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Article

Loan Portfolio of Commercial Banks and Its Quality Improvement Mechanisms

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Abstract: In the context of increasing macroeconomic uncertainty and increasing credit activity of commercial banks, the issue of improving the quality of the loan portfolio and reducing the share of problem loans is becoming particularly urgent. This paper analyzes the reasons for the emergence of problem loans in the loan portfolio of commercial banks of the Republic of Uzbekistan, their impact on banking activities, and the scientific, theoretical and practical aspects of improving the quality of the loan portfolio. The study studied the dynamics of such indicators as the loan portfolio and problem loans of banks. Also, based on the experience of developed countries, scientific and practical proposals and recommendations were developed to improve the mechanisms for managing problem loans.

Keywords: Commercial Bank, Loan Portfolio, Credit Risk, Problem Loans, Bank Assets, Reserves, Macroeconomic Factors, Internal Factors, Portfolio Quality, Efficiency.

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1. Introduction

In the current conditions of globalization, the stable and uninterrupted operation of the banking system is, first of all, closely related to the quality of its loan portfolio. Because the loan portfolio formed by commercial banks not only constitutes the main part of bank assets, but also is an important factor determining their financial stability, liquidity and profitability [1]. In particular, a high concentration of credit risks in banks with low loan portfolio quality leads to increased financial losses, an increase in the volume of required reserves and a decrease in the adequacy of bank capital.

In the process of economic reforms, modernization of the real sector and support for entrepreneurial activity in the Republic of Uzbekistan, the role of commercial banks in lending is increasing. At the same time, the rapid growth in the volume of credit resources allocated by banks to real sector entities makes the issue of credit risk management even more urgent. Because, along with the expansion of lending volumes, the violation of loan repayment discipline, the instability of the financial situation of borrowers, and the increase in the share of problem loans under the influence of external and internal economic factors have a serious negative impact on the financial stability of banks.

An increase in the share of problem loans in the loan portfolio leads to a decrease in bank income, an increase in non-interest expenses, and an increase in the volume of reserves allocated to cover credit risks. As a result, the capital efficiency of the bank decreases and the stability of the banking system is undermined [2], [3].

Therefore, a high share of problem loans in the loan portfolio poses a threat not only to the activities of individual commercial banks, but also to the financial stability of the entire banking system, the continuity of the financing process of the real sector of the economy, and the financial security of the country. It is these aspects that require in-depth scientific-theoretical and practical research into the issues of improving the quality of the loan portfolio, effective management of problem loans and minimizing credit risks.

2. Methodology

This study used scientific research methods such as systematic and logical analysis, statistical analysis and comparison, graphical and tabular methods, induction and deduction, and comparative study of international banking practice. The information base was the data of the Central Bank of the Republic of Uzbekistan, World Bank reports, and scientific literature.

Literature Review

A loan portfolio is a set of all loans issued by a commercial bank over a certain period of time, and it is the most important component of bank assets. The quality of the loan portfolio is assessed by the level of repayment of loans, profitability and risk indicators.

A loan portfolio is a necessary basis for the implementation of credit operations of a bank and represents the total amount of loans issued by a bank [4].

A loan portfolio is a structurally formed set of loans provided to borrowers, which is purposefully formed by the bank and is continuously managed to achieve the bank's development goals, taking into account the characteristics of the market situation [5].

In international banking practice, the quality of the loan portfolio is determined by the following criteria:

- Payment discipline;
- Adequacy of credit provision;
- Financial condition of the borrower;
- Level of credit risk.

A problem loan is a loan in which the borrower does not comply with the established payment terms, that is, problems arise in repaying the loan on time [6].

Problem loans are understood as loans that have shown signs of possible non-fulfillment of obligations under the loan agreement, but the main obligations are still being fulfilled in full, as well as loans that have formed overdue debts with a risk of non-repayment in the future [7].

Problem loans are loans that have exceeded the repayment period or have a low probability of repayment, which are classified by the bank as "unsatisfactory", "doubtful" and "hopeless". Problem loans are expressed as NPL (non-performing loan).

In terms of economic content, problem loans are a real manifestation of credit risk and arise as a result of the bank's inability to adequately manage risks.

Credit risk is the risk of loss due to non-payment of a loan [8].

Credit risk remains one of the main threats faced by financial institutions, and modeling the credit risk of financial institutions is very important [9].

The growth of problem loans has been taken into account by many banks around the world, as banks consider various methods of reducing problem loans.

The existing overdue and problem loans in commercial banks not only negatively affect asset quality, but also lead to an increase in the risk of non-repayment of loans [10].

3. Results and Discussion

According to the World Bank, 67% of problem loans are caused by internal factors, and 33% by external factors (Table 1).

Table 1. Factors of occurrence of problematic loans [10].

Factors	Share (%)
Internal factors	67
Lack of collateral	22
Errors in credit evaluation	21
Lack of monitoring	18
Poor collateral quality	5
Problems in focusing the recovery on the object of collateral specified in the contract	1
External factors	33
Bankruptcy of the enterprise	12
Demanding payment of debt by creditors	11
Deterioration of market conditions, loss of the company's position in the market	6
Cases of theft, fraud	4

Analysis shows that the main causes of problem loans are directly related to the bank's internal management system. Incorrect risk assessment in the lending process, poor monitoring, and insufficient attention to credit history lead to an increase in the share of problem loans.

In 2020-2025, the volume of problem loans in the loan portfolio of commercial banks changed significantly.

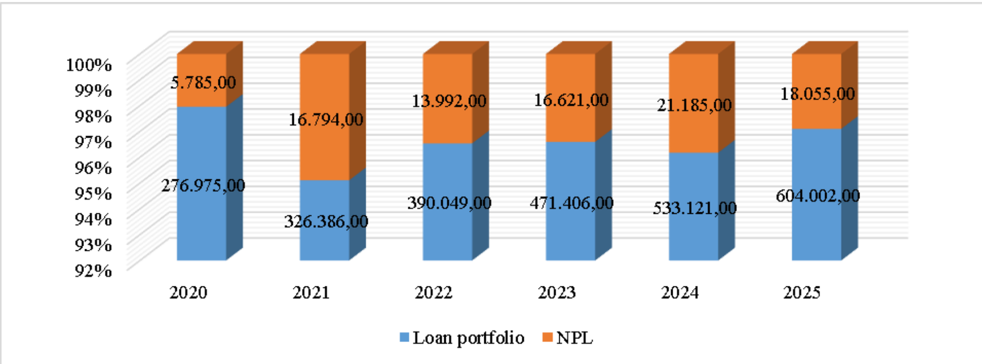

Figure 1. Dynamics of commercial banks' loan portfolios and problem loans in 2020-2025 (in billion soums) [11].

Fig. 1 shows the dynamics of the aggregate loan portfolio of commercial banks and the share of problem loans in it for 2020-2025. It can be seen that during the analyzed period, the loan portfolio has a tendency to grow steadily.

In particular, in 2020, the loan portfolio amounted to 276,975 billion soums, while by 2025 this figure reached 604,002 billion soums. This indicates that the loan portfolio increased by almost 2.2 times over the period 2020-2025. This indicates that the role of bank loans in financing the country's economy, especially the real sector, is increasingly increasing [11].

At the same time, when paying attention to the dynamics of the volume of problem loans, their absolute volume has increased over the years. In particular, in 2020, the volume of problem loans amounted to 5,785 billion soums, while as of January 1, 2022, their share in the loan portfolio was 5.1 percent, and as of January 1, 2025, this indicator reached its highest level - 4.0 percent or 21,185 billion soums. At the end of 2025, the volume of problem loans amounted to 18,055 billion soums, a certain decrease was observed.

When paying attention to the relative indicators of the share of problem loans, they fluctuated in the range of 92-100 percent relative to the main part of the loan portfolio, and in some years the increase in the share of NPLs had a negative impact on the quality of bank assets. In particular, the rapid growth of the volume of problem loans in 2021-2024 indicates the need to increase the effectiveness of credit risk management [12].

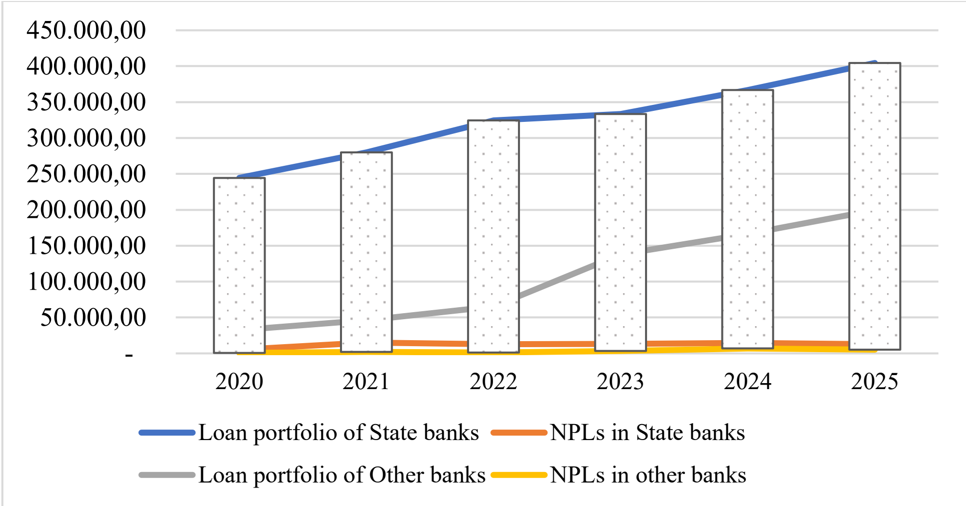

Figure 2. Loan portfolios of state-owned banks and other banks and their problem loans for 2020-2025 [11].

Fig. 2 clearly shows that state-owned banks occupy a leading position in the banking system and form the main part of the total lending volume.

While the loan portfolio of state-owned banks amounted to 244,484 billion soums in 2020, by the beginning of 2026 this figure had reached 404,469 billion soums. This indicates that financing of priority sectors of the economy through state-owned banks is steadily expanding. The growth rates in the loan portfolio of state-owned banks are stable, which confirms that state-owned banks are operating as important financial institutions in the implementation of economic development strategies.

When paying attention to the dynamics of the volume of problem loans in state-owned banks, although their absolute volume has increased over the years, their share in the total volume of the loan portfolio has remained significantly stable. In particular, the lack of a sharp increase in the volume of NPLs in 2023-2025 indicates that the mechanisms for managing credit risks in state-owned banks have improved to a certain extent [13].

Looking at the dynamics of the loan portfolio of other, that is, non-state banks, their lending volume has grown rapidly during 2020-2025. The loan portfolio, which was around 32,491 billion soums in 2020, amounted to 199,533 billion soums by 2025. This indicates that non-state banks have intensified their financing of the private sector, small businesses, and the service sector.

However, although the volume of problem loans in the portfolios of other banks is significantly lower in absolute terms than in state-owned banks, their growth trend has persisted in some years. This indicates the need to further strengthen caution in risk management in the process of rapidly expanding the loan portfolio of non-state banks.

The reduction in the volume of problem loans in 2025 indicates the positive effect of the measures taken by commercial banks to improve the loan portfolio, restructure and return problem assets. This indicates that the banking system is improving risk management mechanisms and implementing more prudent lending practices [14], [15].

The experience of developed countries shows that complex and systemic mechanisms aimed at reducing problem loans are of great importance in ensuring the stability of the banking system and improving the quality of the loan portfolio. In world practice, such mechanisms are primarily aimed at identifying, assessing and effectively managing credit risks in advance, and they are implemented in several directions.

The introduction of credit scoring systems is one of the most effective tools for reducing problem loans. In developed countries, credit scoring models are developed taking into account the financial condition of the borrower, credit history, and cash flow stability, as well as the impact of macroeconomic factors. Such automated scoring systems minimize the influence of the human factor and reduce the likelihood of subjective decisions when granting loans. As a result, credit risks are identified at an early stage, and the likelihood of granting loans to borrowers with low solvency is significantly limited.

At the same time, the use of stress testing and scenario forecasting mechanisms is of particular importance in optimizing the loan portfolio. In the practice of developed countries, banks pre-assess the stability of the loan portfolio in the event of various macroeconomic shocks - an increase in the level of inflation, changes in interest rates, sharp fluctuations in exchange rates, or scenarios of economic recession. This allows them to make dynamic decisions in managing the loan portfolio, ensure the adequacy of capital and reserves, and prevent a sharp increase in the share of problem loans.

4. Conclusion

According to the results of the study, improving the quality of the loan portfolio in commercial banks and reducing the share of problem loans is an important condition for ensuring the stability of the banking system. To achieve this goal, it is advisable to implement a complex of measures covering the institutional, organizational and technological aspects of loan portfolio management.

In the lending process, the introduction of differential interest rates based on the credit history of borrowers is of great importance. In this case, relatively favorable interest rates should be applied to borrowers with a positive credit history, high financial discipline and stable cash flows, and higher rates should be set for entities with a negative or insufficient credit history, corresponding to the level of risk. This approach serves to fairly assess credit risks, increase the payment discipline of borrowers, and prevent the emergence of problem loans.

Strengthening the monitoring system aimed at early detection of problem loans is one of the main factors for effective loan portfolio management. In this case, the financial condition of borrowers, the dynamics of cash flows, the discipline of fulfilling obligations, and external economic factors should be systematically analyzed in the period after the loan is granted. Automated monitoring systems based on modern information technologies allow identifying the risk of problem loans at an early stage and create the conditions for timely application of measures to revise their terms or refinance.

The consistent implementation of these proposals in banking practice will serve to improve the quality of the loan portfolio of commercial banks, reduce the share of problem loans, and strengthen the financial stability of the banking system. At the same time, these measures are also important in increasing the efficiency of financing the country’s economy and ensuring financial security.

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