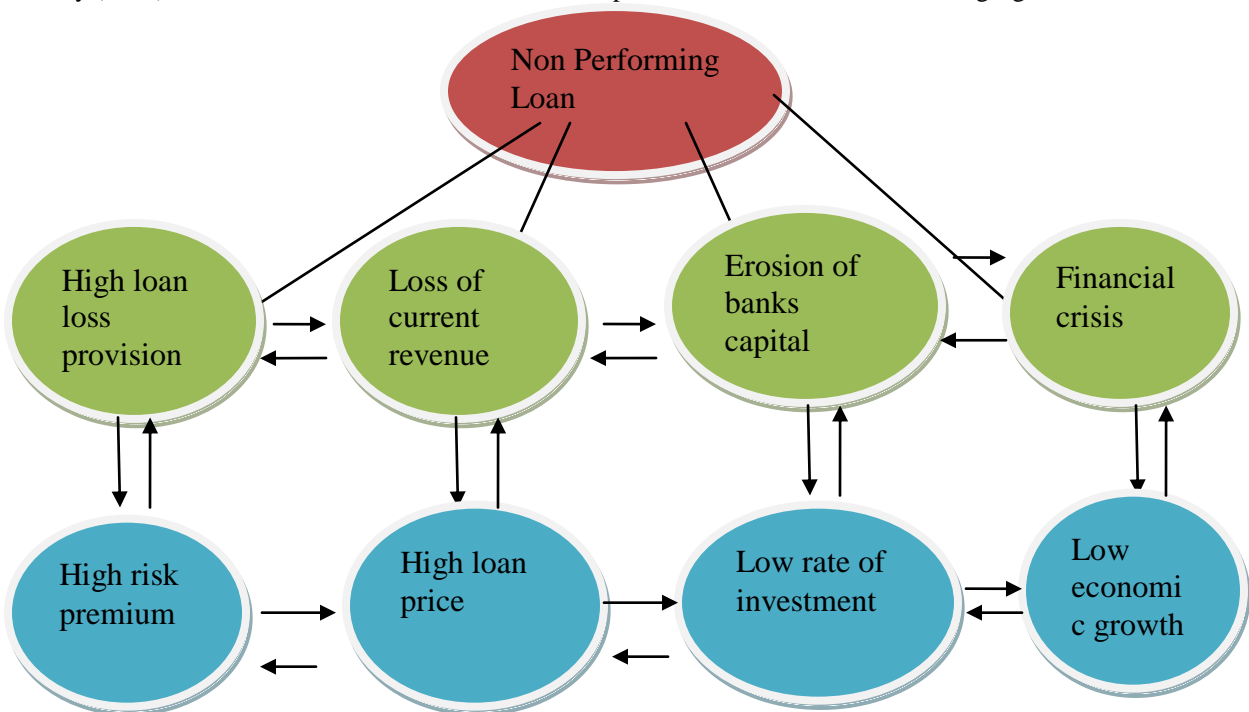
lending risk aversion behavior by the banks the market will face liquidity crises. Sometimes high rate of NPLs may also erode the capital of the bank that ultimately threatens their existence. Andrew Crockett (2003) argues that initially non-performing loans (NPLs) may not seem to have a serious negative effect. Banks remain liquid and depositors retain their confidence in the system. Over time, however, the size of the problem grows, especially if banks are allowed to accrue interest on their non-performing loans (NPLs). Greenidge and Grosvenor (2010), argue that the magnitude of non-performing loans is a key element in the initiation and progression of financial and banking crises. Guy (2011) agrees arguing that non performing loans have been widely used as a measure of asset quality among lending institutions and are often associated with failures and financial crises in both the developed and developing world. Reinhart and Rogoff (2010) as cited in Louzis et al (2011) point out that non-performing loans can be used to mark the onset of a banking crisis.

Because of rapid increase of non-performing loan and high rate of non-recovery, the bank will increase their cost of financing to the business organizations to cover their existing loan loss. That will indirectly hinder to expand business because maximum businessmen will be reluctant to take loan at high cost. Thus ultimately leads to slowdown of the economy.

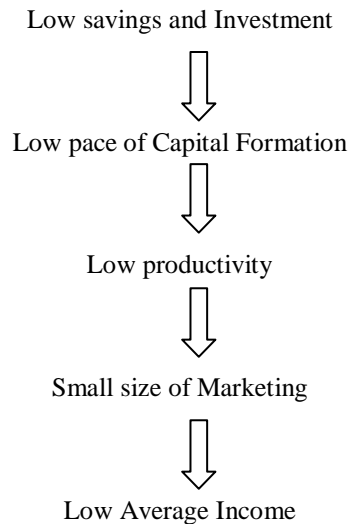
Non-performing loan has another important impact on employment opportunities. Due to NPLs the growth of the banks is being affected so banks can't expand their business smoothly. This leads to contraction of employment opportunities in the financial institutions. Another factor is that lending risk aversion policy hinders in expansion of many potential business that result in losing many employment opportunities in different sectors. And the final one is that if banks can't make profit and business suffers from liquidity crises then both of them lay-off their existing employee that will lead to unemployment.

Another important aspect is that non-performing loan will hinder saving-investment process. Basically the main purpose of investment is to ensure the sustainable development and it is also expected that the investment will be recovered with interest within its stipulated time. Otherwise reinvestment is not possible. Islam et al. (2005) stated that if the invested funds can be captured timely, it can again form a new capital creating a good option for reinvestment or consumption. Both of these reinvestment and consumption functions create a positive impact on the economy. Because economy gets some value added jobs to do. But, in case of non-recovery, the investing party should have to go a long way that is not expected and sometimes this unexpected happenings cause a great harm to the economic framework and structure. Thus, it will lead the economy to be stagnant for the time being, and if not checked, forever. It will accelerate the path of being and remaining poor for the time being.

Adhikary (2005) has shown the economic and financial implications of NPLs in the following figure:



Finally NPLs have a psychological impact on good borrowers. The study found that giant defaulters have been escaped from jurisdiction under laws and sometimes defaulters have been pushed finance again by banks which created negative impression on good borrowers. Adhikary (2005) also found that if NPLs are not properly addressed, bad borrowers can create a negative psychological impact on good borrowers to prolong their payments. This situation becomes worse in an economy where enforcement status of laws is seen as very weak. NPLs, if created by the borrowers willingly and left unresolved, might act as a contagious financial malaise by driving good borrowers out of the financial market. Samuelson and Nordhaus argued that Low saving and investment leads to low income that is shown in following figure:



9. MEASURES SHOULD BE TAKEN TO REDUCE NPLs

9.1 Different Types of training Program

Training programs including formal training, workshop for increasing skill for practicing risk analysis, assessing borrower credit worthiness, effective recovery, periodical credit review, qualitative judgment for early loan classification etc. Learning program assisting the responsible person to be more effective can be a tool for controlling non performing loan.

9.2 Strong & regular monitoring

Among the post loan sanction nurturing steps the most effective one is strong monitoring and regular nursing of the borrower and building rapport so that an early alert system grows. Regular monitoring may be interpreted as daily, weekly, fortnightly reviewing the borrower position in terms of transactions, fund utilization, fund diversion etc.

9.3 Ensure cooperation, sincerity and accountability of employees

Employees dealing with loans & advance processing, enquiry, spot verification and certification required to be accountable for their works. There may be system to monitor the employees so that no kind of biased decision can be taken on assessing buyer credit worthiness and good borrower selection.

9.4 Lessen the interference of political parties & Board of Directors

Many developing countries including Bangladesh has a common scenario of interference or influence of political leaders & Board of directors for sanctioning loans & advances which is most of the times benefits a borrower who is not worthy for a loan or worthy for a little amount than recommended, result in great chance of a loan to be classified. There should be black & white rule that no one other than sanctioning authority can influence a loan sanction process.

9.5 Strict enforcement of existing laws of loan classification

In case of Bangladesh, laws & regulation legislated by Central Bank, in practice has some flexibility in enforcing or marking a loan to be classified because it directly affect branch profit position. Central bank should be stricter about laws dictating loan classification by imposing penalty and other remedial measures. The country must ensure the appropriate punishment of giant loan defaulters and in this case political consideration must be avoided.

9.6 Regulate third party asset management & Credit risk assessment companies works

Sanctioning loan for a substantial amount requires the bank should employ a third party to assess risk rating and asset position which is not strongly monitored. There should be a central body which will continuously monitor borrower assessment process and update the tools by which the third party assesses a borrower.

9.7 Ensuring fair investigation of Banking Corruption & trial of convicted parties

In recent time, Banking corruptions are flooding around utilizing security loophole (online & offline), negligence of bankers, lack of secrecy and traditional banking system including involvement of banker himself. Every Corruption case should be investigated fairly and appropriate punishment must be ensured. In this case political consideration must be avoided.

9.8 Performance based incentives

Performance incentives of loan officers should assess the fair quality of current loan position as well as speculated future position. In case of Bangladesh, private banks are somewhat rational in assessing employees' performance but government banks are still applying outdated appraisal standard and in many cases they have no use. As a large portion of loan disbursed from govt. banks they should adopt employee performance appraisal system to be more competitive and realistic. According to *Collevocchio Declaration*² don't give bonuses to your employees (including Board members) for mere quantity of business achieved, margins and short term profits. Do reward employees who seriously work on the implementation of your bank's policies. Your bonus system should integrate sustainability and longer time horizons and attribute positive value to prudent decision making.

² This Bank Track manual will help you to get started on the slippery path towards sustainable banking. It takes as its starting point the Collevocchio Declaration, named after the Italian village where it was first conceived. This declaration was launched in January 2003, endorsed by over 200 civil society organizations. It outlined the unique role and responsibility the financial sector has in advancing sustainability.

9.9 Ensuring transparency in loan sanctioning & disbursement:

Banks should ensure transparency in every level of loan sanctioning so that the right borrowers get the right amount of loan ensuring equitable collateral security. It will filter the unwanted borrowers and stop the process of NPLs to germinate. Disbursement process should also be needed to be monitored and needed to be transparent so that it may not permit the borrower any further loop to employ.

9.10 Applying conditions for becoming member of Board of Directors

Bangladesh Bank should apply some conditions to become member of board of director's so that they have minimum qualification and understanding of banking business. This will result in improving the efficiency of banking business and analyzing capability towards future. Some restriction should also be imposed for interference of board of director's in case of loan granting.

10. CONCLUSION

Although different steps have been taken to reduce nonperforming loan in our banking industry, recently several scandals in loan distribution by different banks and a large amount of nonperforming loan has created anxiety on the

mind of stakeholders about the performance of financial institutions. There are several reasons of nonperforming loan. But recently fund diversion, political and board of directors interference, political instability, engagement of corrupted bankers, aggressive banking, fall in real estate business, weak monitoring, lack of coordination among related parties are aggravating non performing loan. Strong and regular monitoring, cooperation among related parties and strict enforcement of existing laws help to reduce NPLs. Bangladesh Bank should play a vital role in these issues. Commercial banks should ensure transparency in credit granting and Bangladesh Bank should ensure that the application of credit sanctioning guidelines is being followed to issue new loan. To reduce NPLs, proper steps must be taken for debt recovery and new investment must be safe and sound. Otherwise large amount of NPLs reduce banks' profitability and may erode capital also. That may bring human created disaster in banking industry.

11. Reference

- Adhikary, Bishnu Kumar (2005); "Nonperforming Loans in Banking Sector of Bangladesh: Realities and Challenges" Bangladesh Institute of Bank Management.
- Azad, Sohel A. S.M.; (2005) "An Empirical Analysis of the Factors Affecting Bank Crises in Japan: Learning Points for Bangladesh", Bank Parikrama Volume XXX & XXXI; pp. 57 – 79, September 2005 - December 2006.
- Islam, Mohammad Shofiqul; Shil, Nikhil Chandra and Mannan, Md. Abdul; (2005) " Non Performing loans- its causes, consequences and some learning" Munich Personal RePEc Archive, December 2005.
- Richard, Evelyn; (2011) "Factors That Cause Non- Performing Loans in Commercial Banks in Tanzania and Strategies to Resolve Them", Journal of Management Policy and Practice 12(7), 2011.
- Joseph, Mabvure Tendai; Edson, Gwangwava; Manuere, Faitira; Clifford, Mutibvu and Michael, Kamoyo(2012); "Non Performing loans in Commercial Banks: A case of CBZ Bank Limited in Zimbabwe", Interdisciplinary Journal of Contemporary Research in Business, Vol 4, No 7, November 2012.
- Aziz, Nor Farradila binti Abdul; Ibrahim, Irwan bin and Isa, Maizura binti; (2009) "The Impact of Nonperforming Loans (NPL) Towards Profitability Performance (ROA, ROE & NPM)", 2009.
- Inaba, Nobuo; Kozu, Takashi and Sekine, Toshitaka; (2005) "Non-performing loans and the real economy: Japan's experience", A chapter in Investigating the relationship between the financial and real economy from Bank for International Settlements, Vol. 22, pp 106-27, 2005.
- Shingjergji, Ali; (2013) "An Analysis of the Nonperforming Loans in the Albanian Banking System", International Journal of Business and Commerce, Vol. 2, No.6, pp 01-11, February 2013.
- Greuning H and Bratanovic S.B (2003), "Analyzing and Managing Banking Risk: A Framework for Assessing Corporate Governance and Financial Risk", The World Bank, 2nd edition, Washington DC, 2003.
- Greenidge K and Grosvenor T (2010), "Forecasting non-performing loans in Barbados" Journal of Business, Finance and Economics in Emerging Economies, No 5, PP: 80-107, 2010.
- Cargill, Thomas F. and Parker, Elliot. (2004) "Price Deflation, Money Demand, and Monetary Policy Discontinuity: A Comparative view of Japan, China, and the United States," The North American Journal of Economics and Finance, 15 (1), PP: 125-147, 2004.
- Boudriga A, Taktak N. B and Jellouli S (2009) "Banking supervision and nonperforming loans: a cross-country analysis", Journal of Financial Economic Policy, 1(4), PP: 286-318, 2009.
- Choudhury, T. Ahmed and Adhikary, B. Kumar (2002) "Loan Classification, Provisioning Requirement and Recovery Strategies: A comparative Study on Bangladesh and India," Seminar Paper, Bangladesh Institute of Bank Management, PP: 21-54, January 2002.
- Choudhury, T. Ahmed and Moral, L.H. (1999) "Commercial Bank Restructuring in Bangladesh: From FSRP to BRC/ CBRP," Bank Parikrama, PP: 22-31, March 1999.
- Islam, Muinul and Moral, Liakat (1999). "Bank Loan Default Problem in Bangladesh: A dialogue Between Borrowers and Lenders." Keynote paper (seminar paper) presented at Bangladesh Institute of Bank Management, published in Bank Parikrama, PP: 22-31, 35-37, May 1999.
- Chowdhury, L. R. (2002), "A textbook on Bankers's Advance".
- Samuelson, Paul A. and William, D. Nordhaus , "Economics", 17th Edition, McGraw Hill – Irwin.
- Muniappan, G.P. (2002) "The NPA Overhang- Magnitude, Solutions, Legal Reforms." Paper presented at CII Banking Summit, Mumbai, Unpublished, PP: 25-26, April 200.
- Waweru, Nelson M. & Kalani, Victor M (2009) "Commercial Banking Crises in Kenya: Causes and Remedies" Global Journal of Finance and Banking Issues, Vol. 3. No. 3, 2009.

- Bonin, John P. and Huang, Yiping (January 2001) “Dealing with the Bad Loans of the Chinese Banks” Working Paper Number 357, 2001.
- Jones, Charles P. (2002), “Investments: Analysis and Management”, McGraw Hill- Irwin, Twelfth Edition.
- Bangladesh Bank Annual Report 2012-2013 & 2013-2014