

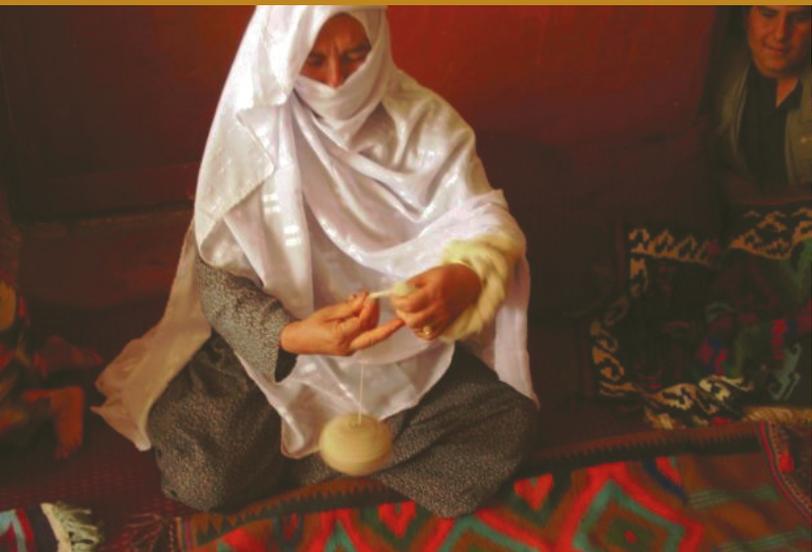


# ARIES

Agriculture, Rural Investment  
and Enterprise Strengthening  
Program in Afghanistan

# FINCA

Program Brief No. 4



**USAID** | **AFGHANISTAN**  
FROM THE AMERICAN PEOPLE



Connecting People > Creating Change

## **The Financial Integration, Economic Leveraging, Broad-Based Dissemination Leader with Associates (FIELD-Support LWA)**

The ARIES Program is a sub-award under the FIELD-Support Leader with Associates (LWA) cooperative agreement — a single, 5-year award created to both advance the state-of-the-practice in microenterprise development and microfinance as well as assist USAID missions and other operating units to design and implement innovative, integrated, market-based approaches to sustainable economic growth with poverty reduction.

Through sector assessments, program design, technical evaluations, and implementation of multi-year projects, FIELD-Support allows USAID Missions and other operating units to pursue their strategic objectives to:

- Strengthen livelihoods and food security for marginalized groups, youth, women and other vulnerable populations such as people affected by HIV/AIDS and natural disasters;
- Foster enterprise development, job creation and broad-based economic recovery in conflict and post-conflict situations as well as other fragile environments;
- Extend the reach of microfinance and develop more inclusive financial systems;
- Upgrade and improve the competitiveness of value chains in which microenterprises participate; and
- Facilitate institutional strengthening and policy reform for broad-based economic growth.

# FINCA Program Brief

The following is one in a series of briefs highlighting the experiences and lessons learned under the USAID Agriculture, Rural Investment and Enterprise Strengthening (ARIES) Program. A \$100 million, three-year initiative, ARIES aims to create a strong private sector foundation for a sustainable, market-driven rural finance system in Afghanistan. ARIES targets USAID's Alternative Development Program (ADP) regions in the east, south and north of Afghanistan, as well as Herat Province in the west.

ARIES is managed by the Academy for Educational Development (AED) in partnership with ACDI/VOCA, the World Council of Credit Unions (WOCCU), the Microfinance Investment Support Facility for Afghanistan (MISFA), FINCA and ShoreBank International (SBI). Each partner focuses upon a different component of the financial landscape, from household micro-loans of less than \$200 to loans of over \$1 million to larger scale Small and Medium Enterprises (SMEs). In addition, WOCCU's affiliate in Afghanistan also offers savings services to members.



## Activity Profile

**Goal:** The objective of the ARIES partnership with FINCA-I is to support the growth of the microfinance sector by expanding FINCA-A's lending in targeted regions. This complements the program's other efforts to stimulate microfinance lending in rural areas through selected MISFA microfinance partners, and through WOCCU's credit union network. Specific targets established for the ARIES-supported FINCA-A effort are to disburse a cumulative total of 155,322 loans worth \$47.7 million through branches in the ADP target regions by the end of the program in December 2009.

**Funding Level:** ARIES initiated its partnership with FINCA-I in September 2006. In September 2007, AED obligated a total of \$8 million to FINCA-I to support the ARIES program. As of March 31, 2009, the total ARIES support to FINCA-A amounted to just over \$16 million, comprising \$4.18 million in grant funds for operational expenses, and \$11.4 million in grant funds for on-lending. As one of MISFA's microfinance partners, FINCA-A also receives a combination of grants and loans separately from MISFA for microfinance operations in its non-ARIES branches.

**Role within ARIES:** FINCA offers individual and group microfinance loans from \$20 to \$2,000 in accordance with Islamic principles. Within the overall ARIES Program, this is in the lowest tier of loan products supported, as the Program's other microfinance partners provide loans of \$100–\$5,000, and its SME partners offer loans from \$3,000 to over \$1 million. FINCA-A has particular focus on attracting and retaining female clients.

## Overview

FINCA-I is a US-based network of microfinance institutions (MFIs) that collectively offer financial services to more than 725,000 clients in 21 countries in Africa, Central Asia, Latin America and the Middle East. FINCA's mission globally is "...to provide financial services to the world's lowest-income entrepreneurs so they can create jobs, build assets, and improve their standard of living".

FINCA established an affiliate program in Afghanistan in August 2003 and, with grant funds from MISFA, began

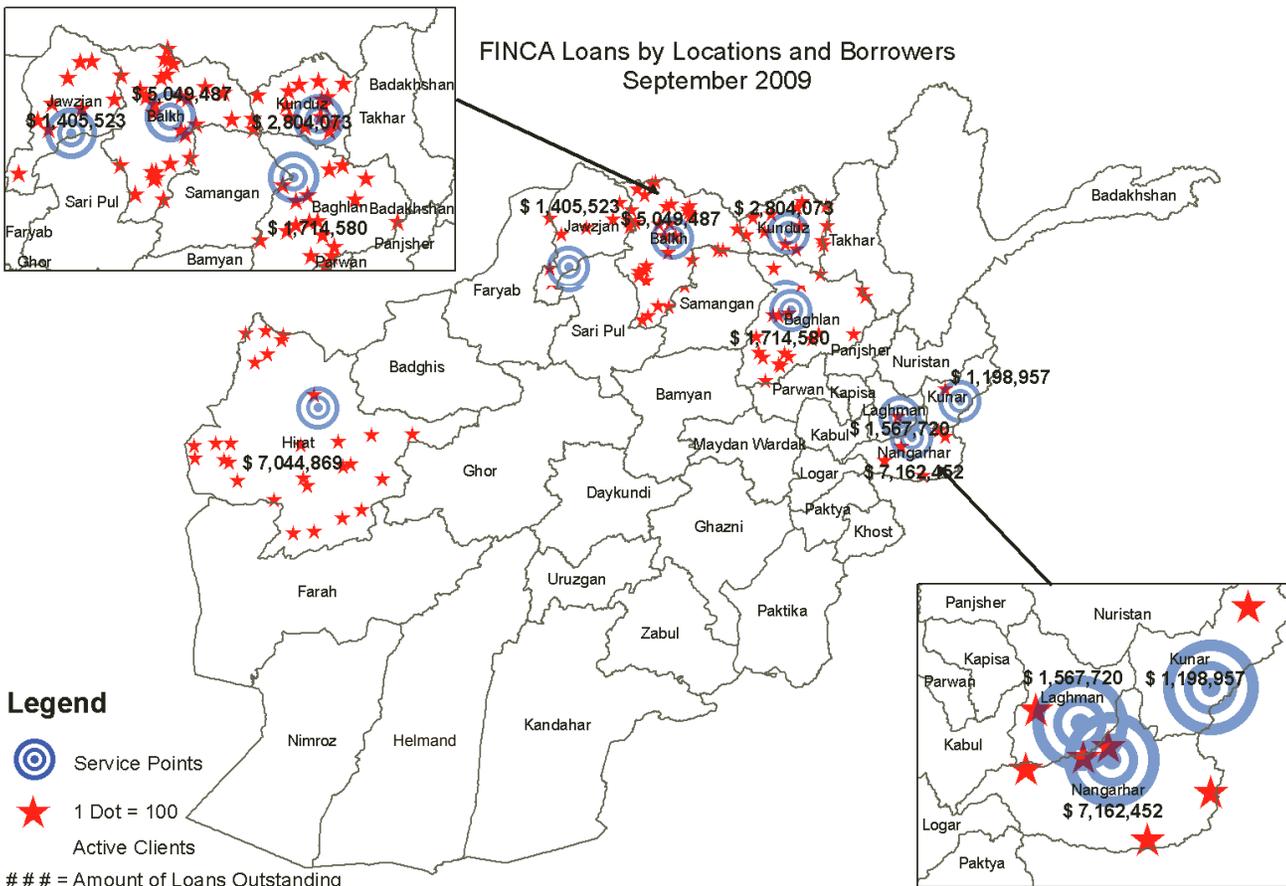
operations in February 2004. FINCA is one of the 15 MFIs now partnering with MISFA to provide microfinance services nationally, and is registered as a joint stock company. With support from ARIES as well as MISFA's multi-donor trust fund, FINCA now offers financial services compliant with Islamic principles in eight provinces in Afghanistan. The financing, *Murabaha*, is not a loan per se, but a pre-approved and mutually agreed upon sale contract that explicitly itemizes the sale of a commodity for cash plus a markup, including administrative costs associated with the transaction.

When FINCA-A first began operations in Afghanistan, its branches offered clients a conventional group loan product carrying a service charge like other MFIs. However, conservative Afghans viewed this product as non-*Sharia* compliant (incongruent with Qur'anic law), as it lacked a risk-sharing element. As a result, there was significant local opposition to FINCA-A and its loan products. FINCA-A subsequently redesigned its products, following extensive stakeholder consultation, to be more acceptable to its potential Afghan clients.

FINCA-A rolled out three refined, *Sharia*-compliant loan products in 2006. The immediate market response to FINCA-A's new *Murabaha* products was extremely positive. The launch of FINCA-A's *Murabaha* products also coincided with the start of its partnership with ARIES to expand its village banking network; both were significant factors in its rapid growth from mid-2006 to early 2008.

In 2008, as the security situation deteriorated, killings of FINCA-A staff and a kidnapping threat against FINCA's country director forced the latter's evacuation and greatly reduced field supervision. This situation, coupled with rapid growth, resulted in challenges to financial oversight. In response, FINCA-A reduced its new lending in 2008, cut staff, closed some of its retail offices, and began a restructuring process that includes modifying its lending, control and client servicing methods.

FINCA is now in the process of addressing the negative impacts of this confluence of issues on its portfolio. Specifically, the institution, which now serves over 27,700 clients, is undergoing a restructuring that includes the consolidation of branches, a slowdown of loan disbursements, and increased investment in the training and professional



development of its staff. The plan is expected to be fully executed by YE2009.

**Areas of Operation:** With ARIES support, FINCA currently operates six branches in five provinces<sup>1</sup> within the ADP regions, as illustrated in the table below. In addition, FINCA-A operates five branches in Kabul funded by MISFA.

of up to 40 women. Loan amounts range from a minimum of 1,000 Afs/ US \$20 to a maximum of 40,000 Afs / US \$800. Clients use these loans primarily for cottage level initiatives like tailoring and carpet weaving. For loans under 19,000 Afs/ US \$380, FINCA offers a “cash” *murabaha* option.<sup>2</sup>

**Table 1: ARIES-Supported FINCA-A Branches**

ADP Regions	North			East	West	Grand Total
Provinces	Balkh	Baghlan	Kunduz	Nangarhar	Herat	
Number of branches	1	1	1	1	2	6

**Financing instruments/products offered**

FINCA offers three types of *Sharia*-compliant, *murabaha* group and individual loan products. Group loans are based on the group solidarity model, with risk shared between the borrowers and FINCA:

- Women’s *murabaha* loans target home-based women and family businesses, and are made to eligible groups

- Market *murabaha* loans are targeted to males in market-based retail and service businesses. Clients are primarily small traders with no credit histories or capacity to collateralize loans. Loan amounts range from 10,000 Afs / US \$200 to a maximum of 40,000 Afs /US \$800.

<sup>1</sup> FINCA-A previously operated additional branches with ARIES support. As part of its restructuring plan, FINCA has consolidated its branches in Laghman and Kunar into its Nangarhar operations.

<sup>2</sup> In this loan option, FINCA appoints the client as its agent for 24 hours, and provides cash. The client purchases the goods on behalf of FINCA, and delivers the items and receipts to FINCA within one day. FINCA then sells the goods to the client with an agreed markup. This reduces FINCA’s time and expense spent processing a loan.



**Table 2: FINCA-A Loan Product Descriptions**

Product Name	Women <i>Murabaha</i> Group	Market <i>Murabaha</i> Group	Business <i>Murabaha</i> Agreement
Group Size	10–40	5–40	Collateralized Individual lending program (includes SME loans)
Client Focus	Home-based women and family businesses	Males in market-based retail and service businesses—primarily small traders with no credit histories or capacity to collateralize loans	FINCA group clients with good credit history, stable businesses, and able to pledge collateral
Minimum Agreement Amount	Afs 1,000/ US \$20	Afs 10,000/ US \$200	Afs 40,000/ US \$800
Maximum Agreement Amount	Afs 40,000/ US \$800	Afs 40,000/ US \$800	Afs 100,000/ US \$2,000
Loan Terms	6–12 months	5–12 months	Up to 18 months
Pricing/Mark-up (all flat rates)			
	2% flat monthly	1st cycle: 3% flat monthly for 5 month loan 2nd cycle: 2.33% flat monthly for 6 month loan 3rd cycle or higher: 2% flat monthly	2% flat monthly (includes both principal and mark-up components)

- Business *murabaha* loans are collateralized individuals up to a maximum of \$2,000.

### Performance

With ARIES support FINCA-A had disbursed a cumulative total of 90,721 loans worth over US \$27.9 million in the program’s targeted areas by September 2009. FINCA-A has 10,612 active borrowers in its ARIES-supported operations, 70% of them women. Loans have been made to a wide range of microfinance clients in the agricultural, service, trade and non-agricultural manufacturing sectors. The majority have been issued to borrowers in non-agricultural sectors, reflecting the urban and peri-urban location of FINCA-A’s branch locations, and the fact that FINCA-A’s loan products are not tailored to the needs and seasonal cycles of agricultural borrowers. Contributing factors and actions being taken are noted below in the “Challenges and Adjustments” section.

**Role of the ARIES Program:** After September 2006, and with the support of ARIES, FINCA-A opened new branches in Balkh, Jawzjan, Kunduz, Baghlan, and Kunar provinces. During the first quarter of its partnership with ARIES, FINCA-A distributed more than US \$3 million in loans to 9,400

clients. Between mid-2006 and early 2008, FINCA-A staff numbers increased from approximately 400 to 771, and its portfolio grew at a rate of approximately 75%. The beginning of this growth curve corresponds both to the introduction of FINCA-A’s *Sharia*-compliant products, as well as to the start of its support from ARIES.

In mid-2008, when portfolio quality issues became apparent, AED fully engaged with the FINCA-A Board and USAID to address them through a comprehensive corrective action plan.

### Achievements

- As of September 2009, FINCA-A disbursed a cumulative total of 90,721 loans worth \$27.9 million through its ARIES-supported branches.
- FINCA-A’s microfinance loans have created and/or sustained over 76,300 full-time, part-time and seasonal jobs in the ADP regions and Heart (September 2009).
- FINCA-A has succeeded in attracting and retaining a high proportion of female clients (70%) in its ARIES-supported branches.

- In 2006, in response to local demand, FINCA-A developed and introduced three Sharia-compliant loan products, which have cumulatively generated over 90,000 loans worth over \$27 million in its ARIES-supported branches.

### **Challenges, Adjustments and Lessons Learned**

For all of the ARIES partners project goals have remained the same while the strategy for achieving them has evolved. FINCA-A has faced significant hurdles, many of them impossible to anticipate at the project's outset. The following points illustrate challenges, how the project has adjusted in response, and the lessons learned for others working in similar contexts.

**Challenge:** *Initial opposition to FINCA-A's loan products.*

**Adjustment:** *In consultation with local communities, FINCA-A developed Sharia-compliant products suitable for Afghanistan.*

**Lessons learned:** *Prior to outreach, consultation with the local community is important to determine what types of financial products and services are appropriate. Customize products accordingly.*

**Challenge:** *Contending with an unforeseen deterioration of security, and increasingly limited access to rural areas.*

**Adjustment:** *FINCA-A employs alternative cash management strategies to reduce the risks of cash-handling by staff and clients. To assist with disbursements to its branches, FINCA-A utilizes Kabul Bank, as well as the hawala system — an informal network of money brokers operating without promissory instruments. It is exploring the feasibility of having clients directly deposit their loan repayments at the Bank to reduce the risks of having it credit officers carry cash. Additionally, the M-commerce initiative soon to be piloted by ARIES with Afghanistan's largest mobile phone provider ROSHAN, should reduce the Program partners' security risks by eliminating the physical transfer of cash from the field back to Kabul.*

**Lessons learned:** *Macro conditions like regional insecurity are beyond the control of the ARIES Program. Flexibility,*

*creativity and contingency planning are key to adapting implementation to the realities of conflict-affected environments. MFIs can employ new technologies for cash transfer/handling systems, such as mobile phone banking, which may also reduce overall operational costs, as well as the potential for theft and financial mismanagement.*

**Challenge:** *Ensuring proper financial oversight and due diligence during a period of very rapid growth in a conflict-affected environment. FINCA-A's operations quickly expanded following the introduction of its Murabaha loan products and addition of ARIES support. This rapid growth coupled with a deteriorating security situation in the country and killings of several staff members resulted in inadequate internal monitoring and controls. In 2008, FINCA-A experienced increasing portfolio quality problems, which has since been brought under control.*

**Adjustment:** *FINCA-A is now consolidating and restructuring its operations, slowing its loan disbursements, and increasing its investment in staff training.*

**Lessons learned:** *Rapid growth coupled with a deteriorating security environment may encourage fraud and delinquencies — especially in conflict-affected environments in which both a regulatory framework and enforcement are weak.*

**Challenge:** *Reaching and retaining female clients in a socially conservative context in which men and women are separated in the public sphere.*

**Adjustment:** *FINCA-A conducts outreach to women in their homes, and in such gathering places as clinics and hairdressing salons. It employs female loan officers specifically to work with women clients, and it has established women-only branches. Moreover, as female borrowers often share their loans with male relatives in family enterprises, FINCA-A permits women clients to use their loans as "family loans".*

**Lessons learned:** *Client outreach and institutional operations, as well as products and services, must be culturally appropriate and context specific in order to be successful.*



## Moving Forward

FINCA-A's most immediate priority is the continuing implementation and completion of its countrywide recovery action plan. This involves the consolidation of branches, a slowdown of loan disbursements, and an increased investment in the training and professional development of its staff while improving internal controls.

It is anticipated that FINCA-A's recovery plan will be successfully completed by the fourth quarter of 2009. FINCA-A is considering following its recovery to up-scale its operations

into SME financing as well as introducing Sharia-compliant housing/home improvement loans — each of which has higher profit margins than microfinance. FINCA-A would modify products to larger individual loans to \$1,000-\$2,000, and gradually reduce the number of group borrower units from 40 to five, as both would better cover operating expenses than its current microfinance loans. Finally, FINCA-A is exploring offering agricultural financing, and extending repayment periods from six to 18 months to better accommodate rural/agricultural harvest cycles.

The Foundation for International Community Assistance (FINCA) is a leading international microfinance organization that provides financial services to the world's lowest-income entrepreneurs, helping them to create jobs, build assets and improve their standard of living. FINCA has been operating in Afghanistan since 2003.

[www.villagebanking.org](http://www.villagebanking.org)

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