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# Methodological Basis of Formation and Management of Banks' Revenue Base

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**Abstract:** This study explores the methodological foundations for forming and managing the income base of commercial banks in Uzbekistan, as outlined in the "Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020–2025." Key objectives include fostering competitive financial markets, improving credit risk management, modernizing banking services, and enhancing technological solutions. Regulatory reforms, such as increased capital adequacy requirements, liberalized currency policies, and improved liquidity management, have been pivotal in strengthening financial stability. The research identifies the net interest margin as a critical indicator of profitability, highlighting its inverse relationship with bank assets and the recommendation that interest income constitutes at least 70% of gross income. Credit risk, particularly from foreign currency loans, poses a significant challenge, exacerbated by currency depreciation. Reforms like raising the minimum authorized capital, adopting Basel Committee standards, and ensuring non-interference from state bodies have further enhanced financial security and operational autonomy. These measures have bolstered liquidity, stabilized capital adequacy ratios, and fostered growth in Uzbekistan's banking sector. The findings underscore the importance of aligning regulatory frameworks with international standards to ensure sustainable income growth, offering practical insights for policymakers to navigate the evolving economic environment effectively.

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## 1. Introduction

The Decree of the President of the Republic of Uzbekistan No. PD-60 dated January 28, 2022 "On the New Development Strategy of Uzbekistan for 2022-2026" established the formation of the income base of commercial banks as one of the priority areas for reforming the country's banking system [1].

The "Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020-2025" sets out the following tasks that are directly and indirectly related to strengthening the income base of commercial banks:

- Creating equal competitive conditions in the financial market;
- Lending only on the basis of market conditions;
- Modernization of banking services;
- Improving the quality of credit portfolio and risk management;
- Following a moderate increase in lending volumes;
- Improving corporate governance and attracting managers with international practical experience;

- g. Implementation of technological solutions for financial risk assessment;
- h. Complex transformation of commercial banks with state share;
- i. Sale of the package of state shares in banks to investors with the necessary experience and knowledge on a competitive basis;
- j. Wide implementation of remote services for residents and small businesses, development of a network of low-cost service points [2].

#### **Literature review**

The methodological basis of the formation and management of the income base of commercial banks has been researched by several foreign and domestic economists, and appropriate scientific conclusions and practical recommendations have been formulated.

In particular, according to the conclusion of professor I. Yudina, the state of the income base of commercial banks in developing countries is directly related to the level of credit risk, and the inability of clients who have received loans in foreign currency to repay them as a result of the depreciation of the national currency leads to an increase in the level of credit risk [3].

This conclusion of I. Yudina is of great practical importance for the banking practice of Uzbekistan. This is due to the fact that with the adoption of the Decree of the President of the Republic of Uzbekistan No. PD-5177 "On Priority Measures for Liberalizing Currency Policy" dated September 2, 2017, the liberalization of currency policy began, and as a result, the national currency depreciated almost twice against the US dollar (the nominal exchange rate of the soum against the US dollar increased from the current 4210.00 soums to 8100.00 soums on September 5, 2017).

In accordance with the Presidential Decree "On Measures for the Further Development and Increase of the Stability of the Banking System of the Republic", firstly, from October 1, 2017, the requirement for the minimum authorized capital of commercial banks was set at 100 billion soums; secondly, the personal responsibility of the heads of the ministries, agencies and other bodies that are the organizers of the projects for the quality and timely implementation of investment projects was determined; thirdly, it was clearly established that ministries and agencies, local state authorities are not allowed to interfere in the activities of banks and their branches; fourthly, it was forbidden to involve banks in state and regional investment programs without a positive opinion of commercial banks [4].

## **2. Materials and Methods**

The research employed a mixed-methods approach, combining qualitative and quantitative analysis to examine factors influencing the income base of commercial banks in Uzbekistan. Data were collected from official publications, including presidential decrees (e.g., No. PD-60, 2022; No. PD-5177, 2017), regulatory documents on liquidity management, capital adequacy, and asset quality classification, as well as financial statements of commercial banks. Descriptive analysis was used to evaluate key indicators like capital adequacy, liquidity ratios, and loan classifications, while policy reviews assessed the impact of government regulations on bank performance. Comparative analysis aligned Uzbekistan's banking reforms with international standards, including Basel Committee recommendations. Document analysis was conducted to interpret legislative and regulatory requirements, and quantitative methods, supported by Microsoft Excel, calculated financial metrics such as effective interest rates and internal rates of return (IRR). Cross-verification of data from multiple sources and consultation with banking experts ensured the reliability and contextual relevance of the findings, offering a robust framework for understanding the income stability of commercial banks and informing policy decisions.

### 3. Results

According to the Law "On the Central Bank of the Republic of Uzbekistan", "firstly, ensuring the stability of the country's banking system is one of the main objectives of the Central Bank; secondly, the Central Bank applies a mandatory reserve requirement to commercial banks, and these mandatory reserves are maintained by transferring funds from banks to special accounts with the Central Bank to the depositor and (or) by maintaining an average amount of mandatory reserves calculated based on the amount of the mandatory reserve averaging coefficient in a representative account opened with the Central Bank; thirdly, in order to ensure the continuity of payments in the event of a temporary liquidity shortage in commercial banks, the Central Bank has the right to provide prompt assistance to commercial banks in the form of short-term loans for a period of up to three months to maintain liquidity, the interest rate on these loans must not be lower than the current rates on other loans of the Central Bank and must be secured by the bank's assets; fourth, the Central Bank regulates and controls the activities of credit institutions, including the activities of commercial banks" [5].

According to the Law "On Banks and Banking Activities", adopted in a new edition in 2019, "banks are independent in making decisions related to the implementation of financial operations; state bodies and their officials are prohibited from interfering in the activities of banks, including the management of entrepreneurial risks related to the formation of the bank's loan portfolio and assets, the appointment of bank managers, as well as demanding various payments and contributions from the bank's funds; the bank's supervisory board exercises general management over the bank's activities, performs control and inspection functions in the process of making management decisions, and is generally responsible for the bank's activities and financial stability; the bank's management is the executive body of the bank's management, which exercises operational management over the bank's activities in accordance with the business strategy and management system approved by the bank's supervisory board, and bears full responsibility for the bank's activities; The bank is not entitled to distribute profits by paying dividends to shareholders, as well as rewarding the members of the supervisory board, management board and employees of the bank in the following cases: (if prudential standards do not comply with the requirements established by the Central Bank or are violated as a result of this distribution; if insolvency (bankruptcy) occurs or signs of insolvency (bankruptcy) appear as a result of this distribution; if the shortcomings specified in the mandatory instruction of the Central Bank, including those regarding the disclosure of information, have not been eliminated or there is no possibility of eliminating them; if there is a requirement of the Central Bank to the bank not to distribute profits; banks must obtain the consent of the Central Bank to distribute profits when the total amount of payments exceeds ten percent of the bank's own capital and there is a loss in the current or previous quarter and (or) financial year); In the event of a deterioration in its financial condition, the bank shall, at the request of the Central Bank, develop a plan for the restoration of the bank's financial condition (hereinafter referred to as the recovery plan), which includes measures to restore it, and submit it for consideration and assessment [6].

In accordance with the Presidential Decree "On Priority Measures for Liberalizing Currency Policy", firstly, the rights of legal entities and individuals to freely purchase and sell foreign currency and freely dispose of their funds at their discretion were fully ensured; secondly, specific tasks were set for the development of the government securities market, as well as the implementation of operations on the open foreign exchange market and operations to pledge government securities to the liquidity of banks, and the introduction of market instruments for managing foreign exchange resources; thirdly, the requirement for the compulsory sale of foreign currency proceeds of all exporting enterprises, regardless of the form of ownership, was abolished; fourthly, state duties, fees

and other mandatory payments were levied only in national currency, with the exception of consular fees [7].

In accordance with the Regulation "On the Procedure for Calculating Interest in Commercial Banks", approved by the Resolution of the Board of the Central Bank of the Republic of Uzbekistan No. 24/7 dated August 23, 2023, "the income of a bank includes only the gross proceeds of economic profit received and due to be received by the bank to its account. In agency relations, the gross proceeds of economic profit include amounts collected on behalf of a third party and not resulting in an increase in the bank's capital. Amounts collected on behalf of a third party are not considered income. In this case, the amount of the bank's brokerage fee is considered the bank's income; interest on the loan amount is calculated from the date the loan is allocated to the bank until the day before the day it is returned to the bank or written off from the relevant account on other grounds; interest on loans is calculated daily, based on the annual base period of 365 days (for certain types of loans, 360 days is taken as the base period); Interest on debt instruments is accrued daily; if unpaid interest accrues before the purchase of interest-bearing investments, then subsequent interest receivable is allocated to the period before and after the purchase, and the part of the interest receivable after the purchase is recognized as income; banks should use the effective interest rate method when calculating interest on financial instruments sold at a premium or discount or when the contract does not specify a monthly interest payment schedule; income based on the effective interest rate method is determined by discounting expected cash flows until they reach the initial book value of the asset (liability). The effective interest rate is calculated using software. In this case, the "Internal Rate of Return" (IRR) calculation function is used in Microsoft Excel; the discount is amortized over the life of the financial instruments using the effective interest rate method; When securities are issued at a discount, the discount is recognized at the date of sale and amortized over the life of the securities using the effective interest rate method; when securities are issued at a premium, the premium is recognized at the date of sale and amortized over the life of the securities using the effective interest rate method" [8].

In accordance with the instruction "On the procedure for the classification of asset quality in commercial banks and the formation of reserves to cover possible losses on assets and the procedure for their use", the following rates of reserve allocations for classified loans were established:

- a. Standard loans – 1 %;
- b. Substandard loans – 10 %;
- c. Unsatisfactory loans – 25 %;
- d. Doubtful loans – 50 %;
- e. Bad loans – 100 % [9].

The regulation "On the requirements for the management of the liquidity of commercial banks" established regulatory requirements for the following four financial ratios in relation to the liquidity of commercial banks:

- a. Instant liquidity coefficient;
- b. Current liquidity ratio;
- c. Liquidity coverage rate ratio;
- d. Net stable funding rate ratio [10].

According to the Regulation "On Requirements for Capital Adequacy of Commercial Banks", "the amount of Tier I capital of a bank shall not be less than the minimum amount of the authorized capital of the bank; Tier I capital shall not be less than 75 percent of the regulatory capital. If the amount of Tier II capital exceeds one third of the amount of Tier I capital, the excess amount shall not be included in the composition of regulatory capital; Tier I core capital shall not be less than 60 percent of the bank's regulatory capital; The Central Bank of the Republic of Uzbekistan may require banks to maintain a higher capital adequacy ratio, based on the risks inherent in their activities, economic conditions and

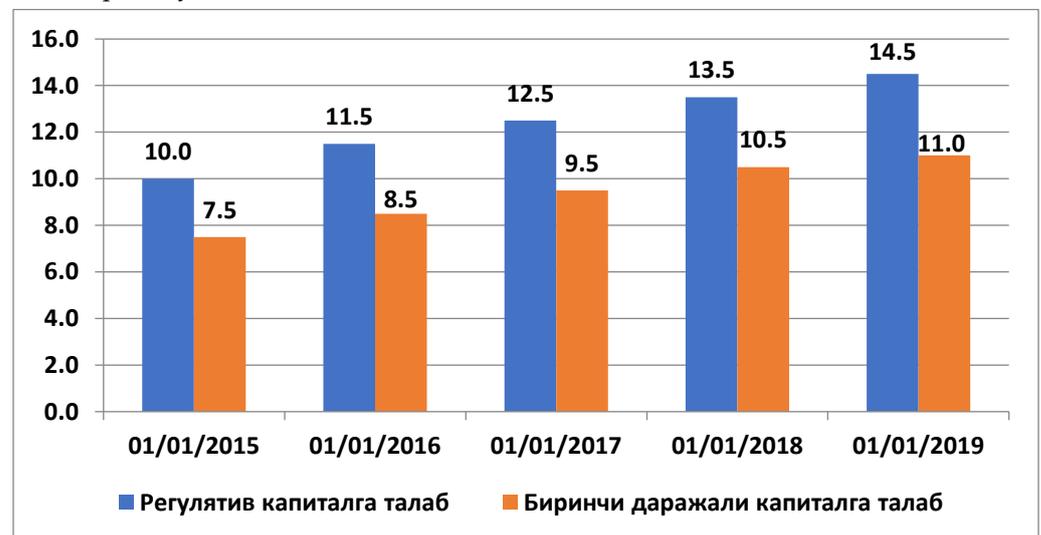
financial condition. Such risks include, but are not limited to, a large volume of problem loans, net losses, high growth in assets, exposure to high interest rate risk, or involvement in risk-based activities" [11]

In accordance with the Law of the Republic of Uzbekistan "On Amendments to the Law of the Republic of Uzbekistan "On Banks and Banking Activities", the minimum authorized capital of commercial banks in the country should be: one hundred billion soums by September 1, 2023; two hundred billion soums from September 1, 2023; three hundred and fifty billion soums from April 1, 2024; and five hundred billion soums from January 1, 2025 [6].

#### 4. Discussion

In our opinion, a significant increase in the requirements for the minimum authorized capital of commercial banks in the country will, de facto, ultimately increase the level of financial security of banks.

One of the new requirements of the Basel Committee on banking supervision is an increase in capital adequacy requirements for commercial banks. This requirement has been adopted by the Central Bank of Uzbekistan.



**Figure 1.** Increased capital adequacy requirements for commercial banks in the Republic of Uzbekistan [11].

As can be clearly seen from Figure 1, the capital adequacy requirements for the country's commercial banks began to increase in 2015, and this process was completed on January 1, 2019. The country's Central Bank also adopted the new Basel Committee requirements for bank capital formation. The essence of this requirement is that the Tier 1 capital of commercial banks is divided into two parts: Core Tier 1 capital; Additional Tier 1 capital.

#### 5. Conclusion

As a result of research conducted on improving the methodological foundations of the formation and management of the income base of commercial banks, the following conclusions were drawn: the net interest margin indicator plays an important role in assessing the profit base of commercial banks, and the net interest margin is inversely proportional to the amount of bank assets; according to the recommendation developed and submitted by specialists of the International Bank for Reconstruction and Development, the share of interest income in the total gross income of commercial banks should be at least 70 percent; the state of the income base of commercial banks in developing countries is directly dependent on the level of credit risk, and the inability of

clients who have taken out loans in foreign currency to repay them as a result of the depreciation of the national currency leads to an increase in the level of credit risk; ensuring the normative level of the net interest spread coefficient developed and presented by the experts of the International Bank for Reconstruction and Development, using it in assessing the stability of interest income from loans given by republican banks, serves to form important practical results. In our opinion, the introduction of positive changes to a number of the above regulatory and legal documents will serve to improve the methodological basis of the formation and management of the income base of the country's banks.

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