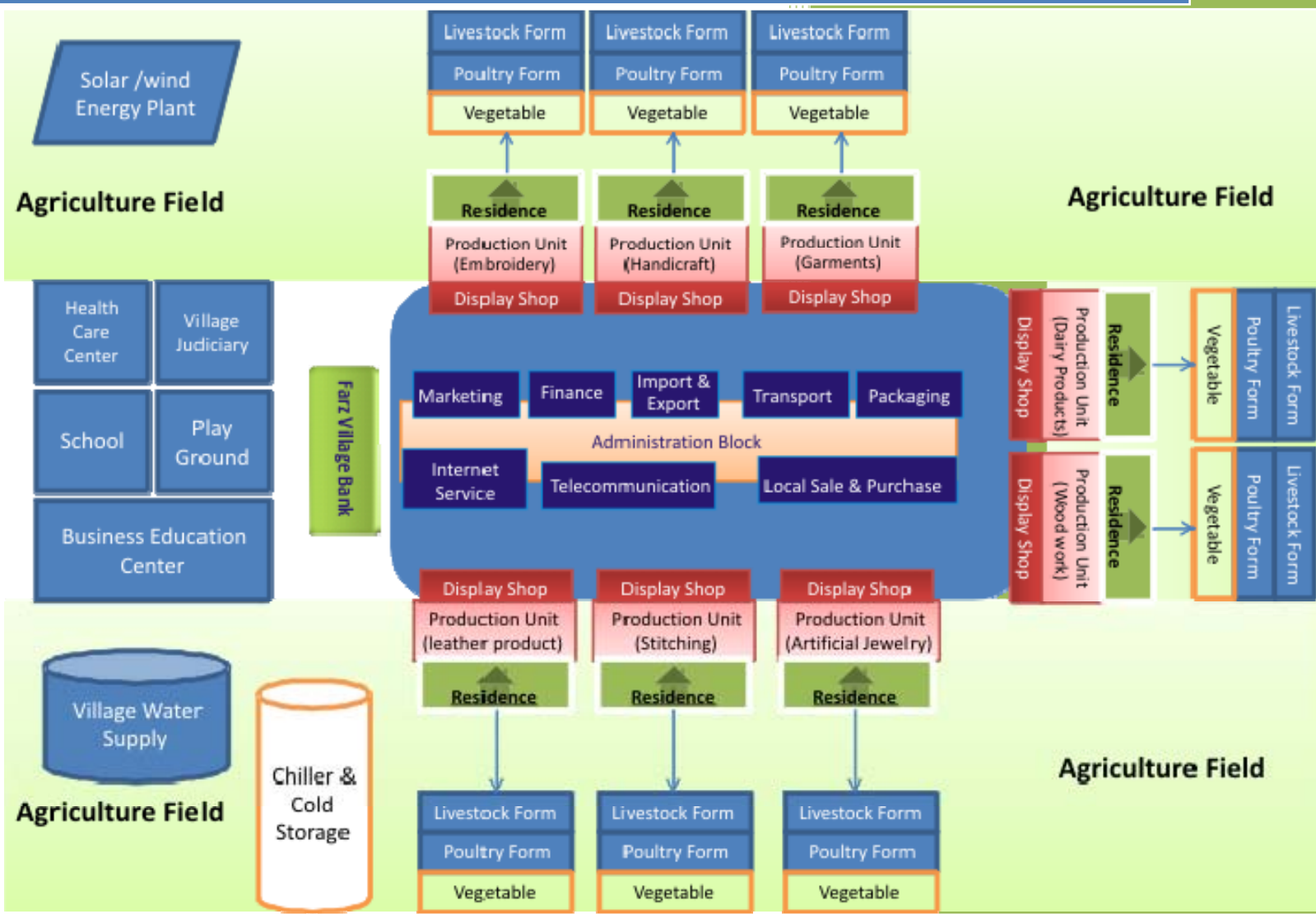




# Concept

## FARZ SME VILLAGE



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### FUNDAMENTALS

Farz Foundation is The First Islamic Microfinance Institute (Shariah Certified) of Pakistan. It believes on innovation and building new horizons through its visionary and creative leadership. After a deep study and observation of the microfinance practices, Farz has designed an integrated methodology reflecting the true spirit of microfinance. Farz Methodology is a social performance based, Shariah Compliant poverty alleviation vehicle with an incorporated approach of providing Health & environment awareness, business education, and Market linkages to the micro entrepreneurs and SMEs to make their businesses sustain. It also facilitates ultra poor by providing them charity and business education to start their economic activity and make them sustained. Diversifying from the trickle down theory we have conceptualized that the sustainability of the micro level can make sure the sustainability of the macro economy. We do not feel hesitation by calling it the theory of TWIST UP ECONOMY.

Twist up theory emerges as a rejoinder to trickle down theory. It is a course with the notion that the sustained micro and small businesses assure the sustainability of the macro economics. It increases the numbers of consumers and their capability to buy. It also strengthens the markets and supports rich persons to expand their businesses. The world has long relied on trickledown theory because it could not ensure desired results. We believe that entrepreneurs and SMEs on the other hand could be very handy in bringing about the desired change at the lowest level but from there the trickledown effect may begin its upward journey to bring about even a macro economic stability. So in brief, the project of Farz SME Village is based on the theory of TWIST UP ECONOMY.

### RATIONALE

A:With the failure of experimenting in top-down (trickle down) development policies for a few decades to alleviate poverty in most developing countries, Financing microenterprises is considered a “new paradigm” for bringing about development and eradicating absolute poverty.<sup>1</sup> Though the importance of developing small-scale enterprises has been discussed for a long time, the innovative poverty focused village-based financing of micro/ small entrepreneurs is relatively a new concept. (*Islamic Economic Studies* Vol.9, No. 2, March 2002)

B:Poverty alleviation is high on Pakistan’s state reforms, conventional microfinance has been one of the main tools selected to deal with this. However to date, overall out reach as only served

5% of its prospective audience. One of the reasons for this has been lack of sustainable microfinance providers which harbor low interest rates. Although commercializing microfinance is on the industry's agenda this would shun the extreme poor, another route suggested by this study would be to provide Islamic alternatives as presently many potential Muslims are restricted from entertaining traditional microfinance.

C: Islamic microfinance is an untapped market with huge potential, bottom line is that its benefits are twofold for Pakistan. It has the potential to improve the economy and be socially responsible by helping people who are in desperate need of financial assistance, but have very few avenues to turn to and thereby be able to generate income and employment. This can be emphasized from existing growth rates of 15% per annum for microfinance and for the past five years for Islamic finance it has been 25-30% growth (Ferro, 2005:1). Ascertaining that Islamic finance and microfinance can be demanding as well as profitable ventures, correct implementation of the joint venture could give astounding results.

Pakistan has been selected as it is one such country where both microfinance and Islamic finance are working independently, although the government is eager to promote these industries in isolation, not enough has been done to ensure they work together to form a synergy. It is a real breath of fresh air to have development tools working well and residing in developing countries like Bangladesh. The hope is that Pakistan can become world leaders in producing microfinance institutions that are both commercially profitable and at the same are true Islamic alternatives tools for poverty alleviation.

## Our Methodology

Farz Methodology is a social performance based, Shariah Compliant poverty alleviation system with an integrated approach of providing Health & environment awareness, business education, and Market linkages to the SMEs to sustain their businesses for long term profitability of the SME sector at international level. It provides rapid economic growth through scalable and sustainable mechanism.

## INNOVATION

It is unique in so far as it links the clients directly to the markets by skipping the middle men usually responsible for the failure of whole exercise. Provision of assets instead of cash, further minimizes the misuse of the facility extend. Another exclusive feature is introduction of committee mechanism (similar to Rosca) which binds the clients with the provider that mitigates the risk of default to almost 0% .Apart from building assets for the clients. It also develops an other source of income for the clients to ensure long term sustainability of SMEs, business education and health& environment awareness and market linkages services are offered to the clients prior to the extension of Shariah Compliant micro enterprise facility. Another innovative component of our solution is to develop SME villages throughout the world, in potential urban semi urban and rural areas, under the umbrella of Farz Foundation and partner organizations. The

concept of Farz SME Village is a scalable, sustainable and profitable project. SME villages will produce, pack and export the different products like dairy, vegetable, leather, embroidery, fruit, poultry, garments, jewelry etc. to the local, national and international markets. This model SME village would consist of a minimum 500 skilled and productive households. These villages can be established through out the world in hundreds. It will be a SME community, productive, independent and cultured, equipped with latest business technology and alternative energy resources and will connect at least 10 sectors as agree, live stock, housing, dairy ,embroidery, handicraft, banking, import export, energy, and microfinance. It will be an ultimate productive, scalable and sustainable model of the history of mankind.

## **LEVERAGING PUBLIC INTERVENTION IN CATALYZING PRIVATE SME FINANCE?**

Farz SME Village Project has the productive capability to pull out the world from the recession by leveraging public intervention in catalyzing private SME finance. Set backs in the previous experience of microfinance and SME sector clearly demonstrates that the poor of the region under discussion were handed over certain amounts of money and were left alone(similar as sub prime loans ) to develop their businesses to pay back the part of their dividend as interest. What we the sector ignored were the peculiar state of their need/ poverty that rendered them un able to make a productive use of the extended loans. The clients, in their sheer desperation used them in making their both ends meet and for fulfilling their immediate needs. This instead of retrieving their situation further threw them in a bottom less pit of poverty. And now their began a desperate effort on the part of providers to recover the lost amounts. For public intervention to catalyze SMEs we need to enable the clients through education for making productive the facility extended. Having realized this, we (Farz Foundation) took pains to empower the clients, although it incurred more expenses. But the out come demonstrated it was the money well spent. During the times when conventional microfinance's plummeted to a dangerous low, we managed about 100% recoveries, that too during the deepest recession of our history. Supposedly negative impact of the public intervention owes it self to the failures at clients level. Now all that we need is ensuring the success at client's level which would ultimately be transformed into the positive impact of public intervention. In other words the success story would only travel from bottom to the top. Unfortunately the success stories were confined to the middle tiers failing the top providers and the client at the receiving end. Instead of public (Pakistan Perspective) financial services provider, the capacity building institutions are far productive in this regard. The capacity building and the skill developing role of the public sector can also be appreciated by connecting and streamlining it with the human resource of SME sector. It will not only leverage the public sector facilities but also catalyze private SME finance. Public sector can be positively engaged by influencing the market intelligently. The public SME financing institutions could get the partnership with private institution and could also expand their scope in spite of their limited resources to cater the SME potential market.

## THE BARRIERS

Asymmetry of information, Informality, Lack of collateral, Lack of financial capacity, Lack of SME access to skills / knowledge / markets, Unavailability of financial products tailored to SME needs, Lack of institutional capacity of financial intermediaries, High transaction costs for financial intermediaries to serve SMEs, Lack of competition / incentives for financial intermediaries to serve SMEs, Underdeveloped local capital markets (term local currency funding, exit options for SME equity), General barriers to SME development related to investment climate, Lack of financing to women entrepreneurs, Specific barriers to fragile and weak states

## SOLUTION

Asymmetry of information and informality stem from ignorance. The prior education how to conduct business and market intelligence can effectively deal with these obstacles. We only approach our clients because of the lack of their collateral and financial capability. We provide market driven and need based assets according to their businesses. On going capacity building of the staff is part of our vision. Farz Methodology focuses on the capacity building of the staff and the clients. This concept has been elaborated in Farz Methodology manual. High cost only make itself felt where losses are incurred at the clients level. By insuring profits at clients level the transaction cost can successfully be met. The profit margin in Farz Methodology ranges from 24 to 27%, which enough to cross the barrier. General barriers to SMEs are first of all in their being unbanked in the areas plagued with poverty. Only way to counter this to formalize their businesses through training and transparent practices on the part of providers. This can also be addressed through directly linking the clients to markets by eliminating middle men who incidentally are the main beneficiaries. Our 80% clients are female entrepreneurs who demonstrated a great sense of responsibility. Our strategy aims at giving strength to the state from bellow through empowering the poor. Ironically the weakness of the states is due to a rampant poverty.

## IMPACT

Given below is the success story of a woman who had been pushed to the edge owing to lack of finances. The Farz Foundation empowered and change her life

My name is Rubina wife of Ejaz Ahmed and I live in Chungee Amar Sidhu Lahore. My husband is earning only Rs 2, 000 as a driver in a factory.

I used to work at a beauty parlor as an assistant. I was making some money, but could not meet my expenses. We have three children and could not afford their education. I was taking loans without knowing how I would repay them. I had no idea how I could get rid of this vicious

circle. One day my friend who was working at some other Parlor, told me about the Farz Foundation, which lends assets and gives business training to women so that they could be self-sufficient. I visited where there was a training session being held by the Farz Foundation. There I met Nomana sister, a trainer at Farz Foundation. I had a five-day course of business development. There we were taught that to be self-sustained and we need to start our own business. And we also need a business education to be successful. They taught us book keeping, preparation of feasibility and estimation of income and expenses. After the training they offered certain productive assets to us to start our business. I wanted to establish my own beauty parlor. They bought me assets worth Rs 10,000 . I started a little parlor from my own home.

In accordance with the education given by the Farz Foundation, I introduced my beauty parlor in the neighboring area. Within one month I shifted my beauty parlor to an independent place. Now I look forward to further development of my business. I now earn about Rs 15,000 to 20,000 a month and can easily meet my expenses, including school fee for my children, apart from paying my installments to the Farz Foundation. Thank you Farz foundation.

## SCOPE

One can imagine the practical capability of the Farz SME Village by having a look at the situation created by flood in Pakistan. It never ever was be need so urgent for rehabilitation of 20 million people displaced by floods In Pakistan. The concept of Farz SME Village so pertinent and timely but we are running out of time very fast. The idea of the village must be translated into reality as soon as possible. Farz SME village of course is a scalable, sustainable and profitable as well for a wide international market. However, it also will be a mile stone in rapidly rehabilitating the millions, who direly await our help. We can again link them with the productive society through implementing this project.

## STRATEGY

The core methodology (Farz Methodology) will remain same. It is an asset based, Interest free and social performance oriented (to know in detail, kindly visit our website [www.farzfoundation.org](http://www.farzfoundation.org)). Only the size is being changed with a few extra involvements of different sectors and stakeholders. As well as Farz SME Village is concerned, there can be two possibilities. First, we can adopt a potential village and facilitate our target clients with all the required products and services. Secondly we can develop a model village, where we will involve different sectors as stakeholders like Housing sector, Agriculture sector, live stock, Dairy, Garments, Handicraft, and Embroidery etc. We will select a suitable piece of land, develop a village, equip it with necessary tools and facilities as we mentioned in the picture and establish the selected, potential, skilled clients providing them residence, workshops, and a healthy working environment with all required services according to, under the one roof concept. And

build the capacity of the clients before beginning the operations. The Farz SME Village will work as one branch. We will link this SME Villages with local, national and international markets to make it sustainable. To serve this purpose, we will again engage different sectors, like import, export, banking etc. It will kick off not only a production cycle but provide a wide support to eliminate the international economic crisis.

## **VOLUME OF PRIVATE SME FINANCE WE AIM TO CATALYZE**

It depends upon the procurement of funds as there lies a huge untapped market in the regions specified earlier. If we go for Farz SME village then we required minimum 30 Billion USD. And if we go for individual HBME clients, then we need 20 billion USD to catalyze.

## **THE REQUIRED TIME FRAME TO REACH THESE TARGETS**

One year for planning, Research, staff hiring and training, one year for pilot project and then five years for first phase. Second Phase will be consisted of 20 years.

## **THREATS**

The success of free market economy lies in making a positive use of capitalism inherent capacity to embrace positive change, which ensured its survival in the face of apparently insurmountable challenges. The new and innovative products should be whole heartedly encouraged to meet the millennium goal of eradicating poverty. However, the rigidity on the part of local providers (existing intermediaries) is and has been the sole factor that could prevent intelligent and honest efforts. UN successful players of conventional financing consciously or unconsciously tend to replicate their failures through thwarting such efforts by their non cooperation. But, thankfully, the international players seem alive to their responsibilities. Sociopolitical instability and wars could also damage the efforts.

## **SOCIAL IMPACT**

The Farz foundation, using Farz methodology, approached a limited number of people owing to financial restraints, but the outcome was so encouraging as in the areas declared red zones by conventional players showed a tremendous turn around with the 100% recovery. The outcome empirically demonstrated the huge potential of this methodology. This experience, even in its embryonic form, lays bare its potential. The social change is always an outcome of economic empowerment as it creates faith and hope in the future. Our existing members keep introducing us to potential clients who anxiously await help. The concept of SME village carries a potential with it which can grow rapidly by involving a considerably large number of people. It can socially and economically knit together at least 500 households in related economic activity. That is the method through which we can rapidly grow in the most backward areas where people

desperately seek help from the microfinance sector. As far its social impact is concerned, we can lift hundreds of people out of poverty and ignorance by giving them hope and economic uplift simultaneously. The Farz foundation also intends to provide them health and environment awareness through its nonfinancial programs. Our focus on women empowerment further makes this exercise useful. One SME village will engage at least 500 households directly and almost create employment for at least 7000 individuals indirectly.

## **SUSTAINABILITY**

All Islamic mode of funding, Equity, Social investment, grants, and development, funds etc.

## **GRADUATION PLAN**

To begin with, the public institutions in Pakistan at least have complex procedures. With a low literacy rate SMEs are invariably intimidated by them. Secondly, these institutions do not have enough resources to facilitate SMEs at required level. On the top of it, the rampant corruption also defeats the very purpose of the whole exercise. The state of the sector bears enough testimony to the submission made here. The idea of the Farz Methodology took its birth in the wake of these failures. To graduate them, we would first assess their financial needs, evaluate their repayment capacity, judge their skills and intent, and then would give them business education and training, along with providing financial services to them like Murabaha, Musharka Mudarabah and Takaful as well. We also graduate our successful clients every year on performance basis, as we have the performance indicators and measurement tools as well. At a larger scale, it is also viable by getting large market share and by becoming a market leader through innovative, need based and market driven products, which is lacking at this time. Particularly, in Muslim countries the Ribah(interest) free financial services for SME sector are the need of the day and when we incorporate non financial services as Farz Methodology implements, it increases the comfort as well as the effort level of the clients towards success and profitability. All this progression leads the clients towards graduation and independence.

## **RISK MITIGATION**

Farz Methodology, instead, is closer to the community because of being interest free. It also shuns complications that are created by cold and distant business relation. What brings them further close to the provider are the non-financial services which are free of charge. For, instance, healthcare, environmental awareness and Social performance (customer code of protection and incentive system) makes the bond even stronger. It even inculcates a sense of loyalty to the provider. The more subtle point to be noted here is that Farz Methodology comes without any political or religious sensitivity. It is purely a microfinance method in line with cultural traditions. It will even drag SMEs away from hazardous political and religious

ideologies through giving them income generating and asset building facilities at their door step. Moreover, it will further build their other sources of income through Farz Committee (Rosca). Takaful (Islamic) is also a preventive measure through which the project makes secure itself from the loss.

## SCALABILITY AND GROWTH

A huge untapped market in the Muslim world desperately awaits such a solution in the first instance. As far rapid growth is concerned, we have already done two pilot projects with amazing rate of success with 24 percent profit rate. We have already developed our Shariah-based systems and procedures. We can even initiate immediate trainings of individuals as well as institutions regarding implementation of Farz Methodology at international level. Particularly, the concept of Farz SME Village has the potential to grow at a large scale. There are millions of the poor households are waiting for any opportunity, which could drive them towards a productive, secure and sustained life. Because the economic insecurity is threatening the whole world. Farz aims to turn this insecurity into a strong motivation along with skillful productive efforts and outcomes as well. Farz believes that the idea of SME village would transform the world into a SME Global Village in productive and sustainable manners. It expands straightway to multiple sectors like Home based Micro entrepreneur, Agriculture, Garment, leather and handicraft, food, live stock, Poultry, microfinance , Banking, Employment, along with the private and Public sectors. It also addresses the SME and social value in a way that will ensure that the SME sector makes an ongoing contribution to the important matter of socio-economic progress and progress out of poverty. More over it bridges the SME sector and development sector to create a strong impact on growth.

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