

## Analysis of commercial banks lending practice

Kholmamatov Farkhod Kubaevich

Senior teacher at Tashkent Institute of Finance

*This article analyzes the establishing of commercial banks' lending, the formation of credit resources and their relationships. In this article, suggestions on improving the lending activity and ensuring resource sustainability are provided.*

**Key words:** credit, credit policy, bank capital, core and additional capital, deposit, deposit policy, deposits on demand, term deposits, savings deposits, deposit certificates, subordinated debts.

### Introduction

Credit relations are the most important aspect of modern economic activity. An effective crediting system is a key to the successful development of production and socio-economic processes. In this regard, improving lending practices by banks is important today.

### Analysis and results

During long-term development, banks have become a large and diverse financial service provider. These include operations on lending to sectors of the economy, purchase and sale of securities, property management operations and other financial transactions. Nevertheless, credit operations continue to be an

important active operation for commercial banks.

Indeed, the lending operations of the banks are distinctive in terms of their value and profitability in active operations of bank. Operations involving the allocation of resources to earn income are called commercial banks' active operations. The commercial operations of commercial banks are primarily related to their credit operations, investment operations, operations with the formation of a commercial banks' property, cash account operations and so on. [3]

At present, banks in developed countries offer more than 300 banking operations and services. Among these operations and services, lending operations of banks are undoubtedly the most important. In a number of developed countries, the share of credit transactions among the bank's assets is estimated to be from 19.9 percent to 83.25 percent on average. [4]

As of October 1, 2018, the share of loans in assets of the banking system of Uzbekistan is 74.79% on average. At the same time, the group of commercial banks with a state-owned share accounted for more than the average amount, and bank loans accounted for 79.1 percent of assets. In

other banks this figure is 52.8%. In some commercial banks, the share of loans in the assets exceeds 80%, in particular, 89.3% in Agrobank, 87.4% in Ipoteka Bank, 84.9% in Uzpromstroybank, 84.4% in Kishlok Kurilish Bank (QishloqQurilish Bank) and 84.1% in Microcreditbank. [5]

These information illustrate that commercial banks' lending operations are the main and primary source of banking activity. In order to effectively manage the lending process of commercial banks, it is necessary to develop their lending policy. Credit policy of the bank is a document that defines the measures and methods adopted by the bank's management in managing the risks arising from lending, and provides credit portfolio management guidelines for the bank's management and staff. [1]

Due to the large-scale operations of bank loans, the source of resources for their implementation remains one of the most pressing issues today. Bank resources can be divided into two large groups: own funds and borrowed resources.

Banks' own funds include authorized capital and other equivalent funds, including reserve capital, special funds, fund of material incentives, other created funds and unallocated profit.

The main source of the bank's resources is attracted funds, with an average share of 70-80%. The share of own funds is from 22% to 30%. [4]

The bank's capital plays a crucial role in the activities of commercial banks. The bank's capital is mainly characterized by the following economic elements:

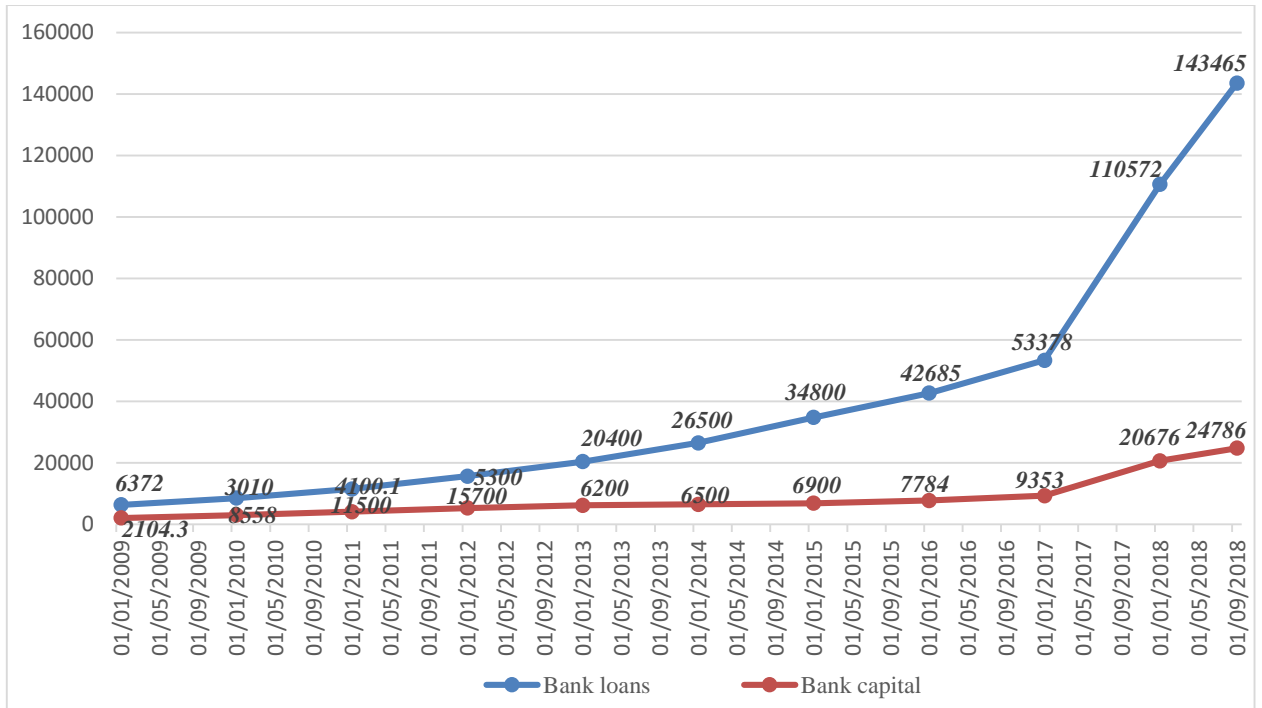
1. It should be long-term (permanent);
2. It should not be subject to mandatory payments;
3. The capital of the bank must not depend on the legal interests of depositors and creditors.

The feature of the bank's equity is that, first, it is the most sustainable resource among financial resources and can be deployed into long-term active operations (credit, investment, leasing, etc.), and second, it requires low costs, in other words, the formation does not require much expense (the attracted resources are associated with a large cost).

At the same time, the bank's capital carries out a number of functions: in the event of risk of loss, performs protective function, in the initial stage of commercial banks activity performs operativeness and regulating functions.

## **Graph-1.**

## Dynamics of bank loans and capital in the Republic of Uzbekistan for 2009-2018, billion UZS [5]



Over the past 10 years, the total value of credit investments of commercial banks in the real sector of the economy has increased by 22.5 times, which indicates a steady increase in the role of the banking system in promoting economic growth. The total volume of credit investments of commercial banks has increased by 29.7% since the beginning of 2018, and on September 1, 2018 amounted to 143.5 trillion UZS.

As a result of targeted measures to increase capitalization level of commercial banks, the total capital of the banking system has grown 11.8 times in the last 10 years.

In 2018 alone, this indicator increased by 20% and on September 1, 2018 amounted to 24.8 trillion UZS.

It is noteworthy that most of the loans provided by own funds and borrowed funds of banks of our republic are long-term, mainly aimed at financing the modernization of strategic sectors of the economy, investment projects for supporting small businesses and private entrepreneurship.

Commercial banks use their own funds, especially bank capital, when implementing long-term, high-risk projects in their lending practice. These two economic categories are the most important elements of

banks' operations, and they are interconnected. This relationship will

be observed in banking practice of Uzbekistan.

**Table-1.**

**The relationship between bank loans and capital in Uzbekistan**

Years	Bank loans (x), bn. UZS	Bank capital (y), bn. UZS	$x^2$	$y^2$	$xy$
01.01.2009	6372	2104,3	40602384	4428078,49	13408599,6
01.01.2010	8558	3010	73239364	9060100	25759580
01.01.2011	11500	4100,1	132250000	16810820,01	47151150
01.01.2012	15700	5300	246490000	28090000	83210000
01.01.2013	20400	6200	416160000	38440000	126480000
01.01.2014	26500	6500	702250000	42250000	172250000
01.01.2015	34800	6900	1211040000	47610000	240120000
01.01.2016	42685	7784	1822009225	60590656	332260040
01.01.2017	53378	9353	2849210884	87478609	499244434
01.01.2018	110572	20676	12226167184	427496976	2286186672
01.09.2018	143465	24786	20582206225	614345796	3555923490
<b>Total</b>	<b>473930</b>	<b>96713,4</b>	<b>40301625266</b>	<b>1376601036</b>	<b>7381993966</b>

Since commercial banks' loans and capital are interconnected activities, we analyze the relationship between these indicators below. Using the above information, we find the correlation coefficient ( $r$ ) between bank loans and capital.

$$r = \frac{\sum xy - \frac{\sum x \sum y}{n}}{\sqrt{\left[ \sum x^2 - \frac{(\sum x)^2}{n} \right] \left[ \sum y^2 - \frac{(\sum y)^2}{n} \right]}} = \frac{7381993966 - \frac{473930 \cdot 96713,4}{11}}{\sqrt{\left[ 40301625266 - \frac{224609644900}{11} \right] \left[ 1376601036 - \frac{9353817396}{11} \right]}} = 0,9939$$

The correlation density coefficient of relation between bank loans and bank capital is 0.9939 and it demonstrates that these factors are closely interconnected. The correlation between these two factors is very strong because the correlation coefficient is very close to 1. This can

be explained by the fact that the capital of the bank is always the most important element in the lending activity of the commercial banks, thus its demand and control are regularly carried out.

Nowadays attracting free money resources in the economy and

allocating those resources effectively are main problems of commercial banks. In addition, bank deposits play a major role in attracting sustainable and long term resources, strengthening the credit potential of banks and increasing it steadily, ensuring liquidity of banks.

Deposit is the sum of money in national and foreign currency that should be returned with or without interest payments and either at the time of demand or according to the period in the contract between two sides or their legal representatives.

Conducting the operations on bank deposits, its rules and criteria are reflected in the deposit policy issued by commercial bank.

Depository operations are the operations related to attracting the funds from individuals and legal entities. More than 90 percent of liabilities of commercial banks may be created with the help of depository operations. Deposit operations are carried out by commercial banks based on their depository policies. The commercial banks' deposit policy is closely linked to its lending policy, interest rate policy and other activities and is aimed at strengthening the bank's resource base and ensuring its stability. [3]

The procedure of deposit operations in banks of the Republic of Uzbekistan is carried out according to

the Instruction "On the procedure of deposit operations in the banks of the Republic of Uzbekistan", registered by the government on August 26, 2015 under No. 2711. This document specifies the procedure of conducting and controlling by banks the operations related to attraction, repayment, interest calculation and payment of deposits in national and foreign currency.

There are following types of bank deposits:

- deposits saved until the time of demand;
- savings deposits;
- term deposits;
- certificates of deposit;
- banks may accept other deposits, other than those mentioned above, which do not contradict the legislation. [2]

Deposits saved until depositors' request are called demand deposits. Deposits in bank plastic cards (excluding term deposits and savings deposits in electronic plastic deposit cards) are demand deposits and their activity is regulated in accordance with special legislation. This type of deposit is cheap, at the same time unstable financial resource for lending activity of commercial banks.

Analyzing the deposit base of banks of the Republic of Uzbekistan, according to the condition on October

1, 2018, demand deposits accounted for 46.8% of total deposits, i.e., if total deposits are 67.4 trillion soums, then its 31.5 trillion soums are demand deposits. [5]

The International Bank for Reconstruction and Development (IBRD) estimates that the adequacy of the deposit base of banks, widely used in international practice, should not exceed 30 per cent.

Savings accumulated on certain terms with the right to deposit additional money into the initial deposit according to the procedure established by the agreement of bank deposit and directed for certain purposes called savings deposits. These deposits are relatively stable resources, but require expenses.

Deposits attracted on the terms of returning upon expiry of the term specified in the contract of bank deposit are considered as term deposits. This type of deposit is one of the most sustainable and the most valuable resources for banks.

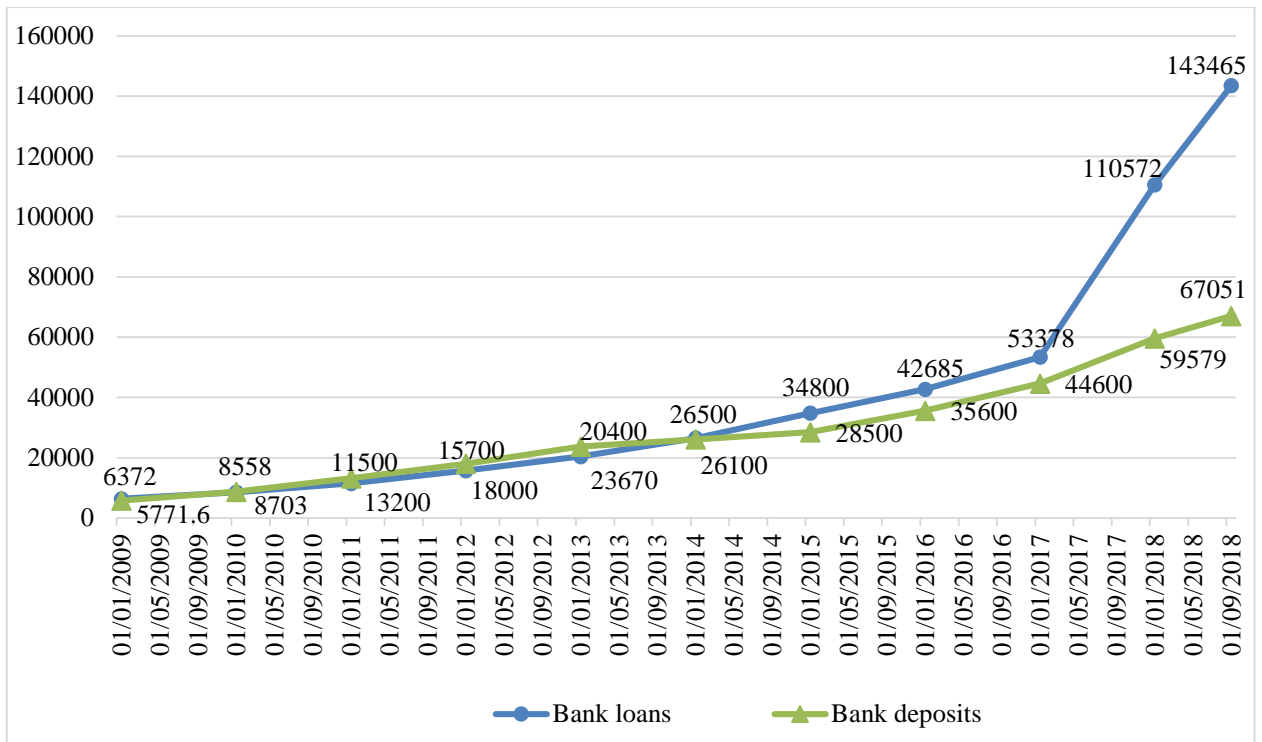
A certificate is a document of security for a depositor with the name of a non-financial depositor and confirming the right to receive a deposit amount and its interest rates mentioned in the certificate from the bank issued the certificate or any branch of that bank. Its uniqueness is that deposit certificates are issued in form of documentary form.

The stable position of the domestic banks serves as a solid foundation for the stable high rates of confidence in the banking system, as well as the volumes of free funds kept by bank deposits of population and business entities.

At the same time, the steady growth of the income of population, improvement of the methods and mechanisms of servicing the population, the measures taken to ensure the safety of deposits, as well as state guarantees of full repayment of the population's savings provide a steady increase in the resource base of commercial banks. This can be seen in the graph below:

### **Graph-2.**

**Dynamics of bank loans and deposits of the Republic of Uzbekistan for 2009-2018, billion UZS [5]**



Because of the implemented work the total volume of deposits of population and business entities in commercial banks increased by 12.5% compared to the beginning of 2018 and reached 67.1 trillion UZS on September 1, 2018. In general, over the last decade, the deposit base of the banks has been growing and strengthening steadily. Especially in the last three years, the volume of commercial banks' loans has increased significantly, compared to

both deposits and bank capital. In particular, the volume of bank deposits in 2008 amounted to 5.7 trillion UZS, compared to 59 trillion UZS by the beginning of 2018 and 67.1 trillion UZS as of September 1. This shows that in the last decade the sum of deposits has grown more than 10 times. These measures, in turn, helped to increase the volume of bank operations, including credit and investment opportunities.

**Table-2.**

**Correlation between bank loans and deposits in the Republic of Uzbekistan**

Year	Bank loans (x), billion UZS	Bank deposits(y), billion UZS	$x^2$	$y^2$	$xy$
01.01.2009	6372	5771,6	40602384	33311366,56	36776635,2
01.01.2010	8558	8703	73239364	75742209	74480274
01.01.2011	11500	13200	132250000	174240000	151800000
01.01.2012	15700	18000	246490000	324000000	282600000

01.01.2013	20400	23670	416160000	560268900	482868000
01.01.2014	26500	26100	702250000	681210000	691650000
01.01.2015	34800	28500	1211040000	812250000	991800000
01.01.2016	42685	35600	1822009225	1267360000	1519586000
01.01.2017	53378	44600	2849210884	1989160000	2380658800
01.01.2018	110572	59579	12226167184	3549657241	6587769188
01.09.2018	143465	67051	20582206225	4495836601	9619471715
<b>Total</b>	<b>473930</b>	<b>330774,6</b>	<b>40301625266</b>	<b>13963036318</b>	<b>22819460612</b>

As noted above, the share of the banks' credit resources correspond to bank deposits. Therefore, we analyze the relationship between banks' loans and deposits using the information given in the table. Using the table data, we find correlation coefficient (r) between bank loans and deposits.

$$r = \frac{\sum xy - \frac{\sum x \sum y}{n}}{\sqrt{\left[ \sum x^2 - \frac{(\sum x)^2}{n} \right] \left[ \sum y^2 - \frac{(\sum y)^2}{n} \right]}} = \frac{2281945679 - \frac{473930 \cdot 330774,6}{11}}{\sqrt{\left[ 40301625266 - \frac{22460964490}{11} \right] \left[ 13963036318 - \frac{10941183605,16}{11} \right]}} = 0,9588$$

Bank deposits and bank loans are closely interconnected. The correlation between these two factors is very strong because the correlation coefficient is close to 1.

### Conclusions and Suggestions

As a result of the analysis of resources in commercial banks lending activity, the following conclusions were drawn:

- the major part of credit resources in commercial banks is consisted of the bank capital and deposits;
- bank capital is used for long-term credit resources that are with high risk, but at the same time with high profit;
- the share of additional capital in the bank's capital is relatively low;

- almost half of the commercial banks' deposits are unstable deposits, i.e the demand deposits;
- bank loans and its capital are strongly interconnected;
- bank deposits and bank loans have also strong links, and most of the resources consist of bank deposits.

High growth rates of bank capital and deposits, in turn, had a positive impact on their activity in financially supporting the real sector of the economy, the growth of bank assets and credit investments.

The following suggestions have been developed with respect to the development of credit operations and improving resource availability of commercial bank:

- to increase bank capital further, in particular with



additional capital and subordinated loans;

- to increase in the share of stable deposits, in particular, through the expansion of the term, savings deposit and issue of deposit certificates;

- to look for new sources of financing for banking operations, in particular, access to the international capital market and attracting resources and investments;

- to expand the activity and operations of commercial banks in the stock market.

These suggestions will open plenty of opportunities for banks to solve their resource problems in the lending process, to increase their credit potential and to operate successfully.

### **Bibliography**

1. The Regulation of the Central Bank of the Republic of Uzbekistan No. 905 "On Requirements to the Credit Policy of Commercial Banks", March 2, 2000.

2. Instruction of the Central Bank of the Republic of Uzbekistan "On the Procedure of Depositary Operations in Banks of the Republic of Uzbekistan" No. 2711, August 26, 2015.

3. Abdullaeva Sh.Z. "Banking". Textbook - Tashkent: "Economics and Finance". 2017. 628 p.

4. Lavrushin O.I. "Banking". - Moscow: Knorus 2009. - 768 p.

5. <http://www.cbu.uz> - The official website of the Central Bank of the Republic of Uzbekistan.