

# Challenges of Microfinance Institutions in Afghanistan

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## ABSTRACT

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Today, in many countries, microfinance is deemed to be one of the main financial services offered to the deprived sections of the economy. It is preferred to reduce poverty, motivate men and women, and support their standard of living. Microfinance in Afghanistan has been vigorously promoted over the last two decades and is a vital instrument for the socio-economic development of weaker sections of society. It has a long-lasting effect on Afghan women's and men's mobility and standard of life. However, besides all improvements and developments of MFIs in Afghanistan, MFIs faced various challenges and problems during the last two decades. Therefore, this analysis attempts to examine the challenges of MFIs in Afghanistan. This study has been carried out using descriptive and Principle component analysis. The result extracted nine factors to categorize the different challenges. The result found that MFIs faced challenges such as a lack of staff knowledge, management skills, technology challenges, lack of government support, and unhealthy competition.

**Keywords :** Afghanistan, Challenges, MFIs, Microfinance

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## Introduction

Microcredit, or microfinance in its broader sense, has become a popular intervention for poverty alleviation in developing and least-developed countries in recent years. In addition, significant global attempts have been made to formalize financial services to the poor for the last four decades (Brau & Woller, 2004). The considerable increase in the microfinance industry is a phenomenal achievement taken into account historically. Prior studies observe that financial institutions offer loans to poor or low-income people and small businesses. These studies also observed that these financial institutions are usually funded by non-profit organizations, government agencies, individuals, and financial institutions. The importance and perspective of

microfinance have grown, and more formal MFIs were developed through equity and debt funding (Lawson, 2008; Ngo, 2013; Singh, 2012; Tadele, 2013).

Cheston and Kuhn (2002) opined that microfinance schemes could change relationships with authority and motivate the vulnerable, both men and women. The authors stated that there is a relationship of esteem between the lender and the borrower in well-run microfinance programs that is profoundly empowering. The study found that microfinance has become essential for many donor agencies and national governments' gender, poverty alleviation, and community development strategies. Sengupta and Auction (2008) by offering micro-loans to the very poor, the Grameen Bank provides these beneficiaries with

the opportunity to become entrepreneurs and gain a reasonably high income to gain freedom from the poverty cycle. The revolutionary contributions of Yunus' have brought sustained consideration to microfinance as a mechanism to eradicate poverty. Yunus (2007) claims that it is essential to differentiate microcredit in all its earlier versions from the particular type of credit adopted by Grameen Bank, which he calls "Grameencredit". Grameencredit is not dependent on collateral or enforceable by law contracts. It focuses on 'trust,' not legal procedures and structures. The success and stability of MFIs depend on their capacity to accurately and efficiently maintain their institutions while delivering their services. (Dunford, 2000; Ehigiamusoe, 2008; Lawson, 2008; Olanike and Adebola, 2014; Wheelen and Hunger, 2013; Yunus, 1998) observed that ineffective MFIs can perform well due to various effective management and financing activities and do not succeed due to misdirection, poor management, and weak lending practices. There is no doubt MFIs face many challenges in their developmental activities in underdeveloped and fragile economies. This paper demonstrates the challenges of microfinance institutions in Afghanistan.

## Microfinance in Afghanistan

During decades of war and political turmoil in Afghanistan, the banking system and the supply of financial services were severely affected. Massive support from the international community was given in 2002 to stabilize and revitalize the financial sector. The establishment of the (MISFA) in 2003 was one of the most significant steps toward facilitating a supportive environment for microfinance growth. MISFA was established to merge and turn a range of donor funding sources into organized, scalable support for Afghanistan's MFIs, tailored to local needs and supported by technical assistance and regular observation of results. It helps many local MFIs and acts as a source of training and technical assistance and a networking mechanism,

knowledge sharing, lobbying, and advocacy on behalf of the industry. According to Joyce Lehman, a Member of the Board of Directors of MISFA, microfinance is a sector that facilitates economic growth programs for people with low incomes. She also stated that around 80 percent of the people in Afghanistan are part of the informal economy. Moreover, microfinance positively impacts the country's development, job generation, and economic growth.

The AMA was established in 2005 and registered with the Afghan Ministry of Justice in 2007, although it was inactive until 2010 due to limited resources and activities. MISFA funded AMA's networking and planning activities under the new Collaboration Arrangement, such as program and legal awareness conferences, general assembly sessions, and CEO coordination meetings. As per the June 2022 report of AMA, six microfinance institutions work in 17 provinces with 107 branches in the country with a Gross loan portfolio of 4,471,321,394 AFN (Afghani). Of about 88,543 active borrowers, around 36% of them are women active borrowers and have 2,031 staff these financial institutions (AMA, 2022).

## Literature Review

Since the development of MFIs in the 1980s, their numbers have grown in developing countries worldwide. However, the progression, success, and stability of MFIs rely very much on their capacity to accurately and efficiently maintain their institutions. Regarding their results, some MFIs have been excellent in achievements, while others have been miserable failures. Ineffective MFIs, due to various effective management and financing activities, can perform well. Conversely, due to misdirection, poor management, and weak lending practices, the less effective MFIs, do not succeed (Dunford, 2000; Ehigiamusoe, 2008; Lawson, 2008; Olanike & Adebola, 2014; Wheelen & Hunger, 2013; Yunus, 1998).

MFIs faced many challenges in their developmental activities. According to Rhyne and Otero (2006), microfinance has had rapid growth in customers and outstanding loans over the last few years, and the result is still not bright. Muhammad (2010) concentrates on the challenges and prospects MFIs face in Pakistan. The study found that various challenges lie ahead for the microfinance organizations, such as inappropriate regulation, increased competition, creative and diversified products, profitability, stability, and weak management capacity of MFIs.

Campion (2002) recorded the observation of the World Bank multimedia distance learning initiative paper on people in Vietnam, Indonesia, Singapore, and the Philippines and pointed out some challenges of micro-finance commercialization. The author found some microfinance challenges like unsuitable donor grants, lack of rules and regulations, monitoring, and limited management capability.

Asiama and Osei (2007) examined the challenges of microfinance sectors in Ghana and stated that the main problem in microfinance is hiring a qualified and adequate workforce. They found that MFIs faced human resources issues such as a scarcity of training facilities and inadequate working conditions. Many of these MFIs' poor results, inefficiency, and high levels of fraud and forgeries reflect the quality of their resources. Also, they observed that these institutions have a high labor turnover rate, which suggests a lack of employee motivation and weak employee relationships.

Irobi (2008) examined the impact of microfinance on poverty alleviation in Nigeria. He found that the main challenges of MFIs are communication gaps and lack of awareness, lack of government assistance, lack of donor financing; inattention to the financial stability of MFIs, lack of fair lending or equity resources to expand loan-able funds, high turnover of MFI staff, lack of standardization of monitoring and performance management

systems. Woldie et al. (2012) examine the challenges in microfinance in Tanzania. They state that the financial sector has struggled to effectively expand microfinance services to SMEs due to higher transaction costs, collateral shortage, and insufficient ability to design and manage bankable schemes. Further, according to the facts obtained, they conclude that borrowers must take out micro-insurance as collateral in cases where failure risk is high.

Abdelrahim (2014) researched microfinance organizations' different challenges in Jordan and found lack of loan facilities and low profitability are the obstacles for microfinance. Furthermore, he observed that microfinance had an excessive leverage ratio, a lack of long-term loans, and a lack of loan assurance. Finally, he states that the remaining problems are statistically insignificant and may be overlooked by Jordanian policy-makers. The World Bank published a brief study on the activities of the MFI in South Asia (2006) and issued a brief report on the MFI operation in South Asia. The study shows that Afghanistan and Nepal face many problems because of poor political conditions. They also point out that South Asian MFIs promote 17 percent of the households. In 2005, microcredit's total demand was \$15 billion, but poor people earned just \$2.3 billion. In India, Bangladesh, Afghanistan, and Sri Lanka, MFIs' coverage for their clients is enhanced.

In Afghanistan, MFIs have faced challenges and problems for several reasons, such as the borrowers, particularly some, do not have to control their loans. Some of them lack collateral security, financial literacy, and religious belief. These difficulties create problems for MFIs to offer loans to borrowers, and according to recent research, most MFIs are located in urban areas.

## **The Objective of the Study**

MFIs play a vital role in improving the standard of living and providing access to finance to marginalized sections of society. Nevertheless, it

is not easy for MFIs to succeed in their objectives for several reasons. Therefore, this study examines the challenges of MFIs in Afghanistan.

## Methodology

The current research is an empirical study that uses primary and secondary data. The primary data was compiled via a structured questionnaire from 2019 through 2021. Primary data is frequently used for data collection within the survey strategy (Saunders, Lewis, & Thornhill, 2009). In addition, the Principle Component Analysis is used to reduce variables and identify the main problems and difficulties of the MFIs.

### Reliability, Validity Test, and Pilot Testing

The reliability of the questionnaire for this study was evaluated by calculating Cronbach's alpha scores. The Cronbach alpha value for 8 questions on administrative issues of MFIs, borrowing issues of MFIs, capital and fund issues of MFIs, training, and problems capacity-building of MFIs, and lack of government support for MFIs were (0.927), (0.867), (0.852), (0.827), (0.770) respectively. According to Nunnally (1978), Cronbach's alpha over 0.70 is acceptable. For this research, Cronbach's Alpha was greater than 0.70, indicating that the instrument used was reliable.

## Sampling Technique

The researcher chose a purposive sampling method for MFIs staff in three provinces of

Afghanistan. The researcher prepared an online Google Form and sent it to employees of MFIs who had sufficient knowledge about microfinance in Afghanistan and collected 124 responses.

The non-probability sampling technique is used when a component is chosen for the sample based on the researcher's judgment and findings. Researchers typically believe they may obtain a representative sample by applying sound judgment, saving time and money. Because of the nature of the research design and objectives, the purposive sampling approach may be helpful when only a small number of persons can serve as a source of primary data.

## Sample Size

For the MFIs staff, the total population was 2,670. The researcher selected 124 staff from three different provinces of Afghanistan based on purposive sampling. The respondents were the CEO, CFO, Regional Director, Manager, Branch Manager, Senior Loan Officer, Deputy Branch Manager, and Loan Officer.

## Challenges of MFIs in Afghanistan

The Principle Component Analysis is used for the overall Problems and challenges of microfinance institutions in Afghanistan. The PCA analysis helps to reduce variables and identify the main problems and difficulties the MFIs face in Afghanistan.

**Table.1**

*KMO and Bartlett's Test*

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.			.849
Bartlett's Test of Sphericity	Approx. Chi-Square		3715.842
	df		903
	Sig.		.000

Source: Survey data

The table indicates that KMO of .849 measured by SPSS shows that factor analysis is appropriate for survey data. In addition, Bartlett's test of Sphericity is statistically significant ( $P < 0.05$ ); thus,

factor analysis is applicable. According to (Kaiser 1974), a KMO value greater than .5 is acceptable. There are mediocre values between (.5-.7), good values between (.7-.8), and excellent values between (.8-.9).

**Table.2**

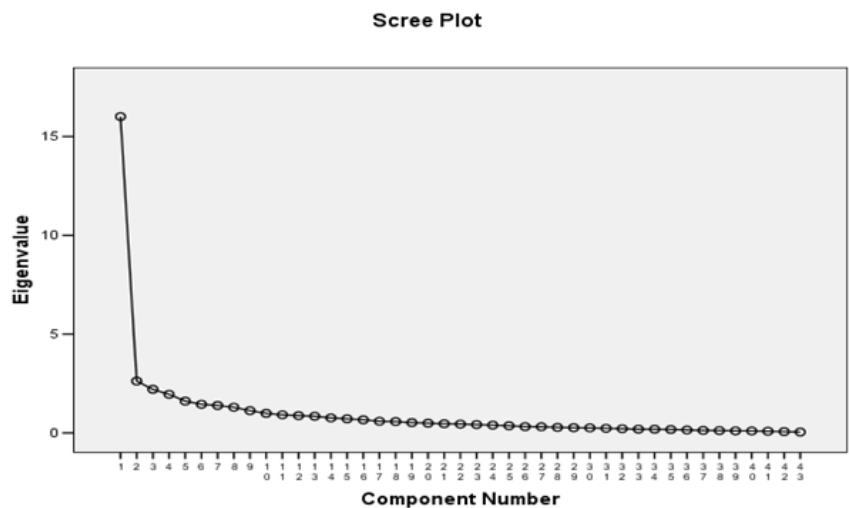
*Rotated Component Matrix(a)*

Components	Initial Eigenvalues			Extraction Sums of Squared			Rotation Sums of Squared		
				Loadings			Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	16.01	37.232	37.232	16.01	37.232	37.232	7.393	17.194	17.194
2	2.625	6.106	43.338	2.625	6.106	43.338	4.702	10.935	28.129
3	2.208	5.135	48.473	2.208	5.135	48.473	4	9.303	37.432
4	1.955	4.547	53.02	1.955	4.547	53.02	2.847	6.621	44.053
5	1.612	3.748	56.769	1.612	3.748	56.769	2.301	5.351	49.404
6	1.449	3.37	60.139	1.449	3.37	60.139	2.283	5.308	54.712
7	1.391	3.235	63.374	1.391	3.235	63.374	2.193	5.101	59.813
8	1.3	3.023	66.397	1.3	3.023	66.397	1.993	4.636	64.449
9	1.127	2.621	69.018	1.127	2.621	69.018	1.965	4.569	69.018
10	0.993	2.31	71.328						
11	0.92	2.139	73.467						
12	0.876	2.037	75.504						
13	0.846	1.966	77.47						
14	0.762	1.773	79.244						
15	0.716	1.664	80.908						
16	0.666	1.549	82.457						
17	0.593	1.378	83.835						
18	0.578	1.345	85.181						
19	0.523	1.217	86.398						
20	0.495	1.151	87.548						
21	0.467	1.086	88.635						
22	0.448	1.041	89.675						
23	0.423	0.984	90.659						



24	0.394	0.917	91.576
25	0.365	0.849	92.425
26	0.319	0.743	93.168
27	0.314	0.73	93.898
28	0.283	0.657	94.555
29	0.268	0.624	95.179
30	0.258	0.601	95.78
31	0.233	0.542	96.322
32	0.214	0.498	96.819
33	0.19	0.443	97.262
34	0.188	0.438	97.7
35	0.175	0.407	98.107
36	0.151	0.352	98.459
37	0.13	0.302	98.761
38	0.121	0.282	99.042
39	0.106	0.247	99.289
40	0.102	0.237	99.526
41	0.088	0.204	99.729
42	0.069	0.161	99.89
43	0.047	0.11	100

Using the Extraction Method, four factors were extracted according to the Scree-test. The eigenvalues of the retained factors are more significant than 1, and the proportion of Variance explained by each component is greater than 5% of the total Variance. The graph indicates the scree plot specifies that nine factors appear before the turning point on factor number ten. Consequently, extractions are based on nine following factors:



**Table .3**

*Rotated Component Matrix(a)*

Factors	Items Numbers	F1	F2	F3	F4	F5	F6	F7	F8	F9
Management Issues	1	0.8								
	2	0.8								
	3	0.7								
	4	0.7								
	5	0.7								
	6	0.7								
	7	0.6								
	8	0.6								
	9	0.6								
	10	0.6								
	11	0.5								
	12	0.5								
	13	0.4								
Administrative Issue	14		0.7							
	15		0.6							
	16		0.6							
	17		0.5							
	18		0.5							
	19		0.5							
	20		0.5							
21		0.4								
Loan Procedure Issues	22			0.8						
	23			0.6						
	24			0.6						
	25			0.6						
	26			0.5						
	27			0.5						

Lack of Technology	28	0.8
	29	0.7
	30	0.4
Lack of Government Support	31	0.8
	32	0.6
	33	0.5
High-Interest Rate	34	0.7
	35	0.6
	36	0.5
	37	0.5
Security Issue	38	0.7
	39	0.6
Lack of Promoting	40	0.8
	41	0.5
Political Instability	42	0.8
	43	0.7

Method: Principal Component Analysis Rotation: varimax with Kaiser Normalization

Source: Survey data

**Item details:**

1. Low level of management skills in a microfinance institution
2. Lack of standardized reporting and Monitoring system for microfinance institutions
3. An unprofessional and weak commitment of staff to the organization
4. lack of staff knowledge of the MFIs financial procedure
5. Non-sustainability of future activities due to lack of funds
6. lack of staff legal awareness
7. Low level of staff education
8. Lack of cooperation, coordination, and teamwork among MFI staff
9. One of the major challenges of microfinance institutions is the communication gap and inadequate awareness
10. Unproductive utilization of loans by borrowers
11. Lack of donor attention on the financial sustainability of MFIs
12. Difficulty in getting financial support from donors/funding agencies/government
13. Non-co-operation of top-level management in conducting the training programs
14. Lack of cooperation among MFIs to provide retail microfinance services to millions of the poor



15. Lack of proper mechanisms and inspectors to control and assess the performance of MFIs
  16. Shortage of funds for conducting the training programs
  17. Unhealthy competition among MFIs
  18. The government doesn't promote micro finance institutions in the country
  19. Staff are facing difficulty in providing loans to women due to their low level of financial and formal Education
  20. MFIs don't have a feedback mechanism
  21. Rigid practices such as collateral and other regulations of financial institutions discourage women borrowers from availing of loan
  22. Difficulty in getting good resource persons for capacity building of staff due to their high fees
  23. Lack of staff interest in participating in training programs
  24. The long and expensive procedure of the borrowers' assessment
  25. There is no proper guidance by MFIs staff in filling out the loan application forms
  26. Lack of Training Institutions to train MFIs staff
  27. Delay in loan sanction by MFIs
  28. Borrowers are not satisfied with the MFIs/MFBs services due to corruption
  29. Inadequate source of funds to grant a loan to all applicants
  30. Lack of high technology system to provide better services
  31. The government doesn't support Microfinance Institutions
  32. There is no specific policy and regulations by the government
  33. Some women are not interested in availing of loans due to their cultural and religious belief that Interest is prohibited in Islam
  34. Borrowers are not satisfied with high-interest rate
  35. The loan interest rate of microfinance is high
  36. MFIs are not financially sustainable to grant the loan at a lower rate of Interest to the borrowers
  37. Borrowers are not satisfied with the allotted period for the repayment of their loan installment
  38. Donors / Investors are not interested in investing more capital due to security problems in Afghanistan.
  39. Security Problems decreased the level of Microfinance services in Afghanistan.
  40. Security threats and development of insurgent jurisdiction in the urban and rural area
  41. Poor response from the promoting agency for conducting training / social awareness programs
  42. MFIs couldn't reach some remote areas since the government doesn't have control over the security
  43. Donors / International Agencies' funds are decreasing due to current political issues in Afghanistan
- A principal component analysis with orthogonal rotation (Varimax) was implemented on the data collected using the Statistical Package for the Social Science (SPSS) version 25 to separate the

related factor measuring the MFIs' challenges. The questionnaire included 43 Variables to assess the MFIs' challenges and nine indefinite factors that account for 69.018% of the Variance.

The first factor, "Management Issue," encompassed thirteen variables such as Low level of management skill in MFIs, Low level of management skill in a micro finance institution, lack of standardized reporting and Monitoring system of MFIs, Unprofessional and weak commitment of staff to the organization, Lack of Staff's knowledge with the MFIs financial procedure, Non-sustainability of future activities due to lack of funds, Lack of Staff's legal awareness, Low level of Staff education, lack of cooperation, coordination, and teamwork among MFI staff, communication gap and inadequate awareness, Unproductive utilization of loan by borrowers, lack of donors attention on the financial sustainability of MFIs, difficulty in getting financial support from donors/funding agencies/government, Non-co-operation of top-level management in conducting the training programs have a variance of 37.2 % and an Eigenvalue of 16.01.

The second factor, "Administrative Issue," encompassed eight variables such as lack of cooperation among MFIs to provide retail microfinance services to millions of the poor, lack of proper mechanisms and inspectors to control and assess the performance of MFIs, Shortage of funds for conducting the training programs, Unhealthy competition among MFIs, The government doesn't promote microfinance institutions in the country, the staff is facing difficulty in providing loan to women due to their low level of financial and formal Education, MFIs don't have a feedback mechanism, Rigid practices such as collateral and other regulations of financial institutions that discourage the women borrowers to avail loan, with a variance of 6.1 % and Eigen-value of 2.6.

The third factor, "Loan Procedure Issues," encompassed six variables such as difficulty in getting good resource persons for capacity building of staff due to their high fees, lack of staff interest in participating in training programs, the long and expensive procedure of the borrowers' assessment, no proper guidance by MFIs staff to fill the loan application forms, lack Training Institutions to train MFIs staff, and delay in loan sanction by MFIs, with a variance of 5.1% and Eigen-value of 2.2.

The fourth factor, "Lack of Technology," encompassed three variables such as borrowers not satisfied with the MFIs services due to corruption, Inadequate source of funds to grant a loan for all applicants, lack of high technology system to provide better services, with a variance of 4.5 % and Eigen-value of 1.9.

The fifth factor, "Lack of government support," encompassed three variables such as the government doesn't support Microfinance Institutions, no specific policies and regulations by the government, Some women are not interested in availing of loans due to their cultural and religious beliefs, with a variance of 3.7 % and Eigen-value of 1.6.

The sixth factor, "High-interest rate," encompassed four variables, including Borrowers are not satisfied with a high-interest rate, The loan interest rate of microfinance being high, MFIs not financially sustainable to grant the loan at a lower rate of Interest to the borrowers, Borrowers are not satisfied with the allotted period for the repayment of their loan installment, with a variance of 3.37 % and Eigen-value of 1.4.

The seventh factor, "Security issue," encompassed two variables: donors/Investors not interested in investing more capital due to security problems in Afghanistan, and Security Problems decreased the level of Microfinance services in Afghanistan, with a variance of 3.2 % and Eigen-value of 1.3.

The eighth factor, "lack of Promoting," encompassed two variables: security threats and the development of insurgent jurisdiction in the urban and rural areas and poor response from the promoting agency for conducting training /social awareness programs, with a variance of 3.02 % and Eigen-value of 1.3.

The ninth factor, "political instability," encompassed two variables: MFIs couldn't reach some remote areas since the government doesn't have control over security, and Donors/ International Agencies' funds are decreasing due to current political issues in Afghanistan, with Variance of 2.6 % and an Eigenvalue of 1.1.

## Discussion

The challenges of MFIs in Afghanistan have different variables, and it is evaluated using PCA, explained in the below sections. PCA identified nine significant challenges faced by MFIs in Afghanistan as "Management Issues," "Administrative Issues," "Loan Procedure Issues," "Lack of Technology," "Lack of government support," "High-interest rate," "Security issues," "lack of Promoting," and political instability. Overall, the forty-three variables with nine major components (Factors) explained 69.01 % of the total Variance.

The first component had 8 questions about MFIs' administrative issues. Furthermore, based on the mean value, the result found that the average score for administrative concerns and challenges was  $2.9 \pm 0.9$ . It revealed that MFIs in Afghanistan have high administrative issues and problems. And the second segment had 15 questions about microfinance borrowing issues. The mean score for microfinance borrowing concerns is  $2.7, \pm 0.6$ . It reveals that lending concerns in MFIs have high issues in Afghanistan. The third factor had 7 questions about MFIs' capital and fund issues. Overall, the mean score for Capital and Funding issues and problems was  $2.5, \pm 2.4$ , indicating high

issues with capital and funding in Afghanistan's MFIs. The fourth section had 7 questions about MFI training and capacity-building. Overall, the mean score for the issue statement on training and capacity-building is  $2.6, \pm 0.7$ . The findings revealed high challenges with training and capacity building in MFIs. And the sixth component contains 6 questions about the lack of government support for MFIs. Overall, the statement of lack of government assistance for MFIs received a mean score of  $2.5, \pm 0.7$ . The findings reveal a lack of government support for MFIs.

## Conclusion

The present study examined the challenges of MFIs in Afghanistan. Therefore, in the last two decades, the MFIs have experienced many challenges in Afghanistan, and this study revealed the specified challenges of MFIs. These challenges concerning the management are administrative problems, loan procedure issues, lack of government backing, high-interest rates, security issues, and political instability, which are the most significant hurdles that MFIs experience.

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