

UNLOCKING ISLAMIC FINANCE OPPORTUNITIES IN UZBEKISTAN: PERSPECTIVES FROM TRADITIONAL FINANCIAL INSTITUTIONS

Kasimov Anvar Alisherovich

Master's degree candidate The Banking and Finance Academy of Uzbekistan

Email: kasimov.anvar@gmail.com

ORCID: 0009-0001-4737-3109

Annotation: Given the rapid expansion of Islamic finance on a global scale, there is significant potential for enhancing financial inclusion within Uzbekistan, a predominantly Muslim nation. While dedicated Islamic financial institutions play a vital role in this endeavor, it's equally crucial to recognize the potential of existing traditional financial institutions to contribute by offering services consistent with Islamic finance principles. This not only improves their financial standing but also fosters inclusive growth and advances the Islamic finance landscape in Uzbekistan. The current article examines the current landscape and emerging trends in Islamic finance alongside traditional financial institutions in Uzbekistan, as well as analogous services in international contexts adhering to Islamic finance principles. Drawing from this analysis, the article presents transformative suggestions for traditional financial entities to introduce supplementary services and explore the Islamic finance market, all while maintaining their core operations intact.

Keywords: Islamic finance, Traditional financing institutions, Financial inclusion

Introduction

Islamic banking offers a unique set of financing instruments that adhere to Islamic principles (Sharia). In contrast, traditional financing services can include usury which is prohibited by Sharia (Tursunov A. S., 2023). This can cause to financial exclusion of the individuals and institutions seeking Sharia-compliant financial products. Despite the Islamic finance market experiencing significant growth, Uzbekistan's IBF landscape is still in its early stages. Despite the limited presence of IBF products, there's a significant potential market. A UNDP study revealed that over half (56%) of individuals and 38% of businesses avoid conventional loans due to religious beliefs (Entrepreneurship, 2024). However, public awareness about IBF instruments remains low (UNDP, 2020).

Capital formation and fully pledged Islamic financing services can require a significant amount of time to operate efficiently. Prompt reaction to meet increasing demand from distinct segments of consumers can hold enormous opportunities for traditional finance institutions. To fulfill the indicated demand traditional financing institutions are required to undergo some transformation which allows the services provided aligned to the Islamic principles.

General financing model in Uzbekistan

In Uzbekistan, the legislation on Islamic finance is constantly being improved. In particular, within the framework of the decree of the President of the Republic of Uzbekistan dated September 11, 2023, on the "Uzbekistan - 2030" strategy, it is determined to accelerate

reforms in the banking system, increase the size of the banking services market and develop competition in the sector. This task includes the introduction of Islamic finance criteria and procedures in at least 3 commercial banks and the formation of the legal basis of Islamic finance. (Lex.uz, 2023)

According to representatives of the Central Bank Department: The conventional banking system and Islamic banking systems exhibit disparities. An official commission has been established to advanced Islamic finance not solely within banks, but also across various sectors. (Daryo.uz, 2024).

Several banks, including Asia Alliance Bank and Trustbank, are in the final stages of establishing such windows, offering Islamic banking products alongside traditional services (Karimova Aziza Mahomadrizoevna, 2022).

Justification of transformation need for the traditional finance institutions

Historically, Islamic finance has been primarily linked with dedicated Islamic financial institutions. However, recent years have witnessed a surge in Islamic finance popularity in non-Muslim countries by different financial institutions. Non-Islamic financial institutions are increasingly recognizing the potential of Islamic finance to cater to a broader clientele and tap into new markets. This is one of the key reasons why the Islamic banking system is currently one of the world's fastest-growing sectors and features innovative financing mechanisms (Tursunov A. , 2020).

Conventional financial institutions can profit not only from attracting presently excluded Muslim clients but also from drawing in non-Muslim clients, as several factors can entice clients to opt for their services aligned with Islamic principles rather than traditional ones.

Ethical and Transparent Practices

One of the core principles of IBF is its emphasis on ethical and transparent practices. IBF prohibits interest-based transactions (riba) and instead focuses on profit-sharing (musharaka) and risk-sharing (mudaraba) models. This resonates with non-Muslim individuals seeking financial products that align with their ethical values. (Ali, 2010).

Financial inclusion

Profit-sharing models can be more accessible than conventional loan structures with high interest rates. Islamic microfinance initiatives, for example, have proven successful in providing financial resources to low-income communities and fostering entrepreneurship and economic development. (Ulfi, 2023)

Investment opportunities

The sukuk, an Islamic bond instrument, offers a Sharia-compliant alternative to conventional bonds. Sukuk structures involve underlying asset ownership, which can be appealing to risk-averse investors. Furthermore, the growing demand for halal products and services creates investment opportunities in sectors like Islamic tourism and infrastructure development (Novikov, 2019).

Successful international practices

Recent years have witnessed a surge in IBF's popularity in non-Muslim countries. Examples can include several countries and financial institutions having successful transformations.

Even though no full-fledged Islamic banks are operating within the USA, a number of conventional banks offer Sharia-compliant products, like:

- **Deutsche Bank** offers Islamic investment products through its subsidiary, DWS.
- **Citigroup** provides Sharia-compliant trade finance solutions.
- **HSBC Amanah** operates as a subsidiary of HSBC, catering to the Islamic finance needs of its global clientele.

Japanese institutions are also participating in the Sukuk (Islamic bond) market, with issuances

by companies like Nomura and Toyota. (Eurekahedge, 2007)

Established conventional banks in the UK, like HSBC and Lloyds have introduced Islamic banking windows catering to the growing Muslim population.

Recommendations

Traditional financial institutions aiming to offer Islamic-aligned finance windows while preserving their core activities should consider several key factors:

- Ensure compliance with relevant Islamic finance regulations and guidelines, which may differ from conventional banking regulations.
- Develop Islamic finance products that adhere to Sharia principles, such as profit-sharing arrangements (Mudarabah), leasing (Ijarah), and joint ventures (Musharakah). Tailor these products to meet the needs of both Muslim and non-Muslim customers.
- Employ staff with expertise in Islamic finance principles and practices to ensure the proper implementation and management of Islamic finance products and services.
- Implement robust risk management frameworks tailored to Islamic finance activities, considering unique risks such as Sharia compliance, asset quality, and liquidity management.

Conclusion

Incorporating an Islamic financing window within traditional financial institutions does not divert their focus from core activities; rather, it serves as an avenue to attract a broader clientele, expand market presence, and enhance profitability. This integration necessitates the establishment of a segregated fund, distinct from profits generated through usury, ensuring adherence to Islamic principles while driving growth and inclusivity within the institution.

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