OPEN ACCESS

Global Journal of Research in Business Management
ISSN: 2583-6218 (Online)
Volume 06 | Issue 02 | March-April | 2026
Journal homepage: https://gjrpublication.com/gjrbm/

Research Article

Credit Portfolio Quality, Risk Governance, and Financial Stability: Evidence from Uzbekistan's Commercial Banks

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DOI: 10.5281/zenodo.19470434 **Submission Date: 25 Feb. 2026 | Published Date: 08 April 2026**

Abstract

Background: Maintaining high credit portfolio quality is essential for ensuring banking sector resilience and macro-financial stability, particularly in emerging economies undergoing structural reforms. Uzbekistan's banking sector has experienced rapid transformation since 2017, yet asset quality challenges persist. Purpose: This study investigates the impact of risk governance mechanisms on credit portfolio quality and examines how improvements in asset quality contribute to financial stability in Uzbekistan's commercial banks.

Methods: Using balanced panel data for 20 commercial banks over the period 2015–2023, the study applies fixed-effects panel regression models. Credit portfolio quality is proxied by the inverse non-performing loan (NPL) ratio, while risk governance is measured through a constructed Risk Governance Index (RGI). Financial stability is assessed using the Z-score indicator. Robust standard errors and Hausman specification tests ensure model validity.

Results: Empirical findings indicate that risk governance significantly improves credit portfolio quality ($\beta = 0.42$, $p < 0.01$). A 1% increase in the Risk Governance Index reduces NPL ratios by approximately 0.38%. Furthermore, improved credit portfolio quality significantly enhances banking stability ($\alpha = 0.55$, $p < 0.01$). The model explains 61% of within-bank variation ($R^2 = 0.61$).

Implications: Strengthening governance frameworks and regulatory oversight can substantially enhance banking stability in transition economies. The findings provide policy-relevant insights for financial sector reform in Uzbekistan and comparable emerging markets.

Keywords: *Credit portfolio quality; Risk governance; Financial stability; Emerging markets; non-performing loans; Banking reforms; Panel data analysis.*

1. INTRODUCTION

The global banking sector has undergone profound transformation since the 2008 financial crisis. Strengthened capital requirements, enhanced risk governance standards, and improved supervisory mechanisms under Basel III have redefined banking risk management practices. Despite these reforms, asset quality deterioration remains one of the primary triggers of financial instability worldwide.

Emerging economies face unique vulnerabilities. Rapid credit expansion, limited risk assessment capacity, and institutional weaknesses often lead to rising non-performing loans (NPLs). Empirical studies confirm that poor credit portfolio quality significantly increases systemic risk exposure.

Uzbekistan's banking system has experienced structural reform since 2017, including: Banking privatization initiatives; Governance modernization; Adoption of international financial reporting standards (IFRS); Strengthening of supervisory oversight.

However, credit concentration and governance heterogeneity remain significant challenges.

While global literature extensively examines banking stability determinants, there is limited empirical research investigating: The governance–credit quality nexus in Central Asian economies; Panel-based bank-level evidence for Uzbekistan.

• The mediating role of asset quality in financial stability.
This study fills this gap.
H1: Risk governance significantly improves credit portfolio quality.
H2: Higher credit portfolio quality enhances financial stability.
H3: Credit portfolio quality mediates the relationship between governance and
To empirically evaluate the interaction between risk governance, credit portfolio quality, and financial stability in Uzbekistan.

Objectives: assess credit portfolio trends (2015–2023); construct a risk governance index; estimate governance effects using panel econometrics; analyze stability transmission mechanisms; provide policy recommendations.

LITERATURE REVIEW

Altman (1968) introduced bankruptcy prediction models.

Merton (1974) developed structural credit risk theory. Stiglitz & Weiss (1981) demonstrated credit rationing under asymmetric information. Diamond (1984) highlighted monitoring functions of banks. These theories establish that governance and monitoring directly affect portfolio risk.

Laeven & Levine (2009) show governance affects risk behavior.

Ellul & Yerramilli (2013) find stronger risk management reduces risk exposure. Beltratti & Stulz (2012) emphasize governance failures in crisis periods. These findings support governance as a determinant of asset quality.

Beck et al. (2010) link institutional quality with banking stability.

Nkusu (2011) (IMF WP/11/161). Klein (2013). Despite strong theoretical foundations, there is: Limited evidence from Central Asia; Lack of governance index integration. Insufficient mediation analysis. This study contributes methodologically and regionally.

MATERIALS AND METHODS

3.1. Experimental Design and Study Sample

This study employs a quantitative, explanatory research design aimed at identifying causal relationships between risk governance mechanisms, credit portfolio quality, and financial stability in commercial banks operating in Uzbekistan. The research design is based on panel data econometric analysis, allowing for the examination of both cross-sectional (bank-level) and temporal (time-series) variations.

The study sample consists of 20 commercial banks operating in Uzbekistan during the period 2015–2023. The selection of banks is determined by data availability, continuity of financial reporting, and representativeness within the national banking system. The sample includes both state-owned and private commercial banks to ensure structural heterogeneity.

The observation period (2015–2023) was chosen for three main reasons:
1. It captures the pre-reform and post-reform phases of Uzbekistan's banking sector transformation initiated in 2017.
2. It includes macroeconomic shocks such as the COVID-19 pandemic.
3. It allows sufficient time variation to conduct robust panel estimation.

The final dataset is a balanced panel comprising 180 bank-year observations. Financial data were collected from the Central Bank of Uzbekistan, annual bank reports, IMF Financial Soundness Indicators (FSI), and World Bank databases.

Credit Portfolio Quality (CPQ) is measured as the inverse of the Non-Performing Loan (NPL) ratio:

$$CPQ_{it} = \frac{1}{NPL_{it}}$$

Where:
NPL represents the ratio of non-performing loans to total loans for bank *i* in year *t*.
The inverse transformation is applied to ensure that higher values correspond to better asset quality. The NPL ratio is widely used in the literature as a proxy for credit risk (Beck et al., 2010; Klein, 2013). It is selected due to its transparency, regulatory relevance, and comparability across banks.

Risk governance is measured using a composite Risk Governance Index (RGI), constructed from publicly available data. The index includes the following components: Presence of a dedicated risk committee; Share of independent board members; Adoption of IFRS standards; Internal audit transparency; Risk disclosure quality.

Each component is scored on a binary or scaled basis and aggregated into a normalized index ranging from 0 to 1.

The rationale for constructing an index rather than using a single proxy lies in the multidimensional nature of governance. Prior studies (Ellul & Yerramilli, 2013; Laeven & Levine, 2009) highlight that governance quality cannot be captured by one indicator alone.

To isolate the governance effect, several control variables are included: Capital Adequacy Ratio (CAR) – measures bank solvency and regulatory compliance; Return on Assets (ROA) – reflects profitability and operational efficiency; GDP Growth Rate – captures macroeconomic conditions; Inflation Rate – controls for macroeconomic instability.

These controls are commonly used in banking stability literature (Nkusu, 2011; Beck et al., 2010).
To estimate the impact of risk governance on credit portfolio quality, the following baseline model is specified:

$$CPQ_{it} = \beta_0 + \beta_1 RGI_{it} + \beta_2 CAR_{it} + \beta_3 ROA_{it} + \beta_4 GDP_t + \beta_5 INF_t + \varepsilon_{it}$$

Where:

- i = bank
- t = year
- ε_it = error term

Panel regression is selected because it allows controlling for unobserved heterogeneity across banks and over time. Compared to cross-sectional analysis, panel data improves estimation efficiency and reduces omitted variable bias.

Both Fixed Effects (FE) and Random Effects (RE) models were estimated. The Hausman specification test was conducted to determine the appropriate estimator. The test results indicate statistical significance ($p < 0.05$), supporting the use of the Fixed Effects model.

The Fixed Effects approach is preferred because:

1. It controls for time-invariant bank-specific characteristics.
2. It reduces endogeneity related to omitted structural factors.
3. It is widely used in banking panel studies.

Robust standard errors clustered at the bank level are applied to address heteroskedasticity.

To evaluate the relationship between credit portfolio quality and financial stability, the following model is estimated:

$$Zscore_{it} = \alpha_0 + \alpha_1 CPQ_{it} + \alpha_2 CAR_{it} + \mu_{it}$$

The Z-score is calculated as:

$$Zscore = \frac{ROA + CAR}{\sigma(ROA)}$$

The Z-score measures the distance to default and is widely used as an indicator of banking stability.

The following tests were conducted: Variance Inflation Factor (VIF) – multicollinearity; Wooldridge test – serial correlation; Breusch–Pagan test – heteroskedasticity; Hausman test – model specification. All diagnostic results confirm model adequacy.

The study follows a two-stage empirical strategy:
Stage 1: Estimate the effect of risk governance on credit portfolio quality. Stage 2: Assess the effect of credit portfolio quality on financial stability. This sequential modeling approach allows testing both direct and indirect effects, consistent with the mediation hypothesis. The empirical design ensures: Cross-sectional comparability across banks. Time-series consistency, Robust econometric inference.

Results

Table 1 presents descriptive statistics for all variables included in the analysis. The balanced panel dataset consists of 180 observations (20 banks × 9 years, 2015–2023).

Table 1. Descriptive Statistics

Variable	Obs.	Mean	Std. Dev.	Min	Max
CPQ (1/NPL)	180	12.84	5.21	4.32	26.45
NPL (%)	180	8.11	3.74	3.78	23.15
RGI	180	0.61	0.18	0.22	0.91
CAR (%)	180	18.72	4.36	11.2	29.8
ROA (%)	180	2.34	1.02	-1.8	5.6
GDP Growth (%)	180	5.48	1.89	-0.2	8.1
Inflation (%)	180	12.6	4.12	7.5	18.9
Z-score	180	15.37	6.28	5.12	31.44

Note: CPQ is calculated as the inverse of the NPL ratio. RGI ranges from 0 to 1. Z-score measures banking stability.

The standard deviation of CPQ (5.21) indicates moderate dispersion across banks and years. The Risk Governance Index exhibits variability (SD = 0.18), suggesting heterogeneity in governance practices. Table 2 reports Pearson correlation coefficients.

Table 2. Correlation Matrix

Variable	CPQ	RGI	CAR	ROA	GDP	INF	Z-score
CPQ	1.00	0.48	0.31	0.42	0.27	-0.19	0.53
RGI	0.48	1.00	0.29	0.36	0.18	-0.11	0.44
CAR	0.31	0.29	1.00	0.40	0.21	-0.14	0.47
ROA	0.42	0.36	0.40	1.00	0.33	-0.22	0.61
GDP	0.27	0.18	0.21	0.33	1.00	-0.45	0.25
INF	-0.19	-0.11	-0.14	-0.22	-0.45	1.00	-0.28
Z-score	0.53	0.44	0.47	0.61	0.25	-0.28	1.00

Note: None of the correlation coefficients exceed 0.70, indicating absence of severe multicollinearity.

Table 3 presents fixed-effects estimation results for the impact of risk governance on credit portfolio quality.

Table 3. Fixed Effects Regression Results (Dependent Variable: CPQ)

Variable	Coefficient	Std. Error	t-statistic	p-value
RGI	0.42***	0.08	5.25	0.000
CAR	0.31**	0.12	2.58	0.011
ROA	0.28**	0.10	2.80	0.006
GDP	0.19*	0.09	2.11	0.036
INF	-0.17*	0.08	-2.02	0.045
Constant	3.42	1.21	2.82	0.005

Model statistics: Observations: 180, Number of banks: 20, R^2 (within): 0.61, F-statistic: 22.84 ($p < 0.001$), Hausman test: $\chi^2 = 14.67$ ($p = 0.021$), VIF (mean): 2.14. Note: *, **, *** denote significance at 10%, 5%, and 1% levels respectively. Table 4 reports the regression results for the financial stability model.

Table 4. Fixed Effects Regression Results (Dependent Variable: Z-score)

Variable	Coefficient	Std. Error	t-statistic	p-value
CPQ	0.55***	0.09	6.11	0.000
CAR	0.33**	0.13	2.54	0.012
Constant	2.78	0.94	2.96	0.004

Model statistics: Observations: 180, R^2 (within): 0.58, F-statistic: 27.15 ($p < 0.001$), Wooldridge test: $p = 0.31$, Breusch–Pagan test: $p = 0.28$. Note: Robust standard errors clustered at the bank level.

Elasticity Estimates. Elasticity of CPQ with respect to RGI:

$$E = \beta_1 \times \frac{R\bar{G}I}{C\bar{P}Q} = 0.42 \times \frac{0.61}{12.84} = 0.38$$

A 1% increase in RGI is associated with a 0.38% improvement in credit portfolio quality.

Summary of Statistical Indicators: Sample size: 180 observations; Cross-sectional units: 20 banks; Time dimension: 9 years; Dispersion index (CPQ variance): 27.14; Multicollinearity: VIF < 5; Serial correlation: Not detected; Heteroskedasticity: Not significant.

5. Discussion

This study examined the relationship between risk governance mechanisms, credit portfolio quality, and financial stability in Uzbekistan's commercial banking sector over the period 2015–2023. Using a balanced panel dataset of 20 banks and applying fixed-effects regression models, the research aimed to identify whether improvements in governance structures contribute to asset quality enhancement and whether improved credit portfolio quality strengthens financial stability.

The empirical strategy was designed to test both direct and indirect relationships, allowing assessment of governance effects on credit risk and the subsequent impact on banking system resilience.

The results demonstrate that risk governance has a statistically significant positive effect on credit portfolio quality. The coefficient of the Risk Governance Index ($\beta = 0.42$, $p < 0.01$) indicates that stronger governance frameworks are associated with lower non-performing loan ratios. This finding is consistent with Laeven and Levine (2009), who showed that governance structures influence bank risk-taking behavior, and Ellul and Yerramilli (2013), who found that stronger risk management functions reduce institutional risk exposure.

The elasticity estimate (0.38) suggests a meaningful economic effect, confirming that governance reforms can generate measurable improvements in asset quality. This result aligns with evidence from emerging markets reported by Beck et al. (2010) and Klein (2013), where institutional and supervisory quality were found to be key determinants of credit risk.

The second-stage regression indicates that credit portfolio quality significantly improves financial stability, as measured by the Z-score ($\alpha = 0.55$, $p < 0.01$). This finding supports the theoretical framework proposed by Acharya et al. (2010) and Adrian and Brunnermeier (2016), who emphasized that asset quality deterioration contributes to systemic risk accumulation. The empirical results confirm that improved asset quality enhances banks' distance to default.

However, the magnitude of the governance effect in Uzbekistan appears lower than reported in studies focusing on EU banking systems. This may reflect structural differences, including higher state ownership, credit concentration in strategic sectors, and transitional regulatory frameworks. These structural characteristics may limit the speed and depth of governance effectiveness.

Despite the positive governance effect, several challenges remain:

1. Heterogeneity in governance implementation across banks suggests uneven reform progress.
2. Macroeconomic variables such as inflation show negative associations with credit quality, indicating continued vulnerability to external shocks.
3. Capital adequacy, although significant, does not fully offset asset quality deterioration risks in stress periods.

These findings suggest that governance reform alone may be insufficient without broader institutional strengthening.

Several limitations should be acknowledged: The Risk Governance Index is constructed from publicly available disclosures and may not fully capture internal risk culture; The study does not incorporate dynamic endogeneity correction methods such as System GMM; The sample is limited to Uzbekistan, which may affect external generalizability; Sectoral loan composition and credit concentration effects were not separately modeled.

Future research could incorporate cross-country panel comparisons, dynamic panel estimation techniques, and bank-level stress-testing simulations. This study contributes to the existing literature by: Providing the first panel-based empirical evidence for Uzbekistan. Integrating governance metrics with credit risk and stability measures. Demonstrating the mediating role of asset quality in financial stability transmission. The results extend governance-risk literature into the Central Asian context and provide empirical support for continued banking sector reform.

Conclusion

This study addressed the problem of improving credit portfolio quality and strengthening financial stability in Uzbekistan's commercial banking sector under conditions of structural transformation and regulatory reform. Given the central role of banks in financial intermediation in emerging economies, deteriorating asset quality poses systemic risks that may undermine macroeconomic stability. The research sought to determine whether enhanced risk governance mechanisms contribute to improved credit portfolio quality and whether improved asset quality strengthens financial stability.

Using panel data from 20 commercial banks over the period 2015–2023, the empirical analysis confirmed that risk governance significantly improves credit portfolio quality. Furthermore, the results demonstrate that stronger asset quality contributes positively to financial stability, measured by the banking Z-score indicator. The findings provide quantitative evidence supporting the importance of governance reforms in transitional financial systems.

First, regarding the objective of assessing credit portfolio trends, the descriptive analysis revealed moderate variability in NPL ratios across banks and over time, indicating heterogeneity in credit risk exposure within the sector.

Second, in line with the objective of evaluating the impact of governance mechanisms, the econometric results confirmed Hypothesis 1: risk governance has a statistically significant positive effect on credit portfolio quality. The Risk Governance Index demonstrated both statistical and economic significance, indicating that improvements in governance structures are associated with measurable reductions in credit risk.

Third, addressing Hypothesis 2 and the objective of assessing financial stability implications, the findings show that improved credit portfolio quality significantly enhances banking stability. The positive relationship between CPQ and the Z-score confirms that stronger asset quality increases banks' resilience and reduces default probability.

Fourth, the mediation mechanism proposed in Hypothesis 3 is supported by the sequential modeling approach, which indicates that governance contributes to financial stability indirectly through improvements in credit portfolio quality.

Overall, the study confirms that strengthening governance frameworks, enhancing transparency, and institutionalizing risk oversight mechanisms are critical factors for improving asset quality and promoting financial stability in emerging banking systems. While Uzbekistan has made measurable progress in banking sector reform, continued efforts toward governance harmonization and supervisory strengthening remain essential.

The empirical results contribute to the broader literature on banking governance and risk management by extending evidence to a transitional Central Asian economy and by integrating governance metrics with asset quality and stability indicators within a unified panel data framework.

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CITATION

Juraeva, N. F. (2026). Credit Portfolio Quality, Risk Governance, and Financial Stability: Evidence from Uzbekistan's Commercial Banks. Global Journal of Research in Business Management, 6(2), 61–67. https://doi.org/10.5281/zenodo.19470434