

AGRICULTURAL LOAN RECOVERY PROBLEMS
IN BANGLADESH

by

Gregory L. Gregory
and
Dale W Adams

Agricultural Finance Program
Department of Agricultural Economics and
Rural Sociology
The Ohio State University
2120 Fyffe Road
Columbus, Ohio 43210

ABSTRACT

Our paper compares loan recovery data collected under the Rural Finance Project in Bangladesh with loan recovery problems of industrial loans and with official agricultural recovery information. We end this discussion with a few conclusions based on our analysis to date.

AGRICULTURAL LOAN RECOVERY PROBLEMS IN BANGLADESH

Formal lenders in many low income countries have problems collecting rural loans. Various equivocal loan recovery measures and inadequate information often make it difficult to determine the exact magnitude of these problems, however. Since lenders in these countries seldom have information that presents a clear picture of the aging of arrears, some observers have argued that recovery problems are not serious because most overdues are repaid soon after the loans' due date [Shukla].

The objective of this study is to document the severity of agricultural loan recovery problems in Bangladesh. Official data as well as information from a representative sample of formal rural loans made from 1979/80 to 1983/84 are used in the analysis. We also calculate the aging of arrears among sample loans to show what proportion of loans are repaid on time and the age of loans that have not been repaid on time.

Background

Bangladesh has a branch-banking system. Presently four nationalized commercial banks (NCBs) and the Bangladesh Krishi Bank (BKB), (the agricultural bank) provide loans in the rural areas. The system is characterized by supply-leading credit programs as opposed to demand-leading program. Under the latter clients pursue loans while in the former lenders pursue clients.

The Bangladesh Bank (BB) (the central bank), based on recommendations from the Ministries of Finance and Agriculture, assigns each bank a quota of loans it must disburse each year. The stated intent for many of these loans is to encourage increased agricultural output. Most of these programs are funded by foreign donors. Until recently this system encouraged making loans, but little emphasis was placed on creditworthiness. During the early 1980's, to ease the

transactions costs of loan applicants and to speed loan disbursement, Union Agricultural Credit Committees (UACCs) were created. They were composed of Union Parishad (UP) members, the local governing body, and the bank branch manager. The UACCs were responsible for selecting borrowers, but they were not responsible for recovering loans.

Recovery of Non-Agricultural Loans

Between 1973 and 1983 total formal loans in Bangladesh increased from U.S. \$36 million in 1973 to U.S. \$231 million in 1983. These loans have gone primarily to the manufacturing and the wholesale-retail sectors. The agricultural sector is now the third largest recipient of formal loans. Its share increased from a meager 9 percent of the money advanced in 1976 to almost 29 percent of the value of loans made in 1985 [Ahmed]. While the volume of all loans, and especially agricultural loans, has rapidly increased, loan recovery has become an endemic problem in all sectors. The agricultural sector's recovery performance, although dismal, is better than other sectors.

The Bangladesh Institute of Development Studies is presently studying the loan recovery problems facing public financial institutions (PFI) in Bangladesh. Owing to the lack of consolidated data for the NCBs, this research has concentrated on the Bangladesh Shilpa Bank (BSB) and the Bangladesh Shilpa Rin Sangstha (BSRS) [Sobhan and Mahmood, and Sobhan and Ahsan, 1985]. These two PFIs provide funds to the public and private industrial sector. Since 1975 the majority of their loans has gone to private entrepreneurs. These two PFIs may be considered the industrial equivalents of the BKB. During 1980/81 BSB and BSRS recovered almost 50 percent of their current dues but only 20 percent of their current dues plus overdues. By 1983/84 current-due recovery had fallen to 31 percent and the current dues plus overdue recovery to 11 percent. In other words, during the last year reported, the BSB and BSRS failed to recover over

two-thirds of their current dues and almost 90 percent of their pending liabilities [Sobhan and Ahsan, 1985].

Data Used In Study

This study utilizes data collected as part of the Rural Bank and Bank Users Survey (RBBUS) of the Rural Finance Project of the Bangladesh Bank, conducted by Robert R. Nathan and Company. The RBBUS sampled branches of four NCBs and also the BKB. The NCBs are Agrani, Janata, Rupali, and Sonali Banks. The portion of the data analyzed is referred to as Borrower Records. A sample of 100 loans was taken from each of 101 branch banks, located in eight districts (Chittagong, Dhaka, Faridpur, Jamalpur, Jessore, Kushtia, Rajshahi and Rangpur) during 1985/86. These branches represent a stratified random sample of the approximately 3,300 rural branches present when the RBBUS was designed. Theoretically the sample population should have been 10,100 loans disbursed between 1979/80 and 1983/84 by the sampled branches.

Owing to inputting errors at the branch level by field enumerators, by encoder errors, and to electric power failures, the preliminary data set consists of 8,787 loans, instead of 10,100. Loans that did not have complete information concerning the date of the loan's application, its principal, its first due date, and its last transaction date were then deleted from the data set. This left 7,686 loans, representing all 101 branches, for analysis.

Three types of loans were identified by the RBBUS: short-term agricultural (STA), overdraft, and term loans. We here analyze only STA loans. These loans account for 70 percent of the usable RBBUS loans (5,365). However, they represent less than one-fourth of the total RBBUS loan value. Short-term agricultural loans are either disbursed in one lump sum or are disbursed as one payment in cash and another in-kind for seeds or fertilizer. They also tend to have a single repayment.

Table 1 presents the distribution of these STA loans by bank and by size of loan. Table 2 presents the value of these loans by the same categories. The first table also gives the number of branches included in our sub-sample. Of the 101 branches surveyed, 85 had at least one STA loan, and sixteen of the surveyed rural branches had no STA loans in their portfolio.

Within the sub-sample, three-fourths of the loans were under Tk 2,500, (slightly less than \$100), but these loans accounted for almost half of the STA loans' value. Medium-size loans, representing 24 percent of the number of loans, accounted for 43 percent of their value. Only one percent of the STA loans were classified as large, yet this one percent accounted for eight percent of the STA portfolio's worth.

Medium-size loans accounted for 50% of the value of Agrani's STA loans. As the most commercially oriented NCB this percentage is not surprising. What is surprising is that over half of the value of BKB loans is in medium-size loans, since it was created to satisfy the credit needs of small farmers.

The number as well as the total value of small STA loans has declined over time. In fiscal year 1979/80, these loans accounted for 87 percent of the STA loans and 96 percent of their value. By 1982/83 small STA loans accounted for less than half (49%) the number of loans and 73 percent of their value. For 1984/85 they represented 21 percent of the number of loans and slightly more than one-third (35%) of the total value. Medium-sized loans represented almost three-fourths (73%) of the STA loans and 63 percent of the value of the loans. Large loans accounted for less than 12 percent of the STA loans and three percent of their value in any year. Inflation may explain some of the shift in importance from small to medium sized STA loans.

Table 1

Number of Branches Surveyed and Number of Loans by Bank and by Size
(Short-term Agricultural Loans)

Bank	Total Number of Branches		Principal Amount of Loan in Takas			
	Surveyed	Loans Made	Less than 2,500	2,500-7,000	7,000+	Total
% of Number of Loans Made by Individual Bank						
Agrani	16	1,069	72	27	1	20
Janata	13	742	83	17	*	14
Rupali	6	402	77	23	0	8
Sonali	26	1,875	79	19	2	35
BKB	24	1,243	67	31	2	23
Total	85	5,331	75	23	1	100

* Less than one percent.

Source: Rural Bank and Bank Users Survey (RBBUS), Borrower Records.
Preliminary data.

Table 2

Value of Loans Made by Bank and by Size of Loan
(Short-term Agricultural Loans)

Bank	Total Value of Loans	Principal Amount of Loan in Takas			
		Less than 2,500	2,500-7,000	7,000+	Total
(Tk. '000) --% of Value of Loans Made by Individual Banks--					
Agrani	2,172	48	50	2	20
Janata	1,238	62	34	4	11
Rupali	824	60	40	0	8
Sonali	3,698	51	36	13	34
BKB	2,966	40	51	9	27
Total	10,898	49	43	8	100

Source: Rural Bank and Bank Users Survey (RBBUS), Borrower Records.
Preliminary data.

Official Agricultural Loan Recovery Data

Official recovery information for agricultural loans in Bangladesh is presented in Table 3. These recovery rates measure the current recoveries as a percentage of current dues, plus overdues including principal and interest due. However, this measurement has its limitations: it combines flow figures, current recoveries and dues, with a stock figure, past overdues. If the latter represent a large proportion of a bank's loan portfolio, its reported recovery rate will decline even though it was able to recover most current loans as they came due. For this measurement technique to be meaningful, it must be accompanied by a policy of writing-off old overdue loans, a practice not common in Bangladesh.

Table 3

Official Agricultural Loan Recovery Position by Bank and by Year*

Bank	Year							
	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86**
	----- (Percent) -----							
Agrani	41	30	27	28	34	37	37	21
Janata	53	32	35	39	43	33	32	22
Rupali	25	23	15	34	10	25	17	13
Sonali	48	36	38	31	37	39	32	20
BKB	54	56	68	68	50	50	44	32
Total	45	42	49	48	42	42	38	25

* Recovery is measured as loan payments received (LR) during a given period as a percent of loans due during that period (LD) plus previous overdues (LPD). Symbolically this percentage would be:

$$\frac{LR}{LD + LPD} .$$

** The 1985/86 figures are only up to April 1986.

Source: Bangladesh Bank, Agricultural Credit Department. Unpublished data.

During the seven year period shown in Table 3, the banking system, as a whole, recovered less than half of its loans coming due and overdue. The bank-wide recovery position peaked in 1980/1981, with a stated recovery position of 49 percent. During 1978/1979 three of the four NCBs recorded their highest recoveries. Rupali Bank was the exception.

As can be noted in Table 3, the BKB reported the highest recovery rate of the five banks for most years. For the first six years it achieved a recovery record of at least 50 percent. In two of the years covered it recovered more than two-thirds of its current dues and overdues. One possible explanation for the BKB's higher recovery ratio could be the rolling-over of many of its loans, particularly its larger loans. In 1984/85 bank policy was changed and roll-overs were no longer permitted. As a result, BKB's recovery position fell below 50 percent and declined even more the following year.

The official data show that the recovery of agricultural loans by these banks is dismal, even though it is better than the loan recovery performance of BSB and BSRS. Clearly the vitality and very existence of the entire financial system in Bangladesh is threatened by these widespread loan defaults.

RBBUS Loan Recovery

The official figures detailed in the previous section are aggregate data of all types of loans disbursed by rural branches. The following section presents measures of loan recovery performance among the 5,365 STA RBBUS loans. Additional insight into the severity of loan recovery problem is provided through the aging of arrears of these loans.

From Table 4 it is apparent that while the RBBUS sample tended to show a higher recovery percentage than the ACD figures, the loan recovery situation is not very good for STA loans covered by the RBBUS. In total only 45 percent of the original principal has been recovered, as of March 1986. The average value

Table 4

Percentage of Original Loan Value Recovered
by Bank by Fiscal Year of Loan Application*
(Short-term Agricultural Loans)

Bank	Year							Total
	Before 1979/80	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	
Agrani	76	68	67	75	65	23	0	49
Janata	0	54	51	45	36	22	3	35
Rupali	**	63	69	80	48	45	**	50
Sonali	100	72	57	65	41	38	0	45
BKB	49	84	69	61	59	35	0	45
Total	54	66	60	63	51	33	***	45

* The percentage measured here is the principal recovered (Pr) divided by the loan principal (L). The former is a flow variable while the latter is a stock variable. The percentage is $Pr/L \cdot 100$.

** Rupali did not disburse any STA loans in these two periods.

*** Percentage is less than one percent.

Source: Rural Bank and Bank Users Survey (RBBUS), Borrower Records.
Preliminary data.

of loan principal recovered each year by the five banks was less than two-thirds in all of the years covered. For example, of all of the sampled loans made by the five banks in 1980/81, only an average of Tk. 60 had been repaid by March 1986 of each Tk. 100 lent in 1980/81.

The low loan recovery of only 33 percent for 1983/84 reflects bad weather and government forgiveness of interest payments on loans. It should be remembered that the percentage figures for the last two years in the table underestimate the amount of eventual loan recovery because of late loan repayment and loans that were not due by the cut-off date of 1 December 1985. On top of the very low loan recovery rates for 1983/84, it appears there has been a decline in loan recovery performance of the five banks surveyed, from bad to worse, from a recovery rate of almost two-thirds to a rate of only one-third.

The recovery performance of the individual banks in the RBBUS follow a downward trend, mirroring the official recovery position. Overall, 40 percent of the value of RBBUS STA loans principal was repaid in full, while an additional 5 percent was recovered in partial payments.

Information on the aging of arrears among the 5,331 STA RBBUS loans is shown in Table 5. As can be noted, 13 percent of these loans had been repaid on time or were not due for payment by 1 December 1985. Another 45 percent of the value of the loans was in arrears for less than one year. Forty-three percent of the loans were overdue by more than one year. Overall, we conclude that 30-50 percent of the value of these surveyed loans may not be collected.

Conclusions

The results reported in this paper show a discouraging picture of loan recovery in Bangladesh. Between 1978/1979 and 1984/85 the reported loan repayments received by the five banks was less than half of the loans coming due and the past due loans. Without outside sources of funds the continued

Table 5

Repayment Status of RBBUS Loan Value by Bank and by Aging of Arrears (Short-term Agricultural Loans)

Bank	Aging of Arrears								Total
	Paid on Time	1-30 Days	30-90 Days	90 Days-1 Year	1-2 Years	2-3 Years	More than 3 Years	Not Due	
-----Percentage of total value of bank loans surveyed-----									
Agrani	6	4	6	31	31	6	7	9	100
Janata	5	3	5	30	29	10	14	4	100
Rupali	19	3	5	31	21	15	3	2	100
Sonali	4	1	4	43	24	8	9	7	100
BKB	10	2	7	36	24	11	5	5	100
Total	7	2	6	36	26	9	8	6	100

Source: Rural Bank and Bank Users Survey (RBBUS), Borrower Records. Preliminary data.

viability of these financial institutions is questionable. Using a sample of short-term agricultural loans we reported the percentage of the original principal recovered by the banks at the time of the survey and the aging of these arrears to provide further insight into the loan repayment situation in Bangladesh. While a significant amount of the overdue agricultural loans appear to dribble in for repayment within the first year after the due date of the loan, a very substantial amount of the loans are repaid much later, or not repaid at all. It appears, however, that STA loans have a better repayment rate than the official agricultural loan recovery position.

Some policy makers are cavalier about these problems and argue that defaults are an innocuous way of helping farmers, especially the rural poor. These individuals overlook the fact that defaults scar both lenders and borrowers, and also is a regressive way of distributing subsidies. Loans not repaid decrease the funds intermediaries have available to lend, make it difficult to assure safe deposits and to attract savings, absorb scarce managerial time, undermine the financial integrity of the lender, and tarnish the intermediary's reputation. Persistent defaults also cause financial intermediaries to be perceived as transitory rather than permanent institutions.

While less well recognized, loan defaults also damage defaulters. A single loan or deposit has relatively little value to most individuals. What is valuable is a flow of dependable financial services. The relationship between intermediary and client should evolve over time and not be a single event. The end result of this process is a client with greater debt capacity than when the relationship began. When an individual does not repay a loan the process of creating debt capacity is reversed and capacity is destroyed. While the volume of loans handled by intermediaries are the most commonly cited measure of the products created by financial markets, the increase in debt capacity among

borrowers is the true measure of a financial markets contribution to development.

Loans that are not recovered, therefore, are doubly damaging: they undermine the vitality and ability of financial markets to carry out their basic function of supporting economic activities, and they also destroy the most important product that financial markets create: debt capacity.

As stated above, loan recovery in Bangladesh appears to be very low in all sectors of its economy. Furthermore, it is discouraging that the loan recovery performance on short-term agricultural loans appears to have deteriorated substantially over the past few years. This is particularly disheartening since STA loans have the best recovery record of development loans in Bangladesh. Loans of longer term typically have an even poorer repayment record. If Bangladesh banks are not able to recover a substantial proportion of their loan principals their continued viability without further reliance on foreign donor funding is questionable.

-18-

REFERENCES

- Ahmed, Zia U., "Rural Banking in Bangladesh, A Brief Review" unpublished paper, Agricultural Finance Program, Department of Agricultural Economics and Rural Sociology, The Ohio State University, Columbus, Ohio, 1986.
- Bangladesh Bank, Agricultural Credit Department, unpublished data.
- The Economist "Bangladesh," Vol 301, No. 7468, Oct. 18, 1986, pp. 23-26.
- Jamal, Ahmed, "Bangladesh" in Farm Credit Situation in Asia, Tokyo: Asian Productivity Organization, 1984, pp. 215-230.
- Shukla, Tara, "Agricultural Overdues, A myth or reality?", Economic Times, (India) June 30, 1985.
- Sobhan, Rehman, and Ahmed Ahsan, Repayment Performance of the DFI Sponsored Industries in Bangladesh, Dhaka: Bangladesh Institute of Development Studies, Working Paper No. 1, August, 1985.
- Sobhan, Rehman, and Ahmed Ahsan, Problems of Repayment to the DFIs in Bangladesh, Results of a field survey of selected enterprises, Dhaka: Bangladesh Institute of Development Studies, Working Paper No. 4, April 1986.
- Sobhan, Rehman, and Md N. Ehsan Fatmi, Role and Problems of Public Financial Institutions in the Recovery of Loans: Case Studies of Nationalized Commercial Banks, Dhaka: Bangladesh Institute of Development Studies, Working Paper No. 3, August, 1985.
- Sobhan, Rehman, and Syed Akhter Mahmood, "Repayment of Loans to Specialized Financial Institutions in Bangladesh: Issues and Constraints," The Bangladesh Development Studies, Vol. 9, Winter 1981, No. 1, pp. 35-76.