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FINANCIAL AND RISK IMPLICATIONS OF ESG MANAGEMENT IN COMMERCIAL BANKS OF UZBEKISTAN: PROFITABILITY, AND SUSTAINABLE GROWTH PROSPECTS

Abdullaeva Sanemkhan

Westminster International University in Tashkent Lecturer

Abduraupov Rustam

University of Digital Economics and Agrotechnologies Professor Dr., Rector

The transformation of Uzbekistan's financial system under the Uzbekistan – 2030 Strategy places commercial banks at the center of sustainable economic modernization. As the dominant financial intermediaries in the country, banks are expected not only to expand credit and support private sector growth, but also to incorporate Environmental, Social, and Governance (ESG) principles into their operational and strategic frameworks (Government of Uzbekistan, 2023; OECD, 2025).

However, the financial and risk implications of ESG integration remain ambiguous in emerging markets. While stakeholder theory suggests that ESG enhances long-term value and resilience, empirical findings from comparable banking systems indicate potential short-term trade-offs. Evidence from panel-based estimations using GMM methodology demonstrates that ESG activities may reduce profitability and increase certain capital costs in developing financial environments (Cantero-Saiz, M et al., 2025).

This raises a critical question for Uzbekistan:

Does ESG management in commercial banks enhance financial sustainability, or does it impose additional cost burdens in the short run?

This article analyzes the financial and risk implications of ESG management within Uzbek commercial banks, linking profitability, cost of capital, and long-term sustainable growth prospects.

Environmental, Social, and Governance (ESG) principles represent a framework used to evaluate how financial institutions manage sustainability risks and opportunities. ESG approaches encourage banks to consider environmental protection, social responsibility, and transparent governance in their operations and strategic decision-making.

In the banking sector, ESG management typically involves:

Environmental factors: financing environmentally sustainable projects, reducing carbon emissions, and supporting renewable energy initiatives.

Social factors: promoting financial inclusion, responsible lending, and employee welfare.

Governance factors: strengthening internal control systems, transparency, board accountability, and risk management structures.

Integrating ESG into banking activities allows financial institutions to manage long-term risks associated with climate change, social inequality, and corporate governance failures. Moreover, ESG implementation enhances banks' reputation and improves their access to international capital markets.

The theoretical framework of the dissertation draws upon Stakeholder Theory and the Trade-off Hypothesis.

- Stakeholder Theory predicts improved financial performance due to enhanced reputation, risk mitigation, and investor trust.

- Trade-off Theory suggests short-term profitability deterioration due to increased compliance, reporting, and operational costs.

Empirical evidence from emerging banking markets indicates that ESG may negatively affect profitability in the short term. This finding is highly relevant for Uzbekistan, where ESG implementation involves:

- Investment in data infrastructure
- ESG reporting systems
- Training and capacity building
- Green project assessment frameworks

For Uzbek banks operating under capital constraints and evolving governance structures, ESG-related expenditures may initially reduce ROA. However, this decline should be interpreted as a transitional adjustment rather than structural inefficiency.

Importantly, ESG-driven improvements in governance quality may indirectly enhance profitability through better credit risk assessment and reduced non-performing loans over time.

Beyond profitability and capital cost, ESG functions as a forward-looking risk governance tool.

In the Uzbek context, the main risk channels include:

- Climate-related credit risk (agriculture, energy, infrastructure sectors)
- Transition risk due to global decarbonization
- Reputational risk linked to governance weaknesses
- Social risk associated with labor and community practices

Integrating ESG into credit scoring models, stress testing frameworks, and capital adequacy assessments can reduce exposure to long-term systemic shocks. As global financial markets increasingly price climate and governance risks, early ESG adoption enhances strategic positioning.

The Uzbekistan–2030 Strategy envisions diversification, green economy expansion, and financial market deepening. ESG management in commercial banks supports these goals through:

- Development of green lending portfolios
- Issuance of sustainability-linked financial instruments
- Attraction of foreign institutional investors
- Alignment with international disclosure standards

However, achieving these outcomes requires structural reforms:

1. Establishment of a national ESG taxonomy aligned with IFRS Sustainability Standards.

2. Mandatory ESG disclosure requirements for commercial banks.

3. Capacity building for ESG risk analysts within banks.

4. Integration of climate stress testing into supervisory review.

Without these reforms, ESG risks remain symbolic rather than transformative.

The financial and risk implications of ESG management in commercial banks of Uzbekistan are multidimensional and transitional in nature.

- In the short term, ESG may exert downward pressure on profitability and increase certain capital costs.

- Governance improvements can reduce debt costs and enhance institutional credibility.

- Long-term benefits materialize through improved risk resilience, investor confidence, and alignment with sustainable growth objectives.

For Uzbekistan’s banking sector, ESG management should not be viewed merely as a compliance obligation under the Uzbekistan–2030 Strategy, but as a strategic mechanism for strengthening financial stability and international competitiveness.

This analysis directly supports the empirical direction of your dissertation, particularly the application of GMM estimation to test the relationship between ESG pillars and financial performance indicators in commercial banks of Uzbekistan.

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