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NON-PERFORMING LOANS (NPL) IN BANK A BANK - CASE STUDY

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ABSTRACT

Non-performing loans (NPL) are a curse to any bank. Identifying key factors, which are external and internal to banks are very important in sustaining and optimizing banking operations. This particular study is aimed to identify the internal and external factors, which are contributing to the rising levels of bad loans in the banking sector. The study follow qualitative research method, exploring the data with content analysis focus discussion and in-depth interviews. The scope of the study include an insight into are economic cycle, changes in Government policies, impact of liberalization on industries, and borrowers' repayment obligations and its relation with Non-performing loans in a Malaysian Bank.

INTRODUCTION

Banking systems play a major role in mobilizing and allocating resources in a market economy. Loans are given to customer in order for financial institution to gain profit from each of the transactions however it is also the main risk or source for non-performing loans (NPL). NPL is a loan that is in default, or close to being default. The loan is becoming to non-performing when it is not being paid, or default for 3 consecutive months, however it can depends on the contract term. According to Oxford Dictionary of Finance & Banking (4th edition), NPL is a loan on which the interest or payment are overdue. Based to Oxford Business English Dictionary, NPL is a loan in which the borrower has not made a payment for a particular period of time therefore the bank ran into trouble with the NPL. According to Bank Negara Malaysia (BNM) Guideline (GP3), NPL is classified as non-performing when the principal or interest is due and unpaid for 6 months or more from the first day of default. The study is aimed to identify the internal and external factors, which are contributing to the rising levels of bad loans in the banking sector. The internal factors have been broadly classified to be related to either the appraisal mechanism or the monitoring and controlling mechanism. Appraisal mechanism refers to the evaluation of the loan application so as to judge whether an applicant should be granted a loan or not. Monitoring and controlling mechanism refers to the post loan disbursal activities that contribute to timely payment of interest or principal repayment by the borrower. A studied made by Justo, Nebat, Mary (2012), microfinance institutions in Kenya experience high level of NPL which threatens viability and sustainability of microfinance institutions and hinders the achievement of the company goals. The study was aimed as assessing the effectiveness of credit management systems as loan performance of micro finance institutions specifically to establish the effect of credit terms, credit appraisal, credit risk control measures and credit collection policies of loan performance. On the other hand, the external factors that contributed to increase in NPL are economic cycle, changes in Government policies, impact of liberalization on industries, and borrowers' repayment obligations.

COMPANY PROFILE

Corp Bank* (Disguised name) was established in 1960 and begin its operation at in Kuala Lumpur, Malaysia. To be the financial leader in Malaysia banking industry, Corp Bank always took the earliest initiative, a step ahead in its strategy, compare to its competitor in Malaysia. This strategy was usually then followed by most of its competitor in Malaysia. It was the first bank to introduce a rural credit scheme in 1974 and the first to introduce mobile bus banking services in 1976. Corp Bank was also the Pioneer in computerization of banking operations in Malaysia (1978) and first Malaysian bank to set up ATMs in Malaysia (1981). Corp Bank strategy for expansion in the region was always through a joint venture or acquisition of bank in other countries since mid-90.

VISSION, MISSION AND STRATEGIC OBJECTIVE

Corp Bank vision is to be a Regional Financial Service Leader. The vision is a picture of how Corp Bank should look like in the future, a core ideology and a purpose of the existence of the company. It provides the basic direction for Corp Bank development and encourage Corp Bank employee to work towards company common goal or objective. The overall concept of how Corp Bank employee should conduct themselves while working towards the company's vision is subject to the mission statement of the company. The company mission, Humanizing Financial Services across Asia, is the company core purpose which set the organization apart from other financial institution in the industry. The mission was set neither in product-specific nor in monetary related targets, but rather to reveal how should the company as a whole conduct to achieve its long term objective and to accomplish the company's vision. Corp Bank's strategic objective are specified for 2015 and the focus of this objective lie on different aspects. Corp Bank strategic objectives are used to operationalize Corp Bank mission statement and act as the basis of its intended competitive advantage in the bank industry. Corp Bank has developed the following Strategic Objectives that it aims to achieve by 2015:-

i. Undisputed No.1 Retail Financial Services provider in Malaysia
ii. Leading ASEAN wholesale bank eventually expanding further into Middle East, China & India
iii. Sustainable champion for Insurance and Takaful
iv. Truly regional organisation, with ~ 40% of pre-tax profit derived from international operations
v. Leading Islamic bank in ASEAN

Corp Bank define NPL whereby the loan is not earning income which result on the revenue and capital gains due to:

i. Full payment of principal and interest is no longer anticipated,
ii. Principal or interest is 90 days or more delinquent,
iii. The maturity date has passed and payment in full has not been made.

REVIEW LITERATURE

According to Mwengei (2013), the banking sector is an indispensable financial service sector for supporting the development plans through channelizing funds for productive purpose, intermediating flow of funds from surplus to deficit units and also supporting financial and economic policies of government. The study identified the factors contributing high rates of NPL, determine the effects of NPL, establish the trend of bad loans and determine the efforts taken to reduce the risks due to NPL. Furthermore as mentioned by Mabvure, Gwangwava, Faitira, Mutibvu, & Kamoyo (2011), loans form a greater portion of the total assets in banks. These assets generate huge interest income for banks which to a large extent determines the financial performance of banks. However, some of these loans usually fall into non-performing status and adversely affect the performance of banks. In view of the critical role banks play in an economy, it is essential to identify problems that affect the performance of these institutions. This is because NPL can affect the ability of banks to play their role in the development of the economy.

INTERNAL FACTORS OR CAUSES OF NPL

Amongst the internal factors that cause the account to turn NPL are:

a. The influence of appraisal factors,
b. The influence of monitoring and controlling factors.

Thus, it is suggested that although both appraisal and monitoring & controlling factors are playing a role in increasing bad loans, monitoring and controlling aspects need greater attention at present. According to Kwambai and Wandera (2013), commercial banks play a major role in the economy due to lending is the main activity of commercial banks, however the commercial bank have had a high rate of loan default from the borrowers which have caused significant losses to the bank. It was due to commercial banks have varied credit information and credit history about the borrowers and these borrowers will try to get as many loans from the banks which will increase the rate of default because the borrower might fail to service back all the loans. The study also identified the factors that account for bad loans and determined the economic sector that records higher bad loans and the efforts taken to reduce the risk in the sector. According to Laurine, Tendekayi and Takaiona (2012), the research findings showed that some banks were sitting on NPL due to poor credit analysis processes, wrong products offered to the clients, lending based on balance sheet strength instead of cash flow based lending, banks taking too much comfort in security, information asymmetry leading to moral hazard, economic environment and political influence.

A study made by Rajiv and Sarat (2003), evaluates as to how banks' NPL are influenced by three major sets of economic and financial factors, i.e., terms of credit, bank size induced risk preferences and macroeconomic shocks. The results suggested that terms of credit variables have significant effect on the banks' NPL in the presence of bank size induced risk preferences and macroeconomic shocks. Moreover, alternative measures of bank size could give rise to differential impact on bank's NPL. In regard to terms of credit variables, changes in the cost of credit in terms of expectation of higher interest rate induce rise in NPL. On the other hand, factors like horizon of maturity of credit, better credit culture, and favorable macroeconomic and business conditions lead to lowering of NPL. Business cycle may have differential implications adducing to differential response of borrowers and lenders. The banks can avoid sanctioning loans to the non-creditworthy borrowers by adopting certain measure as mentioned by Srinivas (2013). Account officer can constantly monitor the borrower in order to ensure that the amount sanctioned is utilized properly for the purpose to which it has been sanctioned. The account officer should get both the formal and informal reports about the goodwill of the customer. The account officer also has to educate the borrowers regarding the effects and consequences of defaulting. By considering all the above factors the account officer can reduce the NPL in a bank. Other studies made by Njanikea (2009), revealed that a number of financial institutions have collapsed or experienced financial problems due to inefficient credit risk management systems. It also established other factors that led to the banking crisis and to outline the components of an effective credit risk management system. The study found that the failure to effectively manage credit risk contributed to a greater extent to the banking crisis. The research also identified poor corporate governance, inadequate risk management systems, ill planned expansion drives, chronic liquidity challenges, foreign currency shortages and diversion from core business to speculative non-banking activities as other factors that caused the crisis. There is also a need for banks to develop and implement credit scoring and assessment methodologies, review and update the insider lending policies and adopt prudential corporate governance practices.

EXTERNAL FACTORS OR CAUSES OF NPL

Amongst the various external factors studied, the following two factors emerge quite important as their influence on the rising levels of bad loans i.e.

a. Economic down turns,
b. Default payment by borrowers.

As mentioned by Oddvar and Katrine (2007), the macroeconomic factors which function as driving forces behind developments in banks' problem loans.

Problem loans include NPL and other particularly doubtful loanwhich was highly sensitive to cyclical developments and will usually increase during economic downturns. According to Gunjan (2007), NPL or bad loans have been a menace for the banking sector across the world. The study revealed that the external factors have a higher influence compared to the internal factors. Economic downturn and wilful default have been found to be most critical while poor credit scoring skills of managers, absence of suitable administrative penalties and target completion have been found to have a significant influence amongst factors related with the loan appraisal mechanism. Seizure and disposal of collateral have been found to be the toughest challenges amongst the factors related with the loan monitoring and controlling mechanism.

As mentioned by this researcher, loan managers' level of motivation, manpower, skills to appraise collateral, efforts to reduce costs, government and political intervention and soft budget constraints have been found to have a lower influence. Furthermore Fofack (2005) has investigated the leading causes of NPL during the economic and banking crises. The results highlighted a strong causality between these loans and, economic growth, real exchange rate appreciation, the real interest rate, net interest margins and interbank loans, consistent with the causality and econometric analysis, which reveal the significance of macro and microeconomic factors. Simulated results show that macroeconomic stability and economic growth are associated with a declining level of nonperforming loans; whereas adverse macroeconomic shocks coupled with higher cost of capital and lower interest margins are associated with a rising scope of NPL.

PROBLEM FORMULATION

In this research, four research questions have been identified in order to achieve the objectives set for the research. The research questions are as follows:

a. How do the business unit define the NPL?
b. How does business unit assess and analysed the NPL?
    i. Are there any established procedures and guidelines in assessing the NPL?
    ii. What are the problems encountered in assessing and analyzing the NPL?

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iii. Is it due to economy conditions or higher interest rate or inflation rate?

c. How does business unit monitor the accounts from turning NPL?

a. What is the frequency of monitoring? Weekly or fortnightly or monthly

b. Is the monitoring effective? If yes how effective? If no what can be improved?

d. How does business unit manage the credit risk management system?

a. What are the challenges faced in managing the risks?

b. How business unit overcome the challenges?

This study has four objectives to achieve such as:

1. To understand the concept of NPL.
2. To identify the assessment and analysis of NPL by business units.
3. To study the monitoring of the accounts from turning NPL.
4. To study the management of credit risk management system.

SIGNIFICANCE OF STUDY

The research is attempt analyze the issue of NPL in business units of Corp Bank which confined to Klang Valley. It is aimed to assist business unit of Corp Bank to detect and identify the major factors that contribute to NPL and ways to reduce the amount of NPL. The research done will enable business unit of Corp Bank to find the right strategy to overcome the problem and the possible actions to be taken in order to maintain their profitability and sustainability.

DELIMITATION OF STUDY

The research has been delimited to interview questions which have been created in order to understand more on the definition of NPL, assessment and analysis of NPL, monitoring mechanism of the accounts from turning NPL and the study of credit risk management system. The interviews have been conducted with 3 selected experience employees of business unit for gathering information and data in order to know the factors that have impacted higher NPL amount and to find possible solutions to reduce the amount of NPL.

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CONCEPTUAL FRAMEWORK

A conceptual model is one theory makes a logical sense of the relationships among several factors that have been identified as important to the problem.
As per figure 1 below, it shows the conceptual framework which has been selected as guidance for further exploration on the enhancement of the factors contributed to NPL.

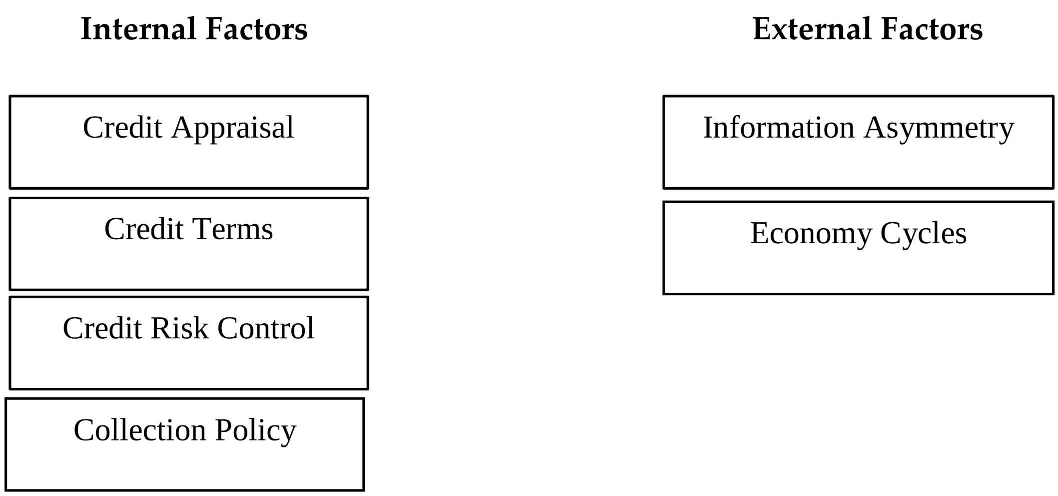

Figure 1: Conceptual Framework on Factors that Contribute to NPL.

The definition of the internal and external factors which contributed to NPL is as below:

a. Credit Appraisal

For credit appraisal, the five characteristic have been chosen in assessing the creditworthiness of the borrower i.e.

i. Character

Character basically is a tool that provides weighting values for various characteristic of a credit applicant and the total weighted score of the applicant is used to estimate his creditworthiness.

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ii. Capacity

Capacity of the borrower includes the personal factors such as age, life cycle stage, occupation, income or economic situation and personality.

iii. Collateral

Collateral represents assets that the company pledges as alternative repayment source of loan. Most collateral is in form of hard assets such as real estate and office or manufacturing equipment.

iv. Capital

Capital is the money where the borrower has personally invested in the business and is an indication of how much the borrower has at risk should the business fail.

v. Condition

Condition refers to the borrower's sensitivity to external forces such as interest rates, inflation rates, business cycles as well as competitive pressures. The conditions focus on the borrower's vulnerability.

b. Credit Terms

The credit terms will specify the credit period and interest rates. Credit period refers to the period of time in which the credit is granted. The length of the credit period is influenced by collateral value, credit risk, the size of the account and market competition.

c. Credit Risk Control

Credit risk is the bank's risk of loss arising from a borrower who does not make payments as promised. Bank losses include lost principal and interest, decreased cash flow, and increased collection costs.

d. Collection Policy

There are various policies that bank should put in place to ensure that credit management is done effectively. The collection policy is needed because all borrowers do not pay the firms bills in time. Some borrowers are slow payers while some are non-payers. The collection effort should, therefore aim at accelerating collections from slow payers and reducing bad debt losses.

e. Information Asymmetry

Information Asymmetry is a situation whereby the borrower knows more about the scenario and risk facing in their business.

f. Economic Cycles

The economic cycle (or business cycle) refers to economy-wide fluctuations in production or economic activity over several months or years. These fluctuations occur around a long-term growth trend, and typically involve shifts over time between periods of relatively rapid economic growth (an expansion or boom) and periods of relative stagnation or decline (a contraction or recession).

Definition of Terms

The following definitions provide the meaning of which loans are classified in this study:

a. **Good**

Performing accounts where timely repayment of outstanding credit facility is not in doubt. Repayment is prompt and credit facility does

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not exhibit any potential weaknesses in repayment capability, business, cash flow or financial position of the borrower.

b. Watch list (WL)

Accounts with weaknesses or potential weaknesses which require close monitoring and pro-active account management to protect bank's position. If theses weaknesses are not corrected they may result in deterioration of repayment prospects, with the likelihood of downgrade to Special Mention Accounts within 12 months.

1. Special Mention Accounts (SMA)

Accounts well defined weaknesses that give rise to serious concern that payment of either interest or principal may default. Debt repayment will require restructuring of debt, restructuring of the business, liquidation of assets or any combination of these.

2. Non-Performing Loans (NPL)

Accounts where the outstanding credit facility is not collectable and little or nothing can be done to recover the outstanding amount from any collateral or from the borrower's assets generally. Loan is past due for 180 days or more.

3. Rescheduling & Restructuring (R&R)

In the prevention process, all business units should be alert for signs of accounts becoming potentially delinquent or non-performing and to take early remedial action including rehabilitating borrowers facing temporary cash flow problems. R&R will provide reasonably effective measures to rehabilitate borrowers facing temporary cash flow problems and allow for turnaround.

R&R provides the opportunity for the repayment of a problem loan to start afresh and for the reclassification of a NPL to performing status. The mandatory criteria for rescheduling and restructuring are:

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a. Genuine and valid reasons for the R&R,
b. Submission of documentary evidence of contracted sales orders or awards of projects,
c. Satisfactory evidence of business continuity,
d. Satisfactory evaluation of financial projections including cash flow, projections that match the terms of R&R requested with the supporting basis and assumptions,
e. Satisfactory conduct of account over the past 6 months,
f. No legal impediments to the R&R,
g. Nor for ever greening (i.e. accounts are not to be rescheduled if the above criteria are not met),
h. Company not placed under receivership or being wound-up by other banks.

STATEMENT OF THE PROBLEM

The aim of the study is to gather what factors contributed to higher amount of NPL and the remedies action to reduce the performing account from turning bad loans or NPL.

FINDING

In data analysis, the researcher has to go through the following processes i.e.

a. Interviewing three informants,
b. Manually coding the interview transcriptions for all the three informants,
c. Preparing the coding templates for the three informants,
d. Finding the themes analysis.

The following four designed research objectives as mentioned below are gathered in order to find the appropriate themes in managing and controlling the NPL.
a. Understanding the concept of NPL,
b. Identifying the assessment and analysis of NPL by business units,
c. Studying the monitoring of the accounts from turning NPL,
d. Studying the management of credit risk management system.

Few parts of the generated themes have been rated by two inter-raters in order to access reliability of the researcher's finding. The percentage of agreement the two sets of coding on each discourse unit were calculated by averaging out both inter-rater scores for the final result. In addition the researcher will also discuss the analytic strategy on the process flow of loan processing for an overview of the loan application until the loan has been approved and accepted by the borrower.

ANALYTICAL STRATEGY - PROCESS FLOW OF LOAN PROCESSING

Each an individual loans need to be accessed thoroughly to avoid the account from turning NPL. The process flow of loan application starts with the prospect for new applications was either through walk in customers, business referral from branches, other organizational or unit or third party e.g. existing borrowers etc. Pre-qualification occurs before the loan process actually begins, and is usually the first step after initial contact is made. The account officer gathers information about the customer's creditworthiness, income and debts of the customer and makes a financial determination about how much loan the customer may be able to afford. This document may consist of Memorandum and Article of Association, Form 49 & 24, tax returns, bank statements, audited or un-audited financial statements or management accounts and any other information the lender deems necessary. Once all the necessary documents have been compiled, the account officer will be filling out the application paperwork and may also seeking for additional questions in order for the account officer to comply Maybank's policy of "Know Your Customer". The customer needs to answer all questions truthfully, because falsifying information on the loan application may result in criminal charges.

When all the documentation is received then the account officer will verify and validate all of the information to be true and correct. Verification requests may be sent to the other lending departments. When all the information is collected the account officer reviews and evaluates the credit reports, verifies the borrower's debts and payment history and conduct preliminary check on Central Credit Reference Information System (CCRIS) on exposures with other financial institutions to facilitate borrower's holistic bank borrowings and repayment behavioural, risk grading via Credit Risk Rating System (CRRS) to determine Borrower Risk Rating (BRR) and Facility Risk Rating (FRR) associated to the borrower. If there are unacceptable late payments, collections for judgment, etc., a

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written explanation is required from the borrower. Once the account officer completes its review of the application, it will send the loan paper to the approving authority e.g. Review Committee, Credit Review Committee and Group Management Credit Committee for making a decision. If the loan is approved for the amount requested, there will be some additional paperwork required to finalize the loan before the process is complete. The approving authority may approve a loan for a lesser amount than the borrower requested or decline the loan application. Letter of offer will be issued and need to be accepted as per the terms stipulated by the borrower in order for Corp Bank to further document, disburse and release the amount approved. Borrower will pay the monthly instalment and proper monitoring and follow up being made by the account officer including to send reminders to existing borrowers for update or settle or regularized arrears on outstanding loans etc. As per table 1 below,it shows the Corp Bank numbers for total loans balances, NPL balances and the NPL ratio for quarter basis starting from March 2012 until Mar 2014. The data shows the NPL ratio has been decreased from quarter to quarter however if the loans not being managed properly the NPL ratio may tend to increase again for instance from Dec 2012 to March 2013 from 1.81% to 1.92% and from Dec 2013 to March 2014 from 1.51% to 1.54%.

Table 1 : Total Loans (RM'000), NPL (RM'000) and NPL ratio (in %). Data source from Corp Bank website of Investor Relations.

Year	**Quarter**	**Total Loans RM'000**	**NPL RM'000**	**NPL Ratio**
2012	Mar-12	279,085,104	7,012,819	2.51%
2012	Jun-12	295,663,090	6,053,999	2.05%
2012	Sep-12	297,587,911	5,799,020	1.95%
2012	Dec-12	311,824,735	5,654,352	1.81%
2013	Mar-13	316,469,377	6,078,752	1.92%
2013	Jun-13	325,963,082	6,177,711	1.90%
2013	Sep-13	333,477,732	6,212,002	1.86%
2013	Dec-13	355,617,527	5,360,903	1.51%
2014	Mar-14	360,120,560	5,561,162	1.54%

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ANALYSIS OF DATA

Detail analysis of data will analyses on each interview questions according to the four designed research questions. Each theme is further discussed under each question:-

RQ 1 : HOW DO THE BUSINESS UNIT DEFINE THE NPL?
Interview Q 1 : How does the NPL being defined?
Themes : Internal Standard policies (e-SPI).

According to all informants, the definition of NPL is properly written in internal standard policies and procedure and as per BNM definition. They commented that:

Informant 1 :*NPL is being defined exactly based on the root cause of NPL being classified in Maybank.*

(DU 2)

Informant 2 :*They are vary stages how we would identify the NPL account.*

(DU 4)

Informant 3 :*Corp Bank NPL definition should be the same as Bank Negara guideline which was governed by the old GP 3 guideline.*

(DU 4)

Interview Q 2 : Does the definition of NPL in business unit as per BNM - definition?
Themes : BNM guidelines.

According to all informants, NPL has been defined strictly as per guidance issued by BNM. They commented that:

Informant 1 : *Based on BNM guidelines classification of NPL. All based on BNM guidelines.*

(DU 4 & 20)

Informant 2 : *Strictly follow Bank Negara guidelines.*

(DU 6)

Informant 3 : *Corp Bank NPL definition should be the same as Bank Negara guideline which was governed by the old GP 3 guideline.*

(DU 4)

Interview Q3 : Do the customers aware on the consequences on the - classification of NPL?

Themes : Offer Letter.
Engagement with customers.
Customer duties and responsibilities.

The offer letter that has been signed by the borrower has stipulated the implications of account turning NPL which will result in future actions taken by the bank. Before the account turning NPL the account officer will actively communicate and discuss with the borrower either to reschedule or restructure the account. It is also the duties and responsibilities of the borrowers to make the prompt repayment to avoid the account turning NPL. They commented that:

Informant 1 *: We highlight this it in the letter offer. The bank rights to recall, banks right to take legal action we already highlighted in letter offer.*

(DU 22)

Informant 2 *: Engage with customer on numerous occasion and we do give a chance to the customer to restructure the account.*

(DU 8)

Informant 3 *: Yes and No. Some customers they will make aware by our front liners, some customers just don't bother at all, so if it is a continuous process that it is important for them to update, keep the repayment prompt so that it doesn't affect their rating and the track record.*

(DU 6)

Interview Q4 : Do the customers negotiate on the repayment of loan balances in order for the loans not turning NPL?

Themes : Communication and negotiation process.

The borrower will proactively inform the bank on their repayment obligation in any circumstances and account officer will negotiate with borrower on the repayment proposal. They commented that:

Informant 1 *: In all circumstances we negotiate with the customers for the repayment proposal to avoid the account from turning NPL.*

Informant 2 : *We would actually seat down with customer before the account being classified NPL to see how not to classify it as NPL but to classify is as R&R (Restructured and Rescheduled account).*

(DU 10)

Informant 3 : *They come back proactively to tell the banker the problem that they are facing.*

(DU 10)

Interview Q 5 : Do the customers granted any exemptions on classification of NPL?

Themes : Restructure and Repayment.
Watch list account.

If the borrower requesting for an exemption, the account officer has to prepare a proposal paper to the approving authority on granting the reschedule or restructure the facility. In addition the watch list account is also being monitored closely in order to avoid the account turning NPL. They commented that:

Informant 1 : *Yes all the facilities we can grant rescheduled or R&R. The bank will still do normal review based on the findings they will approve accordingly.*

(DU28&30)

Informant 2 : *That also a watch list account whereby we monitor closely for the repayment.*

(DU 10)

Informant 3 : *The banks are able to do the R&R for them either restructure or reschedule the repayment to suite their cash flow that hick up so they must come back.*

(DU 10)

RQ 2 : HOW DOES BUSINESS UNIT ASSESS AND ANALYZED THE NPL?

a. **Are there any established procedures and guidelines in assessing the NPL?**
b. **What are the problems encountered in assessing and analysing the NPL? Is it due to economy conditions/higher interest rate/inflation rate**

Interview Q 1 : **How do the internal and external procedures and - guidelines - assist in assessing and analyzing the NPL?**
Themes : **Periodical review to access current situation.**
Internal Standard policies (e-SPI).
R&R Framework.

The internal standard policies and procedures are maintained by the bank on classifying the account to NPL. Account officer will do the periodical review in order to access the creditworthiness of the borrowers. Through periodical review the account officer may detect any abnormality in borrowers' repayment obligations. The account officer may either reschedule or restructure the facility in order to avoid the account to turn NPL. They commented that:

Informant 1 : *In the review, the periodical review the originator will be able to access the current situation and find some remedies to avoid account turning NPL or propose some action plan to avoid the account from turning NPL and also in this case the R& R or reschedule application will take in place will be put in place to avoid the account turning NPL.*

(DU 32)

Informant 2 : *There is SPI whereby guided by our SOP in how to classify this account as NPL internally and externally from Bank Negara.*

(DU 12)

Informant 3 : *The R&R framework is accept by Bank Negara but then every bank would then have to formulate the internal policy with the Board approval.*

(DU 12)

Interview Q 2 : **What are the standard procedures of the other banks?**
Themes : **BNM Guidelines.**
CCRIS Framework.

The bank is strictly following the BNM guidelines and CCRIS framework. Each bank does have the access to check on the credibility of each borrower before the loan is approved. They commented that:

Informant 1 *:As for the guidelines I think, we are strictly following Bank Negara guidelines. But anyhow the R&R all that is up to the discretion of the bank.*

(DU 36)

Informant 2 *:Yeah because all the banks in Malaysia is governed by Bank Negara Malaysia so the same procedures apply.*

(DU 14)

Informant 3 *:Nowadays very transparent under the CRISS framework. The CRISS not only show you the character in the loan repayment it also contain many other information that would be very useful for FI in accessing the credit.*

(DU 8)

Interview Q 3 **:Are there any templates driven in assisting and - analyzing the NPL?**
Themes **:No template however identification of stress account. Trigger checklist for large borrower.**

There is trigger checklist however due to different nature of business between borrowers the checklist is not standardize between borrowers. The quarter checklist is to check on the large borrower accounts by the respective account officer accordingly for detecting any stress account. They commented that:

Informant 1 *:It may vary from customers to customers depending on the nature of business. Not actually template it is like more to identifying the causes of account turning bad or business failure.*

(DU 38)

Informant 2 :*Maybank, we do have the trigger checklist ok. This trigger checklist is actually from our internal whereby the originators need to check every quarter on this large borrower.*

(DU 16)

Interview Q 4 **:Do the templates assist in assessing and analyzing the NPL?**
Themes **:Fill up during periodical review.**
Ample document/system/procedures

The templates being prepared during the periodical review one by the account officer. In Maybank, there is also ample of documents, system and procedures in assisting the account officer in identifying the problematic accounts. They commented that;

Informant 1 :*This template is required to be filled up when they conducting the review. When they are doing the periodical review.*

(DU 42)

Informant 2 :*There is ample document or system or procedure in Corp Bank which can actually assist the originators in identifying these problematic accounts.* (DU 16)

Interview Q 5 **: What is the effectiveness of the templates?**
Themes **: Detection the warning signal/stress account, address root and -find remedies.**

The temple assists in detecting the warning signal or stress account to find the root causes and possible remedies. They commented that:

Informant 1 : *From the template when they answer some questionnaire they'll be able to detect the early warning signal then they'll be able to address the root cause and find remedies for the causes.*

(DU 42)

Informant 2 : *In identifying a stress account.*

(DU 20)

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Interview Q 6 : Does the templates being reviewed to improve the - analysis of NPL?
Themes : LMC and Risk Embedded Unit.
Reviewed accordingly

The templates being review accordingly to improve the account from turning NPL. They commented that:

Informant 1 : All accounts turning NPL the LMC or the Risk Embedded Unit will do the post mortem on the causes of account turning NPL.
(DU 44)

Informant 2 : Yes always being reviewed as and when there is a need and as and when they found you know that there is some lapses.
(DU 18)

Interview Q 7: Does the analysis done thoroughly in assessing the - customers?
Themes : A case study report.
Special Mention Account Unit.
BNM analysis.

A case study report being sent to the account officer in assessing borrowers respectively. In addition, SMA also analyze on ways to improve the existing templates in order for the bank to cover all the consequences. As a regulator to all banks in Malaysia, BNM also has made further analysis in monitoring the NPL. They commented that:

Informant 1 :On quarterly basis they will send the report to all BCs for them as a case study.
(DU 46)

Informant 2 :Special Mention Account Unit always analyzing on ways in how to improve the templates so that can cover all the consequences.
(DU 18)

Informant 3 :I think Bank Negara has set the tone. They have already introduces new measures to cool down the property speculation.

(DU 28)

RQ 3 : HOW DOES BUSINESS UNIT MONITOR THE ACCOUNTS FROM TURNING NPL?

a. **What is the frequency of monitoring? Weekly/ Fortnightly/Monthly**
b. **Is the monitoring effective? If yes how effective? If no what can be improved?**

Interview Q1 : Has the customers being visited to have the feasibility of their operation activities?
Themes : Internal Standard policies (e-SPI).

As per internal guidelines, the customers need to be visited at least four times in a year to have the visibility on the borrower creditworthiness. They commented that:

Informant 1 : As required by our guidelines they have to visit at least four times in a year to the customers.

(DU 54)

Informant 2 : We do our visit because we do have our guidelines on visitation of customers and it is actually based on amount those customers. So it is actually being conducted by our originators.

(DU 24 & 26)

Informant 3 : Of course of course.

(DU 40)

Interview Q 2 : Is there any visibility on the changes of customers' operation activities during their visit?
Themes : Detecting during visitation.
Proactively identify account under stress.

During the visitation, account officer may detect any irregularities on borrowers' business. Account officer also may proactively identify any possibilities on the account turning stress. They commented that:

Informant 1 *:We visit the customer when you prompt the customer will be able to find out whether the actual management team has been changed or they have already diverting to anything else all this is possible to be detected.*

(DU 56)

Informant 2 *:We'll be able to detect whether the customer actually concentrating on that business or they are actually diversifying their business.*

(DU 28)

Informant 3 *:It has to be proactive. When you see the account under stress we must identify the root causes. You need to identify the root causes banks are able to provide solutions.*

(DU 42 & 44)

Interview Q 3: Do the customers disclose and share any obstacles in managing their operation activities?
Themes : Customer duty.
Saturated market.

Borrower is responsible to inform on any obstacles face by them however they may also hide the problem from the account officer thus the account officer need to be alert on the changes of borrowers' business. They commented that:

Informant 1 *:It is the duty of the customer to inform but more often if the customer knows this will be their plus point if not mention they might not mention to the originator.*

(DU 58)

Informant 2 *:Yeah. And furthermore because we do have saturated market so we do hear from other customers as well what this customers are up to. So we able to find out.*

(DU 30)

Interview Q 4 : What is the problem face in monitoring?
Themes: Original assessment.
Prompting and asking customers.

The original assessment is the main analysis in detecting the NPL and the challenges during asking the customer for true and sincere answers. They commented that:

Informant 1 *:The originator has to fall back to the original assessment done by him before he put up the loan then from there he can uses as a check to check back whether the same criteria still applicable to this borrower at the point of time.*

(DU 62)

Informant 2 *:We always prompt them and ask them what is the percentage of them diversifying into other business.*

(DU 28)

Informant 3 *:There are always different type of challenges. Sometimes customer may not want to take your phone call. So the moment you chase them, you press them even visitation to proactively ask the borrower to solve like if you are over committed may be when time are still ok you diverse some of your asset holding.*

(DU 38)

Interview Q 5 : Does the current monitoring effective?
Themes : Very good tool.
Early alert committee meeting.
Monitor closely and effectively.

There is close and effective monitoring and also the early alert committee assist the account officer in monitoring the borrower's account. They commented that:

Informant 1 *: As Corp Bank concerns everything has been intact. It is very good tool to follow up for review and to detect any early warning signal.*

(DU 64)

Informant 2 *:Yeah they do have a unit here to follow up regularly every month or every week on the payment made. And also they do have this early alert committee meeting, every quarterly whereby they will engage* *with every BC what is the next step of action against this customer if let say they see any red light in the repayment.*

(DU 34)

Informant 3 *:It has to be. If you monitor it closely and effectively it would - control.*

(DU 34)

Interview Q 6 **: What action being taken to improve the monitoring?**
Themes **:Very stringent process.**
Asset Quality Management team.
Using modern communication tools.

The process itself is very stringent and does comply with BNM requirement. Asset Quality Management teams also monitor and prompt the business unit on any alert. In addition by using the modern communication tools it will assist in further monitoring processes. They commented that:

Informant 1 *:The process itself very tight and very stringent and always comply to the requirement of Bank Negara and the internal procedures.*

(DU 78)

Informant 2 *:The Asset Quality Management, all of them are actually monitor those accounts, anything prompts them, any alert is actually they will prompt the business unit.*

(DU 42)

Informant 3 *: Using the modern communication tools email, SMS, even call centre they have automatic re-dail and all this.*

(DU 38)

Interview Q 7 **: What is the trend of customers being classified as NPL?**
Themes: **Proper monitoring and managing the stress account.**

The internal and external factors are the main contributor for the NPL thus proper monitoring and managing of stress account need to be handled by the respective account officer. They commented that:

Informant 1 *:The change in management or miss management. Secondly could be concentration risk like concentration risk like customer also involve with other customer supplying the same product which was not very competitive which has less demand in the market then it will be losing in the market share, the pricing and all that or the customer is diversifying to a new business which is not very familiar with is taking the risk then intentional fraud by the customer himself then the staff competency this is referring to the weakness of the bank's originator or the bank's officer who can be exploited and fourthly I think we can also mention about external factors which can affect the business performance.*

(DU 68)

Informant 2 *: Currently is in on reducing trend. Being well managed. We can minimize but close monitoring and the BC Head, the supervisor of each business centre need to be careful when evaluating this account and they need to have regular contact with the customer and also other business other competitors, their competitors to check out what's happening on this customer. The competitors will know best on these customers.*

(DU 36, 38 & 46)

Informant 3 *: Not only in Klang Valley, I think the whole country debt has got something to do with general health of the economy. The new account that is under stress is more and more now so it is important for us to manage the under the early care.*

(DU 14 & 54)

Interview Q 8 : What are the effectiveness & efficiency of the new staff?
Themes : Staff competency.
Staff experience.
No authority limit.

Processing the credit paper need some time to be learnt. Staff competency and experience need to be enhanced for having the skilful and experience staff. They commented that:

Informant 1 *:Credit basically need some time to learn we can't learn overnight so the staff competency plays very important role. The staff has to be well verse on all the aspects and he has to be wisdom assessment based on the current scenario, the past record and future potential of the business.*

(DU 80)

Informant 2 *:Two years, you have to have the experience because the first year they need to get the experience in going to our system, following up procedures but to handle problematic account they need the experience because first they have to understand what that all credit about then what are the triggers of this adverse record then only they can only able to identify all this red flag. So the guidance from the supervisor is very crucial and for this kind this group of officers lot of monitoring on this account need to be by their supervisor.*

(DU 50)

Informant 3 *: Nothing to do with the new recruit because new recruit do not hold an AL to approve not only here the other bank the approving structure. Depend by bank by bank how you delegate the approving power.*

(DU 18)

Interview Q 9 : How does existing staff cope with current environment?
Themes : Guidance from supervisor.

The staff need to be guided by their supervisor since credit is not static and the challenges do happen in daily works. They commented that:

Informant 1 *:At least I think about 3 years to know this job but it doesn't guarantee he will well verse on the job. At least 3 years for him to meet basic requirement.*

(DU 82)

Informant 2 *:It also experience and not experience also plays a major part because nowadays you see those account turning NPL are those long term customers. Operates the business differently or aggressively.*

(DU 60 & 66)

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RQ 4 : HOW DOES BUSINESS UNIT MANAGE THE CREDIT - RISK - MANAGEMENT SYSTEM?

a. What are the challenges faced in managing the risks?
b. How business unit overcome the challenges?

Interview Q 1 : How adequate and reliable the credit risk management system?
Themes : Highlight as learning point.
Prompt on large borrower account.

The credit risk management system will assist the account officer in highlighting as the point and prompting on all the large borrowers' account. They commented that;

Informant 1 : *On quarterly basis they will highlight this as a learning point for the existing and new originators.*

(DU 88)

Informant 2 : *Here is I think is our risk management Business Banking right, they actually prompt us on those account those large borrower.*

(DU 40)

Interview Q2 : What is the effectiveness of the credit risk management - system?
Themes : Monitor and prompt on any alerts.

The credit risk management system is to monitor and prompt on any alerts on the borrowers' account. They commented that:

Informant 1 :*Based on the data, the historical data and the post mortem done on the NPL, they will highlight to all originators on the root cause the account turning NPL because of these factors. To proceed or not to proceed, how to mitigate all these.*

(DU 90&92)

Informant 2 :*The Asset Quality Management, all of them are actually monitor those accounts, anything prompts them, and any alert is actually* *they will prompt the business unit.*

(DU 42)

Interview Q3 : Does alert framework signal assist on the effectiveness of risk assessment?

Themes : Very good tool.
Watch list and SMA.

The alert framework is a good tool in assisting any accounts inclusive of watch list and SMA. They commented that:

Informant 1 :It is very good tool to access because it will highlight any risk, the future risk also going will be merged on this account. All these are our tools to gage whether customers having any financial difficulties on this kind of things or potentially this account may turn NPL.

(DU 94 & 100)

Informant 2 : We will be very careful if there is a change in Management.

(DU 72)

Informant 3 : Bank again they have their various measures being classify between watch list and SMA before it deteriorate further.

(DU 32)

Interview Q4 : Do the credit risk management systems being reviewed to improve the effectiveness of managing the risks?

Themes : On-going process.

The process being reviewed proactively thus the risk can be managed accordingly. They commented that:

Informant 1 :This will be on-going process because credit is not static, it is new thing and every time there's a new case coming in, new factors coming in so they'll update and review also.

(DU 102)

Interview Q5: Does the restructuring and rescheduling of loans repayment assist on managing the customers from turning NPL?

Themes: R&R Framework.

Before the account turning NPL, account officer will assist the borrower by rescheduling the account. They commented that:

Informant 1 : *Try to assist customer to do the R&R or reschedule the loan for the customers. Failing which if the R&R or reschedule is not taken place also fail then only the account being classified as NPL.*
(DU 26)

Informant 2 : *Not to classify it as NPL but to classify is as R&R (Restructured and Rescheduled account). That also a watch list account whereby we monitor closely for the repayment.*

(DU 10)

Informant 3 : *The R&R framework is accept by Bank Negara.*

(DU 12)

Interview Q 6 : Is there any exit plan for NPL customers?
Themes : Exit plan.

The exit plan occurs when the borrower is no longer in business. The informant commented that:

Informant 1 : *Exit plan normally will take place when the customer out of business or not doing any business or the facility not being used for the intended purposes.*

(DU 104)

MAJOR FINDINGS AND INTERPRETATION

The findings of the study examined on four ideas i.e.

a. Understanding the concept of NPL,
b. Identifying the assessment and analysis of NPL by business units,
c. Studying the monitoring of the accounts from turning NPL,

d. Studying the management of credit risk management system.

As a result the findings revealed that in order to avoid the account turning NPL, the account officer needs to monitor closely each borrower by performing thorough review on the loan facility and performing visitation to borrowers' premises to have the feasibility on the existing business. Herewith are some lists of potential cases where about the early signal of stress account i.e.

a. Deterioration in the borrower's cash flow position (including a change in the percentage of cash to total assets over a period of 2 years),
b. Deterioration in key financials (e.g. continuous loss),
c. Disproportionate rise in current debt,
d. Decline gross profit margin,
e. Rating's changes i.e. downgrading,
f. Sudden jump in the size of debt request,
g. Lack of visible management succession planning and/or turnover of key players,
h. Change in key management,
i. Poor industry outlook,
j. Default on other commitments with Corp Bank or other creditors,
k. Growth that strains management capabilities,
l. Inability to obtain financial statements on a timely basis.

CONCLUSION

The new conceptual framework as per figure 2 below, being named as MACNA (Manage and Control NPL Account) has been created by the researcher in finding the possible ways to manage and control the NPL.

The study introduces five main topics on the enhancement of NPL in order for Corp Bank to have a positive impact by reducing the NPL.

a. Objective

The objective of this new conceptual framework is in managing and controlling NPL in order to reduce the number of borrowers turning bad.

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b. Contributing Factors

There are two main contributing factors which lead to NPL i.e. internal factors and external factors. These two factors have been discussed detail in the conceptual framework under chapter one.

c. Improvement

Researcher has chosen continuous training and market intelligence as another process of improvement. Since the credit skill is not static, the account officer needs to be trained proactively and aggressively in order for them to access their credibility in managing the borrowers' account. In addition by having a continuous training it will also enhance the existing knowledge and sharing the issues or problems face by the other account officers. Beside training, the account officer also need to be updated regularly on the current market intelligent in order for them to be aware on the latest and update issues in the current market.

d. Impact

By reducing the NPL, it will impact the staff competencies in processing and reviewing the loan application. Staff may be aware and alert on the surrounding issues and have the capacity in overcoming those challenges.

e. Result

As a result of reducing the NPL it will benefit Corp Bank as a whole by having higher profit and higher return of dividend to shareholders, good company image, trust from the public and leader in the market as per the Strategic Objectives as mentioned in chapter one.

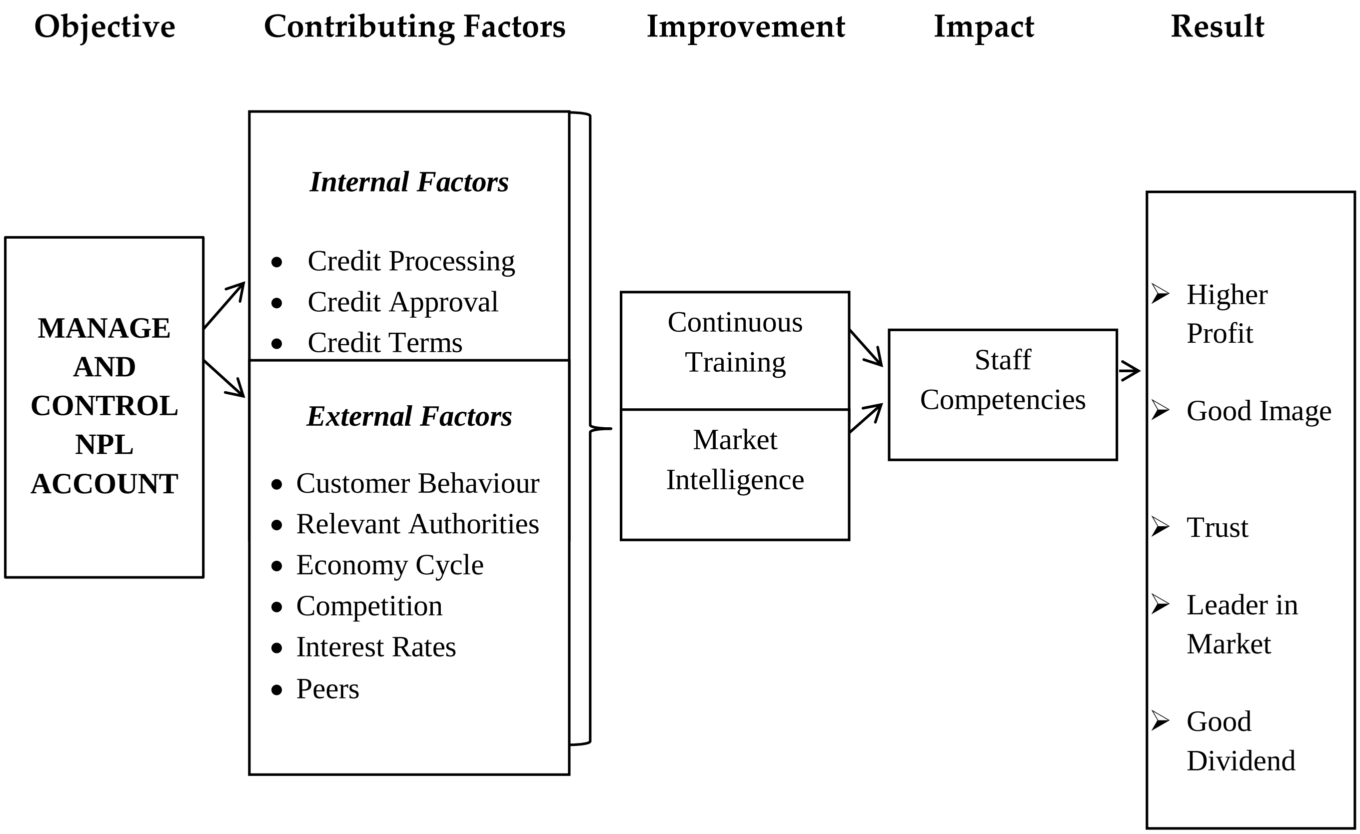

Figure 2: MACNA (Manage and Control NPL Account)

In summary this study has explained on the internal and external factors which have been contributed to NPL and finding remedies and ways to reduce the NPL amount. It revealed that by reducing NPL it will lead to profitability and sustainability of Corp Bank in the presence country.

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