

CASE ARTICLE

## Minimizing Operating Cost of Islamic Microfinance Institutions: A Case of Akhuwat

Zahoor Khan <sup>1\*</sup>, Muhammad Siddique <sup>2</sup>, Malik Muhammad <sup>3</sup>

<sup>1,2</sup> Assistant Professor at Institute of Management Sciences, Peshawar, Pakistan

<sup>3</sup> Assistant Professor, International Islamic University, Islamabad, Pakistan

### Keywords

Islamic Microfinance

Akhuwat

*Qard al-hasan*

Operating Cost

**Received:** 12 March 2018

**Accepted:** 1 October 2018

**Abstract.** This case describes how Akhuwat - an Islamic microfinance NGO, working in various parts of Pakistan on *qard al-hasan* basis, significantly reduced high operating cost through its innovative and Islamically charished process of benevolence and cooperation. In conventional microfinance models, high operating cost is usually considered as unavoidable cost and is ultimately transferred to the poor clients as direct credit supply cost. Akhuwat first channelized *qard al-hasan* to the poor and financially marginalized communities in Lahore region through technically viable, cost efficient, socially responsible and religiously compatible processes which distinguished Akhuwat model of Islamic microfinance. The scheme is now being replicated in other regions and by other similar organizations. This case explains how Akhuwat devised mechanism to minimize operating cost to increase the chance of provision of loans to the poor on sustainable basis while putting minimum financial burden on the organization.

**KAUJIE Classification:** I45, N6, H15.

**JEL Classification:** G21

© 2018 JIBM. All rights reserved.

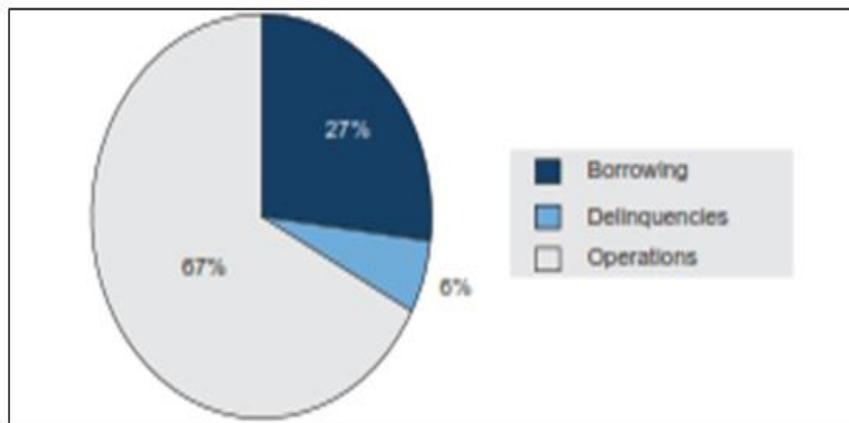
## INTRODUCTION AND BACKGROUND

Unlike the banking industry, where cost of borrowing is considered as a major part of the total cost, operational cost of Micro finance Institutions (MFIs) is considered as a dominant part of total cost to the recipients. Globally, operational cost of MFIs comprises 67 percent of the total cost of financing, which augments the cost of credit supply and are consequently charged from the poor and financially marginalized communities in the form of high interest rates. The following figure shows components of total cost of usual MFIs.

---

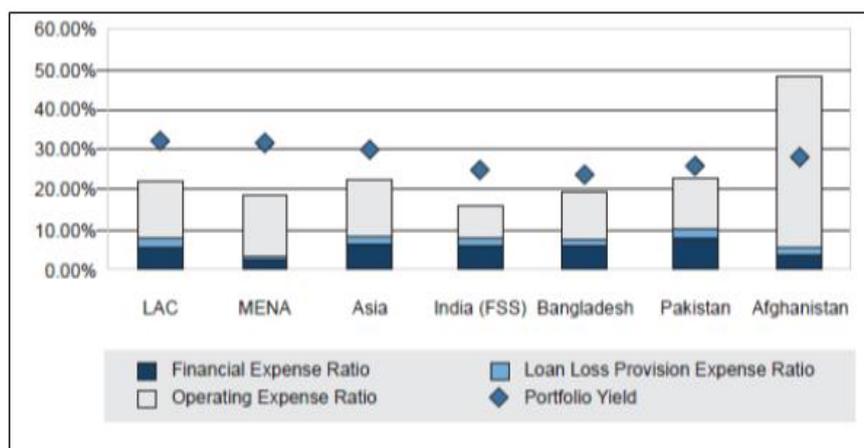
\*Corresponding author: Zahoor Khan

†Email: [zahoor.khan@imsciences.edu.pk](mailto:zahoor.khan@imsciences.edu.pk)



**FIGURE 1.** Main components of total cost of global MFIs  
Source: <http://bit.do/eEi93>

An MFI is supposed to charge interest rate to cover borrowing, delinquencies and operational costs to operate at break-even point. However, to charge a sustainable interest rate further intensifies the burden of cost of full credit supply to the poor. Average interest rate charged by MFIs in Pakistan is about 27 percent which is noticeably higher if compared with interest rate charged by commercial banks from the well-off clients. Though, Pakistani MFIs are charging competitive interest rate in the region, the affordability, however, is becoming a question mark for the poor clients. A comparison of interest rate is given in Figure 2 .



**FIGURE 2.** Regional and country level comparison of interest rates based on the cost structure of MFIs  
Source: <http://bit.do/eEi93>

Akhuwat took the advantage of religious affiliation of the vast majority of people of the country and hence declared all worship places as their offices of operations. Moreover, they adopted simple organizational life style to keep the operating cost at minimum (Khan, 2011). This innovative process significantly decreased operational cost of Akhuwat at one hand while earned trust and confidence of major stakeholders on the other hand. Based on the Mix market data of 2013, Akhuwat’s average cost per borrower was USD 19.5 compare to rest of MFIs in Pakistan which was USD 57.63 during the same time period (2004-2012) .

### A Brief about Akhuwat

Akhuwat was established in 2001 to help the poor and financially marginalized communities through virtue-based approach to poverty alleviation derived from the Islamic history of *mawakhāt* e Madina, a cooperation arrangement suggested by the Prophet (PBUH), acting upon which the well off Ansaar of Madina shared their physical and financial resources with Makki emigrants to support their livelihood and help them earn with dignity (Babar et al., 2011).

Based on the same spirit, Akhuwat started its first interest free loan from a minimal amount of Rs. 10,000, approximately USD 100, to a widow who after successful utilization returned back the loan. This practice encouraged Dr. Amjad Saqib, the founder and Executive Officer of Akhuwat, to repeat this social experiment on a larger scale. A brief and updated contribution of Akhuwat is listed in Table 1.

**TABLE 1**  
**Progress indicators of Akhuwat (January 01, 2018)**

Progress Indicators	Statistics
Total Benefiting Families	2,376,883
Total loan disbursed-Male	1,385,143
Total loan disbursed-Female	991,735
Amount Disbursed as Loan	PKR 53,139,182,837
Percentage Recovery	99.96%
Active Loans	875,998
Outstanding Loan Portfolio	PKR 13,751,730,664
Number of Branches	708
Number of Cities and Towns	250

### Akhuwat's Model of Microfinance

Akhuwat believes that social goals of an MFI are at least as important as its financial goals. Thus, Akhuwat started with serving its social goal first-reaching to the poorest of the poor and women borrower at zero interest rates. To meet the operational cost of Akhuwat was a challenging aspect for which they found an interesting solution. Akhuwat declared all religious worship places of any religion as their branches which tremendously decreased their operational cost at one hand while attracted the attention and confidence of people on the other hand. Sooner, Akhuwat got popularity and credibility among the people. People started giving their donations to Akhuwat which were channelized into "credit to poor" for Islamic microfinance. Akhuwat encouraged their clients to revive an important lesson forgotten in Islamic society "Volunteerism". The beneficiaries realized importance of volunteerism and thus they started contribution in the form of channelizing a part of their income for other deserved people through Akhuwat. As at present, more than 35% disbursed funds are from the contribution of these beneficiaries which marked a new height in the history of microfinance practices. In other words, Akhuwat enabled and transformed the loan seekers to loan providers.

This was the beginning of new era in microfinance industry in multiple ways; First, Akhuwat model of microfinance challenged, the conventional 'cost structure and operational model' and provided a socially acceptable, financially viable and religiously compatible solution (Munir, 2012). Akhuwat discovered that changing conventional financing mechanism into a simple yet effective mechanism can reduce operating cost of the organization at one hand, and increase affordability of the clients on the other hand, to consequently increase access of financially deprived people to financial resources. It also helped in successful repayments. Second, conventional MFIs charge high rate of interest as "poverty penalty". It is based on the presumption that dealing with the poor is itself an expensive activity as compared to well-off clients, which is a genuine reason of charging high interest rate. Akhuwat used a heterodox approach and rejected this hypothesis by introducing a new model of operation, which implied that financing the poor might not be an expensive activity by itself, but the choice of operation model may make it affordable or expensive. Akhuwat analyzed operating cost of MFIs and decomposed it into two parts: cost of conventional operations and cost of simplified operations. Akhuwat realized that a major component of operating cost of MFIs was due to its conventional and formal structure (formal offices, employees, infrastructure etc.). Akhuwat avoided formal organizational operations and thus reduced its operational cost tremendously. Third, Akhuwat developed a sense of responsibility- a lesson forgotten at collective level- among the well-off people to help the poor and financially marginalized people that is a social and religious duty. Akhuwat reminded the well-off class of the society as well as their clients that socioeconomic empowerment of poor through the provision of interest free loan is a joint, religious and ethical responsibility. This strategy worked well and consequently Akhuwat generated sufficient funds from the affluent class in the society for their operations and 'credit pool'. Last but not the least, helping the poor in terms of social and commercial activities through the respective religious institutions encouraged proper utilization, sense of responsibility, social cohesion and repayment of loan among the clients at noticeable level.



**FIGURE 3.** Akhuwat event in a Mosque (Mithan Kot)

Later, Akhuwat realized that poverty does not have a financial face only, but many others. Thus, Akhuwat started the provision of social loans for marriages, education, emergency etc., to meet the diversified needs of the poor. The journey of Akhuwat does not stop here.

Akhuwat believes that sustainable solution of poverty not only requires financial support, but an inclusive package of free quality education, health services, and many more. Akhuwat has initiated all these cohesive programs to free Pakistan from absolute poverty on sustainable basis. Following are some photos showing operations of Akhuwat in Mosques.



**FIGURE 4.** A loan disbursement event in a Mosque

**Source of Funding of Akhuwat**

Based on the credibility of Akhuwat and its innovative models of operations, Akhuwat has attracted significant numbers of individuals and corporate philanthropic funds. Akhuwat initially started with the help of individuals and clients’ volunteer support. As indicated earlier, over 35% of disbursement funds are from the contribution of the beneficiaries. In other words, Akhuwat enabled and transformed the loan seekers to loan providers. Later on, provincial and federal governments realized the contribution of Akhuwat and thus extended government funds to help them in poverty alleviation of the poor masses through Akhuwat’s social model of microfinance. Currently, Akhuwat is the largest example of public-private partnership working for poverty alleviation in Pakistan. It is implementing some interest free loan programs sponsored by the Government. These sources of funding contribute to sustainability and expansion of Akhuwat’s social microfinance model. Following are some of the schemes assigned to Akhwat to disburse loans on behalf of provincial and federal governments and charge 10% as cost of operations.

1. Chief Minister’s Self-Employment Scheme (CMSES)-Punjab (For details see appendix-1)
2. Chief Minister’s Self Employment Scheme- Gilgit-Baltistan
3. Prime Minister’s Interest Free Loan Scheme through Pakistan Poverty Alleviation Fund
4. Interest Free Loan Program through FATA Secretariat

**4.1 Existing cost structure of Akhuwat:**

**TABLE 2**  
**Cost structure of Akhuwat for individuals borrowers**

Interest	Zero
Loan Processing	Fee Zero
Profit	Zero
Application Fee	Rs. 100 - 200 per application
Mutual Support Fund	Around 1% of loan amount (voluntarily)

## CONCLUSION

This case highlights a common problem faced by the microfinance institutions, i.e. high operating cost, and how an Islamic microfinance NGO-Akhuwat, devised mechanisms to reduce it to the maximum possible extent. Akhuwat realised that conventional structure and financing methods were the sources of high operating cost of the industry. It challenged conventional structure of the MFIs by introducing a simple yet effective solution in the form of operating through religious places and employing local staff. This innovative solution tremendously decreased Akhuwat cost of operation.

### Findings of the Case

- Operational cost of MFIs can be reduced if traditional disbursement and collection methods are simplified and developed on informal mechanisms.
- Informal funding is not a problem for MFIs if an MFI has good reputation among the masses and can develop trust among them that their funds are properly and transparently utilized for the purpose they donated.

This case article could be useful for:

- All those who may plan for doing for the social cause by providing interest free loans for consumption by and rehabilitation of the poor;
- Teaching and training material for microfinance practitioners
- Introductory level course about Islamic microfinance and conventional microfinance
- Students and practitioners interested in readings about Islamic microfinance.
- For understanding the governance of microfinance institutions

Higher operational costs of the micro finance institutions resulted in 'micro finance meltdowns' since 2009 in South East Asia and Sub Saharan countries. It manifested clients' over-indebtedness, client withdrawals. As a result, the key MFIs plunged into loss or forced to close or merge. It led to abusing the social policies as a tool of exploitation (Ayub, 2015). The researchers and micro finance policy makers may like to recommend and introduce the Akhuwat's model to reduce the operations cost and to maximize the impact of the efforts made for poverty alleviation at global level.

## REFERENCES AND SUGGESTED READINGS

- Ayub, M (2015). Financial inclusion: Social inclusion with its true paradigm to be the target. *Journal of Islamic Business and Management*, 5(1), 5-16.
- Babar, M. O. A., Javaid, A., Farooq, A., Shahid, F., Umer, F. M., & Javaid, M. U. (2011). *An Interest-free approach to microfinance—Taking lessons from Akhuwat Foundation* (Ph.D. dissertation). National University of Computer & Emerging Sciences, Lahore, Pakistan.

- Obaidullah, M. (2008). *Introduction to Islamic microfinance*. New Delhi, India: NIBF Net (P) Limited.
- Khan, S. S. (2011). *Akhuwat exploring new horizons in micro finance*. Retrieved from: <http://bit.do/eEjd5>
- Khan, A. A., Ishaq, M. S., Afonso, J. S., & Akram, S. (2017). Is it possible to provide qard hasan and achieve financial self-sustainability? The experience of Akhuwat in Pakistan. In M. Harper. & A. A. Khan (Eds.), *Islamic microfinance: ShariâĤah compliant and sustainable*. Rugby, UK: Practical Action Publishing.
- Khan, S. S. (2011). *Akhuwat exploring new horizons in microfinance*. Conference Proceedings.
- Munir, K. (2012). Akhuwat: Making microfinance work. *Stanford Social Innovation Review*. Retrieved from: <http://bit.do/eEjek>
- Khan, Z., Khan, A., & Ullah, A. (2009). Cooperative micro finance: A new option for government and development organizations. *Journal Managerial Sciences*, 3(2), 180-191.

\*\*\*\*\*

## APPENDIX-1

### Features of Chief Minister's Self-Employment Scheme (CMSES)-Punjab

- First ever interest free loans project on such scale.
- Loan size ranges up-to PKR 50,000.
- There is no mark-up or interest on these loans.
- Loans are given for businesses and setting small enterprise only.
- Loans are disbursed in places of worship including mosques and churches to ensure transparency and participation.
- Loans are given after due scrutiny and appraisal according to an eligibility criterion, on first come first serve basis.
- This is the largest interest free small loans scheme in Pakistan jointly ventured by a Government agency and a civil society organization.

**TABLE 3**  
**Progress Indicators Chief Minister's Self-Employment Scheme (CMSES)-Punjab**

Indicators	Statistics
Total Loans	1,750,669
Male Borrowers	933,006
Female Borrowers	817,663
Amount Disbursed	37.8 Billion
Percentage Recovery	99.99%
Active Loans	670,022
Number of Districts	36 (all districts of the Punjab)
Number of Branches	556

### 2. Chief Minister's Self Employment Scheme- Gilgit-Baltistan

#### Features of Chief Minister's Self Employment Scheme-Gilgit-Baltistan

- First ever interest free loans project in Gilgit Baltistan.
- Loan size ranges up-to PKR. 75,000.
- There is no mark-up, interest and service charge on these loans.
- Loans are given for businesses and setting small enterprise only.

- Loans are disbursed in mosques/church/religious places to ensure transparency and participation.
- Skilled persons of Rupani Foundation, Beedar, KADO, NAVTEC will be preferred.
- Loans are given after due scrutiny and appraisal according to an eligibility criterion, on first come first serve basis.
- Total funds: PKR 575 Million.

**TABLE 4**  
**Progress indicators of Chief Minister's self employment scheme-Gilgit-Baltistan**

Indicators	Statistics
Total Loans	67,194
Male Borrowers	50,942
Female Borrowers	16,252
Amount Disbursed	Rs. 1.5 Billion
Percentage Recovery	99.9%
Active Loans	32,553
Number of Districts	10
Number of Branches	30

### **3. Prime Minister's Interest Free Loan Scheme through Pakistan Poverty Alleviation Fund.**

#### **Features of Prime Minister's Interest Free Loan Scheme**

- Providing interest free loan for expanding and establishing business to poor people having poverty score up to 40.
- Loans are given for businesses and setting small enterprise only.
- Interest free loan size of: up to PKR 50,000
- Loans are given after due scrutiny and appraisal according to eligibility criteria.
- There is no mark-up or interest on these loans.
- Mode of repayment of interest free loan: on monthly basis
- Loans are disbursed in places of worship including mosques & churches to ensure transparency and participation.
- Total Funds : PKR 446 Million

**TABLE 5**  
**Prime Minister's Interest Free Loan (PMIFL) Scheme details**

Total Loans	69,410
Male Borrowers	46,502
Female Borrowers	23,358
Amount Disbursed	Rs. 1.6 Billion
Percentage Recovery	99.8%
Active Loans	29,998
Number of Districts	11
Number of Branches	27
Targeted Geographic Areas	Low human development indicators and food security Low or no access to microfinance Investments or activities in livelihoods, employment or enterprise development Community institutions that are socially mobilized and active in managing their own development

#### **4. Interest Free Loan Program through FATA Secretariat**

##### Features of interest Free Loan Program through FATA Secretariat

- Loans are given for businesses and setting small enterprises only.
- Interest free loan size up to PKR 50,000.
- Loans are given after due scrutiny and appraisal according to an eligibility criterion.
- There is no mark-up or interest on these loans.
- Mode of repayment of interest free loan: on monthly basis.
- Loans are disbursed in places of worship including mosques & churches to ensure transparency and participation