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## AN EXPLORATORY STUDY: HOW DOES RELIGION RELATE TO NON-PERFORMING LOANS IN THE CONTEXT OF COMMERCIAL BANKS OF PAKISTAN

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### ABSTRACT

*The role of the banking sector in the growth of the economy of any country is important. It is quite obvious that banks should have processes that may ensure that advances or loans are not only used in safe as well as in profitable projects. The major aim of this research is to examine the factors of non-performing loans (NPLs) which can be divided into dual purposes: Firstly, to propose a conceptual model that explores factors of NPLs and to test this model in the context of the Pakistani banking sector. Secondly, to assist bankers in identifying or executing necessary steps for factors of NPLs in the banking sector of Pakistan. In this exploratory research, the data was gathered through a semi-structured interview method. The interviews were conducted with senior credit managers related to loans and advances departments of commercial banks of Pakistan because they could provide rich information about the dissertation topic. Snowball sampling was used because interviews with senior bankers were required and the researcher could not approach the best sample very easily. The methodology helped to analyze data about factors of NPLs as well as to have an insight into the nature of their relationship with each other. A total of 22 themes emerged from the interviews, out of which the researcher chose a few relevant theme that matched the project: religion of a country. This study considered religionless as significant factor of NPLs in the context of Pakistani commercial banks. Moreover, this study revealed that the Pakistani bankers knew about the loan sanctioning techniques, however, there were issues related to their compliance. It was concluded that the analysis of factors of NPLs would help bankers and policymakers to devise mechanisms that would support the financial sector, especially banks, to control the issue of loan defaults in Pakistani banks.*

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## 1: The Introduction

Several reports suggest a significant amount of problems for banks in both developed and emerging countries (Shubhara and Cheshta, 2020; Arora et al., 2018; Banerjee et al., 2018; Alamelumangai et al., 2017; Bag & Islam, 2017; Tendia et al., 2012). Due to insufficient capital adequacy, poor quality of assets, and incompetent management, banks cannot perform up to the expected standards, and loan defaults have harmed their financial performance (Changjun et al., 2020; Sontakke and Tiwari, 2013).

There is a lot of literature that highlights the issues for banks created by NPLs. For example, the works of Fendri et al. (2020) and Calice (2012) showed deterioration in the value of assets of Tunisian banks. Furthermore, the studies of Nusrat et al. (2019) for Bangladesh, Blanco, and Gimeno (2012) in the case of South Africa and Kolapo, Funso et al. (2012) for Nigeria showed that banks of the aforementioned countries have suffered a lot due to NPLs, raising many questions on their existence. NPLs should also be taken into account as they can quickly be a serious headache for the banking industry. NPLs give birth to different types of issues in various countries. In some countries, NPLs have an indirect effect on the working environment of banks, whereas in other countries they directly affect banks. This issue fascinated a large number of researchers from different countries; so, a variety of studies have been conducted on factors of NPLs. Some of these are presented in the following paragraphs.

NPLs are one of the biggest hurdles for the progress of the banking industry. They disturb the lending size and reduce banks' viability and capability to advance fresh capital (Cucinelli et al., 2018). NPLs can be reduced through moral credit risk supervision practices but the trade-off is a



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decrease in banks' profitability as well as an increase in costs. The study of Nanto and Sinha (2002) showed that the basic factor behind the Asian financial crisis was NPLs. Hence, it can be inferred that big banks, even with government support like the case of China, are not safe from the adverse effects of NPLs.

The negative impact of NPLs leads to adverse selection of borrowers (Islam and Nishiyama, 2019; Brownbridge, 1998b). There are various factors of NPLs which include ROE, ROA, the volume of deposit, bank size, excessive lending, credit growth, total loan, liquidity, interest rate, capital adequacy, inflation, and level of GDP. These factors were determined by various researchers related to a variety of countries (Naseem and Qurrat, 2019; Islam and Islam, 2018; Mileris, 2012; Tomak, 2013; Fawad and Taqadus, 2013; Shingjerji, 2013).

The Pakistani banking industry has exclusive characteristics that differentiate it from the financial markets of other nations. In the present day, there is a trend for the rapid emergence of new banks, which has created an environment of fierce competition among banks. The market share has been shrinking and due to growth in the banking industry, it is expected that this situation will continue. Therefore, under these circumstances, the need to study the determinants of NPLs in the context of the Pakistani banking sector becomes crucial.

The following shows the RQs:

- 1) How does the factor of religion relate to NPLs?
- 2) What are the perceptions of bankers about NPLs and what measures are taken by bankers before sanctioning loans?



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The results of this study which are related to the factors of NPLs of commercial banks of Pakistan are useful for various stakeholders, such as banking sectors, including commercial banks and State Bank of Pakistan (SBP), researchers, and other researchers.

## **2: Literature Review**

Loans that are in default or about to be in default are categorized as NPLs as studied in Rawlin et al. (2012). Thus, it is quite obvious that banks should have processes that can ensure that the amounts given as advances or loans are not only used in safe projects but are also profitable. Otherwise, if loans default in huge amounts or numbers, this can very easily push any bank into insolvency.

As per Hou (2006) and Bloem and Freeman (2005), hypothetically, there is no single definition that is acceptable unanimously in the world. Therefore, it can be seen that, globally, there are ambiguities in the types, scope, and substance of NPLs (Hou 2007). Issa (2009) reported that the definition of NPLs changes a little in different banking systems of the world.

The researcher has also seen in the literature that macroeconomic ups and downs can also augment adverse selection. The studies of Rahman et. Al (2021), Fisher (1933) and Kiyotaki and Moore (1997) indicated that during a boom phase, NPLs show low amounts because borrowers have enough revenues to pay back their loans. Nevertheless, if this prosperous phase continues, then loans are given to an inferior class of borrowers, and consequently the NPLs upturn when the economy enters a recession period.



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The studies of Montalvo and Reynal (2020) and Nawai and Shariff (2012) investigated the factors determining the repayment performance in microfinance programs in Malaysia. The results showed that formal religious education along with other factors significantly affects the loan repayment performance of borrowers. Religious education shows a positive association with loan performance. If the performance of loans is improved then it will decrease NPLs; so, it can be inferred that if religion plays a positive role in reducing NPLs and if religious views are considered by banks, then this can safeguard the latter against the issue of adverse selection of borrowers. If this feature of the borrowers is not considered by banks, then it could lead to the possibility of poor quality of borrowers (Tarron and Sukrishnalall, 2009).

Salas and Saurina (2002) examined the factors of NPLs in the case of Spanish commercial banks. They used a dynamic model and panel data for the period from 1985 to 1997. Their study found that bank size, real growth in GDP, rapid credit expansion, market power, and capital ratio were the factors influencing the NPLs of Spanish banks. Jimenez and Saurina (2006) used a panel regression model to examine credit risks, prudential regulations, and credit cycles of Spanish commercial banks. Their study examined the effect of real interest rate, size of banks, the growth rate of GDP, and two Herfindahl indexes (one for industry and one for area) on NPLs. Their study showed that real interest rate and growth rate are significant factors of NPLs, meaning that an increase in GDP and a decrease in real interest rates lower NPLs. However, the size of the bank does not have a significant relationship with the NPLs ratio. Last, but not least, the rate of loan growth is significant and has a positive relationship with loan defaults.



It is also evident from the literature that religion of the borrower has a significant relationship with NPLs. The argument developed in the literature is that while considering religious education the loan performance of banks has seen to improve, see for example Amir (2019), Demiroglu et al. (2019), and Nawai and Shariff (2012). The literature shows a significant relationship between the character of borrowers and loan performance, which ultimately reduces NPLs (Ogeisia et al., 2014). Thus, the following propositions are formed in this regard:

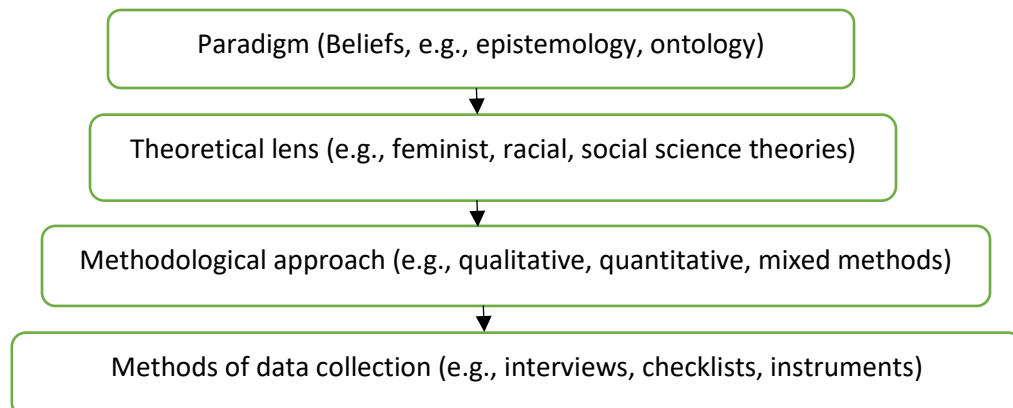
Proposition: Religion of borrower is significantly associated with NPLs.

### 3: Research Methodology and Method

This section explains the research design, ascertains the population of the study and sample, and describes the data collection method and analysis. The bankers of credit departments of Pakistani commercial banks are the work field for this study.

The first step of starting a research study design is to choose an area and paradigm. Paradigm can mean the common principles and values of scholars:

*The knowledge claims, the strategies, the methods, all contribute to a research approach that tends to be more quantitative, qualitative, or mixed (Creswell, 2009, p. 18).*





*Figure 3.2.1.1 Four Stages for Developing a Research Study*

*Source: Adapted from (Creswell, 2009; Creswell and Clark, 2011)*

Figure 3.2.1.1 shows there are four main levels to the design of a research study. The paradigm informs the choice of a theory which the researcher uses. The theory guides the researcher to choose the methodology or research strategy to conduct the research. Finally, the methodology leads to selecting the appropriate methods or procedures to collect, analyze and interpret the data (Creswell & Clark, 2011).

*Table 3.2.1.2 Research Paradigms*

	<b>Post-positivist Paradigm</b>	<b>Constructivist Paradigm</b>	<b>Participatory Paradigm</b>	<b>Pragmatist Paradigm</b>
Ontology (What is the nature of reality?)	Singular reality (e.g., researchers reject or fail to reject hypotheses)	Multiple realities (e.g., researchers provide quotes to illustrate different perspectives)	Political reality (e.g., findings are negotiated with participants)	Singular and multiple realities (e.g., researchers test hypotheses and provide multiple perspectives)
Epistemology (What is the relationship between the researcher and that being researched?)	Distance and impartiality (e.g., researchers objectively collect data on instruments)	Closeness (e.g., researchers visit participants at their sites to collect data)	Collaboration (e.g., researchers actively involve participants as collaborators)	Practicality (e.g., researchers collect data by “what works” to address research question)
Axiology (What is the role of values?)	Unbiased (e.g., researchers use checks to eliminate)	Biased (e.g., researchers actively talk about their biases)	Negotiated (e.g., researchers negotiate their biases with)	Multiple stances (e.g., researchers include both biased and unbiased)




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	bias)	and interpretations	participants)	perspectives)
Methodology (What is the process of research?)	Deductive (e.g., researchers test a prior theory)	Inductive (e.g., researchers start with participants' views and build "up" to theories, and generalizations)	Participatory (e.g., researchers involve participants in all stages of the research and engage in cyclical reviews of results)	Combining (e.g., researchers collect both quantitative and qualitative data and mix them)
Rhetoric (What is the language of research?)	Formal style (e.g., researchers agreed-on definitions of variables)	Informal style (e.g., researchers write in a literary, informal style)	Advocacy and change (e.g., researchers use language that will help bring about change and advocate for participants)	Formal or informal (e.g., researchers may employ both formal and informal styles of writing)

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*Source: Adopted from Rehman, M. (2015, p. 63)*

Table 3.2.1.2 points out four basic paradigms which can be used in an individual or mixed form to give philosophical assumptions for research. These approaches are termed as “constructionist”, “post-positivist”, “participatory” and “pragmatist” paradigms (Creswell & Clark, 2011).

After the discussion of the research paradigms, it is imperative to explain the philosophical assumptions of the current study being conducted. A clear understanding of the assumptions can enable a researcher to establish well-versed decisions in choosing a specific paradigm and research strategies (Bryman and Bell, 2008; Bryman, 2012; Denzin and Lincoln, 2011). The study of Denzin and Lincoln (2011) explained that there are three main assumptions, namely ontological, epistemological and methodological. These philosophical assumptions scheme the methodological options relating to the study.





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The current inquiry is based on an ontological assumption of subjectivity (multiple realities) and constructionist epistemology, these philosophical assumptions have implications for the selection and employment of samples. The process of selection and employment of the sample is given as under.

In this study, a snowball sampling approach was used. The goal of the snowball sampling was to select those individuals who could replicate their know-how so that familiarity with the phenomenon could be expanded (Creswell, 2012). There was also a lack of data availability related to the factors of NPLs, other than macroeconomic and bank-specific data, therefore, the researcher used personal linkage to classify the bankers using snowball sampling.

After selecting the sampling strategy, the next step was to define the number of participants needed to be interviewed to accomplish the research aims. As the research approach of the researcher is interpretivist, the researcher was conscious of the fact that the qualitative approach practices minor samples to produce dense and rich explanations (Miles and Huberman, 1994) as a substitute for big samples that intend to generalize the results (Bryman, 2012), which was not the objective of the study. The sample size of 25 met with Bryman's (2012) and Creswell's (2012) view that a decent sample should be about 20 to 30 interviews.

To employ the potential participants, employment criteria were established to be elastic to obtain the richness of a varied sample. The targeted bankers were selected for the study on the following basis. The bank officials should have held their job for at least three years. The bankers must have a minimum of three years of experience. The bankers must belong to the



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credit department. They must have dealt with clients for all types of loans, especially in the consumer, agriculture, SME, and corporate sectors.

It is also important to mention that out of 25 bankers selected, 8 bankers were senior bank managers. The inclusion of these senior bankers improved the richness of the study in terms of providing dissimilar and conflicting views. There are currently 22 commercial banks working in the Pakistani banking sector out of which 5 conventional banks namely, ABL, MCB, Bank Alfalah Limited, Askari Bank Limited, HBL. It is imperative to mention that initially it was decided to conduct 30 interviews, but later these were shortlisted to 25, which is following the number of interviews conducted in the studies of Rehman, S. (2015), Negera (2012), and Zhang (2010). The availability of the interviewees and the rate of knowledge attainment determined the number of interviewees, consistent with the doctrines of diminishing returns (Lewis, 1994).

Qualitative interviewing (Bryman, 2012; Creswell, 2012) was selected to gather data regarding the factors influencing NPLs of commercial banks in the setting of Pakistan. It was beneficial to gather data through interviewing method because in this way the aims of the study could be met and it also allowed the bankers to spontaneously share their understandings (Gracia and Welter, 2011).

There are two main methods of qualitative interviewing, unstructured and semi-structured (Bryman, 2012). For this research, the semi-structured (Bryman, 2012; Creswell, 2012) type of interview was selected because an interview protocol was drafted to discover the banker's opinions and experiences related to the various determinants of NPLs. A semi-structured interview is a method where the researcher has a themes-based list and practices an informal



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approach of inquiry to retain the conversation inside the space of the study (Bryman, 2012). Furthermore, this feature allowed the researcher to investigate those questions which were not part of the interview protocol but had the potential of being interesting and to make the data-rich (Bryman, 2012).

The participants were first communicated about the interview through telephone. An interview agenda (Appendix I) was sent to the participants before the actual interviews so that they were mentally ready to organize their thoughts. After attaining the agreement of the participants, the interviews were recorded. The duration of the interviews varied between 30 and 40 minutes. Normally there is a disparity experienced in the length of time of interviews (Bryman, 2012). The researcher did not ask all the questions from the interview protocol due to the time constraint of the participants.

After attaining a well-versed agreement, the participants were heartened to give their opinions independently connected to the RQs established by the researcher for the interview protocol. These questions just presented a direction. The bankers were permitted to share their own opinions and experiences and the researcher was just an initiator. A good interviewing method guides an interviewer not to present his/her thoughts at the beginning of an interview to evade bias. The main role of the interviewer should be just to keep the conversation on a path (Kvale, 1996).

Since Urdu is the first language in Pakistan, the interviews were conducted in Urdu and English depending on the convenience of the participants. The researcher did ask the language choice of the participants before starting an interview. However, all the interviews (25) were conducted in



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the Urdu language. The interviews were translated into English with the help of an English expert.

The interview schedule containing open-ended questions was used for data gathering. Due to the diverse and dynamic nature of people, as a qualitative researcher, one has to continuously advance the study instrument. Therefore, the collection of data was not done in the most dynamic and inventive ways (Creswell, 2012). According to Easterby-Smith (2008, p. 424), the unambiguousness of the qualitative procedure of RQs, data collection, and research, which, over the life of the venture, are reiterative, depends on the sophisticated attention of the researcher.

After establishing the interview guide a pilot examination of the tool was conducted. This testing was made to ensure the clarity, relevance, and avoidance of any ambiguity in the RQs. This pilot testing enabled the researcher to improve the interview guide. The important suggestions and missing links as suggested by the participants of the pilot study were included.

The questions which were prepared for the interview guide were designed to be following their significance in the research being conducted. In addition, it was also ensured that these questions met the aims of the research and integrated the opinions of the bankers, how they felt about the social world and how they assigned meaning to it (Bryman, 2012). The questions included in the interview guide were about their opinions about NPLs, how they perceived the influence of factors other than macroeconomic and bank-specific factors in light of the theory of asymmetric information. The factor was: religion.



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All the interviews were transcribed for analyzing the data. As per Oliver et al. (2005, p. 1287), transcription is that influential piece of representation that can mark the conceptualized process of the data. There could be two selections in transcribing the qualitative information: de-naturalism and naturalism (Oliver et al., 2005).

Thematic analysis was used to analyze the data after the transcription phase was completed. This form of analysis is very popular among qualitative researchers. Thematic analysis can be defined as a technique aimed at classifying, examining, and reporting arrangements (themes) inside qualitative records (Braun and Clarke, 2006, p. 79).

After the selection of themes, the researcher once more analyzed the selected themes for additional improvement to shape into more distinct procedures to reduce the data into further manageable data and to safeguard that they formed an adequately sized dataset (Attride-Stirling, 2001; Braun and Clarke, 2006). The themes that were developed from the data allowed the researcher to advance the analysis from an expressive stage to a more explanatory stage. It involved probing for expressive themes and giving them a more comprehensible interpretation of the RQs and crucial theoretical framework (Attride-Stirling, 2001).

After the selection of the method, the most complex goal was to select the suitable criteria to assess the quality of the study in terms of dependability and faithfulness. The main issue of qualitative research is genuineness rather than consistency (Silverman, 2001, p. 13).



Describing the research procedure explicitly and in great detail is one of the most important indicators of quality in interpretive research. To address the quality concerns of the study, the methodology, suitable method selection, and the criteria of sample selection were thoroughly discussed. In addition, adequate information was given in respect of the purposes of the study and the application of the research procedure to contribute to the integrity and precision of the research process.

One of the main parts of the research procedure is ethical concerns (Guba and Lincoln, 1994). It is the prime responsibility of the researcher to be conscious of the ethical associations for the participants (Bryman, 2012).

The obligation of the researcher was not to misapprehend participants' contextualized accounts, as a replacement to add to knowledge. In this regard, the researcher confirms that clarification and sense creation should be completed openly and truthfully. Participants were given the chance to review the transcriptions of the interviews; the results of the study can also be shared with them if they wish.

It was made clear to all participants that they had the right to pull out from the study at any time and they were guaranteed that their data would be demolished after extraction.

The reflexivity of the researcher in qualitative research is very noteworthy in the research procedure (King, 1994). It requires consideration on the part of the researcher of his/her understandings that may or may not inspire the research procedure (Bryman, 2012; Maxwell,



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1996). Reflexivity is understood as self-awareness and consciousness of the connection of the researcher with the research setting (Denzin and Lincoln, 2012).

Thus, the topic of the research is aimed at exploring the factors of NPLs of commercial banks in the setting of Pakistan and it has a serious radical constructionist stance. Nevertheless, the researcher senses that the way the findings of the study are presented is one of the numerous possibilities (Smithson, 2000).

#### **4: Qualitative Data Analysis**

This part of the dissertation analyzes the qualitative data collected through the semi-structured interviews of managers of selected commercial banks. The purpose of the data analysis is to provide rich and detailed insight into the factors of NPLs of the commercial banks of Pakistan. This analysis investigates the views of the senior managers and credit officials of commercial banks.

The first thing asked from the bankers was their understanding of the definition of NPLs. There were various answers given by the bankers. A banker explained NPLs as:

*In my opinion, NPLs are those loans whether commercial loans or consumer loans or any other type of loans relating to export and import or industrial loan, or agricultural loan, when these are stuck up and when the mark-up is not paid and its due date is expired.*



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The aforementioned explained the types of loans along with explaining the definition of NPLs. According to this definition, loans are divided into commercial, consumer, industrial, or any other type related to imports and exports.

Some defined it in objective terms, which means in a period. As one of the bankers said:

*If the principal amount or mark-up is not paid within a specified period, as stated in the State Bank regulations, it is converted into NPLs. There are different periods for different types of loans. The minimum period is 90 days. If a customer doesn't pay 90 days from the maturity, then that loan will be converted into a non-performing loan.*

One of the bankers explained the categories of NPLs, given by the SBP, in the following way:

*There are two kinds of NPLs. Firstly, there is categorization given by the State Bank of Pakistan about the NPLs. Then there are such accounts that face some issues and become problematic. We don't categorize such loans as NPLs but we indicate that these have the potential to become non-performing.*

One of the bankers categorized bank loans in the following manner:

*I think NPLs are those in which the borrower willfully defaults. In addition, NPLs can be conditional, which means that the business situation is against the business executive due to which he is suffering losses. So, we can classify the defaults as willful and non-willful.*





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The above definition gives a new concept about willful and non-willful defaulters. This definition has also explained that some defaulters have the intention to default and some others commit default due to business circumstances.

Another explained NPLs as:

*Yes, if the loan or mark-up or both are overdue after 90 days, we consider it non-performing.*

So, according to these bankers, NPLs are those which are not paid or are overdue after a particular time, which is 90 days.

Therefore, from the above, it can be inferred that bankers themselves consider it an impossible task to completely wipe out NPLs. This definition also uses an example of receivables in other businesses to make the concept of NPLs clear.

The next discussion will throw light on the consequences of NPLs. All the bankers agreed that NPLs are pretty dangerous for the survival of banks and they presented this concern in different ways. Almost all of the bankers were sure that NPLs are the chief reason behind the insolvency of any bank; therefore, in their discussions, they highlighted studying its various determinants with the utmost care. The views of one of the bankers were:

*These directly hit the income of the bank. If a loan portfolio of Rs. 500 or 600 or 1,000 million has defaulted, then the whole bank can become insolvent ... So the income of the bank related to that year is disturbed. These severely hit the bank's*



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*income; so, making it difficult to accurately forecast future revenues and expenditures.*

According to some bankers, NPLs harmed their balance sheets; therefore, they considered it crucial to study the factors of NPLs. A bank manager explained:

*NPLs affect the balance sheet negatively. The reason is that banks have to keep a certain percentage of provision on the NPLs as this is one of the regulations of the State Bank of Pakistan. This can decrease the profitability as well as the amount of capital.*

The bankers considered NPLs dangerous because revenues have been shrinking. The reason is that there is a regulation of SBP that requires a bank to set aside a certain amount as a provision for doubtful debts. Thus, the higher the NPLs, the greater the deduction required from revenues.

The exact concept was explained by a banker in the following manner:

*Certainly, they do significantly affect the performance of banks. The reason is that banks do not have their own money. They get it from people and invest it to earn profit. Obviously when this amount is not returned, on one side profit of banks is reduced, while on the other side customers can demand their deposits back which will lead to a potential loss to the banks.*

NPLs are the main thing that makes the performance of a bank weak or strong. All bank managers agreed on this point and one of them pointed out this in the following manner:



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*Yes, certainly these do affect the performance of the banks. If the amount of NPLs is high in the balance sheet, then the investor may withdraw deposits from the bank. NPLs play a major role in portraying a bad financial picture of the bank.*

From the above, it is concluded that NPLs can be defined objectively as well as subjectively. In the objective definition, we look at the time, whereas the subjective criterion considers things other than the period, such as the differentiation between willful and circumstantial defaulters. Furthermore, the aforementioned discussion also explained the need for studying the determinants of NPLs.

The next question to the bankers was about the influence of a religious person on NPLs. Some bankers showed a sense of confusion regarding the concept of religion. They were of the view that the physical outlook cannot exactly predict the inner side of borrowers; so, as per their thinking, there are certain cases in which the borrowers look religious but they use that physical appearance to get loans and afterward commit default. The exact wording of one of the managers was:

*Look, the thing is, that there is a lot of confusion in the name of religion. We consider such person religious who has grown a beard or has a praying symbol on the forehead or is reciting tasbeeh or has a religious outlook ... In fact, a person can never be judged religious from shaping his/her outlook, however, religion is in one's heart and one's inner side... A person who is clean shave can be very close to religion from that person who has an outlook of a true Muslim ... Religion is inside and you cannot stamp someone as religious or non-religious.*



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Some of the bankers considered individual honesty more important than the religious outlook for timely payment of debts. Some of the views are:

*I don't see it like this. I think that if as an individual you are honest, then you will fulfill your commitment. Now, if someone has a beard or has worn the Christ cross but does not fulfill his commitment honestly, then definitely he will default. If someone is fulfilling his commitment honestly, then we cannot judge that he is religious or not. Every person has his personality and lifestyle.*

*I also don't happen to see any impact of religion on loan defaults as dishonest persons can be seen in almost all religions.*

*No, I think that there is no measure to judge the religious views of someone. A person showing off religious background can default.*

This means that due to the complexity of measuring the level of religiousness, it is not possible to consider it a significant determinant of NPLs.

The bankers were asked if they had experienced a religious person making timely payments (to check the significance of religion in improving the performance of banks as far as loan repayments were concerned). Different views were shared regarding this. One of the bankers responded in the following words:

*During my banking career, I have experienced that religion does not affect the borrower's ability to repay loans. I have seen that the more religious ones normally commit more defaults. They only use religion as a tool to cheat others.*



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So, the above has revealed that religion is being used for personal gain. Some bankers considered personal honesty, not religion, to be the key element determining NPLs. They were of the view that dishonesty is not liked in any religion and anyone asking for a loan is not to be judged on his/her physical appearance. The comments in this regard are as follows:

*The teachings of every religion require its followers to be honest. If someone has shaped him/herself as a religious person but is not fulfilling his/her commitment honestly, then definitely he/she will default. If someone is fulfilling his commitment honestly, then we cannot judge whether he is religious or not.*

*Based on my experience in the banking industry, I don't think religion can have any effect on the loan repayment ability of borrowers as I have seen clients who, by their physical outlook, looked very religious but they defaulted.*

*We cannot judge the religious condition through mere outlook. If I am wearing an Islamic dress, you cannot declare me as religious. Similarly, we cannot tag a person as non-religious only through his physical appearance. Therefore, it is very difficult to judge in this case.*

The above are the comments made by the bankers to discuss the role of religion in influencing NPLs. Most of the bankers (24 out of 25) did not consider religion to be a significant factor of NPLs due to various issues like the complexity of measurement, confusion of defining and judging a religious person through physical appearance. However, honesty is considered a stronger characteristic in a borrower than physical appearance in the repayment of loans.



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This section presents the details about the thematic analysis which has been conducted on the qualitative semi-structured interviews. The process of thematic analysis has already been described in detail in the Methodology chapter. The following shows the themes and sub-themes along with their description.

### **Bankers' Interview-based Themes and Thematic Analysis**

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<b>Sr. No.</b>	<b>Themes</b>	<b>Description</b>
1-	Banking Experience	<ul style="list-style-type: none"><li>a. Time period</li><li>b. Quality of experience (versatile, excellent, good, bad)</li><li>c. Limited job opportunities</li><li>d. Acquiring skills</li></ul>
2-	Inspiration	<ul style="list-style-type: none"><li>a. Family attached to banking</li><li>b. Accidental entry (by chance)</li><li>c. Severe competition in other fields</li><li>d. Project at the university level</li><li>e. The job with matching qualification</li><li>f. Interest in finance</li><li>g. Reference</li><li>h. Business-based family</li><li>i. Growth</li></ul>



- 3- Recruitment
  - a. Easy process
  - b. Test and interview-based job
  - c. Better opportunities in earlier times
  - d. Nationalization v/s privatization of banks
  - e. Post-recruitment issues
  - f. Role of colleagues after recruitment
  - g. Formal education v/s practical field experience
  
- 4- Banking as Earning Source
  - a. Lucrative option (facilities like staff loans etc.)
  - b. Job insecurity and poor earnings
  - c. Average income
  - d. Nepotism
  - e. Qualified v/s unqualified
  
- 5- Job Requirement
  - a. Integrity
  - b. Interpersonal skills
  - c. Self-confidence
  - d. Good negotiation skills
  - e. Business-oriented mind
  - f. Higher education (specialization in finance)
  - g. Convincing style
  - h. Honesty



- i. Varies with a specific department
  - j. Hard work
  - k. Hands-on knowledge of finance
  - l. Analytical skills
  - m. Demands late sitting
  - n. Patience
- 6- NPLs
- a. State Bank regulations (time period based)
  - b. Defaulted loans
  - c. Categories of defaulted loans
  - d. Subjective v/s objective criteria (time-based)
- 7- Effects of Defaulted Loans
- a. Negative effect on the balance sheet
  - b. Bank performance
  - c. Reason for adverse effect
  - d. Reason of insolvency
  - e. Provision for bad debts
  - f. Restriction on credit extension by SBP
  - g. Loss of income
- 8- Category of Loans
- a. Worst category (unsecured/running finance and overdraft)
  - b. Consumer loans v/s SMEs v/s corporate loans v/s agricultural loans (mark-up very high/high)





- volatility/relaxation in mark-up in case of default)
- c. The defaulted category depends on the sector and its situation
- 9- Category of Defaulters
- a. Willful v/s situational defaults (due to cyclical variations or some catastrophe)
  - b. Large firms v/s small firms
  - c. Vulnerability of loan categories
  - d. Reasons of willful defaults (law system)
- 10- Conditions of Sanctioning of Loans
- a. Varying criteria for loan category
  - b. Track record
  - c. Financial aspects (viability of loan) v/s business aspects (requirement of the loan)
  - d. Ratio analysis (balance sheet ratios)
  - e. Effectiveness of ratio analysis
  - f. Ownership of lender
  - g. Government restrictions
  - h. International scenario
  - i. Debt v/s equity finance
  - j. State Bank regulations
  - k. Pledging of residential house v/s business property



- l. Checking of cash flows, sales, and bank statements (window dressing)
  - m. Security (given least importance)
  - n. Locating wilful defaults
  - o. Implementation of five C's
  - p. State Bank regulations v/s banks' internal policies
  - q. Surprise personal visit to the place of business of the borrower
  - r. Result of compromising any condition
  - s. Funded (collateral-based) v/s non-funded (cash flow based) facility
  - t. Account turnover (deposit statement, number of returned cheques)
- 11- Stage of Default
- a. Classification of loans
  - b. Provisioning for various categories of loans
  - c. Expiry of the due date
  - d. Visit the place of business
- 12- Religion
- a. Insignificant role
  - b. Lack of interest of religious people
  - c. Physical appearance v/s inner honesty



- d. Difficult to judge how religious a person is
- e. Usage of religion for personal benefits
- f. Conventional v/s Islamic banks (defaults ratio)

This section explained the qualitative data analysis of the semi-structured interviews. The themes which were derived through thematic analysis are presented in this section. These themes are explained through the discussion of the bank managers. This section closes with the presentation and conduct of thematic analysis, the process of which has been discussed earlier in section 3.

## **5: Discussion**

In this section, the researcher discusses the role of religion as a factor, other than macroeconomic and bank-specific, in influencing NPLs which emerged in the shape of themes as explained in the previous section. The factor, namely religion is discussed in the light of previous research explaining their role in determining the NPLs of Pakistani commercial banks. The themes, including NPLs, also help to understand how the bank managers perceive NPLs and the steps they consider most important while sanctioning loans. Afterward, the findings along with the literature are synthesized to conclude whether these themes significantly or insignificantly influence the NPLs of Pakistani commercial banks.

### **Research Objectives**

1. To explore the factors of NPLs in the context of the banking sector of Pakistan.
2. To propose a conceptual model that explores factors of NPLs and to test this model in the context of the Pakistani banking sector.



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3. To assist bankers in identifying or executing necessary steps concerning factors of NPLs in the banking sector of Pakistan.

## **RQs**

1. How does factor of religion relate to NPLs?
2. What are the perceptions of bankers about the NPLs and what measures are taken by bankers before sanctioning loans?

For this study 25 bankers were selected for interviews. Their demographics are presented in the next lines. All of the bankers are related to the loan and advances department as that particular department deals with NPLs. The majority of bankers (i.e. 68%) were in the age group of '31–40' years. This shows that mature-aged persons are appointed in the loans and advances department as this section is the most critical department in the bank. The reason is that a substantial part of banks' revenue depends on loans and advances issued to clients. Moreover, only 12% of the participants (3) were in the age span of '21–30' years. Another thing to note is that only 12% of the participants (3) were in the age range of '51–60' years, which shows that as the age goes up the banks are not interested to keep aged people in the loans and advances department.

Analysis of the marital status reveals that almost all the bankers are married (96%). A bank job is considered a secure job in Pakistani society and a person who gets that job is assumed to have joined a healthy career. That is the reason for a high marriage percentage.



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Furthermore, it reveals the educational qualifications of the participants. The analysis shows that all of the participants have taken a Bachelor's degree and all have a Master's degree. This proves that higher education is thought to be a minimum qualification for a banker who wants to join the loan and advances department. The reason is that a lot of financial calculation is required before issuing loans and any person belonging to that department should have high knowledge of finance so that he/she might be able to assess the credit risk appropriately.

In addition, analysis of demographics reveals the experience of the bankers involved in the loan and advances department. It can be seen that this department involves persons with vast experience. Of the bankers, 52% have 11–15 years of experience, whereas 20% of the bankers have experience of more than 15 years. This information proves that the bank prefers to include officers in the loans and advances department who are senior in experience.

Moreover, the demographic profiles show the salary scale of the bankers as well. Banking is one of the better-paid jobs in Pakistan. During interviews, most of the bankers considered banking a profession with an above-average salary. A majority of the bankers (88%) are earning a handsome amount in this profession.

The bankers were asked questions relating to a definition of NPLs. They all gave their understanding of the meaning of NPLs. The understanding of bankers about NPLs is following previous studies as Rose (2002) defined NPLs as, “A loan is placed in the NPLs category when any scheduled loan repayment is past due for more than 90 days”. The definitions given by Saad Siddiqui (2012) and Negera (2012) are also under this definition. Therefore, it can be concluded



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that there is no ambiguity in defining NPLs among the previous literature and the Pakistani bankers.

The next question is regarding the study of NPLs. In other words, what is the reason to study this concept in detail? This question was answered during the interviews by various senior bankers. They all considered that NPLs threatened the survival of commercial banks.

## **6: Findings and Conclusion**

The bankers unanimously declared that religion was insignificant in explaining NPLs. There were numerous reasons given in this respect. According to some bankers, religion was being used for personal gains and it was also very difficult to measure it. In addition, it was inferred that the level of religiousness of clients could not be ascertained from their physical appearance. One of the bankers, while sharing his experience, explained that a borrower after signing the contract of the loan at a time of need refused to give back the amount of interest proclaiming it violated the rules of his religion. Furthermore, it was also revealed that personal honesty, instead of religion, should be the key element influencing NPLs. There was limited literature available on religion's influence on NPLs. The available studies showed a significant impact of religion on NPLs.

However, as per the current research, it can be concluded that religion is an insignificant factor in the setting of the Pakistani banking sector, therefore, bankers should not consider it while issuing loans (RQ-1).



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From the above, it is clear that as far as the factors of NPLs are considered, there is a need for commercial banks to look into these factors while making their lending decisions. Other factors influence NPLs, like macroeconomic and bank-specific but these factors are already given too much attention.

There is a detailed analysis using interviews, however, there are some limitations of this study which are indicated in the next lines.

- a. The interviews were held with the managers of five banks; however, other banks can be part of a future study.
- b. As the methodology of the dissertation is qualitative, there may be some researcher bias and interviewee bias.

The following section provides implications and recommendations in the light of the findings of the study:

- 1) The banks should set a secured credit procedure that deals with the determinants of NPLs, mentioned in this study, relating to borrowers. If factors such as education and the character of borrowers are kept in consideration while making lending decisions, the bank performance regarding loans and advances will improve.
- 2) Banks should amend their internal client selection, monitoring, and follow-up processes in light of the factors considered significant in this study.



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- 3) As per the findings of this study, to educate the borrowers, Commercial banks should make special help desks for public awareness regarding the use of loans and advances. These help desks can be operated on a weekly or monthly basis. The advantage of this activity will be that the issues of defaulting loans can be addressed by creating awareness about the consequences of committing defaults. Moreover, the bankers can discuss the positives of investing in production as well as profitable avenues with potential borrowers.
  - 4) This study reveals that despite knowing about the loan sanctioning regulations, their compliance is being compromised. In this regard, the State Bank should take certain steps in respect of defaulters without accepting any government and non-government pressures. It must be ensured that a person who has defaulted should not get the opportunity to take loans from any source for at least 3 years. However, there are certain rules currently available in the State Bank policy draft but, unfortunately, these are not being implemented with true spirit. Presently, a person, in the case of default, takes a loan in a different name with a changed identity. To achieve this, the State Bank has to work in conjunction with NADRA (National Database and Registration Authority) and all commercial banks. In this way, defaulters will be discouraged a great deal and NPLs will improve to a large extent.
  - 5) As this study indicates age to be a significant factor, Commercial banks should only recruit bank officers who have the professional qualification to do the job appropriately.





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Older bank officials must be directed to do refresher courses to upgrade their knowledge to deal with the contemporary challenges of banks.

- 6) As this study takes into account the character of the borrower to be looked upon while issuing loans, therefore, the government should address the issues which build the character of the borrowers to make willful defaults. For example, due to the slowness of our law system, willful defaulters often take pleas behind the veil of banking courts. In banking courts especially, decision-making takes a very long time and the effectiveness of the case almost becomes outdated.
- 7) This dissertation has adopted a qualitative methodology. Future research can verify the results of this study by applying a quantitative approach. In this way, there is scope to not only add knowledge to the literature but the results can also be generalized.

The following are the areas that have the potential to be studied in detail in the future:

- The impact of the factors concerning various types of loans which are issued by banks, such as consumer, business, and mortgage loans. This has not been done to date in previous studies related to commercial banks of Pakistan.
- The literature review points out certain factors of loan defaults on which research is required to be conducted in the setting of developing countries like Pakistan. These factors include macroeconomic (saving, political instability, assets quality), bank-specific (corporate governance, regulatory environment), and social (war on terror, corruption) (Saad Siddiqui, 2012; Tarron and Sukrishnalall, 2009; Boudriga et al., 2009b).



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- Furthermore, some studies have identified the determinants of NPLs in three phases such as pre-crisis, during the crisis, and post-crisis (Louzis et al., 2012; Park and Zhang, 2012). This angle has been ignored in previous studies in the background of the Pakistani banking sector.
  - A future study can amalgamate the bank-specific factors and the determinants of NPLs found in this study using a mixed methodology.
  - A future study can be initiated to study the reasons for defaults from the point of view of loanees (borrowers).

In the light of the above, those factors which are not considered important in defining NPLs, such as religion should be viewed with care as these have shown significance in foreign environments.

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