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*Article*

# Problems of Ensuring Profitability in Commercial Banks

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**Abstract:** Profitability is a key indicator of financial stability and sustainable growth for commercial banks. In the context of Uzbekistan's ongoing financial sector reforms, maintaining a stable return on assets and net interest margin has become increasingly important. This article investigates the main challenges faced by commercial banks in achieving profitability, including the management of non-performing loans, the effectiveness of reserve provisioning, and the impact of interest income structures. By analyzing statistical data from both domestic and international banks, such as Asakabank, Aloqabank, and Bank of America, the study provides practical recommendations to improve credit portfolio quality, enhance risk management systems, and optimize income-expense ratios. The findings emphasize the need for strategic reforms that ensure the proportional growth of net profits and risk-weighted assets, while aligning with international standards for banking profitability.

**Keywords:** Assets, Profitability, Credit, Credit Portfolio, Net Interest Margin Indicator

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## 1. Introduction

Scientific research is being conducted around the world to achieve stability in the net interest spread and net interest margin indicators of commercial banks, to ensure the profitability of bank assets, to develop a risk management system in commercial banks, to ensure a balance between the growth rate of net profit and the growth rate of risk-weighted assets, and to improve the practice of stress testing of banking activities [1]. However, the issues of ensuring the profitability of banks in the face of negative trends in global financial markets and ensuring an acceptable level of profitability in financial crises through stress testing have not been studied on a sufficiently scientific basis [2].

Also, experts from the International Bank for Reconstruction and Development have proposed an assessment methodology for reserve provisions intended to cover losses on loans [3]. According to this methodology, the level of reserve provisions intended to cover losses on loans should not exceed 1.0 percent of the average amount of bank assets.

Since loans account for a large proportion of total assets of commercial banks, the level of loan loss provisions plays an important role in ensuring the stability of the income base of commercial banks. A deterioration in the quality of the loan portfolio leads to an increase in the amount of loan loss provisions. This is because a deterioration in the quality of the loan portfolio leads to a deterioration in the composition of classified loans [4], [5].

To this end, on May 12, 2020, the President of the Republic of Uzbekistan issued the "Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020-2025" which sets out tasks such as "modernizing the provision of banking services, creating an effective infrastructure of banks, improving the quality of credit portfolio and risk management, pursuing a moderate increase in lending volumes, and implementing technological solutions for assessing financial risks." In implementing these tasks, ensuring the profitability of banks, reducing the volume of overdue debt on loans, assessing and preventing banking risks in the activities of commercial banks, and reducing the share of overdue loans are recognized as measures to be taken to develop banking activities [6], [7].

**Literature Review**

According to S. Kumok, it is impossible to increase the rate of return on capital at the expense of reducing capital adequacy in the current period. Fierce competition and the high cost of credit resources prevent the optimal level of capital in relation to assets [8], [9]. Therefore, the main reserve for increasing the rate of return on capital is to increase the rate of return on assets.

According to O. Voloshina, the use of relative indicators in the analysis of interest income allows us to assess the average profitability of credit operations and individual loans [10]. The following ratios are considered as such indicators:

1. The ratio of interest income to the average balance of loan accounts;
2. The ratio of income from short-term loans to the average balance of short-term loans;
3. The ratio of income from individual loan groups to the average amount of loans in this group;
4. The ratio of interest income from long-term loans to the average balance of long-term loans.

However, O. Voloshina does not pay attention to the ratio of the growth rate of interest income from loans to the growth rate of credit deposits when assessing the profitability of loans [11], [12]. However, none of the indicators recommended by O. Voloshina allows assessing the ratio between the growth rate of interest income from loans and the growth rate of credit deposits. According to B. Berdiyarov, it is necessary to ensure the stability of the share of regulatory capital of commercial banks in the volume of liabilities, to ensure a stable level of profitability of assets by ensuring the ratio between the growth rate of net profit and the growth rate of total assets.

Ensuring the stability of the bank's capital allows to increase the solvency of the bank, however, this may not lead to an increase in its financial stability. Since capital is an expensive source of financing.

However, it is worth noting that B. Berdiyarov's conclusion on ensuring the proportionality between the growth rate of net profit and the growth rate of total assets is of great practical importance for commercial banks of our republic [13].

According to F. Kholmatov, it is necessary to prevent an increase in the standard level of reserve allocations intended to cover losses incurred on loans in commercial banks and to increase the share of interest income from loans in the gross income of commercial banks by ensuring a stable level of the net interest margin indicator [14], [15].

This conclusion of F. Kholmatov is of significant practical importance. First, the current level of reserve provisions intended to cover losses on loans in large commercial banks of our republic is higher than the normative level of this indicator. Secondly, the current level of the net interest margin indicator in the country's commercial banks is lower than the normative level of this indicator.

## 2. Materials and Methods

The article uses elements of theoretical and empirical research methods. In particular, from theoretical methods: analysis, classification, generalization, systematic analysis, generalization, abstract-logical thinking, statistical methods, and from empirical methods: observation and verification methods.

## 3. Results

It is worth noting that one of the important indicators characterizing the profitability of commercial banks is the net interest margin indicator. This indicator shows the level of net interest income relative to gross assets and is one of the main indicators used to assess the financial security of banks.

In the banking practice of our republic, the amount of reserve provisions of commercial banks intended to cover losses from loans is fully carried out at the expense of the bank. Therefore, an increase in the amount of reserve provisions leads to a decrease in the net profit of a commercial bank. This, in turn, has a negative impact on the liquidity and solvency of a commercial bank.

Because net profit is one of the main factors determining the sustainable development of the activities of commercial banks. It is worth noting that one of the main factors affecting the change in the level of profitability of commercial banks' assets is a change in the amount of assets at risk. Because there is a direct correlation between the return on assets and the level of risk: the higher the risk of an asset, the higher its return. Therefore, there is a direct relationship between the amount of assets at risk and net profit in commercial banks.

Below, we assess the level and changes in loan loss provisions at JSC "Asakabank" relative to gross assets.

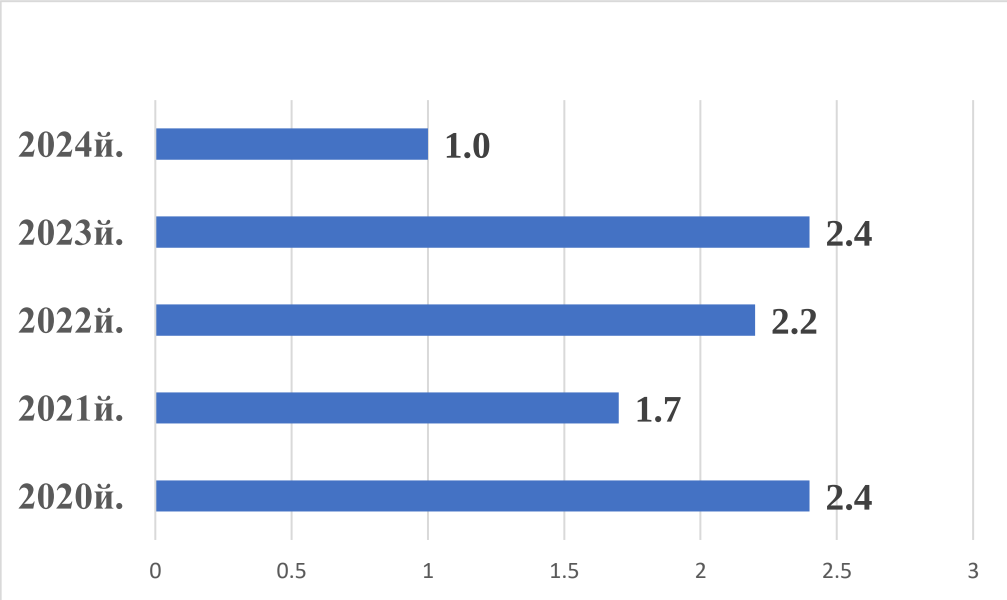


**Figure 1.** The level of provisions for loan losses in JSC "Asakabank" to gross assets, in percent.

The data in Figure 1 shows that in 2020-2023, the level of provisions for loan losses in Asakabank was higher than the generally recognized threshold level of this indicator (1.0%). However, the level of this indicator decreased at a faster rate in 2024 compared to 2020. This is a positive situation from the point of view of ensuring the financial security of Aloqabank.

An increase in the level of provisions for loan losses is a consequence of the deterioration of the composition of classified loans, which has a strong negative impact on the financial stability and capital base of a commercial bank. From this point of view, the level of provisions for loan losses can be included in the list of important indicators characterizing the financial security of commercial banks.

Below we assess the level and change in Bank of America's net interest margin.

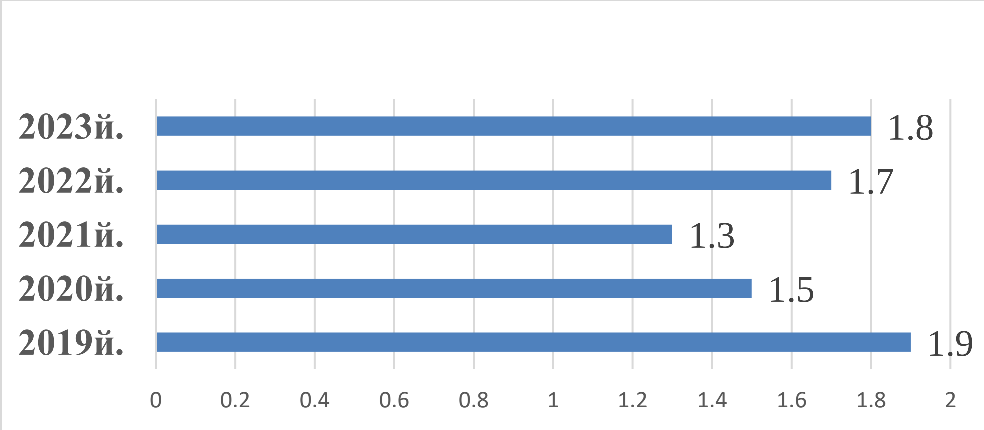


**Figure 2.** Net interest margin level at Bank of America (USA), in percent.

The data in Figure 2 show that the net interest margin level at Bank of America had an increasing trend in 2021-2023.

Ensuring a high and stable level of net interest margin in commercial banks depends on two factors:

1. changes in the ratio between the bank's interest income and interest expenses;
2. whether or not the proportionality between the growth rate of net interest income and the growth rate of gross assets is ensured.

When the proportionality between the growth rate of net profit and the growth rate of gross assets is not ensured, a structural analysis of these two indicators is required.

Below we will assess the level of the net interest margin indicator of Aloqabank.

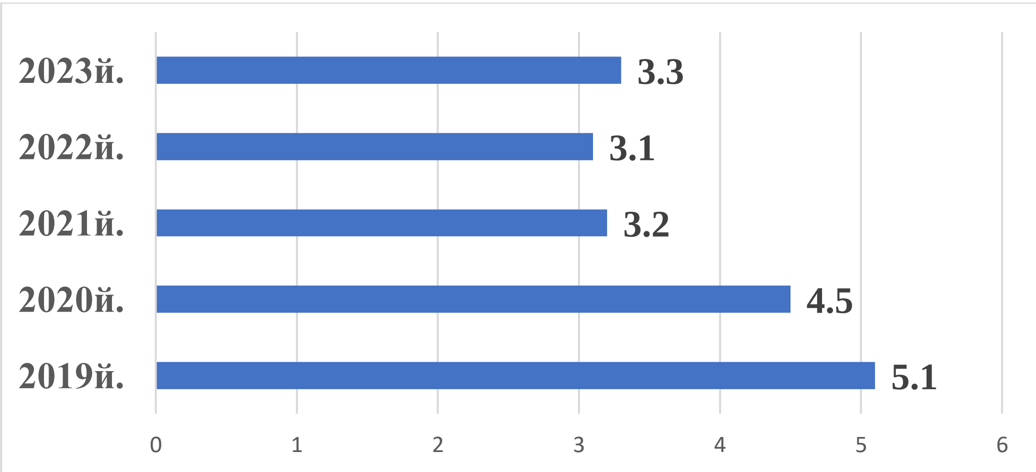


**Figure 3.** Net interest margin level in JSC "Aloqabank", in percent.

From the data in Figure 3, it can be seen that Aloqabank has a tendency to decrease the level of net interest margin in 2019-2022. In addition, the normative level of the net interest margin indicator was not ensured in 2023. These circumstances are considered a negative situation from the point of view of ensuring the financial security of Aloqabank. This is because the net interest margin is one of the main indicators characterizing the financial stability of the bank.

## 4. Conclusion

Based on the analysis of the above opinions of economists, the following measures should be taken to increase the profitability of the assets of commercial banks of our republic:

1. Ensuring the normative level of reserves intended to cover losses on loans plays an important role in improving the credit transformation of attracted deposits. This is because, firstly, the deterioration of the composition of classified loans leads to an increase in the amount of reserves intended to cover losses on loans; Secondly, loans, being a high-risk asset, occupy a high share in the assets of commercial banks; Thirdly, deposits are the main source of financing credit operations.
2. In order to achieve a normal level of the net interest margin indicator in commercial banks, it is necessary, firstly, to ensure a high and stable level of the share of interest income in gross income; Secondly, it is necessary to ensure a normal level of the main indicators affecting the level of net interest margin (net interest spread, reserve for possible losses on loans, cost/income ratio, ratio between the growth rate of interest income and the growth rate of interest expenses).
3. In order to increase the level of gross income of commercial banks in relation to gross assets, it is necessary, firstly, to achieve the formation of a stable ratio of interest income to interest expenses; secondly, it is necessary to ensure the normative level of the cost/income ratio (0.45); thirdly, it is necessary to increase the amount of interest income from investments in securities and its share in the volume of interest income. Since the share of investments in securities by commercial banks of our republic in gross assets is very low, the share of interest income from investments in securities in total interest income is very low.

In addition, in order to increase the profitability of assets of commercial banks of our republic.

Firstly, it is necessary to develop a set of measures aimed at ensuring that the share of overdue loans in total loans does not exceed 3 percent;

Secondly, it is necessary to increase the amount of net profit by increasing the volume of investments in securities by banks;

Thirdly, it is necessary to prevent the growth rate of non-performing assets from exceeding the growth rate of profitable assets.

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