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REBUILDING AGRICULTURAL MARKETS PROGRAM RAMP RURAL FINANCE IMPACT REPORT

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REBUILDING AGRICULTURAL MARKETS PROGRAM (RAMP)

RAMP Impact Assessment # 9 Rural Finance

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Rural Finance Impact Assessment

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Abstract

What were the client impacts from the USAID/RAMP rural finance program in Afghanistan?

The goal of USAID's Rebuilding Agricultural Markets Program (RAMP) was to strengthen Afghanistan's agricultural value chains via technical assistance, infrastructure rehabilitation, and rural finance. This paper presents the disbursement data, projected "value added" at the client level, and lessons learned from the rural finance component of the program.

RAMP financed agricultural credit via microfinance institutions (MFIs), a commercial bank, a leasing company, and a venture capital fund. Though it is too soon from the initial disbursement dates of the small and medium sized enterprise (SME) loans to conduct detailed impact studies, the following can be extrapolated from existing data:

- Microfinance institutions achieved the greatest outreach, making nearly 90,000 loans to clients along the agricultural value chain, the majority of whom were women;
- Pre-existing international microfinance organizations that specialized in finance achieved the strongest results;
- Micro, small and medium-sized agribusinesses can be sound clients for financial institutions that conduct the proper due diligence and enforce repayment terms; and
- By April 30, 2006, the value added from these rural finance credit institutions was over \$1.6 million. MFIs realized \$1.43 million¹ since July 2003, AFC realized \$40,409 since November, 2004, and AIB realized \$134,421 since August, 2004.
- By RAMP's end of project, July 2, 2006, it is estimated that the total value added from these rural finance credit institutions will be \$1.9 million: \$1.7 million due to the MFIs, \$80,000 due to AFC, and \$147,000 from AIB.

The paper concludes that the limitations inherent in Afghanistan's post-conflict environment largely determined which types of organizations would achieve the greatest short-term impact. Creating new financial institutions to fill Afghanistan's SME financing void was a time-intensive endeavor, and it is unclear at this stage in their start-up whether these institutions will succeed or fail after RAMP technical assistance has finished. However, microfinance institutions, particularly the pre-existing international organizations that specialized in microfinance, were less inhibited by Afghanistan's weak financial, legislative, and physical infrastructure, realizing the greatest outreach in the shortest period of time.

¹ Estimated. The AIB and AFC numbers are actuals.

Background

A large body of evidence positively links financial sector development to growth and poverty reduction, particularly in the early stages of development and in countries with large agricultural sectors² (DFID, 13 – 17). Credit has been singled out as a factor in growth and poverty reduction, with studies suggesting a 1% growth in private credit reduces income inequality by .3%, and a 10% increase in the ratio of private credit to GDP lowers poverty ratios by 2.5 – 3% (ibid). With this in mind, USAID’s Rebuilding Agricultural Markets Program (RAMP) undertook to increase access to financial services to SMEs and microenterprises along the agricultural value chain as part of their overall strategy to develop Afghanistan’s agricultural sector.

RAMP was designed to enhance the food security and incomes of Afghanistan’s rural population. The program had two principal objectives: a) increase agricultural productivity and output; and b) increase incomes through effective linkages between producers, processors, and markets. The rationale of RAMP’s Rural Finance component was to provide a continuum of financial services to the agricultural sector through a broad range of financial institutions, thereby assisting in the development of the entire financial sector.

However, after twenty four years of war, Afghanistan’s economy was in tatters when the Taliban was finally driven from the country in 2001. There were no formal financial service providers, over 90% of employment was in the “informal” sector, and the legal environment was weak. Compounding the problem, there were and remain significant barriers to lending in Afghanistan. The poor physical infrastructure increases the cost of doing business, particularly in rural areas with poor roads and little or no communication. Afghanistan is a cash economy and an unstable one, and lenders must take additional security precautions. There are no collateral laws to help secure loans. Borrowers, without past experience with banks and frequently illiterate³, tend not to have reliable financial records, increasing the cost to the financing institution of conducting the due diligence necessary to make the lending decision. Finally, in some areas religious authorities succeeded in driving out financing institutions, claiming that lending at interest was un-Islamic⁴.

How then, to efficiently and effectively deliver financial services to rural areas?

Microfinance institutions (MFIs) provided an obvious answer. “Microfinance requires few preconditions to be able to work... and it can be established more quickly than most

² As of 2005, it is estimated that agriculture accounted for 38% of Afghanistan’s GDP, not including opium production. It is estimated that in 2004, 80% of the population was dependent on some form of agricultural activity for their livelihoods (CIA World Factbook, 2005).

³ The adult (over 15) literacy rate in Afghanistan is estimated at 36%. (CIA World Factbook, 2005).

⁴ FINCA and Madera, both RAMP-funded institutions, reported this to the author in 2005-2006. FINCA began experimenting with more “Islamic-style” lending to mitigate this risk, and nearly all microfinance institutions now charge “fees” rather than “interest” to be more in sync with Afghan sensibilities.

other financial services in an economy that is largely unregulated, well before most reconstruction efforts and formal systems are in place,” (Rasmussen, 21).

In late 2003, RAMP began disbursing funds to MFIs via the Microfinance Investment and Support Facility (MISFA), a multi-donor apex institution. These microloans were targeted toward rural producers and processors involved in any of the following activities: agriculture, livestock, or timber product market systems, including input supply, production, distribution, wholesaling, processing, and marketing/trading. This broad definition of agricultural activity allowed RAMP-funded loans to be disbursed to businesses along the entire agricultural value chain, reducing risk to the lenders through portfolio diversification and deepening their outreach.

Microfinance alone could not achieve the depth of outreach that RAMP was targeting, however. Loans also needed to be made in the small and medium-scale (SME) agribusiness sector. But while microfinance institutions thrived despite Afghanistan’s chaotic environment, the formal financial sector, a more natural source of SME loans, languished.

Though seven commercial banks had established branches by mid-2004, none were operating outside Kabul and few provided loans to private businesses, “much less small businesses with any rural focus” (Rasmussen, 22). Further, no cadre of local professionals trained in banking, lending, or financing existed. Two options remained: to fund start-ups, or to encourage commercial banks to make rural loans. RAMP experimented with both approaches, funding the Afghanistan International Bank (AIB), and funding the start-ups of a leasing company, the Afghan Finance Company (AFC), and a venture capital firm, Afghanistan Capital Partner’s (ACAP) Afghanistan Reconstruction Fund (ARF).

Today, the Afghan finance sector remains in its nascent stages. In a 2005 study by the World Bank, 51% of business owners surveyed listed access to finance as a major or severe constraint to doing business (World Bank, Investment Climate, 14). “In the most recent *Doing Business Rankings for Getting Credit*, a measure of credit information sharing and legal rights of borrowers and lenders, Afghanistan ranks 153rd out of 155 countries,” (World Bank, Investment Climate, 21). The above-cited World Bank report recommends that the government should continue to increase the capacity of formal financial institutions to deliver credit (World Bank, Investment Climate, 21-41). Capacity building in the rural finance sector is a job far from complete.

Table 1: Depth of Outreach – Lenders Funded by RAMP

Lender	Range of Loan Sizes at Disbursement	Average Loan Size at Disbursement	Average as % of GDP per capita ⁵ (\$800 ⁶)	Number of Agricultural Loans Disbursed	PAR ₉₀ (portfolio at risk past 90 ⁷ days)	% Women Borrowers
Microfinance Institutions	\$100 - \$700	\$176	22%	89,433 (as of end of grant – August 31, 2005)	<2%	82%
Afghanistan Finance Company (AFC)	\$8,000 - \$200,000	\$48,703	6087%	13 (as of April 30, 2006)	0%	0%
Afghanistan International Bank (AIB)	\$50,000 - \$500,000	\$400,000	50000%	18 (as of April 30, 2006)	24%	0%

Microfinance

In July, 2003, RAMP provided a \$4M⁸ grant for agricultural lending to the Microfinance Investment Facility for Afghanistan (MISFA), which on-lent the funds in the form of capital financing⁹ to six different MFIs: the Aga-Khan’s Afghanistan Rural Microcredit Program (ARMP-AKDN), the Bangladesh Rural Advancement Committee (BRAC), Community Habitat Finance (CHF), the Foundation for International Community Assistance (FINCA), Ariana Financial Services (Mercy Corps), and Women for Women. By leveraging RAMP and other donor funding, these RAMP/MISFA-funded MFIs made an estimated 89,433¹⁰ loans to microbusinesses in the agricultural value chain as of August 31, 2005 (the end date of their grant agreement with RAMP) in seventeen Afghan provinces. Approximately 32% (28,118 loans) of these loans went towards agricultural production (Weiss, 3). Of the production loans, it is estimated that 70% of the production loans were for livestock purchases and 30% for crop production (Weiss,

⁵ Depth of outreach can be measured by loans as a percent of GDP per capita, which is a proxy indicator for poverty, following the logic that the poor borrow less than the rich. While this indicator is imperfect, it is the most cost-effective for lenders.

⁶ The CIA World Factbook, <http://www.cia.gov/cia/publications/factbook/rankorder/2004rank.html>

⁷ PAR90 (portfolio at risk past 90 days) measures the outstanding loans with payments more than 90 days late, rather than the value of the late payments themselves. The later the loan repayment, the greater the risk that the remainder of the loan outstanding will not be repaid.

⁸ MISFA received an additional \$1 M to provide technical assistance to MFIs in agricultural lending.

⁹ Lent at 5% per annum.

¹⁰ Estimated. Due to the aforementioned reporting issues, samples of clients were taken to determine the extent of clients incorrectly reported as non-agricultural, and estimates of current agricultural clients were based upon the results. Many of these loans were made to repeat borrowers.

3). Eighty two percent of the MFIs' total borrowers were women, and while the MFIs do not track gender by business sector, given the high number of livestock loans to women, the percentage likely correlates to the number of agriculture loans taken by women. The high percentage of microfinance loans to women compared to loans to SMEs reflects both the mission of MFIs to specifically target women involved in productive activities and the Afghan cultural environment, which discourages women from owning and managing larger formal businesses. Additionally, to qualify for larger loans borrowers require collateral, which most Afghan women do not have title to. MFIs typically do not require collateral as a condition for their loans.

Contrary to the widely held beliefs that agricultural loans can't be repaid, or must utilize balloon payments, or must extend for several years, repayment to the MFIs remained high, even though the MFI methodologies typically utilized regular repayment schedules (such as weekly/bi-weekly/monthly) and terms no longer than twelve months. Within their agricultural portfolios, MFIs maintained an average outstanding PAR₉₀ below 2%.

The MFIs which achieved the greatest outreach were ARMP-AKDN, BRAC, and FINCA – all international organizations that specialize in microfinance. Their higher than average results are likely due to a combination of the institutions' experienced management teams, their pre-existing systems that were transferable to the Afghan environment, and their ability to leverage other donor funding.

Small and Medium Enterprises (SME)

In December, 2003 an initial assessment of the agricultural sector was conducted in order to identify financial intermediaries and mechanisms that could be used to provide small and medium enterprises (SMEs) with permanent, on-going sources of credit. A continuation of the findings and recommendations of the initial assessment was conducted in February, 2004. Based on these two assessments, RAMP determined that no such mechanisms existed and, therefore, mechanisms should be created to stimulate lending to the agricultural sector. These credit delivery mechanisms needed to take a flexible approach, developing a diversity of lending products to meet agricultural enterprises' requirements for both working capital and fixed assets.

In April, 2004, RAMP posted a request for proposals (RFP) to establish a retail finance/leasing institution to fulfill the financing needs of SMEs in the agribusiness and processing sectors. A primary goal was to strengthen the value chains of Afghanistan's main agricultural products by introducing or improving processing facilities and equipment, storage/warehouse structures and vehicles, and expanding the services and inputs used by the agribusiness sector. However, because of the need to *start-up* SME financing, SME lending got off to a later start than microlending. The Afghanistan Finance Company (AFC) and Afghanistan Reconstruction Fund (ARF) both won funding to start operations under this mechanism. A third organization, the Afghanistan International Bank (AIB), was awarded grant funding for loan capital under a separate process.

The Afghanistan Finance Company – An SME Leasing Firm

Through the above-mentioned RFP, the Afghanistan Finance Company (AFC) received \$3.5 million for loan capital in November, 2004 and started up with an additional \$500,000 investment from the owners¹¹. The leasing company, however, was and remains plagued by the inability to acquire and/or retain qualified management. Many financial professionals are reluctant to work in combat zones, and after two decades of war there is little local management capacity. This and the inherent time it takes to set up operations resulted in AFC's leasing operations starting in October 2004 with the first review of lease applications by the Credit Committee in March, 2005. By 30 April, 2006, the AFC had disbursed \$596,444 of RAMP-funded leased equipment.

It is unlikely these results would have been achieved without the direct assistance of the staffers from the RAMP rural finance department, who composed part of their credit committee and provided technical assistance, and without leveraging the business development services of RAMP-funded Flag International, which also provided training and helped assess potential agricultural clients.

As of this writing, the AFC had no repayment problems, with a PAR₉₀ of 0%. However, this performance may not be indicative, as repayment problems tend to appear in the latter stages of the loan cycle and disbursements only began in mid-2005.

ACAP Partner's Ltd. Afghanistan Renewal Fund – a Venture Capital Firm

Pierre Van Hoeylandt's ACAP Partner's Ltd. was awarded funding under the same RFP as the Afghanistan Renewal Fund (ARF), and in February, 2005, RAMP granted \$4M for the fledgling Afghanistan Renewal Fund venture capital firm. Of this amount, \$3.8M was budgeted for direct investments in Afghan agricultural enterprises. There was a lengthy delay while the ARF sourced other investor funds, but by January, 2006, the firm had raised the necessary funds. Thanks to RAMP's initial investment, ACAP was able to attract an additional \$16 million to the fund from other investors including Asian Development Bank, Capital for Development and OPIC.

Projected investments ranging from \$500,000 - \$1,000,000 are expected to be made by the Fund though no investments had been made as of the time of this writing. The Fund is expected to begin actively investing during the 3rd quarter of 2006, and because of the extreme volatility of venture capital investing; it is difficult to estimate the impact. Because of this, and as there are no similar venture capital firms operating in Afghanistan for comparative purposes, it is impossible to state with any degree of accuracy what the

¹¹ The owners of AFC are the Afghanistan Reconstruction Company (ARC). ARC is involved in several businesses in Afghanistan – construction, beverages, and financial institutions.

real impact of this program will be. For this reason, the fund's potential impact has not been included in this evaluation.

Afghanistan International Bank

With an eye toward financing processors and other larger-scale industries along the agricultural value chain, RAMP provided the Afghanistan International Bank (AIB) with a \$2 million grant for loan capital in August, 2004. Prior to receiving RAMP funding, AIB had not been disbursing loans, agricultural or otherwise. But by April, 2006 AIB had disbursed over \$2.3 M in agricultural loans. Eventually, the bank had become comfortable enough with lending to agricultural processors to invest some of its own money, lending over \$1.2 million to a sugar cube processor and a meat processor in 2005-2006.

Due to the larger loan sizes involved, AIB was able to more swiftly disburse the entire amount granted to it by RAMP. However, even though the bank was pre-existing, its loan capabilities were not. In the initial drive to get loans out the door, it perhaps moved too swiftly and made some initial errors in judgment, resulting in two "problem" loans. As of April 30, 2006, the PAR₉₀ of the bank's agricultural loan portfolio was 24%, due to one bad loan – the Kabul Flour Mill. A case study was undertaken by RAMP rural finance advisors for AIB, assessing the due diligence conducted for this loan and analyzing steps the bank has taken since to avoid similar situations. However, capacity at the bank to locate potential clients and evaluate loans remains low, with the bank continuing to rely upon outside sources, primarily Flag International, to find clients and prepare loan documentation. To resolve this, the bank's CEO, John Hayes, is seeking additional technical assistance beyond the terms of the RAMP program to assist the bank in securely and efficiently expanding their lending to the SME market. In addition, AIB is increasing the size of their lending staff from 4 to 10 employees which should increase their capacity to manage a larger portfolio.

What Is the Impact?

At this stage in the development of the above financial institutions, impact is difficult to assess. In order to gauge impact at the borrower level, a carefully controlled longitudinal study needs to be done after a significant number of loans have been repaid, comparing current income and household activities to a baseline. However, there is no baseline, and as of this writing, most SME loan terms had not yet ended.

It is similarly difficult to look at the self-sustainability of these financial institutions as a measure of their effectiveness. None of the institutions are yet sustainable, as all are still in their start up phases – most especially the AFC and Afghanistan Renewal Fund, but also the MFIs, which were averaging 52% operational sustainability (defined as the percent of operating costs covered by operating income) as of December 31, 2005. A recent study by the Microfinance Mix concluded that it takes on average five to seven years for an MFI to become self-sustainable (Gonzalez, 1). But Afghanistan is hardly the

average environment for microfinance, and it may well take longer to become sustainable in this environment. As to the two financial institutions started up by RAMP, “newborn DFIs [development finance institutions], just like all newborn firms, lose money until time and growth spread start-up costs and hone technology. Like private investors who judge firms by their Net Present Value, governments and donors must judge DFIs not only in their first year, not only in their most recent year, not only in the next year, but rather all through their whole lifetimes. Of course pro forma data may have a wide margin of error, but... explicit present value analysis is useful even if based on doubtful quality,” (Schreiner and Yaron, 6).

Value Added Projections

The difficulty in assessing value added at the client level is that not enough time has gone by to collect meaningful data. When it comes to financing, it typically takes at least a year to begin showing an impact, and true impact needs the evaluation of two to three years data. Compounding the problem, not only were funds received by the financing institutions at staggered dates, but disbursements were staggered. In the case of the MFIs, for example, a significant portion of the funds were not disbursed until 2005. We can, however, look at the actual yields (i.e. interest income earned) by the organizations as a proxy indicator for value added at the borrower level (see table 2, below), and make projections to the end of the RAMP project, three months later.

Table 2: Financing Yields as a Proxy for Value Added

Finance Institution	Funds for Loan Capital Received	Date Funds Received	Yield (weighted average)	Value added through April 30, 2006 ¹²	Estimated ¹³ value added by RAMP through end of Project: July 2, 2006
Microfinance Institutions	\$4,002,009	July, 2003	35%	\$1,433,386 ¹⁴	\$1,666,836
AFC	\$3,500,000	Nov., 2004	17.36%	\$40,709	\$80,000
ACAP's Afghanistan Renewal Fund	\$3,800,000	Feb., 2005	N/A	\$0	\$0
AIB	\$2,000,000	Aug., 2004	15.94%	\$134,421	\$147,863
Total	\$13,302,009			\$1,608,516	\$1,894,699

To extend this timeline and get a better picture of impact at the client level, one may also project the net present value (NPV) of income streams paid by the borrowers over time to their financing institutions to estimate value added (please refer to Annex 1 for details on these calculations). Two different scenarios were examined over a three-year period of financing: a conservative scenario in which borrowers' value added was equal to the interest they paid (i.e. yield) to the financial institution, and an "optimistic" scenario in which value added was 15% more than the interest they paid (see table 3, below). Given current trends, it appears that the reality will lie somewhere between the conservative and optimistic scenarios.

Without any historical financing data to refer to and since venture capital takes a higher risk/higher reward approach than lending, NPV scenarios for the Afghanistan Renewal Fund were based on its management's own projections for internal rate of return (IRR). However, it should once again be emphasized that this is, at best, educated guesswork.

¹² Actual yields (interest income plus fees) for AFC, ACAP/ARF, and AIB. Estimated yields for the MFIs.

¹³ Estimates for the MFIs over a three month period based on yield on the full loan capital amount (all of RAMP's MFI loan funding, \$4,002,009, is in play at present). AFC value added based on management projections for April-June, which are in turn based on leases "in the pipeline." AFC got off to a slow start, and is only now beginning to hit its stride, with a steep growth curve projected during this period. AIB projections are based on a 10% increase over the two month period. AIB has slower growth than the MFIs and AFC.

¹⁴ The microfinance earnings are estimated, while the AFC and AIB earnings are actuals.

Table 3: Net Present Value Estimates over Three Years of Financing

Finance Institution	Funds for Loan Capital Received	Date Funds Received	Yield	3 Year NPV – Value Added, Conservative Scenario	3 Year NPV – Value Added, Optimistic Scenario
Microfinance Institutions	\$4,002,009	July, 2003	35%	\$3,006,233	\$4,294,619
AFC	\$3,500,000	Nov., 2004	17.36%	\$1,242,117	\$2,315,374
Afghanistan Renewal Fund ¹⁵	\$3,800,000	Feb., 2005	26% IRR ¹⁶	\$1,819,382	\$3,206,935
AIB	\$2,000,000	Aug., 2004	15.94%	\$651,723	\$1,265,013
Total	\$13,302,009			\$6,719,455	\$11,081,941

Because of the solid repayment rates to date of the borrowers in Afghanistan, it appears that the most likely scenario to occur may lie somewhere between the conservative and optimistic scenarios. Although from first glance at the above table it might appear that microfinance institutions (MFIs) demonstrated the greatest client impact, it should be noted that the vast majority of MFI borrowers used their loans for working capital inputs rather than for fixed assets, the latter which was favored by the SME and large-scale borrowers. Investments in working capital tend to and must show a quicker return than investments in equipment and capital improvements if borrowers are to repay the accompanying shorter-term loans set by microfinance institutions. For example, a woman who buys a dairy cow with a microloan can quickly begin selling the milk and earn income, whereas a flour mill that purchases a generator will take a longer time to show a return on this investment. In the end, each institution had different strengths when it came to impact in the agricultural sector.

Other Impacts: Women, Jobs Created, and Outreach

MFIs had greater outreach to women and the poor, and the loans they disbursed showed a quicker return. It should also be noted that MFIs were able to deliver loans to more remote regions of Afghanistan than the organizations targeting SMEs and larger-scale enterprises. Although an eyebrow-raising 82%¹⁷ of MFIs' agricultural borrowers were women in this conservative country, when one looks at Afghanistan's agricultural labor patterns, this should come as no surprise. Women and men participate in different types of agricultural labor, but contribute equal time to it (World Bank, National

¹⁵ Again, it should be noted that the ARF had not begun any investing as of this writing, so all returns are purely theoretical at this point.

¹⁶ Because this is an equity investment rather than a loan, IRR is used for the venture capital fund rather than yield, which is used for the microfinance institutions, AFC, and AIB.

¹⁷ Estimated.

Reconstruction and Poverty Reduction, 55-57). Amongst poor families, women are even more involved in agricultural activities (ibid), and the MFIs funded target the poor.

As to employment generation, the picture is murky. Without the benefit of a rigorous longitudinal or cross-sectional study, the author was forced to rely upon data collected by the financial institutions themselves and anecdotal evidence. A donor mission in February 2006 to Herat found “there is also considerable evidence of job creation, especially through the larger individual loans. The team visited several businesses that employ between 5 and 15 people that have doubled their output and increased their number of employees after linking up with microfinance programs,” (Ministry of Rehabilitation and Rural Development, 3). This is supported by a study by one RAMP-funded MFI, Aga Khan’s Afghanistan Rural Micro-credit Programme (ARMP), indicated that for every \$100 lent by the microfinance program, .2 jobs were created (ARMP disburses \$700 loans, implying that for every ARMP loan, 1.4 jobs were created¹⁸). It is unclear whether this statistic applies to other microfinance lenders in Afghanistan, however, and such informal studies can only whet the appetite for more detailed surveys on the impact of microfinance on employment generation, particularly since the literature on jobs creation by micro and small enterprises is so conflicting. While some assert that micro and small enterprises are labor intensive and, therefore, their growth generates employment, others deny this – stating that micro and small enterprises are in reality capital intensive, most jobs are generated by start-ups, and there is little empirical evidence to support the jobs creation hypothesis.¹⁹

As to the larger-sized loans, in April, 2006 RAMP surveyed AIB’s agricultural clients in good standing to determine how their number of employees had changed since they’d received their AIB loan. Over an 18 month period since loan disbursement, the average number of employees had increased by 24, with a median increase of 10.5 employees. Though this data does seem to support the “trickle down” assumption, the number of AIB borrowers is so small that this survey has little statistical relevance.

The combination of these types of rural finance enabled RAMP to provide greater depth of impact in the sector as a whole.

Lessons Learned

Choosing to start-up financing companies in Afghanistan was a risky, but necessary, endeavor. Financing facilities for SMEs in the agricultural sector simply did not exist before RAMP’s RFP, and without donor funding, banks in Afghanistan refused to take the risk of lending in such a volatile environment.

¹⁸ 13.4% of ARMP loans are for crops, implying that these loans result in seasonal rather than permanent jobs created.

¹⁹ For examples of two such conflicting reports, see Gustav Papanek’s “Poverty Reduction: Focus on the Rural Poor and Micro, Small, and Medium Scale Firms,” and Sarah Gavian’s “The Importance of Agricultural Growth to SME Development and Rural Employment in Egypt,” both available on the Microfinance Gateway (www.microfinancegateway.com).

Even with RAMP funding, in order to ensure loans were made, staffers of the RAMP Rural Finance division were forced to move well beyond the traditional donor “monitoring” role with both the AFC and the Afghanistan International Bank (AIB) – finding, screening, and assessing potential clients, sitting on the credit committees, providing direct technical assistance and aggressively following up on problem borrowers. “Agriculture is highly specialized,” said John Hayes, CEO of AIB. “We needed RAMP’s field people to help assess whether particular deals were viable.” The services of another RAMP-funded program, Flag International, were also leveraged by RAMP staff to source and analyze clients for the AIB and AFC. Without RAMP’s deep engagement with the two lenders, it is unlikely as much funding would have been disbursed to the agricultural sector.

In the end, it was the pre-existing international organizations specializing in microfinance, rather than the start-ups and national NGOs, which achieved the greatest outreach. With agricultural and SME lending still in the embryonic stage, intensive donor technical assistance and support remains a critical need for the sector.

Conclusion

It’s too soon to judge the long-term efficacy of the programs funded. However, in the short-term, several key lessons were learned about the effectiveness of various rural financing mechanisms in the Afghan context.

Microfinance institutions, uninhibited by Afghanistan’s anarchic environment and weak legislative and physical infrastructure, were able to achieve the greatest outreach and impact in the shortest period of time. They lent to an astonishing number of agricultural clients – making nearly 90,000 loans – and were able to reach women borrowers in spite of the many cultural barriers to doing so. By focusing on short-term input funding, they were also able to generate higher yields. Finally, international MFIs with “systems in a box” were able to more quickly start and expand projects in rural areas, as well as leverage other donor financing to attain even greater outreach.

Setting up formal SME financing companies was a bold experiment with mixed results. While the AFC leasing company had high repayment rates and successfully reached rural borrowers, the start-up took more time than expected, and intensive and direct involvement by RAMP personnel was required to ensure lending proceeded, if not on schedule, within acceptable parameters. As of this writing, the venture capital firm had just opened offices in Kabul, but has not yet started investing in Afghanistan.

Afghanistan International Bank, which had been established in Afghanistan if not as a lender, at least as a commercial banking entity, was able to disburse the funding it received and begin “recycling” the loan funds within the period of the grant agreement. However, it too required direct interventions from RAMP staff, and the bank’s inexperience with lending led to some initial bad loans.

Without the intensive involvement of RAMP Rural Finance personnel – sitting on credit committees, finding and assessing borrowers, and providing direct and indirect (via Flag International) technical assistance – it is doubtful whether these results would have been achieved in the SME sector. There are substantial barriers to starting up successful long-term rural lending schemes (i.e. self-sustainable institutions with strong repayment rates). Quicker and longer-term impact may be achieved by working through pre-existing mechanisms where they exist, e.g. in the SME agricultural sector, providing funds and technical assistance for commercial bank downscaling and MFI upscaling.

Yet despite the many barriers to lending in Afghanistan (e.g. resistance among the religious authorities, poor infrastructure, no collateral laws and the higher cost of information gathering), the overall impact and outreach of agricultural lending has been positive. Initial repayments within all sectors have been strong. As of this writing, the leasing company has no “problem” clients and the PAR₉₀ of the MFIs funded remains well below 2%. Demand for credit in all sectors still outstrips supply, estimated at one-million Afghan households for microcredit alone (Goeldner, 25). However, notwithstanding the high demand for credit in Afghanistan, the promise of these remarkable achievements may go unfulfilled.

Although microfinance has achieved outstanding results in the short time it has been operating in Afghanistan, the MFIs are not yet self-sustainable. MISFA, the apex institution which is the primary funding source for MFIs, has projected a serious funding shortfall for the year 2006. Though this does not affect the projections in this paper, which are based on existing RAMP funding, there is the danger that existing financing institutions will not be able to obtain funds to reach sustainability and expand their markets. AFC is seeking additional financing, and AIB is also looking to expand its SME lending. The present finance sector still requires support both financially and technically to reach sustainability and fill the unmet need for credit, rural and urban.

The RAMP project has been able to jumpstart lending to the agricultural sector. It would be unproductive for donor agencies to disregard the initial spark to this sector by abandoning it for the next big developmental idea. Given the length of time it takes to start up a financial services project, building on current financial institutional strengths will demonstrate more efficient and better results than starting the entire process anew.

Annex 1: Method – Estimating Value Added

Value added was based on projected yield earned over a three year period by the institutions. Yields, repayment rates, and repayment timing data were derived from a study conducted by RAMP in November, 2005 of the financial institutions funded.

For the lending institutions, interest earned was calculated based upon each institution's weighted average effective interest rates, terms, and repayment rates. Net present value was calculated using a 15% discount rate²⁰.

“Filters” were then created for each lender/investor's interest earnings, based on the assumptions that not all loans will be repaid (or all business owners successful) and that, based upon their size and type of business, businesses take time to realize gains from their investments. For example, microenterprises which use loans for inventory purchases realize gains more quickly than SMEs which take out leases for equipment or loans for capital improvements.

Three different scenarios were presumed for each institution. First were conservative estimates that the value added to the borrower equaled the interest income paid, optimistic estimates that the value added exceeded the interest income paid by 15%, and a pessimistic scenario that the value added was 15% less than the interest income paid. Performance to date indicates that the actual value added will lie somewhere between the conservative and optimistic scenarios, so the pessimistic scenario was discarded for the purpose of this report.

The venture capital fund's value added was based upon projected IRR. The fund's projection of a 42% IRR over a 5-year period was used as the "Optimistic" case and 10% over a 10-year period for the "Pessimistic" case. The "Conservative" case estimates a value added that is the median of Optimistic and Pessimistic cases.

²⁰ The real interest rate on capital borrowed from banks.

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