

## Agriculture, Rural Investment & Enterprise Strengthening Program

### What is Sharia?

Sharia is the body of Islamic law. It consists of laws derived from the Qur'an, the haddith (sayings and example of Mohammed) and religious precedents.

### How is Sharia related to microfinance?

Under Sharia, *riba* or "interest" is forbidden. This is rationalized by, "the belief that money is not an earning asset in and of itself and therefore cannot earn interest."<sup>1</sup> Microfinance institutions must therefore offer products and develop systems that are fee-for-service based or include explicit risk sharing.

### What are examples of common Sharia-compliant financial products?

*Murabaha*: Primarily used for trade finance, *Murabaha* dictates that a lender buy goods desired by clients directly and then resells these at a markup to the client.

*Ijara*: This is a form of leasing through which a lender purchases an item – such as agricultural equipment - and the borrower pays a monthly usage fee. Many *Ijara* products operate as rent-to-own arrangements through which each payment encompasses both a rental fee and a portion of the cost of ownership.

### Do all Muslims have the same interpretation of Sharia?

No. There are various schools of thought within the Sunni and Shiite sects, each of which views specific aspects of financial service provision differently.

1. Islamic Banking Principles Applied to Microfinance: Case Study: Hodeidah Microfinance Program, Yemen. UNCDF, Al-ZamZami & Grace, 2001.

In October 2006, USAID launched the \$80 million **Agriculture, Rural Investment and Enterprise Strengthening (ARIES)** Program. Administered by the Academy for Educational Development in partnership with FINCA, the World Council of Credit Unions, ACDI/VOCA, MISFA, and Shorebank International, ARIES aims to provide a solid base on which to grow a fully inclusive and sustainable financial sector. By establishing or partnering with commercial banks, microfinance service providers and rural financial cooperatives, ARIES is supporting the provision of a broad range of financial services to rural microentrepreneurs and households. The success of the ARIES program to date is in part related to the ability of ARIES partners to rapidly design and distribute products adapted for Afghans eager to enter the financial system but unwilling to compromise their religious beliefs.

### FINCA Afghanistan: Responding to local beliefs yields increased outreach and growth

FINCA began operations in Afghanistan in 2004 offering a *murabaha* loan product deemed Sharia-compliant through a fatwa from al-Azhar University in Egypt. Despite the fatwa, the more conservative Afghan populace perceived the initial product as out-of-line with Sharia since it did not incorporate the concept of risk sharing or mark-up. In addition, the product was initially mis-priced, with a fee structure that discouraged poorer clients and did not cover the cost of delivery. To better serve the market and accelerate growth FINCA needed to re-engineer its offerings.

Beginning in early 2005, FINCA began working with their staff and religious experts to develop new products that were fully inline with local interpretations of Sharia and could be provided sustainably. The result was a trio of *Murabaha* products that required FINCA to retrain staff, strengthen internal controls and re-price its products. The results of this process have been dramatic.

Since rolling out their revamped *Murabaha* products in

### **FINCA Afghanistan**

To conform with Islamic principles, FINCA Afghanistan offers Murabaha financing, under which clients request the bank purchase certain goods on their behalf.

Murabaha is not a loan per se; it is a pre-approved and mutually agreed upon sale contract that explicitly itemizes the sale of a commodity for cash plus a markup, including administrative costs associated with the transaction.

#### **Current products:**

- Women's Murabaha Group
- Market Murabaha Group
- Business Murabaha Agreement

**Clients:** 44,215 (Women: 35%)

**Portfolio outstanding:** US \$9.1 million

**Operational sustainability:** 54%

\*All data accurate as of May 30, 2007

August 2006, FINCA Afghanistan's operational sustainability has risen from 15 to 54 percent; the number of active clients has risen from 14,000 to over 44,000; and the total portfolio has more than quadrupled, going from \$1.7 million to nearly \$10 million today. All of these figures were certainly assisted by expansion capital provided through ARIES. However, the change in client retention clearly indicates the value of a product and process better aligned with the market.

In the months around FINCA's launch of the new products, the client dropout reached highs of nearly 40 percent. By March of 2007, that figure fell to just two percent. FINCA Afghanistan Country Director Paul Robinson attributes this reduction to the product re-design as well as to improvements in morale, as staff members were more comfortable marketing a product they felt corresponded with their beliefs. In addition, Robinson cites FINCA's new marketing approach, which involves obtaining local leader buy-in before offering services.

Today, FINCA Afghanistan is the fastest growing microfinance institution in the country. It has operations in 97 districts throughout eight provinces

across the country and has plans to expand into less secure areas, confident in the belief that its products will be embraced by even the most conservative populations. FINCA's approach continues to evolve but to date has proven highly successful.

### **WOCCU in Afghanistan: Financial cooperatives as the ideal Islamic institutional type**

Through the ARIES program, WOCCU is developing 20 Investment Finance Centers (IFCs) with multiple points of service in the provinces of Nangahar, Balkh and Kandahar with future implementation activities planned for Helmand province. IFCs provide Afghan clients the opportunity to join a financial institution that is owned, controlled and operated by its members. The model is in line with both cooperative principles and the Islamic value attached to shared risk and reward, with members owning investment accounts, rather than traditional interest bearing share accounts.

### **WOCCU in Afghanistan**

Based on the principles of risk sharing and equity, financial cooperatives are largely inline with Islamic principles. WOCCU is using their expertise in this area to build a network of International Financial Cooperatives (IFCs) throughout Afghanistan.

**Clients:** 6,671 (Women: 15%)

**Portfolio outstanding:** \$926,251

**Total deposits:** \$182,107

\*All data accurate as of March 31, 2007.

When WOCCU began operating in Afghanistan, it focused on secular areas of the country and did not market the Islamic credentials of the cooperative model. However, with expansion into the south and more rural areas, WOCCU has increased emphasis on these characteristics and adjusted certain aspects of its structure to be more aligned with the risk-sharing principles of Islam. In addition, WOCCU is beginning to offer clients a range of Sharia-compliant products including Murabaha and Ijara products. Over time, WOCCU plans to consolidate all IFCs established through ARIES into regional association networks based in the north, south and eastern part of the country.

**Learn more about the FIELD-Support Leader with Associates**

Project Director Paul Bundick: [pbundick@aed.org](mailto:pbundick@aed.org) \* USAID CTO Yvette Dennis: [ydennis@usaid.gov](mailto:ydennis@usaid.gov) \* Online at: [www.microlinks.org/field](http://www.microlinks.org/field)