Review MECAS V° 22/ N°1 / June 2026

The impact of loans on the profitability of Algerian banks Case study of the Algerian external bank

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Received date: 25.03.2026, Accepted date : 02.05.2026, Publication date: 02.06.2026

Abstract :
Through this research paper, we aim to find out the extent of the impact of loans on the profitability of the Algerian external bank as well as the relationship that combines both of them, as lending operations are considered the most important financial operations for the return achieved through financing operations directed to various exploitation activities in addition to financing investment projects, where exploitative loans are generally related to the movements of the institution's own fund, which is once a debtor and a creditor, depending on the frequency of activity in institutions, and the study found that there is a relationship between loans and profitability, that is, if the bank does not mean This may even indicate an improvement in the efficiency of loan management, perhaps through better interest rates, cost control, or the provision of higher quality loans.

Keywords: : loans, profitability, commercial banks, algerian external bank.
Jel Classification Codes: G21- G32- P34

Introduction:

The banking system has long held significant importance in various economic systems, and its importance increases day by day with the developments occurring in national economies on one hand and the profound transformations taking place in the financial environment on the other.

In light of the prevailing circumstances, banks are striving to develop their capabilities and methods of operation to gather funds from various sources and direct them towards the best possible uses. Commercial banks are considered the cornerstone of the banking system, aiming to achieve profitability in the shortest possible time by performing the financial intermediation function between

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economic agents in need of capital and financial agents who provide the funds. Hence, we raise the issue of our topic, which is: How does the volume of loans affect the net result of the Algerian External Bank? To address this, we relied on the descriptive-analytical method as well as the annual reports of the Algerian External Bank over the study years.

The problem of the study :

To what extent do loans impact the profitability of Algerian banks?

The following sub-questions fall under this problem:

- What is the nature of the relationship between loan volume and bank profitability?
- What role does liquidity play in shaping this relationship?
- Does the impact of loans on profitability vary over time?

Main Hypothesis :

Loans have a statistically significant impact on the profitability of Algerian banks

1. BANK LOANS

1.1. Definition of Bank Loans

Bank loans are defined as the services provided by banks to individuals and institutions in society, where the necessary funds are made available to them. In this process, the borrower commits to repaying the borrowed amount along with interest, while providing guarantees that ensure the bank can recover its funds in case the client is unable to repay (Abdul mutalib, 2008).

A loan is defined as an act of trust between individuals, where the bank or creditor grants a sum of money to another party, the debtor, or promises to provide it, in exchange for the debtor's commitment to repay, along with fees or interest. The debtor commits to repayment within the agreed-upon period between the two parties. (Latrash, 2007)

1.2. Elements of Bank Loans:

- **Trust:** The existence of a debt relationship between the creditor and the debtor presupposes trust between them.
- **Loan Amount:** The debt is in the form of a monetary sum.
- **Purpose of the Loan:** The need or nature for which the loan is being sought.
- **Term:** There is a time gap between the creation of the debt and its repayment, and this period cannot be achieved without credit.
- **Consideration:** When the creditor grants the loan to the debtor and waits for a certain period, there is a risk of non-payment, which represents a danger to the creditor. Therefore, there is a consideration for bearing this risk, represented by interest. (Mbana, 2008)

Granting loans by banks contributes to enhancing economic activity and promoting progress and prosperity in the societies they serve. Loans help create job opportunities and increase purchasing power, which enhances the expansion of economic resource utilization and improves living standards. (Abdul Hamid Abdul Mutalib, 2008)

1.3. Types of Bank Loans:

Bank loans can be classified according to various criteria into three types: loans directed towards financing operational activities, loans directed towards financing investment activities, and loans directed towards financing foreign trade.

1.3.1 Loans Directed Towards Financing Operational Activities:

Operational loans help finance a company's production in the short term, usually not exceeding eighteen months. Banks use several methods to finance these activities, and these loans can be broadly classified into three types: General Loans, Specific Loans, Trade Discounts,

1.3.2. Loans Directed Towards Financing Investment Activities:

Investment activities refer to operations undertaken by institutions over long periods, aiming to acquire production equipment or real estate such as land, industrial, commercial, and administrative buildings. Investment is defined as a financial agreement aimed at achieving greater financial returns in the future. Investment differs fundamentally from operations in terms of subject, nature, and duration. Consequently, investment activities require different forms and methods of financing.

1.3.3. Classical Loan Operations for Financing Investments:

Two types of classical methods are distinguished: medium-term investment loans and long-term investment loans.

2. The Bank Balance Sheet:

The financial statements, according to the financial accounting system for banks (System No. 09-05 dated October 18, 2009), are the result of processing various information that requires simplification, structuring, and summarization. The system mandates the preparation of six mandatory financial statements: (Farouk Bouyakoub, 2000)

- The Balance Sheet.
- Off-Balance Sheet.
- Income Statement.
- Cash Flow Statement.
- Statement of Changes in Equity.
- Notes providing additional information and accounting policies used.

A new statement, the "Off-Balance Sheet," has been added due to the importance of the operations it includes for banking institutions. The financial statements must be prepared within six months of the fiscal year-end and must be clearly distinguished from other published information. The amounts must be expressed in the local currency, with the option to express them in thousands of monetary units. Comparative information with the previous fiscal year must also be provided.

The balance sheet presents assets and liabilities separately. The main banking operations are distributed into three categories: treasury and interbank operations, customer operations, and portfolio operations. The remaining items are similar to those of other economic institutions

Table 1. Simplified Model of a Bank Balance Sheet

Assets	Liabilities
Group 1: Treasury Operations and Interbank Operations	Group 1: Treasury Operations and Interbank Operations
Group 2: Customer Operations Accounts	Group 2: Customer Operations Accounts
Group 3: Securities Portfolio and Settlement Accounts	Group 3: Securities Portfolio and Settlement Accounts
Group 4: Fixed Assets	Group 4: Shareholders' Equity and Similar Items

Source: Suhila Bouamama Mohamed Rouazki, 2021, p. 626, The Bank Balance Sheet in the Context of the Financial Accounting System for Banks, Journal of Economic Sciences, Management, and Commercial Sciences, Volume 14, Issue.

3. Profitability

Like other institutions, banks aim to achieve high profits to satisfy their shareholders. A bank's profits depend on the difference between total revenues and total expenses. Revenues are generated from lending and investment activities, as well as capital gains from the appreciation of certain assets. Expenses, on the other hand, include administrative and operational costs, interest paid on deposits, potential capital losses, and non-recoverable loans. To achieve the principle of profitability, the bank must minimize its expenses as much as possible while maximizing revenue. This can be achieved through various measures, such as improving administrative efficiency, reducing operational costs, enhancing lending processes, and minimizing the risks of non-recoverable loans. (Dr. Al-Taher Latrash, 2007)

In short, achieving profitability requires the bank to strike an optimal balance between revenues and expenses, taking the necessary steps to increase revenues and reduce expenses to the greatest extent possible.

3.1. Means of Maximizing Profitability :

There are several ways to improve bank profitability, including: (Benhani, 2003)

- **Exploring new opportunities and services:** Introducing new services in new sectors, activities, geographical areas, or to new customers, or offering new services to existing clients.
- **Increasing prices for certain banking services:** Where banking regulations allow, banks can raise fees and commissions. While most interest rates and commissions are standardized among banks, practitioners often find ways to increase revenues through this approach, especially since interest rates typically have a minimum and maximum range, with the final rate depending on the client and the transaction.
- **Fully utilizing available funds and assets:** While some focus solely on cost reduction, profitability can also be improved by increasing new opportunities, raising fee and commission categories, and making the best use of available assets.

- **Reducing expenses in all areas:** Particularly in general expenses, which are often areas of unchecked spending.

4. Lending and Profitability at the Level of the External Bank

4.1. The Algerian External Bank

The Algerian External Bank was established on October 1, 1967, under Decree No. 67-204, as an Algerian company with an initial capital of 20 million Algerian dinars. Its headquarters is in Algiers, and it has the authority to establish agencies and branches, both domestically and ***abroad, with the approval of the Minister of Finance.***

Table 2. **Classification of Sectors Financed by the Bank**

sector	***Percentage***
Public sector	16%
Small and medium enterprises	20%
Private Sector	44%
Foreign Trade Operations	20%

Source: Algerian External Bank's official website.

4.2. Administrative Organization of the Algerian External Bank

The administrative hierarchy consists of several layers, organized in a pyramid structure. At the top is the General Manager and their advisors, who operate under their direct supervision. Below them are the General Inspectorate and the Purification and Cleansing Unit.

At the subsidiary level, there are strategic units, including the Organization Unit, Accounting Department, IT Department, Treasury Department, and Control and Management Department. These subsidiary departments operate under the supervision of the General Subsidiary Directorate.

Internationally, the General Subsidiary Directorate includes several departments, such as the International Relations Department, Foreign Trade Department, and Overseas Operations Department.

Finally, internal administration, human resources, legal, and administrative matters are organized under the General Secretariat, which includes the Human Resources and Training Department, Legal Studies and Disputes Department, and General Administration Department (Annual Reports, 2019, 2020, 2021, 2022, 2023.)

4.3. the Relationship between Loans and Profitability

Banks are capable of maintaining a high level of liquidity to fullfil their needs, but this may result in missed profit opportunities that could be achieved through Loans. For example, if a bank fully invests its funds in lending, it may achieve higher profits. However, this is associated with the risk of clients defaulting on loans, which could lead to serious financial problems threatening the bank's stability and potentially causing

bankruptcy. This reflects the delicate balance between lending and profitability, as banks strive to achieve stable profits and sustainable growth to ensure consistent returns for shareholders and depositors, thereby enhancing their reputation and customer trust.

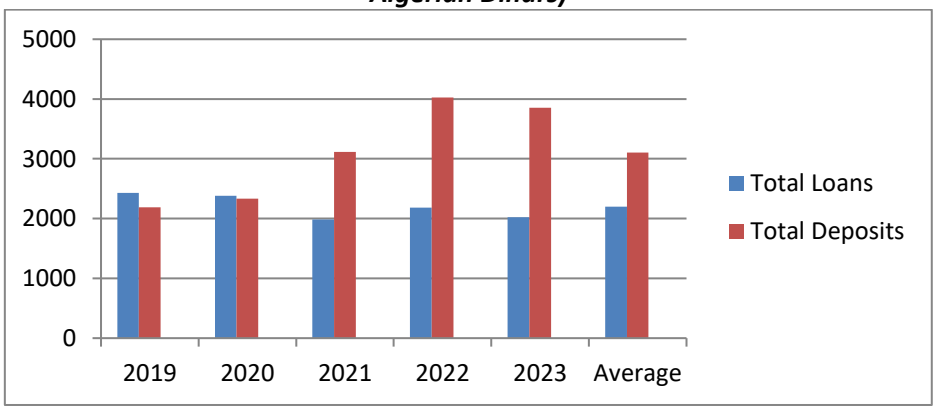
Therefore, banks must choose investments that align with their risk tolerance. Profitability is often balanced against the level of risk exposure, and risky investments can lead to significant losses that negatively impact the bank's reputation and customer confidence

Table 3. **Loans and Deposits of the Algerian External Bank (2019-2023, in Billion Algerian Dinars)**

Years	*Total Loans*	*Total Deposits*
2019	*2431*	*2191*
2020	*2379*	*2331*
2021	*1985*	*3113*
2022	*2181*	*4025*
2023	*2022*	*3852*
Average	***2199.6***	***3102.4***

Source: Prepared by the student based on the annual reports of the Algerian External Bank.

Fig.1. Loans and Deposits of the Algerian External Bank (2019-2023, in Billion Algerian Dinars)



Source: Prepared by the student based on data from Table 3 using Excel**.**

Commentary on the Table and Figure:

The table and figure show the total loans and total deposits over a five-year period (2019-2023). It is evident that total loans have been in continuous decline from 2019 to 2023, with a significant drop in 2021 (1,985) compared to 2019 (2,431). The lowest point was in 2023 (2,022), indicating a potential decline in lending activity or economic factors affecting loan demand.

In contrast, total deposits increased significantly during the same period, rising sharply from 2,191 in 2019 to 4,025 in 2022. Although there was a slight decrease in 2023 (3,852 compared to 4,025 in 2022), the overall trend shows strong growth in deposits.

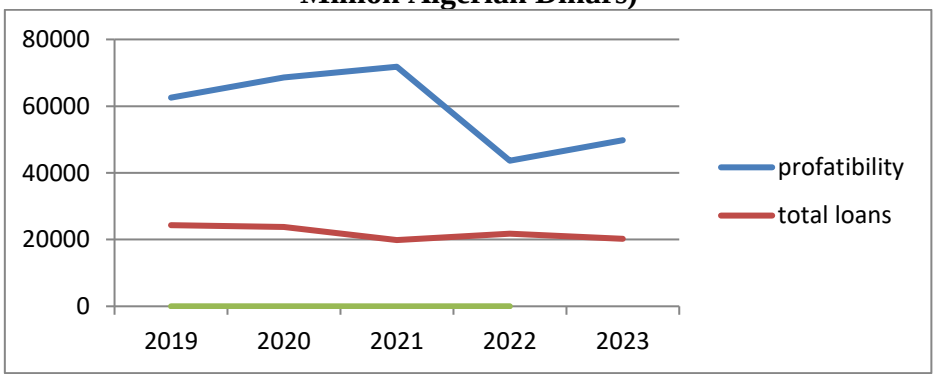
The loan-to-deposit ratio has been decreasing over the years, suggesting that the Algerian External Bank has become more reliant on deposits. For example, in 2019, loans were slightly higher than deposits, but by 2023, deposits were nearly double the loan amount. The growing gap between deposits and loans may indicate an increase in savings or a reduction in borrowing activity, reflecting economic conditions such as decreased consumer confidence in borrowing or higher interest rates discouraging borrowing.

Table 4: Profitability of the Algerian External Bank (2019-2022, in Million Algerian Dinars)

Years	Total Loans	Profitability
2019	2431668	62548
2020	2379031	68620
2021	1985897	71812
2022	2180605	43646
2023	2022489	49746

***Source**: Prepared by the student based on the annual reports of the Algerian External Bank.*

Figure 02: Profitability of the Algerian External Bank (2019-2023, in Million Algerian Dinars)



Source: Prepared by the student based on data from Table 4 using Excel.

Commentary on the Table and Figure:

From the table and figure, we observe the following:

2019: Total loans amounted to 2,431,668 million dinars, with profitability at 62,548 million dinars. This year shows a strong loan portfolio with high profitability, indicating effective resource utilization and good returns on lending activities.

2020: Total loans were 2,379,031 million dinars (a slight decrease from 2019), and profitability was 68,620 million dinars (an increase from 2019). Despite the slight decline in total loans, profitability increased, suggesting improved efficiency in loan management, possibly through better interest rates, cost control, or higher-quality loans.

2021: Total loans dropped significantly to 1,985,897 million dinars, while profitability reached its peak at 71,812 million dinars. This indicates that despite the sharp decline in total loans, profitability reached its highest point, likely due to a focus on higher-margin loans, improved risk management, or reduced operational costs.
2022: Total loans recovered to 2,180,605 million dinars, but profitability sharply declined to 43,646 million dinars. This suggests that despite the increase in total loans compared to 2021, profitability dropped significantly, possibly due to higher default rates, increased operational costs, or external economic challenges (e.g., inflation, market instability).
2023: Total loans decreased to 2,022,489 million dinars, but profitability improved to 49,746 million dinars compared to 2022. This indicates better loan portfolio management, cost improvements, or recovery from the challenges faced in 2022.
In conclusion, there is no clear linear relationship between total loans and profitability. For example:
In 2021, lower loans led to higher profitability, indicating efficiency.
In 2022, higher loans resulted in lower profitability, suggesting inefficiency or external challenges.
In 2023 lower loans again led to improved profitability, reflecting better management.

CONCLUSION:

This study examined the relationship between loans and profitability at the Algerian External Bank, focusing on how lending operations impact financial performance. The findings reveal that while loans are a critical source of revenue, profitability does not always correlate directly with the volume of loans. For instance, periods of reduced lending (e.g., 2021 and 2023) saw higher profitability, suggesting improved efficiency in loan management, such as better interest rates, cost control, or higher-quality loans. Conversely, increased lending in 2022 coincided with a sharp decline in profitability, likely due to higher default rates or external economic challenges. The study underscores the importance of balancing loan volume with risk management and operational efficiency to sustain profitability. These insights highlight the need for strategic lending practices to optimize financial performance in commercial banks like the Algerian External Bank.

Hypothesis testing :

The main Hypothesis: **Loans have a statistically significant impact on the profitability of Algerian banks (Correct hypothesis)**

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