

## ANALYSIS OF THE LEVEL OF COMPETITION IN THE BANKING SYSTEM OF UZBEKISTAN

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**Annotation.** Competition in the banking services market is one of the important components of a stable banking system. The article describes the current state of interbank competition among banks in Uzbekistan, analyzes the main indicators of banking activity, studies the indicators of the Herfindahl-Hirschman index relative to the domestic banking system. The author also makes proposals for stimulating the development of healthy competition between banks in Uzbekistan.

**Key words:** banks; competition; banking market; competitive environment; interbank competition; level of competition

A significant role in the sustainable development of reproductive processes in the regional economy is played by banking institutions, the functioning of which is based on achieving the strategic goals of sustainable development and maintaining a dynamic balance of the social, economic and environmental environment. The ongoing changes in the modern economic space affect all areas of the functioning of industry markets and sectors of public relations. Emerging problems associated with achieving economic equilibrium and sustainable development of industry markets require the formation of new methodological approaches to their solution.

Under the influence of a competitive environment, banks operating on the principles of financial intermediation are being transformed into development institutions that ensure economic growth and integration of the areas of application of environmental, social, information, digital and investment capital. In the conditions of the digital economy in the Republic of Uzbekistan, intense competition in the banking business is already an objective reality, which is constantly increasing every year as the network of credit institutions and other various financial institutions develops. At the same time, improving the quality of financial institutions, which is the basis for the growth of national competitiveness, is also the main goal of structural transformations in the banking and financial sector, necessary to ensure sustainable long-term economic growth. Today, in Uzbekistan, the reform of the banking system has reached a decisive stage, as evidenced by the Decree No. PF-5992 adopted by the President of the Republic of Uzbekistan dated May 12, 2020 “On the strategy for reforming the banking system of the Republic of Uzbekistan for 2020-2025”[1]. The main task in the Decree set for commercial banks is their capitalization and the privatization of banks with a State share, mainly to foreign investors. Against the backdrop of high uncertainty and tension in foreign economic conditions, the Central Bank maintained the main rate of 14% per annum in order to ensure macroeconomic and financial stability in the country, by preventing the growth of devaluation and inflation expectations, maintaining savings activity in the national currency and mitigating the impact of external risks on the economy. The functioning of the economic system is based on market mechanisms - competition and competition - these

categories are key in a market economy. In the Decree of the President of the Republic of Uzbekistan dated January 28, 2022 PF-60 “On the Development Strategy of New Uzbekistan for 2022-2026,” the priority tasks are the accelerated development of the service sector in existing commercial banks and radically change the composition of services provided in the next five years through modern high-tech types.[2]

Interbank competition is a dynamic process in which banks ensure their stable position in the banking market. Many economists, both foreign and domestic, study interbank competition. The classics of economic theory also paid considerable attention to this topic. J. Robinson studied “the mechanism of price formation, considering each producer a monopolist.”[3] F. Hayek emphasized the special role of competition “as a way of identifying new products, the implementation of which allows one to obtain high profits, use new markets and ensure the dynamic development of the economy as a whole” [4]. E. Chamberlin formed a model of market structure in which numerous participants are independent of each other and have no restrictions on entering any sector of the market, while buyers of a number of monopoly products and services purchase them at an increased price [5]. F. Edgeworth studied the state of perfect competition, in which the number of suppliers of products, services and their consumers is infinite, and the exchange equilibrium is certain [6]. Economists O. P. Ovchinnikova and E. A. Dynnikov define competition as a factor in the stability of the banking market [7]. L.V. Demchenko believes that competition increases the risks of banks [8].

Domestic authors, as characteristic features of competition in the banking sector, highlight its close connection with foreign economic and political relations, as well as the increased risk of operations [9]. M.G. Kenzhaev in his works notes that to increase the competitiveness of commercial banks, it is first of all important. widespread introduction of innovations in the form of the development and provision of new types of services and technologies, which will increase customer satisfaction with the bank’s work, improve the quality of service, thereby increasing its stable position in the market[8]. Complementing the previous opinion, other domestic authors consider it vitally important to increase the quantity and quality of online services, for which the development and implementation of a strategy for the development of the digital economy and the transformation of activities in accordance with modern information and communication technologies are important Makhmudova in her works, as the most important directions for increasing the efficiency and competitiveness of domestic banks, proposes, firstly, the transition to digital technologies, which, in her opinion, is designed to increase the transparency of the banking sector, and secondly, increasing the range and quality of online services with the active participation in these processes of non-banking commercial organizations and, thirdly, the issue of securities, which will increase the liquidity and business activity of commercial banks.[9]

Thus, a generalization of the scientific and theoretical views of scientists involved in the development of the banking sector has made it possible to define banking competition as a complex process of interaction between a bank and the external environment, characterized by relations of rivalry, the reason for which is the desire to obtain maximum profit and be most in demand in the

banking services market, which implies, first of all, improving the quality of service and increasing customer satisfaction.

Currently, a stable trend in the development of the Uzbek banking market is an increase in the number of banks. For the period 2016–2022 their number increased from 27 to 33 units. (Fig. 1).

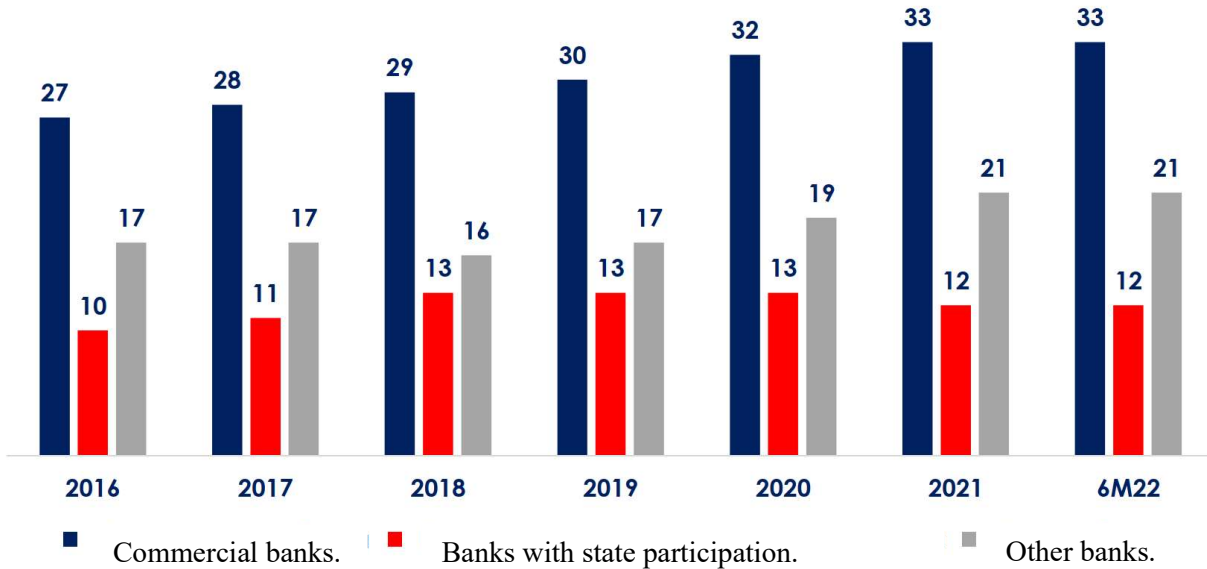


Fig. 1. Number of banks in Uzbekistan, units

Source: compiled by the authors based on data from the Central Bank.

In the financial market there is an oligopoly with a competitive environment with a relatively large level of state participation in the capital of financial intermediaries. 3. By determining the state of interbank competition, it is possible to record the increasing dynamics of a high level of asset concentration. Thus, as of June 1, 2023, 11 banks with state shares own 77% of assets, 81% of the loan portfolio and 60% of deposits of the banking system. The remaining 23 banks are private. Moreover, the loan to deposit ratio in government banks is 275%, while in other banks the ratio is 99%.

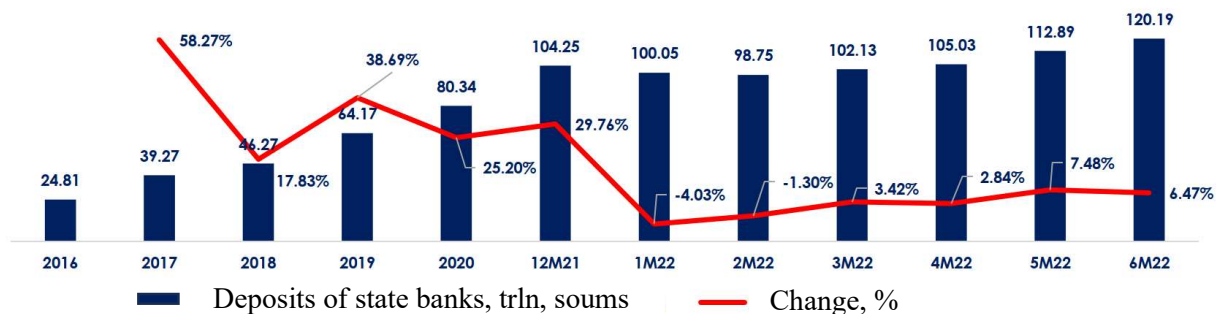


Fig.2 Deposits of state-owned loans, %

At the end of the first half of 2022, the share of state-owned banks accounted for 64.95% (in 2016 year - 66.73%, in 2021 - 66.74%) or 120.19 trillion soums of the total volume of deposits leftovers.

The deposit base of state banks in 2016 amounted to 24.81 trillion soums, and by 6M22 - 120.19 trillion soums, showing an increase of 384.40%.

The assets of the banking system of Uzbekistan in 2016 amounted to 84.08 trillion soums, at the end of 2021 - 444.92 trillion soums (+429.19% compared to 2016), and at the end of 6M22 - 495.66 trillion soums (+489.53%).

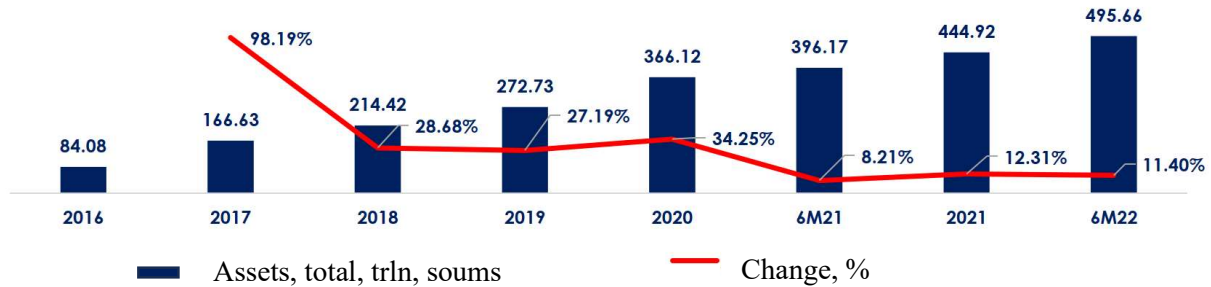


Fig.3. Total assets of banking system of Uzbekistan, trln soums

It should be noted that the share of state-owned banks in total banking assets in 2016 was 77.29%, and by 2021 it increased to 81.46% and at the end of 6M22 - to 79.69%. The maximum share of state-owned banks' assets in total banking assets was reached in 2020, when this figure was 84.07%.

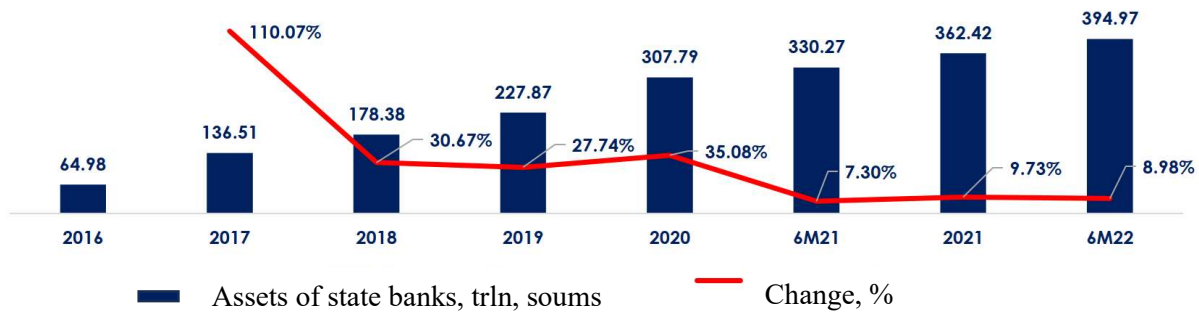


Fig.4 Assets of state-owned banks, trln.soums

The assets of private banks in 2016 amounted to 19.09 trillion soums, by the end of 2021 this figure reached 65.90 trillion soums, and at the end of 6M22 - 100.68 trillion soums.



Fig.5 Assets of private banks, trln, soums

The German Savings Bank Foundation for International Cooperation conducted a study of the demand for banking services in Uzbekistan. The foundation's specialists surveyed residents of all regions of the republic. During the interviews, they asked about the level of trust in banks,

assessment of their work and satisfaction with their services. The financial literacy of respondents was also assessed.

The survey revealed that 98% of participants use banking services. On average, each respondent is a client of two banks, and more than half of them did not choose their main financial institution independently.

Among those who are forced to use the services of a particular bank, the majority (74%) are employees of budgetary organizations. Every fifth person had services “imposed” on them by an employer in the private sector.

The majority of respondents (82%) use mainly bank cards for payments. Another 15% have cards, but pay mostly in cash.

In addition, 85% of respondents express attention to additional services provided by banks. Women are interested in them more often than men, young people - more often than older age groups, and residents of Samarkand, Bukhara, Kashkadarya and Surkhandarya - more than other regions.

83% of respondents noted improvements in the banking system of Uzbekistan since 2016. Confidence in it has increased over the past two years among 61%.

At the same time, a significant number of respondents point to insufficient customer focus (45%) and bureaucratization (42%) of banks. In general, the majority has a neutral attitude towards the system, and positive and negative attitudes are divided equally - 11%.

Most often, respondents named the following factors that would increase their trust in banks:

- reduction of interest on loans;
- improving the quality of service, including detailed information about services;
- elimination of bureaucracy and corruption.

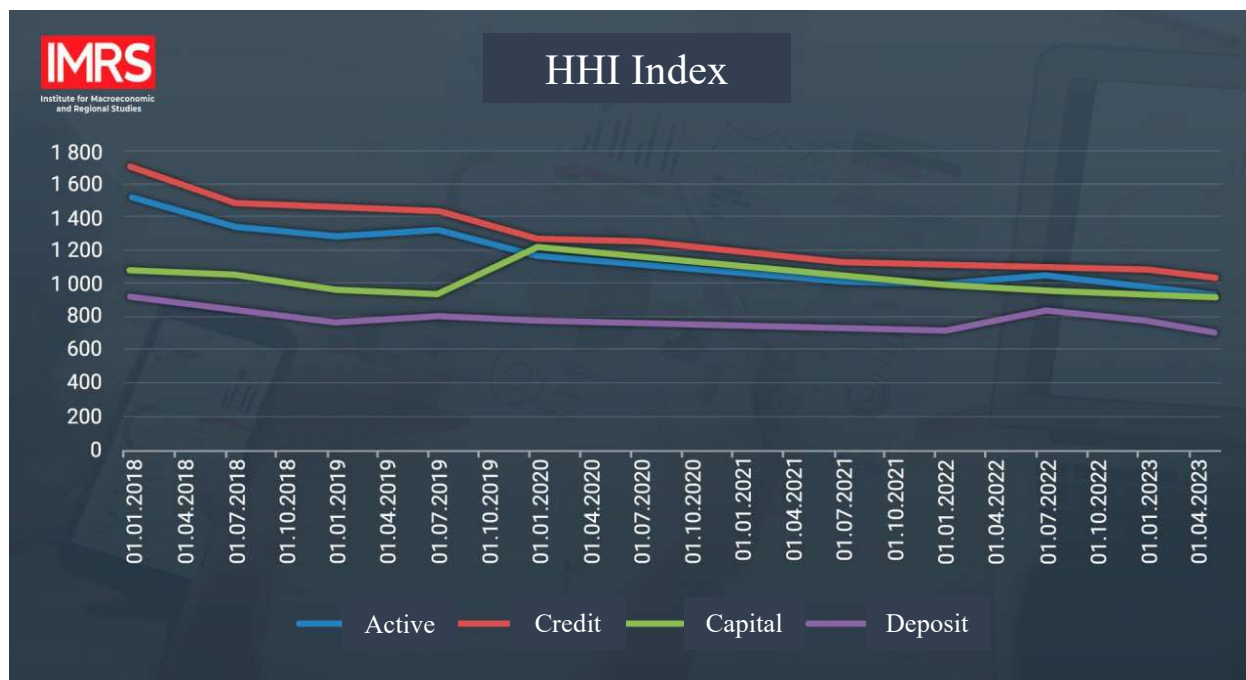
Overall, 80% of clients are satisfied with the functioning of the banking system (36% completely, 44% mostly). Approximately the same number are willing to remain clients of their bank in the coming years.

Dissatisfied customers most often complained about high interest rates on loans, fear of losing money, as well as problems with staff qualifications and communicating information about the banking services offered.[10]

Experts from the Institute of Macroeconomic and Regional Studies analyzed the change in the level of competition in the banking system of Uzbekistan for 2018-2023.

Research has been conducted using the CR (Concentration Ratio) and HHI (Herfindahl-Hirschman Index) indices, which are widely used to determine the level of competition in a particular market. Values of these indices close to zero indicate a high level of competition. Based on these indicators, markets are divided according to the level of competition into the following 3 groups:

- highly concentrated markets:  $70\% < PO < 100\%$ ;  $2500 < HHI < 10000$
- moderately concentrated markets:  $45\% < SR < 70\%$ ;  $1500 < HHI < 2500$
- low-concentrated markets:  $PO < 45\%$ ;  $HHI < 1500$



When calculating the CR and HHI indices, the main performance indicators of all commercial banks operating in the republic in the period 2018-2023 were used, in particular the volume of assets, deposits and loans.[11]

Assets. As of May 1, 2023, the HHI index calculated by assets was 927 and decreased by 593 units compared to January 1, 2018 (1520). This, in turn, indicates that the banking system of our republic has moved from a moderately concentrated level to competitive market principles, and competition between banks has increased significantly. The CR concentration ratio results also show that the level of competition for assets is increasing.

At the beginning of 2018, the share of 3 large banks with a state share (National Bank, Uzpromstroy Bank and Asaka Bank) in the total assets of the banking system was 59.8%, and as of May 1, 2023, this figure decreased to 40.9%. This situation can be explained by the increase in the number of commercial banks and the increase in the share of private banks in the total assets of the banking system of the republic. In particular, the share of 3 digital banks (Anor Bank, Uzum Bank, TVS Bank) in total assets in a short period of time reached 1.25% (as of May 1, 2023).

As of January 1, 2023, the volume of assets of the country's banking system reached 566.3 trillion soums, increasing 3.1 times compared to May 1, 2018 (179.7 trillion soums).

Loans. During the period under review, the HHI index for loans decreased from 1548 to 1031. The CR index (the share of the 3 largest banks National Bank, Uzpromstroy Bank and Asaka Bank) in the total loan portfolio decreased from 60.9% to 42.3%. During this period, the share of Kapitalbank increased from 1.07% to 4.77%, Turonbank - from 0.82% to 2.37%.

In our economy, the volume of loan proceeds allocated by commercial banks has increased over the past 5 years by almost 3.3 times, or from 127.2 trillion soums (40.1% of GDP) to 413.4

trillion soums (46.5%) , of which the volume of allocated loans to individuals increased 7.5 times. These changes mean an increase in the coverage of the monetary market of our republic.

At the same time, the weighted average nominal interest rate on loans in national currency increased from 20.0% in 2018 to 22.5% in 2023 for the corresponding period. At the same time, the real interest rate on the loan increased significantly from 0.3% (20.0-19.7[1]) to 11.5% (22.5-11).

This condition can be explained by the following:

- under the influence of structural changes in recent years and a favorable investment climate, there has been rapid economic growth and increased concerns about economic overheating;
- increased need to control inflation pressures and alternative expectations;
- measures aimed at stabilizing the exchange rate;

and the basis of all this is that the Central Bank is pursuing a tight monetary policy. Deposits. The placement of the index in the range of markets with low concentration throughout the analyzed period indicates the impact of reforms carried out to promote healthy competition in the banking sector. The HHI index for the corresponding period decreased from 893.7 to 703 units.

According to the results of the CR index, as of May 1, 2018, the top 5 banks owned 51.8% of the total deposits in the banking system, and by May 1, 2023, their share decreased to 40.5%. The share of deposits attracted by private banks increased from 32% to 40%. The leader among them is Kapitalbank, whose share in the deposit market increased from 4.9% to 12.1%.

The total volume of deposits increased 3.3 times, that is, as of May 1 of this year it amounted to 208.4 trillion soums, and in the corresponding period of 2018 - 62.6 trillion soums.

Based on changes in the indicators of the HHI and CR indices, based on the volume of assets, loans and deposits, we can conclude that the banking sector in our country is formed on the principles of a competitive market.

In conditions of market turbulence, banks need to ensure their financial stability. Numerous risks have a negative impact on the stability of banks. The most vulnerable may be narrowly specialized banks with low quality risk management, with high business dependence on one segment of the banking market, or on weak economic development of a region or industry. During the current period, the problem of imperfect risk management systems and ensuring the financial stability of banks has become more acute. In our opinion, the issue of risk management in the context of interbank competition stands out as a red line. Much attention should be paid to risk management not only in each individual bank, but also by the mega-regulator in relation to the entire market. Increased risks of one bank can lead to losses, including bankruptcy and liquidation. The impact of systemic risks on the activities of banks can upset the balance in the entire banking system. Banks should prioritize the development of risk management methods.

The main ones are:

- reservation—formation of a reserve to cover unforeseen expenses;
- insurance—creation of an insurance fund of resources to compensate for damage from unforeseen risks;
- hedging—used to minimize possible investment losses due to market risk;

- distributing the degree of risk (indexing the cost of services, providing guarantees, pledging property, a system of penalties);
- diversification of assets;
- avoiding risks by completely refusing the bank from specific transactions;
- minimizing risks by managing assets and liabilities

The emerging trends in the development of the banking market: monopolization, centralization, concentration of capital, federalization, globalization - hinder the effective development of the banking business and the economy as a whole. We consider it appropriate to set the task for the Bank of Russia to ensure conditions for the formation of a healthy competitive environment and strengthening interbank competition. It is fair competition that will allow for qualitative changes in the banking business, aimed at increasing the efficiency of banks. In our opinion, to achieve this goal it is necessary:

- 1) reduce the degree of state participation in the formation of bank capital by establishing a standard for acceptable state participation in the authorized capital of credit institutions 17;
- 2) establish equal “rules of the game” for all participants in the banking market and eliminate state privileges;
- 3) do not mention in advertising of banking products and services the participation of the state in the authorized capital of a credit institution;
- 4) modernize the mechanism for proportional regulation of banks, namely, promote the development of regional small and medium-sized banks through the provision of tax and financial benefits; stimulate the development of new banking products; “to legislate the priority of the participation of regional banks in servicing the region’s investment programs,” etc. [19] 18;
- 5) organize measures to reduce unfair interbank competition and corruption in the banking market;
- 6) promote “the formation of non-price competition to increase the attractiveness of credit institutions” and the development of digital financial infrastructure.

In turn, measures to improve interbank competition cannot go against other areas of development of the banking sector. The Central Bank of Uzbekistan, when approving the policy for the development of interbank competition, adheres to the tasks of ensuring financial stability, establishing confidence in the financial market and the availability of banking products and services.

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