

APPLICATION AND DEVELOPMENT OF ISLAMIC FINANCIAL INSTRUMENTS IN COMMERCIAL BANKS

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Abstract

The article shows how Islamic financial structure is applied by commercial banks in Uzbekistan and analyzes the development of assets worldwide.

Keywords: Islamic banks, banking system, assets, financial resources, banks.

Introduction

Islamic banking system is a banking system in which all financial activities are based on Islamic laws. It has the same objectives and operations as conventional banks, that is, it facilitates the movement of money in the economy to stymie economic activities. Islamic banks and financial institutions offer alternative financial products that comply with the principles of Shariah. Unlike conventional banks, Islamic financial instruments exclude the use of interest (riba) as a form of income or expense. Instead, they may use profit sharing or commission payments for their services. Islamic banks can raise and disburse financial resources, but they follow certain principles to comply with Shariah requirements.

The Role of Banks An economic system in the world constitutes of, at a minimum, hundreds of organizations and thousands of individuals. All these components endeavour to search for what's good for them on the micro-level. However, only when this search exercise is done strategically and wisely, will it result in macroeconomic benefits.

Individuals and organizations are free to connect to each other for achieving best of their economic benefit. This might be true for a simple and basic economy. However, in an overall complex system, wherein information is not properly channelized, the financial intermediaries' play a vital role in connecting the missing ends. Financial intermediaries in any economic system are, for example, banks, brokerage houses, non- banking financing houses. Certainly, banks are the most important intermediary in this process of wealth circulation, which leads to macroeconomic development.

LITERATURE AND METHOD:

As per the World Islamic Banking Competitiveness Report, the current size of international Islamic banking industry is US\$ 882 Billion.¹ However, this figure can further increase if emerging markets are appropriately tapped by offering Shari'a compliant products and services to the local Muslim population.



Table 1.

Number of potential Muslim customers in undeveloped markets around the world¹.

Страна	Мусульманское население
Индия	183,000,000
Китай	22,000,000
Россия	9,400,000
Италия	2,220,000
Албания	1,879,172
Непал	1,253,000
Нидерланды	825,000
Аргентина	784,000
Австрия	573,876
Грузия	442,000
Общий объем развивающихся рынков	222,377,048

The above table clearly shows that the untapped emerging markets have more than 200 million potential Muslim customers. Statistically, based on a conservative assumption of considering only 40% of a society as bankable, a minimum of 85 million (from the above statistics) potential new customers can be leveraged to offering Shari'a compliant products. This will, certainly, result in higher levels of economic inclusiveness, where Muslim investors would be ready for an opportunity to invest their funds in Shari'a compliant deposits and, in return, get financings through organic banking offering.

This will undoubtedly lead to increased financial inclusion as Muslim investors will have the opportunity to place funds in Shariah deposits and in return attract funding through organic bank growth.

At the moment, Islamic banks are losing out to conventional banks in terms of number and size. Quite rightly, we need to achieve micro-economic inclusion for this segment of the economy that has banking facilities but without the means for various Shariah compliant offerings is disadvantaged.

There are a number of defining differences between the Islamic bank and the conventional banking system, which relate to the principles of formation and operation, as well as the types of financial instruments they offer.

Islamic banking is a set of types and forms of financial activities, the essence of which is carried out in compliance with the norms and principles of Shariah. This variety of instruments allows Islamic organizations to conduct their activities within the framework of true Islam.

¹ Compiled by the author based on data from Wikipedia



Table 2.

Differences between Islamic and conventional banks²

Характеристика	Исламский банк	Традиционный банк
Использование процентов	Нет	Есть
Использование исламских финансовых продуктов	Есть	Практически не применимо
Преобладающие операции	Инвестиционные	Кредитные
Критерии оценки заемщика	Этические и финансовые	Только финансовые
При оценке заемщика внимание акцентируется на	Качестве, прибыльности проекта	Возможности погашения
Право банка выносить решение о выдаче кредита в зависимости от обеспечения	Редко применяется	Есть всегда
Доход по депозитам до востребования	Гарантирован возврат суммы вклада	Гарантирован возврат суммы вклада
Доход по инвестиционным депозитам	Не гарантированы ни основная часть долга, ни доход по ней	Гарантирован процент по вкладу и возврат основной его суммы
Доходность вложений	Не определена, зависит от успешности инвестиционного проекта или деятельности банка	Определена в виде процента по вкладу, гарантирована
Участие вкладчиков в прибылях и убытках банка	Есть	Практически нет
Независимость в размещении финансовых ресурсов	Координация действий с партнерами-владельцами средств	Независим в принятии решений

The popularity of Islamic financial instruments is constantly growing due to the successful overcoming of crises and attractive prospects for investing capital in oriental companies. The system of profit sharing and capital participation appears to economists as a promising direction of the economy.

OBSERVATION:

According to ICD (Islamic Corporation for the Development of the Private Sector) reports from 2013 to 2023, the Islamic finance industry has expanded significantly from a niche sector to an important part of the global financial system.

² Гримаренко И., Е. «Сравнительный анализ исламской и традиционной западной банковских моделей». КиперЛенинка 2015г.



Figure 1: Islamic financial assets in the world (2013-2023)³.

Global Islamic financial assets have grown 69% over the past 5 years and 163% over the past decade, from USD 1.71 trillion in 2013 to USD 2.67 trillion in 2019 and USD 4.51 trillion in 2023, according to IFDI data. This growth reflects the healthy state of the industry, driven by strong balance sheets, strong profits, regulatory support and sustained demand from both customers and investors across geographies.

Islamic banks continue to show significant growth across the globe. Islamic banks' assets reached \$3.24 trillion in 2023, a significant increase from \$1.88 trillion in 2018 and \$1.31 trillion in 2012. The number of full-fledged Islamic banks increased by 36% to 336 in 2023, while the number of conventional banks with Islamic windows increased by 84% to 274.

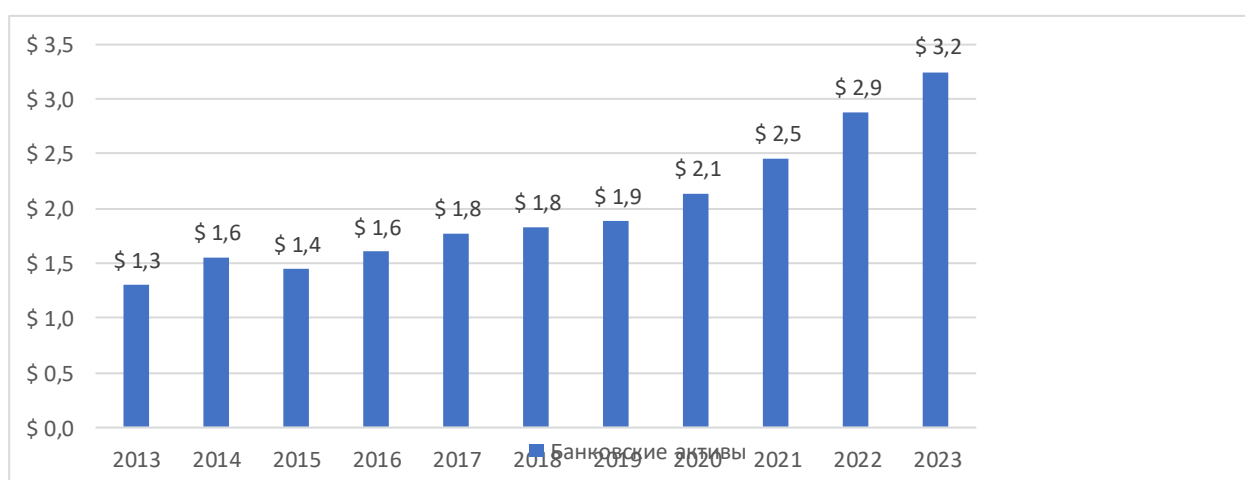


Figure 2: Islamic banking assets⁴.

³ Compiled on the basis of data - ICD - Iseg islamic finance development report 2023.

⁴ Compiled on the basis of data - ICD - Iseg islamic finance development report 2023.

RESULTS:

Commercial banks and non-banking institutions in Uzbekistan can offer a wide range of product services that meet the requirements of Islamic finance. For example, financing based on the Murabaha contract dominates the loan portfolio. Banks have also started to use leasing based on Islamic finance more frequently.

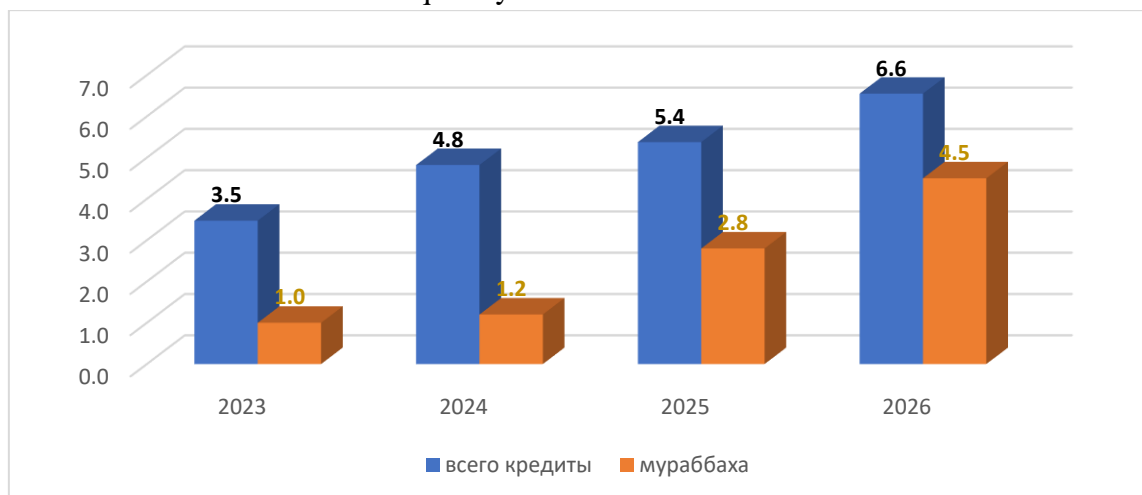


Figure 3: Ratio of credits and Islamic product in CJSC “Trustbank” CJSC trillion UZS⁵.

As we can see from (Fig.3), in the commercial bank “Trustbank” CJSC at introduction of Islamic banking product of murabaha there is an increase in realization of this product, thus giving an opportunity to develop Islamic finance in the country.

In order to meet the needs of customers in Shariah compliant banking services, Islamic banking products must be approved by the Shariah Council. According to Shariah requirements, Islamic banking facilities and products must be managed separately from conventional banking facilities and products. All funds received, invested and disbursed are used in halal modes and investments, under the supervision of the Shariah Advisor. This requirement is taken into account in Muomalat Trust Ltd. and operates under the principles of Shariah Board.

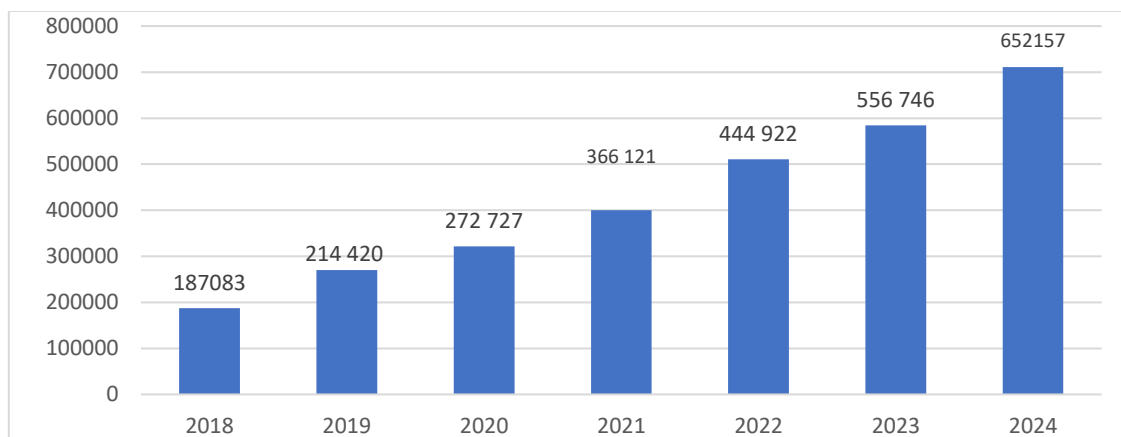


Figure 4: Banking assets of commercial banks in Uzbekistan (billion UZS)⁶.

⁵ Compiled by the author on the basis of the data of the report of the commercial bank CHAB “Trustbank”.

⁶ Compiled on the basis of data from Akhbor-rating agency.

Considering the banking assets in Uzbekistan as of the end of 2023, we can say that the assets increased by 12% and the growth of net credit investments by 16% indicate the stability and dynamic development of the sector. Taking into account that the banking system involves not only commercial but also non-banking commercial organizations, it was appropriate to conduct an analysis on the assets of NCOs. According to the indicators (Fig.16) we can say that the assets of NPOs are a rapidly growing financial sphere, which allows the development of both conventional lending and installment financing on the basis of Islamic financing according to the canons of Shariah.

As a result of research and study of theoretical and practical aspects of Islamic banking, we have come to the following conclusions that, Islamic banking products are an alternative financial instrument based on compliance with the principles of Shariah, which excludes interest (riba), speculation (gharar) and financing of prohibited areas of activity.

Islamic banking has shown significant growth in recent decades, both internationally and in predominantly Muslim countries. For Uzbekistan, where Islam is one of the major religions, the development of Islamic financial products can be an important factor in stimulating economic growth, attracting investment and meeting the needs of the population for financial services that are consistent with their faith .

CONCLUSION

To date, the development of Islamic finance in Uzbekistan is at the initial stage. Despite the high potential, the process of introducing such products faces a number of challenges, including lack of legal framework, limited knowledge of the population about the principles of Islamic banking, lack of qualified specialists and poor infrastructure development . Nevertheless, the existing macroeconomic stability, as well as the growing interest in Islamic finance from international investors, opens up prospects for the introduction and development of Islamic banking products in the banking system of Uzbekistan.

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