

**Challenges, Opportunities and role of Financial Institutions in Development of Financial System of Afghanistan; A Thematic Analysis Approach**

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## **Abstract**

The purpose of this study is to evaluate the current financial system of Afghanistan. The study explores the challenges and obstacles faced by financial system and what opportunities this system offer for local and foreign investors. The role of financial institutions is discussed in the development of Afghanistan's financial system. For the objectives, the study conducted interviews with the market experts and used textual analysis methodology. Based on the interviews, thematic codes were developed in a table through transcribing process. Thematic codes helped in generating thematic networks for further commentary. The study found that the young financial system of Afghanistan faces numerous challenges ranging from security instability to lack of government interest but still the system offers a lot of opportunities. Money laundering and lack of anti-money laundering policies are considered a serious threat for the stability of the system. Financial institutions, like commercial banks and exchange companies, have a pivotal role in the development of financial system. These institutions can help in developing small and medium enterprises; facilitate flow of funds; stabilizes exchange rates; and increase savings in the economy.

Key words: Financial System of Afghanistan, Growth, Financial Institutions, Commercial banks

JEL Codes: G20, G21, G22, G23, G28, F52

## **Introduction**

Financial institutions are considered backbone for an efficient financial system. For the efficient flow of funds, financial institutions play their vital role with the support of the prevailing financial system. In this regard, Afghanistan is no exception. Funds' flow is facilitated by a limited financial market, where commercial banks and over-the-counter are major players. The country is experiencing a tremendous growth in the development of banking market in the last 17 years. Besides commercial banking, insurance and exchange companies started providing their services. Success and growth of these financial institutions can play their role in the overall development of financial system of Afghanistan in the long run.

These financial institutions, being key players in the system, must be studied to locate their contributions in the sustainable improvements of financial system. So this paper tries to explore current growth level of financial system of Afghanistan analyze the role of financial institutions in the sustainable development of financial system of Afghanistan. The paper also shows the challenges and obstacles faced by the financial system and what opportunities it offers for the local and foreign investors. This paper provides an insight for the government to assess and regulate the development in the financial system while considering the challenges and opportunities for these financial institutions.

The study interviews people with some key roles and involvement, both at public and private level, in the current financial system. To analyze the interviews, the study uses 'thematic analysis' where interviews are coded first and then some themes are identified and their patterns are explored.

## **Methodology**

The study uses an interpretive approach to analyze the mentioned problem. Interpretivism promotes the idea “that it is necessary for the researcher to understand differences between humans in our role as social actors (Miles, Huberman, & Saldaana, 2017). This approach focuses on the difference of conducting research among people instead of objects like mobiles and laptops.

## **Data**

The study primarily uses interviews as a data collection tools. Prior to conducting the interviews, some themes were identified in the subject area. Open ended questions are asked and their responses were noted down. The interviews are summarized in tables to identify some further themes in the subject area.

## **Transcribing Process**

Interviews are recorded in Pashto and Dari language and some great care has been taken to translate the interviews in English. Interviews are further recorded in the tables. From the table data, thematic codes are generated which are further used to develop some causal graphs. These graphs show the various roles played by financial institutions in the development of financial system of Afghanistan.

## **Sampling Technique**

The study targets expert and relevant people in the financial sector of Afghanistan. Overall 10 experts are interviewed based non-probability purposive sampling method. Sample is selected keeping in mind the expertise and relevance of the respondents with the subject area. Accessibility to the respondents is another reason for using non-probability purposive sampling method.

## **Analysis Method**

Qualitative methods have enjoyed a growing popularity in the past decade throughout the social sciences (Bryman and Burgess, 1994; Denzin & Lincoln, 1994; Jensen, 1991; Marshall and Rossman, 2011; Morse, 1994). For analyzing and assessing the interviews, the study uses ‘thematic analyses’. Thematic analyses seek to unearth the themes salient in a text at different levels, and thematic networks aim to facilitate the structuring and depiction of these themes (Jennifer, 2001). So the analysis first derives some themes from the textual data and then represent them in graphical form to generate some thematic networks.

## **Coding Process**

Coding is the process of assigning to a data for the purpose of classification or Identification Purposes (Boyatzis, 1998). It is the first step for the analysis of Qualitative data. The study follows the coding technique of Swanson and Holton (2009), where the study first generate the main themes and then sub themes from the interviews textual data. These sub themes are given some codes that represent both the main and sub themes.

So the overall analysis process follows the given pattern:



## Analysis

Based on the methodology mentioned, the interviews conducted are recorded and transformed into table 1. Through open ended questions asked from the interviewees, some predetermined themes (A priori codes) are developed which are used further to generate some sub inductive themes. Based on these sub themes, thematic networks are developed which are further used to identify and interpret patterns.

**Table 1: Codes Development for Themes**

Predetermined Themes	A Priori Codes	Excerpts	Inductive Sub Themes	Codes
Current Financial System	CFS	➤ CFS of Afghanistan is under development	Under development	CFS1
		➤ In last 16 years we had a tremendous growth	Tremendous growth	CFS2
		➤ Off course we have more challenges	Challenges	CFS3
		➤ People has low trust on the financial system of Afghanistan	Low trust	CFS4
		➤ Financial system does not fulfill the peoples requirement in AFG	Not satisfactory	CFS5
		➤ Black money can easily be entered in to the system.	Black money	CFS6
		➤ We have great contribution of international communities	Contribution	CFS7
		➤ Financial system of Afghanistan rely more on commercial banks	Relying	CFS8
Growth in Financial System	GRW	➤ Our Financial system is growing	Growth	GRW1
		➤ We have 13 banks & 5 financial institutes so it helped a lot	Financial Institutions	GRW2
		➤ Security is the main challenge in the growth which cause the FSD	Security	GRW3
		➤ Compare to resource we had good growth	Resources	GRW4
		➤ One of the sector improved better since 2001	Improvement	GRW5
		➤ Investor don't want to invest after Kabul bank crises	Low Trust	GRW6
		➤ If I grade it in poor, good and excellent I will grade it in good only	Good Grade	GRW7
		➤ Quickly growth beside which we had negative	Quick Growth	GRW8

		impact as well		
Obstacles in Development	OBS	➤ A lot of development done in past 15 years	15 years Development	GRW9
		➤ Lack of good policies and procedures can delay the development in FS	Policies & Procedures	OBS1
		➤ If our government authorize more financial institutions, it will help the FS	Authorization	OBS2
		➤ We can connect to international market by having good financial institutions	Connection to International Market	OBS3
		➤ Over the Counter exchange companies will destroy the economy and image of Afghanistan	OTC Exchange companies	OBS4
		➤ OTC Exchange companies should have legal transactions	Legal transactions	OBS5
		➤ Success of the financial system is based on the financial companies	Success	OBS6
		➤ We have lack of education of financial sector	Lack of Education	OBS7
		➤ Public is not fully aware of financial sector activities	Lack of Awareness	OBS8 OBS9
Development Opportunities	DPO	➤ Afghanistan is good market for Financial business	Good Market	DPO1
		➤ We have more foreign investments	Foreign Investment	DPO2
		➤ Proper survey required to check it	Proper Survey	DPO3
		➤ If government provide good environment	Environment	DPO4
Anti-Money Laundering	AML	➤ AML is the big challenge for the government	Challenge	AML1
		➤ Central bank is keenly working to stop the circulation of black money	Central Bank	AML2
		➤ Good compliance software for the filtering	Compliance Software	AML3
		➤ Government to register the higher official & business man 's assets	Government Registration	AML4
		➤ Government to have tight investigation on bank accounts	Investigation	AML5
		➤ To eliminate the black money from the circulation	Black Money	AML6
		➤ Strong AML law is required for implementation	AML Laws	AML7
		➤ Black money is the virus our economy	Black Money	AML8
		➤ We can control the black money by investigation	Investigation	AML9
		➤ DABS is looking serious	Central Bank	AML10
Commercial Banking	COB	➤ Tremendous grade	Grade	COB1
		➤ As our banking sector is too young compare to other	Too Young	COB2
		➤ Developing SMEs	SMEs	COB3
		➤ Increase savings	Savings	COB4
		➤ Facilitate flow of funds	Facilitation	COB5
		➤ Help in exchange rate stability	Stability	COB6

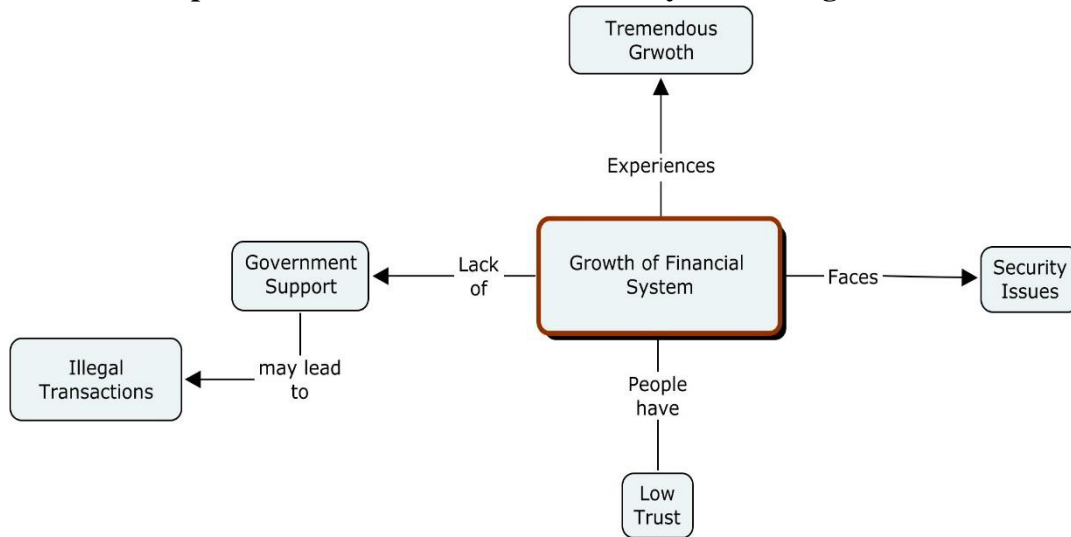
Authorized Exchange Companies	AEC	➤ Provide different financing types	Financing	COB7
		➤ If we authorize the exchange companies they will bring improvement	Improvement	AEC1
		➤ If we legalize it will help the in the development of financial sector	Legalize	AEC2
		➤ More institutes bring more competitions	Competitions	AEC3
		➤ Tasks distribution bring improvements	Task Distribution	AEC4
		➤ Delegation of tasks is always good	Task Delegation	AEC5
		➤ Trading in foreign currencies is the challenge for the government	Challenge	
		➤ Government weakness	Govt. Weakness	
		➤ Its dollarization in Afghanistan	Dollarization	
Exchange Transactions	EXT	➤ Some of the exchange transactions are not having proper record	Proper Record	EXT1
		➤ If we have rules and regulations it will be very good	Rules & Regulations	EXT2
		➤ I am agree if all the foreign currencies transaction comes under scrutiny	Foreign Currencies	EXT3
		➤ It's important to bring them under government record	Government Record	EXT4
		➤ If we Make the transaction identifiable it will be easy to trace	Identify	EXT5
		➤ It's not under record	No Record	EXT6
Remittances	REM	➤ If remittances comes under government supervision it will help the FS	Government Supervision	REM1
		➤ Government consideration is required	Consideration	REM2
		➤ They should pay tax which contribute the national economy	Taxes	REM3
		➤ Establishment good rules to avoid the illegal transactions	Illegal Transactions	REM4
		➤ If the remittance pass through formal channel it helps the economy	Formal Channel	REM5
		➤ Policies and procedures to be implemented	Policies & Procedures	REM6
		➤ Better to bring this under government record	Government Record	REM7
		➤ At this moment it's difficult to control	Difficult Control	REM8

### Thematic Networks:

Following graphs shows some thematic networks which are developed in line with the research objectives. For instance, Graph 1 shows the growth status of the current financial system of Afghanistan. There has been a high growth in the last 15 years, particularly in banking sector while facing severe security issues. The growth would have been much higher if government provided proper support and concentration. Due to the lack of government support in developing and implement policies and procedures, illegal transactions are increasing and

public trust on the financial institutions are decreasing; which severs after Kabul Bank bankruptcy.

**Graph 1: Growth Status of Financial System of Afghanistan**



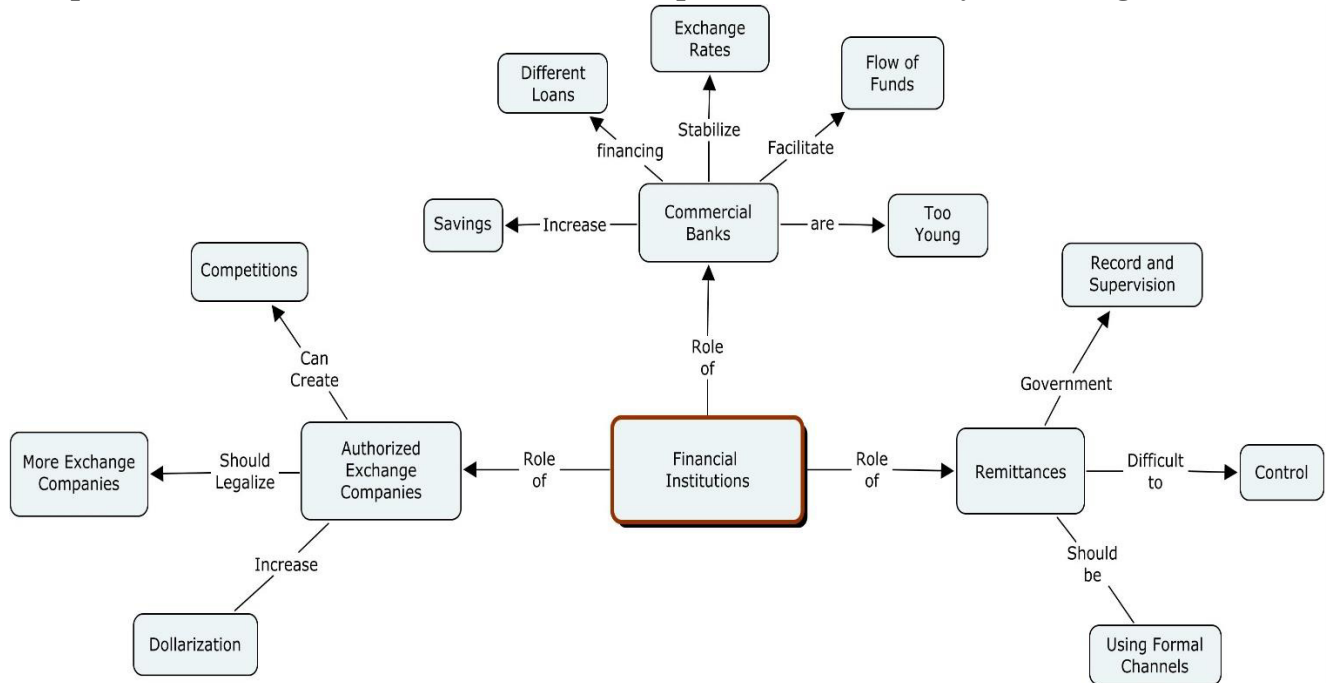
Source: Authors' Compilation

Graph 2 shows the roles played by financial institutions in the development of financial system of Afghanistan. The graph categorizes these institutions as commercial banks, authorized exchange companies, and remittances. Remittances are considered a separate institution, as it is a huge part of current account balance. The interviewees are of the opinion that remittances should be properly recorded and supervised using some formal channels, then government can capitalize on it. As a large part of economy is unstructured and unregulated, so it is a big challenge for the government and difficult to control the informal channels of remittances.

Commercial banks has a very vital role in the overall financial system of Afghanistan, besides it is too young. It is the main institution that can provide different sources of financing plus it is a primary source of savings in Afghanistan. Commercial banks facilitate the flow of funds both within and outside the country. It can also play its role in stabilizing the local currency against the foreign currencies.

Another group in financial institutions is authorized exchange companies, which are few in number against their demand in the country. Government should authorize more exchange companies to provide their services, which will lead to increase in the competition in the market. These companies are also blamed for their role in increasing dollarization in the country.

**Graph 2: Role of Financial Institutions in development of Financial System of Afghanistan**

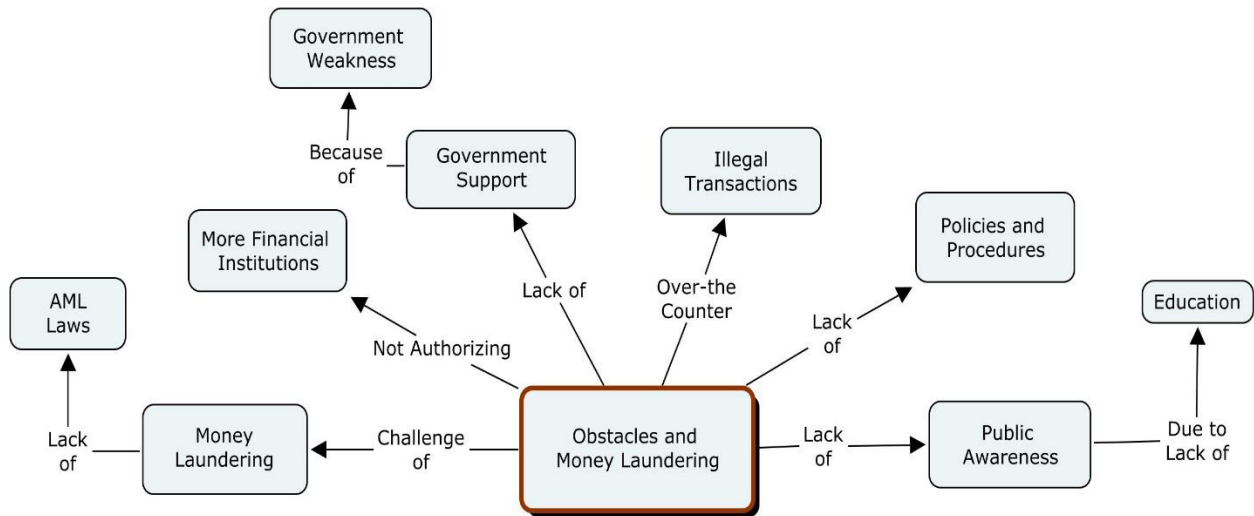


Source: Authors' Compilation

Graph 3 shows the major obstacles faced by the financial system. One of the main obstacles is money laundering due to over-the-counter illegal transactions. Main cause considered for such illegal flow of money is lack of policies and implementations e.g. anti-money laundering laws. Government is not providing full support because government itself has limited capacity. Number of authorized financial companies are limited against their demand. Due to lack of education overall, there is exist serious lack of public awareness about financial services they can get from these institutions. Government does not have defined goals and objectives regarding the future of financial system in Afghanistan.

**Graph 3: Obstacles in the Financial System Development of Afghanistan**

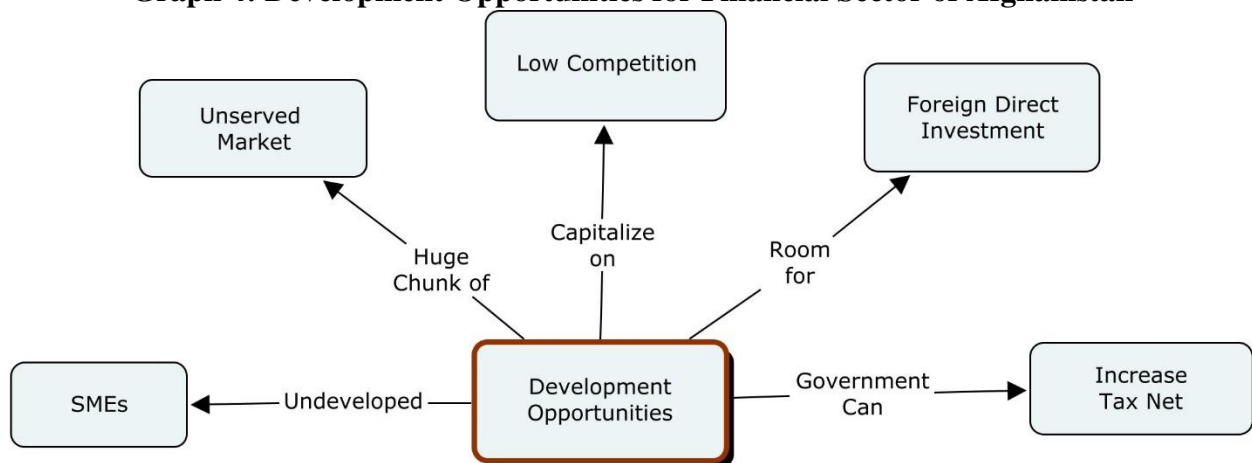




Source: Authors' Compilation

Graph 4 shows some development opportunities for financial sector of Afghanistan. Huge chunk of Afghanistan is considered an 'unserved market' where opportunity exists for financial services providers, subject to the security assurance. Foreign investors can capitalize on low competition in the market. These financial companies, particularly depository institutions, can capitalize on financing the development of 'small and medium enterprises'. With the development of financial sector, government can also increase their tax net circle. These opportunities can made possible if government provide proper support and insure the security of these financial institutions.

**Graph 4: Development Opportunities for Financial Sector of Afghanistan**



Source: Authors' Compilation

## **Conclusion**

Financial institutions play a vital role in the overall development of financial system of any country. It is important to understand growth of a country's financial system, what obstacles mitigate that growth and what opportunities that growth level can offer. The study tries to understand these points and conducts interviews with the relevant people. Interviews are analyzed through 'textual analysis' where interviews are transcribed in a table, codes are given to predetermined and sub-inductive themes. Codes help the study generating thematic networks to achieve the research objectives. Current financial system of Afghanistan is growing and developing with major role played by commercial banks and authorized exchange companies. The financial market faces some major obstacles but yet offers many opportunities for the local and foreign investors.

Government role for strengthening the financial system is very crucial. It needs to come up with investors friendly policies and ensures strict implementations. Besides government, financial institutions should be play their role by increasing public awareness about financial services. More comprehensive researches should be done to help government and financial institutions in strengthening the financial system.

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