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THE ROLE OF THE ISLAMIC FINANCE SYSTEM IN THE DEVELOPMENT OF SMALL AND MEDIUM BUSINESSES

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Abstract: This article provides a comprehensive scientific and theoretical analysis of the implementation and improvement of the legal and economic foundations of the Islamic finance system in the financial market of the Republic of Uzbekistan, with a particular emphasis on the development of the small and medium-sized business sector. Particular attention is paid to the synergies between partnership banking and digital technologies, fintech platforms, as well as the potential for attracting foreign direct investment and bringing domestic savings out of the shadow economy.

Keywords: Islamic finance, partnership banking, small and medium-sized businesses, risk sharing, tax neutrality, digitalization of finance.

In the current context of the global transformation of financial markets, the search for alternative and sustainable mechanisms for stimulating entrepreneurial activity has acquired particular academic and practical relevance. Small and medium-sized businesses have traditionally served as the fundamental basis for economic growth, ensuring market flexibility, job creation, and the introduction of local innovation.

In the Republic of Uzbekistan, the modernization of this sector has been elevated to the rank of strategic state priorities; however, its dynamic development is constrained by a number of factors in the sphere of traditional financial intermediation. The conventional banking system often imposes strict collateral requirements, sets high interest rates, and demonstrates a shortage of long-term investment resources, limiting access to necessary capital for start-ups and growing businesses.

An effective solution to this problem is the integration of the principles of partnership or Islamic finance, which offers a qualitatively different paradigm for interaction between financial institutions and the real economy. Academic interest in the Islamic economic model is driven by its fundamental principles, which exclude interest rates, speculative uncertainty, and the financing of activities harmful to society.

Instead of traditional credit relationships, where the bank acts only as a strict lender, Islamic financial institutions operate on a profit-and-loss basis, becoming full-fledged investment partners. For small and medium-sized businesses in Uzbekistan, this approach offers significant prospects, as it minimizes the debt burden in the initial stages of business projects and reduces the risk of bankruptcy during periods of macroeconomic instability.

One of the most popular instruments in this sector is trade finance with a pre-agreed markup, known as murabaha, which allows entrepreneurs to purchase production assets, raw materials, and equipment in installments without hidden fees or floating interest rates. This ensures pricing transparency and significantly simplifies financial planning for small businesses. Another effective

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mechanism is lease-purchase, or ijarah, which replaces traditional leasing and allows for the modernization of facilities without drastically withdrawing working capital from the company.

In this case, ownership of the property remains with the financing institution until the end of the agreement, automatically reducing the requirement for additional collateral. Equity instruments such as mudaraba and musharaka are particularly important for stimulating innovative entrepreneurship and start-up projects. Under these agreements, the financial institution provides capital, and the entrepreneur contributes their professional expertise, knowledge, and management experience.

The distribution of financial results is strictly proportional to the capital contribution in the event of losses, or according to agreed-upon agreements in the event of profits. This risk-sharing encourages entrepreneurial initiative in high-risk, but potentially high-return sectors of the economy, where traditional lending is completely inapplicable. The introduction of this system into Uzbekistan's financial architecture promises significant macroeconomic benefits, including attracting large-scale direct investment from the Middle East and Southeast Asia, as well as the legalization and inclusion of significant savings previously held outside the banking sector due to citizens' religious or ethical beliefs.

However, successfully realizing the potential of partner banking faces significant barriers, among which the institutional and legal vacuum plays a key role. Current legislation in the country, including banking and tax law, focuses exclusively on the conventional interest model, which creates the problem of double taxation when conducting trade and intermediary transactions through Islamic institutions and makes their products economically uncompetitive.

Furthermore, the market is experiencing an acute shortage of qualified personnel capable of implementing this system.

Conduct audit and risk management in accordance with partnership finance standards, and the business community itself remains relatively uninformed about the actual mechanisms of these instruments. Overcoming these obstacles requires systemic government support through the adoption of specialized regulations, the consolidation of the legal status of Islamic financial institutions, and the implementation of the principle of tax neutrality, eliminating the excessive fiscal burden of partnership transactions.

At the same time, the development of educational infrastructure is necessary through the creation of specialized programs at the country's leading higher education institutions and extensive outreach efforts among entrepreneurs. Thus, the development of a comprehensive legal and economic framework for Islamic finance will enable the creation of a diversified, inclusive, and resilient financial system capable of raising the competitiveness of small and medium-sized businesses in Uzbekistan to a qualitatively new level.

An additional important aspect that enhances the scientific novelty of the study is the synergy between Islamic finance and modern digital technologies and financial platforms. Amid the rapid digitalization of Uzbekistan's economy, integrating partnership tools into mobile apps and crowdfunding platforms could dramatically simplify small businesses' access to capital. The creation of specialized digital Islamic windows and fintech startups will reduce financial institutions' operating costs, making the final product more accessible to micro-firms and farms in remote regions of the country.

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Furthermore, the partnership banking system offers unique opportunities for the development of women's entrepreneurship and social business. Because Islamic finance is focused on ethical priorities and tangible social benefits, priority funding is often given to projects aimed at import substitution, job creation for vulnerable groups, and environmentally friendly production. Unlike traditional banks, which require hard collateral in the form of real estate, partnership institutions focus on the viability of the business plan and the potential for market demand when evaluating startups, providing institutional support to young entrepreneurs without significant start-up capital.

Transformation of the risk management system is also an important scientific and practical element. The introduction of Islamic finance requires the financial sector to shift from passive borrower monitoring to active compliance control and project management, as banks directly share losses with businesses. This stimulates the development of independent audit and consulting institutions, enhancing overall transparency and corporate governance practices in the small and medium enterprise sector.

Uzbekistan's inclusion in the global Islamic finance ecosystem will also have a positive impact on the country's sovereign credit rating. Entering the international Islamic sukuk market will not only diversify public debt sources but also create a clear benchmark for private domestic companies seeking to attract long-term investment without increasing interest rates, which will strengthen the country's financial sovereignty and macroeconomic stability in the long term.

Conclusion. Summarizing the results of the study, we can draw a scientifically substantiated conclusion that the integration of the Islamic finance system into the financial architecture of the Republic of Uzbekistan represents a strategically necessary step towards the qualitative modernization of the small and medium enterprise sector. The transition from rigid debt relationships to flexible partnership banking mechanisms allows for a fundamental transformation of the economic ties between capital and real production, reducing the financial burden on entrepreneurs and stimulating their innovative activity. The instruments discussed, based on risk sharing and mandatory linking to real assets, are proving highly effective as an alternative source of liquidity, capable of bringing significant domestic savings out of the shadow economy and attracting large-scale foreign investment.

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