

WAYS TO INTRODUCE AND DEVELOP ISLAMIC BANK PRODUCTS IN THE BANK BUSINESS

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Abstract

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

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

Introduction

In the modern world, attention is focused on meeting the needs of the population in financial resources and diversifying financial services through the introduction of alternative financial instruments in the system of finance and banking services. The widespread adoption of Islamic finance in the context of the Industrial Revolution demonstrated its profitability as an alternative financial system. According to the Islamic Finance Development Indicator (IFDI), it shows another successful year for the Islamic finance industry, achieving an 11% growth rate, which led to an increase in assets to USD 4.9 trillion in 2023. This growth is largely driven by the continued commitment of the various stakeholders shaping the ecosystem, including financial institutions, regulators, and educational institutions, as stated in the report¹.

LITERATURE AND METHOD:

In recent decades, Islamic banking has shown significant growth, both internationally and in countries with a predominantly Muslim population. For Uzbekistan, where Islam is one of the main 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 corresponding to their religion².

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 the lack of a legal framework, limited knowledge of the population about the principles of Islamic banking, a lack of qualified specialists and poor infrastructure³ development. However, the existing macroeconomic stability, as well as the growing interest in Islamic finance from

¹ <https://www.zawya.com> - data from the official website of Zawya Islamic Finance as of November 2, 2024.

² Kun.uz (2021). Islamic finance is waiting in the wings in Uzbekistan. Available at: <https://kun.uz/ru/news/2021/08/31/islamskiye-finansy-jdut-svoyego-chasa-v-uzbekistane>

³ Spot.uz (2023). "Uzbekistan can easily attract billions of halal dollars" – Hondamir Nusratkhujaev on the introduction of Islamic finance. Available at: <https://www.spot.uz/ru/2023/10/04/islamic-finance/>

international investors, open up prospects for the introduction and development of Islamic banking products in the banking system of Uzbekistan⁴.

We know that Islamic banking in Uzbekistan is at the initial stage of its development. The country lacks a full-fledged legal framework regulating the activities of Islamic financial institutions, which is one of the main barriers to their implementation. Despite this, interest in Islamic finance is growing, which is driven by both the religious preferences of a significant part of the population and the potential economic benefits for the country. At the moment, Islamic banking is presented mainly in the format of pilot projects and individual programs offered by a limited number of banks.

In particular, Uzbekistan has joined the Islamic Corporation for the Development of the Private Sector, which allows the country to receive advisory support and access to Islamic financial instruments⁵.

The population of Uzbekistan shows a growing interest in Islamic products such as interest-free loans (murabahah), partner financing (musharaka) and Islamic leasing (ijara). However, awareness of the principles and opportunities of Islamic banking remains low. This is due to the lack of large-scale information campaigns and the lack of educational programs in this area⁶.

DISCUSSION:

It was important to study and analyze the perception of the population representing different sectors of society, banks and enterprises in terms of the introduction and development of Islamic banking services. The study revealed significant interest in Islamic finance products, such as interest-free loans, leasing and participation in investment projects based on Sharia law. It is important to note that the low level of public awareness and insufficient development of the regulatory framework remain the main obstacles to the introduction of Islamic banking services.

The development of Islamic banks involves adapting products and services to the needs of the population, including the development of mechanisms for attracting deposits and providing loans that comply with Sharia principles. This requires active interaction with the target audience, improving financial literacy and creating specialized training programs for bank employees. In addition, a significant role is given to government initiatives and international cooperation to create favorable conditions for the development of Islamic finance, including the introduction of transparent and understandable regulatory rules, investment promotion and the development of infrastructure that supports Islamic finance.

For the most important bank products, the most important characteristics are especially investment, the principle of profit loss sharing (PLS) is the principle of profit loss sharing (PLS) between the bank and the owner. In practice, many Islamic banks use various forms of circumvention of this principle. For example, they may offer a guaranteed return on

⁴ Spot.uz (2023). "Uzbekistan can easily attract billions of halal dollars" – Hondamir Nusratkhujayev on the introduction of Islamic finance. Available at: <https://www.spot.uz/ru/2023/10/04/islamic-finance/>

⁵ Spot.uz (2023). "Uzbekistan can easily attract billions of halal dollars" – Hondamir Nusratkhujayev on the introduction of Islamic finance. Available at: <https://www.spot.uz/ru/2023/10/04/islamic-finance/>

⁶ RGSBM.uz (2023). Islamic Finance in Uzbekistan: Development, Prospects and Opportunities <https://rgsbm.uz/ru/news/islamic-finance-in-uzbekistan-development-prospects-and-opportunities>



contributions instead of participating in the risks of the project, which is not in line with the ideals of PLS.

While the PLS concept sounds attractive in terms of fairness and complicity of all parties in the risks and rewards of projects, in practice its implementation can be a challenge for banks due to the complexity of accounting for different types of assets and liabilities. Despite this, many Islamic financial institutions are striving for greater transparency in their operations and closer adherence to the PLS principles.

But even with the uniqueness of this model as an effective principle, in the countries of the Middle East and South East Asia, the practice of Islamic banking according to this principle is not widely used. A fairly large number of foreign banks, investment funds and companies carry out their active operations by using financial products on the basis of trade or project financing, where the profit of the commercial bank, commercial payments and other amounts of remuneration are known and fixed. There are several reasons for this.

First, in the case of the PLS (Profit and Loss Sharing Principle) model, there is an agency problem, when entrepreneurs may not be sufficiently motivated to increase labor productivity to increase the profitability of the project. They may prefer to understate the profit margins in order to reduce the amount of fees to be paid to the Islamic bank and the overall profitability of the project. If the profitability and marginality of the project turn out to be lower than the expected level and, accordingly, the costs incurred are not compensated, then the lack of interest of the parties to the *mudarabah* (participation in business on investment terms) and *musharak* (joint activity) agreements to conclude such a contract is quite logical.

Secondly, there is insufficient regulation of property rights and property rights and its concept among the population of Uzbekistan, which can lead to legal risks for the parties to the contract, especially in the event of losses. This may reduce the attractiveness of investments and business interactions in such countries. In order to make Islamic financial products more attractive to entrepreneurs, it is necessary to improve the legislative framework, ensuring the protection of property rights and property rights of each of the parties to the contract (especially important in the event of losses), which will increase their attractiveness.

Thirdly, the presence of fierce competition from traditional commercial banks, which over the long period of their operation have created a wide customer base and established processes and procedures, forces Islamic finance to use less risky models. But it is important to note that some of these less risky funding models may also have restrictions or requirements to comply with Sharia principles. For example, the *mudarabah* model involves the distribution of profits between the parties to the transaction in a certain proportion taking into account the risk, while the *musharakah* model involves a partnership with the overall management of the business and the distribution of profits/losses under pre-agreed conditions.

This is the form of an active system of stimulus systems for companies working on the basis of the fundamental principles of financial and profit and loss sharing.

After determining the list of banks and enterprises, it is possible to specify the following:

- возраст 47 процентов населения, участвовавшего в опросе, составляет от 31 до 45 лет, 44 процентов находился в пределах 18-30. 42% участников имеют высшее образование (бакалавриат), а 36% — среднее. образованные (т.е. окончившие среднюю школу). 25% участвующая страна трудоустроены, а 21% были заняты в частном секторе.



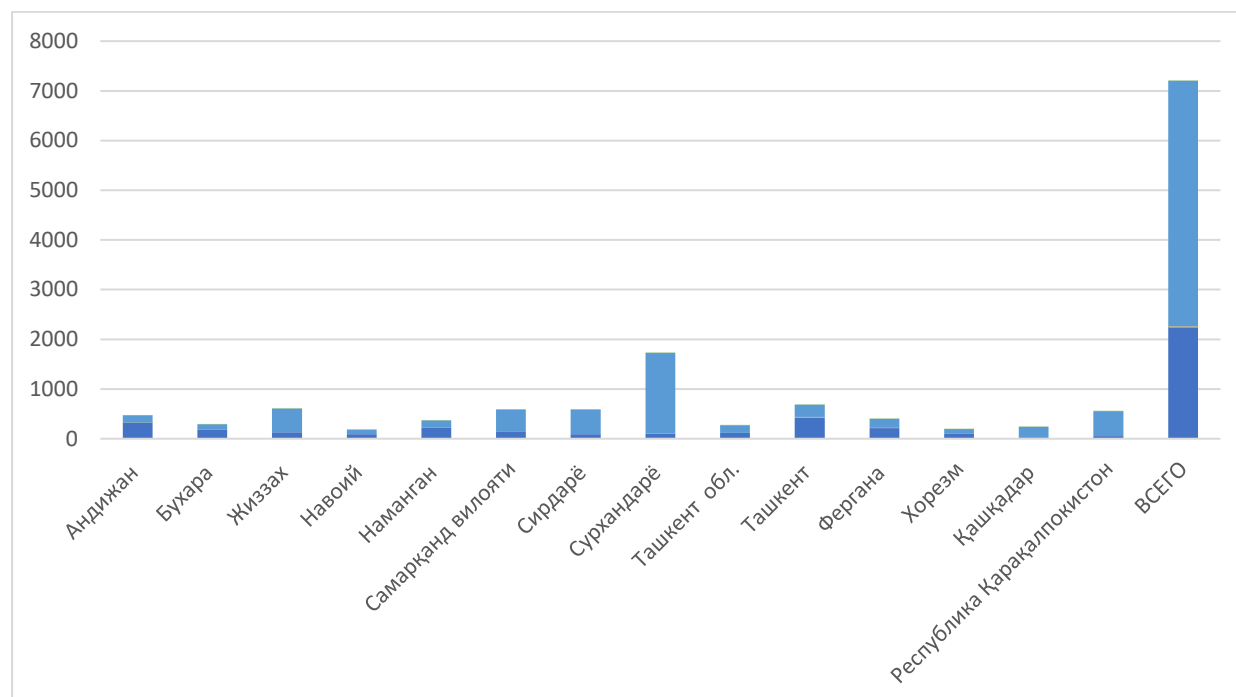


Figure 23. Assessment of opportunities and needs for the introduction of Islamic finance instruments in Uzbekistan 2020-2022⁷.

The largest number of participants in the region are the city of Tashkent (18.66%), the Indian region (14.5%) and the Naman region (10.20%). The organizational form of the business of the entrepreneurs who have taken part in the information on the following:

1. Общества с ограниченной ответственностью – 44%;
2. Private companies – 18%;
3. Private entrepreneurs – 16,000 5% of 64 of them are small firms, 25 are micro-firms and 10 are large companies. 26% of companies operate in the industrial sector, 17% in the field of service, 22% in the trade sector, 13 projects work in the construction sector. 41 of these companies have a total value of less than 100 million soums, 37 of them have a total value of 100 million soums, 37 of them have a total value of 100 million to 1 billion. And only 4 projects have 10 more than a milliard. As for the bank, 2 of the bankas were 100% state bank, 5 parts and 20 joint-stock banknotes.

⁷ JAKHONGIR IMAMNAZAROV LANDSCAPING ANALYSIS OF ISLAMIC FINANCE INSTRUMENTS IN UZBEKISTAN ANALYTICAL PAPER JUNE 2020.

Table 3.1.

Evaluation of effective Islamic banking products in the market⁸.

Islamic banking products that will be effective in Uzbekistan and the reasons	Banks	
	Quantity	Percent
Musharakah and Murabaha (partnership agreements)	22	81,48%
Murabaha (the ability to purchase goods by installments)	18	66,67%
Ijara, (leasing, which is already widely used and it will be easy to implement)	18	66,67%
Salam, (allows advance payments in agriculture)	11	40,74%
Istisna, (provides the possibility of advance payments in project and construction financing)	11	40,74%
Sukuk, (provides an opportunity for the development of capital markets)	12	44,44%

Most commercial banks believe that Islamic products can be successfully developed due to the high demand for such products among the population. It is also important to note that more than 80 percent of bankers claim that musharakah and mudarabah will be effective tools for the development of entrepreneurship in the country. These data indicate that partnership-based financial instruments based on cooperation can be key to stimulating entrepreneurial activity. Given these developments, it can be assumed that the education and advice of clients on the use of these financial instruments will also play a significant role in the successful implementation of the IFs in Uzbekistan.

Commercial banks that offer financial products are currently popular for both entrepreneurs and residents because of their interest in new financial products and services. At the same time, some banks already have the presence of the "window of the Islamic Finance".

OUTCOMES:

For the successful development of Islamic banking in Uzbekistan, it is necessary to solve the problems identified by the respondents. First of all, it is necessary to develop an appropriate legislative framework that would regulate Islamic financial products and services. This will create favorable conditions for the functioning of Islamic banks in the country. In addition, it

⁸ Составлено на основе данных JAKHONGIR IMAMNAZAROV LANDSCAPING ANALYSIS OF ISLAMIC FINANCE INSTRUMENTS IN UZBEKISTAN ANALYTICAL PAPER JUNE 2020.

is necessary to adapt the current tax and banking legislation to the specifics of Islamic finance. This will help remove obstacles to Islamic financial transactions and ensure equal opportunities for all types of banks. The proposal to develop new legislation on Islamic banking should be taken seriously, as it will significantly increase the transparency of the industry and stimulate the development of this area in the country. To overcome the lack of experience in the field of Islamic financial transactions, specialized training programs for specialists in the field of finance can be conducted. This will strengthen the professional expertise of national personnel in this area.

Islamic finance has significant potential for implementation in the global financial system, but the successful use of its tools requires the development of effective models⁹. The first of these models is educational. Lack of awareness of the principles and benefits of Islamic financial products such as murabahah, istisna, ijarah and salam often becomes a barrier to their adoption. Therefore, conducting seminars, webinars and advertising campaigns can significantly increase the level of understanding among customers¹⁰. It is also important to invest in personnel training: the creation of specialized courses at universities, trainings and certification programs will train specialists with deep knowledge of Islamic economics¹¹.

The second model is regulatory. For effective implementation, it is necessary to have a legal framework that would take into account the specifics of Islamic finance¹². For example, laws need to be developed to regulate the release of Shariah-compliant products, as well as adapt tax systems to eliminate double taxation in transactions such as ijarah or murabahah¹³. Shariah compliance monitoring is also an important aspect: the establishment of an independent Shariah Council will ensure transparency and trust from clients (www.iifm.net).

The third model is technological. Digitalization of products and the introduction of modern fintech solutions greatly simplify access to Islamic banking services¹⁴. The use of smart contracts, blockchain, and artificial intelligence allows you to automate operations, reduce risks, and ensure transparency. For example, the creation of mobile applications for the management of Islamic products or the use of blockchain technologies to track transactions can be an effective tool in the development of Islamic ones.

The cooperative model also plays an important role. Partnerships with traditional banks make it possible to use the existing infrastructure to promote Islamic products. The international experience of countries such as Malaysia and Saudi Arabia can be useful for adapting successful practices to local conditions¹⁵.

In order to improve the implementation of Islamic financial products, it is important to take into account the market needs, cultural and religious characteristics of customers, as well as to ensure transparency and trust¹⁶. Adapting to the needs of segments such as small and medium-

⁹ Iqbal, Z., & Mirakhor, A. (2011). *An Introduction to Islamic Finance: Theory and Practice*. Wiley.

Obaidullah, M. (2005). *Islamic Financial Services*. Islamic Economics Research Center.

¹⁰ Obaidullah, M. (2005). *Islamic Financial Services*. Islamic Economics Research Center.

¹¹ www.isdb.org – Official website of the Islamic Development Bank.

¹² Iqbal, Z., & Mirakhor, A. (2011). *An Introduction to Islamic Finance: Theory and Practice*. Wiley.

¹³ www.sbp.org.pk – Islamic Banking Department of the State Bank of Pakistan.

¹⁴ Obaidullah, M. (2005). *Islamic Financial Services*. Islamic Economics Research Center.

¹⁵ www.iifm.net – International Islamic Finance Association.

¹⁶ Iqbal, Z., & Mirakhor, A. (2011). *An Introduction to Islamic Finance: Theory and Practice*. Wiley.



sized businesses, infrastructure projects and housing construction will make Islamic products more in demand¹⁷. Taking into account local traditions and religious preferences helps to increase their attractiveness¹⁸. Transparency of operations and their compliance with Sharia play a key role in building customer trust, which is achieved through regular audits and publication of results.

CONCLUSION

In conclusion, it can be noted that the introduction of Islamic finance in Uzbekistan represents a significant potential for the development of the country's economy and financial system, in turn, will contribute to socio-economic growth and strengthen public confidence in the financial system.

Thus, the participation of international Islamic organizations can not only accelerate the process of introducing Islamic finance in Uzbekistan, but also ensure their sustainable development, contributing to strengthening the country's financial system and attracting international investment.

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¹⁷ Obaidullah, M. (2005). Islamic Financial Services. Islamic Economics Research Center.

¹⁸ www.sbp.org.pk – Islamic Banking Department of the State Bank of Pakistan.

