

Delinquency Management in Private Commercial Banks: The Case of Bangladesh

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Abstract

This study examines delinquency management practices, causes of delinquency, and find out the ways of improving loan delinquency in private commercial banks in the context of Bangladesh. A sample of 250 primary observations has been collected through a self-administered questionnaire using a simple random sampling method from the target population during 2017-2018. The target population includes credit and recovery officers, individual and institutional borrowers from 30 private commercial banks in Bangladesh. To analyze the findings, the descriptive statistics of the variables are used and the results are presented in the frequency tables. This paper exposes that, loan client assessment, collateralized lending, sending reminder messages to the borrowers, credit monitoring, setting realistic terms of credit, and insurance of loans are the delinquency management practices in private commercial banks. This research also reveals that improper selection of a loan client, lack of follow up, unhealthy competition among banks, lack of proper analysis of project viability, higher interest rate, under financing/over financing, poor economic conditions, and information asymmetry are main causes of loan delinquency. This study also discloses that, strict adherence to credit policy, visiting client after loan disbursement, proper valuation of security, regular/timely release of funds, training and advice given to loan clients, loan given to business not against collateral, post loan services, fixation of lower interest rates, and proper documentation before disbursement can be main strategies of improving loan delinquency in private commercial banks. The findings of this research would help private commercial banks to reduce non-performing loans and improve delinquency management.

Key Words: Delinquency management, non-performing loans, commercial banks, Bangladesh

1. Introduction

Any account in which the payment due has passed and the required payment has not been paid is called loan delinquency. Therefore, loan delinquency refers to those as financial assets from which banks no longer receive interest or installment payments as scheduled (Schoenmaker, 2012). Delinquency management is the support, control systems, procedures, policies, principles and practices necessary to manage the outstanding loans and advances repayment and to monitor business risks properly. Delinquency management involves credit risk assessment, loan documentation, loan monitoring, and supervision and delinquency management controls. Delinquent loans play a critical role in commercial banks expenses, cash flows, revenue and profitability (Ahmed, 2015). The most dominant factors in the failure of private commercial banks have been the poor quality of assets and inadequate delinquency management. The economic development of a nation and the stability of the banking system are invariably interrelated. International experience shows that if delinquencies are not managed properly, it will lead to banking failures and nationwide financial vulnerability.

Delinquency management is thus essential to ensure a sound financial system and possibly provides an early alarm to regulatory authorities of the banking system (Prasanna et al., 2014). Bonin and Huang (2001) also stated that the possibility of banking crises increases if loan delinquency is not managed properly. Well functioning commercial banks accelerate economic growth, while poorly functioning commercial banks are an impediment to economic progress and aggravate poverty (Richard, 2011).

The rest of the paper is organized as follows. Section 2 describes the statement of the problem. Section 3 depicts the objectives of the study. Section 4 reviews related literature. Section 5 illustrates the research methodology used in this study. Section 6 presents findings and analysis of the outcomes. Finally, section 7 summarizes our concluding remarks and suggests further research area concerning delinquency management in commercial banks in Bangladesh.

2. Statement of the Problem

There is no argument over the fact that effective delinquency management is the precondition for effective commercial bank management. This is the reason why delinquency management in terms of credit assessment, credit documentation, and non-performing portfolio monitoring and controlling are strongly highlighted in most of the commercial banks around the world. In Bangladesh, private commercial banks were facing serious problems with loan recovery for a variety of reasons, lack of financial discipline and outright breach-of-contract cases etc. Non-performing loans (NPLs) are increasing day by day which in all cases are higher as compared to the international standard of five percent. The effect of this is may be reflected in a reduction in the bank soundness, a situation likely to affect the long-term survival of the bank. In order to make profits and reduce nonperforming portfolios in commercial banks, they need efficient delinquency management tools results in low default rates and continued survival in the competitive market. Despite such a prevailing phenomenon of NPLs in Bangladesh, there is a little study that investigates the contributing factors leading to NPLs. However, there is a little empirical study to examine delinquency management practices, causes, and strategies for improving delinquency in commercial banks in the context of Bangladesh.

3. Objectives of the Study

The main objective of this study is to examine delinquency management in commercial banks in the context of Bangladesh. Under the main objective, the followings are the specific objectives:

- To identify delinquency management practices in private commercial banks.
- To recognize the causes of delinquency in private commercial banks.
- To ascertain the strategies of improving loan delinquency in private commercial banks.

4. Review of Related Literature

In the assessment of credits, most banks apply the so-called five (5) Cs; that is the character, capacity, collateral, capital, and conditions to determine the creditworthiness of the loan applicant (Richard et al, 2008). Before extending credits to a bank applicant, the bank should be sure that the customer has a well-defined purpose for requesting the credit and an intention of paying back and that, the purpose of the loan is consistent with the credit policies of the bank (Rose, 1996).

The traditional role of a bank is lending and loan composition is the bulk of their assets (Njanike, 2009). Lending is not an easy task for banks because it creates a big problem which is called loan delinquency (Upal, 2009). According to Waweru and Kalami (2009), loan delinquency and non-performing loans are closely associated with banking crises.

Greenidge and Grosvenor (2010), argued that the magnitude of NPLs is a key element in the initiation and progression of financial and banking crises. Guy (2011) argued that NPLs have been widely used as a measure of asset quality among lending institutions and are often associated with failures and financial crises in both the developed and developing world. Despite ongoing efforts to control bank lending activities, NPLs are still a major concern for both international and local regulators (Boudriga et al, 2009).

Greenidge and Grosvenor (2010), argued that the magnitude of NPLs is a key element in the initiation and progression of financial and banking crises. NPLs are still a major concern for both international and local regulators (Boudriga et al, 2009). The immediate consequence of a large amount of NPLs in the banking system is bank failure as well as economic slowdown. Non-performing loans have a non-linear negative effect on banks' lending behavior (Hou, 2001). The causes of nonperforming loans are usually attributed to the lack of effective monitoring and supervision on the part of banks, lack of effective lenders' recourse, weaknesses of legal infrastructure, and lack of effective debt recovery strategies (Adhikary, 2006).

During the last two decades, a significant increase in credit growth provided by financial institutions was recorded (Cingolani, 2013). This growth is attributed to the deregulation process of financial markets and the development of information technologies in the banking industry, which lead to the enhancement of financial intermediation (Rinaldi et al, 2006). In addition, the deregulation process strengthened competition among banks (Salas and Saurina, 2003).

Given the above discussion, banks should control and amend their credit advancement policy with respect to mentioned variables to have lower non-performing loans ratio (Filip et al, 2014) and it is necessary to identify the causes of defaults to improve loan delinquency management in private commercial banks leads to economic development of the country which is the major motivation of this research.

5. Research Methodology

5.1. Sources of Data

A sample of 250 primary observations has been collected through a self-administered questionnaire using a simple random sampling method from the target population during 2017-2018. The target population includes credit and recovery officers, individual and institutional borrowers from 30 private commercial banks in Bangladesh. The observation consists of 150 bank staff concerning loan portfolio performance and 100 customers who are facing some challenges with repayments and others whose loans are performing. The questionnaire has been pretested using the alpha coefficient and the overall result was 0.873.

5.2. Data Presentation and Analysis

The data has been collected were thoroughly coded and checked for completeness and consistency to ensure correctness of the information given by the respondents. Data entry and analysis has been done by SPSS software. To analyze the findings, the descriptive statistics of the variables are used in this empirical study and presented in frequency tables.

5.3. Research Design

A quantitative analysis has been used to study the delinquency management practices, challenges and strategies of improving delinquency management in private commercial banks in Bangladesh. The survey was both descriptive and analytical in nature. A five-level Likert scale has been used ranging from strongly disagree (1) to strongly agree (5).

6. Findings and Analysis

Analysis of findings follows the sequence of objectives which include delinquency management practices, the causes of delinquency, and ways of improving loan delinquency management in private commercial banks in Bangladesh.

Several questions concerning each objective were set and a five-level Likert scale has been used to get reply from the respondents, where 1= strongly disagree(SD), 2= disagree(D), 3= not sure(NS), 4= agree(A) and 5= strongly agree(SA).

6.1. The delinquency management practices in private commercial banks

The first objective looks at the delinquency management practices in private commercial banks. In relation to this, loan client assessment, collateralized lending, assessing client's capital requirements, sending the reminder message to the borrowers, credit monitoring, setting realistic terms of credit, insurance of loans, and predicting the economy has been analyzed to reduce non-performing portfolios. The findings on delinquency management practices in private commercial banks are presented below:

Table 1: The delinquency management practices in private commercial banks

Descriptive Statistics	SD(%)	D(%)	NS(%)	A(%)	SA(%)
Loan client assessment is a practice in private commercial banks to reduce loan delinquency	-	7.51	12.35	41.73	38.41
Collateralized lending is a practice to minimize loan delinquency	-	-	6.10	35.31	58.59
Assessing the client's capital requirements are used to reduce loan delinquency	22.71	31.57	19.53	15.28	10.91
Sending reminder message to the borrowers is a practice to manage loan delinquency	-	2.34	3.50	42.35	51.81
Credit monitoring is a practice used to manage loan delinquency	-	-	10.36	67.37	22.27
Setting realistic terms of credit is used to manage loan delinquency		1.51	3.67	56.48	38.34
Insurance of loans is one of the measures used to manage loan delinquency	1.91	3.54	15.23	55.87	23.45
Predicting the economy by the bank management is a practice to reduce loan delinquency	35.59	35.43	27.47	1.51	-

Source: Results obtained (SPSS output) by the authors from primary data

In the above table, a high percentage indicates more trustworthiness of the findings and lower percentage means less consistency. Loan client assessment is a practice to reduce loan delinquency and results showed that 41.73% of the respondents are agreed and 38.41% of the respondents are strongly agreed with the statement. This implies that the loan client assessment is one of the delinquent management practices in private commercial banks to manage loans. Collateralized lending is a practice to minimize loan delinquency because 35.31% of the respondents are agreed and 58.59% of the respondents are strongly agreed with the statement. Assessing client's capital requirements are used to reduce loan delinquency and results showed that 22.71% of the respondents are strongly disagreed, 31.57% of the respondents disagreed, and 19.53% of the respondents are not sure regarding the statement. This implies that assessing the client's capital requirements is not the delinquent management practices in private commercial banks to manage loans. Sending reminder message to the borrowers is a practice to manage loan delinquency and results showed that 42.35% of the respondents are agreed and 51.81% of the respondents are strongly agreed with the statement. This implies that reminder messages are one of the delinquent management practices in private commercial banks to manage loans. Credit monitoring is a practice used to manage loan delinquency and results showed that, 67.37% of the respondents are agreed and 22.27% of the respondents are strongly agreed with the statement. This implies that credit monitoring is one of the delinquent management practices in private commercial banks to manage loans. Setting realistic terms of credit is used to manage loan delinquency and results showed that 56.48% of the respondents are agreed and 38.34% of the respondents are strongly agreed with the statement. This implies that setting realistic terms to the client is one of the delinquent management practices in private commercial banks to manage loans. Insurance of loans is one of the measures used to manage loan delinquency and results showed that, 55.87% of the respondents are agreed and 23.45% of the respondents are strongly agreed with the statement.

This implies that Insurance of loans is one of the delinquent management practices in private commercial banks to manage loans. Predicting the economy by the bank management is a practice to reduce loan delinquency and results showed that 35.59% of the respondents are strongly disagreed and 35.43% of the respondents disagreed with the statement. This implies that predicting the economy by the bank management is not the delinquency management practices in private commercial banks to manage loans portfolios.

6.2. Causes of delinquency in private commercial banks

The second objective looks at the causes of delinquency in private commercial banks. In relation to this, improper selection of a loan client, lack of follow up, natural calamities, unhealthy competition, inadequacy of collateral security, lack of proper analysis of project viability, higher interest rate, under financing/ over

financing, poor economic conditions, information asymmetry has been analyzed to find out the causes of delinquency in private commercial banks. The results on the causes of delinquency in private commercial banks are displayed in the table below:

Table 2: Causes of delinquency in private commercial banks

Descriptive Statistics	SD(%)	D(%)	NS(%)	A(%)	SA(%)
Improper selection of a loan client is a cause of non-performing loans	-	12.67	20.33	35.35	31.65
Lack of follow up is a cause of delinquency in private commercial banks	1.50	3.00	21.50	40.34	33.66
Default due to natural calamities is a cause of delinquency in private commercial banks	45.50	25.50	20.50	8.50	-
Unhealthy competition among private commercial banks is a cause of delinquency	6.00	12.5	20.50	35.50	25.50
The inadequacy of collateral security/equitable mortgage against the loan is a cause of delinquency	22.50	37.85	25.40	14.25	-
Lack of proper analysis of project viability is a cause of non-performing loans	1.00	2.5	25.5	45.50	25.50
The higher interest rate is a cause of delinquency in private commercial banks	-	13.5	30.50	35.60	20.40
Under financing/ over financing is a cause of non-performing loans	-	11.85	20.25	44.25	23.65
Poor economic conditions are a cause of non-performing loans	2.50	3.90	15.00	45.60	33.00
Information asymmetry cause of non-performing portfolios	-	11.00	15.00	31.50	42.50

Source: Results obtained (SPSS output) by the authors from primary data

In the above table, improper selection of a loan client is a cause of non-performing loans because 35.35% of the respondents are agreed and 31.65% of the respondents are strongly agreed with the statement. Lack of follow up is a cause of delinquency in private commercial banks because 40.34% of the respondents are agreed and 33.66% of the respondents are strongly agreed with the statement.

Default due to natural calamities is not a cause of delinquency in private commercial banks because results showed that, 45.50% of the respondents are strongly disagreed and 25.50% of the respondents disagreed with the statement. It also investigated whether unhealthy competition among private commercial banks is a cause of loan delinquency, results were majority 35.50% agreed and 25.50% strongly agreed with the statement. The study also looked at whether inadequacy of collateral security/equitable mortgage against the loan is a cause of delinquency in private commercial banks, where 22.50% of the respondents are strongly disagreed, 37.85% of the respondents have disagreed, and 25.40% of the respondents are not sure regarding the statement. This implies that the lack of adequate collateral security/equitable mortgage against the loan is not a cause of delinquency in private commercial banks. Lack of proper analysis of project viability is a cause of non-performing loans because results showed that, 45.50% of the respondents are agreed and 25.50% of the respondents are strongly agreed with the statement. The higher interest rate is a cause of delinquency in private commercial banks because 35.60% of the respondents are agreed, 20.40% of the respondents are strongly agreed and 30.50% of the respondents are not sure regarding the statement. This means the majority of respondents are agreed with the statement. The study also looked at under financing/ over financing is a cause of non-performing loans and results showed that 44.25% of the respondents are strongly agreed and 23.65% of the respondents are strongly agreed with the statement. This implies that under financing/ over financing is a cause of non-performing loans in private commercial banks. Poor economic conditions could ably explain delinquency issues since the results indicated that, 45.60% of the respondents are agreed and 33% of the respondents are strongly agreed with the statement. The study also engaged respondents to explain whether information asymmetry cause of non-

performing portfolios in private commercial banks, on this results were majority 31.50% agreed and 42.50% strongly agreed. This implies that information asymmetry is a key issue to be addressed since it had the potential to cause delinquency of loans.

6.3. Strategies for improving loan delinquency in private commercial banks

The third objective looks into the issues of improving delinquency management in private commercial banks. In relation to this, strict adherence to credit policy, visiting client after loan disbursement, proper valuation of security, regular/timely release of funds, training and advice given to loan clients, loan given to business not against collateral, post loan services, fixation of lower interest rates, and proper documentation before disbursement has been analyzed to find out the ways of improving loan delinquency in private commercial banks. The results to ascertain the strategies of improving loan delinquency in commercial banks are presented as follows:

Table 3: Strategies for improving loan delinquency in private commercial banks

Descriptive Statistics	SD(%)	D(%)	NS(%)	A(%)	SA(%)
Strict adherence to credit policy can improve loan performance	6.50	9.50	10.50	38.50	35.00
Visiting client after loan disbursement can improve delinquent management	-	6.00	10.34	51.35	32.31
Proper valuation of security can improve delinquent management	-	3.50	18.50	45.60	32.40
The regular/timely release of funds can improve loan performance	5.50	12.50	18.50	31.25	32.25
Training and advice given to loan clients can improve loan performance	-	18.00	21.50	35.00	25.50
Loan given to business not against collateral can improve loan performance	-	3.65	15.50	45.25	35.60
The increase of post loan services can manage delinquent clients	-	3.50	11.25	48.50	36.75
Fixation of lower interest rates can improve loan performance	5.50	15.50	8.50	34.50	36.00
Proper documentation before disbursement can improve loan performance	-	3.50	18.75	38.50	39.25

Source: Results obtained (SPSS output) by the authors from primary data

From the above table, respondents are requested to comment on whether strict adherence to credit policy can improve loan performance, on these results were majority 38.50% of respondents are agreed and 35% of respondents are strongly agreed with the statement. This implies adherence to credit policy help private commercial banks to improve loan performance.

Another factor that was explored whether visiting client after loan disbursement can improve delinquent management, the result indicated that 51.35% of the respondents are agreed and 32.31% of the respondents are strongly agreed with the statement. This implies that visiting client after loan disbursement can improve delinquent management. It also investigated whether the proper valuation of security can improve loan performance, on these results indicated those majorities 45.60% of respondents are agreed and 32.40% of respondents are strongly agreed with the statement. This implies that proper valuation of security can improve delinquency management. The regular/timely release of funds can improve loan performance because 31.25% of the respondents are agreed and 32.25% of the respondents are strongly agreed with the statement. It also investigated whether training and advice given to loan clients can improve the loan performance, on this results were 35% of the respondents are agreed and 25.50% of the respondents are strongly agreed with the statement. This implies that training and advice given to loan clients can improve loan performance in private commercial banks. This study also investigates that loan given to business not against collateral can improve loan

performance because 45.25% of the respondents are agreed and 35.60% of the respondents are strongly agreed with the statement. The increase of post loan services can manage delinquent clients since 48.50% of the respondents are agreed and 36.75% of the respondents are strongly agreed with the statement. Fixation of lower interest rates can improve loan performance since 34.50% of the respondents are agreed and 36% of the respondents are strongly agreed with the statement. These studies also investigate documentation process before disbursement and find that perfect documents meant consistent information thus better able to manage delinquency since 38.50% of the respondents are agreed and 39.25% of the respondents are strongly agreed with the statement.

Conclusion

Financing a client requires a great deal of information about the borrower's nature, the nature of the concerned business, related industry knowledge, competitor analysis etc. It is quite natural to compromise with the lending quality where aggressive banking takes place and this consideration creates bad loans afterward. Sometimes, the client avails more financing than the actual requirement and eventually fails to repay the loan. An important concept in delinquency management is following the lending policy of the private commercial banks in a structured way. Many private commercial banks practice standard lending policy; on the other hand, many go for aggressive banking. Thus, a credit officer must use qualitative as well as quantitative judgment to understand the true nature of the borrower. Proper monitoring is the ultimate remedy of delinquency. Monitoring is required to figure out whether the purpose, for which the loan is taken, is fulfilled or not. A banker must identify and differentiate between the intentional delinquent and the unintentional delinquent borrower. Some borrower, despite having the willingness to pay, can't pay installments for consecutive times on account of having a bad phase in the business or due to some emergency payment. Bankers need to take the borrower's situation into consideration. In addition, the repayment schedule should be made aligned with the cash flow generation time of the business to reduce loan delinquency in private commercial banks.

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