



State-Owned Banks, Problems With Their Management And Solutions Thereto

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ABSTRACT

This article is devoted to the consideration of the role of banks with a state share in the banking system of the Republic of Uzbekistan, their role in the performance of the banking system, as well as problems and solutions in their management. In addition, recommendations are provided to overcome available problems through implementation of efficient corporate governance.

KEYWORDS

Corporate governance, stakeholders, investment attractiveness, bank capital, performance indicators, business transparency, credit policy, general meeting of shareholders, supervisory board, executive bodies.

INTRODUCTION

It should be particularly noted that after gaining its independence, Uzbekistan has selected the path of development in reliance upon free market principles, however, the banking and financial system is based on banks

with high state participation in the capital. Currently, the banking system of Uzbekistan possesses an asymmetric structure, mainly focusing on state-owned banks. State-owned banks have a dominant position in the national

banking system. By establishing a wide network of individual divisions throughout the country, they create a unique “circulation system” for redistribution of financial resources from a highly concentrated region - the capital of the country - to all regions.

Furthermore, the President of the Republic of Uzbekistan Shavkat Mirziyoyev considered this issue in his Message to the Oliy Majlis, noting that over 83% of the charter funds of commercial banks are publicly-owned. [1]

In compliance with the Decree of the President of the Republic of Uzbekistan PD-4720 “On measures to introduce advanced corporate governance in joint stock companies” dated April 24, 2015, starting from July 1, 2015, the word “state” was removed from the names of joint-stock companies and other business entities, regardless of the state’s share in their charter capital, however, even nowadays the direct or indirect state share in these banks remains very high. (Figure 1)

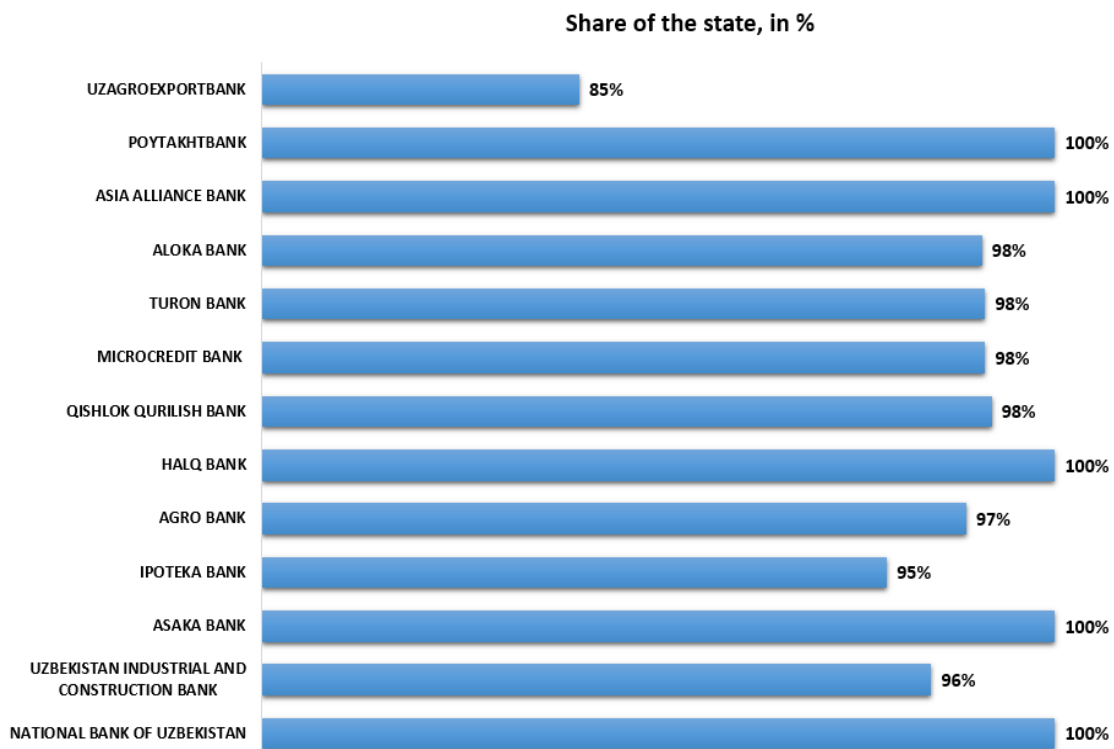


Figure 1. State share in the major banks of the Republic of Uzbekistan (as of April 1, 2021).

Considering 31 banks operating in the banking system of Uzbekistan, 13 have an average of 97 percent of the charter capital directly owned by the public institutions. Even in a few banks, the figure constitutes 100 percent. Such a fact itself testifies to the fact that the banking system of our country is developing in reliance upon the interventionist economic policy and

the impact of the state in the banking system of the country is very high [2]. The high share of state-owned banks in the share of total bank capital is justified mainly due to the public contribution to the charter capital of banks. In particular, in order to ensure financial stability and liquidity of commercial banks and to meet the growing demand for lending in the

economy, the government has allocated the following amounts: 670 million USD in 2017 to the capital of state-owned banks, [3] over 3 trillion UZS in 2018, [4] 1,9 billion USD in 2019 [5].

In his speech at the meeting devoted to the consideration of the priorities of reforming the banking system and enhancing investment activity of banks on October 25, 2019, the President of the Republic of Uzbekistan Shavkat Mirziyoyev said that “in recent years

from the the state budget it has been allocated 8.4 trillion UZS to commercial banks to finance programs, 400 million USD for working capital and 1.7 billion UZS to raise the charter capital. In total, 3.3 billion USD has been allocated over the past two years to raise the capitalization of banks” [6].

The figures of the banks with a state share in the basic indicators of the banking system have remained high for several years (Table 1).

Table 1.

The role of state-owned banks in the banking system of our republic

(as of January 1, 2021).

Billion UZS

Indicators	Assets		Loans		Capital		Deposit	
	amount	share, in %	amount	share, in %	amount	share, in %	amount	share, in %
Total in the banking system	362 309	100%	277 755	100%	59 181	100%	111 035	100%
Share of the state-owned banks	307 471	85%	245 001	88%	49 626	84%	79 655	72%

As it is obvious from the general indicators of the banking system, the most fact of concern is that 3-4 banks constitute the basis of these indicators [7]. State-owned banks are leaders in mortgage lending to the population and at the same time in housing construction sphere. State-owned banks are participants in many social programs and projects in the capital and other regions of the country, in some sectors of the economy. 87 percent of loans to individuals, 88 percent of loans to legal entities, as well as 64 percent of deposits from individuals and 74 percent of deposits from legal entities have occurred due to the state-owned banks. In addition, lending through incoming foreign lines on the basis of state guarantees is basically implemented by state-owned banks and the share of loans in foreign

exchahnge in the amount of 84 percent belongs to the state-owned banks as well. Almost 92 percent of non-performing loans fall to the share of the state-owned banks [8].

In our opinion, the primary cause for the high share of state-owned banks in the market of credit investments is the allocation of additional funds by the state to these banks with the aim of lending various programs.

According to the US company Fitch Ratings, about 40 percent of all loans provided by the banking sector of the country fall to the share of loans extended by the state-owned banks to strategically important sectors of the state (oil and gas, as well as chemical and energy) at the expense of the Fund for Reconstruction and Development of Uzbekistan [9].

This was stated by President of the Republic of Uzbekistan Shavkat Mirziyoyev on July 6, 2020 at the meeting on the implementation of the strategy of reforming the banking system of the Republic of Uzbekistan for 2020-2025 and the acceleration of the transformation of commercial banks [10]. He noted, that “The share of loans from the government constitutes 41 percent in Qishloq Qurilish Bank and 32 percent in Ipoteka Bank. Last year about state-guaranteed credit lines in the amount of 600 million USD were attracted to banks, and

in 2020 this indicator has reached 570 million USD. In addition, the share of savings and time deposits of the population in major banks averages 5 percent. Although the banking system includes banks of various forms of ownership, the distribution of resources remains at the disposal of banks with the public share.

It should be noted that this situation results in the lower liquidity ratios in banks with the state share than in other banks (See Table 2)

Table 2

Data on liquidity indicators of banks in terms of the form of ownership

(as of March 1, 2021). [11]

Billion UZS

Indicator	Assets	Liabilities	Ratio of assets to liabilities	Loans	Deposits	Loan-to-Deposit Ratio
Total in the banking system	366 154	306 625	119%	280 215	113 114	248%
Share of state-owned banks	309 845	260 059	119%	246 632	80 709	306%
Other banks	56 310	46 566	121%	33 583	32 405	104%

The ratio of assets to liabilities is an indicator that determines the degree to which a bank is able to meet its obligations. Therefore, the ratio of the bank assets and liabilities is considered as an indicator of its reliability. It should be noted, that the condition of our banks can be considered satisfactory by means of this indicator. However, the share of loans allocated by the state in the operating banks is higher than the share of attracted deposits, which may cause a lack of liquidity in banks to meet unexpected funding requirements. State-

owned banks have a basis for the development of quality measures to attract the population and businesses to deposit their free funds.

The banking system of our country has a very high share of key indicators of state-owned banks, but performance indicators remain low compared to other forms of ownership (See Table 3).

Table 3

Comparative data on the performance of commercial banks' activity[12]

Commercial banks	Performance indicators	
	ROA, in %	ROE, in %
National Bank of Uzbekistan	1,24	6,5
Uzbekistan Industrial and Construction Bank	1,9	11,9
Asaka Bank	0,85	5,3
Ipoteka Bank	1,72	11,3
Agro Bank	1,03	4,7
Halq Bank	2,31	10,4
Aloka Bank	2,2	10,8
Turon Bank	1,57	9,5
Microcredit bank	1,24	5,8
Qishlok Qurilish Bank	1,56	9,3
Hamkor Bank	3,51	22,9
Ipak Yuli Bank	4,09	21,1
Davr Bank	6,36	33,8
Trust Bank	7,79	38,2
Orient Finans Bank	5,19	21,8

ROA (Return on Assets) is a ratio that reflects the efficiency of using a company's assets to generate revenue. In state-owned banks, this indicator may be low due to inadequate customer base or the bank's conservative lending policy. In banks belonging to other forms of ownership, the high rate is the result of a significant share of the cheap customer base, successful speculative operations and the placement of assets in high-yield operations.

ROE (Return on Equity) is an indicator of the efficiency of how the bank uses its own funds. ROE is considered the most significant financial

indicator that brings income to any investor, business owner. It shows how effectively the capital invested in the business is used. The high ROE rate in private banks can be justified by the fact that in the system of corporate governance particular attention is paid to the selection of qualified and gifted managers and employees, who are especially devoted to the work and responsibilities. In addition, this indicator illustrates how efficient is the HR policy implemented in the bank.

The following aspects are the primary reasons for this low multiplier in banks:

- This is due to the low efficiency of corporate governance under the impact of high government intervention in the activities of banks;
- Disproportionate growth of the net profit of banks and their capital under the impact of funds invested by the state to raise the charter capital of banks;
- The fact that low-interest social security loans are issued through state-owned banks.

The problem of the governance inherent in the state-owned banks is that, on the one hand, even though participation in programs, projects and agreements does not always bring sufficient benefits to the bank, but it plays a particular role in the implementation of the state economic and social policy. However, on the other hand, a bank participating in the both domestic and global financial market must ensure a level of competitive performance in terms of financial results, business efficiency, quality of customer service and level of technology.

Currently the management of state-owned banks is characterized by the following aspects:

- The majority of banks lack well-developed strategies, plans to enhance competitiveness, and overall corporate goals;
- Employees are not adequately aware of the bank's strategic development plans;
- Uncertainty in the distribution of official duties and responsibilities;
- Lack of coordination between agencies that hinders the implementation of interbank projects or reduces their efficiency;
- Not devoting adequate consideration of the needs and goals of customers, their development strategies;
- Use of the payroll system as the basic and only means of motivating employees;

- The notion of “state bank” is deeply ingrained in the minds of employees, implying that “belonging to the state” means “belonging to nobody”;
- Due to the large number of extracurricular activities, lack of time for the core business and main activities or their performance on the half-heartedly basis;
- Inadequate perception of such concepts as “bank brand”, “bank reputation”, “goodwill” and etc.

All the statements specified above are reflected in both the development of the bank's development strategy and its implementation, which significantly complicates the management of state-owned banks.

Solving these problems requires privatization of state-owned banks, involvement of investors, study and application of current and cutting-edge concepts and technologies of strategic management by senior managers of banks.

It is known that the successful performance of commercial banks depends on many factors. Among these factors, the most essential is the right choice of development and strategy to find its place in the financial market, qualified management, experienced staff, ability to raise capital for business development and expansion. Each of these factors can be improved by applying corporate governance principles. Herewith, the biggest contribution of corporate governance to the activities of developing banks is to facilitate access to investment capital. The bank's corporate governance system makes a direct impact on the strategic planning and management system of a commercial bank.

Corporate governance is a complicated, multifaceted concept that reflects aspects of the banking management system and the interactions between shareholders and managers. In terms of its essence, it is aimed at establishing a system of control and regulation

of bank managers on behalf of corporate governors (investors), as well as other stakeholders and groups [13]. The main factor in the urgency of efficient corporate governance is the increase in investment in the economy of our country, the growth in the attractiveness of our banks, i.e. the increase in interest by foreign investors.

The past period demonstrates that the main problems of corporate governance for the banking sector of the country are related not only to the lack of experience in applying its principles, but also to the peculiarities of institutional development.

In our opinion, the following measures should be undertaken to enhance investment efficiency of state-owned banks by raising the level of corporate governance in the country:

1. Enhancing the transparency of banking business. It should be noted that the quality of disclosure of information about our major banks characterizes the level of readiness to communicate with all stakeholders. Research conducted by McKinsey&Company, the international consulting company specializing in strategic management, illustrates that 40% of investors' interest in a company depends on the company's transparency [14].

With the aim of enhancing the transparency and openness of state-owned banks, it is necessary to pay attention to the following factors:

First, banks should use as much as possible the practice of involving international consulting companies (Big Four) in the implementation of corporate projects and programs in order to improve the various processes in the company, to identify common needs, to widely publicize the results in the mass media.

Second, it is recommended to establish a mechanism of interaction with all stakeholder groups (stakeholder), to pursue a policy of real-

life communication by providing extensive information about the company's activities. This can help build trust-based relationships with shareholders, customers, partners and employees, and make banks more transparent.

Third, the Supervisory Board, the system of incentives for executive management and transparency in dividend policy will enhance the interest of investors in the activities of state-owned banks.

Fourth, it is required to ensure that the websites of state-owned banks provide complete and high-quality information about their shareholders and activities.

2. Development of internal control, audit and risk management system. It is crucially important to understand that internal control is not an economic security service and that an audit is not just about verifying the accuracy of financial statements. It is a tool that determines the efficiency of the implementation of financial and economic decisions by the Executive Board and Board members. In general, this is a set of internal control mechanisms that must be implemented in all companies that strive to remain competitive in the market. In this regard it is required to involve consultants (EXPAT) with international experience in improving the audit and risk management system.
3. Intensification of the role of the Supervisory Board. The Supervisory Board plays an important role in the corporate governance system: it sets strategic goals and makes important decisions for the company. However, there are major drawbacks in the activities of the state-owned banks of this institution, which is the nominal participation of the members of the board. The head of a public institution has been appointed as a member of the board of several companies. He cannot be more involved in the activities of the company than the institution he leads. As the world practice

shows, one of the factors of success in the activity of the Supervisory Board is involvement of professionals. It is necessary to ensure that at least 30% of the members of the Supervisory Board are independent members and to improve the work of the committees under the Supervisory Board.

4. Reconsideration by banks of their corporate governance codes. In this regard it is necessary to establish the system according to which the number of minority shareholders in the shareholders of each state bank should not be less than 20%, and the share of one or several interconnected groups of shareholders should not exceed 7-10%. To pursue this aim it is necessary to make modifications to the relevant legislation. It is required to strengthen the practice of selling shares of state-owned banks, first of all, in the domestic market.
5. Creating a modern treasury system. In this regard it is necessary to change the philosophy of treasury policy, that is, to formulate the system of income generation using various economic instruments, not just resource mobilization.

In conclusion, it should be emphasized that the efficient organization of the corporate governance system is in favor of both our government (our state) and our companies. Enhancing the level of corporate governance efficiency can serve as a real objective factor in attracting investments. Therefore, we can say with confidence that creation of conditions for efficient corporate governance should constitute a part of the state economic policy aimed at attracting long-term investment and integration of our country into the world economic system.

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