



**PUBLIC PERCEPTION ON THE FEASIBILITY OF
INTRODUCING ISLAMIC BANKING IN UZBEKISTAN:
CONSUMER PERSPECTIVE**

BY

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**A research paper submitted in fulfillment of the requirement
for the degree of Master of Science in Islamic Banking and
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ABSTRACT

Islamic banking industry is increasingly playing vital roles in the current financial system. Due to the demand by customers for Islamic banking facilities, its expansion has reached not only Muslim countries but also non-Muslim countries within three decades. However, there are still few Muslim majority countries such as Uzbekistan where the implementation of Islamic banking system is lacking. Therefore, the current paper has conducted a feasibility study of Islamic banking in Uzbekistan. The study examines the extent of the level of awareness among the citizens of Uzbekistan and their willingness to use Islamic banking facilities if Islamic banking were introduced in the country. The study has adopted Theory of Reasoned Action (TRA) to examine the factors affecting the customers' behavioural intention to patronize Islamic banking. A self-structured survey questionnaire was employed to collect data from a total of 240 (n=240) Uzbekistan banking customers. The data was then analysed using Statistical Package for Social Sciences (SPSS) and Analysis of Moment Structure (AMOS) software. SPSS was used at the initial stage to perform Descriptive Analysis. AMOS software was employed to run Confirmatory Factor Analysis (CFA), Measurement Model, and Structural Equation Modeling (SEM). The findings of the study show that religiosity and social factors have significant positive effect towards patronizing Islamic banking facilities while customers' knowledge and attitude carry negative effect towards Islamic banking system. It is hoped that the findings of the study will provide policymakers with the preliminary insights towards establishing Islamic banking in Uzbekistan.

ملخص البحث

ا يلعب القطاع المصرفي الإسلامي دوراً حيوياً بصورة متزايدة في النظام المالي الحالي. وبسبب الطلب من قبل العملاء لتسهيلات الخدمات المصرفية الإسلامية، وصل توسعها ليس فقط إلى البلاد المسلمة ولكن أيضاً إلى الدول غير المسلمة خلال ثلاثة عقود. ومع ذلك، لا يزال هناك عدد قليل من البلدان ذات الأغلبية المسلمة، مثل أوزبكستان، تفتقر لتنفيذ النظام المصرفي الإسلامي. لذلك، أجرى هذا البحث دراسة جدوى للمصرفية الإسلامية في أوزبكستان. وقد تناول هذا البحث مدى مستوى الوعي بين مواطني أوزبكستان، واستعدادهم لاستخدام التسهيلات المصرفية الإسلامية إذا تم تأسيس المصرفية الإسلامية إلى البلاد. وقد اعتمدت الدراسة نظرية (TRA) لدراسة العوامل التي تؤثر على القصد السلوكي لدى العملاء للتعامل مع المصرفية الإسلامية. حيث تم استخدام استبيان المسح الذاتي لجمع البيانات من مجموعه 240 (n=240) عميل مصرفي أوزبكستاني. ثم تحليل البيانات باستخدام برمجيات الحزمة الإحصائية للعلوم الاجتماعية (SPSS) وتحليل عزم البنية (AMOS). وقد تم استخدام SPSS في المرحلة الأولية لتنفيذ التحليل الوصفي. واستخدم برنامج AMOS لتشغيل تحليل عامل التوكيدية (CFA)، والقياس النموذجي، وتصميم نماذج المعادلة الهيكلية (SEM). تظهر نتائج الدراسة أن درجة التدين والعوامل الاجتماعية لها تأثير إيجابي كبير نحو التعامل بالتسهيلات المصرفية الإسلامية في حين أن معرفة العملاء وموقفهم فيهما تأثيراً سلبياً تجاه النظام المصرفي الإسلامي. ومن المؤمل أن نتائج الدراسة سوف توفر لواضعي السياسات الرؤى التمهيديّة نحو إنشاء المصارف الإسلامية في أوزبكستان.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Master of Science in Islamic Banking and Finance.

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DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Surayyo Shaamirova

Signature

Date

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*This dissertation is dedicated to my mother and sister, Nafisa Sadikova and Sayyora
Shaamirova.*

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LIST OF ABBREVIATIONS

IB/IBF	Islamic Banking/Islamic Banking and Finance
TRA	Theory of Reasoned Action Model
CIS	Commonwealth Independent States
IDB	Islamic Development Bank
INCEIF	International Centre for Education in Islamic Finance
SPSS	Statistical Package for the Social Sciences
AMOS	Analysis of Moment Structure
EFA	Exploratory Factor Analysis
CFA	Confirmatory Factor Analysis
SEM	Structural Equation Modeling
MLE	Maximum Likelihood Estimation
MI	Modification Indices
AVE	Average Variance Extracted
CR	Construct Reliability
CFI	Comparative Fix Index
RMSEA	Root Mean Square Error of Approximation
df	Degree of Freedom
GOF	Goodness-Of-Fit
GFI	Goodness-Of-Fit Indices
et al.	<i>(et alia)</i> : and others
e.g.	<i>(exempligratia)</i> : for example

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

Islamic banking refers to a banking system which follows the Islamic law in its principle operations. It has similar purpose and operations as the conventional banks. However, the principles govern Islamic banks are mutual risk and profit sharing between parties while ensuring the justice and fairness in any transaction and business operation. The activities which carry interest, gambling and speculative trading are prohibited by the principles of Islam. The establishment of Islamic banking was mainly due to the demand by Muslims for the interest free financing products and services by the financial institutions. Since its inception, due to its fast growth many conventional banks have launched their Islamic banking windows all over the world. Over the past decades, Islamic banking played a vital role with its growth in the international financial system.

Today, there are many modes of financing concepts in banking industry such as leasing, profit sharing, and partnership. Today, there are more than 300 Islamic financial institutions are operating over 75 countries, and over 250 mutual funds that comply with Islamic principles. The World's 100 largest Islamic banks have set an annual asset growth rate of 26.7%. Over the last decade, this industry has experienced growth rates of 15-20 percent per annum trend that is expected to continue (Central Bank of Malaysia, 2007).

Islamic banking industry is gradually increasing in the current conventional financial systems. Today, its expansion reached not only countries with majority of

Muslims, but also other countries where Muslims are a minority, such as the United Kingdom, Belgium, Russia or Japan. However, there are still few Muslim majority countries that have not embraced Islamic banking which is an area of the current study.

1.2 PROBLEM STATEMENT

The Islamic banking is flourishing in different countries around the world; however, there are still some countries like Uzbekistan where Islamic banks have not been introduced yet. It is urgently necessary to understand the prospect of Islamic banking in a multi religious country like Uzbekistan where the Islam is the first largest religion with 90% followers, and the other 10% are Russian Orthodox Christianity, Jews and atheists (Statistics Department of Uzbekistan, 2012). Islamic banking is considered the main source of financing in the societies with majority Muslims such as Malaysia. Since the majority of population of Uzbekistan are Muslims, there is also a need for Islamic way of financing. Based on researcher's knowledge, no research has been conducted in the area of whether the bank customers demand the Islamic banking or not through testing their subjective norms, beliefs, knowledge, and attitudes.

Uzbekistan has 30 Commercial banks with over 4600 branches and retail offices; 110 Credit Unions; and 82 Microfinance Entities. However, none of these financial institutions offer Islamic banking facilities. The interest rate charged on loans and a number of requirements on granting loans are relatively high, because of these reasons most of the small business entrepreneurs and individuals find difficulties in getting loans or credit from banks for the expansion of their businesses. In addition, most of the Muslims who have capital on hand are finding difficulties in dealing with banks in terms of investment activities due to the interest rates involved in properties

or businesses where the fund will be invested. Furthermore, people in general do not have a trust towards financial institutions, they are afraid of losing their capital if they invest into banking investment projects. Therefore, due to the shortage of funds in the financial institutions, the cost of and requirements for loans are high for the individuals and SMEs. Introducing Islamic Banking system in the Muslim dominated States is an important task which has to be taken into consideration by the policy makers.

Hence, it has become important to carry on further studied for identifying which factors will affect the behavioural intention of customers towards Islamic Banking in different countries. This is because the customers residing in different countries are different from each other. Thus, the factors that may affect the intention of customers to patronize Islamic banking facilities may not necessarily affect customers from another country in a same manner. Thus, by looking at the current financial system and situation of the country, several pertinent questions can be raised before implementing Islamic Banking in Uzbekistan. To what extent is the Uzbekistan population aware about Islamic Banking concept? To what extent are they ready to embrace the presence of Islamic Banking? What attitude would they adopt if Islamic Banking were offered in Uzbekistan?

Studies focusing on this issue have been conducted in different parts of the world. However, literature shows that there is scarcity of studied undertaken on this issue regarding Uzbekistan. Therefore, it is very important to conduct the study on this matter in Uzbekistan, where there is a lack of studies pertaining to this case in this country in the academic literature. To the best of the researcher's knowledge examining the factors affecting customers' behavioural intention to patronize Islamic Banking in Uzbekistan remain unexplored. The current study focuses on this country

as it has been neglected in the literature. Furthermore, the study at hand employed TRA Model as this model has been used to measure behavioural intention of the banking customers in different countries. Hence, this study seeks to fill this gap in literature by studying this case in the context of Uzbekistan from the consumers' perspective.

1.3 OBJECTIVES OF THE STUDY

In the light of above background, the general objective of the study is to identify the challenges and prospect of introducing Islamic banking system in Uzbekistan and the factors that are influencing consumers' choice of Islamic banking system. The specific objectives of the proposed study are:

1. To examine the extent to which, social factors influence consumers' choice of Islamic banking.
2. To examine the extent to which, attitude influences consumer choice of Islamic banking.
3. To examine the extent to which, consumers are aware and have a knowledge about Islamic banking and finance
4. To examine the extent to which, religious factors influence consumers' choice of Islamic banking.

1.4 RESEARCH QUESTIONS

- What factors are influencing consumers' choice of Islamic banking system?
- Do social factors influence consumers' choice of Islamic banking system?
- Does attitude influence consumers' choice of Islamic banking system?

- Does consumer knowledge influence the choice of Islamic banking system?
- Do religious factors influence consumers' choice of Islamic banking system?

1.5 SIGNIFICANCE OF THE STUDY

The proposed study has several contributions. First and foremost, the major contribution of the study will be conducted in a country where such topic has not been studied before. Therefore, to the best of the researcher's knowledge, this study is to be claimed to be the first study conducted in this area in Uzbekistan by employing TRA model. This study will contribute to the literature focusing to the Islamic banking and finance, financial system, banks' consumers and policymakers. In addition, the findings of this study will also be beneficial to the management of financial institutions and banks in developing effective strategies for making decision for introducing and expanding the presence of Islamic banking and financial system in different countries around the world.

1.6 ORGANIZATION OF THE RESEARCH PAPER

The *chapter one* of the current paper consists of the background and purpose of the proposed study. Further, it also explained the intended solution to the problem, listed the objectives that paper seeks to accomplish, stated the research questions that paper aims to answer followed by the significance of the study. *Chapter two* of the research paper provides the literatures that have been reviewed to proceed with the proposed study. It starts with the review on the country background whereby the reasons of lacking in implementation of Islamic banking are explained. The section includes

literature reviews on consumers' intention towards Islamic banking. Important variables are identified those are affecting consumers' intention to utilize Islamic banking products and services, and review of past literature for each variable is also provided. This chapter ends by providing the proposed model that has been resulted from the review of past literature and hypothesis of the study. *Chapter three* discusses the methodology that has been used to conduct the current paper. It includes, research method, sample size, research instrument that has been employed, the data collection methods and data analysis. *Chapter four* consists of data analysis and interpretation of data collection through the research instrument intended to use in this study. *Chapter five* provides the findings and discussion of the proposed study. This chapter also includes the managerial implication and limitation of the research paper. The paper is concluded by providing suggestion for the future research.

1.7 SUMMARY OF CHAPTER ONE

This chapter provided the outline of the current paper. The chapter started by giving introductory information about the study. The problems that rose from this research paper discussed in the second stage of the study, followed by stating research objectives as well as research questions. Lastly, significance of the study concluded the current chapter. The following chapter gives short information on country's background in terms of its financial system. It also focuses on the literatures that have been reviewed in the past for the relevant area. Meanwhile, it provides the proposed model and lists the hypothesis for the current paper.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

The chapter two provides the literature that has been reviewed for the present study. To complete this section, general finance and marketing text books, articles from Emerald and sources from other online databases have been used to review the literature. The section starts with the explanation of country background and Theory of Reasoned Action (TRA) that has been employed in the present paper, continues with intention of the consumers to use Islamic banking facilities, and the factors that affect their intention of patronizing Islamic banking products and services.

2.2 COUNTRY BACKGROUND

In order to understand why Uzbekistan is still lacking on establishing of Islamic banking, we have to understand the background of the country and its financial system. Uzbekistan faced different economical and financial systems for over centuries due to the acquisition by the Russian government. The country obtained its independence 2 decades back. As a result, the country faced transmission of economy which changed the entire economic and financial system of the country that caused many people to lose their savings in the banks. This case did not only happen in Uzbekistan, but also other Commonwealth Independent States (CIS). Therefore, researcher believed that giving short information about the current financial system of the country is necessary in order for the reader to have a deeper understanding on the

study at hand. This section will provide the financial system of Uzbekistan before and after the Independence from former Soviet Union.

2.2.1 Uzbekistan's financial system before 1991.

Unlike transition practices of Uzbekistan's European counterparts that had an experience of capitalism banking system, Uzbekistan had no any such experience before adoption of planned economy (Kobil and Dipak, 2009). They cited that Ozerova (2003) stated that the first bank which was the branch of GosBank of Russia was established in Uzbekistan in 1874 by the Russian government. There was a lack of development of commercial banking in the area due to the religious disagreement against banking system on the basis of ethics such as interest or usury prohibited in Islam, and lack of confidence in the composition of economy. By the end of 1913, there were about forty commercial banks in Uzbekistan; however, its function was broken when Bolsheviks came to the power (1917) by the communist ideologies of establishing central planning system in Russia and its colonised territories (Kobil and Dipak, 2009).

Since 1917, the Uzbekistan's banking institutions were a part of the former USSR's banking system. Under USSR system, a country's banking system faced a planned economy where banks performed its activities on a government or state budget, and banks' objectives were accomplishment of social duties.

In general, investment activities are considered one of the main functions of financial system (Alexandr, 2002). He discussed the roles and functions of financial system of Soviet Union in order to give a picture of financial system of Uzbekistan before 1991. According to him, investment decisions are governed by a cost-benefit structure in which the expected rate of return from investment is compare to the

current investment cost. In the planned economy, investment decision or any decision related to financial activities were made by the business entrepreneurs. The main reason was that firstly, non-banking financial institutions were almost undeveloped; and secondly most of the banking activities were provided by the GosBank (State Bank). It provided both central bank and commercial bank's services, offered short term loans, controlled wage payment, and management of completion of business plan, as well as inter-firm lending transactions. However, it didn't provide some traditional banking activities like open market operations. However, the short term credits were passively provided and only granted for particular purposes. There were also some other banks which performed the complementary functions to GosBank. There was also only one insurance company which was called GosStrakh which was wholly-owned by the State, and services were limited. There was also only one pension sector which was also wholly-owned by the government. USSR's financial system was lacking in providing of some important aspects of financial system like money and capital market for state debts, universal payment systems, foreign exchange market, and over control of monetary circulations (Alexandr, 2002).

2.2.2 Uzbekistan's financial system since Independence

2.2.2.1 Banking sector

Alexandr (2002) also discussed the financial system of Uzbekistan after obtaining independence from former Soviet Union. According to him, after obtaining independence the department of Soviet banks became local independent banks of country; and two-tier banking system was established with the Central bank formed from the division of GosBank in Uzbekistan. Since its establishment the primary objective of Central bank is to carry monetary policy, regulation of banks, credit

policy, provision of foreign exchange, and to provide the country with its payment system. The legislation was established to govern the banking system, since that time it is slowly improving. In 1997, foreign assets were transferred to the provision of Central Bank from National Bank of Uzbekistan (NBU); however, NBU is still considered to be a depository of authorised gold reserves on behalf of Central Bank. The government involvement in foreign exchange and financial market affect the growth of banks. The government also implemented a rule of limiting the businesses having only one account, which means deposits will be withdrawn only for the payment of wages and travel expense purposes on the bases of quarter cash plan, and this practice protects the financial institutions from competition. End of 1997, Compulsory Reserve Requirement at the Central Bank was decreased from 25 to 20 percent of deposits. As a result of it, there was an improvement in the income level of financial institutions. The banking system of the country is categorised by small banks such as NBU, private and joint venture banks and sectoral banks which finances particular area of the economy. These sectoral banks have limited capital and bank management skill due to the lack of legal instruments and the way how banking operation is taxed (Alexandr, 2002). Today, there are comparatively few banks functioning in Uzbekistan of about 27 million populations. There are about 800 branches of banks and 1787 mini-bank (Jaffe and Levonian, 2001). The banking development depends on the confidence of the public, this is mainly because big banks have more branches and can offer different services to the customers. Restructuring and transformation of the payment system was considered the most crucial change in the banking sector during the transition, because during planned economy the payment system required physical movement of payment documents therefore it was relatively slow, useless and unreliable. This was recognised during