

The Trend of Default Loans in Bangladesh: Way Forward and Challenges

Md.Toufique Hossain

Stock market analyst & Financial Market Columnist and Assistant Coordinator, WAVE Foundation, Information, Communication and Documentation Division.

***Corresponding Author:** Md.Toufique Hossain, Assistant Coordinator, WAVE Foundation, Bangladesh. toufique2010@gmail.com

ABSTRACT

Bangladesh has done well in the economic development index. The picture of GDP's (Gross Domestic Product) growth rate is very impressive. Bangladesh has been able to keep GDP growth intact at six and a half. Recently, we got the status of developing countries. With the goal of getting SDG in 2030, we have the goal of going to the developed country by 2041. There is some mixed reaction in our financial sector, especially in the Banking. Clearly, the size of our default lot is increasing day by day. According to the central bank's information, the government banks are more likely to have huge default loans. Islamic bank of the private banking system is plagued by this problem. In order to become a developed country, the banking sector needs special reforms to control the default (Non-performing) loan.

This article attempts to analyze what is the current situation of default loan in the country and what is the way to get rid of the bank industry.

Keywords: GDP, SDG, Default, Banking, Non-performing loan

INTRODUCTION

In the last few years, the bank sector of Bangladesh is passing through a difficult time. Experts are claimed that increasing trend of Non-performing loan one of the big factor for this crisis. There is no way but to reduce the defaulted loan in case of stability in the banking.

The lack of proper supervision and absence of good governance has resulted in the dreadful culture of default loans in the banking of Bangladesh. According to the Financial Express report "The volume of Non-performing loans (NPLs) in the country's banking jumped 19.51 percent or Tk. 121.31 billion in the last calendar

year (2017) despite close monitoring of the central bank. The NPLs rose to Tk. 743.03 billion as on December 31 last year, from Tk. 621.72 billion on the same day of the previous year (2016), according to Bangladesh Bank's (BB) latest statistics. It was Tk. 513.71 billion as on December 31, 2015".

THE REAL PICTURE OF DEFAULT LOAN

In the **Figure1** below, an overall picture of the defaulted loan will be available in the banking system. In 2010, the amount of this loan was 227.10 billion in taka which was 741.40 billion in 2017. The amount of these loans has increased significantly in the last eight years.

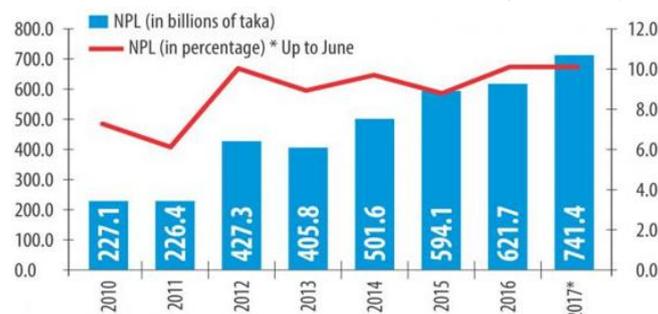


Fig1. Trend of Non-Performing loan in Bangladesh in last 8 years.

Source: Bangladesh Bank. Graph Courtesy The Daily Star: <http://www.thedailystar.net/business/managing-the-banking-sector-fault-lines-1494187>

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Analyzing the effect of the defaulted loan in the emerging economy, then it can be seen-First, Lending Rates have been found to be not so significant in affecting the NPAs contrary to the general perception Bank Assets has turned out to be negatively significant indicating that large banks may have better risk management procedures and technology which definitely allows them to finish up with lower levels of NPAs. Second, private banks and foreign banks have advantages in terms of their efficiencies in better credit management in containing the NPAs that indicates that bank privatization can lead to better management of default risk. **Swamy(2012)**. In the last ten years, the number of banks that were established in Bangladesh was not expected to increase their capacity to address the financial risk. And for the reason, that the country's banking system could not properly manage the Non-performing loan.

A non-performing loan is an important issue that can lead to increased unrest in the financial sector. If consider the Chinese market policies then see, "Chinese regulatory authorities have injected significant capital into the banking system and scrutinized NPLs since 2003. In addition increase in the NPL ratio raises riskier lending, potentially causing further deterioration of the loan quality and financial system instability". **Zhang et. Al. (2016)**

LITERATURE REVIEW

Here, the subject of Non-performing loans is discussed in the context of India's Financial Markets. **Ranjan and Dhal (2003)** their research paper explained that the terms of the credit variables have a significant effect on the banks' non-performing loans in the presence of bank size induced risk preferences and macroeconomic shocks. Moreover, alternative measures of bank size could give rise to a differential impact on the bank's non-performing loans. In regard to terms of credit variables, changes in the cost of credit in terms of expectation of higher interest rate inducers in NPAs. Besides, the authors have tried to analyze that three factors namely good business cycle, favorable macroeconomic situation, and good credit culture all these things help reduce the nonperforming loan.

Munib, Atyia, and Shaheed(2013)

Showed their study that nonperforming loan has a very close relationship with money supply and an interest rate. Their study finds out that NPLs is a disease for any bank which directly affects two main components of the banks responsible

for overall efficiency of any bank i.e. the liquidity and profitability as increasing NPLs demands provisions which devoured income efficiency whereas the mismatch of maturities in assets and liabilities causes liquidity problems for the banks which overall deteriorate the credit ratings and long-run deterioration of bank image.

Irum, Rehana, Muhammad (2012) have described their paper that the "Non-Performing Loan" rate is the most important issue for banks to survive. There are lots of factors responsible for this ratio. Some of them belong to firm-level issues and some are from macroeconomic measures.

Nkusu (2011)

Revealed that NPL plays a central role in the linkages between credit markets frictions and macroeconomic vulnerabilities. Further, he showed that a sharp increase in NPL weakness macroeconomic performance, activating a vicious spiral that exacerbates macro-financial vulnerabilities.

Ding, Thangavelu, and Qing(2005)

Their study showed that the state-owned enterprises (SOEs) got more loans than other firms, other things being equal, and SOEs with high default risks were able to borrow more than the low-risk SOEs and non-SOEs. This suggests that Chinese banks had a systemic lending bias in favor of SOEs, particularly those with high default risks. Here the authors are trying to show, basically the interest of the banking sector is to provide loans to the specific Clients, and this leads to the risk of the nonperforming loan in the market.

Misra and Dhal (2010)

Their study found that the terms of credit variables such as interest rate, maturity and collateral and bank-specific variables had a significant effect on the banks' non-performing loans in the presence of macroeconomic shocks. Ahlem and Fathi() their study found that the minimization of NPL is a necessary condition for improving economic growth. When NPL retained permanently, these will have an impact on the resources that are enclosed in unprofitable areas. Thus, NPL is likely to hamper economic growth and reduce the economic efficiency. Managerial capacity come from author article that poor management in the banking institutions results in bad quality loans, and therefore, escalates the level of non-

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performing loans. Karim, Chan, and Hassan(2010)

Boudriga, Boulila, and Jellouli (2009)

Their study showed three important findings. First, higher capital adequacy ratio (CAR) and prudent provisioning policy seem to reduce the level of problem loans. Second, all regulatory devices do not significantly reduce problem loans for countries with weak institutions, corrupt environment, and little democracy. Finally, the effective way to reduce bad loans is through strengthening the legal system and increasing transparency and democracy, rather than focusing on regulatory and supervisory issues

According to the Dhaka Tribune report(2017), 'Unless political will from both the opposition and the ruling parties, it is very difficult to come out of the bad culture of default loans'

According to the Daily Star Report (2018) revealed that between 2014 and 2018, the NPL ratio has been hovering above the 10-percent mark in Bangladesh. This rate is more than Nepal and India.

OBJECTIVES OF THE STUDY

There are different countries across the world, including the SAARC countries, which have the Non-performing loan culture. Recently, this practice is seen in more in the Banking of Bangladesh.

And keeping attention all this, this article has the following three key objectives-

- To highlight the real picture of Non-performing loan around the globe;
- To find out the current situation of the Non-performing loan in Bangladesh;
- To explore some remedial measures to overcome the situation of the Non-performing loan in Bangladesh.

METHODOLOGY

It is basically a desk based investigative study where secondary information has gained prominence. Recent News Papers, Magazines, and various peer review journals are considered for this article.

STATUS AND OUTCOME OF NON-PERFORMING LOAN IN GLOBE

Globally, find out the reason behind bankruptcy, then see that most of the banks cannot collect their loans during the specified time period or the categories of bank assets are not at the desired level.

Non-performing loans are expected to slow down the country's economic growth as well as reduce the profits of the bank. Some common components of the economic cycle which impede the impact of Non-performing loans. (Show in a Figure 2).

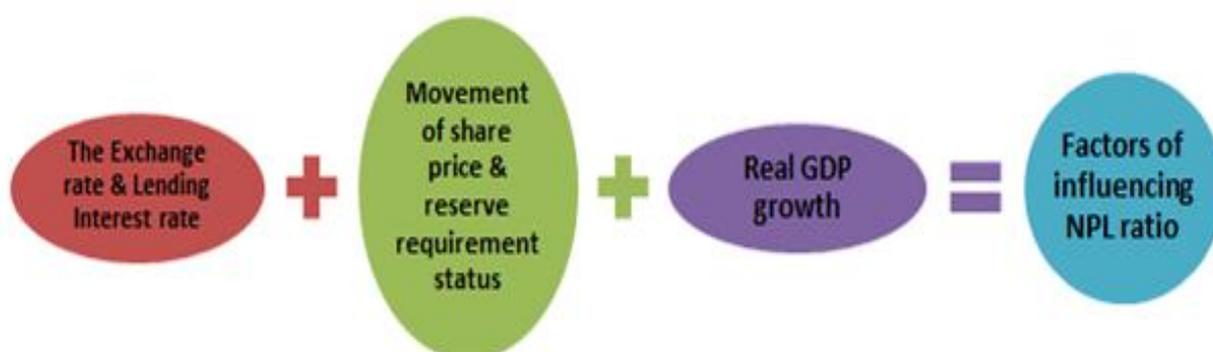


Fig2. Some critical factors of affecting NPL ratio

Source: Prepared by author based on relevant information.

Beck, Jakubik, Andpiloiu (2013)

Analyzed their article that, "In the case of exchange rates, the direction of the effect depends on the extent of foreign exchange lending to unhedged borrowers which is particularly high in countries with pegged or managed exchange rates. In the case of share prices, the impact is found to be larger in countries which have a large stock market

relative to GDP. These results are robust to alternative econometric specifications".

The Figure 3 shows that, top ten countries status about nonperforming loan around the world. The average for 2016 was 7.07 percent. The highest value was in San Marino: 43.38 percent and the lowest value was in Macao: 0.2 percent. Below is a chart for all countries where data are available for: Non-performing loans.

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Apart from this, non-performing loans can be increased or decreased depending on the country's political environment alongside with

internal governance system and the central bank's regulatory ability.

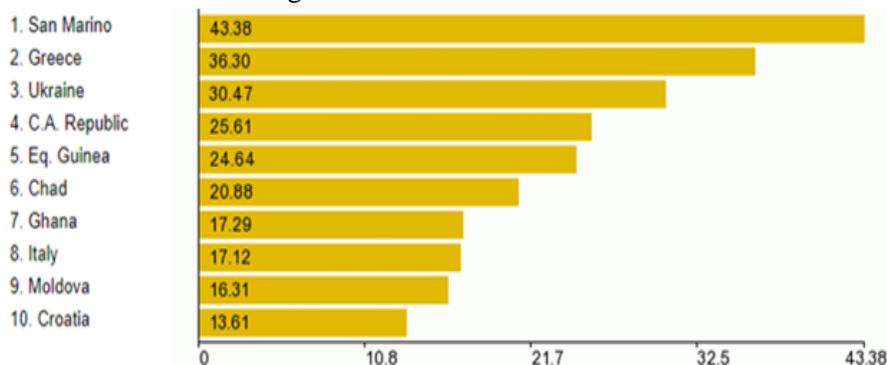


Fig3. Top ten countries around the world about Non-performing loan as percent of all bank loans in 2016

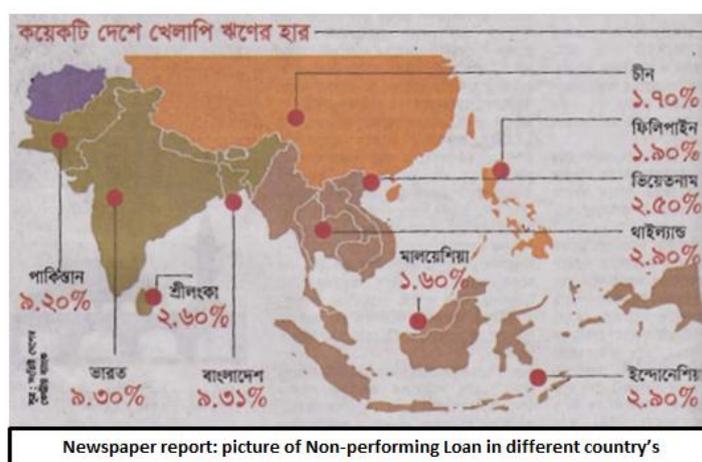
Source: The Global Economy.com and World Bank https://www.theglobaleconomy.com/rankings/Nonperforming_loans/

The contemporary banking crises are not accompanied by declines in aggregate bank deposits, and credit does not fall relative to output, but the growth of both deposits and credit does slow down substantially. In the case of credit growth, stronger banks reallocate their asset portfolio away from loans. This suggests that protecting deposits during a banking crisis may not be enough to protect bank credit, as lack of usable collateral and poor borrower creditworthiness discourage banks from lending. However, protecting bank credit may not be a priority right after a crisis, as the real economy can rebound without it, at least while there is substantial underused capacity.

Among the developed countries, Pakistan has the highest amount of nonperforming loan that is 9.2%.

In this situation, India and Bangladesh are almost equal, in terms of law enforcement; the neighboring country is very much ahead. Recently the Indian government has approved the law namely 'the Economic Offenders Bill 2018' to prevent nonperforming loan. For instance, If anybody is involved in the loan default, all his accounts will be seized. In China, there is a passport blacklist process. Unfortunately, there is no punishment for closing down the defaulted loan in Bangladesh, there are weaknesses in law enactment also. Below is a picture of the default loan scenario in recent times-(see in the Figure 4).

NON-PERFORMING LOAN SCENARIO IN BANGLADESH



Source: BANIKBARTA Newspaper

The biggest problem is the absence of good governance in the banking sector of Bangladesh, which is not possible to take action altogether. Two factors can be identified as a reason for the increase in Non-performing loans. First, the bank's directors aggressively take a loan from

his own bank as well as another bank. In this issue quoted from Financial Express, "Bank directors are taking loans from their own banks as well as from other banks. Directors of 19 banks have taken loans of Tk 4.00 billion from their own banks. Directors of nine banks have

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given loans of Tk 2.31 billion against their personal guarantee.” Second, getting more bank in the economy and expressing their inefficiency. Another quote from Financial Express revealed that “Among these banks, Farmers Bank had the highest default, Tk3.78 billion, at the end of September, 20 17. The financial situation of this bank is deteriorating fast. On the one hand, loans are not being repaid and on the other, sufficient deposits are not coming. The bank is not in a position to return

the money of the depositors. NRB Commercial Bank is second in respect of loan default. Their default amount is Tk1.94 billion. Meghna Bank is third on the list of defaulters. Their default loan amounts to Tk1.52 billion. Midland Bank has a default of Tk460 million. South Bangla Agricultural Bank's default is Tk150 million and Modumoti Bank has a default of Tk14 million.

Seeing the performance of some new banks during 2013, this issue came up.

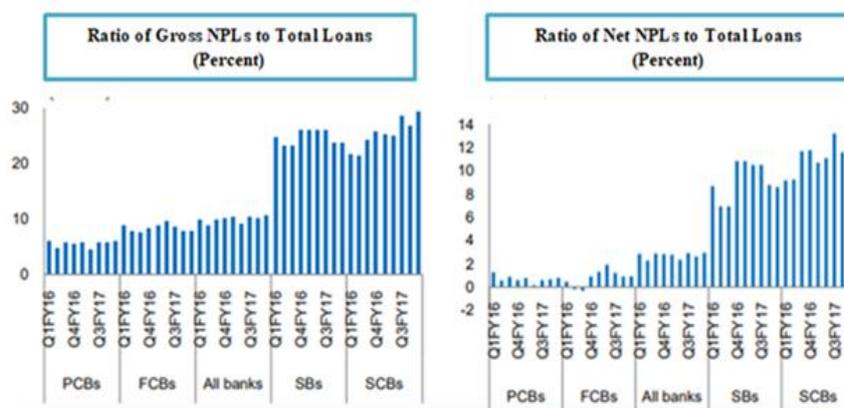


Fig5. At a glance Non-Performing Loan Scenario in Bangladesh

Source: This graph is adapted from Bangladesh Bank special publication and this is presented in this paper by author.

Figure 4 show that Bank industry indicators reflect a mixed performance in early 2018. At the end of September 2017, the liquidity condition of the banking system remains adequate, accompanied by stable capital to the risk-weighted-asset ratio (CRAR). During that period, Non-performing loan (NPL) has increased slightly and provision shortfall position against classified loan has softened, mostly driven by state-owned commercial banks(SCBs). The graph of the left-hand side shows that Gross NPL ratio remains adequate. NPLs in SCBs increased to 29.3 percent in September 2017 that reflects a weaker provision. The graph of the right-hand side shows net NPL increased by 0.3 percent during September 2017.

The latest information is that in the 1st quarter of FY 2018, Gross NPL ratio rising modestly from 5.8 percent to 6.0 percent.

Key findings of the different studies revealed that

Table1. Summary of the key reason for default loan

Issues	Key Findings	Source
1.Fear	Bangladesh bankers can't even dare to send notices to defaulters	Banking conference organized by the Bangladesh Institute of Bank Management
2.Inefficiency and vulgarity	Bangladesh saw an enormous increase in the number of banks in the last decade but the industry's capacity has not improved	Banking conference organized by the Bangladesh Institute of Bank Management

POLICY MEASURES AND FINDINGS OF THE STUDY

In Asian countries, the effective action needed to reduce non-performing loans is seen from the part of this article. **According to the Reddy (2012)** emphasized that “Financial sector reform in India has progressed rapidly on aspects like interest rate deregulation, reduction in reserve requirements, barriers to entry, prudential norms and risk-based supervision. But progress on the structural-institutional aspects has been much slower and is a cause for concern. The sheltering of weak institutions while liberalizing operational rules of the game is making implementation of operational changes difficult and ineffective. Changes required to tackle the NPA problem would have to span the entire gamut of judiciary, polity and the bureaucracy to be truly effective”.

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3. Weak structural and regulatory reforms	Enhancing lack of credibility of private sectors	Banking conference organized by the Bangladesh Institute of Bank Management
4. The inadequacy of the legal system (Bank company Act)	Stressed the need for applying the bank company act accordingly to the directors or the owners of the bank to minimize the NPL of the directors.	Dr. A.B. MirzaAzizul Islam, a former finance adviser to a caretaker government
5. Lack of Good governance	Unethical professional supremacy in the banking sector of the country and tendency of bad borrowers	Most of the expert's point of view.
6. Weak capitalization and poor risk management	More than 80 percent of the NPLs are in the bad loan category. An increase in NPLs by 3, 9 and 15 percent would result in the failure of 7, 21 and 29 banks.	London Based BMI Research, A company of Fitch Group

Source: Table 1 data is rearranged by author in relevant source

RECOMMENDATIONS

- In order to reduce the defaulted loan in Bangladesh, good governance in the banking sector is very much needed for instance banking must stop the family business and there should be strict monitoring cell to observe loan recovery system;
- There should be proper rules for an appointment and cancel the bank's director. In this case, the government and the Bangladesh Bank must have the authority to observe this issue;
- There should be proper policies and surveillance in the evaluation of the performance of the Fourth Generation Banking;
- Basically, Non-performing loans are affected by the capital to risk-weighted assets ratio (CRAR). so this will work to improve the quality of the CRAR and
- Mandatorily to implement Basel III guidelines alongside prudent implementation of the banking law for all banks.

CONCLUSION

Default loan (Non-performing) culture has been found in different countries of the world, in Bangladesh, this problem has become apparent in the last few years. Structural weakness, political will and lack of good governance are main factors for the bank industry depressed. There may also be a reason for the small economy to move more to the bank.

In order to overcome this situation, the family tradition in banking will be reduced in the bank sector in the country, at the same time, the capacity of the country's central bank to increase immediately. As the goal in front of Bangladesh is to become a developed country by 2041. Before that, one of the main goals is to achieve SDG by 2030.

The 16th goal of the SDG's seventeen goals is being 'Peace, justice, and strong institutions'. Making banks a strong institution, to ensure peace and justice at the stakeholder level.

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AUTHOR BIOGRAPHY

Author is a finance & Economics researcher and NGO Development activist. He is the author of the book on 'Bangladesh Share Market: Looking ahead after two big crashes'. toufique2010@gmail.com.



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