



**EVALUATION OF MICROFINANCE, SMALL AND
MEDIUM ENTERPRISE IN AFGHANISTAN**

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**EVALUATION OF MICROFINANCE, SMALL AND MEDIUM ENTERPRISE
IN AFGHANISTAN**

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THESIS APPROVAL PAGE

I certify that in my opinion the thesis submitted by Imam Ali HUSSAINI titled “EVALUATION OF MICROFINANCE IN SMALL AND MEDIUM ENTERPRISES IN AFGHANISTAN ” is fully adequate in scope and in quality as a thesis for the degree of Master of Arts.

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This thesis is accepted by the examining committee with a unanimous vote in the Department of Participated Banking and Finance as a Master of Arts thesis.

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The degree of Master of Arts by the thesis submitted is approved by the Administrative Board of the Institute of Graduate Programs, Karabük University.

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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.

Without being bound by a particular time, I accept all moral and legal consequences of any detection contrary to the aforementioned statement.

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Signature :

FOREWORD

I would like to thank many people for their support while acquiring my master's degree at Karabük University. Since space is limited here, I would like to mention a few of them by name. I am very grateful to the Banking and Finance department's Chair Dr KAYADİBİ, the administrative staff and all the academic personnel who was part of my education. I found them very helpful and supportive. I would like to submit my special thanks to Dr. Osman KURTER, who guided me step by step in the process of writing this thesis and logically conclude my submission. Without his contribution, it would not have been possible to complete my thesis on a timely basis.

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ABSTRACT

This paper analyzes the importance of microfinance institutions and small and medium enterprises in Afghanistan since this sector's establishment in 2002. Despite of many international and national donors and large sums of donations, most of the players in this sector are currently bankrupt, and the operational ones are not financially self-sustainable. This research analyzes this sector's performance and major challenges that it faces by gathering data from publications, reports, websites and conducting various formats of interviews with the key staff and stakeholders.

While establishment of microfinance sector has generated new jobs, provided access to financial services for the people who weren't able to before, increased the local capacity of the financial services sector and attracted more financial institutions into the market, it also created serious issues for the country in financial, social, security and human resources areas. Rampant amount of frauds, lack of adequate internal controls, lack of proper management, totally absent law enforcement and oversight, deficiencies of credit bureaus and absence of national identification system are all have been culprit in failure of majority institutions and continue to be major risks in this sector.

Keywords: Microfinance Institutions, Small Medium Enterprise Finance Institutions, Access to finance Afghanistan, Micro and Small Medium Enterprises (MSME),

ÖZET

Bu makale, 2002 yılında bu sektörün kuruluşundan bu yana Afganistan'daki mikro finans kuruluşlarının küçük ve orta ölçekli işletmelerin önemini analiz etmektedir. Birçok uluslararası ve ulusal bağışçıya ve büyük miktarda bağışlara rağmen, bu sektördeki oyuncuların çoğu şu anda iflas etmiş ve işletme olanlar da finansal olarak kendi kendine sürdürülebilir durumda değildir. Bu araştırma, yayınlardan, raporlardan, web sitelerinden veri toplayarak ve kilit personel ve paydaşlarla çeşitli formatlarda görüşmeler gerçekleştirilerek bu sektörün performansını ve karşılaştığı başlıca zorlukları analiz etmektedir.

Mikro finans sektörünün kurulması yeni işler yaratırken, daha önce yapamayanların finansal hizmetlere erişimini sağlarken, finansal hizmetler sektörünün yerel kapasitesini artırırken ve daha fazla finansal kuruluşu piyasaya çıkarırken, aynı zamanda finansal hizmetler sektörü için de ciddi sorunlar yarattı. Ülkenin finansal, sosyal, güvenlik ve insan kaynakları alanlarında Çok sayıda dolandırıcılık, yeterli iç kontrol eksikliği, uygun yönetim eksikliği, kanun yaptırım ve gözetiminin tamamen yokluğu, kredi bürolarının eksiklikleri ve ulusal kimlik sisteminin yokluğu, çoğu kurumun başarısızlığında suçludur ve bunlar için başlıca riskler olmaya devam etmektedir bu sektörde.

Anahtar Kelimeler: Mikrofinans Kuruluşları, Küçük Orta Ölçekli İşletme Finans Kuruluşları, Afganistan finansmanına erişim, Mikro ve Küçük Orta Ölçekli İşletmeler (MSME),

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ABBREVIATIONS

AKAM:	Aga Khan Agency for Microfinance
AKF:	Aga Khan Foundation
AMA:	Afghanistan Microfinance Association
AMFI:	Afghanistan Microfinance Institution
ARMP:	Afghanistan Rural Microcredit Programme
BRAC:	Bangladesh Rural Advancement Committee (bank)
CGAP:	Consultative Group to Assist the Poor
CFA :	Child Fund Afghanistan
DAB:	Da Afghanistan Bank (Central Bank of Afghanistan)
EU:	The European Union
ESIF:	European Structural and Investment Funds
FMFB-A:	First MicroFinanceBank Afghanistan
FAIDA:	Financial Access for Investing in the Development of Afghanistan
GDP:	Gross Domestic Product
GCA:	Global Corporate Audit
JLG:	Joint Liability Group
MFI:	Microfinance Institutions
MISFA:	Microfinance Investment Support Facility Afghanistan
MoFAD:	Micro Finance Agency for Development
PAR:	Portfolio at Risk
OECD:	Organization for Economic Cooperation and Development
SDG:	Sustainable Development Goals
SHG-BLP:	Self Help Group-Bank Linkage Program
SME:	Small Medium Enterprise
SWOT:	strengths, weaknesses, opportunities, and threats

UNDP: United Nations Development Program
USAID: United States Agency for International Development
WWI: Women for Women International
WOCCU: World Council of Credit Unions

EVALUATION OF MICROFINANCE, SMALL AND MEDIUM ENTERPRISES IN AFGHANISTAN

This thesis is formatted in five chapters. The first chapter contains chronological developments and historical background of Microfinance and SMEs and their historical development in the world. It contains descriptive analysis such as charts, tables, graphs, and publications from authentic sources. Additionally, a regional comparison and the impact of MFI and SME Finance in the development of regions such as South Asia, Africa, East Europe, and South America.

In the first chapter-specific information regarding the MFIs and SMEs in Afghanistan is presented, such as the performance and focus on the financial performance of key MFIs and SME Finance Institution. Further the historical background with internal and external challenges is also presented to list the challenges and areas of risk relating to both internal and external aspects of Afghanistan MFIs and SME Finance Institutions. This chapter also contains charts, graphs, tables, interviews from firsthand sources, and authentic publications such as Microfinance Investment Support Facility Agency (MISFA) and Afghanistan Microfinance Association (AMA) Da Afghanistan Bank (DAB), the Central Bank of Afghanistan, United Nation Development Program (UNDP).

Chapter two contains the Literature review which consider the articles which published. The important topic which are considered to studies are the effects of COVID-19 pandemic, Microfinance in neighboring countries, Microfinance and Islamic Products, Microfinance and SMEs, Microfinance on social aspects and Microfinance and SMEs in Afghanistan. The resent publication gathered from well-known journals and relevance to the article was considered.

Chapter three is Methodology which contains the main research problems which benchmarked the internal and external challenges, which have the main effects on performance of Microfinance and SMEs. The analysis trying to present the sustainability of the microfinance and SMEs sector in Afghanistan. Types of graphs, interview, and publications are gathered for sampling. The scope and limitation which faced during this thesis and the research design, scope of studies. Finally the problem and limitations which considered during gathering of data and analysis is done.

Chapter Four contains interpretation and discussion, which studied in detail analytically the area which considered on hypothesis. Among other challenges the main six area considered the key area to focus which area the collateral issues, management information system (MIS), client and staff behavior toward loans and Microfinance funds, clients Identifications, Security and Law enforcement and the high cost of finance. Each area considered in details and gather the information by articles, publications and interviews.

Chapter five contains the analysis and conclusion the summary of all the research and the reasons and analytical and real overview of the writers. It analyzed in details the issues which considered in chapter four and each part is analyzed. Additionally, it discussed the current issues of microfinance and its impacts on future of this sectors. The synergies method is suggested in this sector to improve the sustainability of this sectors in the future.

1. CHAPTER ONE: INTRODUCTION

Review of MFIs and SMEs

This chapter presents the historical background of MFIs in SMEs in Afghanistan. Themes covered include the need and importance, coverage, and a comparison of the development of social and economic aspects. This chapter also includes a list of MFIs and SME that have operated or are presently operating in Afghanistan, shining the spotlight on exemplary institutions and providing reasons for the collapse of certain MFIs and SMEs.

1.1. Historical Background of MFI and SME in the world.

Although historical accounts of microfinance date back to the early origins of money and commerce, it is very well-known fact that microfinance as we know it today started from the Grameen methodology of Grameen Bank, founded by Muhammad Yunus in Bangladesh. This model used the group lending methodology, along with cross-guarantees by the members of the group and primarily targeted female clients who had challenges accessing traditional finance venues.

Historian Paul Thomas notes that microcredit has been a natural cycle for a long time, and sheds light on this topic through reliable social and historical perspectives. Thomas provided a comparison of microcredit in Europe between the 18th and 21st centuries. N. Srinivasan described the origins of microcredit, tracing it back to several religions, such as in Hinduism as far back as the fourth century BC. In India, it was stipulated that lending with interest is one of 34 religious sins. Later on, lending with interest was forbidden by several religious books such as the Old Testament, Bible, and Holly Quran (Mendelson, 2016).

Seibel mentioned in an article that every country has its own unique historical examples and explanations about the evolution of microcredit. For example, in the old Indian subcontinent, there was an interesting practice of purchasing a cow by initially collecting resources from the entire village. Eventually, all members of the village became the owner of the cow, and the revenue generated from the animal was shared accordingly (Seibel, 2003).

In Europe, it was initially created around the year 1720 in Ireland. The main objective at that time was contributing to interest-free loans for the needy. However, in

1823, the law changed and allowed the institution to charge interest on loans. In 1778, Germany established the largest microfinance system which had three main aspects: community-based savings, savings mobilization, and rural and urban credit. The first Thrift Society was founded in 1778 and a communal savings program in 1801. Microfinance was seen as a natural upgrade to SMEs and microcredit customers who grew their business successfully. They were advanced to the SME finance level and were therefore eligible for higher value financial access with different terms and conditions (Seibel, 2003).

Microcredit can have a significant social and economic impact on individuals and societies. The history of microfinance goes back to thousands of years in Asia in different forms. Franciscan emphasized that the world is a small village in Europe in the mid of 15th Century. Bringing low-income and poor individuals in their communities together and engaging them to mutually develop economically and progress socially yielding positive results. It is challenging to function for progress to take place without financial support. Therefore, it was required for societies to have access to finance. For example, in 1879, Germans were required to build up cooperative loan and saving accounts. To mitigate their risk, they initially allowed those who were employed to join, similar to the current practices of the modern banking system.

Lysander Spooner wrote about the advantages of microfinancing and small credit for farmers and small entrepreneurs while he was researching how to reduce poverty during the mid-1800s. By end of World War II, his plan was credited for creating a significant impact on the poverty reduction.

Timothy Guinnane, a famous economic historian researched Friedrich Wilhelm Raiffeisen and his Village Bank. This German mayor and cooperative banking pioneer's bank did not only give over two million loans to poor villagers between the years of 1864 and 1901, his Raiffeisen banking system was also credited for Germany's miraculous recovery from the economic destruction of WWII.

In Quebec, Canada, from 1900 to 1906 an organization was founded with the objective of providing microcredit to needy, by its founder Marie-Clara Dorimène Roy Desjardins and her husband Alphonse Desjardins. They risked their own personal assets to build up the organization and surmounted two significant challenges which included the creation of the Caisses Populaires Desjardins and achieving the passage of legislation supporting microcredit through the National Assembly of Québec.

As mentioned previously, modern microfinance history starts at 1970s by globally renowned Grameen Bank Model developed by Mohammad Yunus and Akhtar Hameed Khan. The idea of microfinance and microcredits started from a village in one of the poorest countries of the world, Bangladesh. Muhammad Yunus initially provided loans to 42 women to start their small businesses. Since then, a revolution happened in the modernization of microfinance, and the Grameen model was adopted all over the country and other parts of the world (BNP Paribas, 2017).

Innovations were made by them led to the development of the microfinance sector by offering financial services to the poor and needy without fees, providing them with guidance, encouragement, and monitoring their operations closely. Furthermore, in 1973, Shore Bank was founded in Chicago, the USA with a mandate to promote community microfinancing.

It is also noteworthy that the United Nation declared 2005 as the International Year of Microcredit. By 2005, the World Bank and CGAP (Consultative Group to Assist the Poor) efforts benefitted an estimated 7000 MFIs and 16 million people. In 2006, Muhammad Yunus, the founder of Grameen Bank, received a Nobel Prize for his contribution to the microfinance sector. His contribution has been a remarkable impact since he has provided the opportunity for millions of people to access finance without any collateral. His model has inspired many other institutions that offer similar products in many countries (Info, 2021).

After talking so much about the history of microfinance and its natural progress to the current era, let's look at what is microcredit and SME briefly.

Microcredit or microfinance is a banking service primarily provided to low-income groups or individuals, who do not have access to mainstream financial services due to their poor credit, or low credit scores. Unlike other large loans, microcredit normally ranges from \$100 to \$25,000, and additionally other services can be provided to these targeted groups, such as micro insurance, saving accounts, digital/e-payments and remittances. The World Bank states that more than half a million people are receiving services of microfinance related products and most MFIs work in developing countries. MFIs allow their clients to take loans as per their needs and repay them with a pre-determined repayment schedule which indicates interest, service and charges (Kagan, 2021).

SMEs are described by the European Commission as businesses with less than 250 employees, a turnover of under 50 million Euros, and a balance sheet totaling of fewer than 43 million Euros. As depicted in table # 1, micro, small, and medium businesses are the three types of SMEs. According to the SME concept, the SME status of an enterprise that is part of a group will need to be calculated based on; data about employees, turnover, and the balance sheet from the entire group, rather than just the data from the enterprise itself. The SME recommendation includes specific instructions about how much of the group's statistics can be used to assess an individual company's SME status. Unfortunately, these guidelines are difficult to completely enforce in statistical systems. Structural business statistics and other project data sources do not provide details on the total balance sheet of the organizations. As a result, statistics often use size class details based solely on the number of people working in the businesses, rather than looking at the wages, turnover, or balance sheet data from the business's peer group. Since enterprises belonging to a domestic or foreign enterprise community might be in a different role compared to autonomous enterprises, this naturally has statistical implications. For instance, this status impacts their ability to obtain financing, negotiation power, and opportunities to expand into international markets, among other aspects of doing business (European Commission, 2021)

Table 1: SME criteria as per European Commission

Description of Company	Number of Staff	Turnover	Balance Sheet
Micro Size Company	<10	≤ € 2,000,000	≤ € 2,000,000
Small Size company	< 50	≤ € 10,000,000	≤ € 10,000,000
Medium-sized	< 250	≤ € 50,000,000	≤ € 43,000,000

Source: [Statistics on small and medium-sized enterprises - Statistics Explained \(europa.eu\)](https://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&plugin=1)

Criteria for micro-SMEs in terms of the number of staff size is under 10 people and for a small sized companies are between 10 to 50 individuals. Similarly, for medium sized companies, staff size is between 50 to 250 employees. The company's annual turnover, or asset portion of the company for the micro size is less than 2 million Euro, while for the small sized companies it is 10 million Euros. For medium sized companies asset is expected to be between 43 million and 50 million Euros.

Those companies who pass these prescribed assessment criteria achieve two main benefits. Firstly, they acquire eligibility and enrolment to the European Business Support program, where they will get innovation, competitiveness, and research fundings. Secondly, they benefit from a reduction of fees due to their EU administrative compliance status (European Commission, 2021).

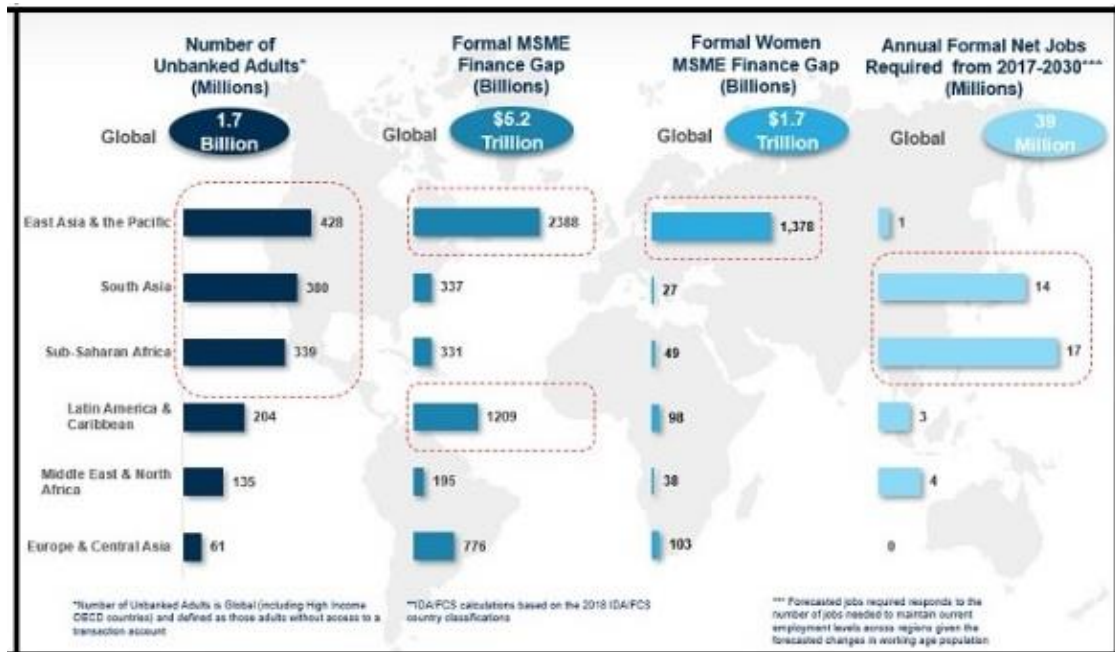
1.2. Definition of MFI and SME

The microfinance loans or microcredits given by MFIs are intended for low-income and needy individuals and groups so they can be self-sufficient. The idea is to help those individuals with a loan structure and design that they are normally not eligible for any type as of credit. This will not only give them an opportunity to run their own businesses, but they will also have chance to exit poverty conditions that they live in (Financial Dictionary, 2021). The size of MFI loans is different from region to region within a country, and you can also find differences on the eligibility criteria from area to area based on the prevailing income and economic conditions of the local population. There are multiple MFIs and banks who are the engine of the economic activities taking place in Afghanistan (FMFB Afghanistan, 2021 & MISFA, 2019b).

While SME's can be found as separate organizations in some other countries, this is not the case for Afghanistan. Afghan-based MFIs and Banks are offering these loan products, as described in the introduction part of this thesis in detail.

The SME play a significant role in most economies, especially in poor and developing countries. In some of these poor countries, these enterprises make up most of the companies who are critical contributors to job growth and countries' economic development. They specifically account for roughly 90% of companies and more than half of the employment source in Afghanistan. In similar developing economies, formal SMEs contribute to 40% of the total national income, known as Gross Domestic Product (GDP). When informal or undocumented SMEs are included in the tally, the numbers are considerably higher. To absorb the rising global workforce, it is estimated that 600 million jobs will be needed by 2030 making SME growth a top priority for many governments around the world. SMEs, which at present account for seven out of ten jobs in emerging markets countries. Access to finance, on the other hand, is a major obstacle for SMEs' growth in emerging markets and developing countries, ranking as the second most cited barrier for business development.

Figure 1: Job Required from 2017 until 2030



Source: <https://www.worldbank.org/en/topic/sme/finance>

The World Bank (WB) report explains that small businesses are less likely than the large businesses to be able to secure bank loans, so they must rely on their internal funds or cash from family and friends in order to start and operate their small businesses. According to the International Finance Corporation (IFC), about 65 million companies in the developing countries or 40% of formal micro, small, and medium enterprises (MSMEs), have an annual unmet funding need of \$5.2 trillion. This staggering amount is 1.4 times the current amount of global MSME loans. The East and Pacific Asia regions with 46% of the gap have the largest share of the global unmet finance, followed by the Latin America with 46% of gap, the Caribbean 23% and Europe and Central Asia with 15% of global financing needs. The distance volume varies greatly from one area to the next. The regions of Latin America and the Caribbean, as well as the Middle East and North Africa, have the largest finance gap relative to potential demand, with 87% and 88% respectively. Approximately half of all formal SMEs lack access to formal credit. When micro and informal businesses are factored in, the funding gap widens even further doubling those calculations.

1.3. The World Bank Observation for SME

The main purpose of the WB Group is to improve the SMEs' access to finance sources by finding creative ways to unlock all potential funding sources. The WB makes the following suggestions for improving the world's SME industry:

- Better assessments of the financial sector to identify areas where regulatory and policy aspects may be improved to allow more responsible SMEs' access to the needed capital.
- Support measures, such as the development of an enabling environment, and the design and implementation of credit guarantee schemes.
- Improving credit infrastructure, such as credit reporting systems, secured transactions, collateral registries, and insolvency regimes to aid SMEs in accessing more funding.
- Using e-lending networks, alternative data for credit deaccessioning, e-invoicing, e-factoring, and supply chain financing to introduce innovations in SME finance.

1.4. Where do SMEs enjoy the best and worst business climates in the world?

SMEs enjoy a very favorable business climate in Canada, Hong Kong, the US, Netherlands, and Singapore. All these five economies except Hong Kong, share a flexible labor market in terms of recruitment and HR practices, a low degree of red tape, and relatively good financing conditions. The top three also profit from favorable tax policies according to Ana Boata, the Senior Economist for Europe, and the study co-author. The SMEs in the United Kingdom, Germany, and France face a less desirable market environment. Although tax policies are a key constraint in the first two countries, in France, labor market stability and financial details on SMEs, as well as red tape, are the main roadblocks. "In comparison to the average business abroad, SMEs in the United Kingdom, Ireland, Poland, Slovakia, and the Czech Republic face considerably more constraints. In most of these countries, financing is a big constraint," says Kai Gerdes, Director of Credit Risk at Euler Hermes Rating.

1.5. Understanding the SMEs

The SMEs play very important role in the overall economy, despite their small sizes and volumes. They outnumber big size corporations by a great margin, employ

more employees, entrepreneurially oriented, and contribute to new and innovative practices.

In the US, there is no standardized method of identifying SMEs. The European Union (EU) on the other hand, has more precise descriptions; defining a small business as one with fewer than 50 workers, and a medium-sized business as, one with fewer than 250 employees. There are micro-companies, which employ less than ten people, in addition to small and mid-size businesses. Many governments also include incentives, such as preferential tax treatment and easier access to loans, to aid businesses in staying afloat. Many citizens in less developed countries work in SMEs. According to the Organization for Economic Cooperation and Development (OECD), SMEs account for approximately 45 percent of total job force and contribute to 33% of the GDP in these countries in 2020. The SMEs are not just important and contributing to the less developed economies. They are documented to provide 77% of new jobs creation in Canada between years of 2002 and 2012. Similar statement could be said about the United States. These companies generated 64% of net new employment creation between the years of 1993 and 2011. In a same fashion, we can produce equally favorable statistics for most of the other developed countries. The SMEs are critical to every country's economic well-being, both in terms of new job creation and tax revenue generation (Liberto, 2020).

1.6. History of MFI and SME in Afghanistan

The history of MFIs and SMEs in Afghanistan goes back almost two decades. The establishment of the post-Taliban government in the early 2000s prompted most Afghan migrants living in neighboring countries, such as Iran and Pakistan to return back to their country. The influx of migrants returning back was very high, and the country's resources were not enough to meet the requirement of all incoming individuals. Since most of the newcomers could not acquire employment, starting small businesses was the most popular solution or alternative for generating economic activity for many of them. That is the reason why the international donor organizations decided to operate and finance various microcredit programs in the country. As the time has evolved, these small programs upgraded to become microfinance institutions and banks. In response to these developments, the Microfinance Investment Support Facility for Afghanistan (MISFA) was established in 2003. The MISFA states its objectives as to coordinate and merge the conflicting donor objectives (MISFA, 2019a).

1.7. Establishment of the MISFA in Afghanistan

MISFA channeling various international organizations funded loans, grants, and technical assistance to the local microfinance programs, institutions and banks is actively engaged in support of SMEs in Afghanistan. MISFA also undertakes monitoring and regulation of organizations that they engaged with. In the early stages, the microfinance programs, institutions, and banks started their activities by replicating the financial service products of various countries such as Bangladesh, India, Pakistan, and countries from Europe and Africa. A few organizations were also able to receive technical assistance and consultancy from reputable international companies and staff operating in other countries.

Initially, MISFA and microfinance programs, institutions and banks were more focused on microenterprises and households. The German organization Deutsche Investitions- und Entwicklungsgesellschaft (DEG), a German NGO working with MISFA in Afghanistan, established a loan guarantee fund to finance high-value credits for SMEs. These enterprises are the backbone of the Afghan economy, and they are surrounded by several microenterprises in their economic system and are vital for job creation. The loans were hovering at the upper limit of credit provided to micro enterprises, which at that time was around a maximum of 5,000 US dollars. Depending on the recurrence of loans, client business appraisal, and client history; the funding ceiling per SME was around 200,000 US dollars. These loans were well appraised and with the loan guarantee, they were well protected and therefore regarded as one of the best product (ACGF, 2021)

1.8. Establishment of Afghanistan Microfinance Association (AMA)

AMA is a network association of financial institutions involved in lending to the MSMEs. AMA was established by MISFA in 2005. In the first 5 years AMA was not very active mainly due to lack of funding and capacity. However, in 2010, United States Agency for International Development (USAID) launched a specific program called Financial Access for Investing in the Development of Afghanistan (FAIDA) this program made available funding to Network organizations like AMA which led to significant improvements in AMA's activities, connection with financial institutions and AMA's corporate governance.

AMA currently has a Board of Directors appointed from within the Financial Institutions lending to MSMEs. AMA's Vision is: To promote financial inclusion

through creation of an enabling environment for the development finance sector in Afghanistan.

AMA's Mission is: To build an inclusive, sustainable and responsible development finance sector through policy advocacy, knowledge management, coordination and networking, and capacity building.

Table 2: Members of AMA

S.#	Name of Organization	Sectors
1	The First MicroFinanceBank	Bank
2	Exchange Zone	Microfinance Institute
3	FINCA	Microfinance Institute
4	IIFC Group	Microfinance Institute
5	MUTAHID DFI	Microfinance Institute
6	OXUS Afghanistan	Microfinance Institute
7	ARFC	Finance Institute
8	AWC	Community-based Saving Promoting Institutions
9	Aga Khan Foundation (AKF)	Community-based Saving Promoting Institutions
10	HAND IN HAND AFGHANISTAN	Community-based Saving Promoting Institutions

Source: Afghanistan Microfinance Association

Table #2 above identifies the members of the AMA who work in four different sectors in Afghanistan (AMA, 2021).

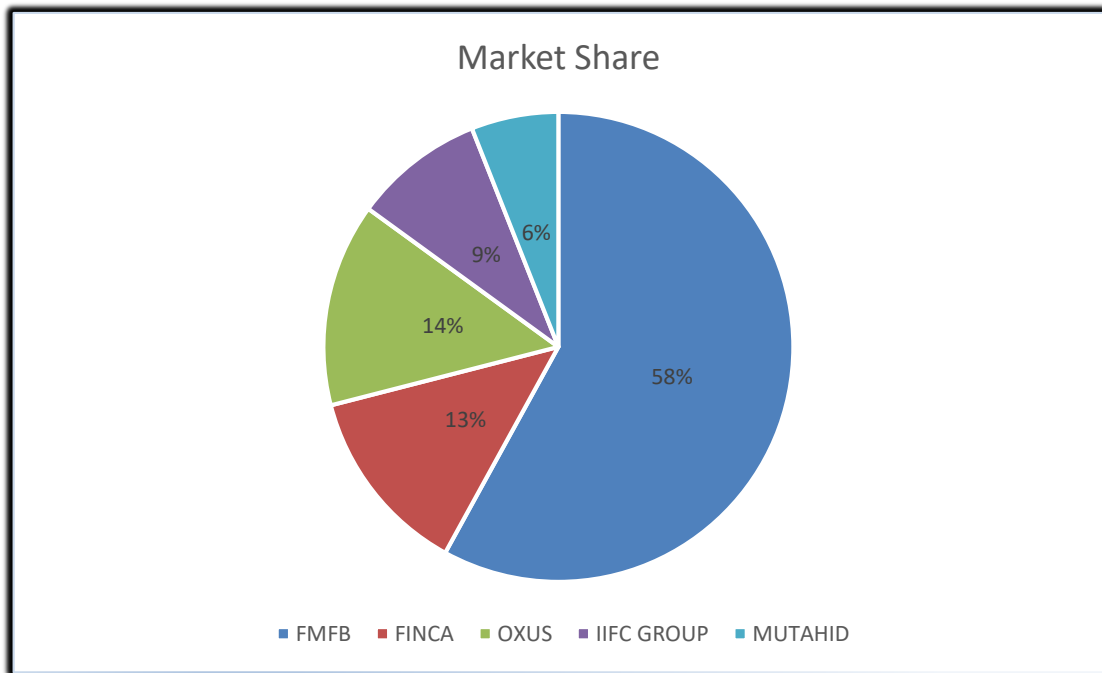
1.9. Establishment of Afghanistan Institute of Banking and Finance (AIBF)

AIBF started its work on 2010 with the purpose of providing research, training and education for commercial banks and MFIs. Based on the observation made by AIBF, most of the staffs in banking and financial institutes rely on foreign nationals as their labor source. It was the aim of AIBF to create an institute to provide capacity building for the staff of banks and MFIs (AIBF, 2010).

1.10. Establishment of Microfinance and SME for the first time in Afghanistan

This section will highlight the top four microfinance Institutes that lead the market in Afghanistan. An attempt has been made to evaluate their activity through a table and figures. These four institutes combined have 91% of the total Afghan microfinance market share which present in figure 2

Figure 2: Market share 2020



Source: AMA report

1.10.1. The First Microfinance Bank (FMFB)

The FMFB is currently working in 15 different countries, mostly in Asia and Africa. It is part of the Aga Khan Agency for Microfinance (AKAM), which operates under the Swiss law headquartered in Geneva, Switzerland. The countries which FMFB operations are located solely in the less developed or developing countries. FMFB is also registered with Da Afghanistan Bank (DAB), the Central Bank of Afghanistan, as the first private bank in 2003. Before operating with an Afghani license, they were working under the umbrella of the Aga Khan Fund for Economic Development (AKFED). AKFED had two departments which operate the Rural, and emergency microcredit programs. FMFB started its operation with a capital of 5 million US dollars and its shareholders included AKFED; International Finance Cooperation (IFC), a WB subsidiary company offers investment, advisory and asset management services in less

developed countries; and Kreditanstalt für Wiederaufbau (KfW), a Frankfurt based German Bank. Currently, FMFB has 34 branches and operates in 14 provinces in Afghanistan (FMFB Afghanistan, 2021)

Table 3 below shows the SME products that FMFB has been offering for the last 5 years. FMFB currently works with multiple SMEs in 11 out of 14 Afghan provinces. The number of clients that they have served until Dec 2020 was 5,704 with distributed loan amount totaling AFN 9,002,182,136. By the end of 2020, the gross outstanding loan amount that they have offered was 1,016,151,916 AFN, while the number of female borrower clients was only 4. Please note from the table that there was a fluctuation in the number of loan officers served the clients. While the distributed loan amount has been increasing steadily from 2017 to 2019, there was a sharp reduction in the number SME loan officers from 28 to 20 and finally increasing to 21 in year 2020.

Table 3: SME Portfolio of FMFB

The First Microfinance Bank (FMFB)	2016	2017	2018	2019	2020
Province	11	11	11	11	11
District	13	13	13	13	13
Active Clients	928	628	590	493	382
Active Borrowers	928	628	590	493	382
Number of loans disbursed (cumulative)	4,723	4,999	5,345	5,543	5,704
Amount of loans disbursed, AFN (cumulative)	5,423,220,905.00	6,112,332,165.00	7,391,816,584.00	8,273,894,035.00	9,002,182,136.00
No. of loans outstanding	928	628	590	493	382
Gross Loans Outstanding, AFN	876,794,748.00	865,070,793.00	1,365,924,232.00	1,221,646,747.00	1,016,151,916.00
Women clients	1	4	6	3	4
Women as % of total clients	0.10%	0.60%	1.00%	0.60%	1.00%
Women borrowers	1	4	6	3	4
Women as % of total borrowers	0.10%	0.60%	1.00%	0.60%	1.00%
Total of SME loan officer	27	28	20	20	21

Source: Compiled from MISFA report

Table 4 below outlines the microfinance activities of FMFB for the last five years. FMFB is providing microfinance and banking services for 14 out of 34 provinces in Afghanistan. It has 212,513 clients and 49,763 active borrowers by end of 2020. The cumulative disbursement made by FMFB in the year 2020 was 61,714,564,887 AFN, the gross outstanding loan amount was 3,568,735,020 AFN and client voluntary savings was totaling 3,223,287,890 AFN. This table also shows female client's number as 51,710, while 12,083 of them were active borrowers. By the end of the year 2020, the number of staff including loan officers, increased from 1002 to 1,449.

Table 4 : FMFB Microfinance Portfolio 2016 to 2020

The First Microfinance Bank (FMFB)	2016	2017	2018	2019	2020
Provinces	14	14	14	14	14
Districts	80	80	80	80	80
Active Clients	137,033	166,712	185,071	203,643	212,513
Active borrowers	56,473	61,347	66,284	58,890	49,763
No. of loans disbursed (cumulative)	494,797	547,984	602,967	647,435	682,999
Amount of loans disbursed, AFN (cumulative)	42,161,250,870	47,728,024,770	53,471,478,201	58,053,021,735	61,714,564,887
No. of loans outstanding	56,473	61,347	66,284	58,890	49,763
Gross Loans outstanding, AFN	3,943,782,251	4,544,844,137	4,930,468,793	4,166,256,110	3,568,735,020
Client voluntary savings	1,675,041,706	1,903,370,561	2,579,380,457	2,752,279,731	3,223,287,890
Client compulsory savings	-	-	-	-	-
Women Clients	31,975	33,095	41,627	47,773	51,710
Women as % of Total Clients	23.10%	19.00%	21.40%	22.80%	23.20%
Women Borrowers	10,501	12,700	14,202	13,496	12,083
Women as % of Total Borrowers	18.20%	20.00%	20.20%	22.10%	23.10%
Total staff (incl Loan Officers)	1,002	1,085	1,117	1,176	1,449

Source: Compiled from MISFA report

1.10.2. Foundation for International Community Assistance (FINCA)

FINCA, founded in Washington, DC, USA by Dr. John Hatch in 1984 as a not-for-profit organization provides microfinance banking services for poor and needy. Since its foundation, it has grown to all five continents of the world and is currently working in 20 different countries. FINCA started its work in Afghanistan in 2003, and it is proud to serve as the first microfinance establishment that launched Islamic microfinance products in the country. FINCA serves clients who are without any capital, and especially caters women and returning refugees. The mission of FINCA is to eradicate poverty by building assets, creating jobs, and raising the standard of living for the poor. The vision of FINCA is to empower low-income and poor communities to invest in their future (Finca Afghanistan, 2021).

FINCA Afghanistan provides loans for microfinance and SME clients both. Table 5 below depicts SME products offered by FINCA, which was published by the MISFA website. We can see from the table that within five years of operations, its operational provinces reduced from 11 to 9 by the end of 2020. The total active clients and borrowers' number was 128 with the cumulative disbursed loan amount of 1,941,510,076 AFN at the end of 2020. During the same time period, the outstanding loan amount was 102,999,444 AFN, and the female client who was served only one. The number of loan officer who was employed in 2016 was 14, while this number dropped to 4 during the operational year of 2020.

Table 5: FINCA SME Portfolio

FINCA- AFGHANISTAN	2016	2017	2018	2019	2020
Province	11	11	11	10	8
District	2	2	-	-	14
Active Clients	360	321	213	131	128
Active Borrowers	360	321	213	131	128
Number of loans disbursed (cumulative)	2,239	2,468	2,571	2,649	2,731
Amount of loans disbursed, AFN (cumulative)	1,348,862,000	1,594,780,000	1,726,687,000	1,840,400,000	1,941,510,076
No. of loans outstanding	360	321	213	131	128
Gross Loans Outstanding, AFN	189,020,611	198,996,270	131,292,429	120,985,761	102,999,444
Women clients	3	3	2	1	1
Women as % of total clients	0.80%	0.90%	0.90%	0.80%	0.80%
Women borrowers	3	3	2	1	1
Women as % of total borrowers	0.80%	0.90%	0.90%	0.80%	0.80%
Total of SME loan officer	14	14	8	5	4

Source: Compiled from MISFA reports

The microfinance operation of FINCA was also playing a very important role in the Afghan financial market. Table 6 below shows 11 provinces were served by FINCA and this number did not change for the last five years. Active client and borrowers decreased from 24,562 in 2016 to 21,744 in 2020. The cumulative loan amount disbursed was 9,123,771,035 AFN in 2016 and this amount increased to 15,235,426,929 AFN in 2020. The outstanding gross loan figure in 2016 was 882,264,558 AFN, and this amount increased to 912,922,985 AFN in 2020. The number of women clients is remarkably high and except the year of 2018, the percentage of total portfolio belonging to women is above 55.20%. The number of staff including loan officers showed a steady increase from 344 to 372, while decreasing to 318 in the year 2020 due to the COVID 19 pandemic.

Table 6: Microfinance Portfolio of FINCA 2016-2020

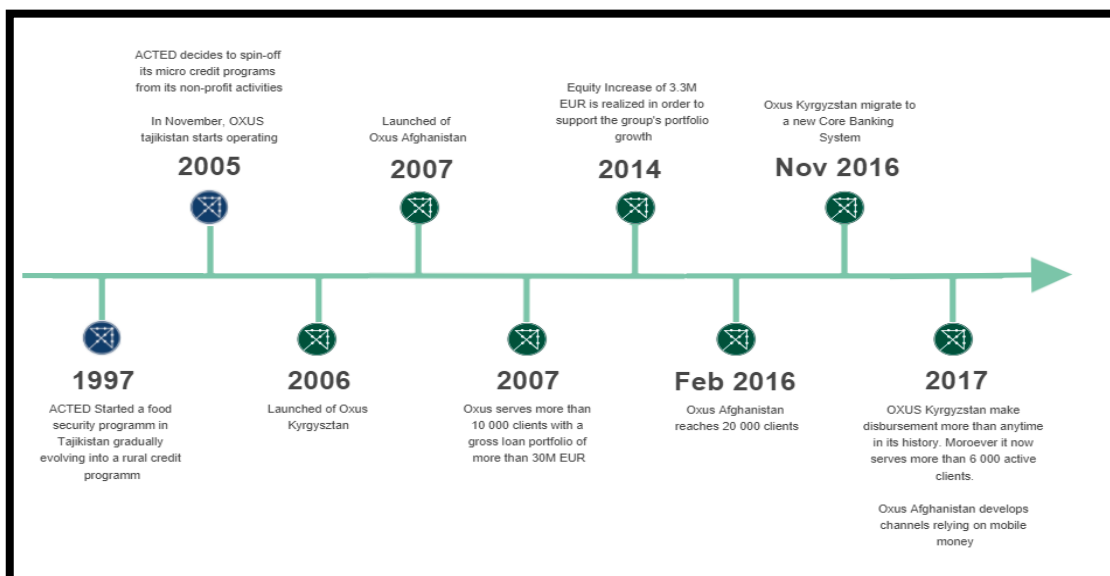
FINCA- AFGHANISTAN	2016	2017	2018	2019	2020
Provinces	11	11	11	11	11
Districts	2	2	2	16	15
Active Clients	24,562	23,938	26,378	27,800	21,744
Active borrowers	24,562	23,938	26,378	27,800	21,744
No. of loans disbursed (cumulative)	362,153	386,703	413,917	442,776	460,654
Amount of loans disbursed, AFN (cumulative)	9,123,771,035	10,649,173,085	12,294,887,735	14,088,744,998	15,235,426,929
No. of loans outstanding	24,562	23,938	26,378	27,800	21,744
Gross Loans outstanding, AFN	882,264,558	984,438,360	1,098,883,576	1,161,893,480	912,922,985
Client voluntary savings	-	-	-	-	-
Client compulsory savings	-	-	-	-	-
Women Clients	15,090	13,924	15,890	16,477	12,248
Women as % of Total Clients	59.70%	56.00%	1	58.20%	55.20%
Women Borrowers	15,090	13,924	15,890	16,477	12,248
Women as % of Total Borrowers	59.70%	56.00%	1	58.20%	55.20%
Total staff (incl Loan Officers)	344	362	372	372	318

Source: Compiled from MISFA report

1.10.3. Oxus Afghanistan

OXUS was a microcredit program sponsored by Agency for Technical Cooperation and Development (ACTED), which was working on an emergency and relief program. ACTED started a food security program in Tajikistan in 1997. ACTED management later separated OXUS from the relief program and created the OXUS network in 2005, as shown in the figure 3 below. OXUS started its microcredit program in Tajikistan in 2005, in Kyrgyzstan in 2006, and finally in Afghanistan in 2007. Oxus Afghanistan did not just achieve 20,000 clients milestone by 2016, it also developed mobile money channels in 2017 (Oxus Network, 2021).

Figure 3: History of Oxus growth



Source: Oxus Network Website

Oxus-Afghanistan activity from 2016 to 2020 is described in the table 7, which captures the activity of SME loans offered by this organization. As it is seen in this table, from 2016 to 2020, the geographical scope of Oxus’s reach was in the same 10 Afghan provinces without any area growth. There was a decline in both SME borrowers and clients within these five years of survey era. Active client numbers drop from 914 in 2016 to 251 in 2020. The cumulative number of loans disbursed in 2015 was 1889, while this number increasing to 3,550 I n 2020. Amount of cumulative loans disbursements was 882,579,855 AFN in 2015, and this amount increased to 2,200,345,558 AFN at the end of the year 2020. Gross outstanding loan amounts showed steady increase from 246,900,376 AFN in 2015 to 313,557,894 AFN in 2019, but this number dropped to 255,037,183 AFN in 2020 due to the adverse effects of the COVID-19 pandemic. The female client’s percentage out of the total customer in OXUS SME portfolio was extremely low, between 0 and 2.7%. The SME loan officer’s number was 15 in 2016, and it increased to 23 by 2020.

Table 7: OXUS SME Portfolio 2015 to 2020

OXUS- AFGHANISTAN	2015	2016	2017	2018	2019	2020
Province	10	10	10	10	10	10
District	-	0	11	4	4	4
Active Clients	914	473	475	472	402	251
Active Borrowers	914	473	475	472	402	251
Number of loans disbursed (cumulative)	1,889	2,460	2,832	3,193	3,449	3,550
Amount of loans disbursed, AFN (cumulative)	882,579,855	1,153,856,856	1,397,947,856	1,733,836,857	2,032,396,857	2,200,345,558
No. of loans outstanding	914	473	475	472	402	251
Gross Loans Outstanding, AFN	246,900,376	181,205,364	195,693,029	294,424,611	313,557,894	255,037,183
Women clients	25	7	8	-	3	2
Women as % of total clients	2.70%	1.50%	1.70%	0.00%	0.70%	0.80%
Women borrowers	25	7	8	-	-	2
Women as % of total borrowers	2.70%	1.50%	1.70%	0.00%	0.00%	0.80%
Total of SME loan officer	15	13	12	16	17	23

Source: Compiled from MISFA Report

The microfinance sectors for the last 5 years from 2016 to 2020 presented in table 8 below shows that OXUS operated in the same 10 provinces. Active borrowers increased from 17,134 to 22,143 first four years but due to the COVID-19 pandemic situation the numbers dropped to 21,200 in 2020. The cumulative number of loan disbursed increased steadily from 112,490 AFN in 2015 to 218,047 AFN in 2020 despite of the pandemic situation. Amount of cumulative loan disbursed was 4,305,875,623 in 2015 AFN, and the amount with an approximate growth trend increased to

9,718,229,463 AFN in 2020. The gross loan outstanding amount by the end of 2020 was 842,030,401 AFN. There was a decrease in the client compulsory savings, which was 3,258,710 AFN in 2016 and this number went down to 476,331 AFN in 2020. An important point from this table is that the number of women clients has increased from 2016 to 2020, from 32.70% of the total number clients to 51.80% of them. The number of staff and loan officers was 334 in 2016, and this number increased to 432 in 2020.

Table 8: Oxus Microfinance Portfolio (2015-2020)

OXUS- AFGHANISTAN	2015	2016	2017	2018	2019	2020
Provinces	10	10	10	10	10	10
Districts	6	3	4	4	5	5
Active Clients	17,134	21,252	22,666	22,349	22,143	21,200
Active borrowers	17,134	21,252	22,666	22,349	22,143	21,200
No. of loans disbursed (cumulative)	112,490	132,329	154,459	176,343	198,129	218,047
Amount of loans disbursed, AFN (cumulative)	4,305,875,623	5,317,117,345	6,417,136,524	7,498,140,624	8,655,144,662	9,718,229,463
No. of loans outstanding	17,134	21,252	22,666	22,349	22,143	21,200
Gross Loans outstanding, AFN	465,139,251	660,721,366	712,096,081	727,962,672	795,270,989	842,030,401
Client voluntary savings	-	-	-	-	-	-
Client compulsory savings	3,258,710	1,009,040	1,197,009	476,331	476,331	476,331
Women Clients	5,595	8,953	10,742	10,616	11,132	11,291
Women as % of Total Clients	32.70%	39.80%	45.00%	46.50%	48.60%	51.80%
Women Borrowers	5,595	8,953	10,742	10,616	11,135	11,291
Women as % of Total Borrowers	33.00%	39.80%	45.00%	46.50%	49.40%	51.80%
Total staff (incl Loan Officers)	334	391	439	407	394	432

Source: Compiled from MISFA Report

1.10.4. MUTAHID Development Finance Instituted (DFI)

MUTAHID DFI was created by MISFA in April 2011 by merging six different MFIs, which included MOFAD, MADRAC, PARWAZ, ARIANA, CHF, and WWI. Unfortunately, this new enterprise was not able to compete in the market. The control of MUTAHID DFI portfolio was taken over and ran by MISFA until they will become sustainable (MISFA, 2021). MUTAHID DFI movement and products are described in detail below.

Table 9 below describes MUTAHID DFI SME products. As we can see from the table, 2016 to 2020 the disbursement of MUTAHID DFI only took place in one province. The number of active clients, borrowers, and number of loans outstanding increased from 2016 to 2018 but dropped from 163 to 111 clients in 2019 and to only 37 in 2020. Cumulative number of loans disbursed in 2016 was 80, and this number was increased to 456 in 2020. The cumulative loan amount was disbursed in 2016 was 30,589,998 AFN, and this amount increased drastically to 295,141,706 AFN in year 2020. Gross outstanding loans in the year 2016 totaled 13,608,778 AFN, while in 2020 this amount decreased to 6,075,304 AFN indicating better economic performance and loan

repayment practice. Women borrowers of this product were very few in 2016 and unfortunately, there were no women clients in 2020. The final observation we can take home from this table is, in 2016 there were 31 SME loan officers, but this number dropped to only 2 loan officers in 2020, indicating the COVID-19 pandemic influence on the microfinance business and more establishing and automating of the operation.

Table 9: MUTAHID SME portfolio

MUTAHID DFI	2016	2017	2018	2019	2020
Province	1	1	1	1	1
District	-	-	1	-	-
Active Clients	58	141	163	111	37
Active Borrowers	58	141	163	111	37
Number of loans disbursed (cumulative)	80	299	404	456	456
Amount of loans disbursed, AFN (cumulative)	30,589,998	219,091,706	267,991,706	295,141,706	295,141,706
No. of loans outstanding	58	141	163	111	37
Gross Loans Outstanding, AFN	13,608,778	44,926,897	42,283,832	24,790,981	6,075,304
Women clients	1	-	-	1	-
Women as % of total clients	1.70%	0.00%	0.00%	0.90%	0.00%
Women borrowers	1	-	-	-	-
Women as % of total borrowers	1.70%	0.00%	0.00%	0.00%	0.00%
Total of SME loan officer	31	6	5	5	2

Source: Compiled from MISFA Report

MUTAHID DFI's microfinance functions more effectively than SMEs and has been active in 6 provinces for the last 5 years between the years of 2016 and 2020. Table 10 demonstrates that there was a fluctuation in the number of active clients from 2016 to 2019 and a sharp decrease in year 2020. Cumulative loans disbursed by 2020 was 127,634 AFN and the cumulative amount of loan disbursed was 6,171,634,435 AFN. The gross loan outstanding in 2016 was 501,791,754 AFN, and by 2020 the amount was 447,521,469 AFN. The number of women clients was 23% of the total client in 2016 and increased to 36.70% in 2020. The total number of staff including loan officers was 270 in 2016 and stayed about same staffing levels up until 2019, but dropped to 234 in 2020, indicating the influence of the pandemic on MUTAHID DFI's operation.

Table 10: MUTAHID MF Portfolio between the years of 2016 and 2020

MUTAHID DFI	2016	2017	2018	2019	2020
Provinces	6	6	6	6	6
Districts	-	-	-	-	-
Active Clients	18,160	17,742	18,681	19,476	14,360
Active borrowers	18,160	17,742	18,681	19,476	14,360
No. of loans disbursed (cumulative)	59,697	77,876	96,341	115,025	127,634
Amount of loans disbursed, AFN (cumulative)	2,530,980,930	3,518,352,572	4,539,776,132	5,504,760,535	6,171,634,435
No. of loans outstanding	18,160	17,742	18,681	19,476	14,360
Gross Loans outstanding, AFN	501,791,754	551,490,374	585,964,818	557,372,154	447,521,469
Client voluntary savings	-	-	-	-	-
Client compulsory savings	1,922,267	-	-	-	-
Women Clients	4,461	4,701	5,866	7,179	5,283
Women as % of Total Clients	22.90%	26.00%	31.10%	35.80%	36.70%
Women Borrowers	4,461	4,701	5,866	7,180	5,283
Women as % of Total Borrowers	22.90%	26.00%	31.10%	36.70%	36.70%
Total staff (incl Loan Officers)	270	274	285	275	234

Source: Compiled from MISFA Report

1.11. Products and Services of MFIs

Organizations in the microfinance sector had many similarities. Initially, the lending model used was group loans for females, which are loans given on collateral of guarantee by group members. Such loans do not have tangible collateral but merely a moral promise to repay. As the groups were involved in microenterprises, the individual loan products were offered based on collateral, business appraisal, and meeting credit ratio criteria. Some organizations also started offering finance for the ultra-poor.

Microfinance loans and SME loans are two separate products offered by microfinance programs, institutions, and banks. The common practice in other parts of the world is that each product has its own criteria based on staff, clients, and turnover. However, the practice is different in Afghanistan. SME is an advanced type of loan given to clients. Table 11 below provides a brief overview of the types of loans which are currently available in the Afghan market.

Table 11: Loan Type Overview

S.#	Description	Loan Size in US\$	Category	Interest Rate
1	Most customers have income less than \$2 days it is like the shape of a grant and loan	\$200<	Ultra-Poverty	Zero or very minimum

2	Small business	\$200-\$5,000	Microfinance Loan	Mostly Flat rate 1.25% to 1.8%
3	Small and Medium enterprises	\$5,001-\$200,000	SME Loan	It varies for short period flat calculation for long terms diminishing
4	Commercial	>200,001	Commercial loan	It follows the terms and conditions of commercial banks

Source: MISFA (2021) and Afghanistan Banker Association (ABA) 2021

This table has been created from the summary of loan products of microfinance and SMEs currently used by microfinance institutes and banks in Afghanistan. Currently, the most common loan products in Afghanistan are individual loans, which are in the second category. The terms for applying for all these types of loans are captured in table 12 below.

Table 12: SMEs Loan Types

Product Name	Eligibility	Terms and Conditions
Small & Medium Enterprise Loan	1. Must be registered with the Government of Afghanistan (GoA) 2. Annual Turnover should be > USD 100,000 3. More than 1-year experience	1. Loan size (AFN 250,000 to 15,000,000) or Equivalent in USD 2. Loan Tenor from 6-36 Months 3. Interest charges on a declining basis 4. Property deed required

Start-Ups Loan (SME Start-Ups)	1. Must be registered with the Government of Afghanistan (GoA)	1. Loan size (USD 10,000 to 40,000) or Equivalent in AFN 2. Loan Tenor from 6-60 Months 3. Interest charges on a declining basis 4. Property deed is not required but must two personal guarantors
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Source: The First Microfinance Bank & MFIs

SME loan sizes vary from MFI to MFI and banks to banks. The table above identifies MFIs and FMFBs. One of the criteria for SME loans, which is not mentioned above but it is a part of the common practice, is that they provide loans to repeat customers with good loan history and the new customers who meet SME criteria.

Table 13: Microfinance Loan Types

Product Name	Eligibility	Terms and Conditions
Group Loan	1. Afghan citizen 2. Group member 2 to 5 people 3. Group members should have work or semi-professions	1. Loan size AFN 5,000 to 25,000 2. Loan tenor 6 to 24 months 3. No title deed but all members must grantee each other 4. Flat interest charges will calculate
Individual Enterprise loan	1. Afghan citizen 2. Lives in the geographical area where Bank and MFIs work 3. Age Between 18-65 4. Must have business 5. Title deeds and guarantors required	1. Loan size AFN 15,000 to 500,000 2. Loan tenor 6 to 24 months 3. Title deed and guarantor required 4. Flat interest charges will calculate

Housing Incremental Loan	<ol style="list-style-type: none"> 1. Afghan citizen 2. Lives in the geographical area where Bank and MFIs work 3. Age Between 18-65 4. Positive loan history or have a salary account 	<ol style="list-style-type: none"> 1. Loan size AFN 15,000 to 500,000 2. Loan tenor 6 to 24 months 3. Title deed and guarantor required 4. Flat interest charges will calculate
Agriculture Loan	<ol style="list-style-type: none"> 1. Afghan citizen 2. Lives in the geographical area where Bank and MFIs work 3. Age Between 18-65 4. Able to Provide Guarantors and Securities deed 	<ol style="list-style-type: none"> 1. Loan size AFN 15,000 to 500,000 2. Loan tenor 6 to 24 months 3. Title deed and guarantor required 4. Flat interest charges will calculate
Personal Consumption Loan	<ol style="list-style-type: none"> 1. Afghan citizen 2. Lives in the geographical area where Bank and MFIs work 3. Age Between 18-65 4. Able to Provide Guarantors and Securities deed 5. Employment contract 	<ol style="list-style-type: none"> 1. Loan size AFN 15,000 to 500,000 2. Loan tenor 6 to 24 months 3. Title deed and guarantor required 4. Flat interest charges will calculate

<p>Vehicle Loan</p>	<ol style="list-style-type: none"> 1. Afghan citizen 2. Lives in the geographical area where Bank and MFIs work 3. Age Between 18-65 4. Able to Provide Guarantors and Securities deed 5. Employment contract 	<ol style="list-style-type: none"> 1. Loan size AFN 15,000 to 500,000 2. Loan tenor 6 to 12 months 3. Title deed and guarantor required 4. Flat interest charges will calculate
<p>Student Loan</p>	<ol style="list-style-type: none"> 1. Afghan citizen 2. Age Between 18-65 3. Able to Provide Guarantors and Securities deed 4. Employment contract 	<ol style="list-style-type: none"> 1. Loan size AFN 15,000 to 500,000 2. Loan tenor 6 to 36 months 3. Title deed and guarantor required 4. Flat interest charges will calculate
<p>Marriage Loan</p>	<ol style="list-style-type: none"> 1. Afghan citizen 2. Age Between 18-65 3. Able to Provide Guarantors and Securities deed 4. Employment contract 5. Must have a running business 	<ol style="list-style-type: none"> 1. Loan size AFN 15,000 to 500,000 2. Loan tenor 6 to 36 months 3. Title deed and guarantor required 4. Flat interest charges will calculate

<p>Home Appliance Loan</p>	<p>1. Afghan citizen 2. Lives in the geographical area where Bank and MFIs work 3. Age Between 18-65 4. Able to Provide Guarantors and Securities deed 5. Employment contract</p>	<p>1. Loan size AFN 15,000 to 500,000 2. Loan tenor 6 to 24 months 3. Title deed and guarantor required 4. Flat interest charges will calculate</p>
<p>Healthcare Loan</p>	<p>1. Afghan citizen 2. Lives in the geographical area where Bank and MFIs work 3. Age Between 18-65 4. Able to Provide Guarantors and Securities deed 5. Employment contract</p>	<p>1. Loan size AFN 15,000 to 500,000 2. Loan tenor 6 to 24 months 3. Title deed and guarantor required 4. Flat interest charges will calculate</p>
<p>Women Individual Enterprise loan</p>	<p>1. Afghan citizen 2. Lives in the geographical area where Bank and MFIs work 3. Age Between 18-65 4. Able to Provide Guarantors and Securities deed 5. Employment contract</p>	<p>1. Loan size AFN 15,000 to 500,000 2. Loan tenor 6 to 24 months 3. Title deed and guarantor required 4. Flat interest charges will calculate</p>

Livestock Loan	1. Afghan citizen 2. Lives in the geographical area where Bank and MFIs work 3. Age Between 18-65 4. Able to Provide Guarantors and Securities deed	1. Loan size AFN 15,000 to 500,000 2. Loan tenor 6 to 24 months 3. Title deed and guarantor required 4. Flat interest charges will calculate
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Source: MFIs and FMFBs-2021

Table 13 explains the group and individual loans by sectors. The eligibility criteria and conditions are very important for the client to be able to access finance. Most of these loans are given to repeat customers, who was able to complete several earlier loan cycles to become eligible for the highest amount of loan.

1.12. List of Banks and MFIs which are Closed Down or Merged with Others

Below is the list of banks and MFIs which are currently closed down or merged with other institutions in Afghanistan.

Table 14: List of Closed MFIs and Banks

S.#	Name of MFI and Bank	Status
1	Afghanistan Microfinance Institution (AMFI)	Closed
2	Bangladesh Rural Advancement Committee (BRAC-Bank)	Closed
3	Child Fund Afghanistan (CFA)	Closed
4	Hope for Life	Closed
5	Sunduq (Khadamati Maali Sunduq)	Closed
6	World Council of Credit Unions (WOCCU)	Closed
7	Afghanistan Rural Microcredit Program (ARMP)	Merged with FMFB
8	Ariana Financial Service (AFS)	Merged with MUTAHID
9	Micro Finance Agency for Development (MoFAD)	Merged with MUTAHID

10	Microfinance Agency for Development and Rehabilitation of Afghan Communities (MADRAC)	Merged with MUTAHID
11	Parwaz Microfinance Institution	Merged with MUTAHID
12	Women for Women International (WWI)	Merged with MUTAHID

Source: Compiled by the Researcher

The starting phase was not well planned and progressed since it was an emergency response to the departure of the Taliban government, following arrival of the international forces, which created so much pressure to kick-start the ailing economy. Therefore, some organizations started their disbursements very rapidly, and most of the times the loopholes in the process were abused by MFIs' staff and clients. This resulted in widespread fraud within the MFI financial services sector, and in a few years many of the enterprises which were funded with millions of dollars from nonprofit international organizations collapsed. These kinds of fraudulent behaviors of employees and clients quickly spread to normally well-managed and ran organizations due to the lack of oversight, and absence of law and order. Based on these issues, MISFA decided to merge most of the MFIs together and create a new one by the name of MUTAHID DFI in 2011 which was mentioned above (MISFA, 2021). The first five MFIs and one bank were closed due to fraudulent activities described above. Most of these enterprises were part of larger international NGO's who were providing philanthropic work in Afghanistan. As we discussed in the introduction section of this study, most of these NGOs started their MFI program with lots of noble intentions, but after being abused by these mentioned fraudulent individuals, they faced great difficulties and became dysfunctional. Serial No 7 ARMP merged with FMFB in 2006 as they were both parts of Aga Khan Fund for Economic Development and related to each other. The main purposes of these mergers were to synergize the organizations and eliminate some of the duplicate departments and positions in both organizations to cut operational costs in half. The last 5 MFIs were merged with MUTAHID and named MISFA-MUTAHID because of unneeded competition in the sector, corruption, misuse of authority, and several other reasons.

1.13. Key Indicators of Microfinance Organizations according to AMA

Table 15 below shows all of the key Indicators for banks, MFIs and other community-based saving programs as at its December 2020 report.

Table 15: Saving by MSME Institutes

Institute Name	No of Province	No of Branches	No of MFI Staff	No of Loan Officer	No of Client	% of Women	No of Active Borrower	% of Women Borrowers
FINCA Afghanistan	10	19	322	130	21,872	56%	21,872	56%
IIFC Group	11	25	216	68	115,969	26%	13,769	20%
Mutahid DFI	6	8	236	112	14,397	37%	14,397	37%
OXUS Afghanistan	10	23	455	220	21,451	53%	21,451	53%
<i>Sub-Total</i>		<i>75</i>	<i>1,229</i>	<i>530</i>	<i>173,689</i>	<i>34%</i>	<i>71,489</i>	<i>44%</i>
FMFB Afghanistan	14	38	1,470	487	212,895	24%	50,145	24%
<i>Sub-Total</i>		<i>38</i>	<i>1,470</i>	<i>487</i>	<i>212,895</i>	<i>24%</i>	<i>50,145</i>	<i>24%</i>
Aga Khan Foundation	7	17	48	32	35,094	71%	4,815	73%
WEERDP	34	76	1,464	206	397,464	81%	93,953	84%
Hand in Hand Afghanistan	4	2	66	23	2,529	100%	522	100%
<i>Sub-Total</i>		<i>95</i>	<i>1,578</i>	<i>261</i>	<i>435,087</i>	<i>81%</i>	<i>99,290</i>	<i>83%</i>
Grand Total	34	208	4,277	1,278	821,671	56%	220,924	57%

Source: AMA Report

This table summarizes the report of the AMA, but the last three organizations are not part of the microfinance because their main activity involves with a community-based organization called Saving Promoting Institute, which works in 34 Afghan provinces. Banks and MFIs, on the other hand, only work in 14 provinces, including the capital and central region, North, Northeast, Eastern Part, and West Provinces.

Table 16 below depicts the activities of SMEs from 2016 to 2020. As we see from this table, a decline in the number of provinces served from 14 to 11, and active clients from 1957 in 2016 to 798 in 2020 were unfortunate realities of this index. More explanation of this table is included in separate graphs.

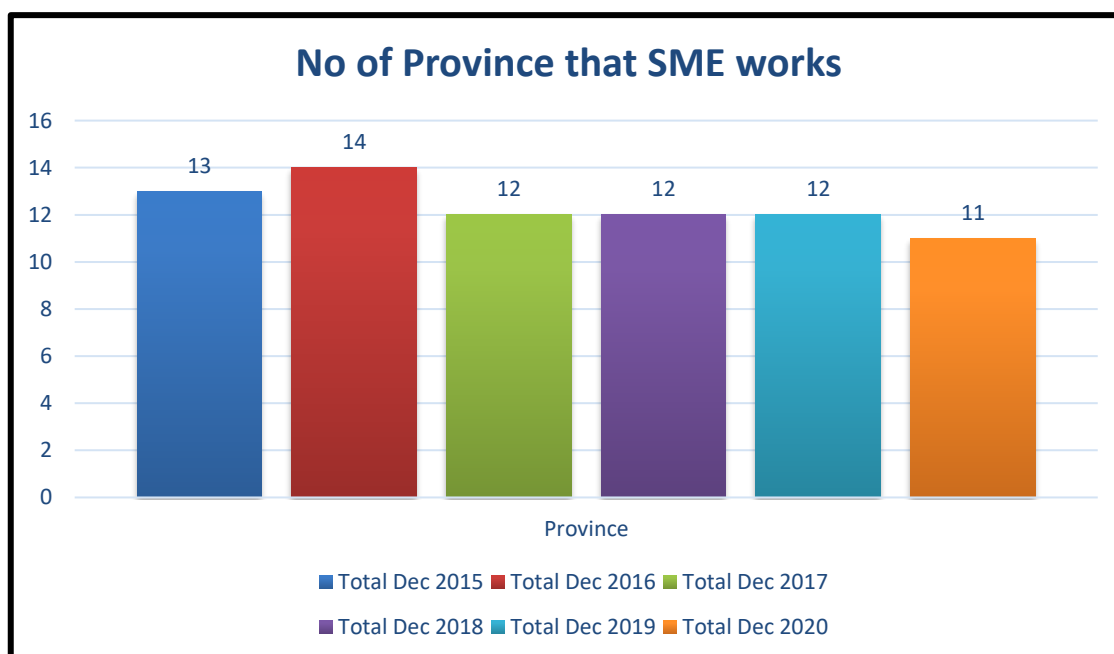
Table 16: Outreach of SME for Last five years

Outreach - SME	Total Dec 2016	Total Dec 2017	Total Dec 2018	Total Dec 2019	Total Dec 2020
Province	14	12	12	12	11
District	13	14	14	14	14
Active Clients	1957	1565	1438	1137	798
Active Borrowers	1957	1565	1438	1137	798
Number of loans disbursed (cumulative)	9700	10598	11513	12097	12441
Amount of loans disbursed, AFN (cumulative)	8,125,771,465.00	9,324,151,727.00	11,120,332,147.00	12,441,832,598.00	13,439,179,476.00
No. of loans outstanding	1957	1565	1438	1137	798
Gross Loans Outstanding, AFN	1,308,645,486.00	1,304,686,989.00	1,833,925,103.00	1,680,981,383.00	1,380,263,847.00
Women clients	14	15	8	8	7
Women as % of total clients	0.70%	1.00%	0.60%	0.70%	0.90%
Women borrowers	14	15	8	4	7
Women as % of total borrowers	0.70%	1.00%	0.60%	0.40%	0.90%
Total of SME loan officer	91	60	49	47	50

Source: MISFA report

Figure 4 below shows the number of provinces where SMEs were activities in certain years. In 2016, they were active in 13 provinces, while in 2017 it increased activity to one more province to 14. They decreased their activities in two provinces from 2017 to 2019. Their activities were limited to only 11 provinces in the year 2020.

Figure 4: No of Province Where SME Financing is Active

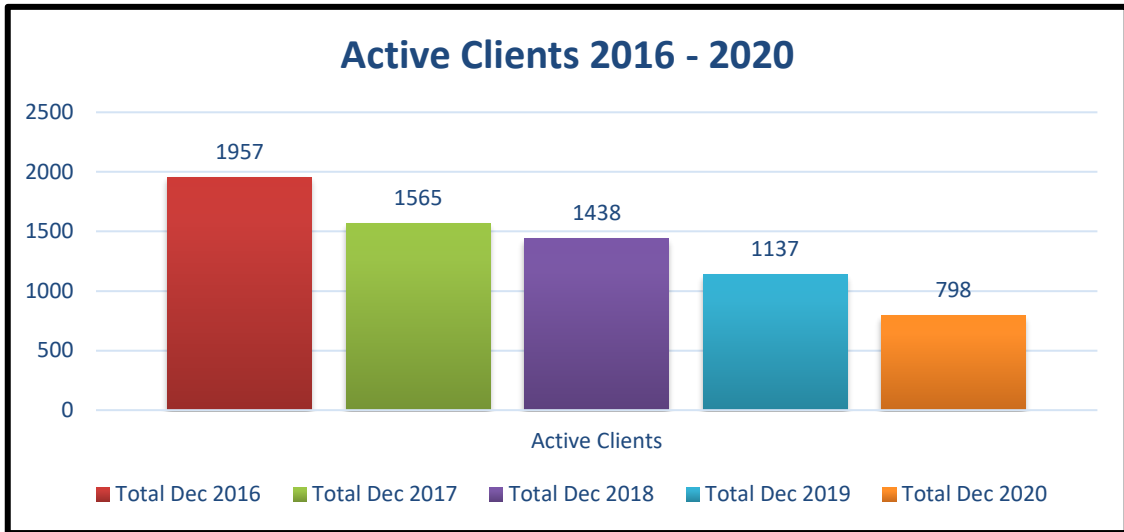


Source: Compiled from MISFA Report

Figure 4 below shows number of active barrowers between the years of 2016 and 2020. As we can see from the figure, there was a remarkable decline in the number of active borrowers from 2016 to 2020. The most important point from this figure is

the margin of the change and the consistent decline trend. Active clients of 2020 were only 41% of what they were in 2016.

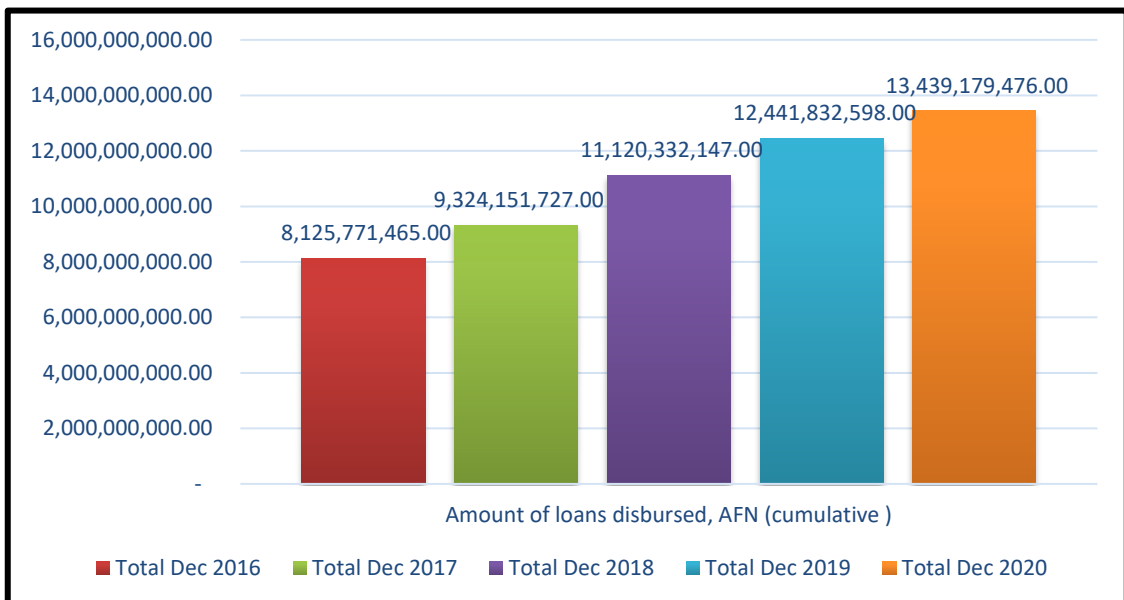
Figure 5: Number of Active borrowers



Source: Compiled from MISFA Report

Figure 6 below expresses the number of loans cumulatively distributed in the country from 2016 to 2020. It was around 8.1 billion AFN in 2016, 9.3 billion AFN in 2017, 11.1 billion AFN in 2018, 12.44 billion AFN in 2019, and 13.43 billion AFN in 2020.

Figure 6: Loan Distributed



Source: Compiled from MISFA Report

1.14. Islamic Products

While Central Bank of Afghanistan issued the first Islamic bank license in 2018, some other commercial banks and MFIs were already offering Islamic banking products earlier. The major Islamic banking products offered in the sector are compiled in table 17 below (Da Afghanistan Bank, 2018). Although banking industry has various Islamic banking products in the sector, Afghanistan does not have an Islamic banking and finance board to regulate them (Hamid, 2016).

Table 17: Islamic Bank & Microfinance Products

S.#	Product Name (Meaning)	Description
1	Qard-Hasan (Benevolent/Interest-free loan)	It is Interest-free but admin cost or another direct cost might be added
2	Wadiah (savings and current accounts)	It is practice same as Current and Saving in the commercial bank but in Saving no return is promised but can get the gift (Hadiah or Hibah)
3	Modaraba (labor capital partnership)	It is based on Asset in one part and Liability in another party, the profit will be shared among them according to prior title deed
4	Bai-Istijrar (repeat purchases from a single seller)	This practice is for a customer who is loyal and continues buy products of a person there would be a good price negotiation between both party
5	Salam (Forward Sale)	Prepayment made to purchase products at a particular time. Mainly in agriculture to use in seasons.
6	Musharaka (Partnership)	Based on the agreed ratio of profit/loss sharing between parties.
7	Murabaha – Cost Plus Sale	This product is used to financing the fixed asset

8	Ijara – Islamic Lease	These products are used to buy the goods by Bank/MFIs then leased to the customer in schedule till the end of the installments.
9	Istisna - Manufacturing contract	This type of product is used in manufacturing products to receive it is the commission in advance or at last when submitting the goods.
10	Mugharassaah (sharecropping)	Bank finance the farmer and then get their shares on the harvesting of goods.
11	Takaful (Insurance)	Insurance is required for mutual take caring of both parties.

Source: Compiled by the author from websites of MFIs and banks

1.15. Difference between MFI and SME

MFIs and SME does not work with the same set of rules, and this is the reason why they are identified differently. In wealthier and bigger countries, it is possible to see bigger banks and organizations operating in this sector, but in developing countries such as Afghanistan, there are only handful SMEs providing services for the public. While we can observe many microfinance clients, such as general stores, bakeries, and barbershops, we cannot see any big banks and companies (Wala, 2021).

At first and for some people microcredit, microfinance, and SMEs could be seen as similar entities, but they are different things and there are some essential points to understand them well. Microcredit loans target those individuals and groups whose income is below normal levels and sometimes unemployed. Despite of their bad credit scores and high-risk levels, borrowers in this sector are not obliged to find collateral in some cases if the loan amount is below certain threshold. SME loans are for those individuals and companies who are in the process of improving their standard of living. By purchasing additional assets and machinery they are able to increase their production and earnings greatly. These types of loans and finances also create a positive impact on the rate of unemployment (Shaji, 2017).

In 2004, an NGO by the name of Afghan Credit Guarantee Foundation (ACGF) was founded by German Federal Ministry of Economic Cooperation and Development (BMZ), and USAID. It was managed and implemented by DEG. Their main activity was

to guarantee the SME clients of banks and MFIs, which they have agreements with (ACGF, 2019).

Table 18 below portrays main differences between SME and microfinance products. Although, there are many differences between them, let's look at the important differences displayed in this table. Products such as group loans are the offerings of MF, but they are not marketed by SMEs. The amount of the loans, that is offered, are the main difference between MF and SME finance products. Startup loans are not given by the SME but is extended by MF. The financial guarantors are required for both marketing areas, but in the case of the SME, it might require more official guarantors, such as a sharia title deed, or two entities rather than one to cosign for the loan. Interest rates is flat if the loan period is within a certain time limit, and if extends that time limit, the declining interest rate method is used. Overdraft facility is not offered to any MF and SME loans by other MFIs, but it is possible to be offered to the clients of FMFB. Registration with the government is necessary for both products, but for MF products and small businesses, it is not so much important. For the SME products on the other hand, loans must be registered with the government entities.

Table 18: Difference between Microfinance and SME

Products	Microfinance	SMEs
Group Loan	Yes.	No.
Amount	AFN 5,000 to 250,000	AFN 250,001-15 million
Startup Loan	Yes.	No.
Experience	1-2 Year	2-5 years
Financial Grantor	Yes.	Yes.
Documentation	Title deeds	Title deeds
Interest calculation	% Flat	% Flat and Declining
Overdraft	No	Yes.
Registration with Government	Yes/No.	Yes.

Source: Compiled from major MFIs' official websites.

2. CHAPTER TWO: LITERATURE REVIEW

For this thesis study, the researcher reviewed both directly and indirectly related research articles compiled in the literature on the topic of microfinance and SMEs.

2.1. Literature on Microfinance during the COVID-19 Pandemic

After a thorough review of research articles written on the current COVID-19 pandemic in the literature, it is identified that only a handful of microfinance and SMEs in the sector have done well. Unfortunately, this success was not realized by the whole sector, and as we saw in the first chapter, some of the portfolios did very poorly during the COVID-19 pandemic and their business shrunk greatly.

Malik and his colleagues authored a research article titled, “COVID-19 and the Future of Microfinance: Evidence and Insights from Pakistan,” on this topic. The article described how COVID 19 rapidly affected the healthcare, businesses, education, and social lives of all. It created new challenges and difficulties for all institutions who serve their communities. It especially created insurmountable obstacles for microfinance institutes and organizations who cater to poor people. The research surveyed 200 loan officers, 1,000 micro-entrepreneurs, and top management of microfinance institutes through a phone call survey. The study took place the week after the lockdown was applied by many countries, and the outcome of the lockdown caused a whopping 90% decline in their total sales. Based on the gathered data, 70% of microfinance clients was not able to make their repayments on time. Loan officers, who were working with the clients on the field, ended up requesting a new repayment plan for their customers from their management (Kashif Malik, Muhammad Meki, Jonathan Morduch, Timothy Ogden, Simon Quinn, Farah Said, 2020).

Zheng & Zhang conducted a research titled, “The Impact of COVID-19 on the Efficiency of Microfinance Institutes.” During their research, they observed that the COVID-19 pandemic had a very negative impact on social and financial spheres. The funding and access to finance was very difficult. The demand and supply were unbalanced. The microfinance’s social efficiency aspect was depressed greatly. For the low-income earners, it was very difficult to meet their repayments on time. The performance of the microfinance institutes declined, and the Portfolio at Risk (PAR) increased tremendously. The downsizing of microfinance institutes became a trend for these institutions to continue operating in the same market. The major areas of decrease were seen in salaries, bonuses, allowances, and fixed and other variable costs. They

analyzed several issues and ultimately found out that there was a positive impact between COVID-19 and MFIs demand in social development area (Zeng & Zhang, 2021).

Prakash Kumar Shrestha published a research titled, “Impact of Covid-19 on Microfinance Institutions of Nepal.” This research investigated the impact of COVID-19 epidemic on the finance world. The researcher examined the impacts of this pandemic on the microfinance indicators such as the savings, loans, non-performance loans, profitability, changes in the number of employees and clients. It is his findings that the negative impact of the lockdown from March 2020 until July 2020 was very significant for the microfinance sectors. MFIs helped by Nepal’s Rastra Bank’s (NRB) provision policy and barely managed to survive the pandemic. It has been noted in the research that due to the pandemic, the demand for borrowing loans was reduced because of the economic uncertainty and clients’ fears of not being able to repay the MFIs’ loans. Therefore, the performance of the Microfinance Institute declined during the pandemic. Some of the MFIs bankrupted while others barely struggled to survive during this difficult time. Since the pandemic is ongoing, genuine innovations, collaboration and resilience needed to manage and survive this difficult time (Shrestha, 2021).

2.2. Research on Microfinance Sector in the Neighboring Countries

Syed Magfur Ahmad (Ahmad, 2020) conducted a research titled, “Microfinance in Bangladesh: A Case Study of Islamic Microfinance.” In this research paper, he investigated Islamic microfinance or banking products including Karz-i-Hasan, Murabaha, Mudaraba, Takaful, Ijarah, and Salam. Islamic microfinance promotes socio-economic elevation of the societies, and this approach is regarded an acceptable practice in many Muslim countries. The Islamic microfinance approach has been playing a vital role in the development of less developed Islamic countries and reducing poverty using Zakat foundation. Zakat is a type of Islamic charity and one of the pillars of Islam, which mandates rich Muslims to give 2.5% of their annual wealth to poor and needy. The importance of microfinance using a case study on Bangladesh showed that GDP of this country increases by 7% consistently due to usage of Islamic banking and microfinance systems. The per capita income of Bangladesh is currently at \$2,000 US dollars per person and is expected to increase soon. Based on this research, there has been presence of microfinance institution in the country since 1980s. Due to sound financial practices of MFIs and Islamic banking practices, Bangladesh is expected to be one of the

promising economies of the region. The future of the Islamic microfinance is looking more promising every day, and there is a potential that these products will achieve 2030 Sustainable Development Goals (SDGs) of Bangladesh (Ahmad, 2020).

Gupta Varsha, Chaddha Sanjeev and Reetu, conducted a research on the performance of MFIs in India named, “A Study on Performance Evaluation of Microfinance Institutions in India-An Empirical Analysis.” This article starts with discussion of microfinance loans and deposits, which are very popular in India with the title of the second most populist country and large low-income individuals. The importance of microfinance is that it can provide loans to the individuals more comfortably than a traditional bank in the rural area. Microfinance offered through a few channels, such as Self Help Group-Bank Linkage Programs (SHG-BLP), Joint Liability Groups (JLG), and MFI institutes. The largest microfinance households were included in this study. The research shows that the registered MFIs experienced a growth of overall 43% in the market, 27% increase in the number of customers, and 32% increase in the opening of new branches during this period. The research contains data, which was collected from the top 10 MFIs that represents more than 80% of MFIs in terms of gross portfolio and the number of borrowers and depositors. Based on this study, India’s 32 states almost have all the MFIs while 19 states only have little over 5 MFIs in their territory (Gupta & Varsha, 2017).

Delfino, Ariel Nabus authored a research article titled, “Impact Pathway Analysis and Sustainability Evaluation of Microfinance Projects in Goa, Camarines Sur, Philippines.” For this microfinance research, project sustainability was evaluated using both quantitative and qualitative methodologies. As a result of this study, it was found that between the years of 2010 and 2013, microfinance projects experienced 9.8% growth in terms of business profitability. The study shows that there are six MFIs with objectives of tracking pathways, measuring performance indicators, producing activities with correspondence and compiling results and impacts reports. The awareness of household beneficiaries who were self-employed had good impact on the performance of MFIs. The study also shows that there is some indication of threats to these sectors for socio-political and economic reasons (Delfino, 2019).

Mohammad Chizari and Enayat Abbasi conducted a researched in one of the Iranian provinces and articulated an article titled, “Microfinance System Analysis in Rural SMEs in Kurdistan.” The authors researched the challenges and difficulties of

microfinance operations in the Kurdistan region of Iran. They conducted a Strengths, Weaknesses, Opportunities, and Threats (SWOT) analysis on the region's microfinance operations. The researchers tried to analyze any obstacles that exist for clients to access finance. They noticed eleven weaknesses that need to be eliminated through awareness and training. Other issues included intervention and regulation of government in the credit market and getting access to the international finance market through the WB and other international organizations. Support systems to assist marketing, insurance and technical assistance were also important and handicaps in front of the sector. The study outcome strongly recommends government to reform policies and procedures in this industry to lead the efforts to improve this sector in the region. Some of the suggested reforms included economic and social development, creating practical education for microfinance employees and customers. The research also focused on the agricultural clients and the available banking system that existed in the province (Chizari & Abbasi, 2020).

2.3. Microfinance and Islamic Products

Aziz et al. in "Harmonizing Microfinance with Islamic Banking," highlights the importance of microfinance and its use against poverty and establishing a more competitive economic growth environment for a country. In some economies, microfinance is still in its infancy stage. These researchers evaluate the importance of Islamic microfinance and the futures of Islamic commercial banks together. According to these researchers, Islamic microfinance products and Islamic banks work in cohesion to promote a better economic environment in a community. The Islamic microfinance model is recommended for a more stable economy, strength, and creation of a sustainable microfinance institute market. This model improves the performance of MFIs to better serve their clients, reach more people, contribute to economic growth, and create social welfare for the poor communities. This paper also discusses challenges for microfinance, which include infrastructure problems, and lack of regulatory framework. It examines ways to improve their lives, serve more people, make them more capable, and to provide them services better. The researchers also suggest further development of this industry by business leaders, government policy makers to create a better environment to support the activities of microfinance (Aziz, Husin & Ashfaq, 2020).

Edaich and Smietanski authored a research article titled, “Islamic Microfinance Model and Hypothesis of Poverty Alleviation.” They focus on the use of microfinance and other futures of Islamic banking to reduce poverty and improve the lives of poor. The study focuses on the Islamic microfinance programs which can be a better alternative to conventional banks in the Islamic countries. The data for their research was gathered from official sources, and the study particularly focused on the development of microfinance in Indonesia as a case study. The paper also discusses Kafalah funds of Saudi Arabia. In addition to Indonesia, the research also evaluated other Islamic countries and their GDP growths published by the WB. The researchers one of the challenges for their study was getting accurate data from both countries of Saudi Arabia and Indonesia. The investigators suggest that Islamic microfinance could have a significant impact on the poverty levels of Muslim countries. Microfinance and Islamic banking also have its limitations due to lack of public policies and regulations. These kinds of deficiencies cause people to getting weaker both financially and socially (Edaich & Smietanski, 2020).

2.4. Microfinance and SMEs

Nyikos & Soós’ conference paper titled “Microfinance and Access to Finance of SMEs,” examines the opportunity of SME financing in the EU countries. They focus on the EU funded operation called Interreg Project. This interregional organization partners with seven different EU countries to provide information and know-how to improve people’s life through research and innovation, SME competitiveness, low carbon economy and efficiency of environmental resources. The researchers conducted twelve meetings with each 7 partners and conducted multiple interviews with the stakeholders. Hungary, Italy, Germany, Spain, Croatia, and Poland were part of this organization. Lack of adequate funding of SMEs is a big issue in the EU. Interred project has been seen as a vital organization since most of the SMEs are considered as non-bankable entities by some of banks. As the part of this project, the said governments conduct interviews and assist those non-bankable SME offering them various microfinance products. These surveys are conducted at national and the EU levels to determine eligibility and the amounts of microfinance loans offered to enterprises using European Structural and Investment Funds (ESIF) for their growth and developments. As the result of this research, it has been suggested that there should be a difference between bankable and non-bankable customers and loans. Within this market, there should be products

offered by banks to support microfinance which yields social benefits in their communities. The purpose of this project to elevate non-bankable customers to bankable levels. This project evaluates risks and opportunities of the loans at different stages of the borrowing process. They stress on the importance of transparency during these meeting stages. The researcher stress on the needs of additional cooperation and coloration between the decision makers, regulators and the SMEs to assist them in a efficient manner (Nyikos & Soos, 2018).

John Aliu et al conducted a research article, titled “Legal framework for ownership of Microfinance Bank and Their Services to SMEs.” The study examines the structure of MF banks with face-to-face services of SMEs and data collected from State and microfinance banks. The period for their data collection took place between 2007 and 2011. Both quantitative and qualitative methods of research was used to interpret interviews, questionnaires, and observation sheets. They worked on making comparison between microfinance banks and the traditional state banks. As the result of their study they recommended establishment of a flexible regulatory mechanism, maintaining adequate capital by the MFIs and establishment of a minimum capital requirement for MFIs. Since these organizations are working with small funds, there should be mechanism to eradicate liquidity risks. MFIs should create motivation for meeting repayment schedules which reduce the number of overdue cases and additional charges. This research also recommends regulation and monitoring of MFIs. (Aliu, Aliyu & Ankama, 2020)

Gloria O. Pasadilla (Gloria, 2010)wrote a research paper on the Asian Development Bank Institute named, “Financial Crisis, Trade Finance, and SME Case of Central Asia.” This researcher investigated the importance of SMEs via multiple surveys during the Russian financial crises. The initial funds and assets were acquired from various European banks and WBs for the construction and development of the SME sector in the country. The SME sector started functioning in Central Asian countries from 1990 and onwards. It required a lot of efforts and funds to development this sector to reach a stage of today’s sustainability. Data shows that, during this time, the contribution by SMEs in the regions employment and job creation rose from 20% to 60%. Findings of this research reveals that there are some specific shortcomings such as Kazakhstan government’s support of the SMEs. They recommend reforms to ensure transparent reporting, good regulatory systems, rights of stable property, lower taxation,

decreasing corruption, and stable infrastructure. It necessitates cheaper funds from the government or international donors, and long-term loans for the SME clients. Regulatory bodies, such as the government and the other concerned institutions, are required to lobby the platforms to provide loans for SMEs. The study shows that the operations of international banks are not fully welcomed in Uzbekistan and Tajikistan. The banks in these countries are still working as government agents like during the Communist era. There is a charge on cash withdrawals in Uzbekistan to discourage clients from taking their own money from the bank. The Uzbek government sometimes issues special allowances for some transactions which allows the use of cash. Kazakhstan on the other hand, has advanced banking system which allows better functioning of SMEs compared to neighboring countries (Pasadilla, 2010).

Ike Kusdyah Rachmawati, Agus Rahman Alamsyah, Eko Aristanto conducted a research on SMEs and published a paper called, “Model of Accommodating Microfinance Institute for SMEs.” The study explained that MFIs are the intermediaries creating positive environments which benefits both the clients and the economy. If they function well, they can create added value in the economy. Based on this research, even small businesses can become the main thrust of the whole economy of a nation. These small microfinance institutions, particularly those that owned and operated by the female microfinance clients will be able to change how the big businesses operates. Ultimately, these added business activities will create jobs and reduce unemployment accordingly. The main purpose of this article is to focus on the long-term economy, development sustainable localities and districts, and create more job opportunities. It also explained in detail the job functions of employees in the MFIs and SMEs. In short, the article comprehensively reviews all the MFIs’ operational activities (Rachmawati, Alamsyah & Aristanto, 2019).

Benedicta Ofosuaa, Maxwell Owusu Duku, Richard Boadi Asante and Peter Dorgbley Kojo conducted a research titled “Role of Small and Medium-Scale Enterprises in the Economic Development of Ghana.” The Study shows the role of Small and Medium-scale enterprises and how they are the only source of prosperity and development in the country. The research highlighted the importance of SMEs in different aspects of life, which are considered a pillar of economic development. Not only do they result in the creation of jobs for locals, but also create business opportunities for the nation. The data from 50 questionnaires showed that 80% of the businesses

survived and created more jobs and development while contributing the GDP growth of Ghana. The result of the research recommends more access to the facilities and capital funds to expand the market; capitalize on human resource to train, develop and mentor them; identify the areas that have enough human capacity for development and apply better management information systems techniques that can produce positive results in a transparent and accurate environment. A focus on human development issues is another fundamental recommendation. SMEs require years of attention from governments and other institutions in order to generate new youth entrepreneur opportunities that they should take on to expand the economy of their country. The youth's energetic skills are required for the development of a country, to increase employment opportunities and compete in the global markets (Ofosuua, Duku, Asante and Kojo 2015).

2.5. Microfinance performance on Social aspects

Gusti Ayu Purnamawati and Ni Ketut Sari Adnyani (Purnamawati & Adnyani, 2020) conducted a research titled, "Performance Evaluation of Microfinance Institutions and Local Wisdom-Based Management Concept." The study shows the performance of Microfinance institutions using the wisdom based concept. Data was analyzed qualitatively and quantitatively. Key performance indicators were analyzed by various stakeholders. The author emphasizes the importance of process and capabilities and how they influence the strategy. The study analyzes the strategy, implementation, and the current or potential ability of a particular village. The important points, which are discussed and referred to, are the contributions and satisfaction of stakeholders. The traffic light system method is used for evaluation of microfinance institutions. It has been noticed that some are in yellow lights, which means they need to operate using extra care. Overall, the research reviews a number of MFIs and their performances in quantitative detail (Purnamawati & Adnyani, 2020).

Javier Sierra, Victoria Muriel-Patino and Fernando Rodríguez-López conducted a research titled, "The Quest for the Evaluation of Microfinance Social Performance." The study shows that different institutes and standards indicate the social impact of Microfinance through financial performance. The methods underlying the changes are considered the progress rate of existing activities. Several methods of evaluation have been used in this paper. MFIs were evaluated by 5 types of social standards which included the MFIs social mission, success in the market and implementation. Although

the method of SP14 assessment and performance was used, which is the most common method that applicable, the data is not reliably estimated about 195 types of microfinance social evaluations that have been made viewed acceptable by the stakeholders (Sierra, Muriel-Patino and Rodríguez-López, 2020).

2.6. Microfinance and SME in Afghanistan

Martin Greeley and Mohit Chaturvedi conducted a research titled “Microfinance in Afghanistan: A Baseline and Initial Impact Study for MISFA.” This study focused on the importance of building MISFA as an organization in Afghanistan by the government and international donors. The post-conflict societies experience key problems such as poverty, mobile populations, rising inflation, destruction of the banking system, short term focus rather than long term sustainability, and many other problems. The data sample included 30 clients from each MFI. Most of the data collected was from 11 provinces which represents 95% of MISFA’s clients (Greeley and Chaturvedi, 2014).

Mujib Mashal conducted a study titled, “Small and Medium Enterprises Development and Regional Trade in Afghanistan.” The research analyzed the role of SMEs in Afghanistan's economic development and the relationship with Central Asian countries. The study shows the challenges faced by SMEs to access funds and other adverse things that affect this sector’s performance in the country. Gender issues are highlighted, since women are having difficulties entering market and accessing the needed funds. Most of the female SMEs are in the handicraft related businesses. They also investigated the relationship between SMEs with military transition movements. As the results of this study, declining foreign aid, uncertainty in the security and politics of Afghanistan issues were raised. According to this research, it remains uncertain what the future of SMEs development will be in Afghanistan. Finally, the researcher made recommendations of raising awareness by the government for economic development, encouraging women to participate more in microfinance and SMEs, implementing SME strategies, finding new markets, increasing knowledge, educating the entrepreneurs, and facilitating engagement with the regional and global markets (Mashal, 2014).

3. CHAPTER THREE: METHODOLOGY

This unit describes the research methodology used for this research, scientific analysis implemented to collect data, and information gathered to evaluate and test the hypothesis. In this section, the sources of data and information, sampling designs, data processing, analysis and limitations of the study were also explained.

3.1. RESEARCH PROBLEM

Afghanistan, a country with a diverse population, is economically and politically unstable and has always been dependent on foreign aid. The country has a 99% Muslim population, experienced multiple civil wars, and the presence of recent Russian and NATO forces. Since 2002, Afghanistan has never experienced stability in political, economic, and social areas. There cannot be enough programs and organizations to satisfy the high demand for the microfinance sector. Therefore, assessing the MFIs and SMEs' problems and finding solutions for them is always a challenge.

3.2. HYPOTHESIS OF THE RESEARCH

After twenty years local and international MFIs and government organizations such as MISFA and AMA's operations, this sector is still not fully self-sustaining due to the lack of implementing the needed rules and regulations, lack of capacity, and high operational costs. Brain drain and short operational planning are also genuine issues which are currently crippling this sector.

3.3. PURPOSE AND IMPORTANCE OF THE RESEARCH

The main objective of this study is to conduct an evaluation of microfinance and SMEs to find out what is the main obstacles that MFIs and SMEs are currently facing.

3.4. METHOD OF THE RESEARCH

Keeping the importance of methodology in mind, efforts has been made to include both qualitative and quantitative procedures for this research. The qualitative data sources were taken from primary and secondary sources such as the interviews. Quantitative data collection was conducted through publications, websites, magazines, indexes, and other publicized documents.

3.5. POPULATION AND SAMPLE

The sample was taken from microfinance and SME institutes in Afghanistan. The sample included top-level management, heads of the departments, Loan Managers, Loan Officers and customers. The sample size for this research included 50 people. Such

as former and current employees of MFIs and SMEs and their customers. The employees were Board Directors, Chief Executive Officers, Chief Operational Officers, Microfinance Heads, SME Heads, Risk Management Directors and Finance Managers. It should also be noted that this group included both expatriate and local staff.

3.6. SCOPE AND LIMITATIONS / DIFFICULTIES

The core challenge to research on MFI and SMEs in Afghanistan is the lack of data as many of the organizations operate with high confidentiality about their affairs. Additionally, the unavailability of technology and high internet charges made it challenging to get information from more resources. Lack of accurate data and the scarcity of reliable publications in the country, produced more problems for the researcher to complete this study.

3.7. Research Design

Multiple individuals and group interviews were conducted to ensure efficacy and accuracy of the data while seeking answer to the question of why the microfinance and SMEs are not self-sustainable in Afghanistan and why the demand for MFIs products was boosted greatly during the post-Taliban regime? These questions along with other survey questions were asked to a cross-section of stakeholders representing Microfinance in the market. The research design did not only cover the historical background and performances of the MFIs and SMEs, but it also included review of performance indexes published on the health and success of them by the independent international organizations and the Afghan institutions. Questions in the surveys and the interviews were all seeking answers to, what were the challenges facing the microfinance sector, and how can the microfinance industry be self-sustainable in Afghanistan?

The research is cross-sectional study investigated availability of funds distributed in the market based on the balance sheet of MISFA and the individuals SMEs. The capacity expansion of the sector, quality control and relations among stake holders were all investigated via questioners and interviews.

3.8. Scope of the Study

The research examined the functions of recent and currently active MFIs and SMEs and their performances. The scope of this study covers 91% of the current microfinance market shares in Afghanistan. The study also touched on the recently closed, bankrupted and merged microfinance programs and enterprises.

3.9. Research Methods

The research involved creation of two types of questionnaires. These were shared with relevant stakeholders via email, and interviews conducted over WhatsApp, Messenger, and other social media platforms. The aim during the data collection was to understand the problems of MFIs from different dimensions for an accurate analysis and the proposition of useful recommendations.

The questionnaires were designed and shared with stakeholders of Microfinance institutes. The interview questions and issues were varied, and they were diverse in their nature. The interviews were conducted with different regions of microfinance staff in Afghanistan. The area where microfinance institutes operate are different in terms of climate, culture, sociology as well as behaviors. The data collection was administrated on a larger area to minimize the influences of geographical and demographical factors.

Interviews were conducted with around 50 staff of MFIs, who are either currently working in the industry or previously worked for them. Interviews were conducted with 20 microfinance customer and 15 SMEs customers to understand their thoughts and measure their satisfaction levels with the products of MFIs. Respondents were diverse in their ages, qualifications, business ranges, religions and included both genders. The interview was designed to gauge the volume, efficiency, and the effectiveness of the MFIs. Most of the interview were recorded and then analyzed separately. The communications were in multiple different languages and most of the interview were recorded and translated. After processing the recordings of the interviews, key themes were summarized in in this research paper.

3.10. Source of Data

The source of data was the top management of MFIs, previous management of the MFIs and MISFA, and other stakeholders, such as current and previous customers served by the industry, and public. The data was also collected from MISFA, AMA, and MFIs' websites, including reports, publications, research articles, and annual financial reports.

3.11. Data Processing and Analyzation

The complete and analyzed information helped answer the research question. The data sorting was sorted, and the information was filtered to distill the sought-after answers. The processes carried out included sorting, categorization, reduction of data,

and summarization. IBM's SPSS program was used for evaluation of data. The data from interviews and questionnaires were presented in figures, tables, and graphs.

3.12. Problems and Limitations

Unfortunately, some microfinance institutes do not publish their performance on their website. Some of the other ones report their activities but the lack of accuracy was a serious challenge for the researcher. Ex-employees of the organizations who are currently working for other companies was not be interested to take part in the interviews. Difficulties of traveling to and from Afghanistan was another limitation and the only way to communicate with participants was through Skype, WhatsApp, or Facebook-Messenger. Due to the poor communication infrastructure and poor connectivity in Afghanistan, it took excessive time to communicate with the test pieces. Some of the previous management staff, who left the organizations and settled abroad, were hard to reach-to due to the time differences. Some other current staff of microfinance institutes had time constraints and were not interested taking part in the interviews due to their tight work schedules. Some were not forthcoming during the interviews due to their fears of sharing some internal confidential information.

4. CHAPTER FOUR: INTERPRETATIONS AND DISCUSSIONS

This chapter will describe and evaluate the current issues facing MFIs and SMEs. Although there are a myriad of challenges and opportunities, only the key ones are highlighted. These challenges have been shared through interviews with top managements of MFIs and SMEs.

4.1. Interpretation and Finding

The creation of microfinance and SMEs finance organizations, and the development of this sector in Afghanistan has been a challenging process. MFIs and SMEs finance were an essential for the revitalization of economy when the Taliban lost their hold on the government. Even over two decades after their departures, it has been very difficult for the government and the players in the microfinance sector to address the obstacles and hurdles that they have been facing. Being in the field during the initial period and for the last few years, I was a witness to the successes and failures of microfinance and SMEs. I have personally witnessed cases where a loan officer had created a fake portfolio worth more than 100,000 US dollars. Luckily, he was caught, but portion of the defrauded the amount was not recovered. On top of the uncovered money amount, more cost was incurred on the legal fees of Lawyer which took so many years. I have witnessed millions of dollars spent on capacity development over several years, while contradictorily depending on the expatriate and foreign staff to run key management operations, instead of creating local employment.

Multiple research studies conducted by many different academic scholars assert that the main engine for economic development is SMEs and people's access to the needed finances. Upon reviewing the annual reports of MISFA, I observed from them that there was still significant amount of cash and bank balance available, while there were large numbers of unsatisfied customers who needed urgent funds in the provinces. The contribution of microfinance and SMEs is very important for the vitalization of the economies of developing countries in terms of the GDP, employment, and self-sustainability at the micro and macro levels. This is even more important for Afghanistan which is dealing with multiple invasions and civil wars in the last few decades. Refer to table 19.

Table 19: Cash and Bank Balance of MISFA

Description	Amount AFN	Column1	Amount USD
Cash and Bank Balance	AFN'000	@	USD' 000
Balance as of Dec 21, 2011	4,305,625	49.43	87,105.50
Balance as of Dec 21, 2015	6,291,357	68.15	92,316.32
Balance as of Dec 21, 2016	6,481,529	66.29	97,775.37
Balance as of Dec 21, 2017	9,715,678	69.39	140,015.54
Balance as of Dec 21, 2018	13,705,442	75.66	181,145.15

Source: Compiled from MISFA Annual Audited Financial Report

Most microfinance models which are functioning in Afghanistan provide loans and funds for SMEs and individuals or groups. In this country, importers are providing Ograyee, a type of bulk sale receipt which they receive payments for them on Mondays and Thursdays of the week. This poses a huge challenge for the microfinance clients. While the majority of the shopkeepers can directly enjoy the products of importers on credit, the advantage is limited to the wholesalers in the big cities of Afghanistan as they are the SME clients of MFIs.

4.2. Collateral

Microfinance institutes take the original title deeds of land and houses as collateral for the loans that they extend, and they are returned to the original owners once the loan is paid-off. The process of placing liens as collaterals for unpaid loans are similar for all the microfinance institutions. Since there is not a centralized body to issues these titles deeds, there is always the possibility that clients who own a single property using several copies of the deeds to obtain more than one microfinance entitlement or identification called, Tazkira. The evaluation of the data shows that these issues were very high until 2014 but declined after the central bank of Afghanistan started implementing a Public Credit Database (PCD) program in 2014, which was launched back in 2008 (Da Afghanistan Bank, 2017). As a result, during the period of 2002 to 2014, large numbers of MFIs collapsed, bankrupted, or merged.

4.2.1.1. Types of Titles and Deeds

There are various problems with registered land titles and deeds in Afghanistan. One of the fundamental issues is the amendment of different and contradictory laws about titles and deeds constituted by each regime that came to power in Afghanistan. Here are the examples of different entities that issue formal land documents, Rawaj as

the customary law, Qanun Madani as the civil law, and Sharia as the religious law. Due to the decentralization of issuing titles and deeds, there are currently more than 60 different laws and amendments regulating the issuing of title and deeds in Afghanistan (Beall & Esser, 2005).

The main types of title and deeds, which are accepted by the MFIs are described in the sections below.

4.2.1.2. Sharia-Formally Registered Titles and deeds With the Government

Formally registered titles with the government are issued by the municipality offices. Less than 30% of land in the urban areas and 10% of properties in rural areas are registered with the government. The original title is given to the owner of the property, and there is a reference registration with the municipalities (Agisa, 2008).

4.2.1.3. Titles and Deeds that are not registered with the Government

Titles and deeds that are not registered with the government offices are prevalent in more than 70% of the urban and around 90% of the rural areas of Afghanistan. These types of title and deeds, called Horofi Qabala, are written informally on a piece of ordinary papers. They are signed and exchanged between the buyers and sellers with one or two witnesses being present (Agisa, 2008).

As the table 4 in chapter one of this thesis depicts, in 14 out of 34 Afghan provinces MFIs operations take place. According to the WB reports, they have been concentrating on five major cities with highest populations of, Kabul 3.07 million, Hirat 1.55 million, Nangarhar 1.26 million, Balkh 1.07 million, and Kandahar 1.0 million populations (Ernesto May, Simon C. Bell and Reazul Islam 2008). Recently repatriated 6.5 million migrants from Pakistan and Iran back to their homeland of Afghanistan, the majority of returning citizens preferred live in big cities of the country rather than going back to their original villages. This wave of repatriation increased the demand for new houses in the big cities. According to the Ministry of Urban Development estimates, the need for new housing was as high as 1 million, and 70% of these one million houses were in the urban areas. The World Bank estimates that the development of housing market in Kabul City alone cost 2.44 billion US dollars. The same report also states that the government owned housing and finance banks were closed in mid-2003 because of their poor and non-existent performance. The estimate was that 2.44 million poor people are living in informal homes in Kabul. If we consider 20,000 new homes will be needed

to construct, the project will require \$154 million a year (Ernesto May, Simon C. Bell and Reazul Islam, 2008)

Figure 7 : Explanation of the status of formally registered titles and deeds in Afghanistan.

Rehabilitating land records in Afghan courts-a success story
Afghanistan's land administration infrastructure was nearly destroyed during two and half decades of war. Land records, including property and transfer deeds, were bombed, eaten by mice, or destroyed completely. Starting in late 2004 the Land titling and Economic Restructuring in Afghanistan (LTERA) Project, funded by the U.S. Agency for International Development, began refurbishing more than half the provincial registration courts (makhzans) in the country. Teams have cleaned, restored, and reorganized 5.4 million legal documents, including 500,000 title deeds. Land administration offices now are able to provide proper documents on land transfers and proof of ownership and prevent the registration of fraudulent deeds. Throughout the country property documents are being photographed and digitalized to prevent future manipulation.

Source: Interview with Dr. Greg Massen, Chief of Party, LTERA Project.

Both above-described title and deed types are used as collateral for microfinance loans. The absence of an organization that can attest to and verify the authenticity of them creates difficulties for microfinance customers and MFIs. The potential pool of microfinance clients is very large in Afghanistan, but the absence of accredited collateral, presents itself as a barrier that is very hard to overcome.

There is an amendment in the court order to register any collateral in the name of MFI or Banks. The process to place a lien on a property's title deed takes two months. There is also a three percent cost on the value of the contract (loan amount) and again three percent when the loan is paid. Transfer of title deeds as collateral to banks costs six percent of the property value and other six percent is charged when it is transferred back to the owner, which amounts to a total of 12 percent. The average interest rate charged by MFI is described in Table 11. The charges on small loans are relatively small and amounts to 1.25% flat fee. If 12 % of cost described above is added on top of the loan, then the cost of the loan would become excessive and unaffordable.

Currently, it is common practice for MFIs to verify the client’s collateral with an authorized body in the government. Loan Officers can create Global Positioning System (GPS) numbers for properties to ease the assessment process for the clients.

4.3. Management Information System

Microfinance is one of the fastest growing sectors in the world. Quality management information systems that meet the requirements of MFIs is a vital need. Six management information systems were analyzed in India for their license, annual maintenance, implementation, and training costs. It is very difficult to judge, compare the performances of competing MIS for their efficiencies and benefits. The cost of MIS varies based on the licenses. The cost for 15,000 to 40,000 or 100,000 clients varies greatly. Table 20 is a comparison between six companies who are vendors for India’s MIS system.

Table 20: Comparison of Indian MIS Vendors.

MIS Vendors	Product Name	15,000 customers	40,000 customers	100,000 customers
Elitser IT solutions India Pvt Ltd	Matrix	N/a	N/a	N/a
Grandatim IT Ventures	MF Resolve	\$44,250	\$44,250	\$46,250
Infrasoft Technologies Limited	Omni Enterprise Microfinance Solution	\$112,000	\$212,000	\$312,000
Sathguru Management Consultants Pvt Ltd / Basics Limited	Delphix	Not Disclosed	Not Disclosed	Not Disclosed
Snowwood Infocom Technologies Pvt Ltd	MFASYS (Mobile Enable Microfinance Accounting System)	\$29,820	\$74,220	\$146,220
Southtech Ltd.	Southeast Ascent Banking	\$194,000	\$251,000	\$483,000

Source: Science Direct. www.sciencedirect.com

The differences, in terms of costs of the six MIS providers, are huge. Currently there are hundreds of software vendors which are chasing thousands of microfinance institutions and .have control over billions of dollars. This encourages MIS vendors to work in a specific area e.g. MFIs to compete and survive in the competitive market (Behl & Singh, 2014).

MFIs and Banks invest heavily in infrastructure for technology hardware and software. This investment is significant and beyond the affordability of the MFIs. Some of these MFIs are granted money to purchase software. As mentioned in the introduction, the culture of each MFI was shaped by various international MFIs and therefore most of these MIS do not match the needs of the organization. During an interview with one of

the MFI's CEOs it was mentioned that Afghanistan Microfinance Association should be a bridge between the donors and the MFIs. This bridge will assist in finding solutions and accessing finance in order to have a solid Management information system (AMA, 2019).

Since the start of the Taliban regime up to 2021, there have been 39 Government and 128 private universities and Institutes. Most of these academic bodies have Information Technology departments. Unfortunately until now none of these institutes were able to develop a local Management Information System that is built to a high international standard (Ministry of Higher Education, 2021).

MISFA supported the establishment of a grant to some of the MFIs for their MIS and to purchase efficient and effective software. The MIS purchased was named as the premier Microfinance core banking system in Afghanistan. This software enabled FINCA MFI to fulfil functions, carry out an internal audit, and control and meet policies developed by the Global Corporate Audit (GCA) for reporting, auditing and securing microfinance institutes in the country. (MISFA, 2019b)

Management information systems are one of the most costly areas in MFIs. Lack of a trained staff and the high cost of supporting them from abroad is always a big challenge for all MFIs. It can be surmised from financial reports of MFIs and Banks that a huge amount of money is invested in this sector. Still, government and local MFIs are not able to have a MIS that can meet the requirements for the geography of Afghanistan.

4.4. Client and Staff Behaviors

Client and staff behaviors are both related to the field of human resources. Therefore, this study tries to shed light on this issue as it is significant to the microfinance sector. Microfinance clients have lower incomes are therefore always moving and migrating. They are not committed to fulfilling their promises and living up to the contracts that they have entered with MFIs. SME clients are primarily located in the urban areas since their loan size are high collaterals are valuable. With respect to staff behavior trends in the Microfinance and SME sectors, staff seem to have short term thinking. Most of the staff seek career shortcuts to attain better positions. Emotionally driven decisions about investments and loans from MFIs and SME sectors have been the norm.

Due to decades of conflict, one cannot compare the issues that continue to cripple Afghanistan with another country in other parts of the world. The conflict has profoundly

impacted the behavior of the average person, who mostly thinks of short-term gains and dreaming of quick recovery from the financial distress. Such behavior led to corrupt practices for both the client and MSME organization's staff levels. Common practices discovered are further elaborated in the paragraphs that follow.

Abuse of group loan products were observed. For example, group loans were offered to female clients, but these females were usually forced by their male spouses to secure the loan and pass the proceeds on to them. This resulted in the use of loans for non-income generating activities and caused a high number of defaults.

Some of the MSME organization staff (mainly loan officers in collusion with their supervisors) also demonstrated corrupt practices and secured kickbacks against loans. Moreover, some staff even stooped down to the level of issuing fake loans for themselves and repaying themselves. It was observed that they were starting the cycle from a low amount loan and moving to a high amount loan and then embezzling the amount which ended up being 100,000 US dollars.

4.5. Client Identification Issues

Afghanistan has been decades behind the global technological revolution and therefore national identification was very primitive. There is still paper-based ID's while other countries are managing their citizen's data on computerized systems. The paper-based system coupled with high levels of corruption, resulted a chaotic environment in Afghanistan which paralyzes the financial services sector. Due to these deficiencies of the system, the microfinance clients can secure multiple loans from multiple organizations using multiple IDs. After swindling so much money from these MFIs, they default on their loans and leave their organizations suffering millions of dollar losses. In the earlier years, not enough efforts were put into this issue by either MISFA or the international agencies to institute a biometrics system to eliminate this loophole that allows massive fraud.

Microfinance clients are known as poor or low income earners who are living in rental houses. The movement and changing of houses are common among most clients. To update records of clients on a timely basis is difficult and time consuming. Most of the frauds are identified when the clients past the loan due date and default on their loans. As a result, PAR values of the organizations increase as an indicator of continued fraud.

The Government of Afghanistan approved electronic identity cards, called Tazkira, which includes name, language, mother's name, religions, and other details

about the ID card holder in 2014. Unfortunately, the implementation of the electronic ID cards was delayed until 2020. The process of attaining the electronic ID cards is very slow at the present time. Afghanistan's Vice President complained about the delay in rolling out the electronic Tazkira. It has taken six years for the Afghan government to launch the electronic ID card, but it is still not fully functional (BBC, 2021).

The Ministry of the Interior of Afghanistan started to issue electronic ID cards in Kabul and other major cities of Afghanistan. It is hoped that this process will be completed country-wide, and everyone will have an ID card soon. Completion of electronic ID project will eliminate duplicate application and the fraud of the MFIs.

4.6. Security/Law Enforcement

Based on several recent reports from international and national news channel, Afghanistan has ranked among one of the most corrupt countries in the world. In 2008, the Daily Mail UK published a report that Afghanistan is the world's fourth most unstable country (Daily Mail, 25 March 2008). This means that government stability depends on the law enforcement. Afghan government hasn't been able to support and implement its own laws in some key areas. Another report published by the United Nations Assistance Mission in Afghanistan (UNAMA) in 2011, states that Afghanistan failed to implement laws to prevent violence which were legislated in 2009. The culture of silence among tribes is always questionable in Afghanistan. The elders' gathering called Jerga, and their decisions take president over constitutionally legislated laws in the tribal rural areas (Huwaida, Muhammad Reza 2011). According to the Transparency International's annual corruption perception index, Afghanistan was ranked as the most corrupt country in 2017. Corruption in the government creates domino effect and influences every area as well as most of the MFI institutions. (Tolo News 22 February 2018)

The main issues in this area are lack of security, corruption, lack of implementation of the law and lack of support from the government institutions. This creates an environment void of law and order, where guilty gets away with his or her crime and feel they have liberty to continue their fraudulent activities. A study, conducted on this topic, extrapolates that submission of complaint cases on fraud is very time consuming and complicated in Afghanistan. It takes months and sometime years without yielding any result. On some other occasions, the amount of fraudulent loans most of the time are not enough to submit to a lawyer prosecute. At the beginning, some

of the MFIs referred their fraudulent cases to the legal system, but the results were not in favor of MFIs. This created an environment where enterprises are discouraged to seek relief and help from the governmental entities. Some of the Judges even suggest that interest-based institutions should be totally banned in Afghanistan.

According to the MISFA’s annual report compiled on the microfinance and MFIs activities taking place 14 provinces out of 34, rates the security issue as the number one threat to the business (MISFA Annual Report 2019). The prevailing concern is that the needy families are still not eligible for microfinance and MFIs loans.

4.7. High Cost of Finance

Most of the microfinance and SMEs were securing loans with interest rates ranging between 20-40 % per year. This rate was too costly for many microfinance SMEs’ clients who were already poor and trying to make ends meet. Payment of such high interest rates affected their profitability and those who could not afford it failed in their business and defaulted on their loans. These kinds of situation resulted not only as a loss of the business, but it also meant loss of job as well as pushing their families back into poverty. Since there was no social welfare system in Afghanistan, this made these clients’ life impossible. Expatriate staff were also securing high salaries for themselves since their pays included danger pay due to being in a dangerous county. Furthermore, the costs of security, computer hardware and software, electricity, generator fuel, rental cost, and high management wages add to the cost of operation to make it impossible to self-sustain.

An example of an average performance calculation of a microfinance Loan Officer is presented in table 21 and it captures the revenue generation of a Loan Officer for the Microfinance Institute. Although the direct cost of Loan Officers for the MFI is very negligible, other important items such as indirect costs of funds and supports are very costly. Based on the historical data from interviews, around 30% of the Loan officers’ performance is listed below as a benchmark.

Table 21: Average Calculation of MF Loan Officer Revenue

Average Loan size for a loan officer to match the equilibrium points	
Account Head	Amount
Average Loan	104,000.00
Average Number of Loan	160

Total Portfolio of Loan officer		16,640,000.00
Average Interest rate 22%		3,660,800.00
Average Expenditure of Loan Officer		
Account Head	Monthly Amount	Annually Amount
Salary	16,000.00	192,000.00
Transport	2,500.00	30,000.00
Medical	1,000.00	12,000.00
Field Allowance	8,000.00	96,000.00
Commission	25,000.00	300,000.00
Top Up Card	2,000.00	24,000.00
Eid Bonus Twice A Year		3,000.00
Total Direct Expenses		657,000.00
Profit/(Loss)		3,003,800.00
Provision Expenses 8%		1,331,200.00
Cost Of Fund Average 6.5%		1,081,600.00
Branch Cost 2%		332,800.00

Head Office Cost 1.5%	249,600.00
Profit/(Loss)	8,600.00

Source: Compiled from MFIs reports

Operation costs in the microfinance and SME sector is huge based on the 2020 financial report of FMFB, elaborated above on table 22.

Table 22: List of top expenses of MFIs

Summarized Account Head	2020	%	2019	%2
Total Revenue	1,301,083,000.0	100	1,470,803,000.0	100
	0	%	0	%
Top five expenses Head				
Personal Expenses	697,348,000.00	54%	675,716,000.00	46%
Other Operating expense	389,545,000.00	30%	532,464,000.00	36%
Depreciation and amortization	139,111,000.00	11%	129,906,000.00	9%
Impairment loss on loan and advance to Customer	48,370,000.00	4%	105,961,000.00	7%
Finance cost on Lease	8,277,000.00	1%	14,215,000.00	1%

Source: FMFB annual financial audited 2020

Based on the above table from the financial reports of FMFB, it seems that personal expenses which are salary and benefits for the local and expat staff in the microfinance sector are very high. For example, this amount was 54% in 2020 and 46% in 2019 as compared to total revenue. Operational costs of this account head that he or she incurred, appear as communication expenses, insurance, office security, IT maintenance and support, travel and transportation, generator fuel and maintenance. Some of these operational expenses cost 30% of the total income in 2020 and 36% in 2019. Amortization and depreciation from assets were 11% in 2020, and 9% in 2019.

Impairment loss as per the instruction of the Central Bank was recorded at 4% in 2020, 7% in 2019 and the finance cost on the lease was 1% in both years.

Based on the findings, it appears that the operating cost is very high in Afghanistan. It takes a long time for MFIs to amortize and stay self-sustainable in the market.

5. CHAPTER 5: ANALYSIS AND CONCLUSION

The findings in the chapter 4 describes and highlights the major areas of problems and challenges that microfinance and SMEs experience while operating in Afghanistan today. The Introduction section covers the historical background of MFIs and SMEs in the Afghan market from 2002 onwards. The products offered by MFIs and SMEs including Islamic financial products which are currently actively offered in the market. Current numbers of successful MFIs in Afghanistan as well as the number of banks and MFIs that were closed-down or bankrupt due to poor performance and insolvency were also detailed.

The researcher highlighted important and genuine issues plaguing MFIs for which solutions are urgently awaiting at the national and sometimes international levels. Based on the hypothesis and the related research questions examined in this thesis work, it's the conclusion of the research that after two decades of operation, the microfinance and SME sectors are still not operational, and self-sustainable.

Analysis was provided to the topic of collateral, which is one of the most important issues for the sector of MFIs and SME loans. Due to the several legislations took place during the past 40 years, laws have been amended which impacts the enforcement and quality of collateral which are important safeguards for lending and operational financial institution. Despite legislating over sixty different types of laws and amendments in the last forty years; unfortunately, genuine solutions to the social and moral ills of the sector and the society are not rehabilitated yet. Therefore, the recommendations are being made by the researcher that the Afghan government must review them and aim to develop a system which improve the quality of the collateral, so the financial institutions can depend on its reliability.

In the research it has been observed that entrepreneur clients, MFI, micro and SMEs staff behaviors are crucial in safeguarding the assets deployed for lending practices, as well as to limit the portfolio at risk. In the interpretation part, it has been discussed that the behavior of some clients and staff are unbecoming and it has been experienced that some individuals desire to reach to their goals by unethical shortcuts that are harmful to themselves and to the financial institutions that they work with. The microfinance and SME sectors have witnessed many frauds that have been organized by clients and staff. These fraudulent activities analyzed earlier as described as using distributed loans for trivial expenses such as wedding expenses, purchasing personal

items and other non-business activities which do not generate income. The Loan Officers' preparation of fake documents, using fake IDs and colluding with clients and senior staff to create fake and unworthy loans are currently plaguing this industry and needing urgent solutions.

Afghanistan still does not have adequate security arrangement for its citizens' safety and educated or more qualified individuals are always attracted to immigrate to other countries. Therefore, brain-drain and loss of qualified individuals is a big issue for Afghanistan. Hard to find funds are spent on training and capacity building of staff, who are in a few years decide to leave the organization and the country. This unfortunate circle does not only impede on the development of a healthy microfinance and SMEs sector, but it also propels the departure of qualified individuals out of the country. Establishment of law-and-order situation could propel the growth of the microfinance and SME sector in many ways, since businesses can only flourish in enabling environments, security being a single pillar of that. Security also affects the operations of financial institutions, from cash transits between branches, to enforcing laws on defaulting clients, fraudulent staff, and confiscation of collateral upon default. The historical security arrangement of Afghanistan has been changed ten times in the past five decades due to the continual governmental changes. The ongoing takeover of Afghanistan by Taliban and the failed peace talks are exasperating the situation. If the Taliban takeover recurs, it would be impossible for interest-based banking and microfinance business since their vision towards interest-based lending is very restrictive. In past years, it happened in the peaceful province of Bamiyan, where a Fatwa was given by the religious leaders and many of microfinance and SMEs' clients did not repay their loans.

Findings show that lack of a functional client identification system is one of the most detrimental issues that Afghanistan is faces in the twenty first century. Establishing an acceptable electronic identification card system would not only help loss prevention aspects of the microfinance and SMEs industry, but it would also help other social, demographic, and criminal management issues of the country.

Each regime who ran the country made some small changes in title and deeds laws and tried to make changes to correct this problem, but still the title and deeds database and identification system, Tazkira, is not working properly. Recently, the Ministry of Interior issued the electronic ID system which added more information in

the title ID', but this system too needs corrections and functionality. It took many years to implement this system in one of the most conflict areas which included information on the ID owners' nationality, religion, ethnicity, and name of mother. With great hopes the government launched the final version of the identification stem in 2020, but it is too early to say how effective it will be and how much the MFI will trust the system.

MIS and IT technology is an enabling tool for analyzing, reporting, and interpreting data for financial institutions. At the end of various interviews and the completion of our study, we confirmed that most of financial institutions in the country purchased their MIS and its support from India due to its price competitiveness, but the systems and the support that they get are still below the industry norms in terms of actual hands-on support and training.

The high cost of financing is the final important point analyzed in this study as the reason why MFIs and SMEs cannot be self-sustainable in Afghanistan. The high cost of financing is said to be due to the higher operational cost of doing business in Afghanistan as opposed to any other parts of the world, but this needs to be pushed to an acceptable level. Out of the fifteen MFIs and banks which has licenses from the government of Afghanistan in the past two decades, only four are operational today. The success factors at the backend of these four institutes are the better management, internal controls, and loyalty of their staff to their firms.

Finally, there will be more challenges and difficulties encountered by MFI in the future, due to the three important issues taking place in Afghanistan. First, the long-term impact of the ongoing COVID-19 pandemic which will reduce the operations of MFIs. Second, if the Taliban dominates the country the second time, they might reduce conventional or interest-based loans which will create more needs and opportunity for the Islamic banking and interest-free products. Third, is the high dependency of Afghanistan on foreign aid. If, the security of the country gets worst and civil wars takes place, there will not be any business left in many sectors.

In conclusion, the current evaluation of MFI and SME in Afghanistan is very concerning, and after heavy investments from international community over the past two decades, not much has been achieved. Furthermore, the outlook seems even bleaker since Afghanistan is currently going through another takeover by Taliban, a potential civil war is simmering, a drought has been forecasting and a financial instability is setting-in.

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LIST OF ATTACHMENTS (IF AVAILABLE)

Questionnaires' from MFI employee:

Name (optional)..... Organization (optional):

Positions (Optional)..... Experience (optional).....

Main Challenges of MFI in Afghanistan

.....
.....

Name riskiest issue that you have faced:

.....
.....

How did you solved these issues:

.....
.....

Questionnaires' from MFI customer:

Name (optional)..... Organization (optional):
.....

Positions (Optional)..... Business Experience
(optional).....

What are the main challenge to get finance

.....
.....

Are you happy with Interest rate :

.....

CURRICULUM VITAE

Imam Ali Hussaini started his primary school education in Afghanistan. After the collapse of the President Dr. Najibullah's government and the start of the civil war, he migrated to Karachi, Pakistan. He completed his secondary education in Pakistan. He returned to Afghanistan in 2004 and started working as an Account Officer for a Commercial Branch of First MicroFinanceBank, Afghanistan. He worked at FMFB-A for almost seven years in various capacities such as Account Officer, Finance Officer, and Account Manager. In 2011, Imam Ali joined Mutahid (DFI) as the Head of Finance and Administration Department and worked for them for 2 years. In 2013, he joined Finest Super Store - the biggest chain supermarkets in Afghanistan, as Finance Manager and he was promoted to the Chief Financial Officer position later. In 2014, he was transferred to Finest Super Store's parent company Sadat Mansur Naderi Investment in capacity of its Executive Finance Manager. In late 2016, Imam Ali migrated to the Republic of Turkey.

Educational Background

Imam Ali received his bachelor's degree education in Business Administration from Maiwand Institute of Higher Education, in Kabul, Afghanistan.

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