MICROFINANCE INSTITUTIONS IN AFGHANISTAN: DEVELOPMENTS AND CHALLENGES

2021
MASTER THESIS
BUSINESS

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MICROFINANCE INSTITUTIONS IN AFGHANISTAN: DEVELOPMENTS AND CHALLENGES

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Prepared as
Master Thesis

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KARABÜK
January 2021

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THESIS APPROVAL PAGE

I certify that in my opinion the thesis submitted by Najeeburahman LUTFI titled "MICROFINANCE INSTITUTIONS IN AFGHANISTAN: DEVELOPMENTS AND CHALLENGES" is fully adequate in scope and in quality as a thesis for the degree of Master of Science.

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This thesis is accepted by the examining committee with a unanimous vote in the Department of Business Administration as a Master of Science thesis. January 29, 2021

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DECLARATION

I hereby declare that this thesis is the result of my own work and all information included has been obtained and expounded in accordance with the academic rules and ethical policy specified by the institute. Besides, I declare that all the statements, results, materials, not original to this thesis have been cited and referenced literally.

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FOREWORD

I would like to extend my special gratitude to my thesis supervisor Dr. Muhammet BELEN, who has continuously provided me with his useful and productive guidance throughout writing this thesis and helped me to finalize the study successfully. Also, would like to acknowledge my deepest appreciation to the entire Department and Faculty of Business Administration of Karabuk University, which was the main source of knowledge and wisdom by offering a platform where I could practice and apply my skills during two years of my educational journey.

In addition, my superior praises go to my respected father Mr. Lutfurahman LUTFI who has played an important role in completing my thesis by his infinite inspiration and encouragement which empowered me to accomplish my academic goals. I personally dedicate my thesis to my Father, whom I respect and love the most. Moreover, my special thank goes to my dearest friend Ms. Fatima HAIDARY for providing invaluable guidance throughout this research and without her genuine support, this would have not been possible. Finally, I am extending my heartfelt thanks to all others who presented deep insight and gave a hand into the study.

ABSTRACT

The aim of this study is to analyze the experiences of microfinance institutions and present a comprehensive view of Microfinance institution practices and experiences in the context of Afghanistan for the purpose of figuring out what lessons do we get for future prospects. The research has shown that since the establishment of microfinance institutions in Afghanistan, they have been successful in certain aspects of their missions, but also have faced difficult circumstances and failures which resulted in massive capital loss, bankruptcy, and had to merge with other companies.

This study relies on primary sources where an online interview was conducted from the high hierarchy or top level of management such as Chief Executive Officers, Experts, Head of Credit, Planning and Strategic Managers and Credit Managers of different Microfinance institutions of Afghanistan. The non-probability sampling method was used for the fulfillment of the research because respondents were selected based on specific characteristics.

Analysis of the responses demonstrated that there are external and internal factors that negatively affected the operation of Microfinance institutions in Afghanistan. The results indicate that despite different Microfinance Agencies working for years in Afghanistan, poverty is still a big concern especially in rural areas of Afghanistan. Also, the study brought examples that show that religious beliefs, corruption, and lack of security in the country are the key reasons behind the challenges and failures of Microfinance institutions in Afghanistan.

On this basis, it is recommended that Microfinance institutions should consider introducing Islamic products and services because Afghanistan is a country where Islamic beliefs are superior. By launching such a product, it will also help microfinance institutions to achieve their potential untapped market.

Keywords: Microfinance Institutions, Poverty Reduction, Financial Access, Credit, Afghanistan.

ÖZ

Bu çalışmanın amacı, mikrofinans kurumlarının deneyimlerini analiz etmek ve gelecekteki beklentiler için hangi dersleri alacağımızı ortaya çıkarmak amacıyla Afganistan bağlamında Mikrofinans kurum uygulamalarına ve deneyimlerine kapsamlı bir bakış sunmaktır. Araştırma, Afganistan'da mikrofinans kurumlarının kurulmasından bu yana, misyonlarının belirli yönlerinde başarılı olduklarını, ancak aynı zamanda büyük sermaye kaybına, iflasa neden olan ve diğer şirketlerle birleşmek zorunda kalan zor koşullar ve başarısızlıklarla karşılaştıklarını göstermiştir.

Bu çalışma, Afganistan'ın farklı Mikrofinans kurumlarının İcra Kurulu Başkanları, Uzmanlar, Kredi Başkanı, Planlama ve Stratejik Yöneticiler ve Kredi Müdürleri gibi yüksek hiyerarşiden veya üst düzey yönetimden çevrimiçi bir görüşmenin yapıldığı birincil kaynaklara dayanmaktadır. Araştırmanın gerçekleştirilmesi için olasılıksız örnekleme yöntemi kullanılmıştır çünkü katılımcılar belirli özelliklere göre seçilmiştir.

Yanıtların analizi, Afganistan'daki Mikrofinans kurumlarının işleyişini olumsuz etkileyen iç ve dış faktörlerin olduğunu göstermiştir. Sonuçlar, Afganistan'da yıllardır çalışan farklı Mikrofinans Kurumlarına rağmen, yoksulluğun özellikle Afganistan'ın kırsal alanlarında hala büyük bir endişe olduğunu göstermektedir. Ayrıca, çalışma, ülkedeki dini inançların, yolsuzluğun ve güvenlik eksikliğinin Afganistan'daki Mikrofinans kurumlarının zorluklarının ve başarısızlıklarının arkasındaki temel nedenler olduğunu gösteren örnekler de getirdi.

Bu temelde, Mikrofinans kurumlarının İslami ürün ve hizmetleri sunmayı düşünmesi önerilir çünkü Afganistan İslami inançların üstün olduğu bir ülke. Böyle bir ürünü piyasaya sürerek, mikrofinans kurumlarının potansiyel kullanılmayan pazarlarına ulaşmalarına da yardımcı olacaktır.

Anahtar Kelimeler: Mikrofinans Kurumları, Yoksulluğu Azaltma, Finansal Erişim, Kredi, Afganistan.

ARCHIVE RECORD INFORMATION

Title of the Thesis	Microfinance Institutions In Afghanistan: Developments And Challenges.
Author of the Thesis	Najeeburahman LUTFI
Supervisor of the Thesis	Assoc. Prof. Dr. Muhammet BELEN
Status of the Thesis	Approved
Date of the Thesis	January 2021
Field of the Thesis	Finance and Banking
Place of the Thesis	KBU/LEE
Total Page Number	126
Keywords	Microfinance Institutions, Poverty Reduction, Financial Access, Credit, Afghanistan.

ARŞİV KAYIT BİLGİLERİ (in Turkish)

Tezin Adı	Afganistan'daki Mikrofinans Kurumları: Gelişmeler ve Zorluklar.
Tezin Yazarı	Najeeburahman LUTFI
Tezin Danışmanı	Doç. Dr. Muhammet BELEN
Tezin Derecesi	Onaylandı
Tezin Tarihi	Ocak 2021
Tezin Alanı	Finans ve Bankacılık
Tezin Yeri	KBU/LEE
Tezin Sayfa Sayısı	126
Anahtar Kelimeler	Mikrofinans Kurumları, Yoksulluğu Azaltma, Finansal Erişim, Kredi, Afganistan.

ABBREVIATIONS

AFN	Afghani (Currency)
AFSG:	Ariana Financial Services Group
AKAM:	Aga Khan Agency for Microfinance
AKDN:	Aga Khan Development Network
AMA:	Afghanistan Microfinance Association
AMFI:	Afghanistan Microfinance Institution
BDT:	Bangladesh Taka (Currency)
BRAC:	Bangladesh Rural Advancement Committee
CIA:	Central Intelligence Agency
DAB:	Da Afghanistan Bank
DFI:	Development Finance Institution
FMFB-A:	First Microfinance Bank Afghanistan
GDP:	Gross Domestic Product
MFIs:	Microfinance Institutions
MISFA:	Microfinance Investment Support Facility Afghanistan
NGO:	Non-governmental Organization
OSS:	Operational Self-Sufficiency
PAR:	Portfolio at Risk
Prof:	Professor
SME:	Small Medium Enterprise
TJS:	Tajikistani somoni (Currency)
UNDP:	United Nations Development Program
USD ($):	United States Dollar (Currency)
WWI:	Women for Women International

MICROFINANCE INSTITUTIONS IN AFGHANISTAN: DEVELOPMENTS AND CHALLENGES

This study particularly focuses on the experiences of Microfinance institutions in Afghanistan where Islamic beliefs are superior, while Microfinance has a concept of a Non-Islamic financial system. Also, it reveals the main challenges and the reasons behind the failures of some Microfinance institutions (MFIs) which went bankrupt in a wider view. These points ultimately led to the fact that what lessons one can learn from their failures and successes for academic and business purposes. Besides, this study also argues on the impact of not having security in the country while most of the customers who are in desperate need of these financial services are in rural areas of the country where the government has no control over.

Furthermore, since Afghanistan has been among the top corrupted government of countries for years, it would be fascinating to figure out what influence corruption of government has on Microfinance institutions. Furthermore, on what scale does this challenge can be problematic to Microfinance institutions in Afghanistan. Moreover, since alleviation of poverty and reduction of vulnerability of poor people is one of the primary missions of Microfinance institutions in Afghanistan, it is compulsory to analyze on what scale do these Microfinance agencies have accomplished their missions. Also, assessing the economic contribution of Microfinance in Afghanistan and the impact of these loans on borrowers.

Overall, the study is focusing to present a comprehensive view of Microfinance institution practices and experiences in the context of Afghanistan. The importance and effectiveness of this topic for the purpose of economic and social development of my homeland Afghanistan has attracted me to research this topic. It has been found very interesting topic due to the fact that no one else has ever researched about this before. Therefore, it is motivating more to conduct the research in order to contribute academically. Besides, personally, through this research, I am able to put all the theoretical lectures and my five years' experience of working in this sector especially with Microfinance institutions into a practical report, which can be definitely an amazing academic experience in my life.

This thesis is consists of three main chapters. In the first chapter, it is all about the comprehensive overview of Microfinance institutions in the world. Besides, it explains general information about microfinance institutions globally in terms of the number of active customers, the loan portfolio of Microfinance, top leading countries in the world, average credit by countries, untapped potential of Microfinance in the world, history of Microfinance, the importance of Microfinance, key principles of Microfinance agencies and relevant previous literature review of the research.

In the second chapter, the thesis focuses on Microfinance's experiences in the context of Afghanistan in terms of the gross loan portfolio, the number of active borrowers, top leading microfinance agencies in Afghanistan with their market shares, total branches or financial service centers, total employees, MFIs loan by sector and geographic outreach of Microfinance agencies in Afghanistan. Also, this chapter covers the history of Microfinance in Afghanistan, the banking history of Afghanistan, and the overall financial system of Afghanistan. In addition, this chapter also studies the impact of Microfinance agencies on employment creation, women empowerment, business development, and poverty reduction in Afghanistan.

In the last chapter, the study analyzes Microfinance's experiences in Afghanistan in terms of what lessons do we get for present and future prospects. In addition, this chapter discusses in detail the challenges and frauds of MFIs and how, why, and what causes these challenges in Afghanistan. Overall, in the last chapter of the study, there is the analysis of primary data, secondary data, interpretation of data, evidence to support the hypothesis, or validation of hypothesis. Also, the analysis of the topic will be discussed including recommendations and conclusion.

RESEARCH QUESTION

What lessons do we learn from Microfinance's experience in the context of Afghanistan?

RESEARCH HYPOTHESIS

However, since the establishment of Microfinance agencies from 2003 till now, MFIs have enormously contributed in different areas such as agriculture, manufacturing, construction, and access of credit for poor people in Afghanistan, still, due to religious beliefs, corruption, and lack of security in the country, MFIs have been facing challenges and failures in some aspect of their mission.

RESEARCH OBJECTIVES

The core objective of this research is to evaluate Microfinance Institution experiences in Afghanistan for the purpose of finding out what lessons we can draw for future prospects for other countries and presenting a comprehensive view about Microfinance institutions practices and experiences in the context of Afghanistan. In addition, analyzing Microfinance challenges and figuring out the reasons behind the failures of Afghanistan's Microfinance institutions in a wider picture is another key objective of this paper. Furthermore, the sub-objectives of this research are highlighted below:

- Reviewing common frauds in the MFIs sector.
- Assessment of successes and failures of MFIs.
- Studying the impact of Microfinance institutions in terms of poverty reduction in both rural and urban areas of Afghanistan.
- Sustainability of Microfinance institutions in Afghanistan

SIGNIFICANCE OF THE RESEARCH

The main reason that this topic has drawn my attention is that these issues are key in the development process of any country like Afghanistan and no one else has ever researched this before. This study is very useful for infant Microfinance institutions that are currently working and it also can be very beneficial for foreign or local investors who want to launch their own financial institutions in this sector inside Afghanistan for the first time in the near future. Besides, this research can be found so effective for all other microfinance institutions outside Afghanistan and for any investors who have a plan to start working in any Islamic country because this paper will give them a complete view of experiences and practices in the field of Microfinance institutions in an Islamic country.

Moreover, it can contribute academically for university students or whoever wants detailed information about MFIs in Afghanistan. Also, this paper can be very beneficial to any researcher who needs accurate research about MFIs in the Financial Sector of Afghanistan. They can strongly rely on this paper due to the accuracy and validity of this research.

SCOPE AND LIMITATIONS

Conducting research on this topic is a complicated task, especially when the research includes Microfinance in Afghanistan, due to lack of security, improper and invalid information, and lack of access to online sources. Meanwhile, Afghanistan is counted as one of the most dangerous countries in the world where most of the rural areas are under the control of the Taliban (Terrorist Group) and many branches of MFIs are located in provinces of Afghanistan where some areas are controlled by the Taliban. Therefore, numerous aspects need to be considered while studying MFIs in Afghanistan.

One of the major challenges of having research on this topic is lack of security because Afghanistan is not secure enough to conduct any close observation research regarding this topic. The existence of the Taliban is prohibiting me from going there and have a direct observation from rural areas. Another factor that may limit my research is the confidentiality of data, which no MFIs are willing to offer complete data because they believe that it will cause them big trouble. Therefore, it made me use some limited online information or data. Currently, I am in turkey. Consequently, it will be difficult for me to have complete access to Microfinance institutions (MFIs) and their members.

However, to improve my findings I interviewed some MFI’s authorities still the majority of my findings rely on secondary sources. According to the research, the most reasonable and important findings were provided by secondary data which explained what lessons do we get from MFIs' experiences in a more productive way. In addition, I will try my best that the mentioned limitations do not affect the quality of the paper negatively, and I will make sure to keep the superiority of the paper. Thus, I am confident enough that the use of both qualitative and quantitative data collection, will make me able to provide and analyze detailed explanations to support the hypothesis of the paper.

RESEARCH METHODOLOGY

This research paper is a descriptive study of the Microfinance institutions in Afghanistan focusing on their experience in terms of what lessons do we get, analyses in-depth the successes and failures of Microfinance institutions and give a comprehensive view about Microfinance institutions' practices in the context of Afghanistan. The research methodology that I used for this study is qualitative data collection because, in its early stages, it aims to explore patterns, themes, and initial models and later on describe or provide a basic understanding of arguments. Ultimately, produce meaningful interpretation or analysis which is the heart of my study. Thus, I am confident that the qualitative method of the research strongly supports the study which can be very effective in the data analysis process throughout my research.

This study is based on the Primary Source, where I have collected first-hand data through an interview in order to address my research question. I also used already available information or pre-existing data provided by other researchers which include surveys, financial reports, and annual publications. By using this method, part of my analysis is based on previously collected quantitative and qualitative data. This method provided me enough sources which have given me the opportunity to make a proper assessment of Microfinance experience in Afghanistan and supporting the hypothesis of the research. Those secondary data were taken from several reliable sources, official websites, books, research papers, reports, and journals where all the sources of information have been acknowledged properly in references and in accordance with academic rules and ethical policy.

POPULATION AND SAMPLE

The population of the study is the all-microfinance institutions in Afghanistan including the total number of agencies and sub-agencies working in Afghanistan. The sample size of the research is 177 persons which are consists of high hierarchy or top level of management of different financial institutions especially Micro credit agencies which includes Chief Executive Officers, Experts, Head of Credit, Planning and Strategic Managers, Credit Managers, and Loan officers. I've chosen these particular individuals for my main focus of scientific inquiry because it could help me to do better my research in terms of validity and effectiveness. The mentioned target respondents were selected based on specific characteristics which means that I've used a Non-probability sampling method for the fulfillment of my research.

RELEVANT LITERATURE REVIEW

Zheng (2021), investigates the effect of COVID-19 on the financial and social efficiency of Microfinance institutions. In general, the study argues about the relationship between pandemic and MFI efficiency. Also, this article explores about what is the negative impacts of COVID-19 on microfinance institutions and examines the supply and demand side of MFIs. The findings of the article conclude that due to COVID-19, Microfinance institutions have been charging a higher interest rate than before. Therefore, this situation has put borrowers in a very tough economic condition and that is the reason where vulnerable borrowers default the loan repayments. On the other hand, the study results reveal that small entrepreneurs and low-income businesses are strongly relying on microfinance institutions and borrowers are even willing to pay the higher interest rate for receiving loans. This pandemic has created a situation where there is a huge demand for small loans in the market. Therefore, it is predicted that MFIs will grow faster.

This study is very beneficial for having a complete insight into the impact of COVID-19 on the microfinance industry. Also, the findings of this study can massively contribute in terms of finding out the importance of Microfinance institutions in a community.

Wellalage (2021), analyses the relationship between microfinance and gender for figuring out the disadvantages that are giving by MFIs in terms of gender. This article addresses gender discrimination in the microfinance industry and suggests different methods for facilitating the process for having easy access to credit for female borrowers. The findings of the article highlight that there has been evidence of discrimination against female-owned firms and female borrowers in the microfinance industry. This study gives a comprehensive overview of the relationship between microfinance and female borrowers. It can be very essential in the research for analyzing the role of females in the microfinance industry.

Alkhan (2020), analyses the practice of Islamic microfinance institutions according to the Sharia (Islamic Law). Under the content of this paper, it has been concluded that Islamic Microfinance institutions are vital in the growth of the economy, poverty reduction, wealth distribution, and circulation. This paper is very useful because it contributes significantly in terms of proving the hypothesis of the research. Also, it can give a complete insight into Islamic microfinance products and services.

Seibel (2005) focuses on the historic background of Microfinance Institutions in Europe and Asia. In the study, he states that for the first time in Europe especially in Ireland and Germany Microfinance agencies were established as informal institutions in the 16th and 17th centuries. These informal institutions started their operation as a type of banking in the financial sector which their target customers were only poor people. In the eighteenth and nineteenth centuries, due to the expansion of their operations, Microfinance Institutions got legal recognition, regulation, and mandatory supervision by Central Bank. Finally, during the twentieth century, it was due to all those changes and revolutions that Microfinance became a part of the formal banking sector. He also argues that in Asia, Each and every developed country and some developing countries, have a rich history of microfinance institutions in their records for reduction of poverty, and strengthening of their economy, and improving the quality of life of their citizens.

This article is useful to know more about the historic background of microfinance institutions. Besides, it also helps to have a deep look at the establishment of Microfinance in the world for the very first time. Finally, this article can be beneficial in my thesis for revealing the reality that Microfinance institutions are not infant organizations which have been recently established in Asia and it was not established for the first time in Bangladesh some decades ago.

Further, Srnec & Svobodová (2009) in their study also declared that Microfinance is not a brand-new theory for mankind because people were familiar centuries ago. He argues that people were using Microfinance agencies back in the 18th century in the middle of Europe. He also claims that we can find clues about Microfinance in many publications of well-known theorists of that period such as Jonathan Swift which was inspired by Irish Loan Funds, Raiffeisen, Robert Owen, William King, G.D.h. Cole and Charles Gide.

By reviewing this literature, we can study more about Microfinance institutions in third world countries that have a relatively rich history. In addition, this article, explains in a much detailed way about the development phases of Microfinance activities over four periods of time in less developed countries in the world. Lastly, this article can help to discuss the importance and development of MFIs since the 70s of the last century in the region.

Parto & Regmi (2008) discuss newly established MFIs and pre-existing or traditional sources providing access to credit to poor people of Afghanistan. Basically, the authors analyzed the impact of microcredit in terms of quality of life, having easy access to credit with a much lower interest rate, and repayment of the loan in rural areas of Afghanistan. As the finding of the article, almost 70% of borrowers in Afghanistan were women. Besides, it is also concluded that traditional lending is still the most common way of having access to credit among people in rural areas of Afghanistan. According to the article, 42% of the interviewee had taken informal loans from traditional local lenders which proves that MFIs couldn't provide access to credit to poor people in all the required rural areas. The problem with that is, credit from traditional sources such as local lenders is more expensive in terms of interest rate than credit from MFIs.

This research article is very valuable to the research due to the fact that it discusses a comprehensive overview of MFIs in Afghanistan in terms of the history of MFIs in Afghanistan, the number of borrowers, the impact of MFIs on the quality of life of borrowers, the gender of Borrowers and geographic outreach of MFIs with many reliable sources. Also, by this article, we can have a deep look at formal and informal lending sources of people in Afghanistan.

Moreover, Hussein (2009) discusses a variety of topics related to Microfinance agencies in Afghanistan such as the growth and outreach of MFIs, the sustainability of Microfinance, demand for microfinance agencies, the impact of Microcredit programs, and challenges that MFIs are struggling with. Primarily through her paper, she tried to give a complete summary about Microfinance Institutions in Afghanistan in terms of evaluating of MFIs performances, developments and failures of MFIs, and market demand for MFIs in the financial sector of Afghanistan. She also mentioned the number of microfinance agencies working in Afghanistan with more details. In addition, in the paper, it is also discussed on all types of Microfinance Products and Services which were offered to the Afghan community by MFIs.

This paper can provide enough secondary data about MFIs in Afghanistan for the purpose of conducting research in a much valid and proper way. The findings of this article may also be supportive in a better understanding of the topic for the purpose of having a logical argument about the hypothesis. As importantly, due to the numerical representation of data in this article about various topics of microfinance in Afghanistan, it can definitely be a strong source to rely on for a comprehensive analysis of the topic.

Mahmud (2010) states that South Asian countries such as Afghanistan, Bangladesh, India, Bhutan, Pakistan, Nepal, Sri Lanka, and the Maldives deserve to claim that Microfinance is an intellectual property right for them. In the modern form of Microfinance, it was all because of south Asian countries that developed an innovative approach for giving access to credit to poor people. He called this new era the microfinance revolution. Besides, he also discussed that through micro-credits, the family income of poor people can be increased. Therefore, he concluded that microfinance gradually can decrease poverty in society. This article is a very essential part of my thesis due to its depth study of topics of Microfinance in south Asian countries especially Afghanistan.

Moreover, Nagarajan & Knight (2006) assess the state of microfinance institutions in the financial sector of Afghanistan and the impact of micro-credit will also be analyzed. The findings of the paper reveal that despite some challenges in terms of social and political prospects, Afghanistan's microfinance sector had some development as well in regards to customer outreach. This paper plays a vital role in the validation of the hypothesis of the thesis. Overall, this report can contribute enormously to the thesis because it includes a variety of subjects being discussed with required details. Due to the high validity of the paper, it is seriously the most valid source for collecting raw data as my secondary source for completing the thesis in a much reliable approach.

Najafizada (2014) argues about the importance of small and medium enterprises such as microfinance agencies which are offering micro-loans and small-medium enterprise (SME) loans. In addition, he also focuses on some other businesses which play a key role in economic growth and development, job creation, and revenue generation. This Master's thesis is important in the research for analyzing the impact of Microfinance agencies in Afghanistan. Also, Najafizada's thesis gives a new dimension to the research, it makes it possible to analyze the role of microfinance agencies for the purpose of the economical contribution.

Stewart (2010) discusses the connection between development and security in developing countries and worldwide. He emphasizes that development and security are so related to each other with a direct relationship. The findings of his paper show that lack of security has massive consequences on economic growth and poverty in a country. Further, Bak (2019) also discusses the factors which are involved in development and corruption in the context of Afghanistan. He argues in his article about corruption in a deep approach. Also, he concluded that significant problems are caused by corruption in the country. These two articles are the foundation of the thesis for proving the hypothesis. Through these two articles, it makes it easier to conduct the research in a much better way and analyze the findings from a completely different perspective. In addition, some needed data that is not available elsewhere with this much accuracy and credibility will be obtained from these articles.

Norcia & Rissotto (2013) focus on religious beliefs' correlation with poverty. He has stated that religion has a strong influence and plays a vital role in such a way that people see and consider the reality around them. In addition, for the purpose of supporting this point, Tomalin (2018) in her article "Religions, poverty reduction and global development institutions" also argues that religious beliefs have always been an important part of people's lives who are experiencing poverty. In conclusion, she stated that religious beliefs can be an important factor in reducing poverty in a community.

Reviewing these kinds of literature regarding religious beliefs allows us to carry out the research with the aim of getting the core of the matter about challenges of Microfinance institutions in terms of customer outreach and repayment of loans. After studying these relevant pieces of literature, it has been revealed that the same causes can be applied in Afghanistan in terms of the religious beliefs of poor people. Thus, by the support of this relevant literature, it makes it possible to conduct the research from this point of view and to prove that Islamic beliefs are the biggest factors that poor people deny from having access to credit from MFIs.

1. CHAPTER ONE:
A COMPREHENSIVE OVERVIEW OF MICROFINANCE

Microfinance is a financial service provider company which the target customer is particularly low income or poor people who are underserved financially in a society. Microfinance is playing a very vital role in the financial system of a country due to the provision of resources and giving access to capital to people who are in need of these types of financial services. Microfinance is providing different types of financial services depending on the structure, size of institutions, and based on the need of society. Some micro finances are only providing credit services, while some others are providing a wide range of financial services such as micro-loans, SME loans, deposits, payment services, money transfers, insurance and so many more.

It has been proved that one of the most influential tools which have a significantly positive impact on poverty reduction is none other than Microfinance, especially in underdeveloped countries. Microfinance is totally different from regular commercial banking or non-profitable organizations with different underlying principles, missions, and visions. Microfinance's ultimate objective is to make a financial system in a society that can be used to help poor people in order to overcome poverty. Since the implication of Microfinance in underdeveloped countries in the world from the 1970s, it has been obtaining unique reputations as a solution to economic and social development. Besides, the experience of South Asian countries shows that Microfinance had remarkable positive changes not only on poverty reduction and raising the quality of life but on many other economic issues as well, such as employment creation, contribution to Gross Domestic Product (GDP), and economic growth.

There is a conflict of ideas regarding the creation of Microfinance's concept for the first time in the world. The majority of scholars who have researched and written about it believe that the history of Microfinance goes back to the 18th century in the middle of Europe, mainly to Ireland and Germany. They have mentioned that in the 1970s, Microfinance's concept was shaped with well-structured and developed by Prof. Yunus in Bangladesh. It was for the first time the experience of Microfinance in Asia. Later on, proved to be a successful experience in many aspects of a community particularly for less privileged communities like Bangladesh, Vietnam, and India.

1.1. Definitions of Important Terms

Microfinance: is made of two words, Micro which is pointing out about small-scale of something, and Finance which refer to monetary resources of any organization such as money, funds, capital, and assets. In the wider picture, it simply defines providing financial activities (small amounts of loans) in well-structured form for poor people in order to help them out economically and socially (Olaoye, 2010).

Loan Portfolio: Refers to the amount of loans (includes both principal and interest) which borrowers or customers are obligated to repay back to financial institutions. A loan portfolio is calculated as an asset in the balance sheet of financial institutions (FARLEX, 2020).

Loan Portfolio Outstanding: indicates the total remaining amounts of credit (includes both remaining principal plus remaining interest amount) which financial institutions are expected to receive (Law Insider, 2020).

Portfolio at Risk (PAR): Points out the percentage of the total loan portfolio that is at risk of not receiving back by financial institutions within 30, 60, 90, and 160 days. In another word, PAR refers to open loans which are overdue by a specific period of time. Normally, PAR 90 loans are counted as bad loans and PAR 160 is considered as non-receivable which will be written off by the institutions due to unrealistic perspective recovery (Support - Loan disk, 2020).

Loan Write Off: The loan writes off is one of the terms related to accounting which is being used for formal consideration of financial statements that means a debtor's asset is not valuable anymore. Regularly, loans are written off in the condition where it is 100 % provisioned and there is no accurate perspective of recovery in the future (Financial & Specialist, 2019).

Social Protection: The term Social protection is described as a set of strategies and programs which are designed to decrease poverty and vulnerability of poor people from society. These strategies, policies, and programs aim to have an efficient labor market where people will have sufficient jobs available and training local labor’s capacity in order to defend themselves from dangers, disruption, and income loss (Development Bank, 2020).

1.2. History of Microfinance in The World

Microfinance institutions are not infant organizations that have been recently established, nor their regulation and supervision. Each and every developed country and some developing countries, mainly in Asia, have a rich history of microfinance institutions in their records for reduction of poverty and strengthening of their economy, and improving the quality of life of their citizens. It is significantly important to know the history of Microfinance because it shows a complete view of the differences between Non-governmental organizations (NGOs) that were associated with credit and Microfinance Institutions. It also reveals the reality that Microfinance was not established for the first time in Bangladesh some decades ago

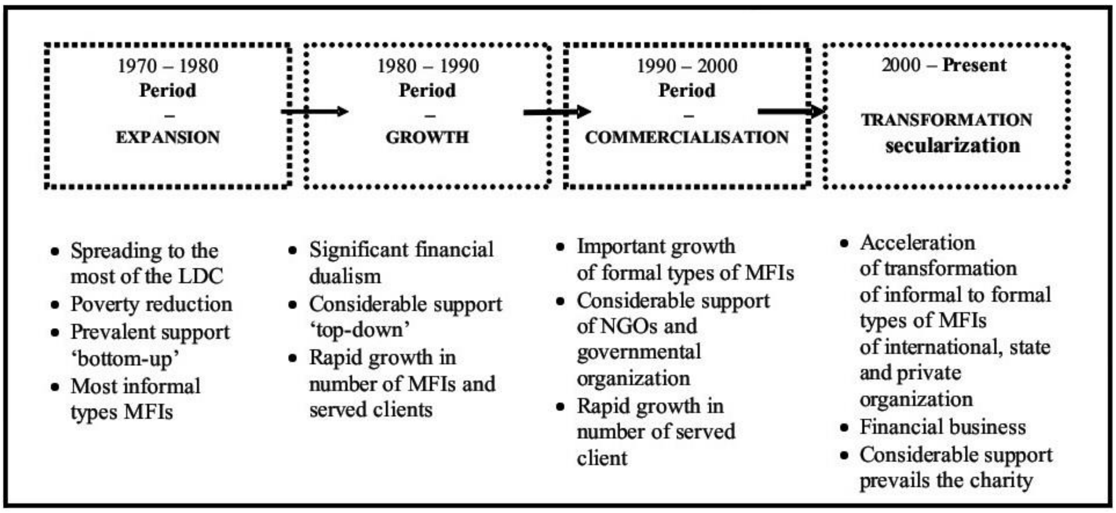
According to Seibel (2005), the birth of Microfinance goes back to the 16^{th} and 17^{th} centuries in Europe especially in Ireland and Germany when there were tremendous increases in poverty. Microfinance institutions were started by the informal structure as a kind of banking services to poor people in a number of European countries and over years it is formed to well-structured and developed to a formal institution.

Supporting Seibel's Idea, Anudevi (2016) also emphasizes in his article that the history of Microfinance dated back to the Middle of 1800s while the famous Theorist Lysander Spooner tried to explain the theory in his book, how credit can benefit entrepreneurs and farmers in order to find a way out of poverty. Later on, at the end of World War II, this concept had an immense effect. Finally, it was in the 1970s that Mohmmad Yunus Shaped and developed Microfinance into a modern and well-structured, and formal institution such as Grameen Bank of Bangladesh to the community of poor people for the purpose of reduction of poverty.

To continue to their points Srnec & Svobodová (2009) also declared that Microfinance is not a brand-new theory for mankind because people were familiar since the ancient era. He argues that people were using Microfinance agencies back in the 18^{th} century in the middle of Europe. We can find clues about Microfinance in many publications of well-known theorists of that period such as Jonathan Swift which was inspired by Irish Loan Funds, Raiffeisen, Robert Owen, William King, G.D.h. Cole and Charles Gide.

They also claimed that Microfinance institutions in third world countries don't have a relatively rich history. The importance and development of MFIs started in the 70s of the last century in this region for the purpose of providing micro-financial services (credit) in a very small amount of money for people who had nothing to give the financial institutions mainly commercial banks as collateral. In addition, as Figure 1 explains the development phases of Microfinance activities over four periods of time in less developed countries in the world.

Figure 1: Development of Microfinance Activities



Source: *Srnec & Svobodová, 2009*

Olaoye (2010) stated that Microfinance's concept grew into a modern and well-structured financial institution in Jobra village of Bangladesh in 1976 by Professor Muhammad Yunus who later on, won the Nobel Peace Prize in 2006 for developing the concept of Microfinance which led to immense contributions to poor people through micro-credits with easy terms. It all started when Professor Muhammad Yunus went on a field visit with all his students to Jobra village.

He interviewed one of the people of that village whose name was Sufia. She was working as a farmer on an agricultural farm of bamboo. During the interview, he found out that local money lenders are misusing the poor people due to not having any access to credit from formal financial institutions. Sufia explained that local money lenders charge 10% per week or even in some other cases 10% on a daily basis which whoever takes out a loan only gets poorer and puts themselves in a very bad financial condition. After a few days, Professor Muhammad Yunus gathered 42 people of that village in order to lend them 856 Bangladesh Taka (BDT) without charging any interest and collateral. This emotional support of Prof. Yunus put the very first step of the establishment of Grameen Bank of Bangladesh (Olaoye, 2010)

In the next part of the article, Olaoye added that more than 6.4 million borrowers were benefited from these attractive financial services with easy terms such as income-generating loans, housing loans, student loans, agriculture loans, and micro-enterprise loans. In the same year, Grameen Bank recorded investing over $5 Billion with a 98% repayment rate which indicates that it is one of the profitable institutions.

The last point revealed by Olaoye was that Professor Muhammad Yunus put a real effort in order to bring positive changes in less privileged societies especially in terms of making economic and social development. The theory is known today as Microfinance institutions or Microcredit agency which were developed by Professor Muhammad Yunus in Asian countries had an enormous impact on over 100 million people worldwide in case of getting a way out of poverty.

Supporting Olaoye's idea, Swope (2010) also declared that Microfinance is a type of banking or providing financial services to poor people which is a global phenomenon developed and reintroduced in a more formal structure by Bangladeshis named Prof. Yunus in the 1970s. Before the establishment of Microfinance, poor people had no permission of taking loans from any institutions due to the wrong belief that poor people cannot repay loans and they don't have valid collateral available with themselves in case if they fail to repay the loans, the bank would use that collateral in order to recover the cost and the amount of loan. Prof. Yunus started the Grameen Bank by providing loans with amounts of less than $50 to poor people with easy terms or in some cases with no collateral. Over the past 30 years, Grameen bank had significant growth with a higher repayment rate than any other commercial bank. Therefore, Prof. Yunus Proved that poor people can also manage to repay loans and they are also equally responsible to participate in any financial activities in any society for the purpose of economic and social development.

1.3. General Aspects of Microfinance Institutions

Micro finances are nonprofit organizations and they are the main provider of financial services such as micro-credit or small loans for poor people in a country for the purpose of enabling poor people to run income-generating activities for a better standard of life. Frimpong (2018) states that Microfinance agencies are assisting a portion of people who are facing the most financial challenges in the world due to not having the requirements of commercial banks in accessing credit facilities.

Microfinance agencies have a concrete influence on the economic development of the country by offering credit facilities to small and medium scale enterprises or businesses which they contribute massively to gross domestic product (GDP), employment, and other economic developments. In addition, in most cases, microfinance's customers not only become self-sufficient but also end up creating jobs for family and other community members. Microfinance programs have a very positive impact not only on the customers, or their families but on society as a whole.

Microfinance is an instrument for poverty reduction by giving poor people access to credit in order to have the opportunity to take part in economic activities for improving their economic conditions which they had been denied before. Microfinance helps low-income individuals or micro-enterprises who are not typically in the plan of any other financial institutions or commercial banks. By the involvement of these entrepreneurial activities, Microfinance has a direct impact on reducing poverty, increasing client's income, and removing the dependency of poor people on traditional money-lenders which charge high-interest rates (Olaoye, 2010).

The fundamental mission of microfinance is to contribute to poverty alleviation and economic development by providing financial services. Reduction of poverty, diminishing the vulnerability of poor populations, and alleviating the economic challenges of poor people has always been the ultimate goal of Microfinance for the purpose of empowering poor people in order to become self-sufficient and improve the quality of their lives (MISFA, 2020b).

1.3.1. Microfinance Target Customers

MISFA (2020) claims that in Afghanistan, the majority of microfinance customers are women, more than 70 percent. Women customers usually take a loan to support the family's livelihoods. The target customer of Microfinance institutions can be as below:

- Poor, low-income people
- Self-employed, household-based entrepreneurs
- Livestock holders such as farmers
- People, (entrepreneurs, or with business skills) but no access to capital
- People in rural areas or underserved communities
- Those, who do not meet the requirements of commercial banks

MFIs are offering small loans to customers with little collateral or no collateral in order for poor people be able to have access to capital for starting or expanding their businesses' operations. In addition, the Micro-credit program is designed to help poor people with specific and least requirements. Therefore, everyone cannot take a loan unless those people with a practical business idea and plan, entrepreneurial skills the ability to repay the loan (MISFA, 2020b).

Customers take out loans for different types of purposes such as starting small businesses for generating income for themselves and their families, expanding an already existing enterprise for more profit. Some typical example of loans used for is listed as below:

- Small retail shops & Beauty salon/barbershop
- Street vending & Repair service (bicycle, motorcycle, car, etc.)
- Livestock and farming and tailoring and handicrafts

In general, female borrowers usually take loans for the purpose of buying equipment such as sewing machines, flour for bread making, and materials for carpet-weaving. Meanwhile, male customers usually borrow to invest in different types of services such as tools for plumbing, electrical repair, food processing, and trade. In rural areas, both male and female borrowers use their loans in small income-generating activities related to agriculture such as livestock and farming (MISFA, 2020b).

1.3.2. Consequences When A Borrower Is Unable/Refusing To Repay The Loan

Each and every MFI has a different credit policy. Therefore, each case is going to be dealt with based on individual circumstances and MFI's credit policy. In general, whatever the case may be, the borrower must repay the loan even if it is medical issues, death, natural disasters, and other emergencies. MFIs will make sure that every effort is made to make the customer repay the loan.

If a borrower continues to default and refuses to repay, in individual lending, MFIs may gain principal plus interest amount back by using the client's collateral or guarantor, while in group lending the money will be gained by the group members. In the worst scenario, the case will be dealt with through government agencies such as the supreme court (MISFA, 2020b).

1.3.3. Differences of Microfinance Institutions and Commercial Banks

Microfinance is a completely different financial institution compared to commercial banks, in terms of mission, financial goal, target customers, procedures, and type of product and services. As Table 1 shows there are main differences between Microfinance and commercial banks in terms of their missions, financial goals, target customers, procedures and loan applications, and cost of operations.

Table 1: Difference Between MFI And Commercial Bank

Area	Commercial Bank	Microfinance
Mission	**Commercial:** Profitability	**Social:** to provide poor people and marginalized groups access to sustainable financial Service
Financial Goal	Maximize profits for shareholders	**1:** Increase income of Poor People. **2:** to become financially sustainable in order to continue services to the poor.
Customer Contact	Customers access Branches	MFIs access customers at their location, although customers are also welcome to visit MFI branch offices
Procedures and Loan Application	Longer, More complicated process before disbursment	Short and simple process, minimal collateral requirement quick disbursment
Cost of Operation	Generate higher profit margin from providing higher loan amounts and paying salary to a smallar number of staff	Generate low, in some cases insignificant profit because loan amounts are very small and require more staff to administer.

Source: *MISFA, 2020b*

1.3.4. Loan Range Of Microfinance

In general, MFIs are offering two types of loan:

1. Group lending
2. Individual lending

Group Lending is a type of loan for customers who don't have collateral. The loan is giving to a group of customers who each and everyone is responsible for the repayment of each member's loan. In fact, the group itself is social collateral which the group members guarantee the repayment of each other. As Figure 2 indicates that Group loans range from 5,000–40,000 AFN.

Individual lending is the second type of loan offered by MFIs for people who require a higher amount of loan and have physical collateral such as a deed of an owned house or property, documents of his/her car. The loan amount ranges from 15,000-500,000 AFN.

Figure 2: MFIs Loan Range in Afghanistan

Source: *FMFB-A, 2020c*

Based on the market demands, some of the Microfinance in Afghanistan have launched SME loans as well for their customers. As the largest MFI (FMFB-A) in Afghanistan, the SME loans range starts from AFN 500,001 to 15,000,000 or equivalent to USD (FMFB-A, 2020c).

1.3.5. Concept Of Interest Rate In Microfinance Institutions

The interest rate charged by Microfinance agencies is called a service charge or administrative fee. MFIs are charging interest rates for the purpose of covering the cost of operation and service delivery. Interest rate amount is used for paying staff salary, office rent, purchase of equipment, transportation, security, and some other costs.

MFIs in Afghanistan charge between 1.25% and 1.5% per month. In Addition, in Afghanistan, the charge fee mount barely covers the operation cost of MFIs due to instability and ongoing conflicts in the country. Compared to other countries like India, Bangladesh, and Pakistan, the operation costs, administrative expenses, and staff salaries are higher. An Afghan loan officer receives twice or three times higher salary than other loan officers in the south Asian region. Moreover, most loan officers in Bangladesh, India, and Pakistan use bicycles or motorcycles for fieldwork while in Afghanistan due to tougher terrain, weather, and security conditions, loan officers are forced to use cars (MISFA, 2020b).

There are practical reasons behind why MFIs don't remove interest rates or why government or donors can't subsidize some of MFIs' operation costs so poor people will not be required for paying the interest rate. One of the main reasons is the sustainability of MFIs in the long term because if a microfinance agency cannot become self-sustainable it will be forced to stop operation due to being bankrupt.

The second point to be noted is that government and donors cannot afford to continually subsidize in long term. Also, foreign financial assistance to Afghanistan is gradually decreasing each year. So, MFIs cannot strongly rely on the funds of the international community which definitely is not on a permanent base.

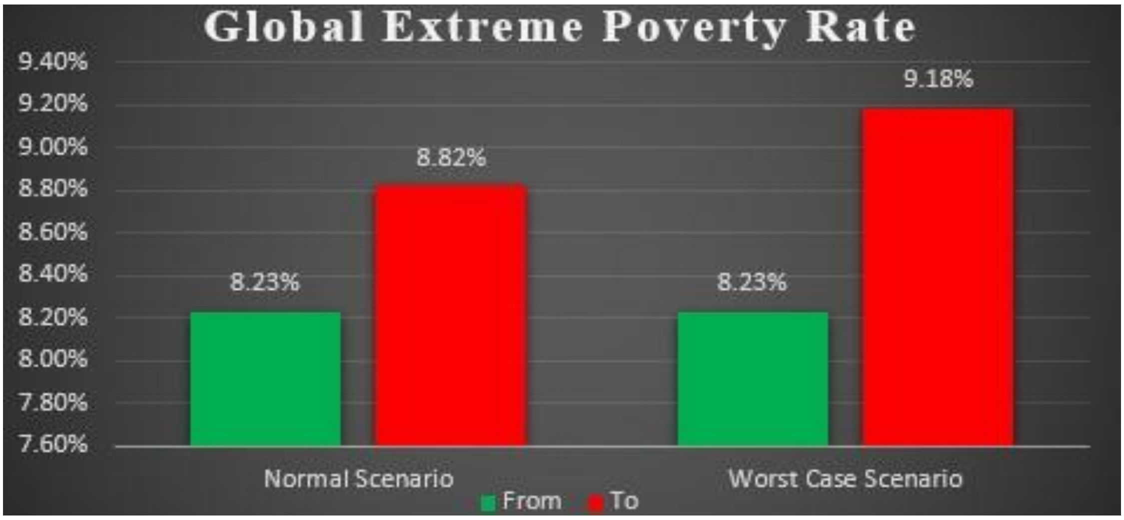
Due to all these reasons, it is significantly vital that MFIs charge a reasonable administrative fee for providing financial services because MFIs will be able to cover their operation and other costs. By charging the administrative fee MFIs will have a better chance of surviving in the long term on their own and they will not be forced to depend on government and donor's money (MISFA, 2020b).

1.3.6. Importance Of Microfinance Institutions

Simanowitz (2008) states that Microfinance activities and practices in Afghanistan have massively helped borrowers to have a much better economic condition. The Financial Services of MFIs have helped people economically but also to have access to health, education, and housing or land. The report indicates that 72% of borrowers have seen a positive improvement in their economic situation. Overall, Micro finances are playing a significant role in improving economic well-being, poverty reduction, job creation, access to health services, and women empowerment in a country.

The World Bank's report (2020), claims that the impacts of COVID-19 (Corona Virus) on poverty and economic well-being of people are going to be quite massive. The report shows that this crisis (COVID-19) could make 71 million people into extreme poverty in the normal scenario and the figure could go even higher in the worst-case scenario up to 100 million people. Countries that are already struggling with high poverty rates and numbers of poor people especially South Asian countries will be affected very significantly. Therefore, with this circumstance, Microfinance can be very crucial even more than before for poverty reduction. In addition, as Figure 3 indicates the global extreme poverty rate in the normal scenario would increase from 8.23% to 8.82% and in the worst-case scenario at 9.18%. Since 1998, it is the first time that there is such an increase in global extreme poverty.

Figure 3: Global Extreme Poverty Rate 2020



Source: *The World Bank, 2020*

Charitonenko (2005) says that poor people definitely need to have access to credit without collateral or with minimal collateral. Therefore, Microfinance benefits the poor by providing a different range of financial products and services. Microfinance agencies can be very useful for helping poor people in different aspects as below:

- Increase in household earnings
- Improved buying power of basic necessities: food, shelter, clothing; as well as manage shocks, such as sickness.
- Ability to build assets—for example, buy land, or save money—which gives them future security
- Helping in natural disasters, or emergency (Medical issue)
- Self-employment
- Regular source of income

In addition, another point that makes MFIs so valuable is that according to MISFA’s report (2020), the majority of borrowers prefer to take loans from MFIs rather than local lenders such as family, relatives, and friends. Many customers believe that taking loans from MFIs saves them from the social disgrace of not having money to survive. Therefore, this cultural aspect also increases the value of MFIs in the community.

1.4. Well-Known Microfinance Institutions In The World

According to Maverick (2020), there are the five largest and most influential microfinance institutions in the world are listed below. Besides these five microfinance institutions in the world, there is another well-known organization by the name of "51 Give" which was founded in 2007 in Beijing capital of China. This organization provides microfinance solution services and facilitates donations or investments for other micro finances in the world. In addition, 51 Give also offers an e-commerce platform which is an online and mobile technology where it tries to connect individuals, companies, organizations with the local MFIs.

- Aga Khan Agency for Microfinance (AKAM)
- Bangladesh Rural Advancement Committee (BRAC)
- Bank Rakyat Indonesia
- Grameen Bank
- Kiva

Aga Khan Agency for Microfinance (AKAM): a group of financial institutions which is full-fledged microfinance banks operating in over 15 countries throughout the developing world especially in Asia, the Middle East, and Africa such as Afghanistan, Kyrgyz Republic, Pakistan, Tajikistan, Egypt, Syria, Burkina Faso, Côte d'Ivoire, Mali, and Madagascar. AKAM was established as a part of the Aga Khan Development Network (AKDN), for reducing poverty, diminishing the vulnerability of poor people, and alleviate economic and social exclusion. AKAM's microfinance offers full-fledged microfinance services such as housing loans, agricultural lending, savings, remittances, small & medium enterprises (AKDN, 2020a).

Bangladesh Rural Advancement Committee (BRAC): BRAC is one of the global leaders of MFIs for providing opportunities for the poor people not only in Bangladesh but all over the world and it is one of the oldest MFIs which was founded in 1972 in Bangladesh. It is always been trying to be a tool where poor people be able to create a life, they want for themselves, their families, and their communities. In addition, BRAC provides a broad range of services in different areas such as human rights, education, health, and economic development including grants and small business loans in more than 11 developing countries in Asia and Africa (BRAC, 2020).

Bank Rakyat Indonesia: is the oldest Indonesian Bank which was established in 1895 in Jakarta by Mr. Raden Aria Wiriatmaja. Since its establishment, the bank has always been focusing on providing Microcredit and SME loans to the country. Bank of Rakyat has the record of being the most profitable bank in 13 consecutive years in the country for providing SME and Micro-loans. Currently, Bank Rakyat Indonesia is the largest financial institution in the country and one of the very well-reputed financial providers in the world. Also, 56.76% of its share is owned by the government of Indonesia. In addition, Bank Rakyat has more than 30 million retail banking customers with more than thousands of branches in the country (Bank Rakyat Indonesia, 2017).

Grameen Bank: was founded in 1983 by a Muslim Professor who is a Nobel Peace Prize winner in Bangladesh by the name of Prof. Muhammad Yunus. The concept of Microfinance was developed and reintroduced by him through Grameen Bank for the purpose of providing Micro banking and credit services to poor people without any collateral in order to alleviate poverty. In 2019, Grameen Bank had 9.60 Million Borrowers which 97% of them are women. Also, Grameen Bank had 2,568 branches throughout the country covering 81,678 villages in Bangladesh (Grameen Bank, 2019).

Kiva: was established in 2005 with headquartered in San Francisco. It is a nonprofit Microfinance agency providing interest-free financing for small businesses, education, and health services such as clean water in more than 80 countries on 5 continents worldwide. In 2020, Kiva has disbursed more than $1.5 billion micro-loans to 3.7 million borrowers, and 81% of the clients are women. In addition, through Kiva 218 thousand borrowers gained access to clean energy, 918,381 farmers were supported and 66,416 students completed their educations (Kiva, 2020).

1.5. Success Stories Of Microfinance In The World

For many people, data and stats seem boring and hard to remember, while stories are interesting which people most likely remember a story than numbers and stats. In addition, retaining clients with the organization is a very crucial task to do. Therefore, organizations can also strengthen the relationship with their customers through client's success stories. Besides that stories are most likely to be retained longer than number and stats, success stories are also very essential to organizations due to the contribution to the below points:

- Increasing Sales of organization
- Helps with Enhancement of a Product or Service
- Helpful with Marketing Campaigns
- Identify Common Problems
- Create Trust and Credibility

1.5.1. Story 1: Lola Jobirova A Microfinance Client Of AKAM

When Lola Jobirova got married, she moved to the capital city of Tajikistan Dushanbe from a rural area of the Varzob district. For the purpose of supporting the family and paying school fees for her four children, she started working with her mother-in-law who was stitching and selling mattresses. Due to the crisis in her business, she needed to apply for a loan. She had a bad experience with commercial banks and other financial service providers, but financial pressure from business and her family left her with no choice.

Mrs. Jobirova heard about AKAM's branch in Tajikistan. In 2004, for the first time, she applied for a loan of TJS 6,000 ($2,070). She enjoyed quite good growth in her business. Therefore, over the next 8 years, she has taken 15 loans from the same microfinance agency. The largest amount she took from AKAM's branch of Tajikistan was TJS 400,000 ($80,000). She invested the money in importing raw materials, diversifying her products, purchasing new sewing machines, and shifting the business to a bigger and better commercial location. These investments paid off significantly. Thus, now she has a contract from government institutions, schools, and large regional companies.

In addition, in 2013, she also applied for a loan of 168,000 ($35,000) for her husband in order that he will be able to open a new convenience store for himself. Currently, Lola Jabirova is a financially independent woman who provides jobs for other women and family members. With the support of AKAM's credit Program, she managed to increase the daily profit from TJS 350-400 before her first loan, to TJS 1,500 today.

As a mother, her children's quality education and bright future have always been her ultimate goal. she said that AKAM's loan programs contributed tremendously to achieve financial security and helped her to fulfill her social obligations and gain a good reputation within the community. Also, with the help of the microfinance agency, she was able to cover the expenditure of the weddings of her two daughters. Moreover, she purchased her own house for her two sons and moved from a rented small apartment to a beautiful two-story house. Furthermore, she was also able to save more than TJS 70,000 ($10,000) for emergency cases or in case of any financial hardship.

Right now, Lola's business is completely self-sustainable which means she no longer needs any loan. Lastly, she has high praises for AKAM. She says that it was a completely new experience that supported me in establishing and growing my own business. She says that transparency and great guidance with different financial services make AKAM a different experience than any other microfinance agencies. She ended by saying that it would have been never possible to achieve all these things without the support of this microfinance institution in Tajikistan (AKDN, 2020b).

1.5.2. Story 2: Her Hands Trembled When She Borrowed Her First Loan Of $64

Mrs. Maloti is one of BRAC's 5 million customers from Bangladesh in the microfinance sector. She has married 13 years ago to Nikhil Das, who by profession is a carpenter which owns a small wood business. She is the mother of a son and a daughter and currently, she is living with her husband, two children, and her in-laws all together in Manikganj a District in central Bangladesh which is a part of the Dhaka Division.

She was in the 10th class of school while her parents got her married to Nikhil Das. After marriage, for the purpose of earning and supporting her husband financially, she started to teach primary classes to school children. After two years of her marriage, her son was born. Therefore, she was forced and had no other choice than to leave the job. This situation put a lot of pressure on the shoulder of her husband. As her son got older, she and her husband felt that the current income is not good enough so they were looking for any opportunities for adding some additional earnings.

After a while, they decided that the best possible option is to invest and expand the wood business. That's when they heard about BRAC from one of their neighbors which is a big and legal financial provider for poor people unlike the rest of the unofficial lenders they knew. She says that back in those days, it took a lot of courage to get the first loan as they heard so many bad things about financial providers and banks. She starts telling her first experience of taking a loan from any official source such as Microfinance agencies with a smile on her face. She says that her hands were trembling while she took the first loan of BDT 5,000 ($64) from BRAC 10 years ago.

She says that as the business did much better than I've thought, I repaid the loan within a few months and Borrowed a larger amount. Currently, her business is going quite well. Also, when her daughter was born, she opened a savings account for the very first time. Since then, she has deposited some small amount on monthly basis for the better future of her daughter.

In addition, she also thanks BRAC because right now she is not only using credit services but also using saving account facilities and mobile banking. She says before mobile banking, I had to come to the branch each and every time to deposit my savings. Now I can pay my loan, deposit, and transfer money on my cell phone which is a very cost-efficient and flexible way. She explained further that each time when she had to visit the branch for deposit or loan repayment, the cost was BDT 50 ($65 cents). Therefore, the integration of mobile banking into microfinance operations is so exciting and it saved both her time and money (BRAC, 2016).

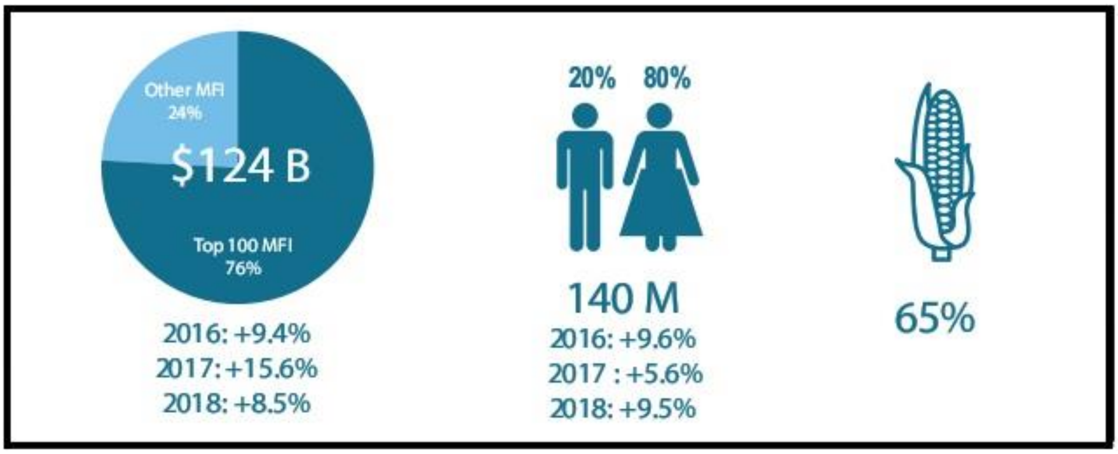
1.6. Development of Microfinance Institutions In The World

Over the decades, Microfinance agencies have developed tremendously all over the world especially in South Asian Countries. Experiences of Microfinance in the world have shown that Microfinance is a universal solution to the development of self-employment, providing credit to poor people, helping to achieve sustainable development goals, and contributing enormously to poverty reduction. In addition, some cases indicate, microfinance is also key for transforming vulnerable people into wealth creators.

(Convergences, 2019) In the last ten years, Microfinance agencies have disbursed hundreds of billions of dollars globally. Meanwhile, the number of borrowers is continued to increase worldwide. The annual growth rate of Microfinance agencies in the world for the last five years is 11.5%.

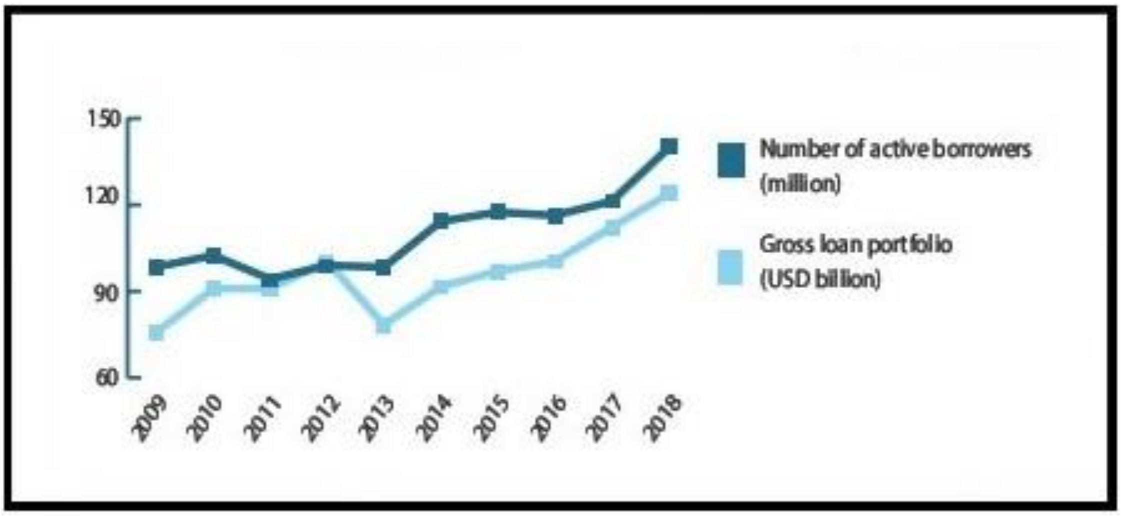
In 2009, the target customers of Microfinance agencies were just 98 million around the world but over the years the number of borrowers has been growing significantly. Figures 4 & 5 show that in 2018, 139.9 Million people which includes 80% of women and 65% of rural borrowers, took advantage of the services of Microfinance agencies with an estimated credit portfolio of $124.1 Billion. Also, it is expected that the number of borrowers worldwide continued to grow even more in the coming years (Convergences, 2019).

Figure 4: Credit Portfolio Worldwide 2018



Source: *Convergences, 2019*

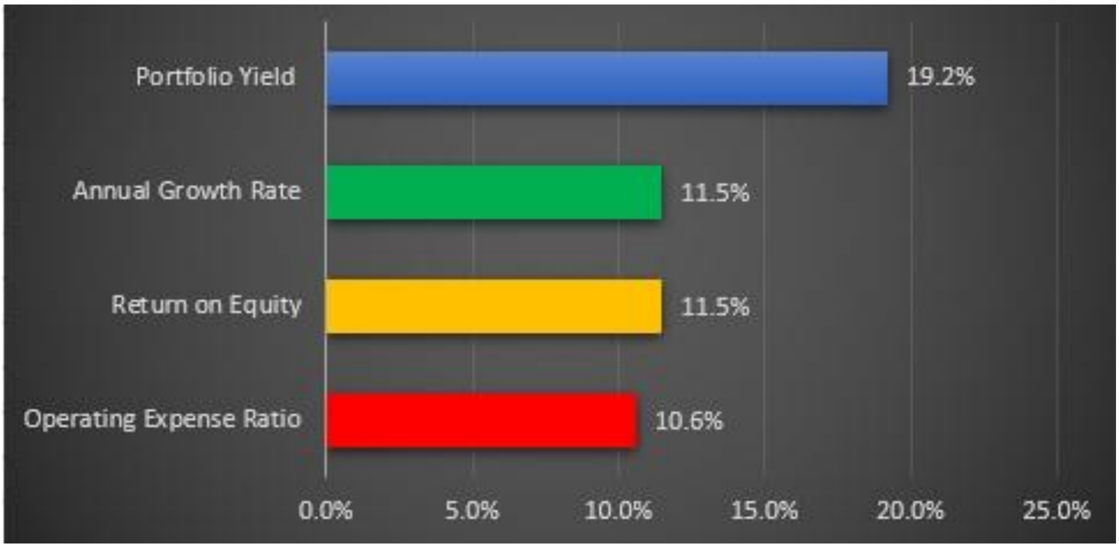
Figure 5: Growth of Number of Borrowers Since 2009 Till 2018



Source: *Convergences, 2019*

At the end of 2017 as Figure 6 indicates that the portfolio yield of Microfinance agencies was 19.2%. Meanwhile, the return on equity of MFIs was 11.5% which in the 2018 MFIs had growth in returns on assets by (+1.3 points) and equity by (+2.9 points). The operating expense ratio of MFIs in 2017 was 10.6% (Convergences, 2018).

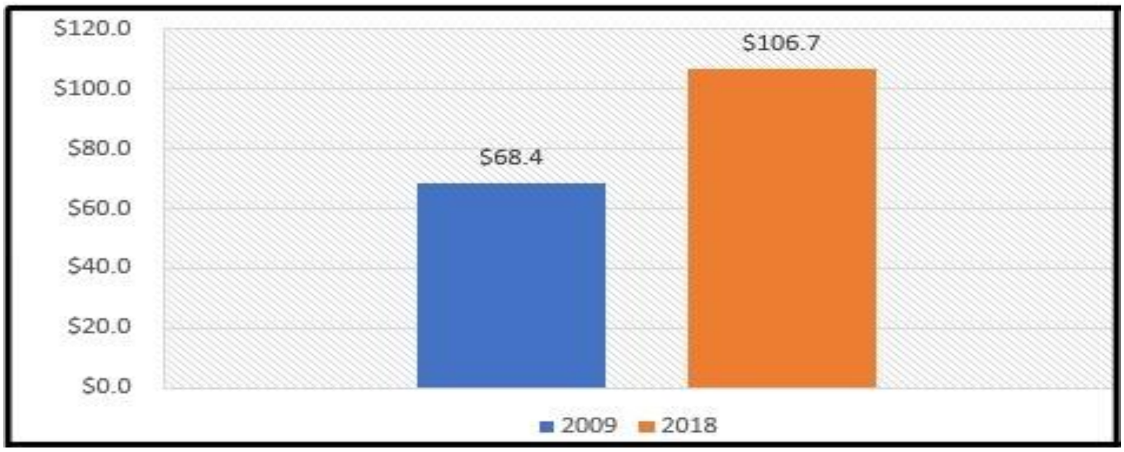
Figure 6: MFIs Global Average Performance Ratios In 2017



Source: *Convergences, 2019*

In 2018 microfinance institutions had (+8.5%) growth compared to 2017. Also, as Figure 7 shows that over the ten years, the cost per borrowers such as administration, operation, service delivery, and other costs have increased (+56%) from an average of $68.4 in 2009 to $106.7 in 2018 (Convergences, 2019).

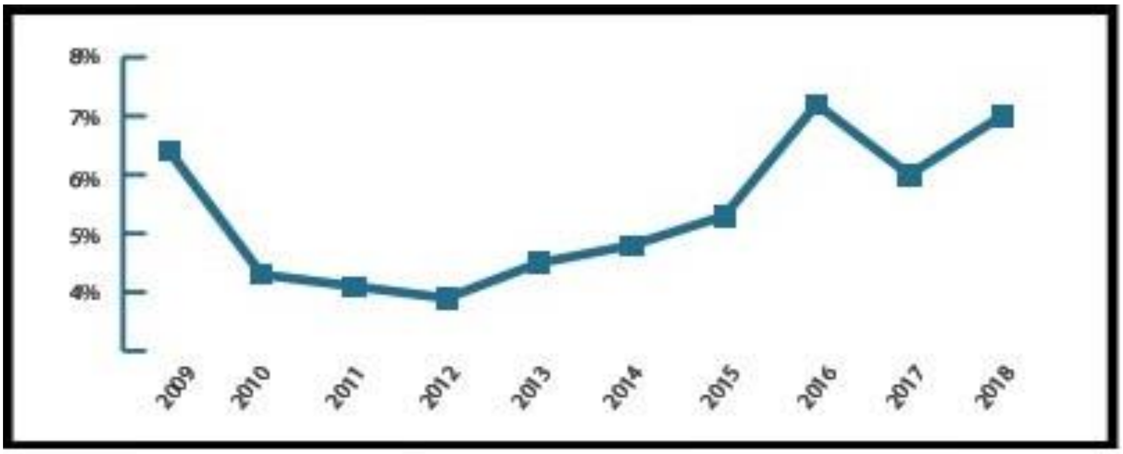
Figure 7: Cost Per Borrower of MFIs (2009 – 2018)



Source: *Convergences, 2019*

Furthermore, as Figure 8 indicates that between 2009 to 2018 there was a slight deterioration in Portfolio at risk (PAR) over 30 days or in commercial banking terms Non-Performing Loan (NPL) of MFIs over 30 days have increased from 6.4% in 2009 to 7% in 2018.

Figure 8: Evolution of Portfolio at Risk > 30 Days



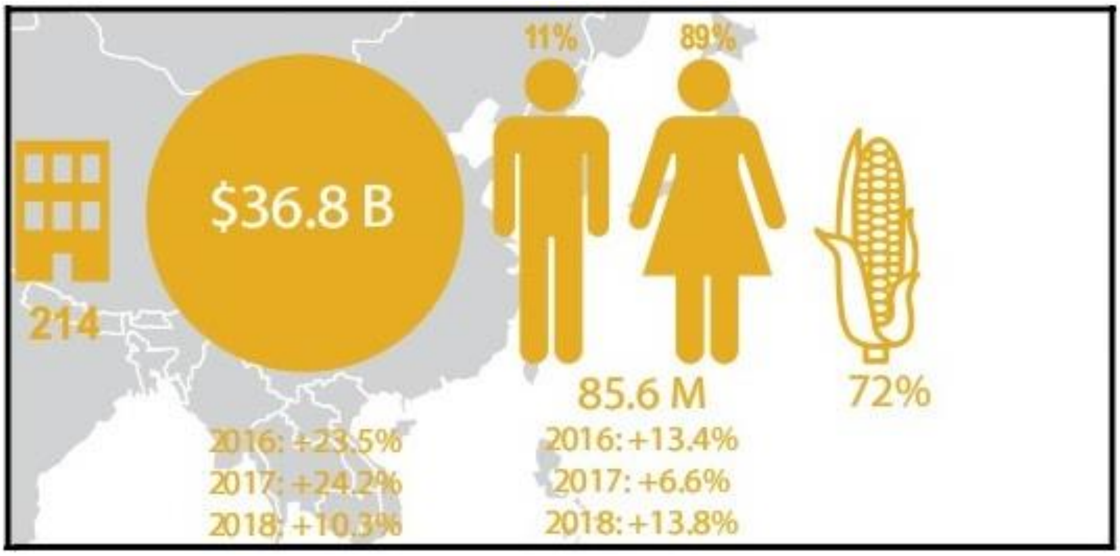
Source: *Convergences, 2019*

1.6.1. Key Figures of Microfinance Institutions in The World by Regions

Convergences' report (2019) claims South Asian Countries are leading in terms of the number of borrowers worldwide by having the largest number of borrowers 85.6 Million people which includes 89% of female clients and 11% of male borrowers. Moreover, the number of borrowers in this region has grown faster than any other regions between 2017 and 2018 by (+13.8%). Thus, right now this region has the top three markets such as India, Bangladesh, and Vietnam in terms of borrowers in the world.

As Figure 9 shows that in 2018 the credit portfolio of South Asian countries was 36.8 Billion dollars which in fact it makes the south Asian countries the second in terms of credit portfolio in the world. There are 214 microfinance institutions having an operation in the region. Also, 72% of clients in south Asian countries are located in rural areas.

Figure 9: Credit Portfolio and Number of Borrowers of South Asian Countries 2018

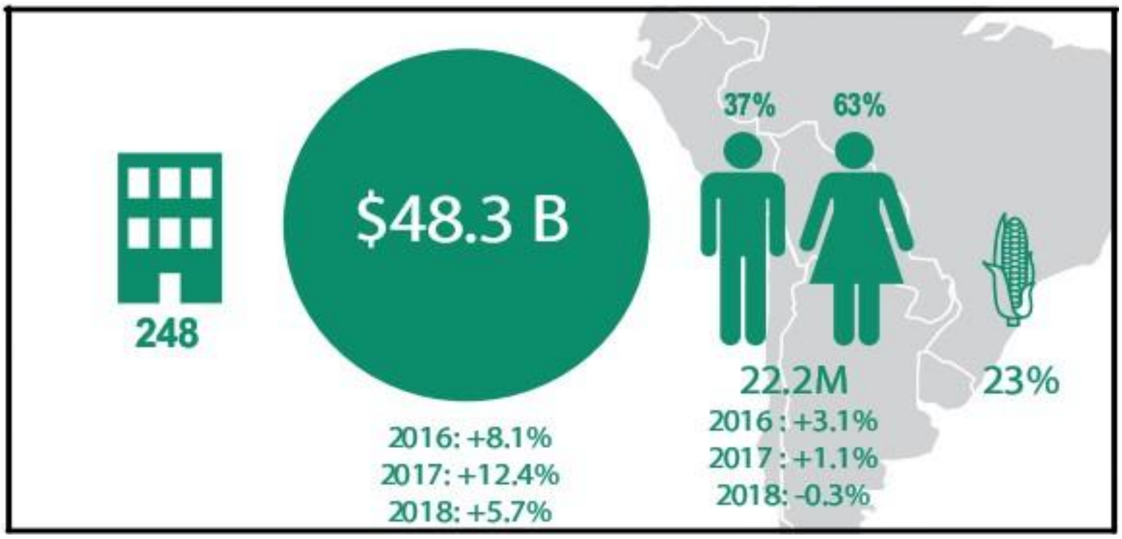


Source: *Convergences, 2019*

As Figure 10 displays that in 2018, Latin America and the Caribbean region have the largest Credit Portfolio in the world with having 48.3 billion dollars and 248 microfinance institutions are working in this region. Also, it is the second in the world in terms of the number of borrowers which is 22.2 million people which includes 37%

male clients and 63% female clients. Also, 23% of customers are living in rural areas (Convergences, 2019).

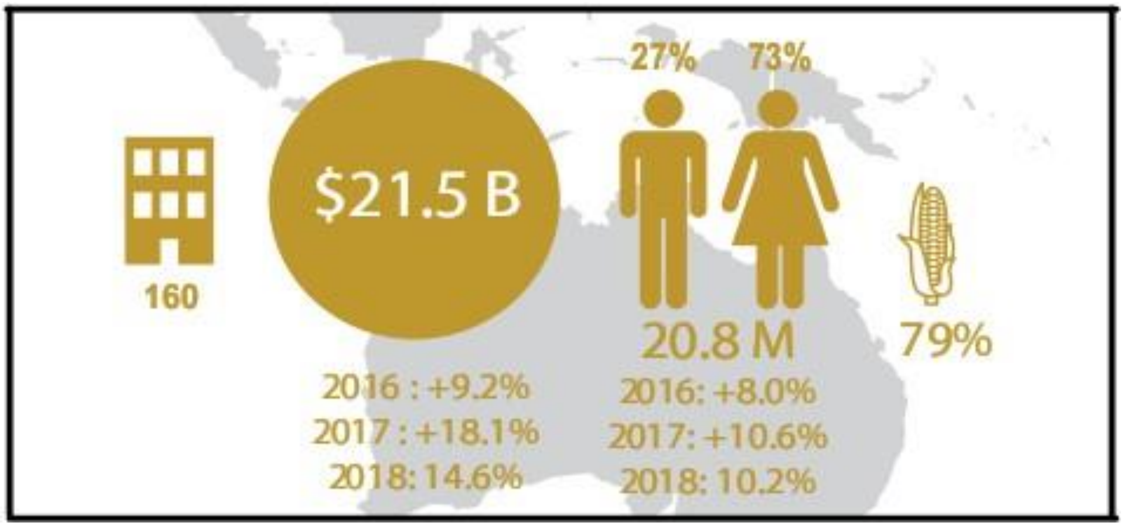
Figure 10: Credit Portfolio and Number of Borrowers of Latin America and Caribbean 2018



Source: *Convergences, 2019*

East Asia and the Pacific region are the third in the world in terms of credit portfolio of 21.5 Billion dollars and the number of borrowers which is 20.8 million people including 27% of male clients and 73% of female clients. Besides, as Figure 11 shows that 79% of all the customers are located in rural areas in this region with having 160 microfinance institutions having an operation (Convergences, 2019).

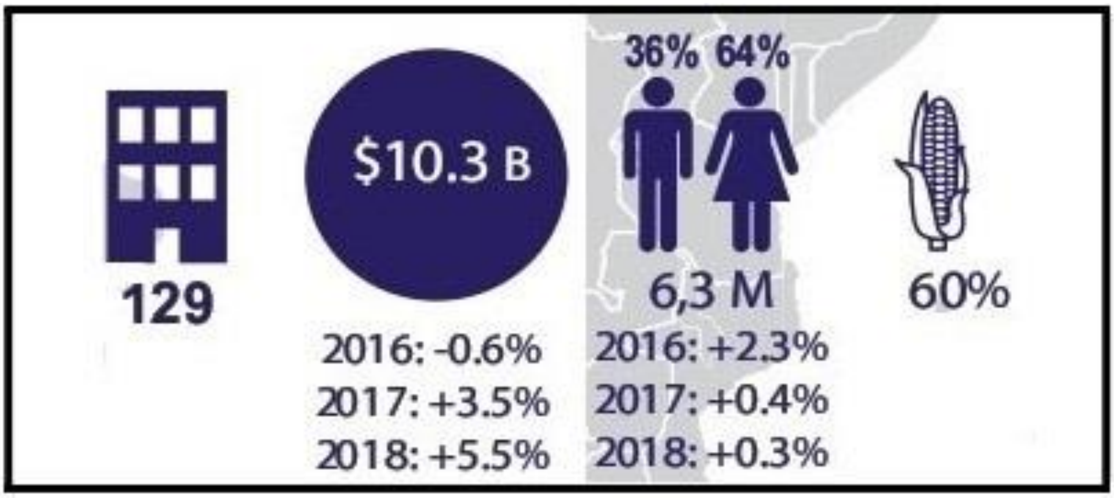
Figure 11: Credit Portfolio and Number of Borrowers of East Asia and Pacific 2018



Source: *Convergences, 2019*

In Africa, the credit portfolio of Microfinance institutions was 10.3 Billion dollars with 6.3 million number of borrowers which is consists of 36% male clients and 64% female clients. Figure12 indicates that 60% of customers are located in rural areas. In this region, 129 microfinance institutions are active in providing financial services (Convergences, 2019).

Figure 12: Credit Portfolio and Number of Borrowers of Africa 2018

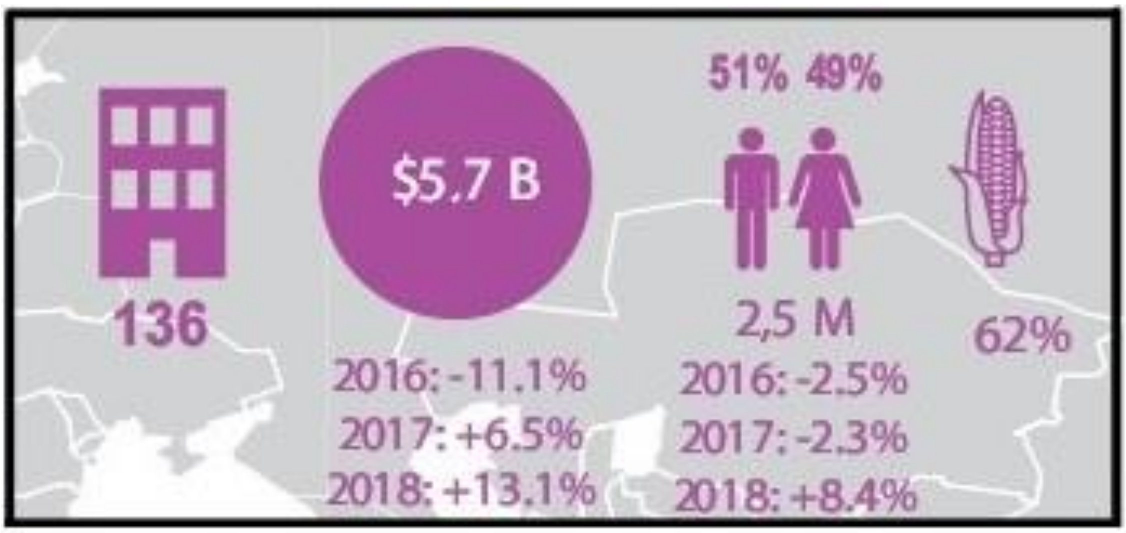


Source: *Convergences, 2019*

In Eastern Europe and Central Asia, the total credit portfolio of MFIs is 5.7 Billion dollars and the number of borrowers in these regions is 2.5 million people which contains 51% of male clients and 49% of female clients. In addition, as Figure 13 shows that 62% of all the borrowers in these regions are located in rural areas. There are 136 microfinance institutions providing different types of financial services and products. In Eastern Europe and Central Asia, there has been a 30% increase from 2012 till 2018 in terms of the number of borrowers. Besides, these two regions are the regions with the lowest proportion of women borrowers in the world (Convergences, 2019).

Note: women are the most reliable target customers among all others in terms of repayment of the credit and they are most likely using their extra income for improving the quality of life of their children and families. Therefore, Microfinance institutions have exceptional attention to serve particularly for women who are entrepreneurs or who have a stable source of income (Swope, 2010).

Figure 13: Credit Portfolio and Number of Borrowers of Eastern Europe and Central Asia 2018



Source: *Convergences, 2019*

The middle East and North Africa have the lowest Credit Portfolio of 1.5 billion dollars and the number of borrowers 2.5 million in the world. In the case of the gender of clients, 40% of clients are male and 60% of them are female borrowers. As Figure 14 indicates There are 29 registered microfinance agencies working and also, 62% of the customers are from rural areas of these regions (Convergences, 2019).

Figure 14: Credit Portfolio and Number of Borrowers of the Middle East and North Africa 2018

Source: *Convergences, 2019*

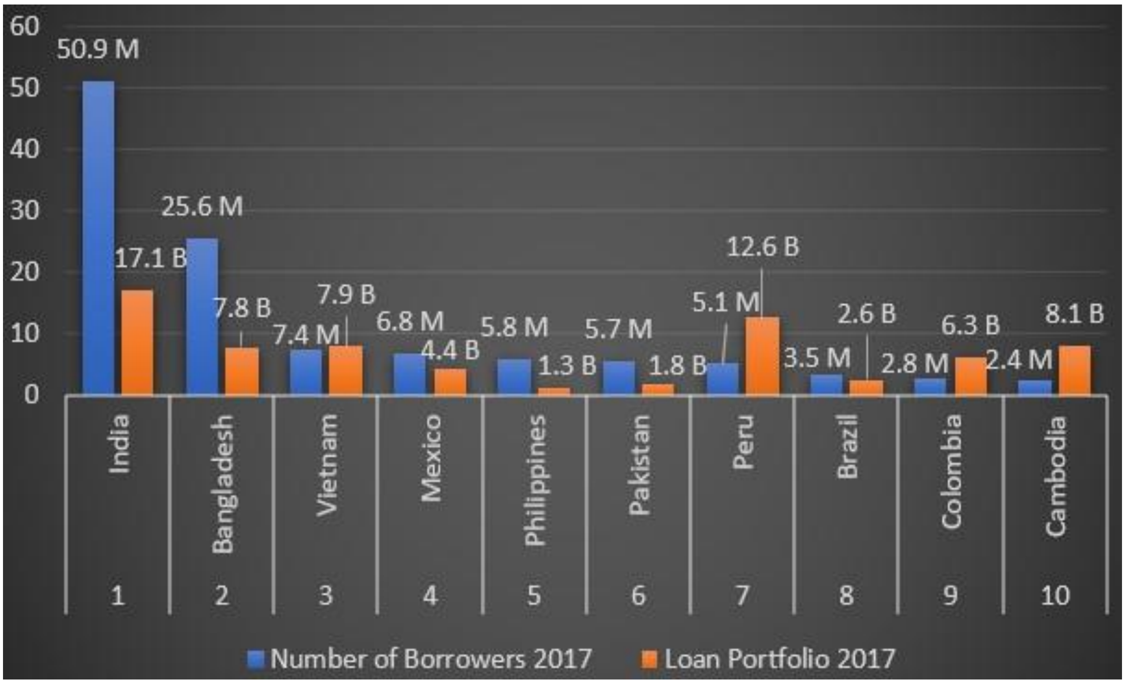
1.6.2. Leading Countries of Microfinance by Number of Borrowers

In 2017, India was ranked first in the world in terms of having the largest number of borrowers with having 50.9 Million people served by Microfinance agencies. Since 2016, Microfinance institutions in India have had a 5.8% growth in their number of borrowers. Meanwhile, there was a 26.3% growth in their loan portfolio. In 2017, the Loan Portfolio of India was 17.1 Billion dollars.

Bangladesh was ranked second in terms of the number of borrowers with having 25.6 million people in the world. Since 2016, there has been a 3.5% growth in the number of borrowers and 17% growth in the loan portfolio in Bangladesh. In 2017, the loan portfolio of Bangladesh was 7.8 Billion Dollars.

Figure 15 indicates that Vietnam has secured third the position in terms of the number of borrowers in the world with having 7.4 million people who were the active borrowers of the microfinance institutions in 2017. In addition, Microfinance institutions in Vietnam had a slight growth of 2.8% in the number of borrowers since 2016, but they had better growth (18.9%) in the loan portfolio. In 2017, the loan portfolio of Microfinance institutions were 7.9 billion Dollars (Convergences, 2018).

Figure 15: Top 10 Countries by Number of Borrowers In 2017



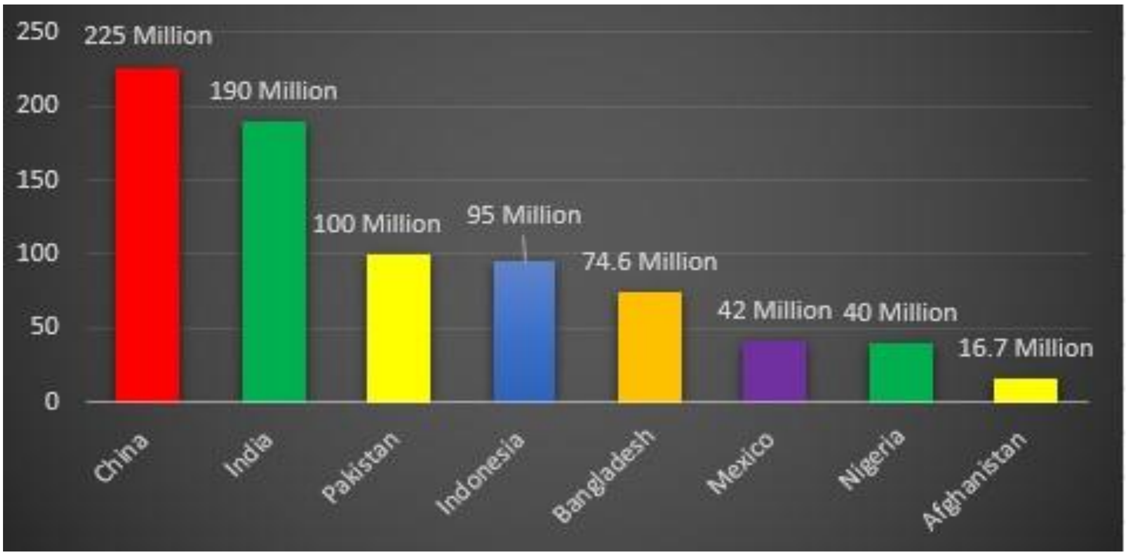
Source: *(Convergences, 2018)*

1.6.3. The Untapped Potential Of Microfinance In The World

One of the reasons for poverty in any community is that majority of its people have remained unbanked. They do not receive any kind of financial services such as micro-credit, savings, commercial loans, etc. Compared to recent years, the number of unbanked people in the world has slightly decreased. In 2017 the number of unbanked people was 1.7 billion globally while in 2014 it was 2 billion people. As Figure 16 shows, China has the largest unbanked population in the world, followed by India, Pakistan, and Indonesia. These four countries combined with the other three countries such as Nigeria, Mexico, and Bangladesh almost make half of the world's unbanked population (Convergences, 2019).

Nosher (2020) as the Acting Governor of the Central Bank of Afghanistan claims that Afghanistan is also one of the countries with the highest number of financial exclusion country in the world. Almost 85% of Afghanistan's population is unbanked and do not receive any type of financial services from any financial institutions such as Microfinance agencies, Commercial Banks, and State Banks. Inadequate financial services that do not meet the needs of low-income people, security concerns, religious and cultural beliefs, and lack of trust in the financial sector are the main factors why a high number of people is unbanked in Afghanistan.

Figure 16: Unbanked Countries in the world by 2018



Source: *Author's Calculation*

1.7. Key Principles of Microfinance

Consultative Group to Assist Poor (CGAP) which is administered by World Bank as a trustee with completely different governance and funding structure was founded in 1995 in Washington, D.C., United States of America (CGAP, 2020). Currently, CGAP has a global partnership with more than 30 leading development organizations, multilateral agencies, worldwide Microfinance institutions, and other top financial institutions around the world. The vision of CGAP is a world where poor people also like everybody else should have access to financial services. It has been working with many leading organizations around the world to empower poor people especially women through financial services in order to bring positive changes in the social and economic condition of poor people. According to CGAP key principles of Microfinance institutions are as below:

1. **"Microfinance Is Not Always The Answer" (CGAP, 2004).** Small loans or Microcredit programs are not suitable for everyone and every circumstance. It may be applicable for most poor countries, but it cannot be beneficial for each and every poor country. In countries with tremendous poverty where people are struggling with hunger and have no income at all, Microfinance cannot be the right instrument against poverty and people with no income are not able to repay the loans. Thus, before using loans, they need other forms of support. In many cases, non-financial services such as infrastructure development, employment, training programs, and small grants are more beneficial for reducing poverty (CGAP, 2004).

2. **"Poor people need not only credit (Loan), but also other financial services" (CGAP, 2004).** A loan is not the only thing that can satisfy the needs of low-income people, because there is also demand in less privileged communities for other financial services such as savings, deposit, insurance, cash transfer. These financial services should be convenient, flexible with rational prices depending on the social and economic situation of poor people. Simply, in other words, poor people just like everyone else should also have the full right of access to all financial services (CGAP, 2004).

3. **“Microfinance is one of the most powerful tools against the reduction of Poverty” (CGAP, 2004).** Having the right of using financial services helps poor people in terms of establishing small enterprises, growing their incomes, building their properties, expanding their business, and reducing their vulnerability against poverty or other financial dangers. Basically, financial services will permit poor households to shift their lives from everyday survival to better, improved, and quality living conditions. Also, these changes will have positive impacts on children’s health and good education. Eventually, after having access to Micro finances, there will be automatically a better society in terms of economic and social (CGAP, 2004).

4. **“Financial sustainability of MFIs is the key in order to achieve its full potential of reaching a large number of poor people” (CGAP, 2004).** Many poor people cannot have access to financial services due to the lack of sustainability of Microfinance institutions. Microfinance Institutions should be financially sustainable in order to reach an enormous scale of borrowers and should have a positive impact on poor people’s lives. Financial sustainability means that Microfinance institutions should be able to cover all of their costs. When Microfinance is financially sustainable, they can expand their operation and reaches the unbanked poor people. Ultimately, Microfinance institutions will be able to meet customer needs by offering flexible and innovative products and services (CGAP, 2004).

5. **“Microfinance aims to build a financial system which only serves poor people” (CGAP, 2004).** The populations of underdeveloped and developing countries are made of an enormous portion of low-income (poor) people. Yet, the majority of these people don’t have access to basic financial services. Unfortunately, in most countries, Microfinance is considered a marginal sector and is giving less importance to other sectors. Therefore, it has less influence on the people and economy of the country. Microfinance should be considered as an essential part of the financial sector because only that way it will be possible to achieve its full potential of reaching an enormous number of poor people (CGAP, 2004).

6. **“One of the goals of Microfinance should be building permanent local financial institutions” (CGAP, 2004).** In long term, there should be always domestic financial institutions that can serve poor people of that society with a different type of financial services on a permanent basis. In addition, those domestic financial institutions should be able to mobilize and recycle savings, extend credit, and provide a different range of financial services. For building domestic financial institutions funding from donors, support of the government, and assistance of financial development banks will be important (CGAP, 2004).

7. **“Interest rate ceilings can cause poor people to not use financial services” (CGAP, 2004).** In fact, it costs significantly more to lend many small loans than a large number of loans. Nevertheless, Microfinance charges interest rates higher than commercial banks, they cannot cover all their costs and their financial sustainability will be depended on funds and donors. Besides, Microfinance institutions should not charge their operation inefficiencies to clients in the other type of prices (interest rate plus other fees) (CGAP, 2004).

2. CHAPTER TWO:
MICROFINANCE EXPERIENCES IN AFGHANISTAN

The financial system of Afghanistan was completely affected negatively due to war in the country for many decades. In 2001, with the creation of a democratic government after the fall of the Taliban regime, the financial system of Afghanistan experienced its new era. The government of Afghanistan due to the absence of domestic Microfinance asked International NGOs and international financial institutions to establish Microfinance for the very first time in the country. In 2002, Microfinance started working in Afghanistan as a part of the rehabilitation process in order that the government should have social protection and be able to provide the basic financial need of citizens for the purpose of improving the income of poor people.

In 2003, In order to build a channel that can connect international donors with Microfinance institutions for the purpose of receiving funds and other technical assistance, the Government of Afghanistan established the Microfinance Investment Support Facility for Afghanistan (MISFA) under the Ministry of Rural Rehabilitation and Development.

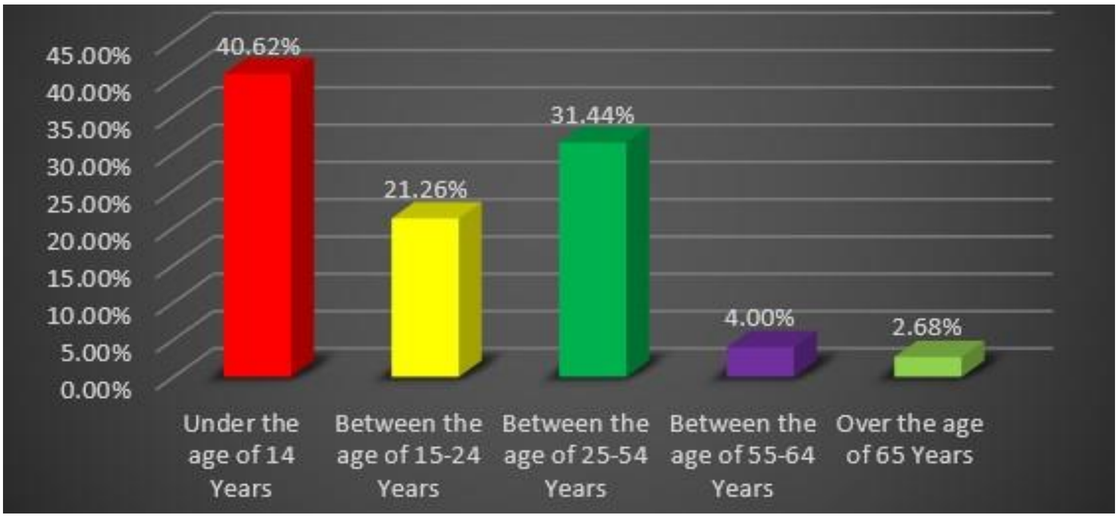
Since establishment, Microfinance institutions in Afghanistan have experienced quite significant growth and development in terms of the number of customers, geographical outreach, women empowerment, job creations, and providing different type of financial service and products to poor people. Although Microfinance institutions have contributed enormously in different aspects, many challenges such as Islamic beliefs, lack of security, and corruption have stopped them from better and further contributions to the country.

As of June 2020, Microfinance Agencies in Afghanistan had operations in 14 provinces and 81 districts around the country through 143 financial centers or branches with having 2,670 employees. In addition, in 2019 more than 7 Microfinance institutions, 12 Commercial Banks including 3 State Banks, 7 Private Banks, 2 Foreign Banks, and more than 5 small financial agencies were actively working in Afghanistan (DAB, 2019).

2.1. Afghanistan: Country Background

Afghanistan is a country located in South Asia which has a 91 Km border to China, 921 km to Iran, 2670 km to Pakistan, 1357 km to Tajikistan, 804 km to Turkmenistan, and 144 km to Uzbekistan. As Figure 17 shows, in July 2020 the estimated population of Afghanistan was more than thirty-six million which includes 40.62% under the age of 14 years, 21.26% between the age of 15-24 years, 31.44% between the age of 25-54 years, 4% between the age of 55-64 and only 2.68% over the age of 65 years. Afghanistan is made of different ethnic groups with the majority of Hazara, Tajik, Pashtun, Uzbek, and some other small groups such as Turkmen, Baloch, Nuristani, Pamiri, Gujar, Brahui, Qizilbash, Aimaq, Pashai, and Kyrghyz (CIA, 2020).

Figure 17: Age Structure in Afghanistan 2020

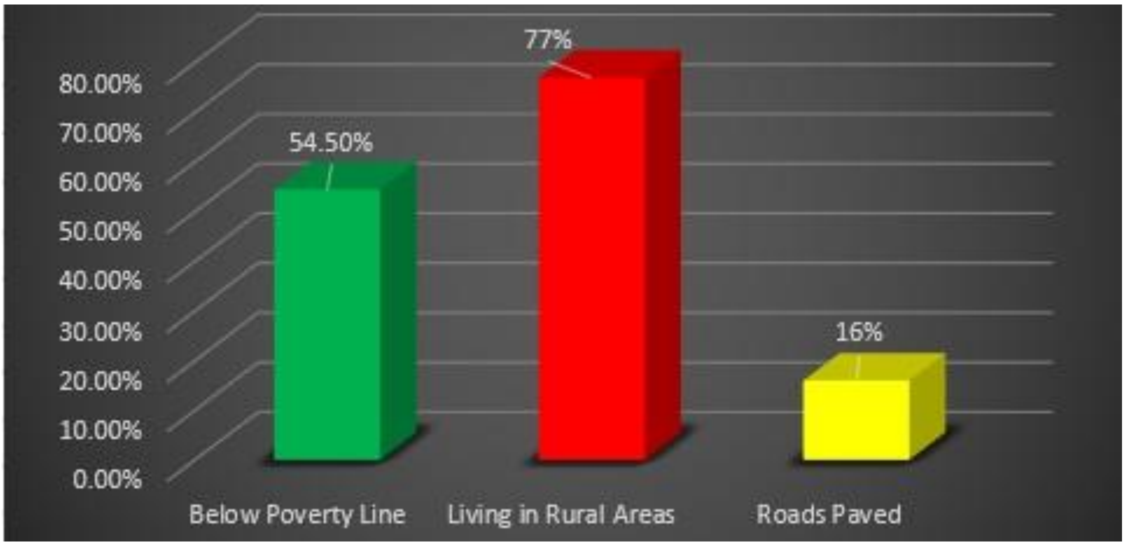


Source: *CIA, 2020*

According to the United Nations Development Program's (UNDP) Human Development Index, Afghanistan got the ranking of 168 out of 189 countries which ultimately proves that Afghanistan is one of the poorest countries in the world. Also, one-fifth part of the rural households in Afghanistan is tremendously poor which they are facing food insecurity throughout the year. Besides, as Figure 18 indicates that 54.5% population of Afghanistan is below the poverty line. In 2017, the unemployment rate in Afghanistan was 24% which was almost one-quarter of the country's labor force. Moreover, According to the World Bank (2020), the unemployment rate in Afghanistan has increased to 37.9% by the end of 2020. In recent years, employment in agriculture became more dominant in the labor market of Afghanistan with having 44% labor force working in this sector (Microfinanza, 2019).

Afghanistan is massively affected negatively by the internal conflicts and wars which has been undergoing for more than three decades. According to Hussein (2009), 77% of the population is living in the rural areas of Afghanistan. Therefore, Agriculture is one of the traditional activities that the majority of people in rural areas are busy with. Unfortunately, this sector has suffered immensely from three decades of war which caused the destruction of its infrastructure. Also, the agriculture sector in Afghanistan has been facing low investment by the government and other donors and sometimes suffers from natural disasters. Afghanistan with only having 16% of the roads paved, is one of the countries with the lowest kilometer of road per square kilometer. Therefore, half of the rural population are inaccessible for the part of the year due to heavy snows and rain. Consequently, there is a lack of quality education and an adequate level of health services.

Figure 18: Afghanistan's Poverty, Population in Rural Areas and Road Paved Percentage in 2020



Source: *CIA, 2020*

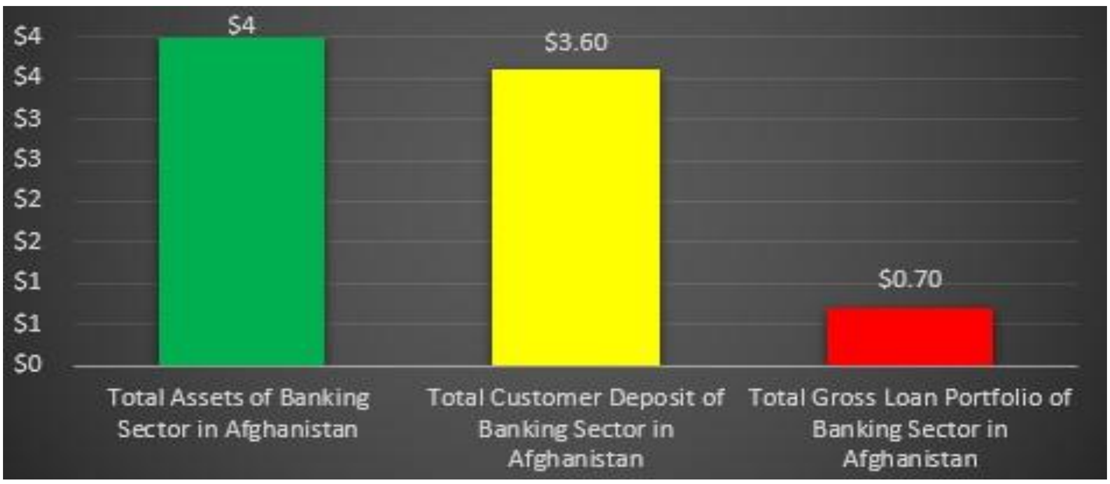
Central Intelligence Agency (CIA) of the United States of America's report (2020) declares that more than 15 terrorist groups are active in Afghanistan. Thus, many areas of Afghanistan are still under the control of terrorist groups and warlords. Consequently, Afghanistan lacks security in many provinces which have impacted economic growth and development.

2.2. Financial System of Afghanistan

In the last two decades, Afghanistan has experienced the worst possible scenario due to the civil war in the country for decades. The basic infrastructure system of the country such as transportation, communication network, electric and water supply system, and along with the financial system of the country has been destroyed enormously. Although, after the Taliban regime the economy of Afghanistan has entered into its new era by the huge inflow of foreign aid and other international investment in the country, Afghanistan's financial sector still remains in desperate need of massive improvements. According to The World Bank report (2018), the financial sector of Afghanistan is particularly weak in credit risk management, operational efficiency, over-staffing, and a lack of efficient and automated processes. Therefore, Afghanistan's financial system needs to bring so many changes in order to have a more diverse, profitable, and efficient financial sector like so many other developing countries have.

The World Bank (2018) has published that private banks are dominating the financial system of Afghanistan. As of the end of 2016, Banking sector assets represent 21 percent of the GDP of Afghanistan. In addition, as Figure 19 indicates, the total assets of the banking sector in Afghanistan including all 15 banks were $4 billion with customer deposits of $3.6 billion and a gross loan portfolio below $0.7 billion.

Figure 19: Total Asset, Deposit and Loan Portfolio of Commercial Banks of Afghanistan 2016

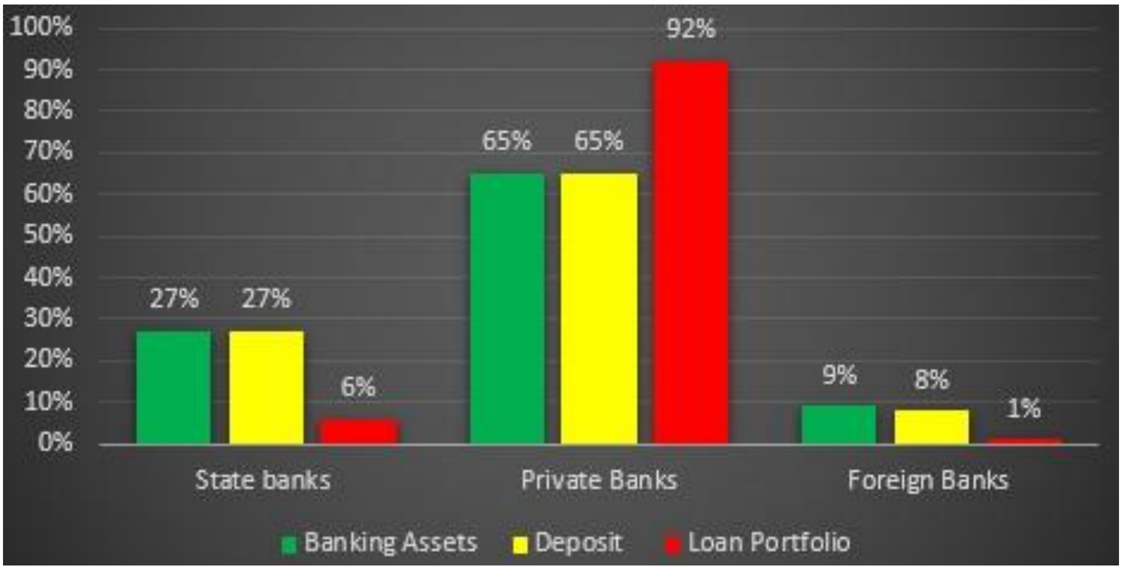


Source: *The World Bank, 2018*

All banks in Afghanistan are regulated and supervised by the Central Bank (DAB). Figure 20 shows that in 2016 three state-owned banks had 27% of deposits and 27% of banking assets with 6% of the total loan portfolio. Meanwhile, nine-private-owned banks were holding 65% of banking sector assets, 92% of the loan portfolio, and 65% of the sector deposits. Lastly, 3 Foreign commercial Banks were maintaining a 9% asset share, 1% share of the loan portfolio, and 8% deposit share of the financial market of Afghanistan (The World Bank, 2018).

In addition, for purpose of comparison between the loan portfolio of Microfinance and Commercial banks, the total loan portfolio Microfinance sector was almost 20% of the commercial banking sector's loan portfolio at the end of April 2017 (The World Bank, 2018).

Figure 20: Banking Asset Classification in Afghanistan 2016



Source: *The World Bank, 2018*

There are tremendous development opportunities in the financial sector of Afghanistan. A large scale of population in Afghanistan is unserved financially. Besides, there are eight provinces with no private banks at all. Thus, this opens the doors of opportunities in the country for international investors to capitalize on the low competition, and as there is a huge unserved market as well. Besides, as there is significant room for foreign direct investment the government can also increase the tax revenues (Waqas et al., 2018).

2.3. Banking History in Afghanistan

The banking sector of Afghanistan is one of the sectors which has massively been influenced negatively by three decades of wars and conflicts. Basically, the formal banking system of Afghanistan was completely collapsed. During the war, the banking sector of Afghanistan was heavily relying on Hawala System for money transfer. Due to not having any commercial banks operating in the country, it was the only effective payment system in the country. After the collapse of the Taliban regime in 2001, the banking sector of Afghanistan has started experiencing the new modern era by the creation of a democratic government in place (Hussein, 2009).

After the new democratic government in Afghanistan in December 2001, at that time only six licensed state-owned Banks were operating mostly in the capital (Kabul) of the country. The central bank of Afghanistan (DAB) with five other state banks were not practicing the commonly agreed and accepted accounting standards. Instead, they were following the 1994 Law on money and banking which was simply out the date and acceptance of international banking norms. Staff capacity was extremely low because managers and top-level management or the high hierarchy of the banks were all political appointees with no banking experience and knowledge. Furthermore, before the new government took over, the currency was depreciating rapidly due to the fact that the central bank was printing money without foreign exchange backing. Meanwhile, four currencies were accepted by people inside Afghanistan for daily transactions. The first currency was Afghani, two different currencies were printed by two different warlords and the last currency was the Pakistani Rupee (Charap & Pavlovic, 2009).

Between 2003 and February of 2004, new laws and regulations for the banking sector in Afghanistan were approved. DAB with the help of the international community and donors developed the capacity to execute the supervision of other banks and monetary policy operations in a completely effective way. Charap & Pavlovic (2009) state the banking system of Afghanistan has experienced extremely rapid growth in the post-Taliban Regime. At the moment, in September 2020 there are twelve banks working in Afghanistan including three state banks, seven private local banks, and two foreign banks. According to Da Afghanistan Bank's annual report of 2018, the total assets of all banks in Afghanistan was AFN 315.78 billion which compared to 2017 there was a decrease of 0.11%. Meantime, Afghanistan's banking sector has enjoyed a sufficient net profit of AFN 2.46 billion compared to 2017 there was a 38.44% increase (DAB, 2018).

2.4. History of Microfinance in Afghanistan

In late 2001, while a new democratic government took over, the financial system of Afghanistan was almost non existing in terms of operations, commercial activities, and credit programs. Therefore, informal sources were the only way where people could access credit (Hussein, 2009). Also, she claims in her article that "according to World Bank's report between 80% and 90% of all economic activities in Afghanistan were occurred in the informal sector including all credit and other financial transactions". In addition, Charap & Pavlovic (2009) also support the point that the commercial activities of the banks were stopped during the Taliban regime, where no banks were allowed to pay or charge interest. As a result of that, lending activities moved to the informal sector such as moneylenders, shopkeepers, traders, landlords, and family. In 2002. There were more than 500 international and local NGOs actively working in Afghanistan in different projects, with only 20 to 25 NGOs providing some basic kind of credit services to poor people. The problems with these NGOs were that their programs were not sustainable and they were not backed by the government. They only could reach a limited number of customers due to religious reasons.

In 2003, it was the time when the government of Afghanistan with the help of international donors decided to offer full support for the Microfinance Institutions in order to develop the financial sector of the country and provide financial services such as credit programs to poor people. It was the time when no private commercial banks were established in Afghanistan, enormous scale or the majority of people in Afghanistan were in need of financial services for expanding their small businesses, starting small shops, and investing for further profit. Due to these points, the government of Afghanistan established an organization by the name of Microfinance Investment Support Facility for Afghanistan (MISFA) under the Ministry for Rural Rehabilitation and Development as the intermediary or tool where connects international donors and government to Microfinance Agencies for technical assistance or receiving funds (Greeley, 2007).

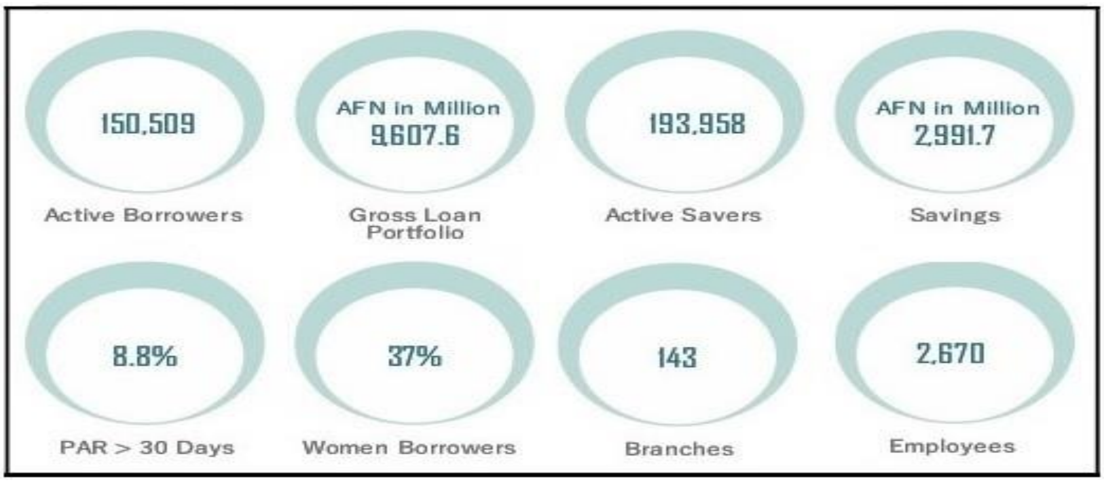
Based on the annual report of MISFA (2019), MFIs in Afghanistan disbursed 125,735 loans worth AFN 11.5 billion. Furthermore, portfolio at risk more than 30 days (PAR>30 days) of these microfinance institutions were only 3.5%. Geographic coverage of microfinance institutions for the year 2019 were 14 provinces and 81 districts across the country.

2.5. Microfinance Institutions in Afghanistan

Since the establishment of Microfinance agencies in Afghanistan, this sector was growing significantly fast. Unfortunately, in 2009, the whole Microfinance sector in Afghanistan suffered enormously in terms of sustainability due to some internal and external factors such as weakened security, drought, and inadequate control measures by Central Bank. As a result of that crisis, some microfinance institutions collapsed and stopped their operations. As well, some other microfinance institutions were forced to merge in order to become more sustainable and to continue their operations. After this crisis, once again the microfinance sector in Afghanistan has been growing extremely well especially in terms of sustainability (Microfinanza, 2019).

According to the Afghanistan Microfinance Association's annual report (2019), the active borrowers of Microfinance institutions in Afghanistan were 150,509 with a gross loan portfolio of AFN 9,607.9 Million. Also, out of the total active borrowers of MFIs, 37% of them were women borrowers. As Figure 21 shows, Microfinance's loan Portfolio at Risk (PAR>30 days) was only 8.8%. Microfinance institutions covered 14 provinces, 81 districts with 143 branches and 2,670 employees.

Figure 21: Afghanistan Microfinance Sector in 2019



Source: *AMA, 2019*

Based on the executive summary report "Impact Assessment Microfinance Services in Afghanistan" by Microfinanza (2019) that shows in Table 2, Individual lending is the most common type of loan product which 90% of borrowers have taken loan whereas only 10% of borrowers have taken group lending and Islamic finance product loans. The average loan size of Microfinance institutions in Afghanistan is from AFN 15,000 to AFN 500,000 depending on the loan product type. Also, in some cases, a loan can be giving up to AFN 15,000,000 depending on the need of the borrower and the experience of the MFI in lending to that type of borrower.

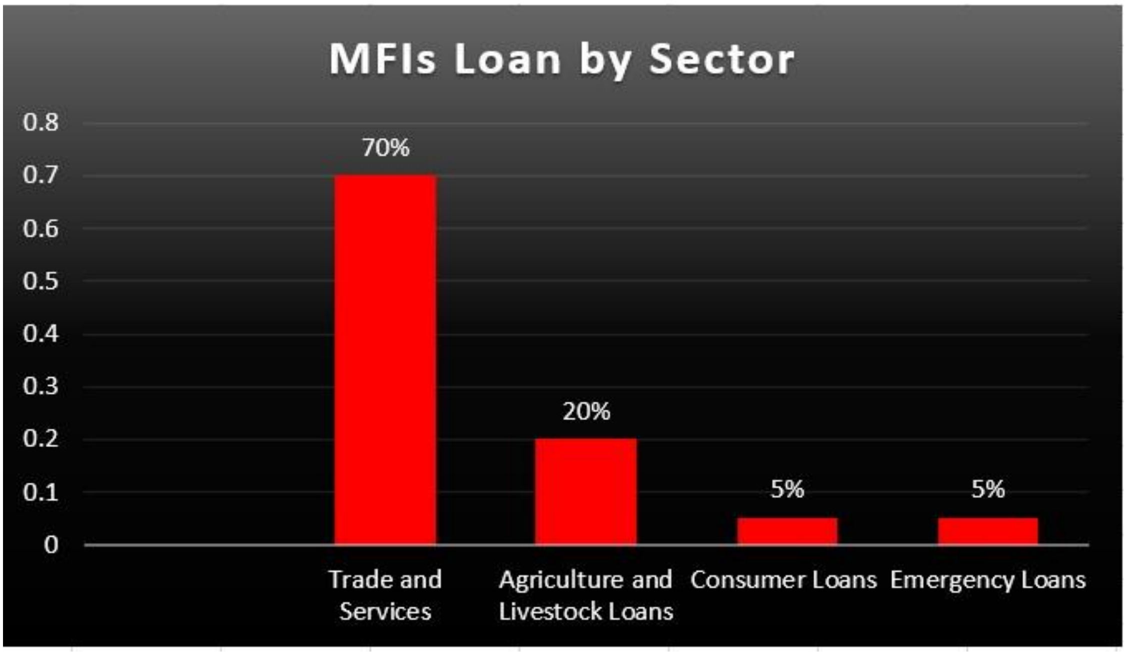
Table 2: Microfinance Loan Outstanding Portfolio

Total loan portfolio (AFN)	2014	2015	2016	2017
Outreach (end of the period)				
Total Outstanding portfolio	5,290,808,143	6,115,290,300	7,283,587,914	**8,180,693,577**
Outstanding portfolio, **FEMALE**	949,022,056	1,234,161,482	1,350,323,734	1,579,609,069
Outstanding portfolio, **RURAL**	1,476,434,531	1,688,227,415	2,029,173,638	2,326,519,198
Total number of active **borrowers**	103,864	122,103	122,297	127,258
Number of active borrowers, **FEMALE**	37,431	44,490	38,959	42,082
Number of active borrowers, **RURAL**	21,819	25,833	27,568	29,589
Number of loans disbursed (during the period)	103,891	122,021	119,245	119,298
Amount disbursed (during the period)	7,420,042,102	8,847,157,338	9,898,903,640	10,408,667,030
Loan methodology (end of the period)				
Outstanding portfolio, **Individual** lending	4,666,125,524	5,241,363,103	6,415,965,100	7,222,800,558
Outstanding portfolio, **Solidarity group** lending	242,551,307	362,938,974	423,319,295	484,604,917
Outstanding portfolio, **Islamic finance** product	382,131,312	510,988,223	444,433,836	473,288,101
Sectors (end of the period)				
Outstanding portfolio, **Trade and Services**	4,018,226,504	4,722,305,415	5,571,717,289	6,134,276,744
Outstanding portfolio, **Agriculture**	1,033,929,922	1,225,439,405	1,478,884,767	1,817,015,005
Outstanding portfolio, **Consumer**	170,375,730	129,206,310	185,740,791	183,183,982
Outstanding portfolio, **Emergency**	68,275,986	38,339,170	47,244,968	40,591,836
Number of active borrowers, Trade and Services	83,003	99,216	96,044	98,631
Number of active borrowers, Agriculture	18,287	21,082	23,427	25,200
Number of active borrowers, Consumer	889	721	1,603	2,102
Number of active borrowers, Emergency	1,685	1,084	1,223	1,252
Active Borrowers / Loan Officers	112	125	122	122

Source: *Microfinanza, 2019*

Trade and Services is one of the leading sectors where the majority of borrowers take loans for running and expanding business. In 2017, 70% of the total outstanding portfolio of MFIs were in this sector. The second sector is the Agriculture sector and livestock loans which are 20% of the total outstanding portfolio of Microfinance institutions. Besides, since 2015 agriculture sector in Afghanistan has been significantly growing at an average rate of 20% per year. The third sector is the consumer sector with only having 5% of the total outstanding portfolio. As Figure 22 indicates the last one is an emergency loan product with having only 5% of the total outstanding portfolio of microfinance institutions in Afghanistan (Microfinanza, 2019).

Figure 22: MFIs Loan by Sector 2017



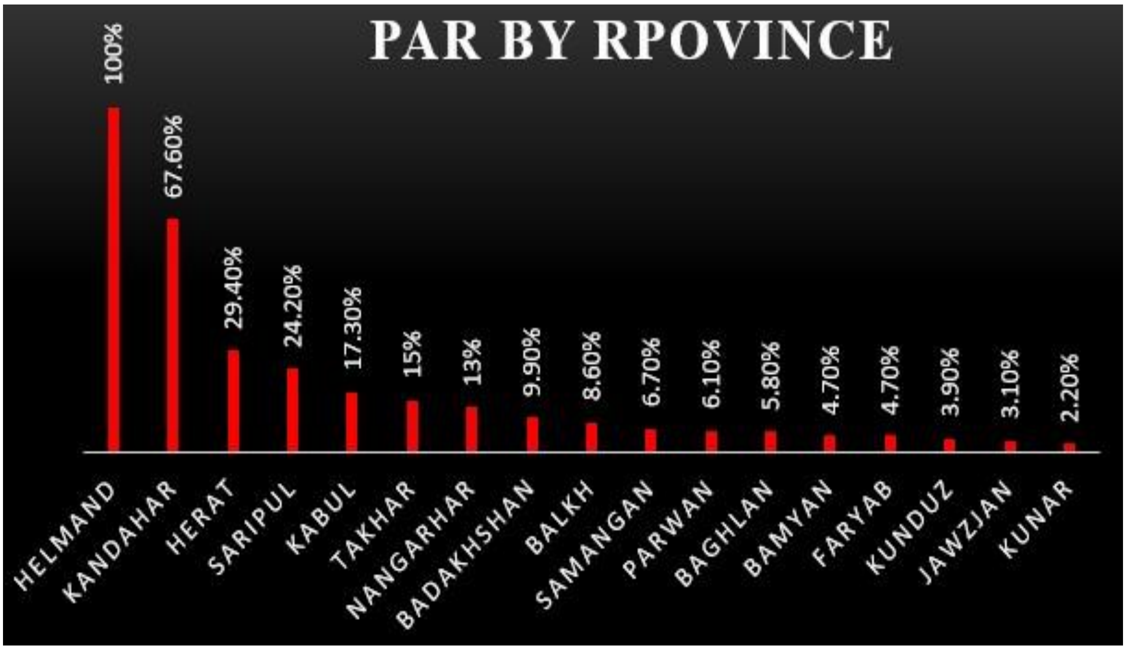
Source: *Microfinanza, 2019*

According to the latest report of AMA in the June of 2020, as Figure 23 shows that Portfolio at risk over the 30 days of MFIs in Afghanistan has massively increased to 15.3% due to COVID-19 or pandemic situation in Afghanistan where the majority of businesses had the minimum operation. Also, Figure 24 indicates PAR by provinces in Afghanistan (AMA, 2020).

Figure 23: PAR > 30 Days 2020

Source: *AMA, 2020*

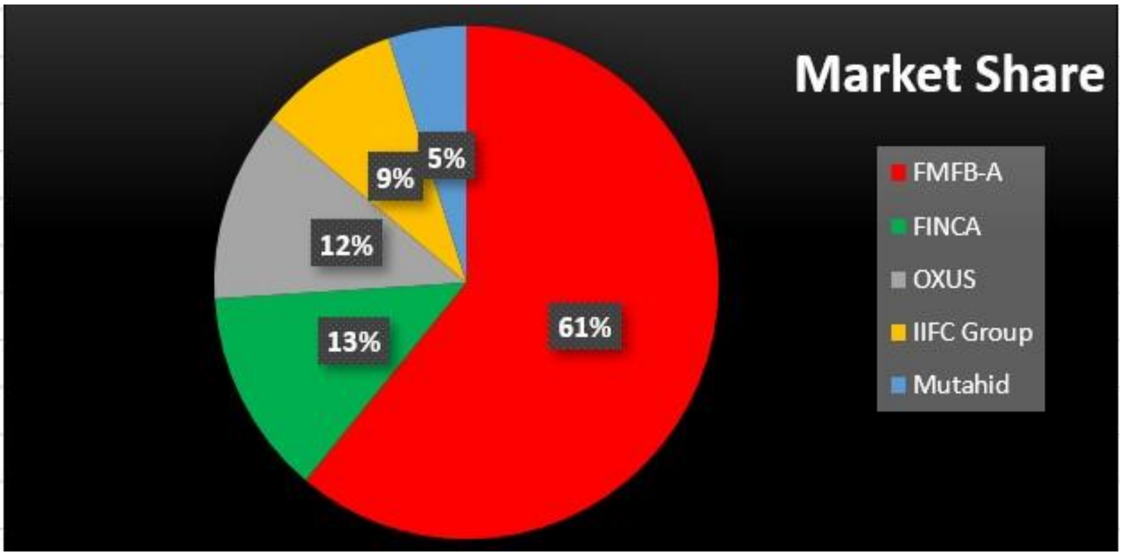
Figure 24: Portfolio at Risk by Provinces 2020



Source: *AMA, 2020*

As Figure 25 indicates that 61% of the market share of Microfinance institutions based on gross loan portfolio is from The First Microfinance Bank (FMFB-A) and FINCA Afghanistan has the 13% of the market share. The third biggest share is from OXUS and the remaining shares are from other small microfinance agencies (AMA, 2020).

Figure 25: Market Share of MFIs in Afghanistan 2020



Source: *AMA, 2020*

2.6. Geographical Outreach of Microfinance in Afghanistan

Microfinance institutions in Afghanistan don’t have full coverage in all the provinces of the country due to a few reasons such as low population density and lack of security. There are still some provinces where terrorist groups have control over. That makes it quite impossible for microfinance institutions to have an operation. Therefore, Microfinance institutions have focused mainly on the central region of Afghanistan. Meanwhile, eastern and northern provinces have also been focused but comparably with a small scale of concentration. Since Kabul is the capital of the country, it has always been the highest province in terms of the number of customers. In 2017, 30% of the loan outstanding portfolio was from this city (Microfinanza, 2019).

Based on Microfinanza (2019), microfinance’s outstanding portfolio is comparable with the traditional banking portfolio except for few provinces such as Kabul and Herat. It is also worth mentioning that Kunduz and Nangarhar which are well-populated provinces are under-served and have always been focused less. As of June 2020, Microfinance Agencies in Afghanistan have operations in 14 provinces and 81 districts around the country.

Figure 26: Geographic Coverage of MFIs in Afghanistan

Source: *AMA, 2018*

2.7. Top Leading Microfinance Institutions in Afghanistan

Top Leading Microfinance institutions in Afghanistan are also MISFA's partners in terms of providing technical financial support and grant and funding agreement. These four top leading microfinance institutions in Afghanistan have almost the 90% of the market share in this sector and listed below:

1. The First Microfinance Bank (FMFB-A)
2. FINCA Afghanistan
3. OXUS Afghanistan
4. Mutahid Development finance institute

The First Microfinance Bank in Afghanistan (FMFB-A): is a part of the Aga Khan Agency for Microfinance (AKAM) which has operations as financial institutions in over 15 developing countries all over the world. It is affiliated with the Aga Khan Development Network (AKDN) which is a group of nine development agencies working in health, education, culture, and rural economic development primarily in Asia and Africa (FMFB-A, 2020b).

In 2004, FMFB-A started working in Afghanistan with the vision to contribute to poverty alleviation and economic development through providing financial services. FMFB-A is working in three separate sectors, Commercial Banking, Microfinance, Small and Medium Enterprises (SME). Currently, it is one of the biggest microfinance institutions in Afghanistan with having 61% of the market share in the country. FMFB-A has more than 192,435 active customers through 28 branches all over the country (MISFA, 2019).

FINCA Afghanistan: is one of the world's oldest and well-reputed microfinance agency which has an operation in 20 different countries such as Africa, Eurasia, Latin America, the Middle East, and South Asia countries. FINCA was the first microfinance Agency that offered Sharia-compliant Financial services (Islamic loans) only for women in Afghanistan. In 2003, FINCA has started working in Afghanistan with the purpose of improving the economic condition of low-income (Poor) people and reducing poverty by providing financial services in order people will be able to create jobs and become self-sufficient, and improving the standard of living

(FINCA, 2020). FINCA is the second top leading Microfinance institution in Afghanistan with having 13% of the market share in the microfinance sector. FINCA has 27,300 active customers in 10 provinces of Afghanistan. Also, 59% of its loan portfolio is made of women (MISFA, 2019).

OXUS Afghanistan: is the third biggest Microfinance institution in Afghanistan with having 12% of the market share of the microfinance sector. OXUS was established in 2007 in Afghanistan with the aim of providing financial service to the working poor and underbanked people across the country. The main shareholder of OXUS is The Agency for Technical Cooperation and Development (ACTED), a non-governmental, non-political, and non-profit organization working to supporting vulnerable populations around the world. OXUS is operating in three different countries such as Afghanistan, Tajikistan, and Kyrgyzstan (OXUS, 2020).

Based on the report, the percentage of female clients of OXUS is 37% out of the total of its customers. Also, OXUS has an operation in 10 provinces through 24 branches across the country with having 22,897 active customers (MISFA, 2019).

Mutahid Development Finance Institution (DFI): It is an Afghan-based company that started working in Afghanistan in 2011 for the purpose of offering financial services to Afghan entrepreneurs and creates opportunities for people who need credit for investments. Mutahid has always been supported strongly by MISFA, World bank, MEDA, and USAID (FAIDA). This microfinance agency is the fourth biggest microfinance in Afghanistan with having 5% of the market share and having 19,225 active clients through 8 branches in 6 provinces across the country (MUTAHID, 2020).

The creation of Mutahid was the best opportunity in order to make one larger, stronger, and more sustainable microfinance institutions in the country. Therefore, MISFA facilitated the merging of three microfinance agencies such as MADRAC, MOFAD, and PARWAZ into completely new microfinance called Mutahid Development Finance Institute which literally Mutahid means “United” in English language (MISFA, 2020a).

2.8. Success Stories of Microfinance in Afghanistan

The Client Success Stories are all about the customer's feelings towards a particular organization, the journey of the customer and the organization together, how the problems of customers were addressed, how the quality of life of customers have improved, and overall, through the client success stories what one can learn. Also, it is not all about the stories, or the organization's marketing strength. In fact, by these stories sometimes we can see the real identification and image of the organization by people.

2.8.1. Story 1: From A Refugee to Job-Creator

Avizha Haidary is a microfinance client of one of the Microfinance Institutions in Afghanistan who has become a highly successful, young businesswoman from once being a refugee to a neighboring country. She is 26 years old, Economics graduate from the Herat University of Afghanistan. She is the mother of a 10 years old son and 5 years old daughter. Despite being a mother, she has achieved great success in terms of academics and pursuing her passion for being a successful businesswoman.

Mrs. Haidary is a rare and brave woman in Afghan society who has been struggling with some culture and social demands of Afghan society. Before starting her business, she has struggled with convincing her in-laws and husband as traditionally they believed that woman's place is in the home looking after the whole family and taking care of the children. Finally, it took a long time where she managed to convince them that she is able to handle both home and the business.

When she returned back to the country years ago, she started her business with only $1,000. Today, she owns and runs her jewelry manufacturing company with having three stores across Herat city. Also, the company has branches in other big cities including Kabul the Capital of Afghanistan. In addition, currently, she employs 12 women in the store and has trained many others. Moreover, she is now able to provide quality education for her children, as her son is enrolled in a private school.

Her success would have not been possible without access to credit from Microfinance institutions. The first loan application was a small amount but based on her good repayment records and business expansion idea, the application with a bigger amount was accepted. Therefore, she used the loan to buy her own polishing machines for gemstones. This was the point where took her business to next level because having her own machines has massively improved her production capacity and the quality of her company's gemstones to sell in the market. Meanwhile, reduced some extra costs for her company.

Before purchasing the machines, she, like many others in the same business, was forced to buy Afghan gemstones at high prices because gemstones were delivered to other countries such as India or Pakistan for polishing. Therefore, the final product costs were higher which definitely impacted the sale and profit of her business. By investing the loan amount for buying the machines, she maximized her profit by reducing production and some other costs (FMFB-A, 2020a).

Avizha defines success as: "*I don't look at success from the financial window only. I have trained many other women. Some of them run their own businesses independently, and some of them are working with me. This is a success for me*."

2.8.2. Story 2: Breaking Boundaries: An Afghan Woman in Shoe-Making

Habiba 30 years old is like so many other Afghan women who were searching for a way out of poverty. She is the mother of four sons and daughters. The only source of income of the family was from her husband who was illegal migrant labor in Iran which occasionally could support the family. Therefore, Habiba was always searching for any income generating-opportunities.

She said that it was not easy for her to see the family suffers and she couldn't do anything about it. She is a person who values children's education really high. Thus, all her children are enrolled in school despite the economic problem. She is an inspiration to the other Afghan women, who have been grown amidst the social-cultural conflicts. She believes, that if women get more and more opportunities in society, then they can surely acquire more experiences. As a result of that women can also be as successful as men.

Habiba found about one of the Microfinance institutions which was providing financial services to poor people. She used the opportunity and successfully received the loan. She used the loan amount for sewing clothes. Unfortunately, her return on investment was not good enough. So, she was thinking about other activities. While she was looking for other opportunities, her neighbor requested Habiba to invest in her shoe-making business. She started this new business as a joint venture with her neighbor four years ago.

After a while, she realized that she had what it takes to compete in the shoe-making business. Therefore, only after one year of partnership, she started her own business with the support of credit from a Microfinance agency. She applied for a loan from a microfinance agency for the purpose of starting up her new business for making a high margin profit. She used the money mostly in purchasing machinery and raw materials for the business.

Since then, her monthly income has been quite steady. Currently, she is the proud owner of a small company, which has eight employees. The company is producing 36 pairs of shoes on a daily basis. Each pair of shoes costs around AFN 250 to the company for production. The company's daily average net profit is AFN 1,000.

She is a very ambitious woman and has a lot of dreams to fulfill in the future. Currently, despite the fact that her business is self-sustainable, she has a lot of plans for expanding if further. She says that loans from the Microfinance agency have helped her significantly and motivated her to work harder and think bigger. She also added that she never dreamed that she could be a self-sufficient person in the future. She believes it would never be possible without the support of Microfinance agencies. Lastly, she sincerely thanks the Microfinance agency not only for economic and financial support but also for respect among society. She strongly believes that after becoming self-sufficient people respect her and her family (MISFA, 2017).

2.9. Impact of Microfinance Institutions in Afghanistan

Microfinance institutions in Afghanistan have contributed massively in terms of employment creation, women empowerment, business development, empowering poor people, and helping the economy to grow. MFIs have been essential for providing resources to entrepreneurs for increasing income-generating activities in order to create employment and expand their businesses. Consequently, Microfinance agencies at some scale have been involved in the reduction of poverty in Afghanistan.

Employment creation is one of the key points where Microfinance institutions had a direct influence. According to the most reliable report on "Impact Assessment Microfinance Services in Afghanistan" by Microfinanza (2019), the average number of employees working in a business were increased by 15% after the owner received credit from Microfinance agencies in Afghanistan. As Table 3 shows, over the last ten years, Microfinance agencies have created more than 1 million estimated number of jobs in the country. Meanwhile, in 2018, the numbers of estimated jobs created by MFIs were 135,000.

Table 3: Estimated Job Created Over Ten Years by MFIs

Employment Creation (in '000)											
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
Jobs created in new businesses	179	155	125	117	100	44	54	65	64	65	69	1,037
Jobs in other businesses benefiting from the loans	628	543	440	410	350	154	191	228	223	228	242	(Flow)
Jobs in existing businesses exiting the MFIs	216	260	149	180	109	26	78	79	97	152	109	(Flow)

Source: *Microfinanza, 2019*

The report of Microfinanza (2019) claims that out of three businesses, only one of them is registered and the other two are operating without any registration. Registration rate in urban areas of the country is higher with (40%) of businesses registered than in rural areas with only (18%) of businesses registered. Another point which is noticeable is that businesses owned by the male are more often registered (43%) than the female ones (17%). According to the world bank's report (2005), between 80% to 90% of economic activities in Afghanistan happen in the informal sector. With consideration of this point, I strongly believe the estimated jobs created through microfinance agencies are even more than what has been reported.

In addition, Microfinance Institutions made almost two-thirds of their customers self-employed throughout providing the needed financial services and products. The percentage of self-employed between men (75%) and women (34%) are very high. Also, it worth mentioning that women are mostly considered housewives due to Afghan traditions and culture. With consideration of this point, only about 8% of female customers in urban areas and 11% of female clients in rural areas consider themselves as full-time employment (Microfinanza, 2019).

Business development is another point where microfinance agencies had some impact. Reports claim that a third or more of customers have experienced increases in their net income, sales, fixed assets, and inventory after taking a loan for the first time from Microfinance agencies. Another positive point which has been noticed in business after obtaining a loan from MFIs is innovation (introducing new products, ideas, or methods) in product and services of businesses. Innovation in female-owned businesses (64%) than male businesses (42%) is higher. Also, innovation in rural areas is 54% which is way more than in urban areas (46%). In addition, it is also stated that expenditure in health, education, food, and household equipment of companies that benefited from financial services has increased (Microfinanza, 2019).

Women empowerment is also one of the aspects where Microfinance Institutions have affected positively. Reports by Microfinanza (2019) state that 40% of female borrowers have experienced positive changes in their lives after obtaining their first loan from MFIs. Female customers have seen an increase in the authority of decision-making for the household in terms of ability to influence their number of children they want, household expenditures, and the ability to have the choice of where to invest.

Authority in decision-making for women after receiving a loan from microfinance agencies differs from region to region. For the purpose of region comparison, it is stated that the possibility of making decisions, regarding the household expenditure, in rural areas 85% which is higher than urban ones which are 79% (Microfinanza, 2019).

MISFA Annual Report (2019) also indicates the same regarding the influence of Microfinance agencies on women empowerment. This report even goes further discussing that these changes seem to be caused by the fact that women contribute massively to overall household income. In some cases, women contribute to the entire household income, thus they find themselves in a position where they are free to make any decision regarding the entire family and themselves.

Agriculture in Afghanistan has always been a very vulnerable sector. Unfortunately, agriculture is the only sector that has not seen significant positive changes by microfinance agencies due to some external factors such as drought and global warming. Based on some reports, 75% of customers working in agriculture and farming, such as growing crops and livestock have noticed the reduction of agricultural water during the year. Besides, 18% of borrowers working in the agriculture and farming sector have a completely negative perspective of their businesses (Microfinanza, 2019).

Lastly, Microfinance agencies in Afghanistan had a key role in the economy of the country. As per the data collected by Microfinanza (2019), microfinance institutions helped the Afghanistan Government for accomplishing development objectives. Microfinance agencies in Afghanistan are becoming an integral part of Afghanistan’s financial system. Furthermore, Microfinance institutions not only had an enormous impact on reducing poverty but also for expanding some businesses across the country.

In terms of customer satisfaction, Microfinance agencies in Afghanistan have done an exceptionally perfect job. The latest surveys indicate that 96% of the microfinance customers stated that they are very satisfied with the services and products of Microfinance agencies. Besides, based on some reliable reports of MFIs, 39% of microfinance customers have noticed an increase in their household incomes and their savings (Microfinanza, 2019).

The report of Microfinanza (2019), it is also declared that Microfinance agencies in Afghanistan are now growing into SMEs due to the need of customers. As it has been discussed earlier that Microfinance clients are expanding their businesses through Microfinance products and services. Thus, now there is a huge demand for a larger scale of loans in the market which simply MFIs cannot satisfy. This point means Microfinance Agencies consider providing SME loans. By paying special attention to the demands of customers, the probability of offering SME service and products is very high.

In another part of the report, it is also mentioned that technology and digital financial services used by Microfinance agencies are the keys to serving the hidden potential of an underdeveloped country like Afghanistan and allows MFIs to access a larger customer base. One of those technologies is mobile banking and services like M-Pesa which Microfinance customer can pay their repayment via their phones. Technology can create long term benefits for both parties, saving time, saving operation, and security cost for MFIs.

To conclude, Microfinance institutions in Afghanistan had an enormous impact and played a vital role in employment creation, women empowerment, business development, poverty reduction and helped the economy to grow in some certain points. Despite all these improvements, I strongly argue that they could have done even more in some aspect of their missions. Analyzing those reasons for the failures and challenges of microfinance institutions in Afghanistan are going to be studied comprehensively in the coming chapter of my thesis.

3. CHAPTER THREE:
FINDINGS AND ANALYSIS OF MICROFINANCE'S EXPERIENCE IN AFGHANISTAN

Microfinance institutions in Afghanistan have started working since 2003. During these years, there have always been great achievements and accomplishments in terms of providing credit services in small and as well medium scale loans to poor people in different sectors such as agriculture, consumer, trade, and service. Despite the fact that Microfinance institutions in Afghanistan have enormously contributed, during 17 years they have faced some challenges, failures, and even worse some of them were forced to merge or went bankrupt.

The Microfinance sector in Afghanistan has gone through different stages since its establishment. In its early stage of operation in Afghanistan, due to the high demand for credit in the market, some microfinance institutions were tempted to put so much effort to achieve operational sustainability in a quite short period of time by focusing on achieving a large number of customers. Their strategy was that a large scale of customers led to a big loan portfolio which ultimately will make any microfinance self-sustainable. This strategy has caused a bigger problem due to insufficient internal controls within the microfinance institutions. Basically, they put a lot of pressure on achieving the fastest growth while, there was less attention to internal controls, portfolio quality, and accountability. All of this made a foundation for the bigger problems such as client default rates got increased, in some cases even had led to big frauds.

After some years, MISFA and MFIs have brought necessary changes by taking some serious actions to rectify these problems. MISFA announced a couple of reforms that brought vital improvement to the microfinance sector in Afghanistan. These changes made MFIs to refocus on quality instead of growth. Also, these reforms included a series of strict rules and regulations to follow such as MFIs must have more reliable business plans, improve their staff's capacity to address the gaps in the risk management and credit operation, and create an internal audit department to improve internal controls for the purpose of reducing frauds. In addition, a reporting system was made by MISFA in order to track MFI progress in implementing these reforms.

3.1. Challenges and Failures of Microfinance Sector in Afghanistan

Microfinance institutions in Afghanistan have enjoyed strong support from the government and some donors throughout their operation in order to follow microfinance's standard practices and to build the capacity and a base in the financial system of the country. The support of the government has led to rapid client outreach and the growth of MFIs in Afghanistan is fairly impressive compared to other conflict-affected countries. Despite all these improvements and growth, the Microfinance sector has faced so many challenges. Unfortunately, in some aspects, MFIs have failed to accomplish their missions. Those major challenges and failures of microfinance institutions in Afghanistan are outlined as below:

3.1.1. Sustainability

High operation costs of MFIs have resulted to become a challenge for microfinance institutions to achieve sustainability. However, there are some other external factors as well to be considered while focusing on the sustainability of MFIs in Afghanistan. Those factors are simply out of control of individual Microfinance. Unfortunately, the influences of those factors such as lack of security in some regions, the extreme discrimination against women, limited economic opportunities, destruction of the infrastructure system, and religious beliefs are enormous on the sustainability of MFIs (Hussein, 2009).

3.1.2. Outreach to Rural Areas

Microfinance institutions in Afghanistan have always been trying to focus on providing financial services in the big cities of Afghanistan. Because the cost of control for wide geographic coverage especially in rural areas is the main issue for micro finances as Afghanistan's population density is only 60 people per square kilometer (Worldometer, 2020). That is one of the reasons that a large part of the country is uncovered. In addition, for the purpose of comparison on the cost of control with population density as Bangladesh's population density is approximately 1.26 thousand people per square kilometer (Statista, 2018). Therefore, it would make no sense to compare and this still remains a challenge for the sector to overcome.

3.1.3. Weak Management and Implementation Capacity

One of the main reasons that attracted some reputable and international MFIs to launch their operation in Afghanistan was that no other microfinance agencies have existed. However, that was a good advantage but the challenge was lack of experience within the community and no people were qualified enough to work effectively in the Microfinance sector in the country. Regardless of the top-level management which is mostly international experts, microfinance agencies had to recruit local staff at the operational level. Microfinance institutions who had to recruit women at the field faced serious challenges as they had to recruit from a pool of community which has always given fewer rights in the society. Therefore, women in Afghanistan especially in rural areas were very limited to have the freedom to work in the organization and they had no training and experience at all. Thus, MFIs were forced to hire staff that was not properly qualified especially at the level of the loan officers. In addition, for the purpose of the cost-cutting strategy, some microfinance institutions intentionally hired staff with no experience. Hence, MISFA has instructed MFIs in Afghanistan to provide training and build the capacity of their staff (Greeley, 2007).

To support and reinforce microfinance's staff capacity, Afghanistan Microfinance Association (AMA) has been established for the purpose of providing training, strengthening staff capacity, evaluation, and monitoring of the sector, and enhance the standard of the industry. Such a supporting organization helped MFIs to evaluate their performance and identify areas where needed to improve (Hussein, 2009). Despite AMA's efforts, weak capacity has still one of the challenges in the Microfinance sector of Afghanistan.

According to the study by World Education News and Reviews (2015), the estimated adult literacy rate in Afghanistan was 38% which is significantly below the international average rate of 84%. It is also much below than neighboring countries like Pakistan (56%) and Iran (87%). Wars and internal conflict which lasted for more than thirty years, have completely destroyed Afghanistan in each and every possible way. Unfortunately, the post-Taliban governments have also been so poor for reinforcing the education system and strengthening the capacity of the citizens in the country. Therefore, with the current situation of the country, Microfinance institutions working in Afghanistan have to deal with this challenge for a longer period of time.

3.1.4. Limited Source of Financing

MISFA is the one and only source for microfinance institutions in Afghanistan to have funds for financing their lending operations. MISFA's loan and funds make almost 90% of the loan portfolio outstanding of microfinance institutions in Afghanistan. Deeply depending on one source of the fund with not securing an alternative will be so problematic because any kind of disruption in loan funds will be directly affecting Micro finances operation as a whole. A good example is when the Ministry of Rural Rehabilitation and Development and MISFA received funds at the end of the year 2005 as it was expected to receive much earlier. Basically, MISFA was not able to provide available funds to MFIs on time. As a consequence of that MFIs disbursed only $24 million, 18% of what was expected to be disbursed ($129 million). In some cases, delays of funds are one of the major challenges of MFIs in an organization's expansion. In addition, most of the microfinance institutions don't have saving programs or deposit facilities in order to mobilize alternative resources for the source of financing in the lending operation of the organization (MISFA, 2019).

3.1.5. Impact on Poverty Reduction

One of the main objectives of microfinance institutions is the reduction of poverty in the country by providing financial services for poor people. That's why Microfinance institutions are mostly working in developing countries which the majority of their population is poor like Afghanistan, Bangladesh, India, Pakistan, Tajikistan, and some countries in Africa.

Hussein (2009) declared that the impact of microfinance agencies on poverty reduction in Afghanistan is less than was expected. Therefore, more task is required to be taken in order to have a proper impact on the alleviation of poverty.

Since Afghanistan is still one of the countries which are struggling with poverty, Microfinance institutions have been trying to cope with this challenge from the beginning. In addition, the COVID-19 pandemic definitely affected the poor people's income in the world especially in Afghanistan which the majority of citizens are poor. Thus, Microfinance institutions have a bigger challenge than they had before and it seems that MFIs in Afghanistan have a long way to go before overcoming this challenge.

3.1.6. Inability to Attract Foreign Investors

Initially, it was the right strategy of the post-Taliban government of Afghanistan to ask international microfinance agencies to launch their operation in the country. It paved the way for building local capacity and establishing a foundation in the microfinance sector in Afghanistan. Also, it facilitated achieving a rapid number of customers, demonstrated good practices, and encouraged other local people. Afghanistan's government via this strategy attempted for attracting local businessmen for establishing permanent forms of microfinance in Afghanistan. Therefore, there were four local microfinance institutions working in Afghanistan such as Parwaz, Ariana Financial Services Group (AFSG), Women for Women International (WWI), and MADRAC. These four microfinance agencies were owned and fully staffed by Afghans. However, these types of organizations which are staffed fully with nationals are very essential for building domestic capacity and increase competition in the market but the form may not be so attractive for foreign investors (Greeley, 2007).

These local Microfinance agencies couldn't attract international investors, large international banks, or any other financial institutions with microfinance programs for financing their lending. Meanwhile, international MFIs in Afghanistan had strong balance sheets with a solid portfolio. Therefore, they were most likely to attract more foreign financing. The inability of attracting foreign and international investors was one of the main reasons that some of these local Microfinance institutions had to merge into one strong microfinance agency in the country. In addition, some other of these local microfinance institutions couldn't overcome this challenge and stopped their operations.

3.1.7. Impact on Gender Equality

Gender inequality is still one of the major problems in underdeveloped and developing countries like Afghanistan. MFIs in Afghanistan like few other organizations are working to bring a positive impact by empowering women in the country. If women are empowered, it will have a direct impact on social status, productivity, household incomes, violence, the number of girls attending school, and the decreasing child marriage rate in the country. As gender inequality in Afghanistan is very high, women empowerment still remains a challenge for MFIs in Afghanistan.

3.1.8. Narrow Product Range

In Afghanistan, only a few microfinance institutions have developed necessary products and services with the right features and characteristics. In general, microfinance institutions in Afghanistan have a narrow range of products and services which don’t meet the requirement of the different activities of poor people. For example, Microfinance institutions in Afghanistan don’t have the appropriate livestock products which can’t address the needs of people. As a result of that farming, households have to sell the animals at a low price (AMA, 2018).

3.1.9. Portfolio at Risk (PAR)

In 2009, the portfolio at risk was a serious concern in the microfinance sector in Afghanistan. Portfolio at risk of some Microfinance institutions were frightening alarm as FINCA with PAR of 47%, Sunduq 36%, MADRAC 29%, Parwaz 24%, Afghanistan Microfinance Institution (AMFI) 20%, FMFB-A 17% and MOFAD 11% (Hussein, 2009).

The overall portfolio at risk of the microfinance sector in Afghanistan was 8.40% in 2019. According to the latest report of the Afghanistan Microfinance Association (2020), at the end of the second quarter of 2020, the overall portfolio at risk of microfinance in Afghanistan has significantly risen to 15.30% due to the COVID-19 pandemic situation in the country. Hence, Microfinance institutions in Afghanistan currently have been facing this challenge on a bigger scale than they had in previous years.

3.1.10.Impractical Strategies

Many Microfinance institutions in Afghanistan use strategies that have been made for some other countries. Whereas some of them are working effectively in the context of Afghanistan, some other of them really need serious consideration. This is particularly important for all microfinance institutions in Afghanistan to reconsider their strategies to the local context and environment of the country. The consequences of wrong strategies are such as poor customer loyalty, high client drop-out, high PAR, and low impact (AMA, 2019).

3.1.11. Lack Of Security

The security situation in Afghanistan is critical as some part of the country is under the control of terrorist groups where Microfinance institutions cannot have any operation. While other parts of the country which is under the control of the government there are also safety concerns. Big cities of the country are where microfinance institutions have most of their operation. Although in these big cities there are also kidnappings, hostage-taking, suicide bombings, and terrorist attacks, Microfinance institutions kept working for providing financial services to people in all these difficult times. This challenge has negatively affected the microfinance institutions in terms of raises of operational costs and reducing their geographical outreach in certain provinces and regions (Kantor & Andersen, 2010).

3.1.12.Political Instability

The security situation of Afghanistan is closely related to the political instability of the government. Political changes in the government have a direct effect on the security situation in some regions of the country. The failure of the government in national unity led to ethnic-socio-political division in the country where it has also impacted microfinance institutions in Afghanistan in some aspect of their businesses in certain regions and community (MISFA, 2014).

3.1.13. Corruption in The Government

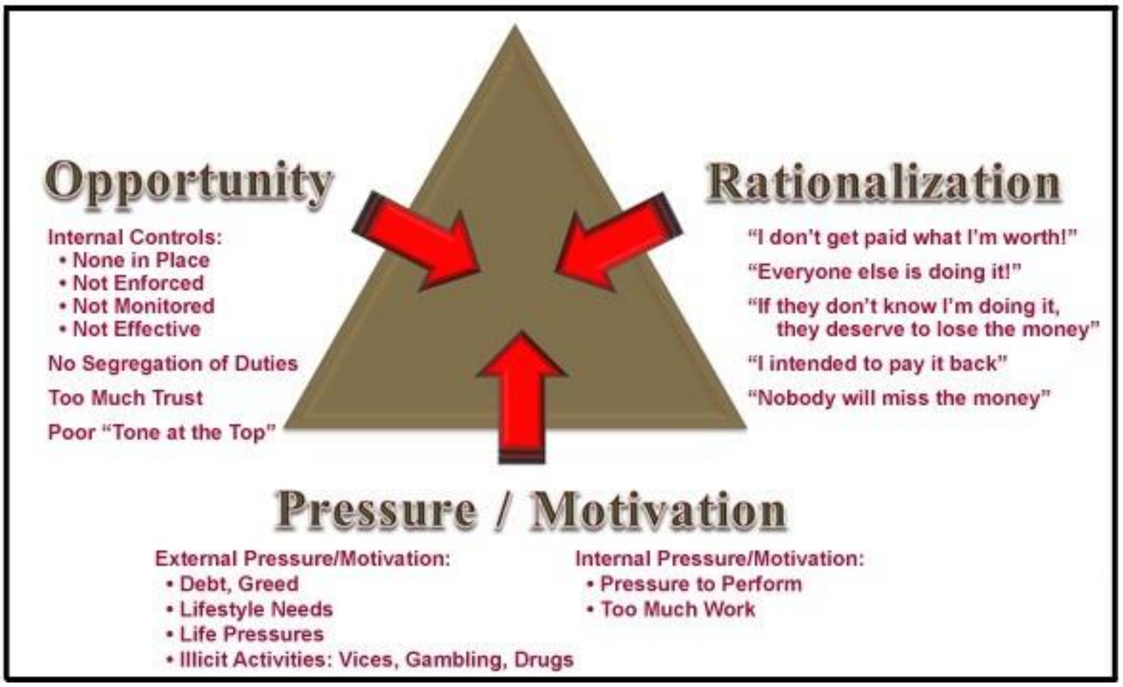
Corruption including all categories such as bribery, extortion, and nepotism is significantly noticeable in the government system of Afghanistan. Over almost two decades, the government of Afghanistan failed to ensure transparency and accountability in the system of the country. According to the report from Transparency International (2019), Afghanistan is the 173rd least corrupt nation out of 180 countries in the world. Thus, Afghanistan is counted as one of the most corrupt countries in the world. Corruption has affected negatively Microfinance operations and activities in different aspects such as failure in loan recovery after fraud, multiple identification cards for borrowers, and failure to obtain the fraud amount through the supreme court or Attorney General Office.

3.2. Frauds in Microfinance Sector

Fraud is defined as intentional wrongdoing or as planned deception committed by an individual for his/her personal advantage which is against an organization's objectives and working ethics. If fraud is not considered a serious issue, then the consequences will be massive damages to the organization. In some cases, the result will be even bankruptcy of the organization. The root causes and main reasons for fraud in an organization are weak internal control, poor accounting controls, poor management, and a non-independent internal audit department.

In 1951, Donald Ray Cressey, a very well-known American criminologist, made the Fraud Triangle which simplifies how and why fraud occurs in an organization. Cressey's hypothesis is that trusted people will become a violator if they are given opportunities while having financial pressure or motivation. Furthermore, in 2004 David Wolfe and Dana Hermanson have developed this theory and added a new element into that "capability" and named that as Fraud Diamond (AGA, 2020). Figure 27 explains the Fraud Triangle in much-needed detail.

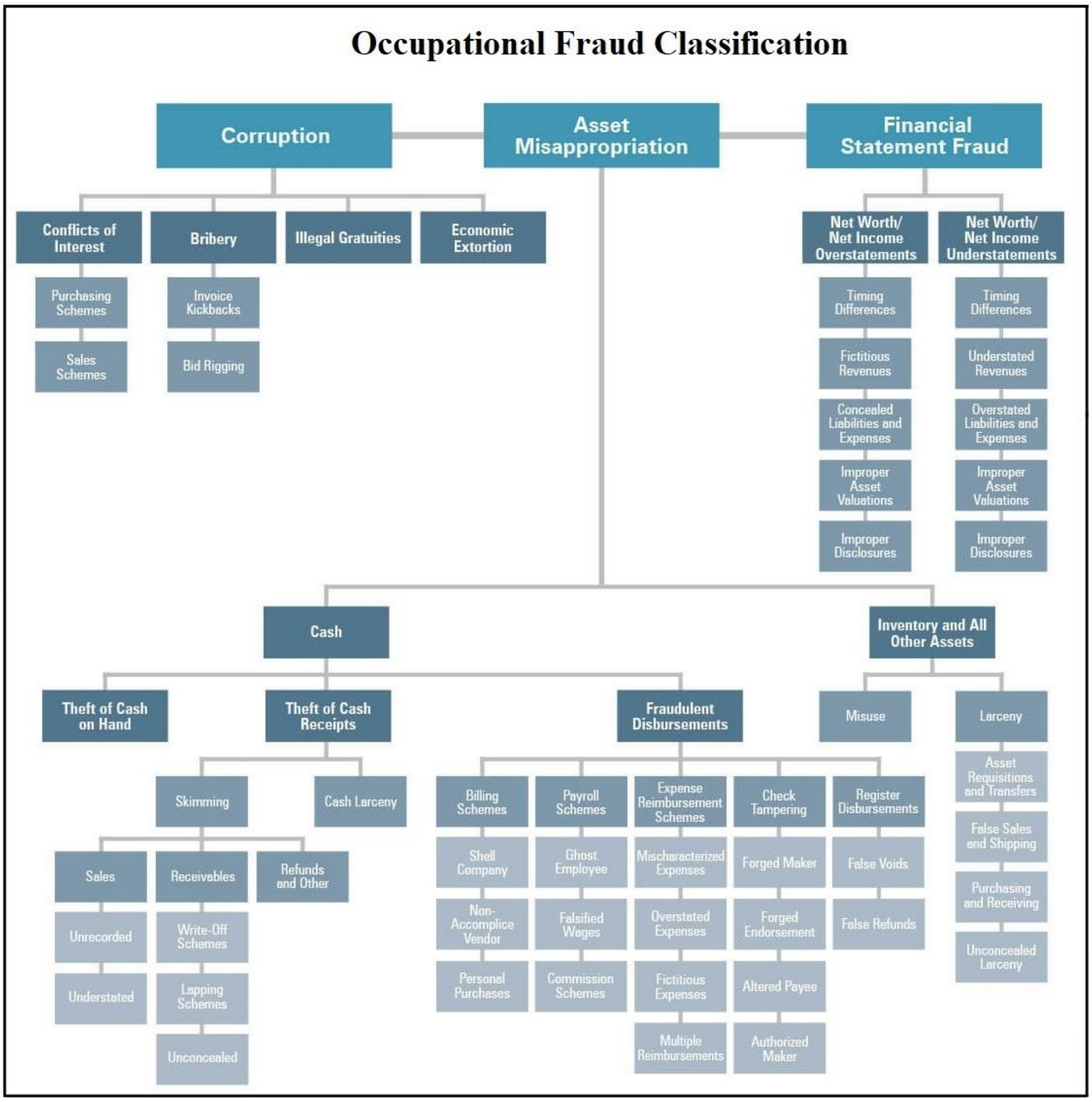
Figure 27: The Fraud Triangle



Source: *AGA, 2020*

Figure 28 below shows The Fraud Tree which is the classification system of occupational fraud in an organization. In financial institutions such as Microfinance agencies and commercial banks, frauds are classified into three-part. First Corruption such as conflicts of interest, bribery, and economic extortion. The second one is Asset Misappropriation such as fraud of physical cash, inventory, and all other assets. The third one is Financial Statement Frauds such as overstatement and understatement of assets and revenue (ACFE, 2020).

Figure 28: The Fraud Tree



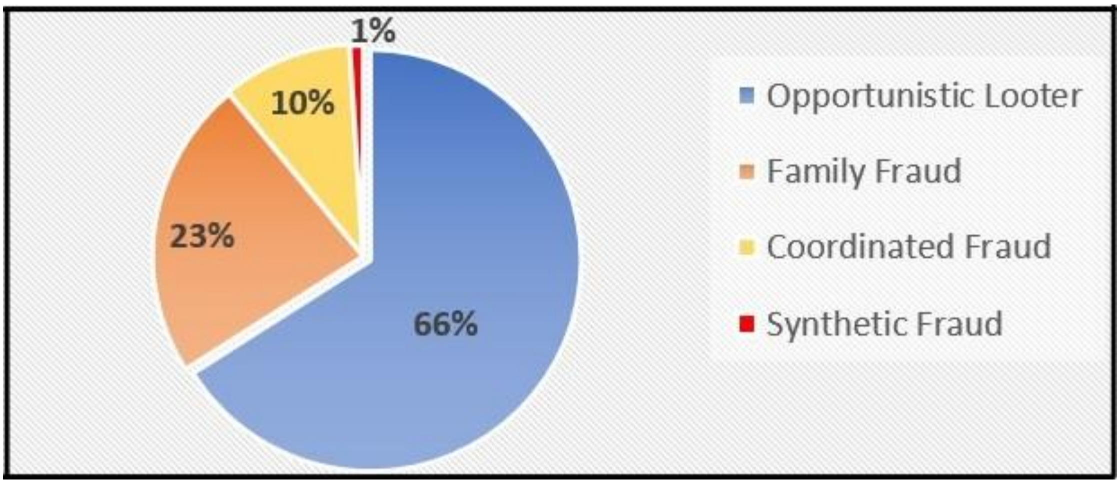
Source: *ACFE, 2020*

Frauds in the Microfinance and Banking sector are slightly higher rather than in other financial institutions in the world because in these sectors any small mistake can lead to a large number of risks particularly frauds. Therefore, most of MFIs have come to realize the importance of handling all types of risks and fraud risk management in order to have measurement techniques and mathematical models to predict the risk and safety of the operational activities (Njenga, 2013).

Almost, no microfinance agency has ever existed with not facing a single fraud case. Consequently, fraud has caused a serious threat to the long-term sustainability of MFIs. Many researches indicate that between 2000 and 2016, a high number of microfinance institutions in the world have downsized their operations due to fraud cases in the organizations (Dabor, 2018).

Management lapses and employee are the two main factors in fraud and its preventions. In general, high profile fraud cases are more likely committed by employees or family and relatives of employees by abusing the access of their family members in the system (Dabor, 2018). In addition, according to Lynch (2020), in general, there are four types of fraud in the financial sector including the microfinance sector. As Figure 29 breaks down the types of frauds with likelihood statistics, the first one is Opportunistic Looter. The second type is Family fraud. The third type is Coordinated fraud which a fraudulent person searches for weaknesses in fraud mitigation strategy and finds the loophole to exploit. The last one is Synthetic fraud which a fraudulent person uses a combination of real and fake information to create a new identity for committing fraud.

Figure 29: Types of Fraud in the Microfinance Sector



Source: *Lynch, 2020*

3.2.1. Common Frauds Cases in Microfinance Institutions of Afghanistan

Microfinance institutions in Afghanistan like many other MFIs in the world have also experienced different types of scandalous fraud cases which some common cases are explained below in detail. There have been various factors such as weak corporate governance, poor accounting practices, weak internal control system, lack of proper implementation of procedures and policies. In addition, contrary to other countries, in Afghanistan dealing with fraud cases are extremely difficult to manage especially in the case of recovering fraud amounts once fraud is committed.

3.2.1.1. Ghost Loans

Ghost loans are fictitious loans recorded in the system of Microfinance where there is no real borrower exists. Basically, the branch manager or loan officer disburses a new loan by the name of a customer with fake documents where the loan amount is used for personal use. In some cases, after the first ghost loans, they falsify the repayment of the ghost loans by creating additional ghost loans in order to cover up the repayment of previous ghost loans. If the internal controls of the microfinance are too weak and the fraud is not observed in audit missions, the fraud especially Ghost Loans cases will increase significantly as fraudulent persons will be sure of not being caught in the crime. In certain circumstances, this fraud case results in a huge financial loss to MFIs.

3.2.1.2. Understating Of Receipt And Vouchers

When the cashier receives the repayment amount from borrowers, he/she doesn’t enter the exact and correct amount of money on the system. Instead, intentionally understates the amount of cash on the book and a duplicate voucher has been giving to the customer with the correct amount on it. Hence, by doing this technique, there has been created a cash difference (Cash Surplus) between actual cash received and recorded one in the book. The surplus amount which has been created fraudulently is taken by the cashier for personal use. This fraud cannot be noticed for quite a long time as there will not be found anything wrong in the daily cash reconciliation between actual cash received and vouchers. Unless, the customer file a complaint against the penalty, this fraud will remain unnoticed.

3.2.1.3. Cash Collection In The Field

In rural areas of Afghanistan where it is difficult for borrowers to visit the microfinance service centers, usually loan officer goes out in the field to collects cash from borrowers as the loan repayment. This scenario gives a really good opportunity to loan officers to commit fraud. While the loan officer receives the cash from borrowers as repayment amount, the understating technique which is explained above is used. In some certain cases, the loan officer receives the repayment amount from borrowers out in the field and gives them fake vouchers. Instead, he/she report back the borrowers in the Portfolio at Risk (PAR) category. After collection of cash from several customers either the collection officer (loan officer) runs away after a few months with all the cash or waits till the fraud is noticed by recovery officers or internal audit officers.

3.2.1.4. Unrestricted Access In Cash In Vault

As per Microfinance procedures and policy regarding safe custodians and key holders, it is obligatory that key holders of the safe should be two different and trusted employees of the organization. This method protects the organization's cash in the vault from the risk of being robbed by one person. The chance of having unrestricted access to the vault by one person occurs when the other keyholder goes on leave for several days. This leaves the manager with both keys to the safe. Thus, the manager has total control of the cash which can run away with all cash from the safe.

3.2.1.5. Misuse Of Borrowers Trust

In Microfinance, the Customer Relation officer is responsible for providing information and helping borrowers especially uneducated borrowers for filling deposit forms for loan repayments. After several times of helping the borrowers with good behaviors, borrowers trust that particular employee. Therefore, borrowers give him/her cash to deposit on their behalf and collect their receipt later. Usually, this happens when the microfinance service center is crowded and borrowers get impatient to wait longer. This opens the door to the employee for committing fraud by having the cash for personal gain and give borrowers fake receipt of the money where no cash is recorded in the book of Microfinance as loan repayment.

3.2.1.6. Loans To Family And Relatives

In certain cases, staffs of microfinance institutions misuse their authority by granting loans to family, relatives, friends, and close associates without proper field verification, missing documents, and collaterals. Therefore, this favor more likely results in fraud by borrowers and staff. In the worst-case scenario, this issue becomes such problematic that Microfinance institutions ultimately become helpless in recovering the fraud amount. Due to missing documents and collaterals, there will be no one left to be responsible and accountable for the loan amounts to be repaid.

3.2.1.7. Kickbacks From Borrowers

In a certain number of cases, borrowers pay bribes to microfinance staff such as loan officers and branch managers for having loan approval for bogus loans. Besides, staffs receive kickbacks for manipulation, misstating, misrepresentation of financial data of borrowers, and not collecting required documents such as collaterals and guarantor for proceeding of loan from microfinance institutions. This type of fraud cannot be traced until audit officers notice in their missions. Thus, microfinance institutions have had a tough challenge to deal with.

3.2.1.8. Financing Illegal Activities

Since Afghanistan is one of the leading countries in the world for producing opium, heroin, and drugs, Microfinance institutions have always put a lot of effort and emphasis on not supporting illegal activities such as banning loans to farmers who are harvesting opium or being involved in other illegal activities. Sometimes, loan officers for receiving bonuses and other financial benefits, disburse loans for illegal activities. Loan officers persuade borrowers to introduce another person who is doing the legal activity. The loan is created in the name of that particular customer, while the actual receiver of the loan is another person who uses the loan amount in illegal activities. Therefore, by this technique “Loan sharing” loan officer legitimates this fraud. This type of fraud will only be revealed by proper field verification by branch managers or audit officers.

3.3. Discussion and Findings of Microfinance's Experience in Afghanistan

During almost two decades, Microfinance institutions in Afghanistan have contributed significantly in different sectors such as agriculture, Livestock farming, trade, and services. However, microfinance institutions in Afghanistan have achieved some success in a country full of challenges and threats, they also faced some failures and challenges which led them to huge financial loss and bankruptcy. If the reason behind the failures of the Microfinance institutions is being analyzed in detail, it will be observed that microfinance institutions are not solely responsible for all the failures. Particularly, several external factors negatively affected microfinance institutions in Afghanistan. External factors such as lack of security, a political issue, and corruption in the government caused more damage to MFIs compared to internal factors.

Experience of Microfinance institutions in Afghanistan shows that they were unsuccessful in some aspects of their missions. Since the establishment of MFIs in Afghanistan, they have always had limited geographical outreach, especially in rural areas. Consequently, Microfinance institutions in Afghanistan couldn't provide sustainable financial services for all poor people who are mostly living in rural areas. According to the Governor of the Central Bank of Afghanistan Mr. Nosher (2020), almost 85% of Afghanistan's population is unbanked and do not receive any type of financial services from any financial institutions such as Microfinance agencies, Commercial Banks, and State Banks.

In general, Microfinance institutions do not have an immediate impact on women empowerment because microfinance practices take a longer time to produce automatic empowerment benefits for women. In the case of Afghanistan, microfinance institutions had sufficient time to produce a long-term impact on women empowerment but their performances in terms of women empowerment are not even satisfactory. Although Afghanistan's case is quite different than other countries due to the socio-cultural barriers such as different social norms and cultural values, MFIs still could have made more progress with the help of government and other international organization programs such as social awareness campaigns.

The findings of MFIs studies show that financially independent women have more power in the household decision-making process. Also, it has been reported that there is a positive impact on women's relationships within the family, particularly against financially independent women there is much less domestic violence observed (Kulkarni, 2011). Women empowerment impacts through microfinance institutions are measured in many dimensions such as decision-making authority, family relationships, domestic violence, social involvement in the society, and having freedom and equal rights (Cheston & Kuhn, 2002).

In Afghanistan, only 40% of female borrowers have experienced positive changes in their lives after obtaining the first loan from MFIs (Microfinanza, 2019). While, 60% of female borrowers have not seen an increase in the authority of decision-making for the household in terms of ability to influence their number of children they want, household expenditures, and ability to have the choice where to invest. In addition, gender inequality is still one of the major problems in Afghanistan and there is a high number of child marriage and domestic violence against women where women do not have equal rights and freedoms compared to men. With consideration of all these statistical data, Microfinance institutions failed in having a great influence on women empowerment. However, one point needs to be taking into account that Afghanistan's social norms and traditions don't allow women to participate in social, political, and economic activities in the community. This cultural constraint really made it difficult for microfinance institutions in Afghanistan to have a concrete impact on women's empowerment.

Microfinance institutions have been contributing not only to the financial sustainability of poor people and women empowerment but also to poverty reduction and the well-being of people in the community. Microfinance institutions have been proved as one of the most influential tools which have a significantly positive impact on poverty reduction. Besides, the experience of South Asian countries shows that Microfinance had remarkable positive changes in poverty reduction and raising the quality of life of people. While in Afghanistan impact of microfinance agencies on poverty reduction is less than was expected because 54.5% of the population were living below the national poverty line in 2016. Also, according to The World Bank (2020), the poverty rate is expected to increase up to 72% by the end of 2020.

Furthermore, in 2019 Afghanistan was ranked as the worst country in the world in terms of standards of living (BBC Farsi News, 2020). These clearly point out that MFIs have failed to bring positive changes to the well-being of poor people and the reduction of poverty in Afghanistan while these are the MFIs' ultimate objectives.

3.3.1. External Factors Affecting Microfinance Institutions Operation in Afghanistan

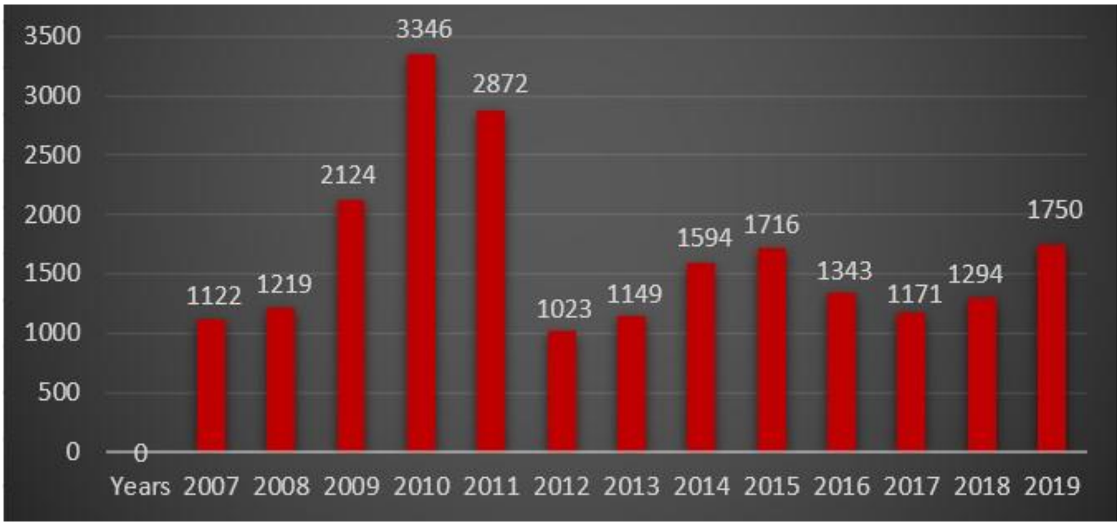
Microfinance institutions have failed in several aspects of their missions in Afghanistan. However, there are some internal factors that negatively affected Microfinance institutions in Afghanistan, external factors had a way more concrete impact on the operation of Microfinance agencies as a whole. External factors such as lack of security in the large part of the country, political constraint, and corruption in the government system caused massive damage in microfinance's operation in Afghanistan for nearly two decades. These external factors had a direct influence on the business strategy planning, capital loss, failures in recovering of fraud amounts, fraud prevention, having broader coverage across the country, and causing marginally higher expenses to microfinance institutions in Afghanistan.

3.3.1.1. Lack of Security

Lack of security is one of the biggest external factors that have been affecting microfinance institutions in Afghanistan since 2003. It is one of the major issues which is also highlighted by 90% of the interviewees as the main obstacle for Microfinance institutions in Afghanistan. As a result, MFIs experienced higher operating costs compared to neighboring countries like Pakistan, India, and Bangladesh. Also, MFIs were forced to downsize their operation which led them to have limited client outreach. Furthermore, some MFIs have not been able to cope with this challenge. Thus, they either have faced the enormous financial loss or were forced to merge into a strong microfinance agency. In the worst case, there were some Microfinance institutions that went bankrupt.

As Figure 30 shows the number of terrorist attacks in Afghanistan over a decade, in 2019 a total number of 1,750 terrorist attacks were recorded in Afghanistan. That was the highest number of attacks since 2011 (Statista, 2020). The security situation in Afghanistan still remains unstable and unpredictable where terrorist groups target local government offices, international organizations, private sector institutions, commercial entities, charity organizations, public gathering places such as mosques, markets, shops, restaurants, hotels, universities, schools, and other education centers.

Figure 30: Number of Terrorist Attacks in Afghanistan from 2007 to 2019



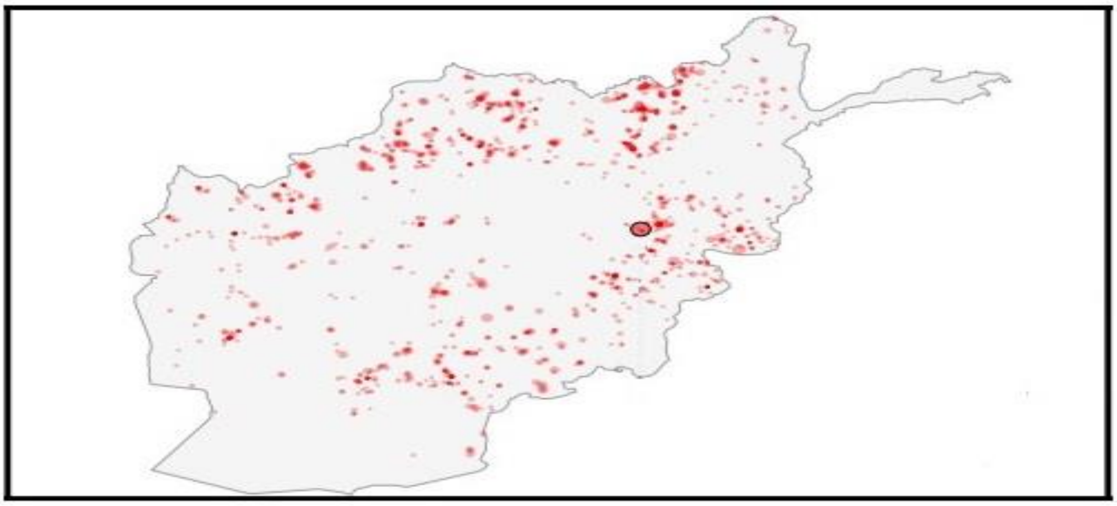
Source: *Statista, 2020*

In Addition, according to Global Peace Index (2020), during 2017 and 2018, Afghanistan was the second least peaceful country in the world after Syria, while in 2020, for the second consecutive year Afghanistan is ranked first in the least peaceful country in the world. Besides, the report from the Overseas Security Advisory Council of The United State of America (2020) claims that Afghanistan is one of the unsafe countries in the world because of critical levels of kidnappings, hostage-taking, suicide bombings, and terrorist attacks in the different part of the country.

Moreover, the Central Intelligence Agency (CIA) of the United States of America's report (2020) states that more than 15 terrorist groups are active in Afghanistan. One of those terrorist groups is the Taliban who are the world's deadliest terrorist group in the world and they are solely active in Afghanistan. In 2019, terrorist attacks were widespread all over the country where all 34 provinces of Afghanistan registered insurgent attacks with the death record in every province.

One point is very obvious from Figure 31 that terrorist groups have activities all over the country. It displays the power of terrorist groups in each and every province, district, and village of Afghanistan. Since many areas of Afghanistan is still under the direct control or indirect influence of terrorist groups, so it is extremely difficult for microfinance institutions to have more geographical outreach in the country. Moreover, due to the same reason, it is more difficult for MFIs to overcome this challenge.

Figure 31: Terrorist incidents in Afghanistan's Territory



Source: *IEP, 2020b*

Afghanistan is an agricultural county where the majority of people are involved in this sector as a traditional profession. Since the cost of living in rural areas is much lower than in big cities, a significant number of poor people are living in rural areas of the country. In addition, agriculture is more suitable in rural areas due to the condition that there is more suitable land for farming and enough water. Also, as there are fewer industries, manufacturing companies, or business activities, people have fewer employment opportunities compared to big cities. This means, agriculture is the only source where people can have some income in rural areas. Therefore, 61.6% of the Afghan labor force is involved in the agriculture sector in Afghanistan. The majority of people living in rural areas are in desperate need of financial services such as small loans. Unfortunately, the lack of security made it impossible for microfinance institutions to have operations in rural areas of Afghanistan. As a result of not having any source of finance, poor people are forced either to take loans from local lenders with high-interest rates or cultivate opium poppies for terrorist groups for receiving little commission.

Table 4 shows the five most and least impacted countries in the world where Afghanistan got the first position in the most impacted country by terrorism in 2020. Terrorism is not the only threat to the security of the country in rural areas of

Afghanistan, cultivation of opium poppies and narcotics trafficking is also one of the factors which affect the security of the country. Also, terrorist groups use the cultivation of opium poppies and narcotics trafficking as one of the ways for financing their terrorist activities.

Table 4: Five Most and Least Impacted by Terrorism Countries in The World 2020

MOST IMPACTED		SCORE	RANK CHANGE
1	Afghanistan	9.592	⟷
2	Iraq	8.682	⟷
3	Nigeria	8.314	⟷
4	Syria	7.778	⟷
5	Somalia	7.645	↑ 1
LEAST IMPACTED			
=135	The Gambia	0.000	⟷
=135	Timor-Leste	0.000	⟷
=135	Togo	0.000	⟷
=135	Turkmenistan	0.000	⟷
=135	United Arab Emirates	0.000	↓ 34

Source: *IEP, 2020b*

For the Taliban, opium cultivation is not only a good source of finance but also connects them with international drug smugglers. Therefore, they put maximum effort to keep these areas unsecure to make sure the government does not have any control in order they will be able to do their business easily. This has mutual benefits, as terrorist groups receive a massive amount of money for the cultivation of opium poppies to finance their terrorist activities. Also, international drug traffickers will have the narcotics in the world for a cheaper amount of money for reselling at high margin prices in the international black markets.

Microfinance institutions were not successful in providing sustainable financial services in rural areas of Afghanistan and MFIs have always focused less particularly on providing different ranges of agricultural products and services. While, over 70% of Afghanistan's population are living in rural areas, and agriculture is the main source of their income. In 2016, agricultural products contributed about 73.3% of the total export in Afghanistan. In addition, 61.6% of the Afghan labor force is engaged in the agriculture sector. In terms of GDP contributions, agriculture is one of the major contributors to Afghanistan's GDP with 23% (Rahimi & Artukoğlu, 2019). On the other hand, in 2017, only 20% of the total loan portfolio of all microfinance institutions were from the agriculture sector in Afghanistan (Microfinanza, 2019). With consideration of these statistical data, it is proved that as a result of having limited geographical outreach in the country, MFIs have failed in bringing positive changes and had less impact on one of the biggest sectors of Afghanistan. Basically, it also means that Microfinance institutions in Afghanistan couldn't provide financial service to their main target customers who are poor people mostly living in rural areas of the country.

According to the Global Terrorism Index (2020), the Taliban has direct control of over 12% of Afghanistan's districts with having 34% further influence on other territories of Afghanistan. Basically, that means the Taliban is governing over 46% of Afghanistan's territory and the Taliban's power in the country especially in rural areas remains a genuine threat to Afghanistan's Microfinance institutions. Due to security concerns, Microfinance institutions in Afghanistan couldn't have full coverage in all the provinces and rural districts of Afghanistan. After 17 years of launching micro-credit programs in Afghanistan, microfinance institutions only have the operation in 14 out of 34 provinces and 81 out of 325 districts around the country.

Security has always been the main constraint for Microfinance institutions in Afghanistan. As a consequence of that, MFIs were not able to provide financial services in most rural areas of Afghanistan where the majority of poor people are living. Microfinance institutions have always focused mainly on urban areas rather than rural areas of Afghanistan. Meanwhile, eastern and northern big provinces have also been focused but comparably with the small scale of concentration to the rural areas. For example, Kabul, the capital of the country, has always been the highest province in terms of the number of borrowers. In 2017, 30% of the loan outstanding portfolio of all microfinance institutions was from Kabul.

Another biggest impact of security was on the economy of Afghanistan, as Afghanistan's economy has been suffering massive financial loss for decades due to lack of security. In 2019, Afghanistan secured the first position in the world as a country whose economy was affected the most by terrorism. As Table 5 displays, Afghanistan's economy suffered 16.7% GDP losses due to the lack of security. However, this year there is a decrease of 2.8% compared to 2018 with 19.5% GDP losses, it is still not comparable to other countries, as in recent years Afghanistan had the highest economic cost of terrorism globally (IEP, 2020b).

Table 5: Ten Most Affected Countries by The Economic Cost of Terrorism 2019

Country	Economics Cost of Terrorism as Percentage of GDP	Global Ranking
Afghanistan	16.70%	1
Syria	3.40%	2
Nigeria	2.40%	3
Burkina Faso	1.90%	4
Mali	1.90%	5
Somalia	1.20%	6
Iraq	1.10%	7
Yemen	1%	8
Sri Lanka	1%	9
Central African Republic	0.90%	10

Source: *IEP, 2020b*

In addition, in recent years an enormous number of people were died in Afghanistan due to terrorist attacks. For the purpose of comparison, 41% of deaths in the world from terrorism were registered from Afghanistan in 2019 (IEP, 2020b). That means it shouldn't be shocking that people want to leave the country because lack of security is the not only root for economic problems but also another key factor that why the majority of Afghanistan's citizens becoming a refugee in other countries. Afghanistan has the second-largest refugee population in the world with having almost 2.5 million people registered as a refugee from Afghanistan in foreign countries (UNHCR, 2018).

Security impacted the whole economy of the country which resulted in a 16.7% GDP loss. This financial loss in the economic system has impacted directly the financial market of Afghanistan including each and every household such as businesses, traders, manufacturers, service providers, and even local street vendors. Besides, unemployment and lack of security created a threatening situation in the country where many people were not feeling safe. Therefore, most people considered Afghanistan not an effective country for business and investment. In the last seven years, a large number of Afghan people left the country in order to invest in other countries where their capital and their lives are safer than Afghanistan. This situation in the country led MFIs in the difficult condition in terms of client outreach and receiving repayments from borrowers. Based on some interviewee respondents from

MFIs top-level management and staffs, in certain circumstances, there have been also some cases that borrowers left Afghanistan after receiving the first loan amount. MFIs couldn't even recover the principal amount as the borrower had already sold the property to someone else.

Many reports indicate that between 2009 and 2013, a high number of microfinance institutions have downsized their operations or went bankrupt due to fraud cases and some external factors such as safety and security concerns in the country. For example, BRAC in the early years of its operation in Afghanistan has achieved tremendous success in terms of achieving a large number of customers in the country. In addition, due to the high demand for credit in the market, BRAC was tempted to put so much effort to cover the highest number of cities in the country regardless of the security concern. As Table 6 shows BRAC was the top leading microfinance institution in Afghanistan with having the highest number of borrowers and with having full geographical coverage in 21 provinces and 101 districts in the country. While other microfinance institutions had operation only in 12 provinces and 56 districts in the country.

BRAC underestimated the security challenges in Afghanistan while launching branches and providing financial services such as microcredit programs. Whereas other microfinance institutions didn't have any kind of operations and activities in certain provinces due to safety and security concerns, BRAC was actively operating in those provinces. Lack of security caused BRAC massive financial loss where it is counted as one of the factors that BRAC in 2013 stopped its operation as a microfinance institution in Afghanistan.

Table 6: Portfolio Summary by MFI (December 2007)

Outreach	Total	AFSG	AMFI	FMFB-A	BRAC	CFA	FINCA	MADRAC	MOFAD
Provinces	23	2	3	12	21	4	10	6	1
Districts	109	27	8	56	101	11	98	12	15
Active Borrowers	365,666	9,292	4,404	30,719	143,097	16,290	63,570	14,222	7,422
Branches	258	2	4	20	163	4	18	11	2

Source: *Hussein, 2009*

As analyzed before, numerous aspects need to be considered while studying MFIs in Afghanistan. Security is one of the factors that need to be focused on while assessing the impact of Microfinance institutions in Afghanistan especially in terms of geographical outreach in rural areas. Afghanistan is known as one of the most dangerous countries in the world where the majority of its territory is under the control of terrorist groups. MFIs couldn't launch their program in certain provinces and districts because the government doesn't have enough control over those provinces. However, there are also some provinces that terrorist groups have a strong influence, Microfinance institutions have limited operation. For example, Kunduz and Nangarhar which are big cities and well-populated, MFIs don't have full-fledged service due to security concerns. Therefore, these two provinces are under-served and have always been focused less. After a deep analysis of the microfinance's experiences in the context of Afghanistan, it is observable that with the consideration of the security situation in Afghanistan, Microfinance institutions have been quite impressive for providing sustainable financial services for poor people.

3.3.1.2. Political Issue

The political issue is another factor that negatively influenced microfinance institutions in terms of loan repayments, client dropouts, and providing sustainable financial service in Afghanistan. Political instability is closely related to the security situation in Afghanistan. Any political changes in the government hierarchy have a direct effect on the security situation in certain regions of the country. The failure of the government in national unity led to ethnic-socio-political division in the country where people are more involved in discriminating on the basis of ethnicity, race, religion, and origin. Thus, this factor has also impacted microfinance institutions in Afghanistan. A good example of this particular issue is Waras, Bamyan fraud case from FMFB-A. Based on the interviewee respondent, FMFB-A lost AFN 85 million in the Waras district of Bamyan city due to the political issue in the region.

In 2013, due to the high demand for credit in the central regions of the country, one of the top leading microfinance institutions in Afghanistan (FMFB-A) focused more on the central provinces for providing sustainable financial services to poor people. FMFB-A has expanded its operation in the Bamyan province. As a result, FMFB-A had great geographical outreach in 9 districts and 200 villages with a fairly good number of borrowers.

In the beginning years, the loan portfolio from newly opened financial service centers was looking quite promising. Therefore, more attention was drawn to having a high number of customers in this region as it is one of the very few provinces of Afghanistan with good security. FMFB-A was experiencing quite significant progress in this region compared to other regions due to the fact that there were high demand and good security in the region. Unfortunately, this remarkable experience didn’t last long as FMFB-A faced a political challenge in Waras, one of the districts of Bamyan, by a strong political party.

This political party accused the microfinance institution as an illegal business entity because the interest rate is strictly prohibited in Islamic Sharia. Therefore, an official statement was given by this political party that due to religious beliefs no one is required to repay the loans of microfinance. Also, afterward, no one is allowed to have any relationship with any microfinance institutions. By using this method, the political party tried to save a lot of its members from repaying the loans. In addition, due to the strong influence of the political party, over the 70 villages of Waras districts didn’t repay the loans to FMFB-A. As a consequence of that, FMFB-A suffered a huge financial loss.

The loan portfolio of FMFB-A was approximately AFN 85 million in the Waras district where people denied to repay the loans. FMFB-A failed to take any legal action against the political party and the people because the political party had the strong support of politicians who were working in the high hierarchy of government. Although, FMFB-A approached different methods, yet they couldn’t recover the full AFN 85 million. The only method they used to recover was giving commission to this political party for recovering the loans from people, as a result so far FMFB-A could recover only AFN 25 million. Another point that needs to be noticed is that some local staff from the FMFB-A office were involved in this case. After investigation, it was observed that some loan officers were encouraging people to take loans because they made sure the loans are not required to pay back. Loan officers were intentionally encouraging people to not repay the loans due to ethnical issues as all the loan officers were from those particular regions. This was the biggest fraud case in the history of MFIs in Afghanistan where the political issue, ethnical and religious beliefs caused significant damage to the microfinance sector.

3.3.1.3. Corruption in The Government

After the Taliban regime, Afghanistan was left with a devastated infrastructure and a collapsed economy where the majority of public and private institutions were tremendously damaged. Therefore, the new government of Afghanistan had no other option except to start from scratch for economic development and having a strong, transparent, and accountable governance in the country. Unfortunately, the government of Afghanistan couldn't succeed in many aspects especially in the elimination of corruption during these two decades. Although the dangers of corruption were anticipated back in 2001, Afghanistan's government couldn't properly implement anti-corruption measures throughout the years. As result, there are still all categories of corruption such as bribery, financial extortion, and nepotism significantly noticeable in the government system of Afghanistan.

Also, Afghanistan is a country whose economy is strongly relying on international donors. According to the United Nations Assistance Mission In Afghanistan (2020), Afghanistan is receiving about USD 8.5 billion from international donors per year. That amount is about 45% of GDP and 75% of government spending. Donors have increasingly stated their concerns about the failures of the government in the implementation of anti-corruption measures in Afghanistan. More importantly, international donors have warned that in case the government doesn't enhance measures to combat corruption, that could affect future funding and supports.

United Nations Assistance Mission In Afghanistan (2018), also claims that decades of war completely transformed the Afghan society and brought fundamental changes that have weakened the traditional norms. Consequently, every citizen is required to pay bribes in nearly every aspect of their daily life. Once these types of corruption might have prevented by traditional norms back in decades.

Furthermore, the root of corruption in Afghanistan is totally different from the majority of countries in the world. As in other countries, corruption occurs due to the lack of public institutions, but in Afghanistan the public institutions and the government system itself is corrupt. For example, the government of Afghanistan has always been accused of massive fraud and corruption in both parliamentary and presidential elections since 2001. The 2019 presidential election which is the fourth presidential election since the fall of the Taliban, has also been plagued by fraud, violence, and allegations of corruption (Mehrdad, 2019).

According to the report from Transparency International (2019), Afghanistan is the 173rd least corrupt nation out of 180 countries in the world. Also, Afghanistan has been consistently ranked among the ten most corrupt countries except in 2015 and 2016. That means corruption has always been a very big constraint in Afghanistan which has enormously impacted the financial sector of Afghanistan. For example: in September 2010, Kabul Bank which was one of the top leading commercial banks in Afghanistan collapsed due to losing a large amount to theft and fraudulent lending. In this fraud case, the saving of one million Afghan people equivalent to $1.3 billion was stolen from the Bank (Mcleod, 2016). Due to corruption in the government, this case has not been solved yet. Besides, the recovery process didn’t go according to plan as nothing was received as repayment from some of the largest and most powerful debtors. The involvement of powerful people from the government in this case, simply indicates how corrupt the whole government system of Afghanistan is.

Corruption is also one of the key constraints which are consistently mentioned by the interviewee as a vital factor that impacted microfinance institutions in Afghanistan. Based on the interviewee respondents, corruption has negatively affected Microfinance activities and operations in Afghanistan. Also, due to corruption MFIs are facing a challenge where borrowers have multiple identification cards, fake documents of land properties from the government. Therefore, MFIs are facing failure in recovering the loan process.

Since public institutions are corrupt, people can easily have multiple identification cards and fake documents for the property. This makes it difficult for microfinance institutions to identify the correct and true information represented by borrowers for loan applications. However, the Public Credit Registry system was created by the central bank of Afghanistan for identifying information of borrowers, that system is not effective in filtering multiple identification cards. In some cases, one borrower can have multiple loans from different microfinance institutions as he/she has different identification cards. As a result of that, borrowers either disappear or will not be able to repay the loan for different microfinance institutions.

In some rare cases, borrowers either represent a fake land property that is verified by the government as collateral to the Microfinance agency or sells the property with another title dead to some other people after receiving the loan from MFIs. These are the types of situations where microfinance institutions don’t have any control and can’t take any measures from preventing it.

To address these challenges, the root of the problem is the weakness and corruption of the government in the financial sector of Afghanistan. The government of Afghanistan couldn’t represent a transparent, centralized, modern, and electronic system for issuing identification cards for citizens where all information and data such as criminal record, illness history, identification, property, asset, liabilities, and credit history should be recorded in one single identification number. Instead, Afghanistan uses the old decentralized bureaucracy system.

Another aspect of corruption that affected Microfinance is the failure of MFIs in obtaining the fraud amount through the Attorney General Office. Usually, the court decision is in favor of a fraudulent person due to giving bribes, having political power, and religious beliefs. According to the interviewee respondents, in most cases, the fraudulent persons were found not guilty in the court due to giving bribes to the judges and attorney general office’s staff. That is one of the reasons that why Microfinance institutions cannot recover any amount of money after the fraud is committed.

Also, the interviewees responded that in certain circumstances, they have been warned by fraudulent persons by saying “I will give 5% of the amount to the supreme court as a commission (bribes) then they will send you to the jail instead of me”. Unsurprisingly, 60% of interviewees experienced this situation during their careers. For example, if a loan officer’s fraud is noticed by the branch manager, the loan officer warns the branch manager to not fire him/her otherwise he/she will claim that the branch manager is also involved in this fraud. In the worst scenario, the loan officer gives a bribe to the supreme court for involving the branch manager in the fraud.

With the consideration of the analysis and interpretation, ultimately these factors validify the hypothesis of the thesis that due to lack of security, religious beliefs/ political issues, and corruption in the government, MFIs have been facing significant challenges and failures in some aspects of their mission.

3.3.2. Internal Factors Affecting Microfinance Institutions Operation In Afghanistan

After the fall of the Taliban regime, Afghanistan entered into a new era of economic development. However, the business environment was full of new threats and challenges which affected some local and international financial institutions. During these periods, Microfinance institutions have experienced some difficult conditions due to some external and internal factors in Afghanistan. Unlike the external factors, MFIs could have managed the internal factors for minimum damage in the organization. Those internal factors are such as weak internal control systems, poor risk management, wrong business strategy planning, and lack of proper policies/procedures. In addition, all the internal factors affected microfinance institutions operation in Afghanistan are explained below with details:

3.3.2.1. Weak Internal Control System

In recent years of establishment, MFIs didn't focus on improving the internal control system and loan portfolio quality. Barely, few microfinance institutions had a good internal control system in Afghanistan. As a result, Microfinance institutions have faced huge financial losses or even went bankrupt. Also, the portfolio at risk of some microfinance institutions was shocking. Therefore, MISFA took some serious actions to rectify these problems by introducing a couple of reforms that brought vital improvement to the microfinance sector in Afghanistan. These changes made MFIs refocus on quality instead of growth. Also, these reforms included a series of strict rules and regulations to follow such as MFIs must have more reliable business plans, improve their staff's capacity to address the gaps in the risk management and credit operation, and create an internal audit department to improve internal controls for the purpose of reducing frauds.

In 2009, the Portfolio at risk of microfinance institutions in Afghanistan was a major concern for MISFA because the total amount of portfolio at risk of the whole sector was more than $13 million. As Table 7 indicates, the portfolio at risk of some Microfinance institutions was frightening as FINCA with Portfolio at risk (PAR) of 47%, Sunduq 36%, MADRAC 29%, Parwaz 24%, Afghanistan Microfinance Institution (AMFI) 20%, FMFB-A 17% and MOFAD 11%. In addition, according to

Hussein (2009), the situation of the microfinance sector might have been more serious than it was officially reported as PAR (>30 days) was estimated to be 55%.

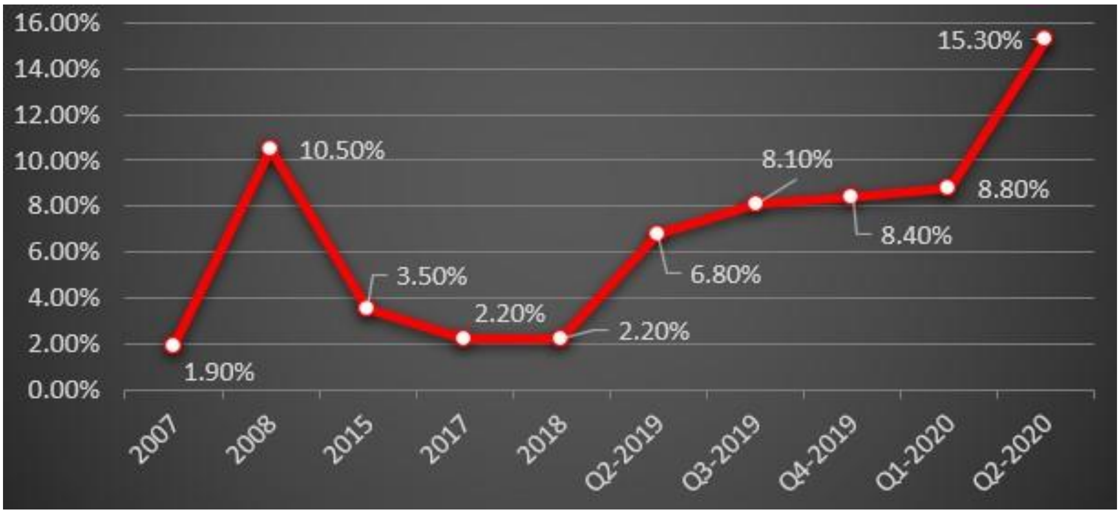
Table 7: Portfolio Summary by MFI 2008

Part One	MADRAC	MOFAD	OXUS	PARWAZ	SUNDUQ	WOCCU
Active borrowers	16,250	11,062	14,394	12,180	10,407	4,800
Client dropout Since establishment	11,811	1,649	20,342	19,113	9,688	2,371
PAR (>30 days), %	29%	14%	11%	24%	36%	4%
1-30 days late	$ 157,080	$ 12,427	$ 75,230	$ 250,454	$ 74,180	$ 103,302
31-90 days late	$ 235,013	$ 59,962	$ 61,303	$ 289,008	$ 210,575	$ 46,187
91-180 days late	$ 239,751	$137,004	$ 145,932	$ 87,447	$ 250,145	$ 35,785
>180 days late	$ 230,779	$120,347	$ 217,243	$ 95,528	$ 66,266	$ 8,387
Part Two	**AFS**	**AMFI**	**FMFB**	**BRAC**	**CFA**	**FINCA**
Active borrowers	11,181	3,896	21,905	140,366	20,145	38,499
Client dropout Since establishment	5,819	-	689	111,512	-	63,213
PAR (>30 days), %	8%	20%	17%	8%	10%	47%
1-30 days late	$ 441,460	$ 49,838	$ 309,434	$ 1,240,149	$ 246,499	$ 368,525
31-90 days late	$ 183,597	$ 50,686	$ 376,260	$ 547,438	$ 130,401	$ 384,459
91-180 days late	$ 69,636	$ 52,473	$ 664,820	$ 359,354	$ 46,091	$ 450,957
>180 days late	$ 29,086	$ 63,672	$ 1,642,715	$ 1,178,321	$ 155,688	$ 1,654,027

Source: *Hussein, 2009*

As Figure 32 shows Nonperforming Loan of Microfinance institutions from 2007 till 2020, there has always been the deterioration in NPL of MFIs in Afghanistan. Basically, it indicates that MFIs have lost a large amount of their loans as borrowers defaulted and haven't made any repayments of principal and interest amount. Since PAR is the cause and the consequence of a weak internal control system in the organization. This ultimately proves that the internal controls of microfinance institutions are still weak and need to be improved significantly.

Figure 32: Portfolio at Risk of Microfinance Institutions during 2007 till 2020



Source: *MISFA, AMA, 2020*

3.3.2.2. Wrong Business Strategic Planning

Many International MFIs were using strategies that were not made for a country like Afghanistan but some other countries. However, in the context of Afghanistan, some of them were working effectively still, some other of them really needed serious consideration. This is particularly important for all MFIs in Afghanistan to reconsider their strategies to the local context and the environment of the country. Due to the usage of wrong business strategies, MFIs dealt with poor customer loyalty, high client drop-out, high portfolio at risk, and low impact on several aspects such as poverty reduction, well-being, women empowerment, and economic development.

In the early stage of the Microfinance operation in Afghanistan, there was a high demand for credit in the afghan market across the country. Therefore, some MFIs were tempted to put so much effort to achieve operational sustainability in a quite short period of time by focusing on achieving a large number of borrowers. However, a large scale of borrowers led to a big loan portfolio which ultimately will make any microfinance self-sustainable but having a big loan portfolio without considering several aspects cause capital loss and bankruptcy. This business strategy was only focusing on growth in terms of having a high number of borrowers rather than internal controls, quality of the portfolio, and risk management. Basically, MFIs have put a lot of pressure on achieving the fastest growth while there was less attention to other essential aspects such as portfolio yield and accountability. Therefore, wrong business strategy planning and implementation caused bigger problems in the microfinance sector such as client default rates got increased, in some cases even to led to big frauds, capital loss, and bankruptcy.

According to the interviewees particularly the top-level management of MFIs, gave another example of wrong strategy planning which has negatively affected MFIs in Afghanistan, which was installing a modern core banking system. In the early years of operation, FMFB-A, one of the top leading international MFIs decided to launch the core banking system for the daily operation of Microfinance and commercial activities. The board of FMFB-A was launching this core banking system in order to standardize the banking process to have more flexibility and minimize the cost of the operation. Therefore, FMFB-A purchased eMerge Core Banking System. It was one of the modern core banking systems of that time, which has already won the core banking system award of the year in the world (Global Custodian, 2007).

Initially, this was a remarkable step for the modernization of the microfinance industry, while later on the experience proved that launching such a state of art core banking system in a third-world country like Afghanistan to be a wrong business strategy. Since it was a modern core banking system, it required high internet connectivity where in Afghanistan there were so many connectivity problems, especially in rural areas. It was a centralized system, if a problem occurred in one branch due to connectivity, the whole banking system would have become down and other branches were not able to work properly. Instead of a solution and improvement to operation, launching this software created significant problems such as financial loss, operational deficiencies, and client dropout to the MFI. Generally, the core banking system was designed for developing countries not for a country like Afghanistan. Due to this reason, the wrong business strategy led to a miserable failure of MFIs.

3.3.2.3. Poor Credit Risk Management

Frauds in the Microfinance and Banking sector are slightly higher rather than in other financial institutions in the world because in these sectors any small mistake can lead to a large number of risks particularly frauds. Therefore, most microfinance institutions have come to realize the importance of handling all types of fraud and credit risk management in order to have measurement techniques and mathematical models to predict the risk and safety of their operational activities (Njenga, 2013).

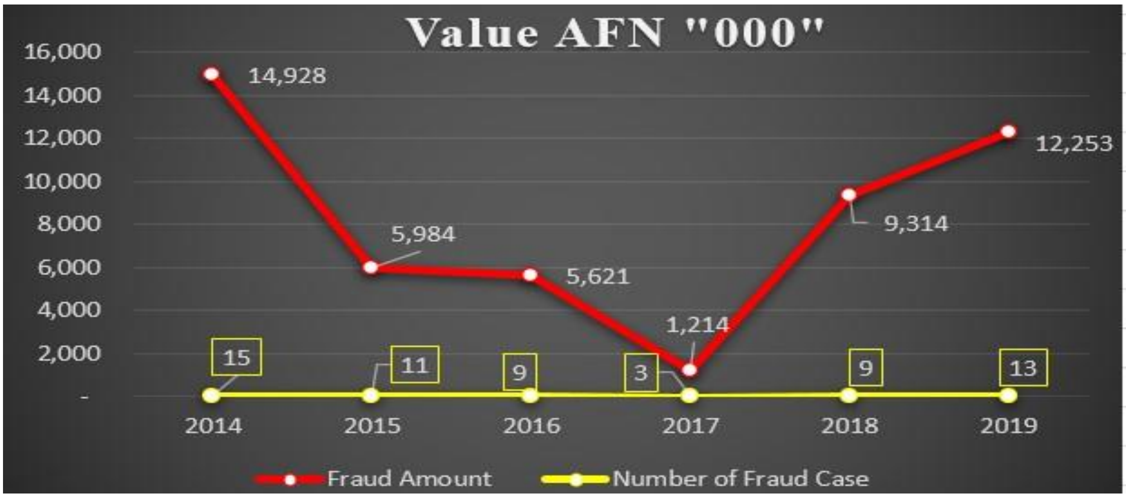
In Afghanistan, Microfinance institutions have suffered during their operations in many cases due to poor credit risk management. In 2008, the portfolio at risk of some microfinance institutions was shocking as FINCA with PAR of 47%, Sunduq 36%, MADRAC 29%, Parwaz 24%, AMFI 20%, FMFB-A 17%, and MOFAD 11%. In addition, 14% of the overall PAR of these microfinance institutions were due to fraud. In 2008 the estimated PAR of the microfinance industry of Afghanistan was 55% which itself is frightening. These conditions led to a big financial crisis in Afghanistan where nearly all Microfinance institutions have faced capital loss, merging into one strong microfinance institution and bankruptcy.

After the financial crisis in the microfinance industry, MISFA announced a series of strict rules and regulations to microfinance institutions such as MFIs must have more reliable business plans, improve their staff's capacity to address the gaps in the credit operation, and create an internal audit department to improve internal controls for the purpose of reducing frauds and mainly MFIs must improve credit risk management measures. Although these couple of reforms brought vital improvement, still credit risk management is not fairly satisfactory in the country.

In the World Bank report (2018), it has been emphasized that the whole financial sector of Afghanistan is weak in terms of many aspects such as operational efficiency, over-staffing and a lack of efficient and automated processes and the sector is weak particularly in credit risk management. It suggests that in order to have a more diverse, profitable, and efficient financial sector, Afghanistan needs to bring so many strict changes in many parts mainly in credit risk management of the microfinance institutions, commercial banks, and other financial provider agencies.

As an example, one of the MFI is considered because it is one of the top leading Microfinance institutions in Afghanistan. Figure 33 shows fraud amounts and cases that happened in that MFI. That figure reveals that organization loses every year a huge amount due to poor credit risk management and the inability to prevent fraud during the year due to weak internal controls. Poor Credit Risk Management is the one common concern in all microfinance institutions in Afghanistan.

Figure 33: MFI Fraud by Year



Source: *Risk Department of MFI, 2020*

3.3.2.4. Weak Corporate Governance

Corporate governance is the structure of rules, practices, and processes used to handle and manage an organization where according to Mersland (2011) it is considered to be one of the weakest areas in the microfinance industry globally. Corporate governance is key in microfinance performance and can help long term survival in the industry.

In Afghanistan, most microfinance institutions especially local micro finances have struggled to become financially self-sufficient and to achieve their social missions of impacting on the well-being of poor people. The reasons behind weak corporate governance in Afghanistan were several issues. Lack of experience and being not qualified is one of the reasons that Afghanistan's microfinance institutions have been poorly managed. Microfinance was a new type of business entity in Afghanistan where in the whole labor force there was a lack of experience and capacity in this field. After years, numerous local microfinance institutions have been established in Afghanistan. Decades of war had definitely affected the capacity of people where the local micro finances were managed by locals who didn't have sufficient experience and qualifications. Some of the local microfinance agencies were fully staffed by local Afghan people.

As a result of that, today there is only one local microfinance institution working in Afghanistan with only 5% of market share and having just 19,225 active clients through 8 branches in 6 provinces across the country. Local micro finances couldn't resist the tough economic conditions and several reasons were involved in their failures such as weak corporate governance of the organization, weak internal controls, and lack of source of financing.

Furthermore, there were four local microfinance institutions working in Afghanistan such as Parwaz, Ariana Financial Services Group (AFSG), Women for Women International (WWI), and MADRAC. These four microfinance agencies were owned and fully staffed by Afghans from top-level management till operational level. However, this type of organizations which were staffed fully with nationals was very essential for building domestic capacity and increase competitions in the market but the biggest problem was not being able to receive fund from international donors.

International donors knew about the weak corporate governance of these microfinance institutions. That's why this type of organization was less attractive to foreign investors. As a consequence, these local microfinance agencies suffered financially.

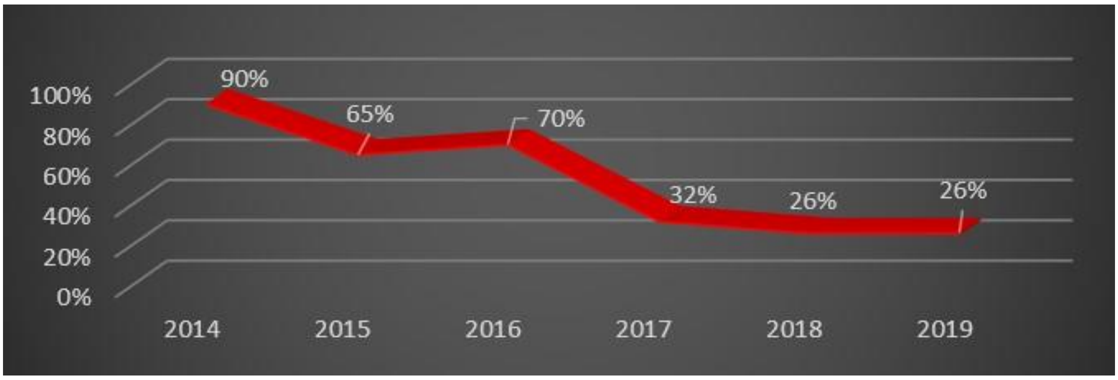
Client retention is another aspect of good corporate governance where the MFI has the ability to retain a borrower over some specific period. Afghanistan's MFIs have always had a problem with client retention due to weak corporate governance. For example, Figure 34 shows closed loans and repeat loans of one of the MFIs (due to confidentiality of data cannot mention the name) in 2019. It clearly displays that a high number of loans have been closed compared to new repeat loans. This is a really good sample from the microfinance industry in Afghanistan because this MFI has a good market share of the microfinance sector. This obviously points out that MFIs in Afghanistan do not have the ability to retain the borrowers. As a high number of borrowers are not expected to return or continue to have financial service from MFI, it proves that microfinance institutions have weak corporate governance. As a result of poorly managing microfinance institutions, borrowers are not quite satisfied with the service and products of MFIs.

Figure 34: One of Afghanistan's MFI Borrowers Retention 2019

Source: *Risk Department of MFI, 2020*

In addition, as Figure 35 indicates, over the years the capacity of that MFI has decreased in terms of recovering fraud amounts. Several factors can be involved in the inability of recovering loans. One of the major reasons is poor corporate governance in the organization. Simply means, this MFI is poorly managed that caused a capital loss in the first place. Secondly, there is no clear instruction or policies/procedures in terms of loan recovery.

Figure 35: MFI Loan Recovery by Years



Source: *Risk Department of MFI, 2020*

To conclude, internal factors had more impact on the long-term survival of local MFIs. The Afghanistan microfinance history shows that so many local microfinance institutions have been damaged, merged into one microfinance institution, and had to stop their operation permanently due to both external and internal factors. Local microfinance institutions in Afghanistan didn't have strong support like many international microfinance agencies, and poor corporate governance resulted to choose the wrong business strategy. Also, these local microfinance institutions couldn't attract foreign investors compared to international micro finances and local micro finances were strongly relying on MISFA's fund for financing their operation. In 2009, MISFA's loan and funds made almost 90% of the loan portfolio outstanding of MFIs in Afghanistan. Basically, MFIs were deeply dependent on only one source of the fund without securing alternatives which any kind of disruption in loan or funds directly affected as a whole Microfinance operation.

Weaknesses in internal controls, rapid expansion, poor management, and weak staff capacity were identified as key issues in the microfinance industry of Afghanistan. All these factors created a big financial crisis in the microfinance industry where MFIs were significantly suffering. Therefore, with the consideration of the critical situation that MFIs were in in Afghanistan, MISFA facilitated the merging of three microfinance agencies such as MADRAC, MOFAD, and PARWAZ into completely new microfinance called Mutahid Development Finance Institute. Mutahid was created for the best opportunity in order to make one larger, stronger, and more sustainable MFIs in the country. In addition, other MFI agencies like BRAC, Sunduq, WWI, AFSG, and AMFI went bankrupt and stopped their operation permanently.

3.3.3. Interest Rates Charged by Afghanistan's Microfinance Institutions

In September of 2020, the Microfinance sector of Afghanistan had AFN 7.1 billion gross loan portfolio with 109,579 active borrowers that 37% of total borrowers are women borrowers. The loan outstanding per borrower is AFN 65,141 (MISFA, 2020c). Furthermore, according to the World Bank (2018), private banks are dominating the financial system of Afghanistan. By the end of 2016, Banking sector assets represent 21% of the GDP of Afghanistan. Moreover, the total assets of the banking sector in Afghanistan including all 15 banks are $4 billion with a customer deposit of $3.6 billion and a gross loan portfolio below $0.7 billion. These statistics represent that as a whole the credit volume in the financial sector of Afghanistan is significantly low with only $0.7 billion. Meanwhile, the loan portfolio of Microfinance institutions is $0.0906 billion which is 13% of the total credit volume in the financial sector of Afghanistan (*The calculation is based on the exchange rate in the 5th January of 2021 which 1 United States Dollar equals78.35 Afghani)*.

Operational self-sufficiency (OSS) is the ratio that is mostly used in MFIs for the purpose of analyzing their ability in generating operating revenues. Basically, it shows the incomes of MFI in order to cover the total cost incurred in running the business. The operational self-sufficiency ratio can be calculated using the formula as operating revenues divided by all expenses (Accounting Guide, 2020). As Table 8 represents Microfinance institutions have been operationally self-sufficient over the recent years in Afghanistan.

Table 8: Financial Overview of MFIs in Afghanistan

Years	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Gross Loan Portfolio	-	-	-	-	5.7 Billion	6.6 Billion	7.9 Billion	8.2 Billion	9.3 Billion	7.1 Billion
Total Number of Borrowers	-	-	-	-	112,910	129,588	126,908	129,744	137,994	109,579
Operational Self-Sufficiency (OSS)	-	-	-	-	108.30%	98.30%	116.10%	109.20%	101.90%	-
Total Comprehensive Income (*AFN'000*)	6,504,218	6,188,931	6,295,128	6,442,782	6,783,899	6,912,883	7,483,191	7,688,916	-	-

Source: *Author's Calculation, 2020*

Furthermore, Microfinance institutions are charging very high-interest rates in Afghanistan. These interest rates are much higher compared to the interest rate of commercial banks in Afghanistan and other countries. Since the majority of people are illiterate or do not have sufficient knowledge about Banking or Finance and Capital Market, Microfinance institutions are intentionally misusing the lack of financial literacy in the country. For example, by advertising on their website for the interest rate of 1.25% on a monthly basis while after the calculation of an amortization table of a microfinance institution (Table 9), it can be calculated that the credit costs nearly 31% effective interest rate on annual basis to the borrowers. Microfinance institutions issue interest rates in such a way to be able to attract a high number of borrowers where people think that they are paying less interest rate while the reality is far from this.

Table 9: Credit Amortization Table from One of Microfinance Institutions in Afghanistan

LOAN REPAYMENT SCHEDULE

Loan Number : [redacted] **Cusomer ID :** [redacted]
Customer Name : [redacted]
Product Description : [redacted]

Disbursed Date : 30-Oct-2019 **Currency :**AFN
Disbursed Amount : 200,000.00
Created By : [redacted]

Installment No	Principal	Markup	Markup Adjustment	Total Markup Due	Penalties	Installment Amount	Due Date	Recovered Amount					
								Paid Date	Late-Days	Principal Paid	Markup Paid	Penalties	Status
1	14292.07	4950	0.00	4,950.00	0	19242.07	Dec 3, 2019	Dec 3, 2019	0	14292.07	4950	0	FULL_PAID
2	15202.92	4039.15	0.00	4,039.15	0	19242.07	Jan 2, 2020	Jan 2, 2020	0	15202.92	4039.15	0	FULL_PAID
3	15277.83	3964.24	0.00	3,964.24	0	19242.07	Feb 3, 2020	Feb 3, 2020	0	15277.83	3964.24	0	FULL_PAID
4	15749.46	3492.61	0.00	3,492.61	0	19242.07	Mar 3, 2020	Mar 4, 2020	1	15749.46	3492.61	0	FULL_PAID
5	16208.43	3033.64	0.00	3,033.64	0	19242.07	Apr 2, 2020	Apr 2, 2020	0	16208.43	3033.64	0	FULL_PAID
6	16376.06	2866.01	0.00	2,866.01	0	19242.07	May 3, 2020	May 3, 2020	0	16376.06	2866.01	0	FULL_PAID
7	16836.97	2405.1	0.00	2,405.10	0	19242.07	Jun 3, 2020	Jun 3, 2020	0	16836.97	2405.1	0	FULL_PAID
8	17283.35	1958.72	0.00	1,958.72	0	19242.07	Jul 2, 2020	Jul 4, 2020	2	17283.35	1958.72	0	FULL_PAID
9	17550.1	1691.97	0.00	1,691.97	0	19242.07	Aug 3, 2020	Aug 3, 2020	0	17550.1	1691.97	0	FULL_PAID
10	17999.56	1242.51	0.00	1,242.51	0	19242.07	Sep 3, 2020	Sep 3, 2020	0	17999.56	1242.51	0	FULL_PAID
11	18404.55	837.52	0.00	837.52	0	19242.07	Oct 3, 2020	Oct 4, 2020	1	18404.55	837.52	0	FULL_PAID
12	18818.7	423.42	0.00	423.42	0	19242.12	Nov 3, 2020		0	0	0	0	NO_PAYMENT
Total :	200,000.00	30,904.89	0.00	30,904.89	0.00	230,904.89		Total:		181,181.30	30,481.47		

Source: *Operation Department of FMFB, 2020*

However, commercial banks don’t have microloans like microfinance agencies and it costs significantly more to lend many small loans than a large amount of loans. If Microfinances do not charge interest rates higher than commercial banks, they cannot cover all their costs. By charging the higher interest rates, MFIs will have a better chance of surviving in the long term on their own and they will not be forced to depend on government and donor’s money (CGAP, 2004).

CONCLUSION

The aim of the research was to analyze the experience of Microfinance Institutions in Afghanistan in pursuance of figuring out what lessons can be learned from Afghanistan's microfinance experiences during two decades for academic and business purposes. Based on the results of the study, it can be concluded that Microfinance institutions have gone through different stages in Afghanistan where the majority of the microfinance agencies have experienced difficult conditions such as capital loss, merging, and bankruptcy.

The findings of this research clearly illustrate that several internal and external factors impacted negatively the operation of microfinance institutions in Afghanistan. Then as consequence, MFIs have a small credit portfolio, limited geographical outreach in rural areas, a high client dropout rate, high nonperforming loans ratio, trouble in legal prosecution, and couldn't achieve their full potential of reaching a large number of poor people. Meanwhile, women empowerment, the well-being of people, and the reduction of poverty have also been negatively influenced. Since these are the main objective of microfinance institutions, the influence of MFIs has been less than expected.

Under the content of the thesis, it has been discussed and analyzed that Afghanistan's Microfinance Institutions have been essential for providing resources to entrepreneurs for increasing income-generating activities in order to create more jobs and expand their businesses. In addition, employment creation is one of the key aspects that Microfinance institutions had significant influence as, over the last ten years, Microfinance institutions have created more than one million estimated number of jobs in the country.

Moreover, this research clearly shows that despite all the external factors microfinance institutions have immensely contributed in different areas, but also raises the question of how better MFIs could have contributed without challenges like lack of security, corruption, political constraints, and religious beliefs. The finding of this study addresses that with the consideration of these challenges, Microfinance Institutions have been quite impressive for providing sustainable financial services for poor people in Afghanistan.

This study also finds that Afghanistan's Microfinance institutions are falsely calculating the interest rate for misleading borrowers. In fact, MFIs are charging the highest interest rates in Afghanistan compared to commercial and state-owned banks. The effective interest rate of Afghanistan's microfinance institutions is marginally higher even than India's MFIs, Bangladesh, and Turkish commercial and state-owned banks. In certain circumstances, interest rate ceilings caused poor people not to use financial services and forced them to borrow from informal lenders. Due to the high-interest rate, borrowers were not able to repay the loans. Therefore, borrowers were forced to sell assets or properties to repay the loans. As a result, instead of positive changes micro-credit programs negatively affected certain borrowers.

As a recommendation, this paper indicates that Microfinance institutions should focus on improving the internal control system of the organization, credit risk management, dual control, and staff capacity building because the portfolio at risk of Microfinance institutions in Afghanistan is high. One of the main reasons for fraud in microfinance institutions is weak internal control and credit risk management. It will definitely help microfinance institutions for preventing fraud in the organization.

Moreover, in Afghanistan, the majority of the people are involved in the agriculture sector, while microfinance institutions have always focused less on this sector. Also, the loan size of agriculture is very small with a short repayment period and the schedule of repayment is too soon. Hence, Microfinance institutions should bring changes to the terms of agriculture products, delivery strategy and should pay more attention as it's the biggest sector with 71% of the Afghan labor force engaged in it.

Lastly, Afghanistan is a country where Islamic beliefs are superior, while Microfinance has the concept of a non-Islamic financial system. Therefore, Microfinance institutions should consider introducing Islamic products and services. Meanwhile, FINCA one of the microfinance institutions in Afghanistan has already experimented with a few innovative products like Islamic products. The result indicates it has huge demand in the market. Thus, it will be found so effective for other microfinance institutions to launch such a product. It will also help MFIs to achieve their potential untapped market.

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CURRICULUM VITAE

Najeeburahman Lutfi was born in Kabul, the capital of Afghanistan, on March 06, 1995. First, he finished his primary education at Muhmmad Alam Faiz Zad High school. Later on, for pursuing his higher education, he got a merit-based full funded scholarship among one thousand Afghan students from Dunya University of Afghanistan (DUAF). In 2017, he was honored with a dual degree from Dunya University of Afghanistan and Umef University of Switzerland in the field of finance. In addition, he has worked with the top leading financial organizations in different positions for more than five years in his field of study where he developed his leadership, problem-solving and analytical skills. Meanwhile, he has also studied foundation in Accountancy at the American University of Afghanistan. During these years, he has successfully built an awesome career in Finance. In addition, he is fluent in English, Turkish, Dari, Pashto, and Urdu languages.

Besides focusing on his academic and professional goals, he has also been involved in many voluntary community activities in Afghanistan. During four years, he has devoted the time and energy necessary to voluntary services even though the schedule has always been tight. In 2019, for the purpose of doing his Master's degree, he got admission to Karabuk University of Turkey. Finally, he has successfully finished his MBA from the Graduate Business School of Karabuk University in 2020.