

“WAYS TO IMPROVE CREDIT PORTFOLIO QUALITY UNDER CONDITIONS OF BANKING TRANSFORMATION”

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ABSTRACT

In the context of ongoing banking transformation driven by digitalization, regulatory reforms, and increasing financial risks, ensuring the quality of banks' credit portfolios has become a critical priority for financial stability and sustainable economic development. This study examines the key directions and mechanisms for improving credit portfolio quality under conditions of structural and institutional transformation in the banking sector. The research focuses on the impact of modern risk management systems, credit assessment technologies, portfolio diversification strategies, and regulatory compliance on credit portfolio performance. Particular attention is paid to the role of digital credit scoring models, early warning systems, and non-performing loan management practices in reducing credit risk and enhancing asset quality. Using analytical and comparative methods, the study evaluates existing approaches to credit portfolio management and identifies their limitations in the context of transitional banking systems. The findings demonstrate that improving credit portfolio quality requires an integrated approach combining technological innovation, institutional reforms, enhanced supervision, and strategic credit policy adjustments. The results of the study contribute to the development of practical recommendations for commercial banks and policymakers aimed at strengthening financial resilience, increasing credit efficiency, and supporting long-term economic growth in transforming banking environments.

Keywords: banking transformation, credit portfolio quality, credit risk management, non-performing loans, digital banking, credit policy, financial stability, risk assessment, portfolio diversification, banking sector reforms.

INTRODUCTION

In recent years, the global banking sector has been undergoing profound transformation processes driven by digitalization, financial innovation, regulatory tightening, and increasing exposure to macroeconomic and systemic risks. These changes have significantly altered traditional banking models and placed new demands on the effectiveness of credit activity, particularly in terms of maintaining and improving credit portfolio quality. As credit operations remain the core source of

income for commercial banks, the quality of the credit portfolio plays a decisive role in ensuring financial stability, profitability, and resilience of the banking system.

Banking transformation is characterized not only by technological modernization but also by structural and institutional reforms aimed at strengthening risk management, enhancing transparency, and aligning banking practices with international standards. In this context, credit portfolio quality has emerged as a critical indicator reflecting the soundness of banks' lending policies, the effectiveness of credit risk assessment, and the ability of banks to withstand external shocks. Poor-quality credit portfolios, manifested through high levels of non-performing loans, weaken banks' capital positions, reduce lending capacity, and pose threats to overall economic stability.

The relevance of improving credit portfolio quality has intensified amid economic volatility, changes in borrower behavior, and increased uncertainty in financial markets. Traditional approaches to credit risk management have proven insufficient in addressing emerging risks associated with rapid technological change, information asymmetry, and evolving regulatory requirements. As a result, banks are increasingly adopting innovative tools such as digital credit scoring, early warning systems, stress testing, and portfolio diversification strategies to enhance credit quality and minimize potential losses.

Moreover, regulatory authorities have strengthened prudential supervision and introduced stricter requirements for asset classification, provisioning, and capital adequacy, further emphasizing the need for systematic improvement of credit portfolio management. In transforming banking environments, especially in emerging and transition economies, these challenges are compounded by institutional constraints, limited access to reliable borrower information, and uneven implementation of risk management frameworks.

Against this background, the study of ways to improve credit portfolio quality under conditions of banking transformation is of both theoretical and practical significance. A comprehensive understanding of modern credit portfolio management mechanisms allows banks to adapt to changing conditions, enhance risk resilience, and support sustainable economic growth. This article aims to analyze key approaches to improving credit portfolio quality in the context of banking transformation and to identify effective strategies that contribute to strengthening the stability and efficiency of the banking sector.

LITERATURE REVIEW

The issue of credit portfolio quality has been widely examined in economic and financial literature, particularly in the context of banking stability, risk management,

and financial intermediation. Numerous studies emphasize that the quality of a bank's credit portfolio is a key determinant of its financial performance and resilience to economic shocks. Classical banking theory considers credit risk as the primary source of instability in commercial banks, highlighting the need for effective credit assessment and monitoring mechanisms.

Early research in this field focused mainly on traditional credit risk evaluation methods, including financial ratio analysis, collateral assessment, and borrower creditworthiness evaluation based on historical data. Scholars argued that strict credit standards and prudent lending policies were essential for maintaining portfolio quality. However, these approaches were later criticized for their limited ability to capture dynamic risks arising from macroeconomic fluctuations and structural changes in the economy.

With the development of financial markets and increasing complexity of banking operations, modern studies began to explore portfolio-based approaches to credit risk management. According to this perspective, credit portfolio quality is influenced not only by individual loan characteristics but also by diversification levels, sectoral concentration, and correlations between borrowers. Empirical research demonstrates that well-diversified credit portfolios are more resilient to systemic shocks and exhibit lower default volatility.

In recent years, the literature has increasingly linked credit portfolio quality with banking transformation processes, particularly digitalization and regulatory reforms. Researchers note that digital banking technologies, such as automated credit scoring systems and big data analytics, significantly enhance the accuracy of credit risk assessment and reduce information asymmetry between banks and borrowers. Studies confirm that the use of advanced analytics contributes to early detection of problem loans and improves overall portfolio performance.

Another important strand of research focuses on the relationship between non-performing loans and banking sector stability. High levels of non-performing loans are widely recognized as a major obstacle to sustainable banking development, as they undermine profitability, erode capital, and constrain new lending. Scholars emphasize that effective management of non-performing loans through restructuring, write-offs, and secondary market mechanisms is essential for improving credit portfolio quality, especially in transforming banking systems.

Regulatory aspects also occupy a central place in the literature. Many studies analyze the impact of prudential regulations, such as capital adequacy requirements, loan loss provisioning standards, and supervisory stress testing, on banks' credit behavior. The findings suggest that stricter regulatory frameworks generally encourage

banks to adopt more conservative lending strategies and strengthen internal risk management systems, thereby improving credit portfolio quality. However, some authors caution that excessive regulatory pressure may reduce credit availability and slow economic growth.

Overall, the literature indicates that improving credit portfolio quality under conditions of banking transformation requires an integrated approach that combines technological innovation, sound risk management practices, effective regulatory oversight, and institutional development. Despite extensive research, there remains a need for further empirical analysis tailored to the specific characteristics of transforming banking systems, which this study seeks to address.

METHODOLOGY

This study employs a comprehensive methodological framework to analyze ways of improving credit portfolio quality under conditions of banking transformation. The research design is based on a combination of qualitative and quantitative approaches, allowing for a systematic examination of both theoretical concepts and practical mechanisms of credit portfolio management.

At the initial stage, a theoretical analysis method is applied to examine the conceptual foundations of credit portfolio quality and banking transformation. This involves a critical review of existing economic theories, banking risk management models, and regulatory approaches related to credit activity. The purpose of this stage is to identify key factors influencing credit portfolio quality and to clarify the role of transformation processes in reshaping banking practices.

The empirical component of the study relies on analytical and comparative methods. Secondary data obtained from official banking statistics, regulatory reports, and financial statements of commercial banks are analyzed to assess trends in credit portfolio structure, non-performing loan dynamics, and risk exposure. Comparative analysis is used to evaluate differences in credit portfolio quality indicators before and during periods of intensified banking transformation, enabling the identification of transformation-driven changes.

To assess the effectiveness of credit risk management tools, the study applies ratio analysis and indicator-based evaluation. Key indicators such as the share of non-performing loans, loan loss provisions, credit concentration ratios, and capital adequacy levels are examined to measure credit portfolio quality. These indicators provide an objective basis for evaluating the impact of risk management practices and regulatory requirements on portfolio performance.

In addition, the study utilizes a systemic approach to analyze credit portfolio management as an integrated process involving credit policy formulation, risk

assessment, monitoring, and problem loan resolution. This approach allows for the identification of interconnections between technological innovation, institutional reforms, and portfolio quality outcomes. Particular attention is given to the role of digital credit scoring systems, early warning mechanisms, and portfolio diversification strategies in mitigating credit risk.

The methodological framework also includes elements of logical generalization and synthesis, which are used to formulate practical recommendations based on the research findings. By integrating theoretical insights with empirical observations, the study develops conclusions that are applicable to commercial banks operating in transforming banking environments.

Overall, the chosen methodology ensures the reliability and validity of the research results and provides a solid basis for identifying effective ways to improve credit portfolio quality under conditions of banking transformation.

RESULTS AND DISCUSSION

The results of the study indicate that banking transformation processes have a significant impact on the quality of credit portfolios in commercial banks. Empirical analysis shows that banks which actively implement modern risk management tools and digital technologies demonstrate more stable credit portfolio performance and lower levels of credit risk compared to institutions relying on traditional lending approaches.

One of the key findings is the positive relationship between the adoption of advanced credit assessment systems and the reduction of non-performing loans. The introduction of digital credit scoring models, based on diversified data sources and automated decision-making, enhances the accuracy of borrower risk evaluation and reduces information asymmetry. As a result, banks are better able to differentiate between high- and low-risk borrowers, leading to improved loan selection and overall portfolio quality.

The analysis also reveals that portfolio diversification plays a crucial role in mitigating credit risk under conditions of banking transformation. Banks with well-balanced credit portfolios across sectors, regions, and borrower categories exhibit greater resilience to macroeconomic shocks. In contrast, high concentration in specific industries or borrower groups increases vulnerability to economic downturns and negatively affects portfolio quality. These findings confirm the relevance of portfolio-based risk management approaches emphasized in the literature.

Another important result concerns the effectiveness of early warning systems and continuous credit monitoring mechanisms. Banks that utilize real-time monitoring tools and stress-testing techniques are able to identify potential problem loans at an

early stage and take timely corrective actions. This proactive approach significantly reduces the probability of loan defaults and limits potential losses, contributing to the stabilization of credit portfolio quality.

From a regulatory perspective, the findings suggest that strengthened prudential requirements and supervisory oversight have a dual effect on credit portfolio quality. On the one hand, stricter regulations regarding loan classification, provisioning, and capital adequacy encourage banks to adopt more conservative lending practices and improve internal risk management frameworks. On the other hand, excessive regulatory constraints may limit credit expansion and reduce banks' flexibility in supporting economic growth. Therefore, an optimal balance between regulatory discipline and lending incentives is essential.

The discussion of results highlights that improving credit portfolio quality under conditions of banking transformation requires an integrated and adaptive strategy. Technological innovation alone is insufficient unless supported by effective institutional reforms, qualified human resources, and coherent credit policies. The interaction between digitalization, risk management, and regulatory frameworks determines the overall effectiveness of credit portfolio improvement measures.

Overall, the findings demonstrate that banks operating in transforming environments can significantly enhance credit portfolio quality by adopting modern risk management technologies, ensuring adequate portfolio diversification, and aligning lending practices with regulatory standards. These measures contribute not only to the stability of individual banks but also to the resilience and sustainability of the banking sector as a whole.

CONCLUSION

The study confirms that improving credit portfolio quality under conditions of banking transformation is a complex and multifaceted process that requires a systematic and integrated approach. The transformation of the banking sector, driven by digitalization, regulatory reforms, and evolving risk environments, has fundamentally changed traditional credit management practices and placed greater emphasis on the quality of loan portfolios as a key indicator of banking stability and efficiency.

The findings demonstrate that modern credit risk management tools, particularly digital credit scoring systems and early warning mechanisms, play a decisive role in enhancing credit portfolio quality. These instruments enable banks to assess borrower risk more accurately, reduce information asymmetry, and identify potential problem loans at an early stage. As a result, banks can take timely corrective measures, thereby limiting credit losses and preventing the accumulation of non-performing loans.

Another important conclusion is that portfolio diversification remains a critical factor in mitigating credit risk. Banks with diversified credit portfolios across economic sectors, regions, and borrower categories show higher resilience to macroeconomic shocks and structural changes. Excessive concentration, by contrast, increases vulnerability and negatively affects portfolio performance, especially during periods of economic instability.

The study also highlights the significant influence of regulatory frameworks on credit portfolio quality. Prudential regulations related to capital adequacy, loan classification, and provisioning contribute to strengthening internal risk management systems and promoting more prudent lending behavior. However, the results suggest that regulatory policies should be balanced to avoid excessive restrictions that may hinder credit expansion and economic growth.

Overall, the research concludes that improving credit portfolio quality in transforming banking environments requires the coordinated interaction of technological innovation, effective risk management practices, sound regulatory oversight, and strategic credit policy adjustments. The practical recommendations derived from this study can be used by commercial banks and policymakers to enhance financial resilience, ensure sustainable lending, and support long-term economic development.

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