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Ways to Mitigate Problematic Loans in the Development of Banking Operations

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ABSTRACT: This article explores the significance of banks' reliance on various factors, including active banking operations, the reduction of problem loans, adaptation to socio-economic changes, the development of new lending strategies and tools, effective credit risk management, and minimising problematic loans. Furthermore, the importance of ensuring the lending operations of commercial banks cannot be overstated, as the overall success of the country's financial system hinges on effectively addressing the existing challenges in financial decision-making and reducing problem loans. The article also offers the author's recommendations for tackling these issues.

KEYWORDS: Bank lending activities, problem loans, financial solutions, financial assets, receivables, lending practices, non-financial assets, real assets, cash management, banking strategy, bank security measures, and strategic management are all encompassed within this discussion.

INTRODUCTION

The increase in the cost of credit resources is one of the important factors leading to the deterioration of the bank's loan portfolio. Banks increase interest rates on loans to maximise their income. Subsequently, this leads to an increase in the borrower's expenses, an increase in the cost of their products and, as a result, a slowdown in trade turnover and a decrease in income and profitability. For this reason, the borrower may experience difficulties in making timely payments on the loan. As a result, a conflict arises; increasing the level of interest rates on loans leads to an increase in the risk of non-repayment of loans.

Thus, in the process of economic transformation, commercial banks are actively developing their lending activities, which helps stimulate economic growth and increase the well-being of society. The Decree of the President of the Republic of Uzbekistan No. PF-5992 "On the Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020–2025", adopted on May 12, 2020, indicated that "an analysis of the current situation in the banking sector shows that there are a number of systemic problems that hinder the development of the banking sector in line with economic reforms and social needs, such as high levels of state intervention in the banking sector, insufficient quality of management and risk management in banks with state participation, and a low level of financial intermediation in the economy." [1]In particular, the main criterion for managing credit risks and preventing problem loans is the study of the client's credit history. Credit bureaus working with credit history help reduce the level of defaults and reduce the factors that hinder financing. The future development of this activity will directly depend on the level of transparency of information, including its reliability, timeliness and full disclosure.However, it is important to remember that it will take some time for the credit history activity to start working properly, create a real working model, and collect the necessary information. The future performance of this model will depend on the quality of the information collected by credit bureaus and the level of its effective use.

LITERATURE REVIEW

In the economic literature, the issues of managing problem loans, minimising problem loans in commercial banks, credit analysis and bank management, studied in scientific studies by several foreign scholars, are reflected in the definitions given to the essence of the concept of problem loans. For example, American economists Chris J. Barton and Diana McNaughton define a loan portfolio as a grouping of loans. [2]. Also, N. Sokolinskaya defines "a credit portfolio as a set of short-term and long-term loans" [3]. The loan term is the focus of this definition, but it doesn't fully capture the credit portfolio's essence. The bank's choice of loan terms and their adherence can significantly impact the credit portfolio's quality.

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M. Malede notes that loans are the largest element of a bank's asset portfolio and, in particular, the main source of income for banks [4]. Therefore, to improve the efficiency of commercial banks, it is important to understand the factors that affect banks' lending behaviour. This is because loans account for approximately 60–65 percent of the asset portfolios of commercial banks.

As foreign economist F.O. Olokoyo noted, "Commercial banks play a crucial role in the overall development of the economy and have always been the driving force of the economy, which is evidenced by the rapid growth of lending to the private sector over time [5]. The availability of funds in the form of bank loans has helped to expand and effectively attract investment in the manufacturing industry, construction, real estate development, retail trade and other sectors of the economy. The ability of banks to provide credit to commercial firms has a positive impact on the efficiency, profitability and future growth of businesses.

In addition, M. Maloba emphasises the importance of understanding bank behaviour in the lending sector, as it plays a crucial role in stimulating economic growth and development [6].

Researchers A.M. Smulov and O.A. Nurzat, who have examined credit risk in commercial banks, addressed the management of problem loans and minimising their occurrence. They define overdue and problematic loans as the total of all debts (obligations) owed to the lender (bank) that remain unpaid (unfulfilled) either in full or on time by the borrower [7].

A. Platonov and S.A. Ivanov further elucidate that problematic loans arise when the debtor fails to repay, either partially or fully, the principal amount along with any accrued interest, in accordance with the terms of the contract established with the bank. Additionally, a problematic loan can be characterised as a loss that the borrower may not repay [8].

According to the conclusions of local scientist K.A. Mukhamedzhanov, who has studied issues related to credit risk and the management of problem loans in commercial banks, the source of credit risk lies in the borrower's improper activities. These actions can lead to an inability to repay the loan in full and on time [9].

U.A. Tukhtabaev further asserts that problem loans are a manifestation of credit risks in practice; they arise from inadequate management of these risks [10].

Indeed, the presence of overdue and problem loans in commercial banks adversely impacts the quality of assets and increases the risk of loan non-repayment [11].

Considering the above points, it is evident that the research conducted by the aforementioned scholars is highly relevant to the current situation regarding problem loans in our country's commercial banks.

RESEARCH METHODOLOGY

In preparing this article, a comparative and critical analysis of the legal and regulatory documents, literature, online resources, and the scientific and theoretical perspectives of economists on the topic was conducted. Throughout the study, a range of general economic methods were employed, including systematic analysis, generalisation, abstractlogical reasoning, and statistical methods.

ANALYSIS AND RESULTS

Today, the overall indicators of profitability within the banking system are on the rise. The banking sector continues to demonstrate a decreasing trend in the proportion of highly liquid assets relative to total assets. The proportion of non-performing loans compared to total loans remains low, while the level of provisions set aside to cover potential loan losses is increasing..

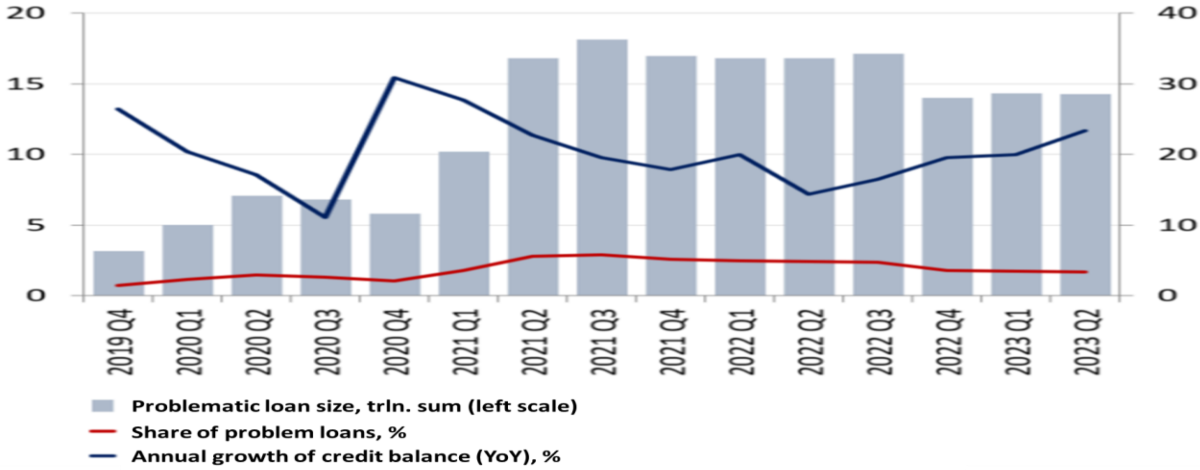

Figure 1. Annual growth rates of the volume of non-performing loans (NPL), overall loan balance, and the proportion of problem loans within the total loan structure.

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According to the figure provided, despite the annual growth rate of loan balances reaching 23 per cent in the first half of 2023, the proportion of problem loans within the total loans of the banking system remained stable. Specifically, as of 1 July 2023, the share of non-performing loans (NPLs) in total loans was 3.4 per cent. This year, the proportion of NPLs in systemically important banks continued the downward trend observed over the past two years, falling to 3.8 per cent as of 1 July 2023. The allocation of directive loans primarily explains the relatively higher level of problem loans in systemically important banks compared to other banks. The ongoing increase in the coverage ratio for problem loans during the first half of 2023 indicates a rise in provisioning levels, with reserves established to address potential losses on NPLs.

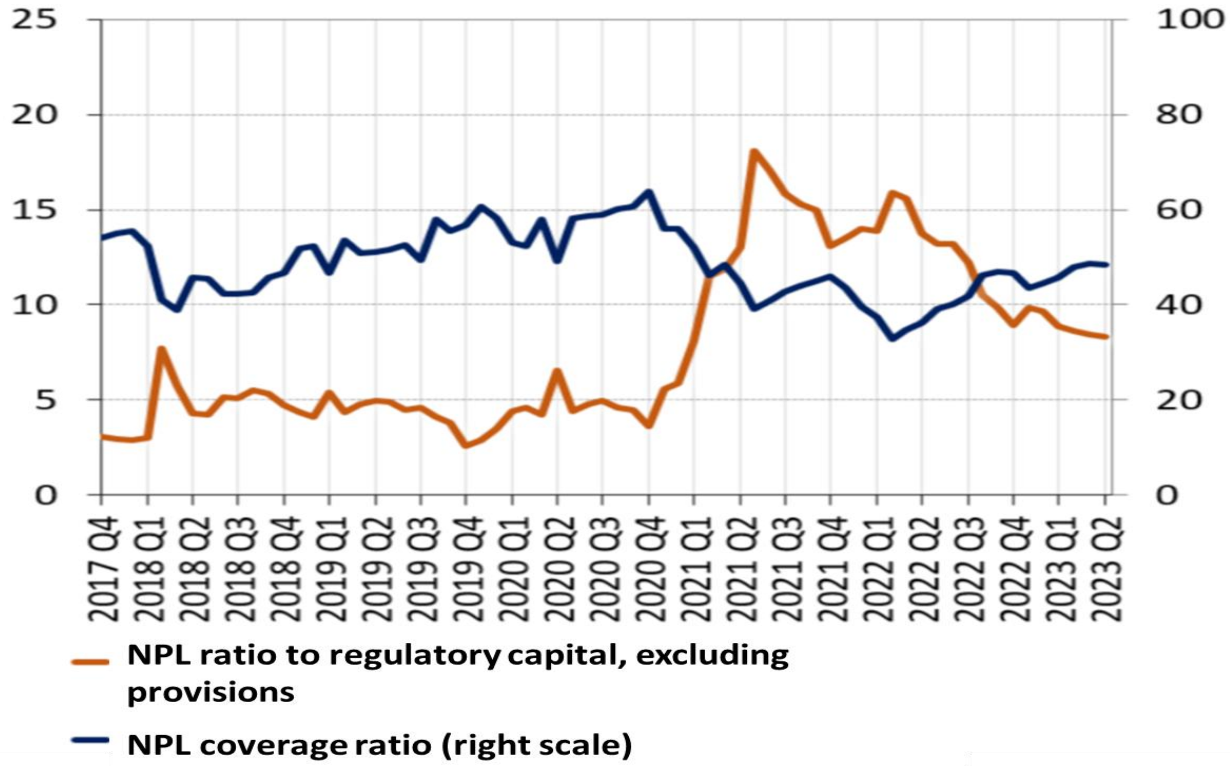

Figure 2. Reserves set aside to address problematic loans and potential losses within the banking system, expressed as a percentage.[1]

In the first half of 2023, the ratio of non-reserved problem loans to capital within the banking system continued its downward trend, as indicated by the data that was presented. As of the first of July in the year 2023, this ratio had nearly five percentage points lower than it had been during the same time period the year before, reaching a total of eight percent.

Table 1 Data on non-performing loans (NPL) of commercial banks as of 1 January 2025, in billion soums.

№	Bank name	Credit portfolio	non-performing loans (NPL)	share of non-performing loans in total loans
Total		**533 122**	**21 185**	**4,0%**
State-owned banks		**366 731**	**14 344**	**3,9%**
Other banks		**166 391**	**6 841**	**4,1%**

As of 1 February this year, the total loan portfolio of banks rose by 868 billion soums, reaching nearly 534 trillion soums, according to data from the Central Bank regarding the loan portfolio and the share of problem loans in commercial banks. The share of non-performing loans (NPL) within the portfolio increased by 2.6 trillion soums, totalling 23.8 trillion soums. Consequently, the share of NPLs in total loans reached 4.5%. Additionally, in January, the loan portfolio of state-participation banks grew by 129 billion soums, with NPLs rising by 2.5 trillion soums. There was a decline in the loan portfolios of Uzmilliibank (-514.8 billion soums), Uzsanoatqurilishbank (-144.4 billion soums), Xalq Bank (-860.6 billion soums), and Turonbank (-99.4

[1] The information was compiled by the author using data from the central bank.

[2] The information was compiled by the author using data from the central bank.

billion soums). The share of NPLs in the portfolios of all state-owned banks increased, with the exceptions of Agrobank and Xalq Bank. The largest increases in NPLs were recorded at UzProsperity Bank (+1.1 trillion soums) and UzMilliybank (503 billion soums). The proportion of problem loans in the loan portfolios of state-owned banks rose to 4.6%.

The loan portfolio of banks not under state control increased by 738 billion soums, and NPL increased by 107 billion soums. During the month, the loan portfolio of 12 non-state banks decreased. Among these banks, the largest increase in NPL was observed at Orient Finance Bank (+82 billion soums). The share of NPL in the loan portfolio of private banks amounted to 4.2 per cent.

The dynamics of the decline in the share of problem loans in total loans were observed mainly due to the decrease in the volume of NPLs and the growth in the balance of total loans. It should be noted that recently, due to the stability of the exchange rate, its impact on the share of NPL in total loans has been negligible.

In Uzbekistan, the share of problems in total loans has tended to decrease, approaching the 25th percentile for the countries of Central Asia and the Caucasus. In particular, as of July 1, 2023, the share of problem loans in Uzbekistan amounted to 3.4 per cent, representing the median indicator for this region. Also, by the end of 2022, nominal wage growth was above the inflation rate in countries in Central Asia and the Caucasus, such as Armenia, Georgia, Tajikistan, Uzbekistan, Kyrgyzstan, and Kazakhstan. The recovery of economic activity in this region and the increase in real wages are making it easier for borrowers to service their loans. This positive change was reflected in the improvement in the quality of the loan portfolio of banks in Central Asia and the Caucasus in the first half of 2023. The rapid annual growth in the balance of loans provided to the population may lead to an increase in credit risks in the financial system, as well as an increase in the risk of bankruptcy for borrowers with relatively low incomes. This situation will result in a higher share of problem loans within the banking system during systemic shocks, and it may also increase the likelihood that banks will negatively impact their ability to provide credit to the real economy.

CONCLUSIONS AND SUGGESTIONS

Increasing the efficiency of the banking system in the Republic of Uzbekistan is closely linked to the active involvement of banks in lending to the real sector of the economy. However, commercial banks in our country face various challenges and issues in their lending activities. There is a significant presence of problem assets among loans, which constitute a substantial portion of the income-generating assets of commercial banks.

Problem assets typically arise when borrowers lack sufficient funds to repay their loans. In some instances, they may also occur when clients refuse to repay loans despite having the necessary funds in their accounts. When there is a potential for problem assets to emerge, banks are required to form mandatory reserves to mitigate possible losses.

It is essential to enhance lending activities by analysing the credit history of individuals applying for loans. In this context, it is crucial to adopt the practice of offering loans to individuals with a positive credit history at lower interest rates compared to those with a negative or no credit history or to reduce collateral requirements. Commercial banks not only conduct lending operations using their own resources but also offer loans sourced from foreign financial and credit institutions. In this process, it has been observed that loans are often not repaid. To address this issue, it is necessary to implement insurance operations that consider the interests of all three parties involved.

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