Evolution of Microfinance Sector in Afghanistan

Back ground of Microfinance sector

The afghan economy has largely been dominated by money lenders in absence of formal banking systems. The micro-finance sector emerged in Afghanistan in the year 2002 as a part of rehabilitation process to provide social protection and alternative means of livelihoods to the poor. In absence of microfinance expertise within the country, international NGOs were invited and supported to establish Microfinance sector in the country. In addition to this, Government and Donors promoted an apex level funding and capacity building institution Microfinance Support Investment Facility for Afghanistan (MISFA) in the year 2003. The MISFA was initially under Ministry of Rural Rehabilitation and Development (MRRD) but was later registered as a company in mid 2006. MISFA supports MFIs in scaling up outreach, developing sustainable microfinance services and products and ensuring international NGO managed microfinance operations become registered afghan institutions.

Currently, there are about 15 NGO type MFIs reported to be operating in Afghanistan covering 23 provinces. BRAC is the largest accounting for 60 % active client base and 40 % of portfolio outstanding. While three NGO type MFIs started functioning by 2002, others were initiated since 2003, when MISFA came into existence.

Since 2004, MISFA has disbursed a cumulative total of US$ 51.1 million to 12 MFIs in Afghanistan. This includes US$ 18.29 million in grants and US$ 32.77 million in loans subject to 5% annual interest paid to MISFA quarterly. 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. 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. Currently, all MFIs depend heavily on MISFA as a source of funds to finance their lending operations. In 2006, loans from MISFA to MFIs almost account for 94% of the MFIs' portfolio outstanding with their clients.

NUMBER OF MFIS	15
Number of Provinces	23
Number of Clients	4, 36,777 (rural 31%, urban 69%)
Active Borrowers	3,73,080
Number of Loan Disbursed (Cumulative)	1,096,742(rural 30%, urban 70%)
Amount of loan disbursed (cumulative) USD	420,010,798
Gross Loan Outstanding	107,523,202
Client Saving Outstanding	12,195,822
Staff	4,681

*Source: MISFA, March 2008,

Nature of MFIs

Until very recently, no explicit regulations restricted MFIs from developing types of products, institutions, clients, and charges for services as per their own requirements. As a result, the microfinance sector in Afghanistan is comprised of diverse types of microfinance providers - credit unions, NGO type MFIs, microfinance banks that offer 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.

The role of the Government

The government of Afghanistan has taken a very proactive role in establishing microfinance sector in the country. MISFA has been instrumental is developing the microfinance sector. Indeed, growth of the microfinance sector to date can be attributed to the funds available from MISFA.According to a 2006 mid tern review of microfinance sector and MSIFA in Afghanistan, the deliberate approach by donors and government to encourage rapid scaling in terms of client outreach has been successful in building microfinance sector in short period of time in the country. The growth of sector in Afghanistan is phenomenal and stands first compared to many conflict affected countries such as Bosnia and Herzegovina, Mozambique, Uganda, Sierra Leone, and Liberia in their early stages of recovery. However, in its present form the microfinance sector in the country is very much subsidized by MISFA and the sustainability of MFIs is a critical issue in future growth. This necessitates the need for a new policy direction to be given by the government to the sector.

Challenges to the microfinance sector

As mentioned above, microfinance was initiated in Afghanistan by World Bank-CGAP led donor funded project. The project is implemented through MISFA which is the most significant financer for MFIs through some NGO-MFIs have got direct funding or have invested their own funds.

MISFA finances MFI through grant funding as well as debt funding on soft terms to build the equity and fund base of MFIs. Over a period of time ratio of grant component is expected to decline as MFI stabilizes the financial position and is able to raise commercial funds from other sources. MFI has been covering their operational expenses and fixed asset purchases through grant component received from MISFA, while on lending has been done by loan component. The debt obtained from MSIFA is of quasi-soft equity, low interest and long tenure because loans are rolled over if MFI meet the targets set for them.

The MFIs are heavily dependent on MISFA for funds for covering their operating costs, lending operation and capacity building needs. Therefore, any delays and uncertainties in funding from MISFA have critical bearing on performance of MFIs. A few talks have been initiated by MFIs to get debt on commercial terms from commercial banks but it has yet to materialize.

In addition to the issue of dependency on MISFA there is another very critical issue for MFIs in Afghanistan of sustainability. All MFIs, except one, amongst existing MISFA partner MFIs have yet to attain sustainability. An overriding focus on achieving a wide geographic coverage early in the expansion stage has diluted the efforts towards achieving sustainability. Sustainability is primarily affected by the high operating costs of the MFIs in Afghanistan. The operating costs are very high in Afghanistan due to expenses incurred on security measures, small sized loans, poor infrastructure, and the high costs of some services and hiring of expatriate qualified staff. The prevailing service charges are not adequate to cover the costs. The challenges of sustainability, human capital constraints and continuing insecurity in many areas continue to affect MFIs in the country.

The microfinance sector in Afghanistan has surpassed all expectation with initial success it achieved in terms of outreach. The nascent microfinance sector is the only source of formal access to financial services for low income people and poor in the country. However, out of an estimated 2 million poor families in Afghanistan, the current sector is serving less than 0.4 million. Moreover, it is not able to cover all microfinance related demand.This represents an enormous opportunity for MFIs to continue expanding and the microfinance sector in the country has a long way to go to meet this demand on a sustainable basis.

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