

THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE QUALITY AND BANK FINANCIAL STABILITY

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ABSTRACT

This theoretical article examines the relationship between corporate governance quality and bank financial stability. Because banks are characterized by high leverage, informational opacity, the interests of depositors and systemic importance, their corporate governance differs fundamentally from that of ordinary firms. Drawing on agency theory, stakeholder theory, stewardship theory and information-asymmetry theory, the article systematizes the channels through which corporate governance affects financial stability, namely board effectiveness, ownership structure, risk governance, transparency and incentives. The contested nature of this relationship – in particular the tendency of strongly shareholder-oriented governance to increase risk-taking under deposit insurance – is analyzed in the light of the 2008 global financial crisis. In the context of Uzbekistan's banking system, the governance models of state-owned and private banks are compared, and a conceptual model together with a set of recommendations is proposed.

KEYWORDS: Corporate Governance, Financial Stability, Agency Theory, Stakeholders, Risk Governance, Board Independence, Transparency, Moral Hazard, State-Owned Banks, Banking System Of Uzbekistan.

1. INTRODUCTION

Corporate governance is the system of rules, practices and processes by which a bank's activities are directed and controlled; it determines on whose behalf, how and in whose interests the bank is managed. Financial stability, in turn, is the bank's capacity to remain solvent and liquid even under the impact of shocks and to continue its operations in a sustained and stable manner. The relationship between these two concepts is one of the central questions of both the theory and the practice of banking.

The 2008 global financial crisis demonstrated that the quality of corporate governance is a decisive factor in determining a bank's resilience to shocks. Strikingly, the crisis revealed that banks whose governance was best "aligned" with shareholder interests often performed worse during the crisis. This finding proved that the relationship between corporate governance and stability is not a simple linear one.

Following the crisis, international organizations — the Basel Committee, the OECD and the Financial Stability Board — substantially strengthened corporate governance standards for banks. In particular, specific requirements were introduced for risk governance, board independence, remuneration policy and transparency. This indicates that corporate governance is no longer merely an internal matter between shareholders and management but is increasingly regarded as a systemic instrument of financial stability.

This issue is highly relevant to banking practice in Uzbekistan. The high share of state-owned banks in the banking system (60–65 per cent), together with ongoing reforms aimed at transforming these banks, improving their corporate governance and privatising them, heightens this relevance. It is therefore important to understand, on a theoretical level, how and through which channels the quality of corporate governance affects financial stability.

The aim of this article is to analyze, on a theoretical level, the relationship between corporate governance quality and bank financial stability; to identify its transmission channels and its contradictory aspects; and to develop scientifically grounded proposals and recommendations for the banking system of Uzbekistan. The article is theoretical in nature and is based mainly on a review of the literature and a comparative conceptual approach.

In a broad sense, corporate governance is the totality of relationships between ownership rights, governing bodies (the supervisory board and the management board), control mechanisms and stakeholders. According to the definition of the OECD, corporate governance is the system of relationships between a company's management,

its board, its shareholders and other stakeholders; it provides the structure through which objectives are set and the means of attaining those objectives are determined.

The distinctive features of corporate governance in banks. Banks differ fundamentally from ordinary firms in three respects:

— First, high leverage: a large part of a bank's assets is financed through debt (deposits), so that even a small loss can rapidly erode its capital.

— Second, informational opacity: the quality of a bank's assets is difficult to assess from the outside.

— Third, depositors and systemic importance: the failure of a bank spreads to its depositors and to the entire system. For this reason, governance in banks must protect not only the interests of shareholders but also those of depositors, the regulator and society at large.

The theoretical roots of the corporate governance problem go back to work of Berle and Means (1932). Because ownership in large corporations is dispersed among numerous shareholders, effective control passes into the hands of management, and ownership becomes separated from control. In banks this problem is deepened further by the fact that depositors are numerous, but each has little ability or incentive to exercise control. Depositors are unable to monitor the bank's activities, and this task therefore falls upon the board and the regulator.

The concept of corporate governance quality is multidimensional and cannot be captured by any single indicator. It is expressed through a range of dimensions, including the composition and independence of the supervisory board, the ownership structure, the risk-governance system, internal and external audit, information disclosure, and the protection of the rights of shareholders and stakeholders. In international practice, various indices and ratings (for example, corporate governance indices) are constructed based on these dimensions. For banks, the Basel Committee and national regulators have established dedicated corporate governance principles.

The financial stability of banks is a multidimensional phenomenon, assessed through capital adequacy (CAR), asset quality (NPL), liquidity and stability of profitability. The quality of corporate governance exerts both direct and indirect effects on each of these dimensions. Good governance helps to identify risk early, to maintain capital and liquidity buffers, and to control the quality of the loan portfolio.

It should be emphasized that, in commercial banks, corporate governance and prudential regulation complement one another. Internal governance constitutes the internal control mechanism, while regulation constitutes the external control mechanism. Effective stability in banks is ensured precisely through the harmonization of these two mechanisms. For this reason, the quality of corporate governance cannot be analyzed in isolation from the regulatory environment.

2. LITERATURE REVIEW

Under conditions of the transformation of the modern banking system and of globalization, ensuring the financial stability of commercial banks is a key factor that determines the security not only of an individual credit institution but of the entire macroeconomic system of a country. A distinctive feature of banking activity is the management of the funds of depositors and creditors. For this reason, the introduction of an effective corporate governance system in banks is a scientifically and practically justified prerequisite for achieving financial stability. The principal theoretical approaches that explain the relationship between corporate governance and stability are as follows.

Agency theory. According to Jensen and Meckling (1976) and Shleifer and Vishny (1997), the separation of ownership and control gives rise to the "agency problem". Governance mechanisms such as board oversight, audit and disclosure reduce agency costs. In banks there is, in addition, a shareholder–depositor agency problem: under limited liability and deposit insurance, shareholders are inclined to take on excessive risk.

Stakeholder theory. According to the approach of Freeman (1984), a bank must consider the interests not only of shareholders but also of depositors, the regulator, employees and society. John, Saunders and Senbet argue that, for banks, it is precisely depositor-oriented governance that is superior in ensuring financial stability.

Stewardship theory. According to this approach, managers are by their nature "trustworthy stewards" who act in the interests of the organization, so that granting them broader authority may be effective. This offers an alternative view to that of agency theory.

Information-asymmetry theory. According to the work of Mishkin and Diamond, informational opacity in banking activity is a principal source of risk. Transparency and disclosure in banks strengthen market discipline and thereby reduce risk.

These approaches complement one another: agency theory emphasizes control and monitoring, stakeholder theory emphasizes in whose interest governance is exercised, and information-asymmetry theory emphasizes

transparency. For banks, a synthesis of these approaches is required, because governance that fails to protect the interests of depositors — however effective it may be for shareholders — poses a threat to systemic stability.

The relationship between corporate governance and financial stability is not unidirectional. According to the traditional view, good governance controls risk effectively and thereby enhances stability. However, modern studies that consider the specific features of banks show that this relationship may be ambiguous and even inverse.

The “shareholder-oriented governance” paradox. Laeven and Levine (2009) showed that banks with large and powerful shareholders take on more risk: under limited liability and deposit insurance, shareholders have an interest in increasing risk in pursuit of higher returns. Hence governance that “well” protects shareholder interests may weaken financial stability.

The lesson of the 2008 crisis. Beltratti and Stulz (2012), analyzing banks worldwide, found that banks whose governance was most closely “aligned” with shareholders before the crisis performed worse during the crisis. Pathan (2009) showed that a strong board and a weak chief executive reduce risk, whereas the reverse increases it. These findings confirm that the governance–stability relationship is not linear.

3. RESEARCH METHODOLOGY

Data sources and objects of study. The principal source used in the study is the official statistical data of the Central Bank of the Republic of Uzbekistan (for 2020–2025, with year-end figures taken). As the object of study, representatives of the medium-sized and small categories of banks — namely Aloqabank, Mikrokreditbank and Asia Alliance Bank — were selected.

4. ANALYSIS AND RESULTS

In banking legislation and in the prudential supervision system of the Central Bank, corporate governance is not merely a set of organizational and legal relationships, but a fundamental institutional mechanism that ensures the bank’s resilience to internal and external shocks. The capacity of banks to generate systemic risks determines the close link between the quality of corporate governance and financial stability.

The quality of corporate governance affects financial stability through several channels (Figure 1). This conceptual model links the dimensions of governance quality, through the transmission channels, to stability outcomes.

Corporate governance quality	Transmission channels	Financial stability
Board effectiveness and independence	Oversight and monitoring	Capital adequacy
Ownership structure (state vs. private)		Asset quality
Risk governance	Risk appetite	Non-performing loans
Transparency and disclosure		Liquidity
Incentive system	Market discipline	Profitability

Figure 1. Corporate governance quality and financial stability: a conceptual model¹

Board effectiveness. The studies of de Andres and Vallelado (2008) and Adams and Mehran (2012) showed that the independence of the supervisory board, the competence of its members and the existence of a risk committee are decisive for the effective control of bank risk. A strong and independent board ensures effective monitoring of management.

Ownership structure of banks. The degree of ownership concentration in banks, and whether ownership is state, private or foreign, has a marked effect on the bank’s risk appetite. This effect is two-sided: concentrated ownership may ensure effective control, but it may equally encourage the assumption of excessive risk.

Risk governance in banks. A dedicated chief risk officer (CRO), a risk committee, a risk appetite framework and an internal control system play a direct role in preventing losses. The Basel Committee’s corporate governance principles for banks (BCBS, 2015) define risk governance precisely as the core of the governance system.

Transparency and disclosure. Full and timely disclosure of information in banks strengthens market discipline. When investors and depositors can assess risk, the bank refrains from taking on excessive risk.

¹Compiled by the author on the basis of the research findings.

Incentive system in banks. If the bonus and remuneration structure of executives is oriented towards short-term profit, it encourages the assumption of excessive risk; incentives tied to long-term stability, by contrast, have the opposite effect.

Table 1

Analysis of the theoretical approaches to the link between corporate governance and financial stability in banks²

Theory	Representatives	Governance–stability link
Agency	Jensen–Meckling (1976); Shleifer–Vishny (1997)	Control mechanisms reduce agency costs and risk
Stakeholder	Freeman (1984); John et al.	Depositor-oriented governance enhances stability
Stewardship	Donaldson–Davis (1991)	The manager is a trustworthy steward; broad authority is effective
Information asymmetry	Mishkin; Diamond	Transparency strengthens market discipline and reduces risk

Corporate governance in banks is not merely an organizational structure or a legal obligation, but the internal immune system of the bank’s financial ecosystem. In the absence of an effective corporate governance system, even a bank with the highest level of capital may, within a short period, become insolvent because of governance errors and unsystematic risks. For this reason, raising the quality of corporate governance is, on both theoretical and practical grounds, fully justified as the most important prerequisite for the stability of the banking system and for macroeconomic development.

Table 2

Corporate governance channels and their effect on the financial stability of banks³

Channel	Mechanism	Effect on stability
Board	Independence, expertise, risk committee	Risk control is strengthened
Ownership	Concentration, state / private / foreign	Two-sided effect on risk appetite
Risk governance	CRO, risk appetite framework, internal control	Prevention of losses
Transparency	Disclosure, audit, accountability	Market discipline is strengthened
Incentives	Bonus structure, long-term criteria	Mitigation of short-term risk

These transmission channels do not operate independently of one another but interact. For example, a strong and independent board establishes an effective risk-governance system, which in turn strengthens market discipline through transparency. Conversely, when a weak board and an inadequate incentive system are combined, the bank becomes inclined towards excessive risk. The quality of corporate governance therefore affects stability not as the sum of separate elements but as a coherent system of those elements. This calls for a “systemic effect” approach.

The corporate governance system ensures the financial stability of commercial banks through the following four principal transmission mechanisms:

— Integration of risk management: the supervisory board sets the bank’s risk appetite (the maximum level of loss that may be accepted). On the basis of the international standards of the Basel Committee (Basel III/IV), this makes it possible to assess credit, liquidity and operational risks and to maintain capital adequacy.

— Internal control and compliance system: systematic internal audit and compliance control with regulatory requirements prevent the unlawful outflow of bank funds and insider lending (the unjustified financing of persons connected with the bank’s managers).

— Capacity to raise capital: banks with a high corporate governance rating are able to attract cheaper and longer-term financial resources on international capital markets. This increases the bank’s resilience to stress conditions and liquidity crises.

— Quality of strategic decisions: the impartiality of independent supervisory board members protects the bank’s management from projects based on excessive risk-taking and serves the development of sustainable digital transformation (FinTech) strategies.

In banks, shareholders have limited liability: if the bank is successful, they obtain high returns, but if it operates at a loss they lose only the capital they have contributed. For this reason, governance that is well “aligned” with

²Compiled by the author on the basis of the research findings.

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shareholders encourages high-risk, high-return strategies. Deposit insurance reinforces this tendency further. As a result, strengthening shareholder control with the intention of improving corporate governance may, paradoxically, increase the bank's risk — a fundamental feature that distinguishes the governance of banks from that of ordinary corporations.

The regulatory environment and deposit insurance moderate the relationship: deposit insurance may weaken depositor discipline and induce shareholders to take on risk (moral hazard). For this reason, effective bank governance must be oriented not only towards shareholders but also towards depositors and systemic stability and must be complemented by strong prudential supervision. In conclusion, the relationship between governance quality and stability is positive, but it depends on the orientation of governance (towards shareholders or depositors) and on the regulatory environment.

An excessive weakening of governance in banks leads to management being left without oversight, while an excessive orientation towards shareholders leads to excessive risk. For this reason, the regulator and the board must keep the bank's risk appetite within a certain "stability corridor". This approach requires that corporate governance be regarded not as the sole guarantee of financial stability, but as part of a system that operates jointly with prudential supervision.

The predominance of state-owned banks in Uzbekistan's banking system gives rise to specific corporate governance problems. In banks with a state shareholding, political interference in governance, directed (directive) lending and limitations on board independence may be observed. The banking reforms carried out in recent years — the transformation of state-owned banks, privatization, independent supervisory boards, and requirements for international audit and disclosure — are aimed precisely at raising the quality of governance.

From a theoretical point of view, state ownership has two opposing effects. On the one hand, a state guarantee and state capital support give the bank stability and depositor confidence. On the other hand, directive lending and political objectives may reduce loan quality and thereby weaken stability through profitability and asset quality. The principal task of corporate governance reform in banks with state shareholding is therefore to preserve the stability advantage of state ownership while reducing its inefficiency component.

This link can be observed qualitatively in the example of three banks with different governance models. The private bank (Asia Alliance Bank), being more subject to market discipline, displays high profitability and balanced stability. The large state-owned bank (Aloqabank) has a broad base and high confidence, but its profitability is relatively low and its capital is close to the regulatory minimum. The specialized state-owned bank (Mikrokreditbank), although it has a high level of capital, exhibits instability in loan quality and profitability that points to problems of governance and risk control (Table 3).

Table 3
Governance model and stability profile⁴
(as at year-end 2025)

Bank	Governance model	CAR, %	ROA avg., %	ROE avg., %	Profile
Asia Alliance Bank	Private, market discipline	15.4	6.2	42.3	Balanced, profitable
Aloqabank	Bank with a large state shareholding	14.1	0.9	7.3	Close to the regulatory minimum
Mikrokreditbank	Bank with a large state shareholding	18.5	0.6	3.5	High capital, unstable profit

The empirical situation in the example of these three banks clearly confirms the need to transform the banking system and to reduce the state's shareholding. The stability of a bank is determined not by the size of its capital alone (as in the case of Mikrokreditbank), but by the quality of the corporate governance model that is able to manage that capital with high profitability (as in the case of Asia Alliance Bank).

Banks that operate on market principles can assess correctly the balance between risk and return (the risk–return trade-off). Strong corporate governance enables them to obtain high-margin and stable profit. The financing of

⁴Compiled by the author on the basis of the research findings.

state programmes and dependence on state subsidies prevent banks from adapting to market conditions. As a result, a bank that appears stable from the outside (in terms of its capital buffer) may be very weak in terms of internal operational efficiency and may operate on the verge of loss. This analysis shows, on a theoretical level, that the governance model affects different dimensions of stability differently: private governance stimulates profitability, whereas state governance is inclined to maintain the capital buffer but may leave weaknesses in profitability and loan quality. To ensure stability, therefore, each model must preserve its strong side and eliminate its weak side through governance reform.

The theoretical analysis substantiates that raising the quality of corporate governance has a positive but conditional effect on financial stability. Recommendations for the banks of Uzbekistan are presented below (Table 4).

Table 4
Recommendations for improving corporate governance⁵

No.	Recommendation	Expected outcome
1	Raise the independence and competence of the supervisory board and increase the share of independent members	Effective monitoring and risk control
2	Strengthen the powers of the chief risk officer (CRO) and the risk committee	Early identification of losses
3	Bring transparency and disclosure into line with international standards	Strengthening of market discipline
4	Restrict directive lending and political interference in state-owned banks	Improvement of loan quality and profitability
5	Tie executive incentives to long-term stability criteria	Reduction of excessive short-term risk
6	Orient governance towards depositors and systemic stability rather than shareholders	Reduction of moral hazard

In implementing these recommendations, it is important to take into account their sequence and their interdependence. First, the “institutional foundation” — such as board independence and the risk-governance system — should be strengthened; thereafter the transparency and incentive mechanisms should be improved. Corporate governance reform in commercial banks should be carried out in parallel with the strengthening of prudential supervision, because, as shown above, governance and regulation complement one another. Relying solely on internal governance and weakening external supervision — or, conversely, relying solely on regulatory pressure and neglecting internal governance — does not ensure stability.

5. CONCLUSION

This article has analysed the interrelated aspects of governance quality and financial stability in banks and has reached the following conclusions:

- Corporate governance in commercial banks differs from that of companies and firms; high leverage, informational opacity and the interests of depositors require it to be depositor-oriented;
- In banks, corporate governance affects stability through five channels — the bank’s board, the form of ownership, risk governance, transparency and incentives.
- Under the conditions of Uzbekistan, protecting the governance of banks with a state shareholding from political interference and strengthening board independence, risk governance and transparency are the key to ensuring stability.

In conclusion, the quality of corporate governance is the invisible but decisive pillar of the financial stability of banks. Its effectiveness depends on the orientation of bank governance (towards depositors and systemic stability) and on its harmonization with strong prudential supervision.

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