

# Ijarah's Prospects in Central Asian: An Example of Uzbekistan

Alam Asadov\* and Khurshid Gazikhanov\*\*

## Abstract

*This paper looks into the subject matter of Ijarah specifically in context of Central Asia. In that respect operations of TAIBA Leasing Company, the only Islamic leasing company in Uzbekistan, is investigated. The role of this study is to show the possible benefits of broad implementation of Ijarah in leasing industry of Uzbekistan and other countries of Central Asia. We took Uzbekistan as reference point, but results are generalized for the entire region. Analyses of current situation and future prospects of Ijarah for countries of Central Asia are drawn from comparison of statistical data and results of interviews conducted. Some recommendations and policy implications that could improve prospects of Ijarah in the region are followed.<sup>i</sup>*

## 1. INTRODUCTION

When we talk about Central Asian region most probable it reminds of future market of new opportunities and some of current challenges of Islamic Finance industry. Newly Independent States of Central Asia represent grant new market for recently developing Islamic finance industry. Islamic financial products are getting introduced and the industry is developing in Central Asian countries since gaining their

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\* Ph.D. student at International Centre for Education in Islamic Finance (INCEIF), [alam.asadov@gmail.com](mailto:alam.asadov@gmail.com)

\*\* Credit, Administration and Follow-up Manager at Taiba Leasing Company Limited, [khurshid.gazikhanov@gmail.com](mailto:khurshid.gazikhanov@gmail.com)

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independence in 1991, after disintegration of Soviet Union. Soviet legacy of centrally planned economy in these countries has greatly delayed such progress. However, with the introduction of Islamic banking and finance, some of those states are already experiencing a considerable change in terms of socio-economic development that should continue to spread throughout the region (Gresh, 2007).

All of the Republics of Central Asian did join Islamic Development Bank (IDB) in 1990s and 2000s. IDB's regional office established in Almaty, Kazakhstan in 1997 serves to promote Bank's efforts in socio-economic development of the region. This regional office has successfully become the center for IDB's operations in the region (IDB, 2013). The IDB regularly lends funds on the base of Islamic principles and does so next to donors that operates with conventional financial instruments. In several memorandums and agreements between the IDB and Central Asian states the support to the development of Islamic finance practices has been mentioned (Aliyev, 2012).

Ijarah is a new Shari'ah compliant leasing alternative which was recently introduced in most of Central Asian countries. Especially the IDB played important role in introduction of Ijarah in the region. As a subsidiary of the IDB, the Islamic Corporation for the Development of Private Sector (ICD)'s, participation in this regard is very important. ICD was in most cases the initiator of Ijarah companies in most of Central Asian states. For instance, the first Ijarah company in the region, Taiba Leasing Co. Ltd., was established in Uzbekistan in 2010 as 100% subsidiary of ICD (Taiba Leasing, 2012a).

Those companies are established in line with ICD's vision to set up Ijarah companies across its member countries. Aim of opening of Ijarah companies by ICD in Central Asia was to support Small and Medium Enterprises in the region. Now such leasing companies are operating in three out of five Central Asian countries and there are plans for near future to open such Ijarah companies by ICD in remaining two countries (IMC, 2013). ASR leasing of Tajikistan and Kazakhstan Ijara Company have just started their operation in 2013. However most of them are already considered among the most competitive leasing companies in their respective countries.

For instance, in 2012 total operations of Taiba leasing amounted to around 1.5 million USD and for 2013 company was planning to increase it to 3 million USD (Taiba Leasing, 2012b). Which means it is planning to increase its market share from 0.5% to 1% of the total market (See Table 2.2 for comparison). Even if 1% of market share does not seem significant it is notable achievement of competitiveness while competing side by side with 98 other market participants and such giants as Uzbek

Leasing International and UzAutoIndustry Leasing with more than 15 years of industry experience.

However, there may be some challenge faced by Ijarah industry in future in Central Asia. Even though there is no barrier faced by Ijarah in these countries at the moment (Taiba Leasing, 2012a), there may be serious impediments on its way. Inexistence of proper legal and institutional framework for operation of Islamic Financial Institutions in most of countries may hinder development of Ijarah in its full capacity in the region.

Kazakhstan which is little further in development of Islamic financing has formed most of necessary institutional framework for incorporation of Islamic finance into its financial sector (Wolters, 2013). Because of its government's proactive decisions in the right direction, Kazakhstan is already considered as future hub of Islamic finance for the region. Uzbekistan also has large chances of dominance in that prospective mainly because of its large population and share of Muslims in it. If little more effort is inserted by Uzbekistan's government, country's status may increase significantly and it could become regional leader in Islamic finance. Opening doors to various modes of Ijarah could be the first step in that direction.

## **2. DEVELOPMENT OF IJARAH IN CENTRAL ASIA**

### **2.1 Development of Ijarah and Islamic Finance in Uzbekistan**

Islamic banking and finance is seen by Islamic scholars as a novel way for uniting Republics of Central Asia to other Muslim countries of OIC into an economic bloc. This eventually can lead to a greater market gains in a competitive globalized economy. One of the keys for entrance to global markets is through supporting socio-economic development both nationally and regionally, and liberalization of economic reform. The IDB regularly lends funds on the base of Islamic principles and does so next to donors that operates with conventional financial instruments. In several memorandums and agreements the support to the development of Islamic finance practices has been mentioned (Aliyev, 2012). Currently there are six IDB credit lines given to local Uzbek banks for operating these funds in Shari'ah compliant manner. In April 2012, Ipak Yuli Bank's credit line was renewed by the IDB and additional credit line was granted to "Uzpromstroybank" and in 2014 it the IDB agreed to advance \$100 million USD to support housing construction in rural areas. (Wolters (2013) and UzReport (2014)).

Ijarah is a new Shari'ah compliant product recently introduced to people of Uzbekistan. The role of the IDB is very important in introduction of Islamic leasing

in the country. Especially, active participation of The Islamic Corporation for the Development of Private Sector (ICD) is visible in that matter. The first Islamic leasing company, TAIBA Leasing Co. Ltd., was established in Uzbekistan in 2010. It was founded as 100% subsidiary of The Islamic Corporation for the Development of Private Sector (ICD), which is a member of the IDB Group. TAIBA leasing was incorporated in line with ICD's vision to set up Islamic leasing companies across its member countries. Aim of opening an Islamic leasing company in Uzbekistan was to support Small and Medium Enterprises in the country. Taiba Leasing started its full operations in 2011 and by now it is considered one of the most competitive leasing companies in the country.

In 2012 total operations of Taiba leasing amounted to around 1.5 million USD and for 2013 company was planning to increase it to 3 million USD (Taiba Leasing, 2012b). Which means it is planning to increase its market share from 0.5% to 1% of the total market. Even if 1% of market share does not seem significant it is notable achievement of competitiveness while competing side by side with 98 other market participants and such giants as Uzbek Leasing International and UzAutoIndustry Leasing with more than 15 years of industry experience.

## **2.2 Development of Ijarah and Islamic Finance in Other Countries of Central Asia**

With opening of Taiba leasing, Islamic leasing is slowly penetrating Uzbekistan's leasing market. Similar pattern is also expected for other countries of Central Asia. Ijarah's growth and future prospects mainly depends on current market conditions, competitive strength of the company, people's perception of Islamic financing (or Islamic leasing in particular), and legal and supervisory framework provided by the governments. Even if there are not many private or public Islamic banks or Islamic leasing companies in the region at the moment, but Islamic credit lines provided by IDB and new Ijarah companies are the sign of bright future for Islamic finance in the Central Asian region.

However, there may be some challenges faced by Ijarah industry in the region in near future. Even though there is no barrier faced by Islamic leasing in Uzbekistan (Taiba Leasing, 2012a) and other two countries at the moment there may be serious impediments on its way (See KIC (2013) and ASR leasing (2013)). Inexistence of proper legal and institutional framework for operation of Islamic Financial Institutions in the most of region may hinder development of Islamic leasing in its full capacity in Central Asia.

Kazakhstan which is little further in development of Islamic financing has formed most of necessary institutional framework for incorporation of Islamic finance into its financial sector (Wolters, 2013). Because of its government's proactive decisions in the right direction, Kazakhstan is already considered as future hub of Islamic finance for the region. Uzbekistan and other three countries of Central Asia have also large potential for development of Ijarah and other Islamic finance products in them, mainly because of the large proportion of Muslims among population. If little more effort is inserted by those governments, the region's attractiveness may increase significantly among Muslim investors and it could become one of centers for Islamic finance. Opening doors to different modes of Ijarah through legal and institutional framework could be the first step in that direction.

### **2.3 Challenges of Islamic Finance in Central Asia**

As much as the financial crisis might have stressed the need for alternative financing, the Islamic finance appeared as the most attractive one. Development of Islamic Finance in particular may have some difficulties in Uzbekistan or other countries of Central Asia to reach the level currently witnessed in Middle East, Malaysia or United Kingdom. However, several conditions should be considered for a full analysis of the development of Islamic Finance in the region.

There are still some aspects of a Soviet heritage of secularism for most of Central Asian states including Uzbekistan and it influences government's approach to religious practices. This tradition of secularism today may be exaggerated by the warning against the dangers of Islamic extremism in light of a rising Taliban force in Afghanistan and recent experiences with radical groups on Central Asian soil.

These factors kept in mind, the Uzbek government reacts on the institutional level on the introduction of Islamic finance against the background of a secularist legal tradition. This politically new Islamic practices of financing may be dealt with a general suspicion, when the danger of Islamic extremism puts all new religious activities under such scrutiny (Stark and Ahrens, 2012).

There is also legal challenge that may face Islamic finance industry in general. Even if Ijarah is functioning without any barriers in Central Asia, there may be some challenges that may prevent its development in the countries further in the future. Despite recent developments and accommodations made for Islamic Finance by most of state governments in the region, inexistence of fully-fledged legal framework for operation of Islamic finance product hinders development of this industry in most of those countries. Since Ijarah also tied to other Islamic finance products such as Sukuk

and Takaful for its financing and further development this problem may have negative influence that can slow down its development in the region.

All those challenges do cast some doubt about future of Islamic finance and Ijarah in Uzbekistan and other countries of Central Asia. However, current trend towards globalization and acceptance of international practices by neighboring countries and other developing Muslim countries shows that Ijarah and other modes of Islamic financing are becoming more accepted practice and vital alternative to conventional financing methods. Kazakhstan among Central Asian countries seems to take advantage of this opportunity by developing legal, institutional and human capital framework for smooth operation of Islamic Finance in the country (Khaki and Malik, 2013).

#### **2. 4 The Research Gap**

Countries of Central Asia, as newly independent states, are points of attraction for Islamic modes of financing such as Ijarah. With majority Muslim population and still developing financial sector, prospects of Ijarah in the region seems to be bright. However, there are some challenges to such financing mainly because of inexistence of proper institutional framework in most of those states and partly because of the “Islamic” labeling attached to those financial products. There has not been separate study pertaining to prospects of Ijarah in the region. Research in the area of Ijarah could be more informative and practical since it is already being practiced by clients of Taiba Leasing Company in Uzbekistan and other Ijarah companies throughout Central Asia. Once this research is concluded we can draw some general summary about future prospects of Ijarah in Central Asian countries.

### **3. RESEARCH METHODOLOGY**

#### **3.1 Methodology**

This research aims to examine some challenges that may be faced by and opportunities open for Ijarah industry in Central Asia. To obtain insightful information for conducting of this research, the research methodology has to be identified, appropriate technique, data and source chosen, which should then be collected and analyzed. Since there are several stakeholders of Ijarah industry and several potential markets that industry can capture, we decided to use different methodology to adjust for background and need of each stakeholder type.

We decided to use mostly qualitative approach for this research. Among qualitative research techniques we are going to use two, namely interviews and direct

observations. Most of the stakeholder of leasing industry (Ijarah in particular) will be interviewed and information pertaining to some potential markets for the industry will be collected through direct observation. However, in this research we also used questionnaires (a tool usually used for data collection in quantitative methods) as confirmation method for direct observation to assure that it is based on facts rather than on general assumptions.

For this study, we have identified all possible stakeholders of Ijarah in Central Asian region as the research population. The ideal target population for this study consists of Managers and Clients of Ijarah companies. However, since there is only one such company in each country in most cases, we decided to incorporate other stakeholders of leasing industry and some potential markets of interest. Nevertheless, because of limited time and financing considerations we are going to use data and information mainly pertaining to Taiba Leasing Co. Ltd and Uzbekistan. Then our findings will be generalized to entire region because of many similarities. Whenever there exist substantial differences between countries in some regards, they will be highlighted. Next we had to process with sample selection. Because of limitations of the original population we decided to include some others stakeholders of the industry in this study. The sources of data and type of methodology uses for each are given in details in following section.

### **3.2 Data Sources and Methodologies**

Since there were not many studies done in this topic, there are not many pre-collected sources of secondary data that can be used for quantitative analysis. Also, because there is mostly one company which deal with Ijarah in each of countries it is not possible to collect data about different companies in each country and compare them. Conducting semi-structured interviews gave us opportunity of observing different opinions from different stakeholders of the industry. Twelve interviews were conducted, five from clients of Taiba leasing and seven from experts related to Ijarah industry in Uzbekistan.

In addition to semi-structured interview we also decided to conduct small questionnaire to evaluated currently existing informal market of automobile hire-purchases in Tashkent city, Uzbekistan. This questionnaire will serve as a tool for confirmation of our observations about potential for Ijarah to enter into housing and automobile market of the region. Since it will be in small size unfortunately it cannot be used to make any quantitative analysis.

Even if there are not many sources of quantifiable secondary data that can be used there still some that exists. Especially, some general and aggregated secondary data that is available for whole leasing industry in Central Asia can be used to make some

generalized conclusions about the industry. Moreover, we can also make use of financial statements that could be obtained from Ijarah companies and some of its conventional competitors to analyze the situation and to draw some conclusions about leasing industry in the region and about Ijarah in particular.

### **3.3 Limitation to the Methodology**

According to the proposed plan about twelve interviews and ten questionnaires were conducted. It was somewhat difficult to get all information from clients of Taiba leasing in Uzbekistan (mainly because of time and privacy considerations). According to Collis and Hussey (2003) method of questionnaires can be applied in both quantitative and qualitative approaches. Therefore we are trying to use qualitative side of questionnaires while surveying suppliers of informal car-leasing in the country. The success of the proposal will depend on the availability of theories related to Ijarah and our assumptions made throughout the paper. The primary data is obtained and scrutinized from responses of clients and suppliers of the Ijarah products in Central Asian region.

## **4. MAIN RESULTS AND DISCUSSION**

### **4.1 Ijarah Companies in Central Asian countries**

Five countries, namely Kazakhstan, Kirgizstan, Tajikistan, Turkmenistan and Uzbekistan, are Central Asian countries we are considering for this research. There is at least one Ijarah company operating in three of the countries, and there are plan for near future to open Ijarah companies in Kirgizstan and Turkmenistan as well. Most of those companies are established with initiative of the ICD, a subsidiary of the IDB. While Taiba Leasing of Uzbekistan is operating for four years, other two Ijarah companies in Kazakhstan and Tajikistan have been operating for a little over than a year.

Overall most of the Ijarah companies are functioning uninterrupted in the region mainly because of little need for special regulations for Ijarah to operate. Since Ijarah could work easily in a country were general framework for operation of leasing companies is set, operations of Ijarah companies in Central Asia is continuing with little or no legal or institutional barriers.

All of Ijarah companies in the region are managed and supervised by Ijara Management Company of Bahrain, a subsidiary of ICD that take care of its Ijarah operations. Additionally, they also report to appropriate ministries in each country,

mainly Ministry of Finance, about their operations and profits or losses. Next we turn to current condition of Ijarah industry in Uzbekistan, by analyzing operations of Taiba leasing company limited, the oldest of Ijarah provider in the region. The analysis of the industry in Uzbekistan will be generalized to draw some conclusions for entire Central Asian region.

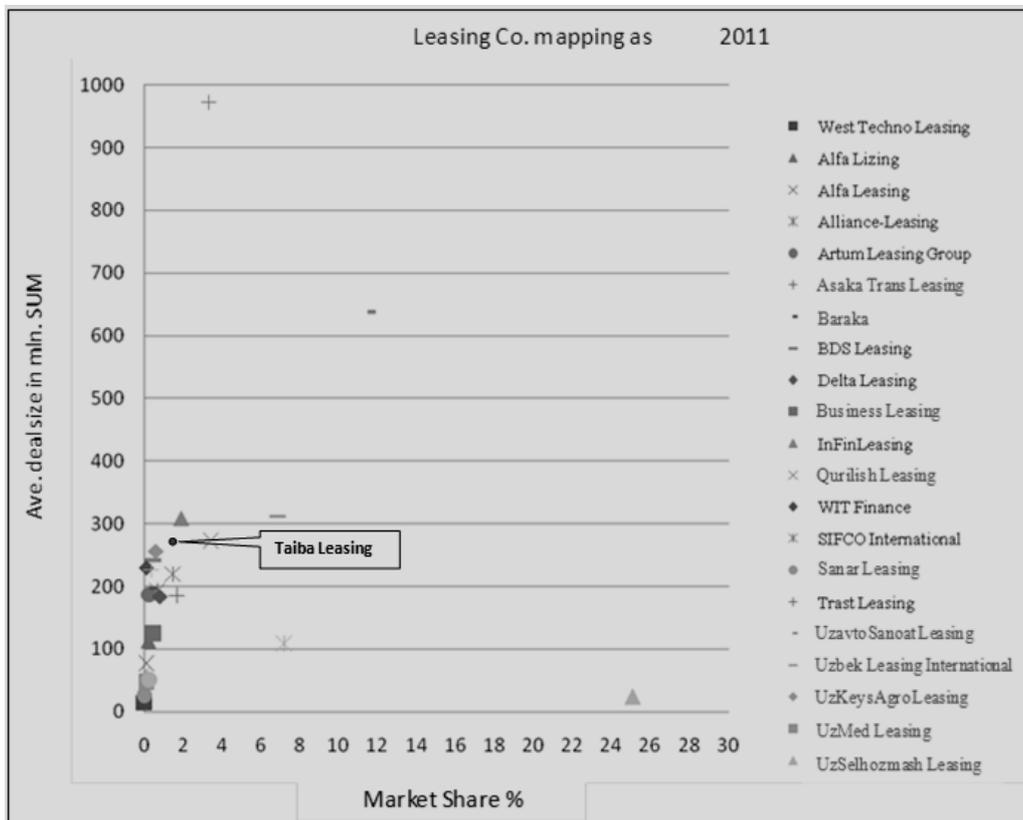
#### **4.2 Taiba Leasing and Development of Ijarah in Uzbekistan**

Taiba leasing is a financial lease company established in 2010 as a 100% ownership of The Islamic Corporation for the Development of Private Sector (ICD). ICD has vision to set up Ijarah companies promoting Shari'ah compliant ways of financing across its member countries and TAIBA leasing is incorporated in line with that vision. Along with promoting ethical ways of financing Taiba has put forward several goals to serve the needs of private sector in Uzbekistan by providing high quality service, suitable leasing conditions, reliability and stability (Taiba Leasing, 2012a).

Entrance of Taiba to Uzbekistan's leasing market has been successful and unquestionably improvement of products provided to the clientele. Most of prospective clients choose Taiba mainly because of religious concerns (to avoid interest charged by other leasing companies), seeking for the transparent sources of financing or those who encountering the foreign exchange barriers and delays on currency conversion which remain problematic in case of Uzbekistan.

In relatively short period of time, Taiba leasing was able to finance several clients forming a substantial amount of portfolio and has created a robust pipeline of potential deals. Portfolios comprising of over 1.4 million U.S.D. deals in sectors, starting from pharmaceuticals to textile and real estate were financed during 2012. Taiba has started utilizing its Uzbek Soum (National currency) positions through lease back facilities in property sector, and plans to form substantial amount of local currency portfolio to increase profitability for its shareholders and effectively utilize its funds. Geographically, Taiba portfolio is concentrated mainly in Tashkent city and Tashkent region. However, the company is striving to source deals from other region of Uzbekistan and planning to sign agency agreements with representatives in different regions (Taiba Leasing, 2012a).

**Figure 4.1: Average Deal size of leasing companies in Uzbekistan (Million UZS)**



Source: Taiba Leasing, Operations and Marketing Report 2012-2013.

Since start of its functioning in early 2011 Taiba Leasing Company Ltd has increasing its operations many times. If we look at Figure 4.1 we can see that it was able to enter ranks of top ten leasing companies by the end of 2012. Leasing industry

in Uzbekistan has grown from just 6 companies in early 2000 to 99 companies by end of 2012. So far there are two organizations that are offering Ijarah services in Uzbekistan (second one being Mission of ICD in Uzbekistan, which deal with large scale deal only), but increase in their numbers is probable in few years.

Islamic finance industry was growing in double digits as was reported by many experts and institutions (The Economist, 2012). Both population and income of Uzbekistan is growing, average GDP growth of the country was around 7-9% per annum for past few years. Such stable and promising growth of GDP shows there is large potential for leasing industry. Additionally, majority of Uzbekistan's population consists of youth, which are potential source of consumer goods in the future. That is why we believe leasing of consumer goods such as appliances and automobiles along with housing has great potential in near future for Ijarah industry in Uzbekistan.

#### **4.3 The Basic Understanding of Ijarah**

One of the goals of this research was to investigate what was basic understanding about Ijarah and Islamic finance in Central Asia. The interviews conducted from clients and industry experts reveal that there is adequate understanding among interviewee and presumably among general public as well. Even though Ijarah's Shari'ah compliance is not widely advertising, it serves as a financial product that some devoted Muslims chose for financing. Even somewhat moderate practitioners of Islam or members of other religions were among the clients mainly because some advantages Islamic leasing had over other conventional competitors.

However, we cannot generalize this finding to entire populations of the region. It was just over 20 years since those countries have obtained their independence. It is known fact that during 70 years of Soviet regime, entire population of the region was force to abandon the most of religious practices and forgotten most of principle concepts of their religion. Even if religious freedom was ensured in the region after independence still majority in populations lacks knowledge of basic principles of Islam. Thus, majority does not know that the prohibition of Riba (interest) is one of the major principles in Shari'ah compliant financial transactions. This is also evident from numerousness of interest bearing saving deposits made or loans obtained by regular citizens. Even if many people claim they are practicing Muslims the most of their financial transactions are not complaint with Shari'ah principles.

Another explanation for popularity of conventional financing in the region may be lack of Islamic financing alternatives at the moment. As can be seen from statements of some clients they switched to Ijarah companies as soon as they were aware of

Islamic compliance of its products from friends or business connections and they consider religious aspect of financing as an important issue.

#### **4.4 Products and Customers of Ijarah**

Currently products of Taiba Leasing and of many other leasing companies functioning in Uzbekistan are mainly catered to serve businesses and entrepreneurs. There are specific reasons for it. The main reason as was mentioned by industry expert from Uzbek Leasing International is special emphasis of Uzbek government on leasing activities as investment into the economy and growth of production and services. That is why special tax and treatment privileges are given for leasing activities directed towards machinery, equipment and real estate financing provided to businesses and most of leasing in the country is directed towards such activities. However, we cannot ignore consumers demand. If such demands are ignored and there is not enough of formal supply of such products, shortage will be filled by informal suppliers and loan sharks.

As survey of informal car suppliers in city of Tashkent shows rates charges by informal suppliers are incredible high, approximately ranging from 50-100% per annum and those are in hard currency (USD). If we pay attention of the terms of the lease there is not a single ownership risk taken by the lessor, all risks are shifted to the lessee and terms of lease rarely exceed two years (See Appendix 1). This is clear evidence of existing shortage in consumers finance markets and introductions of Ijarah in there could improve situations significantly. This is not to say that there are no leasing companies in that market, despite taxing and other fee disincentives. During our observations we noticed existence of some (mainly small and private) leasing companies in this sector. Unfortunately, we did not had chance to speak with their representative and clarify their terms of lease. However, we are sure they are not significantly better than those of informal suppliers and of course they are not Shari'ah compliant.

Another product that is not currently offered neither by Taiba Leasing or Mission of ICD in Uzbekistan is Diminishing Musharakah type of financial lease. Since in leasing and banking regulations of Uzbekistan there are some constraints against such products and legal frameworks in not yet in place. Therefore, neither Musharakah nor Mudarabah approaches to leasing or financing can be used in the country at the moment. If allowed, those modes could simplify and improve early retirement options of Ijarah that most clients of Taiba Leasing complain about. However, this is not necessary condition to resolve issue of early retirement of leasing, which can be done by giving away some Rebate (*Ibra'*) on early payment.

#### 4.5 Market Development and Institutions

Currently there seems to be mainly two types of Islamic financing namely, Murabahah (Sale with deferred payment) and Ijarah (Islamic lease) that can function without requiring many changes in regulations in the Central Asian countries. Since there are some controversies about Shari'ah compliance of some varieties of Murabahah financing among different schools of thought, Ijarah which is universally accepted seems to be the best alternative of Islamic finance applicable. That may be the reason behind ICD's plans for opening Ijarah companies in all countries of Central Asia, plus in Azerbaijan and Tataristan Republic of Russian Federation (See the map below). Muslims being the majority of those Republics, form a great demand for Shari'ah compliant products such as Ijarah. Especially, potential demand is very high in Uzbekistan which is the most populous country in Central Asia with a higher proportion of practicing Muslims among them.

**Figure 4.2: Locations of IMC branches in CIS**



Source: Ijara Management Company website ([http://ijara.co/?page\\_id=153](http://ijara.co/?page_id=153))

For most of the Central Asian market for leasing is in stage close to maturing but for Ijarah industry is still in infant stage (See KIC(2013) and Taiba Leasing (2012b)). Many people who are becoming aware of its advantage are getting interested and becoming clients of Ijarah companies. However, for its further development institutional framework for Ijarah or Islamic finance in general should be formed in the region. Even though leasing, banking and other types of financing was working in the region throughout years and framework for them is in place and functioning, there is no real framework for flawless functioning of Islamic finance in the region with few exception such as Kazakhstan. Kazakhstan is trying to build more suitable environment and legal framework for Islamic finance to attract both local and international investment to it (Khaki and Malik, 2013).

Since most of Ijarah companies in the region are subsidiaries of ICD, and function under directives of ICD, there are not many problems so far. However, answer to questions about operation for any new Ijarah company that is not related to ICD or other international organization is still vague. Since there is no institutional and legal framework, there are no clear directives about procedures and accreditation of such companies. The most importantly, there is no supervisory body that can check and approve Shari'ah compliance of such financial products in majority of countries in the region. Those are the questions that are awaiting answers at current situation especially for those counties with weak or no framework suitable for Islamic financing. A more proactive approach for development of Islamic Financial Services in a developing country in terms of the legal framework and genuine political will is seen as a necessity (Abikan, 2012).

#### **4.6 The Role of States' Regularity Authorities and Institutional Framework**

It is widely admitted that regulatory issues pertaining to leasing operations in Central Asian region are set and very functional at the moment. All leasing companies Islamic or not that are offering leasing services are working in the industry without facing much difficulty. In case of Uzbekistan, leasing operations and its framework has significantly improved after passing of regulations regarding improvement of conditions for functioning of leasing companies.

However there are still some minor problems which need their resolution. As Industry expert from JV Uzbek Leasing International commented there is still no concept of sublease in leasing regulations of Uzbekistan. Also, issue of returned leasing and repurchase of equipment from lessor are not clearly defined as well. In the other hand, there are larger problems when we come to Ijarah in Uzbekistan. One of those is related to financing of such with local capital. If Ijarah company wants to lease its

operations locally it will practically have no outside financial options besides original charter capital and retained earnings. Since there are no options of Islamic saving or current accounts available leasing cannot get it from depositors. Additionally, issuing of Sukuk securities to finance leasing are not possible because of none existence of such legal framework in Uzbekistan.

Options of Mudarabah and Musharakah approaches for leasing are widely available in countries with developed Islamic finance markets, but this is not also possible in most countries of the region because of restrictions mentioned earlier. For type of Islamic finance such as Ijarah to develop in the country its legislative and regulatory authorities should legalize related products and form appropriate framework for free functioning of other Islamic finance products.

In terms of supervisory framework, Ijarah companies do not have any problem. Since the companies are subsidiaries of the ICD, same supervisory board oversees all of them. However, if new companies are formed by local initiatives they should have their own Shari'ah boards and must be supervised by a national or international body for such Islamic finance institutions. Lessors Associations in the region may help them to resolve some regulatory issues, but since they are not experts in Shari'ah matters there may be difficulties faced in those aspects. Currently, the Islamic finance industry is getting more developed and there are many auditing and standard setting authorities (such as AAOIFI and IFSB) forming and functions quiet efficiently. Any new Islamic finance institution can approach any of those organizations for consultation or accreditation purposes, but acceptability of such accreditation may be an issue in some countries of Central Asia since there is no framework regulating functions of Islamic financial institutions.

#### **4.7 Challenges and Opportunities of Ijarah in Central Asia**

As far as opportunities are concerned they are great for future of Ijarah in Central Asia. Since most of leasing legislations and regulations are universal and could foster both conventional and Ijarah alternatives there practically no barriers for starting of Ijarah company in the region. If we take example of Taiba Leasing, it is doing very well and competing strongly with local leasing companies in Uzbekistan. Besides being Islamic leasing company, Taiba has another advantage over most of its competitive which also serves as reason of attraction for its clients. This advantage is availability of foreign currency reserves which could be used to finance imported machinery and equipments for those who have limited access to such reserves. Discipline and consistency policy that company follows is also distinctly approved by its clients.

Despite those advantages mentioned functioning of Ijarah in general are not free of challenges in Central Asia. Firstly, we told that there are practically no barriers of entry of Ijarah in to the leasing industry of the country, but for future growth and local financing of such companies there may be significant challenges which are mentioned in previous sections. Second, we also mentioned that leasing industry is maturing and getting more competitive, thus Ijarah firm entering the market should be as much competitive as those that are already in the market. We also recommend Ijarah companies to enter leasing of individuals consumer needs such as housing, automobile or even electronic appliances in countries with developing consumer markets such as Uzbekistan. However, leasing company may lose its privileges over other financing options as investment activity in such case. The consumptions financing is not seen as investment activity by Uzbekistan's government therefore tax and other privileges may be lost in such financing alternatives.

Nevertheless, the real opportunity that gives strong hope for future of Ijarah in Central Asia is majority's loyalty to principles of their religion Islam. Awakening of this awareness of Shari'ah principles and its dissemination among people will keep shifting their preference towards Shari'ah compliant products such as Ijarah. As our expert from Ijara Management Company (IMC) puts it, in countries with Muslim majority like Central Asia as time passes people may stop consuming conventional (interest involving) financial products such as conventional leasing. Regional Ijarah companies have increased scope of their operations substantially during years of functioning and have future plans for expansion. However, to ensure healthy competition and to enhance further investment in Ijarah industry there needs to more companies entering this market. This becomes possible only if favorable institutional framework is formed in each country of the region.

As an example we can take case of Kazakhstan. Even if Kazakhstan Ijara Company (KIC) was the first fully-fledged Islamic leasing company in the country established in 2013, it was not the first company in the industry. Al Hilal bank, the first Islamic bank in Kazakhstan, was offering Ijarah financing for many years and as of 2012, 42% of its financings products consisted of Ijarah contracts. Since more Islamic finance institutions are entering the country Ijarah industry is getting more competitive (Khaki and Malik, 2012).

In Central Asian, Ijarah providers are competing with many conventional banks and leasing companies. If they are going for new consumer goods market they are going to compete with many more formal and informal competitors. Currently leasing of house is not practiced widely in Uzbekistan because regulations try to encourage mortgage alternative. If they are adjusted so that field for competition is leveled for

both banks and leasing companies, Ijarah may also have fair chance for financing of individual housing. To face such a strong challenge from competitors Ijarah has its own advantages of bearing more ownership risk, being free of Riba and better terms for early retirement of lease contract. Nevertheless, companies should also be compatible in terms of profit margin charges and other contract terms.

A study of Diminishing Musharakah home financing revealed that it can address issues faced by customers of conventional mortgage more fairly during the time of crisis. This is because the bank does not charge its customers a fixed rate, but charges rental rate based on the real value of the property. Since as a partner the bank takes risk of ownership as well those combined factors contribute for crisis proof nature of the product (Abdul-Razak and Amin, 2013). The best practices by other Ijarah companies all around the world could be adopted when and where applicable. But if Central Asia wants to compete for Islamic sources of investment with other countries it should be more open to international investments by developing securities markets and liberating of financial sector.

## **5. CONCLUSION AND RECOMMENDATIONS**

### **5.1 General Conclusions and Some Recommendations**

Islamic banking and finance industry has been growing significantly in last couple decades reaching 1.6 Billion in terms of its asset holding. Every year more and more countries are adjusting their legal and institutional framework so that Islamic finance can enter and prosper in those countries. Ijarah as an Islamic finance alternative is capturing more popularity year on year. Most of automobile and housing financing for individual are done by Ijarah along with machinery and equipment financial for businesses. It is also more advantages compared to other Islamic finance alternatives because there is not much regulatory changes need for Ijarah to work in a country. Islamic leasing has entered Central Asian countries with Muslim majority, where there was not much ready legal or institutional environment for others modes of financing such as Musharakah or Mudarabah.

Even though Ijarah had a good start with establishment of Ijarah companies by ICD in Central Asia, it may face some challenges if legal and regulatory framework is not adjusted for free functioning of Islamic finance in the country. Increasing competition in leasing industry in the region may seriously challenge Ijarah if it is not able to raise financing in local currency by issuing Sukuk or attract saving by other Shari'ah compliant means.

Also framework for Islamic financing should be developed in the entire region for Ijarah to have complementary Islamic finance products such as Sukuk and Takaful

(Islamic insurance) for its future operations. For example, Ijarah should use Takaful -, and only allowed to use conventional insurance for transition period. If Takaful or other complementary products are not permitted Ijarah may face serious difficulties in the future. Such introduction of new products already taking place, as there was first practice of Sukuk issue in Kazakhstan. In August 2012, the Development Bank of Kazakhstan issued Sukuk in the size of 75 Million USD. Even if Kazakh authorities faced some problems during that process issues were resolved rather smoothly (Wolters, 2013).

All those issues pertaining to future challenges of Ijarah or Islamic finance in general also relates to people's awareness and governments' acceptance of such products. The majority of people do not know that there are Islamic finance products are available for them through their local banks or leasing is available through Ijarah companies. Main reason may be not popular advertisement of such products, most probable to avoid discrimination against other religions or not practicing Muslims. Therefore, we would suggest both people and governments should reduce their skepticism of Islamic financial products. They should understand that if something is Shari'ah complaint it does not mean that it relates to Islamic fundamentalism or extremism, it just means that product is permissible according to Islamic principles and could be used without any reservations.

The awareness of Ijarah and its distinctions from conventional options should be cultivated by company employees and religious authorities of Islam in the regions. There are also many potential markets that Ijarah can try itself in Central Asia. Some of such markets are leasing alternative of automobile and house financing. Before entering new markets Ijarah companies should also resolve some issues with such as allowing for early retirement of lease and working on its payment scheme for such case. However, without forming right framework for Islamic financing many of its products could not be introduced. Therefore we recommend that banking and finance framework in most countries of Central Asia should be restructured to dual-banking system such that both Islamic and conventional sources of financing could function freely. Impact of Islamic finance in financing market of Central Asia should be recognized by local authorities and ways for their accommodation and integration into local jurisprudence should be considered. Proactive steps taken in counties such as Kazakhstan could be good example for others to follow (Alexandros Tsikouras (2009) and Rodeheffer (2014)). Such a change may attract large amounts of international investment (from both Muslim and Western countries) to the country as it is currently witnessed in Malaysia and UAE.

## 5.2 Limitation of the Study

The methodology used was combination of some primary data from interviews and questionnaires with some secondary data of numerical nature. This way we tried to avoid shortcoming of each methodology. However something could be improved but because of lack of time and limited scope of this research they were kept as they are. First of all the number of questions in the interview could be increase by few more. Second, we would like to ask clients of not only one company but do the same in more companies with more detailed and longer questions during the interviews. As both client and expert questions were of semi-structured type some additional questions were asked depending on interviewee's response.

Third, initially more quantitative analysis of leasing companies' financial statements was planned. However, since we could not obtain companies' financial statements research was limited to mainly qualitative analysis. That is way quantitative analysis was only limited to that pertaining to some aggregate data from country reports and some general information about Ijarah companies' operations and market share status. Last reason which was out of researcher's control that could cause limitation of the methodology is existence of only one company in Ijarah market of each state in Central Asia. Ijarah companies established by ICD were only functioning Ijarah company in the countries, therefore the scope of this research was limited. However analysis of general practices in others countries during literature review helped us to makes some benchmark comparison.

## 5.3 Suggestions for Further Research

Since current research was limited to only Ijarah and partially touched other Islamic finance products, further more detailed investigation of all other Islamic finance products in Central Asia is recommended. Because there was no such research done before, it should be an enlightening work. During similar research some specific issues of such as issuance of Sukuk by leasing companies or government organizations could also be analyzed for Central Asia.

The research similar to this, limited only to Ijarah industry could also be done after several years when there could be more quantitative information to analyze and more companies to compare in Central Asia. As far as this work is concerned we believe that goals put forth in the beginning of the research were reach in satisfactory level.

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**Appendix 1: Results of Questionnaire for Supplier of Informal Hire-Purchase Market for Automobiles in Tashkent city**

Respondent	1	2	3	4	5	6	7	8	9	10
Questions										
What is the model of the car?*	Nexia	Spark	Matiz	Spark	Nexia	Nexia	Nexia	Spark	Nexia	Matiz
When was it manufactured?	2009	2011	2009	2011	2010	2012	2009	2012	2009	2011
How much down payment are you asking?	5500	3500	3500	5800	7000	6000	4000	5000	5000	3000
What is the monthly payment (R)?	500	640	400	680	500	1000	600	900	500	550
When are the payments made at end or beginning of the month?	End	End	End	End	End	End	End	End	End	End
Number of monthly payments (T)	24	24	24	18	24	12	24	12	24	24
Who covers daily maintenance costs?	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee
Who covers large repair costs such battery, transmission or engine?	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee
What happens in case of accidents where I am not liable?	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee
Who pays insurance and documentation?	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee	Lessee
How do I get assurance so that title will be transferred to be in the end?	Verbal Promise	Notarized Promise	Mutual Promise	Notarized Promise	Mutual Promise	Mutual Promise				
Price Estimate **	12000	11500	8500	12000	13000	14500	11500	13000	12000	9500
Principle (P) (Price- Down payment)	6500	8000	5000	6200	6000	8500	7500	8000	7000	6500
Principle/Payment ratio (P/R)	13	12.5	12.5	9.12	12	8.5	12.5	8.89	14	11.82
Annualized profit margin (rx12)***	66%	72%	72%	96%	78%	72%	72%	60%	54%	80%

\* Models of cars were limited to those manufactured by local producer GM-Uzbekistan since they are most popular cars traded in local markets.

\*\*Price estimate is done by the researcher using prices of comparables cars of same model, year of manufacturing and condition

\*\*\*Profit margin is calculated by the researchers using following formula for amortization:  $P / R = \{1 - 1/(1 + r)^T\} / r$

Where: r - profit margin (or interest rate) per month, P – principal value, R –monthly payment and T-periods of payment.