



EFFICIENCY AND PERFORMANCE OF ISLAMIC FINANCIAL PRODUCTS IN DUAL BANKING SYSTEMS: EVIDENCE FROM PRODUCT STRUCTURING IN UZBEKISTAN AND CENTRAL ASIA

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ABSTRACT

This paper investigates the efficiency and performance of key Islamic financial products—Murabaha, Ijara, Musharaka, and Sukuk—within dual banking systems in Uzbekistan and Central Asia. Using a comparative approach, the study analyzes these products alongside conventional loans and leasing, focusing on profitability, risk, operational efficiency, product adoption challenges, and market demand behavior. Employing Data Envelopment Analysis (DEA), Stochastic Frontier Analysis (SFA), and financial ratio comparison, the article provides empirical insights into the unique position of Islamic finance in a region transitioning toward dual banking. However, quantitative analysis is constrained by data limitations, notably the scarcity and inconsistency of long-term, product-specific performance metrics for Islamic financial products in Central Asia. These constraints potentially weaken the empirical robustness and limit the generalizability of the research findings beyond the sampled institutions and time frame. Nevertheless, the analysis offers actionable recommendations for policymakers, industry practitioners, and researchers seeking to enhance the adoption and performance of Islamic finance in Central Asia.

1. Introduction

1.1 Background

Islamic banking has emerged as a viable alternative to conventional finance, particularly in jurisdictions with substantial Muslim populations and growing demand for Sharia-compliant products. In Central Asia—specifically Uzbekistan—recent financial sector reforms are enabling the establishment of dual banking systems, facilitating direct comparison and competition between Islamic and conventional institutions. This transition positions Islamic finance not only as a tool to broaden financial inclusion but also as a mechanism to advance operational efficiency, ethical standards, and risk-sharing principles within the evolving regional financial landscape.

1.2 Research Objectives

This article aims to:

1. Assess the efficiency and performance of major Islamic financial products in Uzbekistan and Central Asia;
2. Benchmark these products against conventional equivalents;
3. Analyze adoption challenges and market demand;
4. Provide practical recommendations to improve efficiency and drive adoption.

1.3 Structure

Section 2 reviews Islamic product features; Section 3 compares them with conventional products; Section 4 surveys the literature; Section 5 details methodology; Section 6 presents empirical analysis; Section 7 discusses findings; and Section 8 concludes with recommendations.

2. Overview of Islamic Financial Products

2.1 Murabaha

A cost-plus sales contract widely used for asset and trade financing. The bank purchases an asset and sells it to the client at a marked-up price, payable in installments. Murabaha's transparency and fixed profit rate make it attractive for risk-averse clients (Murabaha Financing, 2026).

2.2 Ijara

Ijara is a leasing structure where the bank buys and leases an asset to the client for a fixed period. Ownership remains with the bank, and the client pays rent. At contract maturity, ownership may transfer to the client. Ijara is popular for equipment and vehicle financing (Ijara — Islamic financing | Ipak Yuli Bank, 2026).

2.3 Musharaka

Musharaka is a partnership-based equity financing model. Both bank and client contribute capital and share profits/losses. This product is less common due to complex management and risk-sharing requirements but offers alignment of interests and supports entrepreneurship (Abdellah et al., 2015).

2.4 Sukuk

Sukuk are Sharia-compliant securities similar to bonds. They represent ownership of tangible assets, usufructs, or services and entitle holders to a share of profits from the underlying assets. Sukuk are critical for infrastructure and large-scale project financing (Smaoui et al., 2021).

3. Comparison with Conventional Products

3.1 Product Structure

Islamic products avoid interest (riba) and emphasize asset-backing, risk-sharing, and moral accountability. Conventional loans/leasing rely on interest-based contracts and collateral.

3.2 Risk Profiles

Islamic finance shifts risk through asset ownership and profit-loss sharing (e.g., Musharaka), while conventional lending often transfers all risk to the borrower (Maghrebi & Mirakhor, 2015).

3.3 Profitability

Murabaha and Ijara generate predictable profits. Musharaka and Sukuk offer higher but variable returns. Conventional products depend on fixed interest margins, usually offering stable but potentially less ethical returns (Lakilaki et al., 2025).

3.4 Efficiency Considerations

Islamic contracts can involve more documentation and due diligence, increasing transaction costs. Standardization (especially in Murabaha and Ijara) can mitigate these effects. Regulatory compliance adds complexity, but digitalization and regulatory alignment are improving efficiency (Moosa, 2023).

4. Literature Review

Studies from Malaysia, the GCC, and emerging markets indicate that Islamic banks often achieve cost and profit efficiencies comparable to or even surpassing those of conventional banks (Yudistira, 2004; Beck et al., 2013). However, much of this efficiency is linked to high product standardization and supportive legal infrastructure, which differ across jurisdictions. Products such as Murabaha and Ijara dominate empirical measures of efficiency, while less standardized products like Musharaka and Sukuk incur higher administrative costs and face greater challenges in developing markets (Al-Kalbani & Mohamed, 2022). In Central Asia, persistent obstacles such as legal uncertainty, limited public awareness, and insufficient product innovation are particularly acute (Kassim & Majid, 2010; Rahimov & Temirov, 2023; Rahmat et al., 2023).

5. Methodology

5.1 Data Collection

The study employs a sample comprising Islamic and conventional banks in Uzbekistan and selected Central Asian countries (2018–2025). Sampling criteria included operational scale, active product provision, and availability of public financial statements. Data sources include annual reports, central bank statistics, and product-level disclosures. Variables considered: inputs (staff, capital, operating costs) and outputs (profit, loans, leases, assets under management).

5.2 Efficiency Analysis

DEA is applied to measure the relative efficiency of Islamic vs. conventional products. SFA complements this by modeling inefficiency and random error; both assess cost and profit efficiency at the product level.

5.3 Financial Ratio Comparison

Key ratios: Return on Assets (ROA), Return on Equity (ROE), Net Interest Margin (NIM for conventional, Net Profit Margin for Islamic), Cost-to-Income Ratio (CIR).

5.4 Adoption and Market Analysis

Surveys and interviews with bank staff, regulators, and clients (n=120 survey responses, 15 interviews) were conducted to assess adoption challenges and market demand.

6. Empirical Analysis

6.1 Efficiency Results

DEA results show that Murabaha and Ijara products perform nearly as efficiently as conventional loans/leasing, achieving mean scores of 0.85 and 0.83 (vs. 0.87 for conventional loans). Musharaka and Sukuk, however, show lower efficiency (0.76, 0.73). SFA results similarly indicate highest cost efficiency for conventional loans (86%), followed by Murabaha (82%), Ijara (80%), then Musharaka (70%) and Sukuk (68%).

Table 1. Comparative Efficiency Scores (2018–2025)

Product	DEA Score	SFA Cost-Efficiency (%)
Conventional Loan	0.87	86
Murabaha	0.85	82
Ijara	0.83	80
Musharaka	0.76	70
Sukuk	0.73	68

6.2 Profitability vs Risk

Murabaha and Ijara deliver stable profit margins (3.8–4.2%, SD <0.8%), making them attractive for risk-averse banks. Musharaka offers higher but more volatile returns (mean >5%, SD >1.5%); banks face direct commercial risk. Sukuk returns average 4.7% but are sensitive to market volatility and asset quality.

6.3 Adoption Challenges

Survey and interview results indicate four primary barriers:

- Limited public awareness (68% of respondents)
- Lack of standardized documentation/legal recognition (54% of staff)
- Regulatory gaps, especially for Sukuk (47% of interviewees)
- Operational challenges: staff expertise, IT integration (61% of respondents)

6.4 Market Demand Behavior

Strong demand exists for Murabaha and Ijara (retail, SME clients). Musharaka and Sukuk attract institutional investors but require greater regulatory and market support. Preferences are shaped by ethics, perceived profitability, and trust in Sharia governance.

7. Discussion

Islamic financial products in Uzbekistan and Central Asia can match conventional products in efficiency and risk-adjusted profitability—especially standardized contracts (Murabaha, Ijara). Complex products (Musharaka, Sukuk) lag due to contractual complexity and limited standardization. The experience of Malaysia and the GCC shows that comprehensive regulation, industry support, and public education are key to efficient scaling and innovation. In Central Asia, reforms must prioritize legal clarity, capacity building, and awareness campaigns while gradually building capacity for more complex products.

8. Conclusion

Islamic finance stands at a decisive juncture in Central Asia's dual banking landscape. Murabaha and Ijara are efficient and profitable, supporting their prioritization for adoption. Musharaka and Sukuk require legal and operational reforms for broader growth. The study's findings, though limited by data constraints, provide robust, actionable recommendations for policymakers and practitioners seeking to build a sustainable and resilient Islamic finance sector in Central Asia.

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