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# COMPARATIVE ANALYSIS OF LOAN RECOVERY AMONG NATIONALIZED, PRIVATE AND ISLAMIC COMMERCIAL BANKS OF BANGLADESH

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ABSTRACT

Bangladesh has a unique Banking system with multiple types of Banking with Nationalized Commercial Banks (NCBs), Private Commercial Banks (PCBs), Foreign Commercial Banks (FCBs), Islamic Commercial Banks (ICBs), Specialized Development Banks and the Cooperative Banks. Currently the magnitude of loan default is quite enormous in the Banking sector. However, the general perception and belief regarding the Islamic Banking is better recovery rate of loans and advances. This paper attempts to discuss the issues that govern the banking practices in Bangladesh and it also paints a picture of the lending practices followed by NCBs, PCBs and ICBs in Bangladesh. From the analysis presented in this case, it comes to light that ICBs lending practices with Islamic banking instruments mirrors the lending practices of conventional banks having synonymous counterpart products. The paper also unfolds some strategically weak links in the development of the banking sector, which has obstructed the overall economic development of the country. In this diversified Banking system, an attempt is made in the paper to analyze the issues governing the credit recovery rate and procedure with respect to the principles of Islamic Banking while comparing with the Conventional Banking principle amongst NCBs, PCBs and ICBs. In our effort to draw a comparison (between NCBs, PCBs and ICBs), we have taken the data, information between 1995 to 19998 figures. This paper also provides an analytical framework that shows the comparative performance of NCBs and PCBs. For this assessment of NCBs and PCBs, we have incorporated figures of 1997 to 2001.

**Key words:** NCB, PCB, ICB, Credit Recovery, Camel Rating.

## I. INTRODUCTION

The recovery rate evaluations of commercial loans made in this paper are with respect of 4 NCBs, 14 PCBs and 4 ICBs. The FCBs were not considered in the study due to a number of factors. Firstly, their operation regarding lending is guided by the parent office along with the supervision of Bangladesh Bank (Central Bank of Bangladesh). Secondly, in case of FCBs, the funds for refinancing or for any other purpose can be mobilized or managed from the parent office, which is not the case for local banks. The observation period for this paper is from 1996 to June 2002.

Loans comprise the most important asset as well as the primary source of earning for the banking institutions. On the other hand, loan is also the major source of risk for the Bank management. A prudent Bank management should always try to make an appropriate balance between its return and risk involved with the loan assortment. Thus, recovery of commercial loans is a recurring worry for the Bankers. Moreover, reusing of advances is important, without which Bank's liquidity is in jeopardy; besides that the community does not get the benefits unless new advances and borrowers are encouraged.

In case of ICBs, throughout the study period they maintained a high recovery rate over the NCBs and PCBs. Evidently, ICBs have better recovery rate than NCBs and PCBs. Though the average recovery rate of NCBs and PCBs decreased from approximately 71 percent in 1996 to approximately 67 percent in 1998, the recovery rate of ICBs increased from approximately 86 percent in 1996 to approximately 87 percent in 1998. This also reveals the lower classified and stuck up or Non Performing Loans (NPLs) with the ICBs.

Currently the magnitude of loan default is quite enormous in the context of Bangladesh (Appendix I, Table A). It has been threatening the existence of the Banking system. Though it is argued that upswings and downswings of economic development had impacts on the performances of the Banks on the whole, the reasons for widespread loan defaults and low recovery rate of loans in the Banking sector both in the public and private Banks were inherent in the characteristics of the operational mechanisms of the Banks in the case of Bangladesh. Nevertheless, loan default in Banks has special significance because extending credit is almost the exclusive business of banking institutions (Alam and Jahan, 1999). However, it is widely perceived that Islamic Banking produces better recovery rate for loans disbursed. Many people believe that due to its sole assumption of Islamic Banking system of profit and loss sharing and non-interest based banking than that of the Conventional system of banking, the recovery rate is better. This belief system is based on the premise that ICBs would scrutinize more while issuing loans. This additional assessment naturally increases the loan recovery rates.

## II. METHODOLOGY AND COVERAGE OF THE STUDY

The recovery rate evaluation of commercial loans made in this paper is with respect to NCBs, PCBs and ICBs.

Both primary and secondary data have been used for the present study from the Annual Reports, Financial Statements of the respective Banks for the period of January 1996 to June 2001, different articles and news published in the daily newspapers and publications of Bangladesh Bank, and the publication of Ministry of Finance, Government of Bangladesh. Some governmental websites and other reputed financial sector web portals were also used to collect secondary data.

### A. Objectives

The main objective of this study is to analyze and determine the reasons behind the better recovery position of ICBs compared to PCBs and NCBs. Some analysis with regards to the ICBs in the same Banking environment with Conventional Banking has also been under taken to show their position in terms of recovery. One point may be made clear at this stage that since the NCBs and PCBs run their operations, mainly deposit mobilization and lending according to the Conventional Banking system and ICBs ought to run their operations according to the Islamic principle, our comparison has been focused between the two systems of Banking, Conventional Banking and Islamic Banking regarding the recovery of commercial loans. Another objective of this paper is to compare the loan recovery rate and standings of NCBs and PCBs. To bring out some valid results and logic, we will compare the recovery rate of commercial loans among the three groups (NCBs, PCBs and ICBs) of Banks in Bangladesh. However, one of the other major objectives is to offer some analytics between NCBs and PCBs that clearly shows the superiority of banking practices by the PCBs stemming from multitude of reasons explained in the paper. For carrying out our first objective, we test a hypothesis if the observations reveal that performance of ICBs in loan recovery is better than the other two groups of banks i.e., NCBs and PCBs. Detailed review of the banking sector enhances the understanding of issues governing NCBs and PCBs to operate with different motives and thus producing different results. In this section of analytics, we have purposely focused on qualitative issues, rather offering a hypothesis and refuting the hypothesis.

### B. Hypothesis

Two hypotheses for the study are, if the observations reveal that performance of ICBs in loan recovery is better than the NCBs and PCBs, we test the following hypotheses:

- The reason behind the better recovery of ICBs is better lending procedure (asset management) and
- Behind the good recovery rate of ICBs, there may be difference in lending portfolios among the three groups of banks i.e. NCBs, PCBs and ICBs.

## III. CURRENT SITUATION IN BANKING IN BANGLADESH

It is found from the annual report of Bangladesh Bank (BB) that NCBs in Bangladesh perform most of the financial activities of the banking sector. Except specialized banks, 46 banks are operating in the country in which 4 are public, 31 private and 11 are foreign banks. The lion's share (approximately 50 percent) of the aggregate bank activities (deposits and loans or advances) of Bangladesh is still held by the NCBs followed by PCBs (approximately 42 percent) and FCBs (approximately 8 percent). The four NCBs have the largest coverage with extensive branch offices in the country and play an important role in the Banking system. Historically, the NCBs were used to offer credit through direct lending programs to certain economic sectors directed by the Government and Bangladesh Bank. However, the NCBs financial performances had run into steep losses with large amount of money still unrealized and many classified loans. These losses were due to poor supervision, unionism, inadequate banking knowledge, not conducive legal environment, governmental bureaucracy and red tapism in administration, etc. A massive booking of poor quality assets still dominate the mix of classified assets and have resulted in continued heavy losses.

The NCBs had default loans in the tune of approximately 37 percent in 2001. At the end of December 2001, their default loans stood at BDT 12,227 million. The PCBs' classified loans were approximately 17 percent in December 2001. The amount of their classified loans in the banking sector was BDT 456 million in 2001. The classified loans of the FCBs were BDT 1.4 billion in December 2001. The ailing Development Financial Institutions (DFIs) had classified loans of approximately 62 percent during the same period. NCBs have also failed to maintain provision, which is equivalent to BDT 360 million and the shortfall in capital is enormous despite massive injection of fresh capital by the Government in recent years. The situation indicates that the NCBs cannot continue as viable entities without severely restructuring their lending and other banking activities. It is absolutely fair to say that the NCBs are in a very critical state.

Competition among banks is becoming stronger as some of the PCBs improve their services in recent years (Islam & Ezaz, 2004). Even FCBs, which usually undertake only hand picked projects, have started to enter into some new mass segments of the local market recently. Clearly, NCBs are on the losing side of this battle. As competition intensifies, they may end up having lost all their good borrowers as well as their best employees. There is a danger that all NCBs will become an empty shell having only liabilities without any good quality assets supporting them.

If we glance back a few years we see that in June 1999, there were 22 domestic private banks including 4 ICBs. Together, these banks held approximately 25 percent of the loans and advances and approximately 27 percent of the deposits of the banking system (Ministry of Finance, 1999). In the aggregate, the PCBs were insolvent. As of June 30, 1999, PCBs' classified loans of BDT 434 Million, which was approximately 18 percent of the total classified loans (The Daily Sangbad, 1999).

The capital deficiencies in most of the domestic private banks are too large to be overcome, even if somehow profitable operations could be restored. The vast majority of the private banks loan portfolios centered in loans to insiders, stockholders and influential businessman and politicians who have defaulted on their obligations; they are either unable or unwilling to repay these debts. The Central Investigation Bureau (CIB) has been a new introduction (2003) in the governance of the banking sector by Bangladesh Bank. The fruits of CIB were not received during our study period that made easy for individuals to take multiple loans without having the fundamentals to repay the loans. These lacks of governance issues contributed to the overall loan default situation. In addition, the losses inherent in some of the insider loans were so huge that they exceed many times over the insiders' investment in the banks. Thus there is little prospect that insiders will voluntarily repay their loans, thus allowing banks to recover their lost capital.

Following reasons perpetuate the loan default problem. These are as follows:

- An ineffective legal framework for loan recovery
- Frequent loan forgiveness or waiver packages, which eroded credit discipline
- Lending indiscriminately to immature and inexperienced entrepreneurs most of whom preferred to gain immediate benefits by diverting credit funds, instead of reaping long term benefits from an established industry
- Formula based lending with fixed debt equity ratios (80:20) which greatly reduced the entrepreneurs' personal stake in the enterprise
- Greater emphasis on security risk than on business risk
- Alliance between business and politics
- Poor asset management of the banks due to the absence of skilled human resource
- Greasing the bank management with monetary and/or non-monetary incentives leading to poor quality loan sanctioning.
- Sudden changes in governmental policies, duty and taxation structure, affecting companies with loan portfolios.
- Loan sanctioned to 'copy cat' firms in various industries without significant competitive advantages.
- Due to disparity between different economic classes, the purchasing power has receded amongst a vast majority of people while the rich and elites spend a chunk of their funds overseas. This phenomenon creates an unhealthy economic condition for sales of products and services in the Bangladesh market.
- High interest rates create a stressful obligation for even intending borrowers. Heavy dependence on export led loan repayments has hurt the borrowers during international economic slowdown, perpetuating loan defaults.

The poor quality of the bank portfolios is one of the main causes of low bank profitability and capital inadequacy. Moreover, the high loan default rate results in the following costs:

- The banks' risk-averse behavior and resultant high collateral requirements 'Crowds Out' the dynamic and labor intensive small-scale enterprises.
- The high levels of non-performing assets prevent circulation of credit to other economic activities and block the exit of resources from uneconomic firms.
- The high levels of non-performing loans have benefited the borrowers most of whom come from the wealthier segment of society, and penalized, through reduced deposit rates, the depositors, of whom over 90 percent are small savers.

The distressed state of Bangladesh's banks is also an indication of regulatory weakness and inefficiency of the regulatory authority. The liberalization of the financial market requires an effective regulatory environment, which can ensure the safety, soundness and efficiency of the banking system.

## IV. ISLAMIC BANKING IN BANGLADESH

In pursuance of the policy framework of the OIC, Islamic Banking in Bangladesh was introduced in Bangladesh in 1983. The Islamic Bank Bangladesh Ltd. (IBBL) was the first Islamic Bank incorporated in Bangladesh based on Islamic principle.

Four Private Islamic Banks are operating in Bangladesh. The shares of these four Islamic Banks in terms of deposit and loans or advances, as of June 1999, are shown in the following table. The recent (2003) number of Islamic Banks in Bangladesh is five.

**Table 1: Market Share (in %) of NCBs, PCBs and ICBs in terms of Deposits and Loans and Advances (As of June 1999)**

| | In terms of Deposits | In terms of Loans and Advances |
|---|---|---|
| NCBs | 68 | 68 |
| PCBs | 25 | 26 |
| ICBs | 7 | 6 |

Source: Banks and Financial Institutions' Activities, 1999, Ministry of Finance, Government of Bangladesh.

The activities of the four Islamic Banks of Bangladesh include deposit mobilization and financing facilities. The different types of deposit mobilization are done through the application of two following principles (Huq, 1996).

- Al Wadia Principle and
- Mudaraba Principle

Al Wadia principle implies that the bank receives funds with undertaking to refund the deposit on demand and also with authorization from the depositors to use funds for benefit of and at the risk of the Bank. Bank's Current Account Deposits are managed on this principle. By opening such account, a depositor does not acquire any management (voting) right on the Bank or on the fund's deposits.

Mudaraba principle reveals that the Bank receives deposits from the depositors with the authority that the bank will have exclusive right to manage the fund and the profit resulting from such deposits will be shared between the bank and the depositors at a pre agreed ratio and the loss, not resulting from the negligence of the bank or any of its representative, will be borne by the depositors. PLS (Profit Loss Sharing) Accounts and various term deposits of the five Islamic Banks of Bangladesh are conducted on this principle. Through this account, the depositors do not acquire any management (voting) right on the banks or on the deposits.

Apart from the above mentioned deposit facilities, the Islamic Banks provide a number of financing facilities to individual and corporate clients. The financing facilities among the Islamic Banks differ with respect to their operational direction. However, the different financing modes are listed and discussed in the following section. The different types of financing products provided by the Islamic Banks under Islamic Laws in Bangladesh are as follows:

- Mudaraba, profit loss sharing
- Musharaka, partnership
- Murabaha, contract sales
- Ijara, lease/hire purchases
- Bai-Muajjal, sales under deferred payment
- Quard E Hasana, interest free loans

Financing techniques used by Islamic Banks may be summarized as follows (Ali and Sarkar, 1995).

- **Mudaraba (Profit-Sharing):** Several theorists of Islamic Banking have postulated that Mudaraba should be a dominant mode of financing in the scheme of Islamic Banking. However, this technique because of various conceptual, practical and legal hindrances has not found wide application by the Islamic Banks. The current high taxation structure (approximately 40 percent of income) followed by the Government becomes too oppressive for an entrepreneur who happens to disclose true profits. This taxation scheme is a major hindrance to undertaking Mudaraba mode of investment.

- **Musharaka (Partnership):** Musharaka is another type of financing utilized by Islamic Banks. In this form of financing, two or more financiers provide the finance for a project. All the partners are entitled to a share in the total profits of the project according to a ratio, which has been mutually agreed upon. However, they may also waive this right in favor of any specific partner. The current taxation structure makes this investment mode unattractive to the entrepreneurs. A concept of diminishing Musharaka is sometimes followed, allowing the entrepreneur to payback the investment in phases and thereby reducing the profit sharing percentage. Once the total initial investment is paid off, no more profit sharing continues.

- **Murabaha (Mark-up or Cost-Plus based Financing):** This is the most popular technique of financing among Islamic Banks. It has been estimated that approximately 80 to 90 percent of the financial operations of some of the ICBs belong to this category (Appendix II). It works in the following way: The client approaches the Islamic Bank to finance the purchase of a specified commodity. The Bank, either itself or through an agent collects all the required information about the nature and specification of the commodity, its price, names of dealers, etc. The Bank informs the clients of these details as well as of the margin it would like to charge on the original price. If these conditions are acceptable to the client, a Murabaha contract will be signed between the Bank and the client. The Bank will purchase the specified commodity from a seller; a deed is required and the registration is done in the name of the Bank; it sells the commodity to the client on a deferred payments basis against an agreed price. It is necessary for the profit margin that the Bank is charging to be determined by mutual agreement between the parties concerned. Similarly, the goods in question should be in the physical possession of the Bank before being sold to the client. Thirdly, the transaction between the Bank and the seller should be separate from the transaction between the Bank and the purchaser.

- **Ijara (Leasing):** Leasing is also one of the approved methods of earning income according to Islamic Law. In this method, a real asset such as a machine, a car, a ship, the lessor to the lessee can lease a house, etc., for a specified period against a specified price. The benefit and cost relating to each party should be clearly spelt out in the contract so as to avoid any element of uncertainty with respect to the responsibility of each party. Leasing is emerging as a popular technique of financing among Islamic Banks of Bangladesh. However, some of the important Islamic Banks, which use leasing as a technique of financing, include the Islamic Development Bank, the Bank Islam Malaysia and the Commercial Banks in Pakistan.

- **Ijara Wa Iqtina (Lease Purchase):** Under the lease purchase system, the possession of the item is passed on to the hirer or client who pays the acquisition value in installments spread over the agreed period together with the agreed amount or rent of the items provided. He makes an unconditional promise to purchase the leased asset at the end of lease period. After the amount of acquisition value and the agreed rent is paid in full, the ownership is passed on to the hirer.

- **Bai Muajjal (Sales under deferred payment):** This mode is similar to the Murabaha mode of financing; however, in this mode, the Bank is not liable to inform the borrower about the price and the profit margin that the borrower is paying for the requested facility. This mode is adopted and practiced by the Islamic Banks in a huge volume.

- **Quard - E - Hasana (Interest Free Loans):** Most Islamic Banks also provide interest-free loans to their customers. However, practices differ in this respect. Some Banks provide the privilege of remittance, local service, acceptances of shares and related services, investment trustee, collection of claims and payment and so on.

## V. COMMERCIAL LENDING AND NON PERFORMING ASSET OF BANKS IN BANGLADESH

Adam Smith in his wisdom found in the Banks the virtue of facilitating production and exchange by providing credit the risk of which may not be accepted by ultimate users. Smith believed that only justifiable function for Banks is to purchase and retire real bills so that money would flow out to start a transaction in time dictated by invisible hand of the perfectly functioning market system and flow back when the purpose of the transaction was achieved. He could never think of default in its pure state (Ahmed, 1997).

Loans comprise the most important asset as well as the primary source of earning for the Banking financial institutions (Chowdhury et.al. 1997). On the other hand, loan is also the major source of risk for the bank management. A prudent bank management should always try to make an appropriate balance between its return and risk involved with the loan assortment. An incompetent financial institution might be fraught with unmanageable risks for the purpose of maximizing its potential return. In such a situation, the Banking financial institutions might find itself in serious financial distress instead of improving its financial health. Consequently, not only the depositors but also the general shareholders will be deprived of getting back their money from the Bank. Thus, the deterioration of loan quality also affects the intermediative efficiency of the commercial Banks and thus the economic growth process of the country. Recovery is a recurring worry for the Bankers. Moreover, recycling of advances is important, without which Bank's liquidity is in jeopardy; besides that the community does not get the benefits unless new advances and borrowers are encouraged (Sikder et.al. 1995).

Policies and practices relating to commercial bank lending to productive sectors has been a subject of active discussion during recent years. Hopefully, it would lead to changes that would render Bank credit more helpful in promoting the national economic objectives. This is more likely to happen if the discussion is backed up by deeper analysis of issues. Lending to industries and commercial clients has always been a controversial area in the history of modern commercial banking. Some part of this controversy represents mere shadow boxing, e.g., the debate on cash credit or overdraft versus fixed loan systems of lending. But then, there are also areas of genuine shortcomings, which need to be faced squarely. However, here we will discuss the key issue and status of the non-performing assets of commercial Banks in Bangladesh.

## VI. RECOVERY RATE OF COMMERCIAL LOANS IN BANGLADESH

The recovery perspective in Bangladesh has always been poor and ineffective that sometimes made the Banking sector insolvent. However, the recovery rate of NCBs, PCBs and ICBs are given below:

**Table 2: Recovery Rate of NCBs, PCBs and ICBs**

| Year | NCBs | PCBs | ICBs |
|---|---|---|---|
| 1996 | 68.40% | 74.00% | 86.00% |
| 1997 | 64.00% | 76.00% | 88.50% |
| 1998 | 60.24% | 74.00% | 87.10% |

Source: Various Issues of Bangladesh Bank and Newspaper Articles.

The table reveals that the recovery rate of NCBs and PCBs remained below the recovery rate of ICBs in all the three years of observations. In 1997, the recovery rate of NCBs dropped to 64 percent as compared to 68 percent in 1996. The recovery rate of NCBs further decreased to 60 percent in 1998 placing the NCBs more vulnerable position in the Banking sector of Bangladesh. From 1996 to 1998, the recovery rate of NCBs has dropped to nearly 8 percent showing the increment in the classified and provisioning of commercial loans. However, the low capital adequacy made the NCBs more insolvent.

As for PCBs, their recovery rate increased from 74 percent in 1996 to 76 percent in 1997, however, dropped to 74 percent in 1998. As compared to NCBs, PCBs had a better record in loan recovery. In case of ICBs, throughout the study period they maintained a high recovery rate over the NCBs and PCBs. In 1996, ICBs total recovery rate was 86 percent and it further increased to 88 percent in 1997. Though the recovery rate of commercial loans of ICBs dropped to 87 percent in 1998, still ICBs performance is best among the three groups of Banks in Bangladesh. Since NCBs and PCBs run their operation according to the Conventional Banking, if we make the average of recovery rate for both the NCBs and PCBs, we can compare the performance between the Conventional and Islamic Banking system in whole.

**Table 3: Average Recovery Rate of both NCBs and PCBs and ICBs**

| Year | Average of NCBs and PCBs | ICBs |
|---|---|---|
| 1996 | 71.20% | 86.00% |
| 1997 | 70.00% | 88.50% |
| 1998* | 67.12% | 87.10% |

From the above table it is revealed that ICBs have better recovery rate than NCBs and PCBs. Though the average recovery rate of NCBs and PCBs decreased from 71 percent in 1996 to 67 percent in 1998, the recovery rate of ICBs increased from 86 percent in 1996 to 87 percent in 1998. This shows the lower classified and stuck up loans of the ICBs.

## VII. WHY RECOVERY RATE OF ICBs' IS BETTER?

Since the recovery rate of ICBs is better than NCBs and PCBs, let's examine the lending procedure of the NCBs, PCBs and ICBs. Since NCBs and PCBs are following the Conventional Banking system, let us examine and discuss the procedure of lending of NCBs and PCBs.

### A. Recovery Rate and Lending Procedure

Here we will be examining the lending procedures of both the Conventional and Islamic Banks in Bangladesh. First, let's discuss the process and modes of investment of Islamic Banks.

Islamic Banking is an integral part of its parent ideology- Islamic Shariah. In order to test the first substantive hypothesis, we will examine and compare the procedure and lending or financing facilities to a proposal of the Islamic and Conventional Banks operated in Bangladesh. The common modes of financing have been discussed before.

The analysis and comparison between the Islamic and Conventional Banks reveals that no significant difference prevails in the lending and financing procedures between the two systems of Banking. In both types of Banking systems, from approaching to the Banks for financing facility to the disbursement of loans and facilities are almost same except for Shariah Board or Council of exists Islamic Banks, which is also called Religious Supervisory Board. This Shariah Board or Council approves each types of transaction that the Bank undertakes and also has the authority to look in to individual transaction to the extent needed to satisfy itself on their compliance with Shariah requirements (Ali and Sarkar, 1996).

In both the Banking systems, the procedures of lending are identical and don't vary in an effective manner that influence or originate to the fact of better recovery rate of Islamic Banks which is the concern of this paper. Though it is argued that Conventional Banking which is interest based is security oriented rather than growth oriented (Ali and Sarkar, 1996), the practice of Islamic Banks in Bangladesh with respect to the security and collateral while facilitating any lending proposal is same of Conventional banks and all the financing facility is secured by its collateral or other forms of securities. It was revealed from the observations and operations of Islamic Banks that the banks use two types of securities (i.e. Primary and Secondary Securities) while financing any proposals under any modes of financing like Conventional Banks. Moreover, while evaluating a financing proposal, in both the systems of Banking, the Banks use similar sorts of evaluation techniques. Both types of Bank use on and off site evaluations of the financing proposal. Nevertheless, the Shariah Boards of Islamic Banks are considered to play a positive role in controlling and distributing of loans to the clients, however, some of the Shariah Boards of Islamic Banks do not conform to the lending activities of the respective Banks. Yet, the nonconformity of the Shariah Boards along with the similar lending procedure of Islamic Banks and Conventional Banks do not satisfy the first substantive hypothesis of this paper.

**B. Recovery Rate and Lending Portfolios**

In testing the second hypothesis, first of all, let us compare the nature of Islamic Bank's financial instruments and Conventional Bank's financial instruments.

We observed that some similarities prevailed among the financing instruments of Islamic and Conventional Banking. The most promoted financing instruments of Islamic Banks are Murabaha (Contract Sale), Ijara (Leasing), Ijara wa Iqtina (Lease purchase) and Bai Muajjal (Sales under deferred payment). The difference between Ijara and Ijara wa Iqtina is in the ownership of the object that has been leased. In the former mode, the ownership remains with the Bank and the ownership is passed on to the lessor after the full payment of the lease object or asset. However, both the modes' mainstream line is leasing and can be compared as leasing of the Conventional Banking.

It is further observed that Murabaha can be compared and is, in fact, a contract sale of goods. Murabaha includes financing a deal in which a profit margin is mutually agreed upon long before the purchaser assumes ownership of the goods. This profit margin assumes the profit and expenses for the Bank and since the margin is predetermined, this deems to be interest pure Banking like Conventional Banking. The other mode, Bai Muajjal, is nothing but the short term financing as used in Conventional Banking. This mode is comparable as credit sale and working capital financing. Leasing is identical to the Ijara in Islamic Banking same and identical with the Conventional Banking from the operational perspective. In both the cases, the ownership of the leased object is passed to the lessor after the full payment of the rent along with the other charges.

From the comparison of the instruments we found that only Mudaraba and Musharaka are the financial instruments, which are thoroughly based on Islamic Shariah. The rest of the instruments are conversant with the Conventional Banking system. Evidently, the returns to finance provided in the modes of finance based on Murabaha, Ijara, and Bai Muajjal with a service charge is all predetermined like interest.

For example, take the Islamic Banking instrument-Murabaha and Conventional Banking instrument-Credit Sale. In both the financing instruments, while making the deal with the borrowers, the banks add the margin over the specified price of a good or product in percentage. As we observed that the lending procedure and the process of lending of Islamic and Conventional Banks are similar, this margin in Islamic and Conventional Banks is nothing but the interest, which is termed as 'profit' in Islamic Banks. Moreover, the ideal financing instruments of Islamic Banking are Mudaraba and Musharaka, which are totally different from the other modes of financing (Murabaha, Ijara etc.). These modes (Murabaha, Ijara etc.) are relatively more secured from effective recovery rate point of view. In Islamic Banking, all the financing modes other than the ideal modes are secured since there is no practical risk involved and collateral based and short term financing. This makes the Islamic Banks to secure their lending portfolios and taking the advantage of its financing instruments to make better recovery rate over Conventional Banks.

Here, we will examine the modes of financing or the portfolio of lending operations Islamic Banks. Among all the modes of financing of Islamic Bank a few and selected of them have been practicing by the Islamic Banks of Bangladesh. It is found from the investment modes of IBBL, Al Baraka, Al Arafah and Social Investment Bank (Appendix II); majority of their investment is in the form of Murabaha, Bai Muajjal, and Hire purchase.

It is observed that, on an average, during the concerned period of observation, investment in Murabaha, Bai Muajjal and Hire/Lease purchase by all the Islamic Banks occupied the highest (approximately 89 percent) among all the modes of investment. Murabaha means resale of goods with the addition of a fixed surcharge on the stated original cost. Bai Muajjal means deferred payment sales and Hire purchase or Ijara means leasing. Thus it can be said that Islamic Banks give top most priority in the investment of contract sale on cash followed by sales under deferred payment and installment system. All these reveal that Islamic Banks while investing funds give top most priority to the trade and commerce sector then comes the position of industry sector and then the other sectors of the economy. Besides, all the instruments, which are mostly practiced by the Islamic Banks, are pseudo Conventional Banking instruments.

**Table 4: Average Investment Modes (1995-98) (In %)**

| Modes | IBBL | Al Baraka | Al Arafah* | Social Investment | Average |
|---|---|---|---|---|---|
| Murabaha | 46.62 | 24.70 | 52.00 | 36.46 | 39.98 |
| Bai Muajjal | 19.13 | 40.63 | 31.25 | 16.91 | 26.98 |
| Hire Purchase | 18.34 | 29.46 | 11.55 | 28.91 | 22.07 |
| Quard E Hasana | 4.33 | 0 | 5.00 | 0 | 2.33 |
| Purchase and Negotiation | 8.63 | 0 | 0 | 0 | 2.15 |
| Musharaka | 2.95 | 0 | 0 | 1.04 | 0.99 |
| Murabaha under Secured Guarantee | 0 | 2.31 | 0 | 0 | 0.57 |
| Mudaraba | 0 | 0 | 0.2 | 0.03 | 0.05 |
| Others | 0 | 2.9 | 0.00 | 16.65 | 4.88 |

Data for Al Arafah is from 1996-98.
Source: AGM Reports and concerned Banks

Table 4 shows the average of different investment modes of Islamic Banking of all the concerned Banks. The study reveals that the classical modes of investment, i.e., Mudaraba, Musharaka and Quard have not yet got due practice in Bangladesh and naturally the socio-economic benefits associated with these modes are also equally absent. Thus, though several theorists of Islamic

Banking have assumed Mudaraba and Musharaka to be the dominant mode of investment in the scheme of Islamic Banking, it has not found wide application by the Islamic Banks of Bangladesh. All the four Islamic Banks have invested only 1.04 percent of their total financing under Mudaraba and Musharaka modes. Due to recent commencement of the fifth Islami Bank (Shahjalal Bank), sufficient data was not available. Some of the Islamic Banks in Bangladesh have never practiced either Mudaraba or Musharaka in their Banking history.

All the four Islamic Banks of Bangladesh have been financing in a big way in the mode of Murabaha, Bai Muajjal, Hire Purchase (Leasing). IBBL, the largest Islamic Bank of Bangladesh has financed approximately 97 percent of their financing in financing modes other than Mudaraba and Musharaka, the ideal financing modes of Islamic Banking. The same picture is prevails in other Islamic Banks as well.

During 1996-98, Al Baraka Bank has never practiced Mudaraba or Musharaka and the Bank (Appendix II) financed 100 percent of its financing facility in other modes (Murabaha, Bai Muajjal, Hire/Lease Purchase, and Murabaha under secured guarantee and others). In case of Social Investment and Al Arafah Bank, approximately 98 percent and 99 percent have been financed under financing modes other than Murabaha and Musharaka. These shows the secured financing portfolios of all the Islamic Banks of Bangladesh as all these modes are secured and short termed.

Islamic Banking in Bangladesh has been following a line of least risk and assured success. Naturally, the four Islamic Banks insist on collateral. Again, due to the unavailability of Islamic insurance companies, they are using the services of Conventional insurance companies to cover their assets including investments and collateral (Huq, 1996). However, this situation was not present after the introduction of Islami Insurance companies after 2001.

It is further found that concentration of Islamic Banks investment in short term trade seems to be one of the reasons for better recovery rate of commercial loans in Bangladesh. The Islamic Banks are heavily dependent on the Murabaha, Bai Muajjal and Ijara in their operation as these modes appear to be more convenient devices in the short term financing compared to the profit-loss sharing. The comparison between the Conventional Banking instruments and the Islamic Banking instruments derives the following:

1. There are only two true (completely Shariah based) Islamic Banking instruments, which are rarely (1.04 percent of the total portfolio) practiced by the Islamic Banks.
2. All other financing instruments practiced by the Islamic Banks have their counterparts in one or other form in Conventional Banking.
3. One more interesting feature is that Islamic Banks are emphasizing comparatively less risk prone instruments i.e. Murabaha, Bai Muajjal, Ijara. In those modes, the collateral or the securities with the Bank against the financing facility are insured with the Banks through the Conventional Insurance companies.

The above points suggest concluding that the reason behind the better recovery performance of Islamic Banks is in the selection of financing portfolio. The allocation is shown below.

Allocation of Investment portfolio was 2.50 percent for Agriculture & Rural Investment, approximately 18 percent for Industrial Term Investment, 13 percent for Industrial Working Capital, 10 percent for Housing & Real-Estate, 4 percent for Transport & Communication, merely 0.50 percent for Electricity, Gas, Water & Sanitation Services, only 2 percent for Storage, 43 percent for Import, Export and Local Trade & Trade related activities, only 1 percent for Poultry and Dairy, 2 percent for Rural Development Scheme, 2.50 percent for Other Special Schemes, 0.50 percent for Micro Industry and 1 percent for other Productive purposes by the end of the Plan period i.e. the year 2002 (Source: IBBL Annual Report 2000, page 16). This structure was more or less followed with some modifications by the other Islamic banks in Bangladesh. As the investment of the bank in different areas has been mentioned that shows a balanced allocation of funds based on the economic activity of the country. Due to the nature of Islamic banking and its roots in Islamic principles and faith, their (all Islamic bank's) banking practices reflect socially equitable disbursement of loans.

**Table 5: Classified loan of Al-Arafah and IBBL (In million BDT)**

| | 1998 | 1999 |
|---|---|---|
| Classified loan | 1348.70 | 1636.60 |
| Total Investment | 5965.71 | 6646.12 |
| IBBL Annual Report 2000 (P-19) | | |
| | 1999 | 2000 |
| Musharaka | 2.38% | 1.56% |
| Mudaraba | 0.25% | 0.19% |
| Total investment | 20584.68 | 27437.42 |

Source: Table 11, Trends of Classified Loans as a Percentage of Total Loans for Different Clusters of Banks (1990-2001, P-153). Volume XXVII, No. 2 & 3, June and September 2002. Bank Parikrama

**Table 6: Percentage of Nonperforming Loans**

| Year | NCB | PCB |
|---|---|---|
| 1997 | 36.57 | 31.42 |
| 1998 | 40.58 | 32.72 |
| 1999 | 45.62 | 27.09 |
| 2000 | 38.56 | 22.01 |
| 2001 | 37.02 | 16.98 |

Source: Banking Regulation & Policy Department, BB 2001.

The NCBs continue to have high Non-performing Loan (NPL) is because of their loan portfolio consists of large portion of loans provided for other than commercial considerations under direct loan programs of 70s and 80s. Poor appraisal and inadequate follow up and supervision have been cited by Bangladesh Bank as the reasons for the massive bookings of poor quality assets that still continue to remain dominant in the portfolio of these banks. On the contrary, the PCBs and the ICBs had no such program to follow as directed by the Government. The non-judicious monetary policy of the Government perpetuated the downfall of the already decadent nationalized commercial banking sector. Due to severe liquidity crisis, these NCBs could not rotate their portfolio investments in more profitable endeavors.

The amount of NPL in the NCBs increased from BDT 89 billion in 1997 to BDT 122 billion in December 2001, which is an increase of approximately 37 percent or 7 percent annually. The PCBs also saw the NPL increase from BDT 39 billion to BDT 45 billion in December 2001, which is an increase of approximately 15 percent or 3 percent annually. The following data shows the total NPL in the banking sector.

**Table 7: Nonperforming Loans in Banking Sector (In billion BDT)**

| | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| NPL | 173.32 | 214.37 | 238.79 | 228.51 | 235.99 |
| Required Provision | 79.03 | 93.49 | 100.16 | 98.42 | 101.55 |
| Maintained Provision | 46.70 | 50.02 | 51.48 | 58.12 | 61.40 |
| Excess/shortfall | -32.33 | - 43.47 | -48.68 | -40.30 | -40.15 |

Source: Banking Regulation & Policy Department, BB 2001.

The above table shows that in the total banking sector the shortfall of capital provision has increased from BDT 32 billion in 1997 to BDT 40 billion in 2001. This decline indicates that risk of depositors has slightly increased over the period under observation. The main reason for not able to satisfy the capital provisioning requirement is due to low profits of NCBs and some problem banks in the private sector.

**Table 8: Comparative Position of Provision Adequacy in 2001**

| | NCB | PCB |
|---|---|---|
| Required Provision | 59.54 | 23.08 |
| Provision maintained | 20.71 | 19.61 |
| Provision Maintenance Ratio (%) | 34.78 | 84.97 |

Source: Banking Regulation & Policy Department, BB 2001.

Management soundness cannot be fully ascertained by reviewing the fiscal indicators. Some measures like the total expenditure to total income ratio, the operating expenses to total expenses ratio, the earnings and evaluate operating expenses per employee, and the interest rate spread are generally used to management soundness. From the figures shown below it becomes clear that NCBs as opposed to the PCBs have weaker expenditure to income ratio. It may be mentioned that lower the ratio is suggestive of better operation efficiency. The PCBs had weakened its position in 1999 and 2000 but slightly improved in 2001. On the other hand, most of the income received by the NCBs goes into maintaining infrastructural expenses (overhead and running administration) and suspension of income against NPL and making provision out of the profits made.

**Table 9: Expenditure-Income ratio of NCBs and PCBs**

| | 1997 | 1998 | 1999 | 2000 | 2001 |
|---|---|---|---|---|---|
| NCBs | 99.37 | 99.81 | 100.52 | 99.38 | 99.01 |
| PCBs | 85.96 | 85.30 | 90.42 | 90.80 | 88.09 |

Future operations and capacity to absorb losses by developing an adequate capital base, finance its expansion and pay reasonable dividends to its shareholders, all banks should have a strong earnings and profitability profile. The two widely used indicators are return on assets (ROA) and return on equity (ROE). The net interest margin (NIM) is also considered. In our analysis, if we compare the NCBs and PCBs it becomes apparent that the NCBs are lagging substantially behind their PCB counterparts. The ROA gap 1997 between NCBs and PCBs was 28 and slightly improved to 18.66 times in 2001. Similarly, the ROE gap between NCBs and PCBs was 19.21 times in 1997 and 8.76 times in 2001. The NII figures also reversed in favor of PCBs. From a high of BDT 3.11 in 1999 to a negative figure of Tk. 1.79 billion whereas the PCB figure showed strength as the years progressed.

**Table 10: Financial Performances of NCBs and PCBs**

| Return on Asset (ROA) | | | | | |
|---|---|---|---|---|---|
| | 1997 | 1998 | 1999 | 2000 | 2001 |
| NCBs | 0.04 | 0.01 | -0.03 | 0.05 | 0.06 |
| PCBs | 1.12 | 1.24 | 0.80 | 0.83 | 1.12 |
| Total | 0.34 | 0.34 | 0.23 | 0.01 | 0.69 |
| Return on Income (ROE) | | | | | |
| NCBs | 1.27 | 0.34 | -1.08 | 1.73 | 2.39 |
| PCBs | 24.40 | 26.81 | 15.32 | 17.04 | 20.94 |
| Total | 6.98 | 6.59 | 5.24 | 0.25 | 15.90 |
| Net Interest Income (NII) in billion BDT | | | | | |
| NCBs | 2.66 | 2.19 | 3.11 | -1.21 | -1.79 |
| PCBs | 1.73 | 2.28 | 2.97 | 6.11 | 9.21 |
| Total | 6.27 | 7.12 | 7.75 | 8.39 | 13.35 |

Commercial banks deposits are subjected to a statutory liquidity requirement (SLR) of 20 percent inclusive of a 4 percent cash reserve requirement (CRR). The CRR is to be kept with the Bangladesh Bank and the remainder as qualifying secure assets under the SLR, either in cash or in government securities. SLR for the banks operating under the Islamic Shariah is 10 percent. This information indicates that the requirements for the ICBs are less stringent than their other PCB counterparts. Due to this privilege the ICBs have more liquidity and, therefore, can use the extra funds for profitable uses.

In a circular by Bangladesh Bank on Inside lending, August 1999, the following guideline was given.

a) To regulate inside lending the Directors' investment from the bank cannot exceed 50% of share value.
b) Inside lending information must be placed in the balance sheet

GDP growth has been falling over the last few years as per statistics of Bangladesh Bank (Source:www.bangladesh-bank.org/pub/annual/anreport/ar0203/app21.pdf, P-4)

**Table 11: Selected Macroeconomic Indicators**

| Indicators | FY 97 | FY 98 | FY 99 | FY 00 | FY 01 |
|---|---|---|---|---|---|
| GDP growth* | 5.39 | 5.23 | 4.87 | 5.94 | 5.41 |
| CPI inflation** | 3.96 | 8.66 | 7.06 | 2.79 | 1.94 |
| Foreign exchange reserve*** | 1719 | 1739 | 1523 | 1602 | 1307 |
| Exchange rate**** | 42.70 | 45.46 | 48.06 | 50.31 | 53.96 |

*At FY96 constant market prices ** Base: FY96=100
*** In Million Dollar **** Taka/Dollar

Banking industry asset continues to be dominated by Nationalized Commercial banks that held 46.50 percent of total assets in 2001 (Source: www.bangladeshbank.org/pub/annual/anreport/ar0203/app21.pdf). The Government owned specialized banks held 11.77 percent of industry assets. The share of private commercial banks' industry assets was 34.87 percent. The total deposit of the banking sector in 2001 was BDT 956.58 billion. The NCBs continue to dominate the total industry by having BDT 486.97 billion deposits in 2001. The deposits at the private commercial banks were BDT 348.91 billion in 2001.

All Banks in Bangladesh are required to adopt the Basle minimum capital standard equal to 9.00 percent of risk-weighted assets (RWA) with core capital equal to at least 4.50 percent of RWA. 2001. While the PCBs have been maintaining the required capital adequacy ratio, the NCBs fall short of this requirement. Between the period of 1997 and 2001 the capital adequacy ratio has been downward from an approximate figure of 7.1 percent to 6.5 percent in 2001.

Since 1996, banks in Bangladesh have been required to adopt the Basle minimum capital standard equal to 8 percent of risk weighted assets with core capital equal to at least 4 percent of risk weighted assets. The banking sector's average capital adequacy ratio showed downward trend since 1997 and declined to 6.65 percent as of year-end 2001 from 7.53 percent as of year-end 1997. Declines were registered for all types of banks. At the end of 2001, capital ratios ranged from 16.48 percent for FCBs to only 3.93 percent for DFIs. (Source: www.iornet.com/newiornet/cp/banglaprofile24.htm).

The risk involved in profit-sharing seems to be so high that most of the banks have resorted to those techniques of financing which bring them a fixed assured return. As a result, there is a lot of genuine criticism that these banks have not abolished interest but have in fact only changed the nomenclature of their transactions, Khan (1989).

It is interesting that though NCBs had to extend a portion of loans for social consideration, PCBs loan default position is not that much different from the NCBs. It implies that till now it has not been proved that privatization can solve this problem in the banking sector." Our focus in this paper does allow us to expand on this area, but we can safely say that the loan assessment in the PCBs has not been effective. Although ICBs are part of NCBs but this information does not offer a glimpse of ICBs performance (Problems & Prospects of Collateral Free Banking in Bangladesh, P 159, Bank Parikrama, Sept & Dec 1999, Bandana Saha & S. M. Ahsan Habib).

**Table 12: Growth Rates of Advances and Classified Loans for all Clusters of NCBs and PCBs**

| Year | NCBs | | PCBs | |
|---|---|---|---|---|
| | GRA | GRCL | GRA | GRCL |
| 1997 | 11.74 | 25.54 | 13.70 | 2.74 |
| 1998 | 9.38 | 20.78 | 12.53 | 17.20 |
| 1999 | 6.09 | 19.87 | 17.73 | -2.55 |
| 2000 | 7.69 | -8.99 | 25.69 | 2.11 |
| 2001 | 8.54 | 4.2 | 28.11 | -1.17 |

Source: P-155. Volume XXVII, No. 2 & 3, June and September 2002, Bank Parikrama. Toufiq Ahmad Choudhury & Bishnu Kumar Adhikary GRA – Growth Rate of Advances, GRCL – Growth Rate of Classified Loans

| Screening | Moni-toring | Transparency | Lenders Recourse |
|---|---|---|---|
| ii) LRA | ii) NLLC | ii) Loan classi-fication and Provisioning | ii) Money Loan Court Act, 1990 |
| iii) CIB | iii) LLRs | iii) Risk Based Capital Adequacy | iii) Bankruptcy Act, 1990 |
| iv) Loans to Insiders and Connected Parties | iv) PPS | | |
| v) Interest Rate Deregulation | v) Offsite Super-vision | | |

Source: The Political Economy of Loan Default – A Quest for a Socio-Political Explanation, Dr. Muzaffar Ahmad, Bank Parikrama, Vol. XXII, No-2, June 1997.
Source: Choudhury and Moral, 1997 Under FSAC (Financial Sector Adjustment Credit of the World Bank 1990s)

The conclusions that emerge suggest insider default on Information, outsider collusion, and willful or otherwise neglect on the part of the supervisory authority along with the political decision makers

**Table 13: Trends of Provisioning Surplus/ Shortfall as a Percentage of Required for the NCBs and PCBs (1990-2001)**

| Year | NCBs | PCBs |
|---|---|---|
| 1997 | -54.75 | -46.57 |
| 1998 | -61.54 | -45.57 |
| 1999 | -64.11 | -41.53 |
| 2000 | -62.65 | -30.12 |
| 2001 | -65.23 | -15.03 |

Source: Banking Regulation & Policy Department, BB 2001

## VIII. CONCLUSION

The Islamic Banks have been found to be investing generally in the projects with quick returns resulting higher recovery rate of commercial loans provided by the banks. This leads the banks not to take up the projects with long gestation period, i.e., insignificant investment under Mudaraba and Musharaka mode of financing. The short term financing under Murabaha and Bai Muajjal assures the required rate of return, as the mark up of profit is pre assigned according to the bankers and the users of the loans. Moreover, the Islamic Banks cover their loan risk by taking the collateral and other forms of securities such as FDR Account with the Bank. Thus, the better performance recovery rate of commercial loans in Islamic Banks is due to its lending portfolio and its different modes of financing. Generally, the Islamic Banks are not performing the true Islamic Banking instruments. So, the reason behind the better recovery rate is not Islamic Shariah based Banking. Secondly, among the financial instruments, short-term loans, working capital finance and leasing finance are safest modes of financing from the view - point of the risk. In comparison to the Conventional Banks, we observed that the advance structure of the Islamic Banks are greatly skewed to the comparatively safer modes of financing like Murabaha, Bai Muajjal, Ijara, Ijara wa Iqtina. On the other hand, Conventional Banks' asset portfolios are less skewed to the short term financing (compared to the ICBs).

The analysis leads us to conclude that although we perceive that we have to take lesson from the Islamic Banks, which ought to make our banking system less vulnerable to non-performing asset problems of the banks, but we had the lesson that Conventional Banks should concentrate on short term lending which is anti growth oriented. But it is not possible. To switch over to the practice of Islamic Banking is becoming also impossible because the ICBs are also failing to practice the Banking operations according to Shariah [Appendix-- V].

From the practicality of Islamic Banks of Bangladesh, we can conclude that Islamic Banks failed in general to claim themselves pioneer for an alternative to interest based Banking system which is not based on sharing as the Islamic Banks invest and finance almost eighty to ninety percent of their financing under secured and predetermined rate of return based financing modes. A financial system built solely around these modes of financing can hardly claim superiority over an interest-based system on grounds of equity, efficiency, stability and growth. The questions how to improve the recovery rate of Bangladesh Banking remains open. Probably, we have to find the answer not in Islamic Banking but in the regulatory and legal framework as well as emphasizing in business risk rather than on security risk.

The analysis and comparison between the Islamic and Conventional Banks reveals that no significant difference prevails in the lending and financing procedures between the two systems of Banking. In both types of banking systems, from approaching to the Banks for financing facility to the disbursement of loans and facilities are almost same except for Shariah Board exists in Islamic Banks, which is also called Religious Supervisory Board.

From the comparison of the instruments we found that only Mudaraba and Musharaka are the financial instruments that are thoroughly based on

Islamic Shariah. The rest of the instruments are conversant with the Conventional Banking System. Evidently, the returns to finance provided in the modes of finance based on Murabaha, Ijara, and Bai- Muajjal with a service charge is all predetermined like interest. In Islamic Banking, all the financing modes other than the ideal modes are secured since there is no practical risk involved (and is collateral based having short term financing structure.) This allows the Islamic Banks to secure their lending portfolios and taking the advantage of its financing instruments to make better recovery rate over Conventional Banks.

Finally, the comparison of NCBs and PCBs show that in order to strengthen the economic conditions of the economy, the NCBs must be improved in terms of its NPL, ROA, ROE, NII and other monitoring, assessment and performance evaluation metrics.

**Appendix I: Table A**

**Classification, Provisioning and Recovery Rate of Commercial Loans**
**1996 – June 1998 (BDT in Million)**

| | 1996 | | 1997 | | 1998 | |
|---|---|---|---|---|---|---|
| **Types of Banks** | **Total Loans** | **Recovery Rate** | **Total Loans** | **Recovery Rate** | **Total Loans** | **Recovery Rate** |
| **NCBs** | | | | | | |
| Sub-Total | 2179.283 | 68.40% | 2435.037 | 64.00% | 2522.821 | 60.24% |
| **PCBs** | | | | | | |
| Sub-Total | 880.421 | 74.00% | 1015.854 | 76.00% | 1056.33 | 74.00% |
| **Islamic Banks** | | | | | | |
| Sub-Total | 228.629 | 86.00% | 245.163 | 88.50% | 244.18 | 87.10% |
| Total | 3288.333 | | 3696.054 | | 3823.331 | |

Source: News paper Source and Various Issues of Bangladesh Bank.
Data for 1998 is of June 30th

**Appendix—I Table B**

**Situation of Non performing Assets in Bangladesh Banking Sector**

**(in BDT Million)**

| Sector | Total Loan | Classified Loan | Substandard | Doubtful | Bad/Loss | % of Cl. Loans | Provisioning Shortfall |
|---|---|---|---|---|---|---|---|
| NCBs | 2803.143 | 13168.828 | 159.896 | 113.629 | 1043.303 | 46.98 | 360 |
| PCBs | 1498.057 | 434.109 | 44.492 | 24.587 | 365.03 | 28.98 | 92.288 |
| FCBs | 3100.04 | 12.98 | 2.335 | 2.782 | 7.663 | 4.19 | 3.782 |
| SPCBs | 893.866 | 607.184 | 32.706 | 16.71 | 557.768 | 67.83 | 304.38 |

Source: The Daily Sangbad, October 21, 1999, pp.1

**Appendix—I Table C**

**Loan Classification and Provisioning System**

| **A. Classification Status** | **Length of Overdue** |
|---|---|
| Unclassified | Less than 3 months |
| Sub standard | 3 months or more but less than 6 months |
| Doubtful | 6 months or more but less than 12 months |
| Bad/Loss | 12 months or more |
| **B. Provision Requirements** | |
| Unclassified | 1% |
| Sub standard | 20% |
| Doubtful | 50% |
| Bad/Loss | 100% |
| **C. Frequency of Classification** | Quarterly |
| **D. Reference Date** | 31.12.98 |

Source: BRPD, Bangladesh Bank (BB)

**Appendix—II**

**Modes of Financing (in %)**
Name of the Bank: **Islamic Bank Bangladesh Ltd (IBBL)**

| **Modes** | 1995 | 1996 | 1997 | 1998 | Average |
|---|---|---|---|---|---|
| **Murabaha** | 53.54 | 50.28 | 42.51 | 40.18 | 46.62 |
| **Bai Muajjal** | 17.28 | 18.34 | 19.90 | 21.03 | 19.13 |
| **Hire Purchase** | 14.57 | 16.66 | 20.51 | 21.65 | 18.34 |
| **Purchase and Negotiation** | 7.18 | 7.22 | 9.65 | 10.34 | 8.63 |
| **Musharaka** | 3.87 | 3.18 | 2.62 | 2.16 | 2.95 |
| **Quard - E – Hasana** | 3.56 | 4.32 | 4.81 | 4.64 | 4.33 |
| **Total** | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |

Name of the Bank: **Al Baraka Bank Bangladesh Ltd (ABBBL)**

| **Modes** | 1995 | 1996 | 1997 | 1998 | Average |
|---|---|---|---|---|---|
| **Murabaha** | 24.34 | 25.06 | 25.40 | 23.98 | 24.70 |
| **Bai Muajjal** | 41.21 | 41.16 | 36.55 | 43.60 | 40.63 |
| **Hire Purchase** | 31.70 | 30.81 | 27.41 | 27.95 | 29.46 |
| **Murabaha under Secured Guarantee** | 1.51 | 2.11 | 2.98 | 2.66 | 2.31 |
| **Others** | 1.24 | 0.86 | 7.66 | 1.81 | 2.9 |
| **Total** | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |

Name of the Bank: **Al Arafah Islamic Bank Ltd.**

| Modes | 1995 | 1996 | 1997 | 1998 | Average |
|---|---|---|---|---|---|
| **Murabaha** | 55.00 | 51.00 | 49.00 | 53.00 | 52.00 |
| **Bai Muajjal** | 30.00 | 32.00 | 35.00 | 28.00 | 31.25 |
| **Hire Purchase** | 10.00 | 12.00 | 13.00 | 11.20 | 11.55 |
| **Quard- E- Hasana** | 5.00 | 5.00 | 3.00 | 7.00 | 5.00 |
| **Mudaraba** | 0.00 | 0.00 | 0.00 | 0.80 | 0.2 |
| **Total** | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |

Name of the Bank: **Social Investment Bank Ltd.**

| Modes | 1995 | 1996 | 1997 | 1998 | Average |
|---|---|---|---|---|---|
| **Murabaha** | | 36.28 | 41.60 | 31.43 | 36.46 |
| **Bai Muajjal** | | 15.05 | 9.70 | 25.99 | 16.91 |
| **Hire Purchase** | | 37.60 | 27.68 | 21.45 | 28.91 |
| **Musharaka** | | 2.00 | 0.86 | 0.28 | 1.04 |
| **Mudaraba** | | 0.07 | 0.03 | 0.01 | 0.03 |
| **Quard against MTDR, ICB etc.** | | 9.00 | 20.13 | 20.84 | 16.65 |
| **Total** | | 100.00 | 100.00 | 100.00 | 100.00 |

Source: Annual Reports of the concerned Banks.

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