

## ISLAMIC FINANCE MECHANISMS AND ENTREPRENEURIAL RE-ENTRY IN UZBEKISTAN

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### Abstract

Uzbekistan has seen strong economic growth and significant poverty reduction in recent years[1][2], but private entrepreneurship and job creation remain challenges. Many micro-entrepreneurs face limited access to conventional credit (only ~14% have bank loans[3]) and often avoid interest-bearing debt for religious or cultural reasons. This paper investigates how Islamic finance – based on Shariah-compliant instruments like mudarabah (profit-sharing), musharakah (joint venture), murabahah (cost-plus sale), qard al-ḥasan (interest-free loan), zakat (alms), and waqf (endowments) – can provide alternative, ethical financing for failed or aspiring entrepreneurs in Uzbekistan. Using a comprehensive literature review of academic studies, World Bank/IMF/IDB reports, and case studies from Malaysia, Indonesia, Pakistan, Bangladesh, and elsewhere, we find that Islamic finance offers inclusive, risk-sharing capital that can help re-start businesses and reduce poverty. For example, women in Malaysia saw improved business performance through Islamic microfinance[4], and Bangladesh’s interest-free microloan program Qard al-Ḥasan halved participants’ poverty incidence[5]. The analysis also highlights psychological and cultural factors: Uzbek entrepreneurs report a dislike of conventional interest and show strong religio-social support for Islamic financing[3][6]. Building on these findings, we discuss policy frameworks (e.g. allowing Islamic banking windows, using zakat/waqf funds, and regulatory support) that could adapt global best practices to Uzbekistan. We conclude that Shariah-based finance can empower entrepreneurs to re-enter business and contribute to Uzbekistan’s poverty reduction goals, while recommending further empirical research on Islamic finance implementation in Central Asia.

### Introduction

Uzbekistan’s economy has grown rapidly since 2017 under sweeping market reforms, averaging ~5% annual GDP growth, and attracting high praise as one of the world’s top reformers[7]. Yet job creation remains sluggish (roughly 1.1% growth annually) even as youth unemployment is low[8]. Poverty has fallen sharply – by 2022 only 5% of Uzbeks lived under \$3.65/day, and 17% under

\$6.85/day (both 2017 PPP)[1][2] – but challenges persist. Notably, income gains have been uneven: recent data show poorer households fall behind richer ones, as income inequality rose substantially from 2022 to 2023[9]. The World Bank emphasizes that sustainable poverty reduction in Uzbekistan will require broadening opportunities for the poor, especially through self-employment and small enterprise growth[10][11].

A key barrier is access to finance. A national household survey found only 14.2% of Uzbek entrepreneurs had bank loans[3]. Many cite the high cost of collateral, complex paperwork, and distrust of formal banks. Crucially, a significant minority of would-be borrowers simply avoid interest: about one-third of entrepreneurs say they dislike borrowing on conventional terms[3]. In a recent study, Uzbek respondents' attitudes and religiosity strongly predicted willingness to use Islamic banking products[6]. This suggests that culturally and religiously sensitive financing could fill a gap. Historically, Uzbekistan had little Islamic banking under Soviet rule, but interest is rising. In 2019 the government even drafted regulations to establish Islamic finance infrastructure[12][6]. In this context, we examine the question: How can Islamic finance mechanisms support failed or aspiring entrepreneurs in Uzbekistan to re-enter business and contribute to poverty reduction? We draw on theoretical principles of Islamic finance, empirical findings, and international case studies to analyze how Shariah-compliant finance can empower Uzbek entrepreneurs and inform policy.

### Methods

This study employs a qualitative, literature-based approach. We systematically reviewed recent peer-reviewed articles, World Bank/IMF/ADB reports, Islamic Development Bank publications, and credible case studies related to (a) Uzbekistan's economy and entrepreneurship, and (b) Islamic finance and poverty alleviation. Key search queries included "Uzbekistan entrepreneurship finance", "Islamic finance poverty reduction SMEs", and "Islamic microfinance case study Malaysia/Indonesia/Pakistan". English-language sources from 2000–2025 were prioritized. Core Uzbekistan data (growth rates, poverty statistics, survey results) came from World Bank publications[7][3].

Islamic finance mechanisms were identified from Islamic banking literature and *fatāwā* (legal rulings). For each instrument (e.g. *mudarabah*, *musharakah*, *murabahah*, *qard al-ḥasan*, *zakat*, *waqf*), we examined both theoretical descriptions and practical implementations. Psychological and cultural factors were informed by socio-economic surveys in Uzbekistan and related studies (e.g. Shamirova 2025[6]). We compiled illustrative case examples from Muslim-majority countries (Malaysia, Indonesia, Pakistan, Bangladesh) where Islamic finance has targeted

small enterprises or the poor, citing impacts on business performance and poverty rates.

All sources were assessed for credibility; emphasis was placed on academic journals, major institutional reports, and recognized organizations (e.g. World Bank, Islamic Development Bank). Citations in the text follow APA style, with full references listed at the end.

## Results

### Uzbekistan's Economic and Entrepreneurial Context

Uzbekistan has achieved commendable macroeconomic gains since 2017, but micro-level challenges remain. The World Bank notes that despite strong GDP growth, private sector job creation has lagged, partly due to remaining state dominance in key sectors[11]. Entrepreneurship is being actively promoted by the government's "National Development Strategy 2030", but many new businesses still face hurdles. In particular, access to capital is very limited. In the World Bank's 2022 "Entrepreneurs in Uzbekistan" survey, only 14.2% of respondents had an outstanding loan, despite many reporting credit constraints[3]. Formal borrowing is especially rare among rural and poor entrepreneurs. This credit gap is matched by a reliance on informal finance and self-funding; small business owners often use personal savings or community funding rather than bank loans.

Poverty remains a concern even as the overall rate has fallen. According to recent data, Uzbekistan's poverty rate fell from 17% in 2021 to 11% in 2023 on the national scale[13], and only 17% live under the upper-middle-income line (\$6.85/day) as of 2022[2]. However, inequality is rising: the richest 10% saw income growth far outstrip that of the bottom 10%[14]. The World Bank warns that many poor households have lower employment, education, and assets[10]. Thus, enabling sustainable small business growth could help sustain poverty reduction. Yet Uzbek entrepreneurs report obstacles like inadequate skills, weak infrastructure, and bureaucratic red tape. Crucially, fear of conventional debt emerges as a pervasive barrier: many potential entrepreneurs avoid loans altogether because they dislike paying interest[3]. This attitude is rooted in religious and cultural norms: Uzbekistan is over 90% Muslim, and charging or paying interest (riba) is generally prohibited by Shariah. In this context, demand is high for alternative financing that aligns with Islamic values.

### Principles of Islamic Finance and Relevance to Entrepreneurship

Islamic finance is based on core Shariah principles: prohibition of riba (interest), emphasis on risk-sharing, and ethical investment. Key modes include:

- Mudarabah (Profit-Sharing Partnership): One party provides capital (rab al-māl) and another provides labor/management (mudarib). Profits are split

per contract, but losses fall on the capital owner (unless due to negligence)[15]. This allows banks or funds to finance entrepreneurs as equity partners.

- **Musharakah (Joint Venture):** All partners contribute capital and share profits and losses proportionally[16]. This establishes joint ownership of projects, aligning incentives to succeed.
- **Murabahah (Cost-Plus Sale):** A bank buys an asset (e.g. equipment or inventory) and sells it to the client at a known markup, payable in installments[12]. The markup replaces interest. This is akin to an asset-backed loan, providing financing while avoiding usury.
- **Ijārah (Leasing):** The lender buys equipment or property and leases it to the entrepreneur for rent. The lessee gains use of the asset and can eventually own it, without interest charges.
- **Qard al-Ḥasan (Interest-Free Loan):** A benevolent loan given on the basis of goodwill, to be repaid without any profit to the lender. It is often funded by charity and used purely to help the needy (e.g. entrepreneurs) without financial gain for the institution.
- **Zakat:** A mandatory 2.5% almsgiving on certain wealth, collected by Islamic authorities to help the poor (including destitute entrepreneurs). Zakat funds can be directed toward micro-credit or business grants in some models.
- **Waqf (Endowment):** A philanthropic trust where a donor's asset is dedicated in perpetuity for community benefit. Returns from investing waqf assets can fund social programs, including education, healthcare, or interest-free loans for entrepreneurs.

The practical relevance of these instruments to entrepreneurship is significant. By replacing fixed interest with profit-sharing or equity, Islamic contracts share risk between financier and entrepreneur. For new or failed businesses (high-risk ventures), this means the entrepreneur is not obliged to repay an amount that could bankrupt them if profits falter. Instead, profits are only paid when business succeeds. For example, a failed entrepreneur seeking a second chance could partner with a Shariah-compliant fund under musharakah: if the business prospers, both share gains; if not, the entrepreneur's loss is limited. Likewise, mudarabah allows an incubator or Islamic fund to back skilled managers, taking the loss if the venture fails.

Islamic social finance tools also offer community support. Qard al-Ḥasan loans and zakat can seed projects for the very poor. A notable case: after Cyclone Sidr in Bangladesh, the Fael Khair Waqf program granted interest-free microloans (qard al-ḥasan) to victims to rebuild livelihoods. Evaluations found program participants were 1.46 times less likely to remain poor than non-participants, as the cost-free

credit enabled asset accumulation[5]. In Malaysia, Amanah Ikhtiar Malaysia – an Islamic microfinance institution – offers murabahah and qard al-ḥasan loans to micro-entrepreneurs. Empirical research shows that Malaysian women borrowers using Islamic microfinance had significantly better business performance than those without[4].

In summary, Islamic finance provides alternative, asset-backed and risk-sharing financing. As one review notes, “Islamic economies have devised methods to supply cash to Muslim businesses as an alternative to debt finance through credit sales, partnerships, and interest-free loans”[17]. Another authority observes that Islamic microfinance explicitly channels funds to the underprivileged via Shariah principles[18]. These features suggest such mechanisms can help Uzbekistan’s entrepreneurs re-enter business: by lowering borrowing costs, avoiding exploitative interest, and aligning with local values, they make capital more accessible to those excluded by conventional banks.

#### Psychological, Social and Cultural Dimensions

Psychological and cultural factors strongly shape Uzbek entrepreneurs’ finance choices. Many Uzbek Muslims view interest as unethical or personally uncomfortable, leading them to reject conventional loans even when otherwise creditworthy. The aforementioned survey found roughly one-third of entrepreneurs avoided borrowing due to a “dislike” of interest[3]. In practice, this means a viable entrepreneur may remain stagnant without viable Shariah options.

Socially, Islamic finance is often embedded in community and religious networks, which can bolster trust. Clients financing through an Islamic bank or a mosque-based microfinance scheme may feel their religious obligations are being honored, reducing moral anxiety. A study of Uzbek attitudes found that “attitude, religiosity and social factors” significantly and positively influence willingness to patronize Islamic banking[6]. In other words, stronger religious identity correlates with openness to Shariah-compliant products. Islamic banks and funds also often provide mentoring and group-lending structures that build solidarity, which is culturally appealing.

Moreover, entrepreneurs may perceive Islamic finance as more ethical and equitable. As one review of Muslim entrepreneurship notes, Islamic ethics view business transactions as ‘ibadah (worship) when conducted fairly[19]. This ethical framing can enhance motivation and resilience. Historical anecdotes remind us that Prophet Muhammad himself was a trader, and Islamic tradition encourages profit “with blessing” – making business success socially valued. Thus, beyond pure finance, these mechanisms resonate with Uzbek entrepreneurs’ values of fairness,

community welfare, and religious duty (such as zakat and waqf, which channel wealth back to society).

Finally, the cultural acceptability extends to women and marginalized groups. In many Muslim contexts, Islamic microfinance institutions have successfully reached female entrepreneurs who might otherwise avoid mixed-gender or interest-focused settings. This inclusivity can be crucial for Uzbekistan's many working-poor women, especially in rural areas.

#### International Case Studies

Empirical examples from other Muslim-majority countries illustrate Islamic finance's impact on entrepreneurship and poverty:

- Malaysia (AIM): Amanah Ikhtiar Malaysia (AIM) is a government-linked Islamic microfinance provider. A quantitative study of 120 women micro-entrepreneurs funded by AIM found that "Islamic microfinancing... positively influence[d] the performance of women micro-entrepreneurs"[4]. AIM uses a profit-and-loss sharing model and low fees, and its borrowers report improved incomes and stability. Malaysia's success demonstrates how an Islamic microfinance institution, supported by technology and human capital training, can foster small enterprise growth.

- Bangladesh (Qard al-Hasan): The Fael Khair Waqf interest-free loan program in Bangladesh (mentioned above) serves as a strong case for Islamic social finance. It was initiated after a natural disaster, but the model has since been seen as a blueprint for using waqf funds to combat poverty. In that program, recipients of qard al-ḥasan loans were significantly less likely to be poor than those who did not receive them[5]. The program's success suggests that similar models - funded by zakat or government waqf endowments - could help struggling Uzbek entrepreneurs restart businesses without the burden of interest.

- Pakistan (Islamic Microfinance): In Pakistan's Sindh province, a recent study finds that "Islamic microfinance... combined with an appropriate framework for monetary and fiscal policy, have a favourable impact on Pakistan's efforts to reduce poverty"[20]. Though Pakistan's Islamic finance sector is still maturing, the research indicates growing demand: many small businesses there prefer Shariah-compliant loans over conventional ones, and policy support (e.g. regulatory guidelines for Islamic microfinance) can amplify its poverty impact.

- Indonesia (BMTs): Indonesia has witnessed a remarkable rise in Islamic microfinance. Since the 1990s, Baitul Maal wat Tamwil (BMT) cooperatives have proliferated across Java and elsewhere. A case analysis found that by 2019, BMTs (Islamic village financial cooperatives) accounted for about 61.9% of all microfinance financing in Indonesia[21], dwarfing the contribution of formal

Islamic banks. The number of BMTs grew from 1,522 in 2013 to 3,568 in 2017 (over 32% CAGR)[21]. Many poor rural entrepreneurs rely on BMTs for small loans and saving accounts. The success of BMTs – rooted in community trust and Shariah principles – shows that grassroots Islamic finance can achieve very high outreach and mobilize local savings to fund SMEs.

- Indonesia (Government-backed scheme): The Indonesian government also sponsors Islamic microfinance through the UMi program (Pembiayaan Ultra Mikro) which provides interest-free credit (financing without profit, but with minimal fees). In its first few years, UMi helped hundreds of thousands of ultra-poor entrepreneurs, though it is not strictly Shariah-labeled. Nonetheless, it illustrates how a state can support small Islamic financial products.

These cases consistently report improved business resilience and poverty outcomes when Islamic finance is available. Entrepreneurs often invest Islamic loans in productive assets or inventory, whereas interest payments on conventional loans would have drained cash flow. Across contexts, Shariah-compliant finance tends to target the bottom of the pyramid, aligning with poverty reduction goals.

#### Discussion

The evidence indicates that Islamic finance mechanisms offer viable, ethical alternatives to conventional credit for Uzbek entrepreneurs. By leveraging profit-sharing and interest-free models, these instruments can lower financial barriers and re-engage those who shunned conventional loans. In Uzbekistan, where many small-business owners cite fear of interest as a reason for not borrowing[3], introducing Islamic products could mobilize latent entrepreneurial talent.

For example, a mudarabah fund could allow a successful Uzbek artisan or agricultural entrepreneur to expand production: the bank would provide capital, the entrepreneur supplies expertise, and both share the profit. If the venture fails, the bank absorbs the loss (short of proven negligence by the entrepreneur), avoiding personal ruin for the business owner. This risk-sharing not only alleviates anxiety about fixed debt but also fosters a partnership ethos between financier and entrepreneur. Similarly, murabahah could be used for equipment purchase: an Islamic financier buys a tractor and sells it at cost-plus to the farmer with deferred payments. The markup is agreed upfront, so it feels like a trade rather than a loan.

Psychological comfort is key: as one study of Islamic entrepreneurs notes, “Islamic principles provide an ethical foundation that supports resilience”[17]. Entrepreneurs who perceive financing as halal (permitted) are likely to engage more fully, viewing business success as aligned with faith. Moreover, Islamic contracts often carry social stipulations (e.g. zakat compliance, transparency) that can build customer trust in an entrepreneur, enhancing their market standing.

Policy implications for Uzbekistan: The government and regulators can facilitate these mechanisms. One approach is to legalize and promote Islamic banking and microfinance. For instance, Uzbekistan could license Islamic windows in existing banks or green-light dedicated Islamic banks (as in Malaysia or Indonesia). According to global best practice, regulatory frameworks should allow profit-and-loss sharing contracts, ensure Shariah boards, and provide tax neutrality (so Islamic banks aren't penalized by double withholding)[6][22]. Central banks can also adopt core principles for Islamic finance regulation (IMF and Islamic Financial Services Board have guidelines) to ensure stability while encouraging innovation.

A second avenue is leveraging Islamic social funds. Uzbekistan has considerable zakat potential (around 2.5% of wealth each year from many households) and could more systematically collect zakat for poverty-focused business grants or qard al-ḥasan programs. Similarly, the concept of national waqf (endowment) could be revived: dedicating assets (land, cash, gold) in perpetuity to fund education, skill training, or interest-free loans for enterprises in poor regions. The Amanah Advisors proposal of "inter-mosque money markets" offers a blueprint: mosques establish waqf funds that invest in Shariah assets and channel returns to local businesses[23].

Adopting microfinance best practices is also recommended. For example, Uzbek authorities can learn from Malaysia's Amanah Ikhtiar model: combining finance with training, peer support, and digital platforms. Digital Islamic microfinance platforms (as being piloted in Indonesia and Malaysia) could extend reach to remote Uzbek villages. Government could provide partial guarantees or first-loss funds to back Islamic micro-loans, lowering the risk for private lenders.

Challenges and future work: Careful implementation is needed. Islamic finance is not a panacea: proper governance, skilled Shariah oversight, and financial literacy are crucial. Uzbekistan's financial infrastructure may need to develop Shariah scholars and mobile banking channels to serve rural clients. Additionally, social outreach is vital: many potential entrepreneurs will need education on how Islamic contracts work, to build trust.

Future research should empirically test pilot programs in Uzbekistan, tracking outcomes of entrepreneurs who use Islamic finance vs conventional credit. Longitudinal studies could measure impacts on poverty and business sustainability. Comparative surveys might gauge Uzbek entrepreneurs' preferences more deeply. On the policy front, analyses of legal reforms (for example, banking law to accommodate mudarabah contracts) would inform decision-makers.

Conclusion

This study finds that Islamic finance mechanisms have strong potential to help failed or aspiring entrepreneurs in Uzbekistan re-enter business and contribute to poverty reduction. Uzbekistan's rapid poverty decline and growth agenda face the bottleneck of financial exclusion and cultural aversion to interest[3][2]. Islamic finance – through profit-sharing partnerships, interest-free loans, and charitable endowments – offers an alternative, ethically aligned toolkit. International experiences show that Shariah-compliant microcredit and partnership financing can boost small businesses and lift the poor[5][4][18][21].

For Uzbekistan, embracing Islamic finance means adapting global best practices to the local context: allowing Islamic banking models, mobilizing zakat/waqf resources for entrepreneurs, and educating both regulators and the public. When properly integrated, these instruments could unlock entrepreneurship among those who are culturally or economically sidelined. Ultimately, such inclusionary finance could reinforce Uzbekistan's poverty reduction achievements and foster more resilient, broad-based economic development. Future research should continue to evaluate these mechanisms in Central Asia, ensuring that Islamic finance fulfills its promise of equitable growth and shared prosperity in Uzbekistan and beyond.

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