

**Afghanistan: Establishment of The First MicroFinanceBank - Afghanistan**

**Ex post evaluation report**

<b>OECD sector</b>	24030 Formal sector financial intermediaries	
<b>BMZ project ID</b>	2003 65 809 (random sample 2009), 2004 70 013	
<b>Project executing agency</b>	FMFB-A	
<b>Consultant</b>	HORUS Development Finance	
<b>Year of ex post evaluation report</b>	<b>2009</b>	
	<b>Project appraisal (planned)</b>	<b>Ex post evaluation report (actual)</b>
<b>Start of implementation</b>	Q1 2004	Q1 2005
<b>Period of implementation</b>	132 months (equity stake) 47 months (accomp. measure/training)	131 months (equity stake) 37 months (accomp. measure/training)
<b>Investment cost</b>	EUR 1.5 million EUR 1 million (training)	EUR 1.5 million EUR 1.4 million (training)
<b>Counterpart contribution</b>	-/-	-/-
<b>Financing, of which Financial Cooperation (FC) funds</b>	EUR 1.5 million EUR 1 million (training)	EUR 1.5 million EUR 1.4 million (training)
<b>Other institutions / donors involved</b>	AKFD / IFC	AKAM / IFC
<b>Performance rating</b>	2	
• <b>Relevance</b>	1	
• <b>Effectiveness</b>	1	
• <b>Efficiency</b>	2	
• <b>Overarching developmental impact</b>	1	
• <b>Sustainability</b>	3	

**Brief description, overall objective and project objectives with indicators**

The project comprised the foundation and development of The First MicroFinanceBank - Afghanistan (FMFB-A), a fully-fledged commercial bank specialised in micro and small business lending. The FMFB-A was founded in 2004 as a fully licenced commercial bank and closed joint stock company under Afghan law and is headquartered in Kabul. Its shareholders are the Aga Khan Agency for Microfinance (AKAM), which holds a 51% equity stake, KfW, which holds 32.3% on a trust basis for the German Federal Government, and the International Finance Corporation (IFC), which holds a 16.7% stake. Under the accompanying measure, capacity development measures to build up the FMFB-A and the department in charge of small and medium-sized enterprise (SME) lending were financed.

The overall objective of the project was to contribute to employment and income generation among the target group and to building up a formal financial sector in the country. The following indicators were defined for measuring achievement of the overall

objective: a) after a period of five years the FMFB-A has established itself as a functioning financial institution and b) has achieved a satisfactory return on equity of the enterprises financed. The project objective was to provide basic financial services, above all to private micro and small enterprises (target group) across all sectors. To assess the achievement of the project objective, the following indicators were chosen: a) the outstanding loan portfolio amounts to at least USD 14 million after five years; b) the number of customers is at least 20,000 after five years; c) the portfolio at risk (> 90 days) is no more than 10%; d) the break-even point has been reached within five years.

### **Project design / major deviations from the original project planning and their main causes**

The First MicroFinanceBank-Afghanistan (FMFB-A) was established in December 2003 by the Aga Khan Fund for Economic Development (AKFED) and started business operations in May 2004 as Afghanistan's first fully licenced bank. IFC and KfW (on a trust basis for the German Government) contributed their equity in 2004 and 2005, respectively. KfW's share was worth the equivalent of EUR 1.5 million, corresponding to 32.3% of the subscribed capital. In September 2006 the stake held by AKFED was transferred to the Aga Khan Agency for Microfinance (AKAM) in the course of a reorganisation of the Aga Khan development network; all shareholders approved the transfer. The accompanying measure, worth EUR 1.4 million, was used for capacity development measures needed to build up the FMFB-A and its SME lending department.

### **Key results of the impact analysis and performance rating**

a) Relevance: The lack of access of micro, small and medium-sized enterprises (MSMEs) to formal financial services is to this day a key obstacle to Afghanistan's development and growth. For this reason the assumed chain of impacts - according to which support for private MSMEs in the form of basic financial services can lead to greater investment, higher production and, therefore, to more jobs and additional income - remains valid. Afghanistan's banking sector is still underdeveloped despite the fact that some progress has been made since the end of the war. This together with the fact that the country did not have a functioning banking sector after the war came to an end, lends very high relevance to the foundation of a new financial institution specialised in micro and small business lending - also from a current-day perspective. Even today the FMFB-A is the only bank with a full banking licence that is active in microfinancing. Given this, the hypothesis that establishing the FMFB-A can contribute to the development of a formal financial sector in the country still holds true. The objectives of the project were in line with the developmental goals and guidelines of the German Federal Ministry for Economic Cooperation and Development (BMZ), with the goals set by the other FMFB-A shareholders and with the strategies of the Afghan Government. Overall we assess the project's relevance as very good (rating 1).

b) Effectiveness: The indicators set to measure the achievement of the project objective were largely fulfilled and in many cases even exceeded by a wide margin. For example, some five years after starting business, the bank's credit portfolio is equal to USD 40.6 million - far higher than the USD 14 million originally anticipated. At the end of August 2009 the bank's borrowers totalled 36,927 and its savers added up to 34,254, so the target figure of 20,000 was more than achieved in this respect, too. The bank's portfolio at risk (>30 days) is, at 1.22%, also considerably lower than the target of no more than 10% (PAR > 90 days). Furthermore, the bank reached the break-even point within three instead of five years.

The accompanying measure supported the bank by developing an appropriate organisational and workflow structure, setting up and expanding a branch network, recruiting and training personnel and by installing centralised IT systems. As part of the capacity development efforts the buildup of an SME department was supported, including specialised training in SME lending. The personnel and institutional capacity development

measures were critical for the bank's development and growth. It can be assumed that they played a key role in the bank's positive development since its establishment. The project's effectiveness is rated as very good (rating 1).

c) Efficiency: The way the FMFB-A works can, by and large, be deemed efficient. Every loan officer extends 7.4 new loans per month on average and administers an average of 83.2 loans, corresponding to a portfolio worth USD 91,462. This figure is rather below average in international comparison, yet this can at least in part be attributed to the continued lack of qualified staff, the recruitment of new loan officers, the inclusion of part of the loan portfolio of the rural development programme of the Aga Khan network, and the economic downturn. This is also clearly shown by the fact that at the end of 2008, every loan officer administered 116 loans on average. The portfolio quality can be considered very good. The portfolio at risk (> 30 days) was 1.22% in June 2009. The analysis of the certified financial statements for 2008 discloses the following key figures:

- Current expenses account for 79.1% of operating income and 82% of net interest income;
- The return on equity is 12.8% (excluding donor grants);
- The capital adequacy ratio is 29.96% and the tier 1 capital ratio is 18.58%. The FMFB-A therefore fulfils the minimum capital requirements of the central bank of Afghanistan, which call for a capital adequacy ratio of 12% and a tier 1 ratio of 6%.
- The net interest margin is 12.6%.

The profitability figures ought to be interpreted with caution, however, as they have not been adjusted for inflation. Loans are provided at market conditions. Moreover, over 98% of all loans granted can be classified as microloans averaging USD 956 each. The allocation efficiency can therefore be rated as good.

The accompanying measure supported the FMFB-A by developing the bank, training personnel, setting up a branch network and introducing new products, mainly the SME loans. Given the impacts generated by these efforts, the funds for the accompanying measure can be considered to have been put to efficient use. Overall, we assess the project's efficiency as good (rating 2).

d) Overarching developmental impact: The indicators defined to measure the achievement of the overall objective can be considered as having been met. The FMFB-A has established itself as a functioning financial institution. No specific data are available to measure the fulfillment of the indicator "satisfactory return on equity of the enterprises financed" since the information that would be necessary to calculate the ROE are not available. The bank's good portfolio quality does, however, suggest that this indicator is fulfilled.

The FMFB-A focuses its lending business on the field of microlending. Since over 98% of all loans granted are in this segment, it can be assumed that the target group is indeed reached. Furthermore, the bank's strong growth helped to reach out to customer groups who until then had no access to formal financial products. At the end of 2008 the bank's financing broke down as follows: 79% of the portfolio was in the trade and services sectors, and the geographical focus was on Kabul (42%). Through the bank's expansion into rural areas, however, the agricultural sector is accounting for a growing share of the portfolio.

The bank's structural impacts can be rated positively. Since the formal banking sector lay largely in ruins at the end of the war and the FMFB-A was the first bank to become licenced, it made a significant contribution to setting up and developing a formal banking and financial sector in Afghanistan. The bank's importance for the Afghan banking sector is also reflected in its high market share. Furthermore, the bank generated structural impacts by introducing new financial products. For instance, it designed a microloan programme for private housing finance and a special group lending programme for women. In collaboration with the country's biggest mobile phone service provider the bank also offers financial services via mobile phones (mobile banking). Through these services customers can have microloans disbursed and make repayments or transfer money to other customers. To do so they no longer need to go to a bank's

branch office, enabling even more customers in remote areas to be reached. It is innovative products like these that underscore the bank's pioneering role in Afghanistan's banking sector.

In 2007 the Microfinance Investment Support Facility for Afghanistan (MISFA) carried out an impact assessment in Afghanistan's microfinance sector in cooperation with the University of Sussex. As part of this study, old and new customers of 20 microfinance institutions, non-customers and former borrowers in various regions of the country were compared. Among other things, the study showed that old customers are wealthier than non-customers, who are in turn in a better economic situation than new customers. These differences are not significant, however. The study also revealed that in over 80% of all cases, the loans are used to set up a new business or to expand an existing (micro) enterprise. Based on data by borrowers, it was estimated that every microloan generates some 1.5 new jobs.

A second study carried out by MISFA in the year 2009 on the topic of gender impacts showed that microfinancing also has a positive effect on empowerment, both in a social and in an economic context. Among other things, the study reveals that after taking out a loan, microborrowers play a more active role in decision-making when it comes to financial issues - also compared to non-customers. The study noted an improvement in self-confidence, mobility and participation in social activities, too. Based on the fact that for both studies the surveys were carried out only once, the question remains as to how borrowers would have fared had they not had access to credit. Therefore, the observed effects cannot necessarily be interpreted as being causal, yet they do give an initial indication of the positive effects of microfinance on the target group. Overall we rate the project's overarching developmental impact as very good (rating 1).

e) Sustainability: Long-term refinancing opportunities - especially in local currency - and a difficult economic, political and legal situation will continue to pose challenges for the bank in the future, too, although it should be noted that the bank has only very limited possibilities to determine and/or change the overall conditions. The bank's good key financial figures underscore its positive development over the past years. As the rate of inflation has been high at times, however, these results should be interpreted with caution. Given that Afghanistan's future economic growth and macroeconomic stability are difficult to forecast, the loan interest rates - taking into account the average loan terms and the loan amounts - are comparatively low and make the bank susceptible to inflation fluctuations. An estimate of the actual risk to the bank is difficult, however, owing to the existing level of uncertainty. Yet the expansion of the bank's lending business without additional credit lines and without the support of international financial institutions - also in the future - will not be possible to the extent that can currently be observed. This will hold true for the foreseeable future as well. However, only a significant deterioration in the overall conditions could render refinancing via this channel difficult. In July 2008 Microfinanza assigned the FMFB-A a rating of BBB-, which is good considering the difficult environment. It can generally be assumed that the bank will remain in a position to satisfy demand for its products even if a significant risk remains. Overall we rate the project's sustainability as satisfactory (rating 3).

Taking the individual evaluation criteria and above all the lowering of the sustainability rating owing mainly to the security risk into account, the project is assigned an overall rating of 2 (good).

### **General conclusions and recommendations**

A general conclusion that can be drawn from this project is that the fiduciary holding in the FMFB-A is a good example to follow when a new microfinance institution is founded. The following recommendations can be derived from the ex post evaluation:

In a post-conflict country with a rudimentary banking sector, the establishment of a bank with an international ownership structure that is specialised above all in MSME lending is an appropriate measure to boost the development of the banking and business sector and the country itself.

The indicator "satisfactory return on equity of the enterprises financed" was not suitable for assessing the real economic impacts because of limited available data. Depending on the situation in a given country, indicators should be selected that are based on data which is (and can be) regularly collected by the bank. In order to enable a comparison with the situation at the time of project appraisal, when choosing these indicators it may be worthwhile to collect corresponding data before the project is implemented so that the ex post evaluation can be carried out on a much sounder basis.

### **Notes on the methods used to evaluate project success (project rating)**

Projects are evaluated on a six-point scale, the criteria being relevance, effectiveness (outcome), “overarching developmental impact” and efficiency. The ratings are also used to arrive at a final assessment of a project’s overall developmental efficacy. The scale is as follows:

- 1 Very good rating that clearly exceeds expectations
- 2 Good rating fully in line with expectations and without any significant shortcomings
- 3 Satisfactory rating – project falls short of expectations but the positive results dominate
- 4 Unsatisfactory rating – significantly below expectations, with negative results dominating despite discernible positive results
- 5 Clearly inadequate rating – despite some positive partial results the negative results clearly dominate
- 6 The project has no positive results or the situation has actually deteriorated

A rating of 1 to 3 is a positive assessment and indicates a successful project while a rating of 4 to 6 is a negative assessment and indicates a project which has no sufficiently positive results.

### **Sustainability is evaluated according to the following four-point scale:**

#### Sustainability level 1 (very good sustainability)

The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

#### Sustainability level 2 (good sustainability)

The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected.)

#### Sustainability level 3 (satisfactory sustainability)

The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

#### Sustainability level 4 (inadequate sustainability)

The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and an improvement is very unlikely. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The overall rating on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. A rating of 1 to 3 indicates a “successful” project while a rating of 4 to 6 indicates an “unsuccessful” project. In using (with a project-specific weighting) the five key factors to form an overall rating, it should be noted that a project can generally only be considered developmentally “successful” if the achievement of the project objective (“effec-

tiveness”), the impact on the overall objective (“overarching developmental impact”) and the sustainability are considered at least “satisfactory” (rating 3).