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Disastrous Incident in Banking Sector of Bangladesh: A Case Study on Non-Performing Loans

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Abstract

The main objective of this study is to find the challenges of Non-performing loan, evocative ways for improving the debt recovery environment and cracking the non-performing loan problems in order to safeguard a sustainable banking sector of the country. The most devastating effects on Bangladesh's banking system has been the rise of non-performing loans (NPLs). Financial institutions' non-performing loans (NPLs) have risen by more than 300 percent in the recent decade, amounting to more than 1000 billion Bangladeshi Taka (BDT). There is still a problem with NPL management despite the adoption of international standards for loan categorization and provisioning. The rapid rise of non-performing loans (NPLs) can be attributed in large part to a lack of effective governance, oversight that is inadequate, corruption, political influence in loan approvals, a climate of impunity, and the professional incompetence of bankers in dealing with this critical issue. In this study we have collected forty one banks NPL data. We have also collected data from Bangladesh Bank from the fiscal year 2012-2021. We have analyzed different types of ratio and estimate the trends. In analyzing the data collected, we have used SPSS. It's important to emphasize the importance of credit screening and loan surveillance, as well as the implementation of harsh criminal laws and the centralization of the lending process. Because of this, this research has focused on the difficulties associated with non-performing loans (NPLs), as well as creative solutions for enhancing the debt recovery environment and solving NPL issues, in order to ensure that the country's banking system remains viable.

Introduction

The Bangladeshi banking industry has been dealing with several major issues, including fraud, scams, and heists. As a result, many efficiency and soundness indices show that the sector's overall performance has been impacted. Credit risk connected with the loan and investment portfolios, other real estate owned, other assets, and off-balance sheet transactions is reflected in the asset quality rating. Non-performing loans are the most widely cited indicator of a bank's asset quality (NPLs). Negative equity loans (NPLs) are loans that are already in default or are near to becoming in default (Bangladesh Bank, 2017). Since loans are documented as assets on a commercial bank's balance sheet, non-performing loans are also known as non-performing assets (NPAs). Due to the fact that loan repayments generate a steady flow of income for a bank, this is the reason NPLs should be classified as non-performing loans (NPLs) when: I payments of principal and interest are 90 days or more past due, ii) interest payments equal to 90 days' interest or more have been capitalised, refinanced or rolled over and/or/iii) there is sufficient evidence to classify a loan as non-performing even when the debtor files for bankruptcy. The IMF does not oppose more stringent NPL definitions, even if the 90-day level is recommended as a maximum (IMF, 2006). No uniform definition of an NPL exists, and definitions that may be applicable in one country but not in another are recognised. In order to compare NPLs across countries, it is necessary to make adjustments to the statistics. Countries generally utilise a 90-day time frame to assess whether a loan is working or not (Cortavarria, Dziobek, Kanaya, and Inwon, 2000).

NPLs represent a direct danger to a country's financial stability and growth. It's easy to think of non-performing loans (NPLs) as something that happens when borrowers can't afford to repay high-interest loans. However, a number of studies have indicated that high interest rates in Bangladesh are not directly linked to the country's high level of NPLs (Hossain, 2012). Small and medium-sized businesses (SMEs) may have a problem with NPLs because of excessive interest rates (Jahan, 2016). Uncertainty and corruption are the root causes of non-performing loans, and both have a negative impact on a country's banking sector (Moshirian and Wu, 2012; Lin, 2012). Because of political instability, corruption, bad governance, and weak rule of law, the high number of nonperforming loans (NPLs) in Bangladesh has been linked to by research (Banerjee, et al., 2017). The high NPL levels in state-owned commercial banks have been caused by poor management and malpractices and corruption (CPD, 2018a and CPD, 2018b). State-owned commercial banks (SCBs) have been providing loans based solely on political considerations, defying established banking regulations (Habib, 2017). As a result, many banks don't even do a simple risk evaluation of the borrower's capacity. A company's creditworthiness is largely determined by its political clout. As a result, obtaining huge loans is seen as requiring only solid political credentials. NPLs have been exacerbated by the government's proclivity to subsidise loss-making state-owned firms through SCBs. Over the 2011–2014 period, just 33% of first-time rescheduled loans were recovered, and 30% of third-time rescheduled loans recovered (Habib, 2017). During the same time period, banks wrote down debts of Tk 45,527.4 crore. Only 14% of bank officials believe the borrower selection procedure is extremely effective, according to new research (Habib, 2017).

Objectives of the Study

The main objective of the study is to find the challenges of Non-performing loan, evocative ways for improving the debt recovery environment and cracking the non-performing loan problems in order to safeguard a sustainable banking sector of the country.

The specific objectives are follows:

a. To identify the challenges of non-performing loan in Bangladesh.
b. To find the evocative ways for improving the debt recovery environment.
c. To find out the problems of non-performing loan.
d. To find the way of cracking the non-performing loan problems in order to safeguard a sustainable banking of Bangladesh.

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Theoretical Framework

Non-Performing Loans in Bangladesh's Banking Sector

Bangladesh's banking system has been plagued by NPLs, which have become a significant part of the narrative. According to Violin plots, development financing institutions (DFI) have had the highest median NPL percentage over the past two decades, followed by state-owned commercial banks (SCBs), private commercial banks (PCBs) and FCBs from other countries in the world (Figure 1). From this it may indicate that a cause behind NPLs in Bangladesh may be that poor farmers who borrow from DFIs are unable to repay their debts. Unfortunately, as the accompanying analysis will show, nothing could be farther from the truth. Over the past two decades, the quality of Bangladesh's banking sector's loans has steadily improved.

Despite the fall of bad loans in general, the asset quality of the private commercial banks has aroused concerns in recent six years. Many of the private commercial banks' loans have become non-performing, especially in the wake of the 2011 stock market meltdown. The reasons for the increase of non-performing loans of these banks since 2012 are fairly important. First of all, the inadequate and incorrect methods in giving out the loans to improper clientele are held responsible for this. Non-performing loans are to be expected in every economy, but if they continue to accumulate for an extended period of time, that can be disastrous.

The unpredictability of escalating non-performing loans (NPLs) in Bangladesh has led to concerns about the economy and the safety of depositors' funds. Each phase in the loan disbursement procedure is as vital as the other. However, the correct decision about the evaluation of the loans at the very beginning carries most of the weight whether a loan is going to properly be employed or not. There is a significant amount of lending in Bangladesh that is done on the basis of personal recommendation and without a thorough inquiry. Oftentimes, bank employees rely significantly on references when approving loans. As long as the banks conduct thorough evaluations and investigations before to approving the loans, this issue can be avoided

In addition, several types of management policies and inefficiency can be blamed for political influences and the bank's bad management. The habit of not completing an evaluation can increase the long-term performance of the loans, even if a reference does not increase poor loans. Now we're getting to the connection between poor management and the ability to receive loans because of political clout. Policy, cost management, fund diversion, and inexperience all contribute to managerial inefficiency. When political induction prevails in credit selection, management can lose its effectiveness, which can lead to a bank system failure.

The financial sector in Bangladesh has been severely hampered by political interference, not only because it exists but because it has such sway over decisions about loan approval. Before drawing any conclusions about Bangladesh's current non-performing loan situation, it's critical to track the quality of the loans in question. Although the percentage of non-performing loans to total loans has decreased over the past two decades, the Bangladeshi banking system has experienced a caustic phenomenon from 2012.

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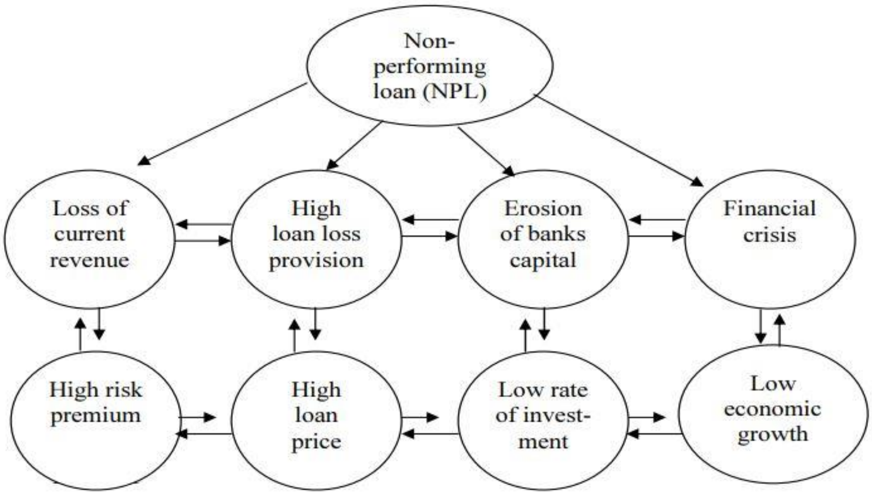

Figure 1: Economic and Financial implications of NPLs

Meaning of Nonperforming Loans

Nonperforming loans have no universally accepted definition. Nonperforming loans (NPLs) are loans that are either in default or are at risk of default. According to contract rules, many loans become nonperforming after a default period of three months. Classification of non-performing loans (NPLs) is closely linked to a bank's loan classification schemes. According on real loan performance and whether or not there has been a delay in paying the principal and interest, the classification is made. For example, loans whose repayments have been postponed by more than three months would be classified as SS. Past-due / overdue debts are those that have been overdue for a brief time; unpaid debts are those that have not been repaid. Due to the exclusion of high-risk loans that were both paying interest and not past due, this strategy significantly understated the severity of NPLs (Lardy, 1998). In 2012, the Bangladesh Bank finally adopted the widely established five-category classification scheme. Non-performing loan (NPL) status is defined by this system as: Standard; SMA; SSS; DF; and BL; with the last three categories being recognised as non-performing loans (NPL).

Today, the three letters "NPL" strike fear in the heart of the banking industry and the wider business community. An NPL is short for a 'Nonperforming Loan'. In the eyes of the bank, a performing loan is an advance that generates profit/interest and other costs. In the banking industry, an asset that does not contribute to or does not generate income for the bank is referred to as a nonperforming loan. In other terms, a nonperforming loan is an advance account that no longer generates money. A loan becomes nonperforming if it is not repaid for a predetermined period of time, such as a year or more. Nonperforming assets, therefore, are loans that have not paid their debts. No profit can be recorded from non-performing loans (NPLs). Profitability is negatively impacted by having to make provisions for NPLs or maintain funds in reserve if the borrower does not pay (Bangladesh Bank, 2019).

A nonperforming loan is one that has gone into default or is about to do so. After 90 days in default, many loans become no-performing, but this depends on the conditions of the contract. If interest or other payments due to a bank remain unpaid for more than 90 days, the entire bank debt automatically becomes a nonperforming loan. Nonperforming loans are those that have defaulted or are close to default. If interest and principle payments have been missed for 90 days or more, the loan is considered non-performing by the International Monetary Fund (IMF). If at least 90 days of interest payments were capitalised, delayed, or refinanced, the loan is considered non-performing by the IMF (Bangladesh Bank, 2019).. Nonperforming loans by bank regulatory definition consist of:

a. Loans that are past due to interest for 90 days or more and still accrue, and
b. Loans placed on non-accrual loans

Loan Classification

Whatever the obligor's credit rating, all categorised accounts should be graded according to Bangladesh Bank criteria, which are presently as follows:

Basis for Loan Classification: A loan/ credit account can be classified on the basis of the following two criteria:

a) Objective criteria
b) Qualitative judgment

Objective Criteria: Loan accounts are categorised depending on their repayment history with the bank, according to this premise. The definitions are as follows:

(1) Past Due/ Over Due: (i) As of the next day, any Continuous Loan that has not been repaid or renewed within the fixed expiration date for repayment or after the bank's demand would be considered past due/overdue.

(ii) As of the next business day following the expiration date, any Demand Loan that has not been repaid or that has been demanded by the bank would be classified as past due/overdue.

(iii) Once an instalment or part of an instalment is past due or overdue, the next day after the expiration date, that instalment will be considered past due.

(iv) After six months, the Short-term Agricultural and Micro-Credit will be declared late if it is not repaid by the due date.

(2) Except for Special Mention Accounts (SMA), all other loans will be treated as Standard.

(3) "Special Mention Account (SMA)" will be opened for any late loans that have been outstanding for longer than two months. Banks will be able to focus their attention on accounts that have potential concerns, and they will be able to detect early warning signs of account vulnerability. The Credit Information Bureau (CIB) of Bangladesh Bank will need to be notified of any loans made into the "Special Mention Account (SMA)". Section 27 KaKa (3) [read with section 5(GaGa)] of the Banking Companies Act, 1991 does not apply to loans other than short-term agricultural and micro-credit loans in the "Special Mention Account" and "Sub-Standard."

(4) Any continuous loan will be classified as:

i. Sub-standard'if it is past due/overdue for 03 (three) months or beyond but less than 06 (six) months.
ii. Doubtful 'if it is past due/overdue for 06 (six) months or beyond but less than 09 (nine) months
iii. Bad/Loss 'if it is past due/overdue for 09 (nine) months or beyond.

Type of Loan	Period Overdue	Status of Classification	Rate of Provision
Continuous Loan (OD/CC, PC, LIM, LTR etc.). Overdue period will be counted from the day following the date of expiry of such loan.	▲ Less than 6 months ▲ 3 months or more but less than 6 months ▲ 6 months or more but less than 9 months ▲ 9 months or more but less than 12 months ▲ More than 12 months	Unclassified SMA Sub-standard Doubtful Bad/Loss	1% (except SE & CF) 2% (for SE&CF) 5% 20% 50% 100%
Demand Loan (Forced LIM, BLC/ PAD, IBP, FBP etc.). Overdue period will be counted from the day following the date of expiry of such loan	▲ Less than 6 months ▲ 3 months or more but less than 6 months ▲ 6 months or more but less than 9 months ▲ 9 months or more but less than 12 months ▲ More than 12 months	Unclassified SMA Sub-standard Doubtful Bad/Loss	1% (except SE&CF) 2% (for SE&CF) 5% 20% 50% 100%
Term Loan Payable Within 5 Years Overdue period will be counted from the day following the expiry of the due date of payment of instalment of such loan	▲ Less than 6 months ▲ If the default amount of instalment is equal to or more than the instalment payable in 3 months ▲ If the default amount of instalment is equal to the instalment ▲ payable in 6 months If the default amount of instalment is equal to the instalment ▲ payable in 12 months If the default amount of instalment is equal to the instalment payable in 18 months	Unclassified SMA Sub-standard Doubtful Bad/Loss	1% (except SE&CF) 2% (for SE&CF) 5% 20% 50% 100%
Term Loan Payable in More Than 5 Years Overdue period will be counted from six (6) months following the expiry of the due date of payment of the instalment of such loan	▲ If the overdue amount of instalment is equal to or more than the instalment payable in 3 months but less than 12 months. ▲ If the default amount of instalment is equal to the instalment ▲ payable in 12 months If the default amount of instalment is equal to the instalment ▲ payable in 18 months If the default amount of instalment is equal to the instalment payable in 24 months	SMA Sub-standard Doubtful Bad/Loss	5% 20% 50% 100%
STAC / Micro Credit Overdue period will be counted from six (6) months following the expiry of the due date of payment of the instalment of such loan	▲ Less than 12 months ▲ 12 months or more but less than ▲ 36 months 36 months or more but less than ▲ 60 months More than 60 months	Unclassified Sub-standard Doubtful Bad/Loss	5% 5% 5% 100%

Source: Banking Regulation & Policy Department circular no. 34, 16, 9 and 14. Financial Sector Review, May 2006, Bangladesh Bank. SE & CF: Small Enterprise and Consumer Financing.

Methodology

This paper has been made based on secondary sources like annual reports of respective banks, research works of individuals, different publications, journals of different institutions, Bangladesh Bank survey etc. Forty one commercial banks data has collected to represent the NPLs and their recovery system. this study is focused on the entire Banking sector of Bangladesh as increasing non-performing loans in the recent years is a problem faced by all the banks local or foreign, public or private operating in Bangladesh; secondly this study is focused on the perception of Bangladeshi bankers regarding the economic determinants of non-performing loans; so this study is focused on all those bankers who are involved in the lending dissension, handling non-performing loans portfolios and making credit risk assessments.

Data Analyse

Trend of the Loan Default Problem in Bangladesh

The ratio of gross non-performing loans (NPLs) to total loans and net NPLs to net total loans is the most important metric for demonstrating the asset quality in the loan portfolio. At the end of June 2021, the gross NPL of the banking sector stood at 11.7%. Table 2 also shows that Foreign Commercial Banks (FCBs) had the lowest and State-owned Commercial Banks (SCBs) had the highest gross NPLs during this period. PCBs' gross NPLs was 7.1%, whereas those of SCBs, Foreign Commercial Banks (FCBs) and Development Financial Institutions (DFIs) were 31.6, 5.5 and 17.8 percent respectively at the end of June 2021.

Table 2. Gross NPLs to Total Loans by Types of Banks (In Percent)

Bank Types	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021 (June)
SCBs	15.7	11.3	23.9	19.8	22.23	21.5	25.1	26.5	30.0	31.6
DFIs	24.2	24.6	26.8	26.8	32.81	23.2	26.0	23.4	19.5	17.8
PCBs	3.2	2.9	4.6	4.5	4.98	4.90	4.60	4.90	5.5	7.1
FCBs	3.0	3.0	3.5	5.5	7.30	7.80	9.60	7.04	6.5	5.5
Total	7.3	6.1	10.0	8.9	9.7	8.8	9.2	9.3	10.3	11.7

Source: Annual Report 2018-21, Central Bank of Bangladesh

The ratio of gross NPLs to total loans indicates a fluctuating trend in the banking system. during 2012-2021. It declined in 2011 and increased in 2014 (10.0 percent) and again declined in 2015 (8.9 percent). Afterward, the ratio jumped in 2016 (9.7 percent) and again declined in 2017 (8.8 percent). But the ratio shows an upward trend in recent years mainly due to increase in total classified loans, defaulted outstanding and non-recovery of loans. At the end of June 2021, it stood at 11.7% (Figure 1).

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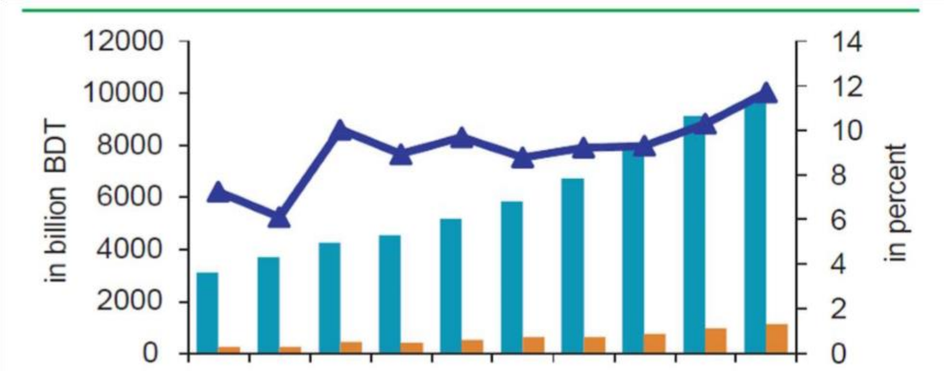

Figure 1. Aggregate Position of NPLs to Total Loans

Figure-3 below shows the amount of NPLs of the four types of banks since 2012 to 2021. During this period, the amount of NPLs of SCBs, DFIs, PCBs and FCBs have increased by BDT 369.5 billion, BDT 5.8 billion, BDT 319.7 billion and BDT 19.4 billion respectively. As of June 2021, the NPL of the banking sector was BDT 1124.2 billion.

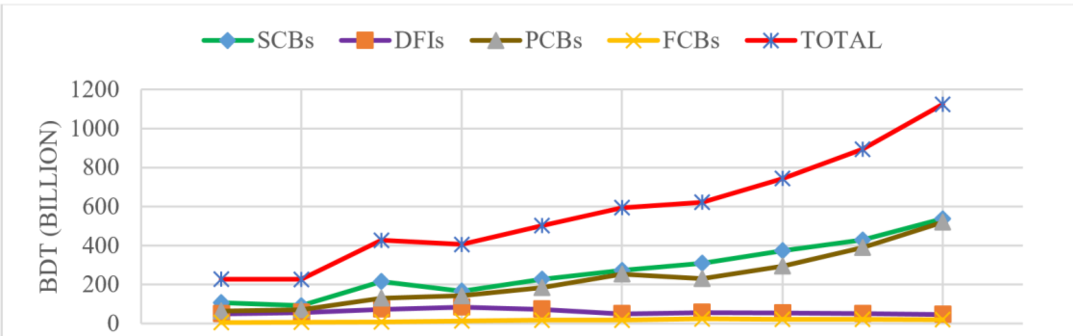

Figure 2: NPLs of the four types of banks since 2012 to 2021

The amount of NPLs have increased in SCBs and PCBs whereas NPLs have decreased in DFIs and FCBs in recent years. The amount of NPLs of SCBs, DFIs, PCBs and FCBs Stood at BDT 537.4, 47.0, 519.2 and 20.6 billion respectively at the end of June 2019.

Table 3. Required Provision and Provision Maintained by the Banking Industry (In billion BDT)

All Banks	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021 (June)
Amount of NPLs	227.1	226.4	427.3	405.8	501.6	594.1	621.7	743.0	939.1	1124.2
Required Provision	149.2	148.2	242.4	252.4	289.6	308.9	362.1	443.0	570.4	712.4
Provision Maintained	142.3	152.7	189.8	249.8	281.6	266.1	307.4	375.3	504.3	620.2
Excess (+) Shortfall (-)	-6.9	4.6	-52.6	-2.6	-7.9	-42.8	-54.7	-67.7	-66.1	-92.2

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Provision Maintenance Ratio (%)	95.4	103.0	78.3	99.0	97.2	86.1	84.9	84.7	88.4	87.10

Source: Annual Report 2012-21, Central Bank of Bangladesh

Table 3 shows the aggregate amount of NPLs, the required loan loss provision and the actual provision maintained by the banks from 2012 to 2021. It shows that except for the year 2013, there were provision shortfall against NPLs in the banking sector. The ratio showed declining trend from 2016 to 2019 and in 2020 the situation was slightly improved with the ratio stood at 88.4 percent. As of June 2021, provision maintenance ratio of the banking industry was 87.10 percent.

The main reason for the shortfall in provision was the inability of some SCBs and PCBs, including those in the problem bank category due to increase in classified loans, poor quality and inadequacy of collaterals, low profit and provision transfer for write-offs. On the other hand, the FCBs were in a much better position since they were able to keep adequate provisions. A comparative position of loan loss provisions of four types of banks as of 2018-2021 is shown in Table 4.

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 worthless as by making provision the number of willful defaulters are increasing day by day. The economic implications of the default loans are not only stoppage of creating new loans but also the erosion of banks profitability, liquidity and solvency, which might sometimes lead towards collapse of the banking financial system. It has, therefore, become sine qua-non for policy makers to study the loan default scenario of the banking sector of a routine basis for estimating classified loan, making appropriate provisioning, adopting effective recovery strategy and thus ensuring soundness and efficiency of the banking sector.

Table 4. Comparative Position of Provision Adequacy by Types of Banks (In billion BDT)

Year	Items	SCBs	DFIs	PCBs	FCBs
2018	Required Provision	174.0	27.8	144.2	16.0
	Provision Maintained	113.2	28.4	149.4	16.4
	Provision Maintenance Ratio (%)	65.1	102.2	103.6	102.5

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2019	Required Provision	216.9	26.1	184.3	15.6
	Provision Maintained	134.3	26.2	198.2	16.5
	Provision Maintenance Ratio (%)	61.9	100.4	107.5	105.8
2020	Required Provision	252.9	25.0	234.6	16.2
	Provision Maintained	162.0	27.9	242.0	16.9
	Provision Maintenance Ratio (%)	64.1	111.6	103.2	104.3
June 2021	Required Provision	353.0	22.3	321.2	15.8
	Provision Maintained	284.5	25.4	293.1	17.3
	Provision Maintenance Ratio (%)	80.6	113.9	91.3	109.5

Source: Annual Report 2018-21, Central Bank of Bangladesh

Impact of Nonperforming Loans in Bangladesh

Banks and other financial entities have historically had difficulty getting their loans back. In order to emerge from these, banks must first believe that it is possible to avoid NPLs, if not then look at the factor that is responsible for it and manage those variables in order to exit.

- **Decreasing bank profitability:** NPL stands for Non-Performing Loans, which refers to the amount of money held back due of a client's poor investment decisions. When a bank has a lot of non-performing loans (NPL), not only does the bank lose money, but it also loses money that could have been spent on other profitable investments. As a result, NPL can have an impact on both current and future profit streams, potentially resulting in the loss of valuable long-term opportunities. Low investment return (ROI) is another effect of decreased profitability on the bank's present earnings. In other words, non-performing loans (NPLs) reduce interest revenue, while write-offs and provisions for NPLs immediately raise costs.

- **Liquidity:** As a result, the company is forced to take out short-term loans, which incurs additional expenditures for the business. An additional reason for non-performing loans (NPLs), such as difficulties making regular payments and dues, is a lack of funds.

- **Involvement management:** Another indirect cost of NPLs is management time and effort. Time and resources would have been diverted from more productive endeavours if NPL had been properly handled and managed. Today's banks hire specialised staff to deal with non-performing loans (NPLs), which adds an additional cost to the institution. When a bank has an issue with non-performing loans (NPLs), it has a negative impact on the bank's creditworthiness. Having a negative impact on the individuals who put their money in the banks, it will lose its reputation and credit of goodwill and brand.

- **Decreasing capital adequacy**: Increased NPLs effectively drained bank capital, making banks bankrupt. Capital adequacy ratios in East Asia were only 5.4 percent, below below Bangladesh Commercial Law's 8 percent requirement before to the financial crisis, according to Li (1998). (Lardy, 1998). The Bangladeshi government recapitalized its banks in 1998 in accordance with the Basel Accord, raising their capital adequacy ratio to 8%. As of 2002, there was only one bank in Bangladesh with a capital adequacy ratio exceeding 8 percent: the Bank of Bangladesh. If NPLs were taken into account, Liu (2001) stated that the four SCBs may have had negative capital. Even though SOEs'return on assets had fallen substantially, state banks continued to extend loan-scale facilities to them, further compounding the problem.

- **Deteriorating bank creditworthiness:** Bangladeshi banks' creditworthiness was seriously harmed by huge NPLs, as indicated by foreign credit rating agencies' downgrading of Bangladeshi financial institutions. According to Moody's, Bangladesh's banks had an average financial strength of "D" in 1999. Apart from North Korea, Pakistan, the former Yugoslavia, and Thailand, this was the worst of any country in the world in that time period. Because of the bad macroeconomic climate, poor asset quality and significant write-offs, Standard & Poor Credit Wire argues that banks in Bangladesh have little capacity for improving credit standing.

- **Adverse selection of bank and firm managers:** Building a market economy typically necessitates the formation of markets, market-oriented businesses, and a wide range of institutions and business practises to support them. In order for markets to work properly, entrance and exit procedures must be robust and disciplined to ensure that market participants are using the most efficient and inventive methods possible. A lack of enforceability of loan contracts and a readiness by banks to lend money to loss-making firms has led to an unhealthy dependence on state banks for SOEs. This has weakened SOEs' willingness and ability to respond to market signals and change their production to meet shifting demand. However, the attitude of certain SOEs that they are not legally obligated to repay bank loans is arguably more severe. Risk of financial contagion and bank failure: The accumulation of non-performing loans (NPLs) has historically been a direct cause of bank collapses. Between 1934 and 1983, loan losses accounted for the majority of major bank failures in the United States. Because of the sheer volume of non-performing loans in Bangladesh, the SCBs are already theoretically bankrupt. There is a lack of trust in them because they are dependent on government funding. Given the importance of the four SCBs in Bangladesh's banking system, it's not an exaggeration to say that if the NPL issue isn't rectified, the SCBs will go under. If a bank is unable to raise adequate cash through the sale of assets, default and eventual failure are both possible outcomes.

- **Economic slowdown:** As a robust financial sector mobilises domestic and international savings and efficiently allocates these funds to real economy investment opportunities, it has a significant impact on the overall economy's performance. As a result of a well-functioning financial sector, economic activity's inevitable financial losses can be appropriately allocated and distributed. Having a well-functioning financial sector is consequently essential to a country's economic and political stability. The financial crises in emerging markets, such as the financial crisis in Asia and Argentina, clearly demonstrate these points. As a result of these crises, it became clear that a shaky financial sector has the potential to harm the entire economy.

Banks categories	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
SCBs	14.5	12.9	5.9	1.9	1.9	-0.3	12.8	1.7	6.1	9.2
DFIs	23.6	19	17	18.3	10.6	17	20.4	19.7	25.5	6.9
PCBs	1.8	1.4	0.9	0.45	0	0.2	0.9	0.6	0.8	0.6
FCBs	-2.6	-1.9	-2	-2.3	-1.7	-1.8	-0.9	-0.4	-0.9	-0.2
Banks categories	2016	2017	2018	2019	2020					
SCBs	11.1	11.2	11.3	5.0	6.9					
DFIs	10.5	9.7	5.7	-32.0	-36.5					
PCBs	0.1	0.2	0.4	13.6	13.3					
FCBs	1.9	0.7	0.7	24.5	24.4					

Table 2: Trends of Ratio of net NPL to total loans by the categories of banks ((in percent) Source: Bangladesh Bank, 2021.

Loan-to-Deposit ratio is a measure of a bank's liquidity and represents the bank's risk-taking mentality. Anjon and Karim (2016) and Dimitrois et.al. (2016) found that a negative influence on NPLs had a P value less than 5%, which is consistent with our results (2016). The profit margin shrinks in direct proportion to the loan to deposit ratio. Therefore, banks offer loans without a credit standard in order to boost their profitability, which may lead to a decrease in the NPLs percentage. Moral hazard hypotheses predict this outcome. As the model's P value shows, the operating inefficiency co-efficient (.87612) is considerable and positive.

Non-performing loans are bolstered by an increase in operating expenses, which in turn promotes inefficiency. Berger and De Young (1997), Podpiera and Weill (2008), Espinoza and Prasad (2010), and Louzis et.al. (2011) all support the 'poor management' concept (2012). Bad bank management could lead to a banking crisis, which demonstrates that stronger management is necessary to improve loan quality. A negative correlation between ROA and NPL, with a coefficient of -1.6793 and a p-value below 5%, has also been found. This shows that poor management of operating expenses has a negative impact on profit and indicates that the sample banks are unable to adequately manage credit risk (Bangladesh Bank, 2021).

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The causes of non-performing loan are explained elaborately in the following:
Default culture in Bangladesh is largely due to customers who are unwilling or unable to make payments. The consumer may feel that defaulting on the loan will not cause them any harm in some instances, such as when the loan's security-backing is insufficient. In that circumstances, individuals are more likely to make a mistake. When the company's cash flow isn't stellar, borrowers are reluctant to repay the loans. Businesses frequently require outside support, such as from government agencies. A corporation may become ill and lose money if it does not receive adequate nutrition over a long period of time. Most businesses in our country lack the resources to withstand the turbulence that comes their way on a regular basis. Loan defaults are also a major problem in the manufacturing industry. Firms operating in less-than-desirable industries are more likely to fail. The company's cash flow suffers as a result of subpar financial results.

As a result of a lack of liquidity, the company defaults on its bank loans. As a result, state-owned banks lend money to specialised industries, such as jute and leather, although they frequently cannot pay back the loans because of the country's sensitivities. Before approving a loan, banks consider the company's management style. Banks don't lend money if they think the company's management isn't competent enough to run it efficiently and effectively. There are situations, however, when banks require that some of the company's most important employees remain in place before repayment of the loan. In order to repay a bank loan, a company must have a strong management team. Defaults on business loans are primarily the result of poor cash flow. There is chaos and illiquidity due to irregular financial flow. As a result, the corporation lacks the resources to make timely payments on service loans, let alone pay interest. Even though a company is profitable, it may go bankrupt due to insufficient cash flow. In rare situations, a corporation may be able to sell most of its finished goods on credit. A default could be precipitated as a result of this deficiency. Low income from a small share of the market leads to low profit, which leads to default. It is possible for a corporation to repay its whole loan obligation and sustain large profits with a relatively small market share while operating in a niche industry. You won't make money, though, when you operate in an unattractive or underserved market with an obscure niche product. Consequently, its interest payments are unaffordable.

Banks frequently postpone the evaluation of company lending proposals. When the business severely requires financing, the bank delays its evaluation, resulting in a lack of funds. This results in a shortage of funds for their commercial operations. They can't even pay back the loans they've taken out to run their firm. Without considering the collateral, bankers frequently grant loans of large sums of money. Banks frequently give loans to people who have defaulted on their loans notwithstanding the Bank of Canada's instructions. As a result, the spike in loan defaults can be attributed to banks in this scenario.

Recommendation

- As the number of non-performing loans (NPLs) rises, so does the strain on a bank's profitability.

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- Additionally, a higher NPL would necessitate a bank's increased efforts to collect the loans from the "bad" borrowers. An increase in operational costs is expected as a result of this process.
- Returns on assets (ROA) and returns to equity are likely to decline.
- Banks' ability to lend is hampered by NPLs, which damage their books and limit their ability to make new loans.
- As the borrower loses the ability to earn enough money to pay back the debt, the economy begins to slow down as a result. Regulators have also prevented any further money injections into the situation, as the borrower has been flagged as a defaulter. As the company's financial situation worsens, the lending bank's chances of recouping its funds decrease.
- Having a large number of non-performing loans (NPLs) can have a negative impact on public confidence in a bank. As a result, attracting deposits would be more difficult, perhaps leading to higher deposit (or borrowing) costs.
- Profitability margins tend to narrow when the cost of capital rises.

Conclusion

It has been a long time since Bangladesh's banking sector adopted prudential regulations. Due to a large number of non-performing loans (NPLs), India and Pakistan are still well ahead of the rest of the world when it comes to the state of their banking systems. Because of the absence of shareholder activism, low availability of bank financing, and lax regulation enforcement and monitoring, the corporate sector in the United States is characterised by significant concentrations of ownership. However, Bangladesh's banking system is plagued by a culture of default. For a long time, there has been an overabundance of non-performing loans in the system. Defaults in Bangladesh have been blamed on information problems in the form of moral hazard, adverse selection or monitoring costs in commercial banks' selection of borrowers; the lack of legal actions against defaulters (as a major portion of the loans goes to influential businessmen, politicians, and insiders) and government debt forgiveness.

Our banking sector is also plagued by low profitability and a weak capital foundation because there are many banks engaged in unhealthy competition among each other. Banking ethics can be considered as a crucial part in establishing a healthy and sustainable credit environment. Increases in non-performing loans (NPLs) will have long-term consequences for the banking industry. In the worldwide wave of banking service globalisation, we will lose competitive edge significantly if it cannot be lowered. This means that the legal system must be improved and various out-of-court settlement strategies such compromise settlement schemes, incentive packaging schemes, the development of asset management businesses, factoring and asset securitization must also be developed.

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