European Journal of Business & Social Sciences
Available at https://ejbss.org/
ISSN: 2235-767X
Volume 07 Issue 14
November 2019

The Importance Of Increasing Of Stability Of Commercial Banks' Capitals

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Abstract. This article analyzes the current status of commercial banks' capital stability. Proposals and recommendations on strengthening the resource base of the commercial banks and improving their capital are developed.

Key words: stability, commercial banks, deposit base, capitalization rate, additional capital, reserve capital, retained earnings, long-term credits, liquidity, loan portfolio, banking services.

In our view, one of the main reasons for the international financial crises and economic stagnation is that, the financial weakness of foreign banks and the loss of public confidence in them. The financial soundness of the commercial banks and the confidence of the population require the increase of their capital stability.

Since independence, commercial banks have expanded their services, accelerated remittances, expanded resources, and increased their involvement in the economic processes.

However, the ongoing global economic crises and increased competition for the attraction of financial resources are causing problems for the sustainability of the commercial banks' capital.

In particular, the significance of commercial banks' capital in total passives has a tendency to decline, as of January 1, 1999, this figure was 4.0%, and as of January 1, 2018, was 3.0%.[1]The significance of unstable devaluation stocks remains high in the regulatory capital of banks, due to the low attractiveness of

[1]It is calculated on the basis of the data provided by the commercial banks of the Republic.

bank shares in the financial and stock markets of the country, emission earnings are not sufficiently formed in their capital stock, there are no contributions to the consolidated subsidiaries of the banks' regulatory capital.

A great deal of work is being done to ensure the capital and sustainability of commercial banks in our country and it is also producing good results.

A number of urgent issues that need to be addressed remain.

In particular, the President of the Republic of Uzbekistan Sh.Mirziyoev said in his speech that "… it is necessary to accelerate the reforms in the banking and financial system, to disseminate widely modern market mechanisms in the sector. Today, the main problem in the banking system is that the majority of their capital, 83%, belong to the state. This, in turn, hampers healthy competition in the banking sector and negatively affects the quality of service".[2]

In fact, the commercial banks' investment portfolio does not reach 1.8% of the country's GDP, while the Central Bank has granted short-term loans, which equal only 292.8 billion soums, or 0.1% of the country's GDP,

to increase the liquidity of commercial banks in the first nine months of 2018. Due to high interest rates on attracted funds of the banks, during the first nine months of 2018, this reserve sum increased from 191.5 billion to 2522.3 billion soums, or 13 times, the level of the national economy's monetary position is 29.8%.[3]All of these are factors that directly and indirectly affect the stability of the commercial banks' capital, which determine the urgency and need for practically and theoretically effective management.

[2] Mirziyoev Sh.M. Application of the President of the Republic of Uzbekistan to the Oliy Majlis on the Key Priorities for 2019.

[3] Author's calculations based on the statistical bulletin of the Central Bank of the Republic of Uzbekistan for 9 months of 2018.

In recent years, a number of decrees and resolutions of the President and the Government of the Republic of Uzbekistan have been adopted to improve the capitalization of commercial banks, as well as the normative acts of the Central Bank are constantly being improved. It is possible to note the tasks set out in the following regulations:

On the State Program on Implementation of the Strategy of Action of the President of the Republic of Uzbekistan dated September 22, 2018 PF-5308 "On the Year of Active Investment and Social Development" in five priority areas of development of the Republic of Uzbekistan in 2017-2021, Resolution “On Priority Measures for Liberalization of the Currency Policy” of September 2, 2017, No. PF-5177, Resolution of the President of the Republic of Uzbekistan "On measures to further develop and improve the stability of the banking system of the Republic", Resolution of the President of the Republic of Uzbekistan dated March 23, 2018 No PP-3620 "On additional measures to improve the popularity of banking services".

The more sustainable, competitive and fast development of our state requires the creation and implementation of fundamentally new approaches and principles At a time when global market conjuncture is changing dramatically, and competition in the context of internationalization is growing.

The Decree of the President of the Republic of Uzbekistan dated February 7, 2017 № PR-4947 "On the Strategy of Action for further development of the Republic of Uzbekistan" outlines the main directions and priorities of the country's development for the next 5 years.

In the third direction of the Strategy of Action, the functions is defined, such as further strengthening of macroeconomic stability and maintaining high rates of economic growth, deepening and supporting banking system reforms, increasing the capitalization and deposit base of banks, strengthening their financial stability and reliability, further expanding lending to prospective investment projects and small businesses and private entrepreneurship.[4]

Therefore, in the developed target parameters of financial and banking system development in 2017-2021, it is planned to double the total capital of the banking system and multiplicate the volume of deposits 2.1 times.

It is planned that strengthening of the capital and resource base of banks will increase the volume of investment credits by 1.7 times, funding of projects of small business and private entrepreneurship by 2.2 times.

The issue of creating a stable and effective banking system in our country is being implemented as a positive result of the reforms done by the head of our state. High economic growth was also achieved in 2018, with GDP growth of more than 5%, in the banking system, productive and positive work has been done, including further increase of commercial banks' capitalization level, attraction of private capital in this area, expansion of commercial banks' deposit base, raising the quality of the assets of commercial banks, the quality of banking activities, and especially the quality of credit risk management, increase of credits to economy and participation of banks in investment processes. Further development of the banking system and fulfillment of the requirements of the ongoing banking reforms and decisions strengthen the long-term and sustainable resource base of domestic commercial banks and strengthen their ability to make long-term investments and provide long-term credits.

[4] Scientific-methodical brochure on the study of the State program on realization of the Strategy of action on five priority directions of development of the Republic of Uzbekistan for 2017-2021. Pages T-2017. 187-188-p.

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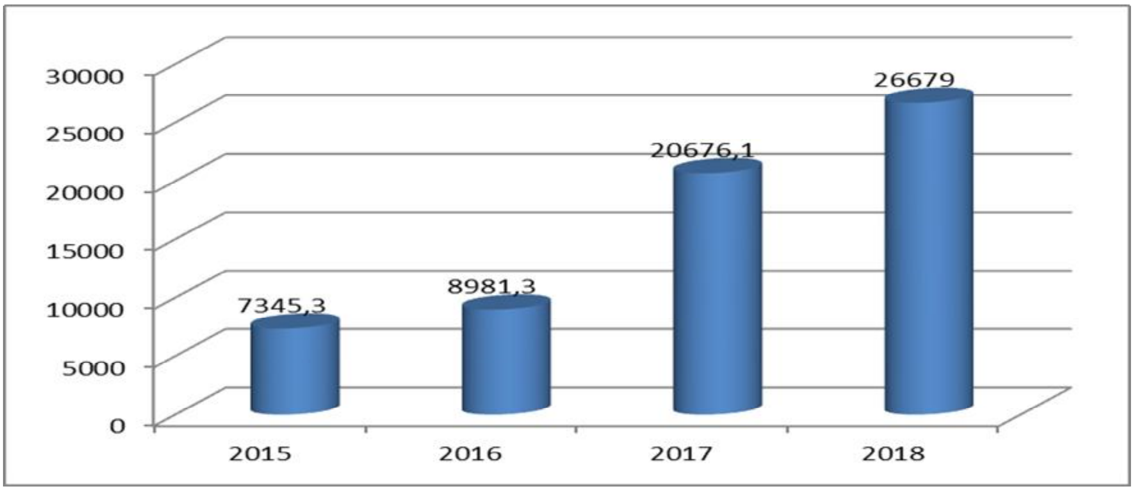
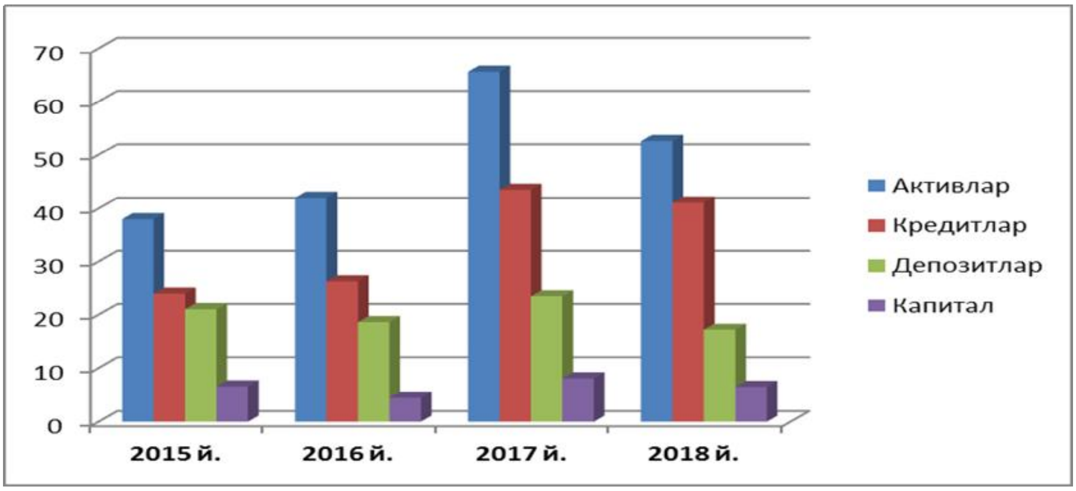


Picture 1. Commercial banks' capitalization rate (as of December 31, ... billion soums)[5].

As you can see from the picture above, the total capital of commercial banks in our country has been growing from year to year. At the beginning of 2015, their sum was 7.3 trillion soums, and by the end of 2018 this amount reached 26.6 trillion soums, and for the same period, we can see that commercial banks' capital increased almost fivefold, which is 3.6 times.

We will see the main indicators of GDP and banking system for 2015-2018 in our country.



[5] The data is based on the site www.cbu.uz

Picture 2. Ratio of main indicators of commercial banks to GDP (as of December 31, as a percentage of GDP)[6].

As the picture shows, despite the rapid growth of GDP, assets, credits, deposits in our country, which are the main indicators of domestic commercial banks, remain relatively low, despite their absolute growth.

For example, in 2015 the assets of commercial banks were 38.0%, credits 25%, deposits 20% and capital 6.5% in relation to GDP, and in 2018 these figures were 52.6%, 41.1%, 17.2% and 6.5%. It means that the degree of capitalization of the banking system in relation to the GDP of the country remains almost unchanged.

At the same time, during the analyzed period, the growth rate of commercial banks' credit investments was higher than the growth of deposits and bank capital. It is worth noting that the assets, credits and deposits of commercial banks over the analyzed period were also relatively low in the country's GDP.

Analyzing the structure and dynamics of the Bank's total capital, the following data (table 1) shows that the ration of the reserve capital in the Bank's capital in 2017-2018 decreased by 7.6 percentage points. As we know, the reserve capital is formed at the expense of the bank to cover the unforeseen losses. However, these funds serve only as a means of protection of capital. But today, the investment function of the capital is crucial.

From the logical point of view, reduction in the amount of reserve money allocated from income causes an increase in retained earnings. In our view, it will increases the capability of the capital to fulfill its investment objectives.

[6] The data is based on the site www.cbu.uz

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November 2019

If we look at the structure of the capital of commercial banks in Uzbekistan, we can see that in recent years it has grown year by year in absolute amount. Of course, there are a number of factors which cause them, including the devaluation of the national currency against foreign currencies in September 2017, changes in the banks' demand for minimum capital, as well as the resolutions of shareholders to increase their capital. The following table gives an overview of the structure and dynamics of commercial banks' capital.

Table 1

Composition and dynamics of capital of commercial banks of the Republic of Uzbekistan

(% As of January 1, total)

Capital sources	2016	2017	2018	2019
Authorized capital	68,9	64,6	69,8	63,7
Additional capital	0,5	0,5	0,3	0,3
Reserve capital	15,3	16,3	8,7	11
Net profit for the current year is	10,1	13,7	12,1	14,9
Retained earnings	5,2	4,9	9,1	10,1
Total capital	**100**	**100**	**100**	**100**

We can see that the structure capital of commercial banks in total capital decreased by 5.2% as of January 1, 2019 as of December 31, 2015, but the authorized capital has been growing at an absolute rate for the period under review. In our opinion, the structure of authorized capital in the total capital of commercial banks should not be reduced, since this source, firstly, is a stable source, and

ISSN: 2235-767X
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secondly, it is one of the cheaper financial resources. Also, the ration of additional capital in the capital of domestic commercial banks should not be reduced.

At the analysis time, the ration of banks' capital in the banks' capital was 0.5% in 2017 and as of January 1, 2019, this amount decreased by 0.2 percentage points to 0.3%, which is very low. This, of course, indicates the low prestige of the stock shareholders of commercial banks in the financial markets and the transparency of the purchase and sale process.

It is known that the authorized capital of commercial banks is mainly spent for the opening of new branches and mini-banks with the aim of expanding the scope of their activities and long-term investments.

This will certainly be a source of additional income in the future. Introduction of new techniques and technologies for the development of the country's economy will facilitate the process of modernization.

Although domestic commercial banks comply with the requirements set by the Central Bank, this does not give the notion that there are no problems with the formation, management and maintenance of capital of commercial banks in our country.

It is worth noting that the following problems exist in ensuring the stability of the capital of domestic commercial banks.

Firstly, there is no source of emission income in the main capital of commercial banks. Emission revenue is indeed a highly sustainable source of capital in the bank's capital compared to other sources. Because the emission income in the capital of commercial banks comes from the increase in the nominal value of their shares and is formed as the difference between the nominal and market value of the shares.

What is the difference between the nominal value of the stock and the market price? If high demand for bank shares on local and foreign stock markets, the bank’s shares has a respectable rating on the stock markets, a stable dividend payment is carried out on bank shares; the bank's shares can increase its market value.

One of the main reasons for the stability of emission income in the capital of banks is that the bank does not pay tax or dividends to shareholders, which means they are exempt from any obligations. However, the formation of emission income as a stable source in the capital of domestic commercial banks remains one of the main problems.

Secondly, the stock market is not developed enough and the population does not have adequate information on the purchase of bank shares.

If the development of the primary and secondary securities markets in the stock market of the country is sufficient, it will have a positive effect on the trading of shares of commercial banks.

However, due to insufficient work done in the country, in particular, the lack of information on the purchase of bank shares and the amount of dividends paid on them have a significant negative effect on public confidence in the banking system. Thirdly, non-emission of securities designed for commercial banks with high profitability in the financial market, especially for individuals, also contributes to the expansion and consolidation of banks' common capital and deposit base. Support of indicators of adequacy and liquidity of commercial banks' assets, management and banking risk systems, management efficiency in commercial banks based on advanced international experience defined as a task according to The Basel Committee on Banking Supervision, in the course of actions for further improvement of the banking system for 2017-2021, with the aim

ISSN: 2235-767X
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of eliminating barriers to the efficient operation of banks through the introduction of modern principles and mechanisms of banking regulation. This, in turn, will enable new approaches to bank management, increase the capitalization of commercial banks, improve the quality of the loan portfolio and further enhance the scale of lending to businesses, and enhance the availability of banking services.

References:

1. It is calculated on the basis of the data provided by the commercial banks of the Republic.

2. Mirziyoev Sh.M. Application of the President of the Republic of Uzbekistan to the Oliy Majlis on the Key Priorities for 2019.

3. Author's calculations based on the statistical bulletin of the Central Bank of the Republic of Uzbekistan for 9 months of 2018.

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