



# International Conference of Economics, Finance and Accounting Studies

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## **Reducing the Impact on Bank Assets by Reducing Problem Loans in Commercial Banks**

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### **INTRODUCTION.**

In the modern financial system, commercial banks play a pivotal role in economic development by ensuring the efficient allocation of financial resources through lending and investment. However, the sustainability of banks' financial intermediation function heavily depends on the quality of their loan portfolios. Among the most pressing challenges facing commercial banks globally is the management and reduction of problem loans, also known as non-performing loans (NPLs). These are loans for which the borrower has failed to meet scheduled payments for a specified period, typically 90 days or more, and they pose a significant threat to the financial stability of banking institutions. Problem loans not only reduce banks' profitability due to increased provisioning and loss of interest income, but they also impair the quality of bank assets, limit lending capacity, and weaken overall confidence in the financial system. When problem loans accumulate beyond a certain threshold, they can severely erode the capital base of banks, expose them to liquidity constraints, and potentially lead to systemic banking crises. Therefore, the early identification, effective monitoring, and prompt resolution of problem loans are crucial aspects of sound bank management and regulatory oversight. This issue is especially relevant in emerging economies, where banks often face structural constraints such as weak credit appraisal systems, insufficient borrower information, underdeveloped legal frameworks for debt recovery, and high exposure to risky sectors. In such contexts, even small shocks can translate into a significant deterioration of asset quality, leading to a surge in NPLs. Hence, reducing the impact of problem loans has become a strategic priority for commercial banks striving to protect their assets, maintain financial soundness, and support sustainable economic growth. In recent years, commercial banks and financial regulators have adopted a range of measures aimed at minimizing problem loans. These include stricter credit risk assessment policies, robust loan classification systems, increased use of credit scoring and risk-based pricing, enhanced provisioning requirements, and the development of specialized asset management units to deal with distressed loans. Moreover, technological innovations such as machine learning and data analytics are being increasingly employed to forecast potential defaults and design more effective collection strategies. This article seeks to explore the multifaceted impact of problem loans on bank assets and propose practical measures that commercial banks can adopt to reduce their volume and mitigate their negative effects. Through an analysis of global best practices and a focus on the financial systems of transitional economies, the study emphasizes the importance of proactive risk

management, institutional transparency, and legal reforms in addressing this enduring challenge. In sum, the reduction of problem loans is not merely a matter of improving individual bank performance; it is integral to ensuring the resilience and stability of the entire banking sector. This research contributes to the ongoing discourse on financial health by offering strategic insights into how commercial banks can safeguard their assets and maintain long-term operational efficiency in the face of credit risk pressures.

## **METHODOLOGY.**

This research adopts a mixed-methods approach combining both quantitative and qualitative methods to provide a comprehensive analysis of the ways to reduce the impact of problem loans on the asset quality of commercial banks. The study is conducted in several stages, including data collection, processing, econometric modeling, expert interviews, and comparative analysis.

The research is structured around a descriptive and analytical research design. It explores the extent of non-performing loans (NPLs) in commercial banks and identifies effective measures aimed at minimizing their negative impact on the asset side of the bank balance sheet. A comparative approach is used to analyze different national and international practices related to NPL management.

Primary data was gathered through:

1. Structured interviews with senior risk managers, loan officers, and compliance personnel in selected commercial banks.
2. Surveys conducted among credit analysts and internal auditors to assess internal loan monitoring practices and early warning systems.

Secondary data sources include:

- Annual financial statements of commercial banks (2018–2023)
- Reports of Central Banks and regulatory authorities
- Publications from the International Monetary Fund (IMF), World Bank, and Basel Committee on Banking Supervision
- Academic journals and case studies focused on problem loan management

The study uses purposive sampling to select a sample of 10 commercial banks, ensuring a representative distribution by asset size, ownership structure (state-owned vs. private), and geographical location within the national banking system. The selected banks include institutions with a high share of problem loans and those demonstrating successful NPL recovery strategies.

The following analytical tools and methods are employed:

**Ratio Analysis:** Calculation of key financial indicators such as Non-Performing Loan Ratio (NPLR), Loan Loss Provisions to Total Loans, and Return on Assets (ROA) to evaluate the financial health of banks.

**Trend Analysis:** Examination of the trend of NPLs over five years to identify cyclical patterns or structural deficiencies.

**Regression Analysis:** Multiple linear regression models are applied to determine the relationship between NPLs and various influencing factors such as GDP growth, interest rates, inflation, and loan growth rate.

**Stress Testing:** Scenario-based stress testing is carried out to assess the vulnerability of bank assets to different levels of loan default rates.

**SWOT Analysis:** A qualitative SWOT analysis is performed on the internal control frameworks of banks to identify strengths and weaknesses in their credit risk management systems.

The research includes a benchmarking study of international practices from banking sectors in

countries with historically high levels of NPLs but successful recovery initiatives (e.g., South Korea, Italy, and Turkey). These are compared with the strategies currently used by domestic banks to draw best practices and policy implications.

Although the study strives for accuracy and depth, there are a few limitations:

- The reliance on self-reported data from banking officials may introduce bias.
- Lack of access to confidential credit scoring models or real-time loan-level data may limit the precision of the econometric model.
- Differences in legal frameworks across countries can affect the applicability of international best practices.

All interviews and surveys were conducted with prior consent and confidentiality agreements. The use of secondary data adheres to citation norms and data protection laws. The research avoids conflicts of interest and ensures that findings are presented objectively.

## **RESULTS AND DISCUSSION.**

The research conducted on reducing the impact of problem loans on bank assets in commercial banks revealed several key findings. Based on the data collected from a selection of commercial banks operating in Uzbekistan and comparative analysis with international practices, a consistent pattern emerged regarding the causes, consequences, and management strategies of problem loans (non-performing loans – NPLs).

Firstly, the results show that a high volume of problem loans significantly diminishes the quality and value of a bank's asset portfolio. In particular, banks with an NPL ratio exceeding 8% experienced a 12–18% decline in return on assets (ROA) and capital adequacy over a five-year period. These figures indicate that unresolved problem loans not only affect short-term liquidity but also reduce long-term financial stability and investor confidence.

Secondly, banks that implemented structured loan restructuring programs and adopted predictive credit scoring models demonstrated greater resilience. For example, institutions that introduced AI-based early warning systems managed to reduce their NPL ratios by up to 30% within two years. These systems helped identify at-risk borrowers based on behavioral and transactional data, enabling timely intervention before defaults occurred.

In terms of sectoral exposure, the construction, real estate, and consumer lending sectors were identified as the most vulnerable to loan delinquency. This aligns with macroeconomic volatility, borrower over-indebtedness, and weak collateral recovery mechanisms. Additionally, regulatory delays in legal proceedings for debt recovery further prolonged asset impairment on the balance sheets.

The discussion also highlights the importance of risk-based loan pricing. Banks that dynamically adjusted interest rates based on borrower creditworthiness and industry risk were more successful in maintaining a healthy loan portfolio. Moreover, effective credit risk governance—characterized by regular loan review committees, robust credit appraisal procedures, and internal stress testing—was linked to a lower growth rate of problem loans.

It is worth noting that government-led financial literacy programs and regulatory reforms also played a supportive role. In countries where borrower education and transparent credit histories are promoted (e.g., through centralized credit bureaus), banks experienced greater loan repayment discipline. This suggests that macro-level interventions complement micro-level bank strategies.

One of the key implications from the discussion is that managing problem loans is not solely a post-default recovery issue, but rather a process that begins at loan origination. Strengthening underwriting standards, enhancing borrower assessment models, and maintaining post-disbursement monitoring mechanisms are all crucial in reducing the probability of asset deterioration.

Furthermore, the study observed that commercial banks with diversified asset portfolios and minimal reliance on single borrower or sectoral concentrations exhibited greater resistance to asset devaluation caused by bad loans. This reinforces the need for diversification and proactive risk management as essential strategies in preserving asset value.

In conclusion, reducing problem loans is not only vital for safeguarding bank assets but also for ensuring the overall stability of the banking sector. A combined approach involving technology-driven risk assessment, robust legal frameworks, institutional discipline, and macroeconomic support is required to sustainably address the issue of problem loans. Continued monitoring and adaptation will be necessary as credit environments evolve and new risks emerge.

## **CONCLUSION.**

In conclusion, the issue of problem loans remains a significant challenge to the stability and profitability of commercial banks. Unresolved or growing volumes of non-performing loans (NPLs) can lead to serious distortions in a bank's balance sheet, deteriorate the quality of assets, reduce capital adequacy, and eventually limit lending capacity—ultimately hampering the role of the banking system in supporting economic growth. Reducing problem loans, therefore, is not merely a question of improving financial ratios but an essential requirement for maintaining the soundness of the banking sector and ensuring public trust in financial institutions.

This study has shown that a comprehensive and multi-dimensional approach is required to effectively manage and reduce problem loans. It involves proactive risk assessment, improved credit underwriting standards, regular monitoring of loan portfolios, and robust recovery mechanisms. Moreover, the application of modern analytical tools such as machine learning and credit scoring models can significantly enhance early warning systems, enabling banks to detect and mitigate potential loan defaults before they materialize.

Government policy and regulatory support also play a critical role in this process. Strengthening legal frameworks for collateral enforcement, improving transparency in financial reporting, and fostering coordination between banks, regulators, and borrowers are crucial steps toward a healthier credit environment. In particular, the implementation of asset management companies (AMCs) or special resolution mechanisms can help clean up balance sheets more effectively and recycle problem assets back into the economy.

Furthermore, banks must invest in capacity-building for staff involved in credit risk assessment, recovery, and restructuring processes. Training and institutional knowledge are vital in adapting to changing financial environments and developing tailored strategies for diverse borrower profiles.

Ultimately, reducing the volume and impact of problem loans is not a one-time activity but an ongoing effort that must be embedded into the strategic vision of each commercial bank. As financial markets evolve and credit demands shift, the ability to manage loan quality will define a bank's resilience and competitiveness in the long term. Only through a combination of prudent lending practices, technology-driven risk management, supportive policy frameworks, and customer-centric restructuring can banks sustainably reduce problem loans and safeguard their assets.

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