

A Study on Non-Performing Loans of the Pakistani Banking Industry during Different Political Regimes

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Abstract

Pakistan has been suffering political instability since its inception in 1947. A mix of military and democratic regimes has ruled the political system. The Pakistani government has been suffering many problems due to an unstable political structure since then. The banking sector is considered one of the key components of any economic system. In contrast, a high volume of NPLs prevailing in the banking industry may affect the profitability of this sector. This reach study tries to investigate the performance of the Pakistani-banking sector under the democratic regime and military regime, mainly from 1996 to 2017. This tenure has a combination of military and democratic governments. In this regard, the Mann-Whitney test compares the average NPLs for both regimes. This study has examined the banking sector's loan performance under military and democratic regimes using NPL (gross) and NPL ratios. It is found that NPLs (gross) were low during military regimes while the democratic government has more NPL (gross), with an increasing trend over the years. The average growth in NPLs (gross) was observed as 8.1 per cent per annum during the tenure of the research study.

Keywords: Banking Industry, Democratic regime, Military regime, Non-performing loans, NPL ratio

Article history:

Received on: May 26, 2023

Revised on: June 23, 2023

Accepted on: June 28, 2023

Published on: June 30, 2023

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INTRODUCTION

It has been seventy-five (75) years since Pakistan has become an independent state. Since its inception in 1947, there have been different political regimes governing Pakistan. Since then, Pakistan has suffered different political upheavals from autocratic (by dictators) and democratic governments. The political party that brought independence to the country, i.e., Muslim League, lacked an internal democratic system. This caused the military forces to intervene in the political system. Moreover, there was no constitution from 1947 to 1956. This time provoked democratic instability in the system. Autocratic governments, i.e., military coups through the imposition of martial law, have dominantly ruled Pakistan four times, with an overall period of around 35 years. All these times, the dictator has tuned as president of the country for all the years of their regime. Though democratic parties had also governed the state, they had always been a victim of downfall by military dictators or had to be stepped down by the country's Presidents. Moreover, the judicial system had also weakened, providing legal empowerment to military dictators to grab the state's authority.

A military regime can be defined as a political system wherein executive power (authority) is derived from the army (military) ruler. In such a political system, democratic governments may not get complete political power and authority and can be dismissed by the military intervention of their armed forces. In countries ruled by military governments, the level of its power can go from the right of veto to the complete absorption of democratic power. Democracy can exist as a presidential or parliamentary system, with different election procedures, veto institutions, and constitutional differences. In this political system, power is vested in people. The Pakistani army, in the form of military power, has always played a considerable role in the country's politics. For around 71 years, the military has defined Pakistan's security priorities at the national level, mainly from the seat of government itself, and many officials have been empowered at dominant economic and political positions. The financial system in economies throughout the globe varies from rudimentary to sophisticated; and from delicate to quite (relatively) stable system. A strand of literature provides evidence that well-functioning financial systems facilitate long-lasting economic growth by allocating financing to productive investments than poorly developed financial systems. This persuasive evidence has triggered financial sector reforms that improve the financial system's performance and thereby promote economic growth & development¹.

The presence of an effective banking sector with independent central banks and financial regulators is very important for economic and monetary control. After a year of independence, the central bank of the country, i.e., the State Bank of Pakistan (SBP) was formed. Habib Bank was established in 1941; it had filled the gap of the central bank until then. The SBP had mandated the development of a commercial banking system to control the money supply and bring economic development through trade and commerce². As per the State Bank of Pakistan, the banking sector of Pakistan was reformed by allowing private banks to operate in Pakistan in competition with public sector banks. The recovery procedures for due loans were restructured and issued revised clear guidelines for classifying the loans (SBP, 2003). The banking sector is considered the most important sector for the financial stability of a country. It plays a critical role in the economic

¹ Rehman, Ramiz, Inayat Ullah Mangla, and Junrui Zhang. "Chinese banking reforms: an analysis and evaluation of non-performing loans." *The Pakistan Development Review* (2016): 563-578.

² Khalabat, Amna. "History of banking in Pakistan—of humble origins and vast potential." *The Express Tribune* (2011).

development of countries. The banking sector is very vibrant to play its intermediary role; however, Non-Performing Loans (NPLs) may affect the performance and profitability of banking sectors. NPLs are described as the financial assets for which the lending bank is not receiving markup or due instalments as per the issued schedule. They are referred to as NPL because the loan has stopped “performing”, and the bank cannot generate income from this loan³.

The soundness of the banking system can be measured via its indicators such as the capital adequacy ratio (CAR), the volume of non-performing loans, the ratio of non-performing loans to total advances, and return on equity. The European Union (EU) has defined a non-performing loan as a loan whose instalments are due for over 90 days. The NPL ratio shows the extent of corrosion of the financing quality extended by a bank. If the NPL ratio is very high, it shows that the quality of banking assets is worse, which may result in causing losses to banks. Though the banking system of Pakistan has been developed into a stable system, the NPLs of banking sectors have had an impact on the profitability of banks that affects the economic sustainability of the country. Banks' lending behaviour is affected by the electoral results of the party affiliated with the bank. The NPL ratio can be calculated by dividing total NPLs by the Total advances of the banking sector. As per SBP data, the NPL ratio reached 16.7 per cent in September 2011 highest of all time and 7.1 per cent lowest of all time, in June 2007 (CEIC, 2018). It is evident from the literature that the military government had brought financial stability in the past (during Gen. Ayub's regime) with a growth of 6 per cent in GDP from 3 per cent. This growth rate with financial stability was retained during the Gen Zia ul Haq regime. This military influence has remained in Pakistan's political system in almost all sectors of the economy. The inefficient bureaucratic system enabled autocratic governments to believe they could manage other sectors more efficiently⁴.

Since Pakistan has seen so many political changes, this study intends to investigate the impact of change in political regimes on economic development and see its impact on the performance of banking loans' performance. It intends to conduct a study on Non-Performing Loans in the Pakistani Banking Industry covering a period from 1996 to 2017. The early period, i.e., 1996 to 1999 partially covered the peak of the democratic and distress time of the Kargil war. This time was followed by a military coup of General Pervez Musharraf against Nawaz Sharif's political government. This period covered the performance of banking loans during one military coup and two regimes of democratic parties. The key objective was to analyse if average non-performing loans are the same during both regimes. Keeping other factors constant, the study investigated if the NPLs are affected by changes in political parties, as with every change government implements its policy reforms, which affects the borrower's capacity to repay. These policies directly or indirectly affect the macroeconomic indicators, banks' lending behaviour and repayment capacity of the borrower and overall credit growth of the economy. Studying non-performing loans is important for academicians, policymakers and especially for bank management. Many researchers evaluate the relationship between macroeconomic changes, bank-specific parameters and non-performing loans. However, little work has been done to analyse the position of NPLs during two different political regimes denominating in Pakistan.

³ Adhikary, Bishnu Kumar. "Nonperforming loans in the banking sector of Bangladesh: realities and challenges." *Bangladesh Institute of Bank Management* 4, no. 26 (2006): 75-95.

⁴ Brömmelhörster, Jörn, and W. Paes, eds. *The military as an economic actor: Soldiers in business*. Springer, 2003.

The issue of non-performing loans has been highlighted recently as a key issue faced by banks and has attracted the interest of banking experts. The researchers and experts have explained, in particular, the matter that a large volume of NPLs can directly lead a bank to its failure. While discussing the issues that cause a bank to fail, studies have discussed that asset quality that is ultimately evaluated by the significance of non-performing loans in the total advances portfolio, is a statistical and important indicator of bank insolvency. Those failed banks suffered many NPLs⁵. The study aimed to discover facts about high NPLs accumulating in the Pakistani banking industry and analyse the phenomena with the change of government effects on the loan default, i.e., NPLs in the banking system during 1996-2017. It was analysed if the average NPLs (gross) were the same during the two political regimes. Reducing NPLs from banking sectors enabled improvement in the economic status. Considering rapid political changes in the country during the study period, i.e., 1996 to 2017, this study aims to answer research questions during the following regimes.

Table 1
Political Regimes

Regime	Type of Government	Period under Study
Regime-1	Democratic by Muhammad Nawaz Sharif	1996 to 1999
Regime-2	Autocratic by General Pervez Musharaff	1999 to 2008
Regime-3-i	Democratic by Asif Zardari	2008 to 2013
Regime-3-ii	Democratic by Muhammad Nawaz Sharif	2003 2017

This study aims to answer the, ‘Does a change of style of government (autocratic or democratic) effects banking NPLs and NPL ratio (also known as infection ratio)? It was tested if the average NPLs (gross) during both regimes are the same.

Hypothesis

This study intended to test the following hypothesis on the relation of change of government style with NPL (gross) and NPL ratio of banks.

H₀: The average NPL (gross) is equal for democratic and military regimes.

LITERATURE REVIEW

Autocracy means to draw power (i.e., cracy) from themselves (auto). It is a political system that combines all the powers and authorities of the political system in one central power. It does not include the interference and participation of the people in that state’s power. Dictators are the individuals possessing such power. Thus, Dictatorship is a type of political system governed by a single ruler, known as a dictator with unlimited powers. The dictator does not need to justify his claim to rule by free elections. The dictator draws his legitimacy usually from a particular danger or a state crisis that he can parry. When the military takes over any government in a country, it involves governance by military men trained for the military with specialisation in the armed forces. They are trained to maintain and follow orders rather than deal with political matters. These

⁵ Bahrini, Raef. "Empirical analysis of non-performing loans in the case of Tunisian banks." *Journal of Business Studies Quarterly* 3, no. 1 (2011): 230.

men are more habituated to hierarchy and more accustomed to obeying orders. This is a general part of their routine training. This is the way they have been raised. Their experience dealing with the civil sector is different⁶.

When democratic governments are ruling, military forces have their defined characteristics. Their commitment is to the people (citizens) of their nation. They are not committed to a person, group, or ethnicity. They are meant to follow the ruling of an elected government. By manifesto, they are not supposed to support any specific political party. Their key responsibility (when the democratic government has power) is to defend their country and look after national security affairs. Their other services may be availed in times of need, such as to perform relief work during a natural disaster or to perform special security when asked for. During democracy, they are law bound to follow orders in the country's interest and perform their routine job responsibilities. For this purpose, they are allocated a budget and facilitated with the required infrastructure and fair system for the career progression of military officers. The literature has found that dictators worldwide have realised that a prolonged military regime may be a bad bargain in the long term. It may make them stand against their people. Therefore, the military has understood the advantages of democracy for their people and their military services. In the case of Pakistan, the case is a bit different. Pakistan has been facing political changes (governing style) since its inception.

Political Change in Pakistan

Pakistan has faced several issues with having stabilised macroeconomic environment. Most importantly, Pakistan has suffered instability in its political system since its existence. It has been mentioned in the literature that it is important to have a strong political system to achieve stability in the macroeconomic environment. Unfortunately, Pakistan has been struggling with political instability, and changing government resulted in this country being deprived of having strong macroeconomic policies. To a significant extent, this political instability was blamed for the larger fluctuations in the development of the main economic sectors⁷. A lot of literature evidence explains the sources of economic growth by considering the important issues of governance structure and policymaking. Considering the spottier history of Pakistan, it seldom experienced a politically stable structure. Military coups have overtaken democracy for over thirty years since its existence⁸.

Pakistan has been under a military regime four times, from General Ayub Khan in 1958 to 1969, acceded to General Yahya until 1971. Thereafter a democratic party, Pakistan People's Party, ruled till 1977. Later on, General Zia ul Haq imposed Martial law during 1977- 89 and ruled for 9 years. The last round of military regime by General Pervez Musharraf's coup was in 1999, and it lasted for another nine years until 2009. Counting all years, Pakistan has been under military dictatorship for over half of its freedom. The military governments always have economic interests in the country. The growth of the military's business interests encourages them to support "policy-

⁶ Geddes, Barbara, Erica Frantz, and Joseph G. Wright. "Military rule." *Annual Review of Political Science* 17 (2014): 147-162.

⁷ Cheema, Faisal. "Macroeconomic stability of Pakistan: the role of the IMF and World Bank (1997-2003)." *ACDIS Occasional Paper* (2004).

⁸ Rehman, Ramiz, Inayat Ullah Mangla, and Junrui Zhang. "Chinese banking reforms: an analysis and evaluation of non-performing loans." *The Pakistan Development Review* (2016): 563-578.

making environments". This supports multiplying their economic benefits and opportunities in the autocratic and non-democratic political system⁹.

Democracy can be defined as a form of government that supports people's wide participation in government. It promotes citizens' views for the smooth functioning of government through a voting system. The form of Democracy in Pakistan is one of the best and most unique democracies in the world. However, unfortunately, it has failed to deliver many times due to the non-observance of what is actually the true essence of democracy. The main reasons for this are due to the unawareness of the people about the form of democracy in Pakistan, faulty political culture, and legal pluralism¹⁰. Military forces around the globe are aimed and determined to defend and support the security interest of the respective country. Compared to it, democracy's purpose is to fulfil the objectives that best serve the interests of the citizens of its country. It is unfortunate to observe that in the case of Pakistan, the democratic governments have failed to accomplish the desired objectives, and true democracy could not be formed in true spirits. The causes may be politicians' malpractices, including corruption. Nepotism, bribery, illegal obligations and other forms of malpractice are linked with democracy. The majority of the political parties lack trained and educated resources, which has been hindering the way of achieving results of socio-political and economic development. The democratic political system of Pakistan mainly lacks the perspective of a long-term vision for the state's interest. Rather, they prefer their self-interest to the country's benefit. This has resulted in political instability and sluggish economic growth, a curse of democracy¹¹. This weakness of democracy has given an advantage to disciplined military governments to take over in the national interest.

However, it is important to note that during the two ruling regimes, i.e., military and democratic, the average Gross Domestic Product (GDP) growth was 6.3 per cent and 4.2 per cent, respectively. It can be assumed that the economy's GDP growth during military times was more than the democratic times. However, the performance of military dictators may vary when compared with each other. In the case of Pakistan, General Ayub Khan's regime is considered a better regime than any of the other military dictators who ruled in Pakistan. General Musharraf's regime is considered the weakest one¹².

Financial Intermediation

Banks are the intermediaries, facilitating transactions in the financial market. Banks intend to perform two key functions, i.e., taking money from lenders (deposits) and lending to borrowers (financing)¹³. Literature contributes that political affiliations considerably affect lending behaviour and the pattern of private banks¹⁴. The financial sector has significance in the growth and

⁹ Siddiq-Agha, Ayesha. "Military inc.: Inside Pakistan's military economy." Oxford University Press. (2007).

¹⁰ Waqas, Muhammad, and Muqaddas Khattak. "Democracy in Pakistan: Problems and Prospects in Making Informed Choices." *International Journal of Social Sciences and Management* 4, no. 1 (2017): 9-11.

¹¹ Hayat, Muhammad Nauman, Kaneez Fatima, Uzma Mukhtar, and Safia Bano. "Economic performance of Pakistan under democracy and military regimes." *Journal of Economics, Business and Management* 4, no. 12 (2016): 690-694.

¹² Ibid.

¹³ Drake, Pamela Peterson, and Frank J. Fabozzi. *The basics of finance: An introduction to financial markets, business finance, and portfolio management*. Vol. 192. John Wiley & Sons, 2010.

¹⁴ Firth, Michael, Chen Lin, Ping Liu, and Sonia ML Wong. "Inside the black box: Bank credit allocation in China's private sector." *Journal of Banking & Finance* 33, no. 6 (2009): 1144-1155.

prosperity of a country via its intermediary role, which includes deposit-taking, lending and transaction facilitation. In the banking sector, considerable attention is paid to credit risk. This is because many banking assets are in the credit portfolio. Therefore, the loan (credit) portfolio is considered the banks' most significant and serious exposure.

Non-Performing Loans and NPL Ratio

NPLs are considered to be very important as they depict the quality of the assets, especially the financing portfolio of a bank. On an aggregate basis, it shows the credit quality of the overall financing of banks in a country. Understanding elements related to risk management and supervision that affect NPLs is critical. There have been different definitions of NPLs used in literature. The International Monetary Fund (IMF), as per their Financial Soundness Indicators' Guide 2006, states that 'loans should be classified as NPL when a) payments of principal plus mark-up are due by 3 months or more, or b) mark-up payments equal to 3 months (90 days) mark-up or more have been reinvested into the original amount, or rolled over (IMF, 2006). More often NPL ratio helps to evaluate a bank's performance and measure its asset quality¹⁵.

The NPL ratio depicts the nominal value of NPLs to all advances. The NPL ratio also helps analyse banking sector efficiency¹⁶. If the NPL ratio keeps increasing, it may be a sign of corrosion in the banking sector. It is mentioned in theories that credit expansion risk and infection ratio (NPL ratio) are to be pro-cyclical during an economic period. One of the IMF studies has deliberated that banks' bad loans may increase considerably due to abrupt changes in market interest rates. It is also discussed while implementing the reform in the Pakistani banking sector that current NPL increased further because of the due amount's composition of principle and mark-up¹⁷. Studies have discussed that the NPL amount is a main factor of concern in the instigation and effectiveness of banking distress. It is also evident from the literature that NPLs are used to check the banking sector's asset quality and are also connected with global financial crises¹⁸.

In order to develop the theoretical background for this study, literature and its impacts on bank lending and financial institutions' performance are used. It has been noted that one of the recent studies by Goel and Hasan (2011) has investigated the impact of corruption on NPLs empirically¹⁹. They have linked the NPLs and corruption by using explaining the relationship between corruption, the legal system, banks financing and NPLs. One of the studies done by Keeton (1999) analysed the effect of the bank's credit policy on NPLs in the case of the US banks (during 1982 and 1996)²⁰. He has resulted that there exists a strong correlation between the credit growth of banks and NPLs. Keeton has concluded that the rapid growth in banking loans, especially business

¹⁵ Festić, Mejra, Alenka Kavkler, and Sebastijan Repina. "The macroeconomic sources of systemic risk in the banking sectors of five new EU member states." *Journal of Banking & Finance* 35, no. 2 (2011): 310-322

¹⁶ Podpiera, Richard. "Does compliance with Basel Core Principles bring any measurable benefits?." *IMF staff papers* 53 (2006): 306-326.

¹⁷ Abbas, Kalbe, and Manzoor Hussain Malik. "Impact of financial liberalisation and deregulation on banking sector in Pakistan." *The Pakistan Development Review* (2008): 287-313.

¹⁸ Alam, Shafiqul, Md Mahabubul Haq, and Abdul Kader. "Nonperforming loan and banking sustainability: Bangladesh perspective." *International Journal of Advanced Research* 3, no. 8 (2015): 1197-1210.

¹⁹ Goel, Rajeev K., and Iftexhar Hasan. "Economy-wide corruption and bad loans in banking: international evidence." *Applied Financial Economics* 21, no. 7 (2011): 455-461.

²⁰ Keeton, William R. "Does faster loan growth lead to higher loan losses?." *Economic review-Federal reserve bank of Kansas City* 84, no. 2 (1999): 57.

loans, may be a symptom of banks' easing credit appraisal procedures, making them vulnerable to losses in slow economic growth. The article has pointed out that an increase in credit growth likely led to higher NPLs and loan losses only if the source of the faster loan growth is a shift in the supply of bank credit. Studies have mentioned that the issue of high NPL emerges after either credit booms or a prolonged period of low or slow growth in weak banking systems. The high NPLs crowd out the new financing, which causes the erosion of the banks' profitability; it can ultimately affect the solvency of banks. It may lead to a systemic risk to the whole bank. When NPLs are high, it may affect sufficiently a large number of banks; this may hinder the normal functioning of the financial system. Banks may be reluctant to lend further, and economic activities may be highly affected²¹.

Banking sector investments are most sensitive than investing in any other economic sector. Any shock in the banking sector makes the whole economy vulnerable due to the lending-borrowing relationship between banking and other economic sectors, which generates economic activities. Most of the economic crises were caused by troubles in the banking systems and then trickled to different other economic sectors, which availed credit supplies of the banking sector²². It has also been researched that the banking sector does not trickle problems by itself. However, it can facilitate the dispersion of economic problems through other economic sectors. Since all financial and economic sectors are well connected, even external shocks can easily be transferred. As per a study of the World Bank compiled by Caprio and Klingebiel (1996), many episodes of banking crises based on macroeconomic data among sixty-nine countries were divided for each country for their respective period, scope and estimated loss of crises²³. The main characteristics of crises included GDP growth, loan magnitude, loss estimates, resolution cost, the process for resolution, growth in new banking credit etc. The study explained that poor management, supervision, weak regulations, weak corporate governance and unnecessary government intervention were the major causes of banking sector insolvencies from the 80s to 90s in those countries. Since every political government implement their policies as per its manifesto, it affects the economic and banking sectors accordingly.

Change of Government and Effects on Macroeconomic Policies

One of the studies on the trends of the NPL ratio in Hong Kong was conducted by different explanatory variables such as real GDP, nominal interest rates, equity prices, bankruptcies, and unemployment rates. It was found that nominal interest rates and bankruptcies directly impact the NPL ratio. Another study has mentioned that increases in the exchange rate, loan-to-GDP ratio, and interest rate directly affect NPLs²⁴. Dr Ishrat Hussain has discussed that during the military regime of General Pervez Musharraf (1999), major economic reforms were undertaken during

²¹ Baudino, P., and H. Yun. "Resolution of non-performing loans–policy options. BIS, Financial Stability Institute." (2017).

²² Fendi, U., I. Sawalha, Jamal Shamieh, and Osama Omar Jaara. "Early Warning Indicators for Monitoring Non Performing Loans in Jordanian Banking System." *International Journal of Business and Social Science* 8, no. 6 (2017): 104-114.

²³ Caprio, Gerard, and Daniela Klingebiel. *Bank insolvencies cross-country experience*. World Bank Publications, 1996.

²⁴ Vatansever, Metin, and Ali Hepsen. "Determining impacts on non-performing loan ratio in Turkey." *Journal of Finance and Investment Analysis* 2, no. 4 (2013): 119-129.

2000-2006²⁵. However, these efforts were slowed down in 2007 due to the political instability, including judicial confrontation and impending democratic elections²⁶. Following the assassination of Mohtarma Benazir Bhutto, the uncertainty increased while the country shifted from an autocratic government to a democratic one. This affected the country's economic condition badly by the incoming government leading to a macroeconomic crisis in Pakistan. It is assumed that economic performance has shown better results in Pakistan during military governments than in democratic regimes. Pakistan's economy is tangled with a mixture of democracy and dictatorship. One of the studies investigated the economic performance of both types of government, i.e., military and democracy. From 1958 to 2014, the Government faces several problems due to a lack of consistency in the political structure. This study discussed macroeconomic variables and their performance during both regimes' time and resulted that military governments performed better, especially in terms of economic growth²⁷.

Conceptual Framework

In this study, the comparison of one variable was made during two different political regimes. In this regard, the average NPL (gross) and NPL ratio was checked for equality during democratic and military regimes that prevailed from 1996 to 2017. The performance of a democratic government has been tested²⁸. As per the studies, political connections statistically influence banking lending to the private sector²⁹. The same framework for comparing NPLs is adapted for this research. The average NPL and NPL ratio on quarterly data from the period of June 2002 to September 2018 would also be analysed based on this framework.

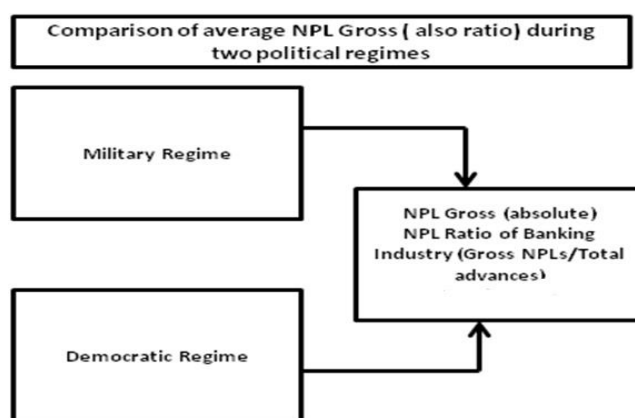


Figure 1. Conceptual Framework

²⁵ Husain, Ishrat. "Economic reforms in Pakistan: one step forward, two steps backwards." *The Pakistan Development Review* 51, no. 4 (2012): 7-22.

²⁶ Abbas, Kalbe, and Manzoor Hussain Malik. "Impact of financial liberalisation and deregulation on banking sector in Pakistan." *The Pakistan Development Review* (2008): 287-313.

²⁷ Hayat, Muhammad Nauman, Kaneez Fatima, Uzma Mukhtar, and Safia Bano. "Economic performance of Pakistan under democracy and military regimes." *Journal of Economics, Business and Management* 4, no. 12 (2016): 690-694.

²⁸ Rehman, Ramiz, Inayat Ullah Mangla, and Junrui Zhang. "Chinese banking reforms: an analysis and evaluation of non-performing loans." *The Pakistan Development Review* (2016): 563-578.

²⁹ Firth, Michael, Chen Lin, Ping Liu, and Sonia ML Wong. "Inside the black box: Bank credit allocation in China's private sector." *Journal of Banking & Finance* 33, no. 6 (2009): 1144-1155.

RESEARCH METHODOLOGY

This paper compared the average of NPLs (gross) during two political regimes. It studied the impact of different government policies (i.e., military & democratic) during a mix of regimes, i.e., military and democratic, in the form of macroeconomic indicators on the asset quality of the banking sector, which is mainly represented by NPL (gross) and NPL ratio. This research used a quantitative research approach. This section comprises data sources, variables under study, draft statistics model, etc.

Data Source and Sample

In order to analyse the NPLs (gross) and NPL ratio of banking sectors of Pakistan under the military and democratic regimes, this study used annual data from 1996 to 2017. Moreover, quarterly data (un-seasonal) from June 2002 to Sept 2018 was also used for the analysis. The study has obtained secondary data to achieve its objective. The central bank periodically released the secondary data source, i.e., the State Bank of Pakistan, statistical documents (SBP), and Banking System Reviews (SBP). The information available from the State Bank of Pakistan and the commercial banks' annual reports was extracted to identify sample banks and collect the necessary information. Annual data consolidated from the banking sector from 1996 to 2017 was analysed. For this purpose, the annual accounts of the banks from 1996 to 2017 are to be checked. Quarterly data from 2002 to 2018 has also been checked to analyse the study further.

Sample and Sampling Technique

Sample design defines the population, sample size, sampling techniques, etc. A sample can be defined as a set of individuals/ companies/ selected from an identified population to generalise the findings to the entire population. A sample is drawn due to constraints that make it difficult to cover the entire research population. For this research study, data from all banks regulated by the State Bank of Pakistan have been obtained from secondary sources. This includes public sector banks, private sector banks and development financial institutions.

Data Variables

The NPL ratio of the banking industry was used as a dependent variable. This ratio was calculated by dividing total NPLs (gross) by the total advances of represented banks. As per one of the IMF working papers, borrowers' repayment capacity is highly influenced by the macroeconomic environment available to them. This study intends to follow a uni-variate variable, i.e., NPL Banking Industry of Pakistan; this variable is compared to two different regimes, i.e., military regime and democratic regime. For this purpose, data from the last 21 years (from 1996 to 2017 annual data) have been obtained from different secondary sources. Quarterly reported data from 2002 and Sept 2018 is also included to conduct the test.

Statistical Model

The study adopted the descriptive design. This study tests the normality test to compare the NPLs during both regimes. Since the annual NPLs (gross) are not normally distributed, the Mann-Whitney test was used to compare average NPLs (gross) during both regimes. It included mainly

annual data from 1996 to 2017. However, quarterly data from June 2002 to Sept 2018 was examined. In order to do data analysis, Statistical Package for Social Sciences (SPSS) version 24 was used. Spreadsheets was used for data consolidation to create graphs, charts and tables for data presentation.

RESULT AND DISCUSSION

Data for NPLs of banking sectors of the Pakistani banking industry was collected from secondary sources. This was mainly collected from the State Bank of Pakistan, their publications, and quarterly reporting on economic indicators. For this research report, total NPLs (gross) were studied. The NPL ratio of the respective period was calculated to see the result. Data was collected as annual data (from CY1996 to CY2017) of public and private banks, including development financial institutions regulated under the State Bank of Pakistan. Since the objective is to check the average NPLs during two styles of government regimes, i.e., military and democratic, quarterly data was also analysed. For this purpose, quarterly data from 2002 to 2018 was available. It was very hard to collect quarterly data before the mentioned period due to the limited period.

Graphical Analysis

The graph (Figure 1) below depicts the annual NPLs (gross) and NPL ratio over the period from CY 1996 to CY 2017.

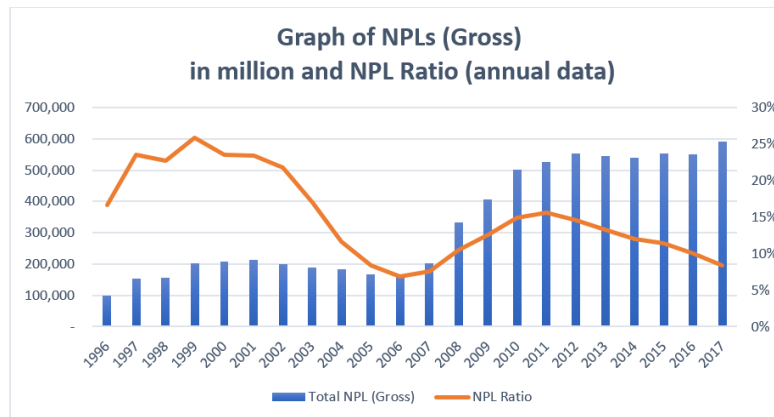


Figure 2. Annual NPLs (gross) and NPL ratio

The graph (Figure 2) depicts a positive trend in the increase in NPLs (gross) over the years; however, a few dips can also be seen. NPLs (gross) were low in 1996 and started increasing until 1999, when the military coup was observed. After that, there is a stagnant time in terms of NPLs (gross) but a decline in the NPL ratio. After the tenure of General Mushraf (after 2007), we can see an increasing trend in NPLs (gross) in 2017. The below-mentioned graph (Figure 3) shows a trend of NPLs (gross) with total advances in the banking industry of Pakistan during the tenure under research.

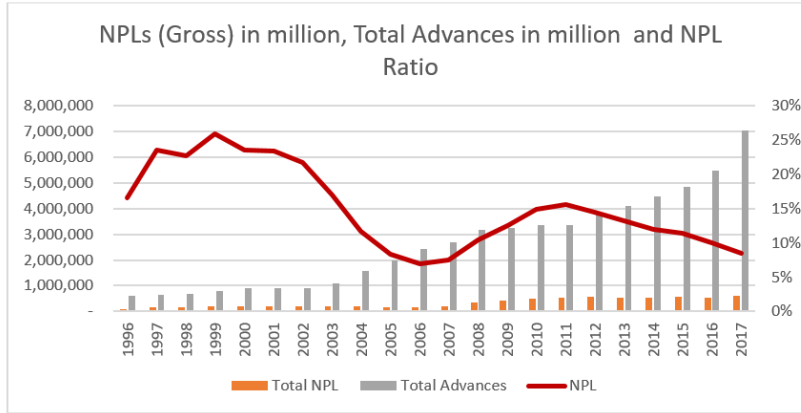


Figure 3. Trend of NPLs (gross) with total advances in the banking industry of Pakistan

It can be seen that total advances have increased significantly from CY 1996 to CY 2017. Since the banks were lending more, NPLs (gross) also show an increasing trend. The below graph (Figure 4) depicts NPLs (gross) and NPL ratio based on quarterly data from June 2002 to Sept 2018.

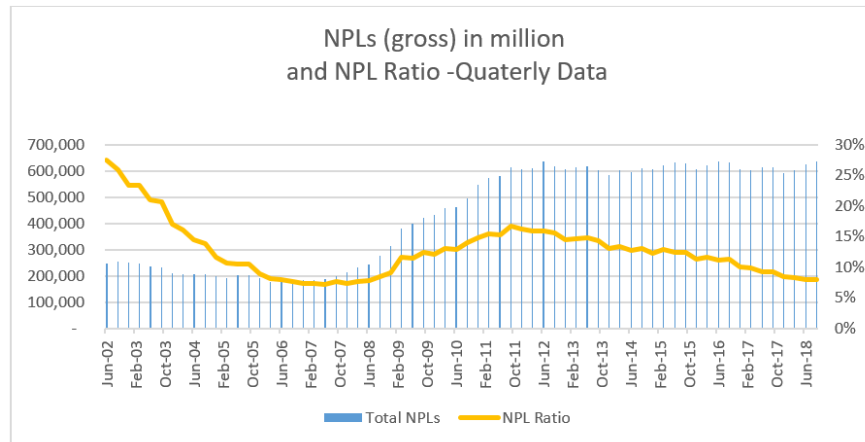


Figure 4. NPLs (gross) and NPL ratio based on quarterly data from June 2002 to Sept 2018.

It can be seen that from June 2002 to June 2008, NPLs (gross) maintained the same pace. However, after 2008, there is an increasing trend. This was the time when there was a change in government (from military to democratic). Figure 5 plotted the quarterly data of total advances, NPL (gross) and NPL ratio to see the trend from June 2002 to Sept 2018.

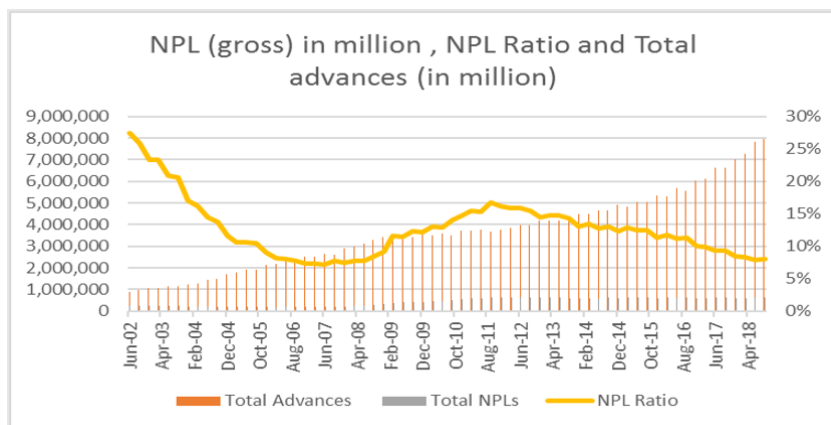


Figure 5. Quarterly data of total advances, NPL (gross) and NPL ratio

Reliability Analysis

Reliability can be defined as the consistency of data stemming from using a particular research method³⁰. However, for the study under discussion, data is collected from secondary sources (annual accounts of banks and from the State Bank of Pakistan). Therefore, a reliability test is not done.

Descriptive Analysis

This section of this research report presented a descriptive analysis of the NPL (gross) data for the mentioned period. The data was analysed by mean and standard deviation. This analysis was needed to understand the nature of the statistical measures and techniques to be applied for inferential research analysis.

Descriptive Statistics of Annual NPLs (gross) and NPL Ratio

Table 2 mentions the basic statistics for NPLs (gross) and NPL ratio annual data.

Table 2
Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Total NPLs	22	99243.09	7029449.31	621932.8100	1441019.75800
NPL Ratio	22	6.89	25.93	15.1114	5.95336

Group Statistic

The period under study is bifurcated into two groups (regimes), i.e., military regime and democratic regime.

³⁰ Taylor, Bill, Gautam Sinha, and Taposh Ghoshal. *Research methodology: A guide to for researchers in management and social sciences*. PHI Learning Pvt. Ltd., 2006.

Table 3
Group Statistics - Annual Data

	Regime	N	Mean	Std. Deviation	Std. Error Mean
Total NPLs	Democrat	13	424014.92080	178266.024400	49442.099350
	Military	9	192602.80330	17319.288700	5773.096234
NPL Ratio	Democrat	13	.14332	.045612	.012650
	Military	9	.16237	.077102	.025701

There are 13 observations for democratic regimes and 9 observations for military regimes. It can be seen from the results that average NPLs (gross) during democratic times (where N = 13) are considerably higher than in military times. Further, the standard deviation is also lower during the military regime. However, the mean ratio and standard deviation are higher in the NPL ratio in military regimes. As per annual data, the mean NPLs (gross) during the democratic regime are around Rs 424 billion; the mean of NPLs (gross) during military government is Rs 192 billion. However, the NPL ratio is 14 per cent and 16 per cent for democratic and military regimes, respectively. Similar Group statistics were analysed for quarterly data from June 2002 to Sept 2018. There was a total of 66 observations, out of which 24 depicted a military regime, and 42 depicted a democratic regime.

Table 3
Group Statistics - Quarterly Data

	Regime	N	Mean	Std. Deviation	Std. Error Mean
Total NPLs	Military	24	209666.29170	24313.554230	4962.983475
	Democrat	42	556011.14290	104391.098400	16107.896180
NPL Ratio	Military	24	.13487	.066971	.013670
	Democrat	42	.12275	.025754	.003974

The average NPLs (gross) on quarterly data from (2002 to Sept 2018) in democratic times are considerably higher than in military times. The average NPLs (gross) of the democratic regime are Rs 556 billion and Rs 209 billion for the democratic government. Moreover, the standard deviation is also lower during military regimes when analysed on quarterly data. In contrast, in the case of the NPL ratio, the mean ratio and standard deviation are higher in military regimes.

Inferential Analysis

This research study does not use an ANOVA table. Hence, model summary and parameter estimates were calculated in the curve estimation. The growth model is applied considering NPLs (gross) are dependent on time.

Table 4
Model Summary and Parameter Estimates-Annual

Equation	Model Summary					Parameter Estimates	
	<i>R Square</i>	<i>F</i>	<i>df1</i>	<i>df2</i>	<i>Sig.</i>	<i>Constant</i>	<i>b1</i>
Growth	.839	104.601	1	20	.000	11.627	.081
Dependent Variable: Total NPLs (gross) annual							

NPLs (gross) - annual are time dependent; their explanatory power is 83.9 per cent, which is highly significant as F-statistics is greater than 4. It can be seen that the average growth of NPLs over the period (1996 to 2017) is 8.1 per cent.

Table 5
Model Summary and Parameter Estimates- Quarterly

Equation	Model Summary					Parameter Estimates	
	<i>R Square</i>	<i>F</i>	<i>df1</i>	<i>df2</i>	<i>Sig.</i>	<i>Constant</i>	<i>b1</i>
Growth	.781	227.806	1	64	.000	12.078	.023
Dependent Variable: Total NPLs (quarterly) data							

In the case of NPLs (gross) - quarterly data, the explanatory power is 78.1 per cent, which is also highly significant as F-statistics is greater than 4. The average growth of NPLs (quarterly) from June 2002 to Sept 2018) is 2.3 per cent.

Test for Normality

Before deciding which test to apply, a test for normality was applied to annual and quarterly data. If the data set is smaller than 2000 elements, the Shapiro-Wilk test is used; otherwise, the Kolmogorov-Smirnov test is used. In the case of this research study, since the data comprises only 20 elements, the Shapiro-Wilk test was used. On annual data of NPLs, below is the result obtained from the normality test in SPSS.

Table 6
Tests of Normality (annual)

	Kolmogorov-Smirnova			Shapiro-Wilk		
	<i>Statistic</i>	<i>Df</i>	<i>Sig.</i>	<i>Statistic</i>	<i>df</i>	<i>Sig.</i>
Total NPLs	.289	22	.000	.812	22	.001
a. Lilliefors Significance Correction						

In order to have a normal distribution in Shapiro-Wilk, the sig value should be greater than 0.05. Since the sig value is 0.001, which is less than 0.05, it shows that data significantly deviate from a normal distribution. A similar test was also applied to NPL quarterly data; the below table depicts its result.

Table 6
Tests of Normality (quarterly)

	Kolmogorov-Smirnova			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Total NPLs	.247	66	.000	.784	66	.000
NPL Ratio	.107	66	.057	.893	66	.000

a. Lilliefors Significance Correction

Since the sig value is less than 0.05, the data (quarterly) also deviates from a normal distribution.

Statistical Test: Mann-Whitney U Test

Since the data was not normally distributed, this research study used a non-parametric test, also known as a distribution-free test that could be used instead of their parametric equivalent. The Mann-Whitney test was first constructed a ranked list of the dataset mentioned in two groups. Then, it worked from the lowest data and give that data value a rank of 1 so that the largest observation, in this case, had a rank of 21. The statistics required for the test are constructed from the ranks and shown in the table for NPLs (gross) and NPL Ratio annual data.

Table 7
Ranks

	regime	N	Mean Rank	Sum of Ranks
Total NPLs	Democratic	12	14.00	168.00
	Military	10	8.50	85.00
	Total	22		
NPL Ratio	Democratic	12	11.54	138.50
	Military	10	11.45	114.50
	Total	22		

It can be seen that the Regime category, Democratic has 12 observations, and the total sum of ranks is 168. This results in a mean rank of 14.00. The military regime has 10 observations whose total sum of ranks is 85. This results in a mean rank of 8.50. Therefore, in the regime category, the Democratic regime has a larger mean rank than the military and therefore has more value. In the NPL ratio, the mean rank for Democratic is 11.54, and the military is 11.45. However, the NPL ratio has a higher sum of ranks with 138.50. The Mann-Whitney test decided whether this difference in mean ranks is significant. This table shows us the actual significance value of the test. It provides the test statistic, *U* statistic, and the asymptotic significance (2-tailed) *p*-value.

Table 8
Test Statistics

	Total NPLs	NPL Ratio
Mann-Whitney U	30.000	59.500
Wilcoxon W	85.000	114.500
Z	-1.978	-.033
Asymp. Sig. (2-tailed)	.048	.974
Exact Sig. [2*(1-tailed Sig.)]	.050b	.974b

a. Grouping Variable: regime
b. Not corrected for ties.

The value of the Mann-Whitney U test is 30.000 for NPL (gross) and 59.5 for NPL ratio. The p-value is quoted next to Asymp. Sig. (2-tailed), is .048, which is less than 0.05. Therefore, we have significant evidence to reject the null hypothesis that the average NPLs in both regimes are the same. In the case of the NPL ratio, we reject the null hypothesis at a 0.10 significant level. A similar test is done on quarterly data. The value of the Mann-Whitney U test is 9.000 for NPL (gross) and 473 for NPL ratio. The p-value is quoted next to Asymp. Sig. (2-tailed), is .000, which is less than 0.05. Therefore, we have significant evidence to reject the null hypothesis that the average NPLS in both regimes is the same.

Table 9
Test Statistics

	Total NPLs	NPL Ratio
Mann-Whitney U	9.000	473.000
Wilcoxon W	285.000	749.000
Z	-6.533	-.289
Asymp. Sig. (2-tailed)	.000	.772

a. Grouping Variable: Regime

The mean distribution of the variable NPLs (gross) was compared for two regime groups, Democratic and Military. However, due to the non-normality of the variable, a Mann-Whitney test was carried out. The democratic regime has the largest rank than the military regime and thus tends to take larger values. Therefore, a statistically significant difference was found for these two groups with (U = 9.000, p is 0.000. Since the p-value of NPLs gross is less than the significance level $\alpha = 0.05$ selected for this research study, the null hypothesis is rejected, and it is concluded that the mean NPLs (gross) during military government regime and democratic government regime is significantly different.

Hypothesis Assessment Summary

The statistical analysis of this study has shown that the significance level is below the cut-off value, i.e., 0.05. Therefore, the null hypothesis is rejected. There is a significant difference in average

NPL (gross) between the military regime and the democratic regime from 1996 to 2017. Therefore, we reject the null hypothesis.

Discussion

This research study compares the NPLs during two political regimes that prevailed in Pakistan. It has attempted to analyse the impact of the military government (which came under power through military coups) and democratic government on Pakistan's economy, for which the banking sector was chosen. In this research study, the Pakistani banking industry was examined to conduct a study on non-performing loans. For this purpose, banking NPLs (gross) and NPL ratios were studied. The main objective was to see the NPLs during the tenure of military government and democratic government. In this regard, sample tenure from CY 1996 to CY 2017 was studied with annual accounts of the banks. This period included the initial three periods of democratic government, i.e., Nawaz Sharif, one military government, i.e., Gen Pervez Musharaf, followed by two democratic governments from 2008 to 2013 (Asif Ali Zardari) & 2013 to 2017 (Nawaz Sharif). Data from the whole banking industry (public sector banks, private banks, and Development Finance Institutions) regulated by the State Bank of Pakistan are included in the research. The research study has highlighted the importance of the political system on the banking sector and its performances, which NPLs mainly judge.

Average NPLS (gross) were compared during military and democratic regimes. It can be concluded that NPLs were in control during the military government, depicting that the banking sector was recovering the financed money. In comparison, the democratic time has witnessed high NPLs (gross). To be more precise, annual data (1996 - 2017) and quarterly (June 2002- Sept 2018) were examined. However, the conclusion appeared to be the same. One of the studies has argued that academic qualification, professional training, social learning and learnt exposure by military officials make them more progressive than civilians. Therefore, they try to neutralise and fix the governing system. The military is motivated to launch a coup by a desire to fix the ailing economy. In his study, Huntington mentioned the military government as a benevolent moderniser and considered military coups a natural part of development. Huntington, in his book, also quoted the 1958 military coup of Pakistan as one of the examples of autocratic governments taking power to restore a distressed economy³¹.

The high volume of NPLs may hinder credit growth, making banks avoid granting further loans. If NPLs were low during the military regime, it could be concluded that since banks were recovering their lent amount, they were lending more. However, in democratic times, since the recovery is slow and NPLs are more, in order to avoid further loss, banks were reluctant to finance fresh loans.

CONCLUSION & RECOMMENDATIONS

The results show that, on average, the economic performance of Pakistani banking sectors (when NPLs are studied) was significantly better in military governments than in democratic governments. NPLs of Pakistani banking sectors have increased during democratic governments in comparison to military governments. Though there is not much difference in the NPL ratio,

³¹ Huntington, Samuel P. *Political order in changing societies*. Yale University Press, 2006.

there is a significant difference in terms of the gross amount. This research report compares the average NPL between military and democratic regimes during the last 22 years (from 1996 to 2017). During this tenure, there was one military and approximately three democratic government regimes. The military regime has a statistically lower average than the democratic regime. This study concludes that the military regime was better for the economy. It may also be concluded that democratic governments implement loose control, which may hinder the recovery of loans. It can also be concluded that poor policies make the economy suffer through energy crises, price instability, inflation, etc., ultimately converting a performing loan into a non-performing loan. There are always deficiencies stayed with bank governance and recovery mechanisms. It is required to have more quality checks during credit appraisals to avoid making bad loans.

This research study was focused on conducting a study on non-performing loans of the banking industry of Pakistan during military regime tenure and democratic regime tenure. However, a period of 22 years, i.e., from 1996 to 2017, was used to study the annual NPL data (gross and ratio) of the banking sector of Pakistan. Though Pakistan has been ruled by a military government four times since its inception, due to the unavailability of NPL data from earlier years, data from 1996 was used (since it was available with the State Bank of Pakistan) for this research purpose. In order to seek information from individual banks, there was a possibility that banks may not maintain old records or NPL data separately as the banking sector reporting has transformed a lot. Similarly, the availability of quarterly data from 1996 was difficult due to limited access to the data source at the central bank. The quarterly data obtained were analysed with no seasonal adjustments. This research study has used only one determinant of banking asset quality, i.e., NPL, to study the banking sector's performance during military and democratic government. High NPL shows that banks lack due diligence in extending loans and suffer from the recovery of loans issues. Other macroeconomic indicators may be used in future research to study their performance during military and democratic regimes.

Recommendations

There is a growing recognition that the quantity or percentage of non-performing loans is related to bank failures and the financial status of a country. After the global financial crisis of 2007, the issue of non-performing loans has grabbed considerable attention because of the rapidly increased default of loans. The NPLs and NPL ratio are therefore considered as a critical measure to evaluate the banking sector's performance, the economic activity of a country, and the national financial stability and soundness. The macroeconomic indicators and bank-specific factors may cause an increase in NPLs. This research study has focused on one determinant of banking performance, i.e., banks' non-performing loans. Therefore, a similar research study may be conducted on another performance indicator of banking sectors during the same tenure of military and democratic governments. This may include analysing their earnings, margins, and profitability.

Similarly, the period for such research was taken from 1996. Future research may analyse the data extracted from individual banks operating from 1947 to 1996 and maintaining NPLs. Data availability from 1947 to date enabled a better picture of the banking sector's performance in terms of loan recovery performance. It facilitated judging the performance of the banking sector during military government and democratic government since the inception of Pakistan. Moreover, NPLs of other countries with similar political structures as Pakistan and similar military coup history may also be explored. This comparison showed the global picture of such instances and their impact. It

is useful to analyse the performance of the military and democratic systems. It was also helpful to scrutinise the impact of their respective policies on the economy's development and the overall economy's growth. The banking sector, the key economic system component, was affected by respective policies. Further, the problem of non-performing loans and high NPL ratios is a continuous challenge. A complete avoidance of bad debts would be impossible in practice; rather, there is a high need for supervisors to have in place a suitable framework to minimise the number of NPLs and how existing NPLs should be dealt with.

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