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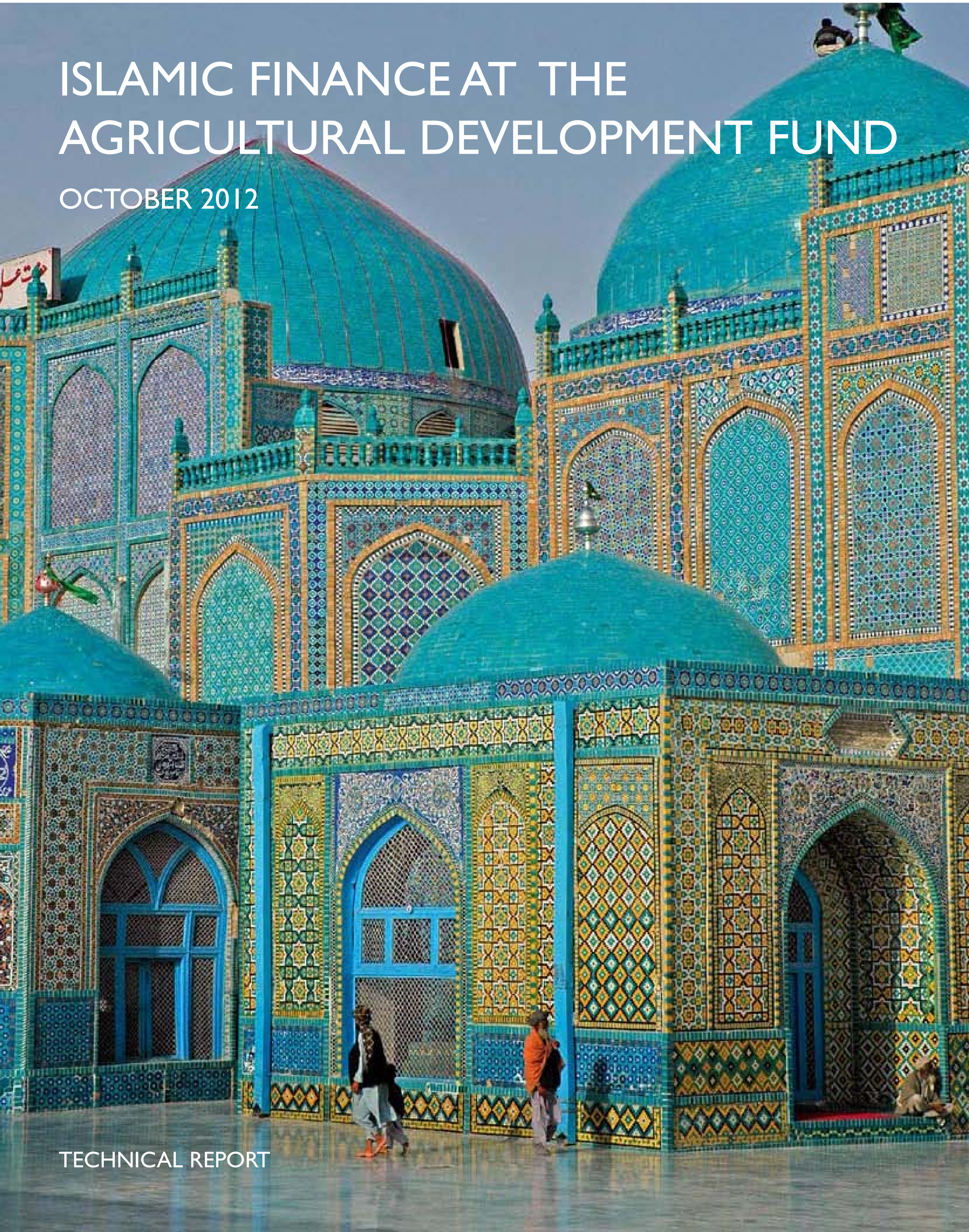
# ISLAMIC FINANCE AT THE AGRICULTURAL DEVELOPMENT FUND

OCTOBER 2012



TECHNICAL REPORT

# ISLAMIC FINANCE AT ADF

OCTOBER 2012

**The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.**

# TECHNICAL REPORT ISLAMIC FINANCE

OCTOBER 2012

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| **Program Title:** | Agricultural Credit Enhancement Program |
| **Contract Number:** | EDH-00-05-00004 |
| **Contractor** | Development Alternatives Inc. |
| **Date of Submission:** | October 2012 |
| **Contracts Officer Technical Representative:** | Ali Ahmad |
| **Contracting Officer:** | Paul Martin |
| **Chief of Party** | Juan M. Estrada-Valle |

# CONTENTS



## ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| ACE | Agricultural Credit Enhancement |
| ADF | Agricultural Development Fund |
| DAI | Development Alternatives Inc. |
| DM | Deputy Minister |
| FTE | Full-time Equivalent |
| GIRoA | Government of the Islamic Republic of Afghanistan |
| MAIL | Ministry of Agriculture Irrigation and Livestock |
| SAB | Sharia Advisory Board |
| USAID | United States Agency for International Development |

# EXECUTIVE SUMMARY

The Agricultural Development Fund (ADF), the first lender to the agricultural sector in Afghanistan in over 25 years, was initially designed to be a wholesale lender utilizing existing financial institutions as conduits to reach farmers. While the original design did not emphasize on the provision of Islamic financial products, there was the implicit assumption that with the help of technical assistance and grants some financial intermediaries would do so.

In the absence of financial institutions interested in engaging in the provision agricultural credit and faced with a significant demand for Islamic finance from the start, the Agricultural Credit Enhancement (ACE) Program which implements the ADF, decided to take the demand seriously and embark on the process to development of a robust Islamic financial services offering. A number of important milestones have been achieved in this process. Firstly, five transaction structures were identified that meet the requirements for agriculture finance, are free of interest and, equally importantly, abide by the fundamental principles of Sharia such as openness, transparency, and fairness. These structures were subsequently translated into highly standardized client documentation that is easy to understand for both the lending staff and clients. Secondly a set of Policies and Procedures has been put in place to ensure that not only the transactions, but also the processing of these transactions is compliant with the Sharia principles.

During the same period, the ADF actively engaged in the recruitment of an important organ of governance: the Sharia Advisory Board. Their role is to ensure that the product structures, policies, procedures and processes are designed to be Sharia compliant and remain so on an ongoing basis. Following a protracted search, three Afghan individuals have been appointed one of whom is a representative of the Ministry of Hajj. Their inaugural meeting took place on the 4th of July during which they approved the product structures. The Policies and Procedures were approved subsequently. In addition, an internal Islamic Finance Specialist has been appointed. After careful consideration, one of the existing Lending Officers was promoted to this post and is showing great promise.
As part of the operational readiness, extensive training has been provided to Lending Officers as well as support departments each designed to meet the requirements of the specific recipients.

At the end of October 2012, ACE can honestly say it has met the objective of this particular part of the project and has a robust Islamic financial offering which appropriately meets all the requirements and principles of Sharia.

CHAPTER ONE

# INTRODUCTION

Until the start of the Agricultural Credit Enhancement (ACE) program in 2010, it had been in excess of 25 years since Afghan farmers had access to any structural form of formal credit. With Afghanistan's banks averse to lend to the agricultural sector, farmers were forced to purchase agricultural inputs such as fertilizer, tools, pesticides, and veterinary medicine from traders on credit at significantly inflated margins. The inputs sold to them were often of inferior quality. A $100 million grant from the U.S. Agency for International Development (USAID) for lending to the agricultural sector via the Agricultural Development Fund (ADF) finally changed this situation. The ADF is not a short-term grant based program, but instead has the characteristics of a commercial lender which reinvests all profits in its own operation. It is designed to create a moderate, sustainable profit through which the ADF will achieve growth and thus the ability to increase their portfolio. This report specifically focuses on how the ADF has adjusted to an unforeseen change in circumstances.

Although it was originally envisaged that ADF would be an interest-based lender, it became clear rather early in the program that a large majority of clients would prefer an Islamic Financial structure. This prompted a sharp strategic turn with the fundamental objective of responding to the specific requirements of clients, especially regarding the religious and cultural appropriateness of lending products. The change in the implementation strategy was followed by several operational changes such as the appointment of a Sharia Advisory Board and an internal Islamic Finance Specialist, and a separate set of policies and procedures. In addition, significant time and effort has been spent on the introduction of the appropriate product structures, client documentation, and capacity building. The current state of Islamic Finance within ADF is that, as the first in Afghanistan, it has a robust operation, well trained staff, and a well rounded product offering that is easy to understand and fully compliant with the principles of Sharia.

CHAPTER TWO

# OVERVIEW OF ADF

The ACE Program is a collaborative initiative between Afghanistan's Ministry of Agriculture, Irrigation and Livestock (MAIL) and USAID. The program aims at increasing the availability of credit to small-scale commercial farmers and to businesses that operate within the agricultural sector. The program is implemented by Development Alternatives, Inc. (DAI) in close cooperation with the MAIL's General Directorate of Programs.

By design, the ACE program focuses on enabling small-scale commercial farmers (1-30 hectares) to access financial services, with concomitant and positive effects in terms of technology adoption, and increases in productivity and profitability. Thus recognizing that maximizing the economic impact of agricultural credit requires a special focus on high-value agriculture, agro-processing and market development.



THE PROGRAM IS SUPPORTING ACCESS TO FINANCE FOR SMALL COMMERCIAL FARMERS THROUGH TWO COMPLEMENTARY ACTIVITIES:

1. Management of a grant to the Government of Islamic Republic of Afghanistan (GIRoA) for the amount of US$100 million to establish the Agricultural Development Fund (ADF), which will provide necessary loan capital for lending to financial and non-financial intermediaries, who will on-lend these funds to farmers.

2. The ACE activity with an approximate budget of $50 million over a four and a half year period beginning in July 2010 and ending in January 2015. ACE will manage the ADF and provide technical support to the agricultural value chains, while also supporting the MAIL in the establishment of a Knowledge Management Facility, a repository of agricultural information and a source of market intelligence.

The objective of the ADF and ACE is to facilitate the rapid disbursement of loans along agricultural value chains, build the capacity of financial intermediaries to deliver agricultural credit to farmers, contribute to developing a high-value agricultural sector, and build confidence in the government, thereby enhancing overall stability in Afghan society.

Farms and agricultural enterprises across the country are eligible for funding through the ADF. The fund is managed to ensure that credit is extended efficiently and equitably to qualified borrowers. While the ACE program was designed to channel the majority of the funds for lending through financial intermediaries—banks and other institutions—the banking sector was unwilling to engage in agricultural credit. The latter resulted in a strategic shift towards the use of non-financial institutions as conduits for credit, thus requiring greater investments by the program, as well as the generation of a set of innovations to meet contractual targets in an unforeseen environment.

From a relatively early stage in the development of the ADF, its customers requested Islamic Financial services in addition to the conventional, interest based lending that was initially intended to be the only offering.

CHAPTER THREE

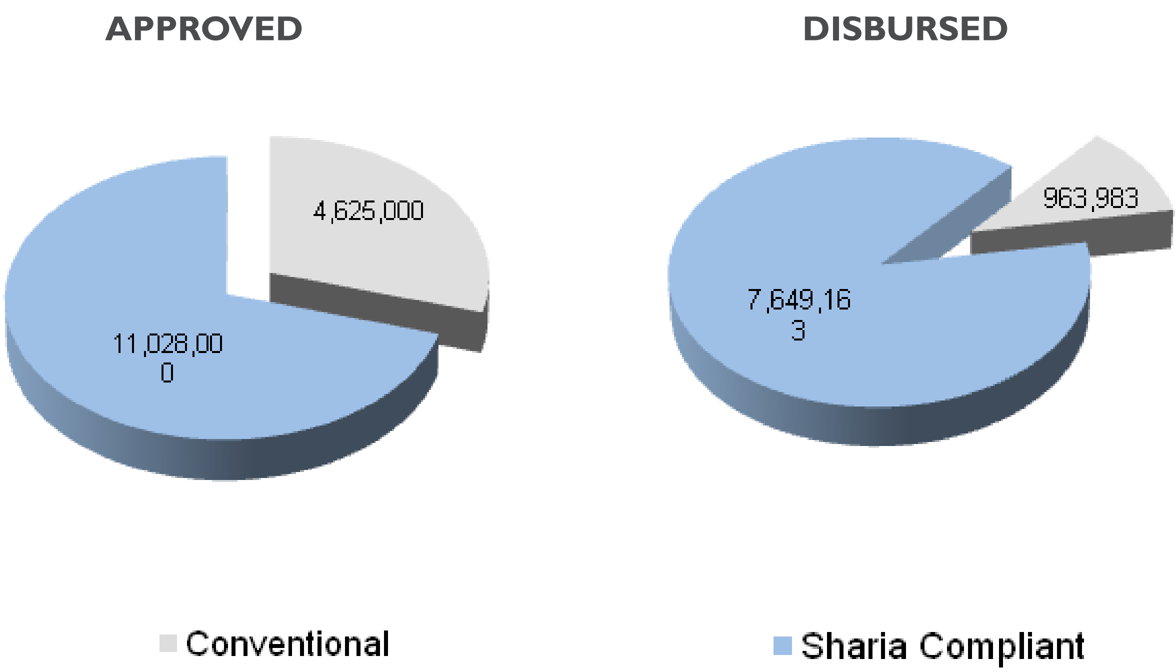
# ISLAMIC FINANCIAL SERVICES AT THE ADF



Although the initial intention was to provide financial services mainly via conventional, interest-bearing loans and credit facilities, many potential borrowers were requesting Islamic financial structures. This demand was deemed to be significant enough to warrant an additional investment in the development of a robust Islamic Financial offering. Initially a trade based contract (murabaha) was the only Islamic financial structure offered and in October 2011, work started on the definition of four Islamic Financial products which, besides being compliant with the fundamental principles of Sharia, had to be transparent, easy to apply, and easy to understand by borrowers as well as ADF staff members. In addition to the trade based contract (murabaha), the ADF developed leasing (ijara), short term production finance (salam), and an agency contract (wakala). The main driver for the selection of these products was the characteristics of the ADF clients' business.

THE DEMAND FOR THESE CONTRACTS CLEARLY SHOWS IN THE ADF PORTFOLIO COMPOSITION FOR THE PERIOD MAY 2011 – APRIL 2012, REPRESENTED BELOW.

| | **APPROVED** | | **DISBURSED** | | **APPLICANTS** | |
|---|---|---|---|---|---|---|
| | Amount in USD | % | Amount in USD | % | Amount in USD | % |
| Conventional | 4,625,000 | 30% | 963,983 | 11% | 4 | 14% |
| Sharia Compliant | 11,028,000 | 70% | 7,649,163 | 89% | 24 | 86% |
| Total | 15,653,000 | 100% | 8,613,146 | 100% | 28 | 100% |




Although a first step, the introduction of Islamic financial products by itself was not sufficient, and a number of additional activities have been undertaken both from an operational and a capacity building standstandpoint.

CHAPTER FOUR

# UNDERLYING PRINCIPLES

In order to be able to implement Islamic financial services, it is important to build an understanding of the underlying principles beyond the prohibition on interest. Islam consists of three main elements:

- Aqidah – Faith and Belief
- Sharia – Practices and Activities
- Akhlaq – Morality and Ethics

Commercial ethics and jurisprudence including financial dealings are covered within Sharia which literally means the path or guidance, and is seen as a framework of guiding principles by which people conduct their lives. A significant part of Sharia covers muamalat which governs the interaction between people and is further divided into political, social, and economic activities. It is within the economic activities of muamalat that rules regarding commerce and finance can be found.

## SOURCES OF SHARIA

There are a number of primary and secondary sources to determine whether something complies with the rules and guidance outlined in Sharia. The primary sources are the Quran which is the primary reference, and the Sunnah containing the words and acts of the prophet. The secondary sources are consulted when the Quran and Sunnah do not provide an answer to the resolution of an issue. The fist of the secondary resources is the consensus of the independent jurists from the Muslim community whose rulings are integrated within Sharia. With the passing of time and the development of societies, new situations would occur that required a solution. The first port of call in this case would be case law, or the application of an existing rule to a new situation.

Finally, once all other sources are exhausted, the last source available is ijtihad or interpretation. There are two kinds of ijtihad: the individual interpretations performed by individual scholars and the collective ijtihad.

## ETHICAL PRINCIPLES AND MAJOR PROHIBITIONS

Islamic commercial and financial ethics are based on the principles of stewardship, integrity, sincerity, and fairness. In practice this translates in a number of guidelines that need to be adhered to. The major prohibitions in Islamic finance are interest (riba), unnecessary uncertainty (gharar), and gambling (maysir) in addition to which a number of other, equally important principles apply.

## MAJOR PROHIBITIONS

The fact that interest and unnecessary uncertainty are prohibited does not mean that there is anything against the creation of wealth. It does, however, result in the fact that wealth can be created via trade or investment and not by making money just from the passage of time or by taking excessive risks.

The lexical meaning of riba is to increase or grow, and it is generally defined as "an increase in one good for another in an exchange, without a compensation for the increase". In finance this results in a situation that no interest can be charged or received. This is different from conventional finance, where interest is deemed to reflect growth, economic circumstances, and the availability of capital. The general accepted notion is that riba is prohibited to avoid injustice, exploitation, and financial loss.

The term gharar is strongly associated with deception and involves taking unnecessary risk. It is also referred to as unnecessary or major uncertainty. Gharar and maysir (gambling) are deemed to be associated with excessive risk taking and are therefore prohibited by Sharia. Gharar also includes ignorance and applies to a wide range of instruments including suspended conditional sales, and future sales. In essence, gharar refers to acts and conditions in exchange contracts, the full implications of which are not clearly known to the parties. The prohibition of gharar does not relate to situations where it is not possible to reveal all details simply because it is in the nature of the asset that not all exact details are known. Maysir or speculation occurs when there is a possibility of total loss to one party in the contract, and is associated with games of chance or gambling.

The prohibition of gharar and maysir, do not imply that no risk can be taken. Business and economic risks are permitted as long as the investing party is fully aware of the risks he is taking. Equally, the risk associated with the possibility of natural disasters and calamities are deemed to be acceptable.

## ADDITIONAL PRINCIPLES

In addition to the major prohibitions, there are a number of underlying ethical principles that need to be adhered to. These principles are strikingly similar to those found in ethical finance companies and consumer protection regulations such as 'Treat Customer Fairly'. Transactions need to be fair, take place in the open market, and all parties need to be aware of the state of the market.

Mr. Nawroz from Behsod district in Nangarhar province one of 4,140 farmers of wheat seed producer

Transactions need to be fair, take place in the open market, and all parties need to be aware of the state of the market. Contrary to Treat Customers Fairly regulations, however, the principles are applied both ways towards the customer and the seller or, in the case of financial transactions, the financier. The principles can be listed to include the following:

1. Disclose all (in)visible faults
2. Avoid misrepresentation,
3. Do not interfere in a transaction that has already been concluded
4. Do not hoard
5. Sell goods in an open market
6. Ensure seller and buyer are aware of the state of the market
7. Do not abuse the other party's ignorance
8. Avoid taking advantage of a seller's helplessness or hardship

## RESTRICTIONS ON THE ASSET

In addition to industries and economic activities that are generally prohibited in society such as illegitimate drugs and illegal weapons trade, there are a number of other industries that are impermissible (haram) within the framework of Sharia. These industries are out of bounds to any investor that wishes to invest his funds in line with Sharia principles, and extends beyond the individual to all Islamic financial services. Generally speaking Sharia prohibits the following industries:

- Conventional Banking and Insurance
- Alcohol, excluding medicinal purposes
- Pork related products and non-compliant food production
- Gambling
- Tobacco.
- Adult entertainment
- Weapons, arms and defense manufacturing.

In addition, the seller must own the asset and be able to deliver it, although delivery does not have to be absolute but could equally be signified by an instruction to the transporter to change the delivery address and a change in the documentary proof of ownership.

## THE IMPACT ON FINANCIAL TRANSACTIONS

Each of the transactions undertaken by ADF as well as its operations, need to be structured as such that they observe the above mentioned principles. As a result, the transaction structures are based on trade and investment and are not just loans at interest without knowing exactly what the funds are used for. It is important that the purpose of the funds is clear, the transaction structure is transparent and easy to understand, and that the client applies the funds as agreed in the contract.

CHAPTER FIVE

# OPERATIONAL READINESS

In order to achieve Sharia compliance, the ADF has taken a number of actions to ensure operational readiness. Firstly, a number of easy to understand, transparent product structures have been defined and implemented including highly standardized client documentation. All key lending staff has received different degrees of training which has enabled them to confidently discuss the most appropriate solution with their clients. Further, specific policies and procedures have been put in place to ensure on-going compliance.

Two functions have been added to the ADF's operational support structure to ensure the Islamic Financial transactions follow the Sharia principles for finance: the Sharia Advisory Board (SAB) and the internal Islamic Finance specialist.

**SHARIA ADVISORY BOARD**

The ADF SAB consists of 3 members and is independent from the ADF management and operations in a way similar to an external auditor. The members of the SAB are all Afghan nationals with a background in Islamic jurisprudence and finance, with one of them representing the Ministry of Hajj. The SAB has held their inaugural meeting on the 4th of July 2012, and is scheduled to meet every 3 months thereafter.

The SAB is responsible for ensuring compliance with the fundamental principles of Sharia at all stages of the lending process, but is not involved in the approval process for individual loans or clients. In this respect, the SAB has approved all transaction structures currently offered by ADF, as well as the policies and procedures. Any amendments or additions will be subject to review and approval. Individual transactions will only be approved in the unlikely event the underlying product structure is new or significantly amended from a previous application.

To ensure on-going compliance, an annual audit will be undertaken by the Audit department. The audit will is based on the Sharia Annual Review Framework which has been approved by the SAB on the 1st of October 2012. The audit will be undertaken once per year on the basis of the Sharia Audit Manual. The results will be reported to the ADF management and to the SAB for review and sign-off.

## INTERNAL ISLAMIC FINANCE SPECIALIST

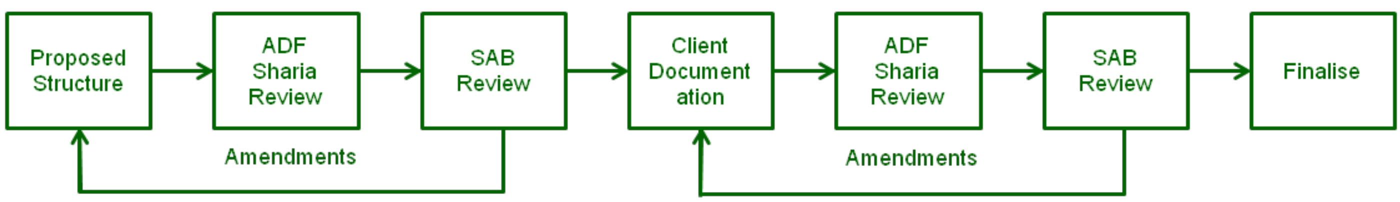
An internal Islamic Finance specialist has been appointed who is the main point of contact for all ADF staff in relation to Islamic finance issues. He is also tasked with reviewing all Islamic financial transaction structures that are offered to ADF clients.  Due to the role, the Islamic Finance specialist has been selected from within the Lending Team, and combines the role with being a Lending Officer. This ensures a strong finance background, significant knowledge about the ADF and a good basis in Islamic finance.

THE SAB APPROVAL PROCESS FOLLOWS THE FOLLOWING STEPS:

The ADF Islamic Finance specialist acts as the first port of call for all questions from clients and staff. In addition, he maintains contact with the ADF SAB, and can draw on their expertise if required. The final component of the ADF internal Islamic finance specialist is to organize and manage the SAB meetings to ensure they take place regularly and all necessary decisions are taken.

## THE APPROVAL PROCESS

All agreements and transaction structures are presented to the SAB for approval. The approval process starts with an initial review that is undertaken by the internal Islamic Finance specialist. Any initial comments will be addressed prior to submitting the documentation and structure to the next SAB meeting. The SAB will then provide further comments or decisions as the case may be.



Once the structure and the client documentation have been approved by the SAB it will be finalized after which it can be offered to clients. The SAB does not opine on issues associated with strategic or economic issues related to the transaction.

## AUDIT

On an annual basis, the SAB ensures that the activities of ADF have been Sharia compliant over the previous period. The audit itself will be undertaken by the Audit Department of ADF based on the Sharia Audit Manual approved by the SAB. The Sharia Audit Manual is based on the Annual Sharia Review Framework.

## POLICIES AND PROCEDURES

In order to ensure that the Islamic financial transactions are processed in line with Sharia principles, a specific set of Policies and Procedures has been designed which have been signed off by the SAB on the 22nd September 2012. The policies and procedures are designed to be independent from the other ADF Policies and Procedures and cover, among others, roles and responsibilities within the ADF organization, governance, general terms and conditions, and how to deal with problem loans.

## CAPACITY BUILDING

The most significant component of Operational Readiness is not related to the appointment of a few individuals or having policies and procedures in place. Ensuring that a broad spectrum of staff understands the principles and what ADF can offer to clients is of the utmost importance. In order to achieve this, a number of different training courses have been provided catering for specific needs of groups of ADF staff. For the Lending Officers, this consisted of in-depth, practical training sessions which combined case studies with work on own cases and a detailed overview of the different products available. For Value Chain, this would be too detailed, and they have instead attended a 1-day introduction training providing them with the level of background they require to speak knowledgeable to clients on the subject without the need to go into further detail. Other support departments such as audit, finance, credit administration, and customer services have been provided with half day, high level training to meet their requirements. On-going mentoring is part of the capacity building exercise.

CHAPTER SIX

# PRODUCTS

In October 2011, an initial four product structures were introduced at ADF which had to meet the USAID requirements, Afghanistan law, requirements related to agriculture finance, be easy to understand by staff and clients, and abide by the principles embedded in Sharia. In April 2012, a fifth instrument was added to this range.

## MURABAHA

The murabaha or trade agreement is most suitable for import/export finance or inventory financing and can easily be applied to finance Ag Inputs. The general principles of the agreement in Sharia are similar to any other legally binding trade transaction. A murabaha transaction is based on an agreed fixed mark-up over and above the original amount which has to be paid on the stipulated date. It is not subject to any profit or loss sharing.

Within ADF, two main types of murabaha are employed. The murabaha for farm stores and associations is applied to the purchase of agricultural inputs such as fertilizer, pesticides, vaccines, and tools. In this case, the ADF appoints the client as its agent to purchase a pre-agreed list of goods that meet the USAID requirements and are suitable for the soil and type of farming. These inputs are then sold to individual farmers with a mark-up for deferred payments. Part of the mark-up will be retained by the client, and part will be paid to ADF. Thus the farmers have access to good quality inputs and typically pay for these at the end of the harvest cycle.

A second form of murabaha is the one in which the ADF pays directly to the supplier to settle the invoice and is subsequently paid by the client with a mark-up at a predefined time in the future.

Within the context of this transaction type, it is important to note that the payment date, original purchase price, and payment date are all fixed in advance and cannot be changed.

## WAKALA

The wakala or agency agreement can be used in a variety of circumstances. The general principles of the agency agreement in Sharia are similar to any other legally binding agency contracts that describe the relationship that arises where one man is appointed to act as the representative of another. Within the wakala agreement, the ADF appoints the client to undertake a specific service and generate a profit doing so. The agreement is restricted, which means that the client will be bound by the activity specified in the agreement. In order to further reduce the risk for ADF, the client has an obligation to inform the ADF immediately when it has any indication he may not be able to generate the profit amount stipulated in the agreement so that alternative arrangements can be discussed. In the even the client fails to do this, he is deemed to be negligent and is liable for the payment of the full principal amount as well as the agreed profit amount. This type of transaction is typically used for processing and production or for the funding of working capital.

A variety on this transaction is the wakala with arbun. Arbun is a down payment on a good of service still to be delivered. The down payment is non refundable, unless the seller does not deliver the goods. This transaction type is suitable for the purchase of raw materials which will then be used for processing. As a rule of thumb, the client will be requested to provide a down payment of around 30% of the final purchase price of the goods. It is typically applied close to harvest time providing the farmer with funds to hire labor or harvest specific tools. The farmer will generally receive a price slightly under market value representing the benefit to the farmer.

## SALAM

The salam transaction is suitable for pre-harvest financing or short term production and manufacturing. Although it is generally not permissible to sell a non-existent commodity, the salam transaction is an exemption to this rule. It is similar to a futures transaction, but has to result in delivery. It is particularly suitable to finance the crop cycle or small sized construction such as hatcheries. In the latter event the hatchery will become the possession of the association who will lease it to the farmer on the basis of a finance lease.

## IJARA

The ijara transaction is a lease transaction in which the client pays for the benefit of having the asset at his disposal. Although there are multiple types of lease transaction, within ACE/ADF the use is restricted to ijara wa iqtina or finance lease, in which the client becomes the owner of the asset at the end of the term. In addition, the ADF will only fund this type of transaction via an intermediary who will assume ownership of the asset and lease it on to the ultimate user. This transaction can, for example, be applied to agricultural equipment such as tractors.

## QARD HASSANAH

The qard hassanah is a benevolent or charitable loan in which ADF provides funds to the client without any charge. The recipient has the obligation to repay the principal in full on the agreed date, but without any additional charges. Due to its nature, the client can apply the funds to meet his requirements without restriction. Due to the fact that there is no profit element associated with Qard Hassanah, it can only be offered to clients under very strict conditions which are defined as follows:

- Only to be applied if none of the other instruments can meet the requirements;
- Can be provided to clients in extraordinary cases such as repayment of loans advanced by the poppy businessman for future poppy delivery, or natural disasters;
- Can only be applied as part of a larger, overall financial structure, not on a stand-alone basis, but shall not be conditional on other instruments;
- Other parts of the financial structure will be charged at a higher profit margin; and
- Can only be offered to the client after the client has accepted the other parts of the financial structure, although the offer is not conditional.

## COLLATERAL AND GUARANTEES

Although transactions are largely based on trust and there is a strong emphasis on the socio-economic benefits, there is also recognition for the fact that parties should take their own responsibility when it comes to risk mitigation. Two main types of risk mitigation are defined, rahn (collateral pledged) and kafala (guarantees).

Rahn translates to pawning or mortgage and is generally interpreted as holding an item in lieu of a legal right that might be satisfied from that item. In other words, it is a valuable asset that is held as insurance against a debt. In the event the debtor cannot meet his requirements, all or part of the asset may be sold in order to fulfill the debtor's obligations. The asset needs to be valuable and cannot be fungible or perishable.

A kafala (guarantee) is an agreement in which a third party agrees to pay the creditor in the event the debtor is not able to do so. It is generally accepted that guarantees cannot attract a fee or commission.

## DEFAULT

Any Sharia financing agreement past due 30 days or more will be reported to the Internal Auditor and to the Credit Committee. It is important to note that within Islam, default or delay of payment by a solvent debtor is deemed to be a sin and may be a legal ground for being publicly dishonored or punished. The ADF has the right to charge a solvent debtor a penalty of $50 for every $1,000 outstanding for each month after the payment date.

Out of this amount, only the actual legal and other expenses incurred can be retained by the ADF, all other funds will be donated to charity.

In addition, the ADF withholds the right to liquidate collateral, call on guarantees, to publicly dishonor the debtor in default, and to include him on a blacklist.

From an Islamic perspective, it is important to ensure the debtor is indeed solvent. The ADF has put in place a mechanism to ensure this and to track all actual cost made.

CHAPTER SEVEN

# SELECTED CASE STUDIES

ADF/ACE/DAI

Not all clients require their financing to be compliant with the fundamental principles of Sharia. Those that do, however, would generally not accept any other mode of finance even when this means they would not be able to grow their business they way they otherwise could. Javed Afghan Threshers, Ghoryan Women Saffron Association and the Dr Abdul Wakil Association each would have continued to grow their business at a significantly slower pace if it would not have been for the fact that the ADF offered them a truly Sharia compliant solution.


*I always dreamed that Afghanistan would one day manufacture its own agricultural machinery. An ADF loan gave me the opportunity be part of this process, create new jobs and help farmers.*

*HAJI MALANG, owner of Javid Afghan Thresher, a recipient of an ADF Loan in Jalalabad, Afghanistan*

# JAVED AFGHAN AGRICULTURE COMPANY

Established in 1997 in Jalalabad, Eastern Afghanistan, the Javed Afghan Agriculture Company (Javed Afghan) produces a range of agricultural equipment. The company is most renowned for its Wheat Threshers which it sells across Afghanistan. Javed Afghan is the first industrial scale producer of agricultural machinery in the country.

In December 2010, Javed Afghan obtained funds on a Sharia compliant basis from ADF for the purchase of raw materials required to produce 300 wheat threshers. The direct result of the loan was an increase in production and value of sales by 41 and 64 percent respectively, the creation of an additional 67 jobs, and an increase in its market share against imported machinery. The original amount plus a pre agreed mark-up were repaid from the proceeds of the sale of the threshers and a second Islamic loan was applied for late 2011, this time to purchase the raw materials to produce 400 threshers and 170 trolleys.

The demand for locally produced machinery is high and the ADF financing has assisted Javed Afghan in expanding the production. The company has outgrown its current premises and will be moving to a new factory over the coming months. To reduce the reliance on imported components, and to be able to provide higher quality machinery to the Afghan market, Javed Afghan will start the manufacturing of Rice Polishers once they move to the new factory. The Rice Polishers are currently imported from China.

*By having access to credit female farmers will no longer be the typical losers in the trade game*

*SIMA GHORYANi, founder of Ghoryan Women Saffron Association*

# GHORYAN WOMEN SAFFRON ASSOCIATION

ADF/ACE/DAI

Saffron, which is generally referred to as Red Gold due to its high price per kilo, is historically grown by women. Unfortunately, this does not mean that women gain most from the saffron industry. To the contrary, women tend to have limited access to capital and are typically not in a position to wait with the sale of their crops until harvest time. They have to rely on cash advances traders provide in return for a commitment to sell their crop at harvest time against relatively low prices. Those who are able to wait until harvest time are likely to receive higher prices, but also generally have to wait another 4 to 5 months before receiving payment.

Women in Afghanistan do not possess assets and can therefore not provide collateral against a loan as a direct result of which they are typically not served by financial institutions and by default excluded them from taking advantage of economic opportunities.

As part of the Zahra program, an initiative specifically aimed at female agricultural workers, the ADF disbursed a Sharia compliant loan to Ghoryan Women Saffron Association (Ghoryan) in February 2012. Ghoryan represents 480 female saffron farmers and beekeepers, 95 of which had access to funds enabling them to purchase agricultural inputs without having to commit to sell their produce at low prices. This has assisted in increasing productivity and quality of the produce.

*This ADF loan will do much more than helping our association; it is helping us develop the apple industry in Afghanistan*

*ENG. HEDAYATULLAH President, Dr. Abdul Wakil Association*

ADF/ACE/DAI

# DR ABDUL WAKIL ASSOCIATION

Afghanistan's apple industry is mainly concentrated in Wardak province which has the highest apple production in the country. As a direct result of the lack of cold storage facilities, farmers are forced to sell their harvest to traders at harvest time when they obtain the lowest price. Apple prices typically increase again starting two months after harvest and more than double in price from seven months after the harvest.

The Dr. Abdul Wakil Association is formed by a group of 10 commercial apple farmers with a view to enhance the income from the apple trade to the farmers. The association purchases apples from its members as well as other associated farmers and stores them in a controlled atmosphere storage facility for 7 months after which the apples will be sold in the local market at a substantial profit, but also at a price below the re-imported apples from Pakistan. The result was a significant profit for the core members, a 14% higher price for the supplying farmers, and a lower apple price for the local market.

Mr. Noorallah, One of 1000 farmers that accessed ADF credit through the Afghanistan Almond Industry Development Organization (AAIDO)

# GLOSSARY

| Term | Description |
|---|---|
| Arbun | Down payment on goods or services |
| Gharar | Unnecessary uncertainty |
| Ijara | Leasing |
| Kafala | Guarantee |
| Maysir | Gambling |
| Muamalat | Part of Sharia governing the interaction between people and is further divided into political, social, and economic activities. |
| Murabaha | Trade transaction in which goods are sold on credit at a mark-up over and above the original purchase price |
| Qard Hassanah | Benevolent loan which has to be paid back in full by the recipient, but does not attract a profit or mark-up |
| Quran | The book of Allah |
| Rahn | Collateral |
| Riba | Interest |
| Salam | Trade transaction in which the buyer pays the full price in advance for a good that does not yet exist. Typically used for pre-harvest or small manufacturing financing |
| Sharia | The collective guidelines followed in Islam |
| Sunnah | Words and sayings of the Prophet Muhammad |
| Wakala | Agency agreement in which one party appoints another to undertake a specific piece of work |

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