

Chapter 14

An Appraisal of Recent Developments in Non-Performing Loans Affecting the Profitability of Commercial Bank in Bhutan: A Case of Bhutan National Bank Limited

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ABSTRACT

This chapter purports to discover the causes of non-performing loans (NPLs) and its impact on the profitability of one of the commercial banks in Bhutan that is Bhutan National Bank Limited (BNBL). The causes and impact were considered from two distinct variables namely bank-specific (BS) and macroeconomic variables (MV); whereas PAT, interest income, and ROE were considered as proxies to judge the profitability of the bank covering ten years (2010-2019) time series data. The selected economic indicators appeared to be non-significant in determining the levels of NPL of BNBL. However, bank specific factors such as capital adequacy ratio (CAR) are positively affecting the NPL of the bank. Similarly, NPL (DOUB and LOSS) of the bank poses a negative impact on its profitability assessed in terms of return on equity (ROE). Further, when bank maintained higher CAR to address crisis in future, it tends to involve in lending loans easily with the assumption that higher CAR would safeguard the bank from going bankrupt or crises.

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1. INTRODUCTION

In recent times, the issue of non-performing loans (NPLs) has significantly impacted the profitability of commercial banks across the world (Singh et al., 2021). Financial inclusion in Bhutan has been a significant focus for both the government and financial institutions to ensure widespread access to affordable and suitable financial services (Jingpeng et al., 2023; Sharma et al., 2020). As a small landlocked country in South Asia, Bhutan has made notable progress in promoting financial inclusion in recent years. The Royal Monetary Authority of Bhutan (RMA) has been instrumental in devising and implementing the National Financial Inclusion Strategy (NFIS), aiming to enhance financial services accessibility, especially in rural and remote areas (Jingpeng et al., 2023; Sharma et al., 2020; Gautam & Sharma, 2022). Bhutan has extended formal banking services by opening branches and banking agents in distant regions, while the adoption of mobile banking and digital payment systems has further eased financial transactions in challenging terrains (Khan et al., 2021). Microfinance institutions have played a crucial role in catering to the needs of small businesses and individuals underserved by traditional banks. Initiatives to improve financial literacy have also been launched by the government, financial institutions, and NGOs to empower citizens in making informed financial decisions (Sharma, 2014; Gangwar & Khan, 2022). To support key sectors such as agriculture and SMEs, Bhutan focuses on providing credit and tailored financial assistance. Additionally, the country has sought collaboration with international organizations like the World Bank and Asian Development Bank to strengthen financial inclusion efforts and the financial sector's capabilities (Tortajada & Saklani, 2018). Bhutan's unique development philosophy of Gross National Happiness (GNH) highlights the importance of financial inclusion in enhancing overall well-being and happiness for its people (Verma, 2017). However, challenges remain, including geographical constraints, limited digital infrastructure in some areas, the need to improve financial literacy, and ensuring a conducive regulatory and policy environment for sustainable financial inclusion (Surge, 2022; Mathrani et al., 2023; Clark et al., 2022). Despite these obstacles, Bhutan's dedication to financial inclusion reflects its commitment to achieving a more inclusive and prosperous society (Sharma et al., 2020).

Bhutan's economy has experienced steady growth driven by hydropower exports, tourism, and agriculture (Ansari & Khan, 2023; Khan et al., 2020). The hydropower sector stands out as a significant economic driver, harnessing the country's substantial hydroelectric potential for both domestic consumption and export to India (Ansari & Khan, 2023). Tourism plays a crucial role, attracting visitors with its unique culture and pristine environment, supported by a "minimum daily tariff" to ensure sustainable tourism (Khan et al., 2022; Tirwa & Khan, 2022). Agriculture remains vital, employing a significant portion of the population, though challenges such as limited arable land and an aging farming population persist (Khan et al., 2020). Bhutan's trade is dominated by hydropower exports to India, while the government maintains fiscal prudence to avoid excessive public debt. The country's currency, Ngultrum (BTN), is pegged to the Indian Rupee (INR) (Khan & Gurung, 2019; Ogino et al., 2019; Ansari & Khan, 2023). Notably, Bhutan's development philosophy of Gross National Happiness emphasizes sustainable well-being over mere economic growth, and the nation faces challenges like diversification beyond key sectors, vulnerability to external factors, and the impact of climate change (Ligori et al., 2022; Ansari & Khan, 2023).

Financial sectors in Bhutan have been experiencing rapid transformation over the last few decades in fulfilling the role of a mediator of resources in the economy (Suresh et al., 2019). Due to growing competition in these sectors, risk and profitability plays a pivotal role towards maintaining macroeconomic stability and establishing financial sectors in the country (Gurung, 2023; Dorji, 2023). Financial

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