



THE REPUBLIC OF TÜRKİYE
SOCIAL SCIENCES UNIVERSITY OF ANKARA
INSTITUTE FOR ISLAMIC STUDIES
ISLAMIC ECONOMICS AND FINANCE DEPARTMENT

**ANALYSIS OF MICROFINANCE INSTITUTIONS PERFORMANCE: THE CASE
OF AFGHANISTAN**

Master's Thesis

SHABANA ZARSHEED

Advisor: Assoc. Prof. Zeynep Burcu UĞUR

Master of Islamic Economics and Finance

Ankara
January 2023

ACCEPTANCE AND APPROVAL PAGE



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, and 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.



ACKNOWLEDGMENTS

My endless praises to the one who taught mankind by the pen.

My mother, my sister, and my husband, as well as my incredible friends, have always been a great source of inspiration and support for me throughout this thesis. It would certainly be difficult and challenging to accomplish the journey without their support.

Last but not least, I would like to thank my thesis supervisor Dr. Zeynep Burcu UGUR for providing me with continuous and valuable guidance throughout the writing of this thesis and for helping me to complete it successfully. Also, would like to acknowledge my deepest appreciation to the members of jury Dr. Tawfik Arak and Dr. Mucahit Ozdemir as well as entire Department and Faculty of Islamic economics and finance of Ankara Sosyal Bilimler University, which was the main source of knowledge and wisdom by offering a platform where I could practice and apply my skills during two years of my educational journey.

This thesis is dedicated to my sister ZUHRA SAHAR.

ANALYSIS OF MICROFINANCE INSTITUTIONS PERFORMANCE: THE CASE OF AFGHANISTAN

ABSTRACT

This research paper assesses the financial and social performance of microfinance institutions in Afghanistan, focusing on five large microfinance institutions: First Microfinance Bank (FMFB), OXUS, Mutahid, FINCA, and The Islamic Investment and Finance Cooperatives (IIFC). The study evaluates the indicators of social performance (depth and breadth of outreach), financial performance indicators (portfolio quality, efficiency, and sustainability), as well as the impact of interest rates on the efficiency and sustainability of these institutions. Both quantitative and qualitative research method is used to analyze the data obtained from MIXmarket.org. The findings of this study suggest that the institutions need to extend their outreach since the percentage of poor clients and female borrowers is low. Even though the institutions achieved acceptable financial performance during the study period (2014-2018), their heavy dependence on loans and subsidies threatens their long-term sustainability and efficiency. As a result, the study concludes that the high-interest expense negatively impacts these institutions' efficiency and sustainability.

Keywords: *Microfinance Institutions, Social Performance, Financial Performance, Outreach, Sustainability, Interest Payable*

MIKROFINANS KURUMLARININ PERFORMANS ANALIZİ: AFGANISTAN ÖRNEĞİ

ÖZ

Bu araştırma, beş büyük mikrofinans kuruluşuna odaklanarak Afganistan'daki mikrofinans kurumlarının finansal ve sosyal performansını değerlendirmektedir: First Microfinance Bank (FMFB), OXUS, Mutahid, FINCA ve The Islamic Investment and Finance Cooperatives (IIFC). Çalışma, sosyal performans göstergelerini (erişim derinliği ve genişliği), finansal performans göstergelerini (portföy kalitesi, verimlilik ve sürdürülebilirlik) ve ayrıca faiz oranlarının bu kurumların verimliliği ve sürdürülebilirliği üzerindeki etkisini değerlendirmektedir. MIXmarket.org'dan elde edilen verilerin analizinde hem nicel hem de nitel araştırma yöntemi kullanılmaktadır. Bu çalışmanın bulguları, yoksul müşterilerin ve kadın borçluların yüzdesinin düşük olması nedeniyle kurumların sosyal yardımlarını genişletmeleri gerektiğini göstermektedir. Kurumlar, çalışma döneminde (2014-2018) kabul edilebilir finansal performans elde etseler de, kredilere ve sübvansiyonlara olan yoğun bağımlılıkları, uzun vadeli sürdürülebilirliklerini ve verimliliklerini tehdit etmektedir. Sonuç olarak çalışma, yüksek faiz giderinin bu kurumların verimliliğini ve sürdürülebilirliğini olumsuz etkilediği sonucuna varmıştır.

Anahtar Kelimeler: *Mikrofinans Kuruluşları, Sosyal Performans, Finansal Performans, sosyal yardım, sürdürülebilirlik, Faiz Ödemeleri*

TABLE OF CONTENTS

ACCEPTANCE AND APPROVAL PAGE.....	II
DECLARATION.....	III
ACKNOWLEDGMENTS.....	IV
ABSTRACT	V
ÖZ.....	VI
TABLE OF CONTENTS.....	VII
LIST OF FIGURES	IX
LIST OF TABLES	X
LIST OF ABBREVIATIONS	XI
CHAPTER ONE.....	1
1.0 Introduction	1
1.1 Literature Review	3
1.2 Study Limitations	5
CHAPTER TWO.....	7
2.0 Political Economy of Afghanistan	7
2.1 Background of Afghanistan’s Economy	9
2.1 Financial System of Afghanistan	10
2.2 Banking Sector	11
CHAPTER THREE.....	13
3.0 Afghanistan’s Microfinance Overview	13
3.1 Microfinance Institutions	14
3.2 The Current Statement	17
3.2 Demand for Microfinance in Afghanistan	18
CHAPTER FOUR.....	20
Research Methodology and Data Description	20
4.0 Data	20
4.1 Research Questions	20
4.2 Data Analysis Methods	20
4.3 Microfinance Performance Determinants	21
4.3.1 Social Performance Indicators.....	22

4.3.2 Financial Performance Indicators.....	22
CHAPTER FIVE.....	25
Results.....	25
5.0 Outreach trend of Microfinance Institutions from 2014-2018.....	25
i. Breadth of Outreach	25
ii. Depth of Outreach	26
5.1 Financial Performance	29
i. Portfolio Quality	29
ii. Efficiency.....	30
iii. Financial Sustainability and Profitability Trends	31
5.2 Interest Expense Effects on Sustainability and Efficiency Performances	34
i. Impact on efficiency	35
ii. Impact on sustainability.....	36
CHAPTER SIX.....	39
6.1 Conclusion.....	39
6.2 Policy Implications.....	39
Bibliography.....	41
Appendices	47

LIST OF FIGURES

Figure 1: Depth of outreach indicator: percentage of female borrowers	28
Figure 2: Trend of PAR>30 days ratio indicator	29
Figure 3: ROA trend of profitability indicator (2014-2018)	31
Figure 4: OSS trend of profitability (2014-2018)	33
Figure 5: Effect of interest expense ratio on efficiency of selected MFIs (2014-2018)	35
Figure 6: Effect of interest expense ratio on ROA of selected MFIs (2014-2018)	36
Figure 7: Effect of interest expense ratio on ROE of selected MFIs (2014-2018)	37
Figure 8: Effect of interest expense ratio on OSS of selected MFIs (2014-2018)	38

LIST OF TABLES

Table 1: List of active banks in Afghanistan.....	12
Table 2: List of active MFI in Afghanistan	15
Table 3: Changes in Key Indicators of Microfinance Providers between Q4 and Q3-2021	17
Table 4: Microfinance Key Performance Indicators in Afghanistan (Quarterly Comparison)...	18
Table 5: Social and Financial Measurement Indicators	21
Table 6: The breadth of outreach indicator over time (2014-2018).....	25
Table 7: The depth of outreach indicator over time (2014-2018).....	27
Table 8: The depth of outreach indicator over time (2014-2018).....	28
Table 9: The efficiency indicator over time (2014-2018).....	30
Table 10: The financial sustainability and profitability indicator over time (2014-2018)	32
Table 11: Data set for interest expense effect analysis	35

LIST OF ABBREVIATIONS

ABA:	Afghanistan Banks Association
AIBF:	Afghanistan Institute of Banking and Finance
AKDN:	Aga Khan Agency for Microfinance
AKF:	Aga Khan Foundation
AMA:	Afghanistan Microfinance Association
AWC:	Afghanistan Women Council
CSPIs	Community-based Savings Promoting Institutions
DAB:	Da Afghanistan Bank
FMFB:	First Microfinance Bank Afghanistan
FX:	Foreign Exchange
GNI:	Gross National Income
HiH-A:	Hand in Hand Afghanistan
IIFC:	Islamic Investment, and Finance Cooperatives Group
IMF:	International Monetary Fund
LAR:	Loan At Risk
MEDA:	Mennonite Economic Development Associates
MFIs:	Microfinance Institutions
MIX:	Microfinance Information Exchange
MISFA:	Microfinance Investment Support Facility Afghanistan
MSMEs:	Micro, Small, and Medium enterprises
NGO:	Non-governmental Organization
OER:	Operating Expense Ratio
OECD:	Organization for Economic Co-operation and Development
OSS:	Operational Self-Sufficiency
PAR:	Portfolio at Risk
ROA:	Return on Asset
ROE:	Return on Equity
UNDP:	United Nations Development Program

USAID: United States Agency for International Development

USD (\$): United States Dollar (Currency)

WWI: Women for Women International



CHAPTER ONE

1.0 Introduction

Poverty continues to be the greatest challenge facing developing countries. In general, poverty describes the human condition such as hunger, lack of shelter, lack of education, poor health, weakness, and social exclusion (Ishfaq & Jamil, 2015). According to new poverty estimates released by the World Bank, poverty has continued to spread in developing countries over the past 25 years. Worldwide, 8.9 percent of people lived on less than \$2.15 per day in 2022 (World Bank, 2022c). It is estimated that the Covid-19 pandemic will push up to 150 million people into extreme poverty by 2021. It is very distressing that 80% of the 'new poor' will live in developing countries (World Bank, 2020a). Developing countries are struggling intensely to fight poverty.

One way to fight poverty is to increase access to financial credit to foster progress and development in developing countries. Microfinance holds great promise in this regard. It claims to promote development through greater financial inclusion and not only enrich its clients but also empower them (Sherratt, 2015).

In many cases, the microfinance business is not for profit or in the best-case scenario only offers modest returns. Those who envision microfinance as a silver bullet that wants to eradicate poverty, see it as a set of financial practices designed to benefit the unbanked poor (Armendariz & Labie, 2011). Globally, around 1.7 billion adults do not have access to banks, any financial institutions, or mobile money services. Half of this unbanked population comes from the poorest percentage of their communities (World Bank, 2017). Due to the risks associated with serving poor households and micro-businesses, banks and other credit agencies do not provide credit to the poor. There are, therefore, 4 billion people in developing countries without access to credit and other forms of financial support (Rabobank, September 2005). As part of efforts to combat the financial exclusion of the poor, microfinance has been growing primarily in developing countries of Asia, South America, Eastern Europe, and Africa. According to Convergences (2019), over 139.9 million households were served by microfinance institutions in 2018, representing an increase of 58.1 million from 2009. After

Latin America, the majority of beneficiaries were in South Asia, where the average borrowing size was US\$36.8 billion.

Besides aiming for reducing poverty, microfinance institutions also work towards fulfilling other social goals. As an example, they provide credit to women, which can empower women as women's economic resources play an important role in their decision-making power within the household (Braunstein, 2008). Thus, a microfinance institution's performance will be determined by the extent it fulfills its goals (Hermes & Hudon, 2018; Simanowitz, 2003).

Asia has the largest population of poor people who are exposed to fluctuating prices and food supply (Ishfaq & Jamil, 2015). With 54.5% of the population living below poverty line, Afghanistan is one of the poorest regions in Asia and is located at the crossroads of South Asia and Central Asia (LUTFI, 2021; Zada, 2018). Afghanistan's banking system represents solely 20% of the country's GDP. In 2014 only 10% of adults had a bank account. Thus, the country has a large unbanked population and an informal sector almost accounting for 80% of the economy (OECD, 2019). Therefore, microfinance institutions have a great potential to reach the vast majority of unbanked and poor people in rural areas and provide them with financial and non-financial solutions to help their livelihoods in Afghanistan (Hussein, 2009).

Given Afghanistan's high degree of poverty and the banks' limited reach, there is a great need for micro-loans, but it is unclear if there is an adequate supply to satisfy this need (Hermes & Hudon, 2018).

The objective of this paper is to provide an overview of the microfinance sector and its outreach in Afghanistan and then investigate both the social and financial performance of the five largest microfinance institutions (FMFB, OXUS, FINCA, IIFC group and MUTAHID,) in Afghanistan for the period of 2014-2018. As Q4 of 2021 these institutions run the current microfinance sector in Afghanistan and the market share of these institutions are accordingly 60%, 13%, 12%, 9%, and 6% (Afghanistan Microfinance Association, 2021c) . Additionally, the study assesses the impact of interest expenditures on the efficiency and sustainability of the selected institutions in order to be able to assess how institutions' expenses affect these performances.

The study consists of six chapters. Chapter one provides an introduction literature review, and study limitations. A general background of Afghanistan's economy and financial system is explored in chapter two. This is followed by chapter three which explains microfinance institutions, demand for financial services, and the current situation of the sector. Section four

contains a discussion of the data, research methodology, and performance metrics. Chapter five presents the results of the study. Chapter six finalizes the study by providing conclusion, and policy recommendations.

1.1 Literature Review

Microfinance is a mean of obtaining financial services to the poor and small enterprises that lack access to banking and related services due to the high transaction costs and eligibility requirements. The prime objective of Microfinance Institutions (MFIs) is to assist vulnerable communities by expanding financial inclusion and eradicating poverty (Hussein, 2009; Kailley, 2009; Sherratt, 2015). In addition to expanding their outreach and serving the poor, microfinance institutions must be able to cover their cost and uphold financial sustainability in order to continue operating over the long term. Therefore, both the outreach (social efficiency) and the financial efficiency should be taken into consideration when evaluating the performance and success of an MFIs (Ferro-Luzzi & Weber, 2006; Gutierrez-Goiria et al., 2017; Hermes & Hudon, 2018; Simanowitz, 2003).

A steadily increasing body of literature has been evaluating the social and financial performance of microfinance institutions (Abate et al., 2013; Etefa & Abera, 2018; Ferro-Luzzi & Weber, 2006; Shu & Oney, 2014). Meanwhile, studies have shown a lot of interest in the trade-offs between financial and social performance evaluating the contradictory aspects of the financial and social performance of these institutions (Abdulai & Tewari, 2017; Adhikary & Papachristou, 2014; BEN, 2012; Woller, 2007).

Microfinance institutions' outreach and overall social performance are measured using the breadth of outreach which measures the inclusion rate of institutions' clients, as a measure of the quantity and the depth of outreach which measures how far it reaches the excluded and most vulnerable parts of society as a metric for the quality of the outreach (Bibi et al., 2018; Etefa & Abera, 2018; Navin & Sinha, 2021; Rosenberg, 2009). Parallel to this, the most common indicators used by the literature to assess the financial performance of microfinance institutions are those related to portfolio quality, productivity and efficiency ratios, financial sustainability, and profitability (Etefa & Abera, 2018; Rosenberg, 2009; Wale, 2009).

Hasan and Batra (2018) carry out an evaluation of thirty-one microfinance institutions to determine the performance of MFIs in Ethiopia. Divided into three areas, maturity, broad outreach, and operation scale, they assess the outreach and financial performance of the chosen

MFIs using return on asset, return on equity, operational self-sufficiency, financial self-sufficiency, and other indicators. According to the study, MFIs in Ethiopia perform poorly in terms of their financial performance and breadth of outreach but better in terms of their depth of outreach.

Similarly, comparable research analyzes the financial and social performance of Islamic and conventional MFIs in Pakistan. In order to evaluate the success of each industry, prior to comparing these two industries Khan (2014) analyses the social and financial performance metrics, such as outreach, profitability, efficiency, and portfolio quality, of four conventional and Islamic MFIs. The results of this study show that while conventional institutions performed better in terms of financial efficiency, Islamic MFIs provide better performance in terms of cost-effectiveness and sustainability.

While evaluating the social and financial performance of microfinance organizations in India, (Navin & Sinha, 2021) tries to determine how these two performances are interconnected. The study makes use of a dynamic framework of simultaneous equations model to determine the nature of this relation. The results revealed that there is a significant correlation between the breadth of outreach and financial sustainability and contends that MFIs may achieve financial sustainability while increasing their outreach to the vulnerable.

There has been a considerable amount of interest from international organizations and national bodies in microfinance in Afghanistan, which has led to the publication of many articles and reports, as well as a few researchers attempting to determine the status and performance of Afghan microfinance institutions (Chandrashekhar & Sultani, 2019; Chowdhury et al., 2006; Greeley & Chaturvedi, 2007; Hussein, 2009; Jahish, 2017; LUTFI, 2021; Style, 2021). Jahish (2017) studies the microfinance institutions in Afghanistan and the main factors determining repayment rates. This study examines the determinants of repayment rates of six of Afghanistan's largest microfinance institutions, including First Microfinance Bank (FMFB), OXUS-Afghanistan, FINCA-Afghanistan, the Islamic Investment, and Finance Cooperatives Group (IIFC), Afghanistan Women Council (AWC), and MUTAHID, using both qualitative and empirical methods. Based on the study, the repayment rate is primarily determined by loan type, loan size, interest rate, and gender. The repayment rate is positively influenced by group loans, larger loans, age, and the cycle of loans, but the rate of interest is found to have a negative impact.

A comprehensive analysis of primary resources is conducted by LUTFI (2021), who analyzes the development and challenges of microfinance institutions in Afghanistan. The study found that although microfinance institutions in Afghanistan have positively impacted the lives of people in some respects, poverty still remains the main concern of the people. The study concludes that religious belief, corruption, and insecurity are the three main reasons why microfinance institutions fail to overcome poverty. The author believes that the establishment of a Shariah-compliant microfinance system will help these institutions reach their full potential in this country.

Unlike previous studies examining microfinance institutions in Afghanistan, the current study is the first study of its kind that evaluates the financial and social performance of microfinance institutions in Afghanistan. Further, as most Afghan microfinance institutions are dependent on subsidies and grants (Jahish, 2017), this study analyzes the impact of interest payable as part of MFI expenses on selected institutions' financial performance using the most recent Mix market data available in the World Bank dataset. In addition to providing a background on the Afghanistan microfinance sector, this study sheds light on important financial and social performance indicators, which will have a significant impact on the beneficiaries of this sector, including the MFIs, as well as a body of literature for researchers and academicians.

1.2 Study Limitations

While this study aims to reflect a comprehensive assessment of microfinance institutions in Afghanistan, political conflicts, security, and lack of reliable data and access to online sources remain the major challenges to carrying out research related to Afghanistan. In order to conduct this study, the researcher uses online platforms to collect the data. The financial and social analytics data is collected from the MIX market. However, Afghanistan microfinance data is available up to 2018. Currently, obtaining the latest data on Afghan MFIs is impossible for many reasons. First and foremost, it has always been difficult and nearly impossible to find the financial reports of all of Afghanistan's microfinance institutions online, as all MFIs do not declare their financial statements to the public. In addition, due to the regime change in the country in 15th of August 2021, microfinance institutions were banned from offering conventional financing and were instructed to become full-fledged Islamic financial institutions (JURIST Staff, 2022). For this reason, some of the institution closed its website temporarily in order to get the necessary configurations in place. Lastly, due to the dire financial situation, most microfinance institutions and organizations that were contacted to

collect the data refused to cooperate. As such, the study relies on the information collected from Mix market, related appendix organizations like AMA and MISFA and related literatures.



CHAPTER TWO

2.0 Political Economy of Afghanistan

Being at the crossing roads of Central Asia, Afghanistan, with its rich history, has always been a geopolitically important land, which was “a center of the ancient Silk Road in Central Asia, a gateway to the Indian subcontinent, connecting China to western Asia and Europe, which carried trade from the Mediterranean to China” (Adamec, 2011). While such a geopolitical location could be an advantage in some other contexts, it proved to be a curse for Afghanistan, resulting in unceasing wars, political conflicts and regime changes, and human insecurity in history and contemporary times. As a large country with about 39.8 million population in 2021, and with a dynamic young population (55.5% population being between 15-64), despite the contemporary wars and conflicts, the fate of the country and its people could have been much different if it was not for the contestation created by the cold war environment between the Soviet polity and communist economic system and the Western democracy and capitalism (World Bank, 2022b). The result for Afghanistan was nothing but a sustained cycle of fragility and a survival-based political economy.

The development of the political economy of Afghanistan has been shaped by significant events in the country. As part of the contemporary political economy of the country, the Republic of Afghanistan (1973—1978) period is marked by efforts toward indigenous development in line with the global political economy of the period. As part of the modernization paradigm, the country embarked on creating a national economy through nationalization, which also saw the emergence of the banking sector to facilitate the country's development mainly through public sector domination. The emergence of the Democratic Republic in 1978 resulted in a substantial political economy shift calling for a Marxist overturn of a very traditional society, which resulted in Soviet occupation and war against the Soviets by various fractions mainly led by Islamic movements supported by the West. This period lasted until 1989, marked by a wartime economy based on survival political economy and millions of Afghans were displaced within the country as well as took refuge in neighbouring countries. Soviet defeat by Western supported Islamic movements and its withdrawal did not bring any peace to the country. 1989 to 1996 was marked by foreign interference and civil war between different factions of the fighting groups who fought against Soviet invasion. The absence of a central government did not allow the emergence of a structured political economy

during this period either. It resulted in the continuation of a wartime economy and survival-based political economy in the country's periphery (Clark, 2020).

The emergence of the Taliban leading to the United Front during 1996-2001 did not bring any stability to the country either, as unity perse could not develop a state of peace economy with a development paradigm. This resulted in sustaining the war economy at the centre and survival at the large periphery.

2001 marked the international intervention to remove the Taliban from the country with heavy involvement of the NATO coalition. From 2001 to 2013, significant foreign military presence as part of the peacebuilding process resulted in investments through foreign aid and donations. The initial political institutionalization through Loya Jirga provided legitimacy for the interim President. From 2014 onward, the decision on decreasing the number of soldiers on the ground by Western countries, fatigue in the international community to support the central administration, the rising tensions in the security and political environment, weakness of state apparatus, and intensifying systematic corruption in government bodies, resulted in a decline in private investments along with a decrease in international aid. On the other hand, the emerging banking and financial sector, along with the microfinance sector and cooperative movement with the increasing service sector, was giving confident hope for a new development strategy (Clark, 2020).

It is, however, essential to note that the post-2001 era political economy can be defined as a rentier state, which implies that the central administration became the front for generating rent or resources from international multilateral aid, donations from international NGOs, presence of foreign military and financial support from foreign countries. An important implication of being a rentier state through rent distribution is to generate consent and legitimacy to the existing political practices. Therefore, a rentiers political economy prevents the consolidation of democracy by undermining good governance resulting in crony capitalism marked with corruption and lack of accountability even to the international bodies providing the funds (Clark, 2020). Thus, as Afghanistan's experience in the post-2001 to 15th August 2021 demonstrates, rent distribution shaped the operative nature of the political economy at the center through provision to the elite, including the peripheral elite such as tribal and religious leaders. In contrast, survival political economy remained the nature of economic life for the rest of the population in the periphery.

The return of Taliban to power and hence the withdrawal of all foreign civil and military presence in the country on 15th August 2021 has dashed the initial development expectations, resulting in dire economic conditions and the emergence of abject poverty. While security issues seem to be resolved relatively, the economic sanctions against the new regime, including frozen Da Afghanistan Bank (DAB) funds in foreign countries, have not left any means for a potential recovery. In particular, the diminishing of grants and aid as part of the sanctions has created huge vulnerabilities even for the survival economy.

Currently, with the deterioration of the business environment and halting of microfinance business, as well as adverse developments in the global political economy along with the visible drought in the country, food security and hence famine is to become a real challenge even for the ongoing survival economy (Human Rights Watch, 11 November 2021).

A simple description of Afghanistan's political economy is fragility and aid dependence with heavy political contestation, resulting in conflicts and regime changes and shifts one after another.

2.1 Background of Afghanistan's Economy

Afghanistan, located at the crossroads of South Asia and Central Asia is a country that is notorious for its political conflict, low human development rank, and extreme poverty (Zada, 2018). Afghanistan has a wealth of natural resources, many of which have gone untapped because years of conflict, insecurity, poor infrastructure and governance, remoteness, landlock, and mountainous location have diminished access to global markets. Deposits of iron ore, copper, aluminum, tin, lead and zinc, gold, rare earth minerals, and a host of other natural resources such as petroleum are found throughout the country. Due to the unfavorable regulatory environment and political uncertainty, international companies have been hesitant to invest in the extraction of these resources (Ministry of Mines and Petroleum, 2019).

As part of international commitment, Afghanistan has received billions of dollars in development aid over the years from international donors. However, despite all the assistance and support, the government has continued to face serious economic challenges, including low revenue collection and job creation, high levels of corruption, weak capacity for government increasing poverty, and inadequate public infrastructure (Australian Government DFAT, 2022). Afghanistan's economy has been in a state of fragility for the past few years. Since 2012,

the economy has grown by less than 3 percent annually due to a combination of declining grant inflows, increasing insecurity, and political instability. The trade deficit remains extremely high at over 30 percent of GDP, mostly financed by grant inflows. In 2019, public revenues reached a new high of 14.1% of GDP but then declined to 11.4% in 2020 (World Bank, 2021). According to the most recent World Bank household surveys, Afghanistan's poverty rate increased from 38 percent in 2012 to 55 percent in 2017. This illustrates the extent of poverty and vulnerability of the 93% of the population living on less than USD 2 per day. These low standards of living led Afghanistan to be ranked 133rd out of 157 countries on the Human Development Index, with a Human Capital Index of 0.39 (World Bank, 2020b). Furthermore, United Nations Development Program (UNDP) estimates that almost 97% of Afghanistan's population is expected to live in poverty by 2022 (UNDP, 2021).

In Afghanistan, agriculture is the largest employer and the largest source of income. According to the World Bank's Afghanistan Development Update, agriculture accounts for 30% of GDP, which is the largest sector after services, employing 44% of the population (57% of rural employment) and it is a source of income for 60% of the population (World Bank, 2021).

2.1 Financial System of Afghanistan

Afghanistan experienced low levels of human capital development and poverty prior to the Soviet invasion in 1979. Agriculture was the main economic sector, with 80% of the rural population engaged in it. Accordingly, agricultural products accounted for almost 60-75 percent of the country's exports in 1977. The lack of financial institutions was one reason for its slow growth (Zada, 2018). Afghanistan had low levels of economic activity in general and banking activities were particularly underdeveloped (Afghanistan Banking Association, 2014). Before 2003, Afghanistan's financial system consisted of two state-owned banks (Bank Millie and Bank Pashtany) and four state-owned special purpose development banks (Agriculture Bank, Export Promotion Bank, Mortgage and Construction Bank, and Industrial Development Bank) (World Bank, 2004).

In 2002, Afghanistan's banking system was technologically obsolete, physically destroyed, and operationally nonfunctional. Demolished buildings were left for six government-owned banks. In post-Taliban Afghanistan, the World Bank, International Monetary Fund (IMF) and international communities' intervention in cooperation with members of the new government was crucial in addressing the problem and establishing a structured and well-governed financial sector. Afghanistan's economy has experienced exhibited substantial growth and positive

achievements, with a GDP growth of an average of 11 percent between 2003 and 2013 and was one of the top performing-economies in Asia. The services sector including the financial industry accounted for 41% of the GDP (Haidary & Abbey, 2018; World Bank, 2013).

Afghanistan's current financial system is primarily divided into the formal and informal sectors. Those activities that take place outside the government's regulatory framework are considered a non-formal sector. This includes transactions that are legal yet informal because of not being registered and licensed as well as illegal production, distributions, and transactions (Zada, 2018). As per the most recent data published by the World Bank, business activities in the informal sector are estimated to account for almost 80% of total business activity (World Bank Group, 2022). The formal sector is consisting of banks and non-banking financial institutions such as Foreign Exchange (FX) dealers, financial service providers, and e-money institutions. It is among the Central Bank of Afghanistan (DAB)'s duties to grant licenses and supervise banks and non-bank financial institutions (Da Afghanistan Bank, 2022b).

2.2 Banking Sector

in 2002, (DAB) was recognized as an independent institution, with its own specific tasks, goals, and responsibilities, and promoted to become the Central Bank of Afghanistan (World Bank, 2004). Afghanistan's banking system is primarily governed by three laws: the Da Afghanistan Bank Law (2003), the Afghanistan Banking Law (2015), and the Regulation for Conversion of a Conventional Bank into an Islamic Bank (May 2018). Accordingly, the DAB Law states that the primary objective of the bank is price stability and that its duties are to devise, implement, and adopt the monetary policy, foreign exchange policy, and manufacture banknotes and coins. The DAB Law also gives the DAB responsibility for licensing and supervising banks, foreign exchange dealers, and other financial institutions, as well as providing a safe and secure payment system (Da Afghanistan Bank, 2022a).

In Afghanistan, banks are the largest part of the financial system. In total, there are 12 banks with more than 400 branches. The majority are located in large cities like Kabul, Herat, and Mazar-e-Sharif. Three state-owned banks, six private commercial banks, one private Islamic bank, and two foreign bank branches exist (Da Afghanistan Bank, 2022b). Afghanistan Banks Association (ABA) is another institution in the banking industry and is a non-profit, independent, non-political association founded in 2004 due to the increasing need for a united body to represent all existing 12 banks in the country (Afghanistan Banking Association, 2014). In 2010, the Afghanistan Banking Association (ABA) established the Afghanistan Institute of

Banking and Finance (AIBF) to develop human resources for the financial sector, state institutions, corporates, and the general public's capacity (AIBF, 2010). The following table provides information about active banks:

Table 1: List of active banks in Afghanistan

No	Name of the Bank	Type of the Bank	License/Relicensed Date	No of Branches
1	Bank Millie Afghan (BMA)	State-Owned	26 July 2004	37
2	Pashtany Bank (PB)	State-Owned	26 June 2004	20
3	New Kabul Bank (NKB)	State-Owned	18 April 2001	12
4	Azizi Bank (AB)	Private Bank	13 June 2006	80
5	Afghanistan International Bank (AIB)	Private Bank	22 March 2004	14
6	Islamic Bank of Afghanistan (IBA)	Private Bank	18 March 2009	59
7	Maiwand Bank (MB)	Private Bank	31 December 2008	42
8	Afghan United Bank (AUB)	Private Bank	4 October 2007	27
9	The First Micro Finance Bank (FMFB)	Private Bank	18 March 2004	37
10	Ghazanfar Bank (GB)	Private Bank	1 March 2009	18
11	National Bank of Pakistan (NBP)	Branch of Foreign Bank	1 October 2003	1
12	Bank Alfalah Ltd (BAL)	Branch of Foreign Bank	21 May 2005	2

Source: Central Bank of Afghanistan, 2022

CHAPTER THREE

3.0 Afghanistan's Microfinance Overview

According to an Organization for Economic Co-operation and Development (OECD) report, Afghanistan's banking system is small and only accounts for 20% of the country's GDP. In 2014, less than 10% of adults in Afghanistan had a bank account. Consequently, there are many unbanked Afghans, and a predominant informal sector accounts for almost 80% of the country's economy (OECD, 2019).

As microfinance is particularly successful in countries with lower formal economic activity but higher social ties between people (The informal economy and microfinance in Kumasi), Afghanistan's economic situation -being largely informal- greatly enhances the potential for microfinance institutions. During the Taliban regime before 2001, financial activities were almost banned, and banks were forbidden from charging interest, so most of the activities shifted to the informal sector, which included lending from traders, money lenders, and relatives. There has been a significant increase in economic and financial infrastructure in the country in the last twenty years, including microfinance institutions, corporations, non-governmental organizations, and commercial banks focusing on microfinance. Around 200 international and local NGOs existed in 2002, 20 to 25 of which offered credit services to the people. The difficulty was that these institutions had limited capacity and coverage and were not backed by the government. Therefore, with international organizations' support, the Afghanistan government established the Microfinance Investment Support Facility (MISFA) in 2003 under the Ministry for Rural Rehabilitation and Development, which supports microfinance institutions in Afghanistan. In Afghanistan, most private and commercial activities began to emerge at that point (LUTFI, 2021) MISFA was created to serve the following objectives (Greeley & Chaturvedi, 2007):

- Co-ordinate donor funding so that the conflicting donor priorities endemic in post-conflict situations do not end up duplicating donor efforts and distorting markets
- Help young microfinance institutions scale up rapidly by offering performance-based funding for operations and technical assistance
- Build systems for transparent reporting and instill a culture of accountability

In practice, donor agencies provided financing to the microfinance sector through MISFA or directly to microfinance institutions (Hussein, 2009). To further support the sector's development, MISFA created the Afghanistan Microfinance Association (AMA) as the national network of Development Finance Institutions (DFIs) in 2005. With support from United States Agency for International Development (USAID)'s Financial Access for Investing in the Development of Afghanistan (FAIDA) project and the continued backing of MISFA, AMA positioned itself as an association that promotes the broader development finance sector in Afghanistan (Afghanistan Microfinance Association, 2022b).

As of 2021, a total of eight microfinance institutions have been providing financial activities in Afghanistan. These microfinance institutions are as follows: FINCA-Afghanistan, IIFC group, Mutahid, OXUS Afghanistan, FMFB Afghanistan, Aga Khan Foundation, WEERDP, and Hand in Hand Afghanistan. These institutions served a total of 963,371 active clients in 2021 (Afghanistan Microfinance Association, 2021a).

3.1 Microfinance Institutions

Afghanistan's microfinance sector has a rich institutional diversity with different structures. The differences can be attributed to their business model and legal status. Except for FMFB, microfinance institutions are not regulated. While FMFB is a commercial bank focusing particularly on microfinance business, Aga Khan Foundation (AKF), Afghanistan Women Council (AWC), and Hand in Hand Afghanistan (HiH-A) are Community-based Savings Promoting Institutions (or CSPIs), which are offering some microfinance services along with other development activities. The rest of the organizations (FINCA-A, IIFC Group, Mutahid, and OXUS) are classified as pure MFIs (Afghanistan Microfinance Association, 2022a). The table 2 provides list of active microfinance institutions followed by a summary of microfinance institutions analyzed in this study is provided below.

Table 2: List of active MFI in Afghanistan

NO	Name	Inception Year	Type*/Legal Status	AMA/MISFA Membership/Partnership
1	FINCA-A	2003	Microfinance Institution / Joint Stock Company	Member of AMA/Partner with MISFA
2	IIFC Group	2009	Microfinance Institution / -	Member of AMA
3	Mutahid	2011	Microfinance Institution / Company	Member of AMA/Partner with MISFA
4	OXUS-A	2007	Microfinance Institution / Corporation	Member of AMA/Partner with MISFA
5	FMFB-A	2004	Microfinance Bank / Commercial Bank	Member of AMA/Partner with MISFA
6	AKF	2003	Community-based Savings Promoting Institution / NGO	Member of AMA
7	HiHAO	2007	Community-based Savings Promoting Institution / NGO	Member of AMA
8	WEERDP	2018	Program / Implemented by Ministry of Women Affairs	Member of AMA

Source: Afghanistan Microfinance Association

- i. **FINCA Afghanistan** was founded in 2003 with the support of FINCA International and registered as a joint-stock company with the Ministry of Commerce and Industries of Afghanistan. It is headquartered in Kabul and focuses on rural and urban areas of the country, primarily in the North, West, and Central regions. Different loan products have been offered (including two Shari'ah-compliant products) such as SME loans, Emergency Credit Lines, Agriculture, and Livestock Loans, as well as Women and Staff loans based on individual and solidarity group loans. FINCA-Afghanistan is helping clients in the informal economy to create their own jobs and build small businesses. The majority of its clients are female borrowers with fewer economic and employment opportunities (MISFA, 2017).

- ii. ***OXUS-Afghanistan*** was founded in 2007 as a part of the OXUS Development Network. It is registered as a corporation under Afghanistan Law. Since its creation, OXUS Afghanistan has been supported by grants and concessional loans from MISFA and an equity investment from its main shareholder, OXUS Holding. OXUS Afghanistan provides various types of loans such as collateral-free group loans, individual loans, SME loans, agriculture Murabaha, etc. (Jahish, 2017).
- iii. ***Mutahid*** (meaning ‘united’) was established in 2011 by the merger of six different microfinance institutions (MFIs). It has been directly funded by MISFA, the World Bank, Mennonite Economic Development Associates (MEDA), and the United States Agency for International Development (USAID). The institution is registered with the Ministry of Commerce and Industries of Afghanistan. Mutahid offers both conventional loan and Islamic financing products through individual and group-based structures. The group's average size varies from 2 to 6 members, while the loan tenor goes from 6 to 18 months. Mutahid also provides Shari’ah-compliant group Murabahah financing to particularly women enterprises with the same features of conventional group loans (MISFA, 2017).
- iv. ***First Microfinance Bank-Afghanistan (FMFB)*** was founded in 2004 and is affiliated with the Aga Khan Development Network (AKDN), which provides financial services in more than ten countries through its banks. The Bank operates as a commercial bank regulated by the Central Bank of Afghanistan. As a commercial bank with a microfinance focus, FMFB provides credit and deposit services to Micro, Small, and Medium enterprises (MSMEs) along with commercial banking and international and domestic remittance services. FMFB has been using a conventional individual lending method only since 2017. This bank is the largest MFI in Afghanistan regarding clients' outreach, the number of provinces operated, and staff. The bank has offered conventional commercial banking services (deposits, SME loans, trade finance products) alongside microfinance products, including individual enterprise loans, women's individual enterprise loans, housing loans, agriculture/livestock loans, healthcare loans, vehicle/student/marriage/home appliance loans, etc. (FMFB, 2022).
- v. ***The Islamic Investment and Finance Cooperatives (IIFC) Group*** was established in 2009 by USAID with funding of about USD 18.6 million. This organization represents

all national networks of cooperatives in Afghanistan, and it is named Islamic Investment and Finance Cooperatives (IIFCs). IIFC Group, the apex entity of IIFCs, provides them with technical assistance, fundraising, and helps in IIFCs' staff capacity buildings, etc. IIFCs have catered to conventional and Islamic financing needs of micro-entrepreneurs in Afghanistan, from 6 months to 24 months term loans. IIFCs (alongside FMFB) are the only MFIs that receive savings from their customers (Afghanistan Microfinance Association, 2022a).

3.2 The Current Statement

Under the uncertainties generated by regime change in August 2021, a dramatic adverse impact has been observed on the financial and risk indicators of the microfinance sector. The effects of the new regime started to surface by the third quarter of 2021. In order to reveal the financial impact of the regime change, Q4-2021, as the latest data provided by AMA, is compared with Q3-2021 data, (Afghanistan Microfinance Association, 2021b, 2021c). The changes between Q3-2021 and Q4-2021 in the key performance indicators for the existing MFIs are summarised in Table 3.

Table 3: Changes in Key Indicators of Microfinance Providers between Q4 and Q3-2021

		No. of Provinces	No. of Branches	No. of Staff	No. of Clients	No. Active Borrowers	Share of Women Clients	Gross Loan Portfolio (m, Afn)	PAR > 30 (%)
FINCA-A	Q3	10	19	317	21,263	21,293	56%	966.2	25.4
	Q4		18	243	19,379	19,379		763.8	54.5
IIFC Group	Q3	11	25	201	112,906	13,495	25%	720.2	34.5
	Q4			166	100,407	12,857	19%	623.8	96.4
Mutahid	Q3	6	8	206	16,871	16,871	39%	452.5	51.8
	Q4			203	16,178	16,178		390.6	90.6
OXUS-A	Q3	10	26	441	24,977	24,977	57%	1,107.7	24.2
	Q4		25	391	22,150	22,150	56%	886.1	28.9
FMFB-A	Q3	14	37	1,478	227,956	52,392	24%	4,977.2	45.8
	Q4			1,418	230,562	46,623		4,055.3	7.1

Source: Afghanistan Microfinance Association

When we look at the Afghanistan microfinance sector's performance in general (including CSPIs), Table 4 clearly shows a significant deterioration in the sector's key indicators. The number of clients (-56.3%), number of active savers (-72.7%), the number of active borrowers (-60.5%) and gross loan portfolio (-24.7%) decreased significantly in the last quarter of 2021

compared to Q3-2021. On the other hand, PAR>30 days slightly improved by 820 bps and recorded 28.3% (36.5% for Q3-2021) because the progress in FMFB-A's PAR ratio stemmed from regulatory change by the Central Bank of Afghanistan (Afghanistan Microfinance Association, 2021b, 2021c).

Table 4: Microfinance Key Performance Indicators in Afghanistan (Quarterly Comparison)

Indicators	Q4 2021	Q3 2021	%
Number of Clients	420,384	961,129	-56.3
Number of Active Savers	196,339	719,920	-72.7
Number of Active Borrowers	121,049	306,728	-60.5
Amount of Savings (AFN, million)	2,457.3	3,206.6	-23.37
Gross Loan Portfolio (AFN, million)	6,760.4	8,986.7	-24.8
PAR>30 days	28.3%	36.5%	-820 bps
Average Loan Size (AFN)	55,849	29,299	90.6
Gross Loan Portfolio Per Loan Officer (AFN, thousand)	7,528.3	7,780.7	-3.2
Number of Borrowers Per Loan Officer	135	266	-49.2
Number of Clients Per MF Staff	170	241	-29.2
Operationally Self-Sustainable Institutions	0	0	

Source: Afghanistan Microfinance Association

3.2 Demand for Microfinance in Afghanistan

Globally, some 1.4 billion adults remain unbanked (World Bank, 2022a). Meaning they lacked access to credit from a formal financial institution like a bank or an account (Demirgüç-Kunt et al., 2015). According to Reed et al. (2011), MFIs had about 10 million clients in 1997; by 2010, this number had risen to almost 200 million. Along with maintaining financial stability, microfinance places a strong emphasis on reaching out to the needy (Morduch, 1999). Providing financial services to the poor and increasing their financial inclusion through these institutions is essential for the growth of the World economy since it facilitates their spending creates entrepreneurial possibilities and enhances their long-term engagement in the formal economy (Collins et al., 2009).

Despite its shortcomings in Afghanistan's context, microfinance has been an important instrument to contribute to micro development in the country by enabling people to earn their livelihood. When considering the country's highly unbanked population and informal sector

which is 80% according to the OECD (2019), MFIs have had a vital role in supporting people, especially in rural areas. Before the Taliban rule in 2021, the country had a significant microfinance sector in outreach (963,371 active clients in Q2 2021) and institutional diversity (Afghanistan Microfinance Association, 2022a).

Agriculture has been one of the main target segments of microfinance institutions in Afghanistan as it is a leading economic sector in Afghanistan and is the primary source of income for most Afghans. According to the World Bank Group (2021), 44% of the total workforce work in agriculture, and 60% of households derive some revenue from this sector. 67% of Afghanistan's microfinance institutions were from rural areas mostly working in agriculture and livestock (Afghanistan Microfinance Association, 2021a). Thus, financial support through microfinance institutions assists households to maintain their food security and enhance their agricultural and labor productivity resulting in overall economic development (Zeller, 2006).

The demand for microfinance in Afghanistan is high. It is due to the fact that 54,5% of Afghans live in poverty, and 77% live in rural areas (LUTFI, 2021). Poverty and living in rural areas make access to banking credit difficult for the majority. It is estimated that Afghan households required approximately 2 million micro-credits in 2004 (Hussein, 2009). According to the latest statistics from the microfinance sector, 963,371 clients received credit in 2021, a coverage of 48% (Afghanistan Microfinance Association, 2021a). Therefore, it is clear that microfinance institutions are in high demand and are capable of meeting the needs of Afghanistan's people.

CHAPTER FOUR

Research Methodology and Data Description

4.0 Data

The purpose of the study is obtained through a combination of qualitative and quantitative approaches. The data for the empirical study is collected from Microfinance Information Exchange (MIX) market through the World Bank website. Mixmarket.org is a global microfinance data source that collects data from about 2000 microfinance institutions. It undergoes a vetting process by analysts, making it the most accurate data source for microfinance institutions (Gutierrez-Goiria et al., 2017; Weber, 2013b). Since, the MIX market contains financial and social performance data for Afghanistan's microfinance institutions until 2018, therefore, to evaluate the latest situation of microfinance institutions, the study also benefits from microfinance individual websites, financial statements, annual reports, and articles related to Afghanistan's microfinance institutions.

4.1 Research Questions

- How efficient have microfinance institutions been in Afghanistan?
- How interest expense affects the financial performance of microfinance institutions in Afghanistan?

4.2 Data Analysis Methods

The data collected from the MIX market is used to determine the financial and social performance of selected microfinance institutions between 2014-2018 through five main indicators. These indicators are outreach (breadth and depth), portfolio quality, financial stability, and efficiency. The study also evaluates the impact of interest expenditures on the financial sustainability and efficiency of selected institutions in order to be able to assess how institutions' expenses affect these performances. As part of the methodological approach to this study, descriptive-analytical data is used to present the results. Thus, the data has been analyzed using descriptive statistics, graphs, and charts.

The table below indicates the main financial and social indicators with their subcategories and variables used in this paper.

Table 5: Social and Financial Measurement Indicators

Category	Sub-Category	Indicators Used
Social performance	Breadth of outreach	I. Number of active Clients II. Number of active accounts
	Depth of outreach	I. Average Outstanding Balance II. Percentage of Female Borrowers
Financial Performance	Portfolio quality	I. Portfolio At Risk (PAR) II. Loan At Risk (LAR)
	Efficiency	Operating Expense Ratio (OER)
	Financial Sustainability	I. Return On Equity (ROE) II. Return On Asset (ROA) III. Operating Self Sustainability (OSS)

4.3 Microfinance Performance Determinants

Microfinance has traditionally been seen as a tool to reduce poverty, so these institutions focus on providing small loans to as many borrowers as possible. Small loans provided to a large number of borrowers create a high cost for these institutions, which are largely funded by donors. A major focus in the microfinance sector these days is on financial returns and sustainability (Weber, 2013a). Without donor support, microfinance institutions must have financial sustainability to be able to provide social services for a long period. Thus, it is primarily the concept of social and financial performance that determines how MFIs function. This particular approach to performance measurement makes MFIs distinctive (Navin & Sinha, 2021). It is best to measure MFIs' social performance by examining their breadth of outreach (the number of customers) and depth of outreach (the poverty level of their clients). A social and economic measure of client welfare can be evaluated to determine social performance.

Portfolio quality, financial sustainability, and efficiency are used to assess MFIs' financial performance (Etefa & Abera, 2018).

4.3.1 Social Performance Indicators

i. Outreach (Breadth of Outreach)

The ultimate goal of microfinance is to expand the breadth of its outreach. However, an extreme expansion of the number of clients early in the institution's history can affect its sustainability. A number of factors are critical to determining the outreach of microfinance institutions such as the year of establishment, productivity, firm size, gross loan portfolio, and others (Gohar & Batool, 2015). One way to measure outreach is by counting the number of clients, active accounts, or borrowers at a given period of time. In comparison with the number of accounts, the number of active clients in a specific period will provide the most accurate picture of how many active clients there are because some of the accounts might be inactive for a long period of time (Rosenberg, 2009).

ii. Depth of Outreach

A depth of outreach examines how microfinance institutions are reaching those who are excluded from the financial system. An increase in the breadth of outreach does not necessarily result in a positive increase in depth, so depth plays a crucial role in assessing the sector's social performance (Navin & Sinha, 2021). Two indicators used to measure the depth of outreach is to measure the average outstanding balance and the percentage of female borrowers (Rosenberg, 2009).

$$a) \text{ *Percentage of female borrowers* } = \frac{\text{*Number of Female Borrowers*}}{\text{*Total Number of Borrowers*}}$$

$$b) \text{ *Average Outstanding Balance* } = \frac{\text{*Gross Amount of Loans or Savings Outstanding*}}{\text{*Number of Active Clients or Accounts*}}$$

4.3.2 Financial Performance Indicators

i. Portfolio Quality

The repayment rate of loans is an exemplary indicator of the success of a microfinance institution. In general, successful microfinance institutions have a lower percentage of bad loans, while a mission-drifting institution will have a higher percentage of non-repayment loans. Microfinance financial performance is therefore largely determined by the repayment of loans. The loan repayment calculation process must be reliable, so as to avoid false calculations caused by system flaws. A Portfolio At Risk (PAR) is an international indicator to determine the quality of a portfolio in a microfinance institution.

$$c) \text{ PAR } (x \text{ days}) = \frac{\text{Outstanding principal balance of all loans past due more than } x \text{ days}}{\text{Outstanding principle balance of all loans}}$$

An additional indicator used by newly established or unsophisticated institutions for examining loan repayment is Loan At Risk (LAR), which simply counts the number of loans instead of their amount.

$$d) \text{ LAR } (x \text{ days}) = \frac{\text{Number of loans more than } x \text{ days}}{\text{Total number of outstanding loans}}$$

It is possible for the value of X to vary based on the repayment schedules of institutions, from a week to a fortnight, to a quarter, but the most common value for microfinance institutions is 30 days. A PAR and LAR value should include both rescheduled and refinanced loans as well. It is also important to take the institution's write-off policy into account since the institution will hide any loan that is written off from PAR and LAR once it writes them off.

ii. Efficiency

Efficiency or productivity is a combination of outreach and efficiency, which measures an institution's non-financial costs as a percentage of its gross loan portfolio. Effectiveness aims to maximize services with minimal operational costs, so a successful microfinance institution maximizes its productivity with the least amount of funds and staff, the most common indicator of productivity is the Operating Expense Ratio (OER) (Rosenberg, 2009).

$$e) \text{ Operating Expense Ration (OER) } = \frac{\text{Personnel and administrative expense}}{\text{Period-Average gross loan portfolio}}$$

The above calculation has the disadvantage that it shows MFIs that have small loan portfolios do worse than MFIs with larger loan portfolios despite having similar productivity. For

instance, two MFIs each undertake an annual operating cost of \$500.000 to serve a loan portfolio of 10.000. The MFI whose average loan size is \$250 has an OER of $500.000/(10.000*250)=20\%$. Other MFI with an average loan size of \$150 would have an OER of $500.000/(10.000*150)=33\%$. Thus, small loans are more expensive and new institutions often have a higher OER, which is why the number of clients served is calculated rather than the number of loans disbursed to maintain a better result. The above formula can be modified as follows:

$$\textbf{Operating Expense Ration (OER)} = \frac{\textit{Personnel and administrative expense}}{\textit{Period} - \textit{Average number of active clients or loans}}$$

iii. Financial Sustainability

The sustainability of each MFI is important for maintaining its activity and expanding its operations. Additionally, it is crucial for those MFIs that receive subsidies to sustain and expand their activities when the subsidy is no longer available. Further, a financial subsidy will ensure that the MFI is profitable, which will attract more investors and donors (Navin & Sinha, 2021). MFIs' financial sustainability is measured by a variety of indicators. Return on assets (ROA) is a measure of how productively MFIs utilize their assets; returns on equity (ROE) assesses the returns produced by the owners; and operational self-sufficiency measures the extent to which MFIs cover their financial expenses with revenue generated. (Etefa & Abera, 2018; Rosenberg, 2009).

$$\textbf{f) Return on Asset (ROA)} = \frac{\textit{After tax profits}}{\textit{Starting (or period average) assets}}$$

$$\textbf{g) Return on equity (ROA)} = \frac{\textit{After tax profits}}{\textit{Starting (or perios average) equity}}$$

$$\textbf{h) Operational Self Sufficiency (OSS)} = \frac{\textit{Financial Revenues}}{\left(\frac{\textit{Financial expenses}}{\textit{+impairment losses on loans}} \right) + \textit{operating expenses}}$$

CHAPTER FIVE

Results

5.0 Outreach trend of Microfinance Institutions from 2014-2018

It is important to distinguish between two concepts of outreach in order to evaluate microfinance social performance. The breadth and depth of outreach are both important measures of outreach. The breadth of outreach measures the inclusion rate of institutions' clients, while the depth of outreach measures how far it reaches the excluded and most vulnerable parts of society (Navin & Sinha, 2021).

i. Breadth of Outreach

The breadth of the outreach being simply the number of active savers or active borrowers has increased with the expansion of the sector (Navin & Sinha, 2021). The higher the number of active borrowers is the better the institutions' outreach performance in terms of its breadth. Table 2 shows the result of the breadth of outreach for five microfinance institutions between 2014-2018.

Table 6: The breadth of outreach indicator over time (2014-2018)

Name of MFIs	No. of Active Clients					
	2014	2015	2016	2017	2018	Average
FINCA	29,047	34,034	24,922	24,259	26,591	27,771
FMFB	51,737	53,640	57,385	61,975	66,874	58,322
IIFC Group	..	20,994	20,384	18,182	15,522	18,771
Mutahid	11,759	16,506	18,298	17,883	18,844	16,658
OXUS	11,439	18,046	21,725	23,141	22,821	19,434

Sources: Researcher's Own calculation from the MIX market database (2014-2018)

The above statistics indicate the development of the number of clients for each MFI. The number of active clients in FINCA shows both increase and decrease for the period of 2014-2018. The number of clients in 2014 was 29,047 and in 2015 it increased to 34,034 with a growth rate of 17.17%. However, the number of active clients decreased to 26,591 in 2018

which indicates a -8% drop. The statistics for FMFB show a positive trend with an increased number of clients between 2014-2018. The number of active clients in this institution was 51,737 in 2014 which reached 66,874 in 2018 indicating a 29% of growth compared to 2014. The IIFC group data from 2015-2018 shows a negative trend in the number of active clients. the number of active clients of this institution was 20,994 in 2015 which has decreased to 15,522 in 2018 showing a -26% decline.

The Mutahid microfinance institution's number of active clients shows positive growth with a slight negative trend. But the number of active clients in this institution has increased to 18,844 in 2018 from 11,759 in 2014 with a growth rate of 60%. The OXUS microfinance shows very high performance in its number of active clients between 2014-2018. The number of active clients in this institution was 11,439 in 2014 which is less than all other institutions, however, this number increases to 22,821 in 2018 with a growth of 100%.

Therefore, we can conclude that among the five institutions only FINCA and IIFC group recorded a drop in their number of active clients between 2014-2018. All other institutions (FMFB, MUTAHID, and OXUS) show a positive and increased number of active clients. Among all institutions, the FMFB, MUTAHID, and OXUS are the third top performers in the number of active clients.

ii. Depth of Outreach

The study used average outstanding loan balance and percentage of female borrowers as indicators of how deeply the outreach occurs. The average outstanding loan balance only represents those loans that are not repaid during a given period of time. This should be distinguished from the total number of loans or deposits provided during a given period of time or the entire loan portfolio of microfinance institutions. The average outstanding balance is often shown as a percentage of per capita Gross National Income (GNI). According to the CGAP report, an average outstanding loan balance below 20 percent of GNI is considered a rough indication that the clients are very poor (Rosenberg, 2009). Table 3 indicates the average outstanding balance calculation result for the selected microfinance institutions.

Table 7: The depth of outreach indicator over time (2014-2018)

Name of MFI	Average outstanding balance / GNI per capita (%)					
	2014	2015	2016	2017	2018	Average
FINCA	73.97%	70.57%	93.4%	101.73%	89.03%	86%
FMFB	172.84%	159.71%	187.65%	184.83%	181.19%	177%
IIFC Group	..	111.72%	117.02%	114.3%	100.11%	111%
Mutahid	70.73%	66.61%	65.29%	69.55%	64.16%	67%
OXUS	110.65%	83.81%	84.21%	81.8%	86.21%	89%

Sources: Researcher's Own calculation from the MIX market database (2014-2018)

The average outstanding balance expressed as a proportion of GNI for all microfinance institutions shows fluctuating results, with no results below 20%. The average outstanding balance of the FINCA was 73.97% in 2014 which increased to 89.03% in 2018. The FMFB also indicates an increase in its average outstanding balance from 172.84% in 2014 to 181.19% in 2018. However, the IIFC group, Mutahid, and OXUS have a decreasing average outstanding balance in 2018 compared to the previous years. IIFC group's average outstanding balance was 111.72% in 2015 which decreased to 100.11% in 2018. With a similar decreasing trend, the average outstanding balance of Mutahid decreased from 70.73% in 2014 to 64.16% in 2018. Finally, the OXUS average outstanding balance was 110.65% in 2015 which shows a decrease to 86.21% in 2018. Among all five-microfinance institution in Afghanistan, Mutahid has the lowest average outstanding balance with an average of 67%.

Although the average outstanding sum never accurately reflects the level of client poverty, this is because better-off customers are less interested in smaller loans. The depth of the outreach can be measured using a variety of social finance measures; however, some are quite expensive to implement (Rosenberg, 2009). The percentage of female borrowers is another social performance measure included in this study. Due to their low literacy rate and unequal opportunities, Afghan women used to have great difficulty supporting themselves and their children. Reaching and empowering women and reducing inequality are among the main goals of microfinance institutions in Afghanistan. Therefore, a better option to evaluate the extent of the reach of microfinance institutions is the percentage of female borrowers.

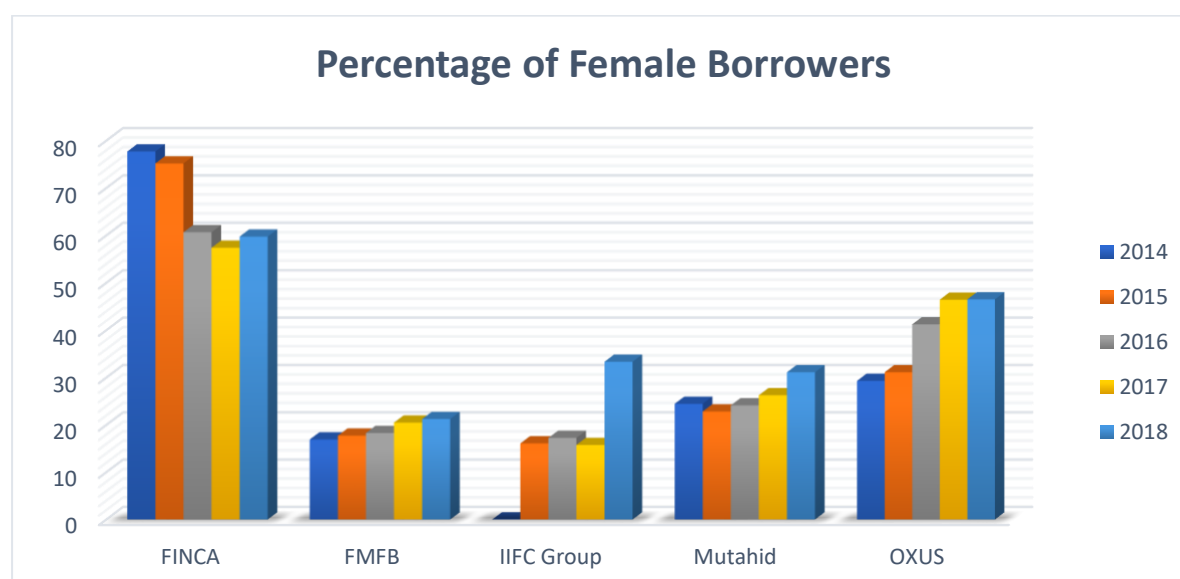
Table 8: The depth of outreach indicator over time (2014-2018)

Name of MFI	Percentage of female borrowers					
	2014	2015	2016	2017	2018	Average
FINCA	77.72%	75.2%	60.68%	57.41%	59.76%	66
FMFB	16.93%	17.74%	18.3%	20.5%	21.25%	19
IIFC Group	..	16.1%	17.26%	15.77%	33.35%	21
Mutahid	24.47%	22.86%	24.14%	26.29%	31.13%	26
OXUS	29.32%	31.13%	41.24%	46.45%	46.52%	39

Sources: Researcher's Own calculation from MIX market database (2014-2018)

Table 4 and Figure 1 indicate the percentage of female borrowers for the selected microfinance Institutions. FINCA records the highest percentage of female borrowers between 2014 to 2018. Although the percentage within the institution has decreased to 59.76% in 2018 from 77.72% in 2014. FMFB shows an increase in the percentage of female borrowers. The percentage of females in this institution has increased by 4.32% in 2018 compared to 2014. The percentage of female borrowers for the IIFC group shows both increase and decrease between the years 2014 to 2018 but the overall performance of the institution has been positive with an increase of 17.25% in 2018 compared to 2015. Accordingly, Mutahid and OXUS both indicate a positive growth of respectively 6.66% and 12.2% in their share of female borrowers between 2014 and 2018.

Figure 1: Depth of outreach indicator: percentage of female borrowers



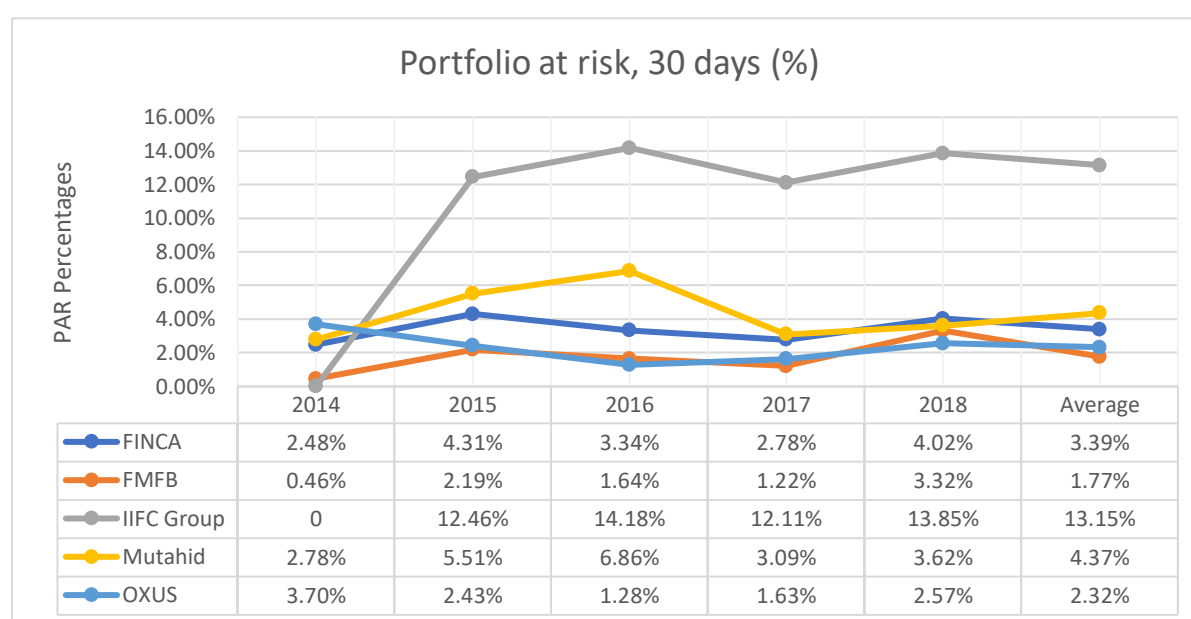
The proportion of female borrowers in FINCA is higher than that of its male consumers it's due to the fact that FINCA internationally focuses on empowering women (FINCA, 2021). However, the ratio of female borrowers for other institutions is seen to be low when compared to the male clientele ratio. Therefore, microfinance institutions should aim to perform better and raise their percentages of female borrowers in a context like Afghanistan where one of the key purposes of microfinance is to expand financial inclusion and empower women.

5.1 Financial Performance

i. Portfolio Quality

Loan repayment or portfolio quality is also an important indicator. Through this indicator, microfinance institutions measure, monitor, and evaluate their loan portfolio. Therefore, this measure is crucial in determining whether a microfinance institution is successful, sustainable, and capable of expanding its outreach and activities. Loan repayment is also related to the real value of the loan to the customer, a customer that needs to maintain a good record in order to qualify for future loans and try to make regular payments. PAR and LAR values above 10% are a red line in microfinance sustainability and need to be reduced in order to prevent them from spiraling out of control (Rosenberg, 2009). Thus, a larger PAR value implies a higher overall number of loans that are not repaid, which can result in the inefficiency and unviability of microfinance institutions.

Figure 2: Trend of PAR>30 days ratio indicator



According to Figure 2, the Portfolio at risk indicator for 30 days for all microfinance institutions is below 10% and 5% percent except for the IIFC group. The IIFC group indicates a higher average PAR over 30 days which is 13.15% and it is above 10% and needs to be reduced in order to have a sustainable loan portfolio. The average PAR for FINCA, FMFB, Mutahid, and OXUS are respectively 3.39%, 1.77%, 4.37%, and 2.32%. From 2014-to-2018, OXUS has the best PAR performance among all institutions, since the number of active clients at the institution increased by 100% from 2014-to-2018, while the PAR decreased from 3.70 percent in 2014 to 2.32% in 2018. This indicates that the institution has an improved strategy for increasing customers and following up with them on a regular repayment system at the same time.

ii. Efficiency

Usually, an MFI's efficiency measures how cost-effective it is. Among the most common measures of efficiency is the ratio of operating expense to loan which indicates how much the MFI earns in comparison to the costs incurred for each loan disbursed and monitored. MFIs with a higher ratio of operating expense to loan rates tend to be less efficient than those with lower OER rates. Many highly efficient MFIs rarely drop below 10% in their efficiency ratio.

Table 9: The efficiency indicator over time (2014-2018)

Years	2014	2015	2016	2017	2018	Average
Name of MFI	Ratio of operating expense to loan					
FINCA	34.38%	31.63%	21.52%	22.26%	21.05%	26.17%
FMFB	19.37%	21.73%	21.62%	20.11%	21.02%	20.77%
IIFC Group	..	10.23%	9.24%	9.08%	9.56%	9.53%
Mutahid	63.51%	35.36%	24.63%	15.98%	3.44%	28.58%
OXUS	34.82%	27.15%	24.59%	24.72%	22.79%	26.81%

Sources: Researcher's Own calculation from MIX market database (2014-2018)

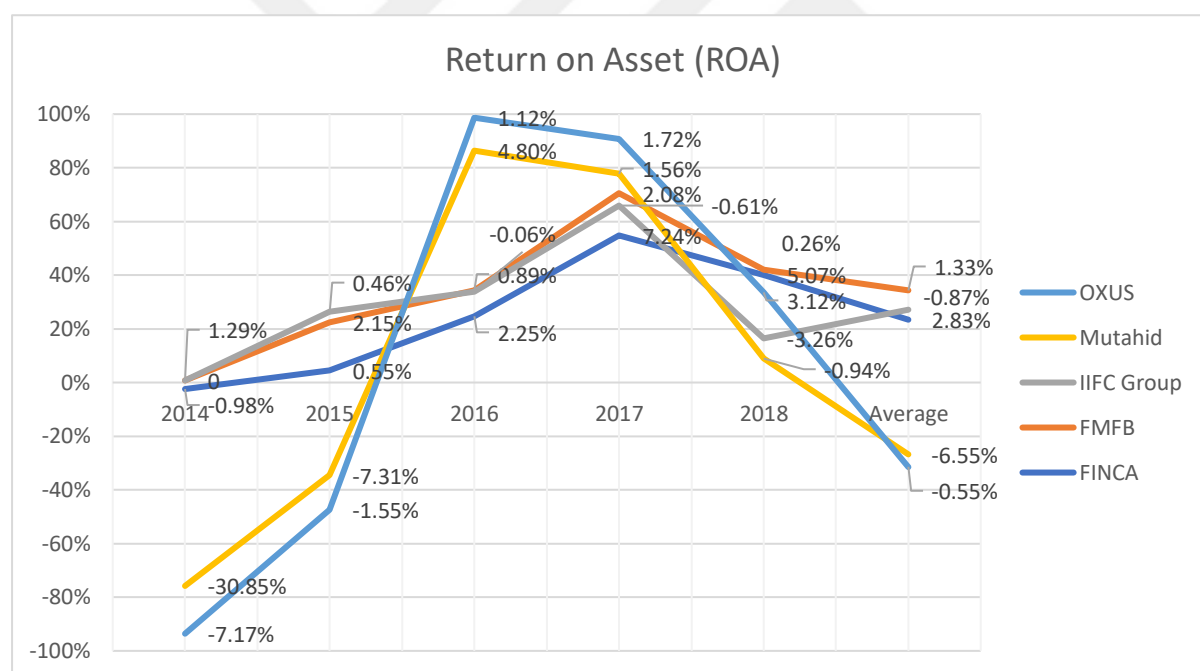
Table 5 indicates the operating expense ratio per average loan. The FINCA shows a decrease in its operating expense ratio in 2018 (21.05%) compared to 2014 (34.38%). Although the FMFB has an average of operating expense ratio lower than FINCA, its operating expense ratio has increased from 19.37% in 2014 to 21.02% which is not in favor of the institution's efficiency. Unlike other performances, the IIFC group reveals an efficient operating expense ratio of lesser than 10% in 2018 when compared to 2015 (10.23%). Mutahid has a very

inefficient operating expense ratio of 63.51% in 2014 and a very low operating expense ratio in 2018 which has been reported to be 3.44%. This result is either due to efficient management of the expenses related to the loans such as employees, administrative, financial costs, and other related costs or due to an error in the calculation and reporting process. Finally, the OXUS starts with a high operating expense ratio in 2014 (34.82%) but succeed to manage and decrease its operations cost per loan to 22.79% in 2018. The overall efficiency ratio for all institutions is quite acceptable, and all institutions except FMFB have achieved better productivity over the years.

iii. Financial Sustainability and Profitability Trends

In order to gauge their financial stability, commercial institutions and banks typically use ROA and ROE. ROE indicates shareholders' equity return, and ROA shows the efficiency with which assets are utilized by the institution. Figure 3 indicates the results for ROA.

Figure 3: ROA trend of profitability indicator (2014-2018)



A higher and positive ROA is always in favor of the MFI and shows its profitability and efficient use of its management. The ROA for FINCA MFI over the years 2014 to 2018 are respectively -0.98%, 0.55%, 2.25%, 7.245%, and 5.07%. The institution had a negative return on its assets in 2014, however, has a positive ROA at the end of the study period. The ROA trends for FMFB are respectively 1.29%, 2.15%, 0.89%, 2.08%, and 0.26% which shows a decrease in the profitability of the institution in 2018 (0.26%) compared to 2014 (1.29%). IIFC group in its ROA performance has a negative growth with a ROA of -3.26% in 2018 compared

to 0.46% in 2015. Although Mutahid has a very negative ROA (-30.85%) in 2014 which indicates its high liability for operating expenses, it shows a positive ROA for 2016 and 2017 respectively 4.80% and 1.56. in 2018 the Mutahid shows a negative trend of -0.94% again. Lastly, OXUS records a low-level ROA of operating income which is -7.17%, however, the ROA grows positively in the next years until it reaches 3.12% in 2018.

The overall ROA results reflect profitability for FINCA, FMFB, and OXUS in 2018. Mutahid and IIFC group indicate a negative ROA which reflects an operating income that is not sufficient to cover operating expenses.

Table 10: The financial sustainability and profitability indicator over time (2014-2018)

Name of MFI	Return on Equity (ROE)					
	2014	2015	2016	2017	2018	Average
FINCA	-3.05%	1.94%	8.66%	23.80%	15.33%	9.34%
FMFB	8.47%	11.96%	5.05%	12.37%	1.54%	7.88%
IIFC Group	..	3.76%	-0.64%	-8.01%	-43.78%	-12.17%
Mutahid	..	..	193.31%	31.80%	-24.14%	66.99%
OXUS	-400.60%	41.96%	-72.38%	64.54%	42.48%	-64.80%

Sources: Researcher's Own calculation from MIX market database (2014-2018)

As reflected in table 6, the ROE results of FINCA MFI for the year (2014-2018) are -3.5%, 1.94%, 8.66%, and 15.33%. although the institution had a negative ROE in 2014, it performed better performance which resulted in a better ROE in 2018. The FMFB, however, shows assorted results starting from 8.47% in 2014 with an increase in 2015 and 2017 (11.96% and 12.37%), and a sudden decrease in the consecutive year 2018 (1.54%). The IIFC group has a positive ROE in 2014 (3.76%), after which it shows a high inefficiency (-43.78% in 2018) in covering its costs and loan losses with its operating revenues. Mutahid has a very high ROE in 2016 which was 193,31% which continues to decrease in the consecutive years ending up at -24,14% with high loan income losses and low profitability. Although its average ROE is 66.99% which is due to the high ROE in 2016. Finally, OXUS starts with a very negative ratio of -400.60% ROE in 2014, however soon succeeds to manage and showed a better profitability performance in 2017 and 2018 (64.54%, and 42.48%). According to Etefa and Abera (2018), the majority of institutions target an ROE of 15% to 25%, thus it could be said that FINCA and OXUS had a better ROE performance in the overall period of the study.

Operating Self Sufficiency, a similar indicator, determines whether an MFI is able to cover its financial costs, impairment losses on loans, and operating costs by utilizing its financial resources. In the long run, an institution with an OSS above 1 (100%) is considered financially sustainable. On the other hand, an OSS below 1 (100%) indicates that the institution has not yet achieved self-sufficiency. (Etefa & Abera, 2018).

Figure 4: OSS trend of profitability (2014-2018)

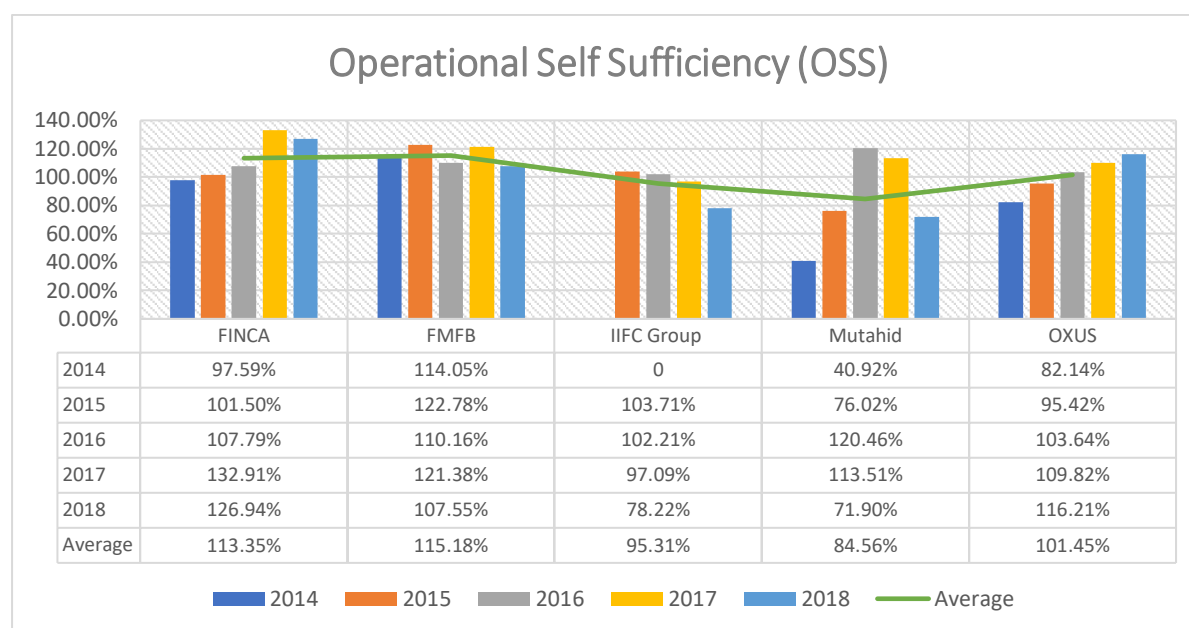


Figure 4 displays that the OSS results report a better performance for the FINCA with an average of 113.35%. The FMFB also has a performance above the breakeven point of 100%, therefore, the average for the consecutive year of 2014-2018 (115.18%) shows better Operational Self-efficiency of the institution. However, the IIFC group and Mutahid have an average OSS of 95.31% and 84.56% which is lower than the threshold. That might be a result of insufficient subsidies received from donors or the heavy liability and inefficient operation of the institution. Lastly, the OXUS started with an OSS of 82.14% but ended up with a better performance of OSS (116.21%). The average OSS result for OXUS is 101.45% which is above the breakeven of 100%.

The overall results show that the FINCA, FMFB, and OXUS had a better OSS and profitability performance during the study period of 2014-2018. The OSS results for the IIFC group and Mutahid is below the threshold of OSS thus these institutions were not able to achieve profitability and Operational Self Sufficiency.

5.2 Interest Expense Effects on Sustainability and Efficiency Performances

Since interest expenditure is a significant portion of MFI expenses, it has a significant impact on the sustainability and efficiency of these institutions. Compared to banks and other financial organizations, MFIs get different types of financing. The absence of demand deposits from pure MFIs as a rule is the first justification. Second, MFIs may not always have access to low-cost funding options like cash from commercial sources which are offered by commercial funds, global banks, and local banks. The majority of MFIs thus get loan funding from non-commercial sources such as governments, development agencies, cooperatives, and other MFIs. This type of loan includes a social component and aims to support the development and fight against poverty in less developed nations (Islam et al., 2014). Afghanistan MFIs heavily depends on loans received from MISFA and their international donors and these loans account for 90% of their portfolio outstanding. In addition, receiving non-commercial loans is more expensive in markets like Afghanistan which has a less-well established institutions and no specific regulations for the microfinance sector (Hussein, 2009).

In order to assess the impact of interest expense on the financial performance of selected microfinance institutions data from the MIX market is used. The data was available for the total of equity and liability as well as total liability. As interest payable to fund the financial operations of the MFIs is considered as part of liability according to Consultative Group to Assist the Poor (CGAP) (2008), Thus, in this paper interest expense ratio is calculated as part of total liability and then is used to assess its impact on financial sustainability (ROE, ROA, and OSS) and efficiency (ratio of operating expense to loan) of selected MFIs between 2014 to 2018. The calculation is based on the total average of interest expense and total liability ratio which is 4.23. Table 7 is a description of the data for the latest year available; for further information on the data for the years 2014–2018, please see Appendix A.

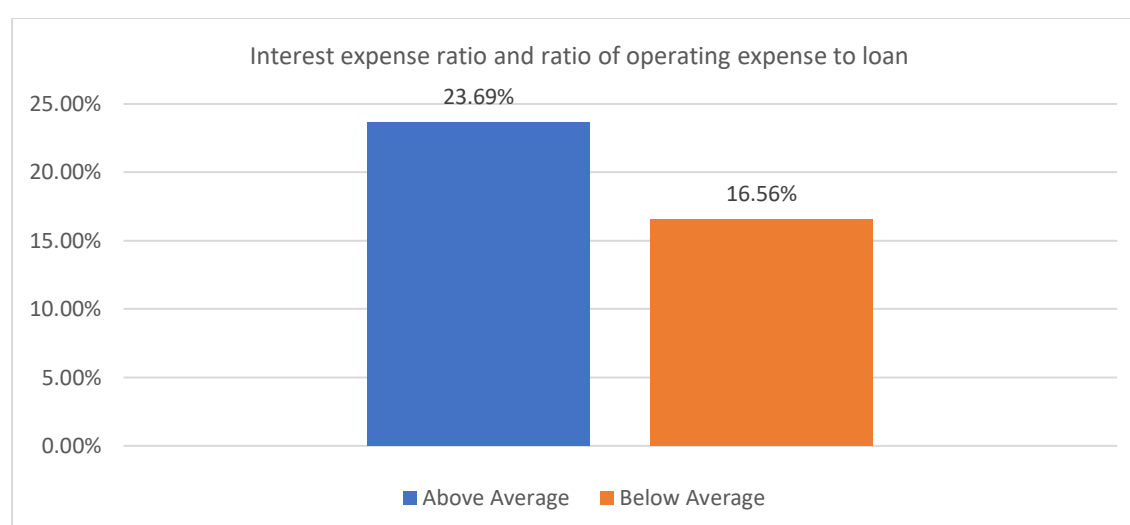
Table 11: Data set for interest expense effect analysis

MFI	Year	Interest Expense/ Total Liability	Category	ROE	ROA	OSS	Ratio of operating expense to loan
FINCA	2018	6.63	Above Average	15.33%	5.07%	126.94 %	21.05%
FMFB	2018	1.43	Below Average	1.54%	0.26%	107.55 %	21.02%
IIFC	2017	4.36	Above Average	-8.01%	-0.61%	97.09%	9.08%
	2018	.		.	.	.	.
Mutahid	2018	0.41	Below Average	- 24.14%	-0.94%	71.90%	3.44%
OXUS	2018	5.03	Above Average	42.48%	3.12%	116.21 %	22.79%

Note IIFC data for 2018 was not available in MIX market.*

i. Impact on efficiency

In order to determine the effect of interest expense on the cost-effectiveness or efficiency of selected MFIs the operating expense to loan indicator from efficiency performance is used. The figure 5 illustrates the results for the whole sector. As shown in the graph when the interest expenses as a ratio of total liability are above the average the operating expense to the loan of MFIs is higher at 23.69%. however, when the interest expense as a ratio of total ability is below the average, institutions record a lower operating expense to a trend which is 16.56%.

Figure 5: Effect of interest expense ratio on efficiency of selected MFIs (2014-2018)

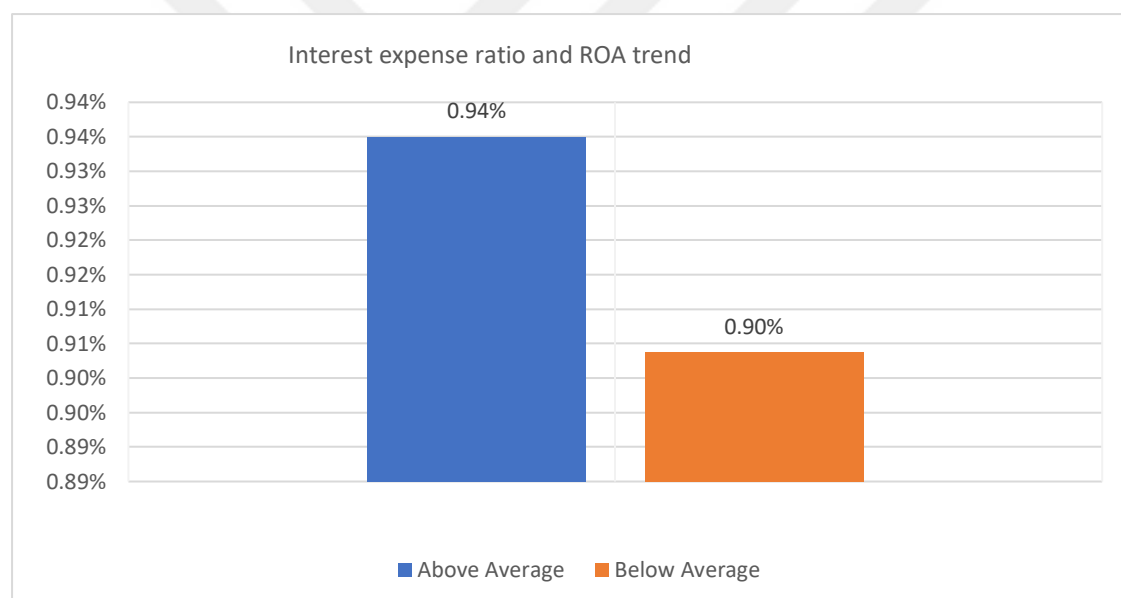
Thus, it can be concluded that there is an adverse relationship between interest expense and efficiency. When the interest expense as a percentage of total liability is higher the institution

records a higher operating expense ratio to loan leading the institution to have a lower efficiency. On the other hand, when the interest expense as the ratio of liability is lower than the total average the institutions record a lower operating expense ratio which reflects a better cost-effectivity of the institutions.

ii. Impact on sustainability

The impact of interest expense as a ratio of total liability on ROA of selected MFIs between years 2014-2018 is demonstrated in figure 6. The results show that when the interest expense ratio is above the average ratio the MFIs have relatively higher ROA (0.94%) when compared to the results with the interest expense ratio below the average (0.90%).

Figure 6: Effect of interest expense ratio on ROA of selected MFIs (2014-2018)

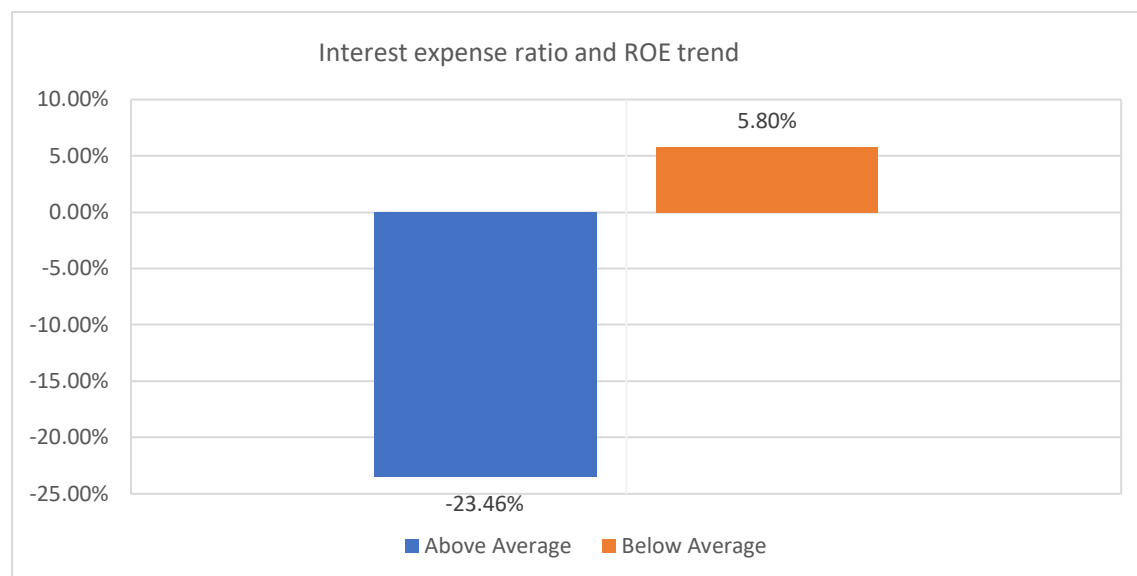


As a result, the finding indicates a favorable relationship between the ROA and the interest expenditure as a percentage of total ability. ROA results in a considerably greater outcome when the interest expense ratio is large. In contrast, the ROA is lower when the interest expense is lower than the average for the chosen MFIs.

Figure 7 demonstrates the comparative analyses performed for ROE. The findings indicate a considerable negative relationship between ROE and the interest expense ratio. When the interest expenditure for MFIs is large, the ROE has a negative result of -23.46%. However,

when the interest expense ratio is below the market average, the return on equity as a measure of MFI sustainability is high (5.80%).

Figure 7: Effect of interest expense ratio on ROE of selected MFIs (2014-2018)

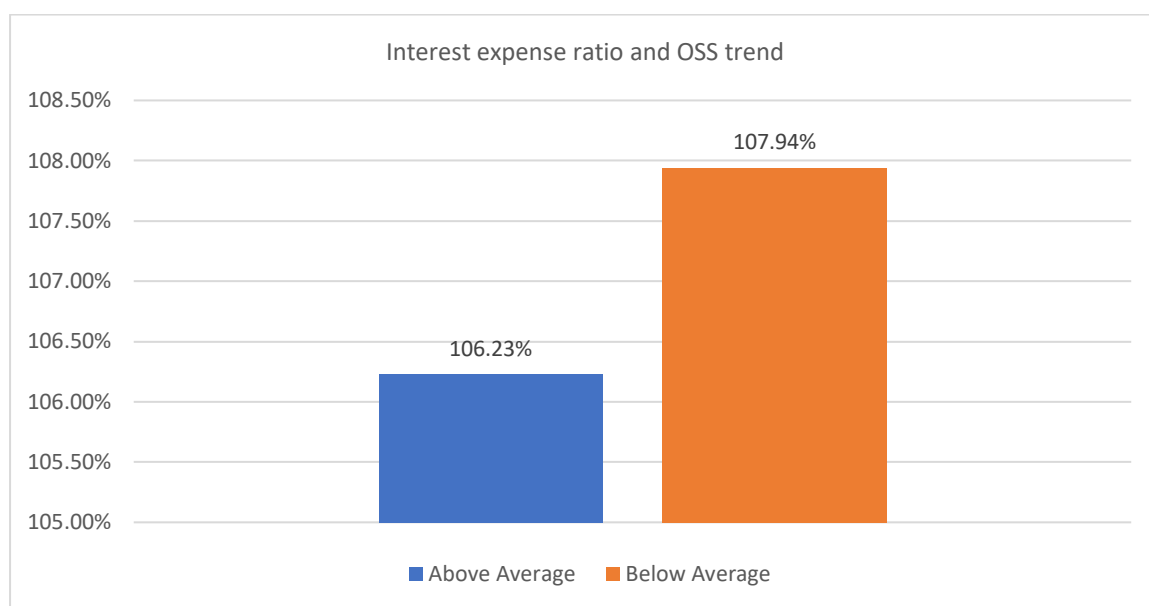


As a result, it may be observed that the interest expense ratio has negatively impacted MFIs' ROE and sustainability. When the institutions' funding sources have higher interest costs, this lowers their return on equity. The institutions have a higher ROE and are more sustainably run if the interest expenditure is lower as a proportion of MFIs' operating costs.

The OSS is an essential indication for determining out whether MFIs can use their financial resources to meet their operating expenditures. Figure 8's evaluation findings show how negatively the interest expense ratio affects MFIs' OSS. When the interest expenditure is higher than average, the OSS is recorded as being lower (106.23%). However, when the interest expense ratio is lower than the average the MFIs do better in their OSS (107.94%).

Accordingly, to sum up, the interest expense ratio has a negative effect on MFI's OSS. Higher interest costs will result in lower OSS for MFIs and, consequently, weaker sustainability, whereas lower interest costs will result in higher OSS for MFIs and stronger sustainability.

Figure 8: Effect of interest expense ratio on OSS of selected MFIs (2014-2018)



CHAPTER SIX

6.1 Conclusion

This study sets out to evaluate the social and financial performance of Afghan microfinance institutions between 2014-2018. There has been little literature exploring microfinance institutions in Afghanistan. For the first time, this paper evaluates the financial and social performance of microfinance institutions and determines the role of interest expense in their financial performance.

The findings of this study reveal that although these institutions have a good outreach in urban areas, they perform poorly at the country level and need to expand their outreach to rural areas, the poor, and women. Except for IIFC and Mutahid, these institutions' financial performance has improved over the study period. Furthermore, due to their heavy reliance on loans, the study concludes that interest expenses on loans are a major impediment of their better financial performance. That is, in these years, high-interest expenses have negatively impacted the return on equity and operational self-sufficiency of these institutions.

The Afghan economy is one of the world's most unstable economies, which affects the performance and stability of microfinance institutions as well. The current study utilized the latest data available on MIX market for microfinance institutions analysis. considering the conflict and challenges that the country is facing in recent years; further studies need to be conducted to examine these institutions' performance more closely.

6.2 Policy Implications

A lack of access to finance remains one of the major obstacles to the growth of microenterprises and the economy at large. Accordingly, based on the study's conclusion and the recent power shift in the country, the study suggests the following policies.

Microfinance institutions in Afghanistan are dependent on loans provided by MISFA and international donors, as explained in this paper. Since the study has found, microfinance institutions' efficiency and sustainability are threatened by their high dependence on interest loans, the study suggests that institutions should rely more on credit guarantee schemes than loans. By absorbing part of the MFI's losses on the loans it made, credit guarantee schemes can unlock finance for microenterprises as a common policy intervention. Thus, establishing a

credit guarantee program based on Islamic finance instruments can boost the efficiency of loans disbursed by MFIs as well as help them expand their outreach by reducing the risk of their portfolio. Additionally, this mechanism is essential for maintaining trust in the financial system and dissuading people from withdrawing their savings simultaneously in times of crisis.

Besides the main policy recommendation, this paper also recommends establishing a Financial Literacy and Capacity Building Program on Islamic Microfinance. Through financial literacy, customers and MFIs would learn about the benefits of microfinance services and the importance of Shari'ah compliance on instruments. By doing so, clients would be able to take advantage of financial instruments and services. The process of capacity building refers to building the skills, capabilities, and knowledge required for institutions to thrive in fast-changing environments.

Bibliography

- Abate, G. T., Borzaga, C., & Getnet, K. (2013). Financial sustainability and outreach of microfinance institutions in Ethiopia: Does organizational form matter? *SSRN*, 37.
- Abdulai, A., & Tewari, D. D. (2017). Trade-off between outreach and sustainability of microfinance institutions: evidence from sub-Saharan Africa. *Enterprise development & microfinance*, 28(3), 162-181.
- Adamec, L. W. (2011). *Historical dictionary of Afghanistan*. Scarecrow Press.
- Adhikary, S., & Papachristou, G. (2014). Is there a trade-off between financial performance and outreach in South Asian microfinance institutions? *The Journal of Developing Areas*, 381-402.
- Afghanistan Banking Association. (2014). *Background*. ABA. Retrieved 2022, January 5 from <https://www.aba.org.af/content.php?lang=en&content=Background>
- Afghanistan Microfinance Association. (2021a). *Microview 33* (Microview, Issue. <http://ama.org.af/wp-content/uploads/2021/09/MicroView-Report-33.pdf>
- Afghanistan Microfinance Association. (2021b). *Microview 34*. <https://ama.org.af/archives/101>
- Afghanistan Microfinance Association. (2021c). *Microview 35*. <http://ama.org.af/wp-content/uploads/2022/03/MicroView-Report-35.pdf>
- Afghanistan Microfinance Association. (2022a). *Membership*. AMA. Retrieved 2022, July 16 from <https://ama.org.af/archives/101>
- Afghanistan Microfinance Association. (2022b). *Overview*. Retrieved 2022, June 20 from <https://ama.org.af/archives/599>
- AIBF. (2010). *Center For Excellence*. Retrieved 2022, 10 June from <https://www.aibf.af/>
- Armendariz, B., & Labie, M. (2011). *The handbook of microfinance*. World scientific.
- Australian Government DFAT. (2022). *DFAT Thematic Report on Political and Security Developments in Afghanistan (August 2021 to January 2022)*. Retrieved from <https://www.dfat.gov.au/sites/default/files/country-information-report-afghanistan.docx>
- BEN, S. B. (2012). Social and financial performance of microfinance institutions: Is there a trade-off? *Journal of Economics and International Finance*, 4(4), 92-100.
- Bibi, U., Balli, H. O., Matthews, C. D., & Tripe, D. W. (2018). New approaches to measure the social performance of microfinance institutions (MFIs). *International Review of Economics & Finance*, 53, 88-97.

- Braunstein, E. (2008). Women's Employment, Empowerment, and Globalization: An Economic Perspective. *Paper. New York-UN Division for the Advancement of women, Department of Economic and Social Affairs.*
- CGAP. (2008). *Financial Analysis for Microfinance Institutions.*
<https://www.cgap.org/research/publication/financial-analysis-microfinance-institutions>
- Chandrashekhara, R., & Sultani, A. (2019). Impact of Microfinance on Women Entrepreneur's in Afghanistan: An Analysis of Selected Cases. *Think India Journal*, 22(25), 18-32.
- Chowdhury, A. M. R., Aminul Alam, M., & Ahmed, J. (2006). Development knowledge and experience: from Bangladesh to Afghanistan and beyond. *Bulletin of the World Health Organization*, 84(8), 677-681.
- Clark, K. (2020). The Cost of Support to Afghanistan. *Afghan Analyst Network.*
- Collins, D., Morduch, J., Rutherford, S., & Ruthven, O. (2009). Portfolios of the Poor. In *Portfolios of the Poor*. Princeton University Press.
- Convergences. (2019). *Microfinance Barometer 2019.* https://www.convergences.org/wp-content/uploads/2019/09/Microfinance-Barometer-2019_web-1.pdf
- Da Afghanistan Bank. (2022a). *History.* Retrieved 2022, April 5 from <https://dab.gov.af/index.php/about-us>
- Da Afghanistan Bank. (2022b). *Licensed Financial Institutions.* Retrieved 2022, January 10 from <https://dab.gov.af/index.php/Licensed-Finacial-Institutions>
- Demirgüç-Kunt, A., Klapper, L. F., Singer, D., & Van Oudheusden, P. (2015). The global finindex database 2014: Measuring financial inclusion around the world. *World Bank Policy Research Working Paper*(7255).
- Etefa, B., & Abera, G. (2018). Analysis of Microfinance Institutions Performance: The Case of
 Jimma Town MFIs *Journal of Poverty, Investment and Development*, 45.
- Ferro-Luzzi, G., & Weber, S. (2006). Measuring the performance of microfinance institutions. *Available at SSRN* 918750.
- FINCA. (2021). *Our Work.* Retrieved 2022, November 15 from <https://finca.org/our-work>
- FMFB. (2022). *About Us.* Retrieved 2022, November 5 from <https://fmfb.com.af/>
- Gohar, R., & Batool, A. (2015). Effect of Corporate Governance on Performance of Microfinance Institutions: A Case from Pakistan. *Emerging Markets Finance and Trade*, 51(sup6), S94-S106. <https://doi.org/10.1080/1540496x.2015.1080559>

- Greeley, M., & Chaturvedi, M. (2007). *Microfinance in Afghanistan: A Baseline and Initial Impact Study of MISFA*. Microfinance Investment Support Facility for Afghanistan.
- Gutierrez-Goiria, J., San-Jose, L., & Retolaza, J. L. (2017). Social efficiency in microfinance institutions: Identifying how to improve it. *Journal of International Development*, 29(2), 259-280.
- Haidary, Q., & Abbey, B. (2018). Financial Performance of Commercial Banks in Afghanistan. *International Journal of Economics and Financial Issues*, 8(1), 242.
https://www.researchgate.net/profile/Boris-Abbey-2/publication/327931434_Financial_Performance_of_Banks_in_Afghanistan/links/5badcf2b299bf13e6051f04f/Financial-Performance-of-Banks-in-Afghanistan.pdf (1-8)
- Hasan, A., & Batra, G. (2018). Performance analysis of microfinance institutions in Ethiopia. *International Journal of Business and Management*, 7(4), 55-66.
- Hermes, N., & Hudon, M. (2018). Determinants of the Performance of Microfinance institutions: A Systematic Review. *Journal of Economic Surveys*, 32(5), 1483-1513.
<https://doi.org/10.1111/joes.12290>
- Human Rights Watch. (11 November 2021). Afghanistan Facing Famine *Human Rights Watch*, . <https://www.hrw.org/news/2021/11/11/afghanistan-facing-famine#>.
- Hussein, M. H. (2009). State of Microfinance in Afghanistan. *Institute of Microfinance (InM)*, 1-95.
- Ishfaq, S., & Jamil, R. A. (2015). The Role of Microfinance in Poverty Reduction: Evidence from South Asia. *International Journal of Management, Accounting and Economics*, , 2(10), 1191-1199.
- Islam, Z., Porporato, M., & Waweru, N. (2014). Cost structure and financial sustainability of microfinance institutions: the potential effects of interest rate cap in Bangladesh. *International Journal of Financial Services Management*, 7(1), 54-72.
- Jahish, M. (2017). Micro-Finance Institutions in Afghanistan and the Main determinants of Repayment Rate. <https://edepot.wur.nl/419667>
- JURIST Staff. (2022). Afghanistan dispatches: ‘neither the central bank nor any other bank for that matter can properly conduct banking activities’. *Jurist*.
<https://www.jurist.org/news/2022/01/afghanistan-dispatches-neither-the-central-bank-nor-any-other-bank-for-that-matter-can-properly-conduct-banking-activities/>
- Kailley, H. S. (2009). *Microfinance in developing countries: the challenge of sustainable financial institutions* Master of Public Policy Program-Simon Fraser University].

- Khan, M. F. Z. (2014). The Social and Financial Performance of Conventional and Islamic Microfinance Institutions in Pakistan. *Al-Idah*, 28(1), 17-34.
- LUTFI, N. (2021). *Afganistan'daki Mikrofinans Kurumları: Gelişmeler ve Zorluklar*
- Ministry of Mines and Petroleum. (2019). *Mining Sector Roadmap*. Kabul Retrieved from https://momp.gov.af/sites/default/files/2019-06/02%20-%20MoMP%20Roadmap%20%2B%20Reform%20Strategy_reduce_0.pdf
- MISFA. (2017). *Annual Report March*. http://www.misfa.org.af/wp-data/uploads/2017/05/Annual_report_2017-interactive.pdf
- Morduch, J. (1999). The microfinance promise. *Journal of economic literature*, 37(4), 1569-1614.
- Navin, N., & Sinha, P. (2021). Social and financial performance of MFIs: complementary or compromise? *Vilakshan - XIMB Journal of Management*, 18(1), 42-61. <https://doi.org/10.1108/xjm-08-2020-0075>
- OECD. (2019). *Boosting Private Sector Development and Entrepreneurship in Afghanistan*. OECD. <https://www.oecd.org/eurasia/competitiveness-programme/central-asia/Boosting-Private-Sector-Development-and-Entrepreneurship-Afghanistan-2019-EN.pdf>
- Rabobank. (September 2005). *Access to financial services in developing countries*.
- Reed, L. R., Marsden, J., Ortega, A., Rivera, C., & Rogers, S. (2011). State of the microcredit summit campaign report 2011. *Microcredit Summit Campaign*. Washington DC.
- Rosenberg, R. (2009). *Measuring Results of Microfinance Institutions; Minimum Indicators That Donors and Investors Should Track*. <https://www.bing.com/ck/a?!&&p=2a8a693f8043d1ccJmltdHM9MTY2MzM3MjgwMCZpZ3VpZD0zMTFiMWUwOS0yOWJlTY1MTktMTM3OS0wZWNmMjgyNzY0ZDQmaW5zaWQ9NTI0Mw&pptn=3&hsh=3&fclid=311b1e09-29be-6519-1379-0ecf282764d4&u=a1aHR0cHM6Ly93d3cuY2dhcC5vcmcvc2l0ZXMvZGVmYXVsdC9maWxlcy9DR0FQLVRIY2huaWNhbC1HdWlkZS1NZWFzdXJpbmctUmVzdWx0cy1vZi1NaWNybzZpbmFuY2UtSW5zdGl0dXRpb25zLU1pbmltdW0tSW5kaWNhdG9ycy1UaGF0LURvbm9ycy1hbmQtSW52ZXN0b3JzLVNob3VsZC1UcmFjay1KdWwtMjAwOS5wZGY&ntb=1>
- Sherratt, L. (2015). *Can microfinance work?: How to improve its ethical balance and effectiveness*. Oxford University Press.

- Shu, C. A., & Oney, B. (2014). Outreach and performance analysis of microfinance institutions in Cameroon. *Economic research-Ekonomska istraživanja*, 27(1), 107-119.
- Simanowitz, A. (2003). Microfinance, poverty and social performance.
- Style, M. (2021). Chandrashekhar. R, Azizuddin Sultani" Impact of Microfinance on Entrepreneurs in Afghanistan: An Analysis of Selected Cases. *International Journal of Science and Management Studies (IJSMS)*, 4, 11.
- UNDP. (2021). 97 percent of Afghans could plunge into poverty by mid 2022, says UNDP. UNDP, New York. Retrieved 2022, April 15 from <https://www.undp.org/press-releases/97-percent-afghans-could-plunge-poverty-mid-2022-says-undp>
- Wale, L. E. (2009). Performance analysis of a sample microfinance institutions of Ethiopia. Available at SSRN 1398167.
- Weber, O. (2013a). Impact measurement in microfinance: Is the measurement of the social return on investment an innovation in microfinance? *Journal of Innovation Economics & Management*, n°11(1), 149-171. <https://doi.org/10.3917/jie.011.0149>
- Weber, O. (2013b). Impact measurement in microfinance: Is the measurement of the social return on investment an innovation in microfinance? *Journal of Innovation Economics Management*(1), 149-171.
- Woller, G. (2007). Trade-offs between social and financial performance. *Journal of Microfinance/ESR Review*, 9(2), 5.
- World Bank. (2004). *The Financial Sector in Afghanistan: Managing the Postconflict Reform Process* 40680). <http://documents1.worldbank.org/curated/en/906721468765919977/pdf/40680.pdf>
- World Bank. (2013). *Afghanistan Economic Update*. World Bank 77083. <https://documents.worldbank.org/curated/en/503371468189860735/pdf/820120WP0WB0Af0Box0379855B00PUBLIC0.pdf>
- World Bank. (2017). *The Unbanked*. https://globalindex.worldbank.org/sites/globalindex/files/chapters/2017%20Findex%20full%20report_chapter2.pdf
- World Bank. (2020a). *COVID-19 to Add as Many as 150 Million Extreme Poor by 2021*. w. Retrieved 2022, May 9 from <https://www.worldbank.org/en/news/press-release/2020/10/07/covid-19-to-add-as-many-as-150-million-extreme-poor-by-2021>
- World Bank. (2020b). *Project Information Document (PID)*. World Bank. New York. Retrieved 2022, April 14 from

<https://documents.worldbank.org/curated/en/596891585836351030/pdf/Project-Information-Document-Afghanistan-COVID-19-Emergency-Response-and-Health-Systems-Preparedness-Project-P173775.pdf>

World Bank. (2021). *Afghanistan Development Update, April 2021 : Setting Course to Recovery*. World Bank, Washington, DC. Retrieved 2022, April 14 from <https://openknowledge.worldbank.org/handle/10986/35363>

World Bank. (2022a). *COVID-19 Boosted the Adoption of Digital Financial Services*. Retrieved 2022, December 10 from <https://www.worldbank.org/en/news/feature/2022/07/21/covid-19-boosted-the-adoption-of-digital-financial-services>

World Bank. (2022b). *Population Ages 15-64 (% of Total Population)*. Retrieved 20 December 2022 from <https://data.worldbank.org/indicator/SP.POP.1564.TO.ZS?locations=AF>. F

World Bank. (2022c). *September 2022 global poverty update from the World Bank: 2017 PPPs and new data for India*. Retrieved 2022, December 30 from <https://blogs.worldbank.org/opendata/september-2022-global-poverty-update-world-bank-2017-ppps-and-new-data-india>

World Bank Group. (2021). *Afghanistan Development Update*. <https://thedocs.worldbank.org/en/doc/e406b6f24c2b7fdeb93b56c3116ed8f1-0310012021/original/Afghanistan-Development-Update-FINAL.pdf>

World Bank Group. (2022). *Afghanistan Private Sector Rapid Survey*. www.worldbank.org

Zada, M. Z. Q. (2018). Afghanistan Economy, and Its Accession to the World Trade

Organisation. *e-journal of Social and Legal Studies*, 4(2). <http://socialandlegalstudies.org/wp-content/uploads/2019/02/3.pdf>

Zeller, M. (2006). A comparative review of major types of rural microfinance institutions in developing countries. *Agricultural Finance Review*, 66(2), 195-213. <https://doi.org/10.1108/00214660680001187>

Appendices

Appendix A

Table A.1: Data Set for interest expense effect analysis

MFI	Year	Total Liability/ Interest Expense	Category	ROE	ROA	OSS	Ratio of operating expense to loan
FINCA	2014	6.37	Above Average	-3.05%	-0.98%	97.59%	34.38%
	2015	7.53	Above Average	1.94%	0.55%	101.50%	31.63%
	2016	6.78	Above Average	8.66%	2.25%	107.79%	21.52%
	2017	7.65	Above Average	23.80%	7.24%	132.91%	22.26%
	2018	6.63	Above Average	15.33%	5.07%	126.94%	21.05%
FMFB	2014	2.00	Below Average	8.47%	1.29%	114.05%	19.37%
	2015	2.11	Below Average	11.96%	2.15%	122.78%	21.73%
	2016	1.60	Below Average	5.05%	0.89%	110.16%	21.62%
	2017	1.34	Below Average	12.37%	2.08%	121.38%	20.11%
	2018	1.43	Below Average	1.54%	0.26%	107.55%	21.02%
IIFC	2014	.		..	..	..	..
	2015	6.10	Above Average	3.76%	0.46%	103.71%	10.23%
	2016	3.69	Below Average	-0.64%	-0.06%	102.21%	9.24%
	2017	4.36	Above Average	-8.01%	-0.61%	97.09%	9.08%
Mutahid	2017	2.55	Below Average	31.80%	1.56%	113.51%	15.98%
	2018	0.41	Below Average	-24.14%	-0.94%	71.90%	3.44%
OXUS	2014	4.95	Above Average	-400.60%	-7.17%	82.14%	34.82%
	2015	4.75	Above Average	41.96%	-1.55%	95.42%	27.15%
	2016	4.64	Above Average	-72.38%	1.12%	103.64%	24.59%
	2017	4.67	Above Average	64.54%	1.72%	109.82%	24.72%
	2018	5.03	Above Average	42.48%	3.12%	116.21%	22.79%
Total Average		4.23					

