

ENHANCEMENT OF ASSETS PROFITABILITY IN COMMERCIAL BANKS OF UZBEKISTAN

Lyudmila Fatkhiddinovna Muradova

Tashkent State University of Economy, Republic of Uzbekistan

mila.muradova@gmail.com

Abstract

The profitability of commercial banks in general and profitability of assets provides first of all the financial stability of bank system. Profitability of assets allows commercial banks to support the optimal level of net interest margin and net interest income which are the main elements of financial stability and solvency. The main aim of any commercial organization is to increase its profit. It is important for shareholders, for management, for clients and for the bank system as a whole. Also, the bank profit is the main source for the capital formation of commercial bank. However, in many countries with transitional economies, including Uzbekistan, there are problems connected with improving the profitability of the commercial banks active operations. In particular, big commercial banks of the Republic of Uzbekistan have a relatively high level of reserve deductions which are intended to cover future loan losses. As of 1 January 2016, the specific weight of reserve deductions which are intended to cover losses on loans relative to the total assets of the National Bank of Foreign Economic Activity, Asaka Bank, Ipoteka Bank had exceeded 1.5% (1). According to the recommendation of the experts from the International Bank for Reconstruction and Development, the value of this index should not exceed 0.5% (2). Therefore, the solution of actual problems connected with increasing the profitability of commercial banks' assets is of great importance for the banking system of the Republic of Uzbekistan.

Keywords: Assets, profitability, margin, credit portfolio, interest income, reserves, capital base

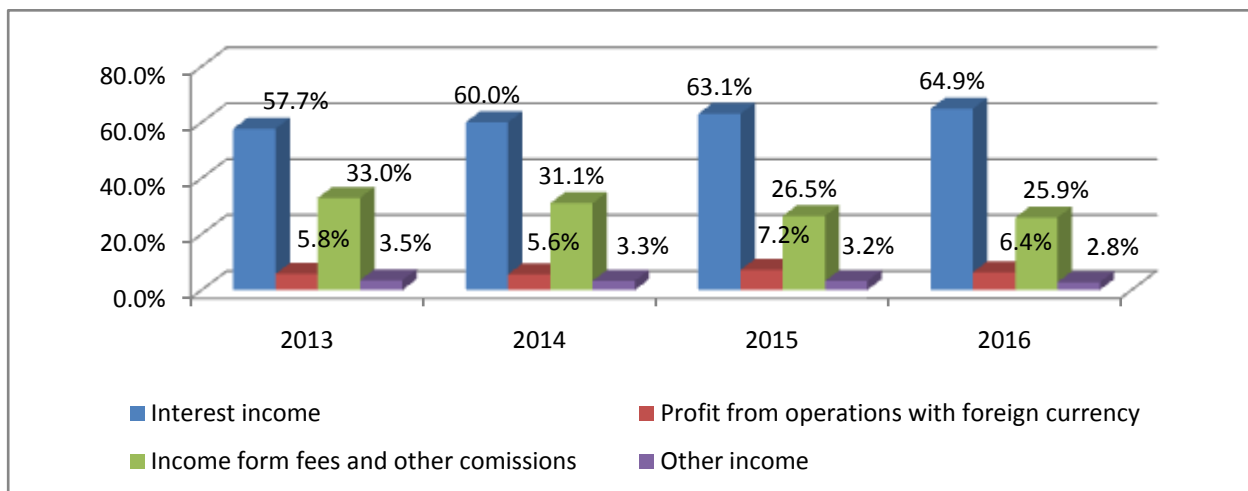
INTRODUCTION

In this article, we try to discover important issues related to increasing the profitability of assets in commercial banks of Republic of Uzbekistan. In this article, it is supposed to examine important issues of increasing the profitability of commercial banks active operations of the Republic of Uzbekistan. On the base of results appeared from analysis we discovered the problems associated with active operations of banks. We managed to develop research proposals aimed to increase the profitability of active operations of commercial banks of the Republic.

The gross income of commercial banks consists of interest- and non-interest incomes. However, interest income is more important than non-interest income. This is because the interest income is received from principal activities of any commercial bank. In Uzbek commercial banks assets structure most of all consists of loans which occupy the largest share. Therefore, the profitability of credit operations is very important for any commercial Bank.

Below, we will consider the dynamics of the main indicators, characterizing the profitability of credit operations of Uzbekistan's major commercial banks.

Figure 1. The structure of incomes in commercial banks in Republic of Uzbekistan



Source: Compiled by author based on the financial statements published in official sites of commercial banks

As we can see from the figure 1 the main share of income in commercial banks belong to interest income. Within our analysis we discovered that commercial banks with state participation focus their attention on interest income.

During the analysis of the annual reports of commercial banks done by the author for 2014-2016, a rapid growth of interest income was revealed due to the growth in the volume of

lending to the economy and investment projects. But at the same time we can see the trend of lowering the average weighted level of credit interest rates (by 0.94% for 2016 - based on the results of the author's selective surveys). When analyzing the incomes of commercial banks with the state share separately from private banks, we see a clear trend of increasing the share of interest income.

Taking into consideration the declining interest rates for loans, this trend is more likely justified by an increase in lending to both existing customers and new (newly attracted) customers and projects. So, the effective average interest rate for loans in state-owned banks declined to an average of 8.8% in 2016 (2015: 9.1%), while the loan portfolio increased by an average of 24% during 2016.

However, we can see that in structure of incomes in private banks non-interest and commission incomes prevail. So, we can conclude that private banks still place a greater emphasis on "fundamentality" of their incomes due to the stable sources. At that time state banks are forced to finance state, socially significant investment programs and investment programs of industrial enterprises, taking a greater risk of non-return.

In general, private banks also see a decrease in interest rates on loans, although the trend is weaker than in banks with state-owned shares.

It is clear that the implementation of the state policy to reduce interest rates and thereby increase the access to credit resources to the real sector of the economy is more clearly traced in banks with government shares.

It is important to note that decrease in the effective average interest rate for loans is not a consequence of the excessive provision of the Uzbek economy with the available credit resources necessary to ensure expanded reproduction.

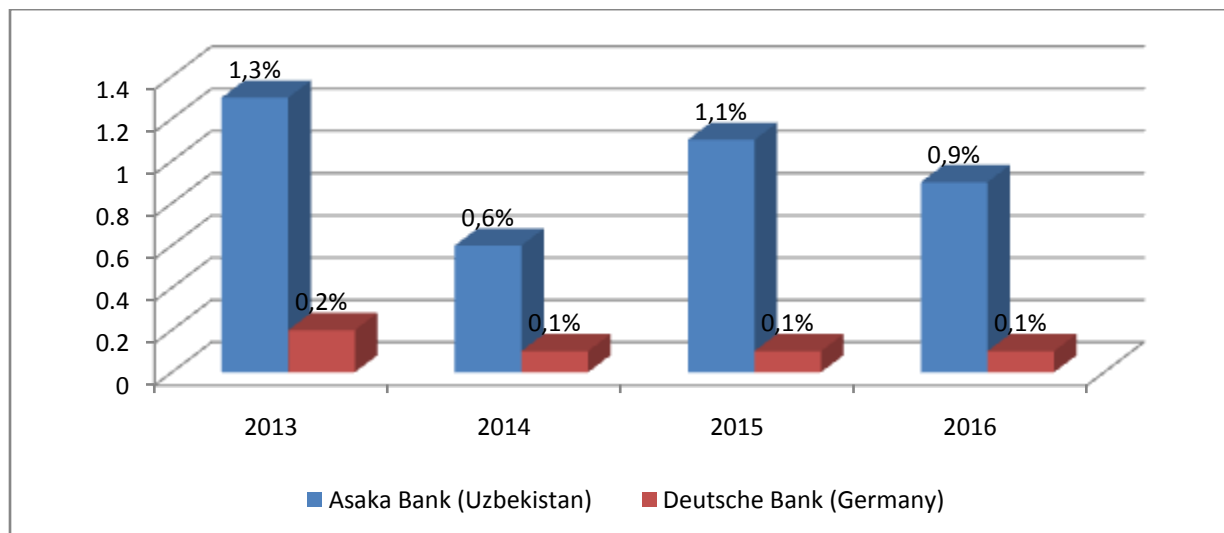
So, for example, in the USA, Great Britain and China for 2016 this indicator was 190.4%, 134.5% and 155.3%, respectively. According to our calculations, in Uzbekistan this indicator does not exceed 26% in 2016. However, due to currency liberalization in 2017 the Central Bank increased discount rate up to 14% from 9% to avoid inflation and surplus of money supply in economy.

It must be emphasized that large banks in Uzbekistan are subjected to an increased credit risk, which, in particular, is connected with the practice of directed lending to those sectors which the government considers necessary to be supported. For example, the National Bank for Foreign Economic Activity of Uzbekistan's loan portfolio has a high concentration on individual subjects of crediting: as of 1 July of 2016, twenty largest borrowers accounted for 56% of the total loans. However, the Government provides guarantees for loans, which fact is somewhat mitigating these risks. The governmental guarantees cover about half of all NBU

(National Bank of Uzbekistan) credits, most of which had been given to state-run transport, industry and communications enterprises. According to the statements of the NBU, on July 1, 2016, the share of loans overdue by more than 90 days, did not exceed 1% of gross loans; however, restructured loans and bad loans amounted to 6.7% (at the end of 2016, their share was 9%) (3). Therefore, it would be advisable to set strict limits on lending in accordance with the type of borrowers.

It is necessary to note that one of the main factors affecting on the profitability of assets in commercial banks is the level of reserve allocations designed to cover possible loan losses. The level of reserve deductions is determined in relation to the average assets of the bank and the normative level of this indicator is 0.5%.

Figure 2. Level of reserves deductions for possible losses from loans (comparison)



Source: Compiled by author based on the financial statements published in official sites of <https://www.db.com> and <https://www.asakabank.uz/uz/>

How we can see from the figure 2, the level of reserves deductions intended to cover loan losses in Deutsche Bank (Germany) does not exceed the normative level of 0,5% but in Asaka Bank (Uzbekistan) this indicator is more than normative one. We pay our attention to the main crucial indicators of the profitability of assets of foreign banks in order to compare them with indicators of local banks and to identify the methodological and practical reasons of differences in these indicators. Up to date, in the banking sector of Uzbekistan there is no loan on overdraft and this fact negatively affects the profitability of credit operations of commercial banks.

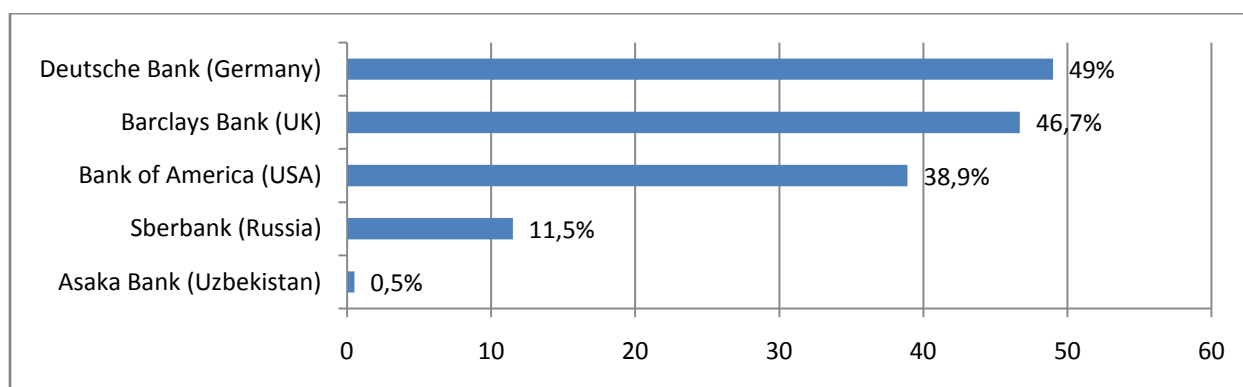
In our opinion, it is necessary to introduce overdraft and current account crediting practice into commercial banks activities of the Republic of Uzbekistan, taking into account the

experience of developed countries of the world. As practice shows, overdraft crediting form is well developed in English-speaking countries, and the current account credits - in the German speaking countries. In addition, the provision of credit balance of current accounts of clients at the end of each month should be a mandatory condition for granting overdraft credits and current account credits of commercial banks.

According to O. Lavrushin, the establishing of uniform time-limits for overdraft credits for all the clients is impractical because the actual terms of use of overdraft credits by borrowers are not the same due to the peculiarities in the organization of settlements (4).

Investments in securities are an important type of assets of commercial banks. In the banks in the US, Japan and Germany, investments in securities, in terms of specific weight, take the second place in the total volume of assets of commercial banks. For example, as of 1 January 2017, the share of investments in securities in the total assets: in Barclays Bank (UK) was on the level of 46,7% (5), in Bank of America (USA) 38,9% (6), in Deutsche Bank (Germany) 49% (7), in Sberbank (Russia) 11,5% (8) and in Asaka Bank (Uzbekistan) only 0,5% (9).

Figure 3. Participation in investment activity (comparison)



Source: Compiled by author based on the financial statements published in official sites of commercial banks

In the commercial banks of Uzbekistan, the profitability of investments in securities remains quite low. For example, as of December 31, 2016, the weight of income from investments in securities in total amount of incomes of the bank amounted to:

- * In Agrobank – 2,8%;
- * In Qishloq Qurilish Bank – 0,1%;
- * In Ipoteka Bank – 6,8%.

The relatively low share of the yield of investments in securities is explained by the fact that banks' investment operations with securities are not developed. Lack of awareness among investors about issuers of securities is one of the main reasons for the underdevelopment of the banks' investment operations with securities.

As shown by the results of scientific research by I. Butikov, «having a sufficiently capacious information about issuers, a regulatory body, unfortunately, has no right to provide and organize this information to be delivered to the potential investors and real securities holders, and this fact certainly holds back the development of the securities market» (3).

Also, in our opinion, the relatively high level of devaluation of the national currency of Uzbekistan negatively affects the investment operations with securities in commercial banks of the Republic.

Also, we consider that one of the main reasons of problem loans is the low level of diversification of the loan portfolio of local commercial banks.

According to the world banking practice in loan portfolio diversification, the huge attention is paying to which industry the borrower belongs to. It should be noted that, currently, the level of diversification of the loan portfolio of commercial banks is considered as low.

Table 1. The level of diversification of loan portfolio in Agrobank (Uzbekistan), %

№	Sector of economy	2016 y.	2015 y.	2014 y.
1	Agriculture	39,40	35,60	36,20
2	Industry	39,50	37,20	35,10
3	Individuals	11,90	13,38	13,10
4	Trade	4,30	6,83	7,10
5	Construction	2,80	2,70	4,60
6	Other	2,10	4,29	3,90
	Loan portfolio-toal	100,00	100,00	100,00

Source: Compiled by author based on the financial statements published in

https://agrobank.uz/ru/page/fin_report

We can see that the level of diversification of the loan portfolio in Agrobank is very low. Over 78% of the loan portfolio in Agrobank are loans granted to agriculture and industrial enterprises. Although Agrobank was established to develop these sectors of economy it does not have any barriers to lend in trade or individuals which are considered as high yield directions.

CONCLUSION

The increase in yield of assets of commercial banks of Uzbekistan requires, first of all, increasing the profitability of loans by increasing the quality of these loans, diversification of loan portfolio and banks investments in securities. This is because, first, the return on loans is unstable and relatively low; second, banks investment operations with securities are remaining at a low level. Therefore, the development of research proposals aimed to increase the profitability of the main types of Bank assets, in terms of ensuring the stability of the banking system of Uzbekistan, is of practical importance.

WAY FORWARD

Today, in terms of currency liberalization in Uzbekistan it is very important to support the liquidity and stability of commercial banks not at the expense of their profitability. The results of our research show the weak points of local commercial banks due to the lack of financial instruments and low quality of loans. But currently in terms of economy liberalization, in terms of extension of implementing the list of financial tools such as corporate securities, corporate bonds, IPO of stock companies commercial banks will have much more opportunities to diversify their assets portfolio, loan portfolio and to improve the quality of loans due to more liquid pledge collateral. Diversification of assets portfolio will allow not to consolidate money only in cash but also in securities which will permit not only to keep liquidity but also to earn interest or margin.

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