

MUTAHID'S MURABAHA PRODUCT (INDIVIDUAL & GROUP) CASE STUDY



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1. EXECUTIVE SUMMARY

Despite the challenging political and socio-economic environment in Afghanistan, Mutahid has been able to roll out *murabaha* Islamic compliant product to five provinces. In order to learn from the past experience and document it for reference in future decision making, Microfinance Investment Support Facility for Afghanistan (MISFA) undertook a case study of Mutahid's *murabaha* products in Herat and Kabul provinces. MISFA gathered both primary and secondary qualitative and quantitative data from total 16 Mutahid staff and 15 clients being interviewed. The purpose of the case study is to document the effectiveness and overall lessons learned during the development, pilot and implementation phases of *murabaha* products (individual and group) and identify key differences in the nature and process of the *murabaha* product, compared to conventional products (e.g. interest-based loans) in order to promote better practices in Islamic product development in the future.

Mutahid is a subsidiary of MISFA established in April 2011 which currently offers four loan products. MISFA commissioned a study assessing the demand for Islamic financial products in August 2011, the study research found that preference towards various forms of Islamic financial arrangements was highly recommended. Accordingly, MISFA supported the development of the first Islamic compliant loan product in Afghanistan to be offered by Mutahid. Mutahid was the first organization to launch an Islamic compliant product after receiving approval from the Islamic Religious Council of Afghanistan (IRCA). Sharia Supervisory Board (SSB) is formed at Mutahid that review the *murabaha* products in accordance with the Sharia rules and principles and has the responsibility to continuously direct, review and supervise the activities and operations.

The gross loan portfolio of Mutahid almost doubled from June 2014 (AFN 227,386,671) to June 2015 (AFN 403,335,510), the number of clients increased from 8,272 to 13,952 during the same period and the number of *Murabaha* clients are increasing continuously. With increase in number of *Murabaha* clients and experience in the market, Mutahid has improved its processes and has simplified several procedures to make it more comfortable for *murabaha* clients in receiving loans through decreasing paper work and duration. Specific policy documents, guidelines including checklists, process flow diagrams, tracking system and client feedback have been developed and implemented at organizational level to enhance performance of *murabaha* product. New marketing techniques have been adopted for *murabaha* product to maximize Mutahid's potential for expanding its client base.

The *murabaha* clients had different perceptions about *murabaha* product. Based on the results of interviews with the *murabaha* clients, 54 percent of the clients absolutely rejected taking conventional loan under any circumstances while the remaining were flexible. Similarly the number of clients dissatisfied with the duration of loan approval and disbursement process decreased from 50 percent to 10 percent when we compared the results of old clients with the new clients. Seventy five percent of *murabaha* clients are highly satisfied with the mechanism of *murabaha* loan and 85 percent may request for re-loan. About 80 percent of clients request for *murabaha* loans to improve their business, this indicates positive attitude of public towards business development. Seven percent of *murabaha* clients are females, the general reason for low number of female clients is because females are mostly engaged in part time job and are more oriented to receive cash instead

of goods. Almost two percent of *murabaha* clients have received minimum amount ($\leq 16,000$ AFN) of loan.

The performance of *murabaha* product is measured by Mutahid on weekly and monthly basis. Annual, monthly and weekly targets are given to the Islamic Finance Service Officers (IFSO), the targets are the number of new clients to attract, amount of loan to disburse and number of potential client to visit for marketing purpose. IFSO submit weekly reports and their performance is measured at the end of the month, reasons for under achievement are discussed and corrective actions are adopted for future.

2. INTRODUCTION

This case study has been undertaken by the Microfinance Investment Support Facility for Afghanistan (MISFA) as part of its strategy to capture lessons and good practices through its Knowledge Management & Learning unit. MISFA is an apex organization established in 2003 and is recognized by both its partners and donors as a credible and effective leader within the microfinance (MF) sector. The two key objectives within MISFA's Strategic Plan (2013-2015) are to strengthen MF sector leadership and to promote an inclusive financial sector in the country. One aspect is to promote inclusive finance through research and development and innovation, including its support to microfinance institutions (MFIs). The purpose of the case study is to document the effectiveness and overall lessons learned during the development, pilot and implementation phases of *murabaha* products (individual and group) and Identify key differences in the nature/process/results of the *murabaha* product, compared to conventional products (e.g. interest-based loans) in order to promote better practices in Islamic product development in the future.

2.1 Background of Murabaha Product

MISFA commissioned a study assessing the demand for Islamic financial products, which was conducted by Afghanistan Public Policy Research Organization (APPRO) in August 2011 in Herat, Jalalabad, Kabul and Mazar-e Sharif. The research found that strong objections to interest payment on loans were widespread and a preference towards various forms of Islamic financial arrangements was highly recommended by religious leaders and community elders. One of the recommendations was for MISFA and partner MFIs to consider developing and piloting an Islamic product.

Accordingly, MISFA supported the development of the first Islamic compliant loan product to be offered by Mutahid. Islamic loan products are designed to provide financial assistance without bearing interest that borrowers have to pay. Mutahid piloted and subsequently offered *murabaha*, a popular Islamic loan product, which involves a finance party (Mutahid) purchasing tangible assets from a seller and then re-selling them to a buyer (microfinance client) at a pre-determined profit margin or mark-up. The contract requires specific installment payments to Mutahid by the client. *Murabaha* is relatively easier to manage and ensures the capital needs for potential micro-entrepreneurs and the poor. The key benefits of the product are;

- Compliant with Islamic principles and competitive profit rates

- Purchases any goods the client requests for a legitimate business and ensures the loan is used for the intended purpose
- Fixed profit rate during the finance terms
- Client knows profit mark-up and installments at the time of signing the contract

Mutahid currently offers two kinds of *murabaha* products. Initially, it launched a *murabaha* individual loan (MIL) in Herat and Kabul in January 2013 and April 2013, respectively. In January 2014, it launched the *murabaha* group loan (MGL) in Kabul; and then in Herat in November 2014, it launched MGL in Mazar-e Sharif, Kunduz, Takhar province in May 2015. The group *murabaha* is similar to the individual *murabaha* product but has been slightly modified to make it more flexible and inclusive. MISFA provided resources to research and develop the policy for *murabaha* product.

2.2 Data Collection

MISFA directly researched and produced the case study of Mutahid's *murabaha* product. The research method for the case study included interviewing primary respondents, gathering both primary and secondary qualitative and quantitative data, as well as reviewing secondary data. In total, 16 Mutahid staff from its main office, Taimani and Chaman branches in Kabul and Herat provinces were interviewed and consulted. Fifteen (15) clients in Kabul and Herat were also interviewed. The clients who were interviewed represented different livelihood activities related to the following businesses; beauty parlor, grocery, bakery, carpentry, garments or clothing, mobile phones, electric equipment supply, tailoring, and painting supplies.

3. BACKGROUND OF MUTAHID (DFI)

Mutahid Development Finance Institution (DFI) was established in April 2011 and is a subsidiary of MISFA. The creation of Mutahid (which means "united" in English) was an opportunity to combine the best components of six consolidating microfinance institutions under one roof, and to salvage the significant investments made over previous years leading up to 2011. Mutahid is an Afghan MFI that aims to offer financial services to, and create opportunities for, Afghan entrepreneurs, through an operationally self-sustainable, innovative, development finance institution. Mutahid provides services in six provinces (Kabul, Herat, Mazar, Kunduz, Takhar, Badakhshan) and currently offers the following five loan products:

1. *Murabaha* Group loans (MGL);
2. *Murabaha* Individual loans (MIL);
3. Conventional Individual loan
4. Conventional microfinance Group loans; and
5. Small and Medium Size Enterprises (SME) loans.

Mutahid has 13,952 active clients as of June 30, 2015 of which 3,310 are women. The total number of *murabaha* clients is 1,956 of which 141 are female clients. The number of *murabaha* clients in

Herat and Kabul are 211 and 1,745 respectively as of June 30, 2015, the number of *murabaha* clients has increased an average of 20 percent on a quarterly basis since January 2015. All the clients (*murabaha* and conventional) are managed by 277 staff members (152 female, 125 male).

3.1 Mutahid’s Position in the Microfinance Market

Mutahid holds five percent (5%) market shares based on size of outstanding loan portfolio. The Gross Loan Portfolio (GLP)¹of Mutahid is AFN 403,225,510 at the end of the second quarter of 2015. This represents an increase by 44 percent compared to the second quarter of 2014. The Portfolio at Risk greater than 30 days (PAR>30) has decreased from 3.8% in January 2014 to 2.5% in January 2015. The increment in GLP and decrease in PAR>30 indicate that high potential market is available to attract new clients in 2015 and beyond. The positive incremental trend has continued in GLP despite an overall recession in Afghanistan’s Gross Domestic Product (GDP), which has contracted from 14.4 percent in 2012 to 2 percent in 2014. The GLP of Mutahid’s *murabaha* product is AFN 63,187,747 which is 15.5 percent of its total GLP.

3.2 Mutahid Balance Sheet

Following is a summary of Mutahid’s balance sheet for Islamic products for the month of June 30, 2015. Mutahid is funded by MISFA only and has not received funding from any other source since it was established.

Table 1: Mutahid Balance Sheet (*murabaha*)

| Mutahid Development Finance Institution | |
|--|-----------------------|
| Balance Sheet (<i>murabaha</i> product) | |
| Jun 30, 2015 | |
| ASSETS | |
| Total Current Assets | 512,516,914.43 |
| Total Fixed Assets | 5,412,133.74 |
| TOTAL ASSETS | 517,929,048.17 |
| LIABILITIES & EQUITY | |
| Total Liabilities | 517,929,048.17 |
| Total Equity | 0.00 |
| TOTAL LIABILITIES & EQUITY | 517,929,048.17 |

4. OVERVIEW OF MURABAHA PRODUCT AND LOAN MANAGEMENT PROCESS

4.1 Sharia Religious Approval Process

Mutahid is the first organization to get the approval of the Afghanistan Scholar Council (ASC) which is an independent entity supported by the Government of Afghanistan. After the product development and policy documents were developed for implementation of Islamic compliant

¹ Also outstanding loan portfolio

products (*murabaha*, *salaam* and *ijara*), it was submitted to the ASC for their approval. After the review process, ASC approved the *murabaha and salam* product, and recommended changes for the *Ijara* product which would require their approval in the future. The Approval Certificate was obtained from ASC which took around 20 days and the product was formally launched in Herat and Kabul.

Compliance with Sharia rules and principles is the essence of Islamic financial products and is the key factor distinguishing them from conventional products. Mutahid has formed a Sharia Supervisory Board (SSB) to review the *murabaha* products in accordance with the Sharia rules and principles. SSB is entrusted with the responsibility of continuously directing, reviewing and supervising the activities and operations of the Islamic MF operations in order to ensure that these are in compliance with the Sharia rules and principles at Mutahid.

4.2 Murabaha Transaction Process

When a client visits Mutahid to apply for a Group *murabaha* loan, s/he approaches the Customer Service Officer (CSO) who fills out a Comprehensive Financial Service Form (CFSF). CFSF has 10 sections divided into two categories. The first category records information about the client’s personal information, home address, contact details, enterprise information, financial position and financial service requested and the second category is filled using the checklist of eligibility (*Table 02*) for each client. *Figure 01* is a flow-chart summarizing the process, from the moment a clients approaches Mutahid to the end.

Figure 01: Process Flow of Group Murabaha product



CSO=Customer Service Officer
 IFSO= Islamic Finance Service Officer
 M&CO=Monitoring & Compliance Officer
 IAO=Internal Audit Officer
 CFSF=Comprehensive Financial Service Form
 IFSM=Islamic Finance Service Manager
 AM=Area Manager
 BM=Branch Manager

Table 02: Checklist for Eligibility

| S.No. | ELIGIBILITY CRITERIA |
|-------|---|
| 01 | Client is not a MISFA / Mutahid employee |
| 02 | Client agrees to approved amount if reduced (from initial loan requested) and has no outstanding amount due |
| 03 | Client has own/relative national I.D (tazkara) |
| 04 | Financing request is for own enterprise only; applicant's age is within 18-60 years; applicant in good health |
| 05 | If Group: group has to have 2-6 clients (with 33percentof group members above 30 years old) |
| 06 | If Group: members will guarantee each other |
| 07 | Disclosed relation with MISFA / Mutahid staff |
| 08 | Checks – Shura(community leaders) /wakil (head of district Council)and neighbors – ok |
| 09 | Client's enterprise is not in exclusion list, residence and enterprise verified |
| 10 | Residence check (electricity/cleaning bill) |
| 11 | If Individual: title deed |
| 12 | 1 Guarantor having fixed enterprise premises; guarantor must be capable of repaying loan |
| 13 | Guarantor has tazkara; guarantor residence and enterprise verified |
| 14 | Guarantor is not client's relative or Mutahid / MISFA staff |

Mutahid offers *murabaha* product in two forms: Individual and Group loans. Although most of the processes are similar, there are a few differences in terms of loan limit, eligibility criteria, and process flow which are as follows:

- The *murabaha* individual loan (MIL) limit starts from a minimum of AFN 50,000 to the maximum of AFN 250,000 in the first cycle, depending on the characteristics of the clients financial capability; the maximum limit in the second cycle and beyond is AFN 500,000. MIL requires a client to provide a title deed of a property as collateral; provide one guarantor,

who agrees to pay the debt in case client defaults and provide copy of business registration documents. The loan should be approved by the Credit and Risk Assessment Committees. In case of a new client, the Branch Manager (BM) checks with local MFIs through a formal correspondence, to ensure that the clients do not take loan from two MFIs simultaneously. Each transaction (the whole process of MIL) takes an average of 5-10 working days to complete. Although the paper work at Mutahid completes within 4-5 days, but the attestation process and providing title deed etc from the client takes longer.

- *Murabaha* group loan (MGL) should be a minimum of two members and a maximum of six members. The loan limit starts from AFN 10,000 to the maximum of AFN 50,000 per group member in the first cycle; each increment from the second cycle to the fourth cycle and beyond is AFN 20,000. The maximum amount of loan for a group member is AFN 100,000 or AFN 600,000 for six group members. The Credit Committee approval, title deed of a property is not required, the clients guarantee each other and only one external guarantor is required. Each transaction takes 3-6 working days depending on the clients' ability to submit the documents.

Rejection and increment criteria of group *Murabaha* re-loans depend on previous loan repayment history and fulfillment of Mutahid's loan utilization policy. If loan repayment is delayed for more than 30 days in 12 months, or two loan repayments are delayed for more than seven days in 12 months, then the re-loan is rejected. Similarly if loan repayment is delayed for more than 12 days in the 12 months, or one loan repayment is delayed by more than seven days in the 12 months, then zero (0%) percent increase in loan size is set for re-loan.

The transaction process for conventional loan products are shorter than *murabaha* in the following ways: IFSO does not need to; verify product specification and quotation, purchase products, sign delivery agreements, make photographic records of products, while it only requires two guarantors when the loan amount is higher than AFN 40,000 in 1st cycle. The client is able to obtain loan within 3-5 days but in certain cases finding two guarantors may delay the process. The markup rates for both *murabaha* and conventional products are 15 percent. However, two percent extra administrative expense is charged for conventional products.

The policy documents are produced for *murabaha* product which are comprehensive and provide step-by-step guidance to staff members. Process flow diagrams and tracking system are prepared for activities to track flow of each transaction from the beginning to the end and hold the responsible person accountable for the overall client support process.

Loan Collection

Islamic Finance Service Officers (IFSO) are responsible for collecting loan repayments. They receive monthly summarized list of the clients from the Management Information System (MIS) department which show the client's loan repayment status. Currently, the maximum loan repayment period is 12 months. The efforts of IFSOs contribute significantly to the repayment of *murabaha* loans. Most of the IFSOs call the clients 2-3 days in advance, or visit them during door-to-door marketing surveys to remind them of their loan repayment period.

The process of loan repayment is similar for both Islamic and conventional loans. If a client does not make payment on time, IFSOs believe the best strategy is to call the client's guarantor, since a guarantor, in most cases, is a close friend. *Murabaha* group clients pay their debt by depositing it in an Express Pay machine available in different locations in Kabul City. Clients can also pay their debt through their mobile phones, a service provided by Roshan Telecommunication Company known as M-Paisa but clients prefer the former method as they receive a paper receipt. While MIL clients pay their debt through depositing it in a local designated bank.

A Microfinance *Murabaha* Default Client Story:

"Loan recovered from a Bankrupt *Murabaha* Individual Client"

Mohammad Hussain approached Mutahid to request AFN 200,000 MIL to expand his bread baking business in Herat. After received goods worth AFN 200,000 his business flourished. He used to pay the installment on time but this trend slowed after three month and halted after five months. He sold his business without informing Mutahid staff and disappeared suddenly. IFSO swiftly visited his home but his wife was not willing to cooperate. At the same time, the IFSO visited Hussain's guarantor but he was not in a position to repay. He closed his business premises and escaped to Iran.

IFSO, the TL and the BM had to play their last card by visiting the person (guarantor) who had provided a title deed as collateral. After multiple visits by Mutahid staff, in fear of his house being auctioned, he made three installment payments, however, he did not have the financial ability to repay the remaining four installments. The guarantor, with the support of Mutahid's staff visited the local community leader and the members. Through continuous dialogue and consultation over a period of three months, the community members agreed to collect charity for Hussain's family. Finally, Mutahid Herat Branch was successful to get the full loan repayment. Although the case suggests hardship for the borrower and the family, it also highlights the efforts Mutahid staff made to recover the loan. Following this incident, Mutahid introduced a more detailed assessment of the assets of potential clients and the guarantors.

4.3 Client Perceptions about *Murabaha* Product

The perceptions of clients about *murabaha* and conventional products differ in Kabul and Herat. According to the interview of 15 clients, 33percent of the respondents in Kabul and 67 percent in Herat rejected taking conventional loans on the basis of religious grounds. Overall, 54 percent of the clients rejected taking conventional loans in both Kabul and Herat under any circumstances. While the clients in Kabul seem flexible in taking conventional loans, other factors such as education level and socio-economic status also affected their decisions.

Results of the survey showed that 50 percent and 35 percent of old MIL and MGL clients respectively complained about the lengthy loan approval process. In the case of repeat loans (re-loans), the number of clients dissatisfied with the length of the loan approval process was 10 percent for MGL

and 35 percent for MIL. Ninety percent of MGL clients and 60 percent of MIL clients were satisfied with the loan repayment methods.

Seventy five percent of *murabaha* clients who were interviewed were highly satisfied with the mechanism of *murabaha* loan and 85 percent indicated that they will request for a re-loan in the future. Fifteen percent of clients who were not prepared to request re-loan had requested loans out of economic necessity and did not need a new loan. Similarly, about 80 percent of the clients requested loans in order to expand their businesses, while 20 percent requested loans out of necessity because they had faced problems, such as economic loss in their business. This shows positive attitude of the public towards business expansion and development.

A Microfinance *murabaha* Client Story: “A child breadwinner ensures own children go to school”

Khawani Khairkhwah was only 14 years old when his father was killed. Consequently Khawani and his family sought refuge in Pakistan. When they returned to Afghanistan in 2003, he got a job as a lorry driver and earned enough income to support his family. However, as the industry started scaling down with the gradual withdrawal of foreign troops from the country. Khawani then opened a grocery shop near his house. This is when a Mutahid staff approached him. Being religiously conservative, Khawani decided to go for the *murabaha* product. He took a first loan of AFN 200,000 (USD 4,000).

For Khawani, the effect of the loan on his family’s quality of life has been significant. “By receiving the loan, my capital increased from USD 6,000 to USD 10,000 and so did my profits”, said Khawani. “My daily sale is more than AFN 10,000 (about USD 200) of which 20 percent is net profit”. According to Khawani, his monthly net profit exceeds AFN 60,000. Now 28 years old, Khawani is a father of four children, three sons and a daughter. He can now afford to send two of his school-age children to a private school in the hope that they are able to get good education and complete their studies, unlike himself who had only made it up to the fourth grade.

Approximately seven percent of *murabaha* clients in Kabul and Herat are female compared to 21 percent of conventional clients. The general reason presented by the interviewees was that most of the women are involved in a part-time, informal home-based business and they do not deal with regular clients compared to the male clients. That is why they are more interested in receiving cash to purchase the raw materials when they need it, while in the case of *murabaha*; the required raw materials have to be purchased at once. The other reasons for low female outreach are:

1. Females are not able to pay the 15 percent mark-up because they are involved in a part-time home-based business
2. Females are usually not able to find guarantors as collateral.
3. Females want to start business from scratch thus making them ineligible for loans.

The number of poorest clients availing of the *murabaha* product is small. Out of a total of 1,956 *murabaha* clients, only 35 clients (1.78%) have received the minimum amount (<AFN 16,000). In

conventional products, 2.15 percent of clients have received the minimum amount ($\leq 16,000$). The average loan at Mutahid is AFN 28,900. According to studies, one reason extremely poor people may prefer not to borrow is because they think debt is more likely to hurt rather than help them.

4.4 Murabaha Product Marketing

Various marketing techniques have been picked to increase the general public awareness of the *murabaha* product. IFSOs conduct door-to-door marketing surveys at residential houses and business shops in the areas assigned to them. Distribution of flyers, pamphlets and visiting cards are other useful marketing methods deployed in both Kabul and Herat. According to the interview survey, 58 percent of clients got information about the *murabaha* loan through a friend or relative which means word of mouth has been the most effective tool, while 10 percent through advertisement on a billboard. The remaining 32 percent were approached by the IFSO through door-to-door marketing surveys. Another effective marketing technique has been adopted that is to increase the awareness of *wakils* (Members of Urban District Councils) and Mullahs (clerics) through meeting them face to face for *murabaha* product. Increasing awareness of mullahs is important, as some clients visit them to seek advice on the type of loan to take. Based on the interview with clients, about 30 percent rejected conventional loans after consulting the mullah.

5. MURABAHA PRODUCT MONITORING AND EVALUATION

Mutahid's main office measure the performance of the field branches against annual work plan. The internal audit, risk assessment and operations departments also visit branch offices on regular basis. Each Branch Manager (BM) prepares a monthly plan where s/he set weekly and monthly target for each IFSO. The targets include the number of new *murabaha* clients to attract, amount of funds to disburse and number of potential clients to visit for *murabaha* product marketing. The targets are set based on previous years experience, on site observations and market trend. Regular meetings are held both in the main office and branch offices on weekly and monthly bases to discuss the progress of work and share the feedback about *murabaha* loan from the clients and market situation.

MISFA assesses Mutahid's activities against 22 performance standards on annual basis, and monitors the loan disbursement (outreach) and collection (loan repayment) on monthly basis. After the annual evaluation, MISFA prepares a gap assessment report that outlines all the findings and recommendation to promote good management and operational practice, including specific recommendations for *murabaha* product.

5.1 Murabaha Process Simplification

During the last two years, Mutahid has introduced certain measures to simplify the processes of *murabaha* product. The simplification of the processes have not only decreased paper work and duration of the loan receipt but it has also motivated more clients to apply for *murabaha*. These simplifications include:

- Decrease number of guarantor for the *murabaha* clients from two to one;

- Develop consistent documents for clients in Kabul and Herat branches.
- IFSOs used to take three quotations from supplier and then select the lowest bid. Currently, clients act as “an agent of Mutahid”, the client takes only one best quotation from the wholesaler he already knows, and Mutahid purchases goods from that particular wholesaler for the client.
- Decrease number of client property valuation by property dealers from three to one; Clients had to attest the value of their property from three property dealers, however currently only one attestation, team leader together with IFSO’s property valuation is approved.
 - In some cases, the district council members do not attest the home location or value of the client’s property. So the IFSO together with TL attest it from the client’s neighbor. Each neighbor fills a form and mostly the local mullah is preferred to fill the form to attest home location and property valuation.

6. CONCLUSIONS

Mutahid has expanded the operations of *murabaha* loans from two provinces to five provinces over the last two years. The loan portfolio has increased and the number of clients are also increasing. Certain *murabaha* product processes have been simplified and information and intelligence related to *murabaha* flows bottom up and vice versa. Clients feel more comfortable while requesting for *murabaha* loans and are satisfied with the services attached to it. Various marketing techniques are put in place to expand the customer base and an Islamic supervisory board is established to ensure that the activities align to Islamic rules and principles and efforts are in place to reach the most vulnerable community members and females.

This indicates that the performance of the product has been enhancing and product is well suited to the needs of the customers in the market. Keeping in view the current positive trend, this seems that *murabaha* product is on the right path towards achieving its objectives. The product is gradually filling the niche in the microfinance market to target the more religious oriented customers and provide them an opportunity to expand their businesses.