

## Article

# Ways to Improve The Bank's Performance By Reducing Problem Loans

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**Abstract:** This article discusses the importance of banks' reliance on various factors, such as active banking operations, reducing problem loans, adapting to socio-economic changes, developing new lending strategies and tools, effectively managing credit risks, and reducing problematic loans. Additionally, the significance of ensuring commercial banks' lending operations is undeniable, as the success of the entire country's financial system depends on addressing existing challenges in financial decision-making and reducing problem loans. The article also presents the author's suggestions for addressing these issues.

**Keywords:** Problem Loans, Banking, Bank Lending Activities, Financial Solutions, Financial Assets, Receivables, Lending, Non-Financial Assets, Real Assets, Cash, Banking Strategy, Bank Security, Strategic Management

## 1. Introduction

The rise in the cost of credit resources is considered one of the key factors leading to the deterioration of the bank's credit portfolio. In an attempt to maximize their revenues, banks increase interest rates on loans. This, in turn, raises the costs for borrowers, increases the production costs of their goods, slows down trade turnover, and reduces income and profitability. As a result, borrowers may face difficulties in making timely loan repayments. This creates a contradiction: increasing interest rates on loans leads to a higher risk of loan defaults.

Thus, during the process of economic transformation, commercial banks are actively developing their lending activities, which contributes to stimulating economic growth and improving societal well-being. According to the Presidential Decree No. PF-5992 of the Republic of Uzbekistan, dated May 12, 2020, "On the Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020–2025", the analysis of the current state of the banking sector reveals "a high level of state intervention in the sector, inadequate quality of management and risk management in state-owned banks, and a low level of financial intermediation in the economy," which are systemic problems hindering the development of the banking sector in accordance with economic reforms and societal needs [1].

In particular, when managing credit risks and preventing non-performing loans (NPLs), the key criterion is the analysis of the borrower's credit history. Credit bureaus that handle credit histories help to reduce default rates and mitigate factors that hinder

**Citation:** Dushabayevich X. Y. Ways to Improve The Bank's Performance By Reducing Problem Loans. American Journal of Economics and Business Management 2025, 8(8) 3742-3747.

Received: 30<sup>th</sup> Jun 2025

Revised: 07<sup>th</sup> Jul 2025

Accepted: 15<sup>th</sup> Jul 2025

Published: 03<sup>rd</sup> Aug 2025



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financing. The future development of this activity depends directly on the transparency of information — specifically, the reliability, timeliness, and completeness of disclosed data.

However, it is important to note that effective operations related to credit history require time to establish a functioning model and gather the necessary information. The future performance of such a model depends on the quality of the information collected by credit bureaus and the efficiency of its utilization.

### **Review of Relevant Literature**

In economic literature, the issue of managing non-performing loans (NPLs) is studied in the context of minimizing commercial banks' NPLs, credit analysis, and bank management practices. The concept of non-performing loans has been defined by several foreign scholars. For example, American economists Chris J. Bartlet and Diana McNaughton define a credit portfolio as encompassing the classification of loans [2]. Similarly, N. Sokolinskaya defines the credit portfolio as “a collection of short- and long-term loans” [3]. However, this definition mainly focuses on the maturity of the loans and does not fully disclose the essence of the credit portfolio. While the loan term is an important factor, it alone cannot determine the quality of the credit portfolio.

M. Malede highlights that loans are the largest component of a bank's asset portfolio and represent a key source of income for banks [4]. Therefore, understanding the factors influencing banks' lending behavior is essential to improving the efficiency of commercial banking activities. This is because loans typically account for approximately 60–65% of the asset portfolio of commercial banks.

According to foreign economist F.O. Olokoyo, “commercial banks play a crucial role in the overall development of the economy and have historically been a driving force behind economic growth, as evidenced by the rapid growth in private sector lending over time” [5]. The availability of financial resources in the form of bank loans has facilitated expanded and effective investments in sectors such as manufacturing, construction, real estate, retail, and other areas of the economy. The ability of banks to provide credit to commercial firms positively affects business efficiency, profitability, and future growth prospects.

Furthermore, M. Maloba notes that understanding bank lending behavior is highly important since the banking sector plays a central role in promoting economic growth and development [6].

Scholars such as A.M. Smulov and O.A. Nurzat, who studied credit risk and the management of non-performing loans in commercial banks, define overdue and problem loans as the total of all debts (obligations) partially or fully unpaid by the borrower to the lender (bank) within the agreed timeframe [7].

According to A. Platonov and S.A. Ivanov, non-performing loans are manifested in the borrower's failure to repay the principal and interest as per the contractual terms with the bank. Additionally, a non-performing loan can be interpreted as a “potential loss arising from the borrower's inability to repay the loan” [8].

Among local scholars, K.A. Mukhamejanov concludes that the source of credit risk lies in the borrower's inappropriate actions, which may result in their inability to repay the loan fully and on time [9].

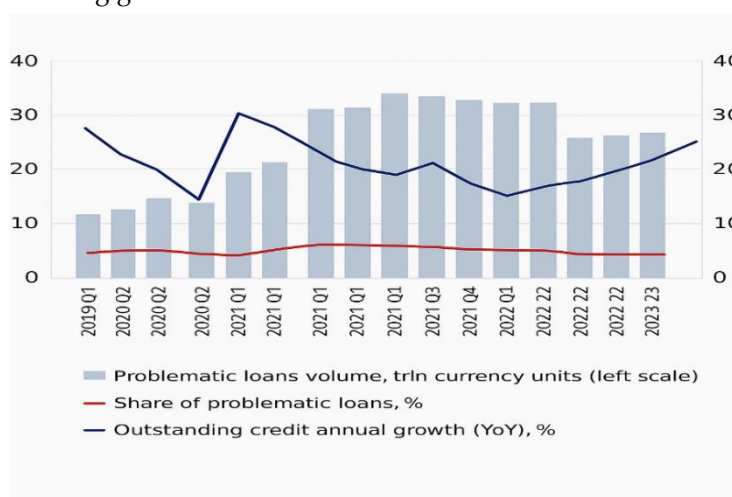
U.A. Tukhtabayev states that non-performing loans are the practical manifestation of credit risks — in other words, a result of ineffective credit risk management [10]. Indeed, the existence of overdue and non-performing loans in commercial banks not only negatively affects asset quality but also increases the risk of loan defaults [11]. Taking all the above into account, it is evident that the issues related to non-performing loans in the commercial banks of our country remain relevant and align with the scientific studies of the aforementioned researchers.

## 2. Materials and Methods

In the preparation of this article, normative legal documents, relevant literature, and official internet sources were analyzed. The scientific-theoretical views of economists on the subject were comparatively and critically reviewed. In the course of the study, general economic methods were employed alongside systematic analysis, generalization, abstract-logical reasoning, and statistical methods.

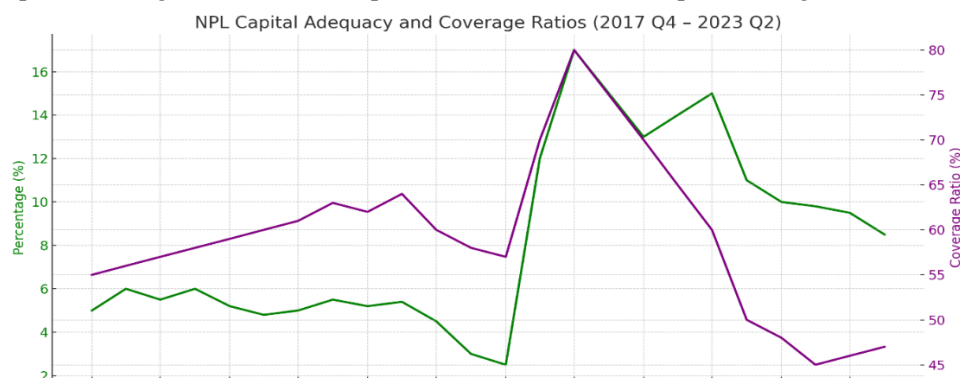
## 3. Results and Discussion

In the Figure 1 shows that currently, profitability indicators in the banking system are increasing. However, the trend of declining shares of highly liquid assets in total bank assets continues. The share of non-performing loans in the total loan portfolio remains at a low level, while the level of provision for potential losses on loans — created to mitigate risks — is demonstrating growth.



**Figure 1.** In the structure of total loans, the volume of problematic loans (NPL), the loan balance and the annual growth rates of the share of problematic loans.

In the Figure 2 shows that according to the data above, although the annual growth rate of the loan portfolio reached 23 percent in the first half of 2023, the share of non-performing loans (NPLs) in total loans across the banking system remained stable. In particular, as of July 1, 2023, the share of NPLs in total loans stood at 3.4 percent. The downward trend in the share of NPLs observed over the past two years in systemically important banks continued this year as well, reaching 3.8 percent as of July 1, 2023. The relatively higher share of non-performing loans in systemically important banks compared to other banks can mainly be explained by the issuance of directive loans. The continued upward trend in the NPL coverage ratio in the first half of 2023 reflects an increase in the level of provisioning created to cover potential losses from non-performing loans[12].



**Figure 2.** Provisions for problem loans and potential losses in the banking system, %.

In the Table 1 Shows that according to the above data, in the I half of 2023, the indicator of the ratio of problem loans to capital, which are not provided with reserves in the banking system, continued to decline. As of July 1, 2023, the ratio of problem loans with reserve deductions to regulatory capital has decreased by almost 5 percent of the employment compared to the corresponding period of the previous year, at 8 percent[13].

**Table 1.** Information on Non-Performing Loans (NPL) of Commercial Banks as of January 1, 2025, in billion UZS.

Bank name	Credit portfolio	Non-performing loans (NPL)	Share of problem loans in total loans
Total	533 122	21 185	4,0%
Banks with state share	366 731	14 344	3,9%
Other banks	166 391	6 841	4,1%

According to data from the Central Bank on the credit portfolio and share of non-performing loans (NPLs) of commercial banks, as of February 1 of the current year, the total credit portfolio of banks increased by 868 billion UZS, reaching nearly 534 trillion UZS. The volume of NPLs increased by 2.6 trillion UZS, totaling 23.8 trillion UZS. The share of NPLs in total loans reached 4.5 percent.

In addition, in January, the credit portfolio of state-owned banks grew by 129 billion UZS, while their NPLs increased by 2.5 trillion UZS. A decrease in the loan portfolios of Uzmilliybank (-514.8 billion UZS), Uzsanoatqurilishbank (-144.4 billion UZS), Xalq Bank (-860.6 billion UZS), and Turonbank (-99.4 billion UZS) was observed. Except for Agrobank and Xalq Bank, the share of NPLs in all other state-owned banks increased. Specifically, the highest increases in NPLs were recorded at Uzsanoatqurilishbank (+1.1 trillion UZS) and Uzmilliybank (+503 billion UZS). As a result, the share of non-performing loans in state-owned banks' credit portfolios rose to 4.6 percent[14].

Meanwhile, the credit portfolio of privately owned banks increased by 738 billion UZS, and their NPLs rose by 107 billion UZS. Over the month, 12 private banks experienced a decline in their loan portfolios. Among these banks, the largest increase in NPLs was observed at Orient Finans Bank (+82 billion UZS). The share of NPLs in the credit portfolios of private banks stood at 4.2 percent.

The downward trend in the share of non-performing loans in total credit is primarily due to the decrease in NPL volumes and the growth of the overall loan portfolio. It should be noted that in recent years, the stability of the exchange rate has minimized its influence on the share of NPLs in total loans[15].

In Uzbekistan, the share of non-performing loans in total credit is on a downward trend, approaching the 25th percentile threshold for Central Asia and the Caucasus countries. Specifically, as of July 1, 2023, the share of NPLs in Uzbekistan stood at 3.4 percent, representing the median indicator for the region. Moreover, by the end of 2022, the nominal wage growth in countries such as Armenia, Georgia, Tajikistan, Uzbekistan, Kyrgyzstan, and Kazakhstan exceeded the inflation rate. The recovery of economic activity and the increase in real wages in this region have eased debt servicing for borrowers. These positive changes were reflected in the improvement of the credit portfolio quality of banks in Central Asia and the Caucasus in the first half of 2023.

The rapid annual growth in outstanding loans provided to the population may lead to increased credit risks in the financial system and a greater probability of defaults among

relatively low-income borrowers. Under systemic shock conditions, this could result in an increase in the share of non-performing loans in the banking system and potentially hinder banks' ability to finance the real economy.

#### 4. Conclusion

Improving the efficiency of the banking system of the Republic of Uzbekistan is directly linked to the active participation of banks in financing the real sector of the economy. However, commercial banks in the country face several challenges and problems in their lending activities. Notably, the presence of problematic assets among the income-generating assets — which form the core of commercial bank revenues — remains significant.

Problematic assets typically arise when the borrower lacks sufficient funds to repay the loan. In some cases, they may occur even when the borrower has funds but is unwilling to repay. When the likelihood of problematic assets emerges, banks create mandatory reserves intended to cover potential losses.

It is necessary to improve lending practices by analyzing the credit history of applicants. For instance, borrowers with a positive credit history should be offered loans at lower interest rates compared to those with negative or no credit history, or requirements for collateral should be relaxed accordingly.

Commercial banks not only provide loans using their own funds but also disburse loans through the credits obtained from foreign financial institutions. In such cases, loan repayment issues are also observed in practice. To prevent this, insurance operations should be carried out, taking into account the interests of all three parties involved.

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