

**HOW ISLAMIC DEVELOPMENT FINANCE SUPPORTS BUSINESS GROWTH: THE
ROLE OF THE ISLAMIC DEVELOPMENT BANK IN MALAYSIA**

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In many developing and emerging economies, access to finance remains one of the most serious obstacles to business growth. Small and medium-sized enterprises (SMEs), which form the backbone of employment and innovation, often struggle to obtain long-term and affordable funding. Conventional commercial banks usually prioritize short-term profitability and risk minimization, leaving many productive business projects underfinanced. In this context, Islamic development finance has emerged as a powerful alternative for supporting real economic activity.

Islamic finance differs fundamentally from conventional finance. It prohibits interest-based transactions and speculative activities, instead emphasizing asset-backed financing, risk sharing, and ethical investment. These characteristics make Islamic finance particularly suitable for business project financing, where funds are directly linked to real assets, trade, and productive ventures. Among institutions operating in this space, the **Islamic Development Bank (IsDB)** plays a leading role.

Established to promote economic development and social progress in its member countries, the IsDB has increasingly shifted its focus toward private sector and SME financing. Rather than acting as a retail lender, the Bank operates mainly through structured institutional channels. It provides Sharia-compliant financing lines, co-financing arrangements, and risk-sharing facilities that are transmitted through domestic financial institutions. This indirect model allows the IsDB to leverage local expertise while maintaining development impact.

Malaysia represents one of the most successful environments for Islamic development finance. Over the past decades, the country has built a mature Islamic finance ecosystem supported by strong regulation, active Islamic banks, and dedicated SME support institutions. Malaysia's dual banking system—where Islamic and conventional banks operate in parallel under unified supervision—has positioned the country as a global hub for Islamic finance.

In practice, IsDB funds directed to Malaysia rarely flow directly to small businesses. Instead, Islamic banks act as the main transmission channel. These banks use Islamic financing instruments such as cost-plus sale (Murabaha), leasing (Ijara), and, in selected cases, partnership-based contracts (Musharakah and Mudarabah) to finance business activities. Trade-based and asset-based instruments dominate in real portfolios because they are operationally simpler, easier to monitor, and more scalable for SMEs.

Another important feature of Malaysia's system is the use of guarantee schemes and program-based financing. Credit guarantees and SME development programs reduce collateral requirements and encourage banks to serve smaller or younger firms. When IsDB financing is combined with these mechanisms, access to finance improves significantly. This layered

approach shows that effective development finance is not just about providing money, but about designing channels that reduce risk and improve inclusion.

However, challenges remain. Islamic financing contracts often require more detailed documentation and compliance procedures than conventional loans. SMEs with limited administrative capacity may find it difficult to meet these requirements. In addition, intermediary banks may still apply conservative risk standards, which can limit access for innovative or early-stage businesses. These constraints highlight a key lesson: the success of development finance depends not only on funding availability, but also on institutional coordination, regulatory clarity, and SME readiness.

Despite these challenges, Malaysia demonstrates how Islamic development finance can effectively support business growth when the ecosystem is mature. Strong regulators, standardized Sharia governance, active Islamic banks, and supportive SME institutions together create high absorption capacity for development funds. In such an environment, the Islamic Development Bank functions as a catalyst—mobilizing resources, shaping incentives, and strengthening financing pathways rather than financing each project directly.

The Malaysian experience offers important insights for other countries seeking to expand Islamic finance for development. First, intermediary partnerships matter more than direct lending. Second, simple and scalable Islamic instruments are crucial for SME financing. Third, guarantees and development programs significantly improve access. Finally, governance and efficiency must be balanced to avoid excessive procedural barriers.

In a world where sustainable and inclusive growth is increasingly important, Islamic development finance provides a compelling model. By linking finance to real economic activity and embedding ethical principles into funding decisions, institutions like the Islamic Development Bank demonstrate that development-oriented finance can support both economic performance and social objectives. Malaysia's experience shows that when the right institutional structures are in place, Islamic finance can move from theory to tangible business impact.

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