



**Why Traditional Banks are Failing Small Businesses in
Uzbekistan: The Islamic Finance Solution**

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Abstract

In Uzbekistan, many young people want to start small businesses. However, it is very hard for them to get money from traditional banks. The main reason is the “collateral rule”. Banks ask for houses or real estate that are worth 120% more than the loan. This paper explains why this rule is stopping economic growth. It also shows how Islamic Finance, specifically the Profit and Loss Sharing (PLS) system, can fix this problem. By using simple comparisons and tables, this paper proves that Islamic banking is a better choice for small and medium enterprises (SMEs) in Uzbekistan.

Key Words

Islamic Finance, Small Businesses (SMEs), Uzbekistan, Collateral, Youth Entrepreneurship, Risk-Sharing, PLS.

1. Introduction: The Young Entrepreneur's Problem

Uzbekistan has a very young population. Every year, thousands of young people graduate from universities with brilliant business ideas. They want to open IT startups, delivery companies, or small farms. But a good idea is not enough. To start a business, you need capital (money).

When a young entrepreneur goes to a normal, traditional bank in Tashkent to ask for a loan, the bank usually says “no”. Why? Because the traditional bank does not look at how good the business idea is. The bank only looks at what the person owns. The bank wants “collateral” - usually a big house or commercial building. If you want a





\$10,000 loan, the bank wants you to pledge a house worth \$12,000. But most young people do not own big houses. Because of this, their great business ideas never become real.

This system is called “Risk-Shifting”. The bank shifts 100% of the risk to the young person. If the business fails, the bank takes the house. This is very safe for the bank, but very bad for the country’s economy because it stops small and medium enterprises (SMEs) from growing.

2. Literature Review

Many writers have studied why small businesses fail to get money. For example, Vahabov (2023) wrote that high interest rates and huge collateral rules are the biggest barriers for SMEs in Central Asia. He noted that without money, these businesses cannot create jobs. Similarly, the World Bank Group (2024) reported that countries with younger populations must find new ways to give loans, otherwise the youth will leave the country or stay unemployed.

On the other side, writers like Iqbal (2011) and Ahmed (2002) explain how Islamic Finance solves this exact problem. They say that Islamic banks do not rely only on real estate. Instead, Islamic banks look at the real business project. Because Islamic finance is based on justice and sharing risk, the bank works together with the entrepreneur. If the business is good, both make money. If the business is bad, both lose. This literature proves that for a country like Uzbekistan, Islamic Finance is not just a religious choice; it is a smart economic tool.

3. The “Collateral Crisis” in Uzbekistan.

To understand the problem better, we need to look at the numbers. SMEs make up more than 50% of the GDP in Uzbekistan. They are the engine of our economy. But they get very little funding from the banks. Here is a simple table 3.1 showing the conflict between what a traditional bank wants and what a normal SME has.





Table 3.1

The Disconnect Between Banks and Small Businesses

| Factors | Traditional Bank Requirement | SME Reality in Uzbekistan | Result |
|--------------------------|---|--|--|
| Primary Security | 120% Real Estate (Houses, Buildings) | Only has business ideas, a laptop, or small equipment | Loan Rejected |
| Focus of the Bank | Collecting fixed monthly interest | Needs time to make a profit | Business goes bankrupt if sales are slow |
| Risk | Bank takes 0% risk. Borrower takes 100% | Entrepreneur can lose everything (including family home) | People are afraid to take loans |

Source: Prepared by author

As we can see in Table 1, the traditional banking rules are designed for rich, old companies, not for new, innovative startups. This is a “collateral crisis.” If we do not change this, our economy will not grow as fast as it could. We need a system that looks at the business project, not just the borrower's house.

4. The Islamic Solution: Sharing the Risk (PLS)

So, how do we solve the collateral crisis? The answer is Islamic Finance. Islamic finance is very different from traditional banking because it uses a system called Profit and Loss Sharing (PLS).

In Islamic finance (using a contract like Musharaka or Mudaraba), the bank does not act like a strict money-lender. Instead, the bank acts like a business partner.



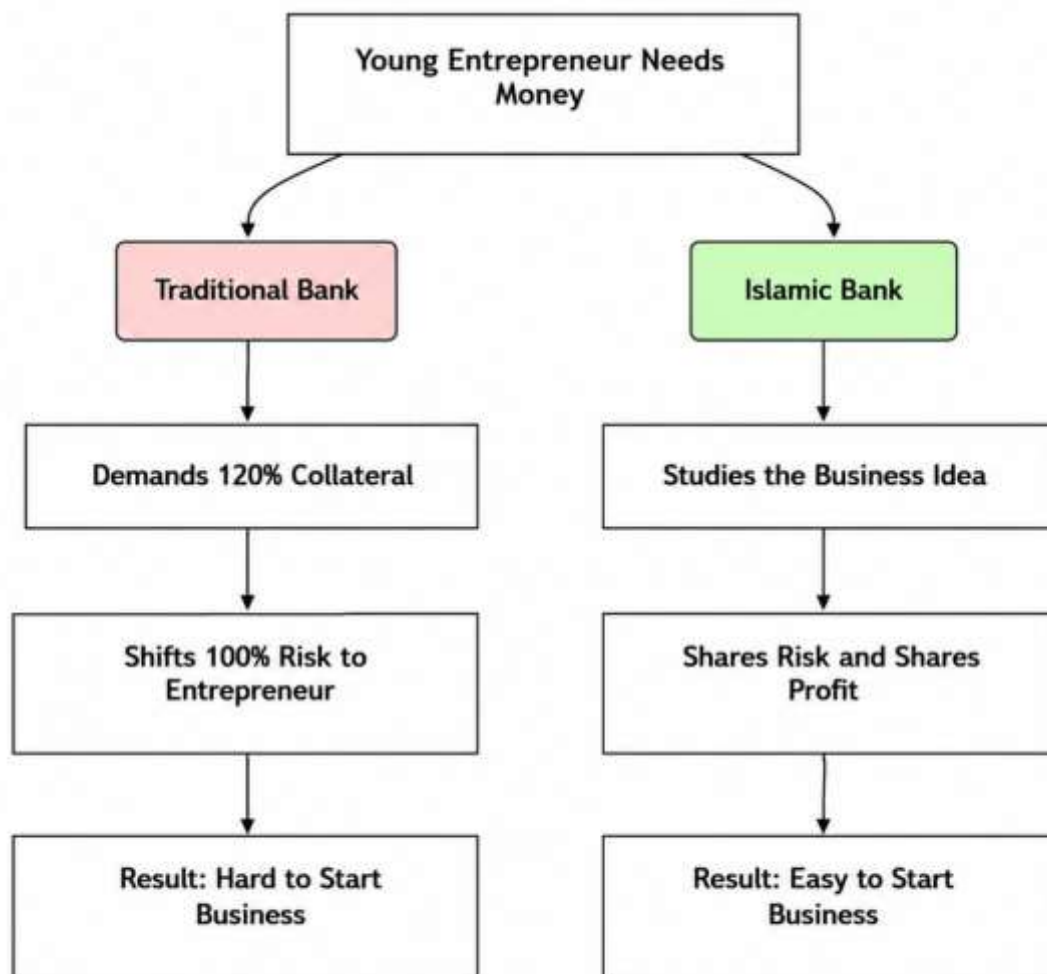


If a young person has a great idea but no house, the Islamic bank will study the business idea very carefully. If the bank thinks the idea is good, the bank will provide the money. When the business makes a profit, the bank and the entrepreneur share the money. But what if the business fails? In this case, the bank shares the financial loss. The entrepreneur only loses his time and hard work.

Because the bank is sharing the risk, the bank does not need to ask for 120% collateral. This is a game-changer for young startups.

Here is a simple chart that shows the difference:

Graph 4.1



Source: Prepared by author





5. Real-World Scenario: Starting a Delivery Business in Tashkent

Let us look at a real-life example to understand how this works in practice. Imagine a young man named Ali living in Tashkent. He wants to start a small logistics and delivery company. He has good clients waiting, but he needs to buy a delivery van. The van costs \$15,000. Ali has no big house to use as collateral. Let's compare what happens if Ali goes to a traditional bank versus an Islamic bank.

Table 5.1

Financing Ali's Delivery Van

| Feature | Traditional Bank (Normal Loan) | Islamic Bank (Partnership/Musharaka) |
|-------------------------------------|--|--|
| What does the bank check? | Does Ali own a house worth \$18,000? | Is Ali's delivery business plan profitable? |
| Does Ali get the money? | NO. (Because he has no house) | YES. (Based on his good business plan) |
| What is the bank's role? | Just waits for monthly interest payments | Acts as a partner. Gives Ali business advice to help him succeed |
| What if the van breaks down? | Ali must still pay full interest every month | The bank shares the problem because they are partners |

Source: Prepared by author

As Table 2 shows, if Ali uses a traditional bank, his delivery company will never exist. He stays unemployed. But if an Islamic bank is available, Ali gets the van, starts his business, pays taxes to the government, and creates new jobs for drivers.

This is exactly why Islamic Finance is the best solution for unlocking the power of small businesses in Uzbekistan.





Conclusion and Recommendations: The “Regulatory Sandbox”

The analysis in this paper shows a very clear truth: traditional banks in Uzbekistan are too strict for modern small businesses. The 120% real estate collateral rule is like a wall that stops young people from achieving their dreams. Islamic Finance, with its Profit and Loss Sharing (PLS) system, breaks down this wall by focusing on the quality of the business idea, not just the size of the borrower's house.

However, we cannot just change the whole banking system in one day. To safely introduce Islamic Finance, we recommend that the Central Bank of Uzbekistan creates an “Islamic Finance Regulatory Sandbox”.

What is a Sandbox? It is a safe testing zone. Inside this Sandbox, the Central Bank can allow two or three local banks to test Islamic finance products (like Musharaka) with real entrepreneurs, like Ali from our example. Because it is a test zone, the banks do not have to follow the strict 120% collateral rule.

If the Central Bank monitors this test for one or two years, they will see that Islamic Finance is actually very safe. When the banks act as business partners, they work harder to make sure the business succeeds. Once the Sandbox proves that this system works, the government can make it a permanent law for the whole country.

In conclusion, Islamic Finance is not just about religion; it is about smart economics. By moving from a “Risk-Shifting” model to a “Risk-Sharing” model, Uzbekistan can unlock the full potential of its young generation. If we give our youth the right financial tools, they will build a stronger, richer, and more innovative economy for everyone.

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