

Impact of Non-performing Investment on Bank's Profitability- A comparative study between SJBL and AAIBL

¹Muhsina Aktar, ²Dr. Md. Firdaus Hossain,

¹Assistant Professor, Department of Business Administration, Manarat International University

²Associate Professor, Department of Islmaic Studies, Bangladesh Islami University

DOI: <https://doi.org/10.51244/IJRSI.2025.12020020>

Received: 22 January 2025; Accepted: 27 January 2025; Published: 28 February 2025

ABSTRACT

The aim of this study was to make a comparative analysis of Non-performing Investment on Bank's Profitability between Shahjalal Islami Bank PLC. and Al-Arafah Islami Bank PLC. The study consists five years data of two sample banks and use both primary and secondary data sources to analyse the data. This research conducted a survey using five-point likert model questionnaire from 04 branches of both sample banks to identify the factors responsible for NPI. Poor loan Monitoring and Political Influence regarding loan sanctioning and disbursement plays a vital role to increase NPI as per the opinion of bankers from selected sample banks. This research shows that Non-Performing Investments (NPIs) badly affects the financial condition of both banks by decreasing profitability, using up the liquidity and stretching the capital adequacy ratios. In both sample banks, NPI is increasing over the years and maximum percentage of NPI is in agricultural sector. However, In some year though the NPI ratio was reduced but it has no impact on ROE and ROA because of some other positive factors. This paper also emphasize having Islamic practices in recovery processes and industry-specific approaches to increase financial resilience. This paper doesn't conduct any survey among bank's customer to identify the factors responsible for non-performing investment and used only ten factors by reviewing several literatures to identify the NPI factors. The present study opens an avenue for more studies in this direction.

Keywords: Non-performing Investment, Return on Asset, Net Profit Change, Return on Equity, Profitability.

INTRODUCTION

Non-performing investments (NPIs) are emerging as a key issue for the Bank and its stakeholders. These investments do not yield the intended benefits, as often external economic factors, management decisions, or defaults hinder them (Hasan, 2023). Hence, for an Islamic bank which is already operating under the legal guidelines of Shariah law, managing the NPI is even more challenging. The provision of Shariah restricts Shariah-compliant banks; they cannot, for instance, use Penalty interest as a tool for dealing with such matters.

The improvement in NPIs significantly impacts bank's economic sustainability. The level of NPIs decreases the bank's profitability, liquidity, and capital core size. They compensate for reduced operational efficiency and limit new possible investments in projects and acquisitions (Usmani, 2021). In the long run, if sustained, it destabilizes stakeholder confidence and the bank's viability.

As financial stability is crucial in banking, the management of strategies NPI is vital. Identifying the factors likely to provoke such investments and providing equally useful recommendations to the bank will help achieve the goal. Thus, for the bank to feel confident about the overall soundness of its practice in conformity with its Islamic provisions, it has to undertake this research.

This research is Understanding the contribution of non-performing investments (NPIs) to the financial system's stability is an important consideration of this research concerning Al Arafah Islami Bank and Islami Bank Bangladesh Limited. Compliance with NPIs is incredibly challenging for Islamic banks because the solutions have to be Shariah-compliant and do not involve components of penalties such as interest charges or a sale of

the security. These challenges must be addressed with measures that cannot go against the precepts of Islamic banking.

The relationship between Islamic banking and NPI management solutions is critical. Thus, it improves fund management and provides a means of avoiding the nasty issues of unethical and religious interpretations. The implications of this research are that Islamic banks will be in a position to consider how they can tackle NPIs while implementing the Shariah provisions.

Research Objectives

Broad Objective

The broad objective is to assess the impact of non-performing investments on the financial stability of two sample banks. Without these the specific objectives are:

Specific Objectives

- ❖ To identify the key factors contributing to non-performing investments.
- ❖ To analyse the impact of non-performing investments on the bank's financial stability.
- ❖ To provide some suggestions to formulate effective management strategies aligned with Islamic banking principles.

METHODOLOGY OF THE STUDY

1. **Research Design:** Employ a quali-quantitative approach to deeply understand the dynamics of non-performing investments within the framework of Islamic banking principles.

2. **Data Collection:**

- **Primary Data:**

Sample Size: 50 Bank Employees from two sample banks,

Questionnaire: Use Five-point likert scale questionnaire

Sampling Technique: Convenient and purposive sampling methods are used to select sample respondents.

- **Secondary Data:** Gather financial statements, research articles, and official bank reports from Bank's official website, Bangladesh Institute of Bank Management, Wikipedia, and Investopedia.
- **Data Types:** Bankers' perception regarding key factors, financial data, scholarly articles, and industry reports about Islamic banking and non-performing investments.

3. **Data Analysis Tools:**

- **Excel:** Applied for quantitative assessment of the changes in loan portfolio, recovery ratio, and non-performing assets.
- **Thematic Analysis:** To categorize thematically and pattern out facts based on the qualitative information about the involvement and effect of non-performing investment.

LITERATURE REVIEW

Uddin (2022) examines the impact of leverage, operating efficiency, non-performing loans (NPL), and capital adequacy ratio (CAR) on the profitability of commercial banks. Using a purposive sample of four state-owned and six private commercial banks, the study analyzes secondary data from annual reports covering four years (2017-2020). Employing a panel data regression model, results indicate that leverage, measured by debt-equity ratio (DER), and NPL have a negative and insignificant effect on profitability (ROA). Conversely, operating efficiency, measured by the BOPO ratio, exhibits a positive but insignificant impact on ROA. Additionally, the study finds a positive and significant relationship between capital adequacy ratio (CAR) and ROA.

Rahman (2022) examines the macroeconomic determinants of non-performing loans (NPLs) in Bangladesh from 1990 to 2020. Using time series data from various sources, including Bangladesh Bank and international organizations, the study investigates the relationship between NPLs and variables such as gross domestic product growth rate (GDPGR), inflation (INF), lending rate (LR), exchange rate (ER), money supply to gross domestic product (M2GDP), and unemployment rate (UR). The findings indicate that NPLs are positively influenced by GDPGR, whereas LR and ER are negatively influenced by INF, M2GDP, and UR.

Akter and Roy (2017) conducted a research based on the data of some commercial banks for last couple of years and found that NPI is one of the most important elements determining bank profitability, and it has a statistically significant negative influence on the net profit margin (NPM) of listed banks over the study period.

Khemra, Saba, & Pasha (1987), to put it another way, GDP growth is directly linked to a decrease in non-performing loans, which means that the economy is growing. According to research, banks who charge higher interest rates and lend excessively are more likely to have a high percentage of non-performing loans.

Jimenez and Saurina (2006), Das and Ghosh (2007), Al-Smadi and Ahmad (2009), Warue (2013), and Brownbridge (1998) discovered a significant and negative link between NPLs and return of banks profitability, indicating that an increase in problem loans led to a decrease in economic activity. Many more empirical investigations back up the tendency.

Titko et al., (2015) conducted a study based on the Latvian and Lithuanian banking sectors found a statistically significant positive association between bank profitability and bank size when expressed as ROE and volume of deposits, respectively. Furthermore, the study discovered a statistically significant positive association between cost-to-income and bank profitability when evaluated by NIM.

In the study of **Chouikh and Blagui, (2017)**, privatization is shown to be statistically significant and positively connected with bank performance. As a result, revisiting the possibility of privatization might be a desirable alternative for government banks. In this study ROA, ROE P/B ratio are taken into thought to be the determinative factor of profitability. Besides these, size of board, size of bank and privatization are also major factor of cost of efficiency, capital to asset as specific variables but no meaningful connection found between these variables and bank profitability.

Another study of **Zhang and Dong (2011)** showed that bank specific factor such as capital proportion, advances and deposits are certainly connected to bank accomplishment when the accomplishment is estimated by ROA. In any case when ROE is considered as a degree of accomplishment, they found an inverse connection capital proportion and ROE. Apart from that, they evaluated the size of bank is certainly related to bank productivity when small size and large size banks are taken into consideration.

Analysis and Findings

This paper aims to analyse the micro and macro finance trends and performance of these two sample banks for the last five years especially the loan disbursement, loan recovery performance as well as the effect of nonperforming investment (NPI). This chapter sets out to evaluate the extent of these factors on the overall financial soundness and business continuity of the bank about NPI trends and management recommendations, hence, aligning with the research objectives.

The results are based on the information derived from the bank's performance reports of loans disbursed, recoveries, and the number of overdue loans, as well as the overall profitability for the period of 2020-2024. This data also contains a sectorial analysis of the disbursed and overdue loans, which gives a complete picture of the bank's credit risk exposure in sensitive sectors like agriculture, SMEs, trading and real estate. Capital adequacy, liquidity and the trends in profitability and their relationship with the NPI ratios and recovery efforts are also determined.

This analysis is important in the research as it connects the financial data findings with the overreaching objectives of doing more in the enhancement of financial stability and also the alignment of NPI management strategies with the tenets of Islamic banking. The preceding discussions and analysis of data points in this chapter offer the requisite background for understanding the issues and prospects facing the bank, upon which subsequent more prescriptive chapters will be based.

DATA AND ANALYSIS AND FINDINGS

The demographic profile of the respondents: At the very beginning of data collection, classify the fifty respondents based on Name of the banks, Job Designation, and Working experience.

Table-1 Demographic Characteristics of the Bankers

Demographic factors	Frequency	Percentage (%)	Valid %	Cumulative %
Name of the Bank				
Shahjalal Islami Bank PLC	21	42%	42%	42%
Al-Arafah Islami Bank PLC	29	58%	58%	100%
Job Designation:				
Branch manager	4	8%	8%	8%
Senior officer	12	24%	24%	32%
Officer	23	46%	46%	78%
Junior officer	11	22%	22%	100%
Working Experience:				
Less than a year	3	6%	6%	6%
Less than 4 year	15	30%	30%	36%
Less than 7year	8	16%	16%	52%
More than 7 years	24	48%	48%	100%

Table-1 presents that 58% respondents are from Shahjalal Islami Bank PLC and 42% are from Al Arafah Islami Bank. The study collected data only from four branches of two sample so the number of branch manager was only 04 (8%), 24% respondents are senior officer, 46% are from Officer and 22% are from Junior Officer. It is also clear from the table-1 that 6% of the respondents had experienced less than one year, 30% had experience between 1-4 years, 16% of the respondents had 4-7 years of experience, and 48% hold more than 7 years of experience.

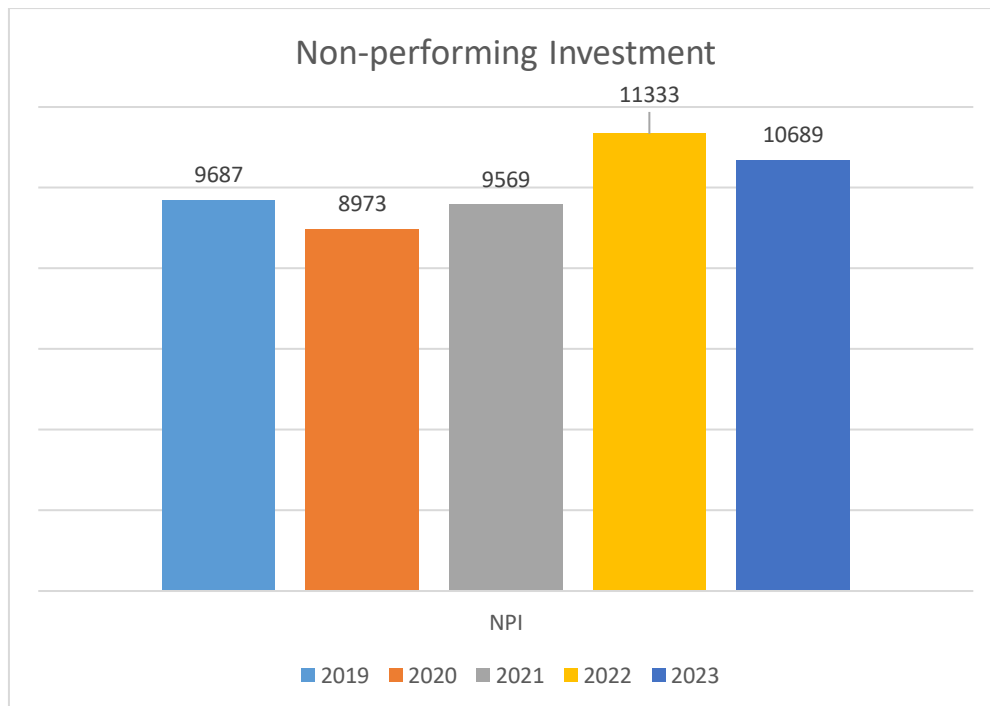
Table-2 Factors Responsible for Non-Performing Investment

Factors Responsible for NPI	SA	A	N	D	SD
Poor loan monitoring	42%	19%	29%	10%	-
Poor credit risk assessment	66%	23%	11%	-	-
Lack of customers sincerity	74%	26%		-	-
Incomplete Loan Documents	64%	27%	9%	-	-
Economic Change	45%	27%	28%	-	-
Political Influence	76%	24%	-	-	-
Inflation	36%	38%	20%	6%	-
Employees Inefficiency	14%	17%	35%	14%	20%

Here, SA-Strongly Agree, A-Agree, N-Neutral, D-Disagree, SD-Strongly Disagree

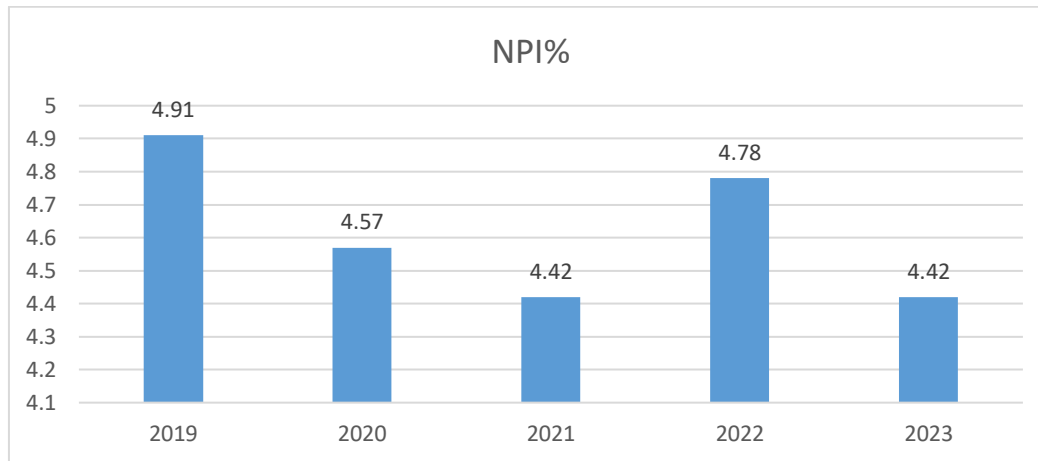
The researcher use five-point likert scale questionnaire to analyse the factors responsible for NPI from the employees of two branches of both sample banks. From table-2, it is seen that most of the employees are strongly agree with two factors; Lack of Customer Sincerity and Political Influence. Incomplete Loan Documents and Poor Credit Risk Assessment are another prime factors for increasing NPI. 20% employee are strongly disagree with factors of employee's inefficiency whereas 35% shows neutral attitude and 14% strongly agreed with their inefficiencies.

Non-performing Investment of Shahjalal Islami Bank PLC



Non-Performing Investments (NPIs) of Shahjalal Islami Bank have been illustrated in the above table in BDT which have been calculated from 2020 to 2024. The NPI ratio was the highest in 2022 with the highest value of NPI amount. This is suggestive of more defaults in that year most probably as a result of stringent economic conditions and sectoral issues.

Year-wise NPI Percentage of Shahjalal Islami Bank PLC



From above table, it is seen that 2021 and 2023, NPI ratio decreased to 4.2 illustrating enhanced approaches in recoveries and the overall risk management.

Therefore, the table shows that the higher NPI ratio is in 2019 (4.91%), the higher the absolute NPIs, whereby such relations demonstrate aspects essential for the stability of financial and operational environments.

Non-Performing Investments (NPIs) Trends of AAILB

Year-wise NPI Ratios

Year	NPI Ratio (%)	NPIs (BDT in Billion)
2020	5.2	6.2
2021	5.8	7.1
2022	6.0	8.0
2023	5.7	7.5
2024	5.3	6.8

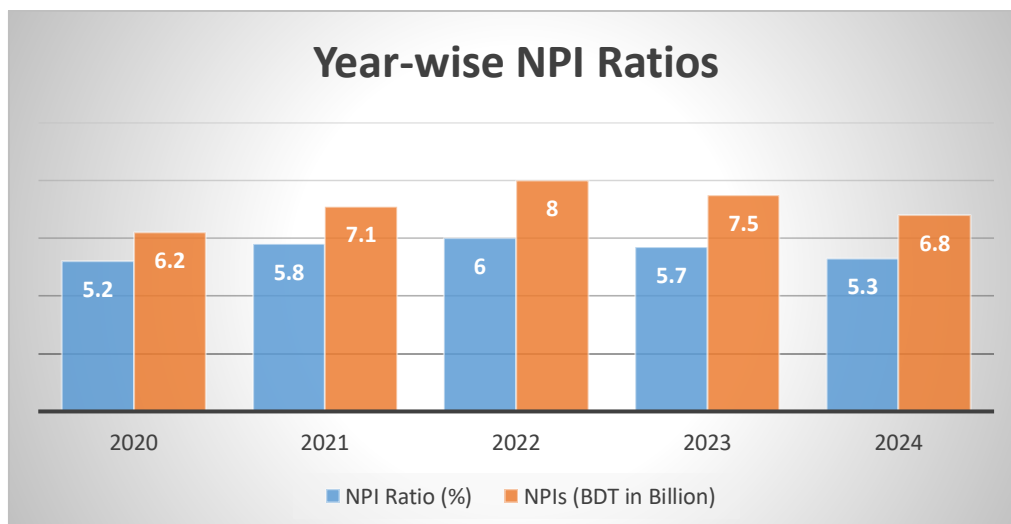


Figure 1: Year-wise NPI Ratios (Source: https://www.bibm.org.bd/single_member.php?id=40)

Non-Performing Investments (NPIs) of Al Arafah Islami Bank have been illustrated in the following table by splitting into two sections- NPI ratio in percentage and the same in BDT which have been calculated from 2020 to 2024. The NPI ratio was the highest at 6.0% in 2022 with the highest value of NPI amount at BDT 8.00 billion. This is suggestive of more defaults in that year most probably as a result of stringent economic conditions and sectoral issues. Finally, by 2024, NPI ratio decreased to 5.3%, and NPIs declined to BDT 6.8 billion illustrating enhanced approaches in recoveries and the overall risk management.

Therefore, the table shows that the more the NPI ratio is, the higher the absolute NPIs, whereby such relations demonstrate aspects essential for the stability of financial and operational environments.

Sector-Wise NPI Trends of AAIBL

Sector	NPI Proportion (%)
Agriculture	35
SMEs	30
Real Estate	20
Trade	15

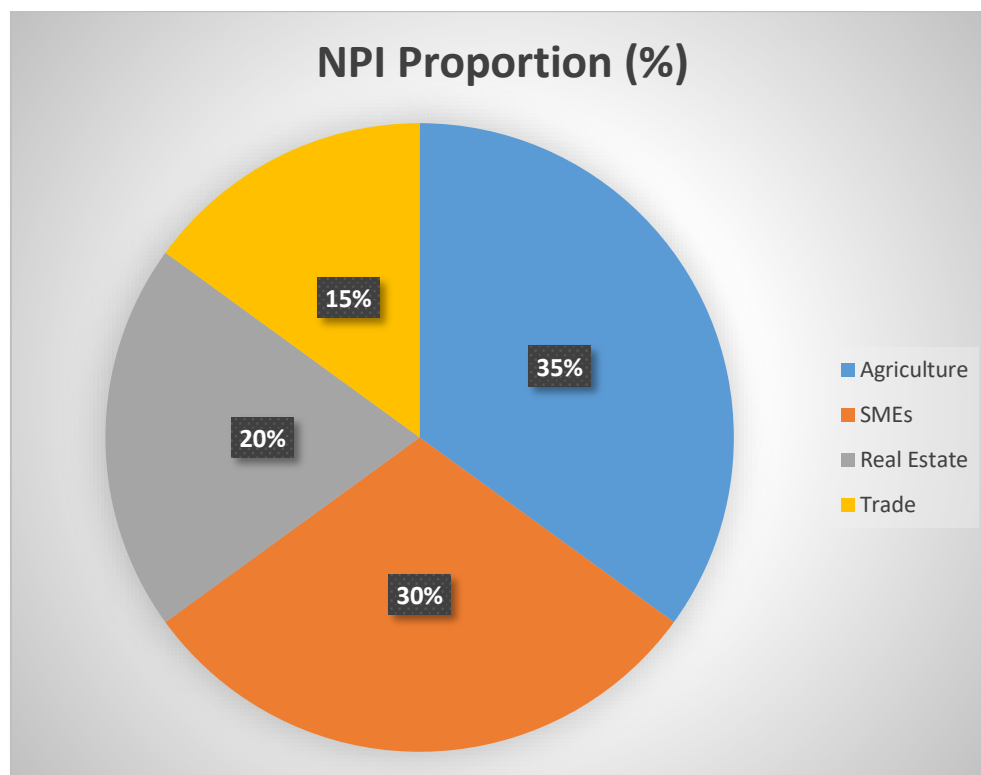


Figure 2: Sector-Wise NPI Trends (Source: <https://www.aibl.com.bd/>)

Sector-Wise NPI Trends table display the percentage rate of Non-Performing Investments (NPIs) of Al Arafah Islami Bank for various business sectors. The largest share of NPIs goes to agriculture at 35%, the second biggest at SMEs at a 30% share, due to high risk rates in agriculture because of seasonal cash flows and limited financial stability among others. Real estate is 20% and is very much impacted on by changes in market value while trade is 15% and is quite affected by external economic conditions. These proportions validly illustrate the difficulties of managing NPIs within sectors with high risk rates. It is therefore important for the bank to address these weaknesses so as to enhance financial sustainability besides enhancing efficiency of loan portfolio.

Financial Impact of NPIs on Stability (Al-Arafah Islami Bank PLC)

Profitability Impact

Year	Net Profit Change (%)	ROA (%)	ROE (%)
2020	-10	1.2	9.8
2021	-12	1.0	9.0
2022	+5	1.1	9.5
2023	+3	1.3	10.0
2024	+4	1.3	10.2

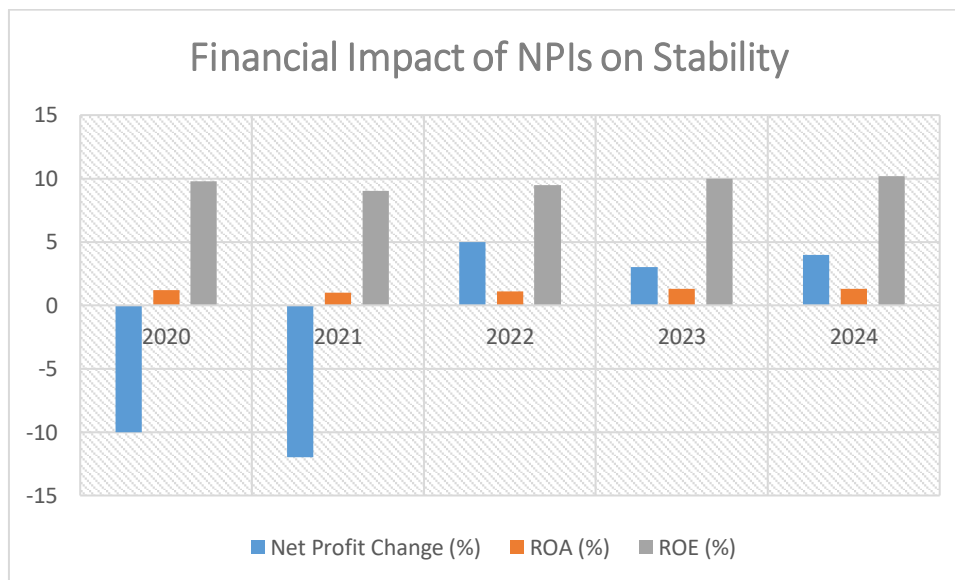


Figure 3: **Profitability Impact** (Source: <https://www.aibl.com.bd/wp-content/uploads/2024/07/AIBPLC-AR-2023-1.pdf>)

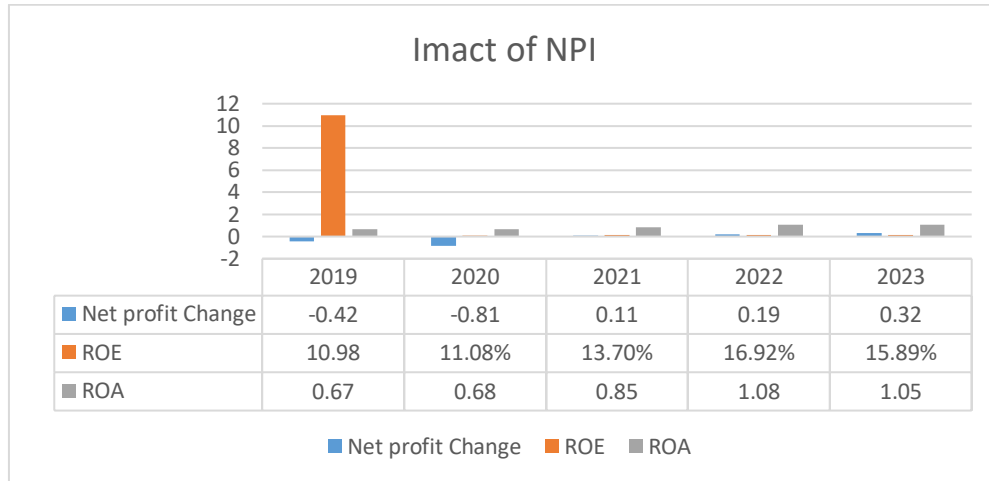
Effect on Net Profit

Non-Performing Investments (NPIs) have especially affects Al Arafah Islami Bank's profitability profile in the last five years. High provisioning requirements and increased write-offs have time and again led to lower net profit throughout fertilizer sector's operations. The bank recorded 10% of its net profit in 2020 and 12% decrease in 2021 due to high provision for overdue loans; the NPIs were at their highest in critical sectors such as agriculture and SMEs. Net profit by the end of the year 2022 had a slight enhancement with 5% growth, due to enhanced recovery efforts. Unfortunately, NPIs persisted to put pressure insisting on moderate growth in 2023 and 2024.

Impact on ROA and ROE

NPIs decreased the Returns on Assets (ROA) and Equity (ROE) implying inefficiency and lower returns on shareholders' investments. In 2020, ROA fell to 1.2% from 1.5% the previous year, while ROE dropped from 10.5% to 9.8%. The situation persisted in 2021, with ROA and ROE declining further to 1.0% and 9.0%, respectively. By 2023 and 2024, gradual improvements were observed, with ROA rising to 1.3% and ROE stabilizing at 10.2%, driven by enhanced recovery strategies. Such trends confirm significant dependence on NPIs in such factors as profitability and efficiency.

Financial Impact of NPIs on Stability (Shahjalal Islami Bank PLC)



NPIs decreased the Returns on Assets (ROA) and Equity (ROE) implying inefficiency and lower returns on shareholders' investments. In 2023, ROA fell to 1.05% from 1.08% the previous year, while ROE dropped from 10.5% to 1.08%. ROE gradually increase but in 2023 it dropped from 16.92% to 15.89%. which indicate enhanced recovery strategies adopted by the bank. Such trends confirm significant dependence on NPIs in such factors as profitability and efficiency.

Comparative Analysis with Competitors

Year	Al Arafah Islami Bank NPI Ratio (%)	Industry Benchmark NPI Ratio (%)
2020	5.2	4.5
2021	5.5	4.7
2022	6.0	5.0
2023	5.7	4.8
2024	5.3	4.6

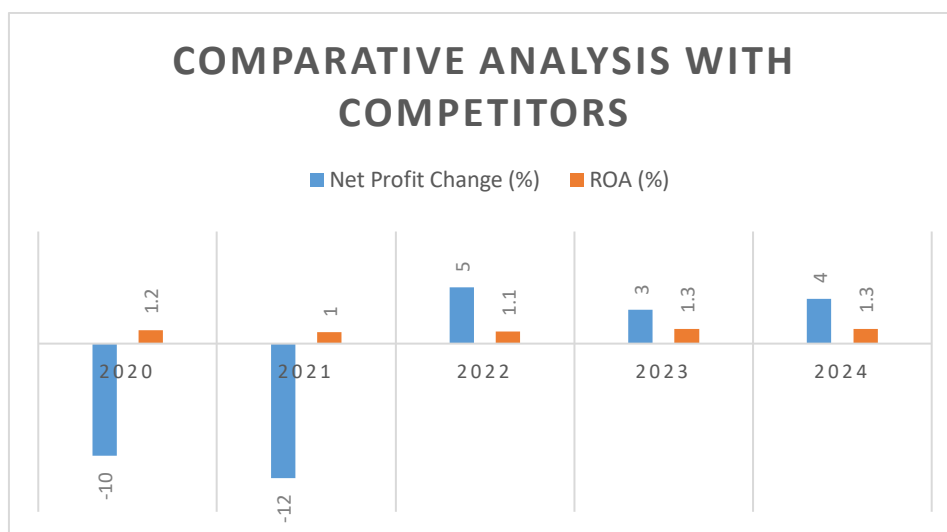


Figure 4: Comparative Analysis with Competitors (Source: <https://www.bibm.org.bd/single-member.php?id=40>)

NPI Trends in Al Arafah Islami Bank vs. Other Islamic Banks

Compared to other Islamic banks operating in Bangladesh, Al Arafah Islami Bank's NPI ratios are a little higher, 5.5% on average in the last five years as against a benchmark of 4.8%. They are like high NPI's in agriculture and SME's due to share same economic problems. Nevertheless, competitor banks present lower amounts of real estate NPIs, which indicates better risk management in this segment.

For efficient management of Non-Performing Investments (NPIs) Bank should integrate sophisticated credit risk models that employ statistical techniques in evaluating credit risks of borrowers. For such key risk segments as agriculture and SMEs, borrower engagement and, in particular, financial advisory services need improvement. The Sectoral Vulnerability can be addressed by diversifying the loan portfolio and to include more Shariah compliant trade and real estate opportunities. Other techniques that help to reduce the NPIs include early warning signals that addresses potential defaults and special accommodation to prepare the troubled borrowers to repay. There should be compliance with Islamic banking principles on all enhancements, especially focusing on the principles of Sharia and justice that imply mutual benefit. Sophisticated credit risk assessments should not violate ethical norms, and any strategies for interacting with borrowers should be transparent and cooperative. The permissible industries should be chosen for diversification and business repayment strategies may include profit and loss sharing in order to share risks fairly. The foregoing measures will guarantee Shariah compliance to overcome operational hurdles, as well as enhance financial sustainability and borrower contact.

CONCLUSION

The strategies, including the credit risk models that are more advanced and the recovery management tactics, opens a door to help Al Arafah Islami Bank to improve its capability of operation resilience to get better financial position. Sectoral risks will be minimized by diversified loan portfolio and responsible management to enable sustainable developments. These strategies borrowed from Islamic banking as they act as win-win approaches hence boosting the ethical profile of the bank. The findings also have general implications for the Islamic banking industry, especially in the area of developing a framework for handling NPIs in line with Shariah requirements. Similar strategies can help the banks to positively enhance their financial and customer bases, which means enhanced stability of the Islamic finance industry.

Adopting the recommendations outlined in this study will enable Bank to build resilience against future financial shocks and sustain growth. Enhancing its risk management mechanisms and integrating the recovery with the Islamic culture will enhance the position of the bank better in ethical banking. Future research could explore novel Shariah-compliant securitization structures and assess profitability and stability profiles of NPIs over a much longer horizon across the Islamic banks. They will create the conditions for making the bank's further development sustainable.

REFERENCES

1. Ahmed, R., 2022. Managing Non-Performing Investments in Islamic Banking: A Strategic Approach. *Journal of Islamic Finance and Management*, 12(3), pp.45-60.
2. Ahmed, S., Majeed, M.E., Thalassinis, E. and Thalassinis, Y., 2021. The impact of bank-specific and macro-economic factors on non-performing loans in the banking sector: Evidence from an emerging economy. *Journal of Risk and Financial Management*, 14(5), p.217.
3. Al-Hassan, M., 2021. Non-Performing Assets in Islamic Banking: Challenges and Solutions. *International Journal of Islamic Banking Research*, 9(4), pp.21-38.
4. Al-Jarhi, M.A., 2017. Islamic Finance and Economic Development: A Systematic Review. *Journal of Islamic Banking and Finance*, 5(2), pp.23-35.
5. Alnabulsi, K., Kozarević, E. and Hakimi, A., 2022. Assessing the determinants of non-performing loans under financial crisis and health crisis: Evidence from the MENA banks. *Cogent Economics & Finance*, 10(1), p.2124665.
6. Arnone, M., Costantiello, A., Leogrande, A., Naqvi, S.K.H. and Magazzino, C., 2024. Financial Stability and Innovation: The Role of Non-Performing Loans. *FinTech*, 3(4), pp.496-536.

7. Atichasari, A.S., Ratnasari, A., Kulsum, U., Kahpi, H.S., Wulandari, S.S. and Marfu, A., 2023. Examining non-performing loans on corporate financial sustainability: Evidence from Indonesia. *Sustainable Futures*, 6, p.100137.
8. Bank for International Settlements, 2023. The Role of Non-Performing Investments in Financial Stability: An Islamic Banking Perspective. [online] Available at: <https://www.bis.org> [Accessed 20 December 2024].
9. Brik, H., 2024. Climate risk and financial stability: Assessing non-performing loans in Chinese banks. *Journal of Risk Management in Financial Institutions*, 17(3), pp.303-315.
10. City Al Arafah Islami Bank Report 2020-2024
11. Definitions: Investopedia.com
12. Definitions: Wikipedia.com
13. Fakhrunnas, F., Astuti, R.D. and Anto, M.B.H., 2022. Determinants of non-performing financing in Indonesian Islamic banks: A regional and sectoral analysis. *Banks and Bank Systems*, 17(4), pp.72-86.
14. Farooq, S. and Khan, A., 2020. Impacts of Non-Performing Investments on Financial Stability in Islamic Banks. *Islamic Economic Studies*, 28(2), pp.14-30.
15. Hasan, T., 2023. Financial Resilience through Shariah-Compliant Risk Management Strategies. *Journal of Islamic Banking and Finance*, 18(1), pp.55-70.
16. <https://www.aibl.com.bd/>
17. https://www.bibm.org.bd/single_member.php?id=40
18. Iqbal, Z., 2021. Analyzing Financial Distress in Islamic Banks: A Focus on Non-Performing Investments. *Journal of Financial Stability*, 6(3), pp.33-50.
19. Islamic Development Bank, 2020. Non-Performing Investments: A Strategic Framework for Islamic Banks. [online] Available at: <https://www.isdb.org> [Accessed 20 December 2024].
20. Kartikasary, M., Marsintauli, F., Serlawati, E. and Laurens, S., 2020. Factors affecting the non-performing loans in Indonesia. *Accounting*, 6(2), pp.97-106.
21. Mubarok, F., Wibowo, M. and Latif, S.D.H., 2024. Safeguarding Stability and Enhancing Profitability: The Case of Islamic Banking in Indonesia. *International Journal of Islamic Economics and Finance (IJIEF)*, 7(1), pp.455-472.
22. Oladele, O.K., 2023. Islamic Bank Financing and Financial Stability: A Risk Assessment.
23. Omri, M.B., 2022. Understanding the Relationship Between Liquidity and Banking Financial Stability in Islamic and Conventional Banks. *Journal of Business and Economic Options*, 5(1), pp.39-47.
24. State Bank of Pakistan, 2022. Report on Non-Performing Investments in Islamic Banks. [online] Available at: <https://www.sbp.org.pk> [Accessed 20 December 2024].
25. Tatarici, L.R., Kubinski, M.N. and Barnea, D., 2020. Determinants of non-performing loans for the EEC region. A financial stability perspective. *Management & Marketing*, 15(4), pp.621-642.
26. Tok, E. and Yesuf, A.J., 2022. Embedding value-based principles in the culture of Islamic banks to enhance their sustainability, resilience, and social impact. *Sustainability*, 14(2), p.916.
27. Usmani, M.T., 2021. *Shariah Compliance and Financial Stability in Islamic Banking*. Karachi: Idaratul Ma'arif.
28. World Bank, 2024. Financial Stability in Islamic Banking: Addressing the Challenges of Non-Performing Investments. [online] Available at: <https://www.worldbank.org> [Accessed 20 December 2024].