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ALTERNATIVE FINANCING MECHANISMS FOR SMALL BUSINESS DEVELOPMENT IN UZBEKISTAN: CROWDFUNDING, VENTURE CAPITAL AND ISLAMIC FINANCE

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ABSTRACT

This article examines the potential of alternative financing mechanisms to improve access to finance for small business entities in Uzbekistan. It focuses on crowdfunding, venture capital and Islamic finance as complementary instruments to traditional bank lending. The topic is relevant because SME financing remains bank-centered and largely dependent on collateral. Using literature analysis, policy benchmarking, institutional analysis and policy synthesis, the study evaluates selected regulatory mechanisms and recent national reforms related to investment platforms, venture funds and Islamic banking. The findings show that alternative finance can reduce dependence on conventional loans, expand financing opportunities for start-ups and innovative firms, and improve financial inclusion. However, effective implementation requires clear regulation, investor protection, digital infrastructure, disclosure standards, financial literacy and risk-sharing mechanisms. The article proposes a phased roadmap based on regulatory sandbox testing, platform governance, venture capital incentives, Islamic finance pilot products and integration with existing SME support institutions. The study contributes to the literature by linking SME finance theories with Uzbekistan's institutional transformation and identifying practical mechanisms for adapting international alternative finance models to national conditions. It concludes that these instruments should complement rather than replace bank lending and should be introduced gradually in line with regulatory capacity and market readiness.

Keywords: Small business; SME finance; alternative finance; crowdfunding; venture capital; Islamic finance; Uzbekistan; financial inclusion; investment platforms.

INTRODUCTION.

Small business entities play a vital role in employment, income generation, regional development and economic diversification. In transforming economies, they also promote innovation, connect local resources with markets and strengthen the competitive private sector. Therefore, improving small business financing mechanisms remains an important policy and research priority.

Uzbekistan has made considerable progress in supporting entrepreneurship and expanding access to financial services. However, small business financing remains largely dependent on commercial banks and state-supported credit programs. Start-ups, innovative firms, businesses without sufficient collateral and entrepreneurs in remote areas often face limited access to loans because of information asymmetry, weak financial reporting, insufficient credit history, high transaction costs and banks' risk perceptions.

The economic importance of the sector highlights the urgency of this issue. In January–September 2025, small businesses accounted for 51.5 percent of GDP value added, 97.1 percent of agricultural output, 75.7 percent of construction, 81.8 percent of retail trade, 55.0 percent of services

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and 32.0 percent of exports (National Statistics Committee of the Republic of Uzbekistan, 2025). At the same time, their financing needs are becoming more complex as firms increasingly pursue digitalization, innovation, exports and productivity-enhancing investment.

Bank lending remains the main source of external finance. As of 1 June 2025, total commercial bank loans amounted to 567,685 billion soums, of which 373,953 billion soums were allocated to legal entities (Central Bank of the Republic of Uzbekistan, 2025). The large role of banks with state participation and the limited development of non-bank instruments demonstrate the need to diversify the financial system.

Recent reforms aimed at supporting venture funds, investment platforms, alternative investment funds and Islamic finance provide new opportunities for expanding SME financing. Against this background, the article examines the potential, limitations and policy conditions for developing crowdfunding, venture capital and Islamic finance in Uzbekistan. Crowdfunding can support small and community-based projects, venture capital can finance innovative and high-growth firms, while Islamic finance can offer asset-based and risk-sharing alternatives to conventional lending.

The article reviews the relevant literature, explains the methodology, evaluates the potential of the selected instruments and proposes policy measures and a phased implementation roadmap.

In this article, the term SME is used as an umbrella concept covering micro, small and medium-sized business entities, while official indicators retain the terminology used in the original national sources.

LITERATURE REVIEW

The literature on small business financing emphasizes that SMEs face greater financing constraints than large firms. The key explanation is information asymmetry. Stiglitz and Weiss (1981) showed that credit markets may not clear through interest rates alone because higher rates can increase adverse selection and moral hazard. In practice, banks respond by rationing credit, requiring collateral or limiting lending to borrowers with established financial histories. This framework is particularly relevant for small firms in emerging economies, where financial statements may be incomplete and collateral markets may be imperfect. Beck and Demirgüç-Kunt (2006) similarly demonstrate that limited access to finance represents one of the main constraints on SME growth, particularly in financial systems where collateral requirements and information asymmetry restrict lending to smaller firms.

Berger and Udell (2006) proposed a more complete conceptual framework for SME finance by distinguishing between different lending technologies, including financial statement lending, asset-based lending, credit scoring, relationship lending, factoring and leasing. Their approach suggests that no single instrument can meet all SME financing needs. Instead, efficient SME finance requires an ecosystem of instruments adapted to firm size, age, transparency, sector and growth potential. This perspective is useful for Uzbekistan because the existing system remains concentrated in bank lending, while many non-bank instruments are still developing.

Agency theory also provides a basis for understanding financing constraints. Jensen and Meckling (1976) explained that conflicts of interest between owners, managers and external financiers generate monitoring costs and contractual frictions. In small businesses, owner-management overlap can reduce some agency problems, but weak governance and limited disclosure can increase risk for external investors. Alternative financing mechanisms attempt to reduce such frictions through platform-based disclosure, staged financing, investor participation, asset backing or profit-and-loss sharing.

Crowdfunding has emerged as a digital mechanism that connects entrepreneurs directly with a large number of small investors or supporters. Mollick (2014) describes crowdfunding as a financing

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method in which entrepreneurs raise relatively small amounts of money from many individuals, often through online platforms. Belleflamme et al. (2014) emphasize that crowdfunding is not only a funding tool but also a market-testing mechanism because backers can signal demand for a product or service. For small firms, crowdfunding can be useful when bank credit is unavailable or when the entrepreneur needs to validate consumer interest before expanding production.

Venture capital is another important alternative instrument. It provides equity or quasi-equity financing to innovative firms with high growth potential. Gompers and Lerner (2001) argue that venture capital contributes not only money but also monitoring, managerial support, networks and strategic guidance. However, venture capital is suitable mainly for a narrow segment of firms that can scale rapidly and generate high returns. Therefore, it should not be considered a universal replacement for bank credit. It is more appropriate for start-ups in technology, digital services, green innovation, biotechnology and other knowledge-intensive sectors.

Islamic finance differs from conventional finance because it prohibits interest-based transactions and emphasizes asset backing, risk sharing, ethical investment and contractual transparency. Instruments such as murabaha, ijara, mudarabah and musharakah can be adapted to SME financing. Murabaha can be used for trade finance and working capital linked to real assets; ijara can support equipment leasing; musharakah and mudarabah can finance partnership-based business projects. For countries with demand for Sharia-compliant services, Islamic finance can increase financial inclusion by attracting entrepreneurs who avoid conventional loans for religious or ethical reasons (Khan & Ahmed, 2001).

The literature therefore suggests that alternative finance should be viewed as a complementary layer within the broader SME finance ecosystem. Crowdfunding can support early-stage and small-ticket projects, venture capital can support innovation and scale-up, and Islamic finance can broaden participation through asset-based and partnership-based products. The main challenge is institutional: without regulation, transparency and investor protection, alternative finance can create new risks rather than solve existing problems.

METHODOLOGY

This study uses a qualitative and analytical research design. The choice of methodology is determined by the nature of the research question, which focuses on institutional feasibility, policy design and adaptation of international financing instruments to national conditions. The article does not attempt to estimate causal effects econometrically; instead, it evaluates alternative financing mechanisms through literature analysis, policy benchmarking, institutional analysis and policy synthesis.

The first method is literature analysis. It is used to identify the main theoretical explanations of SME financing constraints and the economic logic of alternative finance. The theoretical basis includes credit rationing theory, agency theory and the conceptual framework of SME finance. The literature review provides the conceptual foundation for evaluating why alternative instruments may be necessary in a bank-centered financial system.

The second method is policy benchmarking. Regulatory mechanisms identified in the reviewed literature—including platform licensing, investor protection, staged venture financing and Sharia governance—were compared with Uzbekistan's current institutional framework. The purpose was not to rank countries but to determine which institutional practices could be adapted to the national legal and financial environment.

The third method is institutional analysis. This method is used to examine the current policy and regulatory environment in Uzbekistan. The analysis considers official statistical data, Central Bank information, presidential initiatives, legal documents and development partner programs. Institutional

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analysis is essential because the success of alternative finance depends not only on market demand but also on legislation, investor protection, digital infrastructure, taxation, supervision and public trust.

The fourth method is policy synthesis. Based on the literature, policy benchmarking and national context, the article develops a practical roadmap for introducing alternative financing mechanisms. The roadmap is organized by short-term, medium-term and long-term measures and links each instrument to expected results and institutional requirements.

RESULTS

Current financing conditions for small business in Uzbekistan

The analysis shows that small business in Uzbekistan has high economic significance but still operates within a financial system dominated by bank credit. This creates a structural mismatch between the diversity of SME financing needs and the limited range of available instruments. Small businesses differ by size, age, sector, risk profile and growth potential. A newly established digital start-up, a family-owned retail firm, an export-oriented manufacturer and a farmer purchasing equipment cannot all be efficiently financed through the same credit technology.

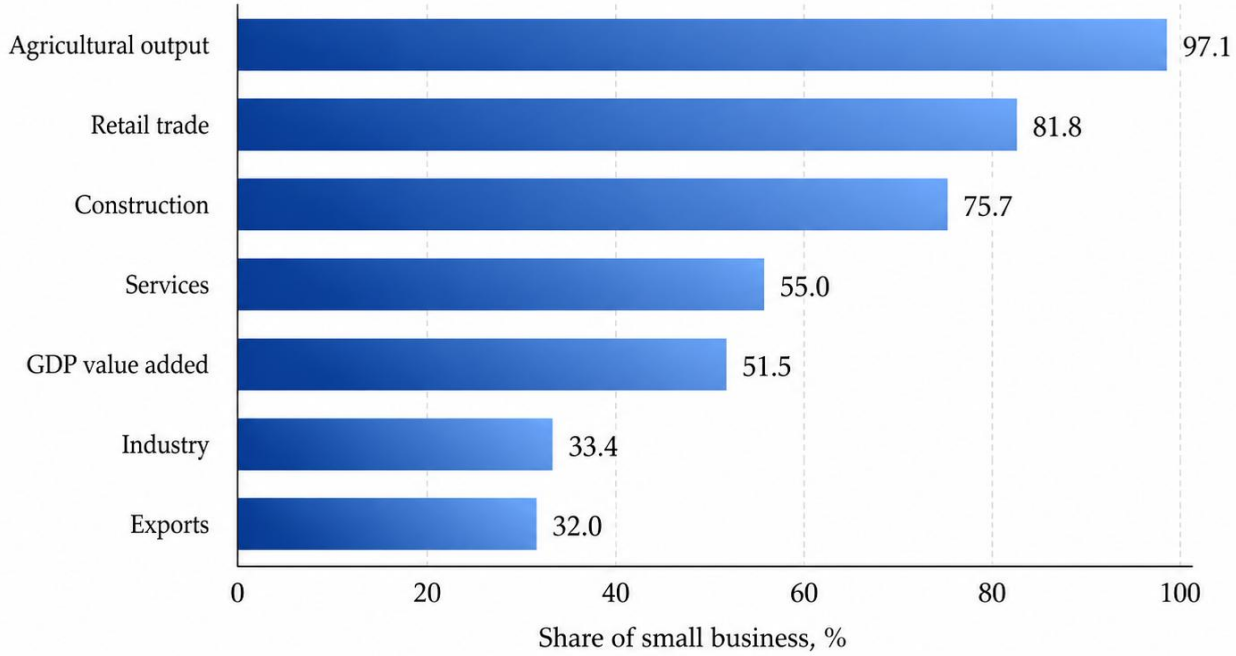


Figure 1. Selected indicators of the role of small business in Uzbekistan, January–September 2025

Source: Author's compilation based on National Statistics Committee data.

Figure 1 compares selected official indicators of small business participation in national economic activity. The particularly high shares recorded in agriculture, retail trade and construction indicate strong demand for flexible working-capital, trade-finance and equipment-financing instruments.

Official statistics confirm that small business has a strong presence across sectors. In January-September 2025, the share of small business in GDP value added was 51.5 percent. Its share was especially high in agriculture, construction and retail trade, while the share in industry was lower. This sectoral pattern suggests that many small firms operate in areas where working capital, trade finance, equipment leasing, seasonal finance and small investment tickets are essential. These needs can be addressed more effectively if bank loans are complemented by leasing, factoring, crowdfunding, venture capital and Islamic finance instruments.

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The banking sector provides the main channel for business finance. As of 1 June 2025, commercial bank loans reached 567,685 billion soums, and loans to legal entities accounted for 373,953 billion soums. Banks with state participation accounted for 389,198 billion soums of total loans. These data show the scale of bank intermediation but also indicate a concentration of financing within traditional credit institutions. In such conditions, alternative finance can play two roles: it can finance projects that banks do not serve efficiently, and it can create competitive pressure for more flexible financial products.

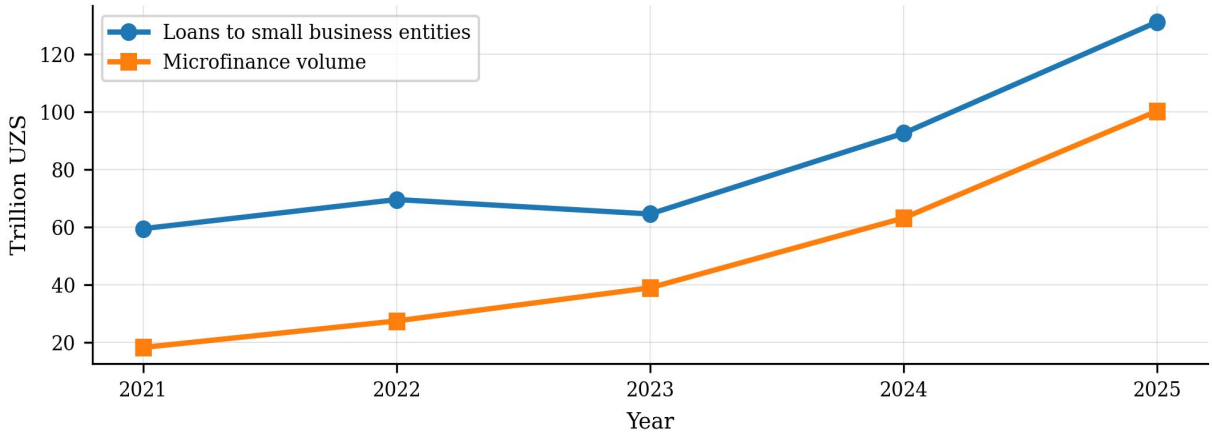


Figure 2. Dynamics of SME lending and microfinance in Uzbekistan, 2021–2025
Source: Author's compilation based on annual and periodic reports of the Central Bank of the Republic of Uzbekistan, 2021–2025.

Figure 2 illustrates that SME credit and microfinance expanded rapidly after 2023, confirming the growing financial demand of small business entities and the need to diversify instruments beyond conventional collateral-based lending.

Recent policy initiatives show that the state recognizes the need for diversification. The decree on increasing the role of small and medium-sized business in the economy set target indicators for 2025, including raising the SME share in GDP to 55 percent, in industry to 34 percent, in exports to 34 percent and in employment to 75 percent (Republic of Uzbekistan, 2025). Achieving such targets requires not only larger credit volumes but also more diversified financing channels and better matching between financial instruments and business needs.

Crowdfunding as a tool for inclusive and early-stage finance

Crowdfunding can become an important instrument for early-stage and small-ticket business finance in Uzbekistan. Its potential is especially relevant for micro-enterprises, social entrepreneurship, creative industries, local production projects and consumer-oriented innovations. Unlike traditional bank lending, crowdfunding does not necessarily require collateral or long credit history. Instead, it relies on project presentation, trust, community interest and digital payment infrastructure.

For Uzbekistan, crowdfunding should initially be developed through a controlled regulatory environment. The approval of the procedure for investment platform activities under a special legal regime indicates that the country is already moving toward platform-based investment mechanisms (National Agency for Prospective Projects of the Republic of Uzbekistan, 2026). This creates a basis for piloting crowdfunding-like models. However, the design of such platforms must distinguish between donation-based, reward-based, lending-based and equity-based crowdfunding because each model has different risk, disclosure and supervision requirements.

The main advantage of crowdfunding is that it can democratize access to finance. Entrepreneurs can raise small amounts from many individuals, while investors can participate with limited capital. In

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addition, crowdfunding may provide a market signal: if a project attracts many backers, it can demonstrate demand and improve the firm's chances of later receiving bank credit or venture investment. This sequential financing logic is particularly useful for start-ups that cannot immediately satisfy bank requirements.

Nevertheless, crowdfunding also creates risks. Investors may not have enough information to evaluate projects. Fraudulent campaigns may reduce trust. Platforms may face operational and cyber risks. Therefore, a national crowdfunding framework should include licensing of platform operators, investor suitability rules, disclosure standards, escrow mechanisms, limits on individual investment exposure, dispute resolution procedures and regular reporting to the regulator.

Venture capital for innovation and high-growth entrepreneurship

Venture capital is not suitable for all small businesses, but it is essential for a specific segment of firms: innovative, scalable and high-risk enterprises. These firms often require long-term capital and strategic support rather than standard debt. Bank loans may be inappropriate because early-stage start-ups may not have stable revenue, collateral or positive cash flow. Venture capital solves this problem by accepting higher risk in exchange for equity participation and potential high returns.

Uzbekistan has started to form the institutional basis for venture finance. Official statements report that in the last five years 53 start-up projects worth 145 million US dollars were implemented through venture funds, while three new venture funds with total capital of 50 million US dollars were created and an additional 50 million US dollars was raised from abroad (President of the Republic of Uzbekistan, 2025). These initiatives indicate that venture capital is beginning to move from policy discussion to practical implementation.

Another important step is the planned development of legislation on alternative investment funds and capital markets. Such legislation can provide the legal basis for private equity and venture funds, fund managers, limited partners, investor rights, valuation practices and exit mechanisms. Without a clear legal framework, venture investors face uncertainty regarding governance, taxation, minority shareholder protection and repatriation of returns (President of the Republic of Uzbekistan, 2026a).

For small business development, venture capital should be connected with incubators, accelerators, universities, technology parks and export support institutions. Public funds can play a catalytic role, but they should not replace private risk assessment. A hybrid model may be more effective: government or development institutions provide anchor capital, while private fund managers make investment decisions based on commercial criteria. This approach can reduce moral hazard and improve the quality of investment selection.

Islamic finance as an asset-based and risk-sharing alternative

Islamic finance is particularly relevant for Uzbekistan because it can expand financial inclusion and diversify the product range of banks and non-bank financial institutions. Islamic finance does not rely on interest-based lending; instead, it uses asset-based sale contracts, leasing, partnerships and profit-sharing structures. This feature can attract entrepreneurs who avoid conventional loans for religious, ethical or risk-sharing reasons.

Recent reforms have moved Islamic finance in Uzbekistan beyond the policy-planning stage. On 27 March 2026, Law of the Republic of Uzbekistan No. LRU-1126 was adopted to establish the legal framework for Islamic banking and is scheduled to enter into force on 29 June 2026 (Republic of Uzbekistan, 2026). In parallel, policy initiatives envisage the launch of Islamic window operations in at least one commercial bank and the establishment of two fully fledged Islamic banks during 2026–2030 (President of the Republic of Uzbekistan, 2026b).

Several Islamic finance instruments can be adapted to SME needs. Murabaha can finance inventories, raw materials and equipment purchases through a transparent cost-plus sale. Ijara can

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support machinery, transport and equipment leasing. Musharakah can finance joint business projects with profit-and-loss sharing. Mudarabah can be used when one party provides capital and the entrepreneur provides managerial effort. These instruments can reduce the contradiction between entrepreneurs' financing needs and the collateral-based logic of conventional lending.

However, Islamic finance requires more than product labels. It requires Sharia governance, accounting standards, tax neutrality, legal recognition of contracts, trained staff, customer education and supervision. Double taxation risks in asset transfers, lack of standardized documentation and weak awareness among entrepreneurs can limit adoption. Therefore, Islamic finance development should begin with simple and transparent products, pilot projects and cooperation with international Islamic finance institutions.

Table 1. Potential applications of alternative financing instruments in Uzbekistan

Instrument	Priority applications	Required institutional conditions	Expected impact
Crowdfunding	Microprojects, social and creative initiatives, local production and product pre-sales	Licensed platforms, disclosure and investor protection rules, escrow accounts, digital ID and payment integration	Early-stage finance and market validation
Venture capital	Technology start-ups, digital services, export, green and productivity projects	Venture fund regulation, tax clarity, minority protection, exit mechanisms and professional managers	Growth of innovative firms and private investment
Islamic finance	Trade finance, equipment leasing, asset-backed working capital and partnerships	Islamic windows, Sharia governance, tax neutrality, standard contracts and trained specialists	Greater inclusion and product diversification

Source: Author's synthesis.

DISCUSSION

The results indicate that alternative finance should not be interpreted as a complete substitute for bank lending. Instead, it should be understood as a complementary layer within a diversified small business finance ecosystem. Each instrument has a different economic function. Crowdfunding reduces entry barriers for small and early-stage projects; venture capital supports innovation and scaling; Islamic finance expands asset-based and risk-sharing options. When these instruments operate together with bank credit, guarantees, leasing, factoring and development finance, the overall financial system becomes more flexible and inclusive.

These findings are consistent with the theoretical literature on SME finance. The continued dependence of small firms on collateral-based bank lending supports the credit-rationing argument of Stiglitz and Weiss (1981), according to which information asymmetry can exclude viable borrowers from formal credit markets. The need for different instruments for firms with different risk, age and transparency profiles also corresponds to Berger and Udell's (2006) SME finance framework. The market-validation role identified for crowdfunding is consistent with Mollick (2014) and Belleflamme et al. (2014), while the strategic and managerial contribution of venture investors supports the conclusions of Gompers and Lerner (2001). In Islamic finance, the need for governance,

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standardization and risk controls is consistent with the institutional risks identified by Khan and Ahmed (2001).

The first policy implication is the need to move from a credit-volume approach to an ecosystem approach. Increasing the volume of loans is important, but it does not automatically solve structural financing gaps. A young entrepreneur may need seed capital, not a collateralized loan. A farmer may need leasing or seasonal Islamic finance. A technology firm may need equity and mentoring. An exporter may need factoring and guarantees. Therefore, the design of SME finance policy should begin with the type of financing gap and then match the appropriate instrument.

The second implication is the importance of regulation. Alternative finance develops faster when regulation is clear but not excessive. Over-regulation can prevent innovation, while under-regulation can create fraud and loss of trust. Uzbekistan's use of regulatory sandboxes for investment platforms is a reasonable starting point because it allows controlled experimentation. However, sandbox experience should be transformed into permanent legislation after practical risks and market behavior are observed.

The third implication concerns institutional coordination. Crowdfunding platforms, venture funds and Islamic finance providers cannot develop effectively if they are isolated from the banking system, tax authorities, payment infrastructure, credit bureaus and business support agencies. For example, a successful crowdfunding campaign could be used as a positive signal in a bank scoring model. A venture-backed start-up could receive export support or tax incentives. An Islamic leasing product could be combined with guarantees for equipment modernization. Such integration can multiply the effect of each instrument.

The fourth implication is investor and entrepreneur literacy. Alternative finance introduces new contractual forms and risk-sharing mechanisms. Entrepreneurs must understand the difference between debt, equity, revenue sharing, platform fees, profit-sharing contracts and asset-based financing. Investors must understand project risk, liquidity risk and the possibility of loss. Without financial education, alternative finance may be misunderstood and misused. Therefore, training programs should be connected with chambers of commerce, universities, banks, fintech platforms and regional entrepreneurship centers.

The fifth implication is the importance of data and transparency. Digital platforms generate valuable information about entrepreneur behavior, investor interest, payment discipline and project performance. If properly regulated and anonymized, this data can strengthen credit scoring and policy monitoring. However, data governance must protect personal information and prevent misuse. Transparent reporting standards for platforms and funds should be introduced from the beginning.

A phased approach is more realistic than rapid liberalization. In the short term, Uzbekistan should focus on legal definitions, pilot platforms, disclosure rules and simple Islamic finance products. In the medium term, the country should expand venture funds, introduce tax neutrality for Islamic finance, create investor protection mechanisms and link platforms with bank scoring systems. In the long term, alternative finance should become a stable component of the national financial market, integrated with capital markets, development finance and regional investment flows.

To construct the readiness roadmap, three institutional dimensions were assessed: legal framework, digital platform infrastructure, and investor protection and literacy. Each dimension consists of five equally weighted sub-criteria. The legal framework dimension covers legal definitions, licensing and supervision, taxation and accounting, dispute resolution, and governance standards. Digital platform readiness covers digital identification, payment integration, escrow mechanisms, data exchange and cybersecurity. Investor protection and literacy cover disclosure, investment exposure limits, complaint mechanisms, reporting standards and financial education. Each sub-criterion was

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scored on a continuous 0–100 institutional maturity scale using five anchor levels: 0 — absent; 25 — officially proposed; 50 — pilot or partially established; 75 — operational but not fully integrated; and 100 — fully operational and effectively enforced. Intermediate scores were permitted when institutional conditions fell between two anchor levels. The annual dimension score was calculated as the arithmetic mean of its five sub-criteria:

$$R_{jt} = \frac{1}{5} \sum_{i=1}^{5} s_{ijt}$$

Where R_{jt} represents the readiness score for dimension j in year t, and s_{ijt} represents the maturity score of sub-criterion i. The values for 2027–2030 represent a baseline policy scenario rather than statistically estimated forecasts.

The scores reflect the author's structured expert judgement based on the stated institutional criteria and should not be interpreted as directly observed statistical indicators.

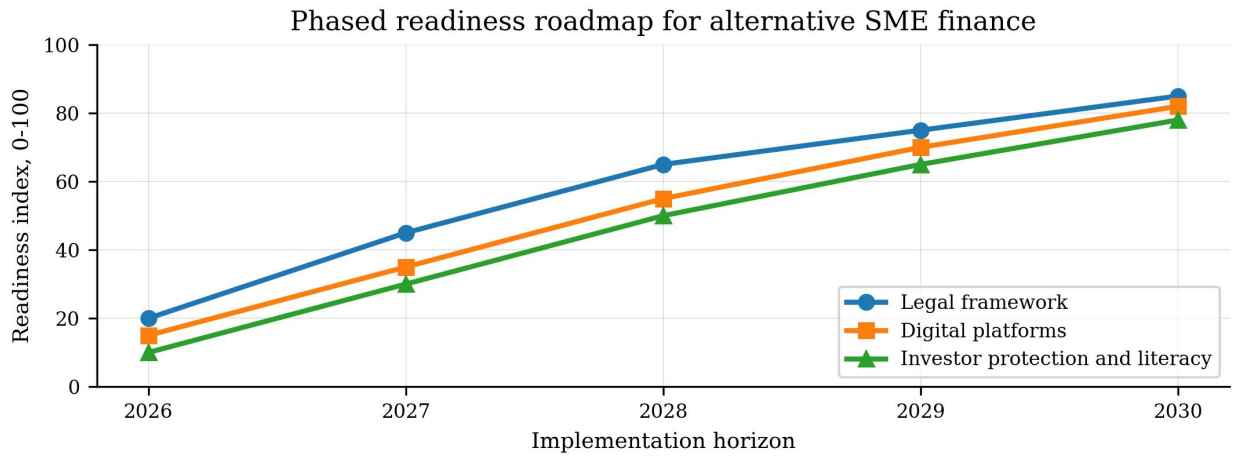


Figure 3. Baseline scenario of the phased readiness roadmap for alternative SME finance in Uzbekistan

Source: Author's assessment based on the institutional maturity scale described in the methodology and official policy documents.

The relatively low readiness scores in 2026 reflect the initial stage of alternative finance development, characterized by regulatory preparation, sandbox testing, early investment-platform rules and pilot Islamic finance initiatives. By 2027, the adoption of core legal definitions, initial licensing procedures and digital platform requirements is expected to raise institutional readiness.

The increase projected for 2028 reflects the transition from policy design to operational implementation, including licensed platforms, venture fund regulation, Islamic finance governance standards, escrow mechanisms and stronger disclosure requirements. The 2029 scores assume broader integration with banking, payment, taxation and credit-information systems, as well as improved investor protection and dispute-resolution procedures.

By 2030, the legal framework is assessed at 85 points, digital platform readiness at 82 points, and investor protection and literacy at 78 points. Scores remain below 100 because full market maturity, nationwide adoption, effective enforcement, investor experience and institutional trust normally require a longer implementation period.

The study has several limitations. It relies primarily on secondary statistical data, official policy documents and theoretical literature. It does not include firm-level surveys, interviews with investors

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and financial institutions, or econometric estimates of the effects of alternative finance. Consequently, the readiness scores should be interpreted as structured institutional assessments and baseline policy scenarios rather than precise forecasts of future market development.

CONCLUSION

This article analyzed the potential of crowdfunding, venture capital and Islamic finance as alternative financing mechanisms for small business development in Uzbekistan. The study showed that the need for alternative finance is determined by the combination of two factors: the high economic importance of small business and the continued dominance of bank-centered financing. Although bank credit remains essential, it cannot fully meet the diverse needs of micro-enterprises, start-ups, innovative firms, exporters and entrepreneurs without sufficient collateral or credit history.

The main conclusion is that alternative finance should be developed as a complementary ecosystem rather than as a replacement for bank lending. Crowdfunding can improve access to small-scale and early-stage finance, while also testing market demand. Venture capital can support innovation, technology-based entrepreneurship and high-growth firms. Islamic finance can expand asset-based, ethical and risk-sharing financial products and attract entrepreneurs who are underserved by conventional credit.

For Uzbekistan, the successful development of these instruments requires a phased and institutionally balanced approach. The first priority is to create clear legal definitions and regulatory standards for platforms, alternative investment funds and Islamic finance contracts. The second priority is to protect investors and entrepreneurs through disclosure requirements, licensing, escrow mechanisms, Sharia governance and dispute resolution. The third priority is to develop digital infrastructure and connect alternative finance data with credit scoring and SME support programs. The fourth priority is to improve financial literacy so that entrepreneurs and investors understand the risks and benefits of new financing models.

The practical contribution of the study is a policy roadmap that links each instrument to specific institutional conditions and expected results. The scientific contribution is the integration of credit rationing theory, agency theory and institutional analysis with Uzbekistan's current financial reforms. Future research may extend this study by conducting surveys of entrepreneurs, banks, fintech firms and investors, or by estimating the potential impact of alternative finance on SME growth, employment and productivity.

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