

Management of Classified Loans: A Study on Commercial Banks in Bangladesh

¹Muhammad Abu Taher, ²Md. Abdul Matin Chowdhury

¹Law Officer and S.P.O, ²Advocate

¹Pubali Bank Limited, ²Judge Court, Moulvibazar

ABSTRACT

This paper is going to exemplify the loan classification of commercial banks in Bangladesh. The study area is selected on commercial banks of Bangladesh. After liberation, our banking business had been performing well but very recent time most of the banks face a problem of loan classification. So they loss some profit and fall under trouble for the loan run. We know that there are 60 commercial banks in Bangladesh. Deposit collection and lending are the main function of these banks. The study is conducted on only five commercial banks of Bangladesh. Last 12 years data of the selected banks are considered to accomplish the study. This research focuses on the major challenges of good loan that obstruct smooth development of Bangladesh. This study conveys the message that if the loan classification is reduced and good loan culture is created, the banking sector will flourish very fast way.

Key words: *Loan, Loan classification, Non-performing loan, Provision*

INTRODUCTION

Effective flow of investments and savings culture is the precondition of the economic development of any country. As a developing country, Bangladesh faces several obstacles such as bad loan culture as well as underdeveloped capital market which mostly depend on the mobilization of the savings and granting credit facilities to the investors by the commercial banks. The performance of the financial sector of our country depends on the performance of commercial banks. If we look the previous decade's performance of our financial sector, we will examine that our financial sector faces the high percentage of non-performing loans (NPLs) or loan classification. For offsetting bad debt loan, Banks always try to create a reserve fund which is created from interest income of the banks.

Every bank always tries to maintain the good loan culture but in some cases it is not possible. There are several reasons for the classification of loan. Loan repayment depends on the willingness and capability of the borrowers. In Bangladesh, the political situation is fully robust. So banks face several obstacles from this sector. The main purpose of this research work is to recognize the impact the loan classification on the profitability of the commercial banks. The goal of this study is to give the opportunity to the readers to know something in real time situations of loan classification.

OBJECTIVES

The objectives of the study are as follows:

1. The fundamental purpose of this research work is to get enough knowledge about the real scenario of management of classified loan of commercial banks in Bangladesh.
2. To ensure cooperation, sincerity and accountability of involved parties such as plaintiffs, defendants, lawyers and judges to make the settlement process vibrant and speedy.
3. To identify the potential and problems loan classification of the banks.

METHODOLOGY

Study design: The study was confined to our Banking Industry. The performance was analyzed on bank, bank group and industry level. Four bank groups and further four banks from each bank group was selected for the study. The study was descriptive and empirical in nature where secondary and primary data was used to address the objectives.

Study Period: The study was conducted from 2004 to June 2019.

Sampling method: Random sampling method was used for the study.

Sample Size: Total 400 respondents were selected for the study. Data were collected from the bankers. Banks were selected for the study.

Sources of Data: Data were collected from primary and secondary sources.

Sources of primary Data: Primary data were collected from the respondents of the study area.

Sources of Secondary Data: Secondary data were collected from Books, Research report, Journal, Thesis, Internet etc.

Tools for Data collection: Questionnaire was used for data collection.

Study area: The study area was conducted on commercial banks of Bangladesh.

Method of Data Collection

The study was conducted based on both primary and secondary data. Primary data was collected through interviews and Questionnaire survey. Structured questionnaire containing both open and closed ended was used. A survey through a standardized questionnaire was conducted to collect both quantitative and qualitative information from. Secondary data and information was collected besides the primary sources side by side secondary data was gathered from journal articles, published books, Internet etc. At the same time the present study was collected qualitative data through face to face interview by using a check list.

Data Processing and Analysis

In qualitative study the researcher has the freedom to marshal gathered data to meet the desired objectives of the study (Creswell 2009).

Partial data of questionnaire survey were processed using simple statistics. The rest of the data were explained carefully to meet the aim of the study and research question and also attempted to establish relation among the variables. Some important and strong statements were referred in the analysis part to add value to the findings. Table, graphs and statistical analysis were done by Computer Program Statistical Package for the Social Science (SPSS) was used for data analysis.

RESULTS AND DISCUSSION

Ratio Analysis of AB Bank Limited

Profitability Ratios

To analyze profitability, six distinct ratios was considered.

- Return on Asset
- Return on Equity
- Return on Capital Employed
- Gross Profit Margin
- Net Profit Margin and
- Operating Profit Margin demand for loans:

Gross Profit Margin

Gross Profit Margin illustrates the cost effectiveness of the entity. Gross Profit Margin was higher in FY 2010 but in FY 2013 it was smaller in respect of other periods. AB Bank is not performing well in case of minimizing their cost of fund.

Table 1: Ratio Analysis of AB Bank Limited

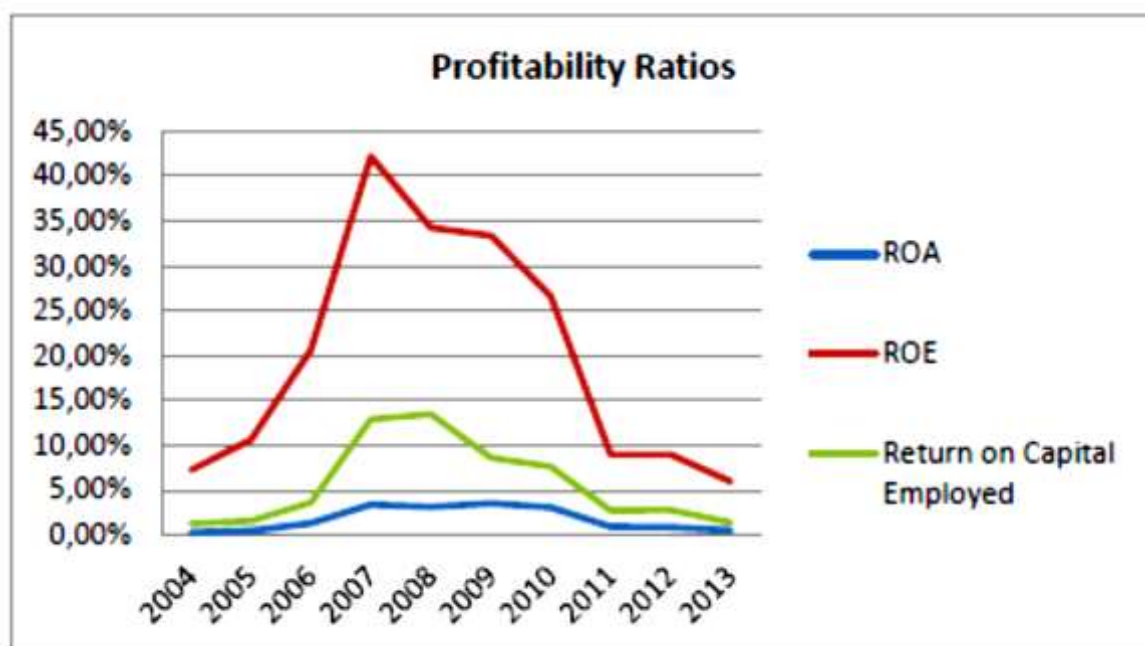
	ROA	ROE	Return on Capital Employed	Net Profit Margin	Net Profit Margin	Operating Profit Margin
2004	0.28%	7.24%	1.27%	71.18%	4.39%	9.26%
2005	0.50%	10.64%	1.60%	69.71%	7.18%	18.01%
2006	1.31%	20.61%	3.59%	78.45%	15.75%	15.75%
2007	3.41%	42.19%	12.88%	88.36%	36.12%	53.47%
2008	3.12%	34.22%	13.46%	83.52%	31.23%	48.88%
2009	3.52%	33.34%	8.62%	91.39%	37.17%	57.53%
2010	3.09%	26.65%	7.61%	110.75%	37.56%	64.61%
2011	0.93%	8.94%	2.71%	60.34%	10.35%	23.05%
2012	0.88%	8.97%	2.76%	53.68%	9.15%	20.30%
2013	0.53%	5.97%	1.41%	54.34%	5.63%	16.62%

Net Profit Margin

The same thing like Gross Profit Margin and Operating Profit Margin was happening in case of Net Profit Margin. The bank was not performing in case of earning profit.

Table 2: Liquidity of AB Bank Limited

Year	Current Ratio	Current Asset Ratio	Loan Deposit Ratio
2004	13.80%	71.46%	60.10%
2005	9.05%	59.37%	78.16%
2006	10.74%	66.20%	74.36%
2007	11.54%	76.14%	76.66%
2008	9.33%	87.53%	82.71%
2009	10.65%	69.60%	85.31%
2010	13.49%	63.37%	91.95%
2011	15.09%	63.59%	81.48%
2012	13.21%	62.98%	75.75%
2013	11.49%	73.86%	86.58%



Loan Deposit Ratio

The bank has an increasing trend in loan deposit ratio. The bank was increasing its loan deposit ratio. The average loan deposit ratio was 79.31%. Combining all the liquidity ratios together, it seems that the bank was performing well in maintaining liquidity. And the bank was able to meet the current liabilities.

Risk and Solvency Ratio

To comment on risk and solvency ratio, the following ratios was to be considered.

- Debt to equity ratio
- Debt to total asset ratio

Table 3: Risk and Solvency Ratio of AB Bank Limited

Year	Debt to Equity Ratio	Debt to Total Asset Ratio	Financial Leverage Ratio
2004	294.03%	96.18%	189.44%
2005	418.24%	95.38%	185.30%
2006	394.60%	94.62%	133.54%
2007	143.67%	92.90%	118.00%
2008	71.20%	92.00%	119.38%
2009	211.19%	90.57%	111.48%
2010	185.77%	89.55%	116.55%
2011	151.15%	90.29%	145.81%
2012	136.49%	90.78%	136.76%
2013	210.39%	91.86%	177.236%

For analyzing risk and solvency, it was seen that debt to equity ratio was fluctuated very highly for the periods. As the debt to equity ratio was decreasing in different years, riskiness of being default was low. The debt to total asset ratio was near constant. The fluctuation was very low. Financial leverage ratio shows the profitability due to use of debt. The bank was maintaining a reasonable leverage that was 143.35% in an average. Combining all together, the ratios show that the bank was able to minimize risk and solvent enough to meet the liabilities.

Loan's Access to Finance

In the survey, the respondents interviewed were mainly the enterprise owner/ manager/ CEO. The respondent reported that on an average they spend Tk.44 or half of USD 1 approximately, to arrive at their respective bank branches to avail financial services. A large portion of the respondents, 89 percent reported that opening a bank account for the business purposes was not so difficult whereas only 11 percent says it was difficult to open a bank account. They reported that the difficulty arises mainly from the requirements of identification documents. In general, to open a bank account or for availing loan, 5/6 identification documents were required. In the context of Bangladesh identification documents is national ID, TIN certificates, trading license and birth certificate etc.

Table 4: Women led loan's Access to Finance

Particulars	Percentage
Women face any difficulties	45%
Women face no difficulties	32%
Face challenges in getting loans	17%
Face no challenges in getting loans	23%

The study asked both male and female sample entrepreneurs about the difficulties of women led enterprise in getting SME loan. Around 45 percent respondents do not feel that women face any difficulties whereas about 32 percent of them argue that women 17 face challenges in getting MSME loans. On the other hand, around 23 percent of the respondents argue that do not have any information about this.

Difficulties in Getting Loan

About 97 percent of the sample respondents reported that they did not face any difficulties in getting loan whereas only 2 percent of them reported that they had trouble in getting loan. They reported that, on an average, 26 days required to get the loan sanctioned. It may be noted that the time required for sanctioning loans was quite high due mainly to processing and disposals from the higher authority of the concerned banks.

Table 5: Requirement for getting home loan

Condition	Frequency	Percentage of Response
Certificate of occupancy	12	22.2
Approved building plan	5	9.25
Survey plan	4	7.4
Bill of quantities	4	7.4
Feasibility and viability report	6	11.1
Evidence of past performance	9	16.7
Environmental impact assessment	6	11.1
Tax clearance	5	9.25
Development levy receipt	3	5.6
Total	54	100

Source: Filed Survey

For developers to meet in getting loan from these institutions. It takes 22.2 percent of the total respondents. Evidence of past performance is another condition that the developers find difficult to meet. This takes 16.7 percent of the total respondents.

Table 6: Requirement of Collateral or Guarantor

Respondents	Percentage
Collateral for taking loan	80%
Did not require any collateral	20%
Guarantor for taking loan	75%
Did not require any guarantor	25%

Around 80 percent of the respondents reported that Collateral is must for taking loan whereas 20 percent of them reported that Collateral was not a requirement for loan. Report also finds that 75 percent respondents required a guarantor for taking loan while 25 percent did not require any guarantor.

FINDING AND ANALYSIS

Management Soundness

Financial soundness indicators were methodological tools that help quantify and qualify the soundness and vulnerabilities of financial systems according to five areas of interests: capital adequacy, asset quality, earnings, liquidity, and sensitivity to market risk. With support from the Investment Climate Facilitation Fund under the

Regional Cooperation and Integration Financing Facility, this report describes the development of financial soundness indicators for Bangladesh and analyzes the stability and soundness of the banking system by using these indicators.

The key challenges to comprehensively implementing reforms and convincingly addressing the root causes of the banking sector problems include Assessing banks' recapitalization needs, Revising classification criteria to guide resolution options, Recapitalization and restructuring that may include foreign partnerships.

Audit and Financial Disclosure

Credible financial information was imperative in attracting investments and business decision making. Financial reporting was one of the main tools used to acquire information and was an important source that can create investor confidence in a market. Financial reporting and disclosure reduce information asymmetry that exists in capital markets between managers and other stakeholders (Healy and Palepu, 2001). IAS/ IFRS compliant financial statements make companies annual reports harmonized and uniform globally.

Political Intervention

Political intervention in credit markets, often with telling consequences, seems to be ubiquitous, regardless of the stage of development of the financial system. It has been well documented that in emerging markets, cozy ties between banks and politicians, as well as state ownership of banks, give rise to a great deal of political influence in credit extension and capital allocation.

CONCLUSIONS

Since 1989, Bangladesh pursues both "overdue criteria" and "qualitative criteria" to estimate a loan classified or unclassified. All loans are divided into five categories such as continuous loan, demand loan, term loan payable within five years, term loan payable in more than five years and short-term agricultural credit or micro credit. All default loans are also reclassified as special mention account (SMA), substandard, doubtful and bad/ losses. In order to maintain the management up to date about the status of loans, bank managers review the loan quality on daily basis. With some exclusion, the banking sector at present pursues a norm of six months overdue for estimating a loan nonperforming. So as we see in our regression analysis that the amount of classified loan increases as total loan increases and at the same time profit also increases as because profit and total loan are positively related. So for maximizing profit we should decrease the amount of classified loan.

RECOMMENDATIONS

1. Bangladesh Bank should increase the supervisory power and monitoring functions to control the banks that engage in malpractice.
2. Bankers should apply the human skill, diligence, prudence while delivering credit. To ensure this ability of employees, training should be provided. More awareness needs to be developed.

3. To increase the ethical standards of the bank officials from all bends to create the credit environment trustworthy and vibrant.
4. To increase the explicit techniques to differentiate the intractable defaulters from the indisputable ones.

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