

## **Transformation of the Banking Sector in Uzbekistan in the Context of Covid-19 Corona virus Pandemia**

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### ***Abstract***

*The article considers the acceleration of the transformation process in the banking sector in the context of the coronavirus pandemic, as well as the impact of the global crisis caused by COVID 19 on the banking and financial system of Uzbekistan. The basis for the transformation of the banking sector is the development and implementation of an effective client-oriented digital strategy of financial institutions. The article discusses various approaches to the transformation of the banking sector and generates author's scientific and practical conclusions.*

**Keywords:** *digital economy, banking system, digital transformation, financial institutions, digital technologies, digital strategy.*

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## **Introduction**

Today, in the context of the COVID-19 coronavirus pandemic, there is a growing need to intensify the process of bank transformation in the banking system of Uzbekistan. In this regard, special attention should be paid to the implementation of the Presidential Decree "On the Strategy of Banking Reform of the Republic of Uzbekistan for 2020-2025" adopted on 12 May this year [1].

In this regard, a meeting chaired by President Shavkat Mirziyoyev was held on 6 July this year to implement the strategy of reforming the banking system of the Republic of Uzbekistan for 2020-2025 and accelerate the transformation of commercial banks.

Today, the word transformation has become one of the most talked about concepts. So why? The answer to this question can be found in the essence of this concept. Transformation is an inevitable process of adapting business in the world to new conditions, to the preferences of society. In particular, such a change in banks - why the transformation is needed and how it is done?

## **Analysis of the relevant literature**

In recent years, the banking system of Uzbekistan has done a lot to improve the quality and scope of banking services. However, the changes in the world, the process of globalization, the overdevelopment of competitiveness, the need to further intensify the process of transformation of commercial banks, the need to take banking services to a new level.

In this regard, President Sh. M. Mirziyoev in his Address to the Oliy Majlis said, "Starting from 2020, each bank will implement a large-scale transformation program. In this regard, we will pay special attention to increasing the capital, resource base and income of our banks" [4].

A number of economists have given their definitions of the digital transformation.

In particular, foreign economists Ablyazov T., Asaul V. [5] believes that the digital transformation process means improving existing business models, as well as using digital technologies to increase work efficiency. This process involves the constant introduction of innovative technologies, which will lead to a complete digital transformation of the entire economy.

Russian economist Vadim Arkadevich Koshcheev [6] believes that in terms of financial sector development, digital transformation is seen as an improvement in practical ways of doing business that creates a new work environment.

Another foreign economist, L. S. According to Pirainen, the digital transformation means the widespread introduction of modern methods of providing banking services [7].

Uzbek economists have also conducted a number of studies on the development of digital transformation and the transformation process in the banking sector. Academician SS Gulomov "Digital business is seen as the emergence of new business models that combine the physical and digital worlds [8].

Digital Economics, Ph.D., Professor Toshmatov Sh.A. According to [9], it is briefly and succinctly defined as follows: The application of digital technologies to the economy, to all processes related to economic gain, has expressed its view that the economy can be called digitalization or digital economy. He also explains that although the digital economy and the

innovative economy complement each other, the important difference is that in the digital economy, the high share of material resources in the traditional economy is replaced by digital technologies, while in the innovative economy it is replaced by more intellectual wealth and ideas.

We believe that the development of digital transformation in the banking sector should be achieved through a careful study of customer needs and analysis of existing opportunities, the development of a new innovative strategy focused on the customer.

These are consumers of banking services and are the driving force of innovative development of banks, as they shape the demand for modern banking products and services by expressing their needs.

The use of digital technologies will improve the relationship between banks, government and potential customers.

The digital transformation of banks is primarily aimed at better understanding the needs of customers: customers and organizations want to communicate with banks faster, easier and cheaper, so in the digital economy, the banking sector must be ready to offer the most modern services.

### **Research methodology**

- Research methods such as analysis and synthesis, induction and deduction, statistics and comparison were used in the research. Brief description of the results of the research:

Scientific views of some economists on the digital economy, the transformation of the banking sector;

- ✓ Recommendations were made to accelerate the process of transformation of the banking sector in the context of the COVID 19 coronavirus pandemic. For example, a critical study of problem loans during the pandemic period, an analysis of the financial population of the bank's customers in remote areas, an individual approach to each client;
- ✓ introduction of innovative new types of online banking services to the population with the development of information technology and communication;
- ✓ Saving time and costs in the implementation of digital banking financial services through mobile and online platforms, ensuring the security of personal data, improving the speed and quality of services.
- ✓ Allocate funds to replenish working capital of businesses whose financial situation has deteriorated during the pandemic, thereby restoring jobs, taking measures to reduce poverty in the country;
- ✓ study and in-depth analysis of lower levels of funding for programs and projects;
- ✓ assessment and control of the activities of employees in the banking system through the KPI system, their material and moral incentives or vice versa;
- ✓ Creation of an effective mechanism to combat corruption in the banking system.

### **Analysis and results**

The financial system in Uzbekistan is developing in accordance with the modern requirements of the digital economy. Due to the digital transformation, business models and concepts for the

development of the banking sector are being developed and improved, in particular, since the advent of Internet banking, innovative methods have been used to present traditional banking operations. As a result, through the innovative development of banks, their competitiveness and sustainable operation, efficiency, and most importantly, the growth of public confidence in the bank are being created.

In recent years, the banking system of Uzbekistan has done a lot to improve the quality and scope of banking services. However, the changes in the world, the process of globalization, the overdevelopment of competitiveness, the need to further intensify the process of transformation of commercial banks, the need to take banking services to a new level.

Currently, the number of branches of commercial banks is declining, and instead of them the activities of banking service centers (branches) are developing.

This, in turn, increases the need to provide many services to customers, in particular, traditional deposit or credit transactions online..

**Table1 Information on the number of credit institutions and banking infrastructure [10 ]**

<i>1. Credit institutions, total *</i>	104	121	148
<i>including:</i>			
<i>- Commercial banks, hence:</i>	28	29	31
<i>Banks with a state share</i>	11	13	13
<i>Other banks</i>	17	16	17
<i>- Nonbank credit institutions, hence:</i>	76	92	118
<i>Microcredit organizations</i>	30	37	57
<i>Pawnshops</i>	46	55	61
<i>2.Branches of commercial banks, total</i>	862	876	853
<i>3. Banking service centers (service offices and mini-banks)</i>	980	1151	1 093
<i>4. 24/7 outlets</i>		907	1 097

From the data of the table we can see that the total number of credit institutions in Uzbekistan in 2018-2020 increased by 44 to 148 as of 01.01.2020. The number of non-bank credit institutions has also increased, from 76 in 2018 to 118 by 2020. The number of banking service centers (service offices and mini-banks) and 24/7 outlets also increased during the period under review. These indicators are explained by the special importance of the banking system in our economy, as well as the growing demand for banking services.

Today, the total number of commercial banks is 31, and when we analyze the form of ownership, the state-owned banks are 13..[10]

At present, the most important task in reforming the banking system is the transformation of banking and business processes in the country. aimed at expanding private equity participation.

In this regard, the Resolution of the President of the Republic of Uzbekistan dated May 21, 2019 No PP-4325 "On measures to restructure and reform state-owned enterprises and commercial banks with state participation in the charter capital" systemic involvement is ensured. [3] In particular, in 2019, the International Finance Corporation and the European Bank for Reconstruction and Development began to participate in the transformation of Uzpromstroybank, Asaka Bank and Alokabank.

In addition, loans from the Fund for Reconstruction and Development of the Republic of Uzbekistan (SRDC) were transferred from the balance sheet of banks to the balance sheet of the SDRC, and a mechanism of direct lending was introduced.

In addition, in 2019, in order to diversify their resource base by commercial banks to attract cheap and long-term resources from international financial markets, Uzpromstroybank sold Eurobonds worth \$ 300 million through the London Stock Exchange.

In addition to assessing the ratio of income and expenses in assessing the effectiveness of banking management, the Central Bank constantly monitors the dynamics of various quality indicators.

The return on assets, which assesses the effectiveness of the use of assets by banks, increased by 0.2 percentage points in the banking system during the reporting period and amounted to 2.2%.

This figure was 1.8% in state-owned banks and 4.8% in private and foreign banks.

The fact that the return on assets of state-owned banks is much lower than the average of private and foreign banks shows that there are significant differences between the financial management strategies of state-owned banks and other banks.

Capital return is an indicator of the efficiency of banks' use of their own capital, and during the reporting year in the banking system of the republic this figure increased from 15.8% in 2018 to 16.7%. The return on capital was 13.7% in state-owned banks and 31.4% in private and foreign banks.

The relatively low level of assets and return on capital of state-owned banks is explained by the high share of small marginal loans in the loan portfolio of these banks under government social programs and the relatively low share of high-yield commercial loans and retail banking services.

Today, the share of long-term loans in the total loan portfolio of commercial banks has decreased from 95% to 92%, but this figure is much higher than international standards (70%). preserved.

In addition, although the dollarization rate has fallen from 48% of total bank loans and from 63% to 58% of liabilities, it still has a high share..

Today, the concentration risk associated with loans to the 10 largest borrowers in the banking system remains high, and as of January 1, 2020, such loans accounted for 35% of the total banking loan portfolio, including their share of foreign currency loans in the corporate loan portfolio reached

At the same time, as of January 1, 2020, the total problem loans in the banking system amounted to 43.2 trillion soums. soums, of which 43% were unsatisfactory, 19% were doubtful and 38% were bad loans.

The share of non-performing loans in total loans is an indicator of the quality of the loan portfolio, and an increase in this indicator will be a key factor in causing serious losses and liquidity problems in the future. At the end of 2019, this figure decreased by 0.1 percentage points in the banking system compared to the previous year and amounted to 1.5% as of January 1, 2020.

As of January 1, 2020, the ratio of net non-performing loans to total capital in the banking system decreased by 1.6% to 2.7% as of January 1, 2020.

The high rate of lending in the country in 2019 has led to an increase in liquidity risk in the banking system. As a result, the share of highly liquid assets of banks in total assets in the first half of 2019 decreased by almost 3 times compared to the beginning of 2018.

In order to strengthen the liquidity of banks, the Central Bank has set target targets for commercial banks from July 2019 to July 1, 2020 to increase the share of highly liquid assets in total assets to 10% by increasing the share of total assets by at least 1%.

Based on the results of the above analysis, we believe that the main goal of the reforms in the banking system is to train commercial banks to work for the customer. In this regard, the implementation of reforms to transform the banking system depends on modern, educated personnel, and the main factor is that the representatives of the banking sector have mastered the effectiveness and content of the ongoing reforms in the banking system..

Paragraph 71 of the Action Strategy pays special attention to the implementation of digital transformation in all service areas. Implementation of the "road map" for the transformation of state-owned banks from June 1, 2020, including measures to improve the quality of banking services provided to the population and businesses and increase the range of modern retail banking services. [2]

To this end, this year the implementation of the tasks set for the broad transformation of the banking system, as well as the introduction of modern models of banking requires the use of practical and effective forms of cooperation between the Central Bank and commercial banks. This approach serves to build and increase public confidence in the banking system in a pandemic.

Nowadays, there is a growing need for the application of digital technologies in the economy, in all processes related to economic gain.

Digital transformation is an inevitable process in which the world's business is adapting to the new conditions and advantages of the digital economy society, which is a tool to improve the living standards of people in society through the introduction of digital technology.

In the process of transformation of banks, an increase in customer demand is inevitable, and as a result of poor quality of advanced innovative banking services in this regard may lead to a decrease in bank customers' confidence in their bank. As a result, bank customers tend to switch banks or use other banking services. Therefore, the transformation of banking activities in accordance with the requirements of customers, i.e. the creation of new banking services using modern information and communication technologies of banking products and services.

In this regard, the revision of the organizational structure of commercial banks to improve it in line with international standards, the simplification of lending conditions are important. At the same time, it is necessary to develop measures to revitalize business-oriented corporate governance and supervisory boards, the introduction of modern banking services.

Analysis of the current situation in the banking sector of the country shows that there are a number of systemic problems in the banking system, such as high level of government intervention, insufficient quality of management and risk management in state-owned banks, low level of financial intermediation in the economy.

To address this shortcoming, it is instructed to register non-banking functions, and to organize training programs at the Central Bank's Corporate Retraining Center to explain the

transformation of banks, primarily for local bank employees.

Most state-owned banks are funded by the state's trust funds and provided on preferential terms to state-owned enterprises and government projects. These loans are constantly being restructured (extension or consideration of other terms), which has a negative impact on the efficiency and profitability of banks.

Therefore, in order to reduce the share and interference of the state in the banking system, measures are being developed to sell state-owned banks to international and local investors..

It is known from practice that investors with stable and high economic potential - to the country, region or any enterprise, in which they are investing, make a decision based on systematic analysis to invest their funds in the project only when the investment project is convinced of high economic efficiency. Therefore, an in-depth analysis of the quality and quantity of investment projects in the banking system of the country is of particular importance.

In this regard, President Sh. In 2018 alone, Mirziyoyev held high-level talks with the heads of more than 30 foreign countries and international financial institutions, and it should be noted that more than 180 bilateral agreements and treaties have been signed..

Currently, 6 commercial banks in the country - Ipotekabank, Sanoatqirilishbank, Turonbank, Asakabank, Aloqabank and Agrobank - have started cooperation with international financial institutions on financial diagnostics, development of long-term strategies and privatization.

However, President Mirziyoyev said that the transformation of other banks is not sufficiently active, paying special attention to the elimination of corruption in the banking system, and the chairmen of all commercial banks should take strict measures to curb corruption and introduce effective control mechanisms. Criticized.

In the current context of the current COVID 19 corona virus pandemic, the issue of improving the loan portfolio of banks and the quality of projects also requires special attention. According to the results of stress tests conducted by the Central Bank, the share of problem loans may increase several times, which in turn is a serious risk for the banking system..

Currently, the Ministry of Finance is tasked with strengthening control over banks as a shareholder in the supervisory board. A total of 14 foreign independent experts are involved in the supervisory board of state-owned banks, and by the end of the year, the Ministry of Finance aims to increase the share of foreign independent experts in the supervisory board of state-owned banks to 30%.

The goal is to effectively manage any business policy of banks (credit policy, exchange rate policy, etc.) and to create a system aimed at preventing corruption by the bank's management.

In this regard, a detailed analysis of problem loans by regions and the development of an effective mechanism to maintain the quality of the loan portfolio instructed the Central Bank to develop specific measures to restore the financial capacity of each client in difficult circumstances after the registration of loan portfolios of all commercial banks..

In particular, it is planned to take systematic measures to restore the activities of banks in each region and sector by allocating funds to replenish working capital to businesses in need of working capital, which are in a difficult financial situation during the pandemic. The goal is to restore jobs, create new jobs and, as a result, reduce poverty in our country.

At the same time, President Mirziyoyev said at a meeting on July 6, 2020 on the implementation of the strategy of reforming the banking system of the Republic of Uzbekistan for 2020-2025 and accelerating the transformation of commercial banks, aimed at increasing the share of the private sector in bank assets from 15% to 60%. criticized the still high share of government-funded funds in state-owned commercial banks, noting that banks should attract financial resources independently, without government support and assistance.

Currently, the share of such loans is 41% in Qishloq Qurilish Bank and 32% in Ipoteka Bank. Last year, banks received about \$ 600 million in state-guaranteed credit lines, while this year the figure is \$ 570 million. At the same time, the share of savings and time deposits of the population in large banks averages only 5 percent. In this regard, the Central Bank was instructed to develop additional proposals to attract deposits of commercial banks.

It is known that in order to ensure the implementation of the Presidential Decree "On the Strategy of Banking Reform in the Republic of Uzbekistan for 2020-2025" [1], the main directions of medium-term reforms in the banking sector are:

- ✓ Restructuring of the sector - change and privatization of banks;
- ✓ Improving the legal framework by introducing the standards of the Basel Committee on Banking Supervision, International Financial Reporting Standards, etc .;
- ✓ improvement and expansion of service quality through customer-oriented services, lending mechanisms and automation of business processes;
- ✓ Professional development.

Also, the goal of the strategy of reforming the banking system of the Republic of Uzbekistan by 2025 is to ensure the implementation of the following tasks:

Increase the share of non-state bank assets in the total assets of the banking system from the current 15% to 60% by 2025;

Increase the share of liabilities to the private sector in the total volume of bank liabilities from the current 28% to 70% by the end of 2025;

Attract at least three strategic foreign investors with the necessary experience, knowledge and prestige to at least three state-owned banks by 2025;

Increase the share of non-bank credit institutions in total lending from the current 0.35% to 4% by 2025.

Globally, each country is implementing different solutions to the corona virus pandemic based on its capabilities and situation. It is not an easy task to determine which of the proposed directions is the most effective. Therefore, the government of our country, along with monitoring the world experience, is developing practical measures to overcome the crisis quickly and effectively within our capabilities:

President of the Republic of Uzbekistan Shavkat Mirziyoyev praised the stable functioning of the banking system and the economy in the context of the corona virus pandemic

stressed the need for a critical review of banks 'project portfolios, given the emerging crisis in the global economy, in order to ensure that they are financially viable.

In this regard, banks were advised to prioritize the allocation of funds to small businesses to



create new jobs and self-employment at home.

- Given that the work in the agricultural sector has not stopped even during the quarantine period, it was noted that commercial banks attached to the agricultural sector should now increase the number of new projects.
- The Central Bank has been instructed to ensure the allocation of 30 trillion soums of working capital through banks so that the activities of manufacturing enterprises do not stop. It was noted that, if necessary, enterprises should be provided with loans to pay salaries.
- Tasks have also been set to expand the range and coverage of remote services.

### **Conclusions and suggestions**

In general, the digital development of the financial system will accelerate in the coming decades as well, and reliable management of the digital transformation in the banking sector will become an integral advantage in a competitive environment.

Despite the existing difficulties in our country due to the pandemic and quarantine, no existing system has stopped, and the banking system has expanded the possibilities of conducting online remotely.

Therefore, in the current situation, it is more important than ever for banks to develop innovative strategies, as well as to expand the resource base and increase the level of capitalization, to offer new banking products based on IT technologies..

1. In world practice, global relations have led to the rapid development of financial technologies, the emergence of new P2P-lending, online scoring, algorithmic trading and similar services.
2. In Uzbekistan, the possibility of real-time banking operations for customers through mobile applications, introduced by commercial banks together with software developers.
3. In summary, in the current context of the COVID 19 corona virus pandemic, special attention should be paid to accelerating the process of transformation in the banking sector, as well as accelerating the integration of the Uzbek banking system into global financial markets:
4. Changing the way banks work, developing their own customer-oriented strategy;
5. Critical study of problem loans during the pandemic, analysis of the financial population of the bank's customers in remote areas, an individual approach to each client;
6. Introduction of innovative new types of online delivery of quality banking services to the population with the development of information technology and communication;
7. Saving time and costs in the implementation of digital banking financial services through mobile and online platforms, ensuring the security of personal data, improving the speed and quality of services;
8. Allocation of funds to replenish working capital of economic entities whose financial situation has deteriorated during the pandemic, thereby restoring jobs, taking measures to reduce poverty in the country;
9. In-depth study and in-depth analysis of program and project funding;
10. Evaluate and monitor the activities of employees in the banking system through the KPI

system, provide them with material and moral incentives or vice versa;

11. Creating an effective mechanism to combat corruption in the banking system.

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