



Internship Report
on
Non-performing Loans in Banking Sector of
Bangladesh: Causes and Effect

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Subject: Submission of the report on “NPLS in Banking Industry in Bangladesh: Causes and Effects”.

Dear Sir,

It is my great pleasure to submit the report on **NPLS in Banking Industry of Bangladesh: Causes and Effects** that you have assigned me.

It has been a great experience for me to prepare a report. I tried my level best to put meticulous efforts for the preparation of this report. Any shortcomings or flaw may arise as I am novice in this aspect.

I have tried to make each and every element relevant to my topic and discussed under the context of whatever I have learned from the course. It would be pleasure for me, if this report can serve its purposes.

Sincerely yours,

Deep Majumder

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Acknowledgement

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Executive Summary

Nonperforming loans is common phenomena for banking industry in Bangladesh. A **Non-performing loan** is a loan that is in default or close to being in default. Many loans become non-performing after being in default for 90 days, but this can depend on the contract terms. NPLs started at the early stage of liberation. During 1980s and 1990s, Privatization and liberalization of banking sector could not control NPLs. Rate of NPLs was 41.1% in 1999. Now it is 11.90%. The amount of NPLs increased to taka 73.3 billion in 2012 from taka 47.3 billion in 2003. There are many reasons behind the NPLs in Bangladesh. First reason is entrepreneurs related. Borrower may be have lack of experience, lack of business and lack of institutional training background or lack of supporting facility. Sometime borrowers do it intentionally. Entrepreneurs age also an important factor. Second reason is business related. Sometime banks give loan to businesses which are not attractive. Strong competition is another business related cause. Borrower becomes defaulter if there is poor management capability, poor financial performance, and poor cash flow. Business could be defaulter because of low market share. Low market share mean low revenue so that business cannot pay the interest payment. Third reason is leading related. It is mainly Bank's fault. Loan could be default if Bank delayed assessment of loan proposal, delayed disbursement of fund, lack of proper monitoring, lack of taking proper action. Last reason is macroeconomic factors. Low GDP growth, increasing crimes, hartals and frequent policy change effect loan. For those reasons loans become default loan. Effects of NPL are such as Stopping Money Cycling, Earning Reduction, Capital Erosion, Increase in Loan Pricing, Frustration etc. As a result, the values of security are increased and the risks of financial recession also see a rise.

1. Introduction

Smooth and efficient flow of saving-investment process is a prerequisite for the economic development of a country. Bangladesh, being a developing country and with an underdeveloped capital market, mainly depends on the intermediary role of commercial banks for mobilizing internal saving and providing capital to the investor. Thus, it matters greatly how well our financial sector is functioning. Looking at the performance of our financial sector for the last decade or so, we observe that our banking sector is heavily burdened with a high percentage of non-performing loans (NPLs).

It is obvious that NPLs reduce banks' profitability, as banks cannot appropriate interest income from their classified loans. NPLs reduce loan able funds by stopping recycling. Banks need to set aside a portion of their income as loan loss reserve to make up bad debt. A bank with a high percentage of NPLs suffers from erosion of the capital if there is no provision (assume). All those adverse impact of NPLs on banks' financial health such as low profitability and low capital base are clearly reflected in Bangladesh banking sector.

The ratio of NPL to total loans of all the banks had shown an overall declining trend from its peak 34.9% percent to 10 percent in December 2012. The ratio further increased to 11.9 percent at the end of June 2013.

1.1. Objective of the Study

The objectives of this paper are

- i. To assess the present situation of non-performing loans in our banking sector.
- ii. To show the trend of the "loan default problem" in Bangladesh.
- iii. To examine the loan default status of commercial banks.
- iv. To discuss legal aspect to recover loans from the defaulters.
- v. To identify the causes and remedies of non-performing loans and.
- vi. To raise some issues and observations which need to be looked upon quickly for ensuring a financially sound banking sector.

1.2. Methodology of Study:

The research methodology of the study has been enumerated below:

Sources of Data and Data Collection:

Data has been collected from the various secondary sources like research works of individuals, different publications, journal of different institutions, Bangladesh Bank Credit Risk Grading manual , Bangladesh Bank annual report etc.

1.3. Limitations of the study:

The limitations of the study are

- 1.This study did not cover primary and unpublished data.
2. The major problem faced while conducting the research was unavailability of relevant data.
3. Time constraint.

2. Definition of Nonperforming Loans (NPLs):

A **Non-performing loan** is a loan that is in default or close to being in default. Many loans become non-performing after being in default for 90 days, but this can depend on the contract terms.

According to IMF, definition of NPLs is

“A loan is nonperforming when payments of interest and principal are past due by 90 days or more, or at least 90 days of interest payments have been capitalized, refinanced or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons to doubt that payments will be made in full” (Wikipedia, definition of NPLs)

By bank regulatory definition non-performing loans consist of:

- loans that are 90 days or more past due and still accruing interest, and
- Loans which have been placed on nonaccrual (i.e., loans for which interest is no longer accrued and posted to the income statement).

Loan may also be non-performing if it is used in a different way than that for which it has been taken. 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. Non-performing loans are also called non-performing assets (NPA), which are loans, classified by a bank or a financial institute, at the instruction of the regulatory authority, on which repayments or interest payments are not being made on scheduled time. A loan is an asset for a bank as the interest payments and the repayment of the principal create a stream of cash inflows. Interest cash inflow is excess money over principal, which is called profit.

Banks usually treat assets as non-performing, if they are not serviced in scheduled time. If payments are late for a short time, a loan is classified as past due. Once a payment becomes late (usually 60 days), the loan is classified as non-performing.

NPL is a sum either of the borrowed money upon which the debtor has not made his/her scheduled payments, which is in default or close to being in default. Once a loan is non-performing, the odds that it will be repaid in full are considered to be substantially lower. If the debtor starts making payments against a non-performing loan, it becomes a performing loan.

2.1. Classified Loan:

A **classified loan** is the term used for any loan that a bank examiner has deemed to be in danger of defaulting. The borrower does not necessarily need to miss payments order for a bank to label the account in this manner. A borrower can have what the bank calls a classified loan for different reasons. This is simply a precaution that financial institutions take to prepare for a possible loss and to prevent any further risk.

The Bangladesh Bank defines an 8-tier loan classifying system such as Superior, Good, Acceptable, Marginal, Special Mention, Sub-standard (SS), Doubtful (DF) and Bad/ Loss (BL). This is actually the key risk grading system in order to measure the assets' quality. This grading must be used to check asset-quality periodically. Downgrading of any facility should be informed in Early Alert Reporting (EAR) for decision-making authorities.

The loans are usually classified by the lending bank, whenever the bank has reasons to believe that the borrower would not be able to repay the loan regardless of whether the loan is overdue or not. Loans extended by a bank are classified into the following three categories.

- i. Substandard: Advances which appear substantial degree of risk to bank by reason of unfavorable record or other unsatisfactory characteristics.
- ii. Doubtful: Advances the ultimate realization of which is doubtful and in which a substantial loss is probable.
- iii. Bad/Loss: Advances which may not be recoverable at all and entire loss is probable.

3. Nonperforming Loan in Bangladesh:

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 in firm banking infrastructure combined with an unskilled work force on the other. The expansion of credit policy during the early stage of liberation, which was directed to disbursement of credit on relatively easier terms, did actually expand credit in the economy on nominal terms. However, it also generated a large number of willful defaulters in the background who, later on, diminished the financial health of banks through the "sick industry syndrome". Despite the liberalizing and privatizing of the banking sectors in the 1980s with a view to increasing efficiency and competition, the robustness of the credit environment deteriorated further because of the lack of effective lenders' recourse on borrowers. 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 alignments of the credit discipline of the country till the end of 1989.

In the 1990s, however, a broad based financial measure was undertaken in the name of FSRP, enlisting the help of World Bank to restore financial discipline to the country. Since then, the banking sector has adopted "prudential norms" for loan classification and provisioning. Other laws, regulations and instruments such as loan ledger account, lending risk analysis manual, performance planning system, interest rate deregulation, the Money Loan Court Act 1990 have also been enacted to promote sound, robust and resilient banking practice. Surprisingly, even after so many measures, the banking system of Bangladesh is yet to free itself from the grip of the NPL debacle. The present study has concentrated on the above issues mainly with a view to assisting policymakers to formulate concrete measures regarding sound management of NPLs in Bangladesh.

3.1. Base for provisioning and accounting treatment of NPLs:

A balance sheet item representing funds set aside by a company to pay for losses that are anticipated to occur in the future. The actual losses for the earmarked funds have not yet occurred, but the general provisions account is counted as an asset on the balance sheet.

The bank managers of Bangladesh deduct the amount of interest suspended and the value of “eligible securities” from the outstanding amount in order to determine the base for provisioning to NPLs. For unclassified loans, however, they keep a general provision (1%) against the outstanding amount and include it in the capital to determine the capital adequacy of the bank (at present 10%). With regard to income recognition, bank managers do not consider the amount of interest on substandard and doubtful loans as income for the bank, but rather keep it separately in an “interest suspense account”. However, if any amount is received against sub-standard and doubtful loans, the said amount is deducted from the total interest suspense amount. In the case of a bad/loss loan, the interest on such loan is also kept in the interest suspense account if a suit is filed in the court. Seemingly, with regard to substandard and doubtful loans, this interest is also excluded from the income of the bank. These accounting measures have made the banking sector more transparent and credible than they were in the past.(Marge with provision)

3.2. Trend of the Loan Default Problem in Bangladesh

Emergence of Default Loans

As banking remains the main intermediary vehicle of harnessing investible capital for accelerating the growth of the productive sectors in Bangladesh, the continuing crisis of accumulation of non-performing and defaulted banks loans has emerged as one of the most serious constraints in the path of economic development of our country. Now we will discuss how the loan default problem has emerged in our country by year-wise.

Post liberation period

After the liberation of Bangladesh, the Awami League Government's decision to nationalize the banks and insurance companies operating in Bangladesh should be considered a logical step but the task of re-organization of the nationalized banks in the chaotic, war-ravaged and crisis-ridden post-liberation years and a very rapid expansion of banking network in rural Bangladesh created some problems for the banking sector. There was no time after nationalization as the most corrupt, undisciplined, over manned and mismanaged concerns mired in sea of recurrent losses in the backdrop of the political and administrative inexperience of the post liberation regime.

In this scenario, the nationalized banks were involved in two sorts of pressure situations, firstly, the almost insatiable demand for credit from the loss making state-owned enterprises kept the banks under constant pressure due to a shortage of adequate liquidity and secondly the newly emerging so called "briefcase business man" with connection with politics and politicians, top bureaucrats and top bankers, and retired military and civil bureaucrats were constantly lobbying for access to bank credit and in the process were vitiating the work atmosphere in the banks by alluring a section of the banker to indulge in corruption and malpractices. It is now widely recognized that today's millionaires of Bangladesh came mostly from the Ranks of those "briefcase businessman" and the groups mentioned, who could successfully establish and maintain this types of patron clients relationship with the bankers and in the process created a host of millionaires from amongst those bankers themselves, who had actively connived and harvested the illicit margins in exchange of the favours rationed out to those fortunate loaners.

The political changes of 1975 ushered in an era of political culture, where in corruption gradually became institutionalized; the economics of rent seeking took firm roots in the body politic of Bangladesh. In the process, sanctioning of bank loans became one of the prime victims of the buying and selling process afflicting the political party affiliation process, and a popular mechanism for doling out financial favors to party leaders as well as political cadres. This politicization of the banking practices has seriously hampered the institutional disciplines of the banks, where professional expertise, integrity and ethical values have become exceptions to some extent rather than rules. Ex-banker emerged as financiers as the newly floated private banks, but

there was no mechanism to make them accountable or to know about the sources of their cash. Defaulters of bank loans taken from nationalized banks or state-owned development finance institutions swelled the rank of directors of the newly established private banks, but nobody intervened on behalf of the loan-giving banks caught in the middle with defaulted loans. The laws, rules and regulations relating to banking remained mostly in the books; and the judicial process utterly failed to take the willful defaulters to task, thereby making the process of lender's recourse on borrowers almost a mockery in Bangladesh. Therefore, we surmise that behind all these malaises, the nature of the state and of politics played the real villainous role by patronizing and developing a class of 'comprador bourgeoisie' in Bangladesh, created, nursed and constantly nourished by state-patronage, and in this nursing process, bank loans were rampantly used as lucrative doles.

In the eighties, the rapid liberalization of Bangladesh's import regime has created the so-called 'sick-industry syndrome', which provided a potent excuse for some, and created genuine hardships regarding repayment of bank loans for the other. The domestic industries have been bearing the brunt of this ill advisedly too rapid pace of liberalization of Bangladesh's international trade without appropriate preparatory policy measures. The political doldrums of the late-eighties provided additional excuses to these swelling groups of defaulters. The BNP government of 1991-96 tried to stem the rot in this field in the initial years of its term. They repeated the blunders of its predecessor of providing lavish encouragement to bank managements to ease and expedite the process of term lending, especially according to its own political exigencies at the later stated of its rule, which added a massive amount of fuel to the fire of the so-called 'default-culture. And earlier lending sprees continues to haunt the banking section even today be sustaining the momentum of the build-up of the defaulted loans of the earlier two decades.

3.3. The Present status of Loan Defaults Culture in Bangladesh

As loans comprise the most important asset as well as the primary source of earning for the banking financial institutions and on the other hand also the major source of risk for the bank management so a prudent bank management should always try to make an appropriate balance

between its return and risk involved with the loan portfolio. But Banking sectors recent involving activities, guidelines and their concentration in that is not satisfactory.

The prudential guidelines also call for making adequate “provisions” against classified loans in order to protect the financial health of the banks are prepared but which is meaningless as by making provision the number of willful defaulters increasing day by day. The economic implications of the non-performing/default loans are not only stoppage of creating new loans but also the erosion of banks profitability, liquidity and solvency, which might sometimes leader towards collapse of the baking financial system. It has therefore become sine qua non for policy makers to study the loan default scenario of the banking sector of routine basis for estimating classified loan, making appropriate provisioning, adopting effective recovery strategy and thus ensuring soundness and efficiency of the banking sector.

Before privatization and liberalization this banking activities were thus directed to disburse credit, according to the government’s economic priority, and hence little attention was placed to identify the problem loans and making provisions thereon, although there was significant amount of hidden default loans. After 1982, the banking sector of Bangladesh underwent a rapid denationalization and privatization process. The out of six nationalized commercial bank Uttara Bank and Pubali Bank were denationalized in 1983 and 1984 respectively with a view to increasing the efficiency of the banking sector. Henceforward, private bank were allowed to conduct banking operations in order to increase, competition, reasons, the efficiency and productivity of the banking sector. But due the various reasons, the efficiency of the banking sector did not increase rather the credit discipline was further eroded.

The very frequent and fashionable style of loan defaulting story in banking sector of Bangladesh is loan scam. Recently a series of scams has started threatening the banking sector in a great way. Last year, Sonali Bank loan scam started the episode and is continuing with Bismillah loan scam, Basic Bank loan scam and so on in a large scale. The story of all episodes is almost same and follows a cycle.

According to Anti Corruption Commission, 41 reputed commercial banks in Bangladesh were involved actively in Sonali bank scam of Tk.3665 crore with Hallmark(*The Financial Express*). Over 100 branches of seven state-run banks, 29 private banks and five foreign banks patronised

that loan scam

according to them.

In 2009, Bangladesh Shilpa Bank and Bangladesh Shilpa Rin Sangsta were merged due to huge amount of NPL in both of them. The operational activities of BSRS came to a halt, when its classified loans reached up to 85 to 90 percent of its total portfolio. The situation was almost same for BSB although it tried to expand its deposit collection on its own rather than rescheduling the previous non performing loans. It had about Tk 250 crore classified loans on the eve of being merged, according to media reports.

3.4. Present Status of Non-performing Loans:

The most important indicator intended to identify the asset quality in the loan portfolio is the ratio of gross non-performing loans (NPLs) to total loans. In 2012 Foreign Commercial Banks(FCBs) have the lowest and State owned Development Financial Institutions (DFIs) have the highest ratio of gross NPLs to total loans. State owned commercial banks (SCBs) had a gross NPLs to total loans of 23.9 percent, whereas Private Commercial Banks (PCBs), FCBs , and DFIs, had ratios of 4.6,3.5 and 26.8 percent respectively at the end of December 2012.

NPL ratios by type of banks

Bank types	2005	2006	2007	2008	2009	2010	2011	2012	End June 2013
SCBs	21.4	22.9	29.9	25.4	21.4	15.7	11.3	23.9	26.4
DFIs	34.9	33.7	28.6	25.5	25.9	24.2	24.6	26.8	26.2
PCBs	5.6	5.5	5.0	4.4	3.9	3.2	2.9	4.6	6.6
FCBs	1.3	0.8	1.4	1.9	2.3	3.0	3.0	3.5	4.7
Total	13.6	13.2	13.2	10.8	9.2	7.3	6.1	10.0	11.9

The gross NPLs ratios to total loans for the SCBs, PCBs, FCBs and DFIs were recorded as 26.4, 6.6, 4.7 and 26.2 percent respectively at the end of June 2013. The ratio of NPLs of all the banks had shown an overall declining trend from its peak (34.9 percent) I 2000 up to 2011 before it increased to 10.0 percent in December 2012.

The amount of NPLs of the SCBs increased from taka 105.7 billion in 2003 to taka 215.1 billion in 2012. The PCBs recorded a total increase of taka 81.8 billion in their NPL accounts, which stood at taka 130.3billion in 2012 as against taka 48.5 billion in2003. The amount of NPLs of the DFIs increased to taka 73.3billion in 2012 from taka 47.3 billion in 2003.

Sonali Bank has the Highest default loan (10,432.43 cores) and HSBC has the lowest default loan(128.06 cores) among the banks at the end of March 2014. In September 2013, Sonali Bank had the highest default loan (12570.21 cores) and HSBC had the lowest default loan (109.05 cores).

Defaulted loan between Sept 2013 and March 2014

(Tk in crore)

Bank name	Defaulted Loan as of Sept 30, 2013	Defaulted Loan as of Dec 31, 2013	Defaulted loan as of March 31, 2014
Sonali	12,570.21	9,629.23	10,432.43
Janata	4,787.22	2,605.26	3,343.48
Agrani	5,119.36	3,317.84	3,324.46
Rupali	1,697.45	1,053.91	1,588.56
BASIC	1,863.33	1,282.57	2,557.34
BDBL	716.08	520.27	615.26
AB	596.18	440.48	464.61
Bank Asia	899.01	587.61	979.90
BRAC	783.85	755.24	840.66
Dhaka	755.23	375.70	563.14
DBBL	474.33	402.04	477.06
EBL	597.96	389.72	427.55
EXIM	1,003.29	516.82	677.02
First Security	218.46	248.38	248.63
ICB Islamic	749.82	717.59	725.88
IBBL	2,786.38	1,364.29	2,065.99
Jamuna	605.28	448.96	558.08
Mercantile	696.90	465.98	534.74
Mutual Trust	331.40	173.10	281.45
National	2,427.62	432.05	607.36
NCC	790.92	486.24	794.26
ONE	573.74	388.54	487.35
Premier	723.41	302.13	495.64
Prime	1,097.49	655.15	949.50
Pubali	800.73	772.50	756.02
SIBL	387.79	338.56	456.85
Southeast	632.52	532.16	546.48
Standard	246.49	259.67	459.35
The City	896.62	706.25	676.56
Trust	305.87	247.04	317.32
UCBL	946.57	556.45	821.92
Uttara	559.53	453.48	641.79
HSBC	109.05	134.51	128.06
NBP	655.36	345	289.49

Source: The Daily Sun

4. Causes of Nonperforming Loans

A. ENTREPRENEURS RELATED

A1: Lack of business experience.

Sometimes people without prior business experience want to do something. It may so happen that after retirement from govt. or private service people want to establish a business, which is not very relevant to his past experience. Besides his own equity they look for bank finance. Normally banks do not finance in the projects where the key personnel do not have enough background in that particular business. When banks finance in the projects here the key personnel lack relevant business experience, it becomes risky for the bank. Probability of failure in these sorts of projects tends to be higher.

A2: Lack of Business and Lack of Institutional Training Background.

Business experience is somehow related to business background. Here business background means family business background. Though family business has a role in entrepreneurial orientation, there is no direct relationship between business background and business performance of loan repayment. It is true that youths coming from business background are familiar with business and banking but there are other ways to get oriented with the same, not necessarily one has to come from business family.

A3: Unwillingness to Pay

.

We all know this is one of the most common reasons behind default culture in Bangladesh. It can happen in some situations like when security-backing loan is weak; customer feels that

defaulting the loan will not harm him much. In that case he tends to default. In other cases like when cash flow from the business is not impressive, people are unwilling repay the loans.

A4: *Lack of Supporting Facilities*

Sometimes business need support from other sources like government authority. When cash flow is lean and the project is in lull, it needs feeding. Without further feeding company may become sick and incur loss in consecutive time periods. In our country most of the companies do not have the supporting sources with which they can withstand the turmoil that comes in to their business from time to time.

B: *BUSINESS RELATED*

B1: *Non-attractive Industry*

Sometimes non-attractive industry acts as primary cause of loan default. Companies operating in non-attractive industries have higher probability of performing poor. Because of poor financial performance, company's cash flow gets affected. Because of cash flow the company becomes less liquid which contributes in defaulting bank loan. Not necessarily that all the companies non-attractive industry perform poor. For example: suppose in Bangladesh Jute industry is one of the non –attractive industries. Now any investor want to invest in this sector may be cause loss. So this investor can't pay the interest.

B2: *Strong Competition*

Strong competition does not directly contribute in defaulting loan. Strong competition takes place when many companies enter into an industry where the industry cannot accommodate so many companies. In strong competition only efficient players survive. So the inefficient companies find it difficult to make profit and sale their product. Once they fail to make profit, the company is likely to default its loan installment in the bank.

B3: *Poor Management capability*

Before sanctioning a loan banks look into the matter that how the management of the company is. If the bank feels that the management is capable enough to successfully run the business and

utilize bank finance, then bank agree to finance otherwise not. Even sometimes banks sets conditions like some of the key personnel must not quit the organization before repayment of the loan. Managerial capability plays vital role in repaying bank loan. The more professional the management is, the less is the probability of defaulting loan.

B4: *Poor Financial Performance*

Definitely poor financial performance is the most important cause of loan default. Once a company is not solvent, it is unlikely to repay its loan. Poor financial performance is the key reason behind maximum loan default. Poor financial performance can be arisen from many other reasons described above.

B5: *Poor Cash Flow*

In most cases poor cash flow is the aftermath of poor financial performance. Because of poor cash flow companies mainly default loan. Because of irregular cash flow, business becomes unstable and illiquid. In that case business does not have enough cash to service loans payment and interest. Even if a company is profitable, the company may default because of cash flow. In some cases, a business may sell most of its finished goods on credit. So it may not have enough cash to support the loan and other debts. So it may cause default.

B6: *Low Market Share*

Low market share may be a reason of loan default but not a single respondent mentioned it as one of the reasons of their loan default. Low market share means low sales, low sales mean low profit and low profit results default. Operating in a niche market, having a very low market share a firm can be profitable enough to repay its entire loan obligation as well as retain sizable earning. But operating in niche product in a market which is not proper or have fewer customers that it expected then it cannot be profitable. So it cannot pay its interest payment.

C: *LENDING RELATED*

C1: *Delayed Assessment of Loan Proposal*

Banks sometimes make delay in assessing loan proposals of the business firms. When the firm badly needs money, it does not get enough funds because of delayed assessment by the bank.

This infuses shortage of cash in their business operations. They hardly manage their day-to-day business expenses let alone repayment of the loans.

C2: Delayed Disbursement of Fund

Even after assessment of the proposal and taking positive decision, banks do not disburse funds until security documentation formalities are completed. As a result business do not get fund when actually it requires it. Some of the defaulters complained about subsequent disbursements.

C3: Lack of Proper Monitoring

Monitoring is one of the most important parts for financial institutions. Through monitoring lenders come to know that whether their fund is being used for the desired purpose or not. Sometimes disbursed money is used for purposes other than the specific areas. In that case risk of loan default gets higher. Banks sanction loan on the basis of feasibility of the project. Bank as a lender expect that the loan will be serviced by the cash flow generated from that particular business. But if credit is used in some other areas desired cash flow may not come from the business and chance of loan default gets high. Therefore banks monitor activities of the borrower whether the fund is being properly utilized or business is generating enough cash flow or not. Banks use specialized formats for loan monitoring. Bank periodically review the performance of the borrower and based on that bank decides whether to renew the facilities or not. The tools used for monitoring are portfolio reviews, profitability analysis etc. before diverse loan, Banks can check the credit rating of the organization. Banks can generate information about borrowers from Bangladesh Bank. Then banks can decide how much money investor needs and how much money he will be invested. Valuation culture of the security or collateral is absent in many of banks.

C4: Lack of taking Proper Action

Action comes after loan monitoring. Monitoring is done for identifying deviations or exceptions. If there is any exception then corrective action needs to be taken. If corrective actions are taken on time chance of default loan reduces. When Customer misses one installment, concerned officer of the bank must visit the customer and understand where the problem lies. If proper action is taken, probability of loan default is reduced

D: *MACROECONOMIC FACTORS*

D1: *Low GDP Growth*

It is evident that companies which deal in consumer products are directly affected by the GDP growth of the entire economy. Regular customers and defaulters have opined that this macro indicator influences the cash generation of a company and hence the repayment of the loan.

D2: *Increasing Crimes*

It is revealed that the effect of the increasing crimes in the business of the companies. They think that forced subscription sometimes make the profitability of the company lower.

D3: *Hartals by the Political Parties*

Political instability of the country hampers the production and the distribution of the products in a smooth way and the political turmoil is considered one of the other causes of the loan default in our country.

D4: *Frequent polity Changed by the Government*

Government is considered as the minor cause of the loan default as per the survey since it has a little impact on the local sales and distribution of the products of the companies. For example: in this budget government increase tax on mobile phones which are imported from foreign country, so mobile phone importer may not generate expected revenue. So importer could not par their interest payment. So they could be defaulter. Without these are other causes such as imperfect lending practice, lack of analysis of business risks, lack of proper valuation of security or mortgage property, undue influence by borrowers, external pressure, loan go Govt. organization, Govt. policy for disbursement of credit, lack of legal action.

Example:

Name of firm	Approved Loan	Types of Loan	Year of Disbursement	Expiry	Reason
Samam Trade International	01 Crore	Term Loan for 3 years	2011	2014	<p>It is a trading firm. It imports Locker from china through issuing L/C. From Oct'13-Jan'14 the firm didn't open any L/C, due to political unrest. It happened because the firm had enough stock in its warehouse, but due to strike it could not sell its goods, as a result the firm got stuck in fund shortage. On the contrary, the firm has a limit of fund for importing goods. Due to nonpayment of loan that created problem against Import process, the outstanding of the loans were getting higher. At the end of November'13 the client listed as SMA, And In March'14 the loan declared Bad Loan.</p> <p>Causes :</p> <ol style="list-style-type: none"> 1. Hartals by the Political Parties: Due to strike, firm did not perform according their plan. So they can not generate enough revenue to pay the interest payment. 2. Poor Financial Performance: They had lack of business plan and lack of proper strategy for strike. So It cannot generate revenue.

Swadesh Steel	50 Lac	OD loan revolving	2012	2013	<p>The client is a local supplier of rod, angel bar etc. It approached the loan to allow a OD limit of 80 Lac. The bank approved 50 Lac for extension of its operation. But the proprietor's intention was mischievous. Instead of investing the fund into business the owner purchased Land in Savar. Just after 3 month of disbursement the client's transaction became irregular. The bank tried to make the client pay the out standings. But the client's business was not capable of to pay the proceeds on regular basis. After 1 year the Loan became Bad Loan. The Bank is trying to recover the amount.</p> <p>Cause:</p> <ol style="list-style-type: none"> 1. Lack of Proper Monitoring: Bank should take information about the client before approve loan. 2. Unwillingness to Pay: The client intension was not good. May be bank kept low collateral so that he thought that it will not harm him a lot. 3. Mis use of fund: Client use the fund to buy the land rather than invest in business. He may thought that it will be more profitable than business.
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5. Effect of NPLs

Effects of NPL are such as Stopping Money Cycling, Earning Reduction, Capital Erosion, Increase in Loan Pricing, Frustration etc. As a result, the values of security are increased and the risks of financial recession also see a rise. Amplifications of the effect of NPL are as follows:

1. NPL can lead to efficiency problem for the banking sector. It is found by a number of economists that failing banks tend to be located far from the most-efficient frontiers, because banks do not optimize their portfolio decisions by lending less than demanded.
2. There is a negative relationship between the non-performing loans and performance efficiency. So, increase in NPL hampers the performing loan. Most of the cases, it occurs when there is an adverse selection. Adverse selection is asymmetric information problem that occurs before the transaction. For example: big risk takers or outright crooks might be the most eager to take out a loan because they know that they are unlikely to pay it back. Because adverse selection increases the chances that a loan might be made to a bad credit risk, lender might decide not to make any loans, even though there are good credit risks in the market place.
3. NPL creates the Credit Crunch situation. Credit crunch is a phenomenon that banks ration loan disbursement and new credit commitments in order to protect, but add more risks. Banks treat loan as an asset. They expect return from it. If loans become NPLs then banks have lack of fund to give loan according their commitment or banks could give loans at their previous interest rate. Clients have to pay more. So loans may be defaulted. Credit crunch also increases the rate of NPL.
4. There is a cyclic relation between poor economic condition and the depressed economic growth as follows:
 - a. During the crisis moment, in order to restore the credibility among creditors and depositors, failing financial institutions not only try to expand their equity bases, but also reduce their risk assets or change the composition of the asset portfolio. Because of such defensive actions, the corporate debtors are always targeted, thus the economic growth is being stalled overall. Banks

try to collect loans amount as fast as possible and most of the banks have huge number of corporate clients so they try to recover those loans as early as possible to reduce risky assets.

b. Money cycling gets stopped due to increase in NPL. Slow flowing of cash always has negative impact on any business.

c. When the NPL is increased, interest earning gets stopped. But the cost of fund and the cost of management are not stopped. To run the management cost along with the cost of fund, the existing lending price has to be increased. Suddenly increased rate of interest makes hard the return of bank money for a new borrower. So rate of investment will be lower.

d. NPL affects opening of LC (Letter of Credit). International importers always choose healthy condition of the exporter's bank. Worse health condition of the bank affects the opening of new LCs. Low rate of LCs makes low bank earning.

9. NPL exists as a natural consequence of lending behavior. When banks re-balance their portfolio, they decide on the degree of risks they will tolerate for a given level of expected return according to their risk preference because banks have to keep 10% of their risk weight asset as capital or 400 cores. Banks treats loans as a risky asset. If the risk is high, banks will expect high return. When the level of non-performing loans goes beyond a certain point banks cannot accept, and then it affects bank's re-balancing actions. So, when NPLs cross the boundary of the above threshold, they start to spawn negative effects on more lending.

10. NPL has a positive relationship with interest rate. When NPL increases, loan which is treaded as asset becomes more risky. So that the rate of interest also increases to get sufficient retune from the loan to cover the risk.

6. Recommendation

1. No compromise with due diligence in the sanctioning process. Keeping in mind "prevention is better than cure." Banks should take high collateral. If a borrower defaults on a loan, the lender can sell the collateral and use the proceeds to make up for the loss. The security or collateral provided must be valued by proper agency or put up on a regular 'mark to market' valuation process.
2. Action plan for potential NPLs. Banks should have some step to collect the NPLs loan. At the end banks should go to Artha Rin Adalat.
3. Identification of highly risk sensitive borrowers in the credit portfolio. Banks should take information about the clients before giving loans. Banks could go Bangladesh Bank to collect the information and verify the financial statement carefully from reliable sources to identify the risky borrowers.
4. Identification of geographical area-wise risk sensitivity. Banks should identify the clients according area wise that's mean in Bangladesh, there is some places where growth rate is low or rate of repay rate is low.
5. Targeting high value end NPL accounts (having exposure of Tk. 5.00 crore and above)
6. Prompt action on credit reports
7. Capacity building of officers and executives in the recovery department. Banks should give proper training to employee. So they can handle loans properly. If there is short of experience employee, bank should recruit experience employee for recovery department.
8. A robust risk management culture, with a 'well articulated' risk management policy can help the institutions to avoid such loan default.

7. Conclusion

Our banking sector is characterized by low profitability and inadequate capital base because there are lots of banks in Bangladesh. Banks revenue comes from spread (Lending rate – borrowing rate). But there is huge competition among banks. So the profit is minimum. The crux of the problem lies in the accumulation of high percentage of non-performing loans over a long period of time. The problem is most severe for NCBs and DFIs. However, starting from a very high rate of 41.1% in 1999 it came down gradually to 11.90% in 2013 according to latest published data. Still, it is very high by any standard. Unless it can be lowered substantially we will lose competitive edge in the wave of globalization of the banking service that is taking place throughout the world. We have had a two-decade long experience in dealing with the NPLs problem and much is known about the causes and remedies of the problem. Unfortunately, the banking system is still burdened with an alarming amount of NPLs and lags far behind the neighboring countries of India and Sri Lanka. Although Bangladesh has to a large degree adopted international standards of loan classification and provisioning, the management of NPLs is found ineffective, as the system has failed to arrest fresh NPLs significantly. It needs to be mentioned that management of NPLs must be multi-pronged, with different strategies pursued at the different stages through which a credit facility passes. Measures should be in place for both prevention and resolution. With regard to preventive measures, emphasis needs to be placed on credit screening, loan surveillance and loan review functionaries both at individual bank levels and in the central bank of the country. Resolution measures must be accompanied by legal measures, i.e. improving the efficiency of the legal and the judicial system and developing other out of the court settlement measures like compromise settlement schemes, incentive packaging, formation of asset management companies, factoring, and asset securitization and so on. Unfortunately, Bangladesh is found to be very weak from the above point of view, and strictly speaking, it has mainly concentrated on a few legal measures that have also been found to be ineffective. Therefore, this study has highlighted some challenges, shown below, for improving the debt recovery environment and solving the NPL problems of the country as well.

8. References

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