International Congress on Economics, Management and Business Studies
Hosted Online from New York, USA
Date: 23rd June , 2026
Website: https://econferencia.com

THE IMPACT OF CORPORATE GOVERNANCE MECHANISMS ON CREDIT RISK MANAGEMENT EFFICIENCY IN COMMERCIAL BANKS

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Abstract

This paper investigates how individual corporate governance mechanisms affect the efficiency of credit risk management in commercial banks. Departing from studies that treat credit risk solely as an outcome level, the paper defines risk management efficiency as the ability of a bank to convert its risk-governance resources into superior credit quality relative to a best-practice frontier. Governance mechanisms are decomposed into board-level, committee-level, executive-level, and disclosure-level components, and their marginal contribution to efficiency is assessed. A two-stage methodology combining frontier efficiency estimation with regression analysis is proposed and discussed in the context of the Uzbek banking sector.

Keywords: Corporate governance mechanisms, credit risk management, efficiency, supervisory board, risk committee, chief risk officer, non-performing loans, data envelopment analysis.

1. Introduction

Credit risk management is conventionally evaluated by the level of realised losses — the share of non-performing loans, the volume of provisions, or the adequacy of capital buffers. Such measures, however, conflate two distinct things: the risk environment a bank operates in and the quality of the managerial system that responds to it. A bank operating in a difficult segment may report elevated losses while managing risk competently; another may report low losses simply because it lends conservatively at the cost of foregone business. What matters analytically is efficiency — how well a bank converts its risk-governance capacity into credit quality relative to what is attainable.

Corporate governance supplies precisely that capacity. The supervisory board sets risk appetite and holds executives accountable; the risk committee translates appetite into limits and monitors exposures; the chief risk officer maintains an independent challenge to business lines; internal audit verifies that controls function; and disclosure exposes all of this to external discipline. Each of these mechanisms carries organisational cost, and each is expected to yield a return in the form of better risk outcomes. Yet the literature rarely asks which mechanisms actually deliver that return, and under what conditions.

The Uzbek banking sector provides a relevant setting. Central Bank data indicate that the share of non-performing loans across the system declined from 4.0 to 3.0 per cent during 2025, while the aggregate loan portfolio grew by more than 13 per cent to exceed 604 trillion soums. Behind these aggregates lies substantial dispersion across institutions: some banks reduced double-digit NPL ratios to below five per cent within a single year, while others improved only marginally. Such heterogeneity, occurring under a common macroeconomic and regulatory environment, points to differences in managerial efficiency rather than in external conditions — and makes the mechanism-level question both tractable and worth asking.

2. Conceptual framework

The study rests on three theoretical foundations. Agency theory identifies the monitoring problem that governance mechanisms exist to solve: without effective oversight, managers may accept risk whose consequences fall on depositors and the state rather than on themselves. The Basel Committee's corporate governance principles for banks convert this insight into institutional requirements, notably board accountability for risk appetite, an independent risk-management function, and the "three lines of defence" architecture. Efficiency theory, finally, supplies the measurement logic: a bank's performance should be judged against a frontier of best attainable practice rather than against an absolute threshold.

Combining these yields the paper's central construct. **Credit risk management efficiency** is defined as the ratio of realised credit-quality outcomes to the outcomes achievable by a best-practice bank endowed with comparable resources, portfolio composition, and operating environment. Governance mechanisms enter not as determinants of the risk level directly, but as factors explaining a bank's distance from that frontier.

Table 1 summarises the mechanisms examined and their proposed empirical indicators.

Governance level	Mechanism	Proposed indicator
Board	Supervisory board independence and competence	Share of independent members; share with financial/risk expertise; meeting frequency
Committee	Risk committee effectiveness	Existence; number of sittings per year; independence of chair
Executive	Chief risk officer independence	Direct reporting line to the board; participation in credit decisions; tenure
Control	Internal audit and control quality	Audit function independence; frequency of credit-process reviews
Disclosure	Transparency of risk reporting	Scope of risk disclosure in annual reports; IFRS reporting; external audit quality

3. Research problem and hypotheses

The research problem is the absence of an efficiency-based framework capable of identifying which corporate governance mechanisms contribute most to credit risk management performance, as opposed to establishing an undifferentiated association between "good governance" and low risk. The following hypotheses are proposed:

H1: Board independence and risk-related board expertise are positively associated with credit risk management efficiency.

H2: An active and independently chaired risk committee raises efficiency more than the mere formal existence of such a committee.

H3: Chief risk officer independence, expressed through a direct reporting line to the supervisory board, is positively associated with efficiency.

H4: Higher risk-disclosure quality is associated with higher efficiency, with the effect strengthening as external market discipline increases.

H5: The marginal effect of governance mechanisms is greater for banks operating further from the efficiency frontier.

4. Methodology

A two-stage design is proposed. In the first stage, relative efficiency scores are estimated for each bank using non-parametric frontier analysis (data envelopment analysis), with risk-management inputs — staffing and expenditure of the risk function, provisioning, and capital allocated to credit risk — mapped against outputs reflecting credit quality and portfolio performance. Stochastic frontier estimation is used as a robustness check, since it separates managerial inefficiency from random noise.

In the second stage, the estimated efficiency scores are regressed on the governance indicators set out in Table 1, using a truncated or fractional regression specification appropriate to bounded dependent variables. Control variables include bank size, ownership form, portfolio concentration, and macroeconomic conditions. Panel data covering commercial banks over a multi-year window are drawn from Central Bank statistics, audited financial statements, and banks' governance and disclosure reports; the qualitative governance indicators are coded through structured content analysis of annual reports supplemented by expert assessment.

5. Expected results and scientific novelty

The expected contribution is threefold. Methodologically, the paper introduces an efficiency-based measure of credit risk management that separates managerial quality from environmental conditions — a distinction absent from studies relying on raw NPL ratios. Empirically, it produces a ranking of governance mechanisms by their marginal contribution to efficiency, allowing reform effort to be directed where returns are highest rather than spread evenly across formal requirements. Practically, it yields a diagnostic instrument through which a bank can locate its distance from the frontier and identify the specific governance deficiencies accounting for that gap.

6. Conclusion

Treating credit risk management as a question of efficiency rather than of loss levels changes what governance research can say to practitioners. It permits the claim that a given mechanism — an independently chaired risk committee, a chief risk officer reporting directly to the board — produces a measurable improvement in the conversion of risk-management resources into credit quality, holding the operating environment constant. For banking systems undergoing institutional reform, where governance requirements are frequently satisfied in form while remaining weak in substance, this distinction is consequential: it identifies which arrangements function and which are merely declared. The subsequent stage of the research will implement the two-stage estimation on bank-level data and formulate recommendations for strengthening the mechanisms shown to matter most.

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