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ISSUES OF ELIMINATING PROBLEM LOANS IN MICROFINANCE INSTITUTIONS

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Abstract: This article explores lending operations of microfinance institutions, highlighting the specifics of lending practices, the nature of problem loans, and their management in microcredit organizations. The study identifies the key causes of the increasing volume of problem loans and offers solutions and recommendations for their elimination.
Keywords: loan, microfinance organization, pawnshop, microloan, microcredit, problem loan, reserve, non-bank credit organizations, financial literacy, risk, collateral.

Introduction

In recent years, alongside commercial banks, non-bank credit institutions in our Republic have also been actively providing microfinance services to the population. Microfinance institutions play an important role in supporting the population, small businesses, and private entrepreneurship by offering credit on fast and convenient terms.

Currently, the policy pursued by the leadership of Uzbekistan in the direction of reducing poverty includes reforms in the banking and financial sector. Alongside commercial banks, the development of non-bank credit institutions has been emphasized in the President's Address to the Oliy Majlis[1]. The significance of microfinance institutions in poverty reduction is also demonstrated by the experience of several other countries.

It should be noted that most commercial banks do not actively offer small-scale loans, microloans, or short-term credits. To quickly and conveniently meet the credit needs of small business entities and the population, the President adopted the Law "On Non-bank Credit Institutions and Microfinancing Activities."[2]

Currently, 96 microfinance institutions in the Republic are widely providing services to meet the credit needs of the population. In addition to supporting private entrepreneurship, these institutions contribute to the economy by offering fast and short-term loans for social support. The Decree of the President of Uzbekistan "On the Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020–2025" focuses on introducing new business models for non-bank financing.[3] According to this decree, by 2025, the share of non-bank credit institutions' assets in the total volume of credit institutions' assets is expected to reach 5%.

Like commercial banks, microfinance institutions and pawnshops also lend at interest. However, they are not authorized to perform banking operations such as opening and maintaining accounts, conducting foreign exchange operations, renting out safes for storing valuables, or transferring money on behalf of clients.

It should be acknowledged that most clients of microfinance institutions lack a positive credit history. Otherwise, they would have turned to banks offering lower interest rates. If microfinance institutions avoided working with borrowers without credit history or outstanding debts, they would not have any clients. Hence, these institutions set high-interest rates to mitigate risks. As with banks, preventing problem loans is crucial for microfinance institutions. This article addresses the causes and solutions of the problem loan phenomenon in these organizations.

Main Part

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On September 7, 2024, Presidential Decree No. 312 "On Measures to Improve the Comprehensive Support Program for Small Business" was adopted. Under the project, microloans of up to 300 million UZS, including an unsecured portion of 100 million UZS financed by the "Entrepreneurship Development Company" JSC, and up to 200 million UZS from banks and microfinance institutions' own funds, are to be provided. [4] On November 10, 2023, a resolution was adopted to increase the maximum microloan amount to 100 million UZS, entitled "On Additional Measures to Increase the Role and Share of Microfinance Services in Developing Entrepreneurial Activity." According to this document, from January 1, 2024, the maximum microloan limit was raised from 50 million to 100 million UZS. This change is expected to contribute to the growth of non-performing loans (NPLs) in microfinance institutions. In addition, plans are in place to double the amount of funds attracted from individuals to the resource base of microfinance institutions and to support nearly 500,000 people who lack formal income by providing them with microfinance services that help them achieve self-employment and develop businesses. [4]

As of December 1, 2024, the assets of pawnshops and microfinance institutions had increased by 1.8 times compared to October 1, 2023, amounting to approximately 8 trillion UZS. The assets of microfinance institutions alone increased by 72%, reaching 7.6 trillion UZS. Pawnshop assets rose by 138 billion UZS, totaling 455 billion UZS. Among these, net loans reached 7.3 trillion UZS, forming the bulk of total assets.

According to the Central Bank's regulation "On Approval of the Regulation on the Coordination and Regulation of Microfinance Institutions and Pawnshops," the classification of asset quality and reserve requirements for expected losses is defined. [5]

Table-1

Assets of a microfinance institution are classified by quality as follows:

Description of loans	**Loan repayment delay**	**Reserve amount %**
Standard	30	0
Substandard	31-90	25
Doubtful	91-180	50
Hopeless	180	100

An increase in doubtful and hopeless loans leads to reduced income for microfinance institutions and decreases the volume of available funds, as reserves cannot be used for other purposes.

Table-2

Non-Performing Loans (NPLs) in Microfinance Institutions (in billions of UZS)

Indicator	2022	2023	2024
Issued loans	501	4 450,7	7 354,0
Including non-performing loans	4%	2,1	2,5
Microloans	452	3 553	6 457
Share in total loan volume	90	87	87

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Non-performing loans (NPLs) in microfinance institutions consist of doubtful and hopeless loans. In 2024, the total volume of loans issued increased by 80% compared to 2023, reaching 7.3 trillion UZS. The share of problem loans rose from 2.1% to 2.5%. The increase in the maximum microloan limit from 50 million to 100 million UZS, along with a growing number of new borrowers with no credit history, has contributed to this trend.

Many clients of microfinance institutions lack financial literacy, leading to misunderstandings of loan terms, interest, deadlines, and the ability to manage personal finances and budgets effectively.

High interest rates increase financial burdens and can trigger debt spirals if payments are missed. Borrowers may be forced to take on additional loans, worsening their financial condition and leading to a higher rate of non-performing loans.

As of October 1,2024, the outstanding balance of microloans to individuals had increased 1.8 times compared to 2023, reaching 6.5 trillion UZS. Consumer loans rose 2.6 times to 11 billion UZS. Loans to business entities increased 1.7 times to 144 billion UZS. Leasing services rose 2.6 times to 10.3 billion UZS, and factoring services by 4.1 times to 41.0 billion UZS.

Segmentation of Loans Issued to Individuals (2024)

- Loans up to 10 million UZS — 39%
- Loans from 10–20 million UZS — 12%
- Loans from 20–50 million UZS — 30%
- Loans from 50–100 million UZS — 19%

The increase in large loans raises concerns about potential problem loans in the future and requires the development of preventive strategies.

According to the Central Bank’s regulation, the total of all charges under a loan (interest, fees, penalties, etc.) must not exceed 50% of the loan amount per year.[6] However, violations are common. Microfinance institutions often attempt to recover collateral in case of payment defaults.

Globally, non-bank credit institutions focus on supporting small businesses and low-income segments of the population as part of poverty reduction strategies.

Conclusions. Reducing the level of non-performing loans in microfinance institutions requires a comprehensive approach:

-High interest rates, which, as international practice shows, can lead to a decrease in clients’ payment capacity and to loan defaults. It is necessary to revise interest rates on loans in microfinance institutions.

-Low financial literacy of borrowers. Low financial literacy among borrowers can lead to misunderstanding of loan terms and poor financial decisions, which in turn may result in delays and an increase in debt. It would be advisable for non-bank credit institutions, including microfinance organizations, to take initiatives aimed at improving the financial literacy of the population.

-Microfinance institutions, when working with a large number of small-scale borrowers, face high operational costs, which may reduce the profitability of the business. It is important to ensure transparency of lending conditions and the loan issuance process. By explaining the loan terms, interest rates, deadlines, penalties, and consequences of non-payment in simple language, it is possible to increase borrower responsibility and prevent misunderstandings and delays.

-Active engagement with borrowers, including prompt communication with borrowers facing difficulties and finding solutions such as loan restructuring. Developing flexible repayment schemes by offering payment deferrals or schedule adjustments can also help reduce delays.

-Encouraging clients who repay their loans on time and applying penalties to defaulters not only helps reduce the share of non-performing loans in microfinance institutions but also improves their reputation and ensures long-term sustainability.

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