CHAPTER - TWO

Modus Operandi of the Consumer Credit Programme

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Modus Operandi of the Programme

2.1 Introduction

Commercial banks in Bangladesh compete with other financial institutions that offer some of the same services. Along with other banks and financial institutions Bangladeshi Commercial banks compete with banks for consumer loans. Consumer credit is a medium term loans to the public for the purchase of goods. Consumer credit has a different system of operation compared to conventional lending. This credit can be managed by third parties and the risk can be minimized by spreading the risks among many customers and via light control in assessment and monitoring. Grameen Bank experience has encouraged commercial banks to initiate consumer credit programme. In this chapter our main objective is to analyse the mode of operations of the consumer credit scheme introduced by the commercial banks of Bangladesh.

2.2 Characteristic of Consumer Loans

By large, consumer loans are regarded by bankers as profitable credits with "sticky" interest rates. That is, they are typically priced well above the cost of funding them, but their contract interest rates usually don't change with market conditions during the life of the loan as do interest rates on most business loans today. This means that consumer loans are exposed to interest rate risk if the bank's funding cost rises high enough. However, consumer loans are usually priced so high (i.e., with a sufficiently large risk premium built into the loan rate) that market interest rates on bank borrowings and default rates on the loans themselves would have to rise substantially before most consumer credits would become unprofitable.[1]

Why are interest rates so high on most consumer loans? One key reason is revealed by the Functional Cost Analysis (FCA) programme conducted annually by the Federal Reserve banks. This cost accounting system suggests that consumer loans are among the most costly and most risky to make per dollar of loanable funds of any of the loans that banks grant to their customers. Consumer loans also tend to be cyclically sensitive. They rise in periods of economic expansion when consumers are

generally more optimistic about the future. On the other hand, when the economy turns down into a recession, many individuals and families become more pessimistic about the future, particularly when they see growing unemployment, and reduce their bank borrowings accordingly.

Moreover, consumers seem to be relatively unresponsive to changes in interest rates when they go out to borrow money. Household borrowings appear to be relatively interest inelastic: consumers are more concerned about the size of monthly payments required by a loan agreement than the interest rate charged (though, obviously, the contract interest rate on a loan influences the size of required loan payments). While the level of the interest rate is often not a significant conscious factor among household borrowers, both education and income level do materially influence consumers' use of credit. Individuals with higher income tend to borrow more in total and relative to the size of their annual incomes. Those households in which the head of the household or the principal breadwinner has more years of formal education also tend to borrow more heavily relative to their level of income. For these individuals and families, borrowing is viewed more as a tool to achieve a desired standard of living rather than as a safety net to be used only in serious emergencies.

2.3 Evaluation of Consumer Loan Application

Character and Purpose

The key factors in analysing any consumer loan application are the character of the borrower and the borrower's ability to pay. The loan officer must be assured that the borrowing customer fells a keen sense of moral responsibility to repay a loan fully and on time. The borrower's income level and valuable assets (such as holdings of securities or savings deposits) must be sufficient to reassure the loan officer that the customer has the ability to repay the loan with a comfortable margin for safety. For this reason, a consumer loan officer nearly always cheeks with the national or regional credit bureau concerning the customer's credit history. These institutions hold files on most individuals who at one time or another have borrowed money, indicating their record of repayment and credit rating.[2]

Often the fundamental character of the borrower is revealed in the purpose of the loan request. The loan officer must ask: has the customer clearly stated what he or

she plans to do with the money? Is the stated purpose of the loan consistent with the bank's written loan policy? Is there evidence of a sincere intention to repay any funds borrowed? Some senior loan officers often counsel new loan officers to take the extra time to visit with each customer, because such conversations often reveal flaws in character and sincerity that have a direct bearing on the likelihood of loan repayment. Frequently, experienced loan officer fills out the loan application rather than letting the borrowing customer do it alone. By asking the customer pertinent financial questions the application is being filled out. A skilled lender often can make a better call off whether the customer's loan request meets the bank's quality standards. The customer's spoken answers may be far more revealing about character and sincerity of purpose than anything typed in a computer file. Particularly larger institutions, to spend less time with the customer Information gathering and loan evaluation increasingly are being turned over to computer programmes. The result is that many consumer loan officers today know very little about the personality and character traits of their customers beyond the information called for on a credit application, which may be faxed or telephoned in or sent via computer to the bank.

In the case of a borrower without a credit record or with a poor track record of repaying loan, a cosigner may be requested to support repayment. Technically, if the borrower defaults on a cosigned loan agreement. The cosigner is obligated to make good on the loan. However, many bankers regard a cosigner mainly as a psychological device to encourage repayment of the loan, rather than as a real alternative source of security. The borrower may feel a stronger moral obligation to repay the loan knowing the cosigner's credit rating also is on the line. But bankers often hesitate to pursue a cosigner vigorously, because this can mean the loss of all the cosigner's banking business and perhaps the accounts of other sympathetic customers as well.

Income Levels

Consumer loan officers consider both the size and stability of an individual's income important. They generally prefer the customer to report net salary or take-home pay as opposed to gross salary, and will often check with the customer's employer to verify the accuracy of customer-supplied income figures, length of employment, residence address, and social security number.

Deposit Balance

An indirect measure of income size and stability is the daily average deposit balance maintained by the customer, which the loan officer normally will verify with the bank involved. In most states, a bank is granted the right of offset against the customer's deposit as additional protection against the risks of consumer lending. This right permits the bank to call a loan that is in default and seize any checking or savings deposits the customer may hold with the bank in order to recover its funds. However, the customer normally must be notified at least 10 days in advance before this right is exercised, which can result in funds disappearing before the bank can recover any portion of its loan.

Employment and Residential Stability

Among the many factors considered by experienced consumer loan officers is duration of employment. Most lenders are not likely to grant a sizable loan to someone who has held his or her present job for only a few months. Length of residence is also frequently analyzed because the longer a person stays at one address, the more stable his or her personal situation is presumed to be. Frequent changes of address are a strong negative factor in deciding whether to grant a bank loan.[3]

Pyramiding of Debt

Consumer loan officers are especially sensitive to evidence that debt is piling up relative to a consumer's monthly or annual income. Pyramiding of debt - where the individual draws credit at one lending institution to pay another - is frowned upon by most bank loan officers, as are high or growing credit card balances and frequent returned checks drawn against the customer's deposit account. These items are viewed as indicators of the customer's money management skills Customers lacking these basic skills may be unable to avoid taking on too much debt and thereby get themselves in serious trouble with the bank.

How to Qualify for a Consumer Loan

Are there ways to improve one's chances of getting a bank loan? One positive factor is home ownership or for that matter ownership of any form of real property such as land or building. Even if such property is not posted as collateral behind a loan it

conveys the impression of stability and good money management skills. Having a telephone is also important as a sign of stability and a low-cost way for the bank's collections department to contact the borrower in case of trouble. Another positive factor is maintaining strong deposit balances with the bank. Not only do above average deposit levels suggest a financially disciplined individual determined to meet his or her obligations. But also the bank can profitably use those deposits to fund other loans.

The most important thing to do, however, is to answer all the loan officer's questions truthfully. Consumer loan officers look for inconsistencies on a loan application as a sign the borrower is untruthful or, at best, forgetful. For example, a Social Security or personal ID number often reveals what geographic area a personal history as indicated on the loan application? Are the borrower and his or her employer located at the addresses indicated? Is the amount reported as take-home pay or annual income the same as what the employer reports? Has the customer reported all debts outstanding or does a credit check reveal many unreported obligations the customer has forgotten or simply walked away from?[4]

2.4 The Challenge of Consumer Lending

Consumer loans are not easy to evaluate. For one thing, it is often easier for individuals to conceal pertinent information bearing on the pay out of a loan (such as their health or future employment prospects) than for most businesses (whose loan applications are frequently accompanied by audited financial statements). Moreover, a business firm can more easily adjust to ill health, injury or financial setbacks than can individuals and families indeed the default rate on consumer loans usually is several times higher than that for many types of commercial loans. The key features of consumer loans that help the loan officer hold down potential losses are that most are small in denomination and are often secured by marketable collateral such as an automobile. The loan officer can experience a substantially greater number of loan defaults in the consumer credit field than in virtually any other type of lending.

Consumer credit scheme of the commercial banks has increased socio-economic impact on the branch development and standard of living of the borrowers / clients in the form of increasing savings, earnings of interest, cost savings, reduced cost of living, better attitude of life, family peace and satisfaction, reducing frustration and

developing harmonious in relation between the banks and the borrowers no idea of stuck up advance is found here. Borrowers are achieving enough to repay their instalments with great zeal and care. Although branch-wise variations are found in disbursement, recovery, yet most of the borrowers are very regular in adjusting their dues in time through cost savings, interest savings, productive uses of loan and more concentration.[5] We may cite below a short sketch of some of the leading commercial banks operating in Bangladesh.

1. Sonali Bank

The largest nationalised commercial bank of the country Sonali Bank was founded in 1972 with a paid-up capital of Tk. 20 million only. Mean while, both paid up capital and reserves of the bank have increased impressively. These two stood at Tk. 3272 million and 2136 million respectively as at the close of 2001. Total assets of the bank stood at Tk.253872 million. The bank having the largest network of 1291 branches had a deposit and credit base of Tk.210.45 billion and Tk. 141.916 billion respectively. Sonali Bank had 25753 employees. The bank, in addition to its normal day-to-day banking, also conducts treasury functions on behalf of the Bangladesh Bank where it does not have any office.

2. Janata Bank

The second largest nationalised commercial Bank Janata Bank having a country wide network of 900 branches was established under the 'Bangladesh Banks (Nationalization) Order- 1972' with a paid-up capital of Tk. 15 million only. Its paid up capital and reserves have increased to Tk. 2594 million and Tk. 539 million respectively as at the year-end, 2001. Total assets of the bank stood at Tk. 151862 million as on end December, 2001. Number of employees including officers working in 900 branches and Head Office stood at 16692 as on end December. 2001.

3. Agrani Bank

Established under the same nationalization Order, Agrani Bank started its operations in 1972 with a paid up capital of Tk. 10 million only. Equally strong like other nationalised banks, more particularly Janata Bank, this bank had a paid up capital and reserves of Tk. 2484 million and Tk. 822 million only as on end- December, 2001. Its total assets stood at Tk. 131068 million. The bank had a deposit and credit base of

Tk. 106713 million and Tk. 80016 million respectively as on the same date. Number of branches and employees including officers stood at 903 respectively.

4 Islami Bank Bangladesh Limited

It was established in 1983 with an authorized capital of Tk. 50 million. Its paid up capital stood at Tk. 7.5 million in 1984. 35 entrepreneurs out of whom 2 are Bangladeshis founded I.B.B.L. The bank had a deposit and credit base of Tk. 43936 million and Tk. 35819 million respectively as on end-March, 2002. I.B.B.L. operated through 121 branches with a total manpower of 3120.

5 Oriental Bank Bangladesh Limited

Jointly sponsored by the Dallah Al-Baraqua Group of Saudi Arabia, Islami Development Bank and Bangladeshi entrepreneurs, Al-Baraka Bank Bangladesh Limited was established in 1987. The bank's majority shares have, however, been taken over by the investors of Hongkong in 2002. The new name of the Bank is 'Oriental Bank Limited'. It had a deposit and credit base of Tk. 12778 million and Tk. 9187 million respectively as on end March, 2002. The bank operated through 34 branches with a total of 633 employees.

6 Al-Arafah Islami Bank Limited

Solely the Bangladeshi sponsors founded the third Islami Bank of the country- Al-Arafah Islami Bank Limited - in 1995. It had a deposit and credit base of Tk. 7712 million and Tk. 5083 million respectively as on March 31, 2002. On the same date, the bank had 40 branches and 741 employees.

7 Social Investment Bank Limited

Founded in 1995 having sponsors from both Bangladesh and abroad, Social Investment Bank Limited is described by its sponsors as a different type of bank having three sector approach, namely, objective of serving:(a) Formal, (B) Informal and (c) Voluntary sectors. The sponsors suggest that the bank is both Islamic participatory commercial bank and informal banking for the poor, the bank had a paid up capital of Tk. 260 million as on end -December, 2001. Total deposit and credit of the bank stood at Tk. 10569 million and 5499 million respectively. The bank operated through 17 branches with 361 officers and employees.

2.5 Modus Operandi of Different Banks

Consumer credit programme is an excellent service towards the consumers. NCBs & PCBs are engaged in all these activities. Modus operandi of some of banks operating in Bangladesh are given below:

1. Oriental bank Bangladesh Ltd. (Private Sector)

Objectives

The main objects of the consumer service under this bank scheme are as follows: (i) To help the professionals and small holders of limited income group. (ii) To make them aware of modern technological development and develop their standard of living. (iii) To increase the efficiency of the family members. (iv) To develop their savings habit. (v) To constitute socio-economic development of the country. Major items of products included in the scheme are as under: (i) Motor cycle, television, VCR, VCP, ratio, cassette and recorder. (ii) Refrigerator, deep freeze, washing machine, sewing machine. (iii) Air conditions, water cooler, water heater, water pump and generator. (iv) Personal computer, UPS, printer and type writer. (v) Cellular phone, camera, movie camera, photo copier, fax machine. (vi) Ceiling patental, table fan, familiar over, blender, micro woven, toaster, pressure, cooker etc. Medical instrument for.

Consumers eligible for this scheme are :

(i) Service holders engaged in government, semi-government, autonomous organizations; (ii) Persons engaged in bank, insurance and financial institutions. (iii) Military, BDR, Police, Ansar, VDP and other shareholders. (iv) Teachers of university, college and schools and madrasha. (v) Officers, engaged in multinational companies. (vi) Doctors, engineers, lawyers, architects, chartered accountants, cost and management accounts. All officers and employees of the respective banks.

Maturity of Investment are of the following types : (i) one year (equal monthly instalment); (ii) two year (equal monthly instalment); (iii) three year (equal monthly instalment);

Mode of Investment : Bai - Muazzal or sales under deferred payment

In this type of investment mode, bank procures goods at the request of the client and sells the same to him on credit with profit. As soon as the transaction takes place the possession and ownership of the commodity passes to the client. To ensure timely payment the bank takes collateral security of a value higher than the price of the commodity the client is required to pay the price to the bank at some specified future date. On default, the bank can realize the same by selling the mortgaged property.[6]

Client Equity : Minimum 15% of the invoice value of the product must be paid by the client before distribution of product, if necessary he can raise the share of equity.

Distribution of Application Form and Its Acceptance

Forms are distributed on payment of Tk. 20. Form register is maintained showing the name and address of the client. After filling up the application forms, following papers are submitted with the applicant form : (i) Two copies of Photo attested by the guarantor. (ii) Income certificate given by the concerned employer. (iii) In case of professionals class one gazetted officer or any S.P.O. of any commercial bank can give the income certificate.

Inspection and Verification : After receipt of the application branch authority / any responsible officer will verify the accuracy of the given information and present his recommendation with signature.

Approval : Branch manager can exercise his full power in case of credit disbursement. He will be responsible of the same according to the recommendation of the verifying officer. Right person is selected before loan disbursement, so that there is no problem of recovery. Branch authority issues a sanction letter, client used to accept the same.

Security Aspect : The client will prepare the necessary charge documents and give the cheque in advance against instalment. A letter of undertaking to pay monthly instalment is to be given.

Insurance policy against the purchase of goods is the main security of this project. In case of motor car loan, the case is registered in both the names of the client and the

bank necessary insurance policy is made by the client and renews the documents of insurance from time to time.

After adjustment of bank credit, it is given to the client. Every loan is granted by third party. In case of self-employed client, savings certificate, bank insurance, guarantee or any other cash collateral of equal amount can be taken. If any third party gives cash collateral, in that case third party guarantee is collected.

2. Prime Bank Ltd. (Private Sector):

The maximum amount of loan, down payment, and the duration of credit periods are given below in table 2.1

Table - 2.1 : Amount Credit and Duration

Commodities	Credit limit (lac.)	Own deposit (%)	Rate (%)	Duration
New car, station wagon and microbus	3.00	30	4	4 years
Recondition car, station wagon & microbus	3.00	50	4	3 years
Motor cycle	1.00	30	4	2 years
Baby taxi / auto tempo	1.00	20	4	2 years
Photo copier	1.00	40	4	1 years
Other	1.00	20	2	2 years

Source : Official Record

Payment System : (i) Bank loan should be repaid in monthly instalments including interest. (ii) 1st instalment should at the next month of taking loan. (iii) The consumers will submit their cheque book to the bank for every instalment, before supplying the goods. (iv) Every instalment should be paid within the 1st month of every month.

Deposit : (i) The consumer will bear all the incidental expenses. (ii) The consumer will submit security bond to the bank. (iii) Expenses like licence fee, registration fee, insurance are borne by the consumer. (iv) The consumer will bear the cost of goods / repairing and maintenance. (v) Consumer will use the goods carefully and bank will not be liable for any accidental loss of goods. (vi) The consumer will personally use the goods. (vii) The consumer will inform his residential address if he changes it.

Amount of Instalment and Duration

The instalment will be 50% of basic salary of consumer. Expected instalment and equity are given below:

Table - 2.2 : Expected Instalment and Equity

Goods	Maximum instalment amount (net)	Equity rate of consumer	Duration
Motor car	3.00 lac.	50%	3 years
PC type, camera, photo copier	1.00 lac.	30%	1 years
Ornaments	0.50 lac.	50%	2 years
Furniture and house hold goods	0.75 lac.	25%	2 years

Source : Official Record.

Payment System : (i) Consumers will repay the credit in equal instalment (principal plus profit current). (ii) Instalment should be deposited in the 1st week of each month after having the goods. (iii) Monthly instalment may be realized in the following ways: (a) consumers are to repay his instalment by deducting his salary. (b) Bank may realize instalment by using the cheque book of consumer. In other cases, the bank can realize its advance from the salary or any other financial service of consumer.[7]

System of Investment Distribution : (i) Bank will supply the desired goods to consumer within 7 days of payment of equity of consumers. (ii) Bank will be the owner of goods when the consumer meet up the total amount of credit.

Deposit : (i) Consumer will pay all the incidental changes of having credit. (ii) Consumer will sign in which he/she argued that he /she will repay the credit regularly. (iii) The grantor will be the same trader / employee or the office authority. (iv) In the case of car or motor cycle, the consumer gives something as security which economic value will be equal to the value of car or motor cycle. In this case following items to be deposited with the bank (a) Land / building mortgage; or (b) ICB Unit Certificate / Bangladesh banks certificate / defense savings bond / FDR / share etc.

Procedure of Application : (i) Consumer must apply in the prescribed form (ii) Application must be approved by the departmental head. (iii) Bank will realize 2% as clerical expenses. This is called supervision charge. (iv) Consumer will deposit 2% in

case of motor cycle, car, photo copiers, and 4% in case of ornaments with equity. This deposit comes under risk fund.

3. Social Investment Bank Ltd. (Private Sector)

Duration of loan ranges between two to four years. In case of private car and motor cycle the maximum time period is four for years and for other purpose is two years.

Investment Procedure

Private car, motor cycle purchases, other by Muazzal (credit sale)

1st product delivery payment is made later.

Clients Obligation:

25 % of the value of product is given by the client initially and 30% is in case of motor car.[8]

4. Al Arafah Islami Bank Ltd. (Private Sector)

The major characteristics of Al Arafah Islami Bank Ltd. may be represented in table 2.3.

Table - 2.3 : Major Characteristics

Commodities	Maximum investment	Equity rate	Duration
Motor car	3.00 lac	50%	3 years
Personal Computer, Type writer, Camera, Photocopier	1.00 lac	30%	1 years
Ornaments	0.50 lac	50%	2 years
Furniture, Electric, Appliances and Kitchen Items.	0.75 lac	25%	2 years

Source : Official Record.

Investment Procedure : (i) Bi Moazzel (credit sale) (ii) Hire purchase on partnership Profit / 14% on net investment of the bank.

Distributions of Investment : (i) Within 7 days of equity payment the product is delivered. (ii) Purchase papers are made in the bank's name to have ownership. (iii) Bank sticker is given on product. (iv) After full payment, ownership is transferred.

Payment Procedure : (i) Bank's investment and profit is paid in equal monthly instalment. (ii) Instalment follows from the next month after giving the product. (iii) Deduction from salary through employer is allowed. (iv) Giving cheque in particular

date. (v) It may be made available through other ways as agreed between client and the bank.

Deposit : (i) All the charges to be made for preparing deed document. (ii) Undertaking of the client. (iii) Guarantee attested by employer. (iv) Mortgage of land building in case of car loan, ICB unit certificate / savings certificate etc.[9]

5. Janata Bank (Public Sector)

The Janata bank is the only public sector bank in Bangladesh which comes forward with the offer of CCS.

The following persons are given consumer credit facilities. (i) Government organizations. (ii) Semi-government and autonomous bodies. (iii) Nationalised Banks and Insurance Companies. (iv) University (Public and Private). (v) Established training institutes and research organizations. (vi) BRAC / Government Bank / Proshika. (vii) International organization / MNCs.(viii) Private Banks and Insurance Companies. The loans on the following consumer goods are offered :Personal computer, scanner, air conditioner, air cooler, water cooler, water pump, freeze, deep freeze, television, dish antenna, ratio cassette player, tow-in-one, three-in-one compact disk, deck, furniture like bed Khat, almirah, sofa set, wardrobe, carpet, sewing machine, sweeter sewing machine, embroidery machine, washing machine, electric calendar, automatic electric grinder, toaster, blender, mixture machine. Presser cooker, oven micro woven, gizzer, camera, movie camera, different fans, ceiling fan, padastral fan, motor cycle / cycle, station wagon, taxi / taxi lab van, microbus lab, telephone set, fax machine cellular phone, mobile phone, cordless telephone, telephone assuring machine, Photostat machine, generator, IPS, UPS, crokeries, dinner set, tea-set. Besides, these other consumer items are also made available under the scheme.

Credit Limit : (i) Maximum value of consumer goods given to a person is Tk. 01 lakh (equity 20%). (ii) Car loan is 5 lakh maximum, equity 40%. (iii) Once car loan is taken, no other loan is available.

Credit Period : This is for one year to 3 year period. In car loan maximum duration is 5 years.

Distribution System : Client deposits his equity in current / savings account combining the loan and equity payment is given to the suppliers through pay orders.

Payment System: Loan is repaid monthly with interest. The instalment is payable by the next month of loan taken (within 10th). Before loan taken, all the cheques to be payable are submitted to the bank in advance.

Interest rate – 15% on compound rate

Security : The bought item is hypothecated to the bank.

Guarantee : Guarantee is given by clients senior BOSS / Colleagues, certified by the institution. In case of motor cycle and car, comprehensive insurance policy is taken at the joint names of the bank and client, registration is done at the joint name. Attested copies of the blue books are kept in bank. Provident fund / gratuity will be on lien.

Other Terms and Conditions : (i) Employers certificate, no objection certificate and present salary certificate are to be given. (ii) To ensure the ownership of bank over the bought items purchase papers are made at the joint names of the client and the banks after final payment, the paper is transferred to the client. (iii) Necessary licence expense, registration cost and insurance expenses are borne by the client. (iv) Repairing and maintenance costs are borne by the client. (v) Client uses the assets, he can't hand over the assets or sell the same or even transfer the possession. (vi) Client will have to use the assets very carefully, if there is any loss due to negligence, client will bear the loss including interest. (vii) Once client fails to repay two consecutive loans bank can take legal steps for collection of advances. (viii) Bank representative ensures the proper uses of asset through monitoring and supervision. (ix) The changing address of the client is to be made available to the bank in time. (x) Any increase in interest rate may be changed and it must be repaid at a time by the client. (xi) Other rules and regulations of the bank are applicable to the client.

The monthly instalment of loan on different amount of loan may be shown in table 2.4.

Table – 2.4 : Monthly Instalment of Loan on Different Amount of Loan.[10]

Loan size	Monthly instalment payable within				
	One year	Two year	Three year	Four year	Five year
100	9.03	4.85	3.47	2.78	2.37
10000	903	485	347	279	238
20000	1806	970	694	557	476
30000	2708	1455	1040	835	714
40000	3611	1940	1387	1114	952
50000	4513	2425	1734	1392	1190
100000	9026	4849	3467	2783	2379

2.6 Security Vs. Purpose-Oriented Lending

Since banks as financial intermediaries have to lend other peoples' money they always remain very cautious about recovery of lent out money. To ensure that they depend primarily on the security aspects of advance. Such security includes primary as well as collateral security including third party/ personal guarantee. Banks everywhere in the world follow this principle of security. Security oriented lending adversely affected the national development including the development of the weaker sections of the society. Many people in the society could not offer any security. By and large, people of small means remained outside the orbit of bank credit.

Historical experience suggests that the security alone does not make an advance realisable. Despite adequate security, many advances stand unrealisable because of legal and other problems. During the last three decades banks in the country did lend money having obtained all kinds of securities. It is observed that a big chunk of credit today stands unrealised because of lack of proper valuation of the securities, poor documentation and physical absence of the securities. Even court cases could not solve the problem. Thousands of cases are pending before the court causing delay in recovery.

In view of the difficulties above lending policy underwent many changes with regard to the security both in Bangladesh and elsewhere. Credit facility is now required to be made available to the desired borrowers without insisting for collaterals or tangible securities. More emphasis is now given on the applicants' business potentiality and feasibility.

Central Bank's definition of security and weightage on security in cases of classification also give lesser priority on collateral security. Not only that institutions like Grameen Bank (GB) have emerged at the backdrop of failure of security oriented lending in production desired results. Consequent upon this change in orientation, more emphasis is now being given to the purpose and potentiality of business.[1]

Categorization of Classified Loans

All classified loans may be classified into three categories, viz., substandard loan, doubtful loan and bad/loss loan. Bangladesh Bank's description of such categorization are given below : (i) Sub-standard Loan: A loan value of which is impaired by evidence that the borrower is unable to repay but where there is a

reasonable prospect that the loan's condition can be improved is considered a substandard loan. (ii) Doubtful Loan: A loan is doubtful when its value is impaired by evidence that it is unlikely to be repaid in full but that special collection efforts might eventually result in partial recovery. (iii) Bad/ Loss Loan : A loan is considered bad/loss when it is very unlikely that the loan can be recovered.

Eligible Securities

All securities are not eligible securities to serve the purpose of classification and provisioning. The following securities have been made eligible by the Central Bank : (i) Goods with a ready market that are physically held in the control of the bank in its godown/warehouse and goods that are physically under the control of the borrower in his godown/ warehouse subject to the conditions that the bank has the full authority of those goods to sell and those have market. (ii) Gold /gold ornaments physically held by the bank. (iii) Fixed and other deposits on which lien is marked and Government bonds or certificates of deposit held by the bank. (iv) Guarantees/ counter guarantees given directly, and formally, by either the government of Bangladesh or the Bangladesh Bank to repay a loan or advance if the borrower defaults. A guarantee by a public sector corporation is not deemed to be a direct government guarantee and is not an eligible security. To be eligible the guarantee must not have expired. (v) Land and building subject to a maximum of 50 percent of market value of such securities.[11]

Required Provision

Classification of advances has to be simultaneously followed by making provision. Rates of provision are different depending on the category of classification. Banks are required to maintain adequate provision as per these rates in addition to one percent general provision on all unclassified loans. The comparative picture on the rates of provision is shown in table 2.5.

Table - 2.5 : Comparative Picture on the Rates of Provision

Particulars	Previous rates of provisions (%)	New rates of provision (%)
Un classified advances	Nil	1
Classified as substandard	Nil	20
Classified as doubtful	50	50
Classified as bad/loss	100	100

Source : Official Record

It appears from the above that the banks are now to make provision once an advance is made irrespective of its performance. Over and above, the rates of provision have also been revised upward.

Classified (Defaulting) Loans

Problem of classified loans (non-performing loans) is one of the biggest problems of serious nature. Almost a quarter of the total loans of the banking sector is now classified or non-performing. According to the latest report based on Bangladesh Bank information published on November 30, 2003, classified or defaulting loans stood at 24 percent in September, 2003.

It appears that the total classified loans of the banking sector as on September 30, 2003 stood at Tk. 21,2480 million as against total loans of the sector amounting to Tk. 886500 million. It may be noted here that the total loans and classified loans as in January, 2003 amounted to Tk.852730 million and Tk. 239620 million respectively.[12] The detailed position is giver below in table 2.6.

Table - 2.6 : Classified (Non performing) Loans (30.9.2003)

(Tk. In Million)

	Total	Percentage
NCB	110530	31
PCBs	52800	14
FCBs	1250	2
DFIs	47900	48
Total:	212480	

The highest amount of classified loans pertains to the NCBs. In their case, 31 percent of the total advances stood classified. In terms of percentage, however, the DFIs topped the list of defaulting loans. In their case, classified loans amounted to 48 percent of the total advances made by them. It is noteworthy that the foreign banks' performance in this regard was by far the best. Classified advances of the foreign banks amounted to only 2 percent of the total advances.

It may be mentioned here that the classified loans have been showing downward trend. According to Bangladesh Bank, it has declined to 24 percent in September 2003 from 28 percent in December, 2002. Bangladesh Bank, is of the opinion that there has been improvement in classified loans took place because of the policy of loan write-off and checking of new loan disbursement. This suggests that improvement in the

position did not take place because of recovery/cash recovery. Had it been so, the banks could have claimed some more credit. However, loan write-off mechanism is, at least, clearing the Balance Sheets of the banks form unnecessary clouds/burden of non-performing assets.

2.7 Restrictions on Large Loans: Central Bank's Norms

Considering credit, as a scarce resource and source of economic and political power, all the societies around the world are careful about its distribution and use. In order to best utilise/distribute credit, therefore, an attempt is made in order to avoid concentration of loans into few hands. In Bangladesh, so long there were no such guidelines to restrict large loans. However, certain loans appearing to be large were subject to Central Bank's clearance.

With a view to ensuring better credit risk management and restricting large loans, Central Bank has recently issued certain guidelines with regard to sanction of large loans. This circular has waived the conditions of obtaining prior approval from Bangladesh Bank. Instead, boards of the banks incorporated in Bangladesh have been authorized to sanction, renew or reschedule large loans. Boards have also been entrusted with the responsibility of implementing the guidelines so issued. For Banks are required to undertake steps to bring down all large loans, sanctioned earlier with Bangladesh bank approval, to conform to the requirement of the circular, if necessary by consortium with other banks.

Customer to Satisfy Three Conditions

Various definitions given by different authors and courts sufficiently indicate that a person should satisfy the following conditions to be customer : (i) He should have some sort of account with the bank, (may be fixed or savings). Frequency of transactions in the account is not essential. One single transaction is good enough. (ii) A banker should habitually undertake to act for him and (iii) The dealings should be in the nature of regular banking business.

Availing of DD/TT facilities and depositing valuables for safe custody and other services occasionally without having any account with the bank are not enough to become a customer.

Banker-Customer : General Relationship

A banker, in course of his day-to-day business, enters into different kinds of relationships with his customers and clients. These relationships may be broadly categorized as: (a) general relationship and (b) special relationship. The general relationship between a banker and customer differs depending on the basis of the types of dealings they undertake between themselves. Laws applicable are also different depending on the nature of services provided by the banks. For example, the relationship between a 'banker' and 'customer' is essentially contractual. Actually contract is made when an account is opened. Since it is a contractual relationship, rights and obligations of an account holder and the bank are determined as per the law of contract. This contract remains in force till the account is closed. Terms of contract between the account holder and banker may, however, be changed, modified, abolished or redefined, if both the parties agree.[13]

Besides this contractual relationship, there are other kinds of general relationships between the banker and customer depending on the services rendered by the bank. Generally the following are the major forms of relationships between a banker and his customers: (a) debtor-creditor, (b) principal - agent, (c) trustee - beneficiary and (d) bailor-bailee.

How to Maximize Bank Profit?

Like all commercial enterprises, banks also try to maximise their profits. Because profit is needed to pay dividend on investment by the shareholders who expect a reasonable return on their investment. Dividend enhances the goodwill and rating of the banks in the stock exchange as well. Hence all banks try for profits as impressive as possible. Banks' profitability is a function of efficient management of resources-both human and financial. In the financial area, two things are very important to a bank for maximizing profit. Of them one is the Cost of fund and the other is yield on fund. Before going into details, let us see the equation below:

$$\pi = Y - (C_f + C_A)$$

Where $\pi \Rightarrow$ *Profit*

$C_f \Rightarrow$ *Cost of fund*
$C_A \Rightarrow$ *Administrative cost*
$Y \Rightarrow$ *Yield on fund.*

It appears from the above equation that a bank can maximize its profit by maximizing income (Yield on fund) and/or by economizing expenditure (Cost of fund and Administrative cost). Let us take up the issues as stated below :

(i) Yield on Fund: In case of yield on fund, banks face a tough job in increasing it. First of all, there is a competition from other banks who may offer lower rate of interest on lending. Borrowers themselves are also very pursuing types of people who always plead for lesser rate of interest. Despite that banks are to struggle for maximizing return on the invested fund. Because yield on fund is actually the main yardstick of profitability. (ii) Cost of Fund: In the cost area important element is cost of fund. It relates to the cost of deposit and borrowing. A bank can keep it at a minimum level if it can design the deposit-mix with low-cost deposit i.e. interest free or less costly deposit. This is not an easy job. Because, here the bank has to keep liquidity aspects in mind. A bank can not afford to have all the deposits in current accounts, which bear no interest but are withdrawable any time. On the other hand, customers may not be willing to keep their deposits in non-interest bearing accounts or in the accounts bearing lesser interests. Because they may be useful to the bank but not profitable at all to the customers. In real life situation, however, it is observed that both the cost of fund and yield on fund are very hard to manipulate because of intense competition. Banks are, therefore, very often left with only one option i.e. administrative cost to maneuver. This is the area where a bank can really economize provided that they are efficient. Enhancing productivity through proper utilization of manpower can do this. In addition to manpower productivity, banks also try to use another option of maximizing the non-funded (guarantee) and commission business. In fact many banks achieve higher profitability by doing more guarantee business which does not involve any fund. On the other hand, doing more L/C, remittance and business maximizes commission business.[14]

2.8 Commercial Banks and the Economy

Commercial banks play an important role in directing the affairs of the economy in various ways. The operations of commercial banks record the economic pulse of the economy. The size and composition of their transactions mirror the economic happenings in the country. For example, the mass failures of commercial banks during the 1930s reflected the phenomenon of severe global depression in the world. Commercial banks have played a vital role in giving a direction to economy's

development over time by financing the requirements of trade and industry in the country. By encouraging thrift among people, banks have fostered the process of capital formation in the country. In the context of deposit mobilisation, given the savings-income ratio, commercial banks induce the savers in the community to hold their savings in the form of socially useful assets of which bank deposit constitutes the most important element. Commercial banks draw the community savings into the organised sector which can then be allocated among the different economic activities according to the priorities laid down by planning authorities in the country. Banks bring together the diverse decisions of the income-earners to save, the decisions of the savers to hold their savings in the form of bank deposits and the decisions of the savers to hold their savings in the form of bank deposits and the decisions of the producers to draw upon the savings of the community for the purpose of capital assets formation. They help the process of saving and of the holding of savings in a socially desirable form. Through their advances, banks also help creation of incomes out of which further savings by the community and further growth potentials emerge for the good of the economy. In a planned economy, banks make the entire planned productive process possible by providing funds for all types of production incorporated in the plan regardless of whether the production is in the public sector, joint sector, or in the private sector, or whether the production is undertaken by one type of organisation or another. All employment, income-distribution and other objectives of the plan are as far as possible subsumed into the production plans which banks finance.[15]

The importance of commercial banks in directing the economic activities in the system-be it a capitalist or a socialist system dominated economy- is indeed overwhelming. Not only in the highly developed industrial and non-industrial economies of the world where in a way the commercial and industrial activities are paralysed in the absence of banks keeping their doors open, even in the developing countries are most economic activities, particularly in the economy's organised sector, are bank-based. This is evident from the fact that trade, industry and government in these countries viewed a threat of strike by bank employees union seriously. In several developing industries, banking has been placed in the category of "essential services" in which strike by the workers is declared illegal. In short, the growth of the economy is tied with the growth of the commercial banks in the economy. Where the commercial banking system is in its primitive stage of

development, there the economy has scarcely come out of the primitive stage of barter with total absence of division of labour and specialisation in production. Consequently, people practice primitive methods of production bearing the hardships of primitive culture and life. Naturally, no development takes place in the economy. With the establishment of commercial banks in the country, the floodgates of accelerated economic development promising great hopes for people in life open. Production no longer remains dependent on the mercy of the small size of local demand. Once it happens, the multiplying process of an ever-expanding demand and supply holds the economy fast in its grip. The banking culture spreads its blessings far and wide in the economic system benefiting the whole community.

2.9 Social Responsibility

Social responsibility of business is much talked about these days. The word "responsibility" means the human sense of answerableness for all acts of thought and conduct. It emanates from the word "obligation" that comes from the Latin word 'obligare' which is defined as "something that one is bound to do or forebear: an imperative duty (as imposed by promise, religion, conscience, ideals or social standards".) Obligations are necessary for the attainment of social objectives are called social obligation. Business in the present day economy has got many obligations towards the society which is defined as an aggregate of individuals, interests and groups which, however organically bound together, are still distinguishable. Ideally, it should include all the interests affected by its economic system". The sense of answerableness for the obligations of Business towards society is called "Social Responsibility of Business". Social obligations are in way projections of family ties among members of a household to the level of members of the society. The obligations are backed by "social motive force where greater regard is being had for the welfare of the society than for the immediate self-interests where only the "private motive force" works. Private motive force or self-interests, however, cannot be dispensed with, as these provide the basic stimulant to economic activity. These interests are very prone to be transformed into self interests in practice. The sense of discharging social obligations provides some automatic checks against this proneness.

The concept of "social obligations" is related to power. With all forms of power, there goes responsibility. "Power corrupts and absolute power corrupts absolutely"

indicates that power has an inherent tendency to bring in many evils if it is left unbridled. Sometimes, persons in power, for their own selves. Resort to those techniques and fix those objectives which may be detrimental to the interests of society. Hence, the concept of social obligations and a sense of responsibility serve as a built-in-mechanism for providing checks against this inherent tendency prevailing among individuals, firms and institutions.

The concept is not synonym for charity where unilateral action is taken by the powerful for the benefit of the poor without expecting anything from the latter. It is based on bi-lateral action where both sides gain something out of their sacrifice in the form of obligations. Business performs all these social obligations in anticipation of wholehearted and reasonably unopposed cooperation from the society, whereas, common interests of the latter are well served by the former. This type of approach is called enlightened self-interest a long term phenomenon as against selfish interests- a short-term phenomenon.

The concept is equated fully with the Gandhian concept of "trusteeship". For Gandhiji : "trusteeship" was essentially a dynamic relationship of confidence between the strong and the weak, governed by an attitude of love and non-violence on their part, the purpose and direction of their efforts being greater equality between them. This relationship also expresses the inherent responsibility of business wants to serve.

Lastly, the concept is relative to time, place and conditions; and thus, reflects the dynamic character of social obligations. In other words, obligations never remain static. They go on changing with the passage of time and with the change in the conditions at a particular place.

2.10 Financial Analysis

Financial analysis is the basic method of appraising a firm's overall standing. As part of a scientific investigation of the firm, it attempts to secure through a systematic study some significant clues about its financial condition and prospects. Its major thrust is the quantification of historical and current facts with a view to projecting the future functioning and viability of a concern. It is a specialized decisional technology through the application of appraising the potential of a firm. A Complete and correct

information about the future is hardly available, except a peeping through the annual account or tentative forecasts and some market surveys. If dependable data regarding the forthcoming outflow and inflow of funds and cash are available, the analysts might be in a better position to assess the capabilities of business. But as things are rather volatile in the business world, financial analysis takes the "laboratory" approach, literally as well as figuratively. Facts have to be gathered from all sorts of sources. Put through the skimming machine fitted with tools and techniques, and an idea formed about the minimum financial status before one can be prompted to act upon. As weather forecasts reduce the risk of going astray in aviation or ruining a picnic, financial analysis forestalls the failure of many entrepreneurs and their financiers by doing the necessary homework.

It is interesting to note that the first ever use of financial analysis was made by credit grantors in the nineteenth century. Upon finding that a trading debtor was unable to meet his claims. The creditors got together and demanded from him a statement of assets and liabilities. They could then decide whether to adjudge him to continue in business under their supervision. By carefully examining their affairs, they succeeded in preventing the collapse of many businesses, which were valuable and profitable, but which were temporarily embarrassed by overtrading and shortage of liquid funds. This practice paved the way for potential lenders to invariably demand of their clients a schedule of properties and indebtedness before they agreed to review the request. The real stimulus to the use of financial analysis was provided, however, when the principle of limited liability was accepted and corporations began to be established as the leading form of business organization. This new factor forced the creditors and bankers to examine more thoroughly the financial position of debtors whose liability was statutorily limited. Moreover, the spread of joint stock companies brought with it a new class of persons interested in financial statements - the investor who had purchased shares in a company. But had no intimate knowledge of or access to detailed information about the business. He was in need of some easily understood information to pointedly tell him of the financial prospects and profitability of the concern in which he had statement—the investor who had purchased shares in a company. But had no intimate knowledge of or access to detailed information about the business. He was in need of some easily understood information to pointedly tell him of the financial prospects and profitability of the concern in which he had staked his resources. It was only one stage farther for

potential investors to ask for this information before they decided to think of shares and securities. The last amongst the users of financial analysis, but indeed the most powerful are the internal managers of concerns. In the day-to-day operations, they have come to utilise it for planning, control and measurement of efficiency in relation to other firms in the same or similar line of business. By all standards, this class of users now far exceeds the rest, and naturally enough, they are introducing most of the new developments in the field. In their anxiety to climb yet higher ladders of success in vastly expanding organisations, they have been forced to evolve some more sophisticated tools of internal management these in turn have been availed of by bankers.

The banker is a risk-lover and his behavior does testify to the presence of some risk factor. But, through the techniques of financial analysis and otherwise he measures the magnitude of risk, and then tries to avoid, or else minimise it. This is plausible as well, since his operations are so patterned that there is very little chance of capital gains; either he receives the full amount or takes a loss - partial or total.

Customer service is not merely the fulfilment of the government's guidelines or the mechanical adherence to the timeframes of services. It is a philosophy and an attitude of professional commitment which believes in the ultimate satisfaction of each customer's wants.

2.11 Regularly Providing Statements and Observing Standing Instructions

Customer service is in fact the perception of a customer of the services he gets from his bank. It is therefore necessary for banks to continuously assess and reassess how customers are and how they can be fulfilled to make customers happy.

Urbanisation has caused the problem of time management which has led to major innovations such as Automated Teller Machines (ATM), telebanking, single window concept, specialised NRI/SSI branches, personal banking, anytime banking, anywhere banking, electronic funds transfer, on-line terminals to customers, Society for World- Wide Inter-Bank Financial Telecommunication (SWIFT), Banknet, Smart Card, Shared Payment Network Systems and the like which meet well the customers' expectations and needs.

Customer service has become an integral part of the training curriculum for various bank staff. New programmes are being designed to cover the staff at the counters in

particular. Apart from undertaking in-house studies for measuring the level of customer satisfaction, banks are also availing of the services of reputed external agencies for the purpose. Several banks have started emphasising the Total Quality Management (TQM) concept. The State Bank of India is implementing the Best Branch for Customer Services Contest with a view to motivating the staff. The Canara Bank has articulated and adopted the Code of Good Banking Practices and has also obtained the ISO 9002 Certification for one of its branches in Bangalore.

The need of the hour is customer service with perfect punctuality, whole-hearted involvement, updated knowledge, utmost sincerity, indefatigable team work and above all courteous talk to customers. Where these are provided, profitability and excellence will automatically follow.

For improving customer service there should be a strategic plan, inclusive of marketing plan and putting in place facilitators like technology, structure, systems and manpower. Banks strive to attain maximum efficiency by minimizing the idle time of the staff at the counters and waiting time for customers.

Customer Satisfaction Survey (CSS) is one of the methods of measuring the impact of customer services. It secures customer loyalty and generates a superior long-term performance. Banking services have to be made more responsive to the needs of the public. In the present-day context customer care and customer concern have become very important. The administration of banking services has a long way to go in earning the co-operation and support from present and prospective customers.

Banks depend on the public for deposits and serve them as an instrument of economic development by offering many fund-based, fee-based and technology-based services. The good performance of all these services decides the destiny of the banks. Their survival and sustenance largely depend upon the way in which these banking services are rendered to the public. A study of customer services and the attitude of customers towards banking services would pave the way for taking certain policy decisions for improving customer service and thereby improving the performance of banks.

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