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COMPOSITION OF CREDIT PROVISIONS IN COMMERCIAL BANKS AND RISKS IN THEIR MANAGEMENT

Eshboyev Shakhobiddin
Tashkent State University of Economics
PhD student

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Abstract:

The structure of credit investments in commercial banks and risks in their management are considered. Also, the importance of credit risks,important elements of reducing credit risks in commercial banks are given. In recent years, after the global financial crisis, the issue of credit risk management has received increased attention from international regulators. Credit risk management frameworks are often not sufficiently integrated within the organization, there is no unified approach, and there is no holistic view of all risks. Likewise, where they exist, sound risk management practices have helped institutions to weather financial crises better than others.

Keywords: *Bank, credit, risk, monetization coefficient, environmental risk, credit risk measurements, market risk analysis.*

INTRODUCTION

All operations in the economy of developing countries are carried out through banks, and of course risks arise in these operations. Risky operations carried out with the specific goal of achieving maximum profit in the activity of commercial banks will definitely lead to profit, and this is especially dependent on the decisions taken by the bank management. The risky operations of commercial banks, on the one hand, provide banking and financial services in all sectors of the economy, satisfy the economic demands of the society, and serve to increase the capital of the whole society, on the other hand, the investment of funds in their effective objects increases the income of banks as an economic entity. While financial institutions have faced difficulties over the years for a multitude of reasons, the major cause of serious banking problems continues to be directly related to lax credit standards for borrowers and counterparties, poor portfolio risk management, or a lack of attention to changes in economic or other circumstances that can lead to a deterioration in the credit standing of a bank's counterparties.

This experience is common in both G-10 and non-G-10 countries. While the exact approach chosen by individual supervisors will depend on a host of factors, including their on-site and off-site supervisory techniques and the degree to which external auditors are also used in the supervisory function, all members of the Basel Committee agree that the principles set out in this paper should be used in evaluating a bank's credit risk management system. Supervisory expectations for the credit risk management approach used by individual banks should be commensurate with the scope and sophistication of the bank's activities. For smaller or less sophisticated banks, supervisors need to determine that the credit risk management approach used is sufficient for their activities and that they have instilled sufficient risk-return discipline in their credit risk management processes. The Committee stipulates in Sections II to VI of the paper, principles for banking supervisory authorities to apply in assessing bank's credit risk management systems. In addition, the appendix provides an overview of credit problems commonly seen by supervisors. Based on the research above questions, the study, which is aimed at addressing the impact of credit risk on bank performances in Sierra Leone, is set to achieve the following milestones or objectives: (i) Examine the relationship between the core variables constituting loan payment default and commercial banks' profitability in Sierra Leone; (ii) Examine the impact of credit risk on the profitability of Sierra Leonean banking system; (iii) Identify relationships between non-performing loans and banks' profitability; and (iv) Evaluate the effect of loan and advance on banks profitability on Sierra Leonean bank. Similar research endeavors have been explored in other countries, but not quite in Sierra Leone, given the uniqueness of the research to utilize Panel Data methodology in assessing banks' performances. The remaining sections of the paper are divided as follows: Section two provides a stylized fact of commercial banks' credit and performance in Sierra Leone, while section three addresses literature background surrounding CR and performance of banks, subsectioned into theoretical and empirical literature. Section four addresses the methodology of exploring the exposition of CR in Sierra Leone's banking system. Section five presents the outcome of the results and

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discussion. Finally, six concludes with proffered recommendations for policy implementation from our findings.

LITERATURE REVIEW

Increasing the efficiency of the banking system of the Republic of Uzbekistan is related to the active participation of banks in lending to the real sector of the economy. However, commercial banks of our country face a number of difficulties and problems in lending activities. Especially today, the presence of problematic assets among loans, which make up the main part of the income-generating assets of commercial banks, is noticeable. As the President of the Republic of Uzbekistan Sh.M. Mirziyoyev noted, "it is necessary to expand the capabilities of banks to return problematic loans, and banks, debtor enterprises, companies and associations, heads of regions should work together to collect them." Improving the quality of the credit portfolio and the quality of risk management, following a moderate level of credit growth, conducting a balanced macroeconomic policy, improving corporate governance and attracting managers with international practical experience, implementing technological solutions for assessing financial risks Ensuring the financial stability of the banking system through. Effective management of the loan portfolio in commercial banks is one of the important tasks. There are four main principles underlying the operation of the bank's credit portfolio management system:

Firstly, within the framework of the requirements of the Central Bank of the Republic of Uzbekistan "On the classification of the quality of assets in commercial banks and the formation of reserves to cover possible losses on assets and the procedure for their use", bank loans are regularly evaluated according to the main criteria ;

Secondly, control over the provision of loans allocated by the bank. In this case, it is necessary to take into account that the security is not considered the main source of extinguishing the loan. The bank uses collateral only to reduce the risk of loan default.

Thirdly, the implementation of credit monitoring. Monitoring of the loan portfolio includes the following:

a) monitoring of the loan;

b) monitoring of the loan portfolio.

MATERIALS AND METHODS

At present, the increase in the volume of bank loans directed to the development of the economy, the increase in the number of clients of various types of ownership and business management using bank loans, the rational placement of loans given by banks and their efficiency, the loans granted and the interest calculated on them Ensuring timely recovery requires constant monitoring of banks' loan portfolio. Therefore, even if the banker hopes to have a gain in this operation, he simultaneously exposes himself to an uncertainty of non-repayment of the borrower. In fact, when credit is granted, the lending institution is not always sure of recovering its funds. Thus, the latter is frequently exposed to credit risk. It may be, certainly due to an economic recession, thus making it impossible for borrowers to honor their commitments, but it is all the more crucial for the banker to find effective ways to protect himself, if not to control this risk of non-repayment of the customer, synonymous with loss or profit. It is utopian for a company to have as its objective the loss of profit. Like all companies, the bank is a commercial enterprise, which also seeks to maximize its profitability. It must therefore be globally profitable in its activity. Credit is an anticipation of future revenues, so its good management is crucial for the performance and sustainability of the bank. The performance of a bank implies good credit risk management through effective techniques.

Fourth, credit portfolio audit and credit risk management. The loan portfolio is audited by internal and external auditors. Commercial banks should immediately report to the Central Bank when there are cases where an increase in risk concentration in any type of risk may lead to significant losses.

In turn, it would be appropriate to analyze bank loans from two aspects. Firstly, the stability of the composition of the loan portfolio is assessed by banks, and secondly, the share of the country's volume of credit deposits in relation to the GDP is determined and evaluated when the monetization coefficient is regulated by the Central Bank. Second, bank lending should be researched to ensure microeconomic stability. In order to ensure macroeconomic stability, the decrease or increase in the price of credit investments is regulated by the interest policy of the Central Bank. As a result, this activity should serve to increase investment activity in the economy, lower prices, and stabilize the purchasing power of the population. In general, there is a need to implement macroprudential policy.

As we mentioned above, the monetization coefficient is considered as the main criterion in the implementation of macroprudential monetary policy. Through this indicator, the level of money supply of the economy, the stability of solvency and the control of inflation allow to implement financial policies.

Russian scientist prof. V. Senchagov describes his attitude towards the monetization coefficient. In particular, if the state implements investment activities

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that support fundamental research, if high-tech products are created in the volume of production processes, the speed of money circulation slows down, and on the contrary, it is emphasized that the production of consumer goods in the short term serves to increase the speed of money circulation. Also, it justifies that achieving an increase in the money supply with a slowdown in the speed of money circulation serves to stabilize the monetization coefficient.

At the same time, A. Kaygorodsev comments on the criteria of the monetization coefficient and emphasizes that its norm of 70 percent and minimum of 50 percent of GDP is an important element of ensuring economic security. Therefore, it is recommended to direct investments to high-tech sectors so that the monetization coefficient in the economy does not cause inflation.

In general, it is appropriate to study the possibility of increasing the monetization coefficient in Uzbekistan, through which directions of capital investments of banks can be implemented or not.

In our opinion, the increase in long-term credit investments reflects the fact that it creates conditions for the formation of long-term investment activities in the economy. It can also be explained by the fact that money can become cheaper.

In this regard, the researcher M.Ahmedov says that "long-term funds" means funds that are stored for at least 3 years, or more than 5 and 10 years, in terms of the duration of the resources of financial institutions. At this point, it is worth noting that the increase in the weight of "long funds" in credit institutions not only accelerates the implementation of investment projects by enterprises, but also leads to the conclusion that commercial banks actively participate in these projects with their credit resources

RESULTS AND DISCUSSION

It should be noted that the high number of loans in foreign currency in the loan investment portfolio can cause the following complications:

- with an increase in sensitivity to changes in the economy of foreign countries, the transfer of their problems to the national banking system can be accelerated. this can lead to an increase in the bank's risk;
- the solvency of foreign currency borrowers may decrease as a result of continued devaluation in the country. As a result, the quality of banks' assets will decrease.

We will try to analyze the development trends of credit investments of selected banks.

The release of additional funds to the economy through banks' credit channels does not have a serious effect on inflation, because the monetization coefficient is not high in Uzbekistan. Therefore, it is recommended that banks expand lending to high-scientific production sectors;

The lowest level of this indicator was noted in Syrdarya region - 26.1%, or 2.2 trillion soums. In the same region, the highest share of costs for the purchase of machinery, equipment and inventory was recorded - 66.1%, or 5.6 trillion soums (Figure 1.) [34].

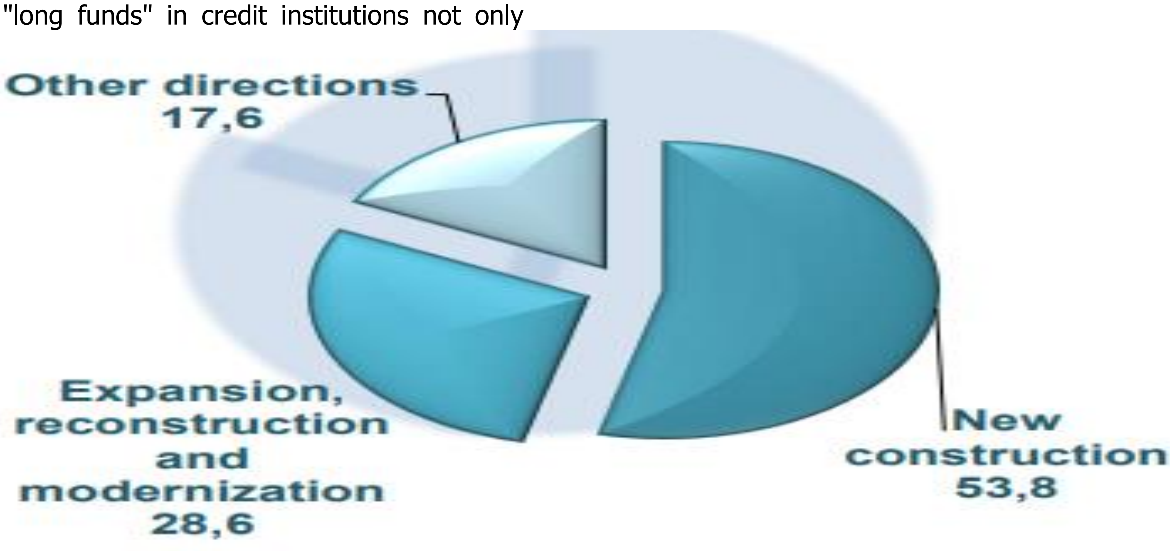

Figure 1. Reproductive structure of investments in fixed assets, % of the total

Critically, the above literature reviews (theoretical and empirical) have helped shape the authors' direction of exploring the study. Many of the studies explored have highlighted failings on the part of commercial banks to

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monitor risks, which range from failings on the part of management to take cognizance of competition, high government spending, and the lack of proper credit analysis by banks. In light of the previous literature reviews, this paper is intended to add value to an existing body of knowledge by exploring historical data for (all qualifying) commercial banks to assess credit risks and performance of banks, which have implications for both price and financial stability. It is hoped that the specific methodology (Panel Data), which has never been explicitly explored in the case of Sierra Leone, will make a value addition to an existing body of future studies.

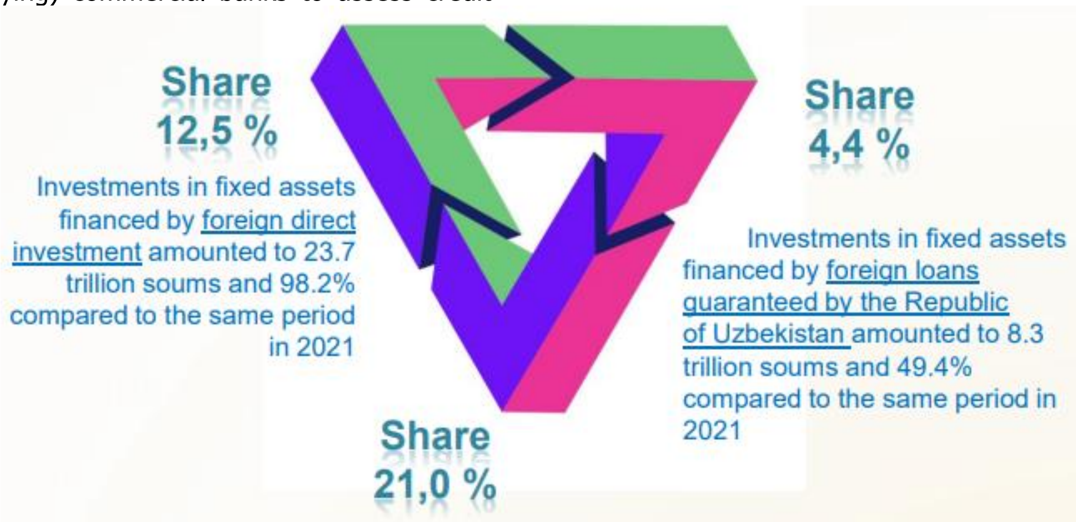

Figure 2. Foreign investments and loans in fixed assests

In the credit portfolio of commercial banks, especially in the activity of TIF National Bank, the volume of loans issued on the basis of foreign currencies has a large share. This may increase the bank's risk sensitivity to currency policy and international economic relations;
Banking activity has a significant share in lending to industry, especially Asaka ADB, but transport and communication networks are also gaining priority in TIF National Bank;
Lending of material and technical support is not reflected as a priority lending network for selected banks, its share in the total is the smallest;
One of the most significant risks of the selected banks in the studied period is the lack of diversification of credit investments in sectors and the fact that they lead only certain sectors. In this light, the amount of money created by banks is determined by the demand for credit from households and businesses to finance all or part of their spending. This thesis, which occupies a central place in post-Keynesian macroeconomics, denies the causal relations between loans and deposits that underlie the representation of the credit multiplier; in reality, Chen and Cheng point out that it is the loans that make the deposits and not the other way around. Banks create money and refinance with the central bank according to their liquidity needs instead of central money being the basis from which banks can grant credit.

CONCLUSION

This work will allow them to understand the positive impact generated by the repayment of their credit. Indeed, this repayment will allow banks to be more efficient, therefore these customers will be able to benefit from more and more loans. However, if credit risk can lead to the failure and bankruptcy of banks, this will not spare companies from filing for bankruptcy. Similarly, it is all the more important for banks to update their credit risk management methods, in the face of competition in their sector, at the emergence of new parameters that influence credit risk as well as market risk. In the same vein, while effective credit risk management is central to banks' profitability, bankruptcies are the negative results of its mismanagement. Thus, this work will constitute, on the one hand, a precautionary tool for new banks in their credit risk management, and on the other hand, for credit institutions that have come close to bankruptcy, this study could serve as a support instrument for a considerable growth, if not a perpetuation, of their main activities as lenders.
The selected banks, being state-owned banks, have a place in the implementation of government programs and reforms, and their role in the establishment of credit lines is being emphasized.

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