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Issues of Preventing Problem Loans in Commercial Banks

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INTRODUCTION.

The stability and efficiency of a country's financial system largely depend on the soundness of its banking sector. Commercial banks, as the main intermediaries in the allocation of financial resources, play a pivotal role in ensuring sustainable economic growth and financial stability. One of the most significant challenges faced by commercial banks worldwide is the issue of problem loans, also referred to as non-performing loans (NPLs). These are loans for which borrowers have failed to meet their contractual obligations, resulting in overdue payments or complete default. The accumulation of problem loans negatively affects banks in several ways: it reduces their liquidity, undermines profitability, weakens their capital base, and increases vulnerability to financial crises. Moreover, high levels of NPLs erode investor confidence, limit banks' ability to extend credit, and create instability within the wider economy. For developing countries like Uzbekistan, where the banking sector is undergoing deep reforms aimed at liberalization, modernization, and integration into the global financial system, managing and preventing problem loans is of strategic importance. The issue of problem loans is influenced by a combination of macroeconomic, institutional, and operational factors. Unstable economic conditions, inflation, currency volatility, and sector-specific downturns can lead to repayment difficulties for borrowers. At the institutional level, shortcomings in risk assessment, inadequate loan monitoring, weak collateral management, and insufficient staff competence in credit evaluation contribute to the growth of NPLs. Additionally, legal and regulatory frameworks play a crucial role in shaping the effectiveness of debt recovery and restructuring mechanisms. In recent years, Uzbekistan has introduced several measures to strengthen the banking sector, including improving credit risk management systems, enhancing transparency, and expanding digital banking services. However, despite these efforts, the share of problem loans in some commercial banks remains a concern, requiring the adoption of more comprehensive preventive strategies. These strategies should encompass both proactive measures—such as rigorous borrower screening, diversification of loan portfolios, and the application of modern credit scoring technologies—and reactive measures, including timely loan restructuring, efficient legal proceedings, and the development of secondary markets for distressed assets. The study of preventing problem loans is particularly relevant in the current global context, marked by post-pandemic economic recovery challenges, geopolitical uncertainties, and increasing competition within the banking industry. By identifying the root causes of NPLs and applying best practices from international experience, commercial banks in Uzbekistan can enhance their resilience, improve profitability, and contribute to overall economic development. This article explores the causes of problem loans, examines current preventive

measures in the banking sector, and proposes recommendations for more effective NPL management, with a focus on aligning these measures with global banking standards and the specific socio-economic conditions of Uzbekistan.

METHODOLOGY.

The methodology of this study on preventing problem loans in commercial banks is based on a combination of qualitative and quantitative research approaches to ensure a comprehensive analysis of the issue. The research process is structured into several key stages: data collection, data processing, analysis, and formulation of recommendations.

The study employs a descriptive and analytical research design. This approach is chosen to examine existing patterns of problem loans, identify their causes, and assess the effectiveness of current preventive measures. Comparative analysis between different banks and regulatory frameworks is also integrated to highlight best practices and weaknesses.

The research relies on both primary and secondary data:

Primary Data: Structured interviews and questionnaires were conducted with senior credit managers, loan officers, and risk analysts in selected commercial banks. In addition, focus group discussions were organized to collect expert opinions on challenges in loan management.

Secondary Data: Annual reports of commercial banks, statistical bulletins of the Central Bank of Uzbekistan, legislative acts, regulatory guidelines, and international banking standards were reviewed. Academic publications, policy briefs, and case studies from both domestic and foreign sources were also used.

A purposive sampling method was applied to select commercial banks with varying market share, ownership structure (state-owned, private, and joint-venture), and portfolio composition. This diversity ensures that findings are representative of different operational models and risk profiles in the banking sector.

Document Analysis: Examination of loan portfolio structures, non-performing loan (NPL) ratios, repayment schedules, and write-off policies.

Interviews: Semi-structured interviews with banking specialists to gather in-depth insights on loan issuance, monitoring, and recovery practices.

Observation: Review of bank operations related to loan evaluation, collateral assessment, and early warning systems.

Quantitative Analysis: Statistical methods were used to measure trends in NPL ratios, calculate loan loss provisions, and assess the correlation between loan growth rates and problem loan ratios.

Qualitative Analysis: Content analysis of interview transcripts and policy documents to identify recurring themes and structural issues in loan management.

Comparative Analysis: Cross-bank comparison to determine which operational strategies yield lower problem loan rates.

The research applies a risk assessment framework that evaluates:

- Borrower creditworthiness criteria;
- Quality and liquidity of collateral;
- Effectiveness of loan monitoring systems;
- Early warning signals and their timely response.

Confidentiality of respondents and sensitivity of banking data were prioritized. All interviews were conducted under strict confidentiality agreements, and bank-specific data is anonymized to avoid reputational risks.

The study acknowledges certain limitations, such as restricted access to some internal bank data, time constraints for large-scale surveys, and the influence of macroeconomic changes during the research period.

By combining statistical analysis with expert perspectives, the methodology ensures that the research not only identifies the current state of problem loans in commercial banks but also provides actionable recommendations for improving loan portfolio quality and minimizing credit risks.

RESULTS AND DISCUSSION.

The study of problem loans in commercial banks reveals that their prevention is one of the key factors determining the stability and profitability of the banking system. Statistical analysis of recent years shows that the share of non-performing loans (NPLs) in the total credit portfolio significantly affects not only the bank's liquidity position but also its ability to expand lending to the real sector of the economy. In Uzbekistan, as in many developing countries, the rapid expansion of credit portfolios has sometimes been accompanied by insufficiently strict credit risk assessment procedures, leading to an accumulation of problematic debt.

The results of the research indicate that the main causes of problem loans include inadequate borrower solvency assessment, lack of effective collateral management, insufficient monitoring of issued loans, and changes in macroeconomic conditions such as inflationary pressure, currency fluctuations, and declining demand in certain sectors. Additionally, poor financial discipline among borrowers, along with weak internal bank controls, exacerbates the problem.

One important observation from the analysis is that preventive measures yield significantly better results than remedial actions taken after a loan becomes non-performing. Banks that apply a proactive approach—such as comprehensive borrower analysis, implementation of early warning systems, and continuous portfolio monitoring—tend to have lower NPL ratios. Moreover, the integration of modern digital technologies, including artificial intelligence and big data analytics, has enabled faster identification of early signs of financial distress among borrowers.

The discussion also highlights the role of regulatory frameworks. The Central Bank's requirements for loan classification, provisioning, and risk-weighted capital adequacy play a decisive role in ensuring that banks maintain prudent lending standards. However, these regulations need constant updating in line with global banking practices and the evolving nature of financial risks.

Furthermore, international experience shows that successful prevention of problem loans often relies on a multi-dimensional strategy that combines credit policy reform, improved risk management systems, effective staff training, and transparent relationships with borrowers. In particular, the development of loan restructuring mechanisms and alternative dispute resolution methods can significantly reduce potential losses for banks while supporting borrowers in overcoming temporary financial difficulties. In conclusion, the findings of this study underline that problem loan prevention is not a one-time measure but a continuous process integrated into the overall credit risk management framework of the bank. Strengthening institutional capacity, enhancing technological capabilities, and fostering a culture of financial discipline among both lenders and borrowers are essential steps toward sustainable banking operations and a healthy credit environment.

CONCLUSION.

The prevention of problem loans in commercial banks is a critical task that directly impacts the financial stability, profitability, and overall resilience of the banking system. Effective measures to address this issue require a comprehensive approach that integrates prudent lending practices, advanced risk assessment tools, robust credit monitoring, and proactive borrower engagement. Banks must focus on strengthening their credit policies, ensuring that loan approvals are based on thorough analysis of the borrower's creditworthiness, repayment capacity, and the viability of the

financed project.

Equally important is the establishment of an early warning system that can detect signs of potential default at the earliest stages. This involves continuous monitoring of borrowers' financial performance, market conditions, and sector-specific risks, allowing banks to take corrective measures before the situation escalates into a non-performing loan. The adoption of modern technologies such as big data analytics, AI-driven credit scoring, and automated risk assessment platforms can significantly enhance the accuracy and efficiency of this process.

Additionally, collaboration between banks, regulatory bodies, and credit bureaus is essential for improving transparency and access to reliable credit information. Strengthening legal frameworks for debt recovery, streamlining collateral realization procedures, and promoting financial literacy among borrowers will also contribute to reducing credit risks.

In the long term, preventing problem loans is not merely a matter of risk management but also a strategic priority for sustainable banking growth. By balancing profitability with risk prudence, commercial banks can safeguard their assets, maintain customer trust, and ensure their role as a driving force in economic development. A strong and preventive stance on problem loans ultimately fosters a healthier credit environment, supports the stability of the financial sector, and contributes to the broader goals of national economic progress.

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