From Zakat Beneficiary (Mustahiq) to Zakat Giver (Muzakki) – 2

The Akhuwat Experiment

Microfinance, Zakat April 8, 2014 Leave a comment

When Dr Malcolm Harper, the grand old man of microfinance visited Akhuwat Headquarters at Lahore some years back, I was pleasantly intrigued. I have known Dr Harper since my days at the Xavier Institute of Management (XIMB) during 1995-2000. During one of his visits to India and XIMB (he also used to frequently visit Hyderabad where he laid the foundation of BASIX India) he got interested in me because of my own fascination with the nascent discipline of Islamic finance. And to my surprise, he presented me with a book on Islamic microfinance (the green book as he would call it) that is perhaps the first book on the subject to the best of my knowledge. It was based on a doctoral study undertaken under his guidance as Professor at Cranfield University, UK and involved an empirical examination of Islamic microfinance experiments in Sudan. The same Dr Harper was traveling all the way to Lahore to study first-hand the Akhuwat experiment. What he wrote after visiting Akhuwat sounded radically different from what I had known as microfinance till then.

There does not seem to be any reason why a programme which depends on brotherhood, generosity and goodwill should be any less 'sustainable' than one which depends on purely financial incentives…. Akhuwat is unique because it breaks just about all the generally accepted rules of microfinance, but has nevertheless (or perhaps for that reason) survived and grown. In the present crisis of opinion and reputation which is swirling around microfinance, not only in Andhra Pradesh and India, but globally, Akhuwat is a lively proof that there is 'another way', which may also be a better way.

Many years later, I had the privilege of spending a couple of days in the company of Dr Amjad Saqib, the founder CEO of Akhuwat. It was an experts' meeting organized by GIZ, the German Development Agency and the Islamic Development Bank at Amman on the shores of the Dead Sea. The time we spent together during the meeting were as exciting and productive as the day following, which we spent visiting many historical places around Amman that attract tourists all the year round. It was during this interaction, the true meaning of the words of Dr Harper dawned on me. At Akhuwat something truly exciting has been going on.

A Day with Dr Ajmal Saqib at Dead Sea, Jordan (left)

Akhuwat[1] was established in the year 2001 in Lahore, Pakistan as a not-for-profit society under the Societies Registration Act, 1860 by a group of civil servants inspired by the vision of Dr Saqib, who sought voluntary retirement from civil service to lead the new organization and put to test his learning from long years of leadership of the Punjab Rural Support Program, a government initiative to alleviate poverty in the province. His vision involved a novel approach to alleviating poverty based on compassion and benevolence, a major departure from the conventional approach. The important lessons from the government sponsored program that formed the basis of the new approach were as follows:

1. The poor were finding it difficult to afford the high cost of loans; which were often justified on grounds of high operational costs. The government-sponsored program entailed an annual interest rate of twenty percent. Private microfinance providers charged much higher interest rates.
2. The poor were reluctant to deal with interest-based loans as it violated their fundamental beliefs.

The Akhuwat experiment began with a fundamental objective of finding an interest-free alternative to providing micro-credit to the poor. This required a two-pronged strategy of (i) bringing down the operational cost of providing micro-credit to the poor through institutionalized volunteerism and other means (e.g. use of places of worship for credit delivery), while (ii) mobilizing charity funds on a sustained basis to absorb the operational costs that were now much lower. Cost of loans not only had to be brought down; they had to be brought down to zero.

Akhuwat has set the following vision-mission-goals for itself.

Vision: A poverty free society built on the principles of compassion and equity

*Mission:*To alleviate poverty by empowering socially and economically marginalized families through interest free microfinance and by harnessing entrepreneurial potential, capacity building and social guidance.

Goals:

- To provide interest free microfinance services to poor families enabling them become self-reliant
- To promote Qard-al-Hasan as a viable model and a broad-based solution for poverty alleviation
- To provide social guidance, capacity building and entrepreneurial training
- To institutionalize the spirit of brotherhood, compassion, and volunteerism
- To transform Akhuwat borrowers into donors
- To make Akhuwat a sustainable, growth-oriented and replicable organization

Achievements:

From a modest beginning in 2001 (with the maiden transaction of Rs10,000 funded through a single donation) Akhuwat has steadily expanded its reach. Currently it has over 254 branches with presence in 165 Cities and towns in Pakistan. Total number of beneficiaries stand at about half a million served by a 1200-strong staff. It enjoys an impressive recovery rate of 99.83percent. Time-series changes in major performance related variables are presented in table below.

Table 1. Time-series of major performance indicators

Indicators	2008-09	2009-10	2010-11	Dec. 2011	Dec. 2012	Dec. 2013
No. of loans	44577	65650	99844	125,646	230,000	438,841
Loan disbursed (Rs. Bil.)	0.488	0.739	1.157	1.5	3.2	6.8
Percentage of recovery	99.50	99.86	99.85	99.82	99.83	99.83
Cities	15	20	34	45	105	165
No. of branches	21	33	53	62	153	254
No. of employees	90	181	358	419	785	1200

How did Akhuwat show such consistently impressive performance year after year since inception? An answer to this requires a careful examination of the strategies and processes at work at Akhuwat.

Charity-Funded Credit Pool

The financing process at Akhuwat involves establishment of a credit pool and making small loans (Qard-al-Hasan) to the poor from pool. The pool itself is created through philanthropy and spirit of brotherhood. It is in the nature of a revolving fund from which is continuously depleted with disbursal of loans and replenished and enhanced with their recovery plus new donations. The cumulative disbursement currently stands at Rs. 6.40 billion.

Unlike many other Islamic microfinance institutions that use murabaha and other for-profit products, Akhuwat uses a simple loan product that is also free from any element of profit for the financing entity. Loans are given to start or expand businesses or meeting social needs that are ultimately aimed at increase in income of poor and improvement in quality of their lives.

Cost of Loan

Regarding the cost of loan to be charged to the borrowers, Akhuwat considered two options that were admissible in Shariah. One option was to provide finance based on cost-recovery. The second was not to charge anything and absorb all costs.

In the initial years of operation Akhuwat preferred the first option under which it would recover the actual cost of provision from the beneficiary without any element of profit for itself. The actual cost to be recovered, termed as administrative fee, was pegged at five percent of the loan amount. Also, cost of loan had no link with the maturity of loan. Further, very small loans (amount less than Rs4000) were to be entirely cost-less as these were targeted at the ultra-poor with least affordability.

As Akhuwat sought to increase the pool of charitable contributions over time, it also observed a noticeable interest among its past borrowers and beneficiaries to contribute. The sustained growth in charitable contributions has now enabled Akhuwat to absorb all costs and make all loans entirely cost-less. This change in pricing strategy effected in 2010, was a major milestone in the history of Akhuwat.

Loan Size & Frequency

Loan size is small. The first loan to any borrower cannot exceed ten thousand rupees. Based on the borrower's need, and repayment performance, loan amount may be increased in subsequent cycles subject to a maximum of Rs. twenty-five thousand. Loans are repaid, usually in installments of one thousand rupees and the maximum maturity of any loan is eighteen months.

It is interesting to note what happens to a borrower upon reaching the threshold limit of Rs. twenty-five thousand. Borrowers are not barred from fresh borrowing, but must restart at the initial level of ten thousand rupees and may again move up to the maximum of twenty-five thousand. The essence of this strategy is to consciously discourage borrowers from ever-increasing cycles of debt, in line with the Shariah that seeks avoidance of debt. This however, constitutes a major departure from the practices of conventional microfinance providers for whom higher levels of debt bring in higher profits. Conventional wisdom entails encouragement to creation of new debt as long as the borrower is in a position to service the same on a sustained basis. Thus, while a conventional MFI would encourage its clients to go for higher levels of debt, Akhuwat encourages its clients to reduce dependence on debt as business grows. Akhuwat's strategy is also necessitated by practical considerations as its overall ability to lend is circumscribed by the flow of charitable contributions.

Beneficiaries

Akhuwat employs systematic screening criteria for identifying its potential beneficiaries. It is estimated that over ninety percent of them have incomes of below USD70 a month, thus belonging to the poorest of the poor strata of the society. Akhuwat also provides a small percentage of loans to the moderately poor that are economically active as micro entrepreneurs.

Another significant aspect of Akhuwat's beneficiaries is that they are not restricted to women as is the case with many conventional MF providers. Confronted with some evidence from Bangladesh that lending only to women could cause major social problems in the form of disintegration of families Akhuwat embarked on a strategy of family loans targeting entire households instead of individuals. It was felt that loan agreements signed by wives and husbands, or mothers and sons, or fathers and daughters would go a long way in strengthening family bondage and relationships while avoiding duplication of loans within the same family.

Lending Method

The lending method at Akhuwat has evolved over time. While in the initial years, Akhuwat's method was largely similar to that employed by the Punjab Rural Support Programme there have been significant changes as new lessons have been learnt.

Initially, Akhuwat employed a group lending method similar to the Punjab Rural Support Programme. While this method rooted in the text-book model of Grameen claimed to provide a robust credit risk mitigation strategy, it also involved processes, e.g. group formation, recurring group meetings that were seen to be highly time-consuming. The observed aversion among many potential borrowers towards transactions in groups also led to a search for a better alternative. Only if alternative (non-collateral-based) risk mitigation strategies could be found and employed (see section below), individual lending would be a far superior option for borrowers. With a new risk mitigation strategy in place, Akhuwat moved over to individual lending. Individual lending saved time for Akhuwat staff and associated costs as well.

Credit Risk Mitigation

Akhuwat seeks to mitigate credit risk using an innovative combination of credit delivery at places of worship and personal guarantees. When places of worship are used for loan disbursement, the probability of breaking one's commitment for timely repayment is significantly reduced. Additionally, borrowers need to bring two other guarantors, who are not from the same household, to co-sign their loans. The guarantors may not be of high net worth but should be of high moral character, displaying piety and trustworthiness and willingness to assist the borrower in times of adversity. This mechanism effectively replaces the group guarantee. Finally, the family loan concept also ensures that the entire family is the guarantor and the beneficiary.

Credit discipline is ensured through an efficient monitoring mechanism. If any payment is overdue more than a month, the borrower and guarantors are immediately contacted for making good. Since loans are provided in small amounts, the possibility of being excluded from future loan cycles acts as an effective deterrent. Consequently, Akhuwat has consistently reported over 99 percent recovery over the years.

Akhuwat also operates a compulsory insurance scheme for borrowers who are required to pay a one percent of loan amount as premium. In case of death or permanent disability, outstanding loan balances are waived, and needy families receive a five thousand rupee cash payment as well as a stipend of three thousand rupees a month for three months.

Loan disbursement at a Masjid

Minimization of Operating Costs

Akhuwat has been following a two-pronged strategy to minimize its operational costs so that these could be easily absorbed by the charitable contributions from its donors. The strategy essentially involves (i) credit delivery and management from places of worship and (ii) combination of volunteerism and necessary compensation for staff. As a result, its operating costs as a percentage of loan amount disbursed has consistently been in the range of 6-8 percent (see table below). Indeed, it has been pushed below the 6 percent mark in 2012-13.

Table 2. Operational Expenses 2008-12

Year	No. of Loans Disbursed	Total Amount Disbursed	Operating Expenses (OE)	OE per Loan	OE as %age of Amount Disbursed
2008	11,388	122.45	8.29	728	6.75

2009	13,821	164.23	10.38	751	6.32
2010	21,073	251.81	17.82	845	7.08
2011	34,194	418.21	36.67	1072	8.77
2012	67,683	1,137.68	68.16	940	5.59
2013	159,138	2,580.47	135.09	848	5.23

The core administrative tasks relating to loan management are carried out from the places of worship. As Prof Malcolm Harper, observes: "This extension of the use of the mosque from purely a place of *ibadat* (worship) to *khidmat-e-khalq* (service to mankind) has become central to the approach of Akhuwat."[2] While this results in substantial savings in administrative costs, it also builds and strengthens the links between Akhuwat and the local communities that the mosque serves.

Akhuwat consciously seeks to minimize its personnel costs by recruiting staff from the same communities as their borrowers, and not to hire highly qualified professionals. This also ensures low staff turnover. The CEO and the top management and about one-third of Akhuwat staff work voluntarily without any remuneration. The organization has made minimal investments in office assets. It owns no vehicles. Its staff sits on the floor as its clients do. It has found a way to do business with the poor keeping costs to bare minimum.

Institutionalization of Philanthropy

Institutionalization of philanthropy is the most important component of Akhuwat's strategy. It has been able to achieve its avowed aim of providing cost-less financing to the poorest of the poor by absorbing all costs through charity funds. That charity funds can be mobilized on a sustained basis is central to this new paradigm. (see table below)

Table 3. Flow of Charity Funds (2008-13)

Financial Year	Donation Received Amount (in Rs. million)	Zakat Received Amount (in Rs. million)
2008	23.2	
2009	36.1	
2010	108	
2011	68.6	2.3
2012	79.4	8.6
2013	67.1	9.1
July 2013- December 2013	43.6	10.3

*Till February 2014

Among the many goals Akhuwat, one that aims at transformation of borrowers into donors, has become an important component of Akhuwat strategy for future. Past borrowers have increasingly sought to donate to Akhuwat. As figures in Table above show, such donations now are a significant pool and cover over one-third of the total operating costs of Akhuwat. Under this strategy, small donation boxes are placed at work places, homes, carts, etc. and existing borrowers voluntarily contribute Rs. 2 to Rs. 5 each every day.

Table 4. Donations from Borrowers (2008-13)

Financial Year	Donation from borrowers	Growth Rate	Operating Expenses (OE)	Donations from borrowers as %age of OE
2008	0.207		8.29	0.25
2009	0.103	(50)	10.38	0.10
2010	6.11	59078	17.82	34.3
2011	12.23	200	36.67	33.4
2012	23.87	195	68.2	37.53
2013	54.09	125	135.1	40.03

Further, there are no institutional donors for Akhuwat and all funds have come from individual donors. Akhuwat consciously avoids donations from foreign institutional donors as the management believes that these are not likely to be unconditional. It also firmly believes in the inherent generosity and spirit of brotherhood (akhuwat) of Pakistani society that would sustain its operations.

And perhaps very rightly Akhuwat seeks to showcase the fact of **past beneficiaries turning into donors** as the ultimate evidence of its client's progression out of poverty. Perhaps, here we have a fascinating case of zakat recipients (mustahiq) getting transformed into zakat payers (muzakki).

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[1]The term “Akhuwat” implies brotherhood.

[2]Malcolm Harper, *Akhuwat: A Case Study*, Accessed from http://www.akhuwat.org.pk/AkhuwatCaseStudy.asp on March 18, 2013