**The Ministry of Education of Azerbaijan Republic**

**Non-Performing and Bad Loans' Portfolio in Banks; Repayment Problems and Solutions**

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This could be realised that the Azerbaijani financial system has a steady growth in the banking system during the first decade of the 21st century. Throughout this advancement, economic organisations such as banks play a massive leadership position. Nevertheless, the conclusion of any growth always follows a negative side. Moreover, the supposition of every development always tends to follow a flipside. Wide ranging project coerces many investment banks to increase debt levels. Bad debt has become a serious issue for the economy of Azerbaijan. Non-performing loan has become a serious problem for the financial system of Azerbaijan Republic.

There have also been tricky outcomes on Azerbaijan and its commercial banks after drop in oil prices. The government, that for more than half of its income relies heavily on petroleum, had no option in 2015 to depreciate its currency. A quarter of the resources of banks have exacerbated, with smaller borrowers and financial institutions out of business. Monitoring the bad loan level is not a simple task for all banks because of this drawback. So many banks just do not have a resolution method. Identifying directives to influence bad debt rates are presented in compliance with each bank's specific function. The main objective of this research is to determine bad loans process improvement policy ideas and examine the banks and a case study of Azeri banks, as well. To make an inspiration to the growth, financial risk management strategies are investigated. Since it has a large part to play in manipulating the Azeri national economy bad loans rate. This dissertation also attempts to build a picture of Azeri banks ' borrowing assessment process and standard. In contrast, the requirements and proposals of the Central Bank of Azerbaijan are also explored to support the thesis.

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# Introduction

## Background of Study

 In the developing world economy, the place and position of banks are rising day by day. Banks bring different benefits and dynamics to a country's economy. The basic function of banks is to transfer the idle funds in the economy to the needy in the most efficient way. Loans are the most basic product of banks. Most of the loans are covered by the savings owners who have deposited their savings. Banks use their deposits as loans and as a result they want to maximize their profits. However, in this process, banks may face the risk of not repaying the loans in a timely manner. Banks aiming to achieve maximum profit with minimum risk should ensure a balance between risk and income in this context. To achieve this balance; a management that can establish the balance between the sources and the use of these resources, identify the causes of the risks that may occur and take measures. The problematic (non-performing) loan can be defined as the disruption of the repayment plan between the debtor and the banks. Non-repayment of loans within a reasonable period of time, delay of collection and the possibility of loss will result in problem loans. If there are no problems with repayment, loans are a very profitable product for banks. Consequently, it is significant to avoid these types of risks. The growth in non-performing loans in developed and developing countries and the drift of the banks due to this reason reveal the importance of the non-performing loan issue. A number of failures in the repayment of loans cause negativity in the banking system and thus in the economic structure. The negative effects of non-performing loans will not be limited to the banking sector. The financial errors in the financial system are experienced due to the mistakes of banks during the crediting process, the problematic loans that may arise due to the management problems of the firms or different environmental factors, and the increasing problematic loans. Correct detection of the factors causing the problematic credit facilitates the solution of the problem. The costs incurred by nonperforming loans are not only limited to banks but can also be valid within the national economy. Within the last three years the Azerbaijani government has introduced multiple regulations to modify the financial system of the country. There is a lack of a coherent approach to dealing with bad loans, while financial risk management organisations used by profitable banks may be less successful. Non-repayment of loans within a reasonable period of time, delay of collection and the possibility of loss will result in problem loans. If there are no problems with repayment, loans are a very profitable product for banks. So, it is vital to stop these kinds of risks. Loans and savings are offeredno to those in need of funding to continue their economic activities. Banking crises state that the bankruptcy of commercial banks may not extend their maturities or fall into liquidity shortage as a result of their inability to meet the sudden withdrawal demands in demand deposits. As a result of the drift of a bank into crisis, the crisis in the bank is highly likely to spread throughout the financial system and lead to a systematic crisis. The growth in non-performing loans in developed and developing countries and the drift of the banks due to this reason reveal the importance of the non-performing loan problem. A number of failures in the repayment of loans cause negativity in the banking system and thus in the economic structure. Commercial banks are uncovered to credit risk for various reasons, from credit assessment to the repayment of the loan. Even, if the beginning of the lending process has been positive, there may be a risk for the loan for an unexpected reason in the future. The negative effects of non-performing loans will not be limited to the banking sector. The financial errors in the financial system are experienced due to the mistakes of banks during the crediting process, the problematic loans that may arise due to the management problems of the firms or different environmental factors, and the increasing problematic loans.

## Statement of the problem

The importance of loans in the development of economic development is considerable. In order to sustain their activities, grow and catch up with the developments, the enterprises meet their fund needs from banks. While the banks direct the funds, they have collected to the investment areas, profitability is the main starting point. Although credit is a profitable product, it is a risky product. Therefore, care should be taken to minimize the damages that may arise when lending. The credit process covers the process of contact with the customer, repayment of the loan with principal and interest, and the termination of the relationship with the release of guarantees. If the loan becomes non-repayable, that is, the banks affected by this situation may also affect other banks. The increase in problem loans may lead banks to increase interest rates and to aggravate banks' lending conditions. This may cause the entire banking sector and the economy to be affected. Disruptions in the payments system will have a negative impact on the real sector as well as the banking sector. Disadvantages will be experienced in the flow of resources to finance the production and the impact of the real sector on the overall economy can change the nature of the crisis in the banking sector. In this case, the depth and costs of the crisis will increase. Due to the inability of real sector companies to pay their corporate debts, the banking system will be delayed and / or non-performing loan rates will increase. With the deepening of the crisis, there will be a decline in the fulfilment of the obligations of all the units in the economy. There may be an increase in the situation of bankruptcy in the corporate sector and similar developments can be experienced in the banking sector. Thus, the economic activities of the people in need are continued and expanded. However, the savings should be protected against this situation. The application of state guarantees to savings deposits has been implemented in our country. However, the moral risk has arisen due to this situation. Banks have been excluded from the control of depositors and the risk factor has not been adequately taken into account. Increased resource allocation to areas that have a high risk of returning and not returning. Ensuring the collection of nonperforming loans requires that the cause of the credit becomes problematic. The policies and activities of the company help in uncovering the reasons of non-performing loans. Doubt in economic markets is similarly frightened. Because, uncertainty in financial markets is not an element that can be measured and managed. Then the risk will be accomplished. The important thing is to manage the risks encountered in the best way and be prepared for the losses. Measured credit risks are used in the determination of credit approval and limits, in the calculation of the reserve, in the risk pricing, in identifying the problem loans, in the calculation of the risk adjusted returns, in the calculation of capital adequacy. If all the credit activities in the banks are perceived within this framework and the risks are effectively managed, the existence of modern credit risk management can be mentioned. In traditional credit risk management, the method is based on the amounts of loans followed in the financial statements; however, the risk level of credit customers is not calculated according to scientific methods. The most important problem is the lack of consistent lending policy. Therefore, a consistent statistical data set cannot be created from credit rating studies

## Significance of the Study

Due to the essential role of banks in the economic system, it is essential to realize the issues affecting these institutions' exercises. Credit portfolios represent a significant part of Azerbaijan's profitability. These advantages give the banks expensive model payment, which determines the execution of banks in association with cash. It can be concluded that a strong lending portfolio affects the financial implementation of banks specifically. In any situation, some of these improvements are useless and have a negative impact on the operations of the commercial banks. These non - performing loans can affect the potential of banks to assume their role in stimulating the economy.

## Objectives of the Study

At first, according to theme of the research, it is significant to recognize many certain research objectives in order to methodically examine the problem. The research itself has a common purpose of the system that characterizes the cause of a bad debt problem and discovers so many ways to tackle this problem in Azerbaijan's commercial banks. Throughout other statements, the dissertation has the following some of detailed purposes:

* What are the tasks of non-performing loans and bad loan portfolio in banks;
* Examining the factors that cause of bad debts in commercial banks of Azerbaijan;
* What are the techniques and proposals that submit to the problem of bad loans;

## Limitation of the Study

Some limitations intimidate the quality of the research. The current data and calculations reported by the state remained isolated from assessment international institutions. Identified the challenges, attempts of the researcher to avoid deductions and analyses based on quantitative analysis. The research will also be supported over a qualitative procedure. Moreover, the function of this paper will be examining and analyzing non-performing loans; the option of purpose is appropriate.

The basic mission of the research is to investigate the situation of bad loans in commercial banks and find ways to tackle this problem. The major limitation of that kind of experimentation is flexible and mysterious data from commercial banks. In any situation, this postulation concentrates on the arrangements and strategies used for the problem of bad loans. The other limit is due to the limited measurements. Due to political pressure, there are many governmental reports that have contrasts and the information are not generally correct. The nearest statistics by international reports will be included in this research.

 It is generally accepted that consumer loans have less risk than commercial and corporate loans. But this is the general judgment of housing, automobiles and so on. In the case of loans used for, the goods received may be accepted as a provision or guaranteed. However, contrary to this situation, this jurisdiction cannot be accepted for the use of credit for durable goods, education, holidays, goods and services. In this case, the credit becomes problematic in order to be confiscated, so that the acquired commodity is not subject to the conversion into cash. In this respect, it would be an optimistic approach to qualify such loans as risk-free or low-risk with the judgment that they have a guarantee or a guarantee.

# Literature Review

This chapter illustrates a useful literature review of bad loans and other significant features of the overall topic. Previously examining some problems of a group of non-performing loans, this section will assess what non-performing loans are and how they rise and are administered. Certain parts are the summary of bad loans, non-performing loans, the identification and provision of loans, the effect of problem lending on banking operations and potential factors leading to problems of lending. This section inspects, before investigative the problems of a portfolio of non-performing loans, what non-performing loans are and how they create.

***RISK CONCEPT IN BANKING***

Globalization trends have led to increased competition in the banking system both at home and abroad. In our country, along with the transition to a free market economy, both banks' funding sources are growing, and there are different alternatives for the use of funds. Increased profitability and productivity in the sector led to increased risk. From this point of view, the rules for monitoring and controlling the dangers faced by banks are of great importance today.

Risk usually refers to an understanding that can lead to negative consequences. The probability of reducing the economic benefit due to the loss of any process or expense or loss is determined in its simple definition. Risk for another definition; is expressed as a positive or negative deviation from the expected value. However, in this concept, the risk is defined as bilateral. An unwanted event or impact when there is one-sided risk. The most prominent features of the risk are that they cannot be accurate and accurate, can change over time, cause and manage negative consequences. From a financial point of view, it is possible that the risk will reach the expected returns. Therefore, the risk is that the expectations are not perceived as a future concept. Given the high level of financial strength and reliability of the customers, there is a risk that in the future, due to the uncertainties that may be the basis for credit transactions, theoretically, there is a risk of not being reduced to zero.

***Types of Risk in Banking***

The risks can be divided into two as systematic and non-systematic risks. Systematic risks; the risks that may arise in the same way but at different levels, arising from the developments in environmental events such as economic, political and social situation. These risks are also referred to as market risk or non-diversified risks. These risks can be foreseen by enterprises but cannot be avoided. Systematic risks; interest rate risk, purchasing power risk, market risk, political risk and exchange rate risk.

The non-systematic risks are the risks arising from the factors that are specific to the enterprise itself, such as the financial structure of the business and the success of the business. It is possible to differentiate non-systematic risks into four as financial risk, operational risk, business risk and management risk. These risks are generally referred to as the risks that can be controlled by the enterprises because they are caused by the internal variables of the enterprise.

 In the banking sector, there are different classifications in the definition of the risks that the sector is exposed to. The regulations issued by the Banking Regulation and Supervision Implementation Committee (Basel) can be given as an example of these classifications. The Basel Committee is a committee of central banks of developed countries, which meet quarterly in Basel, Switzerland. Since 1975, the Committee has issued regulations for the banking sector.

In these publications, the risk issue of banks in capital adequacy regulations is given and the risks that banks face are examined under three headings: credit risk, market risk and operational risk.

**Credit Risk**

Credit risk is defined as the inability of the Group to repay the loan or to partially repay the loan or to lose the value of the securities given as collateral in return for the debt. According to another definition, the credit risk is defined as the probability of loss in a loan transaction arising from the possibility that the debtor or the counterparty in a contract cannot fulfill its obligations in full and on time. Credit risk may be due to the inability of the debtor to fulfill its obligations arising from the principal and interest payments due to the fact that it is inadequate in the economic sense. It may also arise from the lack of willingness to fulfill its obligations. Credit risk can also rise from variations in interest charges. Because in the periods when the interest charges rise, there is a decrease in the net worth of the borrower, which makes the repayment of the loan difficult. Therefore, there is an increase in the credit risks in the periods when the interest rates rise.

The credit risk resulting from the failure of the loans to be returned brings many problems with respect to the bank. In particular, losses incurred as a result of non-repayment of loans adversely affect the share values, capital structures and profitability of banks. In addition, such situations may affect the perception of banks from outside and may cause damage to their reputation and image. Therefore, taking various measures to avoid exposure to credit risk is an important issue for banks. In this sense, it is necessary to analyze the people and institutions that have been granted loans first. In these analyzes, factors such as the ability of the person or the institution requesting the loan to have the ability to repay the loan, the repayment of the debts used in the previous periods, and the capital structure of the institution using the credit are taken into consideration. In addition, banks may also obtain collaterals from creditors or third parties. In this way, it is possible for the bank to compensate the loss partially or completely by applying this guarantee in cases where the principal of the loan or interest is not paid.

**Exchange Rate Risk**

Exchange rate risk is defined as the probability of occurrence of changes in cash flows, income and expenses due to unpredictable fluctuations in the exchange rates of banks. The main reason for banks' exposure to exchange rate risk is that it is not clear whether the measure of change between national currency and foreign currency will change in what direction and amount and the amount of foreign currency that should be kept in the portfolio cannot be fully determined. Therefore, it is an important issue that the balance of properties and obligations of the resources and liabilities in the steadiness sheet of the banks is within their own balance.

The imbalances in the assets and liabilities of the foreign currency of the banks are called open and over positions. Here; open position means that the foreign currency denominated liabilities exceed the foreign currency denominated assets and the excess position denotes the foreign currency denominated assets in foreign currency. A bank with an open position is exposed to a loss due to its open position when the foreign currency gains value and gains from its open position when the foreign currency falls. A bank with more positions obtains a gain due to its excess position when the foreign currency gains value and loses losses due to its excess position when the foreign currency falls. Therefore, the open or excess position in the floating exchange rate policy causes the bank to face currency risk.

**Market risk**

Market risk, balance sheet and off-balance sheet accounts held by banks, arising from fluctuations in financial markets; interest rate risk arising from interest, currency and stock price changes is defined as the possibility of loss due to risks such as equity position risk and currency risk.

Considering the reasons that may be effective in the emergence of market risk, factors such as war environment, election year, existence of chaos environment, political or company specific scandals, increase in gold or oil extraction can be listed. In addition to these reasons, the optimistic or pessimistic direction of the expectations of investors about the future may be effective or decreasing on the market risk. Market risk has a direct impact on the profitability and capital adequacy of banks. Because the bank invests funds in financial instruments such as stocks and government bonds, and provides financial resources such as bonds and bonds. Therefore, the possible negative fluctuations may decrease the return expected by the banks or increase the borrowing costs. It is of great importance to take various measures in order not to be exposed to market risk or to minimize its impact. In this sense, the market risk concept of the Basel Committee was discussed in April 1993, and it was stated that banks should take into account the market risk when determining their capital and the related regulation was published. According to the regulation, banks will have to calculate the risk of each risk factor separately by taking into account the market risk and to keep capital at a fixed rate. The market risk consists of four sub-risk groups: interest rate risk, stock position risk, exchange rate risk and commodity risk. These sub-risk groups will be examined in detail below.

**Interest Rate Risk**

Interest rate risk is defined as the risk that a change in interest rates may cause in the bank balance sheets. More specifically, due to the changes in interest rates, the risks that may be effective in the emergence of the results such as the possible loss of income of the banks, the loss of the shareholders' equity, the disruptions in the cash flows and the decreases in the planned cash inflow values.

When we look at the interest rate risk formation, it can be said that the interest rate applied by banks in obtaining funds and the interest rate they applied when lending loans were exposed to this risk. In other words, banks tend to collect short-term funds but lead them to longer-term loans. The difference between the interest rate paid by the banks and the interest rates of the loans they make constitutes their profits. Interest rates are determined at the time of these transactions and they are not changed until the end. However, in case of an increase in interest rates in the market before the maturity of the loan, the bank is obliged to implement new interest rates while renewing its short-term resources but cannot change the interest rate of the loan. If no action is taken against fluctuations in interest duties, this will result in a loss or loss of profit by the bank.

**Stock Position Risk**

The stock is a security that give the owner the right to a partnership. Equity investment can be made in order to benefit from short-term price movements, while long-term value increase or profit share income can be realized. Equity position risk is defined as the probability of loss due to risks arising from financial fluctuations in equity positions held by banks. While the decrease in the price of the securities held by the investor causes losses, the price increase is considered to be a risk in terms of the banks holding short positions in the stocks.

**Technological Risk**

Technology risk is defined as the risks that may arise as a result of intensive use of technology in the banking sector. In order to speed up activities in banks, withdrawals, deposit, internet and telephone banking

For many services intensive technological sub-studies are required. However, these studies have led to new risks as well as positive developments in banks. These risks can be caused by errors in the information systems of the banks or from the interventions that may come from these systems. For example, the fact that a personal information that uses internet banking is accessible on the internet is both a problem in terms of the reliability of the system and causes the bank to lose reputation and customers. In addition, virus programs and erroneous or inaccurate programming bring about technological risks.

**Non-performing loans in banks**

Non-performing loans are defined as the delay in payment and the possibility of loss due to a significant deterioration of the repayment agreement between the bank and the debtor. As it can be understood from the definition, the fact that the loan is not paid in due time and the payment is delayed does not make the loan problematic. In order for a loan to be identified as problematic, the payment or agreement must be severely disrupted and the collection must be delayed. However, this may vary depending on the type of loan, the delay time, or the delay in one or more approved credits of the firm. For example, the delay in installments on individual loans and the delay of 30 days from the maturity of the commercial loans include these loans in the category of nonperforming loans. Three possible circumstances can happen after a bank loan is allocated to its customer.

- The loan may be allocated by the bank in accordance with the terms of the contract.

- The loan terms and payment plans can be rearranged by the Bank and its customers.

- Loans may not be allocated by the customer in accordance with the contract for various reasons

If the last of the three possible situations that may arise after the loan is allocated, the loan is included in the non-performing loan class. However, it may be clear in some cases that a loan used by the client will not be paid when due. In such cases where the possibility of non-repayment of the loan occurs, the loan may become problematic.

**Causes of Non-performing Loans**

It is not possible to link the cause of a loan to a single factor or event. There are many elements that can cause credit to become problematic. In most cases, credit may be problematic because of a combination of several reasons, not one reason.

The main factors that affect the non-performing loans can be grouped under three headings: business related reasons, environmental factors and errors arising from the banking system.

**Business Related Reasons**

The negative situations caused by the management of the company, the quality of the goods produced, the marketing conditions or the control systems can cause the credit used to become problematic. The reasons for the establishment of the problem loans can be examined under four headings;

a) Management inadequacies: Management is one of the most critical success factors. Therefore, a bad management has a significant share in firms' failures. Poor management can be caused by lack of knowledge, expertise and experience, but also by irresponsibility or bad faith. The fact that the entity has not determined the objectives and direction of the business or that the managers lack the ability to see and plan for the future may cause the firms to fail. For such reasons, it is difficult to pay the loans used by an entity with bad management and the loans may become problematic.

b) Quality of Goods Produced: The superiority and quality of the goods produced in the market allows an enterprise to continue its operations in a profitable manner. However, the situation of the product in the market may change due to the difficulties in supplying raw materials and energy, lack of qualified labor force, changes in consumption preferences or new technological developments. This situation may make it difficult for the company sales and repayment of the loans used.

c) Deficiencies in Marketing Activities: The basis of marketing activities, choosing the right channels of activity, determining the price policy and creating advertising campaigns constitute the factors. However, the fact that enterprises cannot create an effective marketing plan and cannot determine their position and role in the market can cause both sales and profitability to decrease. In such a case, the repayment of the loans used becomes difficult and the loans may become problematic.

d) Failure to Create Control Systems: The success of a business depends on the ability to control the work properly. Therefore, it is necessary to establish systems that control the overall production expenses of receivables, inventories, and thus control over production costs, assets or product quality. Otherwise, any problem can grow more easily, the solution may become impossible, profitability may decrease and the repayment of the credits used may be difficult.

**Environmental Factors**

Environmental factors that may cause a loan to become problematic are economic conditions, technological changes, government decisions and the reasons arising from natural resources. These reasons may cause problems in the repayment of the loan by affecting the profitability and sales of the enterprise. The environmental factors that cause the loan to become problematic can be examined under four headings;

a) Technological Developments: In order to continue production and increase profitability of an enterprise, adaptation to rapidly developing technologies and application of technological innovations are very important. The competitiveness of the enterprises which cannot adapt to the technological innovations and the demand for the product they produce can be reduced. This situation may adversely affect the profitability of the enterprises and also make it difficult to repay the loans used.

b) Economic Conditions: The fluctuations in the economy can directly affect the profits and success of the enterprises. For example, in periods of economic stagnation, businesses may experience serious declines in sales and consequently deterioration in their financial structure. These companies may also have difficulty in repaying the credits they use as their financial structures are damaged.

c) Natural Resources: The raw material supply is very important for enterprises to continue production. For example, in the event of unexpected disasters due to floods, earthquakes, droughts, enterprises may be damaged and financial

structures may be damaged. There may be disruptions in the repayment of the loans used by such enterprises.

d) Political Structure: Decisions on minimum wages, restrictions on import and export conditions, and the decisions taken by the government, such as increasing taxes, can harmfully affect the success, financial structure and repayment of loans used by these enterprises.

**Errors arising from the Banking system**

In addition to the operational conditions and the impact of the environment, the banking errors in the lending process may have an impact on the transformation of the loans used. It is possible to sort these errors as follows;

* The lack of intelligence about the borrowing enterprises.
* Failure to analyze the purpose of the loan and the source of repayment adequately.
* Worry about the loss of customers if no credit is provided
* In case of non-repayment of the loan, the collaterals that may be applied are inaccurate and inaccurate.
* The bad loans lengthy by the banks to establish their own requests without considering the demands of the enterprises
* The bank management's hasty and challenging attitude towards the issuance of credit

The reasons listed above are entirely caused by the administration in the finance system and often lead to a non-performing loan.

**The Effects of Bad Loans Portfolio**

**The Effects of Nonperforming Loans on the Bank**

One of the most important factors that banks should consider when allocating loans is to find a middle way between very low and very high risk. If the bank chooses to take very low risk, they will have missed many opportunities in the market. However, the cost of missed opportunities on the market may cause much less trouble than a troubled loan.

It is possible to list the effects of non-performing and high risks on the bank as follows:

* Nonperforming loans will cause damage to the bank's image and market name, thus adversely affecting the growth and development of the bank.
* The fact that nonperforming loans require significant expertise in legal matters will result in high legal costs.
* It will not be possible to divert funds due to non-performing loans to higher return alternative areas.
* Nonperforming loans will prevent managers from taking their time to more productive areas.

In addition to the above-mentioned negative situations, the inability to collect the credits on the maturity of the loan will affect the bank negatively on issues such as liquidity, reliability and re-resource creation. In the case of very high rates of non-performing loans, the bank may be terminated and the bank's bankruptcy may be in question.

**Effects of Non-performing Loans on the Economy**

In addition to the negative impact of the banking sector on the banks, the increase in non-performing loans also has negative effects on the national economy. It is possible to sort the effects as follows

* The fact that the loans used for the enterprises become problematic means the increase of the expenses in the enterprises. The increase in credit costs may cause sales to fall, as well as the bankruptcy of enterprises. In this case, new ones are added to the current unemployed and the economy is negatively affected.
* Banks whose financial performance deteriorated due to the suspension of nonperforming loans, try to collect their receivables from their credit customers as soon as possible and discontinue offering new credit facilities to these customers. This situation causes economic stagnation and deepens the recession.
* Banks have increased the interest rates on credit due to the fact that the nonperforming loans have a negative effect on the profitability of the banks and this leads to an increase in the cost inflation.

Considering these reasons, it is understood that keeping the troubled loans under control is important not only for the banking sector but also for the enterprises and the economy as a whole.

**Solution of Non-performing Loans**

As the negative effects of nonperforming loans on the banking system are in question, banks should act immediately after determining that loans have become problematic. If a loan becomes non-performing, there are three ways that the bank must apply in these cases;

* To continue maintaining relationships with customers
* Do nothing
* Exchanging guarantee to the cash

The bank's preference for such ways varies depending on the quality of the loan portfolio, the structure of banks, economic conditions and the experience of the bank management.

**To continue maintaining relationships with customers**

In this method, banks provide the opportunity to continue their activities by means of making loans or additional loans to the enterprises whose loans have become problematic. In this case, no decision is taken for the problem loans and the current credit relationship continues. It is therefore a highly risky and highly demanding way of analysis by banks. If it is decided by the bank to continue relations with the customer, the following plans must be implemented.

**Do nothing**

After the detection of nonperforming loans, the bank may also make no move to resolve these loans. However, with such a move, the bank will risk the further deterioration of loans or loss of value of collaterals. Here the bank needs to address the problem, according to the answers to questions such as: “Will the bank's interests be damaged by delaying action?” or “Do the delays worsen the current situation?”

**Exchanging guarantee to the cash**

When banks experience problems during the collection of nonperforming loans, they may choose to convert the funds received as collateral previously. This application can save time for the bank because it does not require large studies. Although this method seems easy at first glance, the intention of the borrower is of great importance. If the debtor's intentions are bad and he acts to prevent bank liquidation, this process can become more difficult, long and costly

**Measures to be taken before loan is purchased**

The reliability of the customer and the accuracy of the credit are important in minimizing the risk level. There are two situations when evaluating credit; the first is to consider the credibility of the customer and to keep the investment elements that will bring income to a large extent, in which case the risk level will be high and the asset quality will be low. The second is to keep the customer credibility in mind and to limit the amount of investment that will bring income. In this case, the investment rate is low, the risk level is low and the asset quality is high. The risk factor and profitability are in direct proportion. To keep the level of risk and investment at a reasonable level:

* Quantity of the available resources of banks should be allocated to loans, strategic credit policies should be established?
* The allocation of the appropriate loan and the purpose for which it is used should be followed. The disqualification of the loan is the main factor in making it problematic.
* The collateral received in credit studies is a deterrent. The rates of collateral turning into cash are important. Some guarantees may take a long time to convert into cash. Therefore, collaterals that can be converted into fast cash should be selected. If it turns into cash, it should also cover the risk. Otherwise, the maximum and maximum guarantee will not reduce the risk.
* A comprehensive study is required for the lending process, but it should be limited to the time it will not lead to customer complaints.
* The documents and signatures received from the customer should not be deficient, the accuracy of the signatures of the customer should be checked.

In this process, the transactions with the customer and the information received should be filed in writing. The credit risk can be minimized by the coordination of important units for monitoring and repayment of the loan from the stage of credit allocation. For this reason, it is important for banks to determine the credit capacity of the customer with the efficiency provided by the credit they have used and determine the credit repayment of this capacity. At the beginning of the lending process, the credit risk rating of the customer is required. Even if the customer's credit risk is rated, the credit risk may change over time depending on various factors. Due to the high share of monetary assets and obligations in the steadiness sheets of banks, the risks exposed are also high. The risk measurement process can be successful if it is carried out using standard rules, which are not changed frequently by local circumstances and individuals. Different pricing policies should be applied to customers according to different risk levels.

**Measures to be taken before making a credit non-performing**

If the loan is used for financing a number of projects, the operation of the projects should be monitored. It is important to properly assess the financial budget of the project. Failures in the operation of the projects will increase the risk of not being paid. Reconstruction of the loan should be considered in case of problems that arise due to logical reasons and problems that are not likely to cause problems. However, in cases where it is foreseen that it will cause a problem, a decision should be made on the way back to the customer. Although the loan is expected to be repaid, banks should have access to information on the measurement of credit risk in both the balance sheet and off-balance sheet activities. It should be ensured that the Bank provides sufficient information to determine the risk concentration. The loans extended to companies and individual customers should be closely monitored and the banks should have systems to monitor the quality and composition of the credit portfolio to reduce and control the risks of different loans. The Bank's strategy and policies regarding credit risk should be reviewed and approved by the Board of Directors on a regular basis. The credit risk strategy should ensure the recognition of the nature of the loan, its yield and size. The risk / return rate should be determined at an acceptable level. The Board of Directors' financial data should be evaluated regularly and should make necessary changes to the credit monitoring strategy as a result of the evaluation. Loan losses are accounted for in a variety of ways. In terms of accounting, loans that are likely to be uncollectible should be defined as doubtful loans, thus credit loss provisions are a method used to determine the decreases in the values ​​of banks' loans. Banks can allocate special provisions as well as general provisioning. General response; it is expressed as a provision on the sum of certain assets that should be set aside to compensate for the risks that are not fully determined but are expected to be realized in the future. The concept of special provision is the response created for the losses determined in a single loan. For example, small-term loans with common characteristics are grouped on a group basis.

It is important to provide timely recognition of the losses identified by the adequacy of the total provisions, specific provisions or loss-offs in the provisioning process for loans. The Bank should provide a provision for credit losses that may occur in the credit portfolio. The method of determining the provisions should provide for the determination of credit losses. Past trends and new trends in losses constitute the first stage of the analysis function but are not sufficient. Changes in improvement practices and lending procedures, changes in local economic and business situations, state of credit densities and changes in the level of these densities, changes in the magnitudes and effects of expired loans, as well as the volume of non-accrued loans, problematic debt restructuring and other loan arrangements Factors such as change should be taken into account in the determination method. It is inevitable that banks, which are likely to become problematic, will have to make a provision for their protection, in part, from adverse situations. The balance between risk and collateral should be maintained during the term of the loan. This situation should be reviewed frequently. However, this frequency varies according to the nature of the collateral. After this review, it may be necessary to renew the report again and take additional guarantees in case of depreciation. The credit status of the loan user also provides information about the financial position. Cash flows of customers with good financial status will also be smooth. However, it is possible to conclude that the credit limits allocated to him / her are limited in relation to the activities and financial situation of the customer in case of full usage of the credit limits. In this case, the customers' checks will start to be written on the market, postpone their payments, lose their discretion about the price and avoid the negotiations with the bank.

**Measures to be taken after the credit becomes non-performing**

For measures to be taken after the existence of a non-performing loan, the loan must be thoroughly analyzed. Credit debtor, loan file, the nature of the collateral and the relationship of the credit debtor with other lending institutions should be examined. It is important to know how honest and reliable the credit debtor is at the stage after the credit becomes problematic. It is important that the borrower be willing and act accordingly to the program that the Bank will apply to solve the problematic loan. There will be a trust-based connection among the two sections. The only option for the credit debtor who is unreliable, unwilling to follow the policies applied by the bank for the solution of the problem, and where immoral situations are observed, will be the cashing of guarantees, as well as taking necessary legal measures.

Risk may be encountered when cashing the value received as a loan guarantee. Because the value of the collateral received may decrease as the company experiences problems. It is important that the collateral meets the risk arising from the lending process of the bank. The guarantee is an asset if it creates the resources that can pay the debt due to the fact that the loan is problematic when it is transferred to the ownership of the bank by providing the necessary legal conditions and when it is sold. When the collateral is taken, the necessary legal transactions and the documents to be obtained must be in the credit file in full. There may be problems in the legal process if there are deficiencies in the credit file created. In fact, the bank may face a failure to claim a claim on the collateral. It should be considered that if there are any deficiencies.

The complete preparation of credit filings provides a quick determination of the problem and the ways to implement the solution. The minimum and most important documents to be included in the credit file are:

* Mutual correspondence between banks and credit customers
* Credit proposals and approval decisions
* Certified documents to show the financial status of the borrower.

**Restructuring Non**-**Performing Loans**

Restructuring is defined as the whole of all financial, organizational and legal measures.

An improvement in the meaning of restructuring means protecting and sustaining the debtor's business or company through financial and organizational economic measures. With restructuring, it is ensured that the insolvency or the debts are solved and the creditors are satisfied with the profit of the newly structured enterprise.

Institutional restructuring is often divided into financial restructuring and operational restructuring:

Financial restructuring refers to changes in the firm's capital structure. Financial restructuring can sustain assets and liabilities restructuring, purchase of additional loans to reduce the cost of the firm, increase the firm's cash flow, and provide the cash flow required to maximize the returns of shareholders and creditors, instead of being forced to liquidate the firm in a difficult situation, some of its shares are taken by the creditor institutions / organizations in return for their debts and these organizations are included in the management of the firm.

In operational restructuring, the improvement of corporate governance, mergers and acquisitions, purchase of a firm by borrowing, sale of a part of the company, division of the firm, exchange of shares between the parent company and the company, the issuance of new shares without increasing the capital, the sale of certain units or the non-profit units. The company tries to improve its financial situation through cost-cutting methods such as closure, spending and restraint in the workforce. Corporate governance is defined as "a directory of relationships between the board of directors, shareholders and other shareholders involved in the management of a firm". Corporate governance is considered as a restructuring tool that enables profitability, growth and competitiveness in the main areas of activity in the sector where the company operates.

As a result, restructuring is a wide-ranging improvement in the implementation of a broad consensus between the borrower and the creditors, including all financial, organizational and legal measures.

Each country follows different methods in the restructuring of the banking sector. These methods should be carefully selected depending on the socio-political and macroeconomic structure of the country. However, the basic principles of restructuring the banking sector do not change in all methods. These basic principles generally consist of four stages. As the first stage of restructuring and regulation in banking sector; trust in the banking sector should be aimed to be restored. Thus, the crisis will be prevented from reaching the advanced dimensions and the groundwork will be prepared for other restructuring efforts. As the second stage; With the legal regulations to be made, banks should have a stronger and more robust structure. Thus, the capital adequacy of banks and their activities in the sector will be rearranged. As the third stage; After financial measures in the form of transferring funds to banks, financial structures of banks will be strengthened and regular payments of payments system will be ensured. The last step in the framework of restructuring and regulations is the introduction of structural measures. With this last stage, the structure of the banking sector, which has deteriorated after the crisis, can be made more efficient and healthier by the structural measures to be taken.

**Financial Restructuring**

Interventions to banks are necessary but not sufficient for the sound functioning of the banking sector. In addition to banks, rehabilitation of the real sector, which is the reason of banks' existence, is also required. The fact that the banking crises that rendered the payments system ineffective were not only limited to this sector, but also had a negative impact on the real sector, led the decision-making authorities to find solution strategies to address both sectors together. This issue, also referred to as debt restructuring, will be examined through an approach. This is the most well-known “London Approach”.

**London Approach**

Due to the economic crises in the world, the economic structures of the countries that have an important place in the countries' economy, financial crises and the negative impact of the country's economy have made it necessary for countries to take some economic measures. These measures stand out as” restructuring” in economic language. With this process, restructuring approaches have been implemented by states.

In general, restructuring is defined as strengthening the financial structure of banks and other institutions and increasing the power of the bank and other institutions to fulfill their net worth and hence their obligations. The main purpose of the restructuring of banks and other businesses is to ensure the financial recovery and payment power of the institutions, to increase their profitability levels and to improve the intermediation capacity of the institutions.

With corporate restructuring;

- The restructuring of the firms which are in a position to survive and the liquidation of those who cannot maintain their existence.

- Strengthening the financial sector,

- Providing the necessary conditions for long-term economic growth

The role played by the state in restructuring programs is very important. In order for corporate restructuring programs to be successful, the state must perform certain tasks. The state can play a principal role in falling the economic and social costs of the financial crisis, constructing the negative conditions experienced in the real sector in a constructive manner and eliminating the problems between different interest groups.

According to the restructuring approaches, the state is able to mediate between the debtor companies and banks and banks. In the event that there are factors preventing the banks or banks to coordinate the restructuring among themselves, the state shall take over and assume the role of intermediary itself. The State is responsible for ensuring compliance between companies, banks and banks, and thus managing the business. The factors preventing banks or banks from restructuring the restructuring among themselves are the lack of bank capital, the lack of sound communication between debtors and creditors, or the lack of incentives to restructure debt due to ineffective management and supervision. These negative factors constitute a serious cost for firms. Borrower causes unnecessary liquidation of companies. So, these steps spread the restructuring procedure. In order to prevent this emerging structure, the state should undertake the mediating role in a more systematic and coordinated style.

The most well-known model of the government-mediated restructuring models is the “London Approach”. The London approach, which was first applied in the UK, provides guidance to banks and other creditor organizations on how to solve these problems of firms with economic problems. The London approach is a restructuring system designed to weaken the financial structure of the real sector which has difficulty in fulfilling its financial obligations and to strengthen the financial structure of the banks that have been in the position of the creditor. With this system, the London Approach has been one of the most accepted approaches by the real sector, as it has been ensured that unpaid bank debts can be solved in a more constructive way outside the bankruptcy option. In this approach, the solution of banks is based on the principle of voluntary acceptance.

The London Approach was first introduced in the 1970s by the Bank of England. It is a set of principles that play an active role in the process of restructuring the debts of companies facing financial crisis, who provide guidance in a sense and have no legally binding ties138. It is one of the state-mediated restructuring models and the most well-known of these restructuring models is the ma London Approach Devlet. In the mid-1970s, banks in the UK, which were faced with high inflation and economic stagnation, had to create corporate rescue units due to the loans they could not pay due to financial crisis companies.

The main objective of the London approach is to approach the banks and other creditor institutions with a view to what kind of a procedure they should follow when facing the problem of problem loans. But in no way as these rules do not have a legal sanction, the decisions of the Central Bank are considered as a recommendation. Since the Central Bank does not have any enforcement power, banks and other parties act in their own interest. However, with the London Approach, it is aimed to prevent the unnecessary damages of banks and other creditor organizations and to find solutions to the problems, while a financially challenging company is not guaranteed. Regulatory authorities do not intervene in the process. In the London Approach, wide participation in the process and this should be based on voluntarism. The London Approach is implemented in different ways in different countries, but shows some common features in each country.

As a result of the economic growth and developments in the financial sector in the 1980s, the Bank of England reviewed its policies regarding the restructuring of companies' debts and decided to relinquish restructuring strategies to the private sector and stepped back to establish a direct connection with firms experiencing economic contraction. The new role has also been identified as a supportive diplomat and catalyst in the process of restructuring the parties to reach beneficial solutions to everyone. In order for the approach to be flexible and easily adaptable, it is deemed appropriate to carry out informal meetings instead of official documents. The approach is adapted in many countries, including Azerbaijan.

Among the basic principles of the London Approach are the following: A broad participation is involved in the restructuring process and the principle of volunteerism is important. At this point, it can be said that the process is voluntary. For companies experiencing a serious financial crisis, banks are particularly advantageous in terms of loans, and firms that have economic difficulties are not pressured for bankruptcy. In the process of improvement, the legal way should not be preferred. The aim is to ensure that the firm maintains its economic presence. Banks act together in reconciliation. When a decision is taken on the future of the borrower, a joint decision is taken by all banks based on the comprehensive information about the company.

In addition to the positive impacts of the London Approach, some negative effects were also observed. The lack of a mechanism to protect the firm from the pressures of the creditors who are out of the scope of the company recovery process and the necessity of reaching unanimity among the banks are seen as the missing aspects of the approach. Although the London Approach does not guarantee the salvage of companies in distress, it ensures the protection of the firm value of creditors and partners, and prevents the reduction of employment and production capacity if implemented successfully. (Pen KENT. “Corporate Workouts: A UK Perspective”, Bank of England, 1997, s.3.)

**3 NON-PERFORMING LOAN PROBLEM IN BANKS**

**International Experiences with Non-performing Loan Portfolio**

The financial sector plays an important role in a modern economy, facilitating financial intermediation, that is, channeling funds from savers to investors. A solid and well-organized economic segment inspires valid and facilitates its distribution to the greatest industrious savings, thus preferring modernization and financial development. Commercial banks are the major economic intermediaries in Europe. Financial institution credit is similarly used to investment the requirements of households, in specific to provide their consumption outlines over time and assist them capitalize in actual major estates. An excessive growth of credit for the acquisition of housing can cause price bubbles in the real estate market. The following occurrence of these steps will be very weakening for the economic sector or the economy as a completely. Considering the risk of loan obtaining causing financial market bubbles, specifically throughout the property sector, supervising the financial sector's adequacy is a critical component in evaluating the flexibility of regional banking systems. European Union Member States apply different policies aimed at containing the possible risks.

The financial sector's modification in the EU countries continued after the downturn. The banking system was outsourcing in 21 of the 28 European Union Member States, as demonstrated by the significant reduction in complete banking assets comparative to GDP, in 2017. The trend of debt reduction, also known as "deleveraging", continued despite the improvement in the estimation of the economy and banks.

Overall, cash flow circumstances for the financial sector remained beneficial. Across Europe, financial institutions expanded their cash reserves to reach the EU's financial regulatory specifications, and most of them made a lot of progress in fixing cumulative non-performing loans. The strength of the banks can be assessed through indicators alike the ratio of bad loans to whole loans, the capital capability ratio and the normal return on equity:

The ratio of non-performing loans establishes a ratio between the nominal value of the bad loans and the one of all the loans. According to the definition of the EU, a loan is considered uncertain if more than ninety days pass without any of its terms being paid.

The proportion demonstrations the grade of weakening in the superiority of non-performing loans arranged by commercial banks. The larger it is, the worse the quality of the assets will be and, therefore, the anticipated losses will be higher. The ratio of capital adequacy shows the solvency of banks. It establishes a relationship between the value of the regulatory capital, that is, the capital instruments recognized by banking regulations, and the risk-weighted assets. This is a pointer of the skill of commercial banks to fascinate losses. The larger it is, the greater the capacity of banks to absorb losses without risking their solvency. The average return ratio of own funds establishes a relationship between the net income of the banks and their total capital. That is pointer of the overall effectiveness of commercial banks. Most high effectiveness advises that commercial banks are in a satisfactory location to rise their capital assets in the instant upcoming, specifically over undistributed incomes.

In general, the quality of bank assets improved in 2017. The commercial banks affected by the economic downturn sustained to clean up their collections. However, there are two exceptions, Cyprus and Greece: in both countries, the repayment of just over one third of the loans continued to be irregular. In 2017, the ratio of non-performing or bad loans continued to decline in Greece, but improved in Cyprus. This proportion was over 11% in five nations: Croatia, Ireland, Italy, Portugal, and Bulgaria. However, all of them managed to reduce it in 2017, like almost all the other Member States. Slovenia, Hungary and Romania made great progress in the area of non-performing loans, and managed to place the corresponding ratio below the 10% reference value.

The investment adequacy ratio continued to improve in most EU countries. The average ratio was in all of them equal to or greater than 12%, well above the regulatory minimum of 9%. In partial of the European Union Member Nations that stood over 17%. The median increased by one percentage point compared to the previous year. The maximum proportion was detected in Estonia (33%), followed by Ireland and Sweden. In Lithuania, the largest decrease was registered in 2017, although it remained at a high level. This evolution was due to the payment of dividends made at the beginning of the year by one of the main banks in the country. Dividends are paid out of undistributed profits, which are part of the capital of a bank. The adequate global capitalization hides differences between countries and banks. In countries such as Portugal, Italy and Spain, the capitalization of some entities is still below the optimum level and makes it difficult to grant new loans.

The profitability of banks improved in most markets, despite the environment of low interest rates. In 2017, the return on equity was at least 8% in half of the EU Member States. The median of said ratio increased by one percentage point compared to the previous year. The countries of central and northern Europe are the most profitable banking markets in the EU. The average profitability skyrocketed in three countries. The largest increase occurred in Greece, although it remained in negative territory. The Croatian and Hungarian banks also greatly improved their profitability. Italy and Portugal were the countries where profitability deteriorated most. Together with Greece, they were also the only banking markets that experienced losses in 2017.

Loans for the purchase of housing increased in most of the EU Member States. The median of the growth rate of non-performing loan portfolio increased from 1.5% in 2014 to 3.8% in August 2017 and continued to rise to 4.4% in June 2018.

The large volume of non-performing loan may explain the slowness of credit growth in some countries. Bad loans portfolio weigh on banks' balance sheets and reduce their profitability by causing revenue losses. They also block part of the capital of the entities, which reduces their capacity to grant new loans. Promoting the granting of new loans requires the extension of the restructuring of the balance sheets of the banks and the renovation of sufficient capital reserves. The volume of non-performing loans remains high in many EU countries and reaches double-digit figures in Greece, Cyprus, Italy, Portugal, Bulgaria, Ireland and Croatia.

**Chart 1**

Chart 1 illustrates how many percentages of these countries’ markets are Non-performing loans. Greece is leading this list among European Union with 46.2%. Despite Italy is the second most Non-performing loans portfolio in nation market, figure is 14,8%

Banks try to restructure non-performing loans or proceed with the execution of doubtful assets. To this end, however, they need the support of an effective legal framework for the collection of debts and the execution of assets. Many countries are promoting the improvement of insolvency frameworks and the operation of the legal system to ensure the streamlining of debt restructuring procedures. For instance, Greece has introduced electronic auctions for the sales of collateral. Another way forward is through out-of-court restructuring solutions, based on the voluntary cooperation of banks and debtors. If the restructuring of the non-performing loans is unsuccessful, banks may consider the disposal of assets whose value has depreciated. They can sell non-performing loans in specialized secondary markets, either directly or as securitized products. National authorities are determined to promote these markets, eliminating regulatory obstacles, adapting tax governments, offering specialized platforms for managing bad loans or providing public guarantees for the higher priority branches of the securitized loans.

The revaluation of the Swiss franc has highlighted, once again, the risks of foreign currency loans or foreign currency loans. The turbulence caused by the sharp appreciation of the Swiss franc was felt most strongly in Croatia and Poland. In Romania, where the majority of foreign currency loans are in EUR, the impact was lower. To help borrowers in foreign currencies, affected countries have already adopted several measures that sometimes impose substantial costs on banks. In Poland, the competent authorities are still discussion the optimal standardization of the relevant proposals, which will have to be approved by government. Policy makers are taking into account the experience accumulated in other markets when balancing the need to help indebted households and the need to preserve the financial solvency of banks and the financial stability of the whole country. The arguments related to social justice are also being considered in the debate.

M.V. Andreev states that consumer loans in developed countries intensively developed due to diversity and diversity of financial institutions (commercial banks, financial corporations, credit unions, non-profit organizations, state structures etc.) that provide loans to the community. It is characteristic that financial institutions follow the active consumer credit market, offer various consumer loans, offer various conditions and create new forms of lending. These are all enhanced by the advanced consumer credit infrastructure (credit bureaus, scoring institutions, collector agencies, consumer credit advisory centers for services for the population, etc.) and for decades with the normative legal basis. In addition, the US and EU member states are developing and implementing consumer credit development programs that increase consumer spending on a regular basis and consequently increase the industrial production of these countries. Therefore, the employment and income of the population is increasing, stability is achieved in the society and the demand for real estate, car and other goods is activated.

**Chart 2**

In chart 2, we can see that Italy has most amount of Non-performing loan portfolio in Q1 of 2018 by 224,2 billion USD. France and Spain is approximately twice less than Italy, their Non-performing loan amount is 142,2 and 131,4 billion USD accordingly.

According to official data, the average interest rate of bank loans in Azerbaijan is 16% in national currency and 17% in foreign currency. Commercial loans vary between 20% and 25% and consumer loans vary between 20% and 20%. In some cases, interest rates on consumer loans reach 36%. The analysis of the credit market of foreign countries shows that the interest rates in the country are high. For example, consumer loans in the European Union are given as an average of 7-8%. Germany, Luxembourg, Finland, Belgium and France account for 2-7% depending on interest rates. In the United States, this figure does not exceed 5%.

Consumer loans in the US are common. Only in the 70s of the twentieth century, consumer loans increased threefold. In the early 1990s, the figure exceeded $ 600 billion. It should be noted that in these years, the growth rate of consumer loans in developed industrial countries exceeded the dynamics of the US market. Thus, in Germany, consumer loans increased by 5 times in the 70s

In the early 2000s, it reached $ 190 billion. However, after the Second World War, the differences in the initial positions of the countries led to a peculiar position of the most comprehensive and developed US market. Therefore, when analyzing the Western experience, it is appropriate to first of all refer to the US experience and to pay particular attention to the experience of consumer credit in that country and to address the problem of non-repayment of loans.

The US has the most advanced consumer lending system. The beginning of consumer loans in this country is equivalent to the twentieth century. Over the past 20-25 years, Americans' consumer loans have increased fivefold. Today, most consumer goods are sold through consumer loans. According to the US Department of Commerce, June 2008, 196.4 billion dollars compared to the pre-crisis period, increased 2.4 times compared to 1992. At the same time, according to the US Federal Reserve System, consumer loans increased 3.2-fold (from $ 797.28 billion to $ 2574.1 billion), while gross domestic product increased by 1.6-fold. At present, the share of commercial banks and financial companies is much more about providing loans to Americans. In 1994, US commercial banks gave consumer loans not targeted up to 24 months, to 13.19% and to 11.1% in 2009. Consumer loans were 37.8%, repayments were 36.4% and other loans were 25.8%. The duration of land in this country is different. Products for long-term use are typically offered for 2 years and new vehicles for 4 years. Commercial banks in the new vehicles gave an annual 8.12% loan in 1994 and the interest rate in 2009 was 6.72%. Interest rates for automobiles were 9.79% in 1994, but in 2009 this rate dropped significantly to 3.82%. Commercial banks, financial companies and dealers offer car loans in this country. Dealers usually sell credit contracts to other financial institutions. The first payment for consumer loans is 25% of the vehicle cost. The analysis shows that the interest rates determined by the commercial banks are higher than the financial companies related to the new vehicle loan. For example, in 2009, the generalized interest rate for banks was 6,72%, while the interest rate in financial companies was 3,82%. Credit conditions are also characterized by the diversity in this country. Therefore, in 2009, financial institutions provided an average of 62.6 months if commercial banks provided loans up to 48 months. As a result, the amount of credit provided by financial companies in the period of 1994-2009 increased 1.83 times.

Since 1999, commercial banks in Russia have begun to issue their first consumer loans. The first Russian Standard Bank was signed in this area. In these years, the main purpose of obtaining credit was, as a rule, the purchase of household appliances and electronic equipment. Soon many other Russian commercial banks joined the practice and began working on 22 different programs in the credit market. In 2005, the first Bureau of Credit Bureau was established in Russia. The activities of credit history boards have enabled banks to manage credit risks typical for consumer lending transactions. From this period onwards, the rapid growth of the consumer loans market in Russia begins. At present, Russia's consumer credit market covers loans from almost all micro-loans or express loans to mortgages. In 2004-2006, consumer loans in Russia increased by 6.2 times to 1.8 trillion rubles. In this period, the share of loans granted to individuals in the total assets of Russian banks increased from 4.2% to 12.7%. The importance of loans to the country's economy is also increasing. The share of these loans in the assets of the finance system enlarged by 3 times in the 2004-2006 period. While the credit volume of the population was 5.7% in 2005, it was 8.3% in 2006.

**Chart 3**

Chart 3 describe the bad loans portfolio amount in Azerbaijan commercial banks. In that case we are obviously just seeing the between 2012 and 2018 years, there is still a massive increase in non-performing loan portfolio of country. (NBCBank report 31.03.2018)

At the same time, despite the rapid increase in consumer loans in Azerbaijan in recent years, the country lags behind some of the developed western countries in this area. For example, the figure in the United States was 74% in EU countries - 52% (for example, 40% in Hungary). In recent years, the rapid increase in consumer loans in Russia and the significant increase in the volume of these loans are double. On the one hand this process is positive, but on the other hand it causes many problems. One such problem is the increase in the number of non-performing loans. The volume of overdue debts increased by 2.4 times in the period 2004-2006. This fact should be regarded as negative, as banks ultimately lose resources and consequently lose their potential incomes. The situation is also complicated by the fact that the volume of consumer loans in these years increased only 1.6 times. Overdue loans, ie overdue loans, rose from 1.2% in 2004 to 2.7% in 2006. Statistical data show that the delayed loans in this country have reached 440 billion rubles by 31 percent (from $ 313 billion), up 19 percent in 2010, 6 percent in 2011, and 13 percent in 2012 and 39 percent in 2013. ($ 13.5 billion). At the same time, according to official statistics, overdue loans in this country decreased from 7.5 percent in 2010 to 4.4 percent at the end of 2013. According to the alternative estimates of Russian experts, the actual level of delayed loans in the country is significantly higher than the official one. In Russia, mainly, banks are busy lending to the population and the advanced infrastructure for consumer credit has not yet been fully established. Sakharova, before the crisis in the world economy, in many countries, including Russia, consumer loans reached a very high level, he said. Experts estimate that by the end of 2008 about 35% of the Russian population had access to this financial product. In 2010, there was a significant increase in the volume of bank loans taken by individuals: the total volume of these loans decreased by 11.3% in 2010 and 11% in 2009.

The entire loan is calculated by the credit institution and the credit recipient is informed in accordance with the decision of the Central Bank of the Russian Federation on 13 May 2008. "A number of steps are being taken at the state level to address the problematic credit problem in Russia in the calculation of the full credit amount. For example, the decision of the Russian Federation Council of Ministers regarding the possibility of the repayment of the loan is given for the citizens who suffer from the crisis. In Azerbaijan, I believe that such a mechanism should be developed in order to eliminate troubled loans.

UK financial institutions are divided into two groups: banking sector and non-banking financial institutions. The banking sector consists of commercial banks (including clearing banks), accounting houses, commercial banks, foreign and consortium banks. Non-bank financial institutions include construction companies, insurance companies, investment companies, pension funds, credit unions. The Bank of the England, created in 1694, is the central bank function in the UK. Although the Central Bank is led by the Ministry of Finance, it is officially independent of the government. Commercial banks constitute the second level of the British banking system. In this country, commercial banks are highly specialized with significant differences. Commercial banks mainly consist of deposit banks, accounting houses, foreign banks and homeowners. Britain's main deposit banks are cleaning banks. These are the largest anonymous banks with clearing liabilities. Other types of deposit banks are financial institutions. These houses are specialized in consumer loans. Approximately 65% ​​of its active activities fall to total consumer loans. Approximately 60% of these loans are directed to vehicle purchases. The minimum loan amount is 500 pounds. Bookstores are a special kind of financial institution in the London market. They engage in short-term credit transactions and act as intermediaries between commercial banks and the central bank. It withdraws funds in the form of deposits and directs them to short-term assets. Accounting houses also play the role of trading bonds. In the UK, it is more convenient to buy lands that are not large enough to buy household appliances. The interest degree of such consumer bad loans does not exceed 5-6% per annum. As a rule, vehicle loans are officially registered up to 3 years and up to 10% per year. The number of banks in each country is different. According to the number of commercial banks, the US leader. There are about 7,000 banks in this country. The majority of American banks are concerned with the historical feature of the country's banking system. In 1927, the US Congress adopted the Macfed Law, which prohibited banks from opening branches in other states. In 1956, Douglas amended the "Law on Banks Holding Companies", forbidding the bank owners to acquire a bank from other countries. The main idea of ​​these restrictions was to increase the competitiveness of local banks. As a result, a large number of banks were established in each state. Although there are no restrictions on the opening of bank branches and subsidiaries, most banks are the historical heritage of the country.

Germany, the second largest country in terms of the number of banks, immediately divided and occupied the territories that lived on its own after the Second World War. Although the area was later abolished, regional authorities had a strong influence on German territory, and as a result, banks were specializing in regional features. Empirical analysis shows that many factors influence the number of banks - historical, macroeconomic and institutional factors. This includes inflation, per capita GDP, relative size of the banking sector, country size, population size, and so on. According to the survey, the country's expansion (excluding Singapore, Hong Kong and similar overseas financial centers) shows an increase in the number of banks. The demand for banking services (money order, loan demand, deposit base) increases as per capita GDP increases. The attractiveness of the banking sector creates new players in the market and this increases the number of banks1. The level of development of the banking sector can also be measured by the ratio of total assets to GDP. According to experts' estimates, the ratio of total assets of the banking sector to GDP in economically weak developed countries does not exceed 5%. The share of the total assets of the banking sector in Azerbaijan is approximately 32%. The volume of bank assets in Azerbaijan has increased by 15.4 times in the last 10 years. Despite the recent increase in GDP in bank assets, Azerbaijan is behind the former USSR, Eastern and Central European countries.

**Chart 4**

Chart 4 illustrates non-performing loan portfolio in the sectors of the economy. (NBCBank report 31.03.2018)

The banking assets of the nations of Eastern and Central Europe (160.5%), Slovenia (140.6%), Estonia (135%), Croatia (119%) and the Czech Republic (111.1%) are considerably higher than the country's GDP. In western Europe, this ratio is higher. Hong Kong should be specifically mentioned when considering the experience of other foreign countries on consumer lending. Here, each credit recipient may have 14 different credit lines up to $ 75,000 on average. In most of the post-Soviet countries, interest rates vary from 10 to 20 percent. In the Baltic states, the annual interest rate of loans does not exceed 10%. In Turkey, annual interest rates are 10%. This proportion can be around just 6 percent, in China. Each Chinese family can take a loan of 4-6% for 20-30 years for purchase of flats, cars, furniture and so on. Thus, legal relations in the field of consumer lending in the legislation of Western countries, as a rule, are regulated by special laws. These laws include provisions specifically designed to protect the rights and interests of all participants in the legal relationship, as well as the specificity of the field.

One of the most important trends in the development of credit systems in developed foreign countries in recent years is the elimination of the differences between bank types, banking and non-bank credit institutions. As of 1 January 2017, there were 150 credit institutions operating under the license of the Central Bank. Of these, 44 are bank and 106 are non-bank credit institutions. One of the banks is state and 43 is private property. 22 of the private banks are foreign capital. It should be noted that in 1995, there were 180 credit institutions operating in the country and they were composed of banks. Since 1995, the number of banks has decreased by more than 4 times due to hard measures, including the minimum capital limit, due to the Central Bank's rigorous capital measures. Thus, at the end of 1995, the number of banks operating in the country was 180, and by the end of 2010, the number fell to 45. Since 1998, only non-bank credit institutions have been established in Azerbaijan. That year, there were 13 non-bank credit institutions. In subsequent years, there was an increase in numbers. In 1999, the number of non-bank credit institutions reached the highest level - a decline was recorded in 106 and subsequent years. Only in 2009, a law regulating the activities of non-bank credit institutions was adopted. One of the important points in the banking system of Azerbaijan is the lack of specialized bank. Therefore, all business banks show universal banking services. The fact that most of the banks in Azerbaijan are at a glance to the banking system shows that many proposals are present and therefore competitive, in reality a slightly different situation arises. Due to the high credit rates in the country, the rigor of these credit taking procedures will strengthen the idea that the high quality of services offered by the banks to the customers, the lack of the role of the banking system in the country's economy and other factors are not competitive.

The level of concentration in the banking system of Azerbaijan is quite high. In 2010, this figure was 60.5%. In 2010, the total assets of five banks (International Bank, Capital Bank, Bank Standard, Xalq Bank and Pasha bank) accounted for 60.5% of all assets. 39.2% of the authorized capital of the country banks, 61.3% of the deposit and 58.2% of the loan portfolio belong to five banks.

**Results**

Beside from their unique missions and structures, financial analysis is the most common and meaningful way to make future plans by examining the historical data of the banks, which are primarily aimed at making profit, like other commercial enterprises. Theoretically to investigate the developments in the banking sector in Azerbaijan, the second is the analysis of the last 6 years of the sector financial analysis. The Azerbaijani economy, which suffered serious problems both until 1995 and under the influence of the new separation of the Soviet Alliance and the influence of the Karabakh War, has started to implement important stability policies since then. As a result of the stabilization policies implemented, the economic development that started in the second half of 1996 continued rapidly until the end of 1998. Although it was affected by the Far East and Russia crises, the economic growth rates in the 2000s have been reached with the increase in oil prices. Azerbaijan's economy has achieved significant success in both economic growth, macroeconomic discipline and openness to innovation. Of course, there have been some problems in the transition process. Empirical studies also show that; a liberalized financial system contributes to more effective and economic development than economies with financial pressure. However, there may be instabilities during the transition from one regime to another (especially from a controlled financial system to a market-centered system), because new patterns of behavior must be learned and new institutions should be formed. For the modernization of the national economy of Azerbaijan administration; It has adopted goals such as raising the living standard of the people by creating a competitive economic system by using oil revenues in order to transform the potential of continuous development in non-oil sectors. In the policies implemented by the Central Bank, the importance of macroeconomic stability has increased. Otherwise, it is not possible to achieve the targeted transformation. The Central Bank has always taken into account the importance of this policy in its policies and targets. The healthy functioning of the banking sector is an important factor in the success of the stability policies implemented. In this respect, the financial situation of the sector in the last six years has been examined by using the data of the central bank.

The control of banks is carried out by the Central Bank of the Republic of Azerbaijan. The Central Bank of Azerbaijan is an important factor in the development of the banking sector by making use of the developed country experiences. The healthy functioning of the banking sector is an important factor in the success of the stability policies implemented. In this regard, the financial situation of the sector in the last six years, the data of the central bank

were investigated. As a result of the analysis, the value of the assets and liabilities of the sector increased from 3.8 billion in 2010 to as low as 14.2 billion AZN in 2016. Although the values ​​of liquid assets increased by 2.1 times, their share in total assets decreased. The revival in the economy led to an increase in credit demands. This increase was approximately 4 times the value, while the share in total assets was only 8%. Although there is an increase in value in the items of dull and other assets, their weight in total assets has not changed much. With the recent Global Crisis, the need for a very serious supervision of the Banking Sector has emerged. It was observed that the latest regulations in this context focused on the performance, effective supervision and supervision of the sector. In terms of international standards, the banking sector risk management, capital adequacy has entered the process of structuring. The capital adequacy ratio was determined as 12% by the Central Bank. If the capital adequacy of the banks falls below the level set forth in the laws, the banks are given a certain period of time to correct the situation and they are taken under strict supervision. If the situation is not corrected in the given period, the banks are subject to serious sanctions by the Central Bank. This led to a high capital adequacy ratio of the sector. Recent developments in the real sector have increased the demand for credit and have made banks more selective in credit evaluations. This behavior of the banks led to an increase in asset quality. As a result of the more efficient use of the funds that banks hold, the liquidity ratios have decreased. At the same time, performance indicators, profitability ratios have increased in general.

**Conclusion**

A nonperforming loan occurs when the payment between the bank and the debtor is not paid within a reasonable time. Delay in collection, the possibility of damage to the loan generated creates a problematic loan. A certain portion of the loans extended by each bank may turn into troubled loans or credit losses. Good management of the credit management of the banks positively affects both profitability and credit risk. Before the loan can be used, the customer's character, capacity, capital, earnings, guarantor will have to be paid attention. After the loan is disbursed, the effective monitoring process of the borrower and the loan becomes important. It is also important to make a provision by assessing the risk situation. If the loan is no longer a problematic loan, the status of the credit guarantee becomes more important. In order to be able to collect the problematic loan, it should be considered how reliable and honest the debtor is.

As a result, it can be said that the increase in non-performing loan ratios in the Azerbaijan banking sector has a negative impact on the country's economy and that it is important for banks to effectively manage credit allocation and management issues.

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