

FINAL

Mid-Term Review of the Microfinance Sector and MISFA in Afghanistan

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List of Acronyms

ACTED	Agence d'aide a la Cooperation Technique et au Developpement
AFSG *	Ariana Financial Services Group
AKF	Aga Khan Foundation
AMI *	Afghanistan Microfinance Initiative
ARMP *	Aga Khan Rural Microcredit Program
ARTF	Afghanistan Reconstruction Trust Fund
BDS	Business Development Services
BRAC *	Bangladesh Rural Advancement Committee
CFA **	Children's Fund, Afghanistan (program of Christian Children's fund)
CGAP ++	Consultative Group to Assist the Poor
CHF	Community Housing Foundation
CIDA ++	Canadian International Development Agency
DAB	Da Afghanistan Bank
DACAAR	Danish Committee for Aid to Afghan Refugees
DFID ++	Department for International Development (UK)
FINCA *	Foundation for International Community Assistance
FMB **	First Microfinance Bank
GoA	Government of Afghanistan
LIP / LID	Local Initiatives Project / Department, Bosnia & Herzegovina
MADERA *	Mission d'Aide au Developpement des Economies Rurales
MFI	Microfinance Institution
MISFA	The Microfinance Investment Support Facility for Afghanistan
MITAF	The Microfinance Investment and Technical Assistance Facility, Sierra Leone
MoF	Ministry of Finance
MOFAD *	Microfinance Agency for Development
MOWA	Ministry for Women's Affairs
MRRD	Ministry for Rural Rehabilitation and Development
NGO	Non-governmental Organizations
NRVA	National Risk and Vulnerability Assessments (
NSA	National Solidarity Program
OER	Operating Expense Ratio
OSS	Operational self-sufficiency
PAR	Portfolio at Risk
SIDA ++	Swedish International Development Agency
SME	Small and Medium Enterprises
UNHCR	United Nations High Commissioner for Refugees
USAID ++	U.S. Agency for International Development
WB ++	The World Bank
WOCCU *	World Council of Credit Unions
WWI *	Women for Women International

* = Current MFI partners of MISFA; **: MFI Partners under consideration; ++ = Current MISFA donors

Current MFI Partners of MISFA

Name of MF Program (Parent Organization)	Areas of Operation	Micro-finance Methodology	Products and Services
AFSG (program of Mercy Corps)	Kabul – Districts # 1 – 18	Solidarity groups of 4-8 Individual lending	Credit
AMI (program of CHF)	Bamyan - Bamyan City Ghazni – Ghazni City	Group lending Individual lending	Credit
ARMP (program of AKF)	36 districts in 8 Provinces: Badakhshan, Baghlan, Balkh, Bamyan, Herat, Kunduz, Samangan, Takhar	Individual lending Group lending Village Banking	Credit Savings
Microfinance Program of BRAC Afghanistan	53 Districts in 12 Provinces: Baghlan, Balkh, Herat, Kabul, Jawzjan, Kapisa, Kunduz, Nangahar, Parwan, Samangan, Sar-i-Pul, Takhor	Village Organizations with sub-groups Small Enterprise	Credit Mandatory Savings
FINCA – Afghanistan	Herat – 15 districts Kabul – 14 districts	Group lending Individual lending	Credit Group Savings
MADRAC (program of DACAAR)	Ghazni – 1 urban district Herat – 1 rural district	Group Lending	Mandatory savings; Credit; Voluntary Savings
MOFAD (program of CARE)	Kabul – 9 districts	Saving & Credit Groups Individual lending	Group Savings; Credit
OXUS – Afghanistan (program of ACTED)	Parwan: Charikar City	Solidarity group Individual loans Collective loans	Credit
PARWAZ	Kabul – 5 districts	Group Guarantee Loan Individual Loan	Mandatory Savings; Credit
SUNDUQ (program of MADERA)	Kunar – 2 districts Laghman – 2 districts Nangahar – 2 districts	Individual loans Small Enterprise Loans Collective loans	Mandatory Savings Credit Voluntary Savings
WOCCU	Balkh – 10 districts Jawzjan – 3 districts	Community Credit Unions	Credit Savings
Microfinance Program of WWI	Kabul – 6 peri-urban districts	Group lending	Credit

Source: MISFA, June 2006.

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Mid-term Review of the Microfinance Sector and MISFA in Afghanistan

EXECUTIVE SUMMARY

An interim review to assess the status of the microfinance sector and the role of Microfinance Investment Support Facility for Afghanistan (MISFA) in its development was carried out between June and August of 2006. The review was commissioned by the Ministry of Rural Rehabilitation and Development (MRRD) and Ministry of Finance (MoF) under the Government of Afghanistan, MISFA's donors, and MISFA.

The review finds that despite social and political challenges, Afghanistan's microfinance sector has made significant strides in increasing outreach within three years and stands out in comparison to its peers. With continued support and an enabling environment, there is potential for many MFIs to become financially sustainable in the next three years. To date, the role of MISFA to support the sector has been highly satisfactory, and justifies a clear need for its continuation to channel funds to the MFIs to improve their capacity, outreach and sustainability. MISFA's design and implementation can serve as a proto-type for building microfinance sector in conflict affected countries. For MISFA to optimally serve the sector in future, however, improved security conditions leading to stability is necessary. In addition, a clear support is required through uninterrupted and timely funding from donors and the Government, continued independence to operate following microfinance best practices, and enthusiastic and committed MFIs to innovate and cost effectively provide services.

Review of the Microfinance Sector in Afghanistan

- The sector has enjoyed strong backing from the Government and donors to follow microfinance best practices, and build the capacity and capital base of MFI's.
- The deliberate approach to encourage rapid scaling in client outreach has been successful in building a microfinance sector in a short period. The resulting growth is impressive and stands first when compared with conflict-affected countries.
- Women comprise the majority of microfinance clients and compares well with South Asian and Arab countries. Lending to women, however, does not automatically imply that vulnerable households are reached.
- Many MFIs implicitly strive to make social impacts although no explicit targeting strategies are used to reach the poorest. MFIs that reach insecure areas and target specific populations have adopted an "alternative livelihoods" approach funded under special programs that have high operating costs and limited coverage.
- The focus on first achieving wide geographic coverage appears to have delayed sustainability objectives, with only one MFI having achieved financial sustainability to date. Afghanistan, although excels in breadth of outreach, lags behind its peers in Bosnia-Herzegovina and Sierra Leone in the number of MFIs that were sustainable after three years. Inherent challenges to achieving sustainability in Afghanistan result from the high operating costs of the MFIs that will need to be addressed.
- The MFIs are heavily dependent on MISFA for loan funds, cover the costs of lending and build internal capacity. Delays and uncertainties in funding from MISFA therefore directly affect the microfinance sector.
- With favorable security conditions, consistent funding and support to develop adequate local human capital, there is high potential for many MFIs to scale-up, reach previously un-banked clients, and to achieve sustainability.

Review of MISFA

- The current status and performance of the microfinance sector in Afghanistan is almost inseparable from the outcomes of MISFA's efforts.

- MISFA's performance has been highly satisfactory in terms of its expected interim results for building a strong microfinance sector.
- The loan and grant funds from MISFA have played a significant role in facilitating the rapid growth in outreach by MFIs.
- While it was not a primary focus at the beginning, MISFA has now rightly shifted emphasis to build capacity of the MFIs so they gain competencies in managing growth and become sustainable by following proven best practices. It also actively promotes management and ownership by Afghans.
- MISFA is effectively engaging in dialogue with donors and the Ministry of Finance to emphasize the demand for funds and communicate the effects of delays on the sector's development. It is also making efforts to diversify funding sources to other donors and social investors.
- MISFA is the first apex microfinance organization in conflict affected countries to transform from an entity within the government to a local limited liability company governed by an independent board of directors.
- MISFA's efforts to move towards commercialization are exemplary in the South Asia region.

Conclusion and Recommendations

The microfinance sector in Afghanistan is at crossroads. It is faced with high expectations to surpass standards set by its own initial success in outreach, to achieve sustainability and improve measurement of social performance. The enormous demand for microfinance in urban and rural areas presents opportunities for MFIs to continue expanding. The next growth impetus, security conditions permitting, will require a shift away from a short-term action oriented approach to a goal oriented long-term one, requiring all stakeholders to collectively define a vision for the industry and develop a clear roadmap for achieving it. MISFA is clearly required to further develop the sector. Its long-term presence and objectives, nonetheless, will depend on outcomes in the next few years. The following summarizes key recommendations:

- *Develop clear policy for Microfinance sector development.* The MoF should take the lead in developing a policy document to articulate linkages between microfinance and poverty alleviation in Afghanistan. It should clarify its expectations for microfinance, in terms of reaching vulnerable populations, extending to rural areas or working in active conflict zones. It should also clarify its expectations for MISFA on the treatment of grants and loans disbursed to the MFIs.
- *Improve coordination.* More effective dialogue between MISFA, donors, and the MoF is necessary to define and operationalize a clear road map for the sector. Such coordination will: a) frame the broader strategic objectives of the sector, MISFA's role within it and define expectations of key stakeholders, and b) ensure that longer-term funding forecasts and commitments are made by donors, and that all operational and disbursement procedures are streamlined. Also, coordination between MISFA and the microfinance sector is necessary to standardize reporting requirements and set reasonable targets for achievement.
- *Pro-active MFIs.* The MFIs need to actively support the Afghanistan Microfinance Association (AMA) to help advocate, train local staff, promote transparency, and disseminate knowledge. The MFIs need evaluate their performance, identify areas to improve, and urgently develop strategies to reduce their costs of operations and become sustainable. Product innovation, process re-engineering, broad applications of new technology, and creation of new strategic alliances will all be essential by the MFIs to develop a strong microfinance sector in Afghanistan.

Mid-term Review of the Microfinance Sector and MISFA in Afghanistan

I. Introduction

In 2003, the Government of Afghanistan, with support from the World Bank and interested bilateral donors, undertook a program to develop a strong microfinance sector to provide much-needed financial services to poor people. The Microfinance Investment Support Facility for Afghanistan (MISFA) was established under the Ministry for Rural Rehabilitation and Development (MRRD) as the vehicle for administering the program. Funding would be allocated from the Afghanistan Reconstruction Trust Fund (ARTF) in accordance with arrangements made with MFIs by MISFA. By mid 2006, MISFA transformed from an entity within MRRD to an Afghan non share holding company owned by the Ministry of Finance (MoF) and governed by an independent board of directors.

An interim review of the microfinance sector primarily supported by MISFA was carried out between June to August of 2006. This report summarizes the findings and recommendations of the review team comprised of three microfinance specialists - Geetha Nagarajan, Henry Knight and Taara Chandani.

1.1. Review Objectives

The interim review was commissioned by the Afghan government, MISFA's donors, and MISFA management to assess the current status of the Afghan microfinance sector program and MISFA's role in developing it. The review includes the identification of opportunities and challenges to create a strong microfinance sector in Afghanistan and suggestions for major stake holders for improving the sector in the future.

1.2. Review Framework

Since MISFA is mandated to build the sector and the performance of MF sector in Afghanistan is closely linked with MISFA, the review in addition to examining the current status of the microfinance sector, also focused on gaining insights on MISFA's additive, multiplicative and diffusive contributions in helping build a strong microfinance sector in Afghanistan.

The additive effects refer to MISFA's ability to expand and sustain its operations efficiently through strengthening its own capacity, choice of quality partners, and types of services offered to build capacity of the partners. Multiplicative effects refer to the outreach, sustainability and social and economic impact of its partner organizations. Since it is too early to assess social impacts made by the microfinance institutions, the review only focused on the social orientation of MFIs – the degree to which MFIs have explicit social objectives and the mechanisms in place to support and monitor them. Diffusive effects are captured by the linkages and collaborations fostered by MISFA with various stake holders to create a ripple effect to strengthen the microfinance sector.

The review team's work consisted of preparatory research and initial telephone interviews with those involved in the startup of MISFA and others who had worked with it. That was followed by a mission to Afghanistan between July 6 to 20, 2006, which involved on-site interviews with members of the MISFA technical team, MRRD, MoF and MOWA, bilateral donors, The World Bank, MISFA board members, and staff of eight MFIs (see annex for list of contacts). The team also reviewed the client-level data that MFIs routinely collect and explored whether they use explicit poverty targeting strategies and conduct impact research. Many focus group discussions and visits to a small selection of clients from four MFIs in Kabul and Charikar were held to get an indication of the clientele served, use of loans, type of business,

borrowing history and client satisfaction with the MFI's services.¹ Consultations were also held with two external organizations that are leading research on the effect of microfinance in Afghanistan to understand the scope of these efforts and recommend possible areas for future coordination with MISFA.

The team compared the current status of the MFIs with their planned / projected performance, objectives, and relevant international benchmarks, wherever applicable and available. The continuing fragility that causes vulnerability and poverty, and the legacy left by the previous regime on women's motivation, capability and capacity to actively participate in the markets, are considered while assessing the performances.

1.3. The Microfinance Sector– Review Highlights

- The sector thus far has enjoyed good support from donors and the Government (MRRD and MoF) to follow many microfinance best practices including charging fees to cover costs, servicing credit worthy clients, and controlling arrears.
- The donors and the government have also adequately supported the sector with funds, despite some funding uncertainties, to build MFIs' capacity and capital base.
- Until now, the deliberate approach by donors and the Government to encourage rapid scaling in terms of client outreach has been successful in building a microfinance sector in a short period.
- The growth in client outreach in Afghanistan is phenomenal, and stands first, compared to many conflict affected countries such as Bosnia and Herzegovina, Mozambique, Uganda, Sierra Leone, Liberia, West Bank/Gaza and Cambodia in their early stages of recovery.
- Women comprise the majority of microfinance clients and compares well with South Asian and Arab countries. But, lending to women did not automatically imply that vulnerable households are reached.
- Many MFIs implicitly strive to make social impacts although no explicit targeting strategies are used to reach the poorest. MFIs that reach insecure areas and target specific populations have adopted an "alternative livelihoods" approach funded under special programs that have high operating costs and limited coverage.
- Currently, all MFIs, except one, amongst existing MISFA partner MFIs have yet to attain sustainability. Even for experienced MFIs, an extensive focus on achieving a wide geographic coverage early in the expansion stage appears to have delayed achieving sustainability. It is shown that it normally takes about 3-5 years to attain sustainability. But, Afghanistan, although significantly excels in client outreach, lags behind its peers in Bosnia-Herzegovina and Sierra Leone in number of MFIs that reached sustainability in the first three years of their operations in a conflict affected country.
- Sustainability is primarily affected by the high operating costs of the MFIs in Afghanistan. The prevailing service charges, while comparable to many low income and conflict affected countries, are not adequate to cover the costs. Whereas it is not surprising that operating costs are higher in Afghanistan, compared to many low income and post-conflict countries in initial stages, due to continuing insecurity and low local capacity, there is an urgent necessity and ample room to reduce the costs in near future.
- The MFIs are heavily dependent on MISFA for funds for covering costs, lending operation and capacity building. Therefore, delays and uncertainties in funding from MISFA tend to affect the microfinance sector.
- For many MFIs, the primary challenges include reaching sustainability, human capital constraints and continuing insecurity in many areas.

¹ These visits were meant to give a flavor of the clientele and businesses supported by different MFI's and were not designed to evaluate social outcomes per se. All group discussions and client visits were conducted in the presence of the loan officer(s) from the MFI.

- High potential, however, exists for many of the MFIs to grow, become sustainable and make an impact on the poor in another three years if security conditions improve, weaknesses of the programs are identified and appropriately rectified on time, and enabling environment and supporting organizations are in place.

1.4. MISFA: Review Highlights

- The current status and performance of the microfinance sector in Afghanistan is almost inseparable from the outcomes of the efforts of MISFA.
- The review team considers that MISFA's performance has been highly satisfactory in terms of its expected interim results in building a strong microfinance sector.
- The funds, both grants and loans, available from MISFA have played a significant role in facilitating the rapid growth in breadth of outreach by the MFIs in the country.
- While it was not a primary focus at the beginning, MISFA has now rightly shifted emphasis to build capacity of the MFIs so they gain competencies in managing growth and becoming sustainable by following proven best practices.
- MISFA actively engages in dialogue with the current donors and the Government to disseminate the demand for funds and effects of funding crunch on sector development. It is also making efforts to expand its sources of funds from other donors and social investors.
- MISFA's efforts as an apex organization to facilitate move towards commercialization stands out in the South Asia region.
- At this juncture, MISFA is in good position to develop the microfinance sector. There is a clear need for MISFA to remain for some more years to continue funding the MFIs, and improve its monitoring and training capacity to build a strong microfinance sector.
- For MISFA to optimally serve the sector in future, however, improved security conditions leading to stability is necessary. In addition, a clear support is required through uninterrupted and timely funding from donors and the Government, continued independence to operate following microfinance best practices, and enthusiastic and committed MFIs to innovate and cost effectively provide services.

1.5. Organization of the report

In what follows, the report is organized into three sections. The next section assesses the performance of the microfinance sector, and is followed by a review of MISFA's efforts to invest in building a strong microfinance sector and support Afghanization of the sector. The final section discusses the potential roles of donors, government, MISFA and the microfinance institutions to develop a strong sector, and summarizes specific recommendations made throughout the report.

II. Performance of Afghan Microfinance institutions

Currently, there are about 15 NGO type MFIs reported to be operating in Afghanistan.² While three NGO type MFIs started functioning by 2002, others were initiated since 2003, when MISFA was started. Indeed, 12 of the 15 MFIs are currently funded through MISFA, and one additional MFI is being considered for future funding. Furthermore, the First MicroFinance Bank is now considered for funding by MISFA. Another microfinance bank, sponsored by BRAC, is expected to be operational soon.

² Some of the multi-functional institutions, including relief type organizations, that were providing microcredit prior to 2003 are reported to have closed down.

Until very recently, no explicit regulations restricted MFIs from developing what they assessed as required in terms of types of products, institutions, clients, and charges for services. As a result, the microfinance sector in Afghanistan is comprised of diverse types of microfinance providers - credit unions, NGO type MFIs, microfinance banks - offering individual and group based loans, and compulsory and voluntary savings products in both rural and urban areas. While many of the MFIs use standard microfinance products used in other countries, some have been adapting financial products that confirm with Islam.

The majority of the MFIs are affiliated with international NGOs and managed primarily by expatriate staff. But, four MFIs (Parwaz, MADRAC, AFSG, Women for Women) are now managed by Afghans, of which one is owned by an Afghan (Parwaz). Many MFIs operate as NGOs but they are now in the process of transforming into Afghan non-distributive limited liability companies.

2.1. Microfinance Sector Outreach

The growth in breadth of outreach has been impressive. Client outreach increased from a mere 12,000 clients serviced by less than 10 NGO- type MFIs with a portfolio outstanding of less than US\$ 1.1 million in 2003 to 197,000 by June 2006. With a current portfolio outstanding of over US\$ 30 million and cumulative loans disbursed of US\$ 63 million over the past three years, it is apparent that rapid growth in portfolio has occurred in the recent year (Annex Table 1). It is to be noted that the rapid and wide breath of coverage was primarily led by one MFI, BRAC, which currently serves 60% of total active clients of MFIs, and accounts for 40% of total volume of portfolio outstanding.

Breadth of outreach is phenomenal compared to its peers. The current number of total active borrowers and average active borrowers per MFI in Afghanistan are about five times more compared to their peers in Sierra Leone and Bosnia-Herzegovina - conflict affected countries with statistics from their third year of developing the microfinance sector. The countries were almost at the same stage of recovery as Afghanistan is now. The average number of borrowers also compares well with Arab non-financially sustainable MFIs that can be considered as peers since almost all but one MFI in Afghanistan is operationally sustainable (Annex Table 2). Indeed, BRAC in Afghanistan is considered as one of the top ten MFIs in South Asia with largest gains in borrowers served within a short period of time.³

Majority of MFI borrowers are women. About three fourths of the total MFI borrowers are women (Annex Table 2). Indeed, outreach to women borrowers in Afghanistan compares well with its peers in Arab Islamic countries and is better relative to Bosnia-Herzegovina, a conflict affected Muslim dominated country (see discussion on social performance below).

A huge market, however, exists for further expansion. Indeed, a recent study shows that only 5% of the demand among the bankable poor (measured by proportion of economically active population below poverty line) are now serviced by the MFIs in Afghanistan, and only 8% of the projected credit requirements are met by the MFIs. Although the Afghan microfinance sector is still in its infancy, the coverage of the estimated potential is much lower, except for Pakistan, compared with its peers in South Asia (Annex Table 3).

MFIs reach clients that are only slightly above the lower-end of the poverty strata. The average depth of outreach (measured by percentage of average loan size to GNP per capita) in Afghanistan is about 27% and compares well with South Asian countries with similar poverty levels. It also compares well with the Arab Islamic countries. Indeed, MFIs in Afghanistan have attempted to reach the poor from the beginning compared to Bosnia & Herzegovina (Annex Table 2). Reaching the poorer clients serves the poverty

³ Source: South Asia Report, TheMIX, 2006. Note that South Asia comprised of Bangladesh, Nepal, India, Sri Lanka, Afghanistan and Pakistan is home to the majority of Muslims in the world.

alleviation objective set out by the Government and Donors for the MFIs. But, it is to be realized that reaching depth of outreach for young MFIs can potentially delay attaining sustainability within a short period, thus prolonging the dependence of the MFIs on grants and subsidized donor funds for their operations.

Many MFIs are observed to struggle to meet their projected outreach in their initial business plans. The MFIs are now scaling down their expectations such that they may attain a 15%, 12% and 6% in growth in borrowers, clients and provincial coverage, respectively, compared to their earlier projections of 36%, 35% and 25% during the period of 2005-2007 (Annex Table 4). Funding constraints experienced in 2005 were reported to limit expansion. However, many MFIs were unable to scale up to match the projections even after funds were released by MISFA. It now appears that continued insecurity in many geographic areas, and low human and physical infrastructure capacity, limit expansion more than just finding constraints. The over estimation by the MFIs of their outreach potential, due in part, led to high initial funding commitments from MISFA.

Recommendations

- While opportunities still exist to increase breadth of outreach, it is now important to analyze the quality and depth of outreach as well. This may require careful analysis of costs of horizontal expansion through establishing branches in many provinces compared to vertical expansion, either going up or down market, within the current operational area.
- It is now important to examine the trade-offs, if any, that have occurred between poverty related outreach and sustainability. It is to be noted that the only MFI that has become operationally sustainable tends to make loans that are much larger than the per capita incomes in Afghanistan. However, the possibility of another MFI that makes small loans becoming operationally sustainable provides some evidence that trade-offs can be managed.
- The primary factors that affect outreach need to be closely examined and addressed in a focused manner. If security concerns and inexperience of MFIs limits servicing certain sectors, such as agriculture, it is important to find other solutions rather than promoting MFIs to serve in these fragile areas without substantial subsidization and expectation of failures.
- The market for SME lending appears to be growing and offer considerable potential for MFIs. SME lending, however, requires well trained staff, large capital base and different terms and conditions that are beyond the capacity of many MFIs. At the current stage, portfolio of larger loans of MFIs could be productively transferred to microfinance banks rather than unsustainable MFIs attempt to offer SME loans.

2.2. Financial Performance of MFIs

Currently, all MFIs in Afghanistan, except one (AKDN), have yet to break-even. It is expected that another MFI, BRAC, may soon become operationally sustainable. The average operational sustainability (OSS) is around 34% (portfolio weighted average OSS is around 73.3%), much lower compared to that observed in many South Asian and Arab countries, and conflict affected countries of Sierra Leone and Bosnia & Herzegovina (Annex Table 6). While it is now shown that it takes about 3 to 5 years for MFIs, on an average, to attain operational sustainability in conflict affected countries, Afghanistan still lags behind Sierra Leone and Bosnia & Herzegovina during their third year of microfinance operations in terms of becoming self-sustainable. It is possible that the continued insecurity in many areas where some MFIs have expanded to achieve scale is beginning to affect their ability to attain sustainability. Evidence from

many countries now shows that rapid growth temporarily depresses profitability.⁴ But, in the end, profitable MFIs tend to grow much faster than unprofitable MFIs since profits help with further growth.

Portfolio quality has been good and improving in almost all MFIs. Also, portfolio yields that indicate interest rates have been comparable with many peer countries, on an average and for top performers. It is to be noted that the *laissez-faire* policy of the Government and the donors to let the microfinance sector set the interest rates to cover some of their costs for lending operations (deducting costs incurred for security measures and expatriate staff salaries) has not led to very high interest rates that may be considered exploitative. Many MFIs stated that the availability of grants for covering most of their operating costs is reflected in the rates charged for the services. It may, however, soon become important for MFIs to revise the service charges, especially those who charge a flat fee for all types and sizes of loans, to cover for the costs of operations, if they need to become operationally sustainable. Nonetheless, for the service charges to remain within the acceptable bounds for the clients and the Government, it is important for the MFIs to reduce their operating costs and increase their productivity. These require adequate retail capacity to be built within the next few years.

Many MFIs incur high operating costs that limit their ability to attain sustainability. The operating costs are very high in Afghanistan due to expenses incurred on security measures, small sized loans, poor infrastructure, the high costs of some services and hiring of expatriate qualified staff. Operating expense ratio, on average, is around 127% (portfolio weighted average is about 70%). However, such expenses cannot be avoided if MFIs operate in an environment that is still insecure and local capacity is low. Nonetheless, staff productivity is lower compared to the peers and requires improvement. As MFIs gain experience, it is expected that productivity would increase (Annex Tables 5 and 6).

“Profitable MFIs serve more poor clients than non-profitable MFIs. Don’t expect scale to make an MFI profitable if it hasn’t gotten there in the first few years. It is the interest rates and spreads that makes an MFI profitable than just efficiency and productivity.” – Richard Rosenberg at CGAP, 2006.

Recommendations

- If the MFIs operate in secure areas, gain experience and retain clients, it is possible for the MFIs to reduce costs, charge acceptable rates to cover for those costs and become sustainable. These require adequate skilled local human capital and retail capacity to be built within the next few years.
- While MISFA can continue to help build the capacity of new MFIs by providing some grants for a very limited time, it is now important for the older MFIs to start their weaning process and cover operational costs through lending operations, and explore alternative sources of funding for technical assistance.

2.3. Social Performance of MFIs

Measurement of social outcomes is seen as necessary for MFIs to measure progress towards a double bottom line (financial and social performance), account to social investors and other stakeholders, and provide responsive services to their target market. Client assessment can help an MFI understand their client needs and navigate the challenges of working in complex environments, particularly in countries that are undergoing conflict and whose MFI sector is relatively nascent. However, regular client assessments (including market research, client monitoring and impact studies) require dedicated financial support, easy-

⁴ See Richard Rosenberg and Adrian Gonzalez, 2006, “[The State of Microfinance: Outreach, Profitability and Poverty. Findings from a Database of 2600 Microfinance Institutions.](#)” Washington, DC: CGAP. They also show that scale tends to lower costs early on but its effects decline once the MFI moves past 5,000 to 10,000 clients.

to-use and reliable information systems and trained personnel. Therefore, the evaluation team assessed the social orientation of MFIs – the degree to which MFIs have explicit social objectives and the mechanisms in place to support and monitor these.

2.3.1. Poverty targeting

Partner MFIs have prioritized “breadth of outreach” over “depth of outreach” (client poverty or vulnerability). While MFIs broadly articulate missions around poverty alleviation and indeed report a depth of outreach that compares favorably with many South Asian and Arab countries (see above), they are not explicitly targeting services to extremely vulnerable or marginalized communities. There is a continuing emphasis in Afghanistan on establishing a presence in communities and continuing to test and adjust products and delivery arrangements rather than on poverty related outreach.

Client selection is based primarily on “ability to repay” rather than “relative vulnerability”. To minimize risk to their loan portfolio, MFIs emphasize the creditworthiness of potential clients rather than their vulnerability. Clients are screened by a combination of physical and social capital, including household or enterprise assets such as an existing retail business, and ownership of land or ability to lease land; and social reputation, through entry and participation in a solidarity group, and backing from community leaders or the local *Shura*. Some MFIs, such as MADRAC, institute compulsory savings before loan disbursement as a way for new clients to build their creditworthiness.⁵

MFIs, nonetheless, reach underserved clients through broad geographic targeting. Most MFIs are working in low-income peri-urban districts that have a high concentration of poverty and where the demand for small loans (between \$100 and \$600) is very high. The Afghanistan Rural Microfinance Program (ARMP), whose average loan size is at US\$600, which is considerably higher than other MFIs, has mandated some portion of their loans to exclusively reach poor clients in the service areas. It provides staff incentives to ensure that poor clients are served: to qualify for a performance bonus, loan officers have to demonstrate that at least 25% of their portfolio comprises clients who earn less than \$1 a day.

Even without explicitly targeting the poor, however, many MFIs are indeed reaching households with no prior access to affordable financial services. Financial services are an important part of a poor household’s livelihood and coping strategies – so extending these services to people without access fulfills a social objective. Besides borrowing from family members during emergencies or purchasing business supplies/enterprise inputs on credit, none of the MF clients reported any previous history with a financial institution.

2.3.2. Outreach to women and vulnerable groups⁶

Women comprise the majority (75 %) of microfinance clients. Four of the thirteen MFIs exclusively / primarily lend to women (Women for Women, BRAC, Parwaz and CARE). This indicates that MFIs have identified appropriate outreach channels and loan products for women. Parwaz uses a cost-effective strategy to reach female clients by hiring part-time community agents, known as Promoters, who live in the community and have strong client relations. They host weekly group meetings and ensure high repayment and social networking. Each loan officer works with 2 community promoters and is able to reach as many as 600 clients. None of the MFIs around Kabul suggested that they have difficulty, or that they face

⁵ Four MFI partners of MISFA mobilize compulsory deposits. Only one MFI, WOCCU currently offers voluntary deposit services. BRAC discontinued offering voluntary deposit services.

⁶ Providing women with access to credit is an important strategy for household poverty alleviation. According to the National Risk and Vulnerability Assessments (NRVA 2003), *female headed households* have the highest incidence of poverty of all vulnerable populations – they are more likely to be landless, do not have access to irrigated land, and have limited access to productive assets such as livestock. Female-headed households also have restricted egress outside their compound and have limited formal entitlements to productive assets. Other vulnerable groups include returned refugees and IDPs, households with disabled people, landless households and households farming only rain fed land.

additional costs by lending to women. MFIs are also able to recruit female loan officers who usually deal with both men and women clients—and are thus important assets to the MFIs lending operation.

Lending to women, however, does not automatically imply that vulnerable households are reached. The specific social and economic vulnerability of women clients is not a condition for receiving a loan. In fact, given the social and physical collateral needed by MFIs, most clients (female and male) are not likely to be among the most vulnerable. Moreover, MFIs do not distinguish in their reporting to MISFA between female clients who are “head of household” (for e.g. widows) or clients who live within an extended household that relies on multiple income sources. Some MFIs, such as CARE, have specific programs targeting widows and will likely collect ample data on this population segment.⁷

Lending to women only implies that all transactions related to the disbursement and repayment of loans is done with women, and not that loans are actually controlled by women. In many cases, the work within the household is shared with women undertaking production and men taking responsibility for selling products in the market. Women tend to rely on other household members or relations in the community to link with product suppliers and retail markets.⁸ In these cases, lending to women may increase their status within the family and the community, but the loan is supporting a broader family or social group. Since it is also common for households to rely on multiple income sources and enterprises to draw on the labor and input from different family members, it is difficult and expensive to track loan use and nearly impossible to isolate exactly who is in control.

2.3.3. *Integration of financial and non-financial services*

Most partner MFIs exclusively provide microfinance services. In accordance with best practice, NGOs that traditionally integrated their financial and social services have started to distinguish between the two - with MISFA support - in order to create independent and sustainable microfinance institutions. Only a few institutions have developed linkages between financial and non-financial services as a way to extend their social reach and impact. These institutions, such as Women for Women and BRAC, which channels technical assistance on livestock to select clients, rely on alternate funding to integrate these programs. Women for Women target vulnerable women – usually with no former business experience and limited productive assets – to receive small grants, entrepreneurship training, business support and health education. Many of these women “graduate” into the institution’s formal microfinance program.

To reach extremely vulnerable populations, MFIs will require appropriate incentives, additional resources and partnership support. If MFIs choose (or are encouraged) to increase the depth of outreach to harder-to-serve populations, they will need to develop appropriate products through market research, offer additional services (such as entrepreneurship training) and develop linkages with other agencies (BDS providers, product suppliers, etc). MFIs will require (from donors and MISFA) dedicated investments in research, MIS and personnel to modify the scope of their portfolio and measure social performance. Pursuing this on a significant basis would represent a different strategy to the more *laissez-faire* approach of fast-tracking the development of the industry and rationalizing poverty related outreach after an initial phase.

2.3.4. *Client Monitoring and Assessment*

To date, each MFI uses its own formats for collecting data and systems for consolidating and analyzing the information gathered from prospective and actual clients. The review team conducted a scan of the baseline data that is being collected by MFIs to assess how this information is channeled into regular monitoring, product development or impact research.

⁷ The evaluation team did not have the opportunity to meet with CARE.

⁸ This may not be true of rural or more conservative areas where barriers for women to participate in the market are higher. Such questions will have to be explored further through additional research.

MFIs regularly collect data of a baseline nature before disbursing loans to their clients. BRAC, for example, collects the following baseline data on each client: Province/District, name of family head, number of family members (and age), ownership of land (in Jerib), type and number of homes (mud or brick), livestock (donkey, camel, cattle, poultry), and membership in another organization. This information is used to approve the initial loan but not to examine social outcomes and impact over time. In addition to baseline-type data some MFIs collect information about their clients at subsequent loan cycles. While none of the MFIs input this baseline and monitoring data in an electronic format that can be easily analyzed, they do invest considerable time and resources in collecting this information. A number of MFIs suggested that this information feeds into their market research and helps them develop and refine their loan products.

Recommendation: MISFA can provide technical support to MFIs to enable them to streamline their collection of baseline data to: collect only what is essential; and manage it in a format that can be used for product development and impact studies.

MFIs already report to MISFA on key outreach indicators and ratios that capture social performance. Impact related indicators can easily be incorporated in the current reporting formats⁹. One of the objectives of social performance and impact studies is to ensure that MFIs are better able to target their clientele and respond to their needs with higher quality services. Based on preliminary discussions with MFIs and the MISFA technical team, there is a need for MFIs to develop stronger systems to measure social outcomes and demonstrate change at the client level. These can be easily incorporated into the ongoing reporting for MISFA so the data are consolidated across the sector. In order to select relevant indicators, standardize their collection and ensure their accuracy, it is important that they are sufficiently tested prior to being launched.

Recommendation: Introduce 2-3 additional indicators that can be easily incorporated into the existing reporting framework and that will provide valuable feedback on the social outreach and performance of MFIs. One approach would be for MISFA to coordinate a system-wide effort to establish a baseline that could be used for periodic progress reporting. This could be done by contracting a firm to carry out the study, perhaps as a project funded separately by interested donors. This could then lead to the development of a reporting of progress by the MFIs using indicators and measures that reflect the baseline references. The specific choice of indicators should arise from discussions with the MFIs and be adequately pilot tested by one or two institutions to ensure the data is of value, easy to collect, and reliable. Suggested examples of social-performance data:

To assess baseline poverty

- % of borrowers earning daily wages vs. self-employed¹⁰: a) unskilled daily wage earner, b) self-employed with some wage labor, c) self-employed with regular waged employment.
- % of borrowers with access to rain fed vs. irrigated land (or by type of crop grown)
- % of female headed households

To monitor changes in business/household

- % of borrowers who reduce their level of debt for business supplies
- % of business who hire labor as a result of the loan

⁹ Currently, MFIs report on several outreach indicators to provide a snapshot of the geographic coverage and vulnerability of the clients. These include: district/province, number of active borrowers, dropout rate, size of loan, outstanding loans and savings, number of women and disabled clients served, and share of women clients in total clients. MFIs are also required to report on the distribution of their loans and outstanding balance by sector.

¹⁰ These categories are drawn from the National Risk and Vulnerability Assessments (NRVA), MRRD. Ch. 9, Assisting the Poor and Vulnerable. 2005.

Regular market research will help MFIs to offer responsive and high quality services. MFI staff has been trained in conducting market research and some MFIs have developed their products with technical support and guidance from MISFA. By conducting ongoing research, MFIs can respond to new market segments (including ways to reach IDPs or vulnerable women) and develop new products as necessary with a greater relevance to demand.

Impact studies can help to shape and prioritize growth of the overall sector. Given the significant growth of microfinance in Afghanistan, it is extremely valuable to monitor the impact of financial services on different population segments, understand the opportunities and limitations of the sector and re-position programs as needed. Such research will be of value at the policy level (to donors, investors and ministries) as well as programmatically, where it should guide the MFIs to develop market linkages and reprogram their efforts as needed. Currently, at least two ongoing qualitative studies are examining the impact of microfinance in Afghanistan, both with a particular focus on women. One study is being funded by the Danish government and the other by Afghanistan Research and Evaluation Unit (AREU), with support from DFID.

Recommendations: (a) MISFA should remain involved in both the above studies to influence the research questions and methodology, so the results and recommendations can be practical and relevant to all stakeholders. While the objectives of these studies may not entirely be in line with MISFA's or those of specific MFIs, MISFA is in a strong position to influence the process and find ways to build on this important work; (b) MISFA should encourage coordination between donors, MOWA and the MFIs to ensure that research agendas are developed and addressed in a way that will inform the entire microfinance sector. The strengthened AMA can also play a role in facilitating future research efforts, and (c) Since impact studies are expensive in terms of resources and time; they will require additional donor commitment and coordination, not only with each other, but also with ministries such as MOWA that are conducting related surveys.

III. Performance of MISFA

MISFA was created in 2003 to: (i) Coordinate donor funding so that the conflicting donor priorities endemic in post-conflict situations do not end up duplicating donor efforts and distorting markets; (ii) Help young microfinance institutions scale up rapidly by offering performance-based funding for operations and technical assistance; and (iii) Build systems for transparent reporting and instill a culture of accountability. In short, MISFA was expected to fast track MF development by making the best use of limited public funds over a limited period of time to (i) invest in institutions that would become sustainable and able to grow further without requiring more subsidies, and (ii) help make a transition from international organizations with microfinance expertise to Afghan organizations with local staff.

The number of MFIs supported by MISFA has grown from only 3 in 2003 to 13 in three years (Annex Fig 1). By June 2006, the Afghan microfinance sector was comprised of 15 NGO type microfinance providers. MISFA is now considering adding a licensed microfinance bank, possibly by end of 2006. While it was not a primary focus at the beginning, MISFA has now realized and is rightly focusing on efforts to build capacity of the MFIs to become competent to manage growth and become profitable by following proven best practices.

MISFA was recently transformed from an entity within a government program to an Afghan company with limited liability. Now, it is a non share holding company owned by the Ministry of Finance (MoF) and governed by an independent board of directors. This provides MISFA with more autonomy to attract new donors and to retain the involvement of those that continue to provide funding directly to government in order to continue to stimulate the expansion of the microfinance sector in the country.

3.1. MISFA Funding

MISFA administers the funds made available largely from the ARTF, that is administered by the World Bank, that finances various reconstruction projects including microfinance development. Donors make contributions to the ARTF, with suggestions on the desired allocation to microfinance development. The World Bank disburses funds either through the Da Afghanistan Bank (DAB – The Central Bank), or directly, depending on the size of the request and other practical considerations. MISFA administers the process by which MFIs justify their funding requests, submit claim documentation for reimbursement and/or advances and follows up on MFI operations and their use of funds.

Since 2004, MISFA has disbursed a cumulative total of US\$ 51.1 million - US\$ 18.29 million in grants and US\$ 32.77 million in loans subject to 5% annual interest paid to MISFA quarterly - to 12 MFIs in Afghanistan (Annex Table 7). The loans approved by MISFA to MFIs are exclusively intended for the MFIs to finance their loan portfolio, while grants can cover operating expenses, purchase of fixed assets and/or expenditures for training or technical assistance. The share of grants in total disbursements to the MFIs starts at 40% and declines over five years to zero. No grants are planned to be made to any MFIs after 2008 (1387). The grants would likely have been recognized on the books of the MFI as an offset to operating costs and thereby absorbed into the financial structure of the MFI. The loans, on the other hand, would remain as a quasi liability (subordinated debt) on the MFI's balance sheet.

3.1.1. Loan funds from MISFA

Currently, all MFIs depend heavily on MISFA as a source of funds to finance their lending operations. By 2006, loans from MISFA to MFIs almost account for 94% of the MFIs' portfolio outstanding with their clients. Indeed, growth of the microfinance sector to date can be attributed to the funds available from MISFA.

Heavy dependence on MISFA puts the sector at high risk. Any disruption in loan funds from MISFA can adversely affect MFIs' operations unless they can secure alternative funding sources. For example, in 2005 (1384), MRRD / MISFA did not receive enough funding to meet the funding requirements identified under contracts that had been signed with MFIs, and much of what was provided came at the very end of the year. As a result of the disruption in fund availability to MISFA, of the US\$ 129.31 million indicated in contracts with MFIs, only US\$ 23.66 million (18%) were disbursed. Funding delays are now suggested to be one of the major reasons that limited planned expansion of some MFIs during 2005. BRAC, the largest MFI, only reached 116,000 active clients by March of 2006 instead of the 285,000 projected in its business plan (60% of the projected reach). Donor commitments for the current year have yet to meet the contracted volume of funds. So, MISFA has informed the MFIs that uncertainties in funding may continue in near future. Therefore, many MFIs have started to reconsider their business plans and scale back their expansion plans, while some may be forced to close operations in some branches if they do not receive further funding. MFIs reported that there has been loss of faith as they could not honor their commitments to the ultimate clients. These are serious concerns since prolonged and frequent blockages in fund disbursements may snow ball into low repayments and eventual failure of the sector. It is to be noted that one MFI, ARMP, has now reached operational self-sufficiency and potential exists for at least few other MFIs to follow suit in the near future. ARMP has maintained its microfinance program as a result of funds invested by one of its affiliated organizations. Research now shows that strong microfinance sectors are built through scaling up and reaching sustainability in the first few years (Rosenberg and Gonzalez, 2006).

Reliable sources of funding that can deliver required amounts of funds on time are required. Although it is commendable that a microfinance sector with potential is emerging within a short period in a conflict affected country, there is still progress to be made to develop strong MFIs and for Afghanization of the

sector. If the funding uncertainties continue for another two to three years, it may result in slower growth and could even jeopardize the investments made to date. It certainly will frustrate the efforts of some MFIs to establish self-sustainability. This also undermines MISFA's role as a funding agency and may render the organization redundant. MISFA is actively engaging in dialogue with the current donors and the Government to disseminate the demand for funds and effects of funding deficiencies on sector development.

MISFA is making efforts to expand its sources of funds from other donors and social investors. MISFA is now engaging USAID, a donor which has been a very minor contributor to MISFA to date, to support some of the MFIs, either directly or through MISFA such that funding burdens for those MFIs can be reduced. It has also approached some investors such as Blue Orchard and Oika Credit to invest into MISFA.

MISFA's efforts as an apex to facilitate commercialization stands out in the region. It is to be noted that (except partly in the Indian case) there is little evidence that apex funding institutions in South Asia have helped MFIs to access funds from financial markets. Since April, 2006, MISFA has initiated discussions with banks in Kabul about lending to MFIs, based on a guarantee from MISFA. The National Bank of Pakistan and Habib Bank have agreed to discuss proposals to provide relatively small amounts (\$1-2 million) to leading MFIs (ARMP, BRAC, the largest MFIs) on the basis of a first loss default guarantee provided by MISFA that would cover 20%. Also, one of the Afghan banks, Bank Milli, has approached MISFA to finance profitable MFIs without any MISFA guarantee. These are positive developments that may help diversify funding sources for MFIs and ensure a relatively stable source of funding for MFIs that could grow over time, and set the path towards commercialization and a sustainable sector. Compared to other South Asian countries, the efforts to commercialize the sector are on a much faster pace in Afghanistan. In addition, this provides investing opportunities for commercial banks in addition to the current SME sector. However, it should be pointed out that this source of funding may not be a complete substitute for the current donor funding during this early period of MFI buildup.

As the industry develops, MFIs may increase their reliance on voluntary deposits as sources of funding. Mobilizing voluntary deposits will require the MFIs to register and be regulated under the new DMFI articles published recently by DAB, the Central Bank. MISFA may require to coordinate with DAB such that MFIs are adequately monitored but not over burdened with reporting requirements.

MISFA, in its endeavor to grow its funding base, needs to address concerns regarding the loans made to the MFIs. This requires resolving the outstanding loan balances to MFIs and a longer term vision for MISFA. Under the fast-track scenario that was the initial concept on which MISFA was established (as implemented in Bosnia and Herzegovina, from which the model for MISFA was designed), there would have had to be provision for the final disposition of the loans at the end of the five-year estimated period for the program. The alternatives would have been: (i) forgiveness of the loan for MFIs that had met the goals and targets set for the MF industry development program; or (ii) use of the loan as a means for effecting reorganization (by merger, portfolio sale, and/or liquidation) in the best interests of the industry. The first alternative would allow MISFA to consolidate the industry by helping sustainable MFIs to achieve strong equity base for raising funds from other sources in future. Under the second alternative, the terms and conditions of the loans provide MISFA with considerable authority to require immediate payment and then to take steps to deal with the MFI that could not repay the loan. However, in a longer-term vision for MISFA, where stakeholders decide to continue its existence, instead of following the original design concept described above, MISFA soon needs to address the funding issues. MISFA may require to reschedule its loans to MFIs for a longer term and collect the 5% interest on the loans. This is a significant planning issue for the MFIs as well as for MISFA, and needs to be resolved soon through effective dialogue with key stakeholders.

Recommendations

- It is most important that MoF and the donors revisit their vision for the sector, appreciate the effects of funding uncertainties and clearly decide their commitment and level of support to the microfinance sector and MISFA to build a strong microfinance sector in the country. This will help MISFA develop a clear and meaningful business plan for the next few years considering both supply of funds and demand for its services.
- MISFA should continue its current efforts to identify new commercial sources of funding for MFIs with potential to grow and become sustainable in the next 3 years. While providing guarantees for the MFIs to access financing from commercial banks can be a short-term partial option, it may not be advisable for MISFA to start a guarantee fund. Operating guarantee funds requires specialized skill to administer and manage. It is useful for MISFA to explore options to partner with the existing guarantee funds, like the Afghan Credit Support Program (ACSP) that targets SME lending in Afghanistan, to also guarantee profitable MFIs making microloans. This will also be helpful for MISFA to build its portfolio in SME lending, if it prefers, in the future.¹¹
- There are also opportunities to engage in brokering international investors such as Oikocredit, Accion Bridge funds, and Gates / Sorros Foundation in providing credit lines for on-lending, and guarantees to the Afghan MFIs, despite the country risk.¹² While some of these sources may not extend grant funding for capacity-building, they may help address liquidity shortages for the MFIs. In doing so, MISFA needs to be careful that the social investors directly support the MFIs without any guarantee from MISFA such that long term relations are built between the investor and the MFIs.
- While political issues may dominate and challenge the proceedings, it is useful for the World Bank and the MoF to engage in dialogue to attract an IDA loan earmarked for developing microfinance in the country. The involvement of the World Bank, with access to considerable amounts of funds, will also ensure appointment of a country level task manager who can dedicate time to the sector's development. It is to be noted that the success of the LIP program in Bosnia-Herzegovina was attributed in large part to the high volume of uninterrupted funding from the World Bank and the presence of a country level task manager knowledgeable in microfinance.
- MISFA, while aggressively looking for alternate funding sources, needs to ensure that diversified funding sources synchronize with MISFA's mission and objectives to build a strong microfinance sector that serves the poor and follows best practices. Care must be taken to dialogue and reach consensus with sources such that they do not dominate / dilute MISFA's objectives, independence, and use of best practices. These may include targeting of clients that are not suitable for receiving microcredit, seeking to penetrate unstable regions and charging below-market interest rates.
- MISFA needs to ensure that adequate funds are in place to continue its operations for some more time. If donor funds decline or cease to continue, MISFA may call back on its current loans to the MFIs. At the end of the current contracted periods, MISFA can either roll over the loan portion to another 3 year term with an option for the MFIs to pay the interest rate of 5% or to start paying back the loan in a mutually agreed schedule with interest paid only on a declining balance basis.

3.1.2. *Grant funds from MISFA*

¹¹ Under ACSP, funded by USAID and KfW, participating banks cover 10% first loss, and the ACSP covers 80% of the remainder.¹¹ For lost interest, the guarantee fund covers the same percentage, limited to three months accrued interest. The bank pays a fee to ACSP for participating in the guarantee scheme.

¹² Recently, the Global Bride Fund at ACCION International has extended a \$1 million guarantee for 18 months to Fundusz Mikro, a leading Polish microfinance institution (MFI), and a \$500,000 guarantee for 18 months to the Constanta Foundation, a leading microfinance institution in the Republic of Georgia (conflict affected). The Fundusz Mikro guarantee backs a \$1.5 million credit line extended by Fortis Bank; the Constanta guarantee backs a €700,000 loan extended by Oikocredit.

Until June 2006, MISFA has provided 12 MFIs with a cumulative total of US\$ 18.29 million in grants to primarily cover expenses incurred on establishing and expanding operations, developing new products, purchasing fixed assets and engaging technical assistance. The objective was to enable many new MFIs to initiate business and build operations to the point of self-sustainability without investing most of its own funds. The approach has successfully attracted many international MFIs to establish operations in Afghanistan amid high insecurity in many areas.

MISFA compares favorably with its peers in conflict affected countries for grant funding. MISFA's strategy from the start has been to reduce the proportion of grant funds significantly by the fourth or fifth year after the MFI becomes operationally sustainable, and to substitute this with debt finance. MISFA expects to stop providing grants by the end of March 2008 (1387). It is expected that a sufficient number of MFIs should be operationally sustainable by then, especially the top three that currently account for 85% of the market. The trends since 2004 show that the share of grant disbursements to total disbursements is declining - it stood at 27% in March 2006 compared to 52% in March 2005 and now projected to decrease to 15% by 2007. The trend compares favorably with experiences in Bosnia-Herzegovina, Sierra Leone and South Asia where most leading microfinance organizations required substantial grants to cover their initial operating costs to build capacity to become sustainable in about three to five years. It is to be noted that it was initially projected that the share of grants in total disbursements will be reduced to 10% by 2007, with most organizations getting no grant funding in 2008. The projected share of grants in total disbursements for MISFA for 2007, however, stands at 15%, a five point above the projected share (Annex Table 7). It is possible that the funding delays in earlier years and inclusion of new partners in the last two years are likely to have caused the slight deviation from the initial projections.

Grants needs to be reduced and stopped in the next few years. But, it can only be achieved if the MFIs are provided with contracted amount of grants for the current periods to build the institutions to become sustainable and eligible to access commercial sources for debt finance. In that context, the funding delays and uncertainties experienced during 2005 are of serious concerns. Even if MISFA brokers linkages between commercial sources and MFIs, the commercial sources can only lend to MFIs that have the potential to become profitable in the near future. They may not be interested in providing grant monies still required for these MFIs to engage in expansion and research. Also, the commercial sources will not be interested in fledgling MFIs that may require funds for capacity building and therefore require more time to become profitable.

It is important that MISFA monitors the grant component. The amount of grants fund required can reflect the development strategy of the MFI. BRAC, for example, took the approach of focusing on market coverage and has opened a large number of branches in various provinces in the early years of the program. A large proportion of the branches had not yet become self-sustainable (management indicated that approximately 20 branches of 140 had reached some level of operational profitability at the time of the review). The disbursements to this one MFI represent a large percentage of the grant funding disbursed to date. At the same time, BRAC has achieved by far the most significant expansion and market coverage. On the other hand, FINCA followed a strategy of using the grants to develop new products that conform with Islam for later use with expanding its market. It is yet to become sustainable. MISFA is playing an important role in monitoring the progress of the grantees. It is intervening to ensure that appropriate progress is being made toward the sustainability of each MFI grantee. The recent effort at MISFA to withhold grants for MFIs that failed to bring costs down is a right move.

It is necessary for MISFA to formally address the concerns on high initial grants to MFIs. The MoF appears to be concerned regarding the initial high grant portion relative to loans to the MFIs. MISFA may clarify the difference between the normal overhead levels associated with traditional development projects (such as irrigation, education and health projects) and the nature of operational needs for grants to MFIs to support their initial establishment and growth. Further, the grants, which address the costs of setting up,

and loans, which fund some of the lending portfolio expansion, are deliberate provisions required to attract international MFIs and to demonstrate demand for microfinance. For MFIs that have the capacity to become sustainable, it is important to fund start-up costs that are generally high initially and that reduce in percentage terms in relation to loan funds as the institution expands.

3.2. Capacity Building

Realizing the challenges in developing a strong microfinance sector in a country with low human capital, the Government and the donors have been very supportive of reputable international MFIs with experience in developing countries, especially conflict affected, to start microfinance operations in the country. In the absence of specialized MFI technical assistance providers within the country, they have also mandated MISFA to undertake capacity building of the MFI sector as one of its prime objectives. In doing so, MISFA has been active in improving the capacity of the MFIs to deliver quality services and in developing its own internal capacity to provide required technical assistance to MFIs.

The grants from MISFA have been instrumental for many MFIs to design appropriate products and build field staff capacity. The MFIs reported that they were able to use grant funds to access technical assistance services from providers of their choice. A small fee that was charged for the MISFA training sessions was debited from the grants provided for the MFIs. Many of the training programs were provided by experienced trainers from reputed regional consulting firms that are familiar with the culture and languages of Afghanistan. However, the effectiveness of the training programs could not be assessed since MISFA does not carry out formal follow-up with MFIs on the training programs. Incidences of inconsistent information and delays in MFIs' reporting to MISFA on their outreach, financial performance and portfolio quality on non-standardized formats may indicate that more efforts are required in capacity building. MISFA has rightly identified the issue and has recently assessed the capacity and training needs of the MFIs by holding individual level consultations with MFIs.

With experience, MISFA has now realized the need to improve monitoring MFIs such that problems can be spotted early for rectification. It was a right decision to strengthen the monitoring unit at MISFA and expand the scope of the unit from only monitoring of portfolio quality to outreach and financial performance as well. As a result, the performance based funding is now fully implemented. The training unit was also combined with the monitoring unit in order to impart skills to MFIs to develop their in-house capacity to continue adequate reporting to MISFA in future months.

MISFA is strengthening the monitoring and training unit, but progress can be made to make it more effective. In order to develop the now combined monitoring and training unit, in March 2006, MISFA has engaged the services of an international consulting firm from the region to help improve its capacity to monitor MFIs. The consultants have been addressing key issues including standardizing reporting formats and establishing feedback loops based on transparent criteria. The MFIs felt that reporting requirements have increased in recent months but the feedback from MISFA regarding their performance based on transparent benchmarks are very useful. MISFA has produced individual performance reports for each of the MFIs and has been holding individual discussions with MFIs to discuss their performance. These discussions have included reviewing progress made so far, assessing their achievements with respect to targets, discussing management and financial issues that emerge from the reports, and reassessing growth possibilities (and funding requirements) for each MFI. The MFIs also found the recent efforts at MISFA to standardize reporting formats and automate the process to minimize errors very useful. Developing in-house capacity of the MFIs to provide reliable information in future is now pursued by holding on-site discussions with MFIs.

Recommendation

- It is important for MISFA to stay the current course in strengthening its monitoring and training unit. This will help to carefully assess the sector to identify MFIs with potential to succeed. Increasingly, it will identify the potential of some MFIs to access commercial sources of funding, and identify weaker MFIs for either tailored technical assistance if they have potential to improve in another 3 years, or find alternative solutions such as mergers, buy-outs and closures if they lack potential to improve in 3 years.
- MFIs are known for their competitiveness and eagerness to improve to match their peers. Therefore, MISFA may provide more benchmarks, in addition to the current benchmarks based on performance of MFIs in Afghanistan, to compare MFI performance of the Afghan MFIs. MISFA may use the performance in South Asian countries such as Pakistan and Sri Lanka, young MFIs in Arab countries including West Bank/Gaza, some conflict affected countries in Africa such as Sierra Leone that are at the same level of recovery as Afghanistan, to obtain more benchmarks. MISFA can consult the MicroBanking Bulletin, and can also network with similar apex organizations in conflict zones to obtain benchmarks.
- To address the financial and social objectives, MFIs may incorporate regular monitoring of social performance into their systems. This is also important for product development and also to account to social investors, donors and the Government who are interested in microfinance impacts on the poor in Afghanistan. MISFA can select a few social performance indicators and motivate the MFIs to report on them regularly. However, care must be taken that general funding from MISFA (excluding funds earmarked for specific projects such as ALP) is not exclusively tied to their social performance (in terms of targeting extremely vulnerable clients, or reaching remote geographic areas).
- Once the reporting formats are standardized and information starts flowing, it is important that MFIs share information among themselves to improve their performance. But, it is not the role of MISFA to motivate sharing of information among the MFIs. The Afghanistan Microfinance Association (AMA) should take on that role. In addition, AMA may also promote transparency by encouraging more MFIs to provide information to the MixMarket website that provides information on MFIs around the world (currently, 9 MFIs provide basic information to TheMix market).

3.3. *Afghanization*

“Afghanization” of the sector is an important objective set by the Government for the microfinance sector to attain, in addition to market outreach and financial sustainability.

Given the low local capacity, a push only for Afghanization from the beginning would not have been fruitful. It was a correct strategy of the initial Government efforts for developing the microfinance sector to deliberately choose international microfinance institutions (MFIs) to establish new “green field” initiatives in Afghanistan while building capacity of local Afghan MFIs. It is clear that the strategy has facilitated achieving scale rapidly, demonstrated good practices, and helped build local capacity. There are now four MFIs (Parwaz, WWI, AFSG and MADRAC) managed by Afghans. Parwaz is also owned and fully staffed by Afghans. MISFA has been instrumental in encouraging Afghan run institutions by providing them with grants and loans for the operations in addition to staff training.

The share of international staff in total MFI staff is fast declining in all the MFIs. MISFA has been pushing international MFIs to hire more Afghans and train them to take up management positions. Except for BRAC, all other international MFIs appear to have hired many Afghans and trained them to fill at least mid-level management positions including finance and MIS. Almost all MFIs hire Afghan women at the

field level. It is especially valuable for MFI's to have female loan officers who can lend to both men and women. Increasingly, Afghan women are also occupying mid-level management positions.

MFI's provide well paying employment for many Afghans. The microfinance institutions already provide employment for over 1,200 Afghans, many of whom have been taught new skills. Over the next three years, the number of people employed in the sector is expected to surpass 4,000. While the current trend in regard to qualified staff is attracting personnel from the education and health sectors is disturbing, it cannot be avoided if the formal sector wages are depressed. It should be expected that the flight of well-trained human capital from one sector to the other will decline over years with the development of all sectors, and with some standardization of pay structures for many essential sectors serving the poor.

The current efforts to register international MFI's as Afghan institutions are a move in the right direction. The objective of government in this regard is to encourage MFI's, especially those that are benefiting from grant funds, to establish permanent forms of organization in the country. The form of incorporation for most MFI's is the limited liability company registered under the regulations of the Ministry of Commerce. These are non-distributive companies but with limitations on the distribution of dividends only for the first five years. Whereas this form of organization will be helpful to building domestic institutions that are staffed with nationals, the form may be less attractive for foreign investors concerned with realizing fast returns on their invested funds.

3.4. MISFA Structure - Ownership and Governance

3.4.1. MISFA as a Government Unit

MISFA was set up in Sep. 2003, initially as a pilot project for 18 months, within MRRD. It operated under MRRD but was governed by a Steering Committee of representatives of key stakeholders, including representatives of Government and Donors. The Steering Committee composed of experienced people met to review progress, provide input and to resolve issues that arose. Ample guidance from experienced personnel that designed and implemented a successful microfinance apex unit in Bosnia-Herzegovina was provided to design MISFA, and an international consulting company was hired to implement the initial set-up of the pilot.

The intent to embed MISFA within MRRD, a ministry that was responsible for rural development, was to open many microfinance outlets throughout the country including rural areas. Since MISFA was a unit within MRRD, it operated within the government's budget and could benefit from donor funds that could only be committed through government under the terms of bilateral and multi-lateral agreements. While the above arrangement worked well with many donors, it was contributing to difficulties in attracting at least one donor, USAID, which would fund activities only if MISFA was not a part of government *per se*.

3.4.2. MISFA as an Incorporated Entity

The Steering Committee, in consultation with the Government, undertook to incorporate MISFA under legislation administered by the Ministry of Commerce. The initiative to incorporate MISFA was based on recognition that MISFA needed to be more separate from the government if it were to attract funding from a broader constituency of donors and external investors. It could appeal to USAID while, at the same time, continue to appeal to donors and institutions preferring to deal through government.

To reflect the direct funding of the microfinance development program by Government, based on funds provided by donors, it was agreed that Government should own MISFA. The shares were to be issued to the MoF. At the same time, to provide a more independent position of MISFA, the statutes were designed

to allocate control over the affairs of the company between Government and the donors through the organization structure of the Board rather than through share holdings. Board appointments were set up strategically to enable a limited number of directors to be appointed by Government, others to be from the national private sector and others to be appointed on the recommendation of donors. Furthermore, specific limitations were rightly included in the statutes on the conduct of liquidation and the distribution of liquidation proceeds that would not favor precipitous action by government.

At the time of the evaluation in July 2006, the Board is yet to set up committees to review and confirm a long term strategic vision for the company. But, this was to be expected since MISFA company had been in existence for only two months prior to the evaluation and just two board meetings had been held, one of which was organizational. It is not surprising that adequate governance arrangements had not yet been established. Management and selected representatives of donors appeared to be providing the overall direction during this interim period. But, it is clear that MISFA, as an incorporated entity, will need to develop stronger governance arrangements over the next few months as directors become more familiar with the work of the company and the various factors that bear on its potential future and success. The initial appointment of directors is for a one-year term. It would appear reasonable, once the most appropriate Board appointments have been confirmed or made that the attention of Board be directed toward the strengthening of governance. This will be important during the next three years in particular when evidence of self-sustainability of MFIs will be a key issue and the future role of the organization will need to be addressed.

Recommendations

- The Board should reconsider the mission and strategic vision for MISFA that was prevalent at the initial set-up of MISFA as a government entity. This will establish a thematic framework within which to hold management accountable for results in future. Within the new mission and strategic vision, MISFA needs to clarify on intended treatment of current loans to MFIs and mobilization of voluntary deposits as a funding mechanism to attain sustainability.
- The Board should consider setting up finance and audit committees, and an investment committee to ensure MISFA's accountability and success.
- It is advisable, once appropriate Board appointments are confirmed, that the term of appointment of directors be extended and perhaps some overlap in the terms of appointment be arranged to provide continuity.

3.5. Review of Results and Outcomes of MISFA

Expected Interim Results for MISFA (2003 to 2006), Outcomes and Reviews

Expected Results	Outcomes	Review
<i>I. Additive effects</i>		
Investing in MFIs with potential to grow rapidly	From June 2003 to June 2006, number of clients served grew 15 folds (12,000 clients to 197,000); portfolio outstanding grew (30 folds (US\$ 1 million to US\$ 30 million). Performance exceeds peers. About half of the MFIs grew rapidly, more than 50% every year.	Exceeds expectation
Investing in MFIs with potential to become sustainable	One MFI became OSS within 2.5 years of operation. Another MFI functioning for 3.5 years now has potential to become OSS soon. Many MFIs are projected to become OSS in five years since initiation.	Satisfactory.

Increase in Afghanization of MISFA staff	Currently, all mid-level managers and operations staff are Afghans. Well qualified expatriate staff occupy 3 positions at the top level of management.	Satisfactory
Autonomous status for MISFA	MISFA transformed from a government program to an Afghan company owned by the Ministry of Finance and governed by an independent board of directors within 2.5 years after its inception.	Highly satisfactory – on schedule
Increase in quality of monitoring staff at MISFA	Recently, the Afghan staff is exposed to many training programs and distance learning courses on financial management and performance monitoring. They are also trained in-house through guidance from an expert advisor and actively implementing improved monitoring systems.	Satisfactory – potential for highly satisfactory if trend continues
Increase in quality of staff at MISFA for training	While external trainers are used for training the MFIs, the Afghan staff is also recently trained to provide trainings (and not just translations).	Nearing satisfaction – needs improvement
II. Diffusive effects		
Effective coordination with donors and government	MISFA engages in dialogue with the multiple donors with varied objectives and the government to resolve issues related to the MF sector; it has expanded the donor base by attracting new donors such as USAID.	Satisfactory
Facilitating AMA	MISFA encouraged formation of AMA, provided grants to cover the first year operating costs of AMA and also housed the AMA coordinator within MISFA. AMA, however, is yet to take off and become a pro-active network.	Nearly Satisfactory
Facilitating DMFI article with Central Bank	Effectively coordinated through facilitating consultations between the central bank and the MFIs to draft the DMFI article. MISFA also disseminated the DMFI article to the MFIs.	Highly Satisfactory
Facilitating MFI registration	MISFA has been active in providing information to MFIs on how to register their institution as an Afghan company.	Highly Satisfactory
III. Multiplicative effects		
Increase in transparency and accountability of MFIs	All MFIs now regularly report to MISFA on a standardized format. Many MFIs are now audited and reporting to theMIX market. One MFI is currently being rated by an international rating agency. The quarterly newsletter on the website profiles MFIs on regular basis and provides useful data on MF sector.	Satisfactory
Increase in MFI capacity to geographically expand further and serve vulnerable clients	20 provinces, mostly in Kabul, North and North-East are covered. South and East are sparsely covered due to high levels of insecurity. But, many rural areas and poorer sections in fairly secure areas remain less covered.	Nearly satisfactory - needs improvement
Increase in MFI capacity to become sustainable	Only one MFI has become OSS and one shows promise. Many MFIs struggle to achieve half of the projected targets for sustainability.	Needs improvement
Increase in Afghanization of MFI staff (all operations and mid-level management)	The share of international staff in total MFI staff is fast declining in all the MFIs. Four MFIs are managed by Afghans. However, there are MFIs	Highly satisfactory in few MFIs to nearly satisfactory in some

	where most of the top and mid-level management positions are still occupied by expatriate staff.	MFIs.
Improvement in social performance measurement (<i>Note: so far, this has not been an explicitly expected result</i>)	MFI's report on a few outreach indicators, including number of women served, number of disabled clients and outreach to rural areas. Baseline data is collected but not used subsequently.	Needs further improvement. MISFA can offer technical assistance to streamline the measurement of social performance.

Scales: Exceeds expectation; Highly satisfactory; Satisfactory; Nearly satisfactory (needs improvement); Least satisfactory.

IV. CONCLUSION AND RECOMMENDATIONS

It is clear that the microfinance sector in Afghanistan is at its cross roads. Expectations abound for the sector to surpass standards set by its own initial success in breadth of outreach, and also attain sustainability and improve social performance. A huge demand exists for microfinance in both urban and rural areas creating opportunities for the MFIs to expand in future. If security conditions improve, the sector has potential to become vibrant and further improvements are possible. The next growth impetus requires a shift from short-term action oriented approach to goal oriented long-term approach by charting out clear vision and strategies by all stake holders to position the microfinance sector in the country.

While the sector is now comprised of diverse players with potential to grow and become sustainable, many challenges remain. Whereas mature and international NGO supported MFIs are still growing, local and small MFIs are still struggling and require substantial levels of capacity building and funds to operate and compete with the larger MFIs. Also, commercial banks are downscaling and attempting to reach small enterprises creating more competition even for experienced big MFIs, especially in urban and peri-urban areas. There is also a growing demand for deposit mobilization that requires MFIs to develop appropriate products and qualified staff to administer the product. Savings products are generally more challenging for new and inexperienced MFIs to provide effectively.

Until now, MISFA has played a prominent role in developing the microfinance sector. Given the status of the sector today, there is a clear need for MISFA to continue providing capacity building services and funds to strengthen the sector. The time required for MISFA to exist is, however, contingent on the strategies followed by the Government, donors, MFIs and MISFA in the next few years. For MISFA to continue in its present form, it needs to improve local human capacity and secure solid funding base. This may require MISFA to support SME and MF portfolios of selected MFIs, phase out grants for established MFIs and provide only a one time grant for new ones, and provide only loan funds at commercial rates to established MFIs and at slightly subsidized rates for a specified period to new MFIs. If stakeholders decide to later transform MISFA and reconstitute it as a finance / investment company, there is a need to clarify the ownership of the company and role of the Government in the management and governance of the company, and find sources of funds and investment options including SME finance providers to sustainably operate the company. The options above, nonetheless, require transparent trigger mechanisms and targets to effect the action.

At present, the sector and MISFA, nonetheless, require strong and continuous support from the Government and the donors for some more time. Otherwise, efforts to date to develop a strong microfinance sector may fail in the long-run. The following provides some broad recommendations for key stakeholders.

4.1. Donors

- The current informal coordination among donors has been useful to discuss short-term decisions that affect the microfinance sector. But, it is now important for the in-country donors to form a forum to dialogue over their respective donor organization's vision for the sector and role for MISFA, and also discuss with the government on timely disbursement of their funds according to their expressed preference for the microfinance sector.
- While it is realized that donors cannot generally commit financial resources for a period longer than one year at a time and funding cycles differ among donors, it will still be useful for the donors to develop a longer-term forecast of financial needs to support completion of the MFI development program. Whereas bilateral donors may be limited in their long-term funding commitments, it is feasible for the multilateral donors such as World Bank to increase its funding under IDA contracts to ease the funding crunch and enable the sector to grow and become strong without funding constraints.
- Donors may convey their reporting requirements to MISFA to justify their investment in the MFI program, and mutually agree on the delivery of information that is feasible to gather. Whereas donor requirements can be expressed, it is to be recognized that some information may not be cost effective to collect and may not be useful for the sector practitioners to make managerial decisions
- Donors may ensure that dedicated funds are provided to MFIs to conduct impact studies, if this continues to be an area of priority for donors over and above what could be done cooperatively. Since impact studies are expensive in terms of resources and time, efforts that are streamlined between donors and with government ministries such as MOWA will ensure the best use of resources.
- Donors shall fund rating evaluations of MFIs (once they reach an appropriate size and have made adequate progress toward self-sufficiency) to facilitate eventual access to alternative sources of funding. The current CGAP/IDB funds that cover expenses of MFIs that opt for rating through recognized rating firms needs to be explored for funding selected Afghan MFIs.
- Donors could support provision of partial guarantees of loans made by foundations, banks or other sources to MFIs. However, it is recommended that donors use existing guarantee mechanisms rather than create special guarantee funds for the purpose.

4.2. *The Government*

- There is a need for preparing a policy document for microfinance development. The document should articulate linkages between microfinance and poverty alleviation. It is important for DAB to take a leading role in developing the policy paper since it has a development role over financial markets and will be administering the new regulations over deposit-taking MFIs. However, DAB may engage in a collaborative effort with other ministries with programs directed at alleviating poverty and gender issues.
- It is important that the government clarify its expectations for microfinance in Afghanistan, in terms of reaching vulnerable populations, active conflict zones and rural areas. To reach extremely vulnerable populations, MFIs will require appropriate incentives, additional resources and partnership with other agencies (BDS providers, product suppliers, etc). The government should also be prepared to bail out failed institutions where security conditions have threatened the success of service offerings.

4.3. *MISFA*

- There is a need for reaching consensus between MISFA, and its donors and the Government regarding the longer-term expectations for MISFA. This will help to provide a clear mission and mandate for MISFA.

- MISFA should strengthen its governance arrangements and clarify the representational roles of directors, their involvement in strategy development, their responsibility for audits and their decisions on major funding and investment issues.
- To make funding commitments to MFIs, especially to those that have attained a considerable scale, MISFA's focus shall increasingly shift towards achieving sustainability and less on expansion.
- MISFA needs to develop transparent policies on grants to new partners and existing partners who have achieved sustainability but have expansion plans that require support.
- MISFA may build on the existing reporting framework by incorporating key social measures that will provide feedback on the social outreach and performance of MFIs. The specific choice of indicators should arise from discussions and pilot testing with the MFIs.
- To ensure that right information is provided to the donors, MISFA, although not conduct studies on its own, could play a constructive role in overseeing the gathering of information on impacts of microfinance on clients that is required by some of the participating donors. MISFA can provide technical support to MFIs so they are able to streamline their collection of baseline data to collect only what is essential, and manage it in a format that can be used for product development and impact studies.

4.4 *The Microfinance Sector*

- The MFIs need to actively support Afghanistan Microfinance Association (AMA) to grow and assume a visible role in lobbying, training, the gathering of performance statistics and other functions that are currently performed by MISFA.
- There is a clear need for the MFIs to taper their heavy dependence on MISFA for funds and capacity building, and secure alternative funding sources.
- Sustainability should become important to achieve within the next three years. Also, there is an urgent need to reduce costs of operations. This requires careful planning of geographic and client coverage and quick building of adequate local capacity to manage the programs. Mergers and liquidations of MFIs, and consolidations of MFI branches are likely to take place for those that are not able to contain costs and achieve self-sustainability within the next three years.
- Product innovation, process re-engineering, broad applications of new technology, and creation of new strategic alliances will all be essential by the MFIs to develop a strong microfinance sector.
- It is in the self-interest of the MFIs to cooperate with MISFA in efforts to obtain base-line data and to collect performance statistics compared with the base-line data. This will help the donors with their finding decisions based on performance. This will also enable MFIs to leverage additional funds from diversified sources.

Annex – Tables and Figures

	2002 - June 2003	As of June 2006
No. of MFIs	10	13
Portfolio outstanding (mill US\$)	1.1	30.8 (62.86 from Sep. 03 to June 06)
No. of active clients	12,000	197,278
No. of active borrowing clients expected in 2008	500,000	757,512
No. of MFIs with potential to grown and become sustainable	2	6
No. of MFIs that are OSS	0	1

Source: CGAP MF sector assessment in 2003; MISFA, June 2006.

	Afghanistan (June 2006)	Sierra Leone* (June 2006)	Bosnia & Herzegovina* (June 2000)	Balkans** June 04	Arab (2004)	Arab non FSS (2004)	Arab young (2004)	S.Asia (2005)
No. of MFIs ***	13	9	8	17	Na	na	na	121
Total no. of active borrowers	197,278	39,122	29,486	Na	Na	na	na	11.8 million
Avg. active borrowers / MFI (#)	15,175	4,347	3,686	5,442	25,561	13,564	31,111	107,875
Total loan outstanding (mill US\$)	30.82	3.01	na	Na	Na	na	na	959
Avg. loan balance / borrower (US\$)	289	47.68	1,800	1,830	348	359	299	113
Avg. Depth (%)	26.9	31.28	163	76.4	19.9	19.1	15.4	22.2
% female borrowers	75	55.8	50	42	78.2	74.2	75.3	83.3

* Conflict affected countries in their third year of establishing a MF sector. ** = Bosnia & Herzegovina, Croatia, Kosovo, Montenegro and Serbia – Conflict affected countries between 5-7 years of establishing MFIs; *** = Refers to MFIs funded by the Apex in A'than, S. Leone and BiH (which is almost equal to no. of MFIs) and MFIS that participated in the MIX reporting.

Source: MISFA, The Mix (S. Asia and Arab reports); MITAF in Sierra Leone; LIP-I in BiH.

Country	MFI coverage of demand among poor	MFI Credit outstanding (Mill US\$)	Projected MFI Credit requirement (Mill US\$)	MFI Outstanding to projected credit requirement (%)
Afghanistan (June 06)	5%	30.8	400	8%
Bangladesh	62%	960	1,733	55%
India	9%	1,050	10,909	10%
Nepal	14%	30	213	14%
Pakistan	2%	50	1,700	3%
Sri Lanka	63%	225	200	113%
South Asia	17%	2,323	15,156	15%

Source: Based on surveys conducted by Sinha et al., 2006, in *Microfinance in South Asia: Towards Financial Inclusion in the 21st Century*, Sinha et al, September 2006, The World Bank, South Asia.

Table 4: Outreach: MISFA Partners' Projections, Achieved and Expectations

Indicators	April 1, 2005 to Mar.31, 06		April 1, 2006 to Mar.31, 07		2005-06 to 2006-07		April 1, 2007 to Mar.31, 08
	Actual as of 31 Mar,06	Projected	Actual (Jun. 30, 06)	Projected	% increase in projected	% increase in actual	Projected
# of Borrowers	145,080	329,321	167,311	448,019	36	15	757,512
# of Clients	176,069	432,056	197,278	582,198	35	12	1,412,758
# of Provinces	18	20	19	25	25	6	34

Source: MISFA, June 2006.

Table 5: Key Performance ratios of MFIs in Conflict Affected Afghanistan, Bosnia and Sierra Leone (Time periods reflect similar ages for the microfinance sector and the apex funding agency)

	Average ^a		Top performance ^b		
	Afghanistan (Mar.2006)	Sierra Leone (June 2006)	Afghanistan (Mar. 2006)	Bosnia (Dec. 1999)	Sierra Leone (June 2005)
Portfolio at Risk (PAR >1 day), %	1.1%	9.98%	0.0%	0.04	2.235
Operating Expense Ratio (OER), %	211.5%	23.09%	17.7%	18.36%	6.44%
Borrowers per loan officer	227	486	474	257	669
Portfolio per loan officer, US\$	26,653	39,722	53,102	Na	60,836
Nominal Yield on portfolio (%)	33.0%	31.3% (int.rate/yr)	44.5%	24.68%	43.71 (int.rate/yr)
Operational Self-Sufficiency (OSS) - %	33.7%	100.44%	113.5%	156.4%	120.0

^a Average value for all 12 MISFA partners and 9 MITAF partners (outliers excluded); ^b Best performance on each parameter out of the 12 MISFA partners in Afghanistan, 6 LIP partners in Bosnia, and 9 MITAF partners in Sierra Leone. Source: MISFA, MITAF, LIP.

Table 6: Financial Performance of Selected MFIs

	A'Than	Sierra Leone*	Bosnia& Herzegovia*	Balkans**	Arab	Arab non FSS	Arab young	S.Asia
	(June 2006)	(June 2006)	(June 2000)	June 04				
No. of MFIs ***	13	9	8	17	16	na	11	121
Avg. loan balance / borrower (US\$)	289	47.68	1,800	1,830	348	359	299	113
Avg. Depth (avg.loan balance / GNI per capita) (%)	26.9	31.28	163	76.4	19.9	19.1	15.4	22.2
Avg. active borrowers / MFI (#)	15,175	4,347	3,686	5,442	25,561	13,564	31,111	107,875
Avg. Operational sustainability—OSS (%)	34 (73.3 - Portfolio wt.avg.)	100.44	113	138	118	94.6	105.9	105.5
No. of MFIs OSS	1	5	7	Na	na	0	na	--
No. MFIs linked with commercial sources	0	0	7	Na	na	na	na	Na
Avg. Portfolio at risk - PAR (30 days) (%)	1.8	9.98	0.71	0.7	2.2	4	0.5	7.6
Avg. Operating expense ratio (%)	126.7 (70.1 - Portfolio wt. avg.)	23.09	25.1	17.1	39.9	48.3	42.4	22

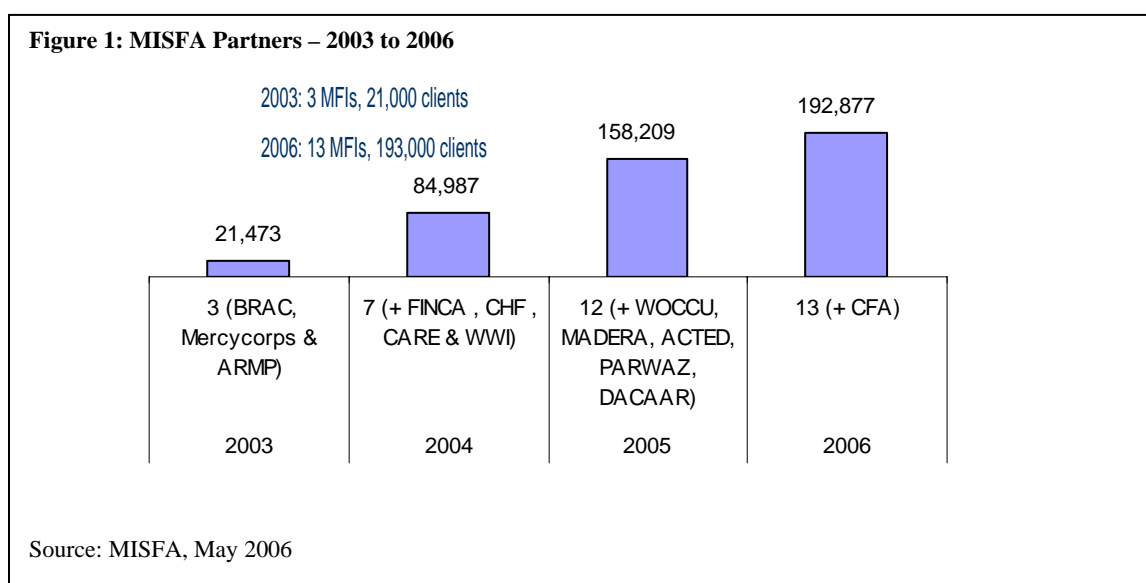
* Conflict affected countries in their third year of establishing a MF sector. ** = Bosnia & Herzegovina, Croatia, Kosovo, Montenegro and Serbia – Conflict affected countries between 5-7 years of establishing MFIs; *** = Refers to MFIs funded by the Apex in A'than, S. Leone and BiH (which is almost equal to no. of MFIs) and MFIS that participated in the MIX reporting.

Source: MISFA, The Mix (S. Asia and Arab reports); MITAF in Sierra Leone; LIP-I in BiH.

Table. 7. Funding at MISFA - Contracted vs. Disbursements (in million USD)

Years	Grants		Loans		Total	
	Contracted	Disbursed	Contracted	Disbursed	Contracted	Disbursed
Dec. 2003 to March 31, 2004(1382)	7.872	1.182	6.531	1.243	14.401	2.425
April 1, 2004 to Mar.31, 2005 (1383)	1.925	7.076	3.502	6.419	5.427	13.495
1382 to 1383	9.797	8.257	10.034	7.663	19.831	15.92
April 1,2005 to Mar. 31, 2006 (1384)	27.713	6.322	101.597	17.345	129.309	23.667
1382 to 1384	37.509	14.579	111.631	25.008	149.14	39.587
April 1, 2006 to Mar. 31, 2007 (1385)	6.681	3.718	17.212	7.763	23.893	11.481
1382 to 1385	44.19	18.298	128.843	32.77	173.033	51.068

Source: MISFA, June 2006.



Annex - List of Contacts

Name	Organization
Government of Afghanistan	
Wahidullah Shahrani	Deputy minister, Ministry of Finance (MoF)
Mahila Sahak	Deputy Minister, Ministry of Women's Affairs (MOWA)
Donor Staff	
Nipa Banerjee	Head of Aid, CIDA, Kabul
Tamin	CIDA, Kabul
Syed Hashemi	Senior Microfinance Advisor, CGAP, Washington, DC
Charlotte Olsen	Deputy Head of Aid , Danish embassy
Douglas Pearce	DFID, London (by phone)
James Medhurst	Program manager, Livelihoods team, DFID, Afghanistan
Sabir Nasiry	Program officer, DFID, Kabul
Mark Meassick	Deputy Office Director, USAID, Afghanistan
Steve Rasmussen	Task manager, The World Bank, Islamabad
Niraj Verma	Financial Specialist, The World Bank, New Delhi (by phone)
Board members	
Wahidullah Shahrani	Deputy minister, Ministry of Finance
Syed Hashemi	CGAP
MISFA staff	
Amjad Arbab	Managing Director
Zurmati	Manager, HR and Coordination
Pooja Kumar	Manager, Policy and External Relations (by email)
Amit Brar	Manager, Monitoring and evaluation
Parwiz Kawa	Deputy manager training
Saifullah Saifi	Deputy manager, monitoring and evaluation
Bashir Khan	Deputy manager, monitoring and evaluation
Mahir Momand	Deputy Manager, Finance
Helena Bahar	Communications
Hijrat Rahimi	Logistics
Abdul and Deedar	Information technology
Microfinance Institutions	
Abdulali Somji	National program manager, Aga Khan Rural Microcredit Program - ARMP-AKDN, Kabul
Armando Sirolla	Ex-Country Director, ARMP-AKDN
Faqir Mohammed Wais	Chief of operations, Aga Khan Rural Microcredit Program (ARMP – AKDN), Kabul
Storai Sadat	Exe.Director, Ariana Financial Services Group (Mercy Corps), Kabul
Gunendu K. Roy	Program coordinator, Microfinance, BRAC Afghanistan, Kabul
Jalaluddin Ahmed	Country head, BRAC Afghanistan, Kabul
Mahinda Gunasekhara	CEO, Childrens Fund, Afghanistan (by phone)
Paul Robinson	Regional director, FINCA-Afghanistan, Kabul

Hashmat	Senior Accountant, FINCA – Afghanistan, Kabul
Sayid Hedayatullah Jalaly	Logistics and master trainer, FINCA Afghanistan
Ahmed Sadiq	Internal accounts, FINCA Afghanistan
Mohammed Adik	Regional Branch Manager in Kabul, FINCA Afghanistan
Richard Chitwood	Product development Specialist, FINCA Afghanistan
John Nyankma	HR and Training, FINCA Afghanistan
Ferdoon	Credit manager, FINCA Afghanistan
Muslimul Haq	CEO, The First Microfinance Bank, Afghanistan
Mansur Ali	CFO, The First Microfinance Bank, Afghanistan
Najibullah Samin	Program Manager, MADRAC(DACAAR)
Madhavan Ati	Chief Technical Adviser & Head, OXUS (ACTED) Afghanistan
Alexis Lebel	Controller, Finance, OXUS (ACTED) Afghanistan
Aziz	Program director, Charikar, OXUS (ACTED)
Siddiq Abubakar	CFO, Parwaz, Kabul
Jamina Sharin	HR officer, Parwaz, Kabul
Jamila	Program Manager, Parwaz, Kabul
Curtis Slover	WOCCU in USA
Edgar Comer	WOCCU in Afghanistan
Renee Salinas	WOCCU in Afghanistan
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