



## **THEORETICAL FOUNDATIONS OF INCREASING THE CAPITALIZATION LEVEL OF COMMERCIAL BANKS**

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<b>ABSTRACT</b>	<b>KEY WORDS</b>
This article discusses safe and effective approaches to increasing the capitalization level of commercial banks. In addition, the study analyzes the volume and dynamics of the capital of commercial banks in the Republic of Uzbekistan, as well as the share of authorized capital in the banks' equity structure. Based on the analysis, relevant conclusions and recommendations are provided.	Commercial banks, capitalization level, resource base, capital, authorized capital.

### **Introduction**

In the Action Strategy for the Further Development of the Republic of Uzbekistan, increasing the capitalization level and deposit base of banks, as well as strengthening their financial stability and reliability, have been identified as one of the priority tasks [1]. In order to ensure the timely and effective implementation of these objectives, the Decree of the President of the Republic of Uzbekistan No. PF-5992, dated May 12, 2020, "On the Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020-2025," established a gradual increase in the minimum authorized capital of banks to UZS 500 billion by 2025 [2].

At present, however, there remain a number of issues that need to be addressed in order to improve the capitalization level of commercial banks in the country. In particular, the relatively low level of capitalization of commercial banks, the substantial allocation of state budget funds to support banks in recent years, the limited participation of commercial banks in the stock market as both issuers and investors, the insufficient quality of banking services provided to customers, the weakness of the resource base, and the low share of bank capital in GDP are among the key challenges facing the banking sector.

### **Literature Review**

The concept of "capitalization level" and the issues related to its enhancement have been widely examined in the existing economic literature by foreign scholars and practitioners, who have proposed various definitions and approaches.

According to A. B. Borisov in the Great Economic Dictionary, capitalization refers to the increase in a bank's capital generated through the issuance and sale of securities, as well as through the allocation of a portion of its earnings to reserve funds [3].

A. S. Klimov defines capitalization as the market value of a credit institution's capital, calculated as the product of the number of shares outstanding and their market price [4]. This approach emphasizes the market-based assessment of a bank's capital rather than its accounting value.

Professor A. Omonov, in his doctoral dissertation entitled "Issues of Effective Management of Commercial Bank Resources," provides a comprehensive classification of the factors influencing the capitalization level of commercial banks [5]. His research highlights the significance of internal financial resources, profitability, asset quality, and resource management in strengthening bank capital. Similarly, I. B. Tursunov, in his research, substantiates that the capitalization level of a particular bank is largely determined by the absolute size of its equity capital [6]. According to the author, the growth of a bank's own capital serves as the primary foundation for enhancing its capitalization level and ensuring long-term financial stability.

## Research Methodology

In preparing this article, practical data related to improving the capitalization level of commercial banks were analyzed. All information used in the study was examined by the author based on current legislation and statistical indicators published by the Central Bank of the Republic of Uzbekistan. The research employed methods such as grouping, comparison, a systematic approach, and structural analysis.

## Analysis and Results

In international theory and practice, two main approaches are distinguished in interpreting the concept of capitalization [4].

The first approach is closely associated with the stock market, within which market capitalization is considered the value of a company's securities based on stock exchange quotations. The second approach defines capitalization as the process of increasing capital through profit accumulation. This approach links capitalization to the amount of a financial institution's equity capital, as well as to the level of capital adequacy established under the internationally recognized Basel and Basel II agreements.

Taking into account the consequences of the global financial crisis, the Basel Committee on Banking Supervision approved the new Basel III framework in September 2010, under which capital requirements for financial institutions were significantly strengthened. In order to comply with the new regulations, banks were required to increase the Common Equity Tier 1 (CET1) capital adequacy ratio from 2 percent to 4.5 percent by 2019.

In addition, each bank is required to maintain a special capital conservation buffer equivalent to 2.5 percent of risk-weighted assets. According to the new requirements, the overall minimum requirement for core capital amounts to 7 percent. Furthermore, the minimum Tier 1 capital adequacy ratio was increased from 4 percent to 6 percent.

It should be emphasized that, under the revised rules, the capital of commercial banks must consist of no less than 50 percent common shares and retained earnings. Moreover, the Basel Committee recommends that the leverage ratio should not exceed 25 times the amount of capital. Although the Committee's decisions are advisory in nature for supervisory authorities, most developed countries have incorporated these recommendations almost entirely into their banking regulatory frameworks.

The issue of determining the adequate level of bank capital has long been the subject of academic research and debate between banks and regulatory authorities. While banks generally prefer to operate with a minimum level of capital in order to maximize profitability and support asset growth, supervisory authorities advocate for higher capital requirements to reduce the risk of bank failures.

At the same time, some researchers argue that bank failures are often the result of poor management practices rather than insufficient capital, suggesting that well-managed banks can operate successfully even with relatively lower capital ratios. In international practice, the amount of authorized capital is generally not restricted by law. However, to ensure the stability of the banking system, regulatory authorities establish minimum capital requirements for commercial banks.

There is no universally accepted approach to determining the minimum capital level of banks. Historical, legal, and economic factors influence national regulatory frameworks, and therefore banking licensing practices vary significantly across countries. Minimum capital requirements are particularly common in many Asian countries (see Table 1).

**Table 1. Minimum Equity Capital Requirements for Banks in Selected Countries with the Highest Regulatory Thresholds (as of January 1, 2020, EUR million)**

Country	Domestic Banks	Foreign Banks	Branches of Foreign Banks
Singapore	722,8	722,8	96,4
Malaysia	392,6	58,9	-
Indonesia	211,8	211,8	211,8
Taiwan	204,9	204,9	3,1
Bahrain	175,4	66,0	-
Kuwait	173,5	173,5	34,7
Nigeria	111,7	111,7	111,7
Thailand	99,6	79,2	
Israel	99,2	99,2	
China	96,8	29,0	

The countries of the European Union have taken a leading position in standardizing the minimum level of bank capital. A common requirement for private capital has been established across EU member states, setting the minimum amount at no less than EUR 5 million. The widespread adoption of this European standard has resulted in most countries around the world establishing minimum capital requirements ranging from EUR 1 million to EUR 5 million.

In general, international experience in regulating capitalization levels leads to several important conclusions. First, licensing requirements related to the minimum capital of banks fall within the exclusive authority of the central bank or financial mega-regulator. Second, in approximately half of the countries, quantitative licensing requirements are denominated in euros in order to prevent the depreciation of monetary thresholds over time. Third, where multiple types of credit institutions operate within a country, differentiated capital requirements are applied according to the nature and scope of their activities.

In recent years, special attention has been paid to increasing the capitalization level of banks in Uzbekistan. In this regard, a number of Presidential Decrees and Resolutions of the Republic of Uzbekistan have been adopted to strengthen the capital base of commercial banks, improve their financial stability, and ensure compliance with international banking standards.

**Table 2. Evolution of Minimum Authorized Capital Requirements for Commercial Banks in the Republic of Uzbekistan**

Date	For joint-stock commercial banks	For banks opening with foreign capital participation	For private banks
January 1, 1998	Equivalent of \$1.5 million USD in soum	Equivalent of \$5.0 million USD in soum	Equivalent of \$0.3 million USD in soum
January 1, 1999	Equivalent of \$2.0 million USD in soum	Equivalent of \$5.0 million USD in soum	Equivalent of \$0.3 million USD in soum
January 1, 2000	Equivalent of \$2.5 million USD in soum	Equivalent of \$5.0 million USD in soum	Equivalent of \$0.3 million USD in soum
January 1, 2002	Equivalent of \$2.5 million USD in soum	Equivalent of \$5.0 million USD in soum	Equivalent of \$1.25 million USD in soum
January 1, 2005	Equivalent of \$5.0 million USD in soum	Equivalent of \$5.0 million USD in soum	Equivalent of \$2.5 million USD in soum
January 1, 2008	Equivalent of €5.0 million in soum	Equivalent of €5.0 million in soum	Equivalent of €2.5 million in soum
January 1, 2011	Equivalent of €10.0 million in soum	Equivalent of €10.0 million in soum	Equivalent of €5.0 million in soum
October 1, 2017	100 billion soum		
September 1, 2023	200 billion soum		
April 1, 2024	350 billion soum		
January 1, 2025	500 billion soum		

It is known that, starting from September 1, 2023, the minimum amount of authorized capital for banks must be UZS 200 billion [12]. The corresponding legislative amendments were adopted in October 2022 and entered into force in April 2023. According to the amendments introduced by the Central Bank to Article 13 of the Law “On Banks and Banking Activities,” the minimum amount of authorized capital was set at UZS 200 billion from September 1, 2023, and is to be gradually increased to UZS 500 billion by January 1, 2025. The Central Bank has emphasized its commitment to ensuring the strict implementation of these requirements. However, at present, not all commercial banks have fully formed the minimum authorized capital required by law.

**Conclusion and Recommendations**

In conclusion, commercial banks should actively seek opportunities to increase their authorized capital. Otherwise, failure to comply with the requirements established under Presidential Decree No. PF-5992 dated May 12, 2020, may hinder the achievement of the banking sector reform objectives. Such a situation could negatively affect the sustainability and future operations of certain commercial banks. The analysis indicates that domestic commercial banks must significantly increase their authorized capital within a relatively short period. Furthermore, there are several challenges associated with the placement of bank shares in the securities market. The average annual dividend yield offered by banks is generally comparable to deposit interest rates. Moreover, dividend payments are variable and may decline as a result of financial difficulties experienced by banks. In addition, the share of share premium (additional paid-in capital) within the capital structure of commercial banks remains insignificant. As

a result, bank shares are often traded at or near their nominal value in the securities market, while factors influencing their market value remain underdeveloped.

The conducted analysis leads to the following conclusions:

- A comprehensive regulatory and legal framework has been developed and adopted in Uzbekistan, creating favorable conditions for a significant increase in the capitalization level of banks.
- The market capitalization of domestic banks remains approximately five times lower than their total capital, indicating the underdevelopment of market-based valuation mechanisms.

Based on the findings of the study, the following scientifically grounded recommendations are proposed to enhance the capitalization level of commercial banks:

- It is advisable to introduce a risk-based model for assessing capital adequacy in commercial banks. Under the current framework, capital adequacy is primarily evaluated through general prudential standards. Therefore, the implementation of the Internal Capital Adequacy Assessment Process (ICAAP), which determines capital requirements based on asset quality, credit portfolio composition, and risk exposure, would enable a closer alignment between capital levels and economic risks.
- Commercial banks should increase the share of retained earnings allocated to capitalization. This requires revising dividend policies and establishing mechanisms that direct a portion of profits toward capital growth. Such measures would strengthen capitalization through internal funding sources.
- The use of capital market instruments for increasing authorized capital should be expanded. In particular, the development of Initial Public Offerings (IPOs) and Secondary Public Offerings (SPOs) would facilitate the attraction of domestic and foreign investment, ensuring sustainable capital growth and reducing dependence on government support.
- It is recommended that commercial banks increase the issuance of subordinated bonds. These instruments provide access to long-term financial resources and contribute to the expansion of Tier 2 capital, thereby improving capital adequacy indicators and strengthening financial resilience.

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