

STATUS AND ANALYSIS OF RISK DIVERSIFICATION IN COMMERCIAL BANKS

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Abstract

The article examines the state and analysis of risk diversification in commercial banks, the main directions of risk diversification in commercial banks at the macroeconomic and microeconomic levels, the possibilities of reducing economic risk associated with risks in banks and preventing financial losses, and the application of the experience of foreign countries in our country.

Keywords: Commercial banks, risks, macro and microeconomic level, monetary policy, bank credit, risk management, risk diversification, bank loan portfolio.

Introduction

In the commercial banks of our country, a number of objective and subjective factors continue to have a strong impact on the diversification of risks. As a solution to these issues, it is important to carry out effective structural reforms in the real sector of the economy, to widely implement the Central Bank’s soft monetary policy, and to ensure economic equality and transparency — which are among the key principles of a market economy.

Under market economy conditions, the relationships of commercial banks with depositors, investors, borrowers, and clients are constantly expanding. This, in turn, leads to a deepening need for effective risk diversification. Bank risks are extremely broad in scope and arise in the implementation of all operations related to the assets and liabilities of commercial banks.

The main asset-side operations of commercial banks that are directly related to risk include credit, investment, leasing, rental, and derivative operations. Liabilities-related risks arise in the process of attracting funds and repaying them with appropriate payments.

In the diversification of bank risks, the main focus is on ensuring the full return of financial resources placed in risky assets and generating the expected profit from them. The mechanism for diversifying bank risks is based on the application of the theory of probability in conjunction with the theory of banking risks.

Based on research and comparative studies, we can state that:

“Diversification of risks in commercial banks means preventing the concentration of risks and avoiding economic losses in order to ensure the stable and efficient development of the bank, regardless of various internal and external factors.”

Literature Review

According to the economist A.V. Belyakov: “For a subject who observes a situation with interest, the presence of possible outcomes that may lead to negative consequences under



conditions of uncertainty about the development of that situation indicates the presence of risk”¹”, ...as defined above, according to E. B. Starodubtseva, “risk is the value-based expression of the probability of events that may lead to losses”².

Thus, the higher the level of risk, the greater the potential for profit. Risks arise as a result of differences between current and future actual performance indicators. These differences can be both positive and negative. Therefore, profit can only be achieved if the possibility of losses is anticipated in advance and proper precautions are taken.

According to Russian scholars, credit risk is defined as “the potential loss that may occur as a result of a counterparty’s failure to fulfill the obligations specified in the contract. The borrower’s inability to pay the remaining interest after deducting the principal and previously paid amounts is regarded as a loss for the creditor.”³, In this way, risk has been linked solely to the credit process.

Western European economists E. V. Ioda, L. L. Meshkova, and E. N. Bolotina approached the definition of banking risks from a dual perspective. In the absolute sense, “risk determines the amount of loss that can be measured in tangible (physical) or value (monetary) terms.” In the relative sense, “risk represents the amount of potential losses that may affect a commercial bank’s financial condition, total operating expenses, or expected income (profit).”⁴, As noted above, Professor Sh. Abdullaeva defines bank risk as follows:

“Bank risk is the execution of banking operations (deposit, credit, investment, currency) under conditions where there is a possibility of losing part of the bank’s funds or failing to earn income, while still expecting a positive outcome.”⁵, ...has provided the following definition.

Analysis and Results

Under market economy conditions, commercial banks are far more susceptible to risk than other business entities, due to several factors. In particular, commercial banks:

Operate mainly on attracted financial resources. For example, their own capital accounts for only about 10–12% of total liabilities, while the remaining 88–90% consists of funds attracted from other individuals and entities. Thus, commercial banks assume corresponding obligations regarding these attracted funds, which naturally leads to the emergence of certain levels of risk. Invest the attracted funds in various risk-bearing operations—such as credit, investment, leasing, and derivatives—in pursuit of profit. This process is directly linked to risk, since the failure of these invested funds to return on time may not only deprive the bank of profit, but also create difficulties in repaying the attracted funds of third parties.

Suffer greatly from risks associated with the loss of trust under market economy conditions. A decline in public confidence in banking activities, coupled with panic among clients, can severely impact banks. Such panic may be fueled by reports from large financial institutions

¹ Беляков А.В. Банковские риски: проблемы учета, управления и регулирования (2-е изд.).

Управленческая методическая разработка. - "БДЦ-пресс", 2004 г.

² Стародубцева Е.Б. Основы банковского дела: Учебник. — М.: ФОРУМ: ИНФРА-М, 2005. — 256 с.

³ Лобанова А.А., Чугунов А.В. Энциклопедия финансового риск-менеджмента. —М.: “Юрайт”, 2006. — С.363.

⁴ Классификация банковских рисков и их оптимизация / Под общ. ред. проф. Е. В. Иода. 2-е изд., испр., перераб. Тамбов: Изд-во Тамб. гос. техн. ун-та, 2002. 120 с.

⁵ Abdullaeva, Sh.Z. Bank Risks and Lending. – Tashkent: Finance Publishing House, 2002. – 304 p.



such as independent audit and rating agencies, international financial exchanges, or by government announcements disseminated through mass media.

Face other contributing factors, such as the deterioration of asset quality, insufficient liquidity, and the failure to pay dividends—all of which can give rise to risks within commercial banks. It is important to note that risks related to active operations receive the most attention in commercial banks. This is because the deterioration in the quality of bank assets leads to a number of adverse consequences, such as the inability to meet obligations, a decline in profitability, and the loss of market position.

In diversifying and mitigating risks associated with liabilities, commercial banks focus primarily on attracting long-term financial resources (3, 5, and 10 years). This approach allows them to diversify and reduce transformational and liquidity risks.

Naturally, factors such as the Central Bank's key rate, credit and deposit interest rates, and the level of inflation exert both direct and indirect effects on these processes. The following table presents comparative data from several countries in this regard.

Table 1 Information on Interest Rates and Inflation in the Banking Systems of Uzbekistan and Selected Countries⁶

Main Indicators	USA	Uzbekistan	Japan	Russia	Kazakhstan
Central Bank Key Rate (%)	4.75	14.0	0.1	16.0	14.7
Average Credit Interest Rate (%)	6–7	26	2.0	22	19
Average Deposit Interest Rate (%)	3.05	22	0.23	14.8	13.9
Inflation Rate (%)	5.6	12.5	0.5	8.5	10.0

According to the data presented in the table, the interest rate risk in Uzbekistan's banking system is significantly higher than that of the United States, Japan, Russia, and Kazakhstan. In our view, the main reason for this lies in the high share of state ownership retained within the capital, assets, and deposits of commercial banks.

For example, as of January 1, 2024, state-owned commercial banks accounted for 67.7% of total assets, 70.7% of total loans, 51.5% of total deposits, and 65.1% of total capital in the country's banking system.

In addition, the high proportion of foreign currency in the credit portfolios and deposit structures of Uzbek commercial banks has also had a negative impact on risk management and diversification processes. In this regard, we believe that the share of foreign currencies in banks' credit portfolios should be gradually reduced to 30–35% over the next five years in order to diversify and partially eliminate currency-related risks.

Based on the analysis of risky assets and unstable liabilities in Uzbekistan's commercial banks, we conclude that effective risk management requires diversification across appropriate categories. Accordingly, we have classified risk diversification in commercial banks into the following three main groups.

⁶ Prepared by the author based on information from the official websites of the Central Banks of the respective countries.

Table 2 Diversification of Commercial Bank Risks

Group	Risk Level	Types of Risk
I	High Risk (Strong Risk)	- Credit risks - Liquidity risks - Liability risks - Currency risks
II	Medium Risk (Moderate Risk)	- Interest rate risks - Operational risks - Fraud risks - Market risks
III	Low Risk (Weak Risk)	- Fund risks - Legal relationship

As can be seen from the table, the diversification of risks in commercial banks is divided into three groups — high-level risks, medium-level risks, and low-level risks. Based on the results of analysis and research, the following conclusions have been drawn regarding the diversification and management of risks in Uzbekistan's commercial banks:

In commercial banks with a high level of state ownership, the formation of risky assets, particularly credit portfolios, continues to be influenced by government directives. As a result, this situation negatively affects the bank's ability to effectively achieve the goals and objectives outlined in its strategic development plan.

Despite the efforts of the government and relevant authorities, the transformation of state-owned commercial banks, especially the privatization of the state's share in bank capital through sales to domestic and foreign investors, has not yet yielded satisfactory results. Consequently, this has hindered the effective organization of risk diversification processes.

Meanwhile, the "Uzbekistan–2030" Strategy outlines several important objectives in this direction, including:

Increasing the annual volume of lending in the banking and financial system to 40 billion USD, and quadrupling the volume of bank deposits;

Continuing bank privatization while maintaining only 3–4 banks under state control, and attracting at least four large and reputable foreign banks to the domestic market;

Improving regulatory frameworks and supervisory standards by introducing internationally recognized minimum standards and requirements into the banking system;

Introducing Islamic finance principles and procedures in at least three commercial banks, and forming the legal foundations of Islamic finance in Uzbekistan.

It should be noted that significant progress has already been made in this area, and positive outcomes are being achieved. However, in our view, to attain higher results, it is essential to carry out large-scale structural reforms in the real sector of the economy, as well as to widely implement the Central Bank's soft monetary policy.

The next stage of our research will continue with an analysis of the composition and dynamics of the assets and liabilities of JSCB "Agrobank."

Table 3 Structure and Dynamics of the Assets of JSCB “Agrobank” of the Republic of Uzbekistan (2020–2024)⁷

(As of January 1, share in total assets, in %)

Main Indicators	2020	2021	2022	2023	2024
Cash on hand	3.3	3.2	2.8	4.5	2.8
Funds in the Central Bank	2.7	4.4	4.2	2.4	1.7
Funds in other banks	2.0	2.5	1.9	1.8	2.5
Investments and other securities	1.5	5.2	5.9	2.2	1.2
Credit placements	85.3	79.2	79.2	81.1	81.1
Fixed assets	3.5	3.7	3.3	3.5	3.9
Accrued interest on assets	0.3	0.8	1.3	2.5	4.6
Provisions for standard assets					

Based on the data presented in the table, it can be concluded that as of January 1 for the period 2020–2024, the high share of loan placements and the relatively low share of investments in the asset structure of JSCB “Agrobank” represent one of the key challenges in risk diversification and management.

The research findings also reveal that the concentration of assets, loans, and capital within specific regions adversely affects the process of managing and diversifying risks. Therefore, diversification of risks across sectors, regions, and ownership structures is of great importance. Implementing such measures, in our view, could potentially increase the financial stability and profitability of commercial banks by up to 5 percentage points.

Notably, in Agrobank’s case, loans account for 58.8%, investments for 22.7%, and funds placed in the Central Bank for 11%, while income-generating assets constitute 92% of total assets.

For comparison, in China’s Industrial and Commercial Bank, the share of term deposits in 2020 made up 70.9%, and funds (loans) from banks and other financial institutions comprised 9%, which indicates that liability-related risks are effectively diversified.

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