

The Importance and Role of Bank Capital in Ensuring the Stability of the Banking System

Kholmamatov Farhodjon Kubayevich
Professor of Tashkent Financial Institute, Ph.D

Abstract: The article examines the role of bank capital in ensuring the stability of the country's banking system, its importance, analysis of capital adequacy and ways to stabilize it.

Keywords: bank capital, bank assets, bank deposits, capital adequacy, retained earnings, reserve capital, additional capital, capital risk, diversification.

Introduction.

At a time when the globalization process is accelerating, the country's economy and its development cannot be imagined without banks. That is why it is important for banks to be free to operate, to be competitive and, most importantly, to have a solid capital base. Because the bank's capital is the initial financial basis of the bank's activity and the source that ensures its development, stability and security.

Bank capital is placed on the liabilities side of the bank's balance sheet . Special attention is paid to the bank's capital, as it is an important insurance fund for claims coverage in the event of bankruptcy and a source of financing for the development of banking operations.

In the conditions of the market economy, bank capital can be divided into two large groups. These are the banks' own funds and borrowed funds. These resources are used in the implementation of the bank's asset operations, that is, the bank's resources are placed in various sectors in order to earn income. Therefore, the nature of bank capital, its increase and the reform of capitalization processes remain one of the most important aspects of the organization and management of banking activities.

Literature review.

A.B. In Borisov's economic dictionary, it is written that "Capital is a set of material resources used for the purpose of obtaining additional income".[1]

According to S.N. Lukash, A.A. Malyutinalar, bank capital is formed not only from the funds raised, but also from the funds allocated from the bank's income. In addition, commercial and industrial capital, like bank capital, also serves to generate future income.[2]

For example, Jan Matuk describes the bank's capital as the primary instrument that ensures its solvency. Of course, the issue of the bank's solvency is one of the most important issues in the organization of its activities. Attention to this issue is related to its reputation, interests of creditors and depositors. The loss of solvency leads to the loss of the bank's creditors and depositors and ultimately to its bankruptcy. [3]

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Professor V. M. Usoskin considers bank capital as an important and integral component of bank financial resources. It can be seen that here, as a result of considering capital as an important and structural part of bank resources, its main tasks (protection, operational and regulation) have been neglected.[4]

One-sided views on bank capital were also expressed by American scientists Chris D. Barlton and Diana McNaughton. According to them, bank capital is a sufficient reserve to prevent various unforeseen situations that occur in the banking activity, and it helps to eliminate the inability to pay when it adapts to changing conditions.[5]

Professors Sh.Abdullayeva and A.Omonov defined bank capital as follows: "The capital of commercial banks is a stable source and a special means of protection that allows the bank to compensate for unexpected losses in the operational process".[6]

In short, bank capital is the basis of the bank's commercial activity, which ensures its independence and guarantees its financial stability and mitigates the negative consequences of bank risks.

Financial stability is a state of financial resources of an institution, in which it is understood that the institution can use these resources based on the existing risk and get a profit while maintaining its liquidity and solvency.

Also, in order for the bank's capital to fulfill its tasks, it should have the following three characteristics:

1. It must be long-term (permanent).

When it is said that the capital of commercial banks must be long-term, the main focus is on the limitation of the ability of the owner of the capital to demand this amount at any time. If the shareholder of the bank at any time withdraws all or part of the funds allocated for the formation of the bank's capital, it is natural that the bank will be in a difficult economic situation.

2. Bank capital should not be subject to mandatory payments.

The freedom of the capital of commercial banks from compulsory payments creates a wide opportunity for the stable operation of the bank. On the contrary, if the bank's capital is subject to taxes, fines and other payments, as well as the bank's obligations, it will have a negative effect on its economic stability, and the capital will always be economically at risk. This situation has a negative impact on the banks in carrying out operations in the financial markets on their own behalf, in attracting depositors and investors to the bank, and in ensuring the trust of the population.

3. Bank capital should be independent of legal interest.

Commercial banks, as financial intermediaries, attract huge amounts of funds from depositors and creditors. The capital of the bank should not be directly dependent on the interest of depositors and creditors in cases related to the return of borrowed funds. That is, depositors and creditors must not have any legal or indirect claims against the bank's capital.

Research methodology. Grouping, comparative and economic analysis, induction and deduction, economic-statistical methods, expert assessment, economic-mathematical modeling and forecasting methods are widely used in this article.

Analyzes and results

The importance of continuous formation of bank capital was proven once again during the financial and economic crisis that began in 2007. The most impressive and biggest losses to the crisis occurred in the banking system. In particular, the financial situation of commercial banks of developed countries has deteriorated dramatically, and their capitalization has decreased.

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One of the factors directly affecting the financial stability of a commercial bank is its capital adequacy. The bank's own investment is an important and integral part of its financial resources.

The role of the bank's own capital in the composition of its funds is extremely important for ensuring the stability and efficiency of the bank's activities. The bank's own mission is the first source of financial resources, and this is especially evident at the initial stage of the bank's activity.

Another important task of the bank is to guarantee the protection of its investment. The capital acted as a kind of shock absorber, allowing the bank to continue its operations in the event of unexpected losses or expenses.

The peculiarity of bank capital is that, firstly, it is the most stable resource among financial resources, it can be placed in long-term asset operations (loan, investment, leasing, etc.), and secondly, it is characterized by low cost, i.e. does not require much cost in the formation of capital financial resources (deposit operations are associated with a large cost).

At the same time, bank capital performs a number of functions, i.e., it performs a protective function when there is a risk of loss, an operational function in the initial period when commercial banks start their activity, and a regulatory function of banking activity.

In 2022, the Central Bank focused on ensuring that the financial stability indicators of the banking system are at an acceptable level, mitigating the negative effects of external economic risks and ensuring the resilience of banks. In order to prevent possible risks in the activity of commercial banks, stress tests were conducted in various scenarios, and prudential measures were taken to minimize negative effects on their capital and liquidity in the future. As a result, in 2022, the level of capitalization of banks will increase by 12% to nearly 80 trillion soums by the end of the year, and the amount of authorized capital will increase by 9% to 60 trillion soums.

Table 1. Ratio of banking system indicators to GDP¹

Indicators name	01.01.2021	01.01.2022	01.01.2023
GDP (annual)*	602 193.0	734 587.7	888 341.7
Bank assets	366 121.1	444 922.5	556 746.3
of assets to GDP ratio , in percent	60.8	60.6	62.7
Credit deposits	276 974.8	326 385.6	390,048.9
Credit of the stakes to GDP ratio , in percent	46.0	44.4	43.9
Deposits	114,746.9	156 189.8	216,737.5
Deposits to GDP ratio , in percent	19.1	21.3	24.4
Capital	58 351.3	70,917.6	79 565.4
Capital to GDP ratio , in percent	9.7	9.7	9.0

It is possible to know the economic situation by comparing the main indicators of the country's banking system with macroeconomic indicators. In relation to the country's GDP, bank assets have increased by 1.9 percentage points in the last three years and will amount to 556,746.3 billion soums by 2023. the fact that bank assets have increased 1 time in 3 years is considered a positive situation.

Although the amount of credit deposits increased from 276.9 trillion soums to 390.0 trillion soums, its ratio in the country's GDP decreased from 46% to 43.9%. The main reason for this is that the growth rate of the country's economy is higher than the growth rate of bank loans.

¹ www . cbu . en prepared on the basis of information

The amount of deposits has increased by 1.9 times in the last three years, and by 2023 it will amount to 216.7 trillion soums. In turn, the share of deposits in GDP increased from 19.1 percent to 24.4 percent. this situation is a positive situation for the stability of the banking system, because the increase in deposits serves to increase the resources in banks.

The capital of the bank amounted to 58.4 trillion soums in 2021, and reached 79.6 trillion soums by 2023. The ratio of capital to GDP decreased from 9.7 percent to 9.0 percent. although the amount has increased, but the percentage has decreased. The greater the bank capital, the stronger the financial stability of the banking system.

Table 2. Capital composition of the banking system of the Republic of Uzbekistan²

Indicators name	01.01.2021		01.01.2022		01.01.2023	
	billion _ soum	share , in percent	billion _ soum	share , in percent	billion _ soum	share , in percent
Constitution capital	44 655.8	76.5	54,760.0	77.2	59,856.7	75.2
Additional capital	434.6	0.7	675.5	1.0	997.5	1.3
Reserve capital	5 205.9	8.9	8 452.2	11.9	7 320.6	9.2
Not distributed benefit	8 055.0	13.8	7,029.9	9.9	11,390.6	14.3
Total capital	58 351.3	100.0	70,917.6	100.0	79 565.4	100.0

If we analyze the capital base of the banking system of the Republic of Uzbekistan, the authorized capital constitutes the absolute largest part of the total capital. In 2021 , the share of authorized capital was 76.5 percent, and by 2023 it was 75.2 percent.

The share of additional capital is almost imperceptible and has averaged 1 percent over the last 3 years. This situation is considered negative for the banking system, because this indicator represents how banks work, their efficiency and the demand for them. The main reason for the low additional capital is that the country's stock market is not well developed and the state's share in the authorized capital of banks is high.

Reserve capital was 5.2 trillion soums or 8.9% of the total in 2021, and reached 7.3 trillion soums or 9.2% in 2023. Reserve capital is also the main stable resource for banks and protects banks from the consequences of various negative situations.

Undistributed profit increased 1.4 times in the last three years and reached 11.4 trillion soums. An increase in retained earnings is not a source of sustainable capital growth, as this indicator may decrease if banks incur losses or as a result of shareholders' dividend policy.

In conclusion, the capital base of the banking system of the Republic of Uzbekistan is very weak, insufficiently diversified and the level of capital risk is very high.

Increasing the level of capitalization of the banking system is carried out at the expense of two sources: internal and external.

An internal source is capitalization at the expense of bank income, that is, additional shares are issued to shareholders instead of dividends or the nominal value of existing shares is increased.

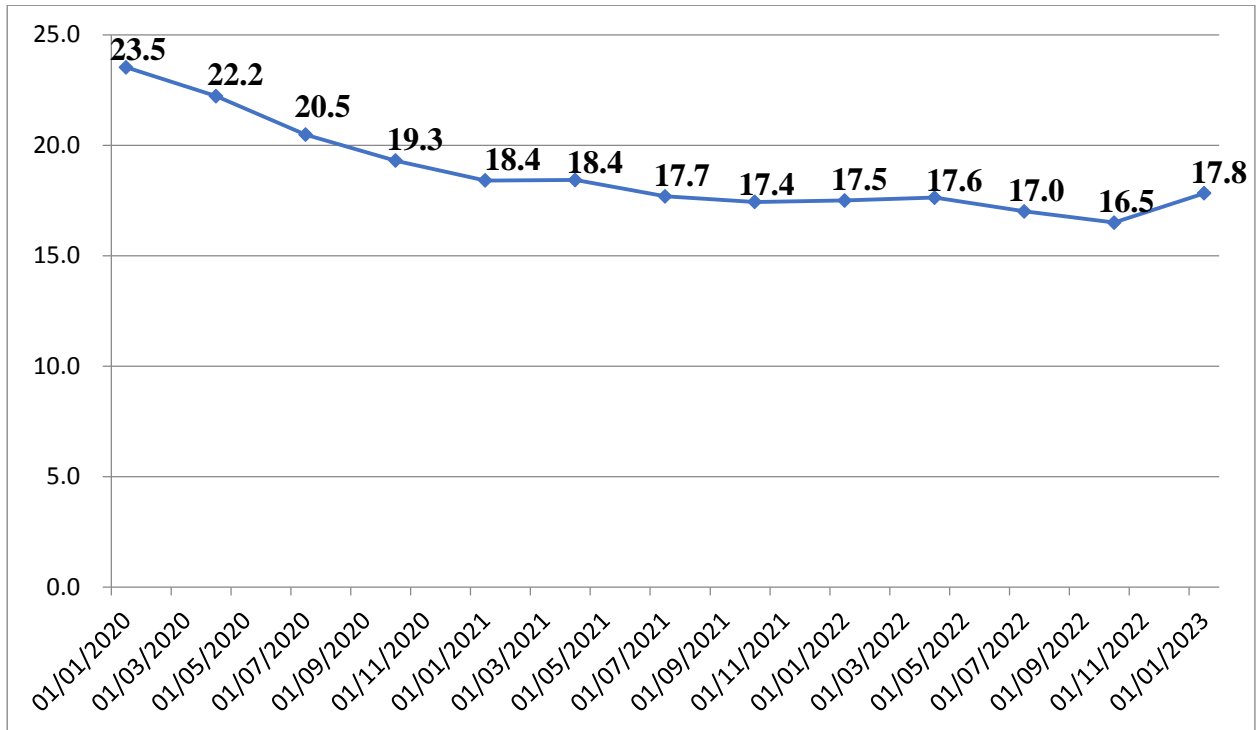
Issuance of shares is carried out by a foreign bank and sold to investors.

The increase in bank capital mainly serves to strengthen the resource base of banks, which, in turn, leads to the expansion of long-term loans for financial support of small businesses and private entrepreneurship,

² www . cbu . en prepared on the basis of information

primarily for investment purposes, the formation of initial capital, new banks allows to introduce types of services and expand operations in international practice.

There are minimum requirements for bank capital adequacy set by the Basel Committee on Banking Supervision. According to it, the total capital adequacy of the bank should not be less than 10.5 percent.



Also, by the end of 2022, the amount of regulatory capital in the banking system reached 83 trillion soums and risk-weighted assets reached 468 trillion soums, the capital adequacy ratio was 17.8 percent (minimum requirement 13 percent), and increased by 0.3 percentage point compared to the indicator.

One of the main indicators of the financial stability of the banking system is the adequacy of bank capital. In Uzbekistan, this financial indicator has slightly decreased in the last three years, but it can be seen that it is much higher than the international required norms.

The systematic implementation of the adopted programs for deepening and expanding the scope of reforms in the financial and banking system opens wide opportunities for the successful operation of banks. This allows the expansion of competition in the market of banking and other financial services, as well as an increase in the quality of customer service, and creates conditions for the development of a modern market infrastructure that meets the highest international standards.

Conclusions and suggestions

Summarizing the above points, it is worth noting that in order to ensure the stability of the banking system, it is necessary to regularly increase the level of bank capitalization. In this case, it is important to increase the bank's capital at the expense of external sources as well as internal sources.

Our conducted scientific research shows the existence of the following problems and shortcomings in the rational formation of the composition of the bank's capital and ensuring its adequacy. Here are the main ones:

1. The weight of additional capital in the total capital of commercial banks is too small.

The essence of this problem is that the absolute main part of the total capital of commercial banks of our republic consists of fixed capital. On average, 95 percent of the total capital of commercial banks corresponds to the core capital contribution.

2. Emission income received as part of the capital of commercial banks is almost imperceptible. In this case, bank shares are sold on the stock market almost at their nominal value. There are no factors affecting their market (real) price.

3. The main part of the bank's income is income from interest and brokerage fees. In fact, the more income from interest and brokerage fees, the better, but the problem is that the weight of income from other operations of our banks remains very low.

We present the following proposals to increase the efficiency of bank capital in ensuring the financial stability of banks:

1. It is necessary to make fuller use of the possibilities of strengthening the additional capital base of commercial banks.
2. It is necessary to ensure that the shares of commercial banks are widely traded on the secondary securities market.
3. It is necessary to ensure the truthful reflection of the capital adequacy of commercial banks.
4. Reorganization in the form of merger and consolidation of several banks, combining the authorized capitals.
5. Attention should be paid to diversifying the income structure of commercial banks.

The full implementation of the above-mentioned opinions into the banking activity, firstly, serves to increase the financial stability of the banking system, secondly, it has a positive effect on their capitalization processes, and thirdly, it serves as an economic basis for their stable operation.

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