

# IMPLEMENTING A COMPETITIVE AGRICULTURE MURABAHA MICROFINANCE PRODUCT IN A RELIGIOUSLY DIVERSE COUNTRY

The Microfinance Project in Albania demonstrated how Islamic microfinance products can be more competitive and provide lower cost of financing due to the negotiation with the suppliers

Economic Empowerment Department





### Title

Implementing a Competitive Agriculture Murabaha Microfinance Product in a Religiously Diverse Country



### Excerpt about the solution

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### What year was the innovation introduced



### #women/youth entrepreneurs served/reached



### (Potential) Lives Impacted

4856



### Budget

USD 5.3 million



### Which organization implemented the solution?

Agrokredit

### Solution Type

Financing



### Topic

Social Impact Investing



### Sectors (max 4)

Islamic Finance



### Video URL

<https://www.youtube.com/watch?v=A7vBrpkosks>



### Location

Albania, Different cities



# Implementing a Competitive Agriculture Murabaha Microfinance Product in a Religiously Diverse Country



## The Challenge:

Although ambivalent to Islamic microfinance, clients were worried that it would not be a better product due to its inflexibility

Islamic microfinance is often promoted in many Muslim-majority countries as the required alternative to the conventional interest-based banking that is prohibited by Shariah. Islamic financial institutions need only to prove that the products they provide are Shariah compliant to tap into the demand. However, this is not the case for Albania. Albania is a religiously diverse and tolerant country. Based on the last census in 2011, Muslims make up about 58% of the population with the remaining population professing as Roman Catholics or Orthodox Christians.

There was a clear need for microfinance products / interventions in the rural areas. The potential for developing rural agriculture and rural tourism was high, especially when the government has invested heavily in Secondary and Rural Roads. In this context, the government requested IsDB to support Agrokredit (formerly known as First Albanian Financial Development Company) with 20 branches throughout of the country, to provide micro-loans to poor rural populations. However, Agrokredit was a conventional microfinance institution that had no knowledge of Islamic finance. In fact, they were concerned about meeting IsDB's requirement that their financing had to be Shariah compliant. Besides their lack of competency in Islamic finance, Agrokredit was also concerned about introducing a Shariah compliant product would be viewed negatively among their clients.

As part of its efforts to raise awareness, IsDB conducted a workshop on Islamic microfinance, explaining its benefits to the management of Agrokredit which were made up of Muslims, Christians and Catholics. Although the majority of the company's management were non-Muslims, they were intrigued by the proposed alternative mode of finance that does not rely on interest and which can be beneficial to financing real economic transactions. They were also keen to learn how to implement the best practices of Islamic microfinance that has proven to benefit the poor in the rural areas.



Prior to committing to the project, Agrokredit decided to conduct a survey at their own expense on how Islamic microfinance products would be perceived by their clients. The study which was conducted in June 2015 consisted of focus group meetings with staff as well as face to face interviews with a sample of 140 rural enterprises

in 14 districts of Albania. About 62.1% of the respondents were willing to accept Islamic microfinance and only 23.6% were against such financing. In addition, almost 60% said they did not have an issue with Agrokredit making direct payments on their behalf to the suppliers. The feedback to this question affirmed that the majority were fine with the Islamic methodology although it also reflected some concerns among clients.



## Solution:

Introduce best practices gradually while keeping to Islamic microfinance values in view of concerns raised by clients

The results of the survey demonstrated that a substantial segment of clients was concerned about losing their ability to handle cash. Although some Islamic microfinance institutions may appoint their clients as agents to purchase assets under the Murabaha agreement, the best practice is to ensure direct payment of the funds to the supplier which will ensure that the financing provided is not diverted for anything other than the intended purchased asset.

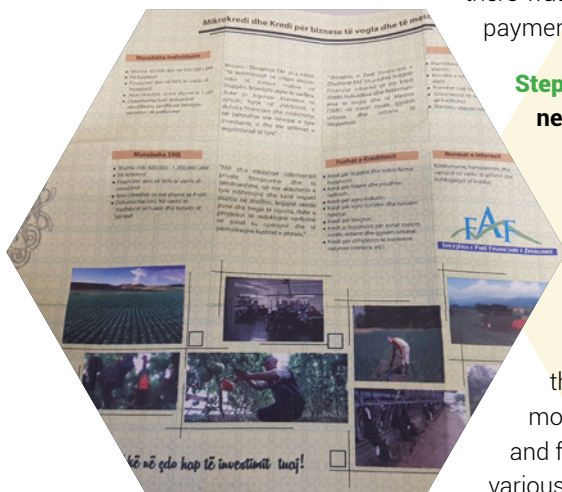
IsDB discussed this issue with Agrokredit and explained the benefits of making direct payments, in view of concerns raised by the clients. IsDB also explained that by making direct payments, the funds would be for genuine purposes and would not be used to pay off another loan, or used for other consumption purposes. The implementation was also carried out in a gradual manner as defined by the steps below.

### Step 1: Introduce Shariah compliant Murabaha by introducing direct payment to suppliers

An Islamic microfinance consultant was hired to help Agrokredit introduce the Murabaha product that differentiated in 3 main ways from the conventional loan product: Firstly, the activity that was to be financed must be Shariah compliant. Secondly, the financing must be asset backed. All financings of Murabaha were made directly to suppliers. Thirdly, since the selling price of Murabaha was fixed, there was no increase in the client debt due to delays or default in payments.

### Step 2: Analyze assets purchased under Murabaha and negotiate with suppliers for lower prices

After about one year, IsDB advised Agrokredit to analyze market data collected with the Murabaha contracts. Murabaha contracts include supplier details and prices of the assets that were being purchased. This was considered as valuable market data which should be used to intervene in the market to generate value for their clients. From the analysis conducted, it was found that most of the financings were used for purchasing greenhouses and fertilizers. There were many suppliers of greenhouses with various quality.



After learning this, Agrocredit staff advised their clients to purchase from specific suppliers with better quality. In addition, Agrocredit also negotiated for discounts of 15 to 20% from the suppliers and the savings were transferred to their clients. Since the profit rate of the Murabaha product was 16.5%, many clients received the financing cost at almost zero cost of financing! By doing so, Agrocredit can cover its running cost without incurring additional charges to their clients.


**Step 3: Systemize practice of Islamic microfinance and explore new products**

Although a standard Murabaha product was implemented in all 20 branches, the value generated from negotiation was not the same throughout as it could not be captured in the Management Information System.

The success of the previous two steps convinced Agrocredit management to purchase a new MIS system which could record Murabaha assets so that the analysis could be done in a more systematic and structured manner.

The MIS system which was purchased and deployed also encouraged Agrocredit management to think of implementing new Islamic Financial products. They conducted value chain studies for targeted Agricultural products which could be financed through Salam.





**Impact and Results:**  
Stronger Demand and Better Portfolio Quality for Murabaha Portfolio

Despite providing a relatively small line of financing of USD 5 million, the project has derived significant results after 4 years of implementation.

As of July 2019, when the Project Completion Report was conducted, 1214 Murabaha loans had been disbursed amounting to ALL 482.37 million (approximately USD 4.32 million). These loans contributed in creating 4856 jobs in rural areas in Albania. Murabaha portfolio within Agrocredit has increased to 31.7% of the number of loans or 40.3% if the quantum of loans disbursed.

Based on the portfolio data, the following can be inferred when comparing the Islamic microfinance portfolio to the conventional portfolio:

- The quality of portfolio for Murabaha loans are similar to that of conventional loans. Even though the Murabaha Individual portfolio, which makes up 99% of the Murabaha portfolio does not require any immovable collateral for the financing, this has not affected the quality of the

portfolio. In comparison, individual clients make up 85% of the clientele for conventional products and 15% are SMEs.

- Quality of loans to SMEs for both Murabaha and conventional loans are significantly higher than Individual loans with 84.6% (quality level 1) compared to individual loans with 76.6% (quality level 1).
- Although 99% of Murabaha products are individual loans compared to 85% individual conventional loans, it has not affected the quality of the Murabaha portfolio. The Murabaha portfolio may be further improved if there is an increased take-up from SMEs.
- In fact, the Portfolio- At- Risk (PAR) more than 90 days (closed portfolio) have been very positive for Murabaha loans at only 2.5%, which is lower to the PAR more than 90 days (closed portfolio) of the conventional loan portfolio which stands at 3.14%.
- Murabaha loans have higher loan sizes in general. The average quantum of Individual Murabaha loans is higher at ALL 390,652 compared to ALL 168,835 for conventional loans. Similarly, the average SME Murabaha loans stands at ALL 1,165,000 compared to ALL 869,514 for SME conventional loans. The reason for this is that the maximum limit for conventional individual loans is ALL 200,000 compared to Murabaha individual loans which has a limit of ALL 500,000.



The Microfinance Project in Albania demonstrated how Islamic microfinance products can be more competitive compared to their conventional counterparts. Clients benefit from lower cost of financing due to the value-add generated through negotiation with the suppliers. By being more aware of the value chain risks, microfinance institutions can remove the collateral requirement for small loans without affecting the portfolio quality. In fact, the portfolio at risk of the closed Murabaha portfolio was lower compared to the conventional loans.

Even non-Muslims are attracted to Murabaha if it is a good financial product. Agrokredit did not hide the fact that it was offering an Islamic Finance product, yet the response was positive as a lot of demand came from word of mouth of previous clients in the rural areas. The project results overcame any concerns that Agrokredit would lose clients by introducing an Islamic Financial product. Agrokredit openly advertised their product in mass media including the mainstream television.