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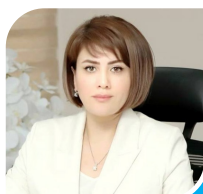
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Zufarova Nozima Gulamiddinovna
DSc., Dean of Tourism Faculty, TSUE

CONTENTS

THE ROLE OF TEACHERS AND SCHOOLS IN STUDENT DEVELOPMENT	56
Pulatova Umida Ulmasbayevna	
THE INFLUENCE OF GADGET USE, TEACHERS, AND SCHOOL ENVIRONMENT ON STUDENTS' COGNITIVE DEVELOPMENT, CHARACTER FORMATION, AND ACADEMIC SUCCESS	61
Aripjanova Nargiza Abduvasitovna	
PROBLEMS AND SOLUTIONS IN PUBLIC PROCUREMENT	66
Abdurakhmonova Mahliyo Nurmatovna	
FINANCING SMALL AND MEDIUM-SIZED ENTERPRISES IN UZBEKISTAN AND INDONESIA: CHALLENGES OF CONVENTIONAL LENDING AND THE POTENTIAL OF THE ISLAMIC PARTNERSHIP (MUSHARAKAH) MODEL	70
Parmanova Rikhsi Khamidulla kizi, Budhi Pamungkas Gautama, Qudratov Inomjon Ne'mat o'g'li	



FINANCING SMALL AND MEDIUM-SIZED ENTERPRISES IN UZBEKISTAN AND INDONESIA: CHALLENGES OF CONVENTIONAL LENDING AND THE POTENTIAL OF THE ISLAMIC PARTNERSHIP (MUSHARAKAH) MODEL

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Abstract: Small and medium-sized enterprises (SMEs/MSMEs) play an important role in the economies of both Uzbekistan and Indonesia; however, they still face difficulties in accessing credit. This article examines the potential of the Islamic partnership model of Musharakah as a development-oriented alternative to conventional lending. The study employs a comparative descriptive design based on secondary data and contemporary literature published between 2020 and 2025.

Official statistics, World Bank materials, OECD reports, and publications of the Otoritas Jasa Keuangan (OJK) are used to compare the economic significance of SMEs, the nature of conventional credit constraints, and institutional readiness for profit-sharing finance. The findings show that SMEs are economically important in both countries, while conventional lending is still shaped by collateral requirements, fixed repayment obligations, information asymmetry, and high screening costs.

Indonesia provides stronger operational evidence for Musharakah, as its sharia banking system is already scaled, standardized, and supervised. Uzbekistan has significant potential in this area, but further improvement is needed in legislation, product standards, tax neutrality, accounting practices, and mechanisms for testing new financial models.

The article argues that Musharakah should not be viewed as a simple replacement for bank loans. Rather, it should be considered a complementary financing mechanism for viable but collateral-constrained SMEs, particularly in productive sectors where partnership-based monitoring can create value for both parties.

Key words: SMEs, MSMEs, Musharakah, Islamic finance, Uzbekistan, Indonesia.

INTRODUCTION

Financing remains one of the most persistent growth constraints for small and medium-sized enterprises across emerging economies. SMEs are frequently expected to generate jobs, expand regional production, support household incomes, and widen the domestic tax base. However, their financing profile often does not match the risk logic of conventional banking. This mismatch is especially visible where firms are small, informal or semi-formal, lightly capitalized, and weakly documented. In such settings, the banking system often prefers asset-backed lending, predictable repayment schedules, and easily verifiable financial statements, while many SMEs operate with limited collateral, seasonal cash flows, insufficient accounting capacity, and incomplete credit histories (OECD, 2024). As a result, the problem is not merely credit rationing, but a structural gap between productive firms that need external finance and financial institutions that price uncertainty conservatively.

This issue is highly relevant in both Uzbekistan and Indonesia, although the two countries are at different stages of institutional development. In Uzbekistan, small business remains a major contributor to national value creation. Official statistics indicate that the share of small business in GDP was 54.3% in 2024, while the January–September 2025 data still show a majority contribution of 51.5% (National Statistics Committee of the Republic of Uzbekistan, 2025a, 2025b). However, access to formal finance remains limited for many smaller firms. IFC (2025), citing the World Bank Enterprise Survey 2024, notes that only 19% of small enterprises in Uzbekistan use credit. This gap is important because it shows that a large business segment contributes substantially to output but remains only partially integrated into the formal financial system.

Indonesia offers a different but equally instructive case. MSMEs account for around 60.3% of GDP and absorb approximately 97% of employment (Badan Pusat Statistik Kabupaten Batang, 2024). At the same time, Indonesia has a deeper Islamic finance ecosystem and a more developed sharia banking sector. OJK (2025a) reports that sharia banking assets reached Rp980.30 trillion in December 2024, with financing amounting to Rp643.55 trillion and third-party funds reaching Rp753.60 trillion. Moreover, OJK (2024a) shows that profit-sharing financing in Islamic commercial banks had already reached a substantial scale by the end of 2024. This makes Indonesia useful not only as a comparator but also as an institutional benchmark for understanding how Musharakah can move from theory to practical implementation.

Musharakah is important in this debate because it is based on partnership rather than pure debt transfer. In principle, the financier and the entrepreneur share capital, risk, and returns. This makes the contract attractive for firms that are economically viable but structurally disadvantaged under collateral-based lending models. However, the practical promise of Musharakah does not mean that it is free from operational challenges. Partnership finance requires stronger information systems, clearer contract design, better monitoring, and reliable legal enforcement. Therefore, the key question is not only whether Musharakah is normatively attractive, but also whether it can be institutionally operationalized in a way that improves financial inclusion without weakening prudential discipline.

This article addresses that question by comparing Uzbekistan and Indonesia. It has three main objectives. First, it examines the economic relevance of SMEs/MSMEs and the continuing limitations of conventional lending. Second, it evaluates the conceptual and operational suitability of Musharakah as a financing model for productive SMEs. Third, it identifies the institutional lessons that Uzbekistan can draw from Indonesia's more mature sharia banking framework. The article contributes to the literature by linking macro-level SME importance, micro-level financing frictions, and contract-level Islamic finance logic within a single comparative framework. Throughout the paper, the term SME is used for analytical convenience, while recognizing that Indonesia's policy terminology more commonly uses MSME.

LITERATURE REVIEW

Recent literature on SME finance consistently shows that access problems are not caused only by a lack of funds in the banking system. They are also shaped by information asymmetry, transaction costs, borrower opacity, and risk-weighted incentives within lending institutions. The OECD (2024) emphasizes that many SMEs continue to face financing constraints due to limited collateral, weak credit histories, and macro-financial tightening. These are not temporary obstacles, but recurring structural features of small-firm finance. In practice, this means that even when loan programs expand, the distribution of finance often remains uneven, with the most document-ready and asset-backed firms receiving the most favorable access.

The Indonesian evidence reinforces this point. Alibhai et al. (2024), in a World Bank study on public credit schemes in Indonesia, find that subsidized credit can help some firms access formal finance for the first time. However, they also show that such schemes do not automatically eliminate deeper and longer-term credit constraints. In particular, collateral remains a challenge, even when programs are explicitly designed to broaden access. This finding is important for the present study because it suggests that conventional and quasi-

conventional credit support can improve entry into finance without necessarily solving the structural mismatch between small-firm realities and bank risk preferences.

Islamic finance literature approaches the problem from a different perspective. Rather than centering the transaction on predetermined interest-based repayment, partnership-based contracts seek to align financing with business performance. Thaker et al. (2020) argue that Islamic banking and finance can be leveraged for small businesses when products are designed around real economic activity and when institutional support reduces operational ambiguity. Within this framework, Musharakah is especially relevant because it distributes gains according to agreed profit-sharing ratios, while losses are borne according to capital contribution. Conceptually, this makes it more suitable than standard debt for firms whose main weakness is not lack of demand, but lack of pledgeable collateral.

However, the literature also warns against idealizing Islamic partnership finance. Musharakah depends on transparency, bookkeeping, verifiable profit calculation, and trust in dispute resolution. Without these conditions, agency problems may simply shift from debt enforcement to partnership monitoring. For this reason, OJK's product guidance is important. OJK (2024b) issued a specific guideline for Musyarakah financing products in 2024, showing that product standardization is treated as a regulatory priority rather than an optional addition. Indonesia's case suggests that Islamic contracts become scalable when they are translated into supervisory standards, accounting routines, and replicable banking procedures.

For Uzbekistan, the emerging literature points to both opportunity and constraint. Asadov and Turaboev (2023) argue that legal barriers remain one of the main obstacles to the development of Islamic finance in the country. Their analysis shows that demand alone is insufficient if the legal and regulatory framework does not clearly accommodate Islamic financial contracts. At the same time, Asadov (2024) identifies meaningful demand for sukuk in Uzbekistan, indicating that market interest in Islamic financial instruments extends beyond a single product line. Waqas et al. (2025) add an important behavioral dimension by showing that perceived benefits, religious commitment, and positive attitudes significantly shape SMEs' intention to adopt Islamic finance in Uzbekistan. Taken together, these studies suggest that the demand side is promising, while institutional readiness remains the key bottleneck.

The research gap, therefore, is not the absence of studies on SME finance or Islamic finance separately. Rather, it lies in integrating three levels of analysis: the macroeconomic importance of SMEs, the operational limits of conventional lending, and the institutional conditions required for Musharakah to function as a practical financing option. This article addresses that gap through a focused comparison between a country where Islamic finance remains legally emerging and a country where sharia banking already provides measurable operational evidence.

RESEARCH METHODOLOGY

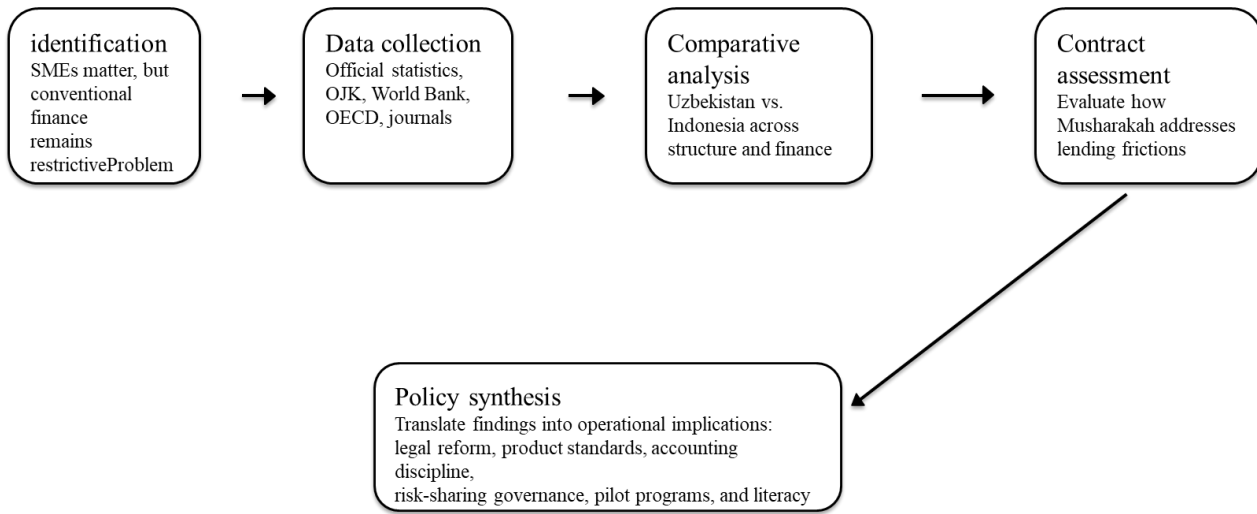
This study uses a comparative descriptive research design based on secondary data. This design is appropriate because the objective is not to test a single causal model using firm-level microdata, but to compare two national contexts and evaluate the policy relevance of Musharakah under real institutional conditions. The analysis combines official statistics, regulatory publications, international reports, and recent academic literature published between 2020 and 2025. The main official sources include the National Statistics Committee of the Republic of Uzbekistan, OJK, the World Bank Enterprise Surveys, IFC, and OECD publications.

The analytical process is carried out in four stages. First, the paper identifies the economic significance of SMEs/MSMEs in each country using indicators such as GDP contribution, employment relevance, active business dynamics, and sectoral weight. Second, it reviews evidence on financing constraints under conventional lending, with particular attention to collateral requirements, limited credit use, rigid repayment structures, and information asymmetry. Third, it examines Musharakah as a contract, both conceptually and in terms of its operationalization within the Indonesian sharia banking system. Fourth, it synthesizes the findings into a set of institutional implications for Uzbekistan.

The study is comparative, although not symmetrical across all variables. This approach is intentional. Uzbekistan and Indonesia differ in size, regulatory history, and financial-sector depth; therefore, the purpose is not strict one-to-one equivalence, but structured comparison. Indicators are selected when they illuminate one of three dimensions: the economic importance of SMEs, the persistence of financing barriers, and institutional readiness for partnership-based finance. Where direct equivalence is not possible, the analysis emphasizes interpretive comparability rather than mechanical similarity.

The study also has certain limitations. It does not estimate firm-level performance under actual Musharakah contracts and does not apply econometric methods to identify the determinants of SME borrowing behavior. Instead, it provides a policy-oriented synthesis. This limitation is acceptable because the central purpose is to develop a clear comparative argument about why Musharakah matters, where it is most applicable, and what institutional reforms are needed for its broader implementation (Figure 1).

Research framework



Source: Author’s construction based on the comparative design of this study.

Figure 1. Research framework used in the comparative analysis

ANALYSIS AND RESULTS

The first major finding is that SMEs are not marginal in either country; they are foundational. In Uzbekistan, official statistical releases show that small businesses accounted for 54.3% of GDP in 2024. The January–September 2025 release shows a still-dominant share of 51.5%, with particularly high participation in agriculture and construction (National Statistics Committee of the Republic of Uzbekistan, 2025a, 2025b). This means that policy discussions on productivity, employment, and diversification cannot be separated from the financing conditions of small firms. In Indonesia, MSMEs remain equally central, contributing about 60.3% of GDP and absorbing roughly 97% of employment (Badan Pusat Statistik Kabupaten Batang, 2024). Therefore, the macroeconomic case for improving SME finance is strong in both countries.

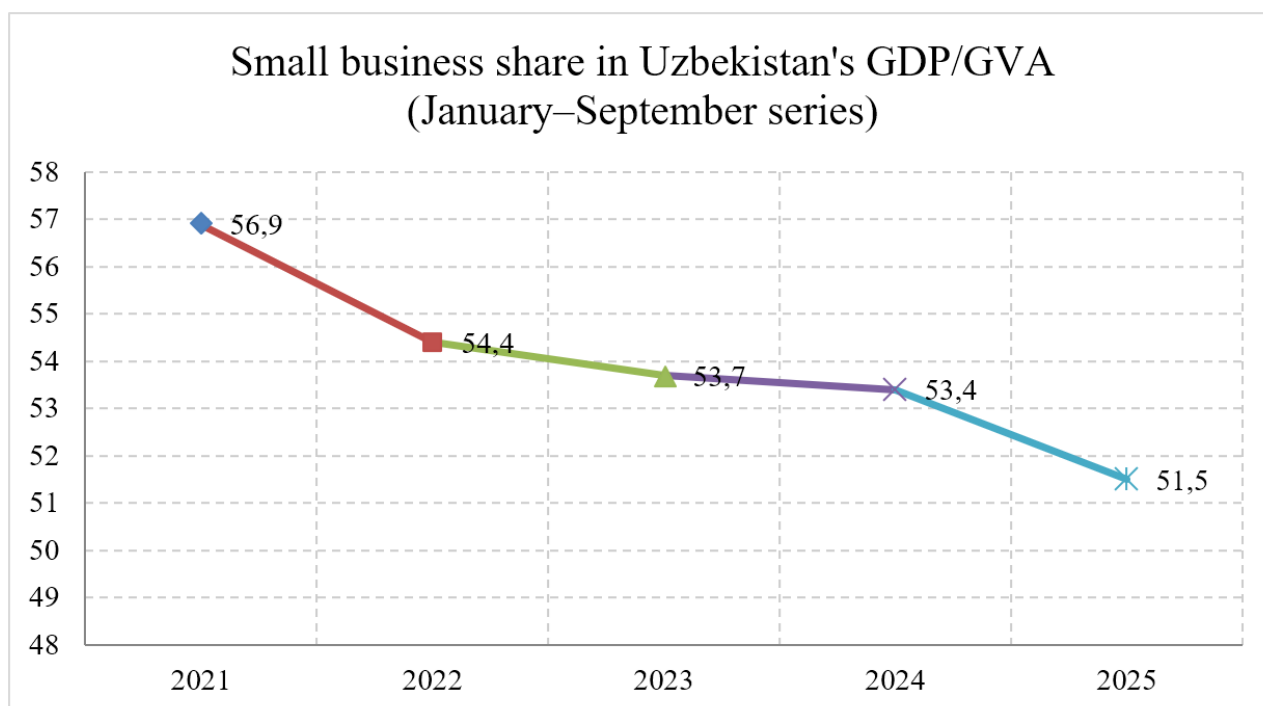
The second finding is that conventional lending remains structurally selective. The banking logic of conventional SME credit prioritizes collateral, formal financial records, measurable repayment capacity, and lower monitoring costs. From a prudential perspective, this logic is understandable. From a development perspective, however, it may limit access for promising firms whose main weakness is documentary rather than productive. The Uzbek case is particularly revealing: despite the importance of small businesses in national output, only 19% of small enterprises use credit (IFC, 2025). This suggests that the bottleneck is not merely a shortage of entrepreneurial activity, but the limited effective conversion of small-firm demand into bankable credit relationships (Table 1).

Table 1. Comparative indicators relevant to SME finance in Uzbekistan and Indonesia

Indicator	Uzbekistan	Indonesia	Interpretation
SME / MSME macro contribution	Small business accounted for 54.3% of GDP in 2024; January–September 2025 still shows a 51.5% share.	MSMEs contribute around 60.3% of GDP and absorb about 97% of employment.	In both economies, SME finance is a macro-development issue rather than a niche business segment.
Access-to-finance signal	Only 19% of small enterprises use credit.	Formal credit access has broadened, but collateral and graduation to unsubsidized credit remain persistent issues.	The volume of finance may rise without fully solving structural access problems.

Islamic finance institutionalization	Islamic finance demand is growing, but legal and contractual infrastructure remains incomplete.	Sharia banking is already supervised, standardized, and large enough to generate operational evidence.	Institutional readiness is the key comparative difference between the two countries.
Operational evidence for partnership finance	Musharakah remains more prospective than systemically scaled.	Sharia banking assets reached Rp980.30 trillion in December 2024; profit-sharing financing also reached material scale.	Indonesia functions as a practical benchmark for translating Islamic contracts into bankable products.

Source: Compiled from National Statistics Committee of the Republic of Uzbekistan (2025a, 2025b), IFC (2025), Badan Pusat Statistik Kabupaten Batang (2024), OJK (2024a, 2025a), and Alibhai et al. (2024).



Source: National Statistics Committee of the Republic of Uzbekistan (2025b).

Figure 2. Small business share in Uzbekistan’s GDP/GVA, January–September series

Figure 2 shows a gradual decline in the January–September share of small business in Uzbekistan’s GDP/GVA from 56.9% in 2021 to 51.5% in 2025. This trend does not imply that small business has become less important. Rather, it reflects a changing structure of value creation and highlights the need for stronger productivity, formalization, and financing support if smaller firms are to maintain their economic weight. The fact that small business still accounts for more than half of GDP/GVA, despite the declining share, strengthens the case for targeted financing reform.

Indonesia’s experience shows that expanding credit volume alone is not sufficient. Alibhai et al. (2024) demonstrate that public credit programs can help firms access formal finance for the first time, yet they do not automatically solve long-term constraints such as weak collateral positions or difficulties in transitioning to unsubsidized commercial lending. This insight is important because it shifts the discussion away from quantity alone. A larger loan portfolio does not necessarily mean a more inclusive financing architecture. The composition of finance, contract design, and risk-sharing mechanisms are also important.

Against this background, Musharakah deserves attention because it changes the structure of the financing relationship. Under Musharakah, the financier is not merely a creditor expecting fixed repayment; rather, the financier participates in a partnership linked to business outcomes. In theory, this can reduce the exclusionary effect of collateral-centered lending by allowing capital provision to be linked more closely to business

prospects and jointly monitored performance. For SMEs that have viable operations but limited fixed assets, this represents a significant advantage. It also aligns finance more closely with the real economy, which is one of the major normative strengths of Islamic finance (Thaker et al., 2020) (Table 2).

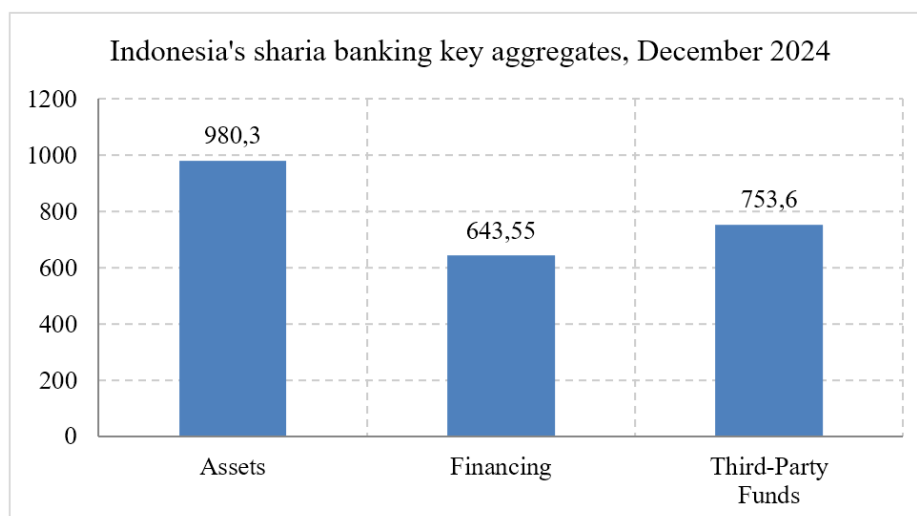
Table 2. Conventional lending frictions and the potential response of Musharakah

Conventional friction	Why it matters for SMEs	How Musharakah can respond	Residual risk / limitation
Heavy collateral requirements	Many SMEs have viable turnover but insufficient pledgeable fixed assets.	Partnership finance can place more weight on business viability and shared capital participation.	Monitoring must be strong; otherwise asset substitution and moral hazard can increase.
Fixed repayment schedules	Rigid installments can pressure firms with seasonal or volatile cash flows.	Returns can be linked to business performance rather than fixed interest obligations.	Profit volatility may reduce predictability for financiers and complicate portfolio planning.
Information asymmetry	Weak records and incomplete statements increase screening costs and rejection rates.	Closer partnership can improve information flow between financier and entrepreneur.	The model still depends on bookkeeping discipline and auditable profit measurement.
Short credit horizon	SMEs may need patient capital for expansion rather than narrow short-term debt.	Musharakah can support growth-oriented investment with longer business alignment.	Exit mechanisms and valuation rules must be clearly specified in advance.

Source: Synthesized from OECD (2024), Alibhai et al. (2024), Thaker et al. (2020), and the comparative analysis in this article.

However, the comparative evidence also shows that Musharakah is institutionally demanding. It requires stronger accounting discipline than many informal or semi-formal SMEs currently possess. Profit-sharing arrangements depend on reliable information, clearer monitoring mechanisms, and enforceable contractual interpretation. This is why Indonesia's regulatory environment is particularly important. OJK has not only supervised a growing sharia banking system, but has also issued specific Musyarakah product guidelines, helping transform an Islamic contract into a standardized financial practice (OJK, 2024b). In addition, OJK's 2025 press release and 2024 statistical publication indicate that sharia banking has already reached a scale at which partnership-based financing is no longer merely experimental (OJK, 2024a, 2025a).

The available data support this interpretation. At the end of 2024, Indonesia's sharia banking assets stood at Rp980.30 trillion, financing amounted to Rp643.55 trillion, and third-party funds reached Rp753.60 trillion (OJK, 2025a). Furthermore, the OJK statistical release indicates that profit-sharing financing in Islamic commercial banks had reached Rp198.249 trillion by December 2024, representing a substantial share of total financing (OJK, 2024a). These figures do not prove that Musharakah is universally optimal; however, they demonstrate that partnership-based and profit-sharing finance can operate effectively at scale when appropriate regulatory, supervisory, and operational structures are in place (Figure 3).



Source: OJK (2025a).

Figure 3. Indonesia's sharia banking key aggregates, December 2024

The scale shown in Figure 3 is important because it demonstrates that partnership-based finance in Indonesia operates within a broader and well-supervised financial ecosystem. Scale alone does not guarantee inclusiveness; however, it makes standardization, product design, internal auditing, and contract enforcement more feasible. This institutional context is one of the key reasons why Indonesia serves as a useful benchmark for Uzbekistan.

Uzbekistan, by contrast, appears to be in a transitional stage. The underlying demand for Islamic finance is becoming increasingly visible, and recent scholarship indicates favorable attitudes toward the adoption of Islamic financial instruments among SMEs (Waqas et al., 2025). At the same time, legal ambiguity remains a significant challenge. Asadov and Turaboev (2023) emphasize that the development of Islamic finance requires a supportive legal environment capable of recognizing and enforcing non-interest-based contracts. This means that Musharakah in Uzbekistan should not be introduced merely as an isolated product innovation. Rather, it should be developed as part of a broader ecosystem that includes enabling legislation, tax neutrality, prudential standards, dispute-resolution mechanisms, and bookkeeping support for SMEs.

A further point of discussion concerns sector targeting. Musharakah is likely to be most effective in productive sectors where cash flows are connected to real business operations and where partnership monitoring is feasible. It may be less suitable for very small survival-oriented firms that lack basic accounting systems or where verification costs exceed the economic size of the transaction. For this reason, an immediate nationwide universal rollout may be less effective than a phased pilot implementation. A prudent strategy would initially focus on SMEs with demonstrable turnover, simple but improvable accounting practices, and activities in trade, manufacturing, agribusiness processing, or services with trackable revenue streams.

The broader implication is that Musharakah should be viewed as a targeted complement within a diversified SME financing architecture. Conventional lending will remain necessary, especially for firms with clear collateral and stable repayment capacity. However, a financial system that relies exclusively on conventional debt may insufficiently serve firms whose growth potential exceeds their available documentation or asset base. Partnership-based finance can partially bridge this gap, provided that institutions are designed to manage the informational and governance requirements associated with risk-sharing arrangements (Table 3).

Table 3. Proposed roadmap for introducing Musharakah more effectively in Uzbekistan

Policy Area	Current Issue	Recommended Action	Expected Effect
Legal basis	Islamic contracts still face legal ambiguity in recognition and enforcement.	Adopt clearer enabling provisions for Musharakah and related Islamic finance contracts.	Greater legal certainty for banks, SMEs, and courts.
Tax and accounting treatment	Unclear treatment may make partnership-based products costly or inconsistent.	Ensure tax neutrality and issue practical accounting guidance for profit-sharing contracts.	Lower transaction frictions and improved reporting quality.
Product standardization	Without standardized contracts, market development remains fragmented.	Develop standardized Musharakah templates, disclosure rules, and monitoring clauses.	More scalable and replicable financing operations.
Pilot implementation	An immediate nationwide rollout may create supervisory and operational pressure.	Launch pilot projects through selected banks or dedicated financing windows in productive sectors with auditable cash flows.	Controlled learning, improved risk assessment, and evidence-based scaling.
SME capability support	Many SMEs lack the records and reporting systems required for partnership-based finance.	Link financing pilots with bookkeeping, digital reporting, and financial literacy support programs.	Improved transparency and reduced information asymmetry.

Source: Author's synthesis based on Asadov and Turaboev (2023), Asadov (2024), Waqas et al. (2025), and the Indonesian regulatory experience reported by OJK (2024a, 2024b, 2025a).

CONCLUSION AND RECOMMENDATIONS

This article has shown that Uzbekistan and Indonesia share a common development challenge: SMEs are economically important, yet conventional lending does not fully correspond to the financing realities of smaller firms. The comparison demonstrates that Musharakah has significant potential as a development-oriented financing model, particularly for viable SMEs that face collateral constraints under conventional banking systems. Its main advantage lies in risk-sharing, close linkage with real business activity, and greater compatibility with productive enterprise growth.

At the same time, the study also makes clear that Musharakah is not a simple substitute for conventional loans. It becomes credible and effective only when supported by legal clarity, accounting transparency, supervisory guidance, and operational standardization. Indonesia demonstrates that these enabling conditions can be successfully developed, while Uzbekistan highlights the importance and urgency of establishing them. Therefore, the practical policy direction for Uzbekistan should not be to replicate Indonesia mechanically, but rather to adapt its institutional lessons. This includes establishing a clear legal basis for Islamic finance contracts, ensuring tax neutrality, developing standardized Musharakah documentation, strengthening SME bookkeeping capacity, and launching carefully supervised pilot programs through interested financial institutions.

Musharakah is best understood as a strategic addition to the SME financing toolkit. Where conventional debt financing may exclude firms because of collateral intensity and rigid repayment structures, partnership-based finance can improve financial inclusion and support productive growth. However, its success depends less on theoretical attractiveness than on the quality of institutional design. Future research may build on this study by examining pilot-level performance data, sector-specific suitability, and the comparative risk outcomes of Musharakah portfolios in Central Asian contexts.

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