



ARIES

Agriculture, Rural Investment
and Enterprise Strengthening
Program in Afghanistan

Program Overview



USAID
FROM THE AMERICAN PEOPLE

AFGHANISTAN



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.

ARIES Program Overview

In 2006, the United States Agency for International Development (USAID) engaged the Academy for Educational Development (AED) in USAID's largest rural finance program to date — the \$100 million Agriculture, Rural Investment and Enterprise Strengthening (ARIES) program with the aim of creating a strong, private sector foundation for a sustainable, market-driven rural finance system in Afghanistan.

ARIES supports USAID Afghanistan's strategic objective of "promoting a licit economy led by the private sector." Specific targets established for ARIES include the disbursement of a cumulative total of 303,907 loans worth \$152 million, by the end of the program in December, 2009.



Activity Profile

Goal: 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 activities complement the efforts of other USAID programs, such as Afghanistan Small and Medium Enterprise Development (ASMED), Accelerating Sustainable Agriculture Program (ASAP) and the Alternative Development Programs (ADPs), which focus primarily on developing new market and enterprise opportunities through technical assistance and grants.

Implementing Partners: AED works with several partners on the ground, who in turn bring their own networks of member and partner organizations. The primary partners are described below.

- **Foundation for International Community Assistance-Afghanistan (FINCA-A).** Through its local affiliate, FINCA-A offers lower-tier individual and group microfinance loans from under \$200 to \$2,000 using their village banking methodology that they have adapted to the Afghan context.
- **World Council of Credit Unions (WOCCU).** Through its local affiliate, WOCCU-Afghanistan (WOCCU-A), WOCCU offers individual and group microfinance loans, as well as savings accounts, from under \$200 to \$5,000 using a credit union model customized for the local environment.
- **Microfinance Investment Support Facility for Afghanistan, Limited (MISFA).** MISFA, a wholesale lending institution, on-lends its ARIES investments (as an apex partner) to 15 microfinance partners who offer individual and group loans ranging from less than \$200 to \$5,000. With technical assistance from SBI, MISFA also supports four SME finance partner institutions, which make loans of \$2,000 to \$100,000.
- **ACDI/VOCA's Afghan Rural Finance Company (AFRC).** AFRC, an independent Afghan rural finance company, serves the upper range of SME finance with loans from \$20,000 to over \$1 million.

Funding Level: The ARIES project is a \$100 million, three-year initiative (2006–2009).

Overview

ARIES offers five different approaches to expanding access to formal financial services for rural and agri-based micro, small and medium-scale enterprises (MSMEs), especially those offering significant job creation potential in the Alternative Development Program (ADP) regions. By partnering with formal institutions, ARIES helps further develop a viable and comprehensive financial system in Afghanistan.

When Hamid Karzai took office of the Presidency, there were seven banks in Afghanistan, including one import-export bank and one development bank. Many Afghan businesses, including import/export merchants and wholesalers at the SME level, customarily maintained accounts in banks outside Afghanistan, in Pakistan, Dubai and elsewhere. Providers of formal credit for the rural and agri-business sectors included these seven and international banks, as well as microfinance institutions (MFIs) of primarily NGO origin. Of the Afghan banks, the Agricultural Development Bank, which had 28 branches across the country, focused on loans to agricultural enterprises, at 15% interest. Although it was dissolved in 2006, the AgBank's loan products and lending procedures have informed subsequent rural financing initiatives, including the USAID-funded Rebuilding Agricultural Markets Program (RAMP) and, subsequently, ARIES.

Areas of Operation: ARIES' central office is in Kabul.

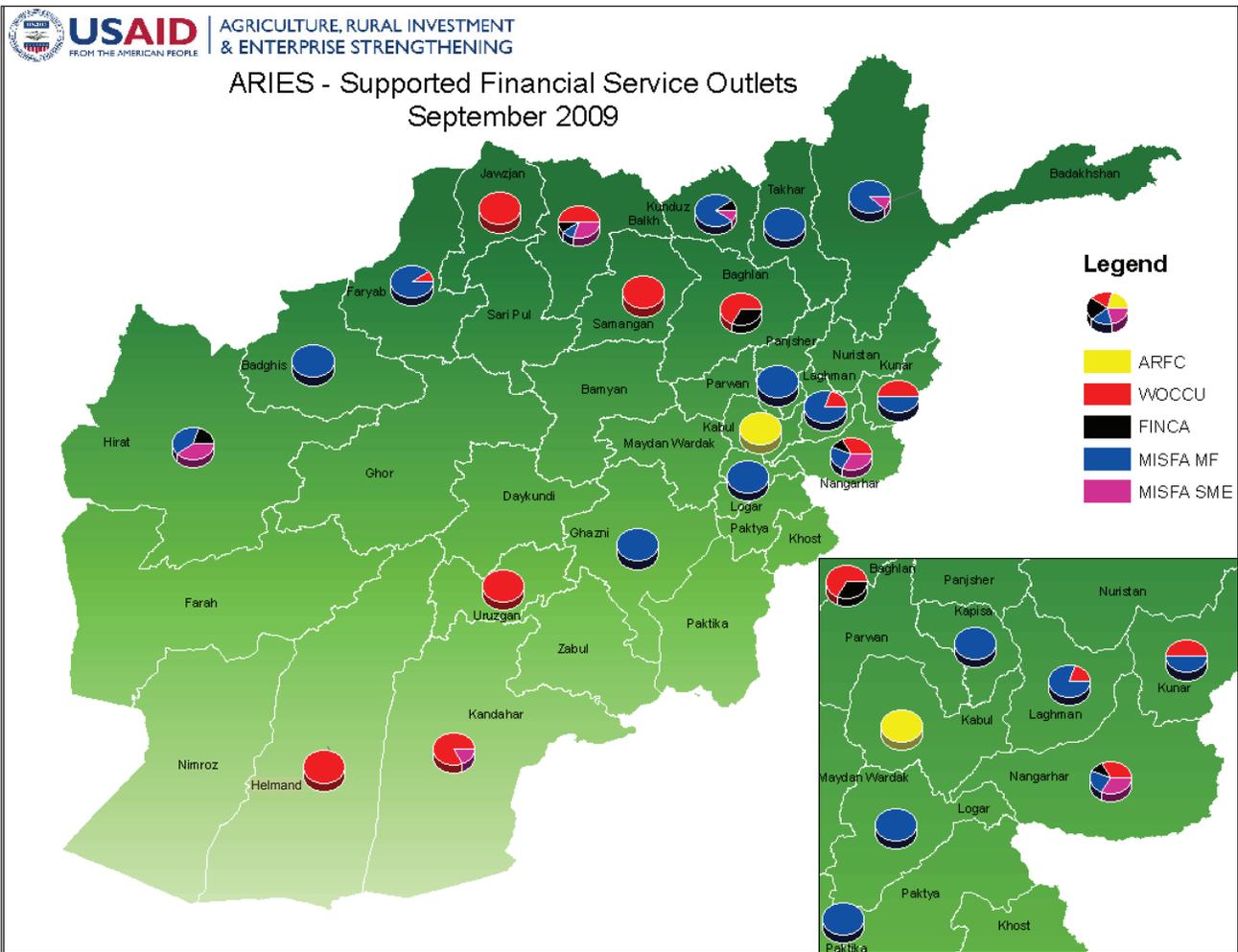
Through our program partners, we reach 24 of Afghanistan's 34 provinces. The following map illustrates where the ARIES partners have financial service outlets as of September 2009.

Financing instruments/products offered

ARIES partners offer a wide range of financial products and services. WOCCU-A, FINCA-A and the other MISFA microfinance partners provide small-scale savings and loan products ranging from less than \$100 to \$5,000. In response to local demand, WOCCU-A and FINCA-A have refined their customary loan products to be in line with Qur'anic law or "Sharia-compliant"; both offer group and individual *murabaha* (deferred financing in which an intermediary makes the purchase and the client pays a higher amount later or in installments). WOCCU also offers *Sharia*-compliant leasing loans and savings accounts.



ARIES - Supported Financial Service Outlets
September 2009

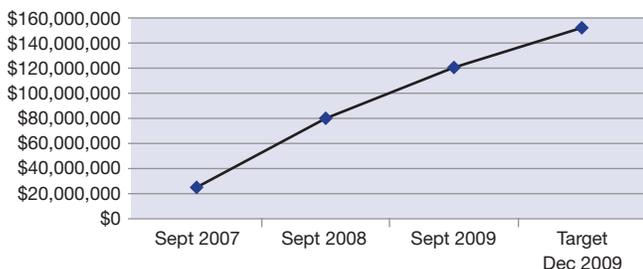


SME loans offered by the partners range from \$5,000 to \$100,000. MISFA on-lends funds to its SME finance partners for a return of 5% per annum. They in turn on-lend funds via conventional or *Sharia*-compliant loans at effective returns of around 16–24% per annum. For larger SME loans ranging from \$20,000-\$1+ million, ARIES partners with ARFC, which also offers conventional and *Sharia*-compliant loans at effective returns around 10–12% per annum.

Performance

Overall, ARIES is progressing well towards most 2009

Amount of Loans Disbursed
(Cumulative)



targets, despite security conditions in Afghanistan deteriorating beyond expectation. Security has increased both the complexity and cost of field operations. Nonetheless, as of September 30, 2009, a total of 217,879 loans, with a cumulative amount of \$122.6 million, have been made through ARIES' five partners.

ARIES partners have been particularly successful in outreach to female borrowers, who represent 49% of their clients. Furthermore, ARIES has helped create or sustain more than 226,000 full-time, part-time and seasonal jobs and supplier livelihoods, most in the ADP regions. One of ARIES' greatest accomplishments is its country-wide presence. ARIES' partners have 113 financial service outlets in the ADP regions.

Achievements

In addition to being on track to meet most of its performance targets, ARIES has achieved a number of important intermediate results. These results were achieved despite human

resource capacity and physical infrastructure constraints as well as deteriorating security conditions. As of September, 2009, ARIES had ongoing activities in 24 of the country's 34 provinces, including all of USAID's target ADP regions.

Some of key achievements of individual ARIES partners include:

- **FINCA-A has served some of Afghanistan's most vulnerable poor** with 54% of its client base being women. Furthermore, FINCA-A developed loan products that are *Sharia* compliant. It has cumulatively disbursed more than 90,700 loans worth \$27.9 million through its ARIES-supported branches.
- **WOCCU-A has played an important role in building a savings culture** and expanding access to *Sharia*-compliant savings, loan and leasing products in Afghanistan, through the establishment of a network of 17 Islamic Investment and Finance Cooperatives (IIFCs), including cooperatives for the Government of Afghanistan's public service employees.
- **MISFA has further developed as an efficient and sustainable wholesale institution, advancing commercialization of the Afghan microfinance sector** through loans and capacity-building assistance to its 16 microfinance partners. The latter collectively serve more than 441,000 active clients, and have an outstanding loan portfolio of \$107 million, and a cumulative repayment rate of more than 95% as of September 2009.
- **With technical assistance from SBI, MISFA has created a functional wholesale window for SME finance and developed the SME finance capacity of five financial institutions;** this market segment was previously underserved by the banking sector. MISFA's initial \$15 million SME finance portfolio, which was wholly financed by USAID via ARIES, provides a foundation upon which MISFA plans to build a wholesale window for agricultural finance.
- **ACDI/VOCA established an independent and operationally self-sufficient rural finance company, ARFC, through which it applied an innovative val-**

ue chain finance approach to stimulate rural and agribusiness SMEs. For example, in its support of the Omaid Bahar Fruit Processing Facility, ARFC demonstrated the model's potential to align Afghan businesses with both local and global market opportunities.

While these results are important in themselves, they do not provide the entire picture of the program's achievements. By coordinating and overseeing these projects and initiatives, ARIES was able to make collective contributions to the development of a sound financial system that exceeds the sum of its parts. For example:

- **Demonstrated the "bankability" of poor rural Afghans in a culturally acceptable way.** Not only did most of ARIES' partners develop *Sharia*-compliant products, they adapted to the realities of rural Afghanistan. For example, WOCCU-A supported community development projects as a way to build acceptance in the community, and engaged local religious leaders in the governance and financing decisions of their IIFCs.
- **Exposed local financial institutions to best practices in microfinance and SME finance, building on lessons learned in other countries and environments.** All ARIES-supported training and technical assistance integrated international best practices, and built upon templates and systems proven to work in similar environments. This helped the Afghan microfinance and SME finance sectors to avoid making some of the mistakes of the past, facilitating rapid market-oriented expansion in a market-oriented fashion.
- **Emphasized the importance of sustainability and Afghanization** of all the partners and institutions it supported directly and indirectly. Despite the push for rapid results, ARIES' initiatives focused on building permanent financial institutions that would increasingly be managed and run by local Afghan professionals. To do so, ARIES emphasized local training and capacity building, with more support going to those institutions that demonstrated progress toward operational self-sufficiency. In contrast to short-term projects, this approach conveyed to clients the importance of repaying their loans in ensuring access to future loans.

- **Rapidly created broad outreach, and network of financial services serving various sectors and niche markets, including special adaptation to serve women and the rural poor.** Microfinance partners undertook additional efforts to serve female entrepreneurs, who represented about half of its microfinance clients at the end of September 2009. For example, to facilitate access to poor rural women, microfinance providers often hire female loan officers.
- **Supported the development of viable alternative livelihoods to poppy farming and to taking up arms for hire.** By coordinating with other USAID-funded programs and supporting financial services outside of urban areas, ARIES helped numerous rural enterprises, particularly in areas of heavy poppy cultivation and in severely conflict-affected region.

Challenges, Adjustments and Lessons Learned

All of the ARIES partners have had to overcome challenges to attain these results. The program's accomplishments played out in a context that included considerable cultural restrictions, poor infrastructure, limited human resource capacity, and increasingly volatile security conditions. This section highlights the major challenges faced by ARIES, how the program partners addressed them, and the lessons learned in the process that may help others working in similar contexts.

Challenge: *Ensuring microfinance products comply with Islamic Law. Credit, and how it is conventionally offered, is widely interpreted in Afghanistan as contrary to Qur'anic, or Sharia law. Islam prohibits riba, or interest, emphasizing the need for shared risk and return in all financial transactions. To offer Sharia-compliant products, ARIES partners were obliged to adapt their products, delivery, and monitoring.*

Adjustment: *Both FINCA-A and WOCCU-A consulted with communities and clerics to customize their traditional loans to be Sharia compliant. In addition, MISFA has engaged two Sharia scholars to review their products and recommend ways to standardize the Sharia-compliant products they provide. While there appears to be less insistence on Sharia compliance among SMEs, the ARFC also offers traditional and Sharia-compliant loans. The development of these products has also driven changes in partner MIS*

platform requirements and in the ways they approach new product development and marketing. Though challenges remain, ARIES partners and Afghanistan's microfinance industry have made significant progress toward Sharia compliance.

Lessons learned: *Successfully adapting microfinance products to Afghanistan's conservative interpretation and practice of Islam depends upon consulting with community members and local religious authorities on product design and structure. By offering client options for both conventional and Sharia-compliant loans, MFIs have largely been able to deter local resistance.*

Challenge: *Balancing security constraints with project objectives. Field-based work in Afghanistan, particularly rural outreach, has grown increasingly difficult as the security environment has continued to deteriorate since ARIES was launched in 2006. Along with Afghanistan's limited infrastructure, a fluid security situation has complicated the transfer of funds to and from partners' local headquarters and branch offices, as well as loan disbursement and collection. Program outreach has therefore been limited to the areas where operations can be safely conducted, supervised and monitored by both international and national staff.*

Adjustment: *ARIES, with MISFA, has advocated alternative cash management strategies to reduce the risks of cash-handling by staff and clients; for example, some MFIs currently use the traditional hawala system that utilizes money-handlers for cash transfers. The M-commerce initiative now being piloted by ARIES with ROSHAN, Afghanistan's largest mobile phone provider, and two MISFA MFIs, is one way in which the ARIES partners' security risks will be reduced, as it will eliminate the physical transfer of cash to and from the field.*

Lessons learned: *Although macro conditions, such as insecurity in the field, are beyond the control of ARIES, they are realities that impact the work of the program and its partners. Programs serving insecure rural areas must creatively identify ways to recover the higher costs associated with risk management, for example, by using urban clients to cross-subsidize the costs of reaching rural clients. In addition, new technologies, such as cell phone banking, can help both overcome security constraints and reduce transaction costs in reaching more remote markets.*

Challenge: Working with limited human resource capacity, especially in the skills needed to expand financial services. The degree of capacity building necessary to establish a solid and vibrant financial sector in Afghanistan is enormous, requiring significant time and resources to train local staff in concepts and methodologies of international financing previously unknown in the country. The intensive technical assistance required is costly.

Adjustment: All ARIES partners, and particularly SBI, MISFA and WOCCU, place substantial emphasis on building the capacity of their managers and loan officers. As financial institution management experience among their Afghan professionals is often insufficient, several of ARIES partner MFIs are currently managed by expatriates who are striving to build local capacity as part of their mandate.

Lessons learned: In conflict-affected countries that have endured “brain drain” and limited educational opportunities, significant time and investment is required to build local capacity to manage and lead formal financial institutions. Development professionals and donors must be patient and willing to make substantial investments in local capacity building, through training, retraining, mentoring and one-on-one technical assistance. In addition, support organizations must recognize that short-term training cannot easily compensate for a lack of higher education.

Challenge: Maintaining portfolio quality amid calls for rapid expansion and increasing security restrictions. While portfolio quality issues are often muted by rapid portfolio expansion, increasing security concerns made it particularly difficult for microfinance partners to conduct thorough internal audits — especially in remote areas — to validate portfolio quality.

Adjustment: ARIES and MISFA are committed to supporting the development of a sound financial system, including institutions with controls adequate to guarantee that savings are safe, clients repay loans and the potential for internal or external fraud is minimized. MISFA has created two-year benchmarks and “report cards” that include governance, capacity, and sustainability indicators, to which it now holds its partners accountable in order to achieve certain standards for continuing to access loans. ARIES and

MISFA closely monitor the performance of MFIs with portfolio quality issues, to ensure that their restructuring plans are in place and appropriately implemented.

Lessons learned: Proper incentives must be in place to balance growth with portfolio quality. If too great an emphasis is placed on expanding outreach, especially in a conflict-affected country, portfolio quality will suffer. This in turn can have a negative impact on the entire financial sector, as word gets out that loan repayment is not expected.

Challenge: Working with banks that are reluctant to lend to SMEs. The banks in Afghanistan are reluctant to lend to SMEs. This is particularly so with lending to agricultural producers, whom they consider too risky. They prefer to lend to traders; 80% of MISFA SME current clients are traders based in urban areas. Furthermore, bank management continues to have a very conservative approach to the sector overall, generally considering it not to be a profitable line of business.

Adjustment: With assistance from SBI, MISFA looked beyond banks to MFIs and other institutions for SME lending, e.g. the latest MISFA SME partners are the MFIs Parwaz and Oxus. It is hoped that the more risk-averse banks will become less conservative, as the MISFA SME partners demonstrate the growth and profit potential of SME finance.

Lessons learned: Banks tend to be more conservative than MFIs, and they are more likely to be followers rather than leaders in exploring new markets. As a result, banks may not be the partners of choice for SME lending, particularly for agribusiness financing in Afghanistan.

Challenge: Coordinating with other donors, the host government, related USAID projects and other key development stakeholders. In a complex aid delivery context like Afghanistan, multiple donor interventions can result in inefficient duplication of efforts.

Adjustment: ARIES has been pro-active in contacting CIDA, DFID and other donors regarding activities in regions of mutual interest. It has communicated with key GoA departments and programs, such as AISA and AREDP, as part of the important effort to leverage donor investments to achieving maximum benefits in rural finance interventions.

Lessons learned: Dialogue and coordination with other stakeholders involved in the same sector reduce costly duplications of effort and ensure that all market gaps are adequately addressed.

Moving Forward

The first two years of ARIES served as an important pilot phase, with the program necessarily focused on the implementation of partner activities in the field, and the development of data collection and reporting tools. In its third and final year, ARIES intends to build on its partners' financial operations, and to move some of them to scale and sustainability. These efforts include:

- Expanding and strengthening of the formal financial system, as well as increased outreach to rural Afghans
- Scaling up of some of the MISFA MFIs to SME lending; these MFIs will then become partners in the MISFA SME initiative
- Strengthening microfinance partners, emphasizing operational self-sufficiency including passing the baton to local management and control, and solidification of portfolio quality
- Increasing the number of WOCCU-A IIFCs in the southern provinces, and continuing to liaise with the PRTs on program-related issues

- Implementing FINCA-A's countrywide plan, which involves the consolidation of branches, loan disbursements, improved internal controls, and increased training and professional development of its staff
- Increasing its linkages with Afghan government partners and programs, such as AISA and the AREDP project at MRRD, as well as with other donors. For example, the CIDA-funded report on the potential for SME financing in southern Afghanistan undertaken by SBI is an area of mutual interest for both ARIES and USAID
- Continuing to engage new stakeholders as they enter the Afghanistan financing sector; MISFA has recently agreed to develop a window for agricultural finance with IFAD, for example.

ARIES has made a remarkable contribution to the development of Afghanistan's financial sector, but there is still a long way to go. For example, southern Afghanistan, which is the most unstable part of the country, has not experienced the degree of penetration of financial services as has the northern and eastern regions. Further rural outreach is also needed, as most financial service outlets remain clustered near Kabul, Herat and Mazar-e-Sharif. Moreover, Afghanistan's financial sector is still young, and achieving sustainability a slow process. In keeping with its program goals and objectives, ARIES will continue to strive to meet these challenges and to support the expansion of formal financial services to the rural poor.

Acknowledgments: Bahram Barzin, Caitlin Reinhard, Claudia Gray, Donald Henry, Stephanie Charitonenko and Whitney Sims.



For more information on the FIELD-Support LWA, please contact:

Paul L. Bundick
Director, FIELD-Support LWA
AED

Phone: (+1) 202-884-8283

Email: pbundick@aed.org

Web: www.microlinks.org/field

www.aed.org

www.microlinks.org/field