

Afghanistan Research and Evaluation Unit
Synthesis Paper Series

From Access to Impact: Microcredit and Rural Livelihoods in Afghanistan



Paula Kantor

June 2009



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About the Afghanistan Research and Evaluation Unit

AREU is an independent research organisation based in Kabul. AREU's mission is to conduct high-quality research that informs and influences policy and practice. AREU also actively promotes a culture of research and learning by strengthening analytical capacity in Afghanistan and facilitating reflection and debate. Fundamental to AREU's vision is that its work should improve Afghan lives.

AREU was established in 2002 by the assistance community working in Afghanistan and has a board of directors with representation from donors, United Nations and other multilateral agencies, and non-governmental organisations. AREU currently receives core funds from the governments of Finland, Norway, Sweden, Switzerland and the United Kingdom. Specific projects have been funded by the Foundation of the Open Society Institute Afghanistan (FOSIA), the Asia Foundation (TAF), European Commission (EC), the United Nations High Commissioner for Refugees (UNHCR), the United Nations Children's Fund (UNICEF), the United Nations Development Fund for Women (UNIFEM) and the World Bank.

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Acronyms

ANDS	Afghanistan National Development Strategy
AREDP	Afghanistan Rural Enterprise Development Programme
AREU	Afghanistan Research and Evaluation Unit
ARTF	Afghanistan Reconstruction Trust Fund
BMFI	Balkh Microfinance Institution
BmMFI1	Bamiyan Microfinance Institution 1
BmMFI2	Bamiyan Microfinance Institution 2
CARD	Comprehensive agriculture and rural development
CDC	Community Development Council
FAO	Food and Agriculture Organisation
KMFI	Kabul Microfinance Institution
MC	Microcredit
MF	Microfinance
MFI	Microfinance institution
MISFA	Microfinance Investment Support Facility for Afghanistan
NGO	Non-governmental organisation
NSP	National Solidarity Programme

Glossary

<i>Baay</i>	Wealthy land owner
<i>Chadori</i>	A loose garment usually with veiled holes for the eyes worn by some women in public
<i>Haram</i>	Not in accordance with Islam
<i>Jerib</i>	Unit of land measurement (1 jerib = 0.2 hectares)
<i>Karez</i>	Irrigation canal
<i>Lalmi</i>	Rainfed land
<i>Malik</i>	Village leader
<i>Mandawi</i>	Wholesale market
<i>Qaraqul</i>	Sheep breed
<i>Qarz e hasana</i>	Credit which is without interest or any benefit to the lender
<i>Shura</i>	Community decision-making group
<i>Sudh</i>	Interest
<i>Sudhghor</i>	Person who gives credit with interest

Executive Summary

Since 2003, partners of the Microfinance Investment Support Facility for Afghanistan (MISFA) have worked to build a sustainable financial services sector to extend access to credit to urban and rural Afghans. The delivery of microcredit (MC) was prioritised during reconstruction as a means to stabilise livelihoods, improve productive assets and stimulate economic development and job creation. This paper examines the effect that the availability of MC has had on existing informal credit systems and on livelihoods in rural Afghanistan. It aims to provide information that can improve the functioning of the MC sector in Afghanistan, i.e. make its engagement more nuanced and reflective of existing credit systems, client needs and best practice. This will benefit both clients and the microfinance institutions (MFIs) alike.

The study used in-depth qualitative methods to investigate the livelihoods and credit use of households in one village in each of three provinces (Kabul, Bamiyan and Balkh). Information on MFI activity concentration guided both province and village selection. Length of a village's credit programme involvement also guided village selection. The study examined three MISFA partners and the presence of different MFIs influenced provincial selection. The incorporation of different MC programmes allows the study to compare outcomes and programme satisfaction across programme characteristics. Within each village, eight households were selected as case studies. Household cases were selected for diversity of livelihood activities, MFI clients and non-clients and reasons for joining or not, uses of credit, and outcomes.

A key overarching finding of the study is that providing access to credit is not in itself sufficient to ensure the desired positive impacts on client livelihood security or MFI viability. Pathways from access to impact are highly varied, influenced by a range of factors, some of which are outside of the MFIs' control (i.e. security, climate). However, the study found that some factors affecting client outcomes that MFIs can influence are not necessarily adequately understood or implemented. Therefore,

the microfinance (MF) sector in Afghanistan has scope for change, which it currently recognises, to become more client-led. This will bring advantages to clients and MFIs alike.

The issues this study identified that MFIs can focus on to make their work more client-focused and impact-oriented include:

- recognising the importance of economic and social context to successful use of MC;
- investing time and money in understanding informal credit systems to design client-responsive MC programmes and products;
- understanding that credit has meaning, beyond the value of the money itself, through its value in creating and maintaining relationships; and
- developing success indicators that are less primarily concerned with MFI sustainability and that also assess client viability.

Context matters to the successful implementation of MC. Past exposure to credit with *sudh* (interest) can make MC more easily accepted, while the vibrancy of the local economy affects clients' ability to earn sufficient returns from productive credit investments. The study villages varied in their economic potential, but in none were the activities profitable enough for most clients to easily find the money to repay MC. This related to the continued need among many respondents to use part of loans for consumption. Clients often prioritised MC repayment over repaying informal credit to avoid both shame and fines. This maintains the success of the MFIs, but at considerable cost to clients, and questions the long term efficacy of the drive to extend outreach in order to reduce MFI costs. Further assessment of the local context and its suitability for MC is required, particularly in rural areas, to ensure both the clients and the MFI benefit from its introduction.

Study data shows that the demand for credit exists

in Afghanistan, but so does a vibrant informal credit system, providing significant amounts of free credit as well as credit that may be offered on more exploitative terms. MC is one choice among many and therefore MFIs must understand the local informal credit system to complement it and compete for clients. Informal credit and MC are also interlinked via the social networks used to access both as well as via the use of credit from one source to repay the other. Study respondents often used informal credit to repay MC in the face of an approaching repayment deadline. Therefore high repayment rates that MFIs report may mask a build-up of informal debt.

Informal credit has been an important source of social protection in Afghanistan; relationships with those to whom you give and receive help and credit, and with those in a position to help, are vital resources. MC has entered this social sphere and, like informal credit, has taken on a social meaning beyond a financial one. It, too, is used to create and maintain help networks, and existing networks are used to gain access to MC, and to bar some. MFIs need to be aware of this in terms of how social relationships are used as collateral and gatekeepers, and to understand how MC rules may be manipulated to achieve social goals.

What do these findings imply for the MF sector in Afghanistan? Below are six recommendations aimed at improving the ability of the sector to respond to rural client needs in order to increase client viability as well as that of MFIs.

1. Make MF one part of an integrated rural development approach. The findings of this study, as well as a wealth of literature on MC, illustrate that MC alone is insufficient to promote either livelihood security or income growth; it is not a panacea for poverty reduction. Structural barriers within local and regional economic and social contexts limit opportunities for credit use. Therefore, MF programmes must be implemented in a sequenced manner supported by wider development initiatives to address infrastructure gaps, limited access to resources, including water, and local power dynamics that may make the room for manoeuvre for many marginal

at best. Without an integrated, coordinated approach to rural development, MF may only assist clients to cope as opposed to stabilising or improving their financial situation. Government-led efforts, such as Comprehensive Agriculture and Rural Development and the Afghanistan Rural Enterprise Development Program are underway in this regard; MFIs can also link with their nongovernmental organisation counterparts to develop integrated development strategies at the village, district or provincial levels.

2. Develop a dual approach to delivering MF in Afghanistan, incorporating both commercial and risk reduction aims. This paper supports the recommendation of the Afghanistan Reconstruction Trust Fund evaluation team that MISFA develop a dual approach to delivering credit in Afghanistan.¹ MISFA and its partners have been successful in developing a commercial financial services sector, but they have done less well in addressing poverty and risk reduction for poorer Afghans. This can be remedied by continuing to expand the commercial side for upper poor and non-poor clients, and using some of these earnings to support new products and programmes targeting the poor. These would be aimed at reducing risk and stabilising livelihoods as a first step to growth. These programmes may not become operationally sustainable as quickly as current MC programmes, if they do at all. However, they would meet some donors' expectations of the poverty reduction focus of MC, which have not yet been met.

3. Expand MC to MF to address risk reduction as well as income growth. Linked to the previous recommendations, MFIs should expand the range of financial services they offer to support risk reduction. The Kabul Microfinance Institution's [KMFI] death benefit for clients is one example that can be expanded on. Others include opportunities for secure savings; health insurance, given the prevalence of health shocks and crises; and crop and livestock insurance. The social protection sector strategy of the Afghanistan National Development Strategy

¹ Scanteam, "Afghanistan Reconstruction Trust Fund: External Evaluation" (Oslo: Scanteam, 2008).

(ANDS) recognises this gap in market-based means of social risk management.² It prioritises diversifying these market-based arrangements, which have largely been based on providing credit, to include community-based savings and insurance. This paper strongly supports action in these areas. In order to support informed action, investing time in learning from innovations in MF service expansion in South Asia is vital. This is not for the purpose of directly importing existing models or programmes, but to inform an assessment of what is feasible and appropriate in the Afghan context. MISFA and its partners are currently making strides in diversifying products, for example developing Sharia-compliant products, focusing on rural finance, and highlighting product quality over client numbers.

4. **Expand performance monitoring to include indicators of client viability.** At present, MFIs in Afghanistan have focused more on institutional success, measured through outreach numbers and repayment rates, than on how clients perform. This is changing as MISFA invests in systems of social performance monitoring and builds partner capacity to implement them. The success criteria need to hold MFIs accountable for client viability and not just their own. Expanding performance monitoring for MFIs must be done in a manner that is not burdensome and which reflects local capacity. It must also be done with an awareness that clients do not want to lose the aid they have, even if it is imperfect. Independent assessments must be built into performance monitoring plans to minimise the likelihood of clients telling MFIs what they want to hear. More constant and informal forms of client feedback are also needed to provide information MFIs can use to adjust programme delivery, letting clients see the usefulness of providing information in this process.
5. **Learn from informal credit systems.** A wealth of experience from other contexts as well as the data from this study demonstrate the need for MFIs to invest in understanding client needs and

interests, including their involvement in other credit systems, in order to design demand-led programmes and products. This has not been done sufficiently in Afghanistan, to the detriment of rural clients and in the end the MFIs. KMFI in particular had difficulty attracting or maintaining clients in the study villages due to uncompetitive products for rural Afghans. While adding this analysis to MFI procedures has time and financial costs, it is an investment worth making for the returns. Improved knowledge of informal credit systems in Afghanistan would make MFIs more client-led, more able to identify niche products that fill a demonstrated gap in demand and may lead to a more dynamic, innovative financial services sector. As MFIs expand more into rural areas this is especially important to ensure that products match client livelihood activities and cash flows (i.e. through appropriate grace periods) and to help ensure the investment activities can generate sufficient returns to support repayment.

6. **Understand how clients use credit to build or maintain relationships to avoid unintended consequences.** MFIs need to be aware of how people use credit to invest in social relationships because these uses can lead to manipulation of programme rules and to over-borrowing for some, increasing risk of default. MF programmes seeking to break down some potentially exploitative forms of informal credit (i.e. those between farmers and input suppliers) need to know how they operate so the MC products do not place potential borrowers in positions where important sources of informal credit are put at risk, leading to increasing insecurity.

The importance of social relationships on access to informal credit and MC was clear in all the case studies. MFIs depend on these relationships within their group lending models and through some of the forms of guarantee required (i.e. *malik* [village leader] or *shura* [community decision-making group] approval.) However, less attention is given to how social relationships may limit credit access for some excluded from local networks. More transparency and stronger accountability structures are needed to ensure that the systems in place to open access to credit do not increase barriers for some.

² Islamic Republic of Afghanistan, “Social Protection Sector Strategy” (Kabul: Government of Afghanistan, 2008).

1. Introduction

This paper represents a synthesis of the findings of the Afghanistan Research and Evaluation Unit's (AREU) research on the influence of formal credit, or microcredit³ (MC), on both existing informal credit systems⁴ and rural livelihoods more generally. Its aim is to understand what effects MC has had on the rural livelihood systems in three villages in three provinces (Kabul, Bamiyan and Balkh). It compares credit delivery processes and outcomes across field sites and MC programme characteristics to develop recommendations regarding how microfinance (MF) can better support livelihood security in rural Afghanistan. Attention to MC is highly relevant in the Afghan context because since 2003 over US\$569 million in MC loans have been disbursed to over 440,000 urban and rural clients through partners of the Microfinance Investment Support Facility for Afghanistan (MISFA).⁵ It is important to assess to what extent MC clients perceive these services to be relevant to their needs, in general, and compared to other credit facilities available, in order to contribute to the effectiveness and pro-poor orientation of continued financial sector development in Afghanistan.

This research builds on a body of rural livelihoods research at AREU that has identified credit as a key livelihoods component among rural Afghan households⁶ and has explored the existence, pervasiveness and functioning of informal credit systems and their livelihood effects.⁷ With the introduction of MC to rural Afghanistan, the logical

next step was to delve into how these credit products enter into and alter existing livelihood strategies and outcomes. In particular, this study investigates questions raised regarding the key assumption motivating the introduction of MC to Afghanistan, specifically those about lack of access to credit and thus, the existence of a large unmet demand.⁸ It also assesses how formal and informal credit systems do and should interact to promote livelihood security; reviews debt management and repayment strategies across credit systems and their implications for livelihood security; and evaluates the outcomes of MC, including a review of how success is assessed among MC providers.

The delivery of microfinance (MF) services, dominated by the delivery of MC but also including savings, remittance services and insurance, has become a global enterprise. The MC industry, and the later expansion to MF, grew out of a response to the failure of subsidised, government-sponsored rural credit programmes in many developing countries. These began in the 1950s in many regions, but came under significant criticism in the 1970s due to low repayment rates and politically motivated debt write-offs using public funds.⁹ However, the MF industry boomed from 1997 with the first global Microcredit Summit. The industry drew support from the prevailing development approach of the time, which emphasised market-based solutions to the problem of poverty.¹⁰

Both the subsidised government programmes and the MC industry justified their services through reference to the assumption of a large unmet

3 Microcredit is small loans extended to poor people for productive investment. In this study, it is referred to as microcredit (MC) and also as formal credit, since it is institutionalised, unlike informal credit.

4 Informal credit is defined as non-institutionalised ways of extending and receiving credit. Transactions often occur between people with some social relationship, and in the Afghan context informal credit has been found to be very flexible in terms of repayment.

5 Microfinance Investment Support Facility for Afghanistan, www.misfa.org.af (accessed 9 June 2009); figures to January 2009.

6 Jo Grace and Adam Pain, *Rethinking Rural Livelihoods* (Kabul: Afghanistan Research and Evaluation Unit, 2004).

7 Floortje Klijn and Adam Pain, *Finding the Money* (Kabul: Afghanistan Research and Evaluation Unit, 2007).

8 Klijn and Pain, *Finding the Money*

9 S. Johnson, and B. Rogaly, *Microfinance and Poverty Reduction* (Oxford: Oxfam & Action Aid, 1997).

10 Ben Rogaly, "Micro-finance Evangelism, 'Destitute Women,' and the Hard Selling of a New Anti-Poverty Formula," *Development in Practice* 6, no. 2 (1996): 100-112.; Johnson & Rogaly, *Microfinance and Poverty Reduction*; Geoffrey Wood and Iffath Sharif, "Introduction," in *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. Geoffrey Wood and Iffath Sharif, 27-58 (Dhaka: The University Press Limited, 1997).

demand for credit among the poor. Both felt they were filling this need, but with substantially different credit models. The former programme designers did not believe the poor could afford market interest rates and hence put interest rate ceilings in place. The MF industry, in response both to project failures in the subsidised programmes and knowledge that the poor do pay high interest on some credit (i.e. from informal money lenders), charges market rates which cover costs. It aims to create financially sustainable institutions.

Since 1997, MC has grown significantly in the developing world and is a case where practice in the Global South has shifted to the North. The growth in microfinance institutions (MFIs) and numbers of borrowers worldwide has fostered both academic and practitioner-oriented literature assessing MC and its impacts and tracing changes in delivery models and approaches. Interestingly, much of the MC practice in Afghanistan has not seemingly taken this analysis into account, perhaps due to the general press for action and achievement in the post-2002 period.

Interest in MC for the poor in Afghanistan started in the post-2001 period when both the Afghan Government and the donor community considered large-scale MF facilities within Afghanistan as a central component of sustainable development programmes.¹¹ Decades of conflict followed by severe drought left many Afghans decapitalised, as is evident in the respondent stories presented in the case study reports.¹² Large-scale credit provision was seen as necessary to stabilise livelihoods, improve productive assets and stimulate economic development and job creation. In August 2003, MISFA was established as a governmental apex institution to coordinate MC activities in the country. MISFA estimated that potentially two million households

were in need of credit—exemplifying the assumption that a large unmet demand for credit exists.

One important requirement for MFIs receiving credit through MISFA is achieving operational sustainability.¹³ This is a worthy goal in that donor dependence in the long term does not make for a stable and reliable financial services sector. However, given the cost structures and security constraints characterising the Afghan context, pressure to achieve sustainability quickly skews incentives for the MFIs, making them treat MC delivery almost solely as a business transaction as opposed to a development intervention. This model of MC, which takes a more commercial than developmental approach, reflects a more recent trend in the industry, which attempts to balance a cost-covering operation with stated poverty reduction and other social goals. The success of efforts to bridge both commercial orientation and poverty reduction aims is still debated, including within this paper.¹⁴

This synthesis paper draws out themes from the findings presented in the three village case study reports, comparing and contrasting them to identify themes that recur across sites and others that may relate specifically to a context but have broader relevance. In all cases, these themes are related to existing literature on MC to situate them within wider debates on MC theory and practice. Section 2 reviews the study contexts and the MFI programmes operating in the study villages. Section 3 briefly describes the methods used in the field work, including an overview of challenges faced in the field. Section 4 presents the study themes and findings before concluding and presenting recommendations in Section 5.

11 www.misfa.org.af

12 Paula Kantor and Erna Andersen, “Microcredit, Informal Credit and Rural Livelihoods: A Village Case Study in Kabul Province” (Kabul: Afghanistan Research and Evaluation Unit, 2007); Erna Andersen, Paula Kantor, and Amanda Sim, “Microcredit, Informal Credit and Rural Livelihoods: A Village Case Study in Bamiyan Province” (Kabul: Afghanistan Research and Evaluation Unit, 2008); Erna Andersen, and Amanda Sim, “Microcredit, Informal Credit and Rural Livelihoods: A Village Case Study in Balkh Province” (Kabul: Afghanistan Research and Evaluation Unit, 2008)

13 Operational self-sufficiency is the ability of an MFI to cover all administrative and financial costs with revenue. This is a less stringent measure than financial self-sufficiency which includes covering costs of loan losses, potential losses and inflation. www.gdrc.org/icm/glossary accessed September 9, 2007.

14 Wood and Sharif, “Introduction”; Thomas Dichter, “Introduction,” in *What’s Wrong with Microfinance?*, ed. by Thomas Dichter and Malcolm Harper, 1-6. (Rugby, UK: Intermediate Technology Publications, 2007); Scanteam, ARTF evaluation.

2. Methods

This study used a qualitative research approach to collect in-depth data from a small number of respondents in order to build a deep understanding of the use of formal and informal credit in their household economies. Semi-structured interviews were the primary method used, supplemented with focus group discussions and key informant interviews. The latter two tools were primarily used early in each field work phase to build an understanding of the history and economy of the village and to identify potential cases for household interviews.

The field team consisted of four Afghan field researchers, an expatriate supervisor and an expatriate intern. The Afghan field team included two females and two males to enable the team to interview both female and male members of all selected case households. This allowed the study to gain insights on the meaning of female-targeted MC lending, intra-household relations particularly around discussing financial matters, and women's informal credit interactions. It also made analysis, at times, complex as there were cases when very different accounts of household economic decisions or loan uses were obtained. This reflected in part a lack of information-sharing within the household as well as less willingness among one respondent to openly share credit-related information.

Field teams spent approximately six weeks, across two field visits, in each study village. This allowed them to make connections in the village and build the rapport needed to discuss personally sensitive information such as credit relations. The Kabul field work was conducted from February 2007 through late April. The Bamiyan research was completed next, from early June to mid-July 2007, and finally the Balkh field work was done from late July to late August 2007.

2.1 Site selection: provinces, districts and villages

One of the more difficult decisions to make in carrying out research is where to do it. Trade-offs between coverage and depth are central to this, and AREU tends to favour depth, which means spending more time in fewer locations. This necessitates carefully selecting those few case study locations. For this study, the process of selecting case study locations was influenced in part by an interest in representing different regions of the country for their differences in livelihood activities, ethnic background, remoteness, or exposure to conflict or other crises. This regional criterion was joined with the need to choose rural locations with high concentrations of MC borrowers and with a significantly long history of MC involvement to ensure the research team worked in more 'typical' MC villages where clients have had a chance to see some impact from their MC loans. These latter two criteria led to a focus on villages near key urban centres in some of the more stable Afghan provinces. A final criterion for selecting provinces and villages was representing different MFI programmes. This allowed the study to compare across programmes in terms of their products, processes and client satisfaction. Based on these criteria, Kabul, Bamiyan and Balkh were selected due to their intensity of MFI activity, history of MFI engagement and presence of three MFIs with very different programme approaches.

Selecting districts and then the study village in each province was more challenging. Primary selection criteria for the study village included: concentrations of MFI activity, in other words, where there were more clients; village receptiveness to involvement in the study; and distance from the centre for both logistical reasons and to ensure all sites had access to a central bazaar. Criteria related to vibrancy of village economies or prevalent livelihood activities became less prioritised mainly due to challenges in some cases in obtaining information about MFI client concentrations. This limited the scope for selecting a study site from a range of possibly

suitable villages. The three selected villages did provide important levels of contrast related to village economies, with one being hindered by after-effects of drought and conflict, even though close to Kabul; and two being in the recovery phase due to new crops (potatoes in Bamiyan) or cultivation methods (greenhouse production of vegetables in Balkh); both of those in recovery were still exposed to prevalent agro-ecological risks and hence were not immune from the need to diversify. These differences between villages had implications for the demand for and use of credit, as this paper shows. However, three villages cannot represent the diversity of environments in which MFIs provide MC and the villages have their own internal dynamics. Therefore, some findings are specific to the study villages. However, other characteristics related to low diversification of economic activities, the need for more investment opportunities and sequencing of interventions are not unique or unusual. The uses and outcomes of MC and informal credit in such circumstances form the basis of more general recommendations to MC providers.

In all cases, the field teams entered the study villages either independently or through an introduction from the National Solidarity Programme (NSP) facilitator. They did not enter with an association with any MFI. This was important for ensuring respondents felt comfortable speaking openly of their experiences with formal credit programmes. This is not to say that all respondents understood this independence right away. At times, it took much effort by the field team before respondents opened up and realised the team was only there to do research and was not linked to the MFI or any other nongovernmental organisation (NGO) which might provide aid. Much time was spent at the start of the field work in each village explaining who the team were, what AREU is and what the purposes of research in general, and this study were. Allocating time for this in each village before moving into household interviews was thus important to build rapport and trust.

2.2 Household case selection and interviews

Household cases were identified by gathering

general village-level information via focus groups with key actors like NSP *shura* (community decision-making group) members, loan group members, and shopkeepers, along with interviews with loan officers and other MFI local staff, including the malik (village leader) and the district officer. The team also walked through the village, stopping to informally chat with villagers to get to know people and their “stories” of credit. These stories formed the basis against which the team selected respondent households with every effort being made to collect a diverse base of stories from which to select, such as by socioeconomic status, livelihood base, uses and outcomes of credit, and reasons for lack of interest in MC. However, since the field team did not meet every household in the village, and the respondent households were not randomly selected, the case stories cannot be said to be representative of the villages.

Because of the depth of information required from each case-household, the field team selected eight households per village for in-depth interviews. This means the study is not a representation of all credit practices or experiences in the study villages. Instead, the study seeks to understand through cases selected for contrasts and diversity of experiences what types of credit practices exist in the village, how respondents viewed the entry and operation of MC and how this entry affected informal credit relations and livelihood security across the respondents. Household experiences of credit, both informal and formal and positive and negative, were one key selection criterion, as was diversity in livelihood activities. The study interviewed households both involved in MC programmes operating in the village and those that were not involved in order to compare credit access and use, livelihood activities and outcomes, and also to explore reasons given for joining and not joining. In most cases, four MC-borrowing households and four non-MC households were selected, with efforts made to ensure the households in both groups were not too different from each other in terms of livelihood portfolios and socioeconomic status, to enable comparisons to be made. In the Balkh case, instead of just two subgroups of respondents—those borrowing from MFIs and those who do not—there were three groups. This reflected the different

programme characteristics of the study MFI, which had considerably more stringent eligibility criteria for borrowing. The research team identified various households in the village who had considered borrowing and had become MFI members, but then did not take a loan as they could not, or would not, find guarantors. So the respondents in Balkh were MFI borrowers, those interested in borrowing but who could not, and those who opted out of the MFI's programme, even if initially interested.

Table 1 (page 6) provides basic information about the case-households—identifying name, location, livelihood activities and borrower or non-borrower household. In all cases, the names used for respondents are pseudonyms to protect their privacy. Village names are also not given for this reason. Case-study households tend not to include the poorest households, because they tend not to be common MC clients.¹⁵ MC clients tend to be the middle and upper poor and those somewhat above the poverty line, who have the assets (land or otherwise) from which to make investments with MC or from which they can base a livelihood largely free of credit for those opting out of the programmes. The mix of livelihood activities, and the presence in many respondent households of a mix of activities, are also not unusual for rural Afghanistan, particularly villages like those where MC first made forays that were closer to urban centres. In this way, while not selected to be representative, one cannot say the household cases are particularly unique or unusual of rural MC clients. The understandings gained from these households were not singular. This was further supported by the commonality of some experiences found across study villages, for example, the use of both informal and MC for investments in social relationships, and attempts to form a group so one person could take over the whole group loan.

In each household, male and female respondents were each interviewed twice to obtain a detailed picture of the household's livelihood portfolio, its engagement with both informal and formal credit systems and decision-making around this. The

first interview gathered information about every member of the household and their activities in the household—from household work, to studying, to working for pay—the family's experience of conflict and migration, and detailed information about its informal credit relations. This involved not only gathering detailed stories from the respondents, but also collecting numerical data regarding the credit given and taken by the household—how much, when, what it was used for, whether or not the credit had been repaid, and, if it had, how. The second interview focused on experiences with MC among those in the programme, and on opinions and knowledge of MC among those who did not join. Again, numerical data about the loans taken were collected, but emphasis was on a substantial discussion about the changes MC had brought to the household and village, with the field team probing for details based on the information gathered during the first interview.

Assessing the impact of an intervention is an extremely difficult task as there are often many changes happening at the same time. Therefore, specifying the effect of any one of them is problematic. In this study, to understand the impact of credit on livelihood security, the study team relied on household data on credit portfolios, expressed need for further borrowing, interest in further MC borrowing or programme drop outs, and repayment strategies, as well as respondents' subjective assessments of the MC programmes.

2.3 Challenges in the field

Conducting field research in any setting always brings challenges and this study is no different. Across the three sites, similar problems had to be overcome, related to independently selecting respondent households, maintaining respondent engagement, obtaining credit-related information and accessing female respondents.

In the Kabul and Bamiyan study villages particularly, the team faced intervention by powerful local actors who wanted to direct the team to particular respondents or who wanted, through their presence during interviews, to control the information other respondents provided. In the former cases, this

¹⁵ This is not only typical in the villages studied or Afghanistan. MC is not necessarily the most appropriate product for the poorest.

Table 1: Respondent information

Case identifier	Study location	MC borrower (yes or no)	HH size	Main livelihood activities
Jamila	Kabul	Yes	6	Vegetable and fruit vending
Nasima	Kabul	Yes	9	Police; selling generator connections; grape production; relative of <i>malik</i>
Qasim	Kabul	Yes	5	Shopkeeping
Akram	Kabul	Yes	11	Agriculture production; milk sales; mason work
Akbar ¹	Kabul	Yes	NI	Shopkeeping
Farooq	Kabul	No	9	Mason work; shopkeeping
Hamid	Kabul	No	6	Mason work; taxi service
Nilofar	Kabul	No	6	Soldiers; cotton preparation
Daud	Kabul	No	8	Teacher
Karim	Bamiyan	Yes	6	Shopkeeping, farming
Haleema	Bamiyan	Yes	13	Mini-bus transportation, farming, livestock, carpet-weaving
Zahra	Bamiyan	Yes	9	Wage labour, sharecropper
Ghulam Sakhi	Bamiyan	Yes	6	Wage labour
Latifa	Bamiyan	Yes	7	Farming, livestock, carpet-weaving
Sayed Jaffer	Bamiyan	No	11	Truck transportation, farming
Zarifa	Bamiyan	No	8	Cleaning at health clinic (only breadwinner)
Jamal	Bamiyan	No	10	Shopkeeping, farming
Sayed Hassan ²	Bamiyan	No	12	Landowner, job with INGO
Mukhtar	Balkh	Yes	9	Farming
Sima	Balkh	Yes	10	Wage labour, selling vegetables on the street during the winter
Murtaza	Balkh	Yes	7	Shopkeeper, livestock dealer, sharecropper
Haji Ahmad	Balkh	Yes	8	Livestock, wage labour, farming
Aslam ³	Balkh	Yes	10	Crop dealer, flour mill
Yaqoub	Balkh	No, but tried; KMFI	9	Farming, sharecropper, livestock
Khan Mohammad	Balkh	No, but tried	7	Farming, sharecropper, livestock
Shabana	Balkh	No but tried; KMFI	5	Teacher, crop dealer, farming
Rahim	Balkh	No, chose not to	10	Shopkeeping, farming

1 Akbar is Daud's brother; his household was initially identified as a possible case household, but Akbar at first refused. His brother's family was included due to their close credit connections. Akbar later consented to be interviewed himself as a key informant.

2 Sayed Hassan is a wealthy landowner and working with an international NGO. The team was unable to carry out full household interviews with him; he was then interviewed as a key informant due to his particular position in the village as a credit giver.

3 Aslam is a wealthy shopkeeper and a relative to Sima's household. The team did not carry out full household interviews with him; he was then interviewed as a key informant due to his link to Sima's MC loans.

benefit would accrue to those being interviewed. In the end, the field team's patience in explaining the study and lack of direct benefits, and the waning of interest among these parties over time, allowed the team to proceed with their work.

Two other challenges were common to all field sites. First, once the realisation that the team is only doing research becomes apparent among respondents and the novelty of their presence declines, people begin to question their presence and the purpose of the exercise. This requires the team to patiently explain again why research is important and the larger, indirect benefits that may come from the work. Second, since credit is a transaction that while important to livelihoods, also has considerable shame associated with it, overcoming this in getting respondents to share very personal credit-related information was a key challenge. This was something shared across all respondents, but was perhaps more common

among the relatively better off, who might also give credit to others, even charging interest. This has negative implications, making many wealthier potential respondents unwilling to participate in the study. As informed consent was needed prior to any interview, identified households in some cases could not be selected because members did not agree to participate.

A final challenge involved gaining access to female household members. In some cases, men of the household disapproved of this, meaning the research team could not pursue that household as a case study, due to the need for consent. If a case story was particularly interesting, for example, that of Akbar in Kabul, it might be included via a key informant interview, meaning the full four interviews (two with women and two with men) were not done. For this reason, there are nine respondents listed in all villages.

3. Study Contexts and MFI Programmes

This section provides details on the villages studied and the characteristics of the MFI(s) operating. This contextual information is very important for understanding the relevance of MC and client responses to it, as Section 4 shows.

3.1 Village contexts¹⁶

This section provides details on the locations of the study villages, the effects of conflict and drought and the main livelihood activities available. It paints a picture of livelihood risk and insecurity, where even the relatively well off are often only a crisis or two away from a severe decline. Household surpluses are not great or are nonexistent, and most live day-to-day or season-to-season. All study villages are near to a town centre, though the size of these centres varies across the study provinces. The declining significance of urban-rural links is consistent across study sites, most particularly in relation to casual wage-work opportunities. Two key variables relevant to livelihood security in the three villages are access to water—in part related to drought but also to decapitalisation during the Taliban's fight to claim territory—and seasonality. The Bamiyan village is more affected by the latter due to its extreme winters.

Kabul village

The Kabul province case-study village is located in Mir Bacha Kot district, about 20 km outside of Kabul city. On both sides of the main road into the district there are shops belonging to the main bazaar of the district centre. The village's connection to this district centre bazaar and its proximity to Kabul are important for understanding the economic dynamics of the village, followed by the villagers' experiences of drought and conflict. The peri-urban location of the village presents opportunities for trading and selling products from the village, mainly fresh and

dried grapes, in the Kabul *mandawi* (wholesale market). However, this potential is currently not fully realised due to the effects of drought on the village water supply and the destruction of the village's water source, the *karez* (canal), during Taliban rule. These experiences have had long-term effects on village asset holdings, influencing the impact MC can have on village livelihoods.

The study village is estimated to have 386 households, including both Tajiks and a small number of Dari-speaking Pashtuns. There are many sources of income generation, with the main ones being fruit-gardening; farming; shopkeeping; daily labour on agricultural land or in gardens and in non-farm activities like vending, transport or goods carrying, largely in Kabul;¹⁷ livestock-rearing; and salaried work. Production from fruit gardens and agriculture tends to be insufficient due to lack of water; they are mainly for personal consumption. While many families own chickens, it is not common for families to own cows and sheep. Some women who do own such livestock stated that they sell dairy products in the bazaar. Availability and cost of grass for grazing is one constraint on owning livestock.

Around ten families earn income from shops in a building in the big bazaar close to the main road in Mir Bacha Kot. The building is owned by the *malik*, who takes rent monthly from each shopkeeper. Inside the village itself, there are three small shops selling a limited variety of food ingredients, vegetables and sweets; there is also a flour mill and tailor. There are around 12 teachers working in the district school, a policeman who serves the district office and around 20 households have a member in the Afghan National Army in Bagram or in the police force in Kabul.

The majority of the women in the village do not

¹⁶ For more detail on the study villages see Kantor and Andersen, "Case Study in Kabul Province"; Andersen, et al, "Case Study in Bamiyan Province"; and Andersen and Sim, "Case Study in Balkh Province".

¹⁷ Some of the respondents reported that opportunities in Kabul are declining due to more competition for work. As a result, some have stopped going to avoid incurring transportation costs only to find no work.

work outside of their homes for income. Their work is primarily housework, child care and livestock rearing. Some women have handicraft skills. The team has recorded a couple of households with sewing machines, and some women say that they sew clothes for other people in the village, but not for payment. As the village is conservative in terms of observing female seclusion, it is rare that women of reproductive age go outside of their homes. Only elder women tend to go out to buy daily food. Women are responsible for drying grapes on the roofs of the houses. This is not an income-generating activity as most of the dried grapes are used for household consumption.

The *malik* holds significant power in the Kabul study village as the head of the Community Development Council (CDC) and through his wealth. He has accumulated relatively significant wealth, in part through his ownership of the building in the main district bazaar in which he rents out ten shops. He runs a pharmacy himself and also owns houses in the village, in which members of his extended family live. The *malik* is generally respected in the village, although some also believe he is corrupt and withholds assistance from the needy.

While the *malik* and people linked to him, either socially or through kinship, hold power and status in the village, another indicator of wealth and power is land ownership. Land holdings are generally recorded in terms of the number of grape vines owned. The number of grape vines owned by villagers range from between 13 at the low end, up to around 200-250. The latter is a large number and requires seasonal wage labour, which is another way to acquire power in the village as the owner becomes a source of income and perhaps credit for poor households dependent on wage labour.

Bamiyan village

The Bamiyan case study village is located in Bamiyan district and is approximately 15 km from the bazaar in the district centre; this is half-an-hour away by car or a 2.5 to three hour walk. Approximately 140 households live in the village—the majority of which are Sadat along with small Hazara and Tajik minorities. All are Shia Muslims. As part of the

implementation of NSP, an implementing partner established one male and one female *shura* three years ago.

The Bamiyan village was ravaged by three decades of intermittent armed conflict. By virtue of its proximity to the district centre and airport, it found itself on the frontline of the fighting during three separate periods. The Taliban conflict had a particularly devastating impact on the livelihoods and economic security of the study village. Roads to the Bamiyan bazaar were blocked and people were unable to access basic goods and services. The main assets of the villagers—namely, their houses, land and livestock—were either destroyed or seized by the Taliban. Villagers are still recovering from this decapitalisation, particularly in relation to livestock numbers. Lack of access to grazing land has also contributed to a shift from emphasis on livestock breeding to agricultural production.

Livelihood activities in the study village are quite diverse and include agricultural production, livestock-breeding, casual labour, trade, transportation and carpet weaving. In addition, a small number of villagers have monthly salaried employment as teachers and cleaners in the neighbouring school and clinic or, in the case of one prominent landowner, as staff of an international NGO (INGO). Livelihood activities are closely linked to the district centre where villagers buy agricultural inputs and sell their produce, restock their shops, transport passengers and goods and, in the case of women's work, contract with carpet weaving companies. Access to the district centre and the bazaar, however, is severely limited during the winter due to heavy snowfall and road blockages.

The majority of villagers are engaged in some form of agricultural production, either on their own land or as sharecroppers for one-fifth or one-sixth of the harvest. Respondents identified four individuals as *baay* (wealthy landowners) who have large landholdings ranging from five to 20 *jeribs* of land (1 to 4 ha), and who are the primary employers of sharecroppers and daily wage labourers. Most other villagers have smaller landholdings of one half to five *jeribs* (0.1 to 1 ha), or in a few cases, own no land at all. Approximately 75 percent of cultivated land is located in the valley and irrigated while the remaining is *lalmi* (rainfed land) in the mountains.

The main crop is potatoes. Many respondents attributed the recent improvement in the village economy to the switch from wheat to potatoes as the main cash crop. The main reasons for the switch include the higher market value of potatoes and the greater suitability of the land for potato cultivation. Other factors contributing to the improved agricultural economy in the village are knowledge of more effective farming techniques gained through previous experience, access to higher quality fertilisers, and the subsequent reopening of markets in Bamiyan, Kabul and Pakistan to the village.

A key resource for villagers is an agricultural cooperative that was established four years ago by the Ministry of Agriculture, Irrigation and Livestock and funded by an Iranian NGO. The cooperative owns four tractors and four threshers. The cooperative not only allows villagers to access heavy farming equipment that would otherwise have been too expensive to purchase, but it also provides wage-labour opportunities in facility construction and equipment maintenance.

The village is still recovering from the loss of livestock that occurred during the Taliban era. Most of the interviewee households' livestock holdings ranged from one to four cattle, one to two oxen, one donkey and one to six sheep. Both female and male household members collect fodder for livestock as well as bushes and dung for fuel in preparation for the long winter season.

In the winter, almost all villagers are without work due to the heavy snowfall in the area. Household goods such as flour, cooking oil, rice and, in particular, fuel, are stocked before the first snowfall and often become scarce toward the end of the season. Farmers must obtain agricultural inputs shortly after the winter as they prepare their fields for planting. Hence, the need for cash and credit either for stocking up or for investing in agricultural inputs is greatest in the late fall and early winter and again in early spring.

During the spring and fall when labour-intensive opportunities exist, a number of villagers, mostly the landless or those with very small landholdings, derive part of their income from casual labour in carpentry, masonry, construction and on-farm work.

Some occasionally go in search of wage labour in the Bamiyan bazaar, but the work is scarce and usually not worth the total expense of travelling to and from the village (60 Afs). Wage labourers are typically paid between 180 and 200 Afs per day (\$3.60 and \$4 per day).

A number of small business ventures, such as shopkeeping as well as passenger- and goods-transportation, have been undertaken in the village in the last three years. Currently four shops in the village sell basic household goods, groceries, fertiliser and gas; six to seven villagers have shops in the Bamiyan bazaar.

All women in the study village are engaged in domestic work, tending livestock, and collecting fuel and fodder, but some also participate in agricultural activities such as weeding as well as cleaning and sorting potatoes during the harvest season. In addition, many women and children work inside the home tailoring, doing embroidery, spinning yarn and weaving carpets—the latter two activities are the most prevalent.

Balkh village

The Balkh case study village is approximately 20 kilometres or half an hour by car from the provincial capital of Mazar-i-Sharif. The main ethnic group in the village is Arab, followed by Tajik and Pashtun. The Pashtuns migrated from the southern and eastern regions of Afghanistan approximately 80 years ago, and are now Dari-speakers. The village was left relatively unscathed by the conflicts of the mujahiddin and Taliban eras, primarily because Balkh was for many years a stronghold of General Abdul Rashid Dostum. Respondents generally reported only one or two instances of migration during clashes between the Taliban and Northern Alliance factions.

The study site contains approximately 300 households, and is part of a larger village that is informally divided into sub-villages affiliated with separate mosques. As part of the implementation of the NSP, an implementing partner established one male and one female *shura* four years ago. Many households in the village are members of

a milk collection centre established by the Food and Agriculture Organisation (FAO) in 2003, which, in conjunction with a U.S.-based dairy company, constructed a dairy processing factory in August 2007. In addition, FAO established four livestock cooperatives whose membership is made up of livestock owners from the study site and surrounding villages. According to the male *shura*, a Thai NGO was also working on animal husbandry in the village and had vaccinated and treated 3,000 livestock in the area. A school and a health centre are located in a neighbouring village. Villagers also described travelling to Mazar city to receive medical care.

Livelihood activities in the study village are quite diverse, and include agricultural production, livestock breeding, casual labour, trade, and in the case of women, domestic labour, tailoring and the sale of food items. Village livelihoods are closely linked to Mazar city, mostly through trade but also through wage labouring and the cultivation of land belonging to those originally from the village but now living in the city. In general, villagers travel to and from the city every two weeks in order to purchase items unavailable in the six shops of the village, which sell only basic household items such as flour, oil and gas. Village shopkeepers also travel to Mazar city every two or three weeks in order to buy goods from wholesalers in the bazaar to replenish their stocks.

The majority of villagers are engaged in some form of agricultural production, either on their own land, as sharecroppers for half of the harvest, or as daily wage labourers during the labour-intensive planting and harvesting periods. The practice of leasing land, and to a lesser extent, mortgaging land, was also reported in the village. Respondents identified five individuals as *baay* in the village who have landholdings of approximately five to six jeribs, while most other villagers have smaller landholdings of half a jerib to five jeribs (0.1 to 1 ha) or, in some cases, own no land at all. Some villagers work as sharecroppers or wage labourers cultivating others' land. Cultivated land within the village itself is irrigated, but villagers also grow wheat in rainfed land in the surrounding mountains.

The main crops are wheat, cotton and vegetables,

such as tomatoes, onions and cucumbers. Agricultural production was adversely affected by drought during the Taliban period, as well as the continuing infestation of locusts and melon flies. Some respondents cited the recent and successful use of pesticides in controlling the problem. The production and sale of cucumbers, in particular, have boomed since the introduction of the greenhouse, most likely by returnees. Farmers can continue to grow cucumbers in the winter season and sell them for a high price when availability is scarce. While this new technique has improved production, it has also had the effect of entrenching informal credit relations between farmers and shopkeepers in Mazar city.

The majority of households own some livestock including cows, sheep, donkeys or goats. Some villagers derive a significant part of their income from the breeding of *qaraqul* sheep, a particular species whose skins are prized for their unique color and texture. Another source of income from livestock is the sale of milk to the milk collection centre described earlier. Women are the ones typically involved in this activity.

A number of villagers, typically those with very little or no land, derive part of their income from casual labour in construction and on-farm work during the labour-intensive planting and harvesting seasons in the spring and fall respectively. Some occasionally go in search of wage labour in Mazar city, but lately there are less casual labour opportunities. Wage labourers are paid between 150 and 200 Afs per day, and must usually combine this work with other livelihood activities in order to generate enough income for the year.

Livelihood activities vary according to season: in the summer and fall, villagers are engaged in harvesting their production, either from their own land or as sharecroppers and wage labourers on other people's land. The summer and fall seasons are also when villagers graze their livestock and collect fodder and fuel in preparation for winter. During the winter, livestock owners tend to their animals indoors and farmers cultivate cucumbers. This is typically the season when villagers are most cash poor and often resort to buying household goods,

fodder, fuel and agricultural inputs on credit. Debts are then repaid in the early spring when lambs are born and their skins sold, or farmers harvest and sell their cucumber production.

All women in the study village are engaged in domestic chores, tending livestock, and collecting fuel and fodder. Some women assist their male household members in agricultural activities, particularly during harvest time. In addition, many women sell milk to the milk collection centre, as described previously, or engage in home-based work such as tailoring and yarn spinning. Some women also bake bread at home for sale in the bazaar in Mazar city, or work as domestic help in other people's homes for payment in-kind, although this latter activity appears to be conducted predominantly by widows.

3.2 MFI programmes

Table 2 provides a comparative picture of key characteristics of the four MFI programmes operating in the study villages. Prefixes denote the location of operation,¹⁸ but note that the Kabul MFI (KMFI) actually operated in all three study villages.

All of the MFIs, including Balkh Microfinance Institution (BMFI), Bamiyan Microfinance Institution 1 (BmMFI1) and Bamiyan Microfinance Institution 2 (BmMFI2) had at least two to three years of lending experience in the study villages at the time of field work, meaning clients had the opportunity to go through multiple lending cycles. They varied in their stated programme aims; all reported that improving access to credit is part of their mandate. However, some included poverty reduction or income improvements and other economic development outcomes (KMFI, BmMFI2) while others focused also on women's empowerment (KMFI, BMFI). KMFI is the most broad-ranging in its objectives, including providing access to sustainable financial services, empowering women and reducing poverty.

Little to no effort is made to directly assess client demand for credit or existing credit products

before MFIs enter a village. BmMFI1 is the only one mentioning some assessment of demand for credit but notes this does not include understanding the informal credit systems operating locally. Otherwise, MFIs tend to enter villages via local leaders, such as the NSP *shura* members, and rely on programme information trickling out from there. This tends to be a male-dominated mode of information dissemination and can lead to uncertainty about programme objectives and rules.¹⁹ Because KMFI directly targets women borrowers, there was more effort to hold group meetings in women's homes.

All of the MFIs offer some form of group-based lending. For KMFI and BmMFI2, only group-based loans are offered in the study villages. The group members in all cases guarantee each other, though most of the group MFI products also require other forms of collateral—such as savings deposited with the MFI, approval from a village leader or a guarantor to back the group loan. The savings deposits are often not available for use on demand, even if MFI rules may state they are. In practice, they are held in case of default, and some respondents report using these savings to make up missed repayments.²⁰ Group loans tend to be smaller than individual loans and are offered to poorer clients or those with less access to collateral in the form of land or guarantors.

Individual loans are offered by two of the MFIs (BmMFI1, BMFI). They are larger in size and have collateral requirements in terms of guarantors (BMFI) or property documents and approval by village leaders (BmMFI1). At the time of the field work, BMFI had the most stringent eligibility requirements while the BmMFI2 the least.

BmMFI1 offers the most flexible loan products and makes the effort to match loan terms and repayments to rural cash flows. This is particularly the case with their agriculture and livestock loans which have six and eight month grace periods

¹⁹ See Kantor and Andersen, "Case Study in Kabul Province"; Andersen, et al, "Case Study in Bamiyan Province"; and Andersen and Sim, "Case Study in Balkh Province" for more information.

²⁰ See Kantor and Andersen, "Case Study in Kabul Province"; Andersen, et al, "Case Study in Bamiyan Province"; and Andersen and Sim, "Case Study in Balkh Province".

¹⁸ K = Kabul; Bm = Bamiyan; and B = Balkh

Table 2: Characteristics of microfinance institutions

Characteristic	KMFI (also in Bamiyan and Balkh villages)	BmMFI1	BmMFI2	BMFI
Date entered village/district	2004	2004	2005	2004
MFI aims	Create self sustaining financial service programme. Poverty reduction. Women's empowerment.	Build appropriate and accessible financial services in rural areas.	Provide MC to poor and low-income men and women to stabilise and increase incomes, create jobs and expand businesses.	Provide access to high quality and affordable financial services via a credit union model. Sharia compliance. Women's empowerment.
Village entry	Survey to identify poor villagers. Group meetings to tell people about MC programme.	Survey to assess demand; not including informal credit systems. Information given to NSP <i>shura</i> ; NSP <i>shura</i> to pass on the information.	Dependent on NSP <i>shura</i> to spread information. Posted some notices.	Provide information to village leaders; meeting in mosque to give some information. Orientations take place in Mazar, where interested individuals obtain more specific information.
Loan products offered in study village and terms	Group loans, poverty focused: 5-10,000 Afs.	Solidarity group loans: Loans from US\$30-300. Groups submit repayments as a unit. Agricultural loans: group or individual; maximum of US\$800 for each group member; individual agricultural loans from US\$100-1,000. Livestock loans: same as agricultural loans except for grace period.	Solidarity group lending model: initial loan of US\$300 per group member, for period of 6-12 months. Loan sizes grow if repaid successfully.	Individual loans: to credit union members. Size depends on use and borrower's asset status. Group loans: for poorer clients; no membership required but must save. Group can take maximum 250,000 Afs. Group decides who receives how much.
Other services/products	Savings (6% return). Death benefit (5,000 Afs).	None	None	Savings; earn 3-8 percent dividend (i.e. Sharia compliance) depending on MFI's performance.
Eligibility criteria	Poverty focused group loans: must save 5% of loan amount and buy passbook. Approval by <i>malik</i> or <i>shura</i> , who bear some risk to ensure repayments are made. One HH member can hold a loan. No loans from other MFIs.	Individual assessment of client creditworthiness. Local <i>shura</i> members or <i>malik</i> verify creditworthiness but are not guarantors. Solidarity group members do not require property documents; other loans do require this.	National ID card and member of a group. Age 18-80 and able to work. No family members in same groups. No property document required.	Individual loans: CU membership (fee 100 Afs); save 20% of loan amount. Have employment or a skill. Creditworthiness assessed by loan officer. 2 guarantors with registered businesses in Mazar city (shifting to <i>shura</i> -based referral system) Group loans: no membership required. Collectively save 25% of total group loan. Previously needed one Mazar-based business as guarantor; now repayment capacity and <i>shura</i> approval sufficient.

<i>Characteristic</i>	<i>KMFI (also in Bamiyan and Balkh villages)</i>	<i>BmMFI1</i>	<i>BmMFI2</i>	<i>BMFI</i>
Interest rate	17.5% of loan.	18% of the loan amount annually but charged as 1.5% monthly. Repaid from start of loan period.	18% of the loan amount.	2% per month on outstanding balance.
Repayment terms	Weekly repayments start after one week; 47 week loan term 98% repayment rate	Solidarity groups: repaid over 3-6 months, depending on use and repayment ability. Agricultural loans: 6 month grace period; total loan repaid in 24 months from loan date. Livestock loans: 8 month grace period; total loan repaid in 24 months from loan date.	Monthly repayment for all loan uses. Group leader collects members' repayments. 100% repayment rate.	6 month loan term. Business use: monthly repayments. Agriculture or livestock use: 3 month grace period; then repay in the 6 month term.
Late fees	Afs 50 per day.	0.15% of loan per day.	No information.	1% of that month's payment. Forgiveness and extensions possible if board approves.
Operational sustainability	In 2007, 82% of costs covered.	In 2007, 118% costs covered.	In 2007, 58% of operating costs covered.	No information
Flexibility; Loan officer discretion	None; fixed programme.	Loan officers decide type of loan and specific terms. Loan officer monitors use.	Loan officer works with borrowers to make repayment schedule. Loan officer monitors loan use.	Decides creditworthiness of individual borrowers and loan size.

respectively. The MFI is well liked for this reason and for its relatively large loans. BMFI also offers a relatively longer grace period for its loans used for agriculture or livestock. KMFI's weekly repayment structure was problematic in all case study villages. While its loan sizes were small, many still struggled to find the money to repay due to the short grace period (one week) and mismatch of repayment periods with household cash flows.

Only KMFI offers a financial service apart from credit or savings. It offers clients a death benefit to be paid to a specified beneficiary if the borrower should die.

Interest rates do not differ substantially across the study MFIs. They are charged at commercial levels to support the MFIs' aims to achieve operational sustainability, something MISFA and its donors strongly support. BmMFI1 is the only one at the time of the study covering all of its operational costs, though KMFI and BmMFI2 had a goal of achieving this in 2008. As we will see, interest charges raise problems in some study areas due to interest being *haram* (not in accordance with Islam). However, context matters to the acceptability of MC and its interest charges, as Section 4 illustrates.

BmMFI1 was the most decentralised among the

MFIs in terms of the scope of action given to loan officers. Loan officers decided the type of loan to give a client and the loan terms, based on loan use. BMFI also provided staff with the responsibility of assessing creditworthiness and loan size in line with this. KMFI put the most responsibility on its loan officers, particularly for on-time repayments. They are the only MFI staff reporting having their salaries cut to make up for late repayments among their clients.²¹ This led to rather unpleasant client-loan officer relations, and an unwelcoming attitude to KMFI in the study villages where it

was operating.²² Some of the MFIs made efforts to monitor loan use but most did not have the staff to do this systematically. Thus, credit was often used for a range of both consumption and productive purposes, even given the stated aim of lending for productive use. This is not surprising given the marginal livelihood activities found among many respondents in the study villages. No MFI reported monitoring how clients found the money to repay or the impact of the loans on livelihood security.

21 See Kantor and Andersen, “Case Study in Kabul Province” for more details about the MFI staff responsibilities.

22 See Kantor and Andersen, “Case Study in Kabul Province”; Andersen, et al, “Case Study in Bamiyan Province”.

4. Themes and Findings

This section analyses the credit experiences of the respondent households. It draws comparisons across village contexts, credit programme characteristics and households to explore the study's key questions about access to and demand for credit, the meaning of credit in rural livelihoods, and the outcomes of MC borrowing on poverty reduction and livelihood security. Given MISFA's emphasis on institutional performance and viability, the section ends by assessing how this focus affects attention to client viability. As appropriate, the themes and findings are placed within the general MC literature to illustrate their broader relevance.

4.1 Access to and demand for credit

This section examines access to and demand for credit. Evidence from the household cases is used to determine whether there is a lack of access to credit in the study villages and if so, for whom and under what circumstances. This section also assesses how credit programme characteristics affect demand for MC and under what circumstances strict eligibility criteria may limit instead of extend access to MC.

Informal credit, MC and the question of access

The aim of major MF actors globally and in Afghanistan to extend access to credit to the poor²³ implicitly assumes that the poor lack access to credit. During the boom time for MC in the mid-1990s, claims about the large unmet demand for credit and about MC's role in poverty reduction were called a "new evangelism." By this was meant that beliefs that MC would support viable self-employment activities and bring reductions in poverty were strongly held if not always empirically established.²⁴ This period also marked a shift from

viewing MC as a development intervention to viewing it as a commercial activity, which could achieve its aims through large scale delivery and operationally sustainable MFIs.²⁵ Later sections of this paper address the commercial orientation of MC in Afghanistan. This section focuses on the assumptions about a lack of access to credit in rural Afghanistan that have been used to justify rapid expansion of MC.

MISFA takes a commercial approach to MC provision. It identifies its objectives as increasing client outreach and improving MFI sustainability, and its website focuses on the need to extend credit to the lower end of the financial sector. However, a change in its rhetoric around access to credit is notable in a recently released report that describes the role of MC as filling a gap between the informal credit system and the banking system in Afghanistan.²⁶ This is a positive shift in language, highlighting recognition of the presence and use of informal credit among the poor and non-poor in Afghanistan. However, as the discussion to follow will show, these words need to find their way into action; knowledge of informal credit systems must feed more directly into the design, development and delivery of MC programmes. To do this, MFIs must find the human and financial resources to invest in building this knowledge base.

Evidence from this study, both from MFI interviews and from household interviews, suggests that in considering potential client demand and developing MC products, little to no assessment has been made of existing informal markets and their strengths and weaknesses. Therefore, the extensive informal

Practice 6, no. 2 (1996): 100-112.

25 Iffath Sharif, "Poverty and Finance in Bangladesh: A New Policy Agenda," in *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. by Geoffrey Wood and Iffath Sharif, 61-81 (Dhaka: The University Press Limited, 1997).

26 Microfinance Investment Support Facility, "Microfinance: Making a Difference in Afghanistan" (Kabul: Microfinance Investment Support Facility for Afghanistan, 2008), 1.

23 Microcredit Summit Campaign website, www.micocreditsummit.org, (Dec 27 access); and MISFA website.

24 Ben Rogaly, "Micro-finance Evangelism, 'Destitute Women', and the Hard Selling of a New Anti-Poverty Formula," *Development in*

credit arrangements active in rural Afghanistan are not factored into decisions about which areas MFIs should provide MC in and what products to offer. In interviewing representatives of the MFIs operating in the study villages, none assessed existing informal credit markets and how they operate within their village entry procedures. KMFI enters a new village through conducting a survey of poor households who are approached to join the programme; BmMFI1 enters with an assessment of demand for its services that does not explicitly include a review of existing credit sources and systems; a similar process is used by BmMFI2, focused more on determining client demand and the suitability of the context;²⁷ BMFI enters villages more to disseminate information than to assess client demand or existing credit systems. However, BMFI reports that offering an alternative to existing informal credit relations between farmers and agricultural input suppliers is one motivating factor. Its ability to do this was limited at the time of the study, as will be shown in the section on barriers to access, due to the strict eligibility criteria it had in place.

This lack of information gathering about informal credit systems is a gap according to recommendations found in some of the MC literature. Some well-known MC practitioners recognise that good product design depends on knowledge of the context and customers.²⁸ This includes knowledge of the financial services already available, why they are used and what borrowers like and dislike about them. Such knowledge allows MFIs to avoid a blueprint approach—offering the same products in the same way to all potential clients—which serves the interests of neither the clients nor the MFIs.

27 An MFI interview noted that an assessment was conducted in Badakhshan about starting the programme there. However, the presence of poppy traders, who threatened staff, made the MFI decide against expansion at that time.

28 Rogaly, “Microfinance Evangelism”; Johnson and Rogaly, *Microfinance and Poverty Reduction*; Geoffrey Wood, “Breaking Out of the Ghetto: Employment Generation and Credit for the Poor,” in *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. by Geoffrey Wood and Iffath Sharif, 289-305 (Dhaka: The University Press Limited, 1997); Iffath Sharif and Geoffrey Wood, “Conclusion,” in *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. by Geoffrey Wood and Iffath Sharif, 371-379 (Dhaka: The University Press Limited, 1997); Stuart Rutherford, *The Poor and Their Money* (Delhi: Oxford University Press, 2000); Raja Ehsan Aziz, “Microfinancing in Afghanistan: Strategies and Options” (Kabul: Acbar, 2000).

Being able to invest more in building knowledge of informal credit systems can assist MFIs in understanding how their products may complement or displace existing credit products, and what the costs and benefits of such changes may be for poor clients.²⁹ Investing the time to understand local credit systems can also lead to more responsive and innovative MF products, which are more widely accepted.³⁰ This can only help both MFIs and client livelihoods to become more viable.

The lack of attention to informal credit systems in rural Afghanistan is detrimental to MC programme design according to the evidence from previous research by AREU on informal credit systems,³¹ and from household interviews in this study. Table 3 provides compiled data on credit borrowed from both formal and informal sources among the households interviewed for this study. It illustrates numbers of loans taken in the past three years; average loan sizes; total credit obtained; and loan uses. This data strongly illustrate that access to credit has not been, and is not currently, lacking; informal credit markets exist in all of the study villages, and some respondents can access quite large loans from informal sources for both consumption and investment purposes. Informal systems provide access to significant amounts of credit in the study villages, in some cases in amounts equal to average loans sizes from MC programmes. Informal loans generally are given *qarz e hasana* (credit that is without interest or any benefit to the lender) and on highly flexible repayment terms based in notions of reciprocity.³² The table also illustrates the mixed uses of formal credit. While MFIs lend for productive use, the reality is that MC is used for a range of both production and consumption uses. The paper

29 Rogaly, “Microfinance Evangelism”; Johnson and Rogaly, *Microfinance and Poverty Reduction*.

30 Hugh Allen, “Finance Begins with Savings, Not Loans,” in *What’s Wrong with Microfinance?*, ed. by Thomas Dichter and Malcolm Harper, 49-59 (Rugby, UK: Intermediate Technology Publications, 2007).

31 Klijn and Pain, *Finding the Money*.

32 See Kantor and Andersen, “Case Study in Kabul Province”; Andersen, et al, “Case Study in Bamiyan Province”; and Andersen and Sim, “Case Study in Balkh Province”.

Table 3: Access to credit among respondent households

<i>Case identifier</i>	<i>Number of loans*</i>	<i>Average loan size (Afs)</i>	<i>Total credit obtained</i>	<i>Loan uses</i>
Kabul (KMFI)				
Jamila				
informal	5	4600	23000	Working capital; car rent to hospital; MC and informal credit repayment; daily needs
formal	1	12000	12000	Medical costs; daily needs; loan repayment
Nasima				
informal	15	7133	107000	Goods for electrical business; fertilizer & seeds; to lend on to nephew; medical treatment; daily needs; funeral costs; wedding costs
formal	3	6000	18000	Medical treatment
Qasim				
informal	8	10400	83200	To start shop; marriage costs
formal	3	10000	30000	Stock for shop
Akram				
informal	8	5475	43800	Daily needs; fuel for well; garden wall; MC repayment
formal	4	9750	39000	House repair; garden investments; daily needs
Akbar				
informal	2	30000	60000	Goods for shop
formal	13	10000	130000	Repay informal credit; stock for shop
Farooq				
informal	7	15214	106500	Goods for shop; rent for shop; migration costs; medical treatment; funeral; daily needs
formal	0	0	0	
Hamid				
informal	2	17500	35000	Wedding costs; purchase taxi; daily needs
formal	0	0	0	
Nilofar				
informal	8	10500	84000	Wedding costs; medicine; daily needs; water pump
formal	0	0	0	
Daud				
formal	3	1327	3980	Daily needs
informal	0	0	0	
AGGREGATE				
Informal	58	9422	546,480	
Formal	24	9542	229,000	

Case identifier	Number of loans	Average loan size (Afs)	Total credit obtained	Loan uses
Bamiyan (BmMF11, BmMF12, KMFI)				
Karim				
informal	2	50000	100000	Open butcher shop; wedding costs
formal	3	58333	175000	Business start up; inputs for business; new business start up after butcher shop failed; wedding costs
Haleema				
informal	4	105000	420000	Land purchase; fertilizer; wedding costs
formal	6	33667	202000	Vehicle purchase; daily needs
Zahra				
informal	13	3930	51100	Daily needs; MC and informal loan repayment; clothes; medical costs; fuel
formal	4	14000	56000	Livestock purchase (for trade); daily needs; gave up 1 BmMF11 & 1 BmMF13 loan to others (Afs 33000)
Ghulam Sakhi				
informal	12	9573	114870	Fuel and oil for generator business; ceremony cost; daily needs; fertilizer; repay MC loans
formal	6	25000	150000	Fertilizer & seed; daily needs; tractor rent; repay informal credit taken to repay MC; mortgage in land; gave some of BmMF12 & 3 loans to others
Latifa				
informal	2	9500	19000	Farming; daily needs
formal	5	21200	106000	Buy livestock; fertilizer & seed; pay farmer; daily needs; gave 10000 Afs to Haleema
Sayed Jaffer				
informal	2	36000	72000	Truck rental; truck repair; farm costs; fertiliser
formal	0	0	0	
Zarifa				
informal	1	5000	5000	Daily needs; medical treatment; ceremony cost
formal	0	0	0	
Jamal				
informal	4	6250	25000	Stock for shop; ceremony costs (clothes)
formal	0	0	0	
AGGREGATE				
Informal	40	20,174	806,970	
Formal	24	28,708	689,000	

Table 3: Cont. Access to credit among respondent households

Case identifier	Number of loans	Average loan size (Afs)	Total credit obtained	Loan uses
Balkh (BMFI & KMFI)				
Mukhtar				
informal	2	57500	115000	Agricultural inputs; leased land
formal	5	22400	112000	Agricultural inputs; wage labourers; daily needs; sewing machine; home furnishings
Sima				
informal	18	3596	64720	For deposit of BMFI1; fertilizer; repay MC; daily needs; wheat for winter; tractor rent; repay informal credit
formal	7	14571	102000	Bought livestock; daily needs; turned over loan to Aslam; MC repayment; fodder
Murtaza				
informal	7	10929	76500	For deposit of BMFI1; MC repayment; agricultural inputs;
formal	3	91667	275000	Agricultural inputs; daily needs; start livestock trading work; repay informal credit used to pay MC
Haji Ahmad				
informal	8	3250	26000	Repay MC; food and salary for shepherd; fodder for animals; medical costs
formal	2	15000	30000	Sheep fodder; daily needs
Yaqoub				
informal	12	3625	43500	Daily needs; medical treatment; wheat thresher and wages; clothes for wedding; seeds; bought calves for trade; tractor rent
formal	3	11333	34000	Sewing machine; bought calf but sold it to make repayments; daily needs; school supplies (BMFI2)
Khan Mohammad				
informal	8	8138	65100	Medical costs; BMFI1 deposit; winter clothes; agricultural inputs
formal	0	0	0	
Shabana				
informal	6	4492	26950	Agricultural inputs; daily needs; winter clothes; borrowed to lend on to relative in need; repay BMFI2
formal	2	14000	28000	BMFI2: gold jewelry; home improvement
Rahim				
informal	6	13083	78500	Stock shop; agricultural inputs; daily needs
formal	0	0	0	
AGGREGATE				
Informal	67	7,407	496,270	
Formal	22	26,409	581,000	

*Note that for formal loans the loans may have been taken at one time, and not have been spread over the three-year recall period.

returns to this theme in Section 4.3 in discussing the risk reduction effects of MC in the rural Afghan context. Examining some cases better illustrates these issues of access. Farooq, a non-microcredit respondent in Kabul, is a mason who finds work irregularly. To diversify his income, he recently opened a shop, renting the premises for his son to run. He also has a garden with 500 vines but no reliable water so only earns irregular income from this source. He opted out of MC due to its association with *sudh* (interest), but this does not mean he is constrained in his credit access. Stocking the shop was a large investment, one for which MC is highly suitable (and others in the village have used MC loans for this purpose); however, Farooq was able to rely on revolving credit from wholesalers in the Kabul *mandawi* (wholesale market) to buy goods. Thus, he was able to obtain significant amounts of business credit from informal sources, as well as informal credit for consumption uses.

Karim from the Bamiyan village is an example of a respondent able to access large sums of credit from both formal and informal sources. Like many, he used credit from both sources for consumption and productive uses, in many ways not differentiating credit use by source. His average loan sizes from both systems were comparable, and he obtained significant sums of credit from both over the three year period. This reflects his social and economic status in the village—his perceived creditworthiness. His case illustrates an expansion of access to credit, with MC adding to existing informal sources. However, whether or not expanded access to credit was good for his livelihood security is a separate issue.

Haji Ahmad is a case from Balkh which shows a different aspect of access. While some, like Karim, could obtain similar average loan sizes from informal and formal credit systems, Haji Ahmad could not; the amount he could obtain on average from informal sources was considerably lower than what was offered from MFIs operating in his village. This likely reflects his poorer socioeconomic status relative to other respondents, and his perceived lower capacity to bear larger loans from informal sources. It also may reflect the lower capacity of his credit network to provide larger informal loans.

However, his credit network is strong and diverse so he could obtain many small informal loans, meaning in total he borrowed at similar levels over the three years from both systems, using the credit obtained for both consumption needs and productive uses. He had access to informal credit both prior to MC's availability, and after opting into the formal credit system.

These brief case studies highlight the existence of demand for credit from both systems, and the ability of most respondents to obtain credit from either to fund a range of needs. They show that for some, MC is an additional, not sole, source of credit, with implications for debt burdens.³³ Therefore, this does not support the assumption that prior to MC entering the study villages, a lack of access to credit existed. People could borrow to meet both productive and consumption needs, and for some, at levels comparable to those offered in the MC system. Hence, providing access to credit is not enough justification for the expansion of MC to rural Afghanistan. MC does not enter an empty credit market; it enters a market operating with considerable complexity, in which MC products must compete. MC must provide products complementing and improving upon what the informal system offers, and what other MFIs offer, in order to retain clients and ensure positive impact on livelihoods. As later sections will show, the formal system is not quite there yet. One step that could move it closer to this aim is developing a better understanding of how MC products interlink with existing informal systems.

Informal and formal credit linkages

A close look at the loan uses in Table 3 points to clear linkages between formal and informal credit systems in the study villages. The existence of these links supports the need for MFIs to invest time and other resources in understanding the role of informal credit in rural livelihoods, and in their own programmes' success.

³³ The issue of debt burdens is not only relevant to MC but to informal credit as well, as both forms of credit need to be repaid, though often on different terms.

Often the links between the credit systems start from a need to find the money to meet a MC repayment deadline, with many borrowers turning to informal sources. However, Akbar's story is different. His story starts from a large informal loan taken from a close friend that needs to be repaid. This need led him to the KMFI for credit.

Akbar opened a shop in the village in 2004 after being jobless for six months after his return from Iran. In order to stock the shop, he took a small loan from a village friend and a large loan from a Kabul wholesaler (Afs 50,000), whom he knew from their mujahiddin days. Over time, Akbar, like many village shopkeepers, ended up selling too many goods on credit. Slow repayment from villagers and his inability to implement strict collection practices due to social norms meant Akbar quickly ran into trouble in keeping the shop stocked sufficiently to earn enough to meet daily needs and debt repayments. His wholesaler friend was pressing him to repay. In order to maintain that social relationship, Akbar turned to the KMFI for loans, since he could not raise the required sum from informal sources in his network. Akbar took five loans over three loan cycles with the KMFI. He broke the programme's rules to take more than one loan per cycle, using his son's and brother-in-law's names to get the extra loans. This money was repaid to the friend, at the cost of restocking the shop. Therefore, shop earnings fell dramatically leading him to take more credit from the KMFI to stock the shop. At the time of the interview Akbar held an unsustainable level of debt—having eight loans outstanding for a weekly repayment of 2,400 Afs. Credit from the KMFI helped him preserve his status and friendship, an investment in a social asset. However, the low returns of his shop linked to the inability of customers to repay in-kind credit meant he could not recover economically from this investment.

Sima's and Ghulam Sakhi's stories show the more-often found linkage between the two credit systems. Sima is a respondent from the Balkh study village. Her household is among the poorer ones in the respondent group. She and her husband borrowed from the BMFI via group loans, but also gave up part of one of the loans

to a relative after they found they could not afford the repayments. The household relies on Sima's husband's income from wage labour, and savings from Sima's work in silk production. They took MC from the BMFI for livestock purchases, but found this activity unprofitable.³⁴ Also, some of the husband's loan was used for consumption, adding to repayment problems. One can see in Table 3 that they used loans from both MC and informal sources for MC loan repayment. This means they held back some of the MC funds to directly repay the MFI. This is not uncommon, particularly for borrowers from the KMFI with its weekly repayment structure. Sima and her husband also borrowed informally to meet repayments and the deposit requirement of the BMFI, meaning they then had to find the money to repay these loans. This strategy buys time and saves money, since informal credit is typically interest-free and offers flexible repayment periods. These characteristics of informal credit therefore support the success of MC, keeping its repayment rates high, though at sometimes considerable cost to borrowers.

Ghulam Sakhi has a similar story. He has taken multiple loans from the BmMFI1 (and from the two other MFIs), and has ended up in a debt cycle due in part to his need to rely on informal credit to repay MC. Ghulam Sakhi is the only earner in his household and he engages in a mixed portfolio of activities to find sufficient income, though all the activities are highly irregular and insecure. He recently separated from his stepfather's household, meaning he has had to manage his household finances independently, including its credit relations. This was a major shift for the family and has led to increasing debt levels and in fact a reliance on debt for daily living. Ghulam Sakhi's wife:

I tell you all of our life is passed with credit. We take credit from one person to pay another person and for household consumption. Even now we don't have anything, we have to take credit.

Ghulam Sakhi has taken MC from the BmMFI1 for productive purposes and has used the majority

³⁴ This household took two loans from the BMFI for livestock purchases and five loans from KMFI largely used for consumption.

of it this way. However, he struggled to repay his first loan through earned income. Because of this, he borrowed informally to meet the repayment deadline, meaning he had to take another MC loan and use part of that to repay the informal credit. For example, his first MC loan was for US\$300 and he had to borrow this full amount from a villager to repay—a short-term loan until his second BmMFI1 loan came through. From this second loan of US\$800, he paid US\$148 in interest and US\$300 to the friend, leaving only US\$352 to invest and earn enough to meet the next repayment. This too he failed to do, borrowing US\$200 from the same friend to repay the full loan amount, and hence taking this amount from his third BmMFI1 loan...reducing what was available to invest. Ghulam Sakhi, like Sima, was able to make his repayments to the MFI, maintaining the “success” of the institution and graduating to larger loans. However, there is little to suggest the household’s livelihood security has improved.

This section has so far questioned the view of MFIs and others that there is a lack of access to credit in rural Afghanistan. Instead, active informal credit markets exist in the study villages, even in the Kabul village where the local economy is not very vibrant. These informal systems support the success of MC through enabling repayment.³⁵ Does the active presence of informal credit and its use as a means to meet MC repayment obligations mean MC has no niche to fill? Not at all; in the Bamiyan and Balkh villages there is evidence to illustrate where MC can make a real difference in the livelihoods of rural Afghans, if designed and implemented in ways sensitive to context and client needs.

Niches for microcredit

This paper is not arguing that MC has no place in the study villages or in rural Afghan livelihoods, but that MFIs need to be more responsive to the social and economic environments in which they are working to better meet client needs. ‘Environments’ is consciously used to reflect the diversity found in Afghanistan. Demand for MC varied considerably

across villages in this study based on social and economic contexts, including current and past characteristics of informal credit systems. MC programmes need to be responsive to these variations to support their own success and that of their clients. Three areas where this study found MC can play a significant, positive role in Afghan rural livelihoods include: supporting shopkeepers to stock their shops, particularly where significantly higher costs are charged for goods bought on credit; weakening what can be exploitative informal credit relations between agricultural input suppliers and farmers; and offering alternatives to informal credit with *sudh* in contexts where this practice is or has been common.³⁶

Shopkeepers were among the respondents in all three study contexts; this is a prevalent economic activity in both rural and urban Afghanistan. Shopkeeping is a credit-dependent activity, both in giving credit to customers and in needing to enter into credit arrangements with wholesalers to stock shops. The latter may offer very good credit terms and be unproblematic, with the quality of terms often depending on the relationships established between local shopkeeper and supplier.³⁷ In some cases, these relationships are between relatives or villagers and hence embedded within expectations of reciprocity with no extra financial costs (see Section 4.2). However, where this is not the case, MC can offer an alternative to what can be higher prices charged when goods are bought on credit.³⁸

36 Gbate notes that in situations where a sole credit provider can extract high profits there are openings for MC to compete in order to bring high credit prices down. Karri Goeldner, “Roles and Opportunities for Rural Credit Initiatives in Afghanistan’s Opium Economy,” in *Rural Finance in Afghanistan and the Challenge of the Opium Economy*, ed. by Zia et al, PREM Working Paper Series, Report No SASPR-9 (Washington, D.C.: World Bank, 2005) notes shopkeeper use (bulk purchase, etc.) Johnson and Rogaly, *Microfinance and Poverty Reduction* note that MC has a role in situations where informal credit can be exploitative or reduce choice. The Balkh study village and MFI provide an example of this.

37 Feinstein International Famine Center, “Human Security and Livelihoods of Rural Afghans, 2002-2003” (Medford, MA: Tufts University, 2004).

38 Farooq’s case, from the Kabul village, illustrates this phenomenon. He is not involved in the MC programme due to its small loan size and association with *sudh*. He could benefit from MC though, because he buys flour on credit from his brother in law’s wholesale shop in Kabul, for 20 Afs more per sack.

35 See Section 4.4 for more on the use of repayment as a measure of “success” in the MC industry.

The loan products offered by MFIs need to be designed with knowledge of the systems in place in the informal market, including the charges offered, to ensure competitiveness and fit with client cash flows.

Perhaps even more potential lies in the other two examples—providing credit in competition either with suppliers of agricultural inputs or with suppliers of larger sums of informal credit but with *sudh*. In the case of credit for agricultural inputs, BMFI related the aim of breaking these existing, potentially exploitative informal credit relationships as a motive for offering credit in rural areas. Two BMFI clients in our respondent group used the credit for this purpose. Two were interested in doing so—in fact drawn to BMFI for the large loans which could be used productively in this way, but ended up not borrowing for reasons related to eligibility criteria. Hence the potential is there for this MFI to make a real impact in targeting farmers and sharecroppers with credit products that can help them to break out of these relations in which they are locked into selling their products to the supplier who gave them credit. Mukhtar clearly shows the benefit of credit for this purpose in the quote below:

The credit which I took from BMFI was very suitable for me but the credit which I took from the shopkeepers three years ago was not very good, because I was under their influence and I could not sell my production to another shopkeeper.

- Mukhtar

Offering MC to farmers and sharecroppers to give them options apart from potentially exploitative credit relations with shopkeepers (input providers) seems straightforward. However, the social relations side of credit, explored more in Section 4.2, makes the story more complex. Often the input suppliers are village residents (who may have shops in the village or the provincial centre) with whom the borrower has a long term relationship of reciprocity and help. Therefore borrowers value maintaining these relations, since other sources of help in times of need often are not available. This consideration makes the decision to shift to MC complicated. The eligibility criteria for taking loans from the BMFI make the decision to replace these informal credit relations

even more difficult. In the case of BMFI, shopkeeper guarantors from Mazar city are needed to qualify for individual loans. This places great importance on maintaining these relationships to ensure access to MC. Therefore, ending informal credit relations for agricultural inputs may also mean losing guarantors, and being unable to access MC. Developing MC programmes based on knowledge of informal credit systems, and with recognition of the importance of social relationships to social and economic security in the Afghan context, could avoid placing potential clients in this contradictory position.

The story from the Bamiyan village is less complex. A history of informal credit given with *sudh*, particularly for larger loans, meant villagers were more open to MFI credit with interest or fees. The availability of informal credit with *sudh* was appreciated, but BmMFI1's lower charges, large loan sizes and grace periods matching rural livelihood cash flows made it a competitive option, as the quotes below illustrate:

Credit from BmMFI1 was good for me because I didn't have to get money from village sudhghors [person who gives credit with interest]. From the credit of BmMFI1 I bought two sheep and one calf. I sold the sheep, and the calf, I still have it. I also used the rest of the money for my household consumption. This credit was good for me and for the villagers because the villagers got rid of the sudhghors.

- Zahra's husband

I myself didn't take credit from BmMFI1, but I like the credit for the poor villagers in the village and it brought some changes to the credit from sudhghors. For example, a sudhghor gets 500 Afs (US\$10) from a 1,000 Afs (US\$20) loan to borrowers, and they are not able to repay it. But the credit of BmMFI1 takes less interest and is easily repaid and most of the villagers use the credit for farming, livestock and shopkeeping so they get good profits.

- Sayed Hassan, wealthy landowner

Also helpful was the lack of direct personal relationships between the informal *sudh* lenders and borrowers, meaning the relations of support and dependence existing in the Balkh village around input credit were not present to complicate the shift in credit providers from informal to formal. While the informal

sudh lender needed knowledge of the borrower to ensure the latter's creditworthiness, this could come through knowledge of the borrower's economic status resulting from residence in the same village, and did not require a close social relationship.

During the Taliban when I migrated I took 250,000 Afs (US\$5,000). He charged sudh. After three years, I repaid him 520,000 Afs (US\$10,400). He was a very kind and good man; he didn't ask for his money right away...He is not my relative. Everyone goes to him to ask for credit and he gives to everyone.

- Respondent in male loan group focus group discussion

We know them and they trust that we will certainly pay the money along with sudh. They know us because we belong to the same village. There are some sudhghor in other villages but they don't know me because I belong to a different village and also they don't know how much land I have.

- Latifa's husband

The evidence supporting potential niches for MC in rural Afghanistan points to the need to design loan products people want, which respond to needs, and service gaps within particular contexts. It also requires ensuring clients can actually access credit when they express interest, through developing appropriate means of establishing creditworthiness which do not unduly limit access. The sections on "Demand, credit products and programme rules" and on "Barriers to access" turn to these two issues, respectively, to point to areas where improved MC programme design is needed to open access and meet client demand.

Demand, credit products and programme rules

As discussed in relation to Table 3, there is demand for credit among rural Afghan households. Credit from informal sources and more recently from MFIs fills this demand, with MC being one more source of credit among those already existing. Because MC enters an existing credit market, MC programme characteristics are very important. MFIs need to invest in understanding the nature of the market they are entering and design products that meet

client interests in order to be competitive. There is little evidence from the case villages that this is currently happening as a standard practice. Instead, interest in MFI operational sustainability and reducing the MFI's risk exposure as much as possible seem to outweigh interest in client needs, though these things really all go together. The BmMFI1 appears to best consider client needs, and particularly rural clients' needs, in the design of its programme. But even it is not exempt from the savvy manoeuvring of some clients in an effort to refashion its lending programme to suit their needs. KMFI did least to adapt to client interests or needs or to respond to client complaints.

As previously noted, MFIs funded through MISFA, as all of those included in this study are, face pressure to meet programme costs with programme income in a relatively short period of five years. High security costs, cultural constraints around charging interest and human resource constraints all make this context a challenge for MFIs.³⁹ Outreach is central to a strategy of achieving operational sustainability, since rising numbers of clients can lower per client fixed costs and increase efficiencies. While this strategy of reaching out to a larger client base could support a stronger client focus, this has not necessarily been the case with the MFIs included in the study, particularly the KMFI. The KMFI prioritised wide outreach via offering a simple standardised product, which did not respond well to local needs. However, all the MFIs, though offering programmes significantly different from each other, experienced changes in operations on the ground relative to stated programme rules.⁴⁰ This signals both a mismatch with some clients' needs, and the interests of some clients to use MC for more than financial objectives. This section reviews some of the manoeuvrings of clients to refashion the MC programmes to suit their needs, particularly around loan size. It also discusses what client drop outs, particularly in the Kabul village, say about credit markets and the role of informal systems.

39 Compiled from key informant interviews with MFI representatives, including the study MFIs and other MISFA partner MFIs.

40 See Kantor and Andersen, "Case Study in Kabul Province"; Andersen, et al, "Case Study in Bamiyan Province"; and Andersen and Sim, "Case Study in Balkh Province" for more information.

Loan size and repayment terms are key characteristics of loan products from both formal and informal systems. While the data in Table 4.1 shows that some borrowers could obtain quite large loans from informal systems, this depends significantly on the people in one's credit networks and their access to cash to lend. This in turn can depend on the local economic situation, as well as one's perceived creditworthiness. So, the amounts of credit available are highly variable across individuals and some have to borrow from a number of people to reach the loan size required for some needs, such as productive investments or weddings. This is an opportunity for MFIs, which can offer larger loans, making it worth the while of clients in the Afghan context where US\$100 loans or less (common in other MC contexts) do not go far. In fact, BmMFI1 and BMFI were highly appreciated by clients because they offered larger loans which were useful for productive investments (as well as consumption) (See Table 2 for loan programme characteristics). However, KMFI offered loans of only US\$100-200 (5,000-10,000 Afs) and was far less appreciated. Many stated that these loans could only be used for consumption, and even then they did not stretch far given the high costs of food and other needs. Farooq in Kabul opted out of MC partly due to unwillingness to take credit with *sudh* but also because the loan offered by KMFI was not large enough to make substantially larger purchases from wholesalers to stock his shop. KMFI was present in all the study villages, reflecting its focus on outreach, allowing respondents in Bamiyan and Balkh to compare across the MC programmes in their villages. They generally found KMFI the least attractive, as the quote below shows:

The BmMFI1 programme is going well in the village. It has many clients and the grace period is also longer. Their grace period is six months and ten months. They also give bigger amounts of credit to their clients compared to other NGOs like KMFI, which is giving credit for a very short time and asking for the money on a weekly basis. Villagers are not happy with KMFI because they are giving less money and asking for repayment quickly. There is another NGO, BmMFI2, which gives big loans to the villagers but asks for money on a monthly basis. I think

BmMFI1's credit is better than the other NGOs.

- Zahra's husband

This quote also shows the importance of the grace period—the time allowed before repayments start—to clients. This loan programme characteristic is particularly important as compared with informal credit that is often given on very flexible repayment terms. In informal credit systems, “default” is infrequent as repayment periods are extended as needed, in light of the reciprocity involved and the lenders' knowledge that one day they too might need help. Grace periods and repayment schedules are often where informal credit has an advantage, though some respondents did note that they preferred the known and fixed terms of the formal credit, as informal borrowers could come at any time to request the full loan back, and if the lender's need was great, the borrower would need to find the money to repay in order to maintain that credit connection. This comparison is between MC and the most commonly reported informal credit—*qarz e hasana*.

The programme of BmMFI1 was the most highly appreciated in relation to both loan size and grace period. While BMFI also offered large loans and longer grace periods, barriers to access, discussed in the next section, limited positive assessments of its programme. These two MFIs in particular had programmes better suited to the rural context based on their grace periods, which matched the client livelihoods and cash flows. KMFI's requirement for weekly repayments, which started on receipt of the loans, was seen as deeply problematic for borrowers, many of whom ended up keeping some of their loans in cash to finance repayment, instead of investing the funds.

The greater satisfaction with BmMFI1 did not make it free from the efforts of clients to manipulate programme rules to fashion a loan programme more suited to their needs. For all three of the major loan programmes active in the study villages—KMFI, BmMFI1 and BMFI—field staff documented divergences between loan programme rules and practices on the ground. This was particularly the case for loan sizes, with clients manipulating systems to obtain larger loans than those on offer

from BmMFI1 and BMFI. In the case of KMFI, where there was a rule that only one loan could be taken per household, clients had other relatives or villagers take loans for them, and even explicitly broke the rule by having household members take loans concurrently, without a response from the MFI. Examples of this practice among KMFI clients across study villages include Nasima and Akbar in Kabul, Haleema, Zahra, Latifa and Ghulam Sakhi in Bamiyan and Mukhtar, Sima and Shabana in Balkh. It was not uncommon. BmMFI1 and BMFI also had clients gaining access to more than one loan at a time, more often through forming loan groups with the intent of having one member “hoard” the total group’s loan. Haleema’s and Murtaza’s cases provide interesting examples to illustrate how this worked.

Haleema’s household in Bamiyan is very savvy in its access to and use of credit. It has a large and complex loan portfolio, including a “hoarded” group loan used to buy a vehicle. This practice broke BmMFI1’s rule about only one loan per business, but without repercussions from the MFI. Haleema reported that the MFI office knew about the practice but accepted it since there was a guarantor. The quotes below tell the story, from Haleema’s view and from those giving up their loans:

Last year, my husband wanted to buy a car so I collected six people—seven including me—and we went to the BmMFI1 office to take credit and my husband was the guarantor. I said to my mother, sister, sister-in-law, neighbour and two relatives, “You should help me get this loan because my husband wants to buy a car.” Usually when someone needs money they will go to their relatives and say, let’s form a loan group and get credit from the MFI and you all give me the money and I will be responsible for repayment.

- Haleema

Interviewer: Did the office know about the whole group taking the money and giving it to one person to use?

Yes, they knew. It was no problem as long as there was a guarantor.

- Haleema

Her husband wanted to buy a car, so Haleema came to me and said we should form a group. She said that all the group members would give her the money so that her husband could buy a car. We kept for ourselves only \$60 from the loan because we didn’t need money at that time.

- Latifa

I took the credit money from the office and I did not need that money and Sayed Jabar (co-owner of car with Haleema’s husband) requested that I give him the money. He was responsible for the profit and loss of the vehicle. I did not have any profit from the vehicle. I even had to go to the office to get the money and give it to him and also on repayment I had to be present with the group.

- Zahra’s husband

A similar story emerged in the Balkh village, in relation to Murtaza, said to be the first BMFI borrower. His story of “hoarding” a group loan also shows knowledge on the part of the MFI. The BMFI seems to largely consider its own risk in this action—allowing it if the required guarantors are in place, as in the Bamiyan example. Murtaza tells his story below:

When I finished the first individual loan I went to the office again and asked for the second loan but a bigger amount. The loan officer told me that if you need a big amount of loan then it is better to make a group of five to ten villagers, then you will be the group leader and then you will be able to take a big loan. The loan officer said to me that you should also talk with your friend who has a shop in the mandawi for your guarantee. Then I came to the village and gathered my friends for taking the second loan. I took my friends’ ID cards and photos to the office and they were also with me. I gave them lunch in the hotel and then I took them to the office...

They (the loan group members) were my close friends and also from our village. I told them I need a big loan for starting trading work. Then they said, “yes we will help you to make a group and take the loan by yourself.” But one thing they said was that “we will not be

responsible for your repayment money. All the responsibility should be on your shoulders not on us.” I also talked with my friend who has a shop in the mandawi. I gave his shop again for the guarantee of my second loan. The office agreed and gave me the loan after one month.

- Murtaza

This practice, found in all the study villages, depends on one’s social networks. A potential borrower needs to know enough people willing to take a loan either individually or in a group and give it up, as well as have links to someone who can serve as guarantor. It provides access to significant sums of money—in Murtaza’s case, 125,000 Afs (US\$2,500), a big jump from his successfully repaid 25,000 Afs (US\$500) individual loan. The outcome of this rule-bending for Murtaza was not positive, as he became over-indebted. It is for this reason that the MFIs have their rules in place. While for some the loan size limits may seem too low, the rules exist to guard clients against over-borrowing, and to protect the MFI from losing its funds due to client default.

Many respondents complained about the loan sizes on offer, and some acted as described to obtain more credit, with this being found more frequently with KMFI. However, it was not clear that respondents always linked larger loan sizes, the desire for longer repayment periods (for KMFI) to the resulting larger repayment amounts and the realities of finding the money to meet these demands. That said, there seems to be scope, perhaps more so for KMFI, to respond to client needs for larger loans with new products, which might guard against situations such as Akbar’s, where he is holding eight notebooks with a weekly repayment of 2,400 Afs, and has no means to repay. If clients did not need to bend MC programme rules to obtain larger loan amounts, but could apply through a process that assessed their borrowing capacity, both the MFIs and clients may be better off.

KMFI, more than the other MFIs, is suffering due to its inflexible loan programme and loan sizes that are not that different from amounts easily available through informal sources. Unlike the other MFIs, it was losing clients after one or two loan cycles, particularly in the Kabul village, as the quotes below report.

For it to maintain operations in Afghanistan, more attention to client needs is required, through a more demand-led and context-sensitive programme:

Due to their rule of weekly repayment and sudh the majority of KMFI clients did not take it again.

- Elder in Kabul village

We didn’t take the second loan because the weekly repayment is difficult, and if the client doesn’t find the money for weekly repayment then the loan officer shouts at them. So we don’t want to hear shouts of the loan officer in paying money late.

- Nasima’s son

The willingness of many in the Kabul village to try MC shows interest in and demand for credit. However, evidence of programme dropouts highlights the need for competitive products from MFIs in light of the functioning of informal credit markets. Client drop-outs in the Kabul village, and those opting out of MC in all the study villages, illustrate a confidence among respondents in their ability to borrow from other informal sources, something the data in Table 4.1 supports. Applying aspects of the flexibility of informal systems could support the success of the MC industry in Afghanistan. Part of this involves ensuring that loan programme eligibility criteria and risk management mechanisms do not bar interested and creditworthy people from participating. The next section assesses barriers to credit access.

Barriers to access

As noted in the paper’s introduction, the aim of most MC providers in Afghanistan and elsewhere is extending access to credit. This is exemplified for Afghanistan in the Interim-ANDS and its focus on extending access to credit to 800,000 rural residents,⁴¹ and on MISFA’s website that lists scaling up MC service provision as the first among three goals for the MF sector.⁴² The

41 This benchmark is not found in the final ANDS document.

42 Islamic Republic of Afghanistan, *Afghanistan National Development Strategy: An Interim Strategy for Security, Governance, Economic Growth and Poverty Reduction* (Kabul: Government of Afghanistan, 2005); and www.misfa.org.af; (accessed 5 October 2008).

Consultative Group to Assist the Poor is a World Bank-based independent resource group developed to promote MC globally. Its website clearly illustrates its focus on access to financial services, including credit, as the answer to a range of development problems, as the following quote illustrates:

*Nearly three billion poor people in developing countries lack access to the basic financial services needed to help them manage their precarious lives. Access to financial services—whether in the form of savings, credit, money transfers or insurance—is a fundamental tool for improving a family’s well-being and productive capacity. Access to financial services empowers the poor by reducing their vulnerability, and offering them opportunities to improve their lives.*⁴³

Section 4.3 assesses to what extent access to credit alone is sufficient to reduce poverty and vulnerability and achieve the well-being outcomes mentioned above. It focuses on credit among the range of financial services available because that has been the primary product delivered in Afghanistan. In this section we examine how well the study MFIs extend access, examining if in some cases programme rules and eligibility procedures may end up limiting access to credit.

On a practical level, transaction costs—the costs involved in actually gaining physical access to a loan—affect access to MC, particularly when considering MC products relative to those commonly available from informal sources, and specifically *qarz e hasana*. Early literature on MC notes its lower transaction costs relative to formal bank lending. Village or community-based information dissemination, loan distribution and repayment collection meant travel costs and costs related to loss of work time were minimal. These characteristics made MC similar to informal credit in terms of ease of access since much of the activity associated with both happened locally.

In examining the MFI programmes operating in the study villages, this similarity between MC and

informal credit in terms of local disbursement was not found in all locations. BmMFI1 and BMFI centralised some or most operations, meaning costs of access are higher than for informal credit, leading to barriers to access for women and poorer clients. For example, BmMFI1 disseminated information about its programme through loan officer visits to villages, but clients had to travel to the MFI’s office in Bamiyan district centre for loan disbursement. This created a barrier for women, due to mobility constraints, and for poorer men due to loss of work time and their inability to afford this. While easier for the MFI, and clearly a means of reducing its costs, it may also mean potential clients do not join the programme. Similarly, BMFI maintained an office in Mazar where potential clients had to come for information meetings, to open an account and make the required saving deposits, and to receive and repay loans. This was costly in terms of time and money, and again served to deter some from joining. KMFI maintains the most localised operations with loan officers coming to villages for loan disbursement and repayment collection; hence, it is closest to informal credit in terms of low transaction costs. It also targets women as clients and this localisation may reflect that focus. However, given the low loan size and repayment terms that do not match rural cash flows, these low transaction costs were not enough to make many clients satisfied with the programme.

Another important barrier to credit access are the eligibility criteria the different MFIs establish, which are often associated with some form of guarantee system. While MFIs, like any bank or financial services agency, need to manage their exposure to bad credit risks, it is also necessary to ensure these risk management mechanisms do not go too far and bar access to some potentially good clients. The three core MFIs located in the villages all relied on social collateral in the form of loan groups but from there differences emerged in terms of other forms of guarantee or collateral required for different types of loans. Approval by village elders or *shura* members, property certificates and individual guarantors were used to different extents, and with different exclusionary results, as described below.

43 CGAP, www.cgap.org/p/site/c/aboutus/ (accessed 5 October 2008).

Social collateral and local gatekeepers

A common feature of many MC programmes is the use of solidarity groups as a means of social collateral whereby group members serve as guarantors for each other in case someone cannot repay. This avoids the need for physical collateral, which poorer clients or women may not have, opening access to them. All of the MFIs encountered in the study villages offered some credit via solidarity groups; both men and women were involved in group lending, with women more likely to only access credit in this way. Group lending is an easy way for MFIs to allow village residents, who generally know significant details of each others' social and economic lives, to decide who to allow into groups and who to exclude, since the members in the end will be responsible for all the loans taken. Those prone to gambling or other risky activities, and those without the means to repay for other reasons such as ill health or irregular income flows are excluded, as are those newer to the village, such as some returnees who may not have the social networks to provide them access.

Some MFIs also try to hire loan officers locally to use their knowledge of village residents to assist in making judgements about who to lend to and who to exclude. This may not always work as the MFI expects, however, as reliance on social networks and reciprocity may mean loan officers cannot deny some people credit because of social connections, and may deny others only due to lack of personal knowledge even if the person's asset base may identify them as a potential client. For example, in the Bamiyan study village, the loan officer was instrumental in both lending to Karim based on a social connection, and perhaps at levels he could not really afford, and also excluding recent returnee Sayed Jaffer, though his asset holdings made him a good MC candidate. The loan officer himself approached Karim and offered him credit, based on Karim's social and economic status in the village. However, Karim was not able to use the loans profitably and ended up managing a large debt burden. He may not have been the MC customer the loan officer expected. Sayed Jaffer, a wealthy landowner like Karim, returned from Iran three years prior to the study period after a long exile. He was not well known in the village, having

returned well after others who also migrated during the conflict. When he approached BmMFI1 for an individual loan, he was refused due to lack of established livelihood activities, social links and a legal property document, as the following quote from Sayed Jaffer supports:

Actually when we returned from Iran three years ago, we needed cash money for our truck and we decided to get credit from BmMFI1. My maternal cousin knew the loan officer and he took me to him. I met the loan officer and asked him for the money. He asked for a sharayi property document (legal according to Islamic state law) but I didn't have that one. Instead I had an urfi property document (customary), but he didn't accept it and didn't give me credit. Because we were new to the village and after passing 27 years in Iran, he didn't have trust in us.

Even though Sayed Jaffer knew someone who knew the loan officer, this was not enough to gain him access to individual loans. He also was not well-known enough to be given entry to a loan group. Luckily, he was able to obtain funds from savings in Iran and make his investments, making him now quite well established in the village, with an upward livelihood trajectory and a reduced demand for credit.

Another means MFIs use to determine eligibility for credit is approval by local leaders, or gatekeepers, often the *malik* (village leader) or NSP *shura* members. KMFI and BmMFI1 used this means, and interestingly, BMFI is moving in this direction, as discussed in the section under guarantors. BmMFI1 largely used the local leaders for their knowledge of applicants' social and economic backgrounds; they would verify creditworthiness of potential clients but would not then bear any repayment responsibility. This was unlike the case of KMFI, where the *malik*, particularly in the Kabul village, played a considerable role in determining access as well as intervening when clients had repayment problems. He both sought more repayment time for the clients and acted as intermediary for the KMFI in collecting repayments from delinquent clients. His intervention on the MFI's behalf often came at the request of the district officer, as the

quote below shows. The KMFI was the only MFI that seemed to actively seek repayment via the district officer's involvement:

There are two men, they took credit from the KMFI this year and one of them didn't repay the credit money for four weeks and one didn't repay for six weeks. The KMFI went to the district office and complained to them. The district officer called me and told me that you are the malik you go with them (KMFI staff) and solve their problem.

- Malik, Kabul village

Use of the *malik* or *shura* members as guarantors or gatekeepers to credit is not necessarily a trouble-free mechanism for MFI risk reduction. *Maliks* or *shura* members may not always make appropriate decisions, and personal interests could intervene. No explicit evidence was found of abuses to this system, but such systems are clearly open to abuse—whether rent-seeking on the local leaders' parts to ensure approval or barring access to some people for personal reasons. For example, Nilofar felt she was excluded from the MC programme due to KMFI's reliance on the *malik's* approval, because she has a long unpaid loan from the *malik*. She felt he would not approve her for this reason. Relying on such systems where local leaders serve as gatekeepers may make sense due to their access to information about potential clients, but they also require strong transparency and accountability structures, as well as means of triangulating the information provided to ensure personal interests do not intervene.

The study MFIs' reliance on social forms of guarantee illustrates how MC access is not solely determined by market-based criteria—who you are and who you know also matters. This social side of MC, and its intersection with the social side of informal credit, is explored in more detail in Section 4.2.

Property

Land and savings were two forms of property some study MFIs used as guarantees. KMFI and BMFI both had savings requirements prior to being eligible to take credit. KMFI requires five percent of the loan value to be saved prior to disbursement, with clients

then free to use these savings as they like, except for applying them against repayments. Clients were in general less clear about their access to these savings, and some reported using their savings for repayments. BMFI had a much higher saving requirement—20 percent of an individual loan and 25 percent of a group loan had to be saved prior to disbursement, making this much more of a guarantee against default than the savings level required of KMFI. These savings requirements, particularly the higher one of BMFI, can exclude potential clients. It can also make some take credit to meet the savings requirement, not necessarily a sustainable livelihood strategy (see Sima's case in Table 3).

Only BmMFI1 had property documents as a criterion for loan eligibility, and this was only for individual loans. As Sayed Jaffer's case above illustrated, BmMFI1 required initially a formal, state-recognised property document. This is challenging to produce in the Afghan context with its history of conflict and changing government structures over these years. Therefore BmMFI1 relaxed this to allow the customary document Sayed Jaffer did have, opening access to individual loans to more clients. The property document requirement, whether customary or not, could still be quite an exclusionary feature for many, including women, who may not have property in their own names.

Guarantors

While KMFI used local leaders as a form of guarantor, at the time of the field work BMFI had strict guarantor criteria that ultimately excluded potential clients in the study village from obtaining access to credit. BMFI required individual borrowers to have two shopkeepers with registered shops in Mazar city serve as guarantors. Previously group borrowers also needed the same guarantee, but this system has shifted to reliance on *shura* approval and an assessment of repayment capacity. This shift was also in process for individual borrowers at the time of conducting the field work. As this section shows, this shift should considerably expand access to BMFI's credit as the guarantor requirement was a high barrier for many to overcome, due to issues of shame and status related to approaching such connections to serve in this capacity. Thus some

respondents (particularly Yaqoub, Khan Mohammad and Rahim) chose not to borrow from BMFI because of the strict eligibility requirements and the costs in time, money and honour involved in meeting them, as the quotes below show. All three were at first inclined to join and made an initial information gathering trip to the MFI's office, along with about 200 other men. Yaqoub even paid his membership fee and deposited 400 Afs in savings. However, none of the three proceeded to take a loan, though all were interested in reducing their reliance on shopkeepers for loans for agricultural inputs.

In Yaqoub's case, the shopkeepers did not trust him enough to be willing to guarantee his loan. This is interesting, since he was able to take a large informal loan from shopkeepers for investment purposes, but the shopkeepers did not render him creditworthy enough to guarantee him for a loan from BMFI:

When we went to the city and asked the shopkeepers whom we knew to be our guarantee for the BMFI they said to us that we know you physically, that you live in the village, but we can't give our shops as guarantee on behalf of you to the BMFI.

- Yaqoub

Khan Mohammad had a range of concerns about BMFI after hearing the details of the loan programme and its eligibility requirements. One was the repayment structure, with a six month grace period, after which the repayment had to be made. He felt this did not fit his livelihood activities. The procedures to become eligible were also not appealing. When he found out about the requirements for guarantors and savings deposits, and the multiple trips to Mazar that were necessary, he decided—according to his wife—to give up the idea of borrowing:

My husband told me that he wanted to take 25,000 Afs. I also wanted to take 25,000 Afs. When we went to the office, they said that they could not give us credit right then. We had to go many times over a long period to the office to save money and also find guarantors. So we decided not to go anymore.

- Wazhma, Khan Mohammad's wife

Rahim's interest in taking credit from BMFI for agricultural inputs lasted only until he too learned about the eligibility requirements. Like Khan Mohammad, the rules made him decide not to continue with the process of applying for a loan. It was not through an inability to find guarantors, as in Yaqoub's case.

In that time I was working as farmer on my land and I needed money for the land but they were asking for the 5,000 Afs as savings and they also asked about the guarantee of two shops in the city. When I heard these conditions of credit from the office I did not like to ask the shopkeepers in the city to guarantee my loan for the MFI. I did not like to stand in front of others and beg for the guarantee.

- Rahim

These strict requirements, in place for the MFI's protection, mean some potential clients who could considerably gain from involvement in MC are either excluding themselves or being excluded. Access has been denied instead of extended.

Conclusion

This section examined issues of access to and demand for credit in the study villages to illustrate how demand for informal and formal credit co-exists and inter-relates, and how MC enters an existing credit market and must be competitive in its products to be successful. Therefore, investing time and funds in gathering information about informal credit systems and their strengths and weaknesses could improve MC outreach, MFI viability and even client viability. In the study villages, niches for MC were identified as were key characteristics of strong MC programmes. However, even the programmes that respondents appreciated more were subject to savvy manoeuvring in their implementation, as borrowers created a loan programme, and particularly loan sizes, suited to their needs. This led to over-borrowing and heavy debt burdens for some. MFI eligibility criteria seek to avoid such outcomes. At times these may be too strict, excluding potential clients. But MFI staff knowledge of some of these client manoeuvrings illustrates that existing rules are not always

enforced locally. This at times reflects the social relations involved in credit exchanges, which are examined in the next section.

4.2 Credit exchange: more than a financial transaction

A key finding of this study complements that of previous AREU research on informal credit systems. AREU's previous research highlighted how informal credit exchanges were often about more than the money; this study points to similar findings for MC among the study households. Though MFIs and other actors conceive of MC as a market-based financial transaction, respondents in the study perceived it differently. They embedded their understanding of the role of MC within existing social relations and used MC as another tool with which to create or strengthen social ties. This should come as no surprise, given the importance of social networks to livelihood security in the Afghan context in the past and present.⁴⁴ Social relationships form the social protection system through which people survived the many phases of conflict in absence of state support, and this continues today. By not recognising the social dimensions of MC and informal credit in Afghanistan, MFIs run the risk of not fully understanding how their programmes operate on the ground and why they may or may not be successful.⁴⁵

The social dimensions of credit are varied as well. One side is in relation to access to MC and how social relations matter—whether that is good relationships with the *malik* or *shura* members, a connection to the loan officer, or sufficient social networks to form a loan group. This is where MC brings aspects of informal credit systems into its operations in order to reduce the risk of bad loans

through social collateral.⁴⁶ Other social dimensions include how obligation and power are embedded within credit relations; the diverse meanings of credit; repayment concerns and how they affect willingness to join MC programmes; and finally, how the values associated with market-based MC may in fact be a threat to livelihood security, to the extent they seek to reverse values of community cohesion in favour of individualised and distant exchange relations.⁴⁷

Credit relations and social protection

Informal credit networks provide social protection through two forms of relationships, those of reciprocity and those of inequality. The latter can be labelled patron-client relations. Reciprocal relations of help and support occur among those of more or less equal social and economic status, often among relatives, but also among wider groups within a village. These are based on notions of balance where help from one is expected to be returned at some date in future.⁴⁸ These relationships do not work based on Western notions of insurance where one side may pay into an insurance pool, but be 'lucky' and never need assistance in return. Instead, they are characterised by balance such that, over time, net payouts will be equal. This brings obligation into the equation since one is expected to help those who helped you, in order to ensure the exchanges continue. Those unable to continue paying out due to continued declines in economic fortune may find themselves excluded from these relations, and dependent on charity. Such reciprocal relations work best in situations where over a relatively short period all involved can expect misfortune—and therefore a return on the investment in the social relationship. Rural Afghanistan fits this model.

44 Feinstein Center, "Human Security and Livelihoods."

45 Prabhu Gbate, Arindam Das Gupta, Mario Lamberte, Nipon Poapongsakorn, Dibyo Pabowo, Atiq Rahman, and T.N. Srinivasan, *Informal Finance: Some Findings from Asia* (Hong Kong: Oxford University Press, 1992); Dichter, "Social Meaning of Debt," Chapter 1, 9-17.

46 Johnson and Rogaly, *Microfinance and Poverty Reduction*.

47 Dichter, "Social Meaning of Debt," Chapter 1, 9-17.

48 Jean-Philippe Platteau, "Mutual Insurance as an Elusive Concept in Traditional Rural Communities," *Journal of Development Studies* 33, no. 6 (1997): 764-796.

Reciprocal relations

All of the households in the study villages are involved in some form of reciprocal networks, as the case studies exemplify.⁴⁹ For example, Hamid in Kabul, a household not involved in MC, gives and takes credit with relatives. Some of this is in cash but he also offers services to those he borrows from—providing his masonry skills free of charge to both a brother and son in law. Likewise, Zarifa in Bamiyan limits her credit involvement due to concerns about repayment, maintaining ties only with family or friends. She has her own reciprocal credit link with a female neighbour to whom she lent 1,000 Afs (\$20) one month prior to the interview, for which she received bricks in repayment because she was improving her house. Loan portfolios in Balkh also show significant borrowing and lending with relatives and neighbours. For example, Yaqoub's extensive credit portfolio shows loans from his brother, sister-in-law, a friend and neighbour, and loans given to the sister-in-law and a few neighbours.

Nasima's case, from Kabul, illustrates the possibility of being excluded from informal help relations. Her household suffered the extreme shock of the ill health and death of the male household head. During his illness, good will from neighbours sustained credit relations, in part due to the male head's membership in the NSP *shura*. But after his death, this evaporated along with the household's creditworthiness due to high debt levels and few perceived means of repayment, though her sons are adults and working. Her credit flows from informal sources dried up, as did her willingness to borrow from KMFI due to past struggles to repay. Their future, with few networks of support, is highly uncertain.

While the importance of reciprocity in informal networks is quite clear, how does MC enter into these existing networks among the borrowing households? How are funds from MC loans valued beyond their financial worth and used to strengthen or even at times weaken existing social relations? Not surprisingly, there

are many ways respondents in the study villages used MC funds as another way through which to maintain or strengthen reciprocal relations. Its availability was valued beyond its financial use. However, MC also could demand more from existing reciprocal relations than they could bear, having the potential to overburden and weaken them.

One way people drew on established reciprocal relations was in accessing MC—particularly in breaking MFI rules to obtain the desired loan size, which was often much higher than allowed. In these cases, helping someone in one's informal credit network to access MC could serve to strengthen informal help relations. This is another way to provide assistance, at little cost to oneself, which could be drawn upon in future. Examples include those who took KMFI credit in their own and others' names—drawing on relatives and others for help, which would be returned in some form in future. In some cases, the “hoarding” of group loans also was a creative use of reciprocal relations, though this could also veer into patron or client relations.

The need to deposit savings at BMFI provided a new reason to turn to existing help networks to raise these funds, for those without the ready cash. Sima and Murtaza turned to friends, relatives and a neighbour to borrow the funds. Likewise, the need to find the money to repay MC brought new demands to informal reciprocal credit relations. The data in Table 3, as already discussed, illustrates how informal credit was often used to repay MC, due to its greater flexibility in loan terms and generally lower cost. Hence the success of MC rests on these characteristics of informal credit, and the existence of strong reciprocal relations. What has to be guarded against is MC weakening these relations in order to protect the security of both MC clients and the MC programmes.

MC might weaken existing social safety nets through raising demand for informal credit, without helping build incomes and the local economy in line with these demands in order to ease repayment. This could lead to increased conflict due the decisions made by borrowers holding both MC and informal credit about which to repay first. The social and economic sanctions associated with late repayments

49 See Kantor and Andersen, “Case Study in Kabul Province”; Andersen, et al, “Case Study in Bamiyan Province”; and Andersen and Sim, “Case Study in Balkh Province”.

of both will influence these decisions.

Late repayment of MC has both social and economic sanctions. This made some respondents prioritise these repayments. This leaves informal lenders waiting, particularly those not filling immediate needs, as the quote from Ghulam Sakhi illustrates:

First we will repay the MFI because if we pay late then there will be a fine. Then we will repay the shopkeepers because we will need to take goods on credit again for the household.

Another means through which access to MC may weaken existing social relationships is by making those receiving MC targets for increased assistance requests from those in their networks. Such requests may slowly lead to a devaluing of social relationships if they begin to be viewed as a burden instead of a form of support, or they become unbalanced. Obligation associated with reciprocity means these requests are difficult if not impossible to deny, as the example of Latifa in Bamiyan illustrates.

Two years ago, my brother came and asked for 5,000 Afs (\$100). At that time I had taken \$2,000 from the BmMFI1. My brother came and told me that now I have money and I should give him some.

Access to MC can raise risks of receiving many such requests, and the closer the connection to the person asking, the harder it is to say no. Such diversions of funds can make investment plans unworkable, affecting the returns from the funds and therefore the ability to meet repayment requirements. Social obligations related to reciprocity can directly affect MFI success—either negatively by undercutting productive use of the loans through obligatory assistance, or positively through providing access to cash to meet MC repayments. The latter can be an unsustainable means of repayment for the borrowers, as debt is only shifted between sources. This in the long term can threaten the MFI's existence because credit demand may decline as debt burdens grow.

Patron-client relationships

Reciprocity is one of two ways social relations form

safety nets. Patron-client relationships are another means. These may exist between relatives of unequal wealth (see Haleema and Zahra's story on page 36), input suppliers and farmers, shopkeepers and customers, or between sharecroppers and landlords. Such relationships are characterised by inequality—in wealth, social status or authority, with the patron having some form of power over the client, often through the assistance, goods or income provided. In some cases, obligation may enter into the relationship—e.g. a wealthy landlord obliged to help poorer village residents,⁵⁰ but there is also gain flowing to the patron through the terms of exchange. But is this all negative for the less powerful party to the relationship? Recent work on social protection systems in developing countries notes that from Western perspectives such relationships are often judged to be purely exploitative, with all gain flowing to the more powerful.⁵¹ But, in contexts such as Afghanistan where weak institutions and informal relations are more common than a formalised and transparently functioning state and market or community institutions, these unequal relationships may be a major, if not the only, way of achieving some form of livelihood security. This is often a dependent form of security, where the decisions of the more powerful party can have undue effects on the life of the client, limiting their autonomy. However, it may be the best form of security in highly uncertain contexts.⁵²

Take, for example, the case of Zahra in Bamiyan. She and her husband own neither land nor a house in the village. Her husband instead works as a sharecropper for two landlords, one of whom provides them free housing. From both they receive

50 Rutherford notes how village money lending, generally a relationship of inequality, tends not to be only about providing a service. Some element of obligation also exists in the relationship because of the ties of residence.

51 Geoffrey Wood, "Staying Secure, Staying Poor: The 'Faustian Bargain'," *World Development* 31, no. 3 (2003): 455-471; Geoffrey Wood, "Informal Security Regimes: The Strength of Relationships," in *Insecurity and Welfare Regimes in Asia, Africa and Latin America. Social Policy in Development Contexts*, ed. by Ian Gough and Geoffrey Wood, 49-87 (Cambridge: Cambridge University Press, 2004).

52 Geoffrey Wood, "Informal Security Regimes: The Strength of Relationships."

a share of the harvest and help when needed in the form of loans and at times charity. There is an obligation of help within the relationship but it is also clearly a relationship of dependence, with Zahra and her family not in a strong position to negotiate sharecropping terms or to seek new landlords. Zahra is Haleema's sister and also is dependent on her family for credit and help; MC has helped Zahra's household to solidify these help relations, as we will see below, bringing greater security.

How has the entrance of MC in the study villages affected patronage relationships? It has introduced a new way in which the powerful can utilise the dependence of the weak through having them obtain MC to give to the patron. But it has also given the clients a way to help patrons. Some of the examples of bending MFI rules around loan groups in Bamiyan and Balkh were not only about firming up reciprocal relations. They were also about less wealthy village residents helping patrons, thereby increasing their usefulness and the strength of these relationships. Sometimes this was help provided at no cost, as was the case in the example of Haji Ahmad and Yaseen in Balkh, but in others the help did come at a cost (e.g. Zahra and Haleema's ties over a KMFI loan in Bamiyan).

Haji Ahmad's household survives on sales of *qaraqol* skins, daily wage labour, wool-spinning, and subsistence production from the half *jerib* of land it owns. These are all rather low return and uncertain activities, and the sale of skins brings income only once per year. Therefore, the household often relies on credit, particularly from shopkeepers, to meet daily consumption needs during most of the year. There is one shopkeeper in particular from whom they buy on credit, Yaseen, as Haji Ahmad's statement below shows:

I need credit because sometimes there is no work for me in the village. I need money to buy goods for my household consumption. So when there is no work it's difficult to afford the expenses of the household. The goods which I bring from the shop, most of them I buy on credit from Yaseen's shop and repay the money to the shopkeeper from my wage labouring work.

Maintaining this relationship with Yaseen is important to the household, as it is their means of obtaining food as well as credit for fodder and for medical needs. MC offered Haji Ahmad a new way of engaging with Yaseen, allowing Haji Ahmad to help him. This ensured that Haji Ahmad could continue to obtain his smaller credit needs for food and other necessities. He provided help by becoming a member of a loan group Yaseen organised with the intent of using the entire loan himself, as Yaseen himself says:

I took 140,000 Afs in a group of 7 members one year ago from BMFI; 35,000 Afs was cut for the savings. I took the money and used it for my shop.

By joining the loan group and giving up his loan—all at no cost to himself—Haji Ahmad has indirectly benefited from MC. It has given him a way to reinforce an existing patronage relationship with an important shopkeeper, improving his livelihood security through ensuring future access to consumption credit.

The story of Haleema and Zahra is less positive than that above, largely because Zahra's household bore some cost for the help it provided Haleema's household, without the capacity to do so. The two women are sisters and this is what binds the households, though in part against the wishes of Haleema's husband who is not aware of all the help Haleema provides. Zahra's household is considerably poorer than Haleema's, as noted before. Therefore, even though they are close relatives, there is a clear difference in wealth and status between the two which affects their relationship; it is largely one-sided. This is where MC comes in—MC allows Zahra to help her sister's family through accessing credit to give away—in the first instance through a second loan from BmMFI1, which was taken in a loan group but given to Haleema's husband to buy a car. This was not problematic, as it did not impose a cost to Zahra's household and she herself kept a small part of it (\$60) to use for household consumption. However, the story around one of two loans taken from the KMFI operating in Bamiyan is different. A year prior to the field work period, Zahra took two loans from KMFI, each for 8,000

Afs. One she and her husband used to buy and sell sheep for profit, while the second was given as informal credit to Haleema's husband, without interest. It was a way to offer help, which in the past they would not have been able to do as they could not have accessed such funds. However, this came at a cost. Haleema's husband implied he only needed the funds for a very short time, promising to pay in three days. He took three months to pay, meaning Zahra's household had to make the weekly repayments, without any recourse to profits, as well as pay all of the loan's interest since it was given as a free loan. Given the highly insecure nature of the household's livelihood, this ended up being a costly effort to strengthen a patronage relationship.

The entry of MC has provided a new source of funds through which social relationships can be strengthened, and, at times, be put under strain. It has entered into existing social meanings of money in the rural Afghan context, which are based, across the three divergent field sites, on achieving security through investment in social ties. Hence, the framing of MC within modern, neo-liberal discourses of individualism, entrepreneurialism and profit may be highly unsuited to developing programmes that respond to local understandings of the exchange value or usefulness of credit in relation to improving livelihood security.⁵³ The stories above demonstrate how great care must be taken not to break or weaken, intentionally or unintentionally, the social ties many respondents have used MC to reinforce, even if in the first instance they seem exploitative. Until the local economy or state can provide alternative means of security, these continue to form the backbone of a social protection system.

Shame, status and credit

Another social dimension of both formal and informal credit is the association of credit with shame in the Afghan context. This was a general sentiment, across field sites and forms of credit, and was not only linked to credit with *sudh*. It is

also not only found in Afghanistan.⁵⁴ While for most the need for credit outweighed this link to shame, others chose not to borrow MC to either avoid the shame associated with possible default or because their wealth allowed them to claim the status associated with not needing to borrow, from either source. Notions of shame also influence some respondent's stated preferences for informal credit or MC, though with no clear pattern emerging.

The story of the brothers Daud and Akbar from the Kabul village illustrate different aspects of the association of credit with shame. For Daud, a teacher with a monthly salary, MC from KMFI is not an attractive option for a range of reasons, including his relatively high economic status. He also believes repayments would be hard to meet as they are weekly, not in line with his monthly salary payments, and he is uncomfortable with the KMFI's hiring of female loan officers. On top of this, he sees *sudh* as *haram* and since he can afford not to take MC, he does not. He seeks to avoid the shame associated with taking credit with interest and interacting with females he feels are acting inappropriately for the rural Afghan context. He even seeks to minimise his informal credit engagements, taking less than 4,000 Afs in credit over the three-year reporting period. However, he does not judge his brother Akbar for taking MC, as he understands his needs are different. For Akbar it is the initial shame associated with his inability to repay a large informal debt to an old friend that moves him to take MC—a shame Daud understands. He therefore supports Akbar's decision to borrow MC as the amount he required was not available from informal networks. However, part of what fed Akbar's inability to repay the initial informal debt was over-lending to his shop's customers and the sensitivity about asking directly for repayments.⁵⁵

The shame Daud and Akbar express, related to an

54 Dichter, "Social Meaning of Debt," Chapter 1, 9-17, notes the social meaning of credit which is linked to debt and is the opposite of thrift. Therefore, for some it is linked to immorality and shame.

55 Qasim is in the same position. He is also a Kabul village shopkeeper, who has high outstanding credit with his customers, which he cannot demand repayment for. His mother shares her son's interest in closing the shop and opening one in Kabul city, where social relations will not be so close, and hence requests for repayment more acceptable.

53 Wood and Sharif, "Introduction."

actual or potential inability to repay credit, was widely raised among respondents in all the study villages. For some this was stated as feelings of shyness in front of creditors, who for informal credit tend to be relatives, shopkeepers, or other villagers, people often met during the course of a day. For example, Jamal in the Bamiyan village expresses dislike of taking credit in general because, “it is a big responsibility and the borrower feels shy in front of the lender.” His wife goes on to note a more specific aversion to MC, around the possibility of missing repayments:

My husband doesn't like it (microcredit). My husband says, “When the office comes and if one time I don't have the money to repay, what should I do?” He says it would be shameful and not good for his reputation.

The shame of missing repayments is clearly linked to notions of honour and reputation. Being in debt and unable to repay when scheduled (microcredit) or when asked (informal credit) is a situation that could bring dishonour to a household. Decisions to take credit involve weighing the risks of default—associated with the terms of the credit, relationship to the lender, availability of other credit networks and expected future cash flows—against the need for funds, to see if the potential shame and loss of honour is worth it.

Aversion to MC due to its link with *sudh* is not uncommon, though is context specific. It is a reason that three non-MC respondents decided not to borrow (Farooq and Daud in Kabul and Rahim in Balkh.) For example, Rahim states, “Some of the villagers said that this is *sudh* and I did not want to be involved with *sudh* because this is forbidden in our religion.” Farooq is even more strongly against MC due to its link with *sudh*, reflecting both personal feelings as well as the seemingly more conservative context found in the Kabul village:

There was one man, he was doing sudh dealing and when he died, after he was buried, three times his body came outside of the grave and his son had to rebury him... For four to five months, noises were coming from his grave. This was the sign of doing sudh dealing...God shows his signs to those doing sudh dealing and

on the day of judgement, God will punish them and send them to hell.

None of the respondents from the Bamiyan village expressed such concern about *sudh* borrowing. This is because of the past connection the Bamiyan village had to *sudhkhors* and their positive view of MC because of its lower charges. This was very different from the experience of the other two study villages, where that historical connection to informal lending with *sudh* was not present or much weaker. Hence none of the Bamiyan respondents expressed the concern with *sudh* that the Kabul respondents did, with the Balkh respondents falling in between.

While MC's link to *sudh* affected some respondents' willingness to borrow from MFIs, others, and particularly the wealthier respondents, did not participate in MC because of the status associated with not needing to borrow. For example, Sayed Hassan in Bamiyan views his avoidance of taking both informal and formal credit as a mark of his status in the village, being more of a credit giver than taker. Likewise, Shabana's husband was shamed by her interest in, and actions toward, borrowing from BMFI. She wanted to borrow to buy gold jewellery, that in itself a signal of the household's wealth (though she told the MFI she was borrowing for productive use.) Shabana started the process of meeting BMFI's eligibility requirements, travelling to the city three times for the information meeting, to open an account and make savings deposits. In total she deposited 3,000 Afs and her membership fee of 100 Afs. However, once she needed to begin finding guarantors, her husband refused to help because of how this would look to his friends. As Shabana relates, her husband told her to stop her application for a loan because his friends know his economic status, and that he does not need credit, so her application makes it look like he cannot meet his wife's financial needs. This, coupled with his own experience while at the BMFI office making a deposit for a loan of his own, for productive purposes, meant he did not want to risk his reputation and status over MC the family did not really need:

When I came down from the office in the ground floor my relatives saw me and asked, “what are you doing here?” I felt shame and I told them that I wanted to see my friend in the 3rd floor of the

building. They said “no, you came here to take the credit.” I decided not to come again to take credit from the office.

His assessment of the benefits of the credit—from his loan and his wife’s—against the risk to his reputation as a relatively well-off village resident, meant he decided against borrowing from the BMFI with its more public process of applying through visits to the city and the need for guarantors. Instead, his wife borrowed from the KMFI branch operating in their village, which offered credit without the strict and public eligibility procedures.

Conclusion

Among the respondents, decisions about borrowing money are not simply financial, driven by self-interest, entrepreneurialism, or even crisis. Nor are they only informed by a comparison of costs and repayment terms across loan sources or products. Many social factors, linked to the establishment and maintenance of social relations and social status, are also relevant to whether credit is available, is taken, from whom and for what uses. This adds substantial complexity to the operation of credit systems in rural Afghanistan and again emphasises the need for MFIs to understand client needs and interests and how existing credit systems operate. This knowledge will better ensure MFIs provide access to desirable products that can have a positive impact on livelihood security, whether directly via investment in productive or consumption needs, or indirectly through building social links which provide security.

4.3 Microcredit, risk and rural livelihoods

In the Afghan context, the objectives of MFIs operating under MISFA’s umbrella are outreach and operational sustainability. A MISFA report recently observed that poverty reduction has generally only been an implicit objective, but one which requires more direct attention.⁵⁶ This paper agrees with this assessment, noting that the study MFIs tend to focus more on people being able to borrow and repay versus what is done with the credit,

how repayments are made and the outcomes for borrowers. This section focuses on the poverty and risk-reduction potential of MC in the study villages to highlight some of the factors MFIs need to be aware of to improve outcomes for clients. It examines risk and vulnerability related to livelihood activities in the study villages and what this means for productive credit use; it then describes how MC client respondents used their credit and made repayments, tracing the implications of both for livelihood security.

Risk and rural livelihoods in Afghanistan

Risk and uncertainty characterise life in Afghanistan for both the poor and the not-so-poor. In rural areas, sources of risk include environmental, climatic and ecological factors; labour markets supplying irregular and low-return employment; ill health and limited access to quality health care; and poorly functioning institutions. Many of these risks affect whole communities and not just individuals, meaning social support networks are slowly weakened by the effect of downturns, such as drought, crop diseases or rising food prices. Because of this, efforts to improve livelihoods and reduce poverty must focus not only on increasing income, but also on reducing risk and insecurity by bringing more regularity or assurance into people’s lives.⁵⁷ This stabilising or protective role for development interventions, including MC, may need to be sequenced prior to efforts to increase incomes, providing a more stable base from which to promote growth.⁵⁸ However, for MC particularly, programmes often focus immediately on increasing incomes without addressing income variability, or valuing reductions in this variability before or along with increases in income.⁵⁹ They also often do not consider the appropriateness of MC in a given economic context. This section examines risks

57 Vijay Mahajan, “From Microcredit to Livelihood Finance,” in *What’s Wrong with Microfinance?*, ed. by Thomas Dichter and Malcolm Harper, 241-249 (Rugby, UK: Intermediate Technology Publications, 2007); David Hulme and Paul Mosley, “Finance for the Poor or Poorest? Financial Innovation, Poverty and Vulnerability,” in *Who Needs Credit? Poverty and Finance in Bangladesh*, ed. by Geoffrey Wood and Iffath Sharif, 97-129 (Dhaka: The University Press Limited, 1997).

58 Johnson and Rogaly, *Microfinance and Poverty Reduction*; Rogaly, “Microfinance Evangelism”

59 Johnson and Rogaly, *Microfinance and Poverty Reduction*.

56 MISFA, “Microfinance: Making a Difference in Afghanistan.”

and rural livelihoods in the study village contexts to examine the scope for using MC to promote growth, and how the limitations of local economic opportunities may affect client outcomes.

The singularity of the outreach objective among some MFIs in Afghanistan may mean MFIs do not appropriately assess social and economic contexts to determine whether MC is an appropriate development intervention. Some contexts, particularly in rural Afghanistan, may not provide sufficient investment opportunities to support MC in its income promoting objective. This risk is summarised in the quote below:

*Microdebt can create considerable opportunities for people to utilize 'lumps' of money so that they can improve incomes and reduce vulnerability. But not all microdebt produces favourable results, especially for poor people working in low-return activities in saturated markets that are poorly developed and where environmental and economic shocks are common.*⁶⁰

The latter description tends to fit the study villages, and most particularly the Kabul village, as well as the types of economic activities on which many respondents had to rely.

As described in Section 3, among the three study villages the Kabul village is the most economically marginal, largely due to the effects of conflict. Its agricultural livelihood is based in its vineyards; however, many vines were destroyed during the conflict as was the irrigation canal system. Hence, villagers face a lack of water for agriculture, meaning this livelihood option is extremely limited. Wage labour opportunities are few, and those in Kabul declining. Many study households have diversified into non-farm activities but these tend not to produce regular income (mason work, selling generator connections, vegetable vending) or only generate very low incomes since they depend on the income of other village residents (shopkeepers). The lack of water to support the village economy is a major barrier to its economic advancement, and one

which limits the usefulness of MC as there are few activities in which to profitably invest the funds. The poor village economy also affects informal credit, reducing trust in others' ability to repay since there is little cash flowing in the village, as the quote below attests:

I mean before the Taliban villagers had good income from their grape gardens and lands, some of them were busy in their own shops. In that time people were giving credit to each other because they trusted each other. When the relatives to whom he gave credit get grapes from the garden and sell them in the bazaar for cash money, then they repaid the credit. Now villagers think that if we give credit how will they repay the money, because there is no grape production and no cash money. Therefore we do not trust each other.

- Jamila's husband

Socially the Kabul village also posed a challenge to the delivery of MC. Evidence suggests its outlook is rather conservative. For example, the idea of *sudh* was more problematic to many village residents, and even some MC clients, compared to other study villages. Many also disapproved of the KMFI's female loan officers. Another signal of the village's conservatism was the inability of two widowed female respondents (Nasima and Nilofar) to work due to their sons' prohibitions, even though they wanted to do so. Women in the two other study villages seemed to have more scope to work for income, inside and outside the home (for example, women in Bamiyan wove carpets and Shabana in Balkh was a teacher.)

Economically the other two village economies offered more potential, with the Bamiyan village being particularly better suited to MC, given both its history of informal credit with interest and its currently booming potato cash crop. The presence of an agricultural cooperative with access to heavy equipment also supported productive agriculture. Significant agriculture production in the Balkh village, including the more recent innovation of greenhouse vegetable production in winter, offered possibilities for productive use of credit, as does the opportunity to raise *qaraqol* sheep. The better options from land or livestock-based livelihoods mean MC may have more of a place in these villages.

60 David Hulme, "Is Microdebt Good for Poor People? A Note on the Dark Side of Microfinance" in *What's Wrong with Microfinance?*, ed. by Thomas Dichter and Malcolm Harper, 19 (Rugby, UK: Intermediate Technology Publications, 2007).

Investing more time and financial resources in understanding village social and economic contexts, including changing informal credit relations, could assist some MFIs in developing more informed strategies regarding both where to extend their programmes and how to do so. It might avoid the possibility of the MC programme becoming another source of risk instead of a means of improving security.⁶¹ The former outcome was evident in the Kabul village due to its lack of water, which meant there were few options for productive investment of credit (MC or informal credit). This along with the KMFI's relatively small loan sizes, which respondents reported were insufficient to support business and were easily diverted to consumption, meant MC for many did not have positive effects. Assessing the structural risks (e.g. lack of water to support agricultural livelihood activities) that might impede productive use of MC is vital to ensuring clients benefit from the extension of MC.⁶² This also will improve the sustainability of the credit programme as this depends in part on the clients' ability to borrow over many loan cycles.

Assessing the potential risk associated with MC does not stop at the village level. Within village economies, even those with economic potential, there is considerable risk inherent in rural livelihood activities.⁶³ This is particularly the case for those based in agriculture and livestock raising or trading, but as noted above, risk and low returns can extend outward from these if non-farm activities rely on the incomes others earn from land and livestock activities. These livelihood-based risks may impede the growth potential of productive credit investments, making financial services for income

protection (i.e. savings, insurance products) perhaps a priority over services geared to income promotion, particularly for poorer households. Apart from risks of loss due to factors beyond anyone's control, many MC practitioners note the challenge of delivering MC in rural areas because of seasonal income flows that affect credit demand, as well as the low rate of return on the available investment activities, particularly those that are crop based or in activities in which there are low entry barriers and high competition.⁶⁴ Credit will increase vulnerability if existing livelihood activities cannot generate sufficient returns to support repayment.⁶⁵ MC becomes a short-term problem-solver, like much informal borrowing, versus an intervention bringing medium- to long- term improvement. Welfare may increase but larger aims of improving livelihood security are not met.

Land and livestock based activities across the study sites are open to a range of risks, including weather, drought, price changes and pests or diseases. These affected households in the study across income levels, but households with more assets were better placed to cope with or reduce the effects of these risks, as Mukhtar's case illustrates.

Mukhtar, a wealthy man from the Balkh village, has considerable land holdings and farming is his main livelihood activity. He borrowed from BMFI1 three times and is happy with his engagement with MC. He profited significantly from his first loan, which was invested in agricultural inputs and wages of farm labourers and a small amount spent on consumption. He used his second loan to support a cotton crop but the market price declined, meaning he experienced a 5,000 Afs loss from this season. He was able to repay his 25,000 Afs loan by selling jewellery, a strategy with fewer negative livelihood consequences than available to others in a lower

61 Hulme and Mosley, "Finance for the Poor or Poorest?" studied microfinance initiatives in many countries and noted that there was little evidence of MF reducing risk of downturns. This was in part because the programmes did not pay attention to the structural characteristics of local economies, which limited how MC could benefit borrowers. See also Dichter, ch 15, 179-92, which notes the potential for MC to raise risks, as well as Sharif, "Poverty and Finance in Bangladesh," which links the potential poverty reduction effects of credit to the wider economic context and the opportunities it presents.

62 Dichter, "Introduction"; Wood and Sharif, "Introduction"; Wood, "Informal Security Regimes"

63 Brigit Helms, *Access for All: Building Inclusive Financial Systems* (Washington, DC: World Bank, 2006).

64 C.A. Gregory, *Savage Money* (London: Routledge, 1997); David Ellerman, "Microfinance: Some Conceptual and Methodological Problems," in *What's Wrong with Microfinance?*, ed. by Thomas Dichter and Malcolm Harper, 149-161. (Rugby, UK: Intermediate Technology Publications, 2007); Malcolm Harper, "Microfinance and Farmers: Do They Fit?," in *What's Wrong with Microfinance?*, ed. by Thomas Dichter and Malcolm Harper, 83-94. (Rugby, UK: Intermediate Technology Publications, 2007).

65 Helms, *Access for All*; Sharif, "Poverty and Finance."

economic situation. He continued to borrow from BMFI1, taking a third loan for 50,000 Afs which he was able to repay in one instalment from income from vegetable production. His is a household well positioned to bear the risk of his chosen livelihood activity, and to benefit from investments supported by MC. One could not say that this is a poverty reduction impact, however, since he was not a poor man to start with. This indicates that MC in Afghanistan's current context may be best suited to less poor clients, who are better able to bear the added risk of credit.⁶⁶

Latifa's household in Bamiyan has diverse livelihood activities including farming, livestock-rearing and carpet-weaving. On their eight *jeribs* of land they grow potatoes to sell, wheat for personal consumption and clover for livestock feed. They have taken loans from BmMFI1 through four loan cycles, using the credit for a mix of productive and consumption purposes, as is often the case. Like Mukhtar's household, they also suffered a loss in one of their credit investments, but struggled to recover. Their first BmMFI1 loan was used to pay off interest-bearing informal debt, to buy a cow and for household consumption. However, the cow died after one month, leaving the household struggling to find a way to repay. They ended up using income earned from their potatoes to repay the loan, leaving them without funds to reinvest in the land or to make it through the winter season. This led them to borrow a second, larger loan from BmMFI1 before winter to use for household consumption in winter and for agricultural inputs in spring. This loan was repaid from income from potato sales, and according to Latifa they also sold a cow and calf. The household has taken two more BmMFI1 loans since then and has slowly been able to move out of its initial deficit position, leaving them with a positive view of MC.

This case shows the potential for MC to support the livelihood of a more middle-income household;

66 The external evaluation of the Afghanistan Reconstruction Trust Fund by Scanteam, released August 2008, reports that borrowers within MISFA's programme, while not wealthy, are a mid-level group who are not normally the targets of poverty reduction focused MC programmes. This is not unique to Afghanistan. Johnson and Rogaly, *Microfinance and Poverty Reduction*, and Allen, "Finance Begins with Savings" both find that it is the not so poor who can most benefit from MC. They tend to have multiple income streams and sufficient asset holdings to both bear the risks associated with MC, and to take risks.

but it also highlights the tenuousness of the household's position. One bad potato crop or a decline in potato prices and their situation would change dramatically. The residents' dependence on the potato crop, which is dependent on water and weather, means improvements tend to be at the margins and can easily be reversed in the face of risks over which they have no control. While MC plays a positive role and is appreciated in the Bamiyan village, by itself it is insufficient to lead to sustained livelihood improvements given the existing risks of agriculture and livestock activities in this context.⁶⁷

From Balkh, Sima's household was among the poorer households. Sima and her husband both borrowed from separate loan groups to buy a cow each in the hope that sales of their products and progeny would generate income to repay the loan. The low and irregular returns of this activity were soon apparent: while the cows gave significant milk in the first months, the quantities declined rapidly, along with the income earned from milk sales. The cost of fodder became higher than the income earned from milk sales. Because of this, both decided to sell their cows. Sima gave up her loan to a relative, selling her cow at a loss and making up the difference between these funds and the loan amount through giving her BMFI savings to the relative as well as a balance of 3,000 Afs taken from her husband's earnings. Sima's husband sold his cow at cost and reinvested these funds in wheat to trade, with the aim of earning a profit and repaying his loan. This did not happen; half of the wheat he sold at cost and the balance they used for consumption. He therefore did not have funds to repay his loan. His father mortgaged land to help him, meaning a major asset is now at risk if they cannot raise the funds to repay. In the end, the MC experience created an increasing burden of debt on the household, due to the low earnings to be obtained from their investment and their weak market position in selling their livestock. It also placed a strain on relations with Sima's father-in-law, which may lead them to take more credit to

67 Hulme, "Is Microdebt Good?" and Mahajan, "From Microcredit" discuss the role of MC as part of an integrated strategy aimed at improving rural livelihoods through reducing risks.

repay him, if they are still eligible:

I don't know. What should we do? He comes all the time asking for his money. We are thinking of taking another loan from the office to repay my husband's father but we don't think the office will give us a second loan because they told us that they will not give us another loan if we repay late.

- Sima

Other productive loan uses, not tied directly to agriculture, also tend to be low return, even in the more vibrant villages in Balkh and Bamiyan. Shopkeepers in particular struggle because of the low cash earnings of village residents. Therefore, while MC can be useful in stocking shops and increasing sales, the limited resources of village residents constrain growth, and also make repaying informal credit from wholesalers or MC difficult because of slow customer credit repayment. Shafiq and Qasim in the Kabul village experienced such struggles, making them wish to move their shop into Kabul city where relations with customers would be more distant, allowing them to make repayment requests. Karim's household in Bamiyan also struggled with MC repayment because of offering too much customer credit and being unable to collect it.⁶⁸

The households in the study villages illustrate that secure livelihoods often depend on a diverse array of assets, some of which MC may do little to promote directly. Remittance income is one important source of security and investment income, as Farooq's Kabul household shows. Remittances from a son in Iran allowed him to prepay rent on his shop. Help networks with relatives—social assets—are important as discussed in Section 4.2. These include shopkeepers who are relatives and who will extend credit on good terms; and relatives who help via cash or in-kind gifts. While MC may assist in cementing social assets, this often results from

⁶⁸ Interestingly, Johnson and Rogaly, *Microfinance and Poverty Reduction* note how informal credit can instill financial discipline through threats of social ostracism (i.e. if borrowers do not repay). However, in the Afghan context, the social ostracism seems to be linked more strongly to requesting repayment of informal credit, which is inappropriate and threatens the *sawab* associated with helping others (religious merit). This constraint hampers the ability of shopkeepers to expand their businesses.

breaking MC rules rather than being something aimed for within the programmes.

Concerns about investment risk and low-return activities are evident in the literature on MC. However, client actions imply they view these risks differently. The frequency with which clients borrowed multiple loans against MFI rules indicates an interest in more credit rather than less. However, the outcome of some of this 'over-borrowing' has not been positive, as illustrated through Murtaza's and Akbar's cases. More research is needed on risk perceptions to better understand the reasoning behind some of these actions.

Opportunities for productive use of credit exist in all the study villages, but the quality of these opportunities tends to be low, making repayment difficult. Another factor that makes finding the money to repay a challenge is the tendency for borrowers to use some if not all of the loans for consumption. This is in part related to the low earnings from rural livelihood activities, which do not support annual expenditure needs. Informal credit or MC are then needed to help families meet consumption needs, whether for daily expenses, stocking up for winter or to meet the costs of sudden shocks or crises. The next section examines the use of loans among the respondent households.

Uses of credit

Table 3 provides information about loan use across the study households. It clearly indicates that one cannot easily categorise either informal or MC loans as used for production or consumption; what is most common is that informal and formal credit are used for a mix of purposes. The funds enter the household economy and are used as needed at that time.⁶⁹ For some this may mean diverting credit from planned productive use due to a sudden crisis. For example, in the case of Jamila from Kabul, a loan for working capital was diverted for medical costs. For others, consumption use of credit simply reflects the reality of day-to-day life in rural

⁶⁹ Allen, "Finance Begins with Savings" also finds that financial services are not solely used for microenterprise activities; they often are used to manage domestic cash flows—to smooth consumption levels.

Afghanistan and the inability to meet daily needs from daily or seasonal income flows. Many need credit to smooth over periods of no or low income, thus to ensure they can meet minimum levels of consumption. It is important to note that a few respondent households worked hard to avoid taking credit—particularly MC but for some also informal credit. They maintained expenses in line with their income, and avoided MC due to an acknowledged inability to invest it productively and fears about the shame associated with being unable to repay on time (e.g. Daud, Zarifa and Karim).

The common practice of diverting portions of MC loans for consumption indicates that MC, and particularly MC alone, may not be the most appropriate intervention to reduce poverty and bring greater livelihood security. Even respondents who are very positive about their MC experience, and have been through a number of loan cycles, still express a need to divert some MC to consumption. This implies they cannot earn enough from their investments to both repay their credit and meet their consumption needs. For example, Latifa's husband reports:

Before this credit [from BmMFI1], I didn't have even a carpet to sit on; but now I have carpet in my home and I could also buy some cheap household equipment and this all because of the MC... When I harvest the potatoes, I repay the credit of the MFI from that money and then I will get another loan from the MFI and that money I use for winter expenses as well as for re-cultivation of my land.

This hints at a dependence on MC, which was not only evident in this case. While this need would be less surprising early in participation in a credit programme, after four loan cycles, the continuation of this dependence is more problematic. It points to the inability of the village economy to support sufficiently profitable and diverse activities to promote client viability.

The use of MC for consumption was most strongly expressed in the Kabul village, linked to its relatively small loan sizes. Evidence from respondents indicates that MC from KMFI was most useful for solving immediate problems versus fostering long-

term economic development at either the household or village level.

But it does not have a positive effect on the household economy because villagers can't work on that money. They are using it for household consumption.

- Hamid

With this credit villagers' income will not increase because they cannot work with this money. As I told you before, they can only solve their problems and use this money for household consumption. From MC villagers could not get any benefit.

- Jamila's husband

The low returns on rural livelihood activities—land-based, off-farm and non-farm alike—mean the need for consumption credit is high. Informal credit has traditionally been the source of this but with the entry of MC, it too is being used for this purpose, in part or in full. This is more problematic for livelihood security because of the fixed repayment periods and late payment fees associated with MC, in comparison to the repayment flexibility found in respondents' use of informal borrowing. Hence, how households repay MC is another indication of the viability of household economies and of the impact of MC use. The next section examines repayment strategies among the study households.

Repayment strategies

The objective of MC programmes is that clients invest their loans in productive activities and the returns from these investments are then used to support both household needs and debt repayment. As Table 4 (page 46) illustrates, this objective has only infrequently been attained among the respondents involved in MC in the study villages, even for those involved in MC through multiple loan cycles. Client households use a range of repayment strategies to meet the MFIs' set repayment rules, including: reserving some loan funds; informal borrowing; sale or mortgage of productive assets; use of savings (livestock and jewellery); and payment from income, either from the investment activity or other income sources. Note that these strategies

do not differ significantly from those respondents reported using to repay informal credit except that the option of postponing repayment – and for some credit forms the postponement was indefinite – was only available for informal credit.

Repayment is especially difficult for KMFI borrowers since this MFI expects repayment to start one week after receiving the loan and then to be given each week after that. Respondents from the Kabul village and those borrowing from KMFI in the other villages reported difficulty with this aspect of the loan programme structure. The monthly repayment of BmMFI2 was less problematic in terms of timing. Borrowers greatly valued the longer loan terms of BmMFI1 and BMFI; these programmes were structured around rural income flows, allowing longer grace periods before principle repayment. This period reflects harvest times and maturation periods for livestock. These loan programme characteristics have some effect on repayment strategies and abilities. However, use of some or all of the loans for consumption and the low returns from many activities make repayment difficult for many MC clients, across programmes. The quotes in Box 1 (page 47) illustrate the repayment concerns of some MC borrowers and non-borrowers, across programme sites and loan uses. Latifa and her husband expressed no problems when asked directly about repayment. They reported saving enough from their land's production to meet the known repayment amount. However, details about how they actually repaid each loan show they also had to sell livestock and would consider selling an ox if the current year's production was not enough to meet the loan repayment. They also still need the next loan to meet winter expenses, indicating an inability to meet all of their consumption costs from income. Karim also reports confidence in repaying when asked directly; his wife, however, was concerned over repayment, which is supported by their actual repayment strategies (see Table 4.2). Their shop income is not sufficient to repay the large sums of BmMFI1 credit taken, so they must also rely on their income from potatoes. Mukthar and Shabana from Balkh are the most able to repay their loans, even in the face of a loss (Mukthar) and after using the loan only for consumption (Shabana). This is because these two households are better off

than others, having either considerable assets to draw upon or a fixed salary.

Respondents choosing to borrow from an MFI know from the start that they will need to find the money to repay and in what time frame. In all cases they did find the money. It may have been more difficult than expected, as some of the quotes in Box 1 illustrate, but no household among our respondents has defaulted on a MC loan. Some have missed payments (for KMFI particularly) or paid a few days late and had to pay a fine. This repayment “success” reflects the prioritising of MC repayment over other credit, due to the fines associated with late payment of MC, shame associated with defaulting, and a concern with maintaining creditworthiness with the MFI as well as informal networks.⁷⁰ Others have described the strategising behind decisions regarding which loans to repay and which to delay as based on, “the relative merits of different lenders and with which it is important to retain a good credit record.”⁷¹ Ghulam Sakhi's decision-making process in relation to debt repayment illustrates some, particularly those borrowing from the KMFI, relate that shame associated with loan officer demands for repayment drive their efforts to repay on time. Akbar, a KMFI borrower, expresses this, noting:

KMFI credit is a stain on the dignity of clients because when clients don't have the money then whatever the loan officer says they must accept. The loan officer is pressurising a lot.

This source of shame is added to that reported previously, related to making payments on time to preserve one's honour and reputation.

Some respondents seem to have an over-confidence in their ability to find the money to repay, which can result in reliance on informal credit systems. This over-confidence is seen in the desire to take multiple loans against loan programme rules. For example, this has led to over-borrowing for Murtaza, and considerable stress due to the burden of his debt. Murtaza, one of the first borrowers from BMFI, started out with hope for his future

70 The implications of prioritising MC repayment for assessments of MFI success are discussed in Section 4.4.

71 Johnson and Rogaly, *Microfinance and Poverty Reduction*, 60.

Table 4: MC repayment strategies

Respondent	MC loan uses	MC repayment strategies
Kabul		
Jamila	Medical costs; daily needs; loan repayment	Reserved loan funds paid back to MFI; borrowed from relatives; help from sister in law; from husband's earnings (after recovery)
Nasima	Medical treatment	Income from sale of milk and eggs; sold earrings, wheat, chickens, a chadori; borrowed twice from loan group leader
Qasim	Stock for shop	Borrowed from neighbour once; from shop earnings; missed one payment and used money to restock shop
Akram	House repair; garden investments; daily needs	Sale of milk products and raisins; sold sheep; borrowing from loan group member and from a neighbour
Akbar	Repay informal credit; stock for shop	From shop earnings; shop decapitalising
Bamiyan		
Karim	Butcher shop start up; inputs for business (livestock); new business start up after butcher shop failed; wedding costs	Sale of potatoes; profits from sale of livestock
Haleema	Vehicle purchase; daily needs	Income from vehicle; sale of ox; borrowing from relative and shopkeepers; sold a car; mortgaged land
Zahra	Livestock purchase (for trade); daily needs; gave up 1 BmMFI1 and 1 BmMFI3 loan to others	Sale of potatoes; from daily wages
Ghulam Sakhi	Fertilizer and seed; daily needs; tractor rent; repay informal credit taken to repay MC; mortgage in land; gave some of BmMFI2 and 3 loans to others	From sale of grasses and potatoes; borrowing from shopkeeper
Latifa	Buy livestock; fertilizer and seed; pay farmer; daily needs; gave 10000 Afs to Haleema	From sale of potatoes; sold cow and calf, may need to sell an ox to repay outstanding loan if production is not sufficient
Balkh		
Mukhtar	Agricultural inputs; wage labourers; daily needs; sewing machine; home furnishings	Sale of agricultural produce; sale of jewellery; use of savings at BMFI1
Sima	Bought livestock; daily needs; turned over loan to Aslam; MC repayment; fodder	Gave up one loan to relative; sold wheat to pay interest; relative mortgaged land to help repay MC; wage labour income; help from Sima's niece; borrowing from friend
Murtaza	Agricultural inputs; daily needs; start livestock trading work; repay informal credit used to pay MC	From production of sharecropped land; used BMFI1 savings; sold calves; borrowed from jalabi workers; unsure how to repay 3rd loan: informal credit or production from land if MFI will wait
Haji Ahmad	Sheep fodder; daily needs	Sale of lambskins; daily wage income
Yaqoub	Sewing machine; bought calf but sold it to make repayments; daily needs; school supplies (BMFI2)	Sale of milk, eggs and dung cakes; wage labour income; sale of calf
Shabana	Buy gold jewelry; home improvement (BMFI2)	From Shabana's salary

and the benefits of MC, “In that time I was very happy and I thought that it (MC) will change my life conditions...” However, his outlook has changed after going through three loan cycles, in two of which he “hoarded” a group loan. Murtaza owns no land or livestock. However, he has built a diversified livelihood around sharecropping in land, livestock-trading and most recently, starting a village shop to try to offset the risks inherent in the first two activities. He started the shop with proceeds from livestock trading and a BMFI loan. His first BMFI loan was used for agricultural inputs and consumption. While not taking a loss on this investment, he had to use all the earnings from the land to repay the loan, plus use the savings deposit for repayment. This did not deter him from taking another loan, and this time in a group so he could access more money by keeping all the money for himself (100,000 Afs after the required savings were deducted). He used this loan to buy livestock and fodder for his trading business and spent half on winter consumption and the monthly interest fees of 2,500 Afs. Sadly, he was unlucky in the livestock trade, only able to sell

the animals at cost or at a loss. Because of this he had to find other sources of income to repay the loan—selling a calf and borrowing 35,000 Afs from two other traders. He took informal credit to maintain his relationship with both the MFI and his shopkeeper guarantor. In order to repay the informal credit and try a new livelihood activity, Murtaza took a third loan with the same group. He again kept the 100,000 Afs for himself, repaying the 35,000 Afs informal debt, using 60,000 Afs to open his store and the remaining 5,000 Afs for consumption. This project, too, is not paying off because his customers have not been able to pay for goods bought on credit—they currently owe him 14,000 Afs. Murtaza is now facing pressure from his guarantor to repay, because the BMFI is pressing him. Murtaza’s current repayment strategy is to either ask BMFI to extend his repayment period by six months, or to borrow from his new sharecropping landlord. As he states below:

Box 1: Repayment struggles

If I knew that it would be this difficult, I never would have asked for credit from the office. Repayment was difficult. - Jamila (Kabul)

[I dropped out] because it was difficult for me to pay every week...that every day when I sold vegetables on the cart, the money I earned was paid to the MFI. - Male loan group FGD participant (Kabul)

When I repay my current loan [the household’s fourth] I don’t want to get another loan because of the weekly repayment, which is difficult for me. - Akram (Kabul)

It [MC] has a benefit. We are happy with the credit. Just the repayment time—we have to find the money from everywhere to repay. - Haleema (Bamiyan)

The credit which I took did not have any advantages for me except the 1000 Afs profit from two sheep. I was afraid if I am unable to repay their money then I will have a problem because I don’t have my own land so I didn’t want to get credit again from BmMFI1. - Zahra’s husband (Bamiyan)

I used that credit for the cow. But after three months, when I could not afford to feed the cow and it was time for repayment, I was worried about repayment. Aslam said to me that I could give him the credit and he would be responsible for it because he needed the money for his jalabi work. - Sima (Balkh)

There is a lot of credit pressure on me. It increases day by day, from one side the credit of the shop and from the other side the credit of BMFI. I am lost in credit, how will I find the way to recover the repayment of credit.

Murtaza's MC repayment strategy is one of many that draws on informal borrowing. This again highlights the interconnection between the credit systems upon which MC claims of success seem to rest. The informal system's more flexible repayment customs and the prevalence of cost-free credit (at least financially if not socially), means many of the study's respondents turn to informal credit networks when facing MC repayment struggles.⁷² Apart from Murtaza, Ghulam Sakhi also heavily relied on informal borrowing to repay his MC, and Sima's household needed help from her father-in-law to repay their MC. This can have longer-term negative effects because of the importance of these social relationships to livelihood security, in the absence of other state-run support systems. A reliance on debt to repay other debt also places households at risk of ending up in a spiral of debt. In Ghulam Sakhi's case, he diverts considerable portions of the next MC loan to repay his informal creditors, as Murtaza did, reducing the amount available for productive use. This, coupled with the riskiness of investment activities (land and livestock based especially) means repayment difficulties can be compounded from one loan cycle to the next. Much of this is hidden from the perspective of the MFI, since they are more focused on getting the repayment—not on how the client was able to repay. In the end, repayment can be painful due to the strategies households must resort to in order to find the money.⁷³ MC programmes could do more to understand and monitor this, to better understand impact and success. Section 4.4 explores these issues.

Conclusion

This section has questioned the ability of MC to positively affect rural livelihood security in the study villages due to the risks inherent in the prevalent

rural livelihood activities and the structural limits to economic development found in the villages. The latter are due in part to the limited investments in the rural economy and infrastructure over the last seven years, which mean most activities, whether on-farm, off-farm or non-farm, tend to be low-return, irregular and risky. These characteristics of the study contexts mean part or all of the MC loans are used for consumption, an outcome increasing immediate welfare, but leading to problems in repayment for many. Households often resorted to further borrowing to repay MC and at times informal credit, as well as asset sales and other negative strategies. This can lead to a spiral of debt and greater insecurity, as successful repayment depends on increasing debt, which may overburden existing social support networks.

4.4 Success and viability for whom?

This section examines how the objectives and success indicators MFIs and MISFA use do well in promoting institutional viability but give less attention to client viability and security. The result is the outcomes described in Section 4.3 among respondent households:

- frequent divergence of loan funds to consumption use due to insufficient income flows to meet basic needs and exposure to crises requiring cash;
- lack of coordinated programming to improve the local village economies, meaning credit is invested in low return activities that are often unable to generate funds to support repayment;
- repayment struggles that can lead some into a cycle of debt, asset sales and consumption reduction.

This section examines how definitions of success within the MC industry in Afghanistan may limit attention to client outcomes, with the end result threatening MFI viability.

MISFA from its start has aimed to establish a commercialised service with funding linked to performance and performance defined as MFI

⁷² Gregory, *Savage Money*

⁷³ Hulme, "Is Microdebt Good?"

operational sustainability.⁷⁴ It has largely been successful in this regard, as noted in an August 2008 evaluation of the Afghanistan Reconstruction Trust Fund (ARTF), which included an evaluation of MISFA.⁷⁵ Most of the MFIs operating under MISFA's umbrella are on track to cover costs with income. They have achieved this through prioritising client numbers and high repayment rates.

There is no doubt that MFI sustainability is important. MFIs with less dependence on donor funding are less influenced by the whims of development agencies and shifting funding allocations. However, an over-valuation of commercial viability, or expecting it too quickly, can lead to less attention to poverty reduction, client outcomes and to the inter-linkages between client and MFI viability.⁷⁶ This paper contends that the MFIs under MISFA are at risk of undermining client viability in favour of that of their institutions, driven by their focus on client outreach, repayment rates and operational sustainability. This may mean that the financial sector expands in the short term, but in the medium to long term this focus may threaten the success of MFIs as clients are unable to continue to find the money to repay or to find benefit from the programmes on offer.

The concerns above are mirrored in the section of the August 2008 external evaluation of the ARTF focused on MISFA.⁷⁷ It concluded that MISFA's performance monitoring is limited to outputs and has not extended to the level of outcomes and impact. It also notes that recent efforts to incorporate measures of impact and outcomes into MFI results monitoring have been limited in relation to their focus on poverty reduction and social performance. Outreach remains the main means of measuring success in meeting the needs and demand of poor Afghans.

Along with outreach, MFIs in Afghanistan and

⁷⁴ MISFA, "Microfinance."

⁷⁵ Scanteam, "ARTF Evaluation."

⁷⁶ Wood & Sharif, "Introduction"; Sharif, "Poverty and Finance"; Johnson and Rogaly, *Microfinance and Poverty Reduction*.

⁷⁷ Scanteam, "ARTF Evaluation."

elsewhere also use repayment rates as indicators of success.⁷⁸ The higher the share of borrowers able to repay loans on time indicates a successful programme. While this indicator can represent improvements in clients' income flows, this is not assured.⁷⁹ As reported in Section 4.3, repayment strategies in some cases were harmful to livelihood security. Therefore, the numeric indicator alone is insufficient as an indicator of either MFI success or client viability. It must be coupled with an understanding of how clients repay, and broader measures of social performance.

The focus on operational sustainability within the financial services sector in Afghanistan, and the rapid timeframe set for achieving the goal, trickles out to influence how clients perceive some MFIs and how some MFI staff behave. This study found that MFI staff actions can ensure MFI evaluators or central office staff see what they want, with this limiting organisational learning; staff behaviour was also found to alienate clients, particularly in the KMFI case.

Clients and MFI staff alike questioned the motives of MFIs; this was particularly the case among KMFI clients, as the quotes below show:

We understood that the KMFI is only looking out for its own profit, not to solve the problems of the people.

- Male loan group focus group discussion participant, Kabul

The KMFI credit is not for the welfare of villagers; it is looking out for its own benefit.

- Hamid, non-MC HH, Kabul

These sentiments are supported by a KMFI staff member, who states:

The KMFI only wants to run its own business and is looking for its own sustainability, not for the poor. Because they are telling us to give loans and get our profit, and don't give to those who you think will not be able to repay the money.

⁷⁸ Rogaly, "Microfinance Evangelism."

⁷⁹ Wood and Sharif, "Introduction."

A similar focus on repayment was attributed to BMFI by a loan officer, who says, “We don’t have a problem in that case—if one person uses all the money or everyone. We are just looking for repayment.” The KMFI was adversely affected by these perceptions. Client drop-outs were described as high by respondents in the Kabul village, with loan officers having less and less work to do. In the Bamiyan village, though KMFI only recently started operations there, it was ending its work at the time of the field work because of its lack of success. Its blueprint approach led to a lack of competitiveness with other MC providers and the informal system. This in the end threatened its viability.⁸⁰

The focus on repayment meant staff at the study MFIs were at times motivated to act in ways counter to Afghan custom, or against MFI stated rules, if the end result was repayment or the appearance of success. KMFI loan officers are held accountable for missed payments through salary reductions. Hence, they pressure clients to repay, leading to female loan officers publicly harassing men and women clients. Loan officers also may hide repayment problems by paying from their own pocket until a client can repay. This means the loan officer does not have her salary cut and appears successful to the KMFI but also that the KMFI is not aware that clients struggle to repay.

Oh yes, sometimes we (the KMFI) deduct the client instalment from the responsible loan officer’s salary and then when the loan officer takes the money from the client, she takes it for herself... In this case the loan officer is compelled to get money from the client.

- KMFI Loan officer

Loan officers don’t behave badly with those clients who repay the money on time. I saw a woman who didn’t repay for two weeks. Then the loan officer came to her house and shouted at her, “Why didn’t you repay the money?”

- Jamila, MC HH, Kabul

The need to make the branch offices look successful

also led BmMFI1 staff to collude with clients at times of scheduled monitoring visits. This might hide consumption use of credit, putting the “right” face forward in terms of productive investment, as the story below illustrates.

There was a person who took credit from the BmMFI and said to the office he would buy some sheep. Instead he used the money for household consumption. When the loan officer and the foreigner came to his house, they asked him where were his sheep. The foreigner became angry and said “We gave you the money to improve your life. You made a problem for yourself by using that money for household consumption; how will you repay it now?” Then the man’s son brought a neighbour’s sheep and showed them to the loan officer and the foreigner and said that they were their sheep. Then the MFI became happy.

- Haleema’s husband, MC HH, Kabul

All of this raises the question of how interested some MFIs are in understanding how clients use their loans and make repayments. It seems that for some, interest stops at the level of appearances, to the detriment of their clients.

MISFA’s focus on operational sustainability affects the client mix and outcomes of its partners. In terms of client mix, it is the mid- to upper-poor and some non-poor who seem to be more likely to be MFI clients, unless it is a case of a client giving up a loan to someone in a help network. KMFI reached down to poorer clients, in part reflecting its smaller loan size. BmMFI1 and BMFI tended to attract a relatively wealthier client group due to their larger loans. The ARTF evaluation supports this, noting that while most borrowers were not wealthy, the client mix tended not to fit that expected from a poverty reduction focused credit initiative.⁸¹ The evaluators link this client mix to the aim of achieving operational sustainability in the relatively short five-year period desired by MISFA; this requires a somewhat better-off client base.⁸²

⁸⁰ Rogaly, “Microfinance Evangelism” cautions against a focus on scale and repayment rates; this reduces client focus and leads to a standardised approach which can limit the sustainability of the financial service offered.

⁸¹ Scanteam, “ARTF Evaluation.”

⁸² Hulme and Mosley, “Finance for the Poor” also link a middle to upper poor target group to MFIs with a financial sustainability objective.

With client viability currently less central to the objectives or performance monitoring of the MFIs in this study, it is not surprising that respondent outcomes were mixed. Those who most clearly benefited from their MC borrowing were those starting from a relatively better position, owning significant assets and/or having a regular source of income (Mukthar, Shabana). Others showed improvement, including Latifa, Haleema and Ghulam Sakhi, as well as Jamila who recovered from a health crisis through use of KMFI credit. However, these improvements are fragile and tend to be welfare-oriented. The latter means that they have led to some improvement in living standards, which is good, but they have not necessarily reduced the households' risk exposure in a manner increasing stability and security. The improvements could be easily reversed by a bad agricultural year or a shock to the household economy. This in part goes back to the risks inherent in the economic contexts that cannot be addressed through credit alone.

Other respondents did not benefit at all from MC, ending up with an unsustainable debt burden or having to sell or mortgage assets to repay the loan (Murtaza, Akbar, Sima, Nasima), or only seemed to break even (Karim, Qasim, Zahra).⁸³ These outcomes support the need for a reconsideration of the intensity of MISFA and its partners' focus on operational sustainability and commercial success and the expansion of performance monitoring to include more qualitative information about client

viability. The latter will be for the benefit of both clients and MFIs as client viability underpins MFI sustainability.

There are definite indications that MISFA is moving in this direction. It is focusing more on social performance and its 2007 baseline and initial impact study recommend a set of social impact indicators to better assess partner progress.⁸⁴ These include indicators of educational attainment, health status and access to health care, housing quality, asset ownership, savings, decision-making control over loan use and proceeds, unmet demand for credit, activity for which credit is needed and satisfaction with the MFI services. While important indicators, this proposed framework has significant gaps based on what the findings from this study point to as barriers to impact. It does not document borrowing from other sources to understand the client's engagement with informal credit systems or other MFIs (debt burdens), nor does it have a section for the loan renewal or exit interview asking clients about actual use of the loan, or how the client plans to repay and does repay. That said, this development is a definite sign of progress in broadening the indicators against which MFI performance is judged. Integrating established social performance monitoring tools, adjusted for context and capacity constraints, is important so MISFA and others can continue the process of strengthening the client focus of Afghan MFIs.⁸⁵

⁸³ Some benefited socially by using their MC to strengthen social relationships, including Zahra and Haji Ahmad.

⁸⁴ Martin Greeley and Mohit Chaturvedi, "Microfinance in Afghanistan: A Baseline and Initial Impact Study for MISFA" (Kabul: MISFA, 2007).

⁸⁵ See in particular the Imp-Act website (www.imp-act.org). This programme focused on building social performance monitoring systems so that client needs are better met, increasing MFI market share through satisfying clients.

5. Conclusions and Recommendations: From Access to Impact

This paper aimed to understand how the availability of MC affects informal credit systems and livelihoods in rural Afghanistan. It used a small-scale, in-depth qualitative research approach to delve into livelihood activities, decision-making processes around borrowing informal and formal credit, and uses of credit and their consequences. This was done in order to inform MC providers about how to improve the livelihood security outcomes of their borrowers. Larger-scale quantitative research has been done on credit in Afghanistan by the MFIs, MISFA and consultants hired by MFIs as well as through questions in the National Risk and Vulnerability Assessment. However, the sensitivity of questions about credit and debt, and the shorter time spent engaging with respondents used in these approaches may preclude them from obtaining the nuanced data this study did on motivations, perceptions and satisfaction, albeit from a small sample. The study's purpose is not to disparage MC but to provide information to make its engagement more sensitive to and reflective of client needs and best practice.

The paper showed how introducing MC in villages in rural Afghanistan based on assumptions of a lack of access to credit can cause problems for both borrowers and MFIs. These problems result from not considering how MC and informal credit systems interact, the social importance of credit relationships and how these might transfer to the MC system, and the importance of informal credit as a social protection system. MFIs in Afghanistan need to invest time and financial resources in understanding the positive and negative features of informal credit systems in order to develop and implement new products and programmes. This includes what people gain from these systems beyond credit and how more exploitative aspects provide niches for MC products. There is clearly demand for credit in rural Afghanistan. However, some of this may be better met via the often more flexible and cheaper informal system. MFIs need to better assess the niches they can fill and the products people want; this is the next phase in the evolution of the financial sector in

Afghanistan, and one which is underway.

Mahajan, in recommending a broadening of MF to livelihood finance, describes five “fatal assumptions” in MC, which are drawn from and added to here for the Afghan context, to summarise the study's findings.⁸⁶

First is the assumption that credit is the primary financial need of the poor. This relates to risk and how credit can add risk to already insecure livelihoods. For some, savings and insurance products may be more beneficial. Second, Mahajan also questions the supposition that MC can almost automatically result in successful investments; this is based on a minimalist credit delivery model where lack of finance is viewed as the key constraint to entrepreneurial success. This study clearly demonstrates the multiple constraints on successful use of credit to promote growth in the study villages, not least of which are the lack of vitality in local and regional markets and the uncertainty around agricultural returns due to climatic risks and the continued effects of conflict-related decapitalisation. This supports the need for broader investments in the rural economy and MF products aimed at income protection as well as growth.

The third assumption is that the poor, and even the mid- to upper- poor, all want to be self-employed, and that MC can assist in achieving this goal. Many people may prefer steady employment, and become self-employed due to a lack of options. For rural contexts, the arguments are more subtle. Those with land can use MC to improve their farming activities. However, the programme must offer credit products which provide sufficient loan sizes to support investment and that fit the seasonal dynamics of livelihoods. This finding was very clear from the study, where BmMFI1 was highly valued due to its grace periods matching rural cash flows, while KMFI was not.

86 Mahajan, “From Microcredit,” 242-3.

The fourth fatal assumption is that providing MC to those above the poverty line is mis-targeting. On the contrary, this may be a way in which to cross subsidise the delivery of different credit and financial products to poorer clients. Respondents in this study were not all among the poorest in their villages. In fact, it was the least poor respondents who had the best outcomes. This does not have to be a bad thing, if programmes are designed to provide different products to different client groups.

The last assumption that is questioned is that all MFIs can become financially sustainable. Available data suggests that in 2007 only about 100 of 10,000 MFIs globally have reached this goal.⁸⁷ Therefore, requiring MFIs in the challenging Afghan context to achieve this in five years, while possible, may minimise attention to client needs and impacts, and to innovative programme design.

Two other inappropriate assumptions found within the MF sector in Afghanistan are that the informal credit system is marginal, and can be ignored in developing new MF services and in understanding the performance of MF, and that MC is all about the money and has no other meaning to borrowers. This study has shown how informal credit and MC systems are linked, even to the point where the success of MC may depend on clients' access to informal credit to support MC repayment. It has also shown that some clients can decide not to join MC programmes based on their access to informal credit, and may leave MC programmes not suiting their needs, given their confidence in finding the money elsewhere. Finally, the social use value of informal credit and MC can influence how clients use credit and how they manipulate programme rules. This side of credit is particularly important in rural Afghanistan, given the role of social support systems in providing some level of security.

What do these conclusions mean for action in the MF sector in Afghanistan? Below are six recommendations aimed at improving the ability of the sector to respond to client needs and to increase client viability and that of the MFIs.

- **Make MF one part of an integrated rural development approach.** The findings of this study, as well as a wealth of literature on MC, illustrate that MC alone is insufficient to promote either livelihood security or income growth; it is not a panacea for poverty reduction. Structural barriers within the local and regional economy limit opportunities for credit use. Therefore, MF programmes must be implemented in a sequenced manner supported by wider economic development initiatives to address infrastructure gaps, limited access to resources, including water, and local power dynamics, which may make the room for manoeuvring for many marginal at best. Without an integrated, coordinated approach to rural development, MF may only assist clients to cope as opposed to stabilise or improve. Government-led efforts are underway in this regard (CARD, AREDP); MFIs can also link with their NGO counterparts to develop integrated development strategies at the village, district or provincial levels.
- **Develop a dual approach to delivering MF in Afghanistan, incorporating both commercial and risk reduction aims.** This paper supports the recommendation of the ARTF evaluation team for MISFA that it develop a dual approach to delivering credit in Afghanistan.⁸⁸ MISFA and its partners have been successful in developing a commercial financial services sector, but they have done less well in addressing poverty and risk reduction for poorer Afghans. This can be remedied by continuing to expand the commercial side for upper poor and non-poor clients, and using some of these earnings to support new products and programmes targeting the poor. These would be aimed at reducing risk and stabilising livelihoods, as a first step to growth. These programmes may not become operationally sustainable as quickly, if at all, but they would meet some donors' expectations of the poverty reduction focus of MC, which have not yet been met.
- **Expand MC to MF to address risk reduction as well as income growth.** Linked to the previous recommendations, MFIs should expand the range

87 Mahajan, "From Microcredit."

88 Scanteam, "ARTF Evaluation."

of financial services they offer to support risk reduction. KMFI's death benefit for clients is one example that can be expanded on. Others include opportunities for secure savings; health insurance given the prevalence of health shocks and crises; and crop and livestock insurance. The social protection sector strategy of the ANDS recognises this gap in market-based means of social risk management.⁸⁹ It prioritises diversifying these market-based arrangements, which have largely been based on providing credit, to include community based savings and insurance. This paper strongly supports action in these areas. In order to support informed action, investing time in learning from innovations in MF service expansion in the South Asia context is vital. This is not for the purpose of directly importing existing models or programmes, but to inform an assessment of what is feasible and appropriate in the Afghan context. MISFA and its partners are making strides in diversifying products, for example developing Sharia-compliant products and highlighting product quality over quantity of clients.

- **Expand performance monitoring to include indicators of client viability.** At present, MFIs in Afghanistan have focused more on institutional success, measured through outreach numbers and repayment rates, than on how clients perform. This is changing as MISFA invests in systems of social performance monitoring and builds partner capacity to implement them. However, the success criteria need to ensure MFIs are accountable for client viability and not just their own. Expanding performance monitoring for MFIs must be done in a manner that is not burdensome and which reflects local capacity. It must also be done with an awareness that clients do not want to lose the aid they have, even if it is imperfect. Independent assessments must be built into performance monitoring plans to minimise the likelihood of clients telling MFIs what they want to hear. More constant and informal forms of client feedback also are needed to provide information MFIs can use to adjust programme delivery, letting clients see

the usefulness of providing information in this process.

- **Learn from informal credit systems.** A wealth of experience from other contexts as well as the data from this study demonstrate the need for MFIs to invest in understanding client needs and interests, including their involvement in other credit systems, in order to design demand-led programmes. This has not been done sufficiently in Afghanistan, to the detriment of rural clients and in the end the MFIs. KMFI in particular had difficulty attracting or maintaining clients in the study villages due to uncompetitive products for rural Afghans. While adding this analysis to MFI procedures may add time and increase costs, it is an investment worth making for the returns. Improved knowledge of informal credit systems in Afghanistan would make MFIs more client-led, more able to identify niche products that fill a demonstrated gap in demand and may lead to a more dynamic, innovative financial services sector. As MFIs expand more into rural areas, this is especially important, so that products match client livelihood activities and cash flows (i.e. through appropriate grace periods) and to help ensure investment activities can generate sufficient returns to support repayment.
- **Understand how clients use credit to build or maintain relationships to avoid unintended consequences.** MFIs need to be aware of how people use credit to invest in social relationships because these uses can lead to manipulation of programme rules and to over-borrowing for some, increasing risk of default. MF programmes seeking to break down some potentially exploitative forms of informal credit (i.e. those between farmers and input suppliers) need to know how they operate so the MC products do not place potential borrowers in positions where important sources of informal credit are put at risk (see BMFI case), leading to increasing insecurity.

The importance of social relationships to access informal credit and MC was clear in all the case studies. MFIs depend on these relationships within their group lending models and through some of the forms of guarantee required (i.e. *malik* or *shura*

89 Islamic Republic of Afghanistan, "Social Protection Sector Strategy."

approval). However, less attention is given to how social relationships may limit credit access for some excluded from local networks. More transparency and stronger accountability structures are needed to ensure that the systems in place to open access to credit do not increase barriers for some.

It is now time for the MF industry in Afghanistan to move beyond extending access to credit to give greater attention to how to improve client viability in both urban and rural areas. This will contribute to a stronger, more responsive and innovative financial services sector as well as a more vibrant rural economy to support Afghanistan's development aims.

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