How Sri Lankan Private Commercial Banks Manage Non-Performing Loans

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Abstract

Commercial banks play a crucial part in any country's financial and economic stimulation process. Credit risk is the likelihood that a bank's borrowers will fail to fulfill their contractual obligations within the agreed-upon credit period. International regulations require loans to be classified as non-performing when principal and interest earned are 90 days overdue or repayments are not likely to be fully collected. This study aims to identify strategies formulated by licensed commercial banks focused on their corporate borrowers to manage the NPL ratio under adverse economic conditions. For the study, the most severely affected five private commercial banks listed on Colombo Stock Exchange (CSE) were selected as the sample. This study used primary data to investigate how Sri Lankan private commercial banks manage non-performing loans under adverse economic conditions. The primary data was collected via structured interviews based on a questionnaire that includes open-ended questions. Based on the eight initial interviews the study found that most of the banks survive the NPL problem by implementing loan modification programs, such as increasing the loan duration, reduction of interest rates, and offering grace periods and step-up plans. Apart from these loan modification programs banks pay very close attention to their Early Warning Systems and they closely monitor and do many follow-ups when such early warnings are identified. During this NPL problem banks are strictly complying with rules & regulations to mitigate the risk associated with NPLs.

Keywords: Bank Lending, Commercial Banks Bad Debt, Credit Risk Management, Non-Performing Loans Under Financial Crisis

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